

One.Tel Case

Strategic Business Risk Assessment, Inherent Risk Assessment and Preliminary Going Concern Assessment

This Case is based on Week 5 to 8

Nature of the Entity's Business

One.Tel was launched in Sydney, Australia in May 1995. They were described as a global telecommunications company offering a fully integrated product list including low-cost international and national calls, Internet services, prepaid and post paid calling cards plus GSM mobile phone services. Their strategies as customer-focused and dedicated to providing innovative, quality telecommunication services at reduced prices. Details of total revenue by geographic segment for the year ended 30 June 2000¹ are as follows:

| <i>Country</i> | <i>\$M</i> | <i>%</i> |
|-----------------------|---------------------|-----------------|
| Australia | 429.4 | 64 |
| UK | 144.7 | 21 |
| France | 15.1 | 2 |
| Netherlands | 36.6 | 5 |
| Hong Kong | 39.2 | 6 |
| Other | <u>13.2</u> | 2 |
| <i>Total</i> | <u>678.2</u> | |

The Industry

Australia's telecommunications infrastructure with a fully digitised network is as sophisticated and as modern as any in the world. Land based phone lines penetrate about 96 per cent of all households, with 2 million Internet subscribers and over 7 million Internet users. Mobile phone services are well established in Australia with more than 8 million users or 42 per cent of the population, one of the highest user rates in the world. Telstra, Optus and Vodafone each operate separate GSM mobile networks. Telstra's market share is around 57 per cent, Optus 31 per cent and Vodafone 11 per cent. (Source: *US Department of State FY2001 Country Commercial Guide*)

Prior to the deregulation of Australia's telecommunications industry on 1 July 1997, there were two carriers. There are now 35 carriers who are often former service providers and are generally reliant upon leasing network capacity from Telstra, although some are developing their own switching and network capability.

The influx of smaller carriers into the telephony market has acted as one of the major developments in producing important competitive results in the deregulated market. These carriers typically provide international and long-distance calls and, more recently, complete telephony services. The

¹ Note 22 of Financial Statements for year ended 30 June 2000 for One.Tel Limited, ACN 068 193 153, and Controlled Entities, One.Tel web site.

growth in revenue does not correspond directly with growth in the number of telecommunication service providers due to greater market competition, reduced prices, and lower revenue per company.

Telstra, the former monopoly carrier, is the dominant provider of Australia's land-based telephony service. This network has nearly 10 million connections and an annual growth rate of five per cent. Telstra still dominates the telecommunications environment although its market share has dropped significantly in recent years.

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Management

The Board of One.Tel comprised nine members, including five non-executive directors and four executive directors. Due to the rapid growth of the industry described in the previous section significant managerial experience in the industry was limited. The functions of the board included:

- i. approval of corporate strategy, and financial plans;
- ii. identifying and addressing areas of significant risk facing the company;
- iii. reviewing and monitoring management processes and reporting mechanisms;
- iv. monitoring financial performance;
- v. appointment of the senior management team.²

² Statement of Corporate Governance in Financial Statements for the Year Ended 30 June 2000 for One.Tel Limited, ACN 068 193 153, and Controlled Entities; One.Tel web site.

Financial Statements³

BALANCE SHEETS AT 30 JUNE 2000

| | Note | Consolidated | | Parent Entity | |
|---------------------------------------|------|----------------|--------------|----------------|--------------|
| | | 2000 | 1999 | 2000 | 1999 |
| | | \$M | \$M | \$M | \$M |
| CURRENT ASSETS | | | | | |
| Cash | 25 | 335.7 | 172.6 | 164.2 | 170.8 |
| Receivables | 9 | 218.4 | 72.0 | 104.0 | 58.9 |
| Inventories | 10 | 5.1 | 2.5 | 4.5 | 1.8 |
| Other | 11 | 68.9 | 49.1 | 50.8 | 35.3 |
| TOTAL CURRENT ASSETS | | 628.1 | 296.2 | 323.5 | 266.8 |
| NON CURRENT ASSETS | | | | | |
| Investments | 12 | — | — | 26.0 | 17.1 |
| Receivables | 9 | — | 2.9 | 356.7 | 62.0 |
| Plant and equipment | 14 | 155.7 | 41.0 | 85.9 | 28.1 |
| Intangibles | 15 | 559.8 | 28.0 | 522.3 | — |
| Other | 11 | 91.9 | 157.9 | 71.1 | 132.3 |
| TOTAL NON CURRENT ASSETS | | 807.4 | 229.8 | 1062.0 | 239.5 |
| TOTAL ASSETS | | 1,435.5 | 526.0 | 1,385.5 | 506.3 |
| CURRENT LIABILITIES | | | | | |
| Accounts payable | 16 | 277.2 | 73.0 | 115.5 | 50.4 |
| Borrowings | 17 | 92.2 | 7.2 | 20.2 | 7.2 |
| Provisions | 18 | 5.8 | 4.7 | 5.2 | 4.4 |
| TOTAL CURRENT LIABILITIES | | 375.2 | 84.9 | 140.9 | 62.0 |
| NON CURRENT LIABILITIES | | | | | |
| Accounts payable | 16 | — | — | 2.3 | 1.2 |
| Borrowings | 17 | 107.3 | 62.9 | 80.5 | 62.9 |
| Provisions | 18 | 8.2 | 15.2 | 8.1 | 14.6 |
| TOTAL NON CURRENT LIABILITIES | | 115.5 | 78.1 | 90.9 | 78.7 |
| TOTAL LIABILITIES | | 490.7 | 163.0 | 231.8 | 140.7 |
| NET ASSETS | | 944.8 | 363.0 | 1,153.7 | 365.6 |
| SHAREHOLDERS' EQUITY | | | | | |
| Share capital | 19 | 1,225.6 | 355.6 | 1,225.6 | 355.6 |
| Convertible notes | 17 | 0.1 | 3.7 | 0.1 | 3.7 |
| Retained profits/(accumulated losses) | | (282.1) | 9.1 | (68.7) | 9.6 |
| Reserves | 20 | 1.2 | (5.4) | (3.3) | (3.3) |
| TOTAL SHAREHOLDERS' EQUITY | | 944.8 | 363.0 | 1,153.7 | 365.6 |

³ Financial Statements for the Year Ended 30 June 2000 for One.Tel Limited, ACN 068 193 153, and Controlled Entities; One.Tel web site.

FINANCIAL STATEMENTS OF CASH FLOWS FOR THE YEAR ENDED 30 JUNE 2000

| | Note | Consolidated | | Parent Entity | |
|---|-----------|----------------|---------------|----------------|---------------|
| | | 2000 | 1999 | 2000 | 1999 |
| | | \$M | \$M | \$M | \$M |
| CASH FLOW FROM OPERATING ACTIVITIES | | | | | |
| Receipts from customers | | 510.9 | 300.1 | 283.3 | 250.2 |
| Payments to suppliers and employees | | (684.8) | (328.1) | (327.4) | (250.2) |
| Interest received | | 16.9 | 1.9 | 11.1 | 1.9 |
| Interest and other borrowing costs paid | | (11.9) | (3.5) | (7.5) | (3.5) |
| Income tax refunded | | — | 0.7 | — | 0.7 |
| Net cash used by operating activities | 25 | (168.9) | (28.9) | (40.5) | (0.9) |
| CASH FLOW FROM INVESTING ACTIVITIES | | | | | |
| Proceeds from sale of investments | | — | 1.6 | — | 1.6 |
| Proceeds from sale of plant and equipment | | — | 19.2 | — | 19.2 |
| Payment for plant and equipment | | (87.5) | (34.0) | (32.3) | (20.0) |
| Purchase of licences | | (525.6) | (9.5) | (523.1) | — |
| Purchase of Controlled Entities | | — | (6.9) | — | (6.9) |
| Payment of deferred consideration | | (1.8) | — | (1.8) | — |
| Loans provided to wholly owned entities | | — | — | (264.4) | (53.8) |
| Loans provided to other parties | | — | (2.6) | — | (2.6) |
| Net cash used by investing activities | | (614.9) | (32.2) | (821.6) | (62.5) |
| CASH FLOW FROM FINANCING ACTIVITIES | | | | | |
| Proceeds from issue of shares | | 818.5 | 280.3 | 818.5 | 280.3 |
| Proceeds from borrowings | | 139.8 | 59.0 | 50.0 | 59.0 |
| Finance lease principal repayments | | (11.2) | (4.2) | (11.2) | (4.2) |
| Dividends paid | | (1.8) | (2.5) | (1.8) | (2.5) |
| Share buy-back | | — | (106.4) | — | (106.4) |
| Net cash provided by financing activities | | 945.3 | 226.2 | 855.5 | 226.2 |
| Net increase in cash held | | 161.5 | 165.1 | (6.6) | 162.8 |
| Cash and cash equivalents at beginning of year | | 172.6 | 8.4 | 170.8 | 8.0 |
| Exchange rate adjustment | | 1.6 | (0.9) | — | — |
| Cash and cash equivalents at end of year | 25 | 335.7 | 172.6 | 164.2 | 170.8 |

PROFIT AND LOSS STATEMENTS FOR THE YEAR ENDED 30 JUNE 2000

| | Note | Consolidated | | Parent Entity | |
|--|------|--------------|--------|---------------|-------|
| | | 2000 | 1999 | 2000 | 1999 |
| | | \$M | \$M | \$M | \$M |
| Earnings/(loss) before depreciation, amortisation, interest, abnormal items and income tax | | (230.4) | 25.2 | (57.3) | 24.7 |
| Depreciation and amortisation | 2 | (35.3) | (12.3) | (26.6) | (9.8) |
| Net interest (expense)/revenue and other borrowing costs | 2 | 3.3 | (1.6) | 4.3 | (1.6) |
| Operating profit/(loss) before abnormal items and income tax | | (262.4) | 11.3 | (79.6) | 13.3 |
| Abnormal items | 4 | (33.5) | (1.4) | (5.4) | (1.4) |
| Operating profit/(loss) before income tax | 2 | (295.9) | 9.9 | (85.0) | 11.9 |
| Income tax (expense)/benefit attributable to operating profit/loss | 3 | 4.8 | (2.9) | 6.8 | (4.0) |
| Operating profit/(loss) after income tax | | (291.1) | 7.0 | (78.2) | 7.9 |
| Retained profits at the beginning of the financial year | | 9.1 | 5.1 | 9.6 | 4.7 |
| Total available for appropriation | | (282.0) | 12.1 | (68.6) | 12.6 |
| Dividends provided for or paid | 7 | 0.1 | 3.0 | 0.1 | 3.0 |
| Retained profits/(accumulated losses) at the end of the financial year | | (282.1) | 9.1 | (68.7) | 9.6 |