

FINANCIAL HANDBOOK



IFU

INVESTMENT FUND FOR
DEVELOPING COUNTRIES

IFU as a partner

IFU – Investment Fund for Developing Countries was established in 1967, and for more than four decades our work has proven that it very often means good business for all parties if investment and development go hand in hand.

IFU's activities are based on the following:

- We invest risk capital on market terms in the form of share capital, loans and guarantees in private sector companies that are established in developing countries or emerging markets.
- We provide professional advice regarding the business environment, investment terms and CSR issues as well as cultural and political barriers, etc. with assistance from our regional offices in developing countries and emerging markets and through our global network of advisers.
- We provide continual know-how and active support to the project companies.

One access – four funds

As fund manager, IFU has invested in nearly 1,200 project companies in developing countries and emerging markets in Asia, Africa, Latin America and Europe. The know-how, insight and experience that IFU has acquired is increasingly being offered in the management of other funds.

IFU is fund manager of four funds:

- IFU – Investment Fund for Developing Countries offers risk capital and advice in 120 countries in Asia, Africa, Latin America and Europe.
 - AIF – The Arab Investment Fund offers risk capital and advice in seven countries in North Africa and the Middle East.
 - IFU Investment Partners has been established in cooperation with the pension funds PKA and PBU and invests equity in project companies that have obtained financing through IFU.
 - KIF – The Danish Climate Investment Fund offers equity and loans to climate projects in developing countries and emerging markets, where e.g. Danish climate technology and know-how can be utilised.
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PREFACE

This Financial Handbook is written for the project companies and other project partners with whom IFU cooperates. The publication sets out guidelines for IFU project companies and explains how they can be used to create a sound business culture within budgeting, accounting, reporting and auditing.

High standards in these areas are crucial for any company to become a success. The handbook therefore recommends and explains the principles in the International Financing Reporting Standards (IFRS) as a tool or reference for good practice to be used in project companies.

In any investment IFU contractually assures that project companies will fulfil certain obligations in terms of budgeting, accounting, reporting and auditing. Such obligations pertain to principles used, frequency and deadlines for reporting, choice of auditor and receivers of the financial reports.

In this handbook, these obligations are highlighted and explained, and our aim is that they can serve as a manual when project companies are working with budgeting, accounting, reporting and auditing as well as securing that reporting to IFU is done professionally and in due time.

The contents of this handbook are very much inspired by IFU's practical experience from almost half a century as a partner and investor in projects in developing countries and IFU's standard contractual requirements. It is our hope that project companies will benefit from this concrete experience, and that the handbook will prove a useful guide when dealing with these important issues.



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Senior Investment Manager



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1

General principles and national regulative frameworks

IFU wishes to promote the use of International Financial Reporting Standards (IFRS). It is, however, not an unconditional requirement that financial statements and quarterly reports are prepared under IFRS as this, in many cases, may be considered unnecessarily burdensome. In order to be able to assess the most material differences between the IFRS recognition and measurement principles and those used, e.g. those prescribed by national financial reporting regulation, IFU has prepared the Financial Reporting Checklist shown as **Example 1**. This checklist is to assist the companies in identifying and quantifying material differences between local financial reporting regulation and IFRS to ensure that as co-investor IFU is able to assess the effect of such differences for the purpose of establishing the best possible view of the development and fair value of the project company.

IFRS is the financial reporting framework used in many parts of the world and comprises a number of standards called International Accounting Standards (IAS), which regulate in detail all accounting items. Moreover, a number of interpretations made by the IFRS Interpretations Committee (IFRIC) and by the Standing Interpretations Committee (SIC) have been issued, which consider the accounting treatment of a number of specific examples.

1.1 Basic IFRS accounting principles

The basic IFRS accounting principles are:

- Going concern
- Accrual
- Materiality
- Gross recognition
- Annual reporting
- Comparative figures
- Consistency

It is basically assumed that the annual report is prepared under a *going concern* assumption. If that is not the case, this must appear clearly from the report prepared; otherwise, the independent auditor's report will be qualified in this respect. In accordance with *accrual-based* accounting, it is moreover a condition that transactions and events are recognised in the period(s) in which they occur irrespectively of the date of payment. An exception has been made in the cash flow statement in which the date of payment is pivotal.



Materiality is defined based on the elements of the individual financial statements and must therefore be assessed for each set of financial statements. Material matters are matters which individually or in aggregate may change the decisions made by the readers of the financial statements. The amount and nature of the individual matters may therefore be of importance for the materiality assessment. For instance due to a materiality assessment, property plant and equipment less than a specific monetary amount are not capitalized.

The main rule relating to assets, liabilities and income and expense items is that the items must be presented on a *gross basis* unless the substance of a transaction is best reflected on a net basis. For instance it is not allowed to offset cost of sales in revenue.

To fulfil the requirement of *annual reporting* under IFRS, the financial period basically comprises 12 months. If not, the reason must be stated.

For the purpose of maintaining the *comparability* of the annual reports, comparative historical figures in respect of all amounts and disclosures must basically be provided in the annual report. There are, however, exceptions to this main rule which are described specifically in the individual standards.

Another element of maintaining comparability is the *consistency* requirement under which presentation and classification must remain unchanged from one period to another unless a change is required under a specific standard or interpretation or a change has occurred in the circumstances of the company.

1.2 National accounting regulation

A company's financial statements must under all circumstances be prepared under local accounting regulations as required by local authorities. As local accounting regulations differ across the world, it is necessary to quantify any material differences in recognition and measurement compared to IFRS. For this purpose, the Financial Reporting Checklist must be applied.

As a general rule, the Financial Reporting Checklist is to ensure that the basic IFRS accounting principles are observed in local accounting policies. If local accounting regulation is not in accordance with the basic IFRS accounting principles, IFU must be informed accordingly.

The Financial Reporting Checklist includes the areas in which deviations between IFRS and local accounting regulations are most often observed. If "no" is replied to one or more points in the checklist, the reason must be stated in the commentary field. Moreover, the effect in terms of amount must be stated in the checklist.

Any type of material deviation from IFRS other than those mentioned in **Example 1** must be added to the list, including the approximate effect in terms of amount.

IFU recommends that the checklist be completed in cooperation with the company's auditor. In case any questions should arise in connection with the completion of the Financial Reporting Checklist, such questions should be directed to the local auditor. The company's auditor should issue a statement on the Financial Reporting Checklist each year.

As indicated above, the shown checklist is not a complete list, comprising all differences between local accounting policies and IFRS. IFU has prepared the list of possible deviation items on the basis of the areas where most differences are observed. Furthermore, the checklist focuses on areas where differences are significant and the monetary effect can be material. The identified areas are: research and development, goodwill, derivative financial instruments, tax, provisions, defined benefit plans, interest and own produced assets and contingent liabilities.

The effect in terms of amount of the deviations identified in **Example 1** may be summarized as follows:

Currency: LCY million				
Deviation from IFRS	Profit/loss	Assets	Liabilities	Equity
Item 12 – No provision is made with respect to restoration although the company must demolish all production buildings when the lease is terminated.	-15		+15	-15
Item 17 – Production machinery constructed for own account is expensed.	+10	+10		+10
Total profit/loss effect before tax (expense)	-5	+10	+15	-5
Explanation of the signs used in the table: <ul style="list-style-type: none"> • The table shows the effect of the deviations between local accounting policies and IFRS. • The first example shows that the income statement would have been reduced by 15, if the accounting had been made in accordance with IFRS. • The second example shows that the income statement and the assets would have been increased by 10, if the accounting had been made in accordance with IFRS. • In total the result would have been reduced by 5, if the accounting had been made in accordance with IFRS. 				

The auditor's annual statement on the Financial Reporting Checklist (ISAE 3000 statement on Financial Reporting Checklist) may look as follows:

Independent auditor's statement

To IFU

We have examined the responses to the enclosed Financial Reporting Checklist of Evergreen Ltd. for the financial year 1 January 201x to 31 December 201x. The responses to the Financial Reporting Checklist have been prepared for the purpose of informing IFU of any special accounting issues relating to Evergreen Ltd. which deviate materially from IFRS for the financial year 1 January 201x to 31 December 201x.

The management of Evergreen Ltd. is responsible for the responses to the Financial Reporting Checklist. Our responsibility is to express a conclusion on the responses to the Financial Reporting Checklist based on our work.

Scope of work

We conducted our work in accordance with the international standard ISAE 3000 on assurance engagements other than audits in order to obtain moderate assurance that the responses to the Financial Reporting Checklist are free of material misstatement. Our work has been limited primarily to inquiries to the management of Evergreen Ltd. and employees as well as analytical procedures and therefore provides less assurance than an audit. We have based our assessment of the responses to the Financial Reporting Checklist on the work performed by us in connection with our audit of the financial statements for 1 January 201x to 31 December 201x. We have provided the financial statements with an unqualified independent auditor's report without emphasis of matter. We have, moreover, assessed the estimates made by management in connection with the responses to the Financial Reporting Checklist. We believe that the work performed provides a reasonable basis for our conclusion.

Conclusion

In connection with our work, nothing has come to our attention that causes us to believe that the responses to the Financial Reporting Checklist do not reflect the accounting arrangements of Evergreen Ltd. for the financial year 1 January 201x to 31 December 201x.

Signed
State Authorised Public Accountant

Encl: Financial Reporting Checklist



2

Budgeting

Budgeting forms part of the planning process for the next financial year. In the budget phase, an overview is obtained of expected income and expenses, and any investments planned and resultant cash flow. Individual budgets may be prepared for each business area or for the company as a whole. However, IFU only requires that a budget is prepared for the project company as a whole. If IFU invests through a holding company, a budget which is consolidated at holding company level must be prepared.

Data from the project company's operational budget are essential in IFU's recommended standard quarterly reporting form as shown in [Example 2](#).

The budget is to act as a management tool for the company enabling company management to follow up on whether the financial targets for each year are achieved. In order to render the process as seamless as possible, we recommend that the budget be based on the accounting principles, format and classification applied for the quarterly and annual reports.

The budget is to be prepared for a period corresponding to the company's normal operating cycle. Generally, the budget period will comprise the calendar year. However, for companies in the start-up phase it must be considered whether it would be relevant for the budget period to comprise a period exceeding one year if the start-up phase is expected to cover a long period of time.

With a view to ensuring regular follow-up on the budgets prepared, it is necessary to adequately decompose the budget. As IFU recommends that a quarterly budget follow-up is made, it is expedient that a budget be prepared at least for each quarter as highlighted in [Example 2](#).

The entire budget has three elements: operating budget, investment budget and cash flow budget.

2.1 Operating budget

The operating budget is to contain profit & loss and balance budgets for the company for the next financial year. The operating budget must include the following:

- Profit & loss and balance budgets
- Applied budget policies
- Any documentation of underlying calculations

The operating budget, normally not subject to any legislation, may be considered a production planning tool and may serve as a management tool for company management.

2.2 Investment budget

The investment budget is prepared for the purpose of determining future profitable investments and any other contemplated investments and for follow-up on already decided investments.

Data from the project company's investment budget are essential in IFU's recommended standard quarterly reporting form as shown in **Example 3**.

The investment budget shows the capital requirements related to the company's planned investments. For major investments it is important that the investment be accompanied by an exposition of the effect on the future earnings of the company from the planned investments (not shown in Example 3).

Moreover, for investments spanning a long period of time, it will be relevant to prepare investment budgets covering a longer period than the period applied for the operating budget, i.e. more than a year.

2.3 Cash flow budget

The overall purpose of the cash flow budget is to provide an overview of the company's future ability to pay. The cash flow budget illustrates the cash implications of the company's transactions. The preparation of the cash flow budget therefore ensures that any unexpected cash requirements are spotted at an early point in time making it possible for the company to initiate the necessary measures to respond to this, e.g. commence discussions with bankers. Therefore, for management purposes the cash flow budget is highly relevant.

In connection with the preparation of the cash flow budget, any local requirements for the company's funds must be taken into consideration in order that such requirements are observed. Moreover, any limitations to which the company is subject must be considered, e.g. covenants relating to existing loans. If the company is subject to such covenants, it must be considered whether the planned transactions fall within the framework of these covenants.

Data from the project company's cash flow budget are essential in IFU's recommended standard quarterly reporting form as shown in **Example 4**.

The basis of the cash flow budget is the opening balance of the company's cash holdings which is then to be adjusted for the cash flow effect of the transactions expected to be performed during the budget period. Examples of such transactions are:

- Loan instalments
- Raising of new loans
- Payment of interest
- Interest received
- Investment in property, plant and equipment – except for investments made through finance leases
- Disposal of property, plant and equipment

- Payments received from debtors
- Payments made to creditors
- Payment of wages and salaries
- Other overheads (e.g. rent)
- Dividends

This list is not exhaustive as transactions with cash flow effect will vary from one company to another.

In order to ensure the consistency between the cash flow budget and the operating and investment budgets, it is important that the cash flow budget is based on the transactions stated in the operating and investment budgets. However, it should be taken into account that there will often be a timing difference between the transaction in e.g. the operating budget and the cash flow effect of the transaction. For example, in connection with the purchase of goods, the company may have a credit period of 30 days; consequently, the cash flow effect is to be postponed for 30 days compared to the time of purchase in the operating budget.

Good check questions:

Is an increase in sales budgeted for?	<ul style="list-style-type: none"> • Consider whether investment in production machinery is required? • Consider whether more staff is required and, consequently, increased staff expenses?
Is an increased gross profit budgeted for?	<ul style="list-style-type: none"> • Remember to give an explanation of this in the budget assumption.
Is an increased capacity utilization budgeted for?	<ul style="list-style-type: none"> • Remember to give an explanation of this in the budget assumption.
REMEMBER!	<ul style="list-style-type: none"> • To check the consistency between the operating, investment and cash flow budgets. • To reconcile the budget basis.
Is growth budgeted for?	<ul style="list-style-type: none"> • Remember that growth generally implies that more cash is tied up in working capital. • Can this be financed?
Financing	<ul style="list-style-type: none"> • Have unconditional promises been obtained from bankers/investors in order that operations/investments next year can be financed?



2.4 Board approval of the budget

The operating, investment and cash flow budgets are to be reported as one document, which is to include a statement from company management, which confirms that the budget has been approved and prepared based on management's best estimate of future events. The board must approve the budget before the beginning of the financial year. Preparation of the budget must be initiated in good time, and it should be presented for approval by the board at the last board meeting before the end of the current financial year.

As the budget functions as a strategic tool for the company, it is of pivotal importance that management has prepared the budget to the best of its ability and agrees on the targeted results. The budget is to be prepared based on reasonable assumptions, and management must describe the most important assumptions applied at the preparation of the budget which are to be submitted together with the budget.

2.5 Follow-up on the budget

It is expedient to follow up on the budget in connection with the quarterly reporting, which generally coincides with the quarterly ordinary meetings of the board of directors. The figures realised must be compared with the budgeted figures. We moreover refer to the requirements described in section 4.2.1, Quarterly reporting.

In connection with the budget follow-up, the budgets already prepared are not changed, only the opening balance of the budget is normally adjusted to the actual closing balance of the prior year. This is a consequence of the budget being prepared before the close of the prior year and therefore originally being based on an estimated closing balance for that year. All budget examples in this manual are based on the prior year actual closing balance.

It is, however, expedient to prepare forecasts for the remaining part of the year which consider the development in the year to date and expectations based on the figures already realised.



3

Bookkeeping and filing of accounting records

Ideally, the financial year of a project company is the calendar year. Accounting must commence on the date of the incorporation of the project company. The project company must maintain books of account and trading records at its principal office and as stated in section 1.2 make reports in accordance with local legislation and fill in the Financial Reporting Checklist. IFU's duly accredited representatives shall under strict confidentiality have full access to the books and records of the project company. The right to make copies of or extracts from such books and records requires the approval by the chairman of the board of directors.

IFU recommends that the company keeps the originals or at least copies of all relevant documents in its files irrespective of local regulations. Such documents include but are not limited to:

- Annual report, signed by the company's management and auditor;
- Auditor's long-form report, signed by the board of directors and the auditor;
- Specifications to the annual report, signed by the company's management and possibly the auditor;
- Tax return and/or tax specifications;
- Minute book of meetings of the board of directors;
- The company's articles of association;
- Financial Reporting Checklist.

IFU recommends that the above be kept by the company for a period of minimum five years or longer if local requirements prescribe that accounting records are to be kept for a period longer than five years.



4

Reporting requirements

As co-investor, IFU wishes to monitor the development of the companies and to identify any matters of material importance to the companies. Therefore, IFU's reporting requirements depend on the current phase of the company. If the company is in the implementation phase, reporting is required to take place more often than is the case for companies in operation.

Often, IFU makes investments together with its Danish partner through a holding company (special purpose company – SPC). In such cases, it is expedient that the administrator of the SPC, typically the Danish partner, arranges for reporting to be made for the SPC group in the form of interim and annual financial statements which are fully consolidated at SPC level at the same time as the reporting for the underlying project company.

The reporting requirements of IFU are constructed so that the same reporting may be used for other shareholders, the board of directors, etc.

Below, we describe the reporting requirements for new investments in the implementation phase and the reporting requirements for existing companies in the IFU portfolio.

4.1 New investments in the implementation phase of a project

For any new investment (brownfield or greenfield), IFU requires a monthly reporting modus during the implementation phase. The monthly reporting must have the initial investment budget as the main point of reference. Thus, until the project company starts its commercial sales, the project company (or until the project company is incorporated, the main project promoter) shall distribute to the directors a monthly progress report containing actual investment costs incurred compared with the initial budget as well as general information on all matters of whatsoever nature which may influence the implementation of the project to be undertaken.

IFU recommends that an 'investment budget progress table' accompanies the mandatory monthly reporting during the implementation phase as shown in [Example 5](#).

The monthly progress report must be distributed to each of the directors of the company not later than 20 calendar days after the end of the reference month.

4.2 Existing investments in the IFU portfolio

IFU requires that quarterly reporting is made for all investments in the IFU portfolio. The reporting requirements for the quarterly reporting are set out below.

4.2.1 Quarterly reporting

A quarterly profit & loss and balance sheet, an investment budget progress statement and a cash flow statement showing detailed figures for the results of the project company shall be distributed to each of the directors not later than 30 calendar days after the last day of that quarter. Another reporting frequency may, however, be agreed for the individual company. If so, reporting must be made accordingly.

Quarterly reporting package

- Profit & loss and balance sheet with comments on deviations versus budget and compared to last year, see [Example 6](#).
- Investment budget progress statement (on-going project) with comments on deviations versus budget, see [Example 7](#).
- Cash flow statement with comments on deviations versus budget and compared to last year, including reporting on working capital and status for covenants, see [Example 8](#).

The quarterly accounts may be presented in the form shown as [Example 6](#) and shall include a profit & loss and balance sheet with comments on any deviations versus the budget for the quarter and compared with the same quarter of last year.

The quarterly investment budget progress statement (on-going project), with comments on deviations versus budget, may be presented in the form shown as [Example 7](#).

The quarterly cash flow statement may be presented in the form shown as [Example 8](#). The cash flow reporting must include:

- Cash flow and cash reporting
- Working capital
- Status for covenants

4.2.2 Annual reporting

An annual report, including financial statements, is to be prepared by management. The annual financial statements must include a profit & loss statement, a year-end balance sheet (including cash flow statement), and must contain a statement which confirms that insurance policies against loss, damage to property and liability have been taken out to such extent as is generally accepted as customary in regard

to property and business of the kind in question. The annual report is to be approved by the auditors of the project company and forwarded to the directors by management within three months after the end of the financial year. An ordinary meeting of the board of directors must discuss the draft annual report, including financial statements, together with a draft independent auditor's report on the annual report. In addition to this, the auditor's long-form report must be submitted by management to the board of directors. The auditor's long-form report is a book provided to the board of directors containing the auditor's long-form reports to the board of directors and management regarding the audit work. The board members must sign the auditor's long-form report as evidence that they have read the auditor's comments. The auditor's long-form report must be maintained by the project company.

In some countries, the auditor's long-form report may not be formally required, but in accordance with the International Standards on Auditing (ISA 260), auditors should communicate in writing with those charged with governance, such as a board of directors, a supervisory board or partners, regarding the significant findings from the audit. Consequently, IFU recommends that the project company request an auditor's long-form report.

At the board meeting where annual accounts are to be approved by the board, it is good practice to ask for the auditors to be present, to be able to clarify any questions to the accounts that the board may have and also to provide their general view on the affairs of the company. In some countries, this may not be formally required. Hence, this practice may not be followed especially in the case of closely held, small private companies.

As part of the annual reporting, the company must also submit a completed Financial Reporting Checklist, see **Example 1**, which has been provided with an auditor's statement. This checklist is to be completed and submitted annually with a view to making it possible for IFU to assess whether the accounting policies of the company deviate materially from IFRS. The Financial Reporting Checklist is described in detail in section 1.2.

The following table mentions the four separate documents which constitute the annual reporting to IFU.

Annual reporting package
<ul style="list-style-type: none">• The adopted and published annual report• Confirmation of insurance policies• Auditor's long-form report• Financial Reporting Checklist, including auditor's statement on the checklist



5

Audit

IFU requires that the company's annual report is audited by an independent auditor who performs the audit in accordance with International Standards on Auditing (ISA) and additional requirements under local audit regulation. This section describes the requirements to be placed on the auditor and the work to be performed by the auditor. It is, moreover, outlined how the audit process may be carried out most efficiently.

5.1 Appointment of auditor and the auditor's duties

In connection with the establishment of the company, the company's supreme authority, the general meeting of shareholders, must appoint an auditor. IFU requires that the auditor is a state authorised public accountant in accordance with the requirements of the country in which the activity is carried out. A state authorised public accountant is assumed to comply with the following requirements:

- The auditor demonstrates integrity, objectivity, confidentiality, professional behaviour, professional competence and due diligence when performing the work.
- The auditor is independent of the company on which the auditor is to opine.

If company management becomes aware that the auditor does not comply with the above requirements, company management must consider whether a change of auditor should be made.

In many cases, it will be difficult to assess whether the auditor complies with the above requirements and in all material respects performs the work in accordance with ISA. There are, however, certain danger signs to which both IFU and company management should pay attention:

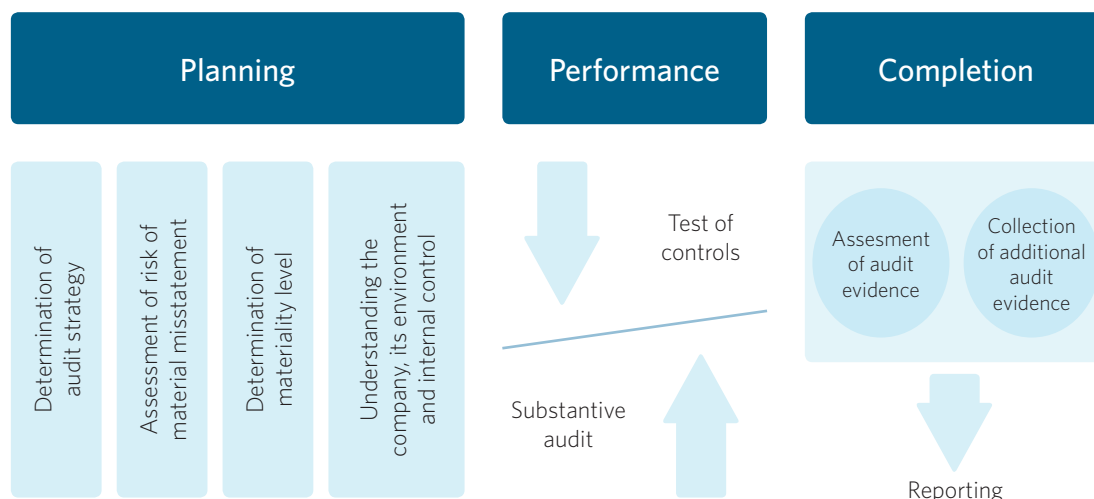
- No reporting is received from the auditor except for the independent auditor's report on the annual report.
- The reporting received from the auditor is inadequate.
- Company management/IFU becomes aware of irregularities to which the auditor should have responded by drawing the attention of the board of directors to the matter through reporting in an auditor's long-form report.

The auditor's duties in connection with the audit of the company's annual report:

- Issue an independent auditor's report on the company's financial statements, including basis of opinion and the opinion itself.
- Keep an auditor's long-form report which describes the nature and scope of the procedures performed and the conclusion hereon.
- Issue a statement on the IFRS Financial Reporting Checklist. The statement is to provide moderate assurance under ISAE 3000. A template for this purpose has been prepared, see [Example 1](#).
- Participate in the meeting of the board of directors at which the financial statements are adopted by the board of directors.

5.2 The audit process

This section describes how the audit process is handled in practice. There may be local differences in the handling of the audit, but this process description is based on the most efficient manner in which to perform the audit. Therefore, we recommend that company management/employees initiate the individual sub-processes if the auditor does not take steps to do so. The audit process is illustrated by the following figure:



The audit process may be described as follows:

1. Receipt of draft engagement letter from the auditor which establishes the following:
 - Fee for the audit of the annual report
 - Team to audit the annual report
 - Timetable for the performance of the audit
2. The auditor's audit plan
3. Performance of interim audit
4. Performance of year-end audit
5. Reporting

IFU recommends that the auditor be contacted when accounting issues arise. If the auditor is used as a sparring partner on a current basis, the company ensures that from the start correct entry is made in the company's accounting records, which will improve the quality of the interim reporting to be sent to IFU on a quarterly basis.

Re 1 – Receipt of engagement letter

It is important to clarify the assumptions for the audit assignment prior to commencement of the work. Moreover, it is relevant to agree on the fee in advance considering the company's internal financial management and budgeting. If the auditor does not himself present an engagement letter, IFU recommends that the company request such a letter.

Re 2 – Audit planning

When the auditor has received a signed engagement letter from the company, the auditor will begin planning the audit. Generally, the auditor will need information from the company in order to plan the audit. Such information may include financial data, e.g. a trial balance sheet, discussions about the development of the company, minutes of meetings of the board of directors, etc. The information requested by the auditor may vary from one company to another.

Initially, the auditor will assess the risks related to the company and determine a materiality level to be applied during the entire audit. The materiality level is used to determine which misstatements would be so material for the readers of the financial statements that the financial statements would no longer give a true and fair view.

In the planning phase, the auditor will determine the audit strategy to be used for the audit of the company's annual report. The audit strategy comprises a breakdown of the audit on test of controls and substantive audit, respectively. In order to be able to issue an independent auditor's report, the auditor must obtain adequate and appropriate audit evidence about all material items of the financial statements. The auditor is required to perform the audit as efficiently as possible; i.e. the auditor considers which combination of test of controls and substantive procedures will most efficiently provide the auditor with the audit evidence required to be able to issue an independent auditor's report. This depends to a wide extent on whether the company has established and implemented internal controls. If internal controls have been established, the auditor assesses whether testing of such controls will be effective to obtain adequate and appropriate audit evidence. Moreover, certain substantive procedures are always required to be performed. Substantive procedures involve analysis of accounting items and, among other things, detailed testing. Moreover, external confirmations must be obtained.

In the planning phase, the auditor will forward a documentation list (Prepared-by-Client-List). This list shows the documents which the auditor expects the company to prepare for the audit. If the auditor does not forward such a list, it is recommended that the company itself prepares a list of documentation expected to be requested by the auditor which the company asks the auditor to approve prior to the commencement of the audit.

The documentation list is used as a tool for matching the company's and the auditor's expectations, and the company has the possibility to prepare the documents in advance, which should release some resources during the audit. Moreover, the company may plan when the documents are to be prepared thus avoiding that this work has to be carried out in connection with the month-end closing, etc.

Re 3 – Performance of the interim audit

If the auditor assesses that part of the audit may effectively be performed as test of controls, this will generally take place two to five months before the balance sheet date. In respect of companies with balance sheet date on 31 December, the interim audit will typically be performed during the autumn. The audit will focus on your internal controls, which will require that key employees are at hand to respond to questions and assist the auditor in the performance of the planned tests.

The auditor will, in writing or orally, report the interim audit findings to the company's executive board. If control weaknesses are identified which are so material to the financial reporting that the auditor assesses that the board of directors should be informed, the findings of the interim audit will also be reported to the board of directors in the long-form report.

Re 4 – Performance of the year-end audit

In connection with the year-end audit, the auditor obtains adequate and appropriate audit evidence about all material items of the financial statements. This may be in the form of check against underlying documentation, such as booked vouchers, check against external confirmations, analyses of items, etc. It is therefore important that the auditor receives from the company the documentation required to perform the audit. The auditor decides which material is required in the specific situation.

In connection with the year-end audit, the key financial staff must be available to the auditor; questions may typically arise during the audit, and the auditor may require additional documents which specify the items recognised. In connection with the completion of the audit, the auditor will request a statement from company management which confirms that company management has placed all documentation at the disposal of the auditor and that no fraud has been identified in the company, etc.

Re 5 – Reporting

The reporting of the auditor includes:

- Independent auditor's report on the company's financial statements
- Reporting to the board of directors in the form of an auditor's long-form report

The independent auditor's report must be issued in accordance with ISA 700. If the auditor needs to modify his opinion in the independent auditor's report, such modifications must be reported in accordance with ISA 705. Any emphasis of matter paragraph and other matter paragraph provided in the independent auditor's report must be made in accordance with ISA 706.

The reporting to the board of directors in the form of an auditor's long-form report is to be made in accordance with the requirements of ISA 260. The auditor must communicate in writing with the board of directors of the company in respect of important findings of the audit when oral communication is not considered adequate. This implies that an auditor's long-form report must always be prepared for company management immediately upon completion of the year-end audit. In the auditor's long-form report, the auditor must, as a minimum, provide the following information:

- Material issues relating to the audit, including especially material uncertainty, misstatements or inadequacies with respect to the company's bookkeeping, accounting records or internal controls.
- Matters which may normally be expected to be of importance to the assessment of the financial statements for the recipient or the principal.

The auditor's long-form report is exclusively for the use of the principal and is not a document to be published together with the annual report. It provides the auditor with the opportunity of communicating in writing with the company's board of directors.

Good check questions:

Appointment of auditor	<ul style="list-style-type: none"> • Is the auditor independent and competent?
Engagement letter	<ul style="list-style-type: none"> • Have you entered into a written agreement with the auditor with respect to fee, team and timetable?
Year-end audit	<ul style="list-style-type: none"> • Have you prepared the documentation requested by the auditor to be available for the audit?
The auditor's participation in meeting of the board of directors	<ul style="list-style-type: none"> • Has it been agreed with the auditor that the auditors participate in the meeting of the board of directors at which the annual report is adopted by the board of directors?

Example 1: Financial Reporting Checklist

Example 2: Form of reporting for profit & loss and balance sheet

Example 3: Form of reporting for investments (on-going project)

Example 4: Form of reporting for cash flow

Example 5: Form of reporting for investment budget progress (new project)

Example 6: Form of reporting for profit & loss and balance sheet

Example 7: Form of reporting for investments (on-going project)

Example 8: Form of reporting for cash flow

All examples are based on the budgets and reporting from the same fictional company, Evergreen Ltd., and numbers should therefore be consistent between the various examples. Please note that some of the examples show identical statements, but with different items highlighted depending on the various topics.

Example 1: Financial Reporting Checklist

Company: Evergreen Ltd.

Financial year: 201x

No.	Question	Yes	N.a.	No	Comments
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Research and development

1	Are research costs charged to expense?		X		
2	Are development costs capitalised when the following conditions are met: <ul style="list-style-type: none">• There is a potential future market for the product or it may be utilised in the company;• The company intends to manufacture and market the product/process;• The company has adequate resources to both complete the development work and market the product or utilise the process;• The technical feasibility of the product or the process has been demonstrated;• The product or the process has been clearly defined, and the costs related to the product or the process can be separately identified.		X		
3	If it is not possible to break down research and development costs, are all costs considered research costs expensed?		X		

Goodwill

4	Is acquired goodwill capitalised?	X			
5	Is goodwill subject to an annual impairment test?	X			
6	Is goodwill not amortised on a current basis?	X			

Derivative financial instruments

7	Are derivative financial instruments recognised in the balance sheet at fair value?		X		
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Tax

8	Is the tax expense for the year recognised in the income statement?	X			
9	Is deferred tax provided in respect of all temporary differences between the tax base and the carrying amount except for goodwill?	X			
10	Is the adjustment for the year of deferred tax recognised in the income statement?	X			

Provisions

11	Are provisions recognised when the company has obligations subject to uncertainty with respect to amount or time of payment?	X			
12	Is a provision for abandonment recognised if the company has an obligation to restore a leasehold, e.g. leased land or rented premises?			X	Not specifically required in local accounting policies and it is expected that the leasehold will be extended.

Defined benefit plans

13	Is the obligation to pay pension based on actuarial calculations?		X		
14	When hedging the pension obligation, has the company paid in adequately in proportion to the identified risks?		X		
15	Are adjustments of the pension obligations recognised in the income statement?		X		
16	Are all actuarial adjustments related to pension obligations recognised in the financial statements?		X		

Interest and own produced assets

17	If assets are produced for own account, are related direct costs and overheads capitalised (e.g. the labour hours which the company's own employees have spent on the construction of the asset)?			X	Not permitted according to local accounting principles.
18	If the company itself constructs fixed assets which are financed through raising of loans, are the related financing costs capitalised?		X		

Contingent liabilities

19	Are contingent liabilities disclosed in a note? E.g. liabilities the existence of which cannot be confirmed or invalidated until the occurrence of one or more uncertain future events outside the company's control, including pending lawsuits.	X			
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Example 2: Form of reporting for profit & loss and balance sheet

Company: Evergreen Ltd.

Currency: LCY millions

Reference quarter: Q2

Financial year: 201x

	Reference quarter			Year-to-date			Full year		
	Actual	Budget	Last year	Actual	Budget	Last year	Current estimate	Budget	Last year
Profit & loss									
Turnover	249.6	269.5	232.0	513.4	508.9	432.4	1,056.0*	1,111.6	982.6
Cost of goods sold	-219.8	-236.5	-208.8	-452.8	-446.9	-390.0	-918.2	-975.6	-872.0
Loss on debtors	-1.8	0.0	-1.3	-4.9		-1.3	-9.8	-5.0	-3.8
GROSS PROFIT	28.0	33.0	21.9	55.6	62.0	41.1	128.0	131.0	106.8
Salaries	-10.4	-10.0	-10.4	-26.6	-30.0	-23.4	-53.2	-45.0	-43.3
Other sales cost	-2.3	-5.0	-2.8	-4.8	-5.0	-5.3	-9.6	-10.0	-10.4
Admin. cost	-3.2	-5.0	-2.5	-6.9	-5.0	-3.5	-10.4	-10.0	-8.1
Royalty & service	-1.7	-4.0	-1.5	-3.4	-5.0	-3.6	-6.8	-5.0	-7.3
TOTAL COST	-17.6	-24.0	-17.1	-41.7	-45.0	-35.8	-80.0	-70.0	-69.1
EBITDA	10.4	9.0	5.0	13.9	17.0	5.3	48.0	61.0	37.7
Depreciations	-1.0	-1.0	-0.5	-1.4	-3.5	-0.8	-3.4	-5.0	-1.9
EBIT	9.4	8.0	4.5	12.5	13.5	4.5	44.6	56.0	35.8
Financing cost	-4.4	-2.0	-3.4	-6.8	-4.0	-5.6	-13.6	-10.0	-5.7
EBT	5.0	6.0	1.1	5.7	9.5	-1.1	31.0	46.0	30.1
Corporate tax	-2.0	-4.0	-3.7	-2.5	-4.5	-3.8	-6.0	-15.0	-10.8
NET RESULT	3.0	2.0	-2.6	3.2	5.0	-4.9	25.0	31.0	19.3

Balance sheet									
Fixed assets	247.8	246.1	217.8	247.8	246.1	217.8	252.7	246.4	217.4
Inventories	97.0	76.8	99.4	97.0	76.8	99.4	110.0	95.0	96.4
Trade receivables	87.4	119.7	123.9	87.4	119.7	123.9	99.7	100.0	121.3
Other receivables	34.3	16.5	34.8	34.3	16.5	34.8	27.4	25.0	24.9
Cash	13.7	8.9	5.2	13.7	8.9	5.2	36.4	33.2	3.8
TOTAL ASSETS	480.2	468.0	481.1	480.2	468.0	481.1	526.2	499.6	463.8
Share capital	304.1	297.0	282.5	304.1	297.0	282.5	314.1	311.5	282.5
Reserves & results	17.4	19.2	4.0	17.4	19.2	4.0	39.2	45.2	14.2
TOTAL EQUITY	321.5	316.2	286.5	321.5	316.2	286.5	353.3	356.7	296.7
Long-term loans	6.7	6.7	20.0	6.7	6.7	20.0	4.2	4.2	12.0
Short-term loans	82.9	56.4	68.6	82.9	56.4	68.6	93.9	90.3	67.6
Trade debt	44.6	65.3	74.9	44.6	65.3	74.9	50.1	24.7	80.3
Other debt	21.6	23.4	30.7	21.6	23.4	30.7	20.0	17.0	6.6
Due corporate tax	2.2	0.0	0.4	2.2	0.0	0.4	4.0	6.0	-0.6
Deferred tax	0.7	0.0	0.0	0.7	0.0	0.0	0.7	0.7	1.2
TOTAL DEBT	158.7	151.8	194.6	158.7	151.8	194.6	172.9	142.9	167.1
TOTAL LIABILITIES	480.2	468.0	481.1	480.2	468.0	481.1	526.2	499.6	463.8

Comments on deviations:

*Sales to export markets in the second half of the year are expected to fall short of the budgeted sales due to fiercer-than-expected international competition.

Example 3: Form of reporting for investments (on-going project)

Company: Evergreen Ltd.				Currency: LCY millions Reference date: 30-06-201x Financial year: 201x
	A Budget 201x	B Realised as of 30/06/201x	C Not yet realised	D Expected deviation (B + C - A)
New trucks	18.0	16.8		-1.2*
IT hardware	16.0	15.0	4.7	3.7**
TOTAL	34.0	31.8	4.7	2.5
Comments on deviations: *23 new trucks at an average price of LCY 0.73m were purchased instead of 25 new trucks at an average price of 0.72m, as the use of the company truck fleet has, in the meantime, been made more efficient. **The update of the existing IT system required 30% more man hours than budgeted for due to unforeseen and unspecified legacy specifications.				

Example 4: Form of reporting for cash flow

Company: Evergreen Ltd.

Currency: LCY millions

Reference quarter: Q2

Financial year: 201x

	Reference quarter			Year-to-date			Full year		
	Actual	Budget	Last year	Actual	Budget	Last year	Current estimate	Budget	Last year
Cash flow									
EBIT	9.4	8.0	4.5	12.5	13.5	4.5	44.6	56.0	35.8
Depreciation	1.0	1.0	0.5	1.4	3.5	0.8	3.4	5.0	1.9
EBITDA	10.4	9.0	5.0	13.9	17.0	5.3	48.0	61.0	37.7
Tax	-2.0	-4.0	-3.7	-2.5	-4.5	-3.8	-6.0	-15.0	-10.8
Change in working capital									
Inventories	-0.3	9.8	-0.9	-0.6	19.6	-1.4	-13.6	1.4	-3.5
Receivables	12.3	5.0	-3.7	24.5	10.0	-8.7	19.1	21.2	-16.4
Payables	-9.2	0.6	12.9	-18.4	1.2	16.0	-12.7	-39.1	7.5
Cash flow from operating activities	11.2	20.4	9.6	16.9	43.3	7.4	34.8	29.5	14.5
Purchase of Fixed Assets	-15.9	-16.1	-10.5	-31.80	-32.20	-21.1	-38.7	-34.0	-42.1
Purchase of Intangible Assets									
Sale of Fixed Assets									
Cash flow from investing activities	-15.9	-16.1	-10.5	-31.8	-32.2	-21.1	-38.7	-34.0	-42.1
Repayment of loans	5.0	-8.3	-3.2	10.0	-16.5	-6.5	18.5	14.9	-12.9
Net financial items	-4.4	-2.0	-3.4	-6.8	-4.0	-5.6	-13.6	-10.0	-5.7
Paid in capital	10.8	7.3		21.6	14.5		31.6	29.0	
Cash flow from financing activities	11.4	-1.0	-6.6	24.8	-6.0	-12.1	36.5	33.9	-18.6
Change in cash flow	6.7	3.3	-7.6	9.9	5.1	-25.7	32.6	29.4	-46.2
Cash at the beginning of the year	7.1	5.6	13.8	3.8	3.8	30.9	3.8	3.8	50.0
Cash at the end of the period	13.7	8.9	6.2	13.7	8.9	5.2	36.4	33.2	3.8

Working capital									
Inventories	97.0	76.8	99.4	97.0	76.8	99.4	110.0	95.0	96.4
Accounts receivable	121.7	136.2	158.7	121.7	136.2	158.7	127.1	125.0	146.2
Accounts payable	69.1	88.7	106.0	69.1	88.7	106.0	74.8	48.4	87.5
Working capital	287.8	301.7	364.1	287.8	301.7	364.1	162.3	171.6	155.1

Covenants*									
List of covenants									
Equity to assets ratio, min. 1:3 (33.33%)	67.0%	67.6%	59.6%	67.0%	67.6%	59.6%	67.1%	71.4%	64.0%
EBITDA to interest bearing debt ratio, min. 1:3 (33.33%)	11.6%*	14.3%*	5.6%*	15.6%*	27.0%*	6.0%*	48.9%	64.6%	47.4%

* If a breach of covenants occurs, please explain the following:

- Is a waiver received from the bank?
- What actions have been initiated to comply with covenants prospectively?
- What is the impact of the breach of covenants?

Explanations:

- As the greater part of the turnover and an even greater part of the profit are generated in the last half year, the agreement with the bank stipulates that whether a covenant is breached or not is only checked once a year, i.e. at the end of the financial year.

Example 5: Form of reporting for investment budget progress (new project)

Company: Evergreen Ltd.

Currency: LCY millions

Date of budget approval: (insert date)

Reference date: 30/06/201x

	A Budget	B Realised as of 30/06/201x	C Not yet realised	D Expected overrun (B + C - A)
Land & buildings	194.4	179.8		-14.6*
Machinery	30.0	50.0		20.0*
Installation of machinery	25.0	18.0	10.0	3.0**
Working capital	22.6	23.9	2.0	3.3
TOTAL	272.0	271.7	12.0	11.7

Comments on overrun:

* Subsequent to the approval of the investment budget, the board decided to opt for a more efficient - but also more expensive - production line. However, as the more efficient line requires less space, savings could be made on building works.

** Installation of the more efficient line requires technicians with slightly higher skills.

Example 6: Form of reporting for profit & loss and balance sheet

Company: Evergreen Ltd.

Currency: LCY millions

Reference quarter: Q2

Financial year: 201x

	Reference quarter			Year-to-date			Full year		
	Actual	Budget	Last year	Actual	Budget	Last year	Current estimate	Budget	Last year
Profit & loss									
Turnover	249.6	269.5	232.0	513.4	508.9	432.4	1,056.0*	1,111.6	982.6
Cost of goods sold	-219.8	-236.5	-208.8	-452.8	-446.9	-390.0	-918.2	-975.6	-872.0
Loss on debtors	-1.8	0.0	-1.3	-4.9		-1.3	-9.8	-5.0	-3.8
GROSS PROFIT	28.0	33.0	21.9	55.6	62.0	41.1	128.0	131.0	106.8
Salaries	-10.4	-10.0	-10.4	-26.6	-30.0	-23.4	-53.2	-45.0	-43.3
Other sales cost	-2.3	-5.0	-2.8	-4.8	-5.0	-5.3	-9.6	-10.0	-10.4
Admin. cost	-3.2	-5.0	-2.5	-6.9	-5.0	-3.5	-10.4	-10.0	-8.1
Royalty & service	-1.7	-4.0	-1.5	-3.4	-5.0	-3.6	-6.8	-5.0	-7.3
TOTAL COST	-17.6	-24.0	-17.1	-41.7	-45.0	-35.8	-80.0	-70.0	-69.1
EBITDA	10.4	9.0	5.0	13.9	17.0	5.3	48.0	61.0	37.7
Depreciations	-1.0	-1.0	-0.5	-1.4	-3.5	-0.8	-3.4	-5.0	-1.9
EBIT	9.4	8.0	4.5	12.5	13.5	4.5	44.6	56.0	35.8
Financing cost	-4.4	-2.0	-3.4	-6.8	-4.0	-5.6	-13.6	-10.0	-5.7
EBT	5.0	6.0	1.1	5.7	9.5	-1.1	31.0	46.0	30.1
Corporate tax	-2.0	-4.0	-3.7	-2.5	-4.5	-3.8	-6.0	-15.0	-10.8
NET RESULT	3.0	2.0	-2.6	3.2	5.0	-4.9	25.0	31.0	19.3

Balance sheet									
Fixed assets	247.8	246.1	217.8	247.8	246.1	217.8	252.7	246.4	217.4
Inventories	97.0	76.8	99.4	97.0	76.8	99.4	110.0	95.0	96.4
Trade receivables	87.4	119.7	123.9	87.4	119.7	123.9	99.7	100.0	121.3
Other receivables	34.3	16.5	34.8	34.3	16.5	34.8	27.4	25.0	24.9
Cash	13.7	8.9	5.2	13.7	8.9	5.2	36.4	33.2	3.8
TOTAL ASSETS	480.2	468.0	481.1	480.2	468.0	481.1	526.2	499.6	463.8
Share capital	304.1	297.0	282.5	304.1	297.0	282.5	314.1	311.5	282.5
Reserves & results	17.4	19.2	4.0	17.4	19.2	4.0	39.2	45.2	14.2
TOTAL EQUITY	321.5	316.2	286.5	321.5	316.2	286.5	353.3	356.7	296.7
Long-term loans	6.7	6.7	20.0	6.7	6.7	20.0	4.2	4.2	12.0
Short-term loans	82.9	56.4	68.6	82.9	56.4	68.6	93.9	90.3	67.6
Trade debt	44.6	65.3	74.9	44.6	65.3	74.9	50.1	24.7	80.3
Other debt	21.6	23.4	30.7	21.6	23.4	30.7	20.0	17.0	6.6
Due corporate tax	2.2	0.0	0.4	2.2	0.0	0.4	4.0	6.0	-0.6
Deferred tax	0.7	0.0	0.0	0.7	0.0	0.0	0.7	0.7	1.2
TOTAL DEBT	158.7	151.8	194.6	158.7	151.8	194.6	172.9	142.9	167.1
TOTAL LIABILITIES	480.2	468.0	481.1	480.2	468.0	481.1	526.2	499.6	463.8

Comments on deviations:

*Sales to export markets in the second half of the year are expected to fall short of the budgeted sales due to fiercer-than-expected international competition.

Example 7: Form of reporting for investments (on-going project)

Company: Evergreen Ltd.				Currency: LCY millions Reference date: 30-06-201x Financial year: 201x
	A Budget 201x	B Realised as of 30/06/201x	C Not yet realised	D Expected deviation (B + C - A)
New trucks	18.0	16.8		-1.2*
IT hardware	16.0	15.0	4.7	3.7**
TOTAL	34.0	31.8	4.7	2.5
Comments on deviations: *23 new trucks at an average price of LCY 0.73m were purchased instead of 25 new trucks at an average price of 0.72m, as the use of the company truck fleet has, in the meantime, been made more efficient. **The update of the existing IT system required 30% more man hours than budgeted for due to unforeseen and unspecified legacy specifications.				

Example 8: Form of reporting for cash flow

Company: Evergreen Ltd.

Currency: LCY millions

Reference quarter: Q2

Financial year: 201x

	Reference quarter			Year-to-date			Full year		
	Actual	Budget	Last year	Actual	Budget	Last year	Current estimate	Budget	Last year
Cash flow									
EBIT	9.4	8.0	4.5	12.5	13.5	4.5	44.6	56.0	35.8
Depreciation	1.0	1.0	0.5	1.4	3.5	0.8	3.4	5.0	1.9
EBITDA	10.4	9.0	5.0	13.9	17.0	5.3	48.0	61.0	37.7
Tax	-2.0	-4.0	-3.7	-2.5	-4.5	-3.8	-6.0	-15.0	-10.8
Change in working capital									
Inventories	-0.3	9.8	-0.9	-0.6	19.6	-1.4	-13.6	1.4	-3.5
Receivables	12.3	5.0	-3.7	24.5	10.0	-8.7	19.1	21.2	-16.4
Payables	-9.2	0.6	12.9	-18.4	1.2	16.0	-12.7	-39.1	7.5
Cash flow from operating activities	11.2	20.4	9.6	16.9	43.3	7.4	34.8	29.5	14.5
Purchase of Fixed Assets	-15.9	-16.1	-10.5	-31.80	-32.20	-21.1	-38.7	-34.0	-42.1
Purchase of Intangible Assets									
Sale of Fixed Assets									
Cash flow from investing activities	-15.9	-16.1	-10.5	-31.8	-32.2	-21.1	-38.7	-34.0	-42.1
Repayment of loans	5.0	-8.3	-3.2	10.0	-16.5	-6.5	18.5	14.9	-12.9
Net financial items	-4.4	-2.0	-3.4	-6.8	-4.0	-5.6	-13.6	-10.0	-5.7
Paid in capital	10.8	7.3		21.6	14.5		31.6	29.0	
Cash flow from financing activities	11.4	-1.0	-6.6	24.8	-6.0	-12.1	36.5	33.9	-18.6
Change in cash flow	6.7	3.3	-7.6	9.9	5.1	-25.7	32.6	29.4	-46.2
Cash at the beginning of the year	7.1	5.6	13.8	3.8	3.8	30.9	3.8	3.8	50.0
Cash at the end of the period	13.7	8.9	6.2	13.7	8.9	5.2	36.4	33.2	3.8

Working capital									
Inventories	97.0	76.8	99.4	97.0	76.8	99.4	110.0	95.0	96.4
Accounts receivable	121.7	136.2	158.7	121.7	136.2	158.7	127.1	125.0	146.2
Accounts payable	69.1	88.7	106.0	69.1	88.7	106.0	74.8	48.4	87.5
Working capital	287.8	301.7	364.1	287.8	301.7	364.1	162.3	171.6	155.1

Covenants*									
List of covenants									
Equity to assets ratio, min. 1:3 (33.33%)	67.0%	67.6%	59.6%	67.0%	67.6%	59.6%	67.1%	71.4%	64.0%
EBITDA to interest bearing debt ratio, min. 1:3 (33.33%)	11.6%*	14.3%*	5.6%*	15.6%*	27.0%*	6.0%*	48.9%	64.6%	47.4%

* If a breach of covenants occurs, please explain the following:

- Is a waiver received from the bank?
- What actions have been initiated to comply with covenants prospectively?
- What is the impact of the breach of covenants?

Explanations:

- As the greater part of the turnover and an even greater part of the profit are generated in the last half year, the agreement with the bank stipulates that whether a covenant is breached or not is only checked once a year, i.e. at the end of the financial year.

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INVESTMENT FUND FOR
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