ADVANCED LEVEL EXAMINATION

Crocus

CORPORATE REPORTING

ADVANCE INFORMATION

Question 1 (Elephant Ltd)

Assume the date is 14 December 2018.

This Advance Information relates only to Question 1 of the Corporate Reporting Mock Exam Crocus.

The Advance Information comprises:

1. This document which includes the scenario, background information (**Exhibit A**) and a matter discussed with the client (**Exhibit B**); and
2. The nominal ledger data for Elephant Ltd (Elephant) for the 11 months ended 30 November 2018, contained within the Data Analytics Software**.** Click here to access the 11 months data.

Exam – 12 months

During the Corporate Reporting Mock exam, you will be provided with access to the nominal ledger data for Elephant for the full 12 months ended 31 December 2018 contained within the Data Analytics Software. You will need to address the new data for the month of December 2018 and to consider the data, patterns and trends for the year ended 31 December 2018 as a whole.

The data for the 11 months to 30 November 2018 remains valid for the exam and will be unchanged. However, in the exam, you will not be able to access the Data Analytics Software data for the 11 months to 30 November 2018 or any notes you have made in the Data Analytics Software for the 11 months to 30 November 2018.

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ADVANCE INFORMATION: QUESTION 1

Scenario

You are an audit senior working for Lister LLP, a firm of ICAEW Chartered Accountants. You have just been assigned to the audit of Elephant Ltd for the year ending 31 December 2018.

Elephant prepares its financial statements in accordance with IFRS. Recently, an audit plan was prepared by an audit manager, Helen Holden, who has now left the firm. You have just been assigned as the audit senior on the audit of Elephant and receive the following email from the newly appointed audit engagement manager, Jake Moore.

From: Jake Moore
Date: December 2018
To: Audit Senior

Subject: 2018 audit of Elephant Ltd

The client requires an early sign-off of the audit report as Elephant will be seeking finance from their bank. We carried out an audit planning visit in early December. During the visit, the client provided Lister with data for the 11 months ended 30 November 2018 from Elephant's nominal ledger. This has been imported into the Data Analytics Software used by Lister.

The final audit visit is now scheduled for February 2019 and I would like you to act as audit senior.

As part of the audit plan, Helen prepared some background information and notes on internal audit work carried out on receivables (**Exhibit A**) and a further matter which she has discussed with the client (**Exhibit B**). I have not had chance to review this matter just yet.

Before the final audit commences in February 2019, I would like you to familiarise yourself with Elephant by reviewing:

(1) The background information (**Exhibit A**) and the matter discussed with the client prepared by Helen (**Exhibit B**); and

(2) The nominal ledger data for Elephant for the 11 months ended 30 November 2018, contained within the Data Analytics Software.

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Exhibit A: Background information – prepared by Helen Holden, 4 December 2018

I had a meeting with Frank Wright to discuss the company and significant events during the year. I have summarised below the key points from my meeting.

Elephant provides marketing services, mainly to digital businesses based in the UK (domestic) and the rest of Europe (overseas). Customers sign a contract with Elephant for the provision of a specific project. Each project is short term, up to two months.

Elephant contracts with customers to deliver short-term marketing projects. Customers are invoiced and revenue is recognised when the customer signs to confirm their acceptance of a completed project. International customers are sometimes invoiced in their local currency.

A typical marketing contract will comprise a contract price for design artwork and concept and brand development. In addition, the contract may specify the selling price for promotional products such as banners, posters and marketing gifts (eg, pens, key rings etc). The price is calculated based on the quantity ordered by the customer.

Costs are incurred by Elephant for each contract, including payroll and cost of sales for promotional products. Also, a large element of cost of sales is in respect of travel, accommodation, motor vehicle costs and consumables. Travel and accommodation mainly relate to expense claims from Elephant staff arising from visiting clients.

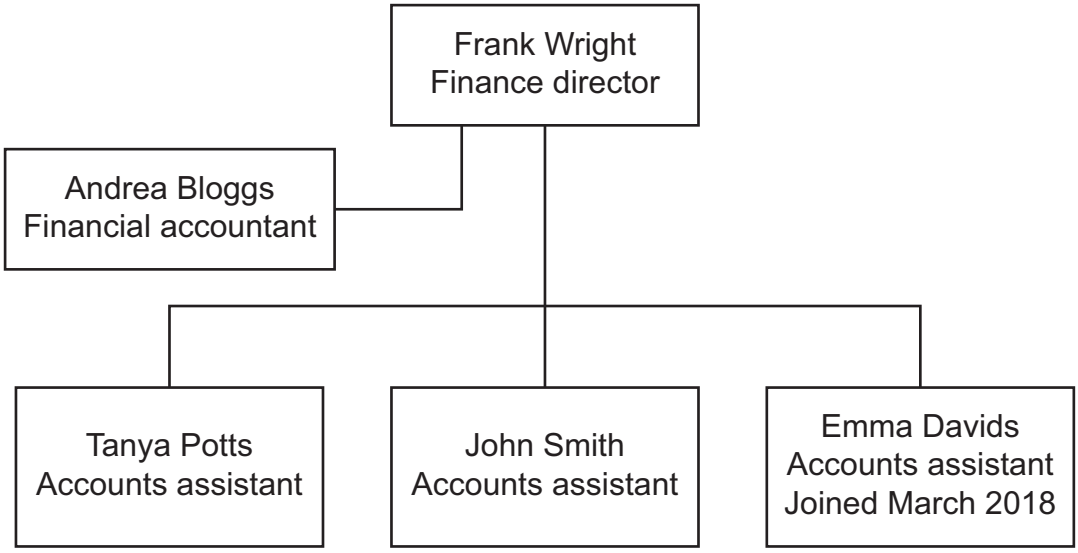
The Elephant board is keen to expand rapidly and is under pressure to present strong results to the bank for the year ending 31 December 2018. The company seems to be achieving this and the draft statement of profit or loss shows that both profit and revenue have increased compared with the year ended 31 December 2017.

Elephant uses invoice financing for short-term finance, but this is expensive. The company intends to obtain a bank loan in 2019 to finance expansion and to reduce the need to use invoice financing in future. The bank will rely, in part, on the financial statements for the year ending 31 December 2018 in making its loan decision.

Set out below are the members of the accounts department at Elephant (users) and their roles.

ADVANCE INFORMATION: QUESTION 1

Organisation roles for key members of accounts staff



Steve Thompson, an accounts assistant became Elephant's internal auditor in February 2018 and was replaced by Emma Davids as an accounts assistant in March 2018.

Frank Wright – Accounting department manager and finance director

Frank is an ICAEW Chartered Accountant and has worked at Elephant since 2016. As Elephant is a small company, he is closely involved with recording all types of transactions on a day-to-day basis.

Frank prepares budgets for Elephant and negotiates loans and contracts on behalf of the Elephant board.

Frank is the only member of the accounting department who is a qualified ICAEW Chartered Accountant. If a member of the accounting department is unsure about how to record a transaction, it is normally recorded in Account code 00990 Suspense account. Frank later corrects the entries by raising a journal and clearing the suspense account.

Andrea Bloggs – Financial accountant

Andrea has worked for Elephant for two years. She previously worked in the purchase ledger department for a large manufacturing company. She is very competent at posting invoices for purchases. She has less experience in posting entries for sales invoices and credit notes but does sometimes assist in recording these types of transactions. She reconciles the bank statement monthly.

Tanya Potts – Accounts assistant

Tanya prepares the payroll together with John Smith. She also helps with sales ledger and purchase ledger transactions.

John Smith – Accounts assistant

John prepares the payroll together with Tanya Potts. He also helps with sales ledger and purchase ledger transactions.

ADVANCE INFORMATION: QUESTION 1

System note for invoice financing

The carrying amount of trade receivables includes receivables which are subject to an invoice financing arrangement. Elephant uses an invoice finance company, Close Real Debt Ltd (CRD). Under this arrangement, Elephant Ltd transfers the relevant receivables to the invoice finance company in exchange for cash. Elephant Ltd transfers late payment risk and credit risk to the invoice finance company. Trade receivables are shown net of invoice financing loans in the statement of financial position.

Elephant transfers receivables to CRD at least 15 days after invoice date. To incentivise customers to pay in this period, thus avoiding invoice financing costs, Elephant offers an early payment discount for settlement within 14 days of invoice date.

Under the terms of the agreement with CRD, Elephant identifies customer invoices for finance from CRD. Although Elephant performs credit checks on all its customers, CRD also carries out credit checks and confirms to Elephant which invoices it is accepting for finance.

When the invoice is accepted by CRD, Elephant transfers the invoice to the invoice finance account (Account code 20021). CRD pays Elephant the invoice amount less a fee based on the amount of the sales invoices transferred. Elephant can draw cash down from CRD up to the amount of invoices accepted by CRD. CRD charges interest on these advances.

Once a receivable is transferred, CRD is responsible for collecting the amount owing from the customer. This is a non-recourse agreement and CRD has no right to return the receivable to Elephant in the event of non-payment. Therefore, credit risk related to non-payment is borne by CRD. However, Elephant remains responsible for disputed invoices.

Elephant Ltd therefore derecognises the transferred receivable assets in their entirety in its statement of financial position.

Internal audit function

Steve Thompson was employed as an accounts clerk in the finance department of Elephant for many years and is approaching retirement age. In February 2018 he left this role and was appointed, on a part time basis, as Elephant's only internal auditor. In this role he reports to the finance director, Frank Wright who is keen to ensure the accuracy of Elephant's accounting records. Prior to joining Elephant, Steve was employed by an audit firm but failed his exams and he did not complete his studies to become an ICAEW Chartered Accountant.

ADVANCE INFORMATION: QUESTION 1

On taking up his new role as internal auditor, Steve began a programme of reviewing the operation of internal controls over each area of the business in turn. In September 2018, he documented and tested internal controls over income and receivables. He documented the invoicing and credit control process as follows:

> "Sales invoices can only be raised against a signed customer contract. Customers are invoiced only when a contract is complete. The project leader signs off to verify the invoice amount and confirm that all agreed services have been provided before the accounts department raises the invoice. Any difference between the invoice amount and the price agreed in the original contract must be authorised by the head of project management. For a number of years Elephant's standard invoice terms have been payment within 60 days of invoice date.
>
> "Sales credits are posted to receivables where a customer successfully disputes part of an invoice, this most commonly occurs where an element of the agreed contract was not supplied yet was included in the invoice in error.
>
> "The majority of receivables are transferred to CRD after at least 15 days from invoice date. As the invoice financing arrangement is on a non-recourse basis Elephant does not bear the credit risk in relation to transferred receivables. A list of the receivables to be transferred is prepared periodically by Andrea and submitted to CRD. Once CRD sends a confirmation of the receivables accepted, the value of the transferred receivables is credited to 21010 Receivables Control A/c and debited to 20021 – Invoice Finance account. Each month, Frank reconciles the total amount transferred to the invoice finance account to the amount of receivables confirmed as accepted by CRD.
>
> "Although the majority of invoices are transferred to CRD at some point after 15 days, if customers pay Elephant within 14 days they receive a discount on the invoice amount. These discounts are also posted as sales credits to receivables. In the past there were instances of sales credits being posted with inadequate justification. Due to this, sales credits of £5,000 or more may only be posted by Frank or Andrea."

As part of his review of income and receivables, Steve performed the following tests of controls on a sample of sales invoices provided by the finance department:

- Confirmed each invoice had been signed off by a project leader prior to dispatch.
- Agreed the invoiced amount to a signed contract price.
- For identified differences to contract price confirmed authorisation by the head of project management for the addition or discount.

ADVANCE INFORMATION: QUESTION 1

Exhibit B: Matter discussed with client – prepared by Helen Holden, 4 December 2018

In November 2018 Elephant bid for a contract with Spooks, a French online virtual cycling and home exercise provider. If Elephant wins this contract, it would be its largest and by far its longest marketing contract to date. The contract relates to creating a new website for Spooks and running a digital marketing campaign for Spooks to increase its membership. From my conversations with Frank, it seems that Elephant are in final negotiations with Spooks and management is very optimistic about the prospects of winning this contract which would start later in December 2018 and run for 18 months.

As negotiations are still ongoing, confirmed details are very limited. However, I just wanted to flag this as something that we may need to look at on the final audit visit. If Elephant are successful, it may have a material impact on the 2018 financial statements. Also, the accounts team at Elephant may struggle to account for this correctly as it will be its first longer term contract.

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ICAEW
Metropolitan House
321 Avebury Boulevard
Milton Keynes
MK9 2FZ
www.icaew.com