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DECISION-MAKING UNDERPINNING BUSINESS LONGEVITY



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According to research by McKinsey & Company, an estimated 20 per cent of business owners believe their business excels in decision-making – and that was pre-COVID!

So, amid far greater uncertainty, what steps can business owners take to improve their confidence in decision-making?

Critically, it's important to consider the broader economic environment and whether some fiscal and monetary levers could impact your business.

Inflation rates are a good starting point, providing an indication of how the macroeconomic environment is evolving. Annual inflation rates are beginning to rise significantly across developed economies in particular. The US recently hit an annual rate of 5.4 per cent and New Zealand is also experiencing its highest rate of inflation since 2011. The annual rate as at the end of June 2021 jumped to 3.3 per cent, which more than doubled the annual rate posted in the March 2021 quarter results.

While inflation in Australia has been relatively subdued to date, with the record high levels of stimulus combined with the record low interest rates, speculation is rife about whether – or when – rates are likely to rise.

In times of uncertainty, traditional approaches to decision-making can be dangerous. Business owners with a strong bias for action, and a just-do-it approach to management can inadvertently lead their businesses astray. On the other hand, business owners who are more risk adverse, and slower to act, can find themselves in a state of decision paralysis.

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While both approaches have merit under normal operating conditions, effective decision-making in times of uncertainty needs to be more calculated, informed and timely than usual.

The best performing businesses are realistic and acknowledge the conditions they are trading in. They consider the alternative scenarios and then focus on the things within their control. They will generally have a strong understanding of the key drivers within their business, monitor them closely and act both quickly and decisively when required.

There will be nuances depending on the industry and sector operated in, as well as the financial strength of any one business, which can impact decision-making, but understanding alternative scenarios is advised irrespective of its position.

If you find yourself in a position where things are turned upside down, you should be ready to take the steps required to protect your position. Conversely, there can also be real opportunities among the chaos for some businesses to position themselves for longer-term success.

Some of the key questions for business owners include:

1. What are the key drivers of demand within our sector?
2. How are the needs of our clients changing throughout this period?
3. How are we positioned against our competitors and what makes us different?
4. Do we have forecasts on key metrics to provide us with foresight?
5. Have we considered the worst-case scenario?
6. Can we improve operational efficiencies?
7. Are there any opportunities within the uncertainty?
8. Do we need help?

Business owners need to be ready to make informed decisions if forced into action by circumstances outside their control. The businesses that can answer these questions will be almost certainly be better placed to survive and prosper.

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CHANGES AFOOT FOR AGED CARE FINANCIAL REPORTING

A number of changes are being introduced to the Aged Care Financial Report (ACFR) in improving transparency and accountability in reporting by aged care providers.

Some of the changes include:

- Consolidated Parent Level Segment Report – to enable the department to make a reasonable assessment of the provider's financial viability at a group level.
- Strengthened Approved Provider Reporting, including:
 - Reconciliations for certain financial assets, loans receivable for related and non-related entities, non-current assets, refundable loans (residential aged care and independent living) and borrowings
 - Presenting the statement of financial position based on liquidity, with the requirement to split resident loan balances on the face of the statement of financial position rather than in a



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separate note. This is to aid in the department's ability to better assess the true liquidity of the provider

- Residential Segment Income Statement at the facility level – for the department to assess the performance of individual facilities
- Permitted Uses Reconciliation – for the department to determine whether Refundable Accommodation Deposit funds have been correctly used for permitted uses during the year.

For providers currently unable to capture information at the levels outlined above, transitional reporting provisions will apply. The department will be checking that providers' ACFR aligns with their general-purpose financial report and may contact providers should this not be the case. HLB Mann Judd recommends providers address this in mitigating a last-minute rush.

Further, there are changes to the Accountability Amendment (Financial Information) Principles 2021.

On 30 June 2021, Minister for Senior Australians and Aged Care Services, Richard Colbeck, amended the Accountability Principles 2014 to achieve the following:

- Provide greater transparency of the financial viability of approved aged care providers;
- Enable the Australian Government to better identify and monitor at-risk providers earlier; and
- Improve the accuracy and validity of financial reporting to the government.

The amendment includes the following:

- The requirement of the ACFR to be signed by those charged with governance

- If the approved provider is a subsidiary of another body corporate, then a 'financial support statement' is required when submitting the ACFR.

Providers will be required to align these changes with their usual governance process for reviewing and approving the organisation's annual report.

HLB Mann Judd recommends considering this now to prevent issues encountered before the 31 October lodgement date. Education may be required of company boards to fully understand the changes in requirements, as well as to fully understand the information disclosed in the ACFR.

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TAX GUIDANCE FOR SERVICE BUSINESSES AND MEDICAL PRACTITIONERS



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The structuring of professional services businesses has historically been an area of interest for the Australian Taxation Office (ATO), particularly around income-splitting arrangements adopted by individual professional practitioners (IPP's) and whether these arrangements are tax-avoidance schemes.

In light of the ATO's draft guideline PCG 2021/D2 (the Guideline), which provides a glimpse at the ATO's compliance approach for professional services businesses, the onus is on taxpayers to assess the riskiness of their current income-splitting arrangements and to determine whether corrective action is required.

The current income-splitting rules that apply to professional firms have been extrapolated from the following pivotal cases:

- The Everett and Galland cases established that partner practitioners could assign a right to income to their spouse or family trust whereas sole practitioners were, typically, viewed as deriving non-assignable income from their personal exertions
- The Phillips case established that professionals could divert professional services income through a services trust, provided the fees paid were commercially justifiable and there was a business case for the arrangement.



In October 2014, the ATO released generic audit risk guidelines which contained the following alternative low risk indicators for service businesses:

- The practitioner receives an appropriate return (based on salaries typically paid for the services being provided)
- At least 50 per cent of the income entitlement of the practitioner (including any entitlement of a service trust) be assessable to them, and/ or

- There is an effective tax rate of at least 30 per cent on the income attributed to the practitioner.

Although these guidelines were withdrawn on 14 December 2017 due to the purported abuse of the “concession” they provided, it is commonplace in industry to interpose discretionary trusts between an IPP and their service business, and to distribute income from the service business within the parameters of the ATO’s withdrawn guidelines.

The Guideline explains the ATO’s risk-based approach to IPP’s and how their professional firms allocate profits, including:

- An arrangement will either be: low (green), moderate (amber) or high risk (red). This is determined using a point-based system and is dependent on the characteristics of the arrangement
- There are two “gateways” which must be passed: the requirement that the arrangement has a commercial rationale (Gateway 1), and that the

arrangement must not contain any “high risk features” (Gateway 2).

In general, arrangements that result in the IPP receiving a disproportionately lower level of income compared to the value of services they provided to the services business will be considered high risk by the ATO and, therefore, more likely to be audited or reviewed.

The ATO’s use of the term ‘professional firms’ in PCG 2021/D2 is intentionally broad, with the Guideline expected to extend to any business that derives income from the personal exertion of its IPP’s.

The Guideline was proposed to apply from 1 July 2021, however the commencement date has been deferred until 1 July 2023 for arrangements that have a higher risk rating under the Guideline, as long as they were entered into before 14 December 2017, and assuming they are commercially driven with no additional risk factors.

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INVESTMENT GOVERNANCE: WHY IT MATTERS IN A PORTFOLIO



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Many people believe a financial plan is predominantly about the return on their investment portfolio.

The reality, however, is far more complex.

A holistic financial plan should also incorporate estate planning, retirement strategies, personal insurance, loan advice and, importantly, risk management. Investment returns should always be considered in light of the risks taken to achieve them.

There is an increasing focus by investors on Environmental, Social and Governance (ESG) elements, which reflect an organisation’s culture, values and risk profile.

Evidence is building that these factors have a significant impact on financial returns. One of the risks we consider carefully when selecting investments for clients is the risk associated with the G pillar.

Governance encompasses the structures and processes by which an organisation operates, and the mechanisms in which it is held to account. It includes factors such as board composition, executive pay and incentives, anti-bribery and corruption

policies, stakeholder communications, and regulatory compliance.

There have been numerous cases in recent years where poor governance has impacted investor wealth. Some examples include:

- An insider trading investigation by the Australian Securities and Investments Commission (ASIC) resulted in sanctions under the Corporations Act for the fund manager involved. In response, several investment platforms sold down the funds affected with no warning, locking in unexpected capital gains for clients, with adverse impacts on their tax positions
- The Juukan Caves incident at Rio Tinto, and the sexual misconduct case at AMP cost directors and executives their jobs, caused reputational impact and led to share price declines
- In a recent example, an investment manager altered its investment strategy at the expense of some shareholders and to the benefit of others, destroying trust in the manager’s integrity
- As part of our due diligence on a portfolio manager who had produced outstanding investment results, we found the company had had three board chairs in 18 months, with one of these under investigation for fraud, and the current chair a family member

of the portfolio manager. This poorly structured and unstable board indicated a poor approach to governance.

Strong governance, on the other hand, incorporates ethical values, transparent fees and incentives, alignment with investors' interests, a diverse and independent board, and open communication with stakeholders, especially during periods of market volatility.

Governance is an important part of due diligence on investment opportunities. It's important to understand not only the fund manager's own in-house governance standards, but also their focus on the governance of the companies in which they invest clients' money.

This forms part of the work we do in the background to reduce risk for investors. An investment opportunity which provides reasonable investment returns but fails governance filters is too high risk for inclusion in our clients' portfolios.

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“It's important to understand not only the fund manager's own in-house governance standards, but also their focus on the governance of the companies in which they invest clients' money.”

BALANCED INVESTOR PROFILE UNDERGOES ALLOCATION SHIFT



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The long-held 60/40 asset allocation rule is no longer adequate if Australians are to retire comfortably, with an 80/20 ratio of risky vs secure assets far more appropriate in the current market environment.

The traditional balanced investor profile previously meant a fairly equal allocation between more secure fixed interest and cash investments, and riskier Australian, international shares and property investments. However, with the ultra-low interest rate environment set to continue for some time yet, the secure part of the portfolio could only return about two per cent over the next 10 years.

The balanced profile is now reflecting an allocation of about 70 per cent risky investments and 30 per cent secure investments. This is the default super option for many industry and retail superannuation funds, however some super funds are classifying higher-risk corporate debt and property-type investments as part of their secure or defensive part of the portfolio. This not only exposes investors to greater risk, but

also shows the importance of comparing like-for-like funds on performance tables.

While the US sharemarket in particular has benefitted from the huge tech sector gains of the past ten years – returning an average of 13.68 per cent – the next 10 years will not be able to generate anywhere near that type of return, given the current high valuations. Excluding the US, global returns over the past decade have been 6.17 per cent, with this projected to be 5-6 per cent in the coming ten years.

Retirees in particular will seek to preserve their capital throughout retirement which requires a 5 per cent plus return from super, indicating they would need to be invested 100 per cent in the share market to achieve this.

It's therefore critical for these investors to carefully consider their risk vs return profile. 20 per cent of their portfolio could be in a secure, four-year bucket of future pension payments at 5 per cent per annum, which should be sufficient to provide liquidity in the event there's a significant pull back in share markets, without needing to sell shares at the worst time.

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GIVING BACK: TRANSFORMING THE NFP SECTOR

Australia's not-for-profit sector has changed considerably in the past ten years, but just how has a global pandemic changed the way corporates and individuals view donating?

Until the Australian Charities and Not-for profits Commission (ACNC) was established in 2012, the guidelines for the sector were generic and open to interpretation. In the period since, NFPs are now governed with guidelines setting out governance and financial reporting standards, much like any corporate organisation.

The ACNC also arguably enhanced the level of trust in the Australian NFP sector, with schools, community and member groups, and registered charities now needing to ensure donations are dealt with appropriately and transparently.

The introduction of the ACNC weeded out many smaller, less established NFPs who didn't have the necessary governance structures in place – some even merged as a result – with the remaining able to adhere to the regulations. Some of the governance structures in place would now arguably rival any listed company.

And while the operating environment for many of these organisations has been on an upward trajectory in recent years, the onset of COVID has irrevocably put the brakes on, and continues to impact public and corporate donations.

Events and other fundraising initiatives have also had to be reimagined – and will be for some time yet. The Leukaemia Foundation's World's Greatest Shave and Light the Night campaigns, for example, changed their format due to widespread lockdowns and restrictions.

The Light the Night initiative – where people walk with lanterns to build awareness of blood cancers – was last year held virtually from people's homes. Television personality Osher Gunsberg recorded a message for participants and, under the circumstances, the revised format was a success.

My own experience with the NFP sector goes back some way. In the mid-1990s, a client - Tim Goyder - had just been diagnosed with leukemia and he contacted me to say he had a job – except that it didn't pay! Tim had the foresight to develop his thoughts into an organisation that provided information and resources to leukaemia patients and their families, and together, we were instrumental in establishing the Leukaemia Foundation of WA.



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Leukaemia Foundation WA then joined up with other leukaemia foundations nationally, and in 2005, all states merged to form a national body (with the exception of Queensland, which joined in 2016).

Following the merger, the Foundation produced a Blood Cancer State of the Nation Report, which incorporated everything from funding, to research and treatments available, as well as support mechanisms for sufferers and their families. It also established a national taskforce panel comprised of 29 of the country's top blood cancer experts and a national action plan to map out where they wanted to take the space moving forward.

There are a range of cancer-based NFPs but the Leukaemia Foundation is the only organisation focusing specifically on blood cancer, and has committed to a strategy of zero lives lost to blood cancer by 2035! It's not necessarily a cure, but is instead aimed at better treatments for prolonged life and more research and clinical trials.

It's an audacious goal, and one that holds even more significance at a time when fewer people are giving fewer dollars to charitable organisations. To offset some of the financial strain, the Foundation is looking to establish an endowment fund so the returns from that go directly towards funding much-needed research and better treatment for patients.

**Lucio Di Giallonardo has recently been named as the chair of the Leukaemia Foundation.*

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NETWORK OF THE YEAR ACCOLADE FOR HLB AUSTRALASIAN ASSOCIATION



TONY FITTLER
Chairman
Australasian Association



The HLB Mann Judd Association has been named Network of the Year at the Accountants Daily 2021 Australian Accounting Awards. The Awards recognise excellence across the entire accounting industry, and showcase the individuals and firms which are leading the way in the industry.

The Network of the Year award recognises the accounting network that works to give growth opportunities to its associated firms and is focused on enabling quality client services. For HLB Mann Judd, the award win is acknowledgment of its enduring commitment to the client experience and undertaking of a net promoter score (NPS) program.

A strong culture of service excellence and personalised service are hallmarks of the brand which is further supported by client feedback.

Instituting the third party managed NPS program has proved instrumental in the way partners and staff interact with clients. It's reinforced the benefits of being proactive, responsive and highly-engaged with clients, particularly at a time of such uncertainty for businesses.

#HLBCOMMUNITIES DAY 2021



HLB Mann Judd firms recently united to celebrate the global advisory and accounting network's third annual #HLBCommunities Day.

The day presents HLB firms with an opportunity to give back to their local communities, build internal relationships and share in the impact HLB creates together as a network. This year, firms showed support for the CSR initiative on World Environment Day.

HLB Mann Judd Australasian Association collectively volunteered 174 hours through 29 participants across 3 community projects.

Globally, the HLB network collectively volunteered 5,007 hours through 790 volunteers across 20 community projects.

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

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STRONG H1 REBOUND FOR IPO MARKET



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The Australian IPO market continued its rebound from the COVID-induced slump of the first half of last year, with a particularly strong start to the year that saw 61 companies listing on the Australian Securities Exchange. This is in contrast to the 12 listings in the same period in 2020, and 74 listings for the whole of 2020.

This and other findings are contained in the IPO Watch Australia Mid-Year Report, which analyses IPO activity over the first six months of the year on a number of key metrics, including listing volumes, share price performance, subscription rates and sector spread, as well as a review of the pipeline for the remainder of 2021.

This year's strong performance is particularly evident in terms of total amounts raised, with \$2.9 billion raised by new market entrants in the first six months of 2021, compared to only \$132 million in the first half of 2020. The increase in total funds raised was driven by the 13 large cap IPOs coming to the market so far in 2021.

The small cap end of the market was also very active during the reporting period, with 48 new entrants (compared 43 for the whole of 2020) who collectively raised \$462 million. The main contributor was the Materials sector which had 26 new small cap listings, compared to only three in the same period last year.

Five of the 13 large cap IPOs in 2021 were from the Materials sector, with both gold and copper projects well represented; 20 new entrants hold gold projects and five hold copper projects. The sector accounted for 51 per cent of all IPOs so far this year, raising a total of \$648.8 million



Outside of the Materials sector, the strongest contributors to total funds raised were listings within the Banks sector and the Health Care Equipment & Services sector.

Looking ahead, the pipeline for IPO activity is healthy, and there continues to be a wide range of companies planning to list across multiple sectors.

Visit hbl.com.au/2021-ipo-watch-australia-mid-year-report to download the full report.

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