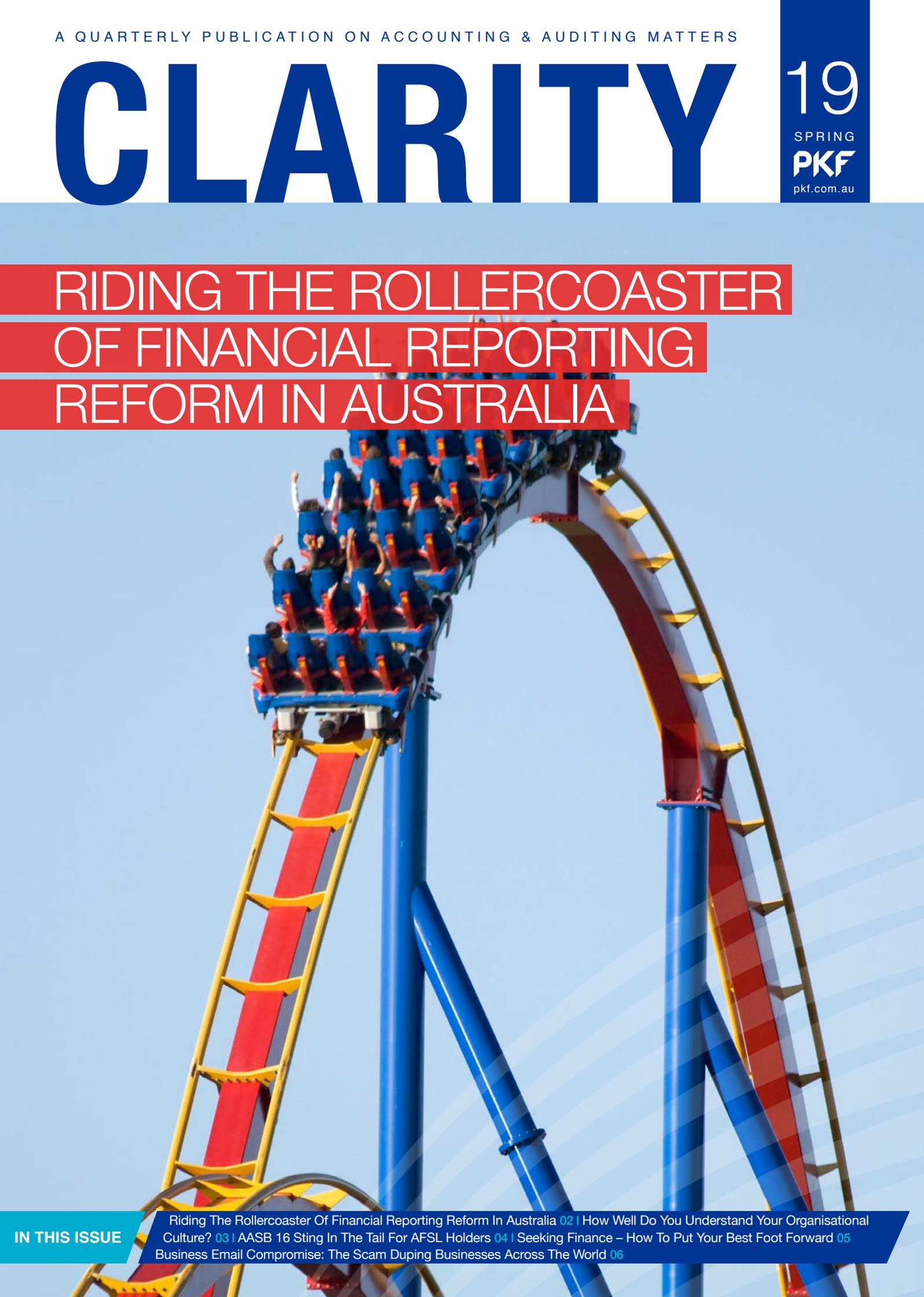


# CLARITY

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## RIDING THE ROLLERCOASTER OF FINANCIAL REPORTING REFORM IN AUSTRALIA



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# WELCOME TO THE SPRING EDITION OF CLARITY



Welcome to our Spring 2019 edition of Clarity. Our aim is to deliver greater clarity and understanding to our clients on the current and emerging accounting and audit issues. We also look to provide thought leadership, and share our knowledge and expertise, in areas that will solve problems and create solutions for clients. We hope you find this edition of value and please feel free to contact your local Audit Partners for any further assistance.



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“ After the Special Purpose Financial Statements removal, the veil of reduced reporting is lifted, and financial information will become publicly available. Many mum and dad companies believe this is a privacy risk. ”

## RIDING THE ROLLERCOASTER OF FINANCIAL REPORTING REFORM IN AUSTRALIA

Reform is upon us and some of the following topics may have some in a head spin!

- Ending Special Purpose Financial Statements (SPFS)
- Disclosing extent of compliance with Australian Accounting Standards (AAS)
- Moving to consolidated financials
- A new reduced disclosure standard

It's all moving too fast for some.

Most financial report preparers have recently gone through a transition to new requirements for financial instruments, revenue and leasing. Now we all need to get across the next suite of changes – which are coming through at velocity.

### AASB requirement for additional disclosures for SPFS

Recent push back has seen the Australian Accounting Standards Board (AASB) retract the proposed requirement to disclose the extent of compliance with AAS for SPFS. This follows overwhelming feedback from stakeholders that the change was excessive, time consuming and be of little consequence to those using financial statements.

Whilst drafting the proposed changes, the AASB became aware that the requirements had become more burdensome and overengineered with exceptions and guidance which left many readers confused.

Another issue voiced was that the requirements would be in place for one year only where a business will need to move to general purpose financial statements (GPFS) from 30 June 2021 anyway; thus, anticipating little value from the changes.

It seems the AASB tried to achieve their wish list, however, there is not enough time to fully grasp the impact for a one-year benefit while financial report users are already battling a barrage of other accounting standard changes.

### Moving to GPFS

The big project underway at the AASB is the removal of SPFS. The project is moving ahead quickly and the AASB is currently requesting responses to the proposed changes that impact for-profit entities.

The changes have been discussed in previous Clarity editions but the largest issue for some is that consolidation will need to be applied in accordance with AASB 10: *Consolidated Financial Reports*.

Currently, several large groups in Australia are lodging only single entity financial statements for the head group. Subsidiary businesses within the group may be exempt from lodging altogether which results in financial information regarding the groups trading not being made publicly available. After the SPFS removal, the veil of reduced reporting is lifted, and financial information will become publicly available. Many 'mum and dad companies' believe this is a privacy risk.

The problem with this concern is that it is not something the AASB can fix but is an issue with reporting requirements under the Corporations Act. Businesses facing this issue have no way to avoid the inevitable and will need to start preparing and lodging their consolidated financial reports on the public record.

The reason why consolidation cannot be avoided is due to it only being possible under the SPFS framework. It is an unintended consequence of the AASB's project to streamline the financial reporting framework in Australia. Whilst unintended, it may be the best outcome as it creates a level playing field for all businesses with a requirement to lodge.

**Moving your financial records to group consolidation can be a difficult and timely exercise. It is important to plan ahead and be ready for the change well before the June 2021 reporting season hits.**

# HOW WELL DO YOU UNDERSTAND YOUR ORGANISATIONAL CULTURE?

Following our article on *'Interrogating Integrity'* and the importance of culture in our last edition of *Clarity*, many Directors are seeking to understand their organisational culture and non-financial risks. As a result of issues raised by the Hayne Royal Commission and the Aged Care Royal Commission, some are asking how, respectively, Directors failed to know about the appalling treatment of clients by financial services providers and residents in some aged care facilities.

Failure to fully understand one's risk culture – or more simply, how the behaviours and actions of staff impact 'how we do things around here' – should be a concern to any business owner who cares about their business reputation.

On a related note, reports from the Australian Prudential Regulation Authority (APRA) have also highlighted:

- The issues arising from over-reliance on the expertise of certain Directors;
- The over-reliance on (often filtered) feedback and reporting from management;
- The failure to fully understand the behavioural consequences of financial incentives in remuneration packages; and,
- The failure to identify and manage the non-financial risks to reputation.

These reports lead many Directors to wonder, "how can I ensure a culture of filtering bad news before it reaches the top is not endemic in my organisation?"

Truly understanding the culture of an organisation, and indeed department-specific subcultures of an organisation, is not achieved via a simple internal staff engagement survey, nor through an 'add on service' from existing financial audit partners. At PKF, we recommend to Directors and business owners that applying an independent lens to risk culture is sound governance, and one step toward mitigating future reputation risk.

Unlike financial auditing, there is no straightforward process or standards that can be applied across different business models or different functions within a business. We believe that risk culture audits, similar to financial audits, need to be conducted by independent specialists and that those specialists should apply a behavioural science perspective.



## How is a risk culture audit conducted?

Usually, the deep dive risk culture assessment will start with an understanding of the business strategy, business model, and stated values. The process may incorporate currently held data such as turnover, sick leave statistics, exit interviews, whistleblower complaints, previous employee surveys; risk and compliance issues, remuneration incentive plans; all points of data which help refine an online staff survey questionnaire. Survey feedback helps scope focus group and individual interviews, which need to be conducted in such a way as to ensure confidentiality. Overall, the process looks carefully at risk and compliance behaviours within the business and how well they align with the stated business strategy.

PKF is working with risk culture specialists, who are also experienced in organisational behaviour, and who have built processes that can be scaled or modified to suit any organisational requirements and budget, including survey tools which can be self-administered.

*For further information please contact your local PKF office. ■*



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“ There are certain requirements that Australian Financial Services Licence holders need to meet to prove to the Australian Securities and Investments Commission (ASIC) that their solvency is assured.

# AASB 16 STING IN THE TAIL FOR AFSL HOLDERS

If you hold an Australian Financial Services Licence (AFSL) and need to apply AASB 16: Leases, then you need to double check your net tangible assets!

Most companies are well into their transition to AASB 16: Leases and have calculated their adjustments to increase assets and liabilities. But AFSL holders have a little extra to worry about.

There are certain requirements that AFSL holders need to meet to prove to the Australian Securities and Investments Commission (ASIC) that their solvency is assured. This includes calculating the net tangible assets, which the regulations refer to as adjusted assets less adjusted liabilities.

There is a risk that by adopting an accounting standard change, some businesses might end up having compliance issues in demonstrating their solvency. It's just a book entry, there is no change to actual cash flows, so the logic doesn't follow that AASB 16's implementation should have this detrimental effect.

This issue hasn't gone unnoticed. There has been word that ASIC is aware of the potential problem and is looking for a

“Time is ticking, and a solution is needed ASAP with many companies implementing AASB 16 from 1 July 2019 and the ongoing regulatory requirement for AFSL holders to continually meet solvency tests.”

Adjusted assets will be the total assets according to normal accounting standards, less certain excluded assets including intangible assets. When you recognise your right-of-use asset under AASB 16 it could be interpreted as an intangible asset which is defined as: “a non-monetary asset without physical substance”.

But what about the liability? There is no ability to remove the liability from the “adjusted liabilities” as it is not an excluded liability.

The example below shows the impact of AASB 16 adoption on your net tangible assets calculation.

solution, which will likely be to exclude the lease liability or include the lease asset so as not impacting the ratio. Time is ticking and a solution is needed ASAP with many companies implementing AASB 16 from 1 July 2019 and the ongoing regulatory requirement for AFSL holders to continually meet solvency tests. This means some businesses may, in fact, be in breach right now (but we won't know until reporting time).

Keep an eye on the issue if you are an AFSL holder and be sure to keep in contact with your PKF representative to get regular updates as ASIC addresses the issue. ■

	Pre AASB 16		Post AASB 16	
Total assets	100,000		140,000	
Adjusted assets		100,000		100,000
Total liabilities	(70,000)		(110,000)	
Adjusted liabilities		(70,000)		(110,000)
Net tangible assets/ (liabilities)		30,000		(10,000)

# SEEKING FINANCE – HOW TO PUT YOUR BEST FOOT FORWARD

As traditional banks tighten their lending appetites, a new wave of lenders have emerged to plug the gap. While these alternate financiers appear to be more welcoming of new to bank customers, they are known for their rigorous review and vetting process. So, as a business owner or manager, how do you put your best foot forward when applying for new finance?

The key focus of both traditional banks and alternate financiers will be confirming that both you and your business are a sound investment. To assess this, they will require a business plan and an overview of management's capability and track record of successfully executing similar plans.

PKF specialise in helping businesses position themselves for growth. They work with management to build a solid foundation for growth by focusing on:

- The detail behind the growth strategy;
- The value proposition for the target market; and most importantly
- Financial projections.

Financial projections, in particular a cash flow forecast, are tools which will allow businesses to articulate their strategy and growth trajectory. It also provides a financier with a basis for estimating the future value of a business. PKF's key focus areas in preparing financial projections are:

## 1 Historical position

It is difficult to know where you are going if you don't know where you've come from. Financiers will want to understand the peaks and troughs in a business in the last three – five years of trading. Therefore, we focus on articulating your past performance with transparency including a normalised position with support for all trends and assumptions.

## 2 Forecast position

A financier will want to know that your forecast is realistic, complete and most importantly achievable. Therefore, we help you build a forecast in which all trends are supported either through historical data or market research. This forecast will communicate your understanding of the target market, impact of seasonality and operational levers on the business.



## 3 Working capital

An optimised working capital cycle will ensure that cash is not tied up in your business unnecessarily. That is, inventory, collections and payable practices are managed efficiently to ensure the cash collection cycle is as short as it can be. This will require an operational component to ensure the team are utilising working capital levers. We can help you understand your working capital cycle and put an implementation plan in place to make sure your working capital cycle is as optimised as it can be in your business plan.

By being proactive in providing more sophisticated financial projections to your potential financiers there is a greater probability that you will obtain the finance that you need, and you could even negotiate more favourable rates and covenants. Better quality forecasting will also assist your financier in maintaining an ongoing understanding and transparent overview of the business, which will also help with ongoing trust and credibility.

*Please contact your local PKF firm to discuss with their specialists how they can help your business position itself for growth. ■*



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“BEC scams generally occur when a hacker gains access to a business or a business’ supplier’s email account and mimics a legitimate email address using a domain similar to the targeted business’ actual domain.”

# BUSINESS EMAIL COMPROMISE: THE SCAM DUPING BUSINESSES ACROSS THE WORLD

Businesses across the world are being bombarded by a range of cyber scams with one of the most prevalent being Business Email Compromise (BEC), also known as ‘CEO Fraud’. Between October 2013 and May 2018, more than \$12 billion USD in domestic and international losses were attributed by the FBI to BEC scams.<sup>1</sup>

It has been found that an average of five BEC scam emails has been received by businesses in the last 12 months which means there is a 17% chance of receiving at least one BEC email per month. In the previous 12 months, an organisation would have received an average of four BEC emails per month.<sup>2</sup>

So, what should your organisation be doing to minimise this and other cyber related risks?

## What is BEC?

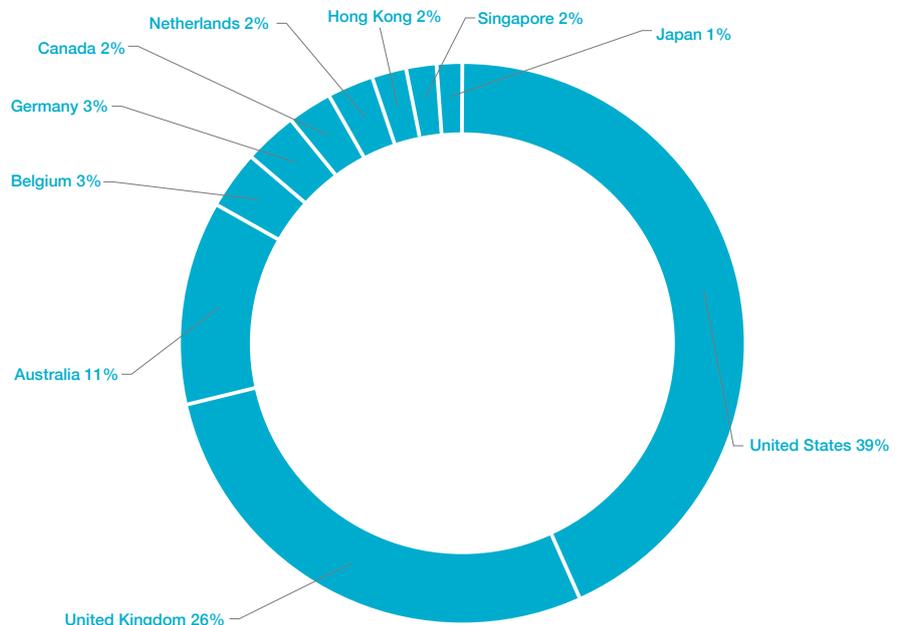
BEC scams generally occur when a hacker gains access to a business or a business’ supplier’s email account and mimics a legitimate email address using a domain similar to the targeted business’ actual domain. The cyber criminal then sends a fraudulent email impersonating the CEO or CFO of their target, usually to someone in the finance department who manages money or another senior staff member, instructing that an amount of money needs to be urgently transferred to a nominated

bank account. Often, emails will purport to be from a supplier requesting a change to its bank account number and instructing that any future invoices should be paid into the new account. A range of apparently justifiable reasons may be given for the change, but if accepted, payments will then start to be paid into the cyber criminals’ bank account. Often, the cyber criminal and associated bank accounts are based in foreign jurisdictions and this makes it difficult to track and recover lost monies.

According to the ACCC, reports of BEC scams increased by a third from 2017 to 2018<sup>3</sup> and Australian small businesses have lost 42% more to BEC in the first half of 2019 than all of 2018.<sup>4</sup>

The top three of the top 10 regions targeted by BEC scammers in the last 12 months are the United States (39 percent), United Kingdom (26 percent) and Australia (11 percent).<sup>5</sup> (Refer to Figure 1 below). ▶

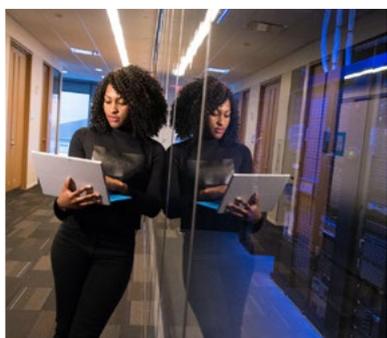
Figure 1 – Top 10 BEC victim regions, July 2018 – June 2019



Given the relative size of the Australian business market to that of the US and UK, it appears Australia is fertile ground for exploitation.

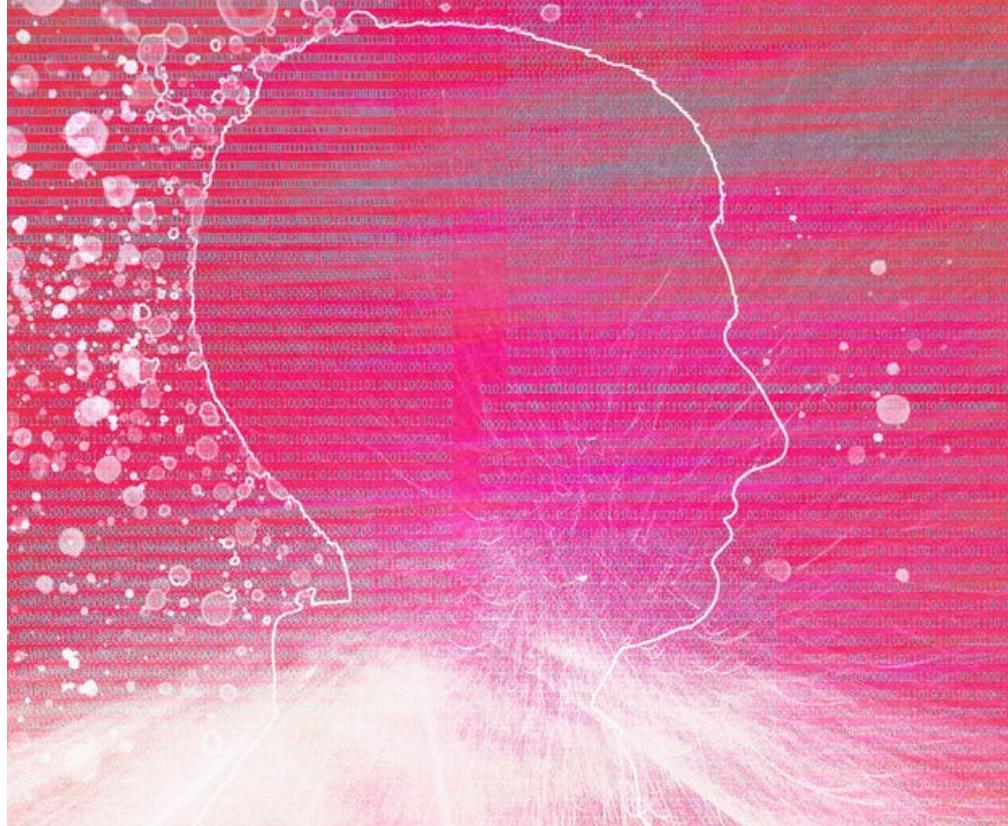
### Why does it work?

BEC email scams play on a range of basic human traits, including our instinct to trust. The cyber criminal identifies and targets specific employees in an organisation who has the authority to make payments. At first glance, the email received by this person looks similar to a legitimate email from a senior executive or a senior supplier representative. This creates an obligation on the part of the receiver to comply. When combined with a general unwillingness to question the boss and a sense of urgency created by the use of words such as 'IMPORTANT' and 'URGENT', it is no wonder the scam has a reasonable chance of success.



### What does this mean for business?

It appears that employees are unlikely to be liable for losses incurred due to making a payment to a cyber criminal particularly if they acted in good faith and in the belief that they were following a lawful instruction from someone in authority. The fact that they failed to question a payment request may also be



compounded by a lack of training and awareness provided by the employer about what should be done when such requests have been received.

Testing these principles is a company in Scotland, Peebles Media Group, who is suing a former employee for negligence and breaching the duty to exercise reasonable care as a result of transferring nearly £200,000 to a BEC fraudster. The employee claims that the company never

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“...a relatively low-tech type of financial fraud, but it has proved to be a high-yield and lucrative enterprise for scammers.”<sup>7</sup>

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provided training about online fraud. The outcome of this case will set important precedents about employee and employer obligations and duties of care when dealing with specific cyber crime incidents and the risk generally.

### What needs to be done?

All the evidence supports the fact that the incidence of the BEC scam and associated financial losses are increasing significantly. In terms of sophistication, it has been characterised as ‘...a relatively low-tech type of financial fraud, but it has proved to be a high-yield and lucrative enterprise for scammers.’<sup>7</sup>

There is a range of technological, procedural and awareness measures that can be undertaken to effectively deal with this risk. One of the key mitigating measures is as unsophisticated as the risk itself and that is to increase employee vigilance through appropriate training and education; especially about the existence of the latest threats and how they work, adopting a questioning mindset and establishing a culture of group responsibility for mitigating the risk.

*PKF is providing a series of Integrity Forums across Australia to discuss the challenges facing organisations when it comes to dealing with cyber fraud. If you would like to learn more about these forums, please contact the PKF Integrity team. ■*

1. <https://www.symantec.com/blogs/threat-intelligence/bec-scams-trends-and-themes-2019>
2. <https://www.symantec.com/blogs/threat-intelligence/bec-scams-trends-and-themes-2019>
3. <https://www.crn.com.au/news/losses-from-business-email-compromise-scams-up-by-a-third-acc-516059>
4. <https://www.cso.com.au/article/665767/record-australian-bec-scam-losses-highlight-need-better-end-user-education/>
5. <https://www.symantec.com/blogs/threat-intelligence/bec-scams-trends-and-themes-2019>
6. <https://www.cso.com.au/article/657653/ex-employee-sued-by-firm-after-falling-bec-scam/>
7. <https://www.symantec.com/blogs/threat-intelligence/bec-scams-trends-and-themes-2019>

# About PKF

PKF brings clarity to business problems with simple, effective and seamless solutions that break down barriers for sustainable growth.

PKF Australia firms are members of the PKF International Limited (PKFI) network of legally independent firms in 440 offices, operating in 150 countries across five regions. PKFI is the 10th largest global accountancy network.

In Australia, PKF offers clients the expertise of more than 94 Partners and 750 staff, across audit, taxation and specialist advisory services.

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## Our values

- Passion
- Teamwork
- Clarity
- Quality
- Integrity



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