FINANCIAL TIMES

SUMMER 20/2021

Thomas Noble & Russell

Accountants | Auditors | Business Advisers

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FINANCIAL MODELLING SUPPORTING DECISION MAKING

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A robust financial model allows management and other users to analyse various scenarios and make decisions when assumptions, and consequently the outcome, is uncertain.

In any business, planning is a difficult task for management given the number of uncertainties and various potential outcomes, which is emphasised in today's economic environment resulting from COVID-19.

A financial model can help to alleviate difficulty in decision making and minimise potential risk, by allowing assumptions to be clearly stated and imposing a logical calculation of the likely outcome should those assumptions hold true.

Management can also use this tool for scenario analysis and compare best and worst-case scenarios to ensure all bases are covered when making critical decisions.

Another benefit of a well-constructed financial model is once these assumptions change and crystallise, the financial model can be updated, and decision makers can have the most up-to-date information on the likely outcomes for the business.

There are many examples of how businesses can use financial models for strategy and decision making: forecasting key financial information such as profit and cash, assessing the likely return on a particular project, comparing options for debt or equity raisings and valuing businesses for a potential merger or acquisition.

In all of these cases, the benefit of using a financial model in decision making is outputs are clearly calculated and communicated, and should certain assumptions be challenged or used in a scenario analysis, assumptions can be changed by any user and outputs will update in real time.

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A practical example of how financial models can support business strategy and decision making is the recent Energy Fiji Limited transaction completed with Fiji banks totalling FJ 335M. Several banks were invited to submit tenders for financing Energy Fiji, with HLB Debt Advisory acting as the core independent adviser to Energy Fiji in this transaction.

In order to submit their tenders, the banks needed an understanding of what the key ratios of the business would be, such as debt covenants. As the advisers, HLB prepared a financial model which showcased these key ratios based on forecast financial information. In building this forecast model, there were a few unknown assumptions such as the dividend payment ratio and capital expenditure, as these decisions were yet to be made by management. It was important the financial model included a scenario analysis summarising how these key ratios would differ if different assumptions were used to calculate the forecast financial information, as this allowed the banks to assess the key ratios under each situation and ultimately allow them to submit their tenders despite uncertainties relating to the forecast position. Without the aid of a financial model and scenario analysis, the banks would not have the necessary information to be able to make an informed decision.

Furthermore, the management team and Board of Energy Fiji Limited used - and continues to use - the financial model to assist them in critical decision making and covering key items such as major capital expenditure planning, dividend payments and future equity-based transactions.

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SECTOR TACKLES UNCONSCIOUS BIAS

TONY FITTLER
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The HLB Mann Judd Australasian Association was recently invited to participate in a landmark global study addressing the issue of unconscious bias within leadership positions of professional service firms.

The study and its findings shone fascinating insight into an area the Australasian Association has been proactively seeking to address and engage on for some time now; that diversity and inclusiveness is critical to the underlying success of a business, and that the process for addressing many of the issues identified in the report is well underway.

The Unconscious Bias Awareness Study questioned whether unconscious bias is the underlying cause of inequality within the professional services industry. Through research, both with HLB managing partners across the globe and external sources, the study considered the impact unconscious bias has on career progression, diversity and inclusion within the profession.

Professor Kamal Munir from Cambridge Judge Business School, University of Cambridge, led the research team and delivered the findings.

The Australasian Association intends to use the study's findings as a barometer for current practices, and identify where and why bias overtakes objectivity throughout its initiatives.

Some of the key findings of the research include:

- While the number of female public accountants has steadily increased, there is still a significant lack of female leadership within the industry, with the traditional career curve for women in accounting rarely accommodating motherhood
- The lack of diversity in leadership positions comes as a direct result of practices and unconscious bias which exists on the grassroots level within the industry. This has a direct impact on the attractiveness of the profession, with 67 per cent of HLB managing partners agreeing that prospective employees look at the demographic make-up of the firm and leadership team when assessing an employer brand
- Unconscious biases are small bricks that support our mental 'mortars' and stand at the foundations of many organisational practices. Removing all of them at once is neither feasible nor sustainable. However, gradual minor adjustments made both on the grassroots and leadership levels can yield a substantial impact for the professional services industry.

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DIRECTORS' OBLIGATIONS POST PANDEMIC

TRAVIS RICKARD
Partner, Audit & Assurance
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2020 has proven to be a whirlwind for Australian businesses with many struggling to cope with the financial implications and fallout of COVID-19, shining a spotlight on the obligations of company directors.

Those with large workforces - and particularly businesses involved in aged care and disability - have had to manage the increased costs associated with managing the spread of the Coronavirus infection, while continuing to provide services to their clients.

This has translated into significant increases in direct service costs without a proportionate increase in revenue, resulting in reduced surplus or, in some instances, increased deficits.

Some organisations face the prospect of not being able to pay their debts when they fall due in the foreseeable future and thereby risk trading insolvent. Others may be in a stronger position but are still impacted by the financial fallout of COVID-19, resulting in a deferral of planned growth initiatives or delays in capital expenditure commitments.

So, what is the role of management in reporting these implications?

Boards need to be provided with accurate, relevant and timely information that enables them to make necessary decisions for the future. For some organisations, traditional profit and loss reporting will not be sufficient and cash flow reporting will need to be adopted.

Many organisations have delayed the annual budgeting process until certainty is provided on their sector's future. Now is the right time to forecast where the organisation's cash position will be in three, six and 12-months' time. Even with this level of uncertainty, a cash flow forecast in current conditions will provide a base point of the financial life and viability of the organisation.

There will be a number of key areas for directors to consider in the June 2021 reporting period, including:

- Cash flow and going concern - can your organisation pay its debts when they fall due? Responsible persons signed a statement to this effect in the 30 June 2020 financial report which covered a minimum period of 12 months from date of signing the 30 June 2020 financial report. Since March 2020, JobKeeper has been the lifeline for many organisations who would otherwise be severely impacted
- Impairment of assets - as a result of reduced financial performance, and deteriorating operational cash flows, is the carrying value of land and buildings impaired? Are clients and customers facing the same financial difficulty? This could cast doubt over their debts to the organisation and whether they are collectable. If so, directors may need to consider impairment in the 2021 financial report
- Fraudulent financial reporting - are there any pressures or motives for management to manipulate revenue and expenses to achieve a desired result for the year? There is certainly the incentive for organisations that are struggling to be able to qualify for JobKeeper and other government stimulus measures. Is there a potential risk of manipulation of an organisation's financial results in order to continue receiving this stimulus?

In addition to the above areas, there are also reporting obligations specific to the not-for-profit sector which directors within these organisations need to adhere to. Responsible persons (defined generally as boards or committees) for charities registered with the Australian Charities and Not-for-profits Commission (ACNC) need to ensure their organisation complies with ACNC legislation, as well as fulfilling their own duties under the ACNC governance standards.

They are responsible for the fair presentation of their financial reports in accordance with Australian Accounting Standards and for such internal control determined necessary to enable the preparation of a financial report that is free from material misstatement, whether due to fraud or error.

Boards should be monitoring these points more regularly going forward considering the uncertain future facing organisations today.

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AGED PENSION AND AGED CARE POST COVID-19

LUKE ROBSON
Financial Adviser
BRISBANE

The pandemic-induced economic crisis has produced both great challenges and great opportunities.

The Federal Government has responded both swiftly and generously across a number of financial channels to help households get through the current uncertainty. The effect of these changes can be seen across the superannuation system and government entitlements, but there are nuances for the aged pension and aged care systems, including:

Aged pension

When calculating aged pension payments, Centrelink will use two tests - the assets test and the income test.

Assessable assets in most cases are calculated based on market values, so if COVID-19 has negatively impacted the value of one's investments, property or super, you may be eligible to receive an aged pension or have a current payment increased.

Assessable income is calculated by either looking at the actual income earned or applying a deeming rate. In response to COVID-19, the government has lowered the deeming rates for a single person to .25 per cent on the first $53,000, and 2.25 per cent for every $1 above. Current cash rates are very low, so it's unlikely you will be earning 2.25 per cent. It's therefore important to make sure you are maximising your earnings potential on investments within your risk tolerances, as it will not negatively impact your aged pension payment.

It's worthwhile considering the value of an aged pension in the current environment. Aged pension thresholds dictate a loss of $3.00 per fortnight for every $1,000 you have over the asset test threshold. In other words, it costs you $78 a year to keep an extra $1,000 in the bank, which is effectively a 7.8 per cent earnings rate. A full single aged pension is $24,551 per annum, at current cash rates of 1 per cent, you would need $2.45 million in the bank to earn an equivalent income. Restructuring your current assets to take advantage of an aged pension can result in a lucrative payment based on today's cash rates.

Aged care

Prior to COVID-19, the choice of either paying a Refundable Accommodation Deposit (RAD) or Daily Accommodation Payment (DAP) could be calculated with more certainty where a client's asset base supported either option. Most lump sums for aged care are funded from either the family home or investment assets. Today, both of those asset pools may have experienced reductions in capital values.

The choice is now more difficult; should you pay the 4.10 per cent DAP interest rate and keep those investment assets, or liquidate assets and accept a potential capital loss?

Both share and property markets have recovered faster than anticipated. If this trend continues, it makes the decision to liquidate assets important and potentially very costly in the long term.

Every individual's situation is now likely to have changed and should be carefully considered.

To ensure the right outcome, it is best to seek the advice of experts to help guide your decision making.

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GOVERNANCE IN A PANDEMIC

JUDE LAU
Partner, Audit & Assurance
MELBOURNE

The importance of having an appropriate governance framework and the necessary processes to support the framework has never been more important.

Sound governance arrangements have enabled countries and businesses worldwide to cope, survive and for some, to thrive during the global pandemic.

Understanding some of the core ingredients needed to create a sound governance framework in order to prosper or survive is paramount. The key factors of sound governance typically include:

- Structure – this is commonly referring to the organisational and reporting structure established by the Board or those charged with governance (TCWG). It needs to be underpinned and reflect an organisation's values. It commonly accepted that TCWG are accountable for all acts (both undertaken or omitted), and/or whether they were formally approved or implemented by TCWG. Governance applies to all size and type of organisation, and it is incumbent upon TCWG to exhibit and act with leadership, integrity and conviction at all times in upholding its values
- Oversight – without oversight and analysis, one is unable to determine if the established protocols, processes and procedures are being observed, otherwise it's difficult to identify and implement adjustment opportunities
- Talent and culture – it's commonly accepted that people are the most important asset of any business. It's therefore incumbent upon TCWG to empower its people via suitably designed and fit for purpose business management processes and principles to implement the stated objectives and strategies of the business. It's important that the framework allows for growth and development, and importantly, learning from errors made
- Resources and infrastructure – these represent the suite of tangible and intangible resources needed to enable an organisation to function.

An organisation's risk appetite and ethics also play a critical role in framing its governance framework. It's important to take considered and calculated risks in business while balancing the need to comply with business regulations and professional standards, while acting at all times with integrity and respect.

In times of crisis such as a pandemic, it becomes clear that TCWG observe its governance framework without fail, and ensure its decision-making framework does not waiver from its guiding values. It is also important to accept responsibilities for failings and address them in a timely manner.

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APPOINTMENTS

KAPIL KUKREJA
Director, Risk, Assurance & Consulting
MELBOURNE

Kapil Kukreja has been promoted to director of the Risk, Assurance & Consulting Division in Melbourne.

With more than 14 years' experience in providing professional advisory services, Mr Kukreja has extensive experience in providing advisory services including internal audit, risk management, fraud investigations, Sarbanes-Oxley Section 404 compliance, cyber security, probity, and process mapping and improvement projects.

His client base is concentrated within the manufacturing, retail, natural gas transmission, automotive, telecommunication, and government sectors.

Mr Kukreja holds a Bachelor of Commerce (Honours) an MBA (Accounting and Finance) and a Post Graduate Diploma in Professional Accounting from Griffith University. He is also a Certified Internal Auditor with the Institute of Internal Auditors.

Melbourne's Risk, Assurance & Consulting services encompass a broad range of services to support government departments and councils as well businesses and NFP organisations.

THE COVID STIMULUS BUDGET – WHAT'S IN IT FOR ME?

PETER BEMBRICK
Partner, Tax Consulting
SYDNEY

What a difference a year makes! We've gone from last year's expectations of being "back in the black" for the first time in several years, to record deficits not seen in the post-war era.

The massive extent of the Federal Government's fiscal stimulus was obviously expected and encouraged by many, with the inevitable analysis of which groups gained and lost the most from this year's Budget measures.

Some of the key areas of focus include:

Personal tax cuts

The centrepiece of the Budget was the bringing forward of stage two of the previously announced tax cuts from 1 July 2022, not just to 2021, but backdated to 1 July 2020. This was a surprise move, and one that provides a more immediate cashflow benefit.

Now that the legislation has been passed, employees should have seen an increase in their after-tax pay from November, although they will have to wait until lodging their 30 June 2021 tax return to get the benefit of the tax cut that relates to the period from July to October 2020.

Those paying PAYG instalments, including investors and business owners, would need to vary their instalments by estimating their expected tax for 2021 under the reduced rates in order to gain an immediate benefit.

Any individuals earning less than $126,000 will also benefit from the decision to retain the Low and Middle-Income Tax Offset (LMITO) for 2021, despite the tax cuts, although again this benefit will not be received until lodging their 2021 tax returns, and the benefit is short-lived as it disappears from 2022.

Tax concessions for small business

Business taxes were a key focus of the Budget, with the government wanting to do everything possible to help drive economic activity, especially as JobKeeper continues to wind down.

One initiative has been to progressively expand the scope of certain key small business concessions that have previously been available only to those with aggregated turnover up to $10 million by raising the turnover threshold to $50 million.

Instant asset write-off concessions

Another major area is further changes to the rules on outright deductions for capital asset purchases, with all business having aggregated turnover up to $5 billion being able to deduct the cost of new depreciable assets (subject to the normal luxury car limits) purchased from Budget night (October 6) up to 30 June 2022. For second-hand assets, the existing concession for claiming purchases costing up to $150,000 still applies for turnover up to $500 million that are purchased by 31 December 2020, with an extra six months being granted until 30 June 2021 to first use or install such assets.

Loss carry-back rules

The next major initiative is the temporary re-introduction of loss carry-back rules, which existed briefly in 2013. Any corporate entity with aggregated turnover of less than $5 billion may choose to carry-back the benefit of losses from the 2020, 2021 or 2022 years where tax has been paid in 2019 or later years. The benefit will be received as a refundable tax offset, limited to the amount of previously taxed profits and ensuring that the tax offset does not produce a franking account deficit for the company.

While this is a very welcome measure and one to be applauded, unfortunately the first opportunity to claim the tax offset will be on lodgement of the company's 2021 tax return, so it will be some months before any direct cash flow impact will be felt.

Superannuation

There were only minor changes to superannuation this year, focused around improving efficiency for members of larger funds. These changes include the proposed development of a new *YourSuper* portal that will enable new employees to choose from a table of *MySuper* products, the "stapling" of an existing account to a member to avoid the creation of a new account when changing employment, and *MySuper* benchmarking of products by APRA from July 2021 to improve transparency.

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"This was a surprise move, and one that provides a more immediate cashflow benefit."

HLB SUPPORTS COVID-19 AFFECTED HOMELESS, YOUTH

An initiative designed to support COVID-19 recovery in local communities was recently undertaken by HLB Mann Judd.

The HLB Mann Judd Australasian Association participated in #HLBCommunities Day, a corporate social responsibility initiative rolled out globally. HLB Mann Judd collectively volunteered 2,223 hours through 117 participants across seven individual community projects.

The Australian firms took part in several different projects to help the homeless and youth on the streets by packing backpacks and care packs.

The staff in Fiji partnered with local community organisations to clean up the streets of Nadi Town as well as plant mangroves to mitigate climate change.

The day was just one example of the global network working together in recognition of the greater good. While most people have been adversely impacted by COVID-19, there are some in our communities who have been affected more than other, with #HLBCommunities Day a practical means for the firm-at-large to give back to those less fortunate.

Our Melbourne office, in particular, rose to the task given their own challenges faced with the state's extensive lockdown period. The team came together virtually to show support for #HLBCommunties Day, which was appreciated by all involved.

Globally, the HLB network collectively volunteered 7,393 hours through 1,111 participants across 31 community projects.

CONTACT

The HLB Mann Judd Australasian Association comprises a number of independent accounting firms in Australia, New Zealand and Fiji.

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CLIENT CHOICE AWARDS 2020
beaton nab
WINNER

SPOTLIGHT ON... PERTH

LUCIO DI GIALLONARDO
Managing Partner
PERTH

With its hard border stance, Western Australia has largely weathered the fallout from the COVID-19 pandemic and the state's economy is on track for further growth in 2020/21. Newly-elected managing partner of HLB Mann Judd Perth, Lucio Di Giallonardo, explains how the firm is poised to capture and service growing demand from local business owners.

From a very young age, I was taught the piano accordion and my teacher was a partner in an accounting firm in Perth. We kept in touch throughout high school and when I indicated I was interested in a career in accountancy, he arranged a meeting between myself and another partner in his firm.

It was an unconventional foray into accounting and, fortunately, it's been like that somewhat ever since; the profession has endured constant change since I became partner in the mid-90s, which is exciting. Technology has really driven much of the change, and with new developments, particularly to do with automation and the way clients are serviced, it's re-engineered the way our firm operates.

At a strategic level, using these advancements in technology will form a major part of my tenure – how can we continually improve the way we deliver our service to the benefit of our clients?

COVID-19 of course has also led to developments involving technology and client engagement through the widespread adoption of platforms such as Zoom and Microsoft Teams, and has changed the way we do business.

In addition to technology, we're also grappling with the volume of continually-changing government regulations, which have increased markedly during my time in the profession. Dating back to Enron and other high-profile corporate collapses over the years, regulators now react quite sharply with the introduction of new regulations. Our firm and indeed the profession-at-large has systems in place which are documented, monitored and recorded, and has unquestionably made us more accountable.

At a very practical level, our partners and staff have been doing all they can to ensure our clients are taking advantage of the various stimulus packages available. Our clients need to receive the appropriate advice required to see them through troubled times. Even though WA hasn't been badly impacted from a health perspective, there are still plenty of businesses struggling to stay afloat. Mergers are often needed to achieve economies of scale, particularly in the not-for-profit space.

We're also looking to expand our business services division, not by means of a merger but rather seeking to align with one or two-partner practices that are struggling to cope with the increased regulations. Under such arrangements they could potentially leverage from our internal infrastructure, such as IT, HR, finance and marketing support. This will be a key area of focus for me over the coming couple of years.

In terms of sectors, we're very strong in energy and resources; within audit and corporate services, we audit around five per cent of the total listed companies in Australia, with a large number of these being in resources. However, the number of listed clients in other sectors such as technology, manufacturing and agriculture, is expanding.

Within our business services division, property and building construction is one of our key sectors, along with medical specialists. The latter in particular is seeing growth as a result of COVID-19, and we're starting to offer a back-office service as many specialists are increasingly time-poor and don't have capacity for 'the numbers' so we're now able to perform that on their behalf.

With so much change and uncertainty, it's vital for the firm to be in a position to respond to new opportunities – or business risks – and act quickly and appropriately.

We also have a number of firm values in place, with every decision aligning with these values. COVID-19 has really brought accessibility and trust to the fore, and it's my job to ensure all our staff and partners are living by these values.

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