ADVANCED LEVEL EXAMINATION

MONDAY 21 JULY 2014

(3½ HOURS)

# CORPORATE REPORTING

This paper consists of **THREE** questions (100 marks).

1. Ensure your candidate details are on the front of your answer booklet.

2. Answer each question in black ball point pen only.

3. Answers to each question must begin on a new page and must be clearly numbered. Use both sides of the paper in your answer booklet.

4. The examiner will take account of the way in which material is presented.

**The questions in this paper have been prepared on the assumption that candidates do not have a detailed knowledge of the types of organisations to which they relate. No additional credit will be given to candidates displaying such knowledge.**

**IMPORTANT**

Question papers contain confidential information and must NOT be removed from the examination hall.

**DO NOT TURN OVER UNTIL YOU ARE INSTRUCTED TO BEGIN WORK**

You MUST enter your candidate number in this box

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## QUESTION 1

You work for Hartner as an audit senior. Hartner is a firm of ICAEW Chartered Accountants. You have recently been asked to act as an audit senior on the audit of UHN plc, an AIM-listed company.

UHN manufactures wing parts for the aircraft industry. It has survived the recession and order levels have started to recover. In addition, low interest rates and the ability to keep costs controlled have improved the company's financial performance in recent years.

The audit engagement partner, Petra Chainey, gives you the following briefing:

"We have been very short-staffed on the UHN audit and Greg Jones, the audit senior, has been acting as the audit manager on this assignment. Greg has just gone on study leave and I would like you to take on his role for the remainder of the audit. Before he left, Greg prepared a handover note (**Exhibit 1**) which includes information on UHN's covenants and its draft summary financial statements for the year ended 31 March 2014. The handover note also includes Greg's summary of the key financial reporting issues. These issues are either unresolved or, in Greg's opinion, issues where the directors have exercised judgement in the application of accounting policies and estimates in the preparation of the financial statements for UHN. The planning materiality is £100,000. The audit closure meeting is scheduled for this Friday.

"I would like you to prepare a working paper in which you:

- Set out and explain the implications of the financial reporting issues in Greg's handover note (Exhibit 1). For each issue, recommend the appropriate financial reporting treatment, showing any adjustments that you would need to make to the draft summary financial statements.

- Using your recommendations above, evaluate and explain the overall impact of your adjustments on the gearing ratio and the interest cover ratio at 31 March 2014 in accordance with the bank's loan covenants.

- Explain the key audit risks that we need to address before signing our audit report on the financial statements. I do not need the detailed audit procedures; just concentrate on the key risks.

"I will ask the tax department to review any further deferred tax and current tax adjustments.

"I have also forwarded you an email from the UHN finance director, Melvyn Hansi, requesting Hartner to accept a one-off assurance assignment (**Exhibit 2**). I need to respond quickly to this email as the matter is urgent. I am concerned that if we do not do as UHN requests, they may engage with another assurance firm, not just for this one-off engagement, but also for future audits.

"We may not have the expertise in-house to complete this one-off assignment as the nature of UHN's industry is specialised, but I am sure we can put together a convincing report.

"I would like you to prepare a file note explaining the ethical implications for our firm if we decide to accept this one-off assurance assignment."

### Requirement

Prepare the working paper and the file note requested by the audit engagement partner.

**(40 marks)**

**Exhibit 1 – Handover note prepared by Greg Jones**

**Loan covenants**

UHN is financed by equity and debt. In 2010, UHN was rescued from insolvency by its bank, which provided a £20 million loan, repayable in 2018. The loan contract with the bank stipulates two covenants which are based on the year-end audited financial statements. Failure to meet either covenant could result in the loan facility being withdrawn. The covenants are as follows:

(1) The gearing ratio is to be less than 130%. The ratio is defined as:

$$\frac{\text{Non-current liabilities (excluding provisions and deferred tax liability)}}{\text{Equity (Share capital and reserves)}} \times 100\%$$

(2) The interest cover is to be greater than 3. The ratio is defined as:

$$\frac{\text{Profit before finance costs (including exceptional items)}}{\text{Finance costs}}$$

Covenants are determined at each 31 March year end.

As part of the loan agreement, audited financial statements must be presented to the bank within four months of the accounting year-end.

**Exhibit 1 continued overleaf**

## UHN – Draft summary financial statements for the year ended 31 March 2014

Statement of profit or loss for the year ended 31 March 2014

| | £'000 |
|---|---|
| Revenue | 56,900 |
| Operating costs | (49,893) |
| Exceptional item (**Issue 1**) | 3,540 |
| Operating profit | 10,547 |
| Finance costs | (2,200) |
| Profit before tax | 8,347 |

Statement of financial position at 31 March 2014

| **ASSETS** | **£'000** |
|---|---|
| Non-current assets | |
| Property, plant and equipment (**Issue 2**) | 20,040 |
| Current assets | |
| Inventories (**Issue 3**) | 21,960 |
| Trade receivables | 15,982 |
| Cash and cash equivalents | 128 |
| | 38,070 |
| Total assets | 58,110 |
| **EQUITY AND LIABILITIES** | |
| Equity | |
| Share capital – ordinary £1 shares | 1,000 |
| Share premium | 15,000 |
| Retained earnings - deficit | (500) |
| Total equity | 15,500 |
| Non-current liabilities | |
| Loans | 20,000 |
| Long-term provision – (**Issue 4**) | 8,520 |
| Deferred tax liability | 1,000 |
| Total non-current liabilities | 29,520 |
| Current liabilities | |
| Trade and other payables (**Issue 3**) | 12,350 |
| Short-term provision – (**Issue 4**) | 740 |
| Total current liabilities | 13,090 |
| Total equity and liabilities | 58,110 |

**Financial reporting issues identified by Greg Jones**

Issue 1 – Sale and leaseback of factory

On 31 March 2014, UHN entered into a sale and leaseback agreement for its freehold factory and land in Swindon. The factory and land were originally acquired by UHN on 31 March 2004, at which point the factory had a useful life of 30 years and a zero residual value. The sale proceeds from the sale and leaseback agreement were £7.5 million, which is equal to the fair value of the freehold factory and land. The property was leased back on a 20-year lease from 31 March 2014 at an annual rental of £763,900 to be paid annually in arrears. The directors told me that, as the rentals are at market value, they have treated the lease as an operating lease. The first lease rental will be payable on 31 March 2015 and will be charged to the statement of profit or loss in the year ending 31 March 2015. The profit on the disposal of the factory and land has been included as an exceptional item as follows:

| | **Factory £'000** | **Land £'000** |
|---|---|---|
| Disposal proceeds allocated according to the sale agreement | 6,000 | 1,500 |
| Less: Carrying amount at 31 March 2014 | (2,960) | (1,000) |
| Profit recognised as an 'exceptional item' | 3,040 | 500 |

Although we have vouched this transaction to the lease agreement and other documents (and there is plenty of evidence on the audit file relating to this transaction), as it is such a material amount I thought I would draw it to your attention.

I have calculated the interest rate implicit in the lease to be 8% per annum.

Issue 2 – Service centre in Russia

On 1 April 2013, UHN set up a service centre in Russia at a cost of RUB266 million. The service centre is situated at Moscow airport and operates as a repair depot for flights in and out of Moscow airport. The service centre had an estimated useful life of 6 years at 1 April 2013, with a zero residual value.

In March 2014, new regulations were introduced in Russia which prevented extended stays at Moscow airport for a number of major airlines. Therefore significantly fewer aircraft could be serviced at UHN's Moscow service centre. The UHN finance director recognised this regulatory change as an impairment indicator and carried out an impairment test exercise at 31 March 2014 on the service centre.

As a consequence of this exercise, the service centre was determined to have a value in use of RUB180 million and a fair value less cost to sell of RUB204 million at 31 March 2014.

The finance director therefore calculated an impairment charge of RUB18 million. He translated this at RUB48= £1 to give an impairment charge of £375,000 in operating costs.

I haven't studied this area of financial reporting at college yet, so I thought I should bring it to your attention. I have checked the exchange rates which are as follows:

| | |
|---|---|
| At 1 April 2013 | RUB53 = £1 |
| At 31 March 2014 | RUB48 = £1 |

Issue 3 – Hedge against increase in price of titanium

UHN uses titanium in its production process and holds titanium inventory of around 680,000 kilograms to ensure a constant supply for production. UHN's selling price of its products is linked to the price of titanium. On 1 January 2014, UHN had 680,000 kilograms of titanium at a total cost of £8.2 million in inventory. At that date, UHN signed a futures contract to deliver 680,000 kilograms of titanium at £14 per kilogram on 30 September 2014 to hedge against a possible price fluctuation of titanium. At 31 March 2014, the market price of titanium was £15 per kilogram and the futures price for delivery on 30 September 2014 was £16.60 per kilogram.

The arrangement was clearly designated as hedge accounting for financial reporting purposes in the documentation prepared on 1 January 2014. However, no adjustment has been made in the financial statements to 31 March 2014 to use hedge accounting or to adjust the fair value of the inventory. I was informed that, as UHN had met the interest cover requirement for its bank covenant for the year ended 31 March 2014, the directors want to hold back profit in order to recognise it in the year ending 31 March 2015. The loss on the futures contract of £1.768 million is included in operating costs and in trade and other payables.

Issue 4 – Provision for claim for damages

In 2010, a cargo plane, fitted with wing parts made by UHN, crashed in the Sahara desert. There was no loss of life, but legal claims were made against UHN and other manufacturers as the crash was blamed on faulty wing props. UHN has contested the case. However, as the directors believed that it was probable that there would be a settlement, but were uncertain as to the amount, a provision was made on 31 March 2012 for the most likely outcome of £10 million to be settled in approximately 3 years. The provision was discounted at 8% per annum.

The case was settled in March 2014 and the amount of the final settlement was agreed at £9.1 million. The payment terms have been agreed as 25% payable in April 2014 and 75% payable in April 2015. No adjustments have been made to the financial statements as a result of the settlement because the directors believe that the existing provision should cover the payments they will be required to make.

## Exhibit 2 – Email from finance director of UHN

**To:** Petra.Chainey@Hartner
**From:** M.Hansi@UHN.com
**Date:** 21 July 2014
**Subject:** One-off assurance assignment

UHN and one of its customers, Geocraft Ltd, are jointly tendering for a major contract to build wing parts for a foreign government. Geocraft designs mixed-signal integrated circuits for UHN's products. It is important that UHN has assurance over two aspects of Geocraft's business:

- Financial stability – as delivery schedules are in excess of 9 months, cash flow is crucial; and
- Inventory system – as this affects the basis of the profit sharing formula. Geocraft has invested significant amounts of money in technology and has a very specialised and complex inventory system which communicates directly with its manufacturers.

As part of the agreement with Geocraft, UHN is entitled to appoint external advisers to provide assurance over these two aspects of Geocraft's business and I would like Hartner to accept this one-off assurance assignment. I expect that Hartner will be able to charge a low fee for this work as Geocraft is an existing customer of UHN. I am sure you will be able to use some of your audit work for this assurance assignment.

## QUESTION 2

Snedd Enviroclean plc is engaged in the manufacture and supply of environmentally-friendly home cleaning products. It was set up several years ago by its two founders and has been very successful. Snedd is currently unlisted, but the company's founders, who are the two principal shareholders and directors, plan to list the company on the AIM within three to four years. Snedd's accounting year end is 31 May.

Snedd has built up a substantial cash surplus and the directors decided in 2013 to use this to achieve growth, principally through investments in established businesses. On 1 June 2013, Snedd made its first acquisition, being 75% of the ordinary share capital of Bellte Ltd, a competitor company. On 1 December 2013, Snedd made its second acquisition, being 100% of the ordinary share capital in Terald Inc, an unlisted company in Distanlan, a foreign country.

You are Bill Smyth, the recently-appointed financial controller at Snedd.

You have been supplied with working papers, prepared by an assistant (**Exhibit**), which contain the draft financial statements for Snedd and Bellte for the year ended 31 May 2014, together with Terald's trial balance as at 31 May 2014. The working papers also include notes on outstanding issues prepared by the Snedd finance director before he left on a trip abroad negotiating the acquisition of another subsidiary.

The finance director has left you the following instructions:

- Set out and explain the correct financial reporting treatment, showing appropriate adjustments for each of the outstanding issues I have identified; and

- Prepare Snedd's consolidated statement of profit or loss and other comprehensive income for the year ended 31 May 2014 and a consolidated statement of financial position at that date. Please take into account any adjustments for the outstanding issues and set out your workings showing how you arrived at your consolidated figures so that I can understand them.

## Requirement

Respond to the finance director's instructions.

**(30 marks)**

**Exhibit – Working papers**

**Draft statements of profit or loss and other comprehensive income for the year ended 31 May 2014**

| | Snedd | Bellte |
|---|---|---|
| | £'000 | £'000 |
| Revenue | 8,511 | 2,186 |
| Cost of sales | (5,598) | (1,544) |
| Gross profit | 2,913 | 642 |
| Operating expenses and finance costs | (1,541) | (502) |
| Profit before tax | 1,372 | 140 |
| Tax | (354) | (28) |
| Profit for the year | 1,018 | 112 |
| Other comprehensive income | 600 | – |
| Total comprehensive income for the year | 1,618 | 112 |

**Draft statements of financial position at 31 May 2014**

| | Snedd | Bellte |
|---|---|---|
| | £'000 | £'000 |
| **ASSETS** | | |
| **Non-current assets** | | |
| Property, plant and equipment | 3,512 | 1,463 |
| Financial assets (**Notes 1 and 2**) | 900 | – |
| | 4,412 | 1,463 |
| **Current assets** | 2,365 | 586 |
| **Total assets** | **6,777** | **2,049** |
| **EQUITY AND LIABILITIES** | | |
| **Equity** | | |
| Share capital | 300 | 30 |
| Retained earnings | 4,075 | 1,014 |
| Revaluation surplus | 600 | – |
| | 4,975 | 1,044 |
| **Non-current liabilities** - deferred tax brought forward on 1 June 2013 (**Note 3**) | 92 | 46 |
| **Current liabilities** (**Note 4**) | 1,710 | 959 |
| **Total equity and liabilities** | **6,777** | **2,049** |

## Notes on outstanding issues

### (1) Investment in Bellte Ltd

On 1 June 2013, Snedd acquired 75% of the ordinary share capital of Bellte for a cash payment of £800,000. Snedd decided to value the non-controlling interest at its proportionate share of net asset value. The fair value of the net assets acquired approximated to their carrying amount at 1 June 2013 of £932,000, except for any adjustments arising from the following information:

- A contingent liability in respect of a product liability, which had not been recognised by Bellte (but which was referred to in a note to Bellte's financial statements for the year ended 31 May 2013) was estimated to have a provisional fair value of £20,000 at 1 June 2013. This liability was subsequently settled, on 1 October 2013, for £40,000. An expense of this amount was recognised in operating expenses in Bellte's individual financial statements on that date.

- Bellte purchased a bespoke soap-making machine for £100,000 on 1 June 2008, when the estimated useful life of the machine was 10 years, with a residual value of zero. The provisional fair value of the machine, which is a specialised item of plant, was estimated on 1 June 2013 to be £60,000 with a remaining useful life of five years. A specialist valuation firm was requested to produce a fair value for the plant as at 1 June 2013. Due to various delays, the valuation work was not completed until 30 June 2014. The valuer concluded that the fair value of the plant at 1 June 2013 had been £65,000. Snedd's policy is to recognise plant at depreciated cost, and to recognise all depreciation in cost of sales.

### (2) Investment in Terald Inc

On 1 December 2013, Snedd acquired, for £100,000, 100% of the ordinary share capital of Terald Inc, a company operating in the country of Distanlan. Terald's accountant has sent the following trial balance at 31 May 2014:

| | D$'000 | D$'000 |
|---|---:|---:|
| Revenue | - | 150 |
| Cost of sales | 112 | - |
| Operating expenses | 15 | - |
| Income tax | 3 | - |
| Share capital | - | 10 |
| Retained earnings at 1 June 2013 | - | 140 |
| Non-current assets | 160 | - |
| Current liabilities | - | 40 |
| Current assets | 50 | - |
| | 340 | 340 |

The functional currency of Terald is the Distanlan dollar (D$). The carrying amount of the net assets of Terald at the acquisition date was D$160,000, which approximated to fair value.

Terald uses Distanlan GAAP in preparing its financial statements. Distanlan GAAP is very similar to IFRS. However, it differs in respect of the measurement of financial assets. Terald's non-current assets at 31 May 2014 include D$10,000, which is the cost of an investment in a derivative financial asset acquired on 30 November 2013. Distanlan GAAP requires measurement of this type of financial asset, subsequent to acquisition, at cost. The fair value of the financial asset at 31 May 2014 was D$15,000.

Relevant exchange rates are as follows:

| | |
|---|---|
| At 1 December 2013 | £1 = D$2.0 |
| At 31 May 2014 | £1 = D$2.2 |
| Average for period 1 December 2013 to 31 May 2014 | £1 = D$2.1 |

**(3) Deferred tax**

No adjustments have been made for deferred tax in the draft financial statements for the year ended 31 May 2014. At that date, Snedd had taxable temporary differences in respect of accelerated capital allowances of £300,000. Also, at 31 May 2014, Bellte had taxable temporary differences in respect of accelerated capital allowances of £180,000. During the year ended 31 May 2014, Snedd recognised a revaluation surplus of £600,000 in respect of its head office building. As permitted by IFRS, Snedd's directors have decided not to make an annual transfer from the revaluation surplus in respect of this revaluation. The revaluation surplus will be taxed when the building is sold in the future. Snedd estimates that the appropriate tax rate for recognition of deferred tax liabilities at 31 May 2014 is 22%.

It may be assumed that no deferred tax adjustments are required in respect of any other items for Snedd, Bellte or Terald.

**(4) Payment of a supplier in ordinary shares**

With effect from 1 April 2014, Snedd's directors decided to adopt a policy of paying certain key suppliers in Snedd’s shares in order to ensure that the suppliers have a stake in the company’s long-term success.

On 1 April 2014 Snedd issued 270 of its £1 ordinary shares to Whelkin Ltd, a supplier of soap flakes, in full settlement of a trade payable amount of £6,000 which had been outstanding since 28 February 2014. No accounting entries have been made to recognise this transaction, and the payable of £6,000 is still included in Snedd's trade payables in the draft financial statements at 31 May 2014. An external consultant has estimated that, at 1 April 2014, one ordinary share in Snedd had a fair value of £26.50.

## QUESTION 3

You are Steph Carter, an audit senior with J&K LLP, a firm of ICAEW Chartered Accountants which audits Erskin Technology plc (ETP).

You receive the following briefing from Lauren Haynes, the audit manager responsible for the ETP audit:

Welcome to the ETP audit team. This week you are scheduled to plan the ETP audit for the year ending 30 September 2014. It's important we get the planning completed so we can focus on updating our controls work on revenue at our interim audit visit next month.

I'm aware that you have not worked on ETP before, so I have provided some background information from last year's audit file (**Exhibit 1**). I've also sent you a working paper setting out the results of preliminary analytical procedures performed last week by our audit assistant, Joshi Khan (**Exhibit 2**). Planning materiality has been set at £850,000.

Yesterday I received an email from the ETP finance director, Mari Johnson (**Exhibit 3**). She has asked us for some advice and I'll need your help with my response.

You and I are scheduled to meet up later today. I would like you to do the following in preparation for that meeting.

- In respect of the audit for the year ending 30 September 2014:
    - Prepare review notes on Joshi's work (Exhibit 2), which explain the weaknesses and limitations in the procedures he has performed. Perform additional analysis where you think this is required. Set out clearly the additional audit procedures you would like him to perform and the queries you would like him to resolve when he returns to the client later this week to complete the preliminary analytical procedures.
    - Identify and explain the financial reporting issues and related audit risks you have identified from the information provided, and outline, for each, the implications for our audit approach. Detailed audit procedures are not required at this stage.

- Draft a response to Mari's email (Exhibit 3) that explains how a review of the interim financial statements for the period to 31 March 2015 would differ from a statutory audit and set out the benefits of such a review for ETP.

**Requirement**

Respond to Lauren Haynes' requests.

(**30 marks**)

**Exhibit 1 – Background information on ETP from J&K's audit working papers for the year ended 30 September 2013**

ETP is a listed company which supplies data storage devices and secure archiving systems.

ETP has three main revenue streams:

Hardware

Hardware revenues are generated by sales of data storage devices which are manufactured for ETP by a third party manufacturer in Asia. These devices are sold under the "Stor-It" brand name which was purchased by ETP for £5 million on 1 October 2011, at which date the brand had a remaining expected useful life of 10 years. At the same date, ETP invested £1.6 million in patents for a new range of "Stor-It" devices. These costs were capitalised as non-current assets. The new "Stor-It" devices went on sale on 1 April 2013 and were expected to have a market life of around four years from that date. Revenue from sales of hardware is recognised when the hardware is delivered.

Systems

Systems revenue is generated from the sale of complete archiving and data storage systems comprising hardware, software and related services. System projects typically take 6 to 12 months to deliver and revenue is recognised on confirmation by the customer that the project is complete.

Services

Service revenue is generated by sales of training and consultancy. This is a very competitive market segment. It has been historically important for ETP and remains a core part of the company's business plan. Service revenue is recognised as the service is performed.

**Exhibit 2 – ETP audit for the year ending 30 September 2014 – Preliminary analytical procedures working paper prepared by Joshi Khan**

This working paper considers the following key performance indicators identified by ETP:

- revenue growth;
- gross margin; and
- receivables – days sales outstanding (DSO).

This working paper compares actual performance reported in the company's interim financial statements for the six month period to 31 March 2014, with:

- the budget; and
- the average performance of a comparator group of companies identified during the audit for the year ended 30 September 2013 as being most closely aligned to ETP in terms of activity.

Comparisons are also made if applicable to performance in a prior period. Where actual results appear out of line with budget or the comparative data, explanations have been sought from Julie Barwell, Financial Controller, and notes from these discussions are documented below.

**1. Revenue growth**

Total revenue for the 6 months ended 31 March 2014 was as follows:

| | **£ million** |
|---|---|
| Hardware | 25.4 |
| Systems | 100.3 |
| Services | 17.9 |
| Total | 143.6 |

<u>Revenue growth for the six months ended 31 March 2014</u>

| | **Hardware** | **Systems** | **Services** |
|---|---|---|---|
| | % | % | % |
| **ETP** | | | |
| Actual growth for six months to 31 March 2014 | –15.0 | 25.0 | 12.0 |
| Budgeted growth for six months to 31 March 2014 | 5.0 | 10.0 | 1.0 |
| **Comparator group of companies** | | | |
| Average growth for six months to 31 March 2014 | 5.0 | 6.0 | –2.5 |
| **Notes** | (i) | (ii) | (iii) |

(i) Hardware sales of Stor-It devices were disappointing in the first half of the financial year following the introduction of cheaper and more advanced products by ETP's competitors. From discussions with Julie, sales have continued to decline in the third quarter and storage space for hardware inventory is becoming a problem.

(ii) Systems sales were very strong in the first half of the financial year. ETP reviewed its revenue recognition policy for systems sales in October 2013 and is now invoicing and recognising revenue and associated costs as each project progresses. This resulted in the recognition of additional revenue totalling £30 million on part-completed projects in the six months ended 31 March 2014. The recognition of revenue on part-completed projects was not foreseen at the time the budget was prepared and hence actual performance was significantly better than budget.

(iii) Services revenues for training and consultancy were strong in the first half of the year despite an overall decline in this sector of the market. Julie attributes this strong performance to the introduction of an “all in” advice package. Customers pay an up-front annual fee and are then able to access telephone and online advice as and when they need it. They are also entitled to discounts of up to 20% for the company’s training programmes. This new service has proved very popular and revenues of £5 million were received in the six months ended 31 March 2014. The up-front fees are recognised as revenue on receipt as they are not refundable.

## 2. Gross margin

| | Hardware<br>% | Systems<br>% | Services<br>% |
|---|---|---|---|
| **ETP** | | | |
| Actual margin for six months to 31 March 2014 | 31.4 | 46.0 | 63.9 |
| Budgeted margin for six months to 31 March 2014 | 35.0 | 45.0 | 50.0 |
| Actual margin for six months to 30 September 2013 | 35.0 | 44.8 | 50.1 |
| | | | |
| **Comparator group of companies** | | | |
| Average margin for 6 months to 31 March 2014 | 42.0 | 44.7 | 50.3 |
| | | | |
| **Notes** | | (iv) | (v) |

(iv) Gross margin on systems sales for the six months to 31 March 2014 is higher than budgeted as the new projects that started during the period have generated margins higher than those experienced on the older projects which have now been completed. These higher margins were, however, offset by a loss recognised on a new project for a government department. At 31 March 2014, this project was approximately 40% complete and revenue of £3.6 million was recognised in the six months to 31 March 2014. Costs incurred on this project in the period amounted to £4.6 million giving rise to a £1 million loss.

(v) The gross margin on services revenues is higher than expected due to the recognition of £800,000 of training revenue relating to training courses held in September 2013, but only invoiced in October 2013. Related costs were recorded in September 2013.

**Exhibit 2 continued overleaf**

### 3. Receivables – Days sales outstanding (DSO)

| | Days |
|---|---|
| **ETP** | |
| Actual DSO as at 31 March 2014 | 78.4 |
| Budgeted DSO as at 31 March 2014 | 66.0 |
| Actual DSO as at 30 September 2013 | 66.2 |
| | |
| **Comparator group of companies** | |
| Average DSO for comparator group as at 31 March 2014 | 65.0 |
| | |
| **Note** | (vi) |

(vi) Overall DSO increased to above the industry average and prior year, as customers were generally slow to pay invoices for stage payments on systems sales. In addition, a number of distributors for the “Stor-It” hardware devices struggled to make timely payments as their sales of the product fell and inventory levels increased.

**Exhibit 3 – Email from ETP finance director, Mari Johnson**

**To**: LaurenHaynes@J&K.com
**From:** MariJohnson@ETP.com
**Date:** 21 July 2014
**Subject:** Interim audit

Hi Lauren

I was surprised when I joined ETP that we did not ask J&K to complete review procedures on our interim results. I'd like ETP to do this in future, but I am having some difficulty persuading the board that we should incur the additional cost. Please therefore provide me with a brief summary of the key benefits that an interim review and report by J&K would provide.

ETP's budget for the year ending 30 September 2015 forecasts revenue for the year to be £350 million. The revenue growth is mostly attributable to a major systems sales contract with an overseas company which will commence in April 2015. ETP will prepare interim results to 31 March 2015 and I think it would be relevant information for our shareholders to recognise revenue evenly over the year and therefore reflect half of this new contract revenue in the interim financial statements for the six months to 31 March 2015. A review and a report by J&K would add credibility to the interim financial statements for our shareholders.