

Business Finance 2
Assignment 1

1. B
2. C
3. C
4. A

5.

- a) Realisation Concept: According to the realisation concept, income is recognised as and when it is earned regardless of payment status.

Accruals Concept: According to the accruals concept, expenses are recognised as and when they are incurred irrespective of payment status.

- b) In the case of an insurance company, the premiums to be paid for the year health plan can be recognised as income according to the realisation concept and the claims to be paid (adjusted based on mortality rates) on those policies can be assumed to be incurred based on the accruals concept. Additionally, reinsurance can be treated in a similar fashion, wherein premiums ceded to reinsurer and the adjust reinsurance premium that the company will receive are recognised.

6. Companies may overstate their profits, to jack up their share price and instil a false sense of optimism among the shareholders of the company and in the market.

The company might want to understate profits to pay less taxes, this would be done by inflating expenses.

Directors of the company may not be acting in the best interests of the shareholders.

7.

Event	Change in Gross Profit	Change in Cash
Property that the company possess has been revalued upwards by Rs 100 crores by the Valuer.	No change	No change
There has been an interest payment of Rs 1000 crores towards Masala bond issued by the company.	No change	Decreases
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 manpower and production cost.	No change	No change
There was a depreciation of plant and machinery to the extent of Rs 250 crores.	Decreases	No change
It was decided to write off Rs 200 crores due to EHFL defaulting.	No change	Decreases

8.

- i) The role of regulators is:
 - a) To supervise, regulate and provide rules to ensure the soundness of the financial system.
 - b) To prevent illegal and fraudulent activities.
 - c) To enforce safety standards and protect the rights of the consumer.
 - d) Ensure that the market is competitive to avoid a select few firms from exercising market power.
 - e) Provide adequate frameworks by which the market is fair, and all companies have an equal chance to thrive.
- ii) Securities and Exchange Board of India (SEBI), Reserve Bank of India (RBI), Insurance Regulatory and Development Authority of India (IRDAI), Ministry of Corporate Affairs (MCA), Registrar of Companies (ROC), Competition Commission of India (CCI), Association of Mutual Funds in India (AMFI), Pension Funds Regulatory and Development Authority (PFRDA).
- iii)
 - a) RBI
 - b) PFRDA
 - c) IRDAI
 - d) SEBI
 - e) AMFI
 - f) SEBI
 - g) RBI
 - h) RBI

9.

- i) Cost Concept: According to this concept, non-current assets must appear in the balance sheet at their original cost less depreciation to date subject to a possible impairment write down.

Going Concern: A company is assumed to continue indefinitely in its present form. This acts as a justification to the limitations of the cost concept as there is no harm in reporting historical figures if the assets concerned are not going to be sold soon.
- ii) While the share price will increase in the short term because of optimistic accounting, when actual reports come out and the company fails to meet its own optimistic financial outlook, its share price will fall. Additionally, the company's reputation will also take a hit as it would fail to deliver on the promises that have encouraged greater number of investors to invest in the venture.

10.

S.No	Institution	Role	Source of Funds	Application of Funds
1.	Investment Bank	An investment bank offers underwriting services for IPOs and handles mergers and acquisitions. Investment Banks serve as an intermediary between investors and corporations. They help governments, and corporations to meet their financial and regulatory challenges by helping them procure financing	Customers, Capital Markets, underwriting fees.	The funds procured are used to provide the services. These funds are also invested in the markets by dedicated teams.
2.	Pension Scheme	Pension funds are institutions that aggregate large sums of money to be invested in securities markets to generate a profit. Their main aim is to provide for the pensions of their investors upon retirement.	Funds collected from investors (premiums)	Investing in securities markets as per subscriber preferences and regulatory guidelines.
3.	Life Insurance Company	Provide insurance cover to customers depending on the plans in return for a premium that the customer pays.	Premiums earned from customers.	Paying out insurance claims, investing the premiums in the stock markets.

11. The challenges one would face because of multiple regulators for the same industry are:

- a) The regulators may have differing accounting standards and rules which would make it harder to compare accounts of different companies.
- b) Treatment of certain items may differ from company to company.
- c) Differing disclosure rules will cause companies to disclose different amounts of data making it tougher to interpret the accounts.

12.

i) It is tougher to prepare accounts for an insurance company as:

- a) The concept of profit for an insurance company is not so straightforward: Insurance companies are paid premiums by policyholders, but the companies do not know how much profit the policy would make as it could last for many years. To account for the future cashflows, the company sets up an account for estimated liabilities (reserve).
- b) The calculation of reserves involves extensive application of statistics or involves an expert judgement, making it a more tedious task when compared to calculating profits for another company.
- c) The provisions made for future liabilities are likely to be conservative in nature, with the result that current profit is under-stated.

ii)

- a) Earned Premiums: Premiums earned from policyholder's net of reinsurance ceded.
- b) Investment Income/Realised capital gains: Amount earned on investments held to cover the insurance liabilities.
- c) Claims Incurred or Benefits Payable: Claims or benefits that are due net of reinsurance.
- d) Net operating expenses incurred: Operating expenses for the company inclusive of investment expenses.

13.

i) Advantages:

- a) The IFRS eliminates or at least reduces variations between companies in the way that they prepare accounts.
- b) The discussion process leading up to a standard being issued focuses attention on areas for debate about accounting practice.
- c) They oblige companies to disclose more information than is required by law.
- d) They allow for some flexibility in the way that legislations do not.

Disadvantages:

- a) The rules contained in the standards may not be applicable to all companies under all circumstances.
 - b) The standards may have been influenced by industry lobbying or government pressure and may not be completely objective.
 - c) Standards often allow for more than one alternative treatment; this negates the aim to ensure conformity.
 - d) Some standards are so general that they can be regarded as meaningless while others are extremely detailed.
- ii) In addition to the standards, companies can be asked to prepare accounts in a certain way by local regulatory bodies (like RBI, SEBI etc.), industry specific bodies (IRDAI, PFRDA), practices by leading companies, principles concepts and conventions.
- iii) The cashflow statement shows how healthy the business is in terms of liquidity, it records the cash that comes in and goes out of the business and hence the accrual, realisation and matching concepts do not apply here. The amounts are recorded at cash value and it shows the actual amounts of cash that are held by the business.

14.

ABC Ltd. Statement of Comprehensive Income for year ended 31st March 2019		
Particulars	Amount (000's)	
Revenue	1500	
Cost of Sales	-647	
Gross Profit		853
Sales and Delivery Expense	-211	
Administrative Wages	-3	
Marketing Cost	-55	
Operating Profit		584
Interest Paid	-10	
Profit Before Tax		574

ABC Ltd. Statement of Financial Position as on 31st March 2019		
Particulars		
ASSETS		
Non-Current Assets		
Buildings	693	
Delivery Vehicles	124	
Machinery	55	
Land	800	
		1672
Current Assets		
Trade Receivables	210	
Closing Stock	30	
Total Assets		1912
Equity and Liabilities		
Equity		
Share Capital	200	
Retained Earnings	959	
Revaluation Reserves	540	
Total Equity		1699
Liabilities		
Non-Current Liabilities		
Loan Capital	145	
Current Liabilities		
Bank Overdraft	18	
Trade Payables	50	
		213
Total Equity and Liabilities		1912

Statement of changes in equity				
	Attributable to Equity Shareholders			
	Share Capital	Other Reserves	Retained Earnings	Total Equity
	200	180	250	630
Revaluation Reserves		540		
Profit for the Year			574	
Dividend Paid			-45	
Totals	200	720	779	1699

Workings:

- Revaluation:**
 $\text{Revaluation reserves} = (800,000 - 600,000) + (693,000 - 40,000 - 7,000) = 540,000$
- Retained Earnings:**
 $\text{Retained Earnings} = 250,000 + 574,000 + 180,000 - 45,000 = 959,000$
- Value of Non-Current Assets:**
 $\text{Buildings} = 700,000 - 7,000 = 693,000$
 $\text{Delivery Vehicles} = 325,000 - 201,000 = 124,000$
 $\text{Machinery} = 150,000 - 95,000$
- Sales and Delivery Expenses:**
 $120,000 + 60,000 + 31,000 = 211,000$
- Cost of Sales:**
 $350,000 + 100,000 + 21,000 + 175,000 = 647,000$

15.

ABC Ltd. Statement of Comprehensive Income for year ended 31st December 2019		
Particulars	Amount	
Revenue	58000	
Cost of Sales		
Gross Profit		58000
Depreciation (Laptops and Office Equipment)	-5041	
Office Supplies	-1000	
Rent	-14207	
Salaries	-14000	
Electricity Bill	-4000	
Mobile and Internet Bill	-583	
		-38831
Operating Profit		19169
Financing Costs		0
Profit Before Tax		19169
Tax Paid	-3000	
Profit Attributable to Shareholders		16169

ABC Ltd. Statement of Financial Position as on 31st March 2021		
Particulars	Amount	
ASSETS		
Non-Current Assets		
Laptops	31792	
Office Equipment	18167	
		49959
Current Assets		
Trade Receivables	3500	
Bills Receivables	5000	
Inventory of office supplies	1000	
Cash	1000	
Provision for Rent	1710	
		12210
Total Assets		62169
Equity and Liabilities		
Equity		
Share Capital	32000	
Retained Earnings	11169	
Total Equity		43169
Liabilities		
Non-Current Liabilities		
Current Liabilities		
Provision for Salary	4000	
Provision for Tax	3000	
Trade Payables	3000	
Unearned Fees	9000	
Total Liabilities		19000
Total Equity and Liabilities		62169

Retained Earnings	
Profit for the Year	16169
Dividend Paid	-5000
Total	11169

Workings:

- **Rent Paid:**

$$1000 \left(\frac{(1.05)^{11} - 1}{(1.05 - 1)} \right) = 14207$$

Provision for Rent = 1710

- **Salaries:**

Total = 10,000 + 4,000 = 14,000

Provision for Salaries = 4,000

- **Book Value of assets and depreciation:**

Laptops:

Depreciation till Dec 2019 = 3208

Book Value as on 31st Dec 2019 = 35,000 – 3,208 = 31,792

Office Equipment:

Depreciation till Dec 2019 = 1833

Book Value as on 31st Dec 2019 = 20,000 – 1,833 = 18,167