

Synopsis of Guidance Note on 'Audit of Payment of Dividend'

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Background:

The Auditing and Assurance Standards Board of the Council of the Institute of Chartered Accountants of India has issued the Guidance Note on Audit of Payment of Dividend, way back in August 2005, when the [Companies Act, 1956](#) was in force. Post the introduction of the [Companies Act, 2013](#), the provisions relating to dividend have undergone some change and this Guidance Note requires revision. However, this guidance note still holds good from the audit point of view and gives guidance to the auditor to comply with the statutory requirements relating to payment and distribution of dividend.

Synopsis:

The term "Dividend" is defined in the "[Guidance Note on Terms used in the Financial Statement](#)" as "A distribution to shareholders out of profits or reserves available for this purpose". It means a return on shares held in an entity and payable out of distributable surplus. The term dividend includes any interim dividend. The erstwhile [sections 205, 205A, 205C, 206, 206A and 207](#) of the Companies Act, 1956 relates to dividend. Pursuant to the introduction of the Companies Act, 2013, the provisions of [Section 123 to 127](#) read with The Companies (Declaration and Payment of Dividend) Rules, 2014, are applicable for declaration and payment of dividend and need to be complied with. In this article, the relevant provisions of Companies Act, 2013, is touched upon wherever necessary, even though the Guidance Note talks about the provisions contained in the erstwhile Companies Act, 1956.

Audit Procedures:

As a part of normal audit procedures, an auditor needs to obtain sufficient and appropriate audit evidence to satisfy himself that dividend has been declared and paid in accordance with the applicable provisions. Further, he needs to examine whether the relevant laws and regulations applicable to the entity has been complied with regard to all the transactions relating to declaration and payment of dividend and the same have been properly accounted for and disclosed. Thus, his scope of examination, would include:

- Verifying whether dividend has been declared out of distributable surplus after proper authorisation, as required under law;
- Evaluating the internal control system relating to payment of dividend;
- Examining compliance with the requirements of the relevant laws; and
- Examining the system for recording and appropriate disclosure of transactions during the year relating to payment of dividend.

Internal Control Evaluation:

The Guidance Note mandates the auditor to study and evaluate the system of internal control relating to payment of dividend, to determine the nature, timing and extent of his audit procedures particularly the following:

- Verify whether all transactions in the dividend account have been authorised by the competent authority;
- Verify whether the registers containing the details of members and dividend have been properly maintained by the entity;
- Verify whether there is an effective system of segregation of duties in place with regard to maintenance of shareholders register, preparation of dividend warrants, and maintenance of warrants dispatch register etc.,
- Internal control procedures about preparation of dividend warrant, dispatch of the same, reconciliation of unclaimed dividend and records maintained for the same. Further, separate records of unclaimed dividend should be maintained for each year's dividend / interim dividend
- The procedure adopted for payment of unclaimed dividend with appropriate documents.

In case the above activities are outsourced, the auditor needs to obtain sufficient audit evidence as detailed in the [Standard on Auditing 402](#) "Audit Considerations Relating to an Entity Using a Service Organisation".

Verification:

As part of his audit procedures, an auditor needs to verify the payment of dividend by performing the following procedures, viz.,

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

The auditor should verify the companies with the laws and regulations, provisions contained in the governing charter, viz., Articles of Association in case of companies, bye-laws or rules and directions /

instruction 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.

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 approval of Directors is final and in case of final dividend, the auditor needs to verify the recommendation of the directors and the approval of the members in the general meeting. It may be noted that members / shareholders can reduce the quantum of the dividend proposed by the directors, but they can't increase the recommended by them. The auditor also needs to ensure compliance with other laws / agreements, viz., [Foreign Exchange Management Act, 1999](#), covenants of Listing Agreement with Stock Exchanges in case of listed companies, Shareholders Agreements containing restriction on payment of dividends etc.,

Though in the erstwhile Companies Act, 1956, the transfer of profits to reserves depending on the quantum of dividend declared, was mandatory, now in the Companies Act, 2013, it is recommendatory.

Also, he needs to check whether the dividend, so declared, has been transferred to a separate bank account and the payments therefrom has been effected within the timelines prescribed in the Act. The unclaimed dividend, if any, needs to be transferred to a separate Bank Account and has to be transferred to "Investor Education and Protection Fund" as per the requirements of the statute.

In case of any declaration out of reserves, the auditor needs to verify whether the same is in accordance with Rule 3 of the Companies (Declaration and Payment of Dividend) Rules, 2014 viz., "Declaration of dividend out of reserves".

Disclosure:

As per the requirements of Schedule III, the proposed dividends on both equity and preference shares and the related amount per share shall be disclosed separately in the notes. It also requires separate disclosure of the arrears of fixed cumulative dividends on preference shares. Unclaimed Dividends should be shown in Balance Sheet under the head "Other Current Liabilities"

Management Representation Letter:

The Auditor should obtain appropriate written 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 transfer to Investor Education and Protection Fund and that the dividend has been paid to the persons entitled to it.

Documentation:

The auditor should maintain adequate working papers regarding audit of payment of dividend including the management representation letter as part of his audit file.

Conclusion:

Considering the statutory compliance requirements, the auditor needs to perform appropriate audit procedures to verify the declaration and payment of dividends. He needs to get updated with the changes in the law, the process, and types of dividends. Considering all these, it is time for the ICAI to update and revise the Guidance Note at the earliest to incorporate the changes as contained in the Companies Act, 2013 and the rules framed thereunder

[Click here](#) to access the Guidance Note issued by ICAI

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