Business Finance 2
Assignment 2

Q1. D. ii and iv

Q2. C. An adverse opinion

Q3. C. Chairman's Report

Q4. B. ii only (Cost concept)

Q5.
(a)
The Realisation Concept

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

→ A business might report income long before the related cash inflows which may be a problem for a growing business.

The Accruals Concept

→ Expenses are recognised 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 earned premium for the year is calculated by considering the earned portion of the total written premium in the year and carried forward unexpired risk premium is an application of realization concept.
→ The incurred claims for a financial year considers the paid claim during the year, outstanding claim reserves for known and unknown claims at end and start of the financial year.

Q6.

Different ways of manipulating accounts are:
- Inappropriate depreciation of tangible assets
- Inappropriate amortisation of intangible assets
- Inappropriate valuation of inventories
- Inappropriate valuation of future liabilities
- Unwarranted revaluation of tangible assets
- Creating intangible assets of questionable true worth
- Omitting contingent liabilities
- 'pre booking' of anticipated sales revenues

Q7.

i) Property that the company possess has been revalued upwards by Rs 100crores by the Valuer.

→ Gross Profit: No change

→ Cash Flow: No change

ii) There has been an interest payment of Rs 1000 crores towards Masala bond issued by the company.

→ Gross Profit: No change

→ Cash Flow: Decreases

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.

→ Gross Profit: No change

→ Cash Flow: No change

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

→ Gross Profit: Decreases

→ Cash Flow: No change

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

→ Gross Profit: No change

→ Cash Flow: No change

Q8.

(i)

Main roles of regulation in the financial system are:

- Maintain public/ investor confidence
- Promote stability of the financial system
- Protect investors
- Maintain international confidence
- Deter fraudulent behaviour

(ii)

- The Reserve Bank supervises via prudential regulations all deposit taking activities as well controls foreign exchange market beside overall stability of financial system and setting monetary policy and payments system.

- SEBI is responsible for financial market integrity, companies consumer protection in relation to financial products and services, and enforcement of law relating to financial products and services. It also licenses and supervises a number of financial market participants such as security brokers, underwriters, depositories, mutual funds etc.

• IRDA is responsible for insurance companies in a manner similar to RBI in arena of banking. It licenses all insurance sector related intermediaries and prudentially supervises over them.

(iii)

a) Banks RBI
b) Superannuation Products IRDA
c) General Insurance companies IRDA
d) Stock brokers SEBI
e) Mutual Funds SEBI
f) Market for listed securities SEBI
g) Foreign exchange dealers RBI
h) Money changers. RBI

Q9.

(i)

→ According to the cost concept, non-current assets should be valued at cost less depreciation.

→ According to the going concern concept, accounts should be prepared on the assumption that the business will continue indefinitely in its present form.

(ii)

Key guiding principles for setting accounting policies for unusual transactions are -

a. There is a general requirement that the financial statements give a true and fair view. Amongst other things, that any treatment gives a realistic and representative treatment of the transaction.

b. The guidance provided by Accounting Regulations Board in this regard should be considered. For example, the objectives of relevance, reliability, comparability and understandability should be applied.

c. The directors might consider looking at the treatment laid down by standards for similar balances, even though those standards might not be strictly applicable. That would ensure that the logic underlying the chosen treatment was consistent with good accounting practice.

(iii)

→ Most of the optimism in making accounting choices is quite visible to the analysts and market participants. For example, companies publish their accounting policies and so it is possible to tell whether a particular approach has been followed and accordingly opinions formed about the price.

→ The stock market examines information carefully to ensure that it does not misprice securities. If shares are overpriced then there will be opportunities for astute market participants to make profits by identifying the overpriced companies and selling shares.

→ Market forces would push the shares down and these activities would also draw attention to the distortion.

→ Markets usually reward companies with good corporate governance which is also reflected from the conservativeness of estimates and accounting policies.

Conservative policies also provide ability to the company to present more smooth results in volatile times which can work in favour of its stock price.

Q10.

a) **Investment Bank**

→ Role: Advice Companies and help companies raise finance

→ Application of Funds: Receive fees for advice, underwriting commission, fund management, Eurobond dealing, trusteeship, and bill acceptance. Borrow money by running banking accounts and issuing certificates of deposit.

→ Sources of Funds: Invest in bills and provide loans and leases to companies.

b) **Pension Scheme**

→ Role: Channel savings for retirement into long term capital markets.

→ Application of Funds: Contributions from employers and employees only. No borrowings.

→ Sources of Funds: Typical fund invests in equities and longerdated loan securities and company debt. Also some investment in overseas securities. Small proportion of the assets invested in property, money market

c) Life Insurance Company

→ Role: Pool mortality and investment risks by channelling savings into long term capital markets.

→ Application of Funds: Premium income from policyholders. Do not usually borrow money.

→ Sources of Funds: Typical fund invests in a mixture of equities and short and long fixed interest securities. May have some investment in overseas securities, property, money market investments and index-linked gilts.

Q11.

The possible limitation and challenges are as follows:

i. Different regulation will govern these companies on a same subject may bring difficulty in comparison e.g. solvency ratio.

ii. There may be subjectivity involves in few

sections of accounts e.g. revaluation of assets, accounting of tangible assets.
iii. There is be difference between these companies as their business is different which will make comparison difficult e.g. Reserve utilization.
iv. There is inherent limitation in different ratio analysis e.g. ignore the size of business

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): This 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

b. 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.

Q 13.

(i)

Advantages of compliance with international accounting standards.

• They eliminate, or at least reduce, variations between companies in the way they prepare accounts. This improves the ability to compare the financial statements across various entities operating in the country

• The discussion process leading up to a

standard being issued focuses attention on particular areas for debate about accounting practice
• They oblige companies to disclose more information than that required by national laws
• They allow some degree of flexibility in a way that legislation often does not. This is even more crucial for a newly formed country

Disadvantages of international accounting standards :
• The sets of rules contained in the standards may not be appropriate to all companies in all circumstances
• Standard-setting may not be entirely objective (some standards in the past have been the subject of government pressure or industry lobbying).
• Standards often allow more than one alternative treatment, which negates the attempt to ensure conformity between companies
• Some standards are so general as to be

meaningless, while others are far too detailed

(ii)

Sources of regulations influencing the preparation of financial statements for companies

- Principles, concepts and conventions of accounting
- National company laws
- Stock exchange requirements
- Best practices in accounting followed by leading companies from time to time

(iii)

Additional information available from cashflow statement.

- Whether the core business operations of the entity have led to a net cash inflow or outflow. This is important because even if the entity generates a lot of profit, it may not lead to any positive cash inflow as the profits may get locked up in current assets like accounts receivable and inventory. If an entity is regularly demonstrating profits

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(i) ABC Ltd. Income Statement
for year ended 31st March 2019

Revenue	1500000
Cost of sales	(647000)
Gross profit	853000
Administrative staff wages	(3000)
Distribution cost	(266000)
	584000
Interest	40000)
Profit for the year	574000

(ii) ABC Ltd. Statement of changes in equity for the year end 31.3.19

	Share Capital	Revaluation reserve	Retained Earn.	Total
Opening balance	200000	180000	250000	630000
Revaluation		540000		540000
Profit for the year			574000	574000
Dividend paid			(45000)	(45000)
Closing Balance	200000	720000	779000	169900

(iii) ABC Ltd. Statement of financial position as at 31st March 2019

Non current assets	
Property, Plant and equipment	1672000
Current Assets	
Inventory	30000
Trade Receivables	210000
	240000
Total Assets	1912000

Date

Equity and Liabilities	
Equity	
Share capital	200000
Revaluation reserve	720000
Retained earnings	779000
	1699000
Non-current liability	
Loan	145000
current liability	
Trade payables	50000
Bank	18000
	68000
Total equity and liabilities	1912000

NOTES:

1) Property, plant and equipment

Cost or valuation	Land	Building	Machinery	Vechiles	Total
Opening Balance	600000	400000	150000	325000	1475000
Revaluation	200000	300000			500000
Closing balance	800000	700000	150000	325000	1975000

2) Depriciation

Cost or valuation	Land	Building	Machinery	Vechiles	Total
Opening balance		40000	80000	170000	290000
Revaluation		(40000)			(40000)
Closing balance		7000	15000	31000	53000
		7000	95000	201000	303000
Net book value	800000	693000	55000	124000	1672000

Date

3) Cost of Sales

Cost of Inventory consumed	350000
Factory running costs	100000
manufacturing wages	175000
Depricaltions of buildings	7000
Depriciation of machinery	15000
	647,000

4) Cost of Distribution

Advertising cost	55000
Delivery vehile runn cost	60000
Sales salaries	120000
Depriciation of vechiles	31000
	266,000

Date

Ques 15

Profit and loss account for year end Dec 31, 2019

Revenue		Amount
Fee revenue earned		58000
Investment Income		200
TOTAL		58200
Employee's salary	(14000)	
Office supplies	(1000)	
Office electricity	(4000)	
Mobile and internet bill	(583)	
Depriciation		
Laptops	(3208)	
office equipment	(1833)	
office building rent	(14207)	
Income Tax	(3000)	
Total	(41832)	
Total profit		16368

Calculation details

Fee revenue earned = 55000 + 2000 + 1000 = 58000

Emp. salaries = 10000 + 4000 = 14000

office supplies = 2000 - 1000 = 1000

office building rent = $15917 - 1000(1.05)^{11}$ = 14207

Depriciation

Laptops = $35000 \times 1/10 \times 11/12$ = 3208

office equipment = $20000 \times 1/10 \times 11/12$ = 1833

Date

Balance Sheet as on 31.12.2019

Asset		
Laptops	35000	
Less Depreciation	(3208)	31792
office equipment	20000	
less Depreciation	(1833)	18167
office supplies		1000
Trade receivables		1500
Cash		1000
Bills Receivable		5000
office building rent		1710
Revenue receivable		2000
Int receivable		200
Total Assets		62368
Liabilities		
Trade payables		3000
Unearned fees		9000
Employees salaries O/S		4000
Income tax O/S		3000
Share capital		32000
Retained earnings		11368
Total Liabilities		62368

Statement of Retained Earnings

Retained earning calculation

Net profit for the year	= 16368
Less Dividend	(5000)
Net retained	11368