Question 2.1

Using your recent work experience, describe how you have used your technical expertise and/or business knowledge to analyse a business or professional situation.

EXAMPLE ANSWER

ANALYSING CLIENT TRADE DEBTOR BALANCES TO DETERMINE APPROPRIATE LEVEL OF BAD DEBT PROVISIONING

In 2015 the real estate industry in Zedd City suffered a severe jolt due to a recession in that sector mainly because of a law and order situation. Additionally, relations with the neighbouring country of Obo nose-dived causing loss of business for nearly all manufacturing companies, including the steel industry. Cross-border terrorism channelled through Obo also badly hit almost all business activity in Zedd City.

With this background information, I prepared my audit planning strategy for the annual audit of EEE Steel Mills Ltd for the year ended March 2015. Two of the most significant audit areas at the client were that of stock and receivables or trade debtors. The audit plan and audit program for the Trade Debtors that I had designed for my audit team aimed at testing the design and operational effectiveness of controls over debtors. It also aimed at finding other critical audit information about trade debtors that could indicate potential problems – for example, in the quality of and therefore the valuation of trade debtor balances for e.g. debtor types (Federal/Local Government bodies, Corporate and other customers), the total debtor balances by debtor type, debtor turnover days, debtor payment history etc.

To analyse the situation further, I constructed a customised debtor ageing analysis that analysed the age of the receivable balances (grouped by customer type and individual customers constituting each type) and related that to the probability of receiving the balance based on multiple criteria like customer type, location, industry, payment history (i.e. poor, average, good), financial strength (analysing debtor liquidity from their annual reports) and credibility (gauged from the CIB Report which is a public document released by the state central bank that shows all loans taken by corporates and government bodies from scheduled banks including those on which they are defaulting). I instructed my team on how to fill out the special debtor ageing analysis template I had constructed, with information from the client and other sources.

Based on the results of the above analysis and a more granular analysis of debtor turnover days (i.e. quarterly and yearly) I reached the conclusion that bad debt provisioning was insufficient to the extent that it distorted the receivables valuation thereby putting into question the reliability of the financial statements. The client's contention was that most of the receivables were owed from Local and Federal Government Bodies and were, therefore, relatively secure. However, considering the outlook of the economy and the poor payment history of these government organisations (with long-stuck receivables and loan defaults with other banks) I considered it prudent to increase the bad debt provision substantially. The provision amount calculation was based on the results of the special debtor ageing analysis that I had constructed for this purpose.

Utilising this audit approach for the trade debtors I was able to determine the appropriate bad debts provision and get the client to recognise the same in their financial statements in order to fairly value trade debtor balances. This analysis and its findings were key to getting the client to write-off some bad debts.

EXAMPLE ANSWER

INTERNAL AUDIT ON THE REVENUE CUT-OFF

FGH is a technology company listed on the Stock Market in 2017 and its fiscal year ("FY") was from July 1 to June 30. In August 2021, I performed the internal audit as part of 404 terms of Sarbanes-Oxley Act of 2002 ("SOX") Internal Control Assessment requirement to ascertain if the revenue was recorded in appropriate accounting period for FY21.

First, I analysed the revenue pattern across FY21 to ascertain if there were any anomalies in the monthly revenue which I should focus on. My analytical review found an unusual increase in revenue in the last month of Quarter 4 (April 1~June 30,2021) as compared to the same month in the last fiscal year or last quarter, and also the revenue forecast even though the business condition remained unchanged. That red flag indicator suggested that I dig further to confirm if there was issue in the cut-off of revenue per my previous experience of this topic.

With this background information, I prepared my internal audit strategy according to the International Standards on Auditing for the year-end SOX audit. One of the most significant audit areas was the revenue cut-off testing, a high risk and critical area of the financial statement.

Accordingly, the internal audit plan and program I designed aimed at testing the design and operational effectiveness of internal controls on revenue cut-off to ensure it was record in the correct accounting period.

To analyse the situation further, the first step in my audit strategy was to understand the workflow of how revenue was recorded, including a review of the business agreement with customers and analysis of the key information closely related to revenue cut-off control. I considered the following factors:

a) the type of sales, e.g., direct sales or channel sales
b) the criteria for revenue recognition per agreement
c) the cut off point for revenue recognition
d) types of the international commercial term ("Incoterm") specified in the shipment file
e) sales/ logistics /finance's job and responsibility in the workflow

Following the above analysis, I then carried out a preliminarily assessment of the effectiveness of controls design and operation in revenue cut-off process through a walkthrough of a sample of each revenue stream. This focussed on what kind of shipment documents that the finance team reviewed and the communication between finance and logistics teams to determine the correct accounting period for the revenue recognition. Thirdly, I performed testing on 10 samples of revenue transition cut-off under different sales models. In addition, I analysed the revenue turnover days (monthly and quarterly) and assessed the trends.

With the results of the above audit procedures, I came to the judgement that some of revenue transactions were not recorded in the right accounting period. I then performed the root cause analysis and found out that it was due to contract terms for some new customers being incorrectly captured. I understood that this was due to a errors by member of the logistics team.

Utilising the audit approach and the data analysis for the revenue cut-off, I was able to detect the common issue in revenue cut-off process from internal audit perspective and demonstrated the controls in place to detect errors was still broadly effective in corporate governance terms.

EXAMPLE ANSWER

ANALYSIS ON LMN GOLD MINE CONTRACTS FOR LEASES

IFRS 16 Leases became effective on 1 January 2019 and for LMN's financial year end of 31 March, at LMN Gold Mine we were meant to implement in the FY2020 (01 April 2019 to 31 March 2020). IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases. It aimed at ensuring that lessees and lessors provided relevant information that faithfully represented those transactions. That information gave a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of LMN Gold Mine. To facilitate implementation of the standard, as the Financial Accountant, I had to analyse each and every LMN contract with various suppliers and contractors.

The first thing I did was to request the LMN Contracts file from the Management Accountant to enable me to start the process. There are IFRS guideline steps that are followed in order to determine if a contract contains a lease or not. I began the analysis by determining for each and every contract if they meet the definition of a lease. The first step was to ascertain if there was an identifiable asset within the contract. I needed to verify if LMN has the right to control the use of an identifiable asset if any for a period of the contract. I eliminated all contracts that were service in nature such as ABC Ltd, ZET Ltd and FESO Ltd as they did not meet the definition of a lease which involves the implicit and explicit identification of an asset which is not apparent in service contracts. I also excluded LMN Mining Lease because lease contracts that involve mining and farming do not form part of the IFRS 16 context. I then checked if they were short term leases, those below a year and the ones that have a monetary value of below USD5,000.00, in order for me to apply an exemption. There were no short term leases.

I determined only 6 contracts passed first step which were Alpha, Beta, Gamma, Delta, Kappa, Eta, Upsilon and Theta. Most that failed this step had in their contract terms dominant substantive rights to their assets and also, they reserved the right to configurations or alterations of the asset in use.

I then I went on to the second step where I had to determine if LMN has the right to obtain substantially all economic benefits from the use of the asset throughout the period of use. Only three contracts passed this test, which were Beta, Gamma and Kappa. All the other ones were restrictive and maintained control of the asset.

On the third and final stage, I had to ascertain if LMN or the supplier has the right to direct how and for what purpose the identified asset is used throughout the period of use. If LMN has the right to operate the asset throughout the period of use without the lessor having the right to change those operating instructions and if LMN designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used throughout the period of use.

After the review, all the remaining 3 contracts, currently held with LMN do not constitute a lease arrangement as per IFRS 16 guidelines.

After the above the analysis, the implementation of IFRS 16 had no impact in the financial statements of LMN and our auditors confirmed the assertion after their own review.