CLARITY

A QUARTERLY PUBLICATION ON ACCOUNTING & AUDITING MATTERS

PKF
21
WINTER

WALKING THE ACCOUNTING WORLD TIGHTROPE – IS YOUR BALANCE OFF?

IN THIS ISSUE

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WELCOME TO THE WINTER EDITION OF CLARITY

Welcome to our WINTER 2021 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 and Assurance Partners for any further assistance.

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"For many companies, ensuring their staff act appropriately and in alignment with the corporate values and ethics is one of the greatest business risks."

Governance Challenges In The Pandemic Era

How can an organisation monitor, assess and then reward its alignment with culture? This is certainly not easy and requires effort and out of the box thinking, but is critical to ascertain the true health of an organisation.

The most recent Governance & Risk Management Forum held by the Governance Institute of Australia saw professionals all over the nation come together to discuss business risks in the pandemic world.

I was fortunate enough to open the Sydney Forum by interviewing Ms Ann Sherry AO, current Non-Executive Director of National Australia Bank.

What became clear from Ann's address is that many of the previously well-regarded governance practices like the development of five-year strategic plans have become outdated in the pandemic era. Strategies need to be sufficiently nimble to accommodate rapidly changing environments, and strategy check-ins need to become a more regular part of every meeting agenda to ensure relevancy.

"Changing consumer behaviours have contributed to the long-term impact on the travel and hospitality industry and as we become less social in lockdown periods this effects our post-lockdown behaviour."

How Australia is able to respond cohesively to this changing dynamic, especially for international visitors, will be a challenge to pre-existing providers.

What works for companies yesterday has no guarantee of working today or even tomorrow in the pandemic era. Expectations of Director and Board compositions have shifted to the likes of the three C's: curiosity, courage and compassion. What was once

purely based on skill diversity sees these above traits being most favourable for those in these leadership positions.

For many companies, ensuring their staff act appropriately and in alignment with their values and ethics is one of the greatest business risks. Are business leaders considering that if all they are hearing is good news stories, it is most likely they aren't getting the full picture? Is there a tendency for Directors and Senior Management to hear what they want to hear, as opposed to having a proper look under the bonnet and getting the real story from their team and customers?

Monitoring culture effectiveness in an organisation, is arguably one of the most critical ways in measuring its sustainability yet, this area is often not rewarded and often does not form part of its remuneration structure.

Evidently, the direct link between good governance and business sustainability – in the pandemic era and the application of "fit for purpose" governance practices provides Directors and Senior Management with a clear understanding of the current business state and their focus' for the future.

PKF were proud to sponsor the event that provided valuable insights for business owners and the accounting profession.

Credit to the Institute as the Forum's content was excellent, and it was refreshing to have delegates in a room again in every Capital City. The conference was also delivered online for those unable to make it.

Be Prepared For Payment Times Reporting

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Introduction of the Payment Times Reporting Scheme

From 1 January 2021, the *Payment Times Reporting Act 2020* will require mandatory public reporting for most large businesses to report on its payment terms and times for payments to small business suppliers (businesses with annual turnover below $10m).

This change is hoped to provide information to small businesses, allowing them to make more informed decisions about their business dealings with larger businesses, including better understanding of how the payment terms may impact their cash flows. It is also envisaged that this reporting will assist in improving payment times from large to small businesses due to potential reputational impact.

Who needs to report?

Businesses, other than charities, that have income that exceeds more than $100m in a year. The income threshold is measured using the taxable income of the business. It also includes consolidated entities whose consolidated income exceeds $100m in a year and any subsidiary whose income is over $10m.

- ✓ Single entity >$100m income
- ✓ Consolidated entity >$100m income
- ✓ Single subsidiary of a consolidated entity >$10m income

What is to be reported?

Aggregated data about the reporting entity's payment terms and practices will need to be provided along with the reporting businesses details and other relevant information. The report will need to be signed by a responsible member of the business.

When is reporting due?

The first reporting period is 1 January 2021 to 30 June 2021 with the report being due for lodgement before 30 September 2021, through an online portal. Reporting periods will be every six months continuously, with lodgements due three months after the end of the reporting period.

Potential consequences of non-compliance, in addition to reputation risk, include financial penalties for failure to report or inaccuracies in reporting.

How to prepare

We recommend that large businesses start to assess their readiness and ability to collect the required and relevant data and ensure this is of the required quality and accuracy. The type of information that will need to be reported includes:

- The standard payment period (calculations based on your actual payment days);
- Summary of small business invoices paid (disaggregated by payment days);
- Value of procurement from small business compared to all procurement; and
- Other qualitative information such as financing arrangements, prescribed invoicing terms, progress payment terms, etc.

To assist with collating your data, the Australian Government has developed a tool whereby you can upload a list of supplier ABNs and the tool will indicate which ABNs belong to small businesses which need to be considered in your report.

Additional information

For more information on the reporting requirements you can refer to Payment Times Reporting Scheme: guidance for reporting entities by the Australian Government *or reach out to your local PKF Audit & Assurance representative for support, guidance and potential solutions.*

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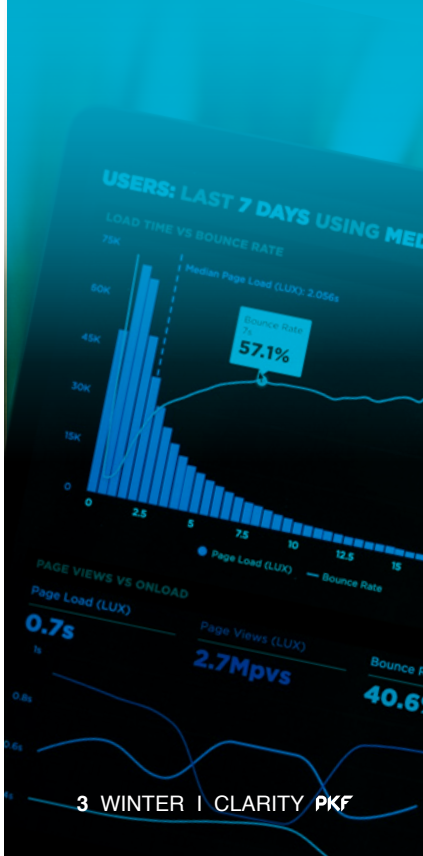

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"They are continuing to operate in uncertain times, with ongoing threat of lockdowns, reduced classes and fee pressures – balancing student safety and wellbeing with delivery of effective services."

Insights From The Education Sector

Education providers are complex organisations, faced with unprecedented challenges by an array of stakeholders, including students, staff, parents, governments (often several layers), community members and the media. It seems everyone has an opinion on the best way to educate our population, both young and old.

Across PKF Australia and New Zealand, we work alongside many types and sizes of educational organisations, from pre-schools through to adult community education providers.

We recently asked a cross section of our education clients what they saw as their biggest challenges and the following are the common themes and highlights:

The key COVID effects

- The ability to pivot nimbly to provide online learning and the ability to react quickly and implement change rapidly was generally seen as a positive.
- The importance of wellbeing of staff and students, that flexible working arrangements can work, and having a blend of online and face to face delivery is important going forward.
- Exec management needed to act swiftly and it was important that they had healthy relationships with the Board, particularly the Chair, to provide empowerment.
- The unexpected loss of fees and students, where courses were restricted or cancelled, highlighted the importance of having a sound financial base.
- COVID-19 had a big impact on the higher learning sector due to heavy reliance on international students.

Lessons learnt in the last 12 months

- They are continuing to operate in uncertain times, with ongoing threat of lockdowns, reduced classes and fee pressures – balancing student safety and wellbeing with delivery of effective services.
- The importance of change management was highlighted and the need to formally incorporate this in their approach to planning and strategy.
- Board and Management are now more aware of the unexpected and the need to have a practical and easily executed Business Continuity Plan (BCP).
- The value of being prepared through a documented BCP Plan has ensured that schools are well progressed in respect of staff practices and technology, considering full lesson capture and time shifting lessons.

Planning for the future

- Need to continue to investigate flexible delivery of courses and increase course offerings.
- Focus on how to change the business model to attract more domestic students.
- Invest in ongoing Governance training for the Board and Management.
- Establishing orderly Director Succession Plan for director roles, so as to maintain the culture across the Board and at the same time maintain a diversity of perspectives.
- Ensuring the cohort of directors have a well-developed mindset and are there for the right reasons.

"Encouraging directors to attend industry events to keep abreast of current issues facing the sector."

Management and prioritising of risk

- Finding the right staff with the appropriate skills and fit for the organisation.
- Funding – The complexities of the various funding bodies, the constant changes, and the competitive open market.
- Student wellness is a top level priority as a school, which includes mental health, bullying and sexual misconduct.
- Reputational risk amid increased competition – Need to protect reputation through placing a strong emphasis on being good corporate citizens and being conscious of how staff and students are behaving at all times.
- Pressing concerns relating to continuing compliance to Tertiary Education & Quality Standards Agency (TEQSA) and the proposed changes to its cost recovery and fees/charges model.
- Encouraging directors to attend industry events to keep abreast of current issues facing the sector.

Special thank you to the following for their insightful responses;

Andrew Leake – COO, Wenona School for Girls, North Sydney, Chair, Governance Institute of Australia

Jade Vermeer – CEO, Tamworth Community College, Board Member – Community Colleges Australia

Brad Seaman, Board Member, Australian Chiropractic College, Adelaide I

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"If a parent entity lends money to a subsidiary entity without interest, then any interest portion not paid would reflect the parent entity's contribution to the subsidiary."

Accounting For Loans With Below Market Terms

When a loan occurs it usually attracts a market interest rate, establishment fees and maturity dates. Terms like this are considered normal as they match the risk associated with the money that is being lent. Sometimes loans occur on non-commercial terms and accounting standards are not explicit on the treatment. In these circumstances there needs to be consideration of the commercial substance of the loan, with accounting for any below-market portion as per its substance.

For example

If a parent entity lends money to a subsidiary entity without interest, then any interest portion not paid would reflect the parent entity's contribution to the subsidiary. Reason being is that the subsidiary would have otherwise had to pay interest if borrowing those funds under normal market terms.

We would need to determine the fair value of the loan and record that portion as a debt instrument, whereas the remaining portion would be considered a contribution or investment in the subsidiary entity.

The accounting issue

Accounting standards consider all transactions on normal commercial terms. Therefore, when accounting for a loan under AASB 9: 'Financial Instruments' we must recognise it at its fair value. Meaning that the non-commercial portion, or the difference between the transaction price and the fair value of the loan, should be accounted for appropriately.

Determining the below-market element

The fair value of the transaction must first be determined by using normal market rates comparable for the loan term. Using the market rate, a calculation can be performed to determine the appropriate fair value using a Net Present Value (NPV) technique. This fair value can then be compared to the transaction amount to determine the below market-element.

To view examples of below market elements based on different loan types click here.

Short-term loans

Often group entities will have high turnover loans which acts as cash sweeping accounts, intended to spread cash across the group. This style of loan usually acts as a bank overdraft or cash balance and are expected to be repaid in the near future. Under these circumstances, the loan amounts (being the transaction values) would likely be similar to the fair value and no adjustment would be needed for a below-market element.

Undocumented loans

Sometimes loans between group entities are poorly documented, with no stated interest rates or repayment terms. In this case, steps will need to be taken to consider the substance of the loans and to document the terms to allow for the above analysis to occur.

For any further guidance, please contact your local PKF audit representative.

How To Identify Intangible Assets

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Despite the widespread economic impact of COVID-19, the Australian market activity rebounded strongly in the second half of 2020 with a resurgence in company acquisitions and mergers. Although such transactions can have significant benefits for an acquiring company, the related accounting is often complex.

AASB 3 'Business Combinations' requires an extensive analysis to be performed, in order to accurately detect, recognise and measure at fair value the tangible and intangible assets and liabilities acquired in a business combination.

In particular, the accounting for intangible assets acquired in a business combination is challenging for a number of reasons, including:

1. Intangible assets are by nature less detectable than tangible ones;
2. Many are not recognised in the acquiree's pre-combination financial statements; and
3. Determining their fair value usually involves estimation techniques as quoted prices are rarely available.

Due to this, the excess consideration may incorrectly be recognised as purchased goodwill, and an appropriate analysis, in determining whether the recognition of an identifiable intangible asset(s) will be required.

To perform this analysis, you need to determine whether the asset is identifiable as defined within AASB 138 Intangible Assets, being **separable** or arising from **contractual** or **legal rights.**

The detection of identifiable intangible assets depends on the context of the acquisition. Useful sources to detect identifiable assets in the context of a business combination are outlined in the below example.

Therefore, should you be currently in the process of acquiring, or looking into potential acquisitions, ensure that you take into consideration the above matters so as to identify all assets that are being acquired, as all reported amounts of intangible assets and goodwill will be closely scrutinised by investors, analysts and regulators.

Should you need any assistance and/or guidance please do not hesitate to contact your local PKF expert.

> "To perform this analysis, you need to determine whether the asset is identifiable as defined within AASB 138 Intangible Assets, being separable or arising from contractual or legal rights."

Source of information	Possible indicators
Acquiree's financial statements and other internal reports	Some intangible assets will have been recognised in the acquiree's financial statements. Other financial information may also provide indirect indicators eg: • Significant marketing costs may be an indicator of the relative importance of brands, trademarks and related intangible assets. • Significant expenditures on research and development may indicate the existence of technology-based intangible assets. • Significant expenditure related to customer care may point to customer relationship intangible assets.
Purchase agreement and accompanying documents	May include references to certain trademarks, patents or other intangible assets that are established by contract or legal rights. May include non-compete provisions that sometimes give rise to a potential intangible asset.
Due diligence reports	May include information that assists in understanding the acquired business, resources and how revenues are generated.
Website materials, press releases and investor relation communications	May contain discussions, by either acquiree or acquirer, of the unique characteristics of the business which may translate into potential intangible assets.
Industry practice	Results of similar business combinations may provide indicators of the types of intangible assets that are typically recognised in such situations.

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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.

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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