Tutor Conference February 2019 Corporate Reporting - Candidate B

	A	B	C	D	E	F	G
1	<u>**Research and development expenditure**</u>						
2	**Project Sound**						
3	<u>Financial reporting treatment</u>						
4	According to IFRS, any expenditure that is directly atrributable to the construction or development of an asset should be capitalised, otherwise any other income or expense should be expensed in the statement of profit or loss. In the case of KJL, we need to consider whether all the expenditure of the two projects have been correctly recognised in the profit or loss. In order to do this, we need to consider whether the development of the projects has been started. According to the standard, any expenditure on research of the project should be directly expensed. Therefore given the information in the scenario, the project has been started at 1 April 2018. Therefore any expenses before that should be expensed. Allocated general overheads are generally expensed as they are recognised as related expenses for the operations.						
5		**O$ 000**		Nice clear layout - uses technical knowledge applied to the scenario			
6	Material for prototype model	1725					
7	New computer equipment	1700					
8	Salary costs	1270					
9		4695					
10	Therefore an amount of 4965000 should be capitalised and be recognised as an asset under IAS 16. The standard requires the non-current asset to be measured either under cost model or revaluation model. A depreciation charge should be recognised and expensed in the statement of profit or loss annually and deducted by the carrying value of the asset. Considering that new equipment has a useful life of 2 year then we have a depreciation = 4965 x 1/2 x 6/12 = 1241						
11	DR Non-current Asset	4695000		DR Depreciation	1241000		
12	CR P&L	4695000		CR Non-current Asset	1241000		
13	**Project Entertain**						

Financial reporting treatment

The expenses of the second project has been correctly identified as an expense in the statement of profit or loss and we need to consider whether GetGo has been recognised as a trade payable in the statement of financial position. Further consideration needs to be made in the expenses of this project in order to obtain whether they are correctly treated. A breakdown of the amount, like in the first project should be provided.

disappointingly doesn't pick up the classification point

Weaknesses on audit procedures

No valid audit procedures have been made for this project considering that the auditors have been just followed the instructions of the company and consider that all expenditure of this project as expenses for the year. There is an audit risk of undervalue of PPE of the company which is materially mistated. Also we need to consider that the useful life of new equipment is valid.
Two years seems too small compared to the useful life of other equipments. There is a risk that the management tries to manipulate the results of the company with unvalid reasons. Also there is an additional risk of the company using an invalid useful life of other assets.
There is an increase in audit risk considering that the company is trying to not capitalised any non-current asset according to IFRS in order to prevent CEO from paying any personal tax liability. This can be considered as a fraud, and therefore the audit risk of management manipulation needs to be considered as well.
Also there is an audit risk that other projects that have not been mentioned have expensed their expenditure and have not followed the correct treatment under IAS 16.
No further information has been given for the Project Entertain, considering a breakdown of expenses. There might be any expenses that will need to be capitalised, considering that in the first project, there have been mistakes. Therefore there is a risk of undervalue of the non-current assets of the company.

The format of this could be better - there are some really good points buried here

Additional audit procedures:

- We need to obtain a list of other projects of the company and consider whethe the company has meet the criteria under IAS 16.
- Inspect documentation of the projects to consider that the correct date of construction has been identified in order to start capitalised the expenses.
- Obtain the reasonableness of the useful life of the new equipment, comparing with useful lifes of similar assets.
- Take a sample of other assets of the company, and indicate whether the correct useful life has been assigned to it and that the depreciation has been calculated accordingly.
- If GetGo's report analysis is not been provided, we need to obtain further consideration to the amount of trade payable considering that its value is material.

Test include some justification and some active verbs

Income tax receivable balance

Considering that research costs have been overvalued due to the corrections above, then we need to make an adjustment to the amount of income tax receivable that is overvalued.
Therefore we have: 10700-4965 = 5735
250% x 5735000 x 30% = 4301250
This should be the correct tax refund of the company.

DR Tax Refund	3723750
CR Current tax receivable	3723750

Weakness on the audit procedures

Incorrect calculation has been obtained due to other audit risks that have been arisen from other areas of audit.
There is an audit risk of the management trying to manipulate the profits of the company by increasing to the maximum any income.
There has been no audit procedures to the the percentage identified to the calculation of 250%. Further consideration has to be provided for this. There is a risk of a limited audit approach from the company considering that they are relying to the audit work made by the tax department of its firm. Considering that the amount of income tax receivable is material this means that additional audit procedures should be made by the firm.

Good identification of weakness of procedures

Additional audit procedures:

- Enquire with the management to obtain explanations of the 250% in the calculation.
- Consider whether any deferred tax has been ommitted from the calculations and calculate appropriately.
- Review to ensure that the company is in compliance with IAS 12.
- Review to ensure that any changes in accounting policy have been disclosed.

weak verbs here - review? ...consider...

Financial reporting treatment for outstanding issues from Janet Grey

Loan to KJL

Under IAS 39, any amount given as a loan should be classified as a financial asset. The appropriate category will be loans and receivables. According to the standard, loan should be initially recognised at fair value, being the loan amount. Then the asset should be subsequently measured at amortised cost using the effective rate method. Financial asset should be recognised in the individual and consolidated statements of the company.
A finance cost will be recognised in the statement of profit or loss.

Given that Zmant gives the loan in a foreign currency, then under 21 the company needs to translate this amount in its functional currency. The amount on its recognition will be translated at the spot rate at the date of the transaction.
Any receivable is considered as a monetary item according to the standard. All monetary items are retranslated at the closing date using the closing rate of the foreign currency and any gains or losses will be recognised in the statement of profit or loss. Also finance cost measured at an interest rate of 6% should be translated at the average rate.
Therefore we have:
Recognition: 3500000
Closing date: 4375000
A exchange foreign gain of 875000 should be recognised in the statement of profit or loss to the individual financial statements of Zmant
A deferred tax asset will be recognised as gains and losses are taxed when the loan is repaid. Therefore the company is making tax savings now.
Deferred tax asset = 875000 x 20% = 175000

DR Deferred tax asset	175000	
CR Profit or loss	175000	

Super - nice layout too

Inventory

Intra-group trading items must be eliminated upon consolidation.
The journal entry required to remove intra-group sales from group sales and cost of sales.
In addition a provision of unrealised profit is required in respect of any inventories remaining in hand at the end of the year.
Thefore we have:

DR Revenue	5500000	
CR Cost of sales	4074074	
CR Profit	1425926	
Selling price	135	5500000
Cost	100	-4074074
Profit	35	1425926

Profit has been incorrectly calculated. The correct amount of profit is 9574074. Given that there is an amount of 2500000 remaining to th inventory this there are is an unrealised profit of 648148 (2500/5500 * 1425926)
Unrealised profit should be deducted from the cost of sales of KJL (seller) in its calculation of consolidated schedule for the consolidated statement of profit or loss.

Also under IAS 12, unrealised profit gives rise to a deferred tax asset, as once the inventories have been sold to third parties the cancellation made now will not longer be required. This gives a temporary difference. Unrealised profit needs to be multiplied by the tax rate and a deferred tax asset should debited and an equivalent expense will be recognised in the statement of profit or loss.

Calculation of the goodwill

	O$000	
Consideration	52800	
Less Net assets @ acquisition		
(25000+45000+15000x9/12)	-81250	
Add NCI (81250 x 40%)	32500	
	4050	
Translated @ 6	675	*The difference of 169000 should be recognised in other comprehansive income of*
Translated @ 4.8	844	*the consolidated income statement of the company as an exchange gain*

Ethical Issues and actions

In order to consider whether any ethical issues are arising we need to investigate the accusations.
According to the journalist KJL is facing an ethical fraud of tax evasion. This is considered to be a criminal offense.
Given that the person of corruption accusations is the husband of the CEO of KJL gives higher indications of conflicts of interest.
Even if we dont believe to the facts of the journalist with the assumptions that he is trying to damage the image of the company, considering that a finance assistant of the company is saying that there is a manipulation of the numbers to the financial statement in order to avoid tax payment then there is evidence that KJL is making a fraud.
In such cases, the firm should be resigned as a group auditor and there will be no engagement to the company. There is an indication of lack of professional competence with the components auditors given that the firm is still provide audit work to the company.
Legal advice could also be considered due to the lack of knowledge that Zmant have on Otherland's laws and regulations.

The layout doesn't help -
very dense text
What about Janet?

Question 2

Revised statememt of profit or loss for the year ended 31 October 2018

	£000				
Revenue	30600				
Cost of sales	-22083				
Gross profit	8517				
Operating costs	-8235				
Finance costs	-632		No workings shown - doesn't help the marker here		
Loss/ profit before tax	-350				
Tax expense	0				
Loss/ profit for the year	-350				
Other comprehansive income (347-66)	281				

Revised statement of financial position as at 31 October 2018

Non-current assets					
Property plant and equipment	53675				
Financial asset	1850				
	55525				
Current assets					
Inventories	2770				

Trade receivables	7710					
Tax asset	0					
Cash	0					
TOTAL ASSETS	66005					
Equity						
Share capital	10000					
Other components of equity	916					
Available for sale reserve (+347)	850		working thanks!			
Retained Earnings (-350	36944					
	48710					
Long term Liabilities						
5% convertible bonds	9854					
Current Liabilities						
Trade payables	6304					
Tax payable	0					
Bank overdraft	1219					
	17377					
TOTAL EQUITY AND LIABILITIES						

Financial reporting treatment of the outstanding matters

Convertible bonds

A convertible bond consists of a liability and an equity component since there is an option of converted at the choice of Chelle into ordinary shares. This means that a liability and an equity component needs to be measured at the initiation of the financial instument.
Liability component was measured at the present value of the cash outflows that will be occured during the loan term.
PV of liability will be = (500k x 6.088) + 10m x 0.604 = 3044+6040= 9084m
Therefore equity component will be 10m - 9.084m = 916000
The equity component will not be changed thereafter, where the liability component will be measured subsequently at amortised cost.

	Opening balance	Finance cost	Coupon	Closing
2012	9084	590	-500	9174
2013	9174	596	-500	9270
2014	9270	603	-500	9373
2015	9373	609	-500	9482
2016	9482	616	-500	9598
2017	9598	624	-500	9722
2018	9722	632	-500	9854

Wastes quite a lot of time - didn't identify that this is not the first year of the bond.

The amount of 500000 was incorrectly recognised as a finance cost in the statement of profit or loss
The finance cost of 632000 should be debited in the statement of profit or loss as a finance cost where a constant of 500000 will be deducted from the loan amount each year and be credited to the cash account as paid.

Available for sale asset

Under IAS 39, available for sale assets are initially recognised at fair value. They subsequently measured at fair value with any gain or loss recognised in other comprehensive income.
Therefore given that fair value at 2017 is 1503000 and the fair value at 2018 is 1850000 then we have a gain of 347000 that will be recognised in the statement of other comprehansive income.

Current tax

Current tax of the company will be changed considering that there have been adjustments to the values in the profit or loss.
This indicates that according to convertible bond, since the finance cost is increasing from 500 to 632 then we have an additional current tax of 132 x 19% = 25
If current tax relates to item recognised in OCI then tax expense also in OCI. This will be 19% x 347 = 66
However since the company is making losses then a tax expense will not be recognised. The trading losses will be transfered to the next year in the case where profits have been made and they are allowable to be deducted for the next 7 years.
Therefore no tax expense will be recognised in the statement of profit or loss.

Earning per share calculation

Since the company is loss making we need to calculate a negative earning per share.
This will be = -350 / 10000 = 0.035 per share
In the case of loss, diluted and basic earning per share are equal. This means that dilluted per share = 0.035

Financial Analysis of the company's performance position and cash flows

	2018	2017	2016
Gross profit margin	25%	28%	29%
Loss/ profit margin	-1%	6%	6%
Current ratio	1.42	2.25	2.84
Gearing ratio	20%	20%	19%
Receivables days	92 days	86 days	82 days
Payables days	101 days	76 days	61 days

Nice table - but does not use any of these in the analysis below

Revenue of the company from 2017 to 2018 has been decreased by almost 4% which is a slightly smaller decrease compare to the decrease made to the company from 2016 to 2017. On the same concept, costs of the company have been decreased from one year to another. This indicates that the costs of the company are mostly variable, but further consideration is needed for this.
There is a risk of adverse exchange rates that worries the directors of Chelle of increasing its costs. However this does not appear to happen in this case. However a break down of the costs in order to illustrate this will be helpful.
Gross profit of Chelle has been decreasing during the years, and this gives warnings to the performance of the company. Also due to the loss making during 2018, it indicates that the company might not be in a good position.
This can be also be illustrated due to the fact that the current ratio of the company is worsen from one year to another. An illustration of quick ratio can show more prudent results to this.
One of the main risks that the company is facing is its cash position. There is a financial risk considering that the cash flows have become negative since 2018. Also an overdraft appears in 2018 to its financial statements indicating the bad cash position of the company.
Also payables days have been singnificantly increased showing that the company might be unable to pay its obligations. On the other hand

receivable days have been increasing as well during the years, creating additional problems to the company's cash flows.
Further information according to the terms and conditions that are illustrated to the contracts with customers and suppliers can help whether the company can make improvements to its cash position.

ok to recognise need more information but tell us what you would need and do with the information

Discusses cash but doesn't get to the elephant in the room point

Uses the scenario - but does not explain why the exchange rate worry impacts on cost - no % movements given

Question 3

Explanation why audit matters from last year are relevant and how these have been changed this year

Considering that the company is stil providing a package of goods and services to the customers, this indicates that the complex of transactions that have been made for the revenue recognition continue in this year as well. Therefore revenue recognition is an audit key matter for this year's audit as well.

The company needs to consider any large complex revenue transactions and identify whether the revenue recognition have been correctly identifired deducting any discounts or any services that have not yet been provided to the customer.

The provision of onerous lease will be an audit key matter in this year, considering that the company still not identified any sub-lessee for the lease agreement of the office premises. In the case where the premises will not be leased for more than two years, then this indicates that a higher provision should be recognised in the financial statements of the company.

Also given that there is a remaining life of 15 years for the company, this indicates that the area of provisions will be material for the next years.

Additional audit matters

An audit risk appears considering material mistatements made to the financial statements due to the lack of experience that the revenue accountant has. SInce the accountant has been employed by Solvit at the end of last year, this indicates that might several errors appeared in this year when the new accountant will be responsible for the treatment of company's transactions.

This indicates that materiality of the company needs to be decrease.

Trade receivables can also be included in the key audit matters of our audit work considering that the trade receivables days have been increased from one year to another. A judgement should be made to any impairment of receivables if we conclude that these customers cannot pay back their obligations.

Also further consideration needs to be made to the profits of the company, whether there is a risk of management manipulation due to the management bonus that has been offerred.

Considering that the company had not performed well in the first half of the year, this increases the risk that the management might try to increase its profits to achieve the bonus.

Financial reporting standard for each key audit matter

Revenue recognition

Under IAS 18 , regarding revenue of goods, revenue should be recognised once the risks in relation to the products have been transferred to the buyer. This is normally upon delivery.

On the other hand, regarding revenue recognition of services, revenue should be recognised when :

- The amount can be measured reliably
- Probable economic benefits will flow to the entity
- The stage of completion at the end of the year can be reliably measured.

Audit procedures:

Fair value of each component need to be established, regarding the packages of goods and services.

Need to ascertain any authorisation for any discounted selling prices

Perform cut - of test s on sales made around the year. Ensure that all goods for which revenue has been recognised pre year end were ordered for pre year end delivery and that risk has passed to the customer

Obtain terms and conditions on the agrements of customers

Review any credit notes and ensure to be in line with the contractual rights identified.

Management bonus

Management bonus should be treated under IAS 37 where the conditions are met.

In this case, the profits targets needs to be made in order to recognise any provision amount at the end of the year. The company should not be recognised half of the provision in the budgeted terms.

A provision should be recognised whether the company has been achieved the preferrable profit margins.

Therefore in the case where profit is not the appropriate one, no management bonus should be recognised in the financial statements.

Audit procedures:

Obtain the reasonableness of the assumptions that have been made to calculate the provision amount

Recalculate the provision amount in order to obtain where any errors have been made.

Ensure that a management bonus has been deducted in the financial statements only in the case where profit targets have been met.

Read terms and conditions of the agreement that made with the directors for their bonus.

Receivables

Receivables needs to be deducted in the case where customers are unable to repay their obligations and thus an impairment loss should be calculated and expensed in the statement of profit or loss.

Audit procedures:

Note amounts of the receivables being outstanding

Perform aged debt analysis and compare the profit to the prior year

Enquire with the management in order to identify whether there are any indications of customers that are not paying their obligations

Claims of customers can also be obtained in order to identify whether there are any customers that are refusing to pay for its debts.

Onerous leases

Onerous leases are treated according to IAS 37. Onerous contracts are occured in the case where future benefits under a contract are expected to be less than the avoidable costs. The excess of unavoidables costs should be provided at the time a contract become onerous. The standard requires provision to be discounted at the risk adjusted rate specific to the liability. In these circumstances, there is no discounting or any future rental payments therefore the provision amount might be wrongly stated.

Audit procedures:

We need to obtain whether they are any proposed lessees who are considered to sub-let the office premises form the company.
Discounting the excess of costs that the company is planning to made.
Consider whether the rental payments are in consistent with the market.
Enquire with the management to explain the moves that they will make in order to identify a buyer for the sub-letting of the premises.

Sale and leaseback

Under IAS 17 in order to identify the correct treatment of the lease, we need to identify whether it is a finance lease or an operating lease. The standard requires that a lease will be qualified as a finance lease if:
- the lesse has transferred all risks and rewards of the asset
- the lease term is for the major part of the useful life of the asset
- present value of the minimume payments are substantially all of the assets fair value

Considering that the lease term and the useful life of the asset are not even close, and that present value of the lease is not equal to the fair value of the asset , then a treatment of operating lease will be identified. Therefore the asset will be derecognised and a profit will be recognised. In the case where proceeds are higher than the fair value of the asset then a deferred income will be recognised

DR Bank	18m
CR Asset	11m
CR P+L	4m
CR DI	3m

Audit procedures:
Inspect the lease terms to the agreement
Assess reasonableness of the fair value of the asset
Consider whether rent payments are in line with the market

IFRS 16 Leases

When IFRS16 comes into force, a lease liability and corresponding right of use of asset will be recognised in the statement of financial position
The difficulty in subletting the property at the rental that is payable by the entity indicates tha the right of use of asset is impaired, because is underperforming. An impairment test is needed and recognised in P&L.
This will substitute the standard IAS 37.