Summer '24

PKF

clarity

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by PKF Australia

Data governance as a catalyst: driving business forward

IN THIS ISSUE

- Data governance - a decision making approach
- Cyber security as a cornerstone of sustainable supply chain
- Local government reporting changes - a sign of the times
- ASIC surveillance results - areas of improvement for financial reporting and audit quality
- How the economy is impacting financial reporting

Summer '24

Welcome to the **Summer 2024** edition of Clarity

Our aim is to deliver greater clarity and understanding for businesses, on 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.

Your insights and expertise are highly valued, and we cordially invite you to contribute to future editions of Clarity. We actively seek captivating and thought-provoking articles that will not only enrich the pages of Clarity but also ignite intellectual exploration. Please submit any suggestions for articles to clarity@pkf.com.au.

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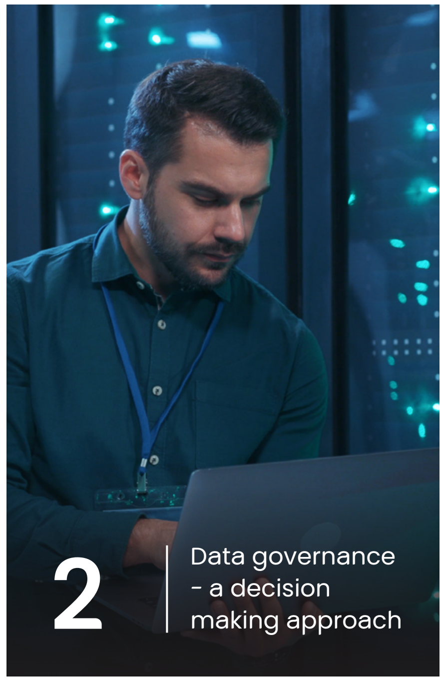
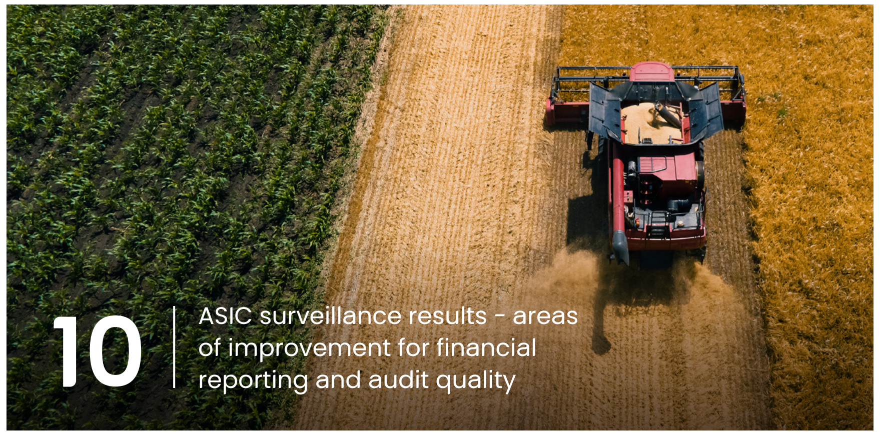
Contents



2 Data governance – a decision making approach

6 Cyber security as a cornerstone of sustainable supply chain

8 Local government reporting changes – a sign of the times



10 ASIC surveillance results – areas of improvement for financial reporting and audit quality

12 How the economy is impacting financial reporting

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Data governance – a decision making approach

Over the past year, PKF, working with the Governance Institute of Australia, Macquarie University's DataX Research Centre, and other expert organisations, has supported an important research study to assess the data governance landscape in Australia. The findings are unexpected and motivating.

Survey participants and process

In August 2023, the Governance Institute of Australia initiated an online survey on data governance. A total of 345 responses were received over a one-month period.

The largest cohorts of respondents were senior governance or risk management professionals (25%) or CEO or C-suite executives (21%). As such, the survey results reflect the strategic thinking and high-level planning of organisations relating to data governance.

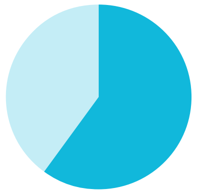
While the survey respondents represent a diverse set of Australian organisation types, it is dominated by not-for-profit organisations (36%) and government (21%) organisations, with small to medium commercial enterprises forming 18 per cent of respondents and ASX listed companies forming a mere 10 per cent. This may perhaps suggest that the commercial sector is presently somewhat hesitant to engage in data governance discourse.

This may further reflect an appreciation of the potential commercial risks and reputational damage associated with not having an appropriate data governance strategy, and the imprudence of communicating on this matter without due consideration and formal endorsement.

As the data governance practices and policies of organisations develop and crystallise, we can expect greater involvement in such surveys by the commercial sector. We have seen such a trajectory in relation to digital data privacy, where initial uncertainty and a reluctance to engage has been replaced with greater confidence and transparency on privacy policies and practices.

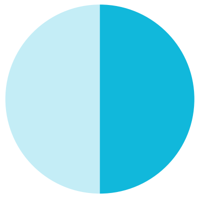
Key learnings and conclusions

The study delivered important key findings and conclusions into the data governance landscape in Australia.



60%

Almost 60% say the board does not have an understanding of the organisation's current data governance challenges.



>50%

More than half of participating organisations do not have a data governance framework, mostly due to lack of capacity or resources.

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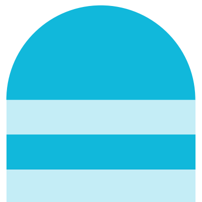
Just under a third of organisations regularly purge data. Most commonly, it is done annually.

Cyber attacks

The standout risk around data governance is cyber attacks, followed by emergent technologies and AI.



Siloed data

Siloed data holdings, underestimating the value of data and not having proper data governance frameworks, are key issues for organisations to address.

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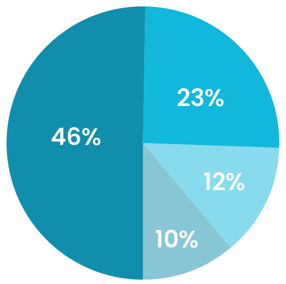
A third of participating organisations don't have data governance on their risk register.

Opinions differ as to the most effective committee structure:



- **46% think it should be included as part of existing audit and risk committee**
- **23% think it should be included at the board level**
- **12% as part of a separate risk committee**
- **10% as part of a separate technology committee**

There is little consistency on who is responsible for data governance:

Data governance - a decision making approach (continued)

Conclusions

- Governance structure: A clear majority of the surveyed organisational leaders are of the view that data governance forms part of wider ICT governance, relates to privacy and security, and should be part of information and records management.
- Data governance understanding: However, opinion is divided as to whether the boards of organisations have 'sufficient' understanding of the organisation's current data governance strategies. For those who believe that the board lacks understanding, this is primarily attributed to a lack of formal technology skills and education and a failure to prioritise data governance.
- Data assets: While survey respondents are divided as to whether boards have sufficient understanding of data governance, the majority are of the view that their board understands the organisation's most important data assets and how they are protected. Such confidence is strongest for ASX listed companies and lowest for non-profit organisations.
- Reporting to board: While an overwhelming number of respondents believe that their organisation's data governance is 'linked' to the organisation's overall governance and risk management strategy, there is no such consensus on the related question of reporting to the board. A clear majority respond that reporting to the board is done on a quarterly or less frequent basis. In light of the serious loss that can be generated by inadequate data management and breaches, this is of concern and needs to be addressed.
- Data governance framework: The risks associated with a lack of reporting to the board is exacerbated by the fact that a majority of respondents work for organisations that do not yet have a data governance framework.

Recommendations for good data governance

Building on the analysis, we make the following recommendations for organisations in relation to data governance.

1. Provide greater education and training to members of the organisation, including senior leadership, on:

- Identifying the various data assets of the organisation
- Quantifying the value of data assets held by the organisation
- Identifying the level of risk associated with each such data asset.

2. Develop guidelines for designing, implementing and maintaining an effective data governance framework, including:

- Identifying the parties within the organisation who are responsible for data
- Delineating the nature and extent of their responsibilities
- Enacting policies and oversight mechanism to support safety and trust
- Formalising lines of reporting and accountability, including to the board.

3. Create mechanisms for collaboration between all relevant parts of an organisation, including:

- Delineating the respective roles of technical, financial, risk management, legal, administrative, human resources and others
- Developing a reporting and accountability framework that connects the work of these different domain experts to a central cohesive data management and security plan.

4. Implement methods to measure the success of data governance frameworks, including:

- Aligning these measures to an organisation's existing governance and privacy reporting policies and procedures
- Updating the data governance framework, as needed, in light of evolving technologies and emerging threats.

To read the full report on this study, visit us at pkf.com.au/data-governance

For any assistance to address the data governance needs of your organisation, contact your local PKF Audit & Assurance expert.

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Cyber security as a cornerstone of sustainable supply chain

Imagine this... your business has undergone rigorous internal audits and your processes gleam. But, a single security breach in one of your supplier's systems exposes sensitive data, disrupts operations, and shatters customer trust.

In 2024, with rampant cybercrime, complex global partnerships, and data privacy regulations tightening, ignoring supply chain security is a ticking time bomb. Forgetting your vendors' security posture is like locking your front door but leaving the back window wide open – a glaring vulnerability in today's digital storm.

> "Weak vendor controls, insecure infrastructure, and unintentional data breaches can leave your financial data exposed and your reputation vulnerable.

In today's interconnected world, your financial security rests not only on your own doorsteps, but also on the shoulders of your trusted partners. These are the companies you rely on for crucial services like data hosting, IT infrastructure management, and beyond. To navigate the complexities of contemporary business environments, organisations increasingly rely on collaborative partnerships with third parties to fulfil essential service needs.

However, while onboarding third-party capabilities can optimise business operations, third parties come with their own set of risks and dangers. Therefore, integrating third-party control assessment into financial statement audits has become increasingly important.

The reality is that many businesses are oblivious to the hidden risks lurking in their third-party ecosystem. Weak vendor controls, insecure infrastructure, and unintentional data breaches can leave your financial data exposed and your reputation vulnerable. This isn't only about protecting your immediate finances; it's about safeguarding your organisation's future.

Here's how businesses can take control of vendor managed controls:

1. Leverage third-party security assessments

Evaluating vendor controls by leveraging IT expertise and implementing their recommendations can significantly improve the overall security of your organisation. Like vigilant scouts, they map your vendor landscape, pinpoint vulnerabilities, and recommend robust countermeasures. They act as shields against data breaches and cyberattacks, pave the path to compliance, and provide the cornerstone for trust-building partnerships.

2. Prioritise data security

Building an impregnable internal fortress won't suffice in today's hyperconnected world. Your success is ultimately tethered to the strength of your weakest link, including your partners. To be cyber-resilient data security should be weaved into any business' DNA and get the same from vendors. Integrating best practices into vendor selection and management mitigates financial and reputational risk, unlocking secure and sustainable partnerships. Pre-screening vendors through security questionnaires, conducting risk assessments and utilising tools like SIEM platforms are key steps in building your cyber-fortress.

3. From trust to verification: proactive engagement

Blind trust is a luxury no business can afford. Real engagement goes far beyond checking boxes. It's about actively participating in vendor training, sharing security insights, and promptly addressing any concerns. By actively monitoring and mitigating risks, you can transform potentially vulnerable vendors into invaluable partners in building robust cyber defences.

Ready to build a resilient future where trust and security go hand-in-hand?

Contact PKF today and learn how our integrated third-party security assessments can safeguard your financial data, fuel your growth, and position you for success in a world where resilience is the key to thriving.

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Local government reporting changes – a sign of the times

NSW local government

As of mid-2022 all NSW local government councils and joint organisations were required to have considered the 2023 Risk and Audit Guidelines. The 2023 Guidelines replace the 2010 NSW Government's Internal Audit Guidelines for Local Government in NSW. They seek to incorporate findings and lessons learnt from relevant industry reviews inclusive of recent Independent Commission Against Corruption ("ICAC") investigations, the Revitalising Local Government inquiry (2013) and Auditor General enquiries.

Further, from 1 July 2024, all councils will be required to attest to compliance with the following requirements within their 2024/25 annual report:

- An appropriately qualified Audit, Risk and Improvement Committee "ARIC". The ARIC is tasked with ensuring adequate and independent monitoring and oversight over council's key risks, performance and governance arrangements;
- A robust risk management framework that supports the achievement of council's strategic and operational objectives, which clearly articulates and mitigates key existing and emerging risks; and
- An effective internal audit function that provides council with independent assurance services as to control effectiveness, industry best practice and opportunities to enhance both efficiency and performance.

For local government risk and audit practitioners, these changes are welcome as they will help ensure these important council functions receive the necessary attention, support and resources.

For many councils their Risk and Assurance Frameworks are in varying states of maturity, with internal risk and assurance practitioners often wearing many hats. This includes providing risk education and support, assisting with the development and review of risk registers and incident management, and providing timely advice to assist others with strategic, operational and project decisions. This of course impacts their capacity and ability to deliver on their own strategic agenda.

If not already in place we would recommend ouncils develop an enhancement roadmap or project plan to support integration, establishment and continued maturity of the required guidelines and related governance mechanisms.

> " These changes are welcome as they will help ensure these important council functions receive the necessary attention, support and resources.

The consolidated work plan should detail objectives, the various tasks associated with achieving compliance and monitoring and oversight mechanisms to ensure the plan is adequately resourced and remains on track.

Queensland local government

For the past ten years, Queensland local governments have reported against three key indicators of sustainability:

- Asset management and renewal
- Infrastructure capital sustainability
- Financial capital sustainability/ viability.

These were measured by the following ratios:

- Asset sustainability ratio
- Net financial liabilities ratio
- Operating surplus ratio.

Queensland local governments have calculated and reported on these ratios in their financial statements each year.

Following a comprehensive review, the Department of State Development, Infrastructure, Local Government and Planning issued new financial sustainability measures. These measures will apply for the first time for the financial year ending 30 June 2024.

The key changes include:

- Grouping of similar councils for sustainability monitoring and reporting purposes
- Removal of net financial liabilities ratio
- Expanding the number of relevant financial sustainability measures from three to nine
- Targets are based on the council's allocated grouping and a small number of contextual measures have no targets.

The following measures must be calculated and included in the statutory financial reports and councils should be establishing systems and processes to calculate these measures.

PKF has local government expertise across the country and can assist with an independent tailored review to help build your roadmap and identify key priorities, and also help with the development, review and enhancement of key framework processes.

Please reach out if you need assistance with these fast-approaching reporting deadlines.

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ASIC surveillance results - areas of improvement for financial reporting and audit quality

In October 2023, ASIC published its annual surveillance report. The report highlights areas where the quality of financial reporting and audits can be improved.

The surveillance report summarises findings from ASIC's reviews of both financial reports (180 ASX-listed entities and large unlisted entities) and audit files (15 related audit files at 11 audit firms) for the period 1 July 2022 to 30 June 2023.

Company directors (including audit committees) and auditors are expected to constructively discuss these findings and take action to improve financial reporting and audit quality.

The majority of ASIC's findings from financial report surveillances related to:

- Insufficient disclosure of material business risks in the operating and financial review (OFR);
- Impairment of assets;
- Revenue recognition; and
- Other financial report disclosures.

Insufficient disclosure of material business risks in the OFR

Many entities still need to significantly improve the information they report in the OFR. ASIC noted that:

- Entities that are newly listed might find writing an OFR challenging
- Entities that regularly raise funds cannot rely on other external sources of document such as recent fundraising documents as a substitute for the OFR
- Entities with more complex business models ASIC expects that the OFR to provide an adequate explanation of the key features of the business model and industry.

Impairment of assets

During this surveillance period, ASIC contacted 20 entities about their impairment testing, mainly on goodwill and other intangible assets. It noted that directors should question the need for, and adequacy of asset impairment, and the adequacy of related disclosures.

Revenue recognition

ASIC contacted 14 entities about their revenue recognition including disclosures of accounting policies, with three of these entities making adjustments.

Financial reporting disclosures

ASIC contacted seven entities about their financial report disclosures including:

- Going concern
- Operating segments; and
- Non-audit service fee disclosures.

The key audit areas with audit findings continued to relate to impairment of non-financial assets, asset values, revenue recognition, impairment of receivables, inventory and costs of goods sold, provisions, and investments and financial instruments.

Directors and preparers

In the surveillance report, directors and preparers are asked to support the audit process by ensuring that:

- The OFR disclosure is not generic and reflect the entity's specific circumstances and the business environment it operates in
- Management produces quality and timely financial information, supported by robust position papers with appropriate analysis and conclusions referencing relevant accounting standards
- The entity applies adequate resources, skills and expertise to promote quality in the reporting process. Position papers should be prepared for directors (including audit committees), especially in areas that involve significant estimation uncertainty and judgement, e.g. asset values, revenue recognition and provisions
- There is effective and clear communication channels with the auditor to flag any risks affecting the information in the financial report and that relevant information and explanations are provided to the auditor in a timely manner
- There is a robust process for the selection of the auditor, appropriate audit fees are set and there are clear communication channels between the auditor and the audit committee to support financial reporting and audit quality.

For any further guidance on the current ASIC expectations, please do not hesitate to contact your local PKF team.

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How the economy is impacting financial reporting

> "The economy has changed very quickly, with consumer confidence and sentiment changing also. There is significant uncertainty as to where the economy will go.

Our economic climate is changing, and so too is how we must approach the preparation of financial reports for upcoming reporting periods.

Changing conditions means that the preparation of financial reports will not simply be a rollover of the estimates used in the preparation of the previous financial report.

Many key estimates will need to be revisited with consideration to:

- High interest rates
- High inflation (in Australia, we have not seen these levels since the 1990s)
- Wage pressure due to labour shortages
- Supply chain issues.

This is against the backdrop of ESG and a drive to sustainability.

Interest rates

The significant increase in interest rates has a direct impact on the application of accounting standards, and particularly in estimates that require the use of discounted cash flow projections.

For entities using the VIU model to determine the recoverable amount of an asset, including goodwill and intangible assets, the increase in interest rates means that the discount rate in the VIU model increases.

It would be incorrect to have used a discount rate of 10% last year and in prior years, and to continue to use the same 10% discount rate in 2023. The risk-free rate has gone up, and the world has become more uncertain. Preparers and auditors will need to carefully consider the appropriateness of the discount rate used in VIU models.

Discount rates are used extensively in determining the fair value of assets. They are important when determining the value of provisions, including make good provisions and lease liabilities. The increase in interest rates has a direct impact on these assets and liabilities and could be material to an entity's December 2023 financial reports.

Inflation

The economy has changed very quickly, with consumer confidence and sentiment changing also. There is significant uncertainty as to where the economy will go. The Reserve Bank is striving to reduce inflation by reducing demand.

Will this trigger a recession? When will the consequences of the Reserve Bank's actions impact the economy?

Many companies are struggling. This should be reflected in an entity's December 2023 financial report, with potentially larger bad debt provisions, impairment of goodwill, a reduction in the value of investments etc. Many entities will be very much incentivised to be aggressive or very optimistic when making accounting estimates.

It's difficult for entities to raise finance at the moment, and that includes either being able to raise equity or to borrow money. This of course has an immediate impact on going concern, and again represents an incentive to show the performance of an entity in a very positive manner.

Wage pressure

We have inflation, we have labor shortages, so we have wage inflation. This impacts impairment assessments, may give rise to onerous contracts, and again may impact going concern.

Supply chain issues

If a business cannot get the raw materials, key components or the required labour, it is not likely to complete the contract on time. This increases the risk of penalties and onerous contracts, and increases the risk of incorrect revenue recognition under AASB 15. It also increases the risks around going concern.

There is also a high probability that the costs to complete a contract will increase, even if the contract can be completed on time. If an entity tendered on a fixed price contract and didn't lock in the materials and cost of labour, the margin and profitability of that contract is going to be squeezed.

The culmination of all of these factors makes it reasonable to predict that many companies (with perhaps the exception of the major supermarkets and the major banks) are going to be less profitable in upcoming reporting periods.

This of course is extremely relevant when considering the cash flow projections that will be used to support the recoverable amount of goodwill, and assessing whether there is a material uncertainty as to the ability of an entity to continue as a going concern.

Careful consideration required

Entities need to give careful consideration to the current environment and how it impacts their ongoing reporting requirements.

The current economic environment will have a direct impact on:

- Financial reporting
- The application of accounting standards
- Making accounting estimates
- The risk of bias when making accounting estimates, and
- Uncertainty as to going concern.

For any assistance with preparing your financial reports, please contact your local PKF Audit representative.

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

PKF is a global community where dynamic business and wealth advisors can belong, grow, and thrive. Together, we create powerful opportunities to propel the success of our clients, our people, and our communities.

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