



INDIAN INSTITUTE OF MANAGEMENT KOZHIKODE



Case Study

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LAJ Company: Financial Reporting Quality

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LAJ Company: Financial Reporting Quality

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About LAJ Company:

LAJ Company was found in 1979 and listed on the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) in India. Currently, it is a diversified infrastructure conglomerate in nature. It develops, constructs, and manages hotels, golf courses, resorts, real estate, sports infrastructure, and highways. LAJ company is also involved in power generation, transmission, and sale. LAJ has its headquarters in Delhi with its operations in many states such as Telangana, Andhra Pradesh, Karnataka, Uttar Pradesh, Uttarakhand, Himachal Pradesh, Madhya Pradesh, Jharkhand, Chattisgarh, Arunachal Pradesh, Assam, Meghalaya, and Maharashtra and Gujarat.

Financials of LAJ Company:

During 2017-18, LAJ Company generated sales revenue of Rs 6,14,308 lakhs with a profit after tax of Rs 35,171 lakhs as presented in the statement of Profit and Loss in Exhibit-1. The company's total assets are Rs 36,39,606 lakhs with a net worth of Rs 10,33,113 for the year ending 31st March 2018, as presented in the company's Balance sheet in Exhibit-1. The company also has more current assets than current liabilities to meet the requirements of short-term payment obligations. The company's intangible assets are also at a minimum of Rs 13 lakhs for the year ending 31st March 2018.

Accounting Notes to the Financial Statements:

LAJ disclosed financial statements and notes on financial statements in their audited annual report for 2017-18. These notes to financial statements consist of a summary of significant accounting policies, detailed disaggregation of each line of financial statements, and Management's assumption related to the measurement of assets, liabilities, revenues, and expenses. It also consists of the justification of Management for following specific accounting methods and changes in particular methods of accounting policy. The select accounting notes of LAJ company are presented in Exhibit 2. In this exhibit, Note 39 relates to non-current accounts receivables, Note 40 relates to investments, Note 41 relates to inventory, and Note 42 relates to investments, receivables, corporate guarantee, and contingent liabilities.

Users of financial statements, such as investors, bankers, bondholders, suppliers, customers, credit rating agencies, regulators, and others, need to understand the financial health and condition using the financial statements of LAJ company for their investment, lending, and managerial decisions. Applying ratios to understand financial health and performance is an easier task. However, linking the financial statements to accounting notes to understand the quality of financial reporting and cleaning the financial statements with the substandard quality of financial reporting takes much work.

Questions:

1. Compute the following ratios of LAJ Company and evaluate its financial condition and performance of the company:
 - i. Current Ratio
 - ii. Debt-to-Equity Ratio
 - iii. Interest Coverage Ratio
 - iv. Net Income Ratio
 - v. Return on Assets (ROA)
 - vi. Return on Equity (ROE)
2. Do LAJ's financial statements give a true and fair view of the company?
3. Does "accounting note" help users of financial statements evaluate the quality of the company's financial reporting?

Exhibit 1: Financial Statements of LAJ Company (Source: Annual report of the company)
BALANCE SHEET AS AT 31ST MARCH, 2018

` Lakhs

			NOTE	As at As at 31-Mar-18	As at 31st March 2017
			No.		
ASSETS					
[A]	NON-CURRENT ASSETS				
	(a)	Property, Plant and Equipment	2	6,71,495	6,44,902
	(b)	Capital Work-in-Progress		1,20,068	1,78,930
	(c)	Intangible Assets	2	13	14
	(d)	Intangible Assets Under Development		0	0
	(e)	Financial Assets			
	(i)	Investments	3	7,03,404	7,15,138
	(ii)	Trade Receivables	4	2,65,542	2,99,105
	(iii)	Loans	5	6,429	5,740
	(iv)	Other Financial Assets	6	3,681	4,013
	(f)	Other Non-Current Assets	7	1,65,944	1,53,441
	TOTAL NON-CURRENT ASSETS			19,36,576	20,01,283
[B]	CURRENT ASSETS				
	(a)	Inventories	8	3,88,823	8,74,789
	(b)	Financial Assets			
	(i)	Investments	3	6,889	4,454
	(ii)	Trade Receivables	4	1,16,001	1,31,417
	(iii)	Cash and Cash Equivalents	9	27,123	22,341
	(iv)	Bank Balances other than Cash and Cash Equivalents	10	25,136	7,236
	(v)	Loans	5	0	0
	(vi)	Other Financial Assets	6	1,56,844	2,26,320
	(c)	Other Current Assets	7	2,93,927	2,25,154
	TOTAL CURRENT ASSETS			10,14,743	14,91,711
[C] NON-CURRENT ASSETS CLASSIFIED AS HELD FOR SALE			19	6,88,287	11,52,521
TOTAL ASSETS				36,39,606	46,45,515
EQUITY AND LIABILITIES					
[A]	EQUITY				
	(a)	Equity Share Capital	11	48,649	48,649
	(b)	Other Equity	12	9,84,464	7,07,250
TOTAL EQUITY				10,33,113	7,55,899
[B]	LIABILITIES				
	NON-CURRENT LIABILITIES				
	(a)	Financial Liabilities			
	(i)	Borrowings	13	5,36,122	15,25,617
	(ii)	Trade Payables	14	11,833	61,903
	(iii)	Other Financial Liabilities	15	58,059	68,120
	(b)	Provisions	16	9,497	9,936
	(c)	Deferred Tax Liabilities [Net]	17	0	0
	(d)	Other Non-Current Liabilities	18	13,502	19,058
TOTAL NON-CURRENT LIABILITIES				6,29,013	16,84,634
	CURRENT LIABILITIES				
	(a)	Financial Liabilities			
	(i)	Borrowings	13	18,674	3,00,768
	(ii)	Trade Payables	14	1,27,028	1,54,830
	(iii)	Other Financial Liabilities	15	1,91,390	12,86,517
	(b)	Other Current Liabilities	18	2,99,060	2,76,393
	(c)	Provisions	16	223	216
TOTAL CURRENT LIABILITIES				6,36,375	20,18,724
[C] LIABILITIES DIRECTLY ASSOCIATED WITH ASSETS IN DISPOSAL GROUP CLASSIFIED AS HELD FOR SALE			19	13,41,105	1,86,258
TOTAL EQUITY AND LIABILITIES				36,39,606	46,45,515

STATEMENT OF PROFIT & LOSS FOR THE YEAR ENDED 31ST MARCH, 2018			
			₹ Lakhs
	NOTE No.	2017-18	2017-16
INCOME			
Revenue from Operations	20	6,14,308	6,61,584
Other Income	21	14,502	14,084
TOTAL INCOME		6,28,810	6,75,668
EXPENSES			
Cost of Materials Consumed	22	1,88,985	2,00,661
Purchase of Stock-in-trade	23	7,226	677
Changes in Inventories of Finished Goods & Work-in-Progress	24	803	25,183
Manufacturing, Construction, Real Estate, Hotel/Hospitality/			
Event & Power Expenses	25	1,75,568	1,91,706
Excise Duty on Sale of Goods		9,404	39,652
Employee Benefits Expense	26	50,050	63,934
Finance Costs	27	96,754	3,56,728
Depreciation and Amortisation Expense	28	50,675	87,820
Other Expenses	29	75,701	1,45,818
TOTAL EXPENSES		6,55,166	11,12,179
Profit/(Loss) before Exceptional Items & Tax		-26,356	-4,36,511
Exceptional Items - Gain/(Loss)	30	61,527	-48,034
Profit/(Loss) before Tax		35,171	-4,84,545
Tax Expense			
Current Tax		-	-
Deferred Tax		-	-48,388
Profit/(Loss) for the year after Tax		35,171	-4,36,157

Exhibit 2: Select Significant Accounting Notes from Annual Report of LAJ 2017-18

NOTE No.”39”

Non Current Trade receivables include ` 2645.45 Crore, outstanding as at 31st March 2018 (` 2983.52 Crore, outstanding as at 31st March 2017) which represents various claims raised on the Clients based on the terms and conditions implicit in the Power-Plant Construction Contracts in respect of closed / suspended/under construction projects. These claims are mainly in respect of cost over run arising due to suspension of works, client caused delays, changes in the scope of work, deviation in design and other factors for which Company is at various stages of negotiation/ discussion with the clients or under Arbitration/ litigation. On the basis of the contractual tenability, progress of negotiations/ discussions/ arbitration/ litigations, the management considers these receivables are fully recoverable.

NOTE No.”40”

The Company has made an investments of ` 340 Crores (34 crores Equity Shares of ` 10/- each, fully paid up) in LCGPP, an associate company. Lenders of LCGPP has invoked the entire pledged shares of LCGPP held by LVPI [holding company of LCGPP] on 18th December 2017 due to default in payment of interest to Banks/ Financial Institutions. Keeping in view the above facts, the impact on the carrying value of the Equity shares of LCGPP held by the Company is currently unascertainable and considered at Book Value.

NOTE No.”41”

The Company has received Termination Notice for construction of a power plant allotted by Nominated Authority. The Hon’ble High Court has granted a stay against the Termination Notice and invocation of Performance Guarantee. Since, the matter is now being sub-judice in High Court, the recoverability of the amount invested aggregating to ` 293.01 Crores as on 31.03.2018 in the construction of power plant and impact of the invocation of the Performance Guarantee is uncertain, no provision has been considered necessary to be made in the Financial statements.

NOTE No.”42”

IDIDI Bank Limited had filed Petition with Hon’ble National Company Law Tribunal [NCLT], Allahabad Bench [the Bench] U/s 7 of Insolvency & Bankruptcy Code, 2019 in respect of LIJ [Subsidiary of the Company] which was admitted vide Order dated 9th August, 2017 and Interim Resolution Professional (IRP) was appointed to carry the functions as mentioned under the Code.

While admitting the Petitions / Interventions filed by certain house buyers of LIJ, Hon’ble Supreme Court vide its various Orders gave directions to LAJ to deposit a sum of ` 2000 Crores with the Court on 11th September, 2017, which was modified vide its order(s) dated 22nd November, 2017 and 21st March,2018 to deposit in instalment an amount of ` 750 Crores by 10th May, 2018. The Company has deposited ` 750 Crores (including ` 550 Crores till 31st March 2018) with the Hon’ble Supreme Court till date.

In view of the ongoing IRP/ legal proceedings with Hon’ble National Company Law Tribunal (NCLT), Allahabad Bench and Hon’ble Supreme Court, the impact on the carrying value of the Investments in LIJ amounting ` 849.26 Crores (84,70,00,000 Equity Shares of ` 10/- each

excluding shares invoked by SBI) , Current Receivables amounting ` 341.75 Crores, Corporate Guarantee given to Lenders of LIJ amounting ` 232.17 Crores and deposit of ` 550 Crores [till 31st March, 2018] with the Registrar, Supreme Court is currently unascertainable. Hence no provision is considered necessary in the Financial Statements for the year ended on 31st March 2018 by the Management.

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