

Guidance Note on Audit of Payment of Dividend*

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* Issued in August, 2005.

The following is the text of the Guidance Note on Audit of Payment of Dividend issued by the Auditing and Assurance Standards Board of the Council of the Institute of Chartered Accountants of India. This Guidance Note should be read in conjunction with the Standards on Auditing issued by the Institute.

1. Paragraph 2.1 of the “Preface to the Statements on Standard Auditing Practices¹” issued by the Institute of Chartered Accountants of India states that the “main function of the Auditing Practices Committee (APC)² is to review the existing auditing practices in India and to develop Statements on Standard Auditing Practices (SAPs)³ so that these may be issued by the Council of the Institute”. Paragraph 2.4 of the Preface states that the “APC will issue Guidance Notes on the issues arising from the SAPs wherever necessary”.
2. The Auditing and Assurance Standards Board has also taken up the task of reviewing the Statements on auditing matters issued prior to the formation of the Board. It is intended to issue, in due course of time, Engagement Standards or Guidance Notes, as appropriate, on the matters covered by such Statements which would then stand withdrawn. Accordingly, with the issuance of this Guidance Note on Audit of Payment of Dividends, paragraphs 8.19 to 8.24 of the “Capital and Reserve” section of “Statement on Auditing Practices” shall stand withdrawn.⁴

Introduction

3. Guidance Note on Terms Used in the Financial Statements, issued by the Institute, defines dividend as “A distribution to shareholders out of profits or reserves available for this purpose”.
4. Dividend means a return on shares held in an entity and payable out of distributable surplus. The dividends, which are paid on winding up, are in fact distribution of the entity’s assets and not of profits, even if those assets include some profit earned on winding up of the entity. However, the proviso to section 205(3) of the aforementioned Act permits a company to capitalise its profits by issuing fully paid bonus shares or paying up any amount being unpaid on shares held by its members. Further, under section 205(3) of the Companies Act, 1956, no dividend is payable otherwise than in cash.

¹ The said Preface has been withdrawn pursuant to issuance of the Revised “Preface to Standards on Quality Control, Auditing, Review, Other Assurance and Related Service”, by the Institute of Chartered Accountants of India. The Revised Preface is effective from April 1, 2008. The text of the revised Preface is reproduced in the Vol-I.A of this Handbook.

² Now known as the Auditing and assurance Standards Board (AASB).

³ Now known as Engagement Standards.

⁴ Since the Statement was withdrawn in March, 2005, the entire paragraph is redundant.

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5. Dividend includes any interim dividend. It may also be noted that in case of a company, provisions of section 205, 205A, 205C, 206, 206A and 207 of the Companies Act, 1956 apply to interim dividend as well.

6. In any auditing situation, the auditor employs appropriate procedures to obtain reasonable assurance about various assertions as laid down in paragraph 6 of the Standard on Auditing 500, "Audit Evidence". In carrying out the audit of payment of dividends, the auditor's primary objective is to obtain sufficient appropriate audit evidence to satisfy himself that dividend has been declared and paid in accordance with the applicable provisions, if any, of the relevant laws and regulations applicable to the entity and that all the transactions relating to declaration and payment of dividend have been properly accounted for and disclosed. The auditor's scope of examination would, therefore, include:

- (a) verifying whether dividend has been declared out of distributable surplus after proper authorisation, as required under law;
- (b) evaluating the internal control system regarding procedure of preparation and issuance of dividend warrants /instructions for direct transfer of funds to the shareholders' accounts and also check the timeliness of dispatch of warrants and deposition of the dividend amount in the separate bank account, if any, maintained for this purpose;
- (c) examining compliance with the requirements of the relevant laws and regulations relating to payment of dividend, for example, mandatory transfer to a reserve fund or transfer to other funds, such as unclaimed dividend account, Investor Education and Protection Fund, etc., as applicable to the entity; and
- (d) examining the system for recording and appropriate disclosure of transactions during the year relating to payment of dividend.

Internal Control Evaluation

7. The auditor should ascertain whether the governing charter, for example, Articles of Association in case of a company, or any similar document of the entity, permits payment of dividend to the members by the entity. For example, a company formed under section 25 of the Companies Act, 1956 is prohibited under the said section itself from paying any dividend to its members.

8. The auditor should study and evaluate the system of internal control relating to payment of dividend to determine the nature, timing and extent of

his other audit procedures. He should particularly review the following aspects relating to payment of dividend:

- (a) whether all transactions in the dividend account have been authorised by the competent authority;
- (b) whether the registers containing the details of members and dividend have been properly maintained by the entity;
- (c) whether there is an effective system of segregation of duties in place. Special attention should be given to the segregation of the duties towards maintenance of shareholders' register, preparation of dividend warrants and maintenance of warrant dispatch register;
- (d) the internal control procedures with regard to preparation of dividend warrants and posting them to the members, or the instructions given for electronic transfer of funds or any other mode of payment of dividend to the members, and records maintained to record the details of unclaimed dividend. Separate records of unclaimed dividend should be maintained for each year's dividend/interim dividend;
- (e) the procedures for payment of unclaimed dividend and should satisfy himself that they are not paid without adequate safeguards being taken as to identification of the payee, checking of the payee's claim, etc.

In case, the above activities are outsourced, the auditor should evaluate the activities of the service organisation and if finds them significant, he should obtain sufficient information to understand the accounting and internal control systems of the service organisation and assess control risk at either the maximum or a lower level, as appropriate, if tests of control are performed. For detailed guidance in this respect, reference may be made to Standard on Auditing 402, "Audit Considerations Relating to an Entity Using a Service Organisation."

Verification

9. Verification of payment of dividend may be carried out by performing the following procedures:

- (a) examination of compliance with laws and regulations and such other relevant information having a bearing on payment of dividend; and
- (b) examination of the system of maintenance of records.

10. The auditor should verify the compliance with laws and regulations, provisions contained in the governing charter, e.g. Articles of Association in

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case of companies, bye-laws or rules and directions/instructions issued by any regulatory authority applicable to the entity and/or the terms of the banks/financial institutions which may lay down certain restrictions or conditions on declaration of dividend. For example:

- (a) In case of companies, the following conditions have to be complied with before declaration of dividend:
 - ◆ It has provided for depreciation for any previous financial year(s) which fall(s) after the commencement of the Companies (Amendment) Act, 1960 [section 205(1)] and further that such depreciation has been computed in accordance with the requirements of section 350 and other provisions of section 205(2) of the Act
 - ◆ It has provided for any losses incurred in any previous financial year(s) which fall(s) after the commencement of the Companies (Amendment) Act, 1960 [section 205(1)]
 - ◆ Where the company has declared dividend for any financial year out of the profits for that year, it has also transferred to a reserve such percentage (or a higher percentage) of profits as may be prescribed in the Companies (Transfer of Profits to Reserves) Rules, 1975 [section 205(2A)]
 - ◆ It has complied with the requirements of section 80A, dealing with redemption of irredeemable preference shares etc., of the Companies Act, 1956.
- (b) Under the Banking Regulation Act, 1949, dividend can not be paid without first writing off intangible assets and transferring certain percentage of profits to statutory reserves unless permitted by the Central Government to do so. Section 17 of the Banking Regulation Act, 1949 requires that a banking company incorporated in India must transfer twenty per cent of its annual profits to a reserve fund before any dividend is distributed unless a specific exemption has been obtained from the Central Government.
- (c) State Co-operative laws lay down that certain percentage of profits have to be transferred to various reserves and a minimum percentage of profit has to be paid as dividend.

11. The auditor has to verify that the dividend is declared only out of distributable surplus. For example, in case of a company, under section 205 of

the Companies Act, 1956, dividends can be distributed out of profits for the year in which dividend is declared, accumulated profits of any preceding year or under any guarantee given by Central or any State Government.

12. The auditor should verify that a specific resolution for payment of dividend has been duly passed at the meeting of the Board or any similar authority. In case of interim dividend, the dividend declared by the Board of Directors or similar authority is final. In case of final dividend, the auditor should also verify that the recommendations of the Board have been approved by the members at the annual general meeting. It may, however, be noted that in case of companies, the members can reduce the amount of dividend or decide for non-payment of dividend but they can not increase the dividend recommended by the Board.

13. If the entity has non-voting shares and/or shares with variable rights and/or preference shares with various options like, cumulative, participatory, etc., the resolution declaring the dividend should also specify different rates of dividend on the shares having variable rights or preferential rights as to dividend. In such cases, the auditor has to verify that the dividend paid is in accordance with the terms of the resolution and also the resolution is in accordance with the terms attached to these shares.

14. Other laws and regulations, relating to payment of dividend, governing the entity may impose similar or other restrictions. The auditor has to be familiar with the laws and regulations governing the entity and verify whether these laws and regulations have been complied with. For example, the auditor has to examine the compliance with provisions of the Foreign Exchange Management Act, 1999 for the payment of dividend in foreign currency pursuant to issue of shares to non-residents and issue of ADR/GDR. **Appendix** to this Guidance Note contains relevant extracts of the provisions of various statutes having a bearing on the declaration and payment of dividend.

15. In case of a listed company, the auditor should also verify whether the provisions of the Listing Agreement as to declaration of dividend, e.g., prior intimation to the Stock Exchange about the Board meeting at which declaration/recommendation of dividend is to be considered, intimation to Stock Exchanges of all dividends and/or cash bonuses recommended or declared or the decision to pass any dividend or interest payment at the Board meeting, have been complied with or not.

16. The nature, timing and extent of substantive procedures to be performed by the auditor is, however, a matter of professional judgment of the auditor

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which is based, *inter alia*, on the auditor's evaluation of the effectiveness of the related internal controls.

17. The auditor should examine that the mandatory transfer of the amount specified to a separate fund, where so required by the relevant laws and regulations, have been made before payment of dividend.

18. The auditor has to verify that the dividend is paid in accordance with the terms prescribed in resolution by the Board/members.

19. The auditor should verify that the dividend warrants have been dispatched to the members within the time limit prescribed.

20. If an interim dividend is declared, the auditor has to verify whether the same is approved in a general meeting of the members and the provisions contained in the Articles of Association or bye-laws or other statutes governing the body corporate permit it to pay interim dividend. In case of statutory corporations and nationalised banks, the Board may be empowered to declare and pay the dividend and resolution by the members may not be necessary. In case of companies, the auditor should verify that the financial statements have been prepared and presented before the Board and the Board while considering the interim dividend, has taken into account the depreciation to be provided for the full year, profit to be transferred to reserves under Companies (Transfer of Profits to Reserves) Rules, 1975 and the dividend payable to preference shareholders.

21. If the laws and regulations applicable to the entity require it to deposit the amount of dividend, interim and/or final, in a separate bank account, the auditor has to verify whether such transfer of funds to the separate account has been made within the prescribed time limit. The auditor should also verify the compliance of law with regard to unclaimed dividend. For example, in case of companies, the dividend declared has to be deposited within prescribed period in a separate bank account and if dividend is not claimed within such number of days, of such transfer, as may be specified by the Companies Act, 1956 or rules made thereunder and the amount remaining in the separate bank account has to be transferred to unpaid dividend account separately opened with any scheduled bank and the amount remaining in that account after the expiry of such period of opening such unpaid dividend account, as may be prescribed together with interest accrued thereon, if any, has to be transferred to Investor Education and Protection Fund Account established under the Companies Act, 1956. It may be noted, that within specified number of months prior to the transfer of unclaimed dividend to Investor Education & Protection

Fund, the company has to give notice to individuals who have not claimed such dividend. If the auditor finds that the amounts required to be transferred as above have a material effect on the financial statements, and have not been properly reflected in the financial statements, the auditor should assess the impact of such non-compliance on his audit report.

22. The auditor should verify that adjustment, if any, made in the dividend payable, towards calls in arrears or any other sums due from members is in accordance with the terms of issue, laws and regulations applicable to the entity.

23. The auditor may verify the total amount of dividend transferred to a separate bank account is in agreement with the statement prepared by the body corporate reconciling the total dividend payable on shares in physical form, dematerialised form, and dividend withheld in respect of shares pending for registration of transfer and adjustments, if any, made for the calls in arrears and other dues from the members.

24. The listed companies are required to electronically transfer dividend to bank accounts of the shareholders, wherever Electronic Clearing Services (ECS) facility is available and the members/depositories furnish details of the respective bank accounts of the members and in respect of others, distribute the dividend through dividend warrants. In such cases, in addition to test checks for individual payments, the auditor should examine the overall reconciliation of the total payment made through electronic transfer and payment made through dividend warrants.

25. The auditor should verify that the dividend is paid:

- (a) (i) in respect of shares held in electronic form, to those persons whose details as on record date/book closure date are furnished by the depositories; and/or
- (ii) in respect of shares held in physical form, to the members whose names are appearing on the record date/ immediately after effecting the transfers submitted till the date of book closure; and
- (b) in respect of share warrants to the holders of share warrants.

26. The auditor should apply the analytical procedures before forming any overall conclusion so as to find out any material fluctuations and deviations from the relevant information that he has gained during the course of audit. Such analytical procedures may be regarding the changes in the shareholding pattern, dividend pay out ratio, ratio of gross dividend payable to the paid up

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share capital or ratio of net dividend payable with the gross dividend payable by the entity. In case of listed companies, the auditor may also review the minutes of the meetings of the Investors' Grievances Committee, wherever such Committee exists, to have an overview of the nature and number of complaints related to dividends as the same would provide the auditor an additional evidence as to the efficacy of the internal control system in relation to payment of dividend.

27. The auditor should verify that the total amount remaining in the unclaimed dividend account, for example, because of dispute about ownership on account of court cases etc., or the amount not claimed by shareholders, tallies with the schedule of unclaimed dividend for each year for which dividend remains unclaimed.

28. The auditor has to verify that in case the entity proposes to pay dividend out of its accumulated reserves, whether the same has been paid after complying with the statutory requirements, if any. For example, a company can pay dividend out of its accumulated reserves only after complying with the provisions of sub-section (3) of Section 205A of the Companies Act, 1956 and the Companies (Declaration of Dividend out of Profits) Rules, 1975. These Rules provide for the maximum amount that can be paid as dividend. In cases where the company declares dividend that is not in accordance with these Rules, the auditor must verify that the company has obtained prior approval from the Central Government for the same. Similar provisions, if any, in the laws applicable to other entities have to be complied with.

29. The auditor should also verify that:

- (a) If capital profits are distributed as dividend:
 - (i) the Articles or the bye-laws or other rules and regulations applicable to the entity, permit such distribution; and
 - (ii) it has been realised in cash; and
 - (iii) the Board or similar authority is satisfied that net aggregate value of the assets remaining after distribution of that profit will not be less than the book values so that share capital and reserves remaining after the distribution will be fully represented by the remaining assets.
- (b) Capital surplus arising on the revaluation of fixed assets is not directly or indirectly available for distribution as dividend.
- (c) Any reserve in the nature of capital reserve arising on acquisition of a

business as a going concern or on amalgamation in the nature of purchase and Securities premium collected on the issue of securities can not be utilised for declaration of dividend.

Disclosure

- 30. Proposed dividend should be shown as appropriation of profit in the Profit and Loss Account and as provision under "Provisions" in the Balance Sheet.
- 31. Unclaimed dividends should be shown in Balance Sheet under the head "Current Liabilities".
- 32. In respect of companies, all arrears of cumulative preference dividends should be shown as a contingent liability.

Management Representation

- 33. The auditor should obtain representation from the management of the entity about the amount retained in unclaimed dividend account by reason of disputes pending in various courts of law and also that it has complied with all laws and regulations applicable to the provisioning and payment of dividend including transfers to Unclaimed Dividend Fund or any other fund such as Investors Education and Protection Fund, where so required and that the dividend has been paid to the persons entitled to it.

Documentation

- 34. The auditor's working papers should contain the plan devised for verification of payment of dividend. Among other papers, he should maintain in his audit file, the management representations and any other relevant document, such as copy of the Board resolution authorising payment of dividend, etc. He should ensure that all significant matters that require the exercise of his professional judgment, together with the auditor's conclusion thereon have been properly included in his working papers.

Appendix

**Provisions of Certain Acts and Rules
With Regard to Declaration and Payment of Dividend⁵**

The Companies Act, 1956

205. Dividend to be Paid only out of Profits – (1) No dividend shall be declared or paid by a company for any financial year except out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of sub-section (2) or out of the profits of the company for any previous financial year or years arrived at after providing for depreciation in accordance with those provisions and remaining undistributed or out of both or out of moneys provided by the Central Government or a State Government for the payment of dividend in pursuance of a guarantee given by that Government:

Provided that –

- (a) if the company has not provided for depreciation for any previous financial year or years which falls or fall after the commencement of the Companies (Amendment) Act, 1960 (65 of 1960) it shall, before declaring or paying dividend for any financial year provide for such depreciation out of the profits of that financial year or out of the profits of any other previous financial year or years;
- (b) if the company has incurred any loss in any previous financial year or years, which falls or fall after the commencement of the Companies (Amendment) Act, 1960 (65 of 1960) then, the amount of the loss or an amount which is equal to the amount provided for depreciation for that year or those years whichever is less, shall be set off against the profits of the company for the year for which dividend is proposed to be declared or paid or against the profits of the company for any previous financial year or years, arrived at in both cases after providing for depreciation in accordance with the provisions of sub-section (2) or against both;
- (c) the Central Government may, if it thinks necessary so to do in the public interest, allow any company to declare or pay dividend for any financial

⁵ The Acts and Rules specified in this Appendix are only illustrative in nature and are not meant to be exhaustive for the purposes of the laws dealing with the payment of dividend by different entities.

year out of the profits of the company for that year or any previous financial year or years without providing for depreciation:

Provided further that it shall not be necessary for a company to provide for depreciation as aforesaid where dividend for any financial year is declared or paid out of the profits of any previous financial year or years which falls or fall before the commencement of the Companies (Amendment) Act, 1960 (65 of 1960).

- (1A) The Board of directors may declare interim dividend and the amount of dividend including interim dividend shall be deposited in a separate bank account within five days from the date of declaration of such dividend.
- (1B) The amount of dividend including interim dividend so deposited under sub-section (1A) shall be used for payment of interim dividend.
- (1C) The provisions contained in sections 205, 205A, 205C, 206, 206A and 207 shall, as far as may be, also apply to any interim dividend.
- (2) For the purpose of sub-section (1), depreciation shall be provided either –
 - (a) to the extent specified in section 350; or
 - (b) in respect of each item of depreciable asset, for such an amount as is arrived at by dividing ninety-five per cent of the original cost thereof to the company by the specified period in respect of such asset; or
 - (c) on any other basis approved by the Central Government which has the effect of writing off by way of depreciation ninety-five per cent of the original cost to the company of each such depreciable asset on the expiry of the specified period; or
 - (d) as regards any other depreciable asset for which no rate of depreciation has been laid down by this Act or any rules made there under, on such basis as may be approved by the Central Government by any general order published in the Official Gazette or by any special order in any particular case:

Provided that where depreciation is provided for in the manner laid down in clause (b) or clause (c), then, in the event of the depreciable asset being sold, discarded, demolished or destroyed the written down value thereof at the end of the financial year in which the asset is sold, discarded, demolished or destroyed, shall be written off in accordance with the proviso to section 350.

(2A) Notwithstanding anything contained in sub-section (1), on and from the commencement of the Companies (Amendment) Act, 1974 (41 of 1974), no

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dividend shall be declared or paid by a company for any financial year out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of sub-section (2), except after the transfer to the reserves of the company of such percentage of its profits for that year, not exceeding ten per cent, as may be prescribed:

Provided that nothing in this sub-section shall be deemed to prohibit the voluntary transfer by a company of a higher percentage of its profits to the reserves in accordance with such rules as may be made by the Central Government in this behalf.

(2B) A company which fails to comply with the provisions of section 80A shall not, so long as such failure continues, declare any dividend on its equity shares.

(3) No dividend shall be payable except in cash:

Provided that nothing in this sub-section shall be deemed to prohibit the capitalization of profits or reserves of a company for the purpose of issuing fully paid-up bonus shares or paying up any amount, for the time being unpaid, on any shares held by the members of the company.

(4) Nothing in this section shall be deemed to affect in any manner the operation of the section 208.

(5) For the purposes of this section –

- (a) “specified period” in respect of any depreciable asset shall mean the number of years at the end of which at least ninety-five per cent of the original cost of that asset to the company will have been provided for by way of depreciation if depreciation were to be calculated in accordance with the Provisions of section 350;
- (b) any dividend payable in cash may be paid by cheque or warrant sent through the post directed to the registered address of the shareholder entitled to the payment of the dividend, or in the case of joint shareholders, to the registered address of that one of the joint shareholders which is first named on the register of members, or to such person and to such address as the shareholder or the joint shareholders may in writing direct.

205A. Unpaid dividend to be transferred to special dividend account—

(1) Where, after the commencement of the Companies (Amendment) Act, 1974 (41 of 1974), a dividend has been declared by a company but has not

been paid, or claimed, within thirty days from the date of the declaration, to any shareholder entitled to the payment of the dividend, the company shall, within seven days from the date of expiry of the said period of thirty days, transfer the total amount of dividend which remains unpaid or unclaimed within the said period of thirty days to a special account to be opened by the company in that behalf in any scheduled bank, to be called "Unpaid Dividend Account of Company Limited/ Company (Private) Limited".

Explanation: In this sub-section, the expression "dividend which remains unpaid" means any dividend the warrant in respect thereof has not been encashed or which has otherwise not been paid or claimed.

(2) Where the whole or any part of any dividend, declared by a company before the commencement of the Companies (Amendment) Act, 1974 (41 of 1974), remains unpaid at such commencement, the company shall within a period of six months from such commencement, transfer such unpaid amount to the account referred to in sub-section (1).

(3) Where, owing to inadequacy or absence of profits in any year, any company proposes to declare dividend out of the accumulated profits earned by the company in previous years and transferred by it to the reserves, such declaration of dividend shall not be made except in accordance with such rules as may be made by the Central Government in this behalf, and, where any such declaration is not in accordance with such rules, such declaration shall not be made except with the previous approval of the Central Government.

(4) If the default is made in transferring the total amount referred to in sub-section (1) or any part thereof to the unpaid dividend account of the concerned company, the company shall pay, from the date of such default, interest on so much of the amount as has not been transferred to the said account, at the rate of twelve per cent per annum and the interest accruing on such amount shall ensure to the benefit of the members of the company, in proportion to the amount remaining unpaid to them.

(5) Any money transferred to the unpaid dividend account of a company in pursuance of this section which remains unpaid or unclaimed for a period of seven years from the date of such transfer shall be transferred by the company to the fund established under sub-section (1) of section 205C.

(6) The company shall, when making any transfer under sub-section (5) to the Fund established under section 205C any unpaid or unclaimed dividend, furnish to such authority or committee as the Central Government may appoint in this behalf a statement in the prescribed form setting forth in respect of all

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sums included in such transfer, the nature of the sums, the names and last known addresses of the persons entitled to receive the sum, the amount to which each person is entitled and the nature of his claim thereto, and such other particulars as may be prescribed.

(7) The company shall be entitled to a receipt from the authority or committee under sub-section (4) of section 205C for any money transferred by it to the Fund and such a receipt shall be an effectual discharge of the company in respect thereof.

(8) If a company fails to comply with any of the requirements of this section, the company and every officer of the company who is in default, shall be punishable with fine which may extend to five thousand rupees for every day during which the failure continues.

205B. Payment of unpaid or unclaimed dividend— Any person claiming to be entitled to any money transferred under sub-section (5) of section 205A to the general revenue account of the Central Government, may apply to the Central Government for an order for payment of the money claimed; and the Central Government may, if satisfied, whether on a certificate by the company or otherwise, that such person is entitled to the whole or any part of the money claimed, make an order for the payment to that person of the sum due to him after taking such security from him as it may think fit:

Provided that nothing contained in this section shall apply to any person claiming to be entitled to any money transferred to the fund referred to in section 205C on and after the commencement of the Companies (Amendment) Act, 1999.

205C. Establishment of Investor Education and Protection Fund— (1) The Central Government shall establish a fund to be called the Investor Education and Protection Fund (hereafter in this section referred to as the "Fund").

- (2) There shall be credited to the Fund the following amounts, namely:
- (a) amounts in the unpaid dividend accounts of companies;
 - (b) the application moneys received by companies for allotment of any securities and due for refund;
 - (c) matured deposits with companies;
 - (d) matured debentures with companies;
 - (e) the interest accrued on the amounts referred to in clauses (a) to (d);

- (f) grants and donations given to the Fund by the Central Government, State Governments, companies or any other institutions for the purposes of the Fund; and
- (g) the interest or other income received out of the investments made from the Fund:

Provided that no such amounts referred to in clauses (a) to (d) shall form part of the Fund unless such amounts have remained unclaimed and unpaid for a period of seven years from the date they became due for payment.

Explanation: For the removal of doubts, it is hereby declared that no claims shall lie against the Fund or the company in respect of individual amounts which were unclaimed and unpaid for a period of seven years from the dates that they first became due for payment and no payment shall be made in respect of any such claims.

(3) The Fund shall be utilised for promotion of investor's awareness and protection of the interests of investors in accordance with such rules as may be prescribed.

(4) The Central Government shall, by notification in the Official Gazette, specify an authority or committee, with such members as the Central Government may appoint, to administer the Fund, and maintain separate accounts and other relevant records in relation to the Fund in such form as may be prescribed in consultation with the Comptroller and Auditor – General of India.

(5) It shall be competent for the authority or committee appointed under sub-section (4) to spend moneys out of the Fund for carrying out the objects for which the Fund has been established.

206. Dividend not to be paid except to registered shareholders or to their order or to their bankers—(1) No dividend shall be paid by a company in respect of any share therein, except—

- (a) to the registered holder of such share or to his order or to his bankers; or
- (b) in case a share warrant has been issued in respect of the share in pursuance of section 114, to the bearer of such warrant or to his bankers.

(2) Nothing contained in sub-section (1) shall be deemed to require the bankers of a registered shareholder to make a separate application to the company for the payment of the dividend.

206A. Right to dividend, right shares and bonus shares to be held in abeyance pending registration of transfer of shares— Where any instrument of transfer of shares has been delivered to any company for registration and the transfer of such shares has not been registered by the company, it shall, notwithstanding anything contained in any other provisions of this Act,—

- (a) transfer the dividend in relation to such shares to the special account referred to in section 205A unless the company is authorised by the registered holder of such share in writing to pay such dividend to the transferee specified in such instrument of transfer; and
- (b) keep in abeyance in relation to such shares any offer of rights shares under clause (a) of sub-section (1) of section 81 and any issue of fully paid-up bonus shares in pursuance of sub-section (3) of section 205.

207. Penalty for failure to distribute dividends within thirty days – Where a dividend has been declared by a company but has not been paid, or the warrant in respect thereof has not been posted, within thirty days from the date of declaration, to any shareholder entitled to the payment of the dividend, every director of the company shall, if he is knowingly a party to the default, be punishable with simple imprisonment for a term which may extend to three years and shall also be liable to a fine of one thousand rupees for every day during which such default continues and the company shall be liable to pay simple interest at the rate of eighteen per cent per annum during the period for which such default continues:

Provided that no offence shall be deemed to have been committed within the meaning of the foregoing provisions in the following cases, namely:

- (a) where the dividend could not be paid by reason of the operation of any law;
- (b) where a shareholder has given directions to the company regarding the payment of the dividend and those directions cannot be complied with;
- (c) where there is a dispute regarding the right to receive the dividend;
- (d) where the dividend has been lawfully adjusted by the company against any sum due to it from the shareholder; or
- (e) where, for any other reason, the failure to pay the dividend or to post the warrant within the period aforesaid was not due to any default on the part of the company.

Companies (Transfer of Profits to Reserves) Rules, 1975

[GSR 426 (E), Dated 24-7-1975]

In exercise of the powers conferred by sub-section (2A) of section 205, read with clause (a) of subsection (1) of section 642, of the Companies Act, 1956 (1 of 1956), the Central Government hereby makes the following rules, namely:

Short title

1. These rules may be called the Companies (Transfer of Profits to Reserves) Rules, 1975.

Percentage of profits to be transferred to reserves

2. No dividend shall be declared or paid by a company for any financial year out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of sub-section (2) of section 205 of the Act, except after the transfer to the reserves of the company of a percentage of its profits for that year as specified below:

- (i) where the dividend proposed exceeds 10 per cent but not 12.5 per cent of the paid-up capital, the amount to be transferred to the reserves shall not be less than 2.5 per cent of the current profits;
- (ii) where the dividend proposed exceeds 12.5 per cent but does not exceed 15 per cent of the paid-up capital, the amount to be transferred to the reserves shall not be less than 5 per cent of the current profits;
- (iii) where the dividend proposed exceeds 15 per cent but does not exceed 20 per cent of the paid-up capital, the amount to be transferred to the reserves shall not be less than 7.5 per cent of the current profits; and
- (iv) where the dividend proposed exceeds 20 per cent of the paid-up capital, the amount to be transferred to reserves shall not be less than 10 per cent of the current profits.

Conditions governing voluntary transfer of a higher percentage

3. Nothing in rule 2 shall be deemed to prohibit the voluntary transfer by a company of a percentage higher than 10 per cent of its profits to its reserves for any financial year, so however, that:

- (i) Where a dividend is declared, -
 - (a) a minimum distribution sufficient for the maintenance of dividends to shareholders at a rate equal to the average of the rates at which

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dividends declared by it over the three years immediately preceding the financial year, or

- (b) in a case where bonus shares have been issued in the financial year in which the dividend is declared or in the three years immediately preceding the financial year, a minimum distribution sufficient for the maintenance of dividends to share holders at an amount equal to the average amount (quantum) of dividend declared over the three years immediately preceding the financial year, is ensured:

Provided that in a case where the net profits after tax are lower by 20 per cent or more than the average net profits after tax of the two financial years immediately preceding, it shall not be necessary to ensure such minimum distribution,

- (ii) where no dividend is declared, the amount proposed to be transferred to its reserves from the current profits shall be lower than the average amount of the dividends to the shareholders declared by it over the three years immediately preceding the financial year.

Penalty

4. If a company fails to comply with any of the provisions contained in these rules, the company and every officer of the company in default, shall be punishable with fine which may extend to five hundred rupees, and, where the contravention is a continuing one, with a further fine which may extend to fifty rupees for every day, after the first, during which such contravention continues.

Companies (Declaration of Dividend out of Reserves) Rules, 1975

[GSR No. 427 (E), Dated 24-7- 1975]

In exercise of the powers conferred by sub-section (3) of section 205A, read with clause (a) of sub-section (1) of section 642, of the Companies Act, 1956 (1 to 1956), the Central Government hereby makes the following rules, namely:

Short title

1. These rules may be called the Companies (Declaration of Dividend out of Reserves) Rules, 1975.

Declaration of dividend out of reserves

2. In the event of inadequacy or absence of profits in any year, dividend may be declared by a company for that year out of the accumulated profits earned by it in previous years and transferred by it to the reserves, subject to the conditions that -

- (i) the rate of the dividend declared shall not exceed the average of the rates at which dividend was declared by it in the five years immediately preceding that year or ten per cent of its paid up capital, whichever is less;
- (ii) the total amount to be drawn from the accumulated profits earned in previous years and transferred to the reserves shall not exceed an amount equal to one-tenth of the sum of its paid-up capital and free reserves and the amount so drawn shall first be utilised to set off the losses incurred in the financial year before any dividend in respect of preference or equity shares is declared; and
- (iii) the balance of reserves after such drawal shall not fall below fifteen per cent of its paid-up share capital.

Explanation: For the purposes of this rule, “profits earned by a company in previous years and transferred by it to the reserves” shall mean the total amount of net profits after tax, transferred to reserves as at the beginning of the year for which the dividend is to be declared; and in computing the said amount, the appropriations out of the amount transferred from the Development Rebate Reserve [at the expiry of the period specified under the Income-tax Act, 1961 (43 of 1961)] shall be included and all items of Capital Reserves including reserves created by revaluation of assets shall be excluded.

Insurance Act, 1938

Restriction on dividends and bonuses

49. (1) No insurer, being an insurer specified in sub-clause (a) (ii) or sub-clause (b) of clause (9) of section 2, who carries on the business of life insurance or any other class or sub-class of insurance business to which section 13 applies, shall, for the purpose of declaring or paying any dividend to shareholders or any bonus to policy-holders or of making any payment in service of any debentures, utilize directly or indirectly any portion of the life insurance fund or of the fund of such other class or sub class of insurance business, as the case may be, except a surplus shown in the valuation balance-sheet in such form as may be specified by the regulations made by the Authority submitted to the Authority as part of the abstract referred to in section 15, as a result of an actuarial valuation of the assets and liabilities of the insurer; nor shall he increase such surplus by contributions out of any reserve fund or otherwise unless such contributions have been brought in as revenue through the revenue account applicable to that class or sub-class of

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insurance business on or before the date of valuation aforesaid, except when the reserve fund is made up solely of transfers from similar surpluses disclosed by valuations in respect of which returns have been submitted to the Authority under section 15 of this Act or to the Central Government under section 11 of the Indian Life Assurance Companies Act, 1912 (6 of 1912):

Provided that payments made out of any such surplus in service of any debentures shall not exceed fifty per-cent of such surplus including any payment by way of interest on the debentures, and interest paid on the debentures shall not exceed ten per-cent of any such surplus except when the interest paid on the debentures is offset against the interest credited to the fund or funds concerned in deciding the interest basis adopted in the valuation disclosing the aforesaid surplus:

Provided further that the share of any such surplus allocated to or reserved for the shareholders (including any amount for the payment of dividends guaranteed to them, whether by way of first charge or otherwise), shall not exceed such sums as may be specified by the Authority and such share shall in no case exceed ten per-cent of such surplus in case of participating policies and in other cases the whole thereof.

(2) For the purposes of sub-section (1), the actual amount of income-tax deducted at source during the period following the date as at which the last preceding valuation was made and preceding the date as at which the valuation in question is made may be added to such surplus after deducting an estimated amount for income-tax on such surplus, such addition and deduction being shown in an abstract of the report of the actuary referred to in sub-section (1) of section 13:

Declaration of interim bonuses

112. Notwithstanding anything to the contrary contained in this Act, an insurer carrying on the business of life insurance shall be at liberty to declare an interim bonus or bonuses to policy-holders whose policies mature for payment by reason of death or otherwise during the inter-valuation period on the recommendation of the investigating of actuary made at the last preceding valuation.

The Banking Regulation Act, 1949

15. Restrictions as to Payment of Dividend

(1) No banking company shall pay any dividend on its shares until all its capitalised expenses (including preliminary expenses, organisation expenses,

share-selling commission, brokerage, amounts of losses incurred and any other item of expenditure not represented by tangible assets) have been completely written off.

(2) Notwithstanding anything to the contrary contained in sub-section (1) or in the Companies Act, 1956 (1 of 1956), a banking company may pay dividends on its shares without writing off-

- (i) the depreciation, if any, in the value of its investments in approved securities in any case where such depreciation has not actually been capitalised or otherwise accounted for as a loss;
- (ii) the depreciation, if any, in the value of its investments in shares, debentures or bonds (other than approved securities) in any case where adequate provision for such depreciation has been made to the satisfaction of the auditor of the banking company;
- (iii) the bad debts, if any, in any case where adequate provision for such debts has been made to the satisfaction of the auditor of the banking company.

17. Reserve Fund

(1) Every banking company incorporated in India shall create a reserve fund and shall, out of the balance of profit of each year, as disclosed to the profit and loss account prepared under Section 29 and before any dividend is declared, transfer to the reserve fund a sum equivalent to not less than twenty per cent of such profit.

(1A) Notwithstanding anything contained in sub-section (1), the Central Government may, on the recommendation of the Reserve Bank and having regard to the adequacy of the paid-up capital and reserves of a banking company in relation to its deposit liabilities, declare by order in writing that the provisions of sub-section (1) shall not apply to the banking company for such period as may be specified in the order:

Provided that no such order shall be made unless, at the time it is made, the amount in the reserve fund under sub-section (1), together with the amount in the share premium account is not less than the paid-up capital of the banking company.

(2) Where a banking company appropriates any sum or sums from the reserve fund or the share premium account, it shall, within twenty-one days from the date of such appropriation, report the fact to the Reserve Bank, explaining the circumstances relating to such appropriation:

Provided that the Reserve Bank may, in any particular case, extend the said period of twenty-one days by such period as it thinks fit or condone any delay in the making of such report.

The Regional Rural Banks Act, 1976

21. Disposal of profits— After making provisions for bad and doubtful debts, depreciation in assets, contributions to staff and superannuation funds and all other matters for which provision is, under law, necessary or which are usually provided for by banking companies, a Regional Rural Bank may, out of its net profits, declare a dividend.

The Multi-State Co-Operative Societies Act, 2002

62. Funds not to be divided by way of profit— (1) No part of the funds, other than net profits, of a multi-State co-operative society shall be divided by way of bonus or dividend or otherwise distributed among its members.

(2) The net profit of a multi-State co-operative society referred to in sub-section (1) in respect of a society earning profits shall be calculated by deducting from the gross profits for the year, all interest accrued and accruing in relation to amounts which are overdue, establishment charges, interest payable on loans and deposits, audit fees, working expenses including repairs, rent, taxes and depreciation, bonus payable to employees under the law relating to payment of bonus for the time being in force, and equalization fund for such bonus, provision for payment of income-tax and making approved donations under the Income-tax Act, 1961 (43 of 1961), development rebate, provision for development fund, bad debt fund, price fluctuation fund, dividend equalization fund, share capital redemption fund, investment fluctuation fund, provision for retirement benefits to employees, and after providing for or writing off bad debts and losses not adjusted against any fund created out of profit:

Provided that such society may add to the net profits for the year interest accrued in the preceding years, but actually recovered during the year:

Provided further that in the case of such multi-State co-operative societies, as do not have share capital, the surplus of income over expenditure shall not be treated as net profits and such surplus shall be dealt with in accordance with the bye-laws.

63. Disposal of net profits (1) A multi-State co-operative society shall, out of its net profits in any year.

(a) transfer an amount not less than twenty-five per cent to the reserve fund;

- (b) credit one per cent, to co-operative education fund maintained, by the National Co-operative Union of India Limited, New Delhi, in the manner as may be prescribed;
- (c) transfer an amount not less than ten per cent, to a reserve fund for meeting unforeseen losses.
- (2) Subject to such conditions as may be prescribed, the balance of the net profits may be utilised for all or any of the following purposes, namely: -
 - (a) payment of dividend to the members on their paid-up share capital at a rate not exceeding the prescribed limit;
 - (b) constitution of, or contribution to, such special funds including education funds, as may be specified in the bye-laws;
 - (c) donation of amounts not exceeding five per cent of the net profits for any purpose connected with the development of co-operative movement or charitable purpose as defined in Section 2 of the Charitable Endowments Act, 1890 (6 of 1890);
 - (d) payment of ex-gratia amount to employees of the multi-State co-operative society to the extent and in the manner specified in the bye-laws.

64. Investment of funds: A multi-State co-operative society may invest or deposit its funds—

- (a) in a co-operative bank, State co-operative bank, co-operative land development bank or Central co-operative bank; or
- (b) in any of the securities specified in Section 20 of the Indian Trusts Act, 1882 ; or
- (c) in the shares or securities of any other multi-State co-operative society or any co-operative society; or
- (d) in the shares, securities or assets of a subsidiary institution or any other institution; or
- (e) with any other bank; or
- (f) in such other mode as may be provided in the bye-laws.

Explanation: For the purposes of clause (e), “bank” means any banking company as defined in clause (c) of Section 5 of the Banking Regulation Act, 1949, and includes-

- (a) the State Bank of India constituted under the State Bank of India Act, 1955;

- (b) a subsidiary bank as defined in clause (k) of Section 2 of the State Bank of India (Subsidiary Banks) Act, 1959;
- (c) a corresponding new bank constituted under Section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970) or a corresponding new bank constituted under Section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (40 of 1980).

Multi-State Co-operative Societies Rules, 2002

24. Distribution of profit to members.

- (1) No part of the funds, other than net profits of a multi-State co-operative society shall be distributed by way of bonus or dividend or otherwise among its members.
- (2) Payment of dividend to the members on their paid-up share capital shall be as specified in the bye-laws.
- (3) The bye-laws of a multi-State co-operative society may provide for distribution of patronage bonus to its members in consonance with the transactions of a member with the society.
- (4) Every multi-State Co-operative society may also provide for in their bye-laws the subjects and purposes for which the reserve fund will be utilised.