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Subject: Business Finance – 2

Chapter: Unit 1 & Unit 2

ASSIGNMENT 1

1. Which of the following errors in recording transactions has an impact on profitability?

- I. Purchase of a new machinery in the last month of the financial year was not recorded at all**
 - II. Cash paid to one of the suppliers recorded as being paid to buy a depreciable asset**
 - III. Loan taken from bank at the start of the year not being recorded at all**
 - IV. Amount collected from one of the customers to whom goods were sold on credit being recorded as additional sales made**
- A. IV. Only**
- B. All of the above**
- C. I. II. and IV.**
- D. II and IV**

ANS. A. IV. Only

2. The auditor believes that the financial statement do not give a true and fair view and the effect is so material that a disclosure is required to the extent that financial statement may be misleading or incomplete in nature, the auditor should issue –

- A. a disclaimer of opinion**
- B. a qualified opinion**
- C. an adverse opinion**
- D. an unqualified opinion, but includes a reference to This matter in the audit report**

ANS. C. an adverse opinion

3. Which of the following is NOT required as part of a listed company's accounting statement: -

- A. Cashflow statement
- B. Statement of change in equity
- C. Chairman's report
- D. Income statement and Balance Sheet

ANS. C. Chairman's report

4. Which of the following accounting concepts are likely to distort the true economic value of an entity as reflected by its statement of financial position?

- I. Money measurement concept
- II. Cost concept
- III. Prudence
- IV. Accrual concept

- A. II only
- B. II and III
- C. All the above
- D. I, II and III

ANS. B. II and III

5. a) Briefly explain the realization and accruals concepts of accounting concepts.

b) A Health insurance company sells one year medical plans throughout the year. Describe the specific ways the realization and accrual concepts is utilized in preparing the accounts of the company.

ANS. A) The realization principle is the concept that revenue can only be recognized once the underlying goods or services associated with the revenue have been delivered or rendered, respectively. Thus, revenue can only be recognized after it has been earned.

Accrual accounting is an accounting method where revenue or expenses are recorded when a transaction occurs rather than when payment is received or made. The method follows the matching principle, which says that revenues and expenses should be recognized in the same period.

B) The realization concept comes into effect when the policy is actually claimed. And the accrual concept is used as soon as the policy is sold.

6. Explain different ways through which accounts can be manipulated along with example of each.

ANS.

1. Accelerating Revenues

One way to accelerate revenue is to book lump-sum payments as current sales when services are actually provided over a number of years.

2. Delaying Expenses

It is way in which the expenses are delayed or recorded at a time other than the expense is realized.

3. Accelerating Pre-Merger Expenses

It may appear counterintuitive, but before a merger is completed, the company that is being acquired will pay—possibly prepay—as many expenses as possible. Then, after the merger, the earnings per share (EPS) growth rate of the combined entity will appear higher compared to past quarters. Furthermore, the company will have already booked the expenses in the previous period.

4. Non-Recurring Expenses

By accounting for extraordinary events, non-recurring expenses are one-time charges designed to help investors better analyze ongoing operating results. Some companies, however, take advantage of these each year. Then, a few quarters later, they "discover" they reserved too much and put an amount back into income

5. Other Income or Expense

Other income or expense is a category that can hide a multitude of sins. Here companies book any "excess" reserves from prior charges

6. Pension Plans

If a company has a defined benefit plan, it can use the plan to its advantage. The company can improve earnings by reducing the plan's expenses. If the investments in the plan then grow faster than the company's assumptions, the company could record these gains as revenue.

7. Off-Balance-Sheet Items

A company can create separate subsidiaries that can house liabilities or incur expenses that the parent company does not want to disclose. If these subsidiaries are set up as separate legal entities that are not wholly owned by the parent, they do not have to be recorded on the parent's financial statements and the company can hide them from investors.

7. What happens to the Gross profit and Cash flow of the company for a particular financial year (whether there is an increase / decrease) in the following cases:

- i) Property that the company possess has been revalued upwards by Rs 100crores by the Valuer.
- ii) There has been an interest payment of Rs 1000 crores towards Masala bond issued by the company.

iii) There has been an increase in inventory of Rs 500 crores which were manufactured out of raw materials available in the previous year end, ignoring any man power and production cost.

iv) There was a depreciation of plant and machinery to the extent of Rs 250 crores.

v) It was decided to write off Rs 200 crores due to EHFL defaulting.

ANS. i) Gross profit – Increase

Cash flows – No change

ii) Gross Profit – Decrease

Cash flows – Cash outflow

iii) Gross profit – No Change

Cash flows – No Change

iv) Gross profit – Decrease

cash flow – No change

v) Gross profit – No change

Cash flows – No change

8. i) Briefly list the main roles of regulation in the financial system.

ii) Identify the regulatory bodies which regulate the Indian Financial system.

iii) Identify the regulatory authorities currently responsible for supervising each of the following:

a) Banks

b) Superannuation Products

c) General Insurance companies

d) Stock brokers

e) Mutual Funds

f) Market for listed securities

g) Foreign exchange dealers

h) Money changers

ANS. i) The main role of regulation in the financial system is to guarantee fair and efficient markets and financial stability.

ii) India has two primary financial services regulators - the Reserve Bank of India (RBI) regulating India's banking industry and the Securities & Exchange Board of India (SEBI) regulating the capital markets industry.

iii)

a) Banks :-

Reserve Bank of India

Securities and Exchange Board of India

Insurance Regulatory and Development Authority of India

Pension Fund Regulatory and Development Authority

Forward Markets Commission

b) Superannuation Products :-

Pension Fund Regulatory and Development Authority (PFRDA)

c) General Insurance companies:-

Insurance Regulatory and Development Authority of India (IRDAI)

d) Stock brokers :-

Securities Exchange Board of India (SEBI)

e) Mutual Funds :-

Securities and Exchange Board of India (SEBI)

f) Market for listed securities :-

Securities and Exchange Board of India (SEBI)

g) Foreign exchange dealers :-

Securities and Exchange Board of India (SEBI)

h) Money changers:-

Reserve Bank of India

9. i) A company's accounts should comply with various accounting concepts. Outline the cost concept and the going concern concept.

ii) A company has entered into an unusual transaction that is not directly covered by any accounting standard. Explain how the Board of Directors can go about selecting the appropriate accounting policy for this situation.

iii) The Directors of a listed company believe that if optimistic accounting policies are applied consistently, the stock market will reward the company by increasing its share price. Explain why this may not be true.

ANS. i) In accounting, the cost principle is part of the generally accepted accounting principles. Assets should always be recorded at their cost, when the asset is new and also for the life of the asset. Going concern is an accounting term for a company that has the resources needed to continue operating indefinitely until it provides evidence to the contrary. This term also refers to a company's ability to make enough money to stay afloat or to avoid bankruptcy.

ii) the board of directors should check if the unusual transaction is partially being covered by any of the accounting concept and then come up with a miscellaneous concept which stands true for the unusual transaction.

iii) always applying accounting policy may not be a good idea because in business one should always expect worst. prudence concept covers this.

10. Discuss the role, sources of funds and application of funds for the

following financial institutions:

a) Investment Bank

b) Pension Scheme

c) Life Insurance Company

ANS. a) In essence, investment banks are a bridge between large enterprises and the investor. Their primary roles are to advise businesses and governments on how to meet their financial challenges and to help them procure financing, whether it be from stock offerings, bond issues, or derivative products.

Investment banks provide a variety of financial services, including research, trading, underwriting, and advising on M&A deals.

Proprietary trading is an effort to make profits by trading the firm's own capital.

Investment banks earn commissions and fees on underwriting new issues of securities via bond offerings or stock IPOs.

Investment banks often serve as asset managers for their clients as well.

b) In simple terms, a pension scheme is just a type of savings plan to help you save money for later life. It also has favorable tax treatment compared to other forms of savings. A pension scheme is issued by a company or a government to its employee or citizens. A part of employee's salary is taken and later when he or she retires it is paid in form of multiple payments or annuities called pension.

c) A life insurance company is a corporate entity which provide life insurance to its customer. The main source of fund is through sale of life insurance products. And it uses the fund to invest in different ventures to make profits and also to provide cover to its customer.

11. There are general insurance and life insurance companies operating in a country, each of which is governed and regulated by a different regulator. If you want to interpret the accounts of these companies for your investment decision, what limitations and challenges are possible?

ANS. The most primal problem would be to understand what are the regulatory requirements that the two bodies demand, there would be a lot of similarities and differences in the regulatory requirements. So therefore, before investing one has to be thorough with not just one but two regulators. And with that comes the need to check the different accounting standards mandated by the two regulators.

12. i) Briefly describe why it is more complicated to prepare insurance companies accounts as compared to normal company accounts.

ii) List and define the major component of reserves for a general insurance company's technical account.

ANS. i) It is difficult to prepare an insurance companies account because of the unprecedented nature of the insurance business. No one can tell for certain when and how much claim the company has to pay in a financial year.

ii) The claims reserve is funds set aside for the future payment of incurred claims that have not yet been settled.

The outstanding claims reserve is an actuarial estimate, as the amounts liable on any given claim is not known until settlement.

Money for the claims reserve is taken from a portion of the premium payments made by policyholders over the course of their insurance contracts.

An outstanding claims reserve is recorded as a liability on a company's balance sheet.

13. A newly formed country is debating whether it should mandate compliance with the International Accounting Standards. As a reputed member of the accounting profession in a neighboring country, you have been asked for your advice.

i) Describe four advantages and four disadvantages of compliance with the International Accounting Standards.

ii) List the various sources of regulations that influence the preparation of financial statements for companies in addition to the accounting standards.

iii) Describe the additional information that cashflow statements provide which is not available in the Statement of Financial Position and Statement of Comprehensive Income.

ANS. i) Advantages: -

1. It would create a single set of accounting standards around the world.
2. It would reduce the time, effort, and expense of preparing multiple reports.
3. It would make it easier to monitor and control subsidiaries from foreign countries.
4. It would improve the rates of foreign direct investment around the world.

Disadvantages: -

1. It would lead to concerns with standards manipulation.
2. It would require global consistency in auditing and enforcement.
3. It would increase the amount of work placed on accountants.
4. It would require changes at the educational level as well.

iii) a company's cash flow statement measures the flow of cash in and out of a business, while a company's balance sheet measures its assets, liabilities, and owners' equity. The statement of comprehensive income reports the change in net equity of a business enterprise over a given period.

14. As an account officer, you have been requested to assist ABC Ltd., a company, to prepare its annual accounts. The following information has been provided from the company's Book-keeping records:

Balances as on 31 March 2019 Administrative staff wages: 3,000

Cost of Marketing: 55,000 Bank

overdraft: 18,000
 Buildings – depreciation: 40,000
 Buildings – valuation: 400,000
 Cost of inventory consumed: 350,000
 Delivery vehicle running costs: 60,000
 Delivery vehicles – cost: 325,000
 Delivery vehicles – depreciation: 170,000 Dividend paid: 45,000
 Factory running costs: 100,000 Interest: 10,000
 Inventory at 31 March 2019: 30,000 Land – valuation: 600,000
 Loan (repayable 2024): 145,000 Machinery – cost: 150,000 Machinery
 – depreciation: 80,000 Manufacturing wages: 175,000
 Retained earnings: 250,000
 Revaluation reserve: 180,000
 Revenue: 1,500,000
 Sales salaries: 120,000
 Share capital 200,000
 Trade payables: 50,000
 Trade receivables: 210,000

In addition to figures shown above, below information is provided:

1. A revaluation exercise was conducted on 1 April 2018. Land was revalued at 800,000 and buildings at 700,000

2. Depreciation has still to be charged as follows:

- Buildings – 1% of cost or valuation
- Delivery vehicles – 20% reducing balance
- Machinery – 10% of cost

Prepare: i) An Income Statement for the year ended 31 March 2019

ii) A Statement of changes in Equity, and

iii) A Statement of Financial Position as on 31 March 2019

ANS. i) ABC Ltd. Income statement for the year ended 31st March 2019

Revenue	1500000
Cost of Sales	(647000)
Gross Profit	853000
Administrative Staff wages	(3000)
Distribution Cost	(266000)
	584000
Interest	(10000)
Profit for the year	547000

ii) ABC Ltd. Statement of changes in equity for the year ended 31st March 2019

	Share Capital	Revaluation Reserve	Retained	Earnings Total
Opening Balance	200,000	180,000	250,000	630,000
Revaluation		540,000		540,000
Profit for the year			574,000	574,000
Dividend Paid			(45,000)	(45,000)

Closing Balance	200,000	720,000	779,000	1,699,00
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iii) ABC Ltd. Statement of financial position as at 31st March 2019

Non-current Assets

Property, Plant and Equipment	1,672,000
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Current Assets

Inventory	30,000
Trade Receivables	210,000
	240,000
Total Assets	1,912,000

Equity and Liabilities

Equity

Share Capital	200,000
Revaluation Reserve	720,000
Retained Earnings	779,000
	1,699,000

Non-current Liability

Loan	145,000
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Current Liability

Trade Payables	50,000
Bank	18,000
	68,000

Total Equity and Liabilities	1,912,000
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Notes:

1) Property, Plant and Equipment

Cost or Valuation	Land	Building	Machinery	Vehicles	Total
Opening Balance	600,000	400,000	150,000	325,000	1,475,000
Revaluation	200,000	300,000			500,000
Closing Balance	800,000	700,000	150,000	325,000	1,975,000

2) Depreciation

Cost or Valuation	Land	Building	Machinery	Vehicles	Total
Opening Balance		40,000	80,000	170,000	290,000
Revaluation		(40,000)			(40,000)
Closing Balance		7,000	15,000	31,000	53,000

		7,000	95,000	201,000	303,000
Net book value	800,000	693,000	55,000	124,000	1,672,000

3) Cost of Sales

Cost of Inventory Consumed	350,000
Factory running costs	100,000
Manufacturing wages	175,000
Depreciation of buildings	7,000
Depreciation of Machinery	15,000
	647,000

4) Cost of Distribution

Advertising Cost	55,000
Delivery Vehicle running costs	60,000
Sales Salaries	120,000
Depreciation of Vehicles	31,000
	266,000

15. An interior designer company "ABC Ltd." has been set up on January 1, 2019 to provide advice to high value customers. The company has taken an office on rent starting from February 1, 2019. The terms of payment for rent are as follows –

1) Annual payment for 12 months will be INR 15917.

2) First month rent payment will be INR 1000.

3) Every month rent will be increased by 5% of previous month rent on compounded basis.

ABC Ltd. List of Balances on December 31, 2019 (Amount in INR)

Account	
Laptops	35,000
Office Equipment	20,000
Office Supplies	2,000
Trade Receivables	1,500
Cash	1,000
Bills Receivables	5,000
Office Building Rent	15,917
Dividends	5000
Employees' Salaries	10,000
Office Electricity Bill	4,000
Mobile and Internet Bill	583
-	-
Unearned Fees	10,000
Share Capital	32,000
Trade Payables	3,000
Fee Revenue Earned	55,000

In addition, the following information is not reflected in the figures above:-

1. The Laptops and Office equipment purchase date: February 1, 2019 and having 10 years useful life.
2. The inventory of supplies on December 31 is INR 1000.
3. Fee revenue of INR 2000 is due from customers.
4. Unearned fees include INR 1000 earned in December.
5. December salaries of employees total INR 4000 have not been paid.
6. The bills receivable account is a six month bill for INR 5000 given by a customer on July 1, 2017. This bill carries INR 200 as interest income for the remaining financial year which will be paid at the end of the financial year.
7. Income tax of INR 3000 is payable on December 31.
8. The company's depreciation policy uses the straight line basis, with no salvage value after the useful life of machines and equipment.

Produce a Profit and Loss account, a Statement of Retained Earnings and a Balance Sheet (Statement of Financial Position) for ABC Ltd for the year ended December 31, 2019.

Q15)

Income Statement

Particulars	Amount
Revenue from operations	66000
Other Income	200
Total Revenue	66200
Expense	
Purchase of stock in Trade	1000
General and Administrative	14121
Employees Benefit Expenses	14000
Utility Expenses	4503
Depreciation	8042
Total Expenses	38746
Profit before Interest at Tax	27454
Less: Dividend	(5000)
Taxable Income	22454
Less: Tax payable	(3000)
Profit year ended 31 Dec 2019	19454

Notes

①	Revenue from operations	
	Fee Revenue earned	55 000
	Unearned Fee Revenue	10 000
	Less: Earned in Dec	(1000)
	Add: Fee dues	2 000
		66 000
②	other Income	
	Interest Income	200
③	General & Administrative	
	Rent paid	15917
	Less:	(1796)
		14121
④	Depreciation	
	$(3500 + 2000) \times \frac{11}{12}$	5042

Balance Sheet as at on 31 dec 2019

Particular	Amount
Assets	
<u>Non current Assets</u>	
(a) Fixed Assets	
(i) Tangible Assets	49958
Accrued Income	1100
<u>Current Assets</u>	
(a) Investments	1000
(b) Trade Receivables	1500
(c) Cash	6200
(d) other current assets	1796
Total Assets	71454
<u>Liability</u>	
1) Shareholders fund	
Share capital	32000
Reserve or surplus	22454
2) Non current liability	
3) Trade Payable	3000
other Non current	5000
	71454