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Business Finance 2 - Assignment 1

MCQs

1
Ans (D) II and IV

2
Ans (C) an adverse opinion

3
Ans (C) Chairman's report

4
Ans (C) All of the above

5 (a)
Ans (1) There are numerous accounting concepts that back the accounting standards that are in place.
(2) Realization concept of accounting tells as to when should income be recorded in the financial statements. According to realization concept, income should be recorded for when you are 100% sure that the goods are considered to be sold irrespective of whether you have received the money or not
(3) Similarly, the accrual concept of accounting gives instructions as to when the expenses are to be recorded in the financial statements. The accrual concept of accounting states that record the expenses when you have incurred

irrespective of whether you have settled the bill or not.

(b)

Ans (1) When the Health insurance company sells a particular medical plan, the company should record the written premium as income as per the realisation concept of accounting

(2) In case of insurance companies, written premium includes both earned premium in respect of the policy as well as the unearned premium reserve

(3) Whereas, the health insurance company should record the incurred claims as expenses as per the accrual concept of accounting

(4) Incurred claims consist of the paid claims, case reserve and IBNR reserve

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Ans (1) The key objective of any business is to maximise 'shareholder wealth'. And this objective can be fulfilled by increased profitability.

(2) This is one of the reasons why directors may be inclined towards manipulation of accounts

(3) Accounting concepts and standards are based on numerous assumptions and practices. Thus, ~~A~~ accounts can be manipulated by altering the assumptions and estimates

(4) Manipulation may also involve inflating current operating income (via an increased in booked sales or decrease in expenses) or reduce current operating income (to increase future earnings).

(5) Accounting practices that can lead to such manipulations are:

- inappropriate depreciation of tangible assets
- inappropriate amortisation of intangible assets
- inappropriate revaluation of inventories and non current assets
- not recording for contingent liabilities
- not accounting for bad debt, etc

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Ans

	Particulars	Gross profit	Cashflow
(i)	Property that the company posses has been revalued upwards by Rs 100 crores by valuer	NO change	NO change
(ii)	There has been an interest payment of Rs 1000 crores towards Masala bonds issued by the company	NO change	Decrease
(iii)	There has been an increase in inventory of Rs 500 crores which were manufactured out of raw materials in the previous year end, ignoring man power and production cost	Increase	NO change
(iv)	There was a depreciation of plant and machinery to the extent of Rs 250 crores	Decrease	NO change
(v)	It was decided to write off Rs 200 crores due to EHFL defaulting.	~~Decrease~~ No change	Decrease

8 (i)

Ans Few important roles of regulation in the financial system are:

(1) Check whether the financial companies and institutions are operating legally or not

(2) Maintain investor confidence by protecting them against scams and scandals

(3) Frame rules and policies to ensure a safe and standard procedure throughout the system.

(4) ~~To~~ Ensure transparency and track of international transactions

(ii)

Ans A number of regulatory bodies that regulate the Indian financial system are as follows:

(1) Reserve Bank of India (RBI)

(2) Securities and Exchange Boaard of India (SEBI)

(3) Insurance Regulatory and Development Authority of India (IRDAI)

(4) Ministry of Corporate Affairs (MCA)

(5) Competition commission

(iii)

Ans (a) Banks - RBI

(b) Superannuation products - IRDAI

(c) General insurance companies - IRDAI

(d) Stock brokers - SEBI

(e) Mutual funds - SEBI

(f) Market for listed securities - SEBI

(g) Foreign exchange dealers – RBI
(h) Money changers – RBI

9. (i)

Ans (1) Cost concept of accounting gives information as to how the entity's non current assets should be recorded in the financial statements

(2) The cost concept states that the non current assets should be recorded at their original cost less depreciation till date subject to any possible impairment writedown

(3) Because of it's limitations, the accountancy profession is now gradually moving from historic cost concept to realisable fair value concept

(4) Going concern concept of accounting states that the financial statements should be prepared with the assumption that the business will continue it indefinitely in it's present form until there are evidences to prove otherwise

(5) The going concern concept actually backs the cost concept This is because, according to going concern concept the non current assets are never going to be sold. Thus recording them at their historic costs are appropriate compared to recording them at their realisable fair values

(ii)

Ans (1) One way the Board of directors could resolve this issue would be to use these accounting standards which are implied in comparable situations

(2) Otherwise, the Board of directors can use those accounting standards for which the financial statements give a 'True and fair' view; also more importantly they are reliable or relevant

(3) The financial statements are said to be reliable if they are free from any manipulation, they are accounted for honest numbers and they are not misleading

(4) The financial statements are said to be relevant if they help the user groups in making informed decisions

(iii)

Ans (a) The financial statements are basically the reporting and representation of the company's performance

(b) If the accounting policies are correctly applied consistently, it basically means that your financial statements are free from any manipulations and they give a 'true and fair' view

(c) The application of accounting policies being correct or not is nowhere going to change the performance of the company

(d) Also, share prices if increasing would reach a certain maxima and is bound to decrease. Because people would actually profit from overpriced stocks. Thus, the market will react and would lower the price of such stocks

10 (a)

Ans **Investment Bank**

(1) Role

- Assist companies in the process of mergers and acquisition. They are the ones who are hired by companies to negotiate with the other company and also for related legal works
- Perform business valuations for companies
- Help the companies in obtaining stock exchange quotation. Also, to assist the respective companies in marketing and to reach the bigger investors
- To help companies in raising capital

(2) Sources of funds

- They receive a particular amount of fees from the companies who they assist for
- In case of offer for sale, they receive a certain percentage of the entire issue amount

(3) Application of funds

- They invest in securities, daily operations, provide loans and lease to companies

(b) **Pension schemes**

(1) Role

- Provide a steady source of income as pensions post retirement

(2) Sources of funds

- The contributions from employee and employer during the accumulation phase

(3) Application of funds
- They invest the contributions received from employee and employer in capital markets so as to receive returns after few years

(c) Life Insurance Company
(1) Role
- To provide financial protection to insured in the event of survival or death for exchange of premiums. In the case of death of insured, the sum assured should be given to the nominee

(2) Sources of funds
- Premiums received from the policy holder in respect of the life insurance policy

(3) Application of funds
- To pay claims and to create case reserve as well as IBNR reserve
- The premiums received are invested in equities and other securities to generate higher returns according to the liability duration

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Ans (a) The limitations and challenges that are possible are as follows:
(1) Since, the general insurance and life insurance companies have different regulators, their statutory requirement may be different

(2) Depending on the regulators, they might have different accounting treatments for the same aspect
(3) Since, the nature of the business is in itself different, there would be difficulty in comparing the accounts
(4) There might be a possibility that the general insurance companies might have different ratios than that of life insurance companies

12 (i)

Ans Preparing insurance company accounts is more complicated than normal company accounts for the following reason:
(a) The premiums if transferred as profits to the shareholders before the maturity of the policy would hamper the company's financial stability.
(b) The insurance contracts with policyholders fall due outside the accounting period and are uncertain in size.

(ii) The major component of reserves for a general insurance company's technical account are as follows:
(a) Unearned premium reserve = This reserve is kept to cover the claims and expense that are expected to emerge from an unexpired portion of the insurance cover in future period
(b) Case reserve = This is the reserve that is created to cover the claims for outstanding claims i.e the claims that are reported but not yet settled.
(c) IBNR (Incurred but not reported) reserve = This is the reserve that is created to cover claims that could

have happened but are not yet reported

13 (i)

Ans (a) Advantages of compliance with International Accounting Standards

1 They eliminate or at least reduce variations ~~to~~ between companies in the way they prepare accounts. This helps the stakeholders in easily comparing different company's accounts.

2 The discussion process that leads to a standard being issued focuses attention on particular areas for debate about accounting practice

3 They oblige companies to disclose more information than required by national laws.

4 They offer a degree of flexibility that legislation often does not

(b) Disadvantages of compliance with International Accounting Standards

1 The standards issued are not applicable to all companies in all circumstances.

2 They offer multiple treatments as alternatives, which negates the attempt to ensure conformity between companies

3 The standard setting may not be entirely objective

4 Some standards are far too general to be meaningless, whereas some standards are far too detailed

(ii) The various sources of regulations that influence the preparation of financial statements for companies in

addition to the accounting standards are as follows:
(i) National company laws
(ii) Principles, concepts and conventions
(iii) Stock exchange requirements.
(iv) Good practice by leading companies
(v) Other legislation

(iii)
Ans (a) The statement of financial position and statement of comprehensive income are prepared on accrual, realisation and cost concept basis
(b) They do not give information about the actual cash transfers nor do they represent the true value of the entity
(c) On the other hand, a cashflow statement gives information about the actual cash inflows and outflows. The cashflow statement gives the stakeholders the information as to what were the investments and financial cashflows for the period
(d) It tells the user groups about cashflows from operating activities, cashflows from investing activities and cashflows from financing activities

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Ans Income Statement of ABC Ltd for year ended 31 March 2019

Particulars	Amount (000)	Amount (000)
Revenue		1500
Cost of inventory consumed	350	
Factory running costs	100	
Manufacturing wages	175	
Depreciation - Building	~~3~~ 7	
Depreciation - Machinery	15	
Cost of sales		~~67~~ 647
Gross profit		~~824~~ 853
Selling and distribution expenses		
Cost of marketing	55	
Delivery vehicle running costs	60	
Sales salaries	120	
Depreciation - Delivery vehicles	31	
		266
General and administrative expenses		
Administrative staff wages	3	
Operating profit		584
Finance costs		10
Profit for the year		574

Statement of changes in equity for year ended 31 March 2019

Particulars	Amount (000)	Amount (000)
Share capital		200
Retained earnings - Opening Bal	250	
Current year profit	574	
Dividends paid	(45)	
Retained earnings - Closing Bal		779
Revaluation Reserve - Opening Bal	180	
Current year revaluation	540	
Revaluation Reserve - Closing Bal		720
Total equity		1699

Statement of Financial position as of ABC ltd as at 31 March 2019

Particulars	Amount (000)	Amount (000)
Assets		
Non current assets		
Land	800	
Building	693	
Machinery	55	
Delivery vehicles	124	
	16	1672
Current assets		
Inventory	30	
Trade receivables	210	
		240
Total assets		1912
Equity and liabilities		
Equity		
Share Capital	200	
Retained Earnings	779	
Reserves and Surplus	720	
Total equity		1699
Non current liabilities		
Loan		145
Current liabilities		
Bank	18	
Trade payables	50	
		68
Total equity and liability		1912

Notes

1 ~~Depreciation on~~ land adjustment

Opening balance	600
Revaluation	200
Closing balance	800

2 Depreciation on building

~~Opening balance~~ Cost	400
Less: Cummulative depreciation	(40)
~~Of~~ Pre-revaluation value	360
Revaluation	340
Current year depreciation	(7)
Closing balance	693

3 Depreciation on delivery vehicles

~~O~~ Cost	325
Less: Cummulative depreciation	(170)
Opening balance	155
Current year depreciation	(31)
Closing balance	124

4 Depreciation on machinery

Cost	150
Less: Cummulative depreciation	(80)

Opening balance	70
current year depreciation	(15)
Closing balance	55

15.

Ans Profit and loss Account of ABC Ltd for year ended 31 December, 2019

Particular		Amount	Amount
Revenue			58,000
Depreciation - Laptops		3208.33	
Depreciation - Office equipment		1833.33	
Office supplies		1000	
			6041.66
Gross profit			51958.34
Office Building Rent		14206.66	
Employees' salaries		14000	
Office electricity bill		4000	
Mobile and Internet bill		583	
			32789.66
Operating profit			19168.68
Finance Income			200
			~~19368.68~~
Profit before tax			19368.68
Tax			3000
Profit after tax			16368.68

Statement of financial position as at 31 December, 2019

Particulars	Amount	Amount
Assets		
Non Current assets		
Laptops	31791.67	
Office Equipment	18166.67	
		49958.334
Current assets		
Office supplies	1000	
Trade receivables	1500	
Cash	1000	
Bills receivable	5000	
Office building rent	1710.34	
Revenue receivable	2000	
Interest receivable	200	
		12410.34
Total assets		62368.68
Equity and liabilities		
Equity		
Share capital	32000	
Retained earnings	11368.68	
Total equity		43368.68
Non current liability		0
Current liability		
Salaries payable	4000	

~~Ak~~ Unearned fees		9000	
Tax Payable		3000	
Trade payable		3000	
Total liabilities			19000
Total equity and liabilities			60368.68

~~Notes~~ Statement of Retained earnings for year ended 31 March, 2019

	Particulars		Amount	Amount
	Profit for current year		16368.68	
	Dividend		(5000)	
	Retained earnings - closing balance		11368.68	

Notes:

1 Depreciation adjustment

	Laptops	Office equipment
Cost	35,000	20,000
Less: Current 11 months depreciation	$\left(\frac{35000-0}{10}\right) \times \frac{11}{12}$ = 3208.33	$\left(\frac{20000-0}{10}\right) \times \frac{11}{12}$ = 1833.33
Closing balance	31791.67	18166.67

2 Inventory adjustment

Office supplies	2000
Less: Used supplies	(1000)
Closing stock	1000

3 Fee revenue Earned adjustment

Accounted fee revenue earned	55,000
Fee revenue due from customers	2,000
Unearned fees earned in december	1,000
	58,000

4 Employees' salaries adjustment

Accounted salaries	10,000
December salaries	4,000
	14,000

5 Office Building Rent adjustment

Annual rent	15,917
The one month excluding rent	$1000 \times (1+5\%)^{11} =$ 1710.34
Total rent	14206.66