ISSN 2616-5783 Vol.2, Issue 7: 41-49, DOI: 10.25236/AJHSS.2019.020706

Financial Reporting and Analysis Syndicate Case-Study-Lendlease Corporations Ltd (LLC)

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ABSTRACT. *This report gives an evaluation of the FY 2018 annual report of Lendlease Corporations Ltd (LLC), provides questionable numbers and summarizes the press discussion of the company's recent performance. Methods of analysis include horizontal and vertical analyses as well as the evaluation of press discussions. The examples have been attached in Appendix. Results of data analyzed show that the disclosures in LLC's report are meet the requirements of AASB. However, the report finds the questionable numbers still could be found in revenue and intangible assets, LLC didn't impair any asset in FY 2018. Also, the poor performance in their engineering and services business didn't included in the annual report.*

KEYWORDS: *Lendlease Corporations Ltd (LLC), horizontal and vertical analyses, press discussions*

1. LLC's activities

With the vision of successfully combining the disciplines of construction, development and investment, LLC was formed by David Dusseldorp in 1958. LLC is a leading international property and infrastructure group headquartered in Sydney, Australia. LLC operates with approximately 13, 000 employees in Australia, Asia, Europe and the Americas. LLC's core business activities include designing, developing, constructing, funding, owning and co investing in operating and managing property and infrastructure assets. Operations at LLC is categorized into three main segments: Development, Construction and Investment management.

2. Key accountings policies in use

2.1 AASB 15 Revenue

The provision of services and the sale of development properties are considered as revenue in LLC group.

2.1.1 Accounting policy for revenue from the provision of services

The provision of services of revenue is recognized in the Income Statement at the balance sheet date which the accounting policy is related to AASB 15. Construction and Development are revenue from the provision of services and will be always recognized (AASB 15). Moreover, Revenue from the sales is recognized in the Income Statement. It will change from the current implementation to arrangement. The process of valuation and distribution of the various components of a revenue transaction will not change.

2.1.2 Flexibility in Accounting Policies & Accounting Strategy

The Group has a wide range of customers and each project has its own risks. For instance, agents have the flexibility to set prices in order to generate additional revenue through the arrangement of services for goods or services offered by other customers (Treasury, 2018). The value of work carried out using the percentage complete method is an accounting determination as management uses judgement to consider expenses incurred to date. For the purpose of evaluating construction revenue and cost forecasting, a selection of project used to understand project progress is conducted, revenue and risks prediction as well as worked with KPMG engineering specialists where required. A typical Retirement Living Deferred Management Fees (DMF) agreement provides for an annual fee for a fixed period on the property paid by a resident. For owned retirement villages, DMF income is estimated based on the expected period of the resident's license and the capital increase after the resident's first occupation of the unit is determined on an annual accrual basis. In order to assess development revenue and cost forecasting, revenue recognized to contract terms of sale and settle accounts of cash were selected. Moreover, evaluating the company’s judgement of the risks and rewards of ownership, the customers’ credit risk as well as the company’s cost allocation method.

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2.2 AASB 136, AASB 138 and AASB 3 Intangible Asset

2.2.1 Key Accounting Policies

Intangible asset is a significant material item, which accounts for 8.4% of total assets on the balance sheet of LLC Group 2018 Annual Report, seen from appendix A.1, among which goodwill on acquisition of subsidiaries is included in intangible assets as goodwill only if it meets the definition of an intangible asset in AASB 138 Intangible Assets and its fair value can be measured reliably. The notes to Consolidated Financial Statements shows goodwill is 85% of intangible assets, seen from appendix A.2. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses (AASB 136).

2.2.2 Flexibility in Accounting Policies & Accounting Strategy

For impairment testing, goodwill is allocated to cash generating units (CGUs). Lacking fair value of goodwill, the recoverable amount of the Construction CGUs is determined based on value in use (VIU) calculations, which is estimated by the past experience and future expectations. The amount of VIU is quite flexible because the discount rate applied to the cash flow projections vary between 13.7% and 21.4%. Therefore, they concluded no impairment arose as a result of the review of goodwill for the Construction CGUs for the year ended 30 June 2018. Besides, other intangible assets' amortization is charged to the Income Statement on a straight-line basis over the estimated useful lives of the intangible assets, ranging from 3 to 20 years.

In conclusion, an aggressive application of accounting policies is performed given the above examples. The company can use VIU to avoid the decrease of the value of intangible assets and, in other words, manipulate the profit of the company by recording zero impairment loss of goodwill. Thus, managers could relieve the decline of total assets and make the balance sheet look better. Besides, the Group operates equity-settled share-based compensation plans that are linked to LLC's security price. In the short run, an aggressive application of accounting policies can help the company keep the constant value of shares so that employers can still get benefits from the overestimation of assets. However, it will have bad influence on the value of shares in the long run, which, in turn, threatens the compensation of managers.

2.3 AASB 102 Inventory

Development properties and work in progress are considered as inventories at LLC. Development properties which are properties that have been acquired for the development and sale in the ordinary course of business are recognized as a current asset. Work in progress is recognized as a non-current asset. Inventories are a material amount in the financial statements of LLC.

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2.3.1 Key Accounting Policies

Property acquired for development and sale in the ordinary course of business is carried at the lower of cost and Net realizable value (NRV). NRV is an estimate selling price, less the estimated costs of completion and selling expenses. The policy is in accordance to the AASB102. The management acknowledges in the policy that the estimation of both the selling price and the cost of completion to be an area of estimation uncertainty. They further state that the estimation considers the market conditions affecting each property and the underlying strategy for selling the property.

2.3.2 Flexibility in accounting policy and accounting standard for inventory

Inventories shall be measured at a lower of cost and realizable value (Aus 9). The cost of inventories shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. (Aus10). NRV is based on estimates that the inventories are expected to be realized. Such estimations are to be made with considerations to the fluctuations of price and costs that are in direct relation to the events affecting the inventories.

The estimations involving the calculation of NRV in relation inventory gives the management flexibility and as a result provides an opportunity for the management to exercise discretion in accounting for the valuation of the development properties within the LLC group. As inventory is a material amount in the financial statements, the flexibility that is given in the standard through the use of management discretion to gauge the selling price of inventory and the estimation in costs relating to the completion and sale gives the management an opportunity to recognize amounts that are favorable to the outlook of the financial statements. A company may be encouraged to state inflated levels of assets especially in times of financial negativity in order to provide investors with a positive outlook and to maintain debt covenants.

3. Quality of disclosures

The LLC annual report for the financial year of 2018 is its third year of presenting an integrated annual report, through which the company intends to communicate the creation of long-term value to their stakeholder through the recognition of the five pillars of value. Namely, which are health and safety, financial, customer, its' people and sustainability. The annual report has been created with reference to the international integrated reporting (IIR) framework, which highlights the importance of recognizing areas that add value to the business in its entirety and how this recognition would in the long term contribute to sustainable returns its stakeholders. Icons representing each pillar of value are used throughout the report in order to link the business activities to the value created.

The annual report highlights snapshots along with more detailed number representations in the three main segments of development, construction and investment. Each operational segment in each operational region (Australia, Asia, America and Europe) has been clearly represented through snapshots relating to the performances for the year, the proportion per region against the total, outlook of the operational movements through the year.

Accounting policies that have been followed have been disclosed in the financial statement. Areas of flexibility that requires estimation and management discretion has been exercised have been highlighted in the financial statement notes. Accounting policies adapted are in accordance to the requirements and framework of the relevant accounting standards.

4. Questionable accounting numbers

There is no impairment loss in goodwill for the year ended 30 June 2018, which is suspicious because there are some indications of impairment due to internal poor economic performance. The engineering and services businesses of LLC is underperformance. The shares of LLC lose $2.3 billion, and it plans to write down $350 million (Chau 2018). However, in LLC 2018 annual report, it assumed the next five years cash flow would increase by 3% constantly. Due to this bad news, it was hard to achieve a cash flow growth rate at 3%. The discount rate assumed to calculate the VIU is based on the range of 13.7%-21.4%, which is flexible. Based on the principle of accounting prudence, LLC should reduce cash growth rate to 2% and choose 21.4% as discount rate to recalculate the recoverable amount, shown below.

Year	2018	2019	2020	2021	2022	2023
Cash flow $m	221.8	266.16	319.392	383.2704	459.9245	551.9094
Recoverable amount $m	**1,071.22**					

Therefore, the new calculated recoverable amount $1,071.22 million is lower than carrying amount $1,421.4, so there is an impairment loss of $350.18 million and the amount of intangible asset should be written down to $1,071.22 million. The impairment loss would be directly subtracted in the income statement.

	2018 $m
Profit before tax	1,066.20
Less: Impairment loss	350.18
Adjusted profit before tax	716.02

Besides, for the businesses which are underperformance, LLC may need to disclose in the annual report. It will help the management and investors get a better idea of the business operations.

The number of revenues from construction and the sale of development properties are questionable, $12922.4 and $2602.9 respectively. For construction

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revenue, it is measured by reference to costs incurred to date as a percentage of total forecast for each contract. Management uses the percentage complete method, and we cannot know if their forecast will be overstated or understated. For development revenue, it recognized based on an assessment of when the risks and rewards of ownership transfer to the purchaser an assessment of the contractual terms of sale and of settlement risk is required. We still need to make judgments on the assessment of development revenue and profit recognition. The same with construction revenue, we cannot judge whether the predicted number is accurate.

The annual report showed revenue from the sale of development properties reduced by around 200 million. This number maybe we can estimate accurately. We can compare revenue recognized to contractual terms of sale and cash settlements and assess the LLC Group's determination of the risk and return of ownership transfer by analysing the contract sales terms in detail in accordance with the accounting standards.

5. Press discussion of LLC

LLC writes off $350 million off their books as a result of this poor performance later in November 2018 (ABC 2018). It is questionable as to why the company did not acknowledge the poor performance in their engineering and services business during the financial year of 2018.

The announcement of the write off caused a selloff in its shares causing a loss of around $2.3 billion (ABC 2018). This may have also been due to the anticipation of further write downs in the future. Investor confidence may have also taken a negative effect due to the volatility in the building/ construction industry.

Companies may choose to use the allowances given through accounting standards to exercise flexibility and management discretion in order to withhold write offs (bad news) for one specific and particular year so that the recovery in the consecutive years may in comparison seem promising and material in number.

There has also been some speculation in the media regarding a takeover of LLC by a Japanese giant Mitsui (Sydney Morning Herald 2019). Both parties have declined the speculation. However, it can be noted that generally when a company is heading towards a takeover and is in favor of it, there may be an incentive to write off assets in order to bring the net worth of a company lower than it really is. The resulting plunge in stock prices could also work in their favor in the bid to convince the shareholders to favor a takeover. Shareholders who are hesitant to sell their ownership off at a lower rate would be encouraged by the positive effect the takeover would bring to the share prices.

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6. Appendix A Tables

Table A.1 statement of financial position

Statement of Financial Position

As at 30 June 2018

	Note	June 2018 $m	June 2017 $m
Current Assets			
Cash and cash equivalents	15	1,177.1	1,249.2
Loans and receivables	22	2,670.2	2,749.2
Inventories	11	2,369.2	2,152.0
Other financial assets	14	6.7	33.0
Other assets		91.0	77.9
Total current assets		**6,314.2**	**6,261.3**
Non Current Assets			
Loans and receivables	22	787.8	507.7
Inventories	11	3,177.1	2,975.4
Equity accounted investments	12	2,626.6	834.6
Investment properties	13a	278.2	6,967.4
Other financial assets	14	1,547.8	1,203.3
Deferred tax assets	9c	120.0	129.4
Property, plant and equipment		464.7	425.8
Intangible assets	32	1,421.4	1,415.1
Defined benefit plan asset	33	154.7	64.3
Other assets		71.1	69.9
Total non current assets		**10,649.4**	**14,592.9**
Total assets		**16,963.6**	**20,854.2**

Table A.2 financial disclosure

Financial Disclosure	Note	June 2018 $m	June 2017 $m
Goodwill	32a	1,215.7	1,194.2
Management agreements		41.7	52.5
Other intangibles		164.0	168.4
Total intangible assets		**1,421.4**	**1,415.1**

Financial Disclosure	June 2018 $m	June 2017 $m
Revenue from the provision of services		
Construction	12,922.4	12,646.5
Development	605.0	581.6
Investments	291.9	507.0
Total revenue from the provision of services	**13,819.3**	**13,735.1**
Revenue from the sale of development properties	2,602.9	2,829.3
Rental revenue	37.9	23.3
Other revenue	96.0	71.3
Total revenue	**16,556.1**	**16,659.0**

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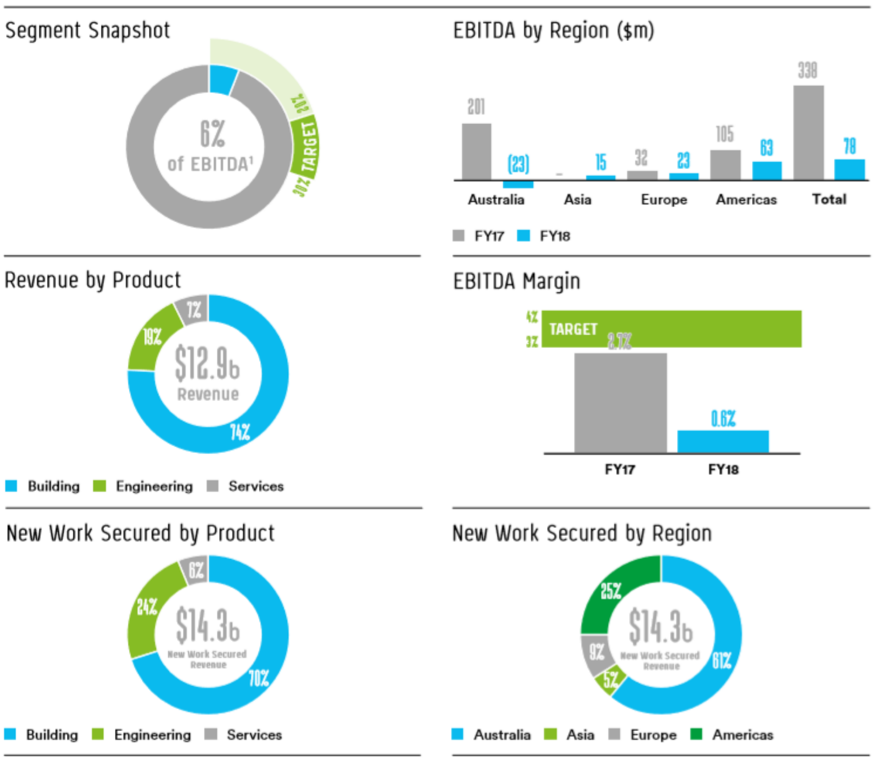
Table A.3 Cash flow

Cash Flows from Investing Activities		
Sale/redemption of investments	74.4	164.9
Acquisition of investments	(448.9)	(257.3)
Acquisition of/capital expenditure on investment properties	(112.4)	(244.4)
Net loan repayments from associates and joint ventures	409.7	5.7
Disposal of consolidated entities (net of cash disposed and transaction costs)	433.6	548.4
Disposal of property, plant and equipment	7.9	13.1
Acquisition of property, plant and equipment	(110.3)	(136.4)
Acquisition of intangible assets	(32.2)	(23.9)
Net cash provided by investing activities	**221.8**	**70.1**

7. Appendix B-Charts



1. The proportion of EBITDA from Operating Businesses.

Chart 1. Segment snapshot and Construction performance

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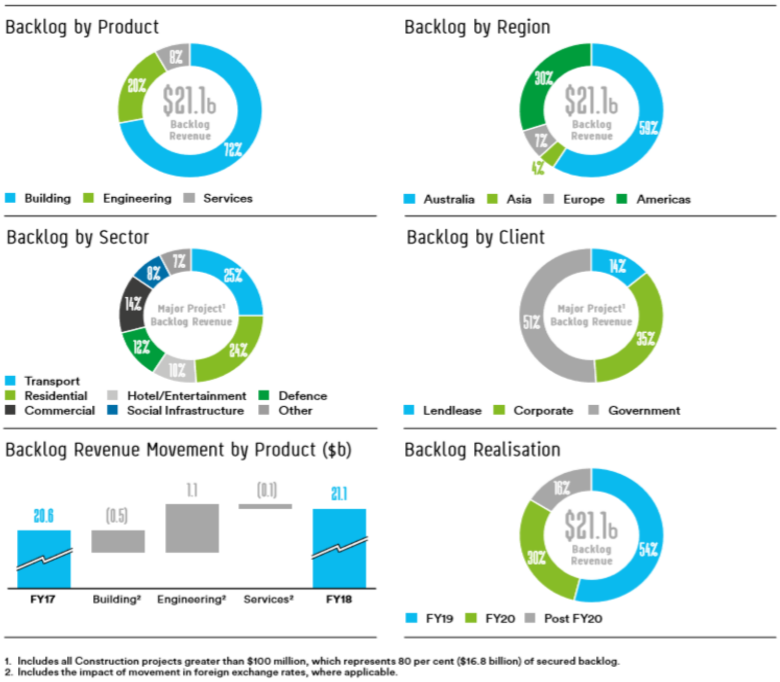

Chart 2. Construction Outlook

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