Business Finance - 2
Assignment - 2

1. B All of the above

2. C an adverse opinion

3. C chairmans report

4 A.

5.

a) Realisation Concept :
- Income is to be recognized as and when it is earned. Not necessary to wait until customer settle the bill.
- This avoids fluctuations in reported income which may arise if everything was accounted for cash basis.
- It also creates the impression that the business is running well, even though it may be in the danger of running out of cash.

Accrual Concept :
- Expenses are recognised as and when they are incurred regardless of whether it has been paid.
- It avoids random allocation of cost periods depending on whether the bills happen to have been paid or not.

b.) As part of the realization concept in preparing the accounts of the company, the earned premium of the year is calculated by considering the earned position of the premium & unexpired risk premium.
As part of the accrual concept, the claim paid during the year & reserves created for the expected claims are considered.

6) Different ways through which accounts can be manipulated are :

→ Inflating current operating income by increasing book sales or decrease in expenses.
This is done using the following practices.

i) inappropriate depreciation of tangible assets.
ii) inappropriate amortization of intangibles.
iii) inappropriate valuation of inventories or future liabilities such as pension provisions.
iv) unwarranted revaluation of tangible or treating intangibles of questionable worth.
v) omitting contingent liabilities
vi) Pre-booking of anticipated sales revenues.

7) i) There is no change in the gross profit and cashflow of the company.
ii) Gross profit does not change, cashflow decreases
iii) Profit and cashflow does not change.
iv) Gross profit decreases and cashflow does not change.
v) Gross profit & cashflow does not change.

8. (i) Main role of regulation in the financial system

a) Market confidence : to maintain confidence in the financial system.
b) financial stability : contributing to the protection & enhancement of stability of financial system
c) Consumer protection : securing the appropriate degree of protection of consumer.

ii) The regulatory bodies which regulate the Indian financial system

→ Reserve Bank of India (RBI)
→ Securities & Exchange Board of India (SEBI)
→ Insurance Regulatory & Development Authority of India (IRDAI)
→ Pension Fund Regulatory & Development Authority (PFRDA)

iii) a. Banks - RBI
b. Superannuation Products - PFRDA
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) The cost concept emphasizes that non-current assets appear in the balancesheet at their original cost less depreciation
Going concept assumes that the business will continue indefinitely in its present form.

ii) Financial statements should give a true & fair view

→ Any treatment of the said unusual transaction must be realistic & a representative treatment of the same.

→ The Objectives of relevance, comparability & reliability should be applied.

→ The directors could look at treatment for similar balances which would ensure that the logic of the same was ~~consisted~~ consistent with good accounting practice.

iii) The optimistic accounting policies is quite visible to analyst. It is possible to refer whether a particular approach has been followed which further derives about the opinions about the companies share price.

Market examination of information available is key such that any overpriced company that is identified will be subject to its share being sold in order to make profits.

10. a) Investment Bank:

ROLE:

→ advise businesses & governments on how to meet their financial challenges, asset management, hedging etc.

SOURCE OF FUNDS

→ raise money by selling securities such as shares & bonds to investors.

APPLICATION OF FUNDS:

→ It helps government raise money, trade securities & buy or sell crown corporations.

b) <u>Pension Scheme</u>:

<u>ROLE</u>:

→ provide protection in the form of lump sums to dependants or to maintain standards of living in retirement

<u>SOURCE OF FUNDS</u>:

→ collect money from employer & employees

<u>APPLICATION OF FUNDS</u>

→ they split their funds and assets among bonds, stocks and commercial real estate.

c) <u>Life Insurance Company</u>

<u>ROLE</u>:

→ It ensures an individuals dependants against the risk of financial loss in case of death.

<u>SOURCE OF FUNDS</u>:

→ Insurance company's major source of income is from the premium it charges from its customers upon selling of a policy.

<u>APPLICATION OF FUNDS</u>:

→ they invest their earned premiums in securities such as stocks, bonds etc & use their ~~game~~ gains from that to pay out claims.

11. While interpreting the accounts of the 2 firms the following conditions & challenges are possible:

COMPARABILITY: different users could use different methods to create their accounts making comparison difficult.

CREATIVE ACCOUNTING: firms could also deliberately choose ~~those~~ these policies that maximise profits

FORMATS: different accounting formats can also be chosen making comparisons difficult.

LEVEL OF AGGREGATION: Some firms show more detailed splits of items than others. While comparing the least disaggregated item across all firms will be the lowest level at which the accounts can be analysed.

12.

(i) It is more complicated to prepare insurance companies accounts as compared to normal ones as:

→ the underlying contracts are uncertain in size & fall outside the accounting period.

→ premature transfer of profits to shareholders may endanger the financial stability & its ability to meet future liabilities.

13] i) Advantage: Comparability, Guidance, Uniformity
Disadvantage: Principle driven, Rigid Rules
Many options to choose whehas very diff

ii) IFRS, GAAP, Ind-AS
Financial Acc Standard Board
Int Accounting Standards Board
Accounting Standard Board

iii) P&L and B/s donot provide sufficient insights about the movements of cash balances. Even profitable companies collapse if they are not liquid.
Even causes of charges in Cash/Bank cannot be ascertained from B/s.
Shareholders read a more structured details of Cashflow.
It answers the quest like:

- Is comp. generating enough cash as related to profit.
- What was done with any loan taken.
- Why was Bank o/d increased despite profitable year.

14)

i) Comprehensive Income Statement for the year 18-19

PARTICULARS	WN	₹
Revenue	(iv)	15,00,000
- Cost of Sales	(v)	(6,78,000)
Gross Profit		8,22,000
- Admin Expenses	(iii)	(3000)
- Distribution expenses	(ii)	(2,05,000)
Operating profits		614000
- Financial Expense	(vi)	(10,000)
Profit before Tax		604000
- Tax expense		(0)
Profit After Tax		604,000

ii) Statement of changes in Equity

	Share Capital	Ret. Earnings	Revaluation Reserve
Opening Balance	2,00,000	250,000	180,000
+/-			
- Dividend paid		(45,000)	
- Building reval^n			300,000
- Land reval^n			200,000
+ Current yr profits		604,000	
Closing Balance	200,000	8,09,000	6,80,000

iii) Statement of financial position

PARTICULARS	WN	₹
ASSETS		
Non Current Assets	(iv)	1632000
Current Assets	(viii)	240,000
		187,2000
Equity & Liabilities		
Equity		
Share Capital		200000
Retained Earnings		809,000
Reserves		680000
Non Current liabilities	(vii)	145000
Current liabilities	(iii)	68000
		1872000

Working Notes:

(i) Administration expenses

Administrative Staff Wages 3,000

<ii> Distribution expenses

Cost of marketing	55,000
Delivery vehicle running costs	60,000
Sales Salary	120000
	235000

<iii> Current liabilities

Bank overdraft	18000
Trade Payables	50,000
	68,000

<iv> Non current Asset

	Buildings	Delivery vehicle	Land	Machines
Cost	400,000	325000	600000	150,000
+ Land revaluation	~~[illegible]~~		200000	
+ Build revaluation	300000			
Accrued deprn	40000	170000		80000
+ Current deprn	7000	31000		15000
Net Book Value of Assets	653000	124000	800000	55000

v.) Cost of Sales

Cost of Inventory consumed	350 000
Factory running cost	100 000
Manufacturing wages	175 000
CY. building depr	7000
CY. delivery vehicle	31,000
CY. machinery	15 000
	6,78,000

vi.) Financial Expense

Interest	10,000
	10,000

vii.) Non-current liability

Loan	145000
	145,000

viii.) Current Asset

Trade receivables	210,000
Closing inventory	30,000
	240,000

15.

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Comprehensive statement of Income

PARTICULARS	Note	
Revenue	vii	58,200
- Cost of Sales	viii	(4041)
Gross Profit		54159
- Admin expenses	iii	(34790)
- Distribution expenses		-
		-
Operating profit		19369
- Financial expense		-
+ Financial income		-
Profit before tax		19,369
- Trade expense	(v)	(3000)
Profit after tax		16369

Statement of Changes in Equity

	Share Capital	Retained Earnings
Opening balance	32000	
- Dividends		(5000)
+ CY profit		16369
closing balance	32000	11369

Statement of financial position

PARTICULARS	WN	₹
Assets		
Non-Current assets	ii	49959
Current assets	iv	12410
		62369
Equity & liability		
Equity		
Share Capital		32000
Retained Earnings		11369
Liability		
Non Current liabilities		
Current liabilities	(v)	19000
		62369

Working Note

(i) Calculation of rent:

Rent for 11 Months $= 1000 + 1000\left[\frac{(1.05^{10}-1)\,1.05}{1.05-1}\right]$

$\Rightarrow$ ₹ 14207

(ii) Non current asset

	Laptops	Equipments
Cost	35000	20000
- C/ depreciation	(3208)	(1833)
Net Book Value	31792	18167

iii) Administration Expenses

Office supplies	2000
Office building rent	14207
Employees salaries	10000
Electricity bill	4000
Mobile & internet bill	583
O/s salaries	4000
	34790

iv) Current Assets

Trade Receivables	1500
Cash	1000
Bills Receivables	5000
Closing Inventory	1000
Fee revenue dues	2000
Bill interest	200
12th Month Rent	1710
	12410

v) Current liability

Trade Payables	3000
Unearned fee	10,000
Unearned fee (earned)	(1,000)
O/s salaries	4,000
Tax expense	3,000
	19,000

vii) Revenue

Fee Revenue	55,000
Fee Revenue due	2,000
Unearned fee (earned)	1,000
Bill interest income	2,000
	582,000

viii) Cost of Sales

Closing inventory	(1000)
Depr^n of laptops	3208
Depr^n of equipment	1833
	4041