IFRS SYSTEM

WARNING

USEFUL INFORMATION INSIDE

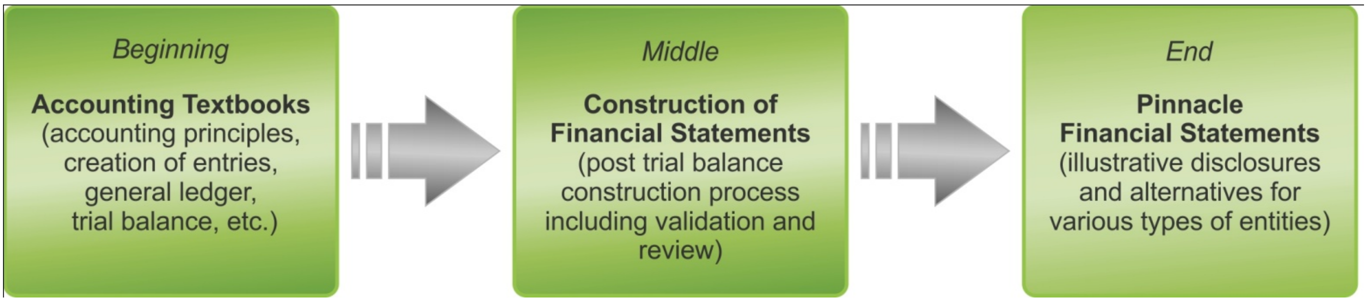
Construction of Financial Statements

Contents

Introduction

Before you read this booklet, if you have internet access, check you have the latest version by following this link: http://files.ifrssystem.com/PFS/ConstructionOfFinancialStatements.pdf

Whilst our popular publication IFRS SYSTEM Pinnacle Financial Statements (http://ifrssystem.com/publications) provides 30 different illustrative examples and is updated every six months (June and December editions), it only demonstrates what the financial statements should look like (together with appendices identifying the alternative disclosure options). Thus, there is a piece missing - how to construct financial statements. This booklet tells you how, using our financial reporting experience, and drawing upon every tip, trick and process we have ever employed. It also poses what questions should be asked along the way.



Even if you use the IFRS SYSTEM Financial Reporting Software (http://ifrssystem.com/software), this is merely an accountant's tool just like a nail gun is to a builder, and users should read this booklet as much of it is still relevant.

The aim was to keep the reading of this booklet to a small investment of time. We have achieved this and we have tried to keep it as light as possible. We wouldn't call it lunchtime reading (who has a lunch break anyway?) but have a meeting with yourself and digest it. It will be worth it.

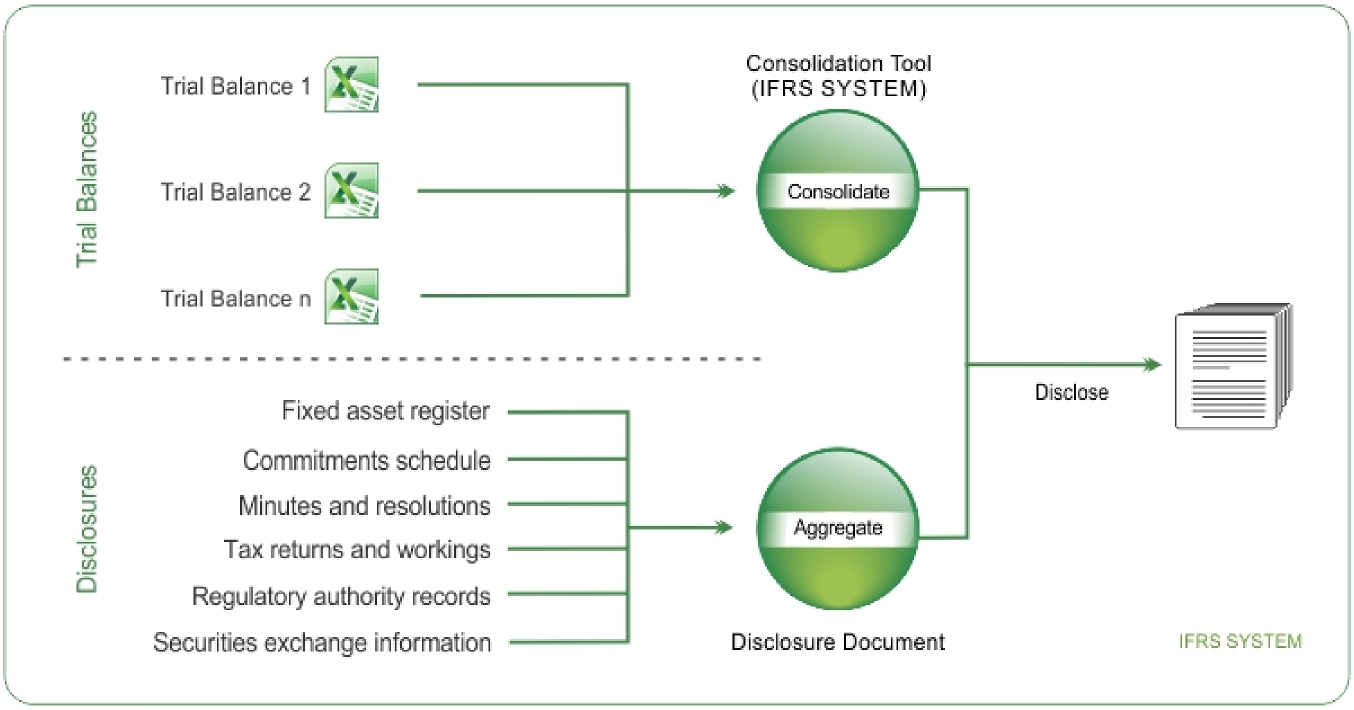
Like our other booklets, this booklet is complimentary and as it is a PDF, it can be freely distributed and copied, excluding products for public sale. It is also an evolutionary booklet, as it will be updated periodically as we receive feedback and generate additional ideas. If you would like to contribute to the evolution of this booklet, please email support@ifrssystem.com.

Finally, we would like to thank Manoj Santiago who dared to seek an answer to the question 'How were these financial statements constructed?'. We had never considered the scientific approach we take for every set of financial statements we prepare could be a booklet, until then.

Timing

Financial statements often take a back seat to the audit; and are prepared after the audit field work is complete. However they are a critical piece of audit information, as they aggregate data and give auditors the chance to see the overall financial performance and position of the entity, so we consider that the 1st draft of the financial statements should be compiled before the audit commences.

Source documentation
Source documentation includes Trial Balances and Disclosures (captured in our case by a Disclosure Document - refer below). Retaining the integrity of the source documentation is vital, so the auditors can be assured that it is reliable. For instance, exporting a Trial Balance from a General Ledger and subsequently editing the numbers in a spreadsheet breaks down the audit trail. Once data becomes unreliable, the auditor loses confidence and will have to revert to the original source. In the construction of financial statements, you need to retain a clean and non-manipulated link back to source documentation. Also, you need to gather all of this source documentation before you commence work, otherwise you have holes from the beginning.



Trial Balance ('TB')
Extract an electronic copy of Trial Balance(s) from the General Ledger. The suggested format is 4 columns: account number, account name, current period and prior period.

Consolidation spreadsheet (if applicable)
The IFRS SYSTEM Financial Reporting Software (http://ifrssystem.com/software) deals with consolidations and as part of its outputs has audit trails by entity both 'down the page by entity/division with detailed General Ledger account information' or 'across the page by entity/division with summarised account allocation information'. If you just want consolidation workings, then the bronze licence of the IFRS SYSTEM Financial Reporting Software will suffice.

Alternatively, a consolidation spreadsheet with details of each entity Trial Balance and details of adjustments will be required to be manually prepared.

If you are a single entity with one Trial Balance, you need to aggregate the numbers for the classifications and sub-classifications within the financial report, using the abovementioned software or a spreadsheet.

Disclosure Document
IFRS SYSTEM have developed a Disclosure Document to capture Disclosures, as this file is a seamless way of gathering a lot of information in one place (such as key management personnel details, income tax, plant and equipment reconciliations, commitments, etc). Without it, if you are not both the number cruncher and the preparer of the report, you will need to ask a lot of questions via phone and email. The alternative is to 'fill in the blanks' directly on the rolled Annual Report.

Company Historical Extract (if the entity is a company)
Based on the assumption that the Company public record has been updated correctly, order the Company Historical Extract from the Regulator. This will provide the registration number, type of company, information on directors (names, appointment dates and resignation dates), registered office address, principal place of business address, the shareholders (useful when foreign controlled) and ultimate controlling entity (once again, useful when foreign controlled).

Source documentation (continued)

Fixed Asset Register ('FAR')
The Fixed Asset Register needs to be checked to ensure the cost and accumulated depreciation tie back to the Trial Balances values. Then scan for any assets that should be written off, especially those with a zero written down value.

Commitments Schedule
This is a spreadsheet detailing the commitments in the coming financial periods. This is primarily for operating leases, but also finance leases and capital commitments. This information should be summarised by class into bandings ('Within one year', 'One to five years' and 'More than five years'), except for capital commitments which is now exempt from bandings.

Prior year's tax return(s) and workings
Prior year's tax return(s) and workings are required to perform a 'true-up', which confirms the opening tax balances and any required adjustment.

Company minutes and resolutions during the period
Read through the company minutes and resolutions during the period. These should assist in confirming any significant changes and dividends paid.

Securities Exchange announcements (listed public entities only)
Read through the company Securities Exchange announcements during the period. These should assist in confirming any significant changes and also confirm that the financial report is consistent with these announcements.

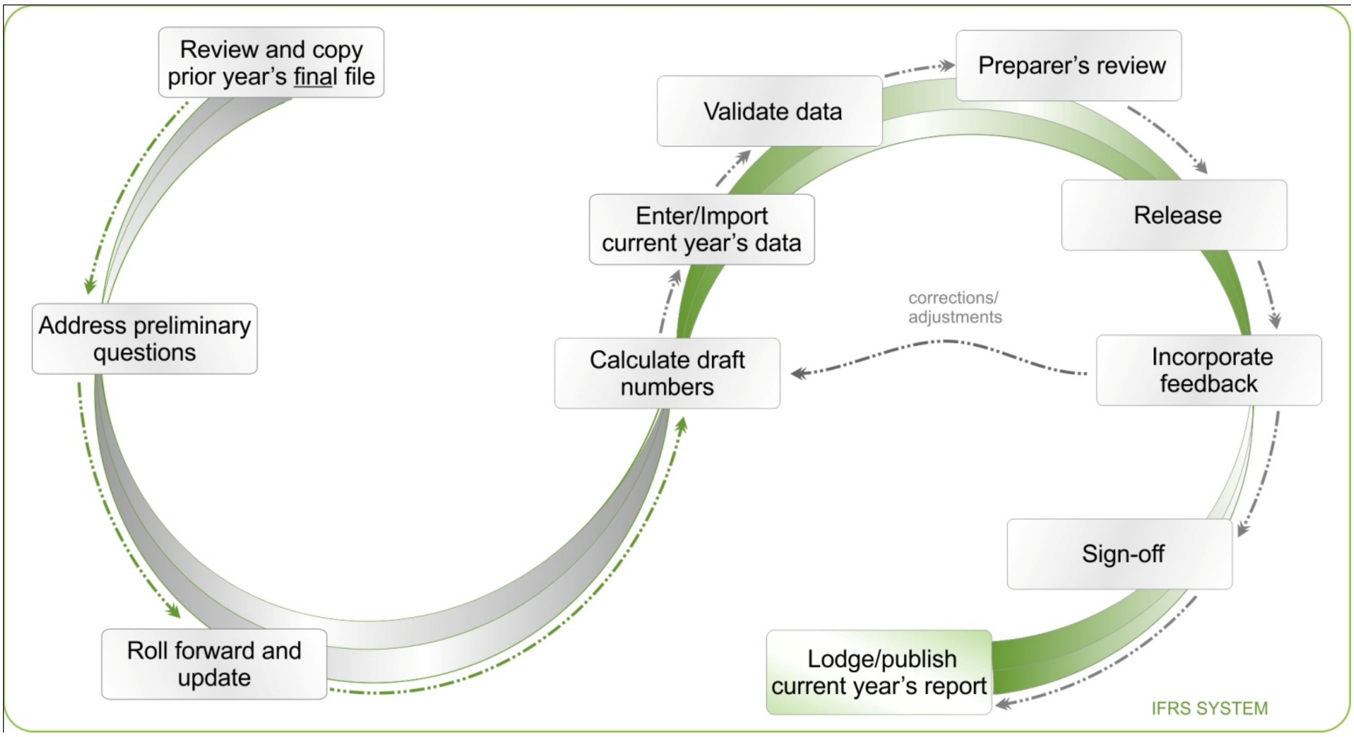
Shareholder Information (listed public entities only)
The Share Register can provide a report detailing the information such as 'Distribution of equitable securities' (by banding and also 'Holding less than a marketable parcel') and 'Twenty largest quoted equity security holders'.

Substantial holder forms that have been lodged (listed public entities only)
On the Securities Exchange announcements there will be substantial holder forms detailing the latest holding of any substantial holder.

Preliminary questions
The biggest danger in rolling forward a report is to simply follow what was done for the prior year. You should answer some preliminary questions:
- Entity: is the correct entity type identified in the financial report?
- Purpose: is there an opportunity to change to Reduced Disclosure?
- Have there been any change in circumstances or have there been any significant changes?
- What is the impact from changes in the Legislation, Accounting Standards or other source literature?
- Is there still compliance with old literature (such as number of employees or economic dependency)?
- Is the functional currency and presentation currency correct? For instance, they do not have to be the same and nor do they have to be the local currency. If 99% of your sales are in US dollars, it is highly likely that your currency is that.
- Are the headers used appropriate?
- Is the rounding of amounts at the correct level?
- Is this a for-profit or not-for-profit entity and is the correct terminology being used? For instance, if not-for-profit the terms surplus or deficit (as apposed to profit or loss), retained surpluses or accumulated deficits (as apposed to retained profits and accumulated losses) and members (as apposed to owners) should be used.
- Is the order of the notes logical?
- Finally, are all of the disclosures 'material' (and constantly think about 'materiality' during the process)? Are the disclosures Essential, Fundamental, there for Legacy reasons, Important, Critical, Key and Significant? If not, consider removing.

The construction of financial statements process

After you have gathered all of the source documentation and answered the preliminary questions, you are then in the position to commence the construction of financial statements process.



Following is the step-by-step scientific process:

1) Retrieve and copy the prior year's final version of the file.
2) Based on the preliminary questions, if you are changing the Purpose to say a Reduced Disclosure, do this now. You will need to update significant accounting policies, directors' declaration and remove or modify the required disclosures.
3) Based on the preliminary questions, remove any compliance with old literature and any other issues you have discovered in the preliminary review (such as rounding, terminology and order of the notes).
4) Roll forward the numbers, headers and general disclosure from current to comparatives.
5) Update the template so it complies with new literature, including the significant accounting policy for new accounting standards adopted.
6) Calculate the 1st draft of the statement of comprehensive income and statement of financial position (excluding tax).
7) Calculate the 1st draft of the tax disclosures and incorporate these numbers into the statement of comprehensive income and statement of financial position.
8) Calculate the 1st draft of business combinations (if applicable).
9) Calculate the 1st draft of the statement of cash flows and related reconciliation note.
10) Calculate the 1st draft of the financial instruments (if applicable).
11) Calculate the 1st draft of the deed of cross guarantee (if applicable).
12) Enter the current year disclosures, including Trial Balance and Disclosure information.
13) Disclose any significant changes.
14) Check the disclosures back to the source information, to ensure that they agree.
15) Perform an adds-check, cross-reference check and overall sense-check.
16) Self-review the financial statements and correct any errors or omissions found based on the guidance below.
17) Release the financial statements for review.

The above steps will get you to the 1st draft. As disclosures change based on new information or reviewer feedback, steps 6 onwards are likely to be repeated at each subsequent draft.

The aim should be to produce no more than 4 drafts of the financial statements: preliminary (including queries), pre-audit, post audit (after audit adjustments, auditor review comments processed and tax finalised) and final (final draft for directors and audit partner approval). The secondary aim is to stick to the Regulatory lodgement deadlines. If you do these two things, the timing will run smoothly and the process should stay within the budget.

The following few pages go through the various sections in the financial statements and covers items and questions whilst both constructing and reviewing financial statements.

Directors' report

Directors
Use the Company Historical Extract (source) to identify the current directors, appointments and resignations since the start of the financial period. Regardless of any changes, check the spelling of names.

Principal activities
Does the statement on principal activities correctly reflect what the entity does? Have there been any discontinued activities that should be disclosed?

Review of operations (if applicable)
Never roll comments on the financial results and position. You could have mentioned the growth in profit when this year you made a loss. Review of operations should always be completely rewritten based on the review of the current period.

Significant changes in the state of affairs
As a starting point, refer to the prior year's Annual Report for 'matters subsequent to the end of the financial year' as typically these events should be slightly reworded (to be post tense) and included here.

Include any significant changes that occurred during the financial period. For instance, the acquisition of a business combination, a newly discontinued activity, the purchase of a core asset, the sale of a core asset, change in financing arrangements, breach of financing covenants, etc would be considered significant.

Matters subsequent to the end of the financial year
You should simply copy the wording from the 'Events after the reporting period' note. Refer to this note later in this booklet for additional comments.

Likely developments and expected results of operations
More often than not, quote a standard paragraph that claims that comments would be likely to result in unreasonable prejudice.

Environmental regulation
Is the statement something like 'The company is not subject to any significant environmental regulation under the relevant laws.'? If so, is this a believable statement for its industry? If in professional services or retail, then this is likely to be correct, but if it is a manufacturer, repairer or in hazardous waste then check for regulations and licences - operations personnel are likely to know more about this than finance personnel.

Information on directors (public entities only)
Information on directors is required to be disclosed by public entities only (limited by guarantee, unlisted public and listed public).

Is the directors' name, title and qualifications listed?
Is the experience and expertise up-to-date and relevant? (There is no need to list every award ever won)
Are the special responsibilities (chairperson or member of a committee) listed? Do these align with the meetings of directors?

Only unlisted public entities and listed public entities need to disclose other current directorships and former directorships in the last 3 years. You only need to quote listed public directorships (even if it is an unlisted public entity disclosing this information).

Only listed public entities need to disclose interests in shares, options and rights.

Company secretary (unlisted public entities and listed public entities only)
Company secretary (or secretaries if more than one) is required to be disclosed by unlisted public and listed public entities only.

Is the information up-to-date and relevant?

Meetings of directors (public entities only)
Meeting of directors is required to be disclosed by public entities only (limited by guarantee, unlisted public and listed public).

Are the correct committees listed?
Have the attendances and number of meetings been verified?
Have the number of meetings been adjusted for those directors who were not appointed for the whole period?

Directors' report (continued)

Remuneration report (listed public entities only)
The remuneration report is required to be disclosed by listed public entities only.

Principles used to determine the nature and amount of remuneration:
Are the principles listed relevant and consistent with the rest of the remuneration report? For instance, does it state 'there are no long term incentives' yet there are options issued to key management personnel?
What is the executive reward framework?
What is the role of the Nomination and Remuneration Committee (or equivalent)?
Was there a link between entity performance and remuneration?
Was there use of remuneration consultants?
What was the voting and comments made on the remuneration report at the last AGM?

Details of remuneration:
Are the key management personnel (other than the directors) identified?
Are the remuneration tables for the current and prior year's sub-classifications consistent with the key management personnel note (refer below)?
Do the percentages (fixed remuneration, at risk - STI and at risk - LTI) make sense back to the amounts?

Service agreements:
Ensure the service agreements identify the name, title, agreement commencement, term of agreement (perhaps 'ongoing') and details (including base remuneration, scope and circumstance of bonus (discretionary, and by whom, or non-discretionary?), termination notice, non-solicitation clause, non-compete clause, etc).

Ensure any service agreements with resigned directors and executives are removed, as they are no longer an ongoing obligation.

Share-based compensation:
Were there any issues or shares, options or rights to key management personnel as part of remuneration that need disclosing?

Additional information:
When there is a link between entity performance and remuneration, ensure earnings for the last five years and total shareholders return, along with any other relevant information, is disclosed.

Indemnity and insurance of officers
Was the insurance policy paid by the entity or a related party?
Does the contract of insurance prohibit disclosure of the nature of liability and the amount of the premium?

Financial report
The statement of comprehensive income and statement of financial position within the financial report have several possible classifications and sub-classifications. The IFRS SYSTEM Chart of Accounts is comprehensive and assists in identifying these. Link:
http://files.ifrssystem.com/userguide/masterchartofaccounts.html

In addition, each entity type has different reporting requirements.

General information
Use the Company Historical Extract (source) to confirm the type of company.

Use the Company Historical Extract (source) to confirm the current registered office address and principal place of business address.

Check the company constitution to confirm that the directors have the power to amend and reissue the financial report.

Statement of comprehensive income
Expenses can be disclosed either by 'nature' (raw materials and consumables used, depreciation and amortisation, employee benefits, etc) or 'function' (cost of sales, distribution, marketing, administration, etc). There is an increasing trend to employ a 'hybrid' between these two, which is technically not allowed (and also poses classification issues such as William the machine operators wages - cost of sales or employee benefits?), so if you have employed 'hybrid', consider reclassifying to 'nature'.

Do the expense classifications make sense based on your knowledge of the business? Do the fluctuations coincide with your expectations? For instance, you know money was lost on a major contract so is this reflected in employee benefits or cost of sales as a percentage of total revenue? Where are those legal fees for the major court case classified?

Are you confident that expenses are 'paired' and 'classified' on a consistent basis between the two financial periods (current and comparative)? If not, are the different allocations identified? Is there a clear audit trail?

Other expenses should be less than 10% of total expenses.

If expenses are disclosed by function in the statement of comprehensive income, then depreciation, amortisation, impairment and employee benefits expenses must be disclosed in the expenses note.

Statement of financial position
Once again, are you confident that assets, liabilities and equity are 'paired' and 'classified' on a consistent basis between the two financial periods (current and comparative)? If not, are the different allocations identified? Is there a clear audit trail?

Are there any assets that should be classified as current assets under either 'Non-current assets classified as held for sale' or 'Assets of disposal groups classified as held for sale'? Likewise, are there any related liabilities that should be classified as current liabilities under 'Liabilities directly associated with assets classified as held for sale'?

Are all assets debits and liabilities credits? For instance, if 'income tax' is a debit balance, move it up to assets as 'income tax refund due'.

Do the fluctuations make sense? For instance, is there an unexpected large increase in inventory? Perhaps an entry has been double booked? Any classification with a significant change should be reviewed. As a good rule of thumb, any classification with greater than 20% increase or decrease should be rationalised as to why the change.

If a consolidation, do the net assets of the parent exceed those of the consolidation? If so, consider the impairment of intercompany receivables or investment in subsidiaries.

Confirm that 'Net assets' matches 'Total equity'.

Financial report (continued)

Statement of changes in equity
Confirm the headers and closing balances in the 'Statement of changes in equity' match the 'Statement of financial position'.

The following should be separately disclosed:
- Restatement of prior period opening balances (if any)
- Profit/loss after income tax
- Other comprehensive income
- Total comprehensive income
- Contributions of equity (if any)
- Share-based payments (if any)
- Dividends (if any)

Statement of cash flows
To prepare the statement of cash flows and related reconciliation, you need a completed:
- Statement of comprehensive income and supporting notes
- Statement of financial position and supporting notes, including reconciliations (such as for property, plant and equipment)
- Business combinations note
- Non-cash investing and financing activities note

Plus you need the following additional information (as requested in the Disclosure Document):
- GST/VAT on sales for the year (if not all GST/VAT applicable)
- Net income taxes refunded/paid (so you can validate the income tax movements)
- Proceeds from sale of property, plant and equipment (so you can validate disposals plus profit less loss)
- Proceeds from borrowings (so you can gross-up borrowings received and repaid)
- Non-cash interest revenue accrued during the year (so you can correctly reduce interest received to cash basis)
- Non-cash interest expense accrued during the year (so you can correctly reduce interest paid to cash basis)

After completing the statement of cash flows, considering the following:

Have the ‘Receipts from customers’ and ‘Payments to suppliers and employees’ been gross-up for GST/VAT?

Does the net operating inflow or outflow make sense to the profit or loss (the cash flow reconciliation note helps here)?

Does the net operating inflow or outflow match the cash flow reconciliation note?

Does the ‘Interest and other finance costs paid’ exclude any non-cash expenses such as intercompany interest or accrued interest?

Does the ‘Income tax paid’ match the movements in the income tax balances?

Are the investing activities correct? Has the purchase of plant and equipment (check the PPE reconciliation additions, less any non-cash items such as additions via a finance lease) or sale of plant and equipment (PPE reconciliation disposals plus profit on sale less loss on sale) been correctly accounted for?

Are the financing activities correct? Were there any proceeds from issue of shares? Have the borrowings been ‘grossed-up’ for borrowings received and repaid, rather a net figure? Was there a dividend paid (check the dividends note, less any dividends issued as shares as part of a dividend reinvestment plan)?

Are there any material opening foreign currency cash balances that need to be reconverted to the current year rate as ‘Effects of exchange rate changes on cash’?

Confirm that the closing cash balances matches the cash balances on the face of the statement of financial position (net of any bank overdraft).

Financial report (continued)

Significant accounting policies
Are the significant accounting policies both correct and relevant? There is little point including an 'associates' accounting policy if you do not have any. These policies should be reviewed and culled where possible.

New, revised or amending Accounting Standards and Interpretations adopted:
Only list the relevant Accounting Standards and Interpretations.

Going concern:
The trigger points of a 'going concern' are:
- 'current liabilities' exceeding 'current assets' (net current asset deficiency)
- 'total liabilities' exceeding 'total assets' (net asset deficiency)
- cash flow forecasts for future periods
- to a lesser extent a current period loss, especially weighed up next to cash and other current assets

Consider these and whether disclosure of a 'going concern' is required.

If there is a 'going concern', consider that the following is disclosed:
- a statement of facts as to why there is a going concern (for example, 'a net current asset deficiency of $1,530,132')
- if there are any separately identifiable liabilities that are unlikely to be called (such as a related party loan)
- if there is a letter of support (such as from a controlling entity)
- what the management's intentions are in the future (raising capital, negotiating new financing arrangements, selling assets, discontinuing certain operations, etc) or that sufficient future operating cash flows will meet the business objectives and financial obligations
- that 'the financial statements have been prepared on a going concern basis'

For a range of going concern examples, go to the following website link:
http://files.ifrssystem.com/PFS/GoingConcern.pdf

Accounting period:
Where the current or prior financial periods are not full year's, include an accounting policy.

Basis of preparation:
Ensure that the basis of preparation correctly states what the financial statements comply with (Accounting Standards and Legislation).

Historical cost convention:
Consider the relevance of the wording and if no assets are held at fair value, state 'The financial statements have been prepared under the historical cost convention.'

Trade and other receivables:
Check the number of days when generally due for settlement and number of days overdue when impairment is considered.

Inventories:
Confirm whether 'first in first out', 'weighted average' or 'specific identification' is employed. Note that 'last in first out' is not permitted.

Financial report (continued)

Sub-classes:
Ensure that the sub-classes listed in the following accounting policies match those of the actual note, to ensure relevance:
- Revenue recognition
- Inventories
- Property, plant and equipment
- Intangibles

Trade and other payables:
Check the number of days when usually paid.

New Accounting Standards and Interpretations not yet mandatory or early adopted:
Only list the relevant Accounting Standards and Interpretations. When management has not yet assessed their impact, consider a general statement instead of listing specific standards.

Critical accounting judgements, estimates and assumptions
Are the critical accounting judgements, estimates and assumptions relevant? There is little point include 'Provision for impairment of inventories' if you do not have inventory. On the other hand if 'warranty provision' is significant it should be disclosed.

Restatement of comparatives
There can be a restatement of comparatives through either a correction of error, change in accounting policy or a reclassification.

Operating segments (listed public entities only)
Do the operating segments align with the directors' report principal activities?
Do the operating segments align with the management reports?
Are there any geographical segments?
Do financial instruments disclose any receivables risk or concentration with major customers and are the related percentage of sales disclosed here?

Revenue/income
There are three classes of revenue/income:

Revenue:
Does the description of revenue correlate to both the principal activities and accounting policy? For instance, does this entity provide consulting services and revenue is noted as 'Sale of goods' rather than say 'Fees', 'Rendering of services' or 'Services'?

Share of profits of associates accounted for using the equity method:
Are there any associates? Is there an investment in associate in the statement of financial position?

Other income:
Consider the following:
- Insurance recoveries: was there an insurance claim that was paid out?
- Net foreign exchange gain: does the entity transact in foreign currencies?
- Net gain on disposal of assets: was there a sale of an asset?
- Subsidies and grants: was a Government grant received?

Income tax
Was there a 'true-up' to the prior years lodged tax return, which confirms the opening tax balances and any required adjustment?

Income tax expense:
Confirm the tax effect of the non-deductible permanent difference items such as entertainment, legal fees, impairment of goodwill and share-based payments.

Deferred tax assets and liabilities:
Confirm the tax effect of the straightforward items: provision for impairment of receivables, provision for impairment of inventories, employee benefits, lease make good, warranties and other provisions. Other items are harder to check on the face of the statement of financial position, such as: prepayments, plant and equipment, accrued expenses and black hole expenses.

Financial report (continued)

Provision for income tax and income tax refund due:
Confirm the balance of either provision for income tax or income tax refund due (unless in multiple jurisdictions you should not have both). Does this align with the tax workings and does it seem reasonable? For instance, does the refund exceed the tax paid? If so, is this an R&D credit or some other credit that makes this possible? Does the provision for income tax seem reasonable versus tax on taxable income and tax already paid?

Discontinued activities
Were there any discontinued activities? This does not have to be an entity - it could be a business or significant product line. Also, it does not have to be a disposal (sale); it could also be a cessation (closure or shutdown).

Trade and other receivables
Is the current and non-current classification correct? Consider any current receivables that have been carried for years without interest or payment - should these be impaired or reclassified to non-current? Are there any receivables that are overdue that should be impaired?

Is there a significant balance in other receivables? What is this?

If applicable, does the banding of the ageing of receivables impaired and not impaired make sense? For instance, should it be days rather than months?

Inventories
Are inventories stated at the lower of cost and net realisable value?
Do the classifications reflect the types of inventory you would expect for the industry the entity is in?
Typically there are three inventory sub-classifications: raw materials, work in progress and finished goods. This can be extended to goods in transit or very specific names.

Property, plant and equipment
The Trial Balance provides the cost and accumulated depreciation of the various classes of property, plant and equipment; but are these values overstated? Have all of the assets that have a zero written down value or no longer in the entity's possession been written off? Surely that typewriter, fax machine and VCR were thrown out years ago. A clean and concise Fixed Asset Register (source) makes for a happy auditor.

Is there land and buildings that were revalued more than 5 years ago (which is the maximum period)?

Intangibles
Have the intangibles been subjected to impairment testing and are they carried at fair value?
Have the intangibles with finite lives been amortised for the period? Does this amortisation match the period quoted in the accounting policy?

Trade and other payables
Is there a significant balance in other payables? What is this?

Borrowings
Is the current and non-current classification correct? Ensure that the principal due in the next 12 months matches the current portion. Are the financing facilities due to expire in the next 12 months? If so, the related borrowings should be current.

Are there any secured liabilities and are the related assets pledged as security disclosed?

Are the financing arrangements correctly disclosed? Has the total facility changed? Has the finance facility expired?

Provisions
Is the current and non-current classification correct? Consider any current provisions that have been carried for years without change, such as lease make good, and consider reclassifying to non-current. Likewise, is there any non-current that should be classified as current, such as the portion of long service leave (employee benefits) for those over 10 years of service and thus legally entitled to?

Financial report (continued)

Issued capital
Use the Company Historical Extract (source) to confirm the number of shares and classes of shares.

If there is any increase (share issue) or decrease (share buy-back) in issued capital, a reconciliation should be disclosed.

Capital risk management (if applicable):
Confirm that the capital risk management wording is accurate and reflects the actual practice.

Reserves
Consider the following:
- Revaluation surplus reserve: has the entity revalued assets, such and land and buildings?
- Foreign currency reserve: does the entity have foreign subsidiaries?
- Hedging reserve - cash flow hedges: does the entity have derivative financial instruments assets and liabilities where the movement should be recognised through reserves?
- Share-based payments reserve: does the entity have equity-settled share-based payments?

Retained earnings (retained profits or accumulated losses)
For retained earnings (retained profits or accumulated losses), does the comparative closing balance match the current opening balance?

Non-controlling interest (if applicable)
If in the subsidiaries note there is a subsidiary with less than 100% ownership, there is a non-controlling interest.
There are three parts to a non-controlling interest: Issued capital (what was paid for the shares in the subsidiary). Reserves (the share of the subsidiary reserves, if any) and Retained profits (or Accumulated losses) (the accumulated share of profits or losses, or which the movement should tie into the statement of comprehensive income).

Dividends
Check the company minutes and resolutions (source) for any dividends paid. If this is not shown in the report, is it mistakenly buried in expenses? Or perhaps it was issued in shares as part of a dividend reinvestment plan?

Financial instruments (if applicable)
Are there derivative financial instruments in the statement of financial position that need disclosing in more detail here? For instance forward foreign exchange contracts and interest rate swap contracts.

Are there any foreign currency denominated financial assets and financial liabilities (especially foreign subsidiaries)?

Is there any receivables risk or concentration with major customers?

Are the interest rates fixed or floating? Do the interest rates seem reasonable in relation to market rates? Do the interest rates multiplied by the average borrowings for the period tie back in an approximate way to the actual finance cost in the statement of comprehensive income?

Key management personnel disclosures (if applicable)
Are the listed other key management personnel correct? Have you considered new positions or new people that had the authority and responsibility for planning, directing and controlling the major activities of the entity?

There are five sub-classifications of compensation:
- Short-term employee benefits
- Post-employment benefits
- Long-term benefits
- Termination benefits
- Share-based payments

For listed public entities, do the sub-classification totals agree with the remuneration report?

Remuneration of auditors
In addition to the lead auditor, are there other firms that have undertaken audit work during the financial period whose fees should be disclosed?

Are there fees for other assurance (such as due diligence) and non-audit services (such as tax), performed by these same audit firms or their related firms, that should be disclosed?

Financial report (continued)

Contingent liabilities
Are there any contingent liabilities? There are usually at least bank guarantees (which will appear on the bank confirmation letter).

What about legal claims (if noted in the directors' report proceedings on behalf of the company and if not already a provision)?

What about guaranteeing the debts of others (including a single entity that is party to a deed of cross guarantee)?

Commitments
If there were no lease renewals, does the total approximate the prior period's total less this year's rental expense (as disclosed in the expenses note)?

For finance leases, do the future finance charges make sense? Does the interest rate (in the financial instruments note, if applicable) multiplied by the average borrowing term remaining tie back in an approximate way to the future finance charges?

Are there capital commitments that should be included? For instance, if a new lease was signed close to the reporting date, is there an associated fit-out contract that was also signed before the end of the reporting period?

Parent entities (if applicable)
Use the Company Historical Extract (source) to confirm the immediate parent entity and ultimate controlling entity.

Related party transactions (if applicable)
Where there are related party transactions, sales or revenue would normally result in a receivable at the reporting date. Likewise, purchases or expenses would normally result in a payable at the reporting date.

As well as intercompany sales, key management personnel related transactions need to be included, such as purchases from director-related entities.

Business combinations (if applicable)
Were any business combinations (businesses or subsidiaries) acquired?
Do these values tie in with statement of financial position additions?
Are these values preliminary or final?

Subsidiaries
Perform a Company name search and confirm the names of the subsidiaries. Likewise, most foreign company offices have easy-to-use name searches on their websites. Were there any changes of name? Were there any deregistrations?

Investments in associates (if applicable)
Are the associates' name, principal activity and percentage interest correct? Does the share of profit match the statement of comprehensive income?

Deed of cross guarantee (if applicable)
Is there a deed of cross guarantee in place? Have any new subsidiaries been added to the list of entities party to the deed?

Do the differences to the consolidated entity numbers make sense? For instance, cash and cash equivalents should always be lower in the deed of cross guarantee numbers.

Confirm that 'Net assets' matches 'Total equity'.

Events after the reporting period
This note covers the significant events that occurred between the reporting date and signing date.
Has a significant event occurred after the reporting date that affects entity's operations, the results of those operations, or the consolidated entity's state of affairs in future financial years?
For instance, the acquisition of a business combination, a newly discontinued activity, the purchase of a core asset, the sale of a core asset, change in financing arrangements, breach of financing covenants, etc would be considered significant.
Also, has a dividend been paid, recommended or declared after the reporting date?

Financial report (continued)

Reconciliation of profit after income tax to net cash from operating activities
Do the non-cash expenses match the statement of comprehensive income, such as depreciation and amortisation, impairment, write offs, share-based payments, etc?
Do the asset and liability movements match the statement of financial position (after accounting for business combinations and non-cash items)?

Non-cash investing and financing activities (if applicable)
The cash flow workings will highlight any non-cash investing or financing activities, typically shown as adjustments.

Any increase in lease liabilities, unless related to a business combination, will be 'Acquisition of plant and equipment by means of finance leases'.

Any increase in lease make good provision, unless related to a business combination, will be 'Leasehold improvements - lease make good'.

If there is a business combination and this was partially or wholly financed by a share issued, this is 'Shares issued in relation to business combinations'.

If there is an active dividend reinvestment plan, this is 'Shares issued under dividend reinvestment plan'.

Earnings per share (listed public entities only)
Does the number of shares match the issued capital note?
Is there any dilution due to options or rights?
Are both the basic and diluted earnings per share quoted on the face of the statement of comprehensive income?

Share-based payments (if applicable)
Were there any options, rights or shares issued as share-based payments (this is usually directors and employees, but can be others such as suppliers)?

Shareholder information (listed public entities only)
The shareholder information must be current at a date specified by the entity which is no more than 6 weeks before the annual report is sent to shareholders.

Check that the distribution bandings are the number of holders, not the number of equities held.

A marketable parcel is $500. Check the number of shareholders with less than a marketable parcel, which will be included on the Share Register report (source).

Substantial holdings are those of 5% or more of the total votes attached to the voting shares or interests in the entity, which will be supported by a substantial holder form (source).

Closing comments
After you have compiled the financial statements, and you think you have finished the 1st DRAFT (no doubt with a list of queries to be answered), read the report from cover to cover. It is hard to review your own work, but not impossible, so take your time and read through the report. Does it reflect your understanding of the entity? Does the information tie in? Is this information 'objective' and 'relevant'; is it material? Is there a piece of the story missing?

Financial statements are intended to convey a picture to the reader, not to mention being 'true and fair', so consider that they do this.

The role of the auditor is pivotal to help achieve all of this. With good source documentation, reliable audit trails aligning to quality financial statements, and a sound financial reporting process, the auditors can perform their role effectively.