

Business Finance

Assignment 1

Q1)

D: II & IV

Q2)

C: adverse opinion

Q3)

C: chairman's report

Q4)

B: II & III

Q5)

a)

Realization concept:

Income is recognized as and when it is earned. It is not, therefore necessary to wait until the customer settles his bill. This avoids the fluctuations in reported income which might arise if everything was accounted for on cash basis. It can also create the impression that the business is performing well when, in fact is in danger of running out of cash.

Accruals Concept:

Expenses are recognized as and when they are incurred, regardless of whether the amount has been paid. Again, this avoids the random allocation of costs to periods depending on whether the bill happens to have been paid or not.

b)

The health insurance company will record the claims as expenses now itself under the accruals concept and which could reduce the present year's profitability and cash or just create a reserve in the liability section. The company will also record premium payments as an income as it is recognized in this year and further income this in the financial statements.

Q6)

The manipulation may involve:

a) Inflating current operating income.

Example- The company could show increased sales or decreased expenses in order to show the increased profit.

b) Reducing current operating income.

Example- Show increased expenses or less sales and more accrued income to increase the future earnings by decreasing the profits for this year and show a boom in other years.

Accounting practices that can lead to such misstatements include:

1. Inappropriate depreciation of tangible assets. E g. Sometimes companies show less depreciation in year where they want to show more profits and vice versa, because depreciation is very subjective and can be manipulated using different residual values.
2. Inappropriate amortization of intangible assets. E g. Goodwill, patents etc. can be shown differently in the financial accounts.
3. Inappropriate valuation of inventories. E g. Raw materials, semi produced goods or finished goods and goods from last year can be manipulated by increased sales or less production.
4. Inappropriate valuation of future liabilities. E g. Pension provisions, loan repayment could be valued wrongly and can lead to consequences.
5. Omitting contingent liabilities.

Q7)

- i) Gross profit decrease, Cash flow increase
- ii) Gross profit nothing, Cash flow decrease
- iii) Gross profit decrease, Cashflow decrease
- iv) Gross profit decrease, Cashflow nothing
- v) Gross profit decrease, Cashflow nothing

Q8)

i) Main roles of regulation in the financial system are:

- a. Maintain public/ investor confidence
- b. Promote stability of the financial system
- c. Protect investors
- d. Maintain international confidence
- e. Deter fraudulent behavior.

ii)

India has 5 regulatory bodies –

1. RBI (Reserve bank of India)
2. SEBI (Securities and Exchange board of India)
3. IRDAI (Insurance regulatory and development authority of India)
4. FMC (Forward market commission of India)
5. PFRDA (Pension fund regulatory and development authority)

iii)

Institution	Regulatory Authority
1. Banks	RBI
2. Superannuation products	IRDA
3. General Insurance Companies	IRDA
4. Stock Brokers	SEBI
5. Mutual Funds	SEBI
6. The market for listed securities	SEBI
7. Foreign exchange dealers	RBI
8. Money Changers	RBI

Q9)

i)

Cost concept:

The cost concept has been presented as one of the cornerstones of accounting for a very long time. Under this concept, non-current assets generally appear in the statement of financial position at their original cost less depreciation to date, subject to a possible impairment write down.

Going concern-

It is usually assumed that a business will continue indefinitely in its present form. This concepts acts as a justification for the limitations imposed by the cost concept because there is little harm in reporting historical figures.

ii)

IAS 8 states that in the absence of a specific rule to specify an appropriate accounting policy, the company should select the policies on the basis that they yield information that is

both relevant and reliable. Information is relevant if it informs decisions taken by users of financial statements. Information is reliable if it provides a faithful representation of the entity's financial position, is neutral, expresses prudence etc.

iii)

According to the prudence concept, the preparers of financial statements should avoid

presenting an unduly optimistic set of results. The lowest reasonable figure should be stated for profit and highest reasonable figure should be stated for any liabilities. Market price will sometimes not increase as the shareholders might by looking at the financial statements feel that the company is being unduly optimistic and this might lead to lost shareholder confidence and hence share price would either fall or remain constant.

Q10)

a) INVESTMENT BANKS

Role: Investment banks play a very important role in the banking sector. Role of investment banks

include underwriting of new stock issue, handling mergers and acquisitions and acting as a financial advisor. Companies have the greatest support of investment banks as they advise them when to go public and issue shares and also provide them investors for their debt requirements.

Sources of funds: Investment banks usually earn income from providing services to companies, governments or investors who in turn pay them for their advice help or service. They receive fees or commission. They make most money by charging higher rate of interest to borrowers rather than they pay to savers.

Application of funds: Investment banks work with governments to raise money, trade securities, and buy or sell crown corporations. Banks work with institutional investors who manage other people's money to help them trade securities and provide research.

b) PENSION SCHEMES

Role: Receiving of Subscribers funds from Trustee Bank for investments as per subscriber preferences. Investing the funds in securities prescribed in the investment

guidelines issued by Authority and Investment Policy approved by the Board of Pension Fund.

Sources of funds: Pension plans are funded by contributions from employers and occasionally from employees. Public employee pension plans tend to be more generous than ones from private employers. Private pension plans are subject to federal regulation and eligible for coverage by the Pension Benefit Guaranty Corporation.

Application of funds: The main investment style of a pension fund is diversification and prudence. Pension funds aim for portfolio diversification, allocating capital to different investment instruments (stocks, bonds, derivatives, alternative investments, etc.). Many pension funds have transferred from active stock portfolio management to passive investment instruments, investing in index funds and in exchange-traded funds that track stock indexes. Emerging trends are to allocate capital to alternative investments, specifically to commodities, high-yield bonds, hedge funds, and real estate.

c) **LIFE INSURANCE COMPANY**

Role: Life insurance company safeguards the interests of people from loss and uncertainty. It may be a social device to reduce or eliminate the risk associated with life or property. It also encourages savings through its different suitable plans. Insurance turns accumulated capital into productive investment.

Sources of funds: The company collects premiums from the insured which has a small profit margin. More over these premiums are invested in various projects from which life insurance companies earn revenues which are a major source of income.

Application of funds: The income they earn from investing the premiums is divided into 2 parts. One part is given as sum assured to the insured and the remaining amount is kept aside as savings.

Q11)

- a) Since both the companies, general insurance as well as life insurance, there will be different kinds of regulations imposed on them.
- b) They would have to produce financial reports in different formats, various vivid disclosures may be expected.
- c) Treatment of various items imposed by both the regulators will be different.
- d) Either statistical basis or expert judgements for estimating future liabilities must be assessed.
- e) Different companies in similar circumstances were following completely different accounting policies, leading to different and incompatible results.
- f) I want to invest in either of the one. But due to different regulators, an appropriate comparison is not possible.
- g) I cannot interpret the retained earnings calculations or the assets the companies are holding.

Q12

- i) The reason of complication in preparing the insurance companies accounts as compared to normal company accounts are as follows –
 - a) The insurance contracts with policyholders fall due outside the accounting period and are uncertain in size.
 - b) Premature transfer of profit to shareholders may endanger the financial stability of the company and ability to meet the future liabilities.
- ii) The major component of reserves for a general insurance company's technical accounts are as follows
 - a) URR (Un-expired risk reserves)

b) Outstanding claim reserves

c) URR (Un-expired risk reserves): These reserves is kept to cover the claims and expense that are expected to emerge from an unexpired portion of the insurance cover in future period d) Outstanding claim reserves: This reserves is kept to cover the claims and expense for all outstanding claims that have not yet been settled. These claims and expense may or may not be reported or known at the time of preparation of accounts.

Q13)

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 offer more flexibility in the accounting practices.

Disadvantages:

1. It would increase the cost of implementation for small businesses.
2. It would lead to concerns with standards manipulation.
3. It would require global consistency in auditing and enforcement.
4. It would increase the amount of work placed on accountants.

ii) Various sources of regulation

- International financial reporting standards
- Principles, concepts and conventions
- National company laws
- Good practices by leading companies
- Stock exchange requirements
- IRDA

iii)

1. The statement of profit and loss and statement of financial position do not provide a sufficient insight into movements in cash balances.
2. This is unfortunate because even profitable companies will collapse if they are not sufficiently liquid.
3. Hence the cashflow statement is important to supplement.
4. Cashflow statements show any cashflow from investing activities or financing activities or any bank overdrafts taken and cash generated from different operations.

Q14)

Q14]

ABC Ltd. Income Statement for the year ended 31st March 2019

Particulars	Amount (£)
Revenue	1,500,000
Cost of Sales	(647,000)
Gross Profit	853,000
Administrative staff wages	(3000)
Distribution cost	(2,66,000)
	584,000
Interest	(10,000)
Profit for the year	5,74,000

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

	Share Capital	Revaluation Reserve	Retained Earnings	Total
Opening Balance	2,00,000	1,80,000	2,50,000	6,30,000
Revaluation		5,40,000		5,40,000
Profit for year			5,74,000	5,74,000
Dividend paid			(45,000)	(45,000)
Closing Balance	2,00,000	7,20,000	7,79,000	16,99,000

iii) ABC Ltd. Statement of Financial position as on 31st March 2019

Particulars	Amount (₹)
Assets	
Non-current assets:	
Land, Building, Machinery, Vehicles	16,72,000
Current assets:	
Inventory	30,000
Trade Receivables	1,10,000
	2,40,000
Total Assets	19,12,000
Equity and Liabilities	
Equity:	
Share capital	2,00,000
Revaluation Reserve	7,20,000
Retained Earnings	7,79,000
	16,99,000
Non-Current Liability:	
Loan	1,45,000
Current Liability	
Trade Payables	50,000
Bank	18,000
	68,000
Total Equity and Liabilities	19,12,000

Working :-

① Non-current Assets - Revaluation

Valuation	Land	Building	Machinery	Vehicles	Total
Opening Balance	600,000	400,000	1,50,000	3,25,000	14,75,000
Revaluation	200,000	300,000			5,00,000
Closing Balance	8,00,000	7,00,000	1,50,000	3,25,000	19,75,000

② Depreciation :-

Valuation	Land	Building	Machinery	Vehicles	Total
(Depreciation) Opening Balance		40,000	80,000	1,70,000	2,90,000
Revaluation		(40,000)			(40,000)
Closing Balance		7,000	15,000	31,000	53,000
		(7,000)	(95,000)	(2,01,000)	303,000
Net Book value	8,00,000	6,93,000	55,000	1,24,000	16,72,000

③ Cost of Sales

Cost of Inventory consumed	3,59,000
Factory Running costs	1,00,000
Manufacturing costs/wages	1,75,000
Depreciation of Buildings	7,000
Depreciation of Machinery	15,000
Total	6,47,000

④ Cost of Distribution

Advertising Cost	55,000
Delivery Vehicle Running cost	60,000
Sales salaries	1,20,000
Depreciation on vehicles	31,000
Total	2,66,000

Q15)

15)	Profit and Loss Account for the Year ended 31st December 2017		
	Particulars	Amt (₹)	Amt (₹)
	Revenue:		
	Fee Revenue earned	58000	
	Investment Income	200	58,200
	Expense:		
	Employee's Salaries	(14000)	
	Office Supplies	(1000)	
	Office electricity	(4000)	
	Mobile and Internet Bill	(583)	
	Depreciation:		
	Laptops	(3208)	
	Office equipments	(1833)	
	Office Building Rent	(14207)	
	Income Tax	(3000)	
	Total	(41832)	(41,832)
	Total Profit		16,368

	Balance Sheet as on 31st December 2017		
	Particulars	Amount	Amount (₹)
	Assets:		
	Laptops	35000	
	Less: Depreciation	(3208)	31,792
	Office Equipment	20000	
	Less: Depreciation	(1833)	18,167
	Office Supplies		1000
	Trade Receivables		1500
	Cash		1000
	Bills Receivable		5000
	Office Building Rent		1710
	Revenue Receivable		2000
	Interest Receivable		200
	Total Assets		62,368
	Liabilities:		
	Trade Payables		3000
	Unearned fees		9000
	Employee's Salaries Payables		4000
	Income Tax Payable		3000
	Share capital		32000
	Retained earnings		11368
	Total Liabilities		62,368

Working:-

$$\begin{array}{r} \text{Fee Revenue earned :-} = 55000 \\ 2000 \\ 1000 \\ \hline 58000 \end{array}$$

$$\begin{array}{r} \text{Employees' Salaries} = 10000 \\ + 4000 \\ \hline 14000 \end{array}$$

$$\begin{array}{r} \text{Office supplies} = 2000 \\ - 1000 \\ \hline 1000 \end{array}$$

$$\begin{array}{r} \text{Office building Rent} = 15917 - (1000 \times (1.05)^{11}) \\ = 14204 \end{array}$$

Depreciation:

$$\begin{array}{l} \text{Laptop. (Purchased on 1st Feb.)} \\ \hookrightarrow 35000 \times \frac{1}{10} \times \frac{11}{12} = 3208 \end{array}$$

$$\text{Office equipment} = 20000 \times \frac{1}{10} \times \frac{11}{12} = 1833$$

$$\text{Unearned fees} = 10000 - 1000 = 9000$$

Retained earnings:

$$\text{Net Profit of the year} = 16,368$$

$$\text{Less: Dividend} \quad (5000)$$

$$\text{Net Retained} = 11,368$$

