Planning and Risk Auditing at Allegiance Coal Limited

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Executive Summary

Allegiance Coal Limited is a publicly listed company based in Australia and listed on the Australian Securities Exchange (ASX: AHQ). The company's main business activities include investment in advanced and near production in metallurgical coal in countries like British Columbia and Canada. The company is involved in the acquisition and exploration of coal tenements with other potential countries for investments. The choice of its countries' investment is based on factors such as countries with good investment records and low levels of political upheavals or risks. Allegiance Coal Limited bases its assessment of its projects on capital expenditure, which is not prohibitive but less costly before making any investment. The company is committed to building a sustainable working environment with the local people with whom it engages in its investment projects.

With its presence in other countries, the company faces significant business and audit risks. Some of the notable risks include fluctuations in the currency, stiff competition from other firms, interruption of its business operations, seasonal factors and risks associated with taxation. The above highlighted risks affect the company's financial performance and audit review should be performed to assess them during audit processes. This report of Allegiance Coal Limited will encompass financial performance by looking into the following financial ratios: current ratio, quick ratio, gearing ratio, debt ratio, profitability ratio such as ordinary earnings per share and finally, assessment of the management efficiency based on the return on equity. Analysis of the company's financial ratios and interpretation indicates the company has a better financial performance in comparison with the industry averages. The audit and assurance process of Allegiance Coal Limited, especially on the risks and financial assessment, shows areas of risk of material misstatement, which are crucial areas of interest for an auditor. Revenues and assets are items that are usually prone to the risk of material misstatement. Allegiance Coal Limited is actively engaged in sustainable development programs with the indigenous in areas of its presence by building sustainable working relationships. These areas of sustainable development assurance also need external audit assurance to ascertain the risks.

Introduction And Business Overview

Allegiance Coal Limited is an international Australian firm established in 2011 and headquartered in New South Wales, Australia. The company is involved in the acquisition and exploration of metallurgical coal tenements. It has a flagship project called Telkwa metallurgical coal project based in British Colombia, Canada. The company also has an interest in the Back Creek project in Central Queensland parts of Australia. Other projects include the Kilmain project in the Bowen Basin.

Allegiance Coal Limited acquired Telkwa Coal Limited on 23rd November 2016 after the approval of its shareholders. The project is located in British Colombia and enjoys access to rail and port from the Ridley Island Terminal. This proximity creates a short shipping distance to the Asian steel mills. TCL has engaged in exploration and evaluation projects costing substantial amounts of capital. TCL's adjacent location to the Canadian National Railway line provides access to cheap haulage, saving significant amounts in capital and operation costs.

The company has drilled a significant number of coal holes, totaling 828 holes both for rotary and core. Drilled coal samples are sent to laboratories for testing and analysis. Analytical testing of coal involves seam analysis, testing of the product, complete washability analysis and burn tests. Since the acquisition of Telkwa Coal Limited, the company has successfully conducted a drilling and bulk sampling program with no safety-related incidents. A substantial amount of coal has been drilled from the mine and transported to other mineral testing fields across Canada.

To ensure proper management of its business operation in Canada Allegiance Coal Limited has made significant changes in its executive composition. At the board level, Mr. Fawcett, who held the position of a non-executive director, has been appointed the chairman of the Non-Executive, dethroning Mr. Malcolm Carson. Mr. Carson was the chairman who oversaw the acquisition of the Telkwa project and the completion of two pre-feasibility studies in the year 2017. In his capacity, he delivered outstanding results, and he will still remain Non-Executive Director.

In 2017, Allegiance Company was able to locate nine groundwater wells, which were installed 20 years ago by former project owners. Several of the wells were in good working condition, which meant a reduction in the cost associated with drilling new wells. The same year, the company completed pre-feasibility studies of the projects, which were conducted by SRK Consulting Company. This was done to ensure that production is safe and the mines are environmentally sustainable for quicker, affordable and achievable production. The pre-feasibility studies projected the mining of about 250,000 tones of saleable coal for the first year and a subsequent increase in the coming years.

The annual report about its finances for the year 31st December 2017 indicated huge losses, majorly attributed to the heavy investment and acquisition that the company undertook and the related capital expenditure projects. Revenues plummeted, and as of 31st December, it stood at AUD 3,090 against what was recorded a year ago (AUD 5,041). There was a significant loss before income tax expense during the year 2017. However, with the current investment the company has undertaken, it

has projected an increase in revenues in the coming years due to an increase in the mining quantity of coal (ASX News 1).

Significant Business And Audit Risk For Allegiance Coal Limited

Allegiance Coal Limited faces both business and audit risk, which undermines its operations. Business risks are those events that a business encounters during the normal operation of its business that affect its stability and revenues. Some of the business risks that Allegiance Coal Limited faces include market risks, financial risks, compliance risks and strategic risks. Audit risks are those risks associated with material misstatements in the financial statement of a company. Risks affect the audit outcomes and impact the operations of the company's business. The above risks are discussed below.

- Foreign Currency Risk

Allegiance Coal Limited is an Australian multinational company headquartered in New South Wales, Australia, with a presence in British Colombia, Canada, where it has a major flagship project- Telkwa Limited. This implies that the company deals with different foreign currencies subject to foreign exchange risk as a result of fluctuations in foreign exchange rates. Changes in the exchange rates affect the expected cash flow for the company. These changes in the foreign rates also lead to the transaction risks that occur during sales and purchases of materials. Revenues that the company makes in Canadian dollars from its business in Canada have to be changed to Australian dollars relative to the prevailing foreign exchange rate, and this affects the overall revenues and profitability of the company. Pricing risks, which usually arise due to fluctuations in currency rates, also affect purchases of supplies and materials. Translation risks also arise when the company consolidates its financial statements into one currency. A clear strategy should be developed to help mitigate these risks, which could lead to material misstatements during the audit process. In the 2017 annual report of Allegiance Coal Limited, Note 20 Financial Instruments, the company has a financial risk management program to mitigate this risk by using derivatives such as forward foreign exchange instruments (ALLEGINCE COAL, ANNUAL REPORT 2017, p. 55).

- Tax Risks

Allegiance Coal Limited's operation as a multinational company with its presence in other countries exposes it to various dynamic and unique tax environments. During various tax regulations in different countries and regular amendments, it becomes difficult for the company to report on tax and declare profits accurately. The various interpretations of tax laws make it difficult to consolidate the financial statements of the business. Besides being a business risk, tax risks are also an audit risk to the business. Due to differing interpretations of tax laws, there is the likelihood of material misstatement occurring during audit procedures. It is, therefore, important that the audit process within the company entails the assessment of these exposed audit risks.

- Business Interruptions Risks

This is another risk that could potentially impact the operations of a business. This risk is associated with the occurrence of unexpected events and disasters during the normal operations of a business. Some of these risks, especially in regard to coal mining, include earthquakes, floods and bad weather. The occurrence of these unexpected events will affect the operations of Allegiance Coal Limited and ultimately affect profitability. These events could also affect the value of assets. It is, therefore, important for a business to assess the business interruption risk during auditing to explain the changes in the business financials as a result of these occurrences.

- Commodity Price Risk

This risk is a result of the adverse movement in the price of metallurgical coal. Changes in the price of coal lead to a decrease in revenues for Allegiance Coal Limited, which ultimately affects the reporting of revenues in the financial statements. The disparities in reporting of revenue figures, if not identified during the audit process, may lead to material misstatements of financial figures.

Standard Regulations For Mining Companies

Different Australian states have enacted separate legislation in regard to the exploration and extraction of minerals within their boundaries. However, similar regulatory approaches are adopted in each jurisdiction. The Mining Act and State Agreements deliberate on the entitlement to mine in different states and to exercise control over an interest in mineral deposits. Mining Acts are used by states to grant licenses to miners over a designated area, while State Agreements are developed for specific large mining projects.

3.1 Mining Acts

Each state in Australia has its respective Mining Act, which dictates the entitlements to mine state minerals on land owned by the state or even private lands. Laws inscribed in the Mining Acts prescribe the conditions for obtaining certain mineral interests. The governments within the states have also adopted a common licensing system to ensure the administration of the mineral deposits. Mining licenses differ, and the type issued by the state will largely depend on the project. A prospecting license allows the holder to prospect for minerals and has the advantage that there are certain priorities for grants or general-purpose leases. Exploration license just like prospecting license allows the holder to explore minerals and a priority for grant. A retention license gives the holder the to further explore mining as well as priority for a grant. A mining lease is given to a miner as a right to work and extract minerals from the land (PRACTICAL LAW 2).

The general purpose leases are given to allow miners to erect, place and operate machinery related to mining operations or any other specific purpose associated with mining. In addition to these mining

licenses, there is a miscellaneous license granted to support the building of infrastructures that support mining activities.

3.2 Registration Of Mining Licenses And Lease.

The states maintain the registrar of mining licenses and leases issued over land. Any dealing in mining license must be legally registered by the state. Registration ensures that there is transparency in support of the overall mining license and lease system.

3.2 State Agreements

These are agreements negotiated between the applicable state government and the developers who intend to do mining. In a state agreement all the rights and obligations of both parties are outlined during the period of the development project. Before the state agreement is brokered, the developer must demonstrate the ability to finance the project and provide a logical development plan. Commitment to the project by the miner can be demonstrated by the following criteria: preparation of a feasibility study that defines the project, addressing issues relating to the environment and other indigenous issues and finally, a proper identification of the developer and the shareholders. Once all these procedures are done and settled, the state agreement is then ratified by the parliament. Ratification ensures that the state agreement stands above any provisions by other laws (PRACTICAL LAW 2).

3.3 Reporting Requirements

After a successful brokering of the state agreement, a miner will be bound by certain reporting obligations. The mining company will be required to publish an annual report of the mining activities in the area defined by the state agreement. There will be a requirement to submit quarterly investigation reports on mining activities and some specific disclosures on the financial and market arrangements. These reporting requirements are important for monitoring the progress of the mining projects.

Areas Of Concern In The Annual Financial Report 2017

4.1 Material Misstatements

Material misstatements are those errors that occur during the presentation of financial statements and could significantly affect the view of a business during a particular accounting period. Material

misstatement is covered under the International Standards on Auditing (ISA) 450, Evaluation of Misstatements Identified during the Audit (Public Company Accounting Oversight Board 1). The areas of material misstatement in financial statements based on the assessment of the financial ratios and audit risk can either be internal or external to the business. Some of the common areas of material misstatement include inaccurate implications of accounting and tax laws, the nature of the company, internal controls, capital structures and the performance measures of the company (IFAC 5).

4.2 Nature Of The Company

Allegiance Coal Limited operates as a multinational coal mining company with a presence in other countries. It presence of other countries and states affects its operations in terms of revenues and profits because of factors such as foreign exchange fluctuations and interruptions of its business operation due to events such as earthquakes. These are both internal and external risks that it faces that could lead to material misstatements. Failure to take into account the following factors when reporting its annual financial reports by auditors could lead to material misstatements and inaccurate reporting of financial results.

4.3 Capital Structure

The capital structure of a company is determined from the statement of financial position. Financial ratios such as debt-to-equity ratios can be manipulated and lead to a misstatement error during auditing. Manipulation is usually done to give a false view of the company's financial position and source of financing. From the annual report of Allegiance Company, the capital structure is majorly made up of equity rather than debts (borrowings plus long-term liabilities).

4.4 Company's Financial Performance Measures

Some of the measures of a company's financial performance include the current ratio, quick ratio, return on equity, turnover ratios and gross margin. These financial ratios can be easily manipulated and give rise to the risk of misstatement to reflect perhaps high profitability or sales turnover, which might not be the case. The audit process should check on the accuracy of these ratios to ensure they give a fair view of the company's performance (IFAC 5).

Financial Ratios

Tax Risks	Formula	2017		2016		Industry Average

Current Ratio	Current Assets/Current Liabilities	1,859,295 350,010	5.31	1,429,101 2,063,015	0.69	2
Quick Ratio	cash + cash equivalents+ trade and other receivables/current liabilities	94, 832+1,637,343 350,010	4.95	1,418,192+5,536 2,063,015	0.69	1
Gearing Ratio	total liabilities/ total equity	933,232 4,144,066	0.23	2063015 383,914	(5.37)	
Debt Ratio	total debt/ total assets	933, 232 5,077,298	0.18	2,063,015 1,679,101	1.23	
Ordinary earnings per share Return On Equity	(net income-preferred dividends)/ outstanding common shares net income/ shareholder's equity	 984,621/4,144,066	(0.80) (0.24)	 3,263,070/383,914	(9.25) (8.50)	

Commentary On The Financial Performance

6.1 Liquidity

The above financial ratios show how the company has performance for the accounting period 2016 and 2017. The current ratio is used to show how the company is able to meet its short-term obligations. The current ratio for the year 2016 was 0.69 which has improved to 5.31 in the year 2017. This shows that the company is liquid and is able to meet its obligations when they fall due. In comparison with the industry average, the company is highly liquid, especially in the year 2017 (ASX News 1).

The debt to equity ratio is used to assess the composition of the capital structure of the company. The company has more assets, which it uses to generate more money; hence, it is less leveraged. The

gearing ratio is also used to assess if the company can survive during the economic downturn, and it also shows the leverage of a firm.

6.2 Profitability

In terms of profitability and assessment using the ordinary earnings per share, the firm is not doing well, and it is not creating value for the shareholders. Ordinary earnings per share are very low for both years (ASX News, ANNUAL REPORT 1).

6.3 Efficiency

The management of the firms is quite appalling, as indicated by a negative return on equity. It is evident that the management decisions on investment are poor. The current management is not creating any value at all to the shareholders in the two successive years.

Audit Assessment

Yes. I clear understanding of the client's business and audit risks will make it easier to conduct auditing and assurance, taking keen consideration in areas of material misstatements to avoid problems with inaccurate financial reporting and audit-related fiasco.

Conclusion

Due to the nature of Allegiance Coal Company and its presence across other countries, it faces significant risks that are possibly affecting its operations. There is a need to assess this risk in this audit process. Financial analysis of this company reveals a favourable liquidity position, however, the efficiency and profitability of the company is adverse. This area needs to be reviewed during the audit to avoid any errors or material misstatements during financial reporting.

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