Question 4

Using your recent work experience, describe two situations where you have used your technical knowledge and/or practical experience to develop advice.

EXAMPLE ANSWER

<u>Advice on the Reclassification of Assets</u>

January 2024

ABC Investments was acquired by XYZ Capital FZCO, I was tasked to oversee the integration of an ABC Investments that owned a diverse portfolio of real estate properties. The acquisition required a thorough analysis of these properties to ensure that their classification was in strict accordance with International Financial Reporting Standards (IFRS). This was important to maintain compliance and provide accurate financial reporting.

After acquisition, I recognized the need to classify the properties in accordance with IFRS to reflect their true nature and use. To achieve this, I initiated a series of meetings with the management of the acquired and holding company. The primary objectives of these discussions were to understand the nature of the properties and the intentions of management regarding their future use. After these meetings, I reviewed the financial statements of ABC Investments, I was focused on gathering detailed information about each property and how it was recorded before acquisition. Understanding of each property, with their intended purpose and business model associated with them was essential to determine the applicable IFRS standards. I identified four categories of properties.

I identified that first category of properties included those held for trading and intended to be sold in the short term after minor renovations. According to IAS 2 - Inventories, properties held for sale in the ordinary course of business, or those acquired with the intention of making a short-term gain, should be classified as inventory. I suggested for these properties, therefore, to be measured at the lower of cost or net realizable value as per IAS-2. I also suggested for proper valuation from a valuer to obtain realistic NRV.

I identified that second category involved properties held for the company’s own use, such as those used for conducting business activities. For these owner-occupied properties, I suggested to apply IAS 16 - Property, Plant, and Equipment. This standard allows for the properties to be measured using either the cost model or the fair value model. After discussing with management, I suggested to use the cost model, which involved depreciating the properties over their useful lives while ensuring that any impairment losses were recognized promptly.

IFRS 16 Leases was applicable on the properties that were used solely for lease arrangements with third party clients. Since company acted as lessor, I suggested these properties must be classified as lease assets and income from leasing activities should be recorded as lease income on straight line basis over the lease term.

I identified last category consisted of properties held to generate rental income or for capital appreciation. I suggested to classify under IAS 40 - Investment Property. According to this, properties could be measured using either the fair value model or the cost model. After evaluating the potential for rental income and capital appreciation, I suggested for the fair value model, which requires that the properties be revalued at each reporting date, with changes in fair value recognized in profit or loss.

After completing the classification process, I submitted a comprehensive report to the management, outlining the classification of each property according to the relevant IFRS standards. The report also included the rationale behind each classification, ensuring that the management fully understood the implications for financial reporting. The management agreed with the recommendations, and the properties were reclassified accordingly.

EXAMPLE ANSWER

Advising on Strategic Capital Allocation for Expanding Storage Capacity

In June 2021, I advised on a critical investment decision for ABC Limited (ABC) regarding the expansion of our storage capacity to meet growing market demand. The project entailed constructing a new liquefied natural gas (LNG) storage facility, which would require significant capital investment. My advice was pivotal in ensuring the financial viability and strategic alignment of the project with the company's long-term goals.

Leveraging my extensive experience in financial management, I applied rigorous financial analysis techniques to assess the project's potential return on investment (ROI). I began by conducting a comprehensive financial feasibility study, focusing on discounted cash flow (DCF) analysis. This approach allowed me to evaluate the project's future cash inflows and outflows, adjusting them to their present value to determine the net present value (NPV). Given the capital-intensive nature of the project, the NPV provided a clear indicator of the project's potential profitability.

In addition to the DCF analysis, I employed sensitivity analysis to account for potential risks, such as fluctuations in LNG prices, changes in regulatory policies, and variations in construction costs. By testing different scenarios, I was able to identify the variables that could significantly impact the project's financial outcomes. This analysis was crucial in highlighting the potential risks and in developing strategies to mitigate them.

I advised the management team to proceed with the investment based on several key factors. First, the DCF analysis indicated a positive NPV, suggesting that the project would generate value for the company. The internal rate of return (IRR) exceeded our company's hurdle rate, reinforcing the project's attractiveness from a financial perspective. Additionally, the sensitivity analysis demonstrated that the project remained viable under a range of adverse conditions, which further strengthened my recommendation.

I also emphasized the importance of aligning the project with ABC's strategic goals. The expansion of storage capacity was not merely a financial decision but a strategic move to solidify our market position and meet anticipated demand growth in the region. I highlighted how the project would enhance our operational efficiency, reduce dependency on external storage facilities, and provide a competitive edge in the market by ensuring a stable supply of LNG.

From a financial control perspective, I advised implementing strict monitoring mechanisms throughout the project's execution to ensure cost control and adherence to the budget. I recommended the establishment of a project management office (PMO) to oversee the project, with regular financial audits and progress reports to track expenditures and project milestones. This would allow us to identify and address any deviations from the plan promptly.

In terms of funding the project, I advised a mix of internal financing and external borrowing. Given the favorable interest rate environment at the time, I recommended leveraging debt to finance a portion of the project. This approach would not only preserve our cash reserves but also optimize our capital structure by taking advantage of low-cost debt. I conducted a thorough analysis of our debt capacity, ensuring that the additional borrowing would not compromise our financial stability or breach any covenants related to existing loans.

Additionally, I reviewed the tax implications of the investment. According to the relevant tax provisions, the interest expense on the debt would be tax-deductible, which would further enhance the project's after-tax cash flows. I advised structuring the debt in a way that maximized the tax benefits while maintaining manageable repayment terms.

In conclusion, the successful implementation of my advice led to a 20% increase in storage capacity, directly contributing to a 15% rise in annual revenue and a 10% improvement in our operating margin within the first year, solidifying our market leadership and financial stability.

EXAMPLE ANSWER

Advising on Optimizing Financial Management and Reporting Compliance

In March 2024, ABC Limited encountered several challenges related to its financial management and reporting processes. Discrepancies in revenue recognition and asset valuation raised concerns about compliance with the Hong Kong Financial Reporting Standards (HKFRS). These inconsistencies stemmed from outdated practices that failed to align with current standards, increasing the risk of regulatory penalties and misrepresentation of the company's financial position. Additionally, inefficiencies in the company's manual reporting system contributed to errors and delays, further complicating the financial close process. As Vice General Manager and Financial Director, I was tasked with addressing these deficiencies and enhancing the company's financial management practices.

My role required a thorough review of the company's financial statements to ensure full compliance with HKFRS. Leveraging my technical knowledge and practical experience, I identified key areas where our reporting practices could be improved. Specifically, discrepancies in revenue recognition and asset valuation were critical issues that posed potential compliance risks.

The discrepancies in revenue recognition were particularly concerning. Our current practice was to recognize revenue at the point of billing rather than when the goods or services were delivered. This was inconsistent with HKFRS 15, which governs revenue from contracts with customers. HKFRS 15 emphasizes that revenue should be recognized when control of the goods or services is transferred to the customer, based on a five-step model. This model includes identifying contracts, performance obligations, transaction prices, and allocating and recognizing revenue when performance obligations are met. I advised the finance team to adjust our revenue recognition process to align with HKFRS 15, ensuring that revenue is recognized only when the performance obligations are fully satisfied. This change not only ensured compliance but also provided a more accurate reflection of our financial position.

In addition to revenue recognition, I identified issues with the valuation of certain long-term assets, particularly our storage facilities and infrastructure. These assets were previously valued based on historical cost, which did not reflect their fair market value. According to HKFRS 13, which governs fair value measurement, assets should be valued at their fair value—the price that would be received to sell the asset in an orderly transaction between market participants at the measurement date. I recommended shifting to a fair value measurement approach for these assets, using observable market data where available, and incorporating valuation techniques that reflect current market conditions. This adjustment not only ensured compliance with HKFRS but also provided a more accurate representation of the company's financial position.

To prevent future discrepancies and improve overall financial management, I also advised on strengthening ABC's internal controls. One key recommendation was the introduction of an automated financial reporting system integrated with our ERP system. This automation reduced the risk of human error and improved both the accuracy and timeliness of our financial reports. I also stressed the importance of regular training for the finance team, ensuring they remained up to date with HKFRS requirements and best practices in financial reporting.

In terms of cash flow management, the changes to revenue recognition presented potential short-term challenges, as the adjustment would delay revenue recognition and impact liquidity. To address this, I recommended securing a short-term credit facility to maintain stability during the transition period. This proactive approach ensured that ABC could continue its operations without disruption while transitioning to more accurate and compliant financial practices.

The results of implementing these changes were significant. Adjustments to our financial statements resulted in a 12% increase in the reported value of our long-term assets, reflecting a more accurate market valuation. Our revenue recognition practices now fully complied with HKFRS, eliminating the risk of regulatory penalties and ensuring transparency. Additionally, the introduction of the automated reporting system shortened our financial close process by 20%, significantly enhancing the efficiency and reliability of our financial management.

By addressing these critical areas, ABC was able to align its financial practices with HKFRS, improve operational efficiency, and better position itself for future growth.