

CommBank **Accounting** **Market Pulse**

Conducted by Beaton Research + Consulting

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Positive long-term outlook remains steady despite subdued conditions



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National Manager, Professional Services
Commonwealth Bank

Welcome to the second-half edition of the CommBank Accounting Market Pulse for the 2014/15 financial year, conducted in partnership with Beaton Research + Consulting.

The second half survey of large accounting firms, restructuring firms and other firms reveals short-term expectations across the sector have softened. The outlook across the next 24 months however remains squarely in positive territory, and steady when compared to the previous half's results.

In a downward half-on-half shift, the economic outlook has dipped with a negative overall reading. This outlook is weighing on sentiment, but with the accounting sector often acting as a bellwether for broader business and economic confidence, it is encouraging to see the longer-term view remains positive.

“When looking at the split in results between the different segments, over the short-term, large firms remain more optimistic than the rest of the market with the perception of other firms building over the longer term.”

Large firms indicate the highest expected revenue growth by practice area has been economic and social policy advice, while sustainability and climate change related work witnessed the highest growth in the other firms' category. Both large and other firms share the view that the wealth management and financial planning, and corporate finance practice areas offer significant revenue growth potential.

“The survey also reveals the areas with the highest expected revenue growth are offshore in Asia and UK/Europe.”

Despite a subdued outlook, 40 per cent of firms are still planning to expand geographically, with Brisbane flagged as the top destination for expansion. The primary reasons for geographic expansion are as a result of a strategic alliance or merger with an existing firm.

While negotiating prices with clients eased moderately when compared to the previous half, it remains the top challenge for firms. Client led negotiation often resulted in margin compression over the half, and firms continue to implement changes aimed at reducing costs and increasing efficiencies.

This trend is evidenced by a continuation of firms seeking to leverage technology to build efficiencies within their businesses, and therefore it was not surprising to see 55 per cent of firms stating IT software and hardware expense will see the largest percentage increase over the next six months.

In an ongoing trend of diversification in service offerings across the sector, the move to providing non-accounting services continued this half, with all large and restructuring firms and 77 per cent of other firms indicating they offer non-accounting services. This shift was further evidenced by the fact that these firms reported an increase in revenue from non-accounting services.

Firms are seeking to increase fee earning and salary/equity partner numbers, as firms report keeping quality staff has become substantially more difficult over the last six months. Conversely, as outsourcing and offshoring remain a prevalent trend amongst Australia's leading firms, we saw an expected decrease in hiring for shared service, secretarial and administrative staff.

I trust you will find this edition of the CommBank Accounting Market Pulse informative and useful for your firm's planning and benchmarking. We look forward to continuing to monitor key financial and operational performance indicators within the industry and sharing these insights with you.

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Economic outlook



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The Australian economy is expected to grow by 2.5 per cent in 2015, marking a record 25 consecutive years of growth. While an expanding economy is good news for accountants and their clients, there are some caveats. Not only is the rate of growth set to remain well below the long-term historical trend of 3 per cent, but the ongoing transition from mining to non-mining growth continues to create highly variable conditions across industry sectors.

“ Both businesses and the economy as a whole need to find new sources of revenue as mining investment tails off. Some elements in the transition are on track, with a surge in resource exports set to be a significant new source of income growth over the next two years.”

The residential construction upturn is also firmly entrenched, and consumer spending is growing at a faster rate than before. However, non-mining business capex growth has been faltering. The unemployment rate remains elevated because the growth transition is patchy and is expected to rise a little further, putting consumer spending growth at risk.

Looking beyond Australia, global growth seems set to strengthen, although volatility will remain an issue in financial markets, potentially denting consumer and business confidence. The US

recovery has helped drive activity, despite uncertainty surrounding the timing of the first US Federal Funds rate hike. However, lower growth rates in China will remain a topic of concern, particularly for Australian exporters.

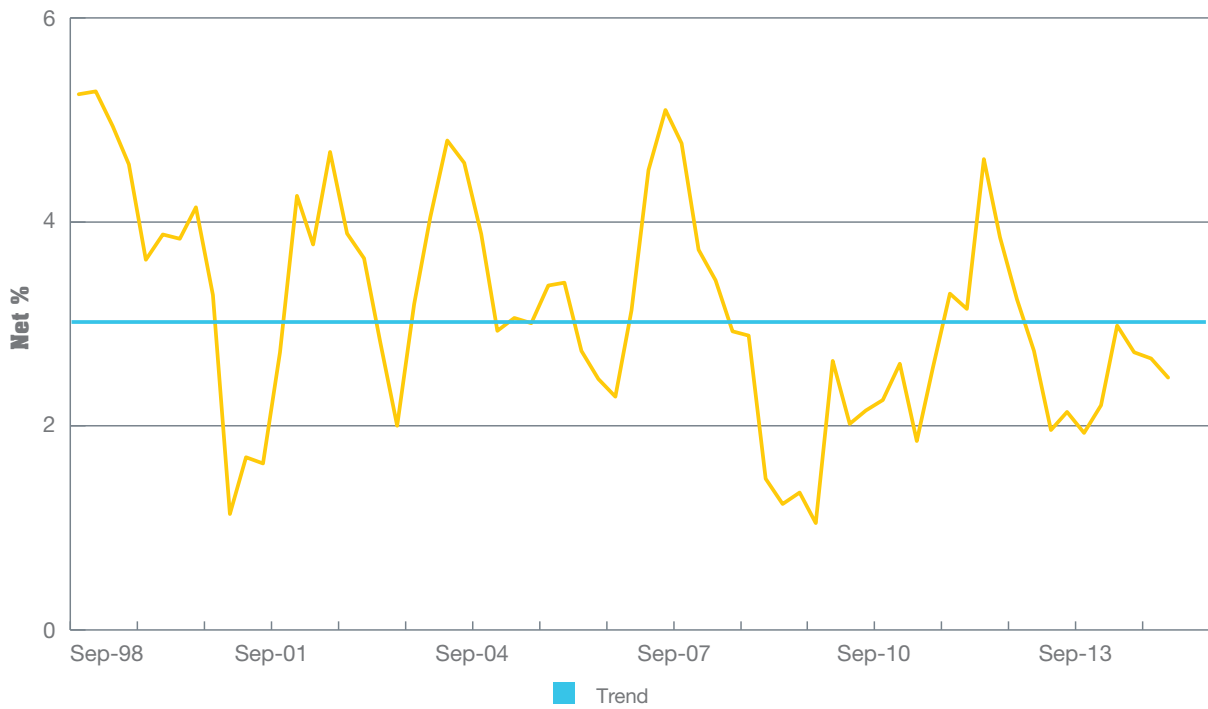
At home, the 2015 Federal Budget small business package is likely to prove positive for many accountants and their small business clients, helping to support business confidence. There are already some signs consumers have responded positively to the budget measures, although it remains to be seen whether higher consumer and business confidence will translate into increased spending.

Although the Reserve Bank of Australia (RBA) left rates untouched at their last meeting in June, the 0.25 per cent cut to the cash rate in May to a new low of 2 per cent reflects a more uncertain view of the non-mining capex transition. Fortunately, a low-inflation environment gives the RBA the room they need to adjust rate settings, while concerns about an overheated housing market are really confined to Sydney. While the RBA has provided little forward guidance around the interest rate outlook, below-trend growth and inflation, plus expectations unemployment will trend higher probably mean it is too soon to call the end of this rate-cutting cycle. Readings of key data, particularly employment data, will be key to gauging upcoming RBA policy deliberations.

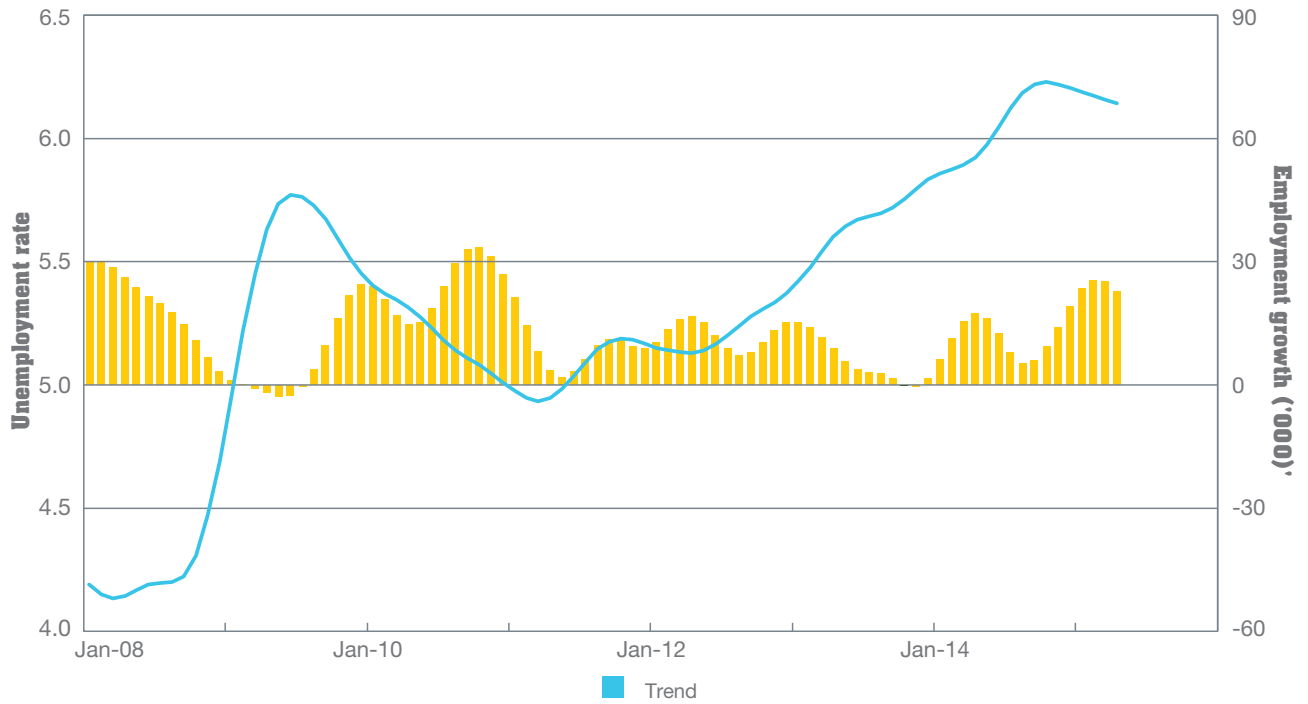
For accountants, question marks surrounding non-mining business investment continue to impact perceptions of business conditions. While the latest CommBank Accounting Market Pulse indicates firms are positive about the short to medium-term outlook, sentiment has softened over the last six months. Similarly, firms' perceptions of economic conditions are weaker, with one in four expecting the economy to perform negatively over the next 12 months.

However, the long-term outlook for business conditions remains unchanged, suggesting most practice principals still see this as a period of transition, rather than the beginning of a period of subdued growth.

Real GDP (annual % change)

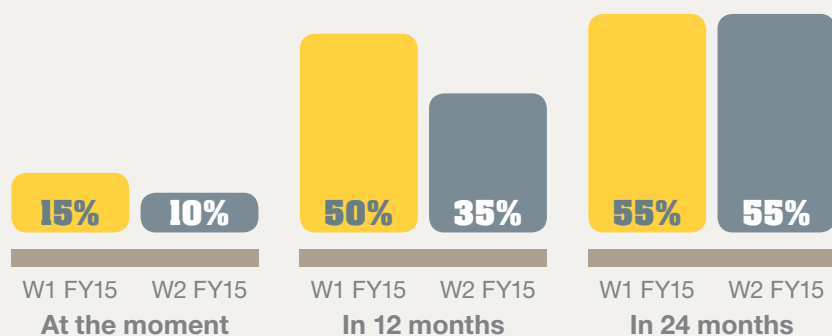


Labour Market Trends



Snapshot of survey findings

Perception of business conditions



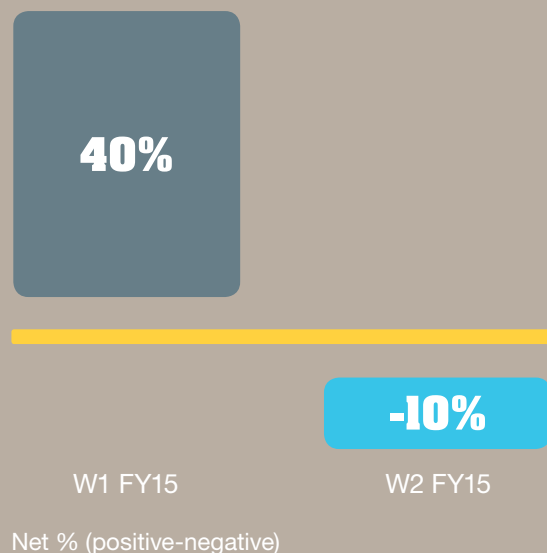
Provision of non-accounting services

Large firms **100%**

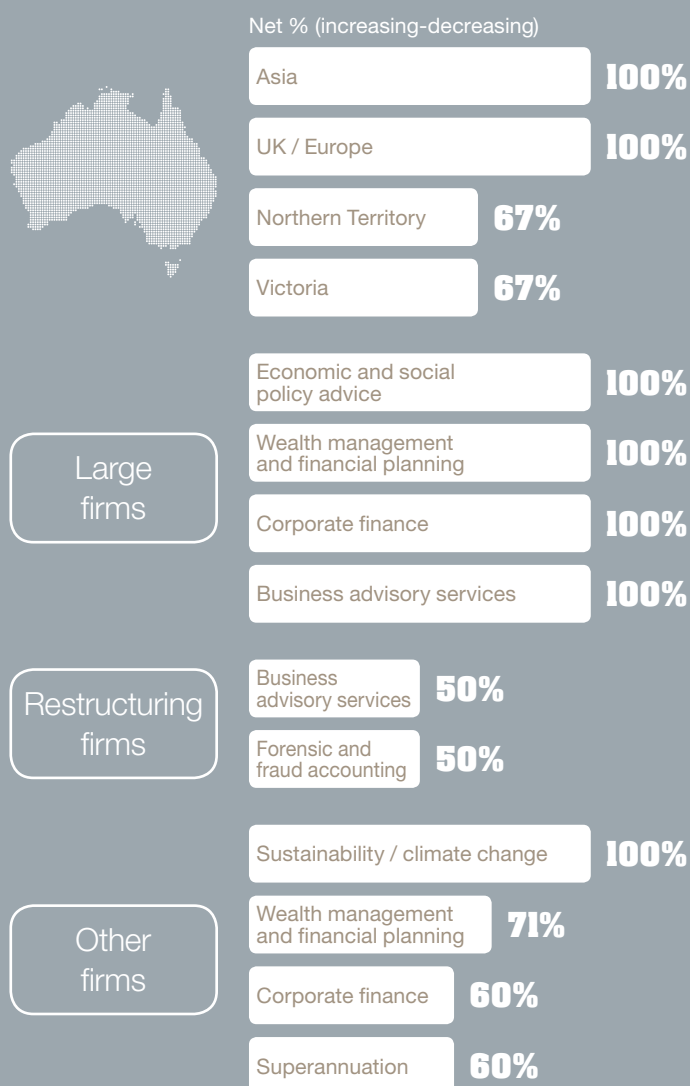
Restructuring firms **100%**

Other firms **77%**

Perceived performance of the Australian economy over the next 12 months



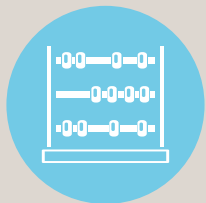
Geographic and practice areas with highest expected revenue growth



Top 3 challenges for accounting firms



Operating margins forecast



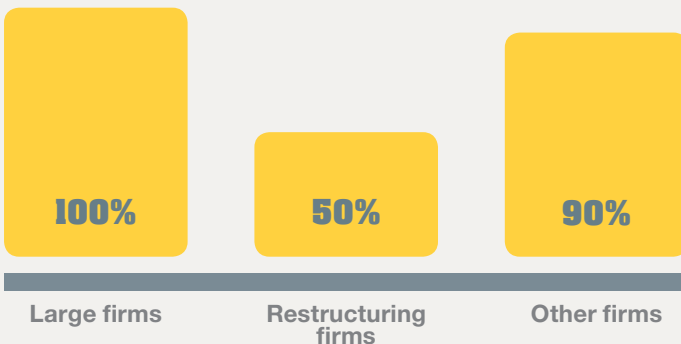
Restructuring firms **100%**

Large firms **80%**

Other firms **8%**

Net % (increasing-decreasing)

Changes in revenue from non-accounting services



Net % (increasing-decreasing)

Geographic expansion



of firms considering expanding

Top cities for expansion

Brisbane **38%**

Canberra **25%**

Melbourne **25%**

Sydney **25%**

Changes in staffing



- Junior to mid-level accountants
- Fixed share / salary partners
- Equity partners
- Directors / managers

- Shared service staff
- Secretarial and administration staff

Top 3 expenses with the highest net increase over the next 6 months

55%

IT hardware and software

45%

Knowledge management

45%

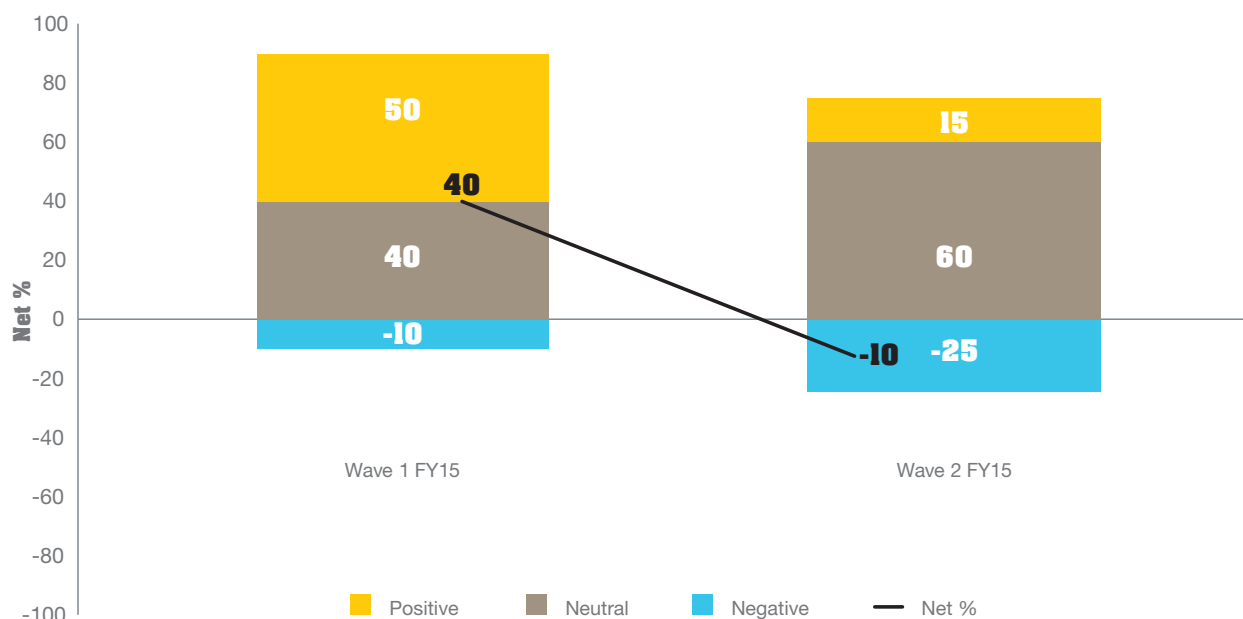
Staff training and development

Net % (increasing-decreasing)

Business conditions

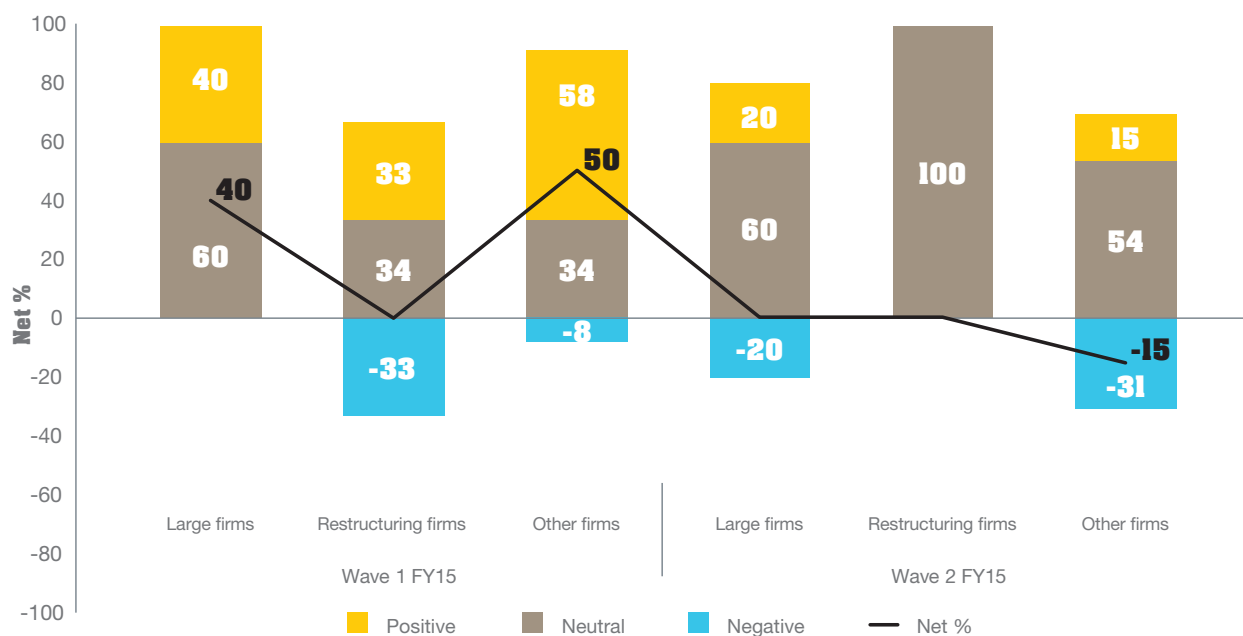
Perceived performance of the Australian economy

The perceived performance of the Australian economy has declined in this report period, with one in four accounting firms believing the economy will perform negatively in the next 12 months.



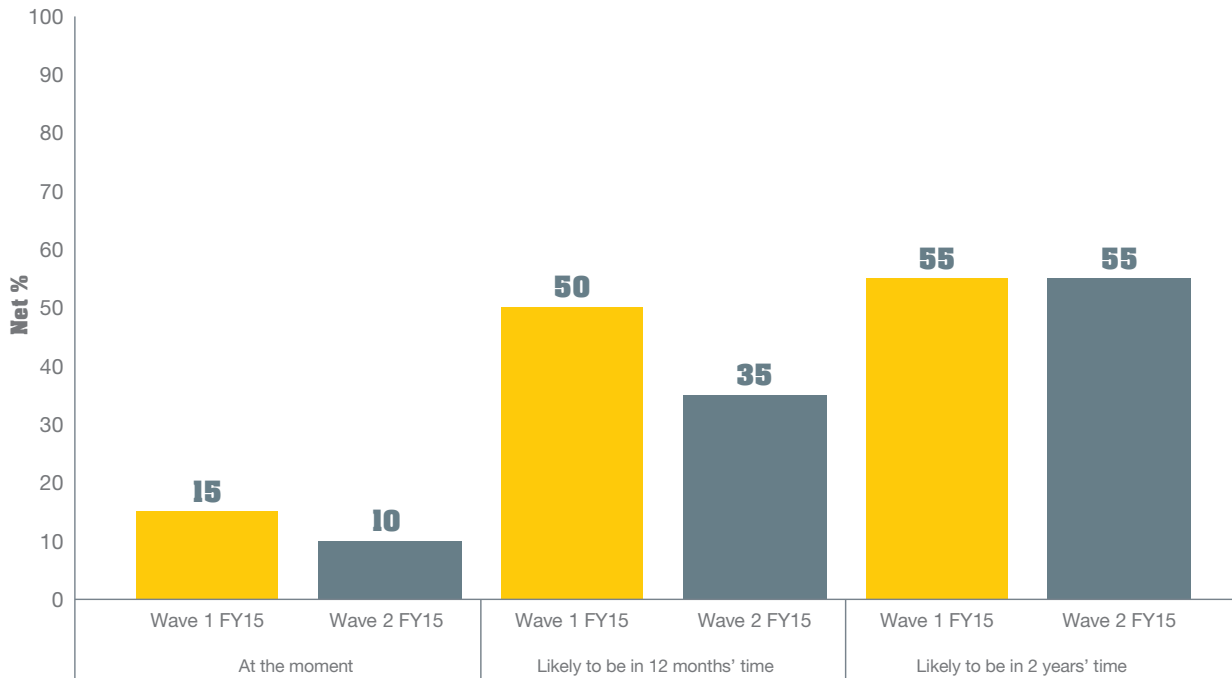
Perceived performance of the Australian economy by segment

Of the three segments, 'Other firms' are the least optimistic about the Australian economy's performance.



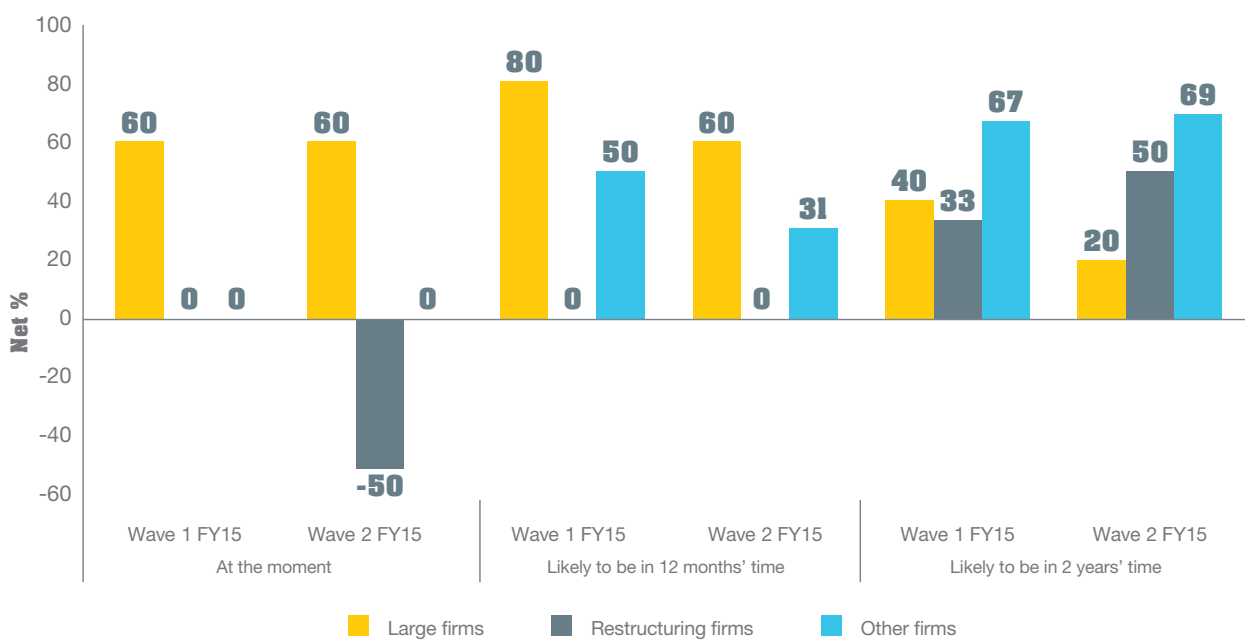
Perception of business conditions – present to 2017

While business confidence remains positive across both the short and long-term, accounting firm leaders are less positive compared to six months ago.



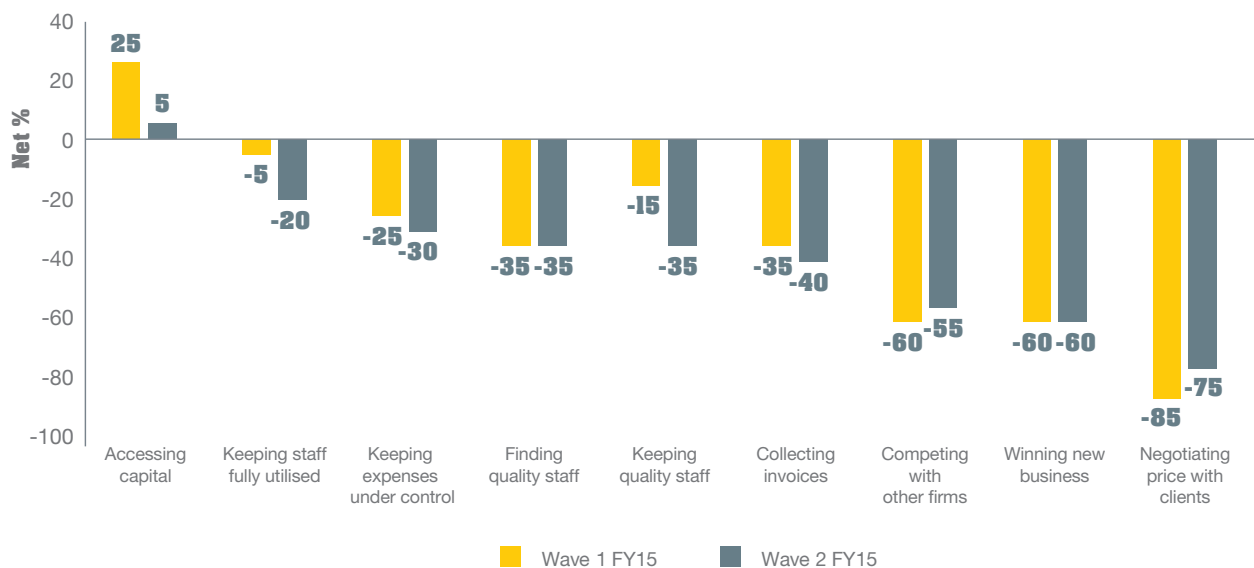
Perception of business conditions by segment – present to 2017

Over the short-term, large firms remain more optimistic than the rest of the market.



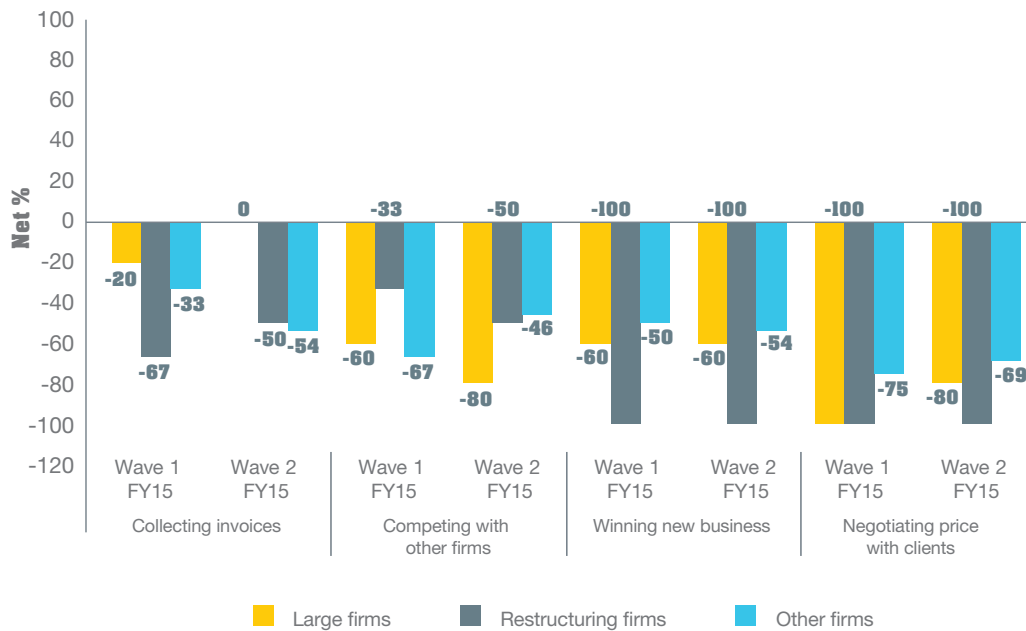
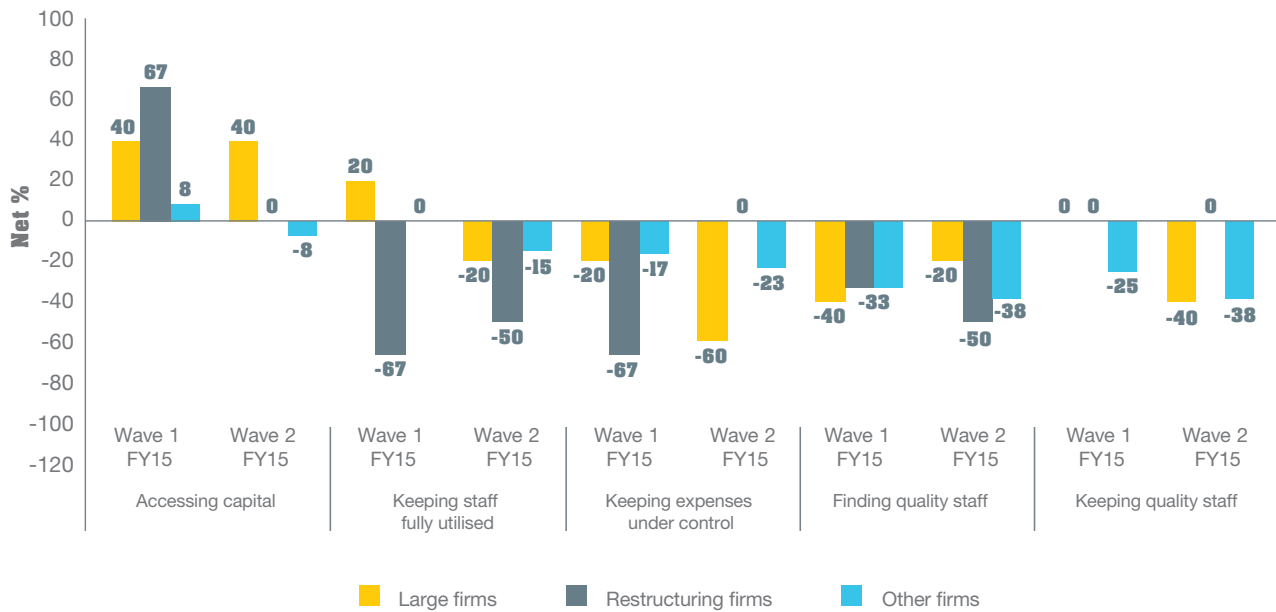
Perception of business conditions by area

Price negotiations, revenue generation and competitive activity continue to be the primary challenges faced by accounting firms.



Perception of business conditions by area and firm type

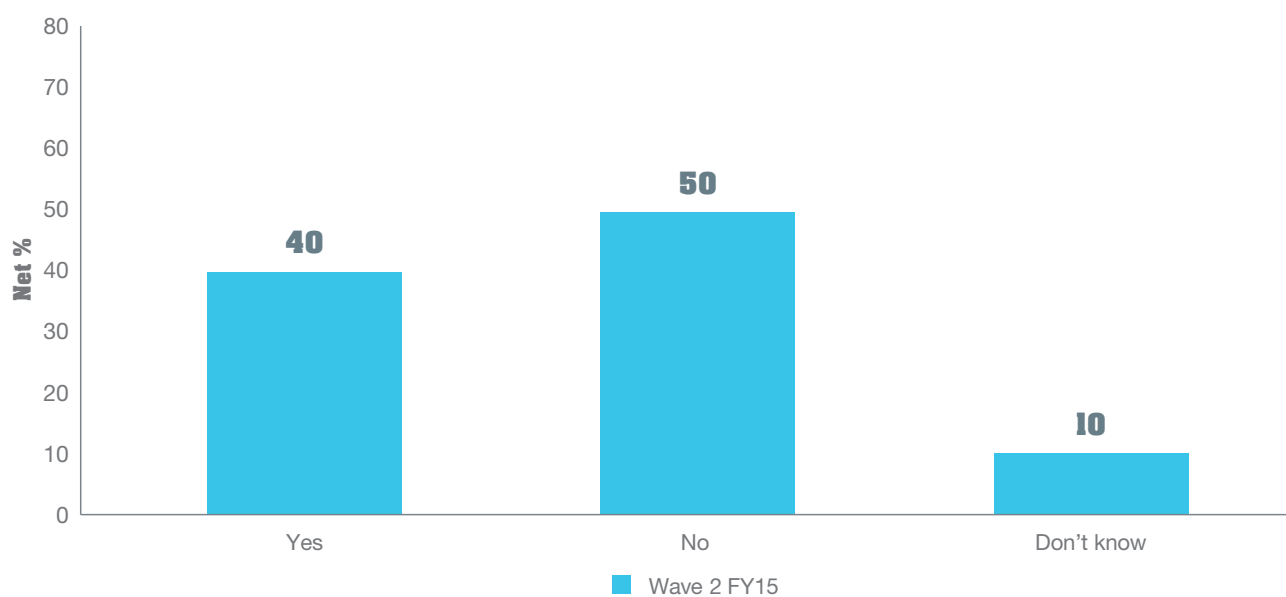
Large firms are finding it more challenging to control expenses, retain quality staff and compete with other firms.



Business priorities

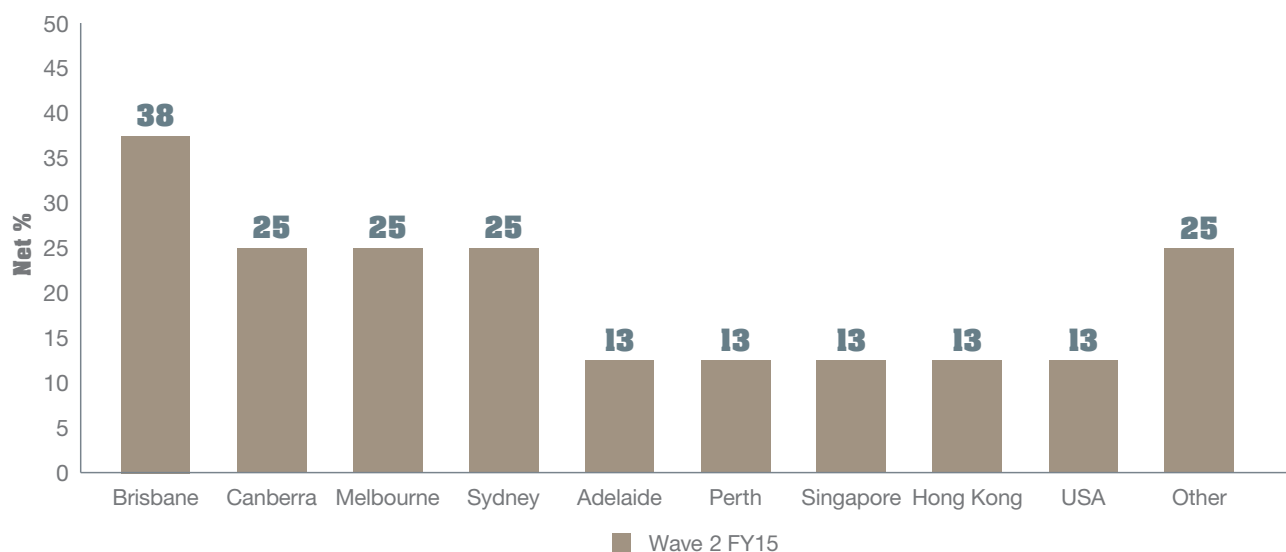
Geographic expansion

Two in five accounting firms are looking to expand geographically in the next 12 months.



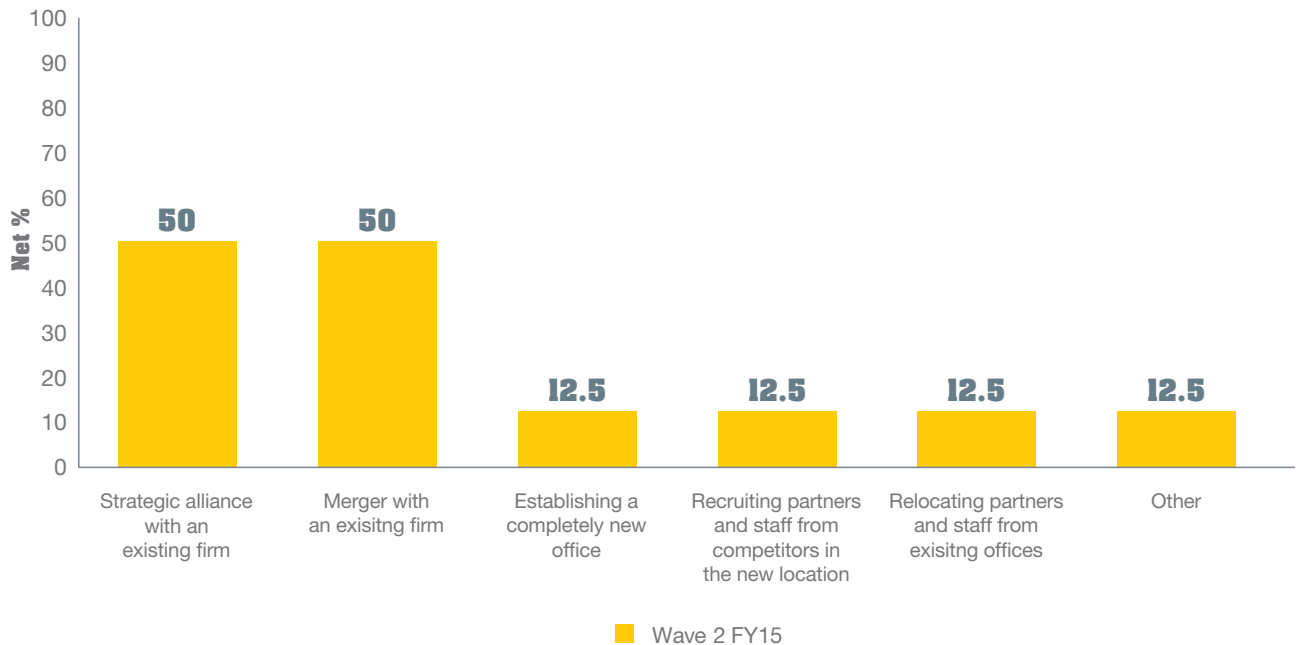
Geographic expansion by location

Of those looking to expand, the majority of firms will do so within Australia as opposed to Asia or the USA.



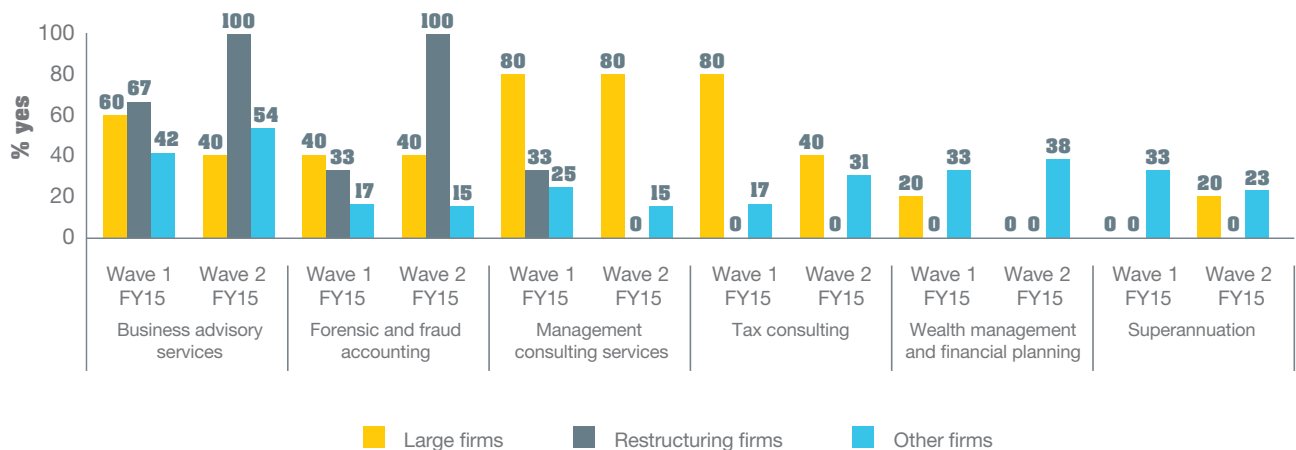
Reasons for geographic expansion

The reason for expansion is primarily due to a strategic alliance or merging with an existing firm.

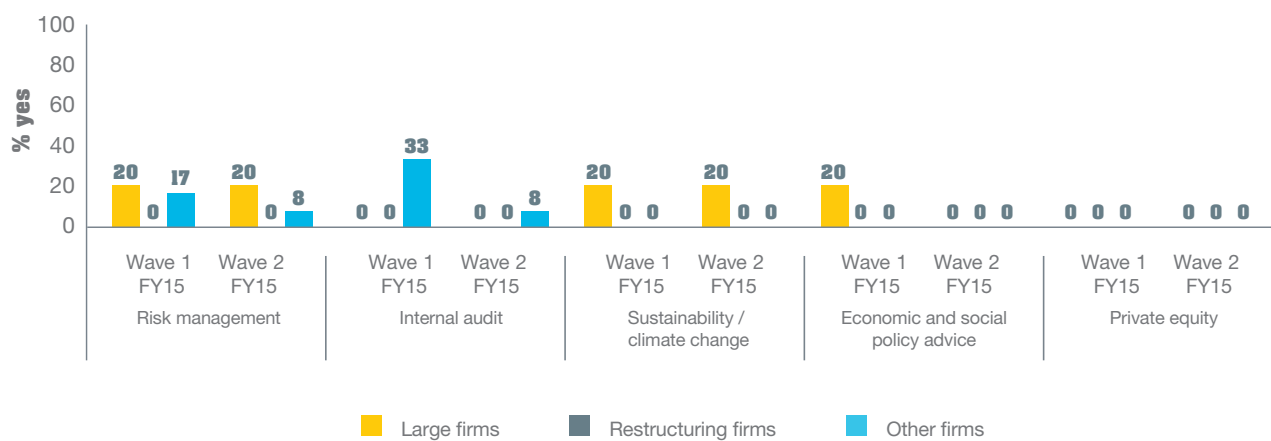
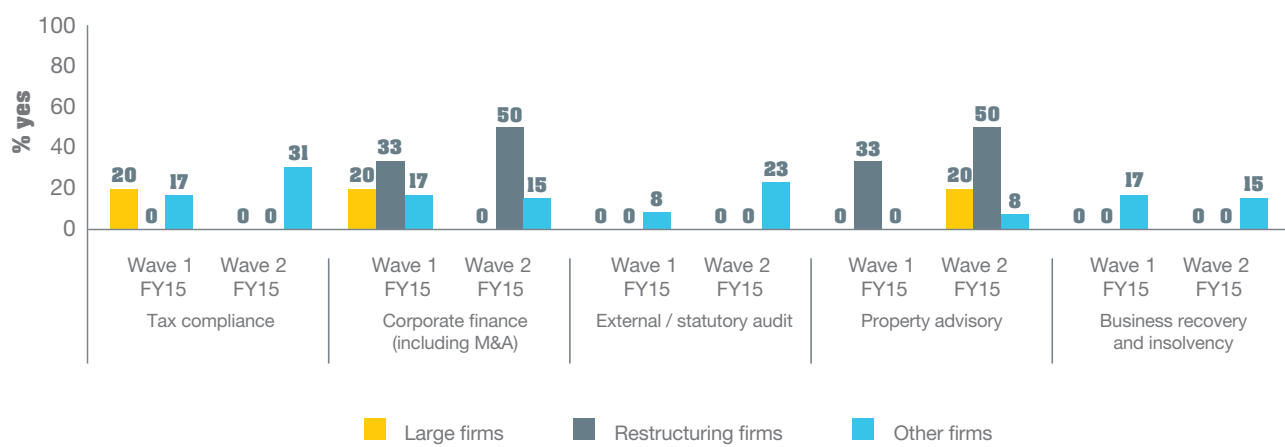


Market entry by segment

Large firms are focused on growing their management consulting services, and restructuring firms are looking to grow their business advisory services as well as forensic and fraud accounting.



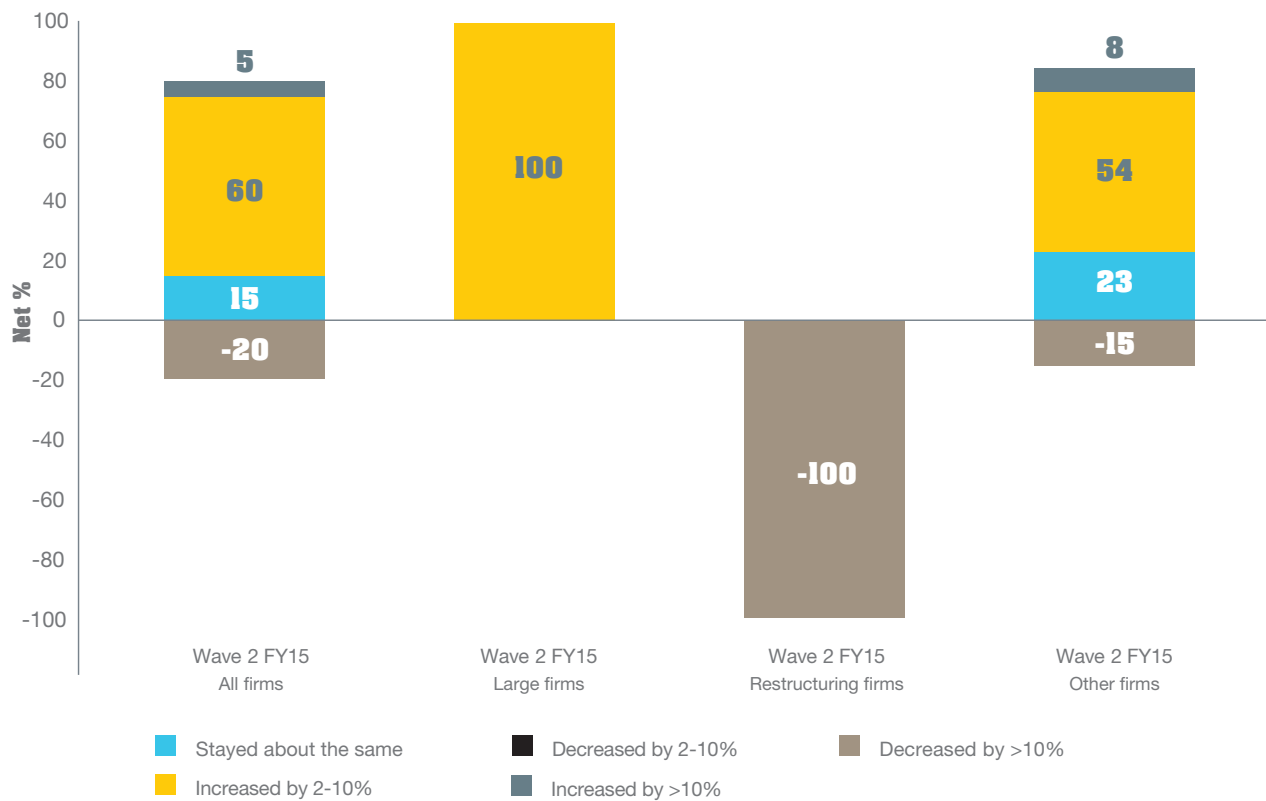
Market entry by segment (continued)



Revenue predictions

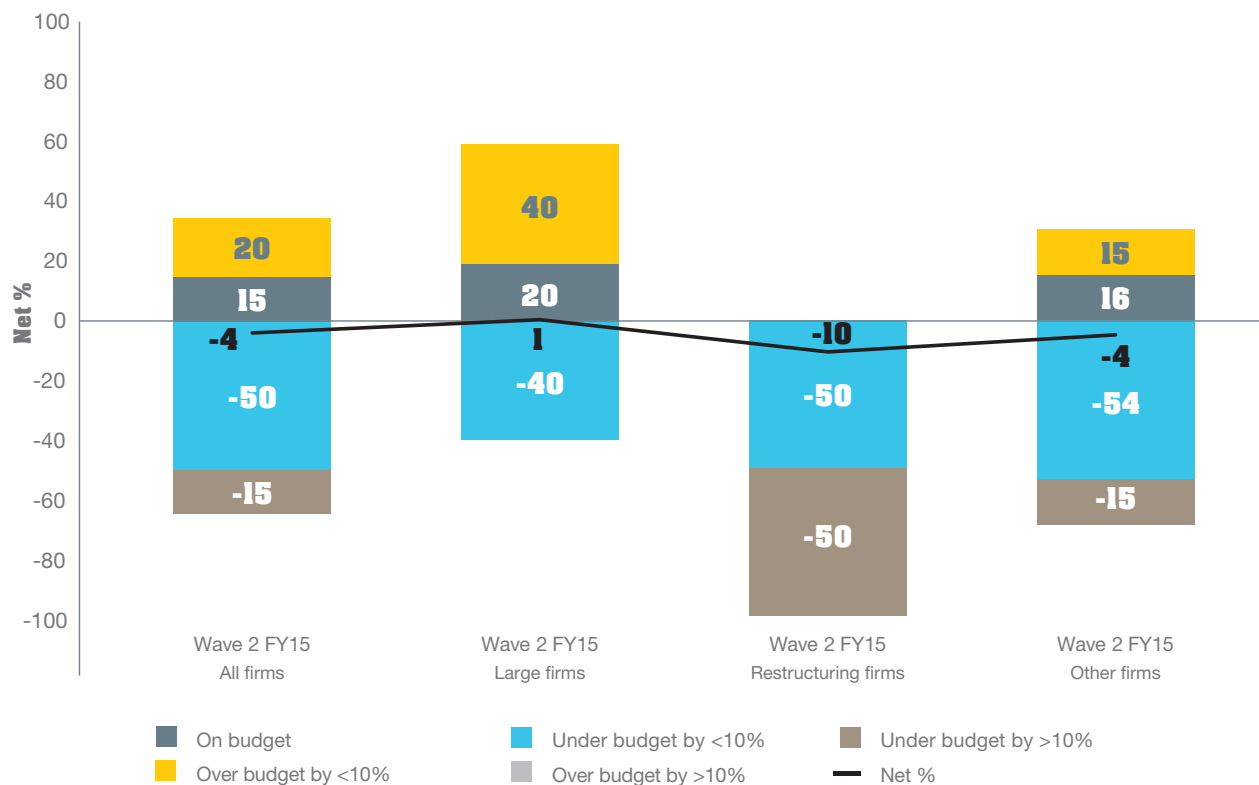
Changes in revenue from FY14 to FY15

Large firms have seen an increase in revenue this financial year, whereas restructuring firms' revenue has decreased.



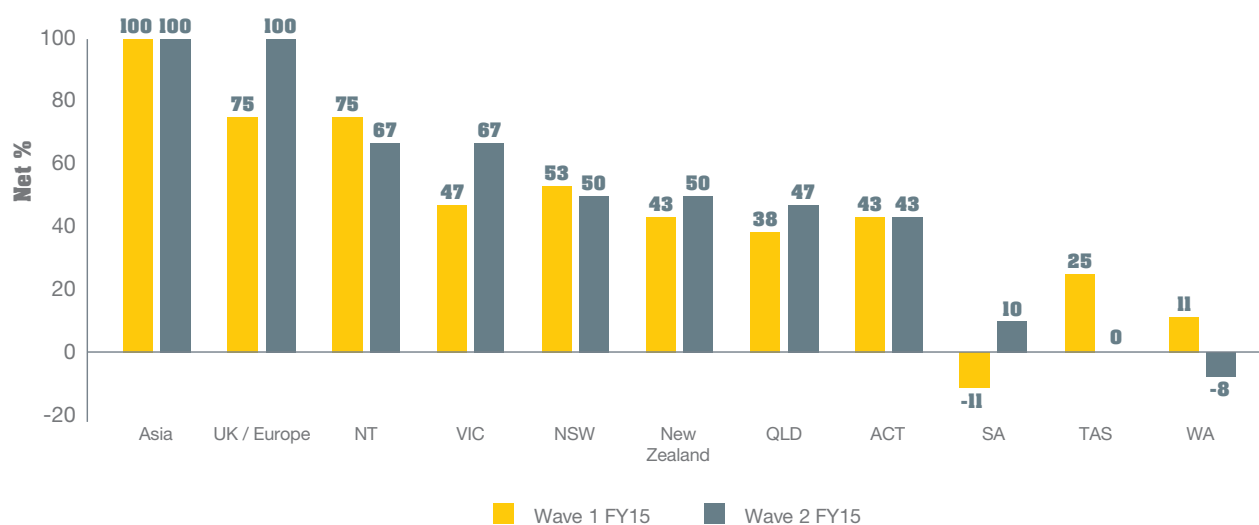
Difference between FY15 budgeted and actual revenue

Firms' FY15 revenue is slightly below budget, largely driven by restructuring firms.



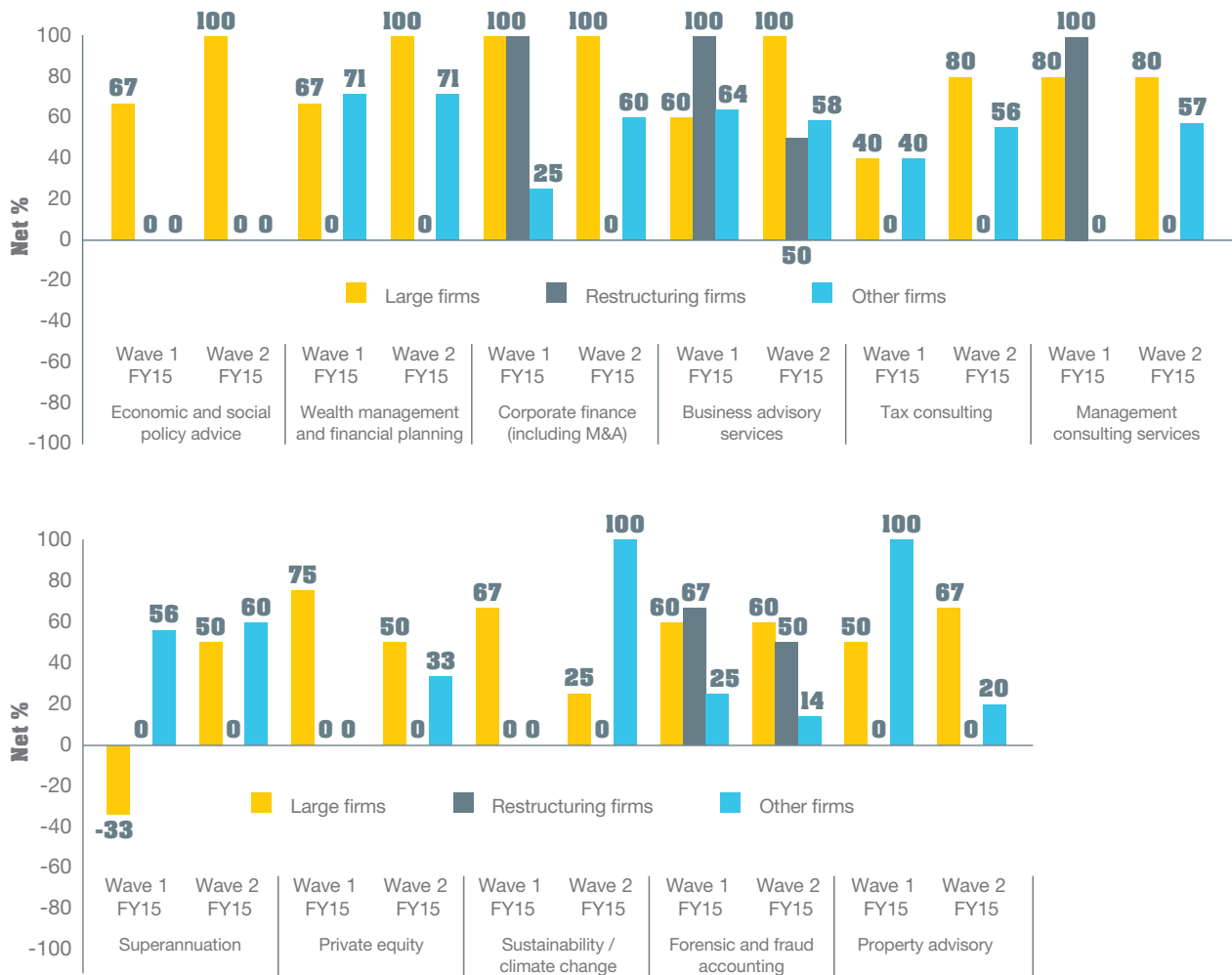
Changes in revenue by location over the next 6 months

The primary locations for revenue growth are forecast to be Asia, UK / Europe, Victoria and the Northern Territory.



Changes in revenue by service line over the next 6 months

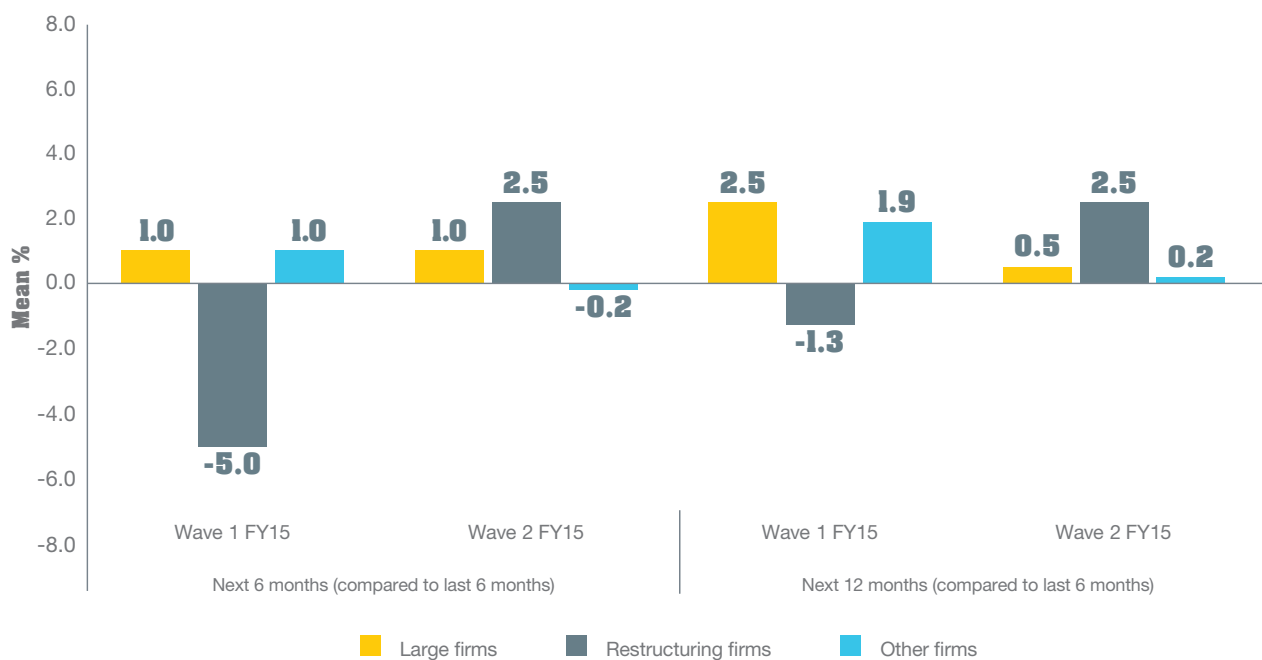
Large firm leaders are more optimistic across most service lines except private equity, sustainability / climate change, and forensic and fraud accounting.



Realised rates

Expected changes in realised rates over the next 6 and 12 months

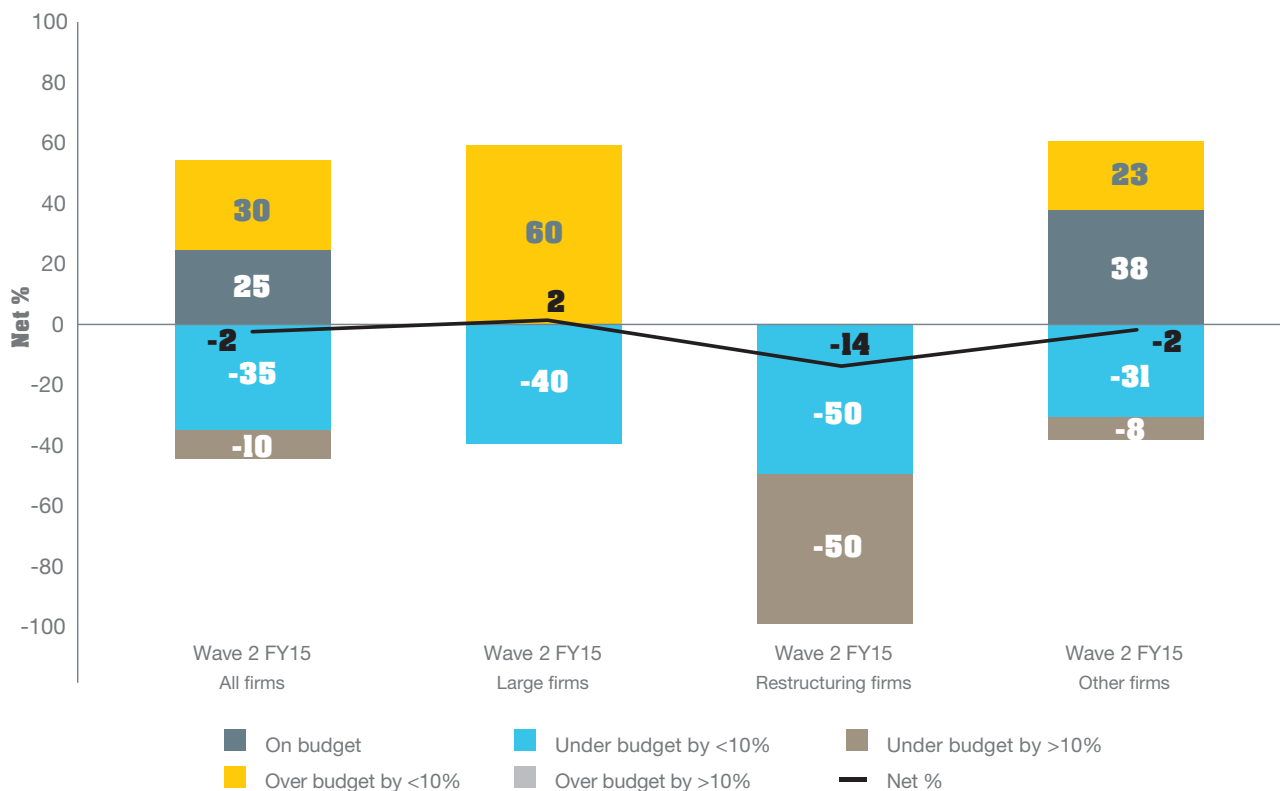
Restructuring firms are more optimistic about forecasted changes in realised rates over the next 6 months, compared to results in our previous report.



Expense and profitability predictions

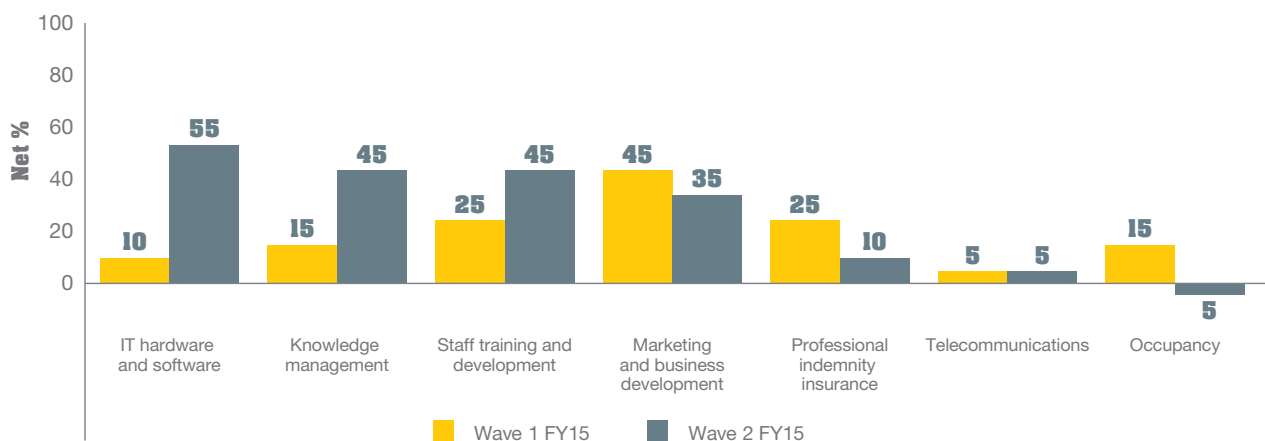
Difference between FY15 budgeted and actual expenses

Restructuring firms' actual expenses are under budget as they continue to tighten their spending.



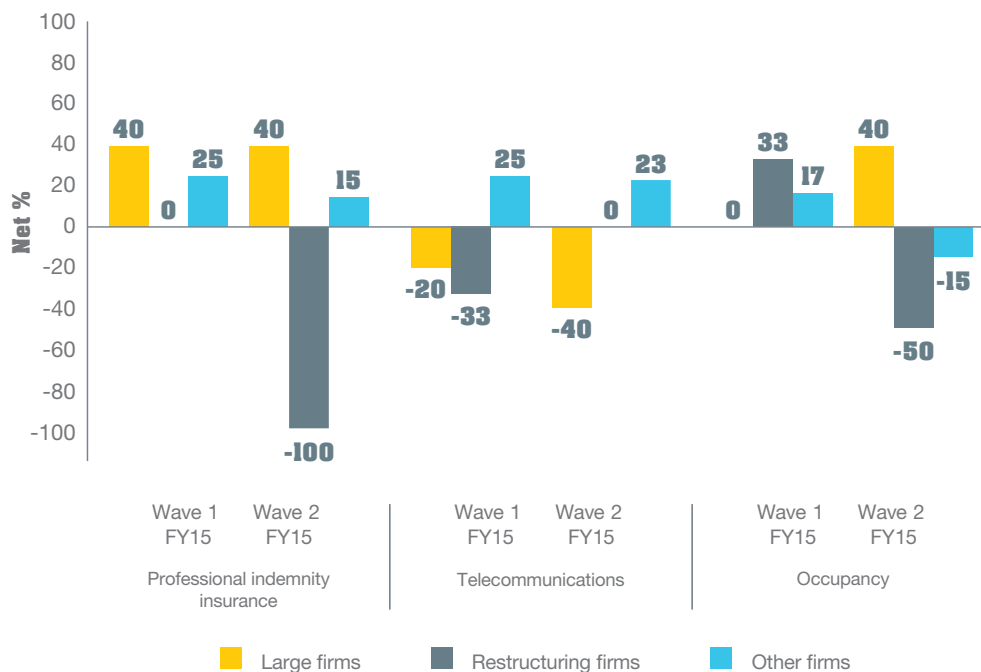
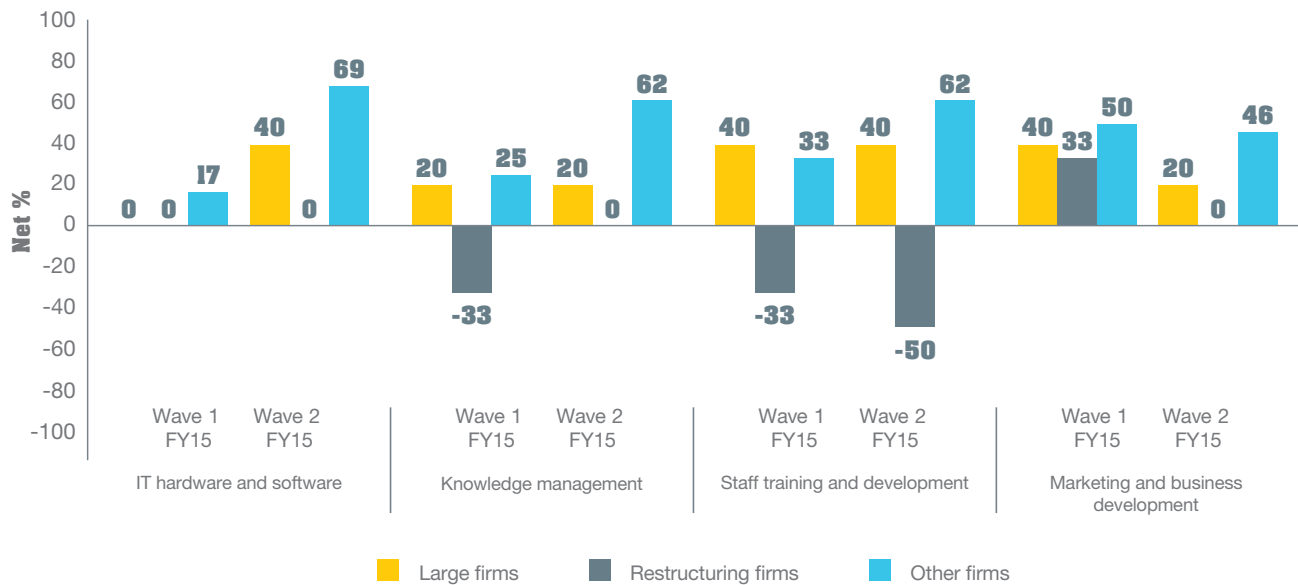
Changes in expenses over the next 6 months

There is an expectation of a significant increase in IT and knowledge management expenses over the next 6 months.



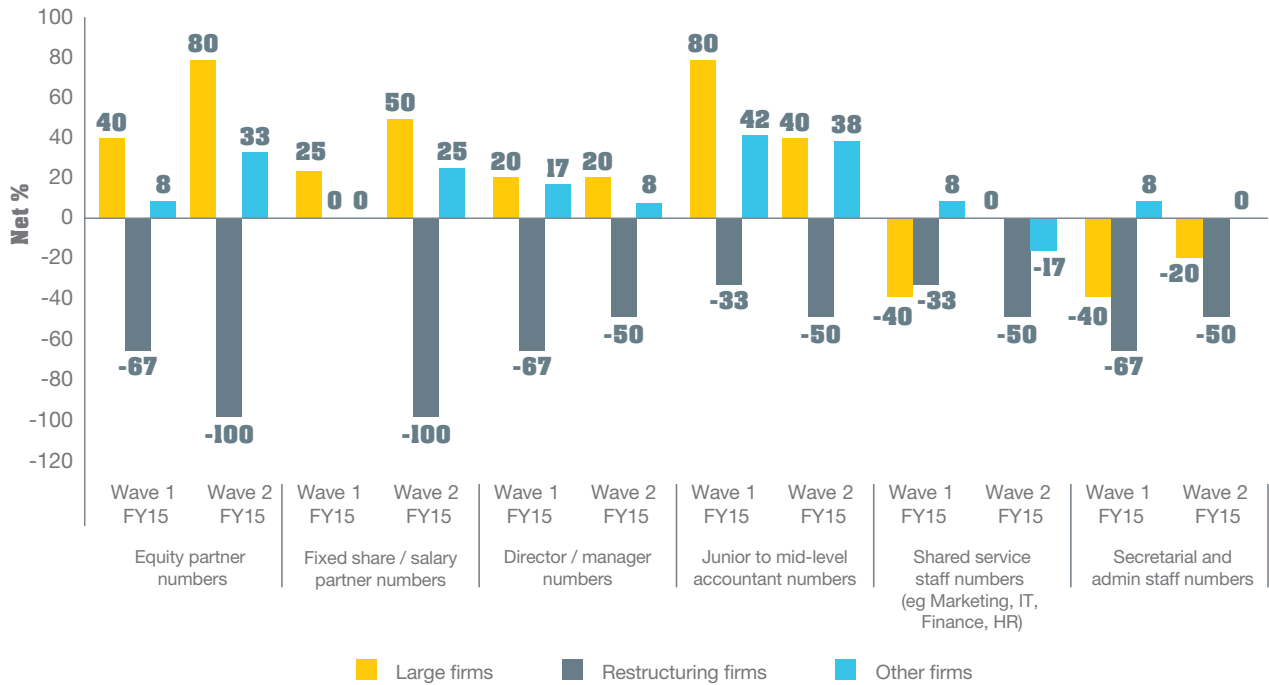
Changes in expenses by segment over the next 6 months

Restructuring firms are controlling expenses in the areas of staff training and development, occupancy and professional indemnity insurance. Conversely, other firms are looking to improve across IT and knowledge management.



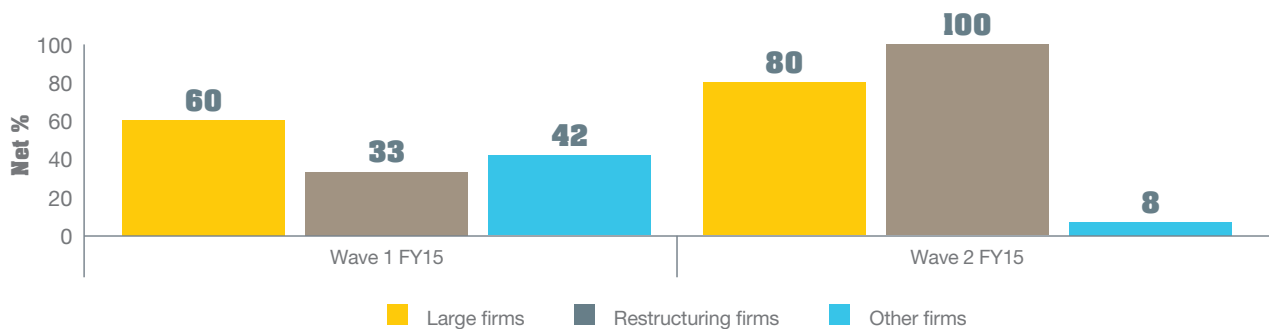
Changes in staffing by segment over the next 6 months

Restructuring firms are likely to reduce staff numbers across all levels.



Change in operating margins for the next 6 months

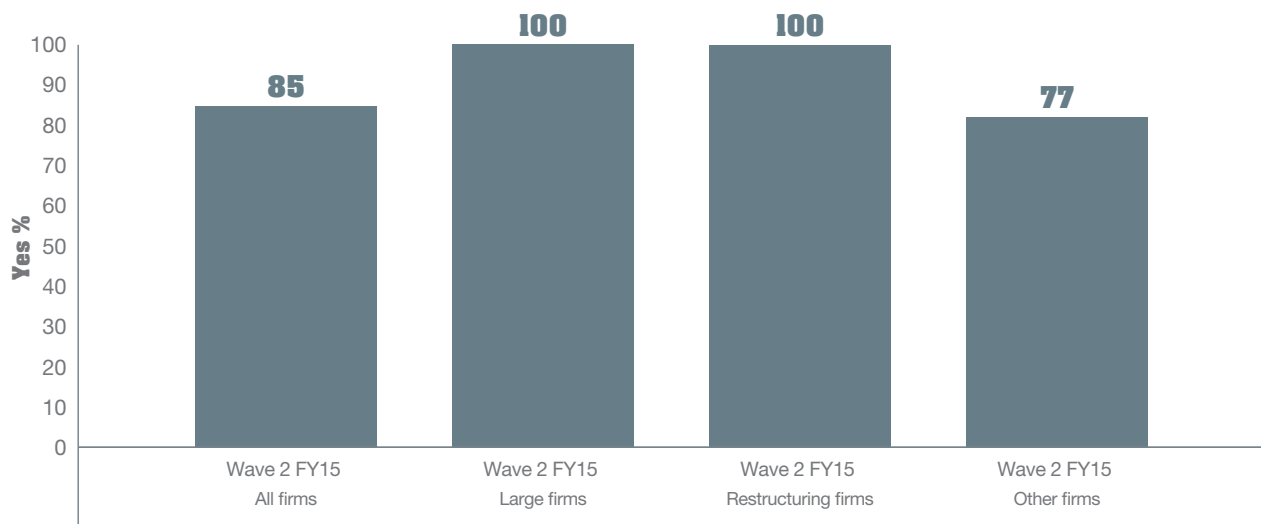
Overall, all firm types are forecasting an increase in operating margins for the next 6 months.



Provision of non-accounting services

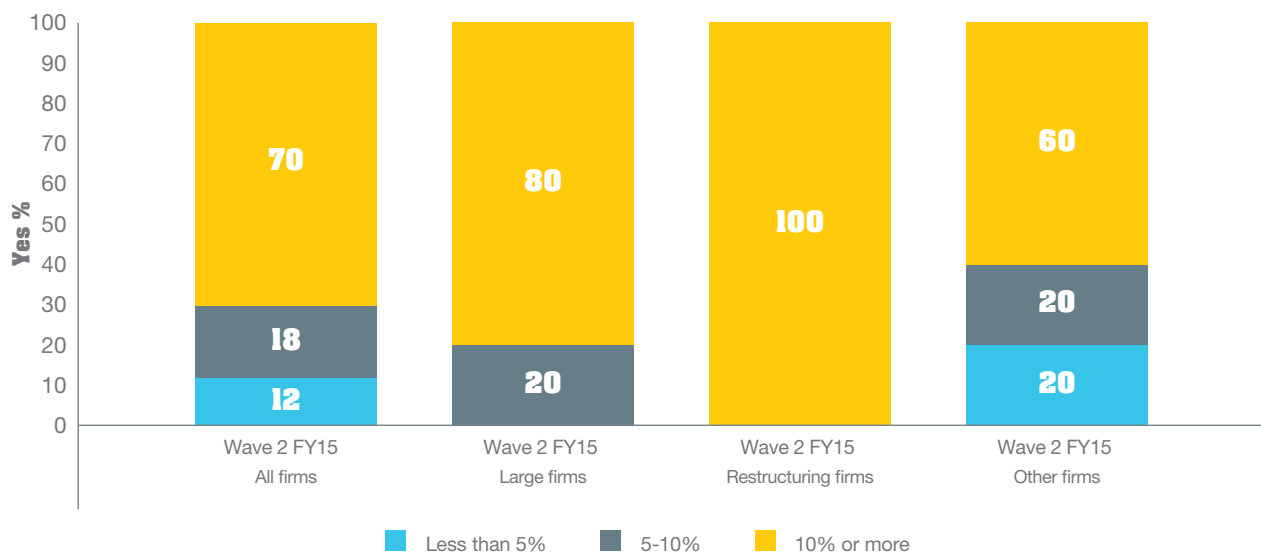
Provision of non-accounting services

The majority of firms surveyed currently provide non-accounting services.



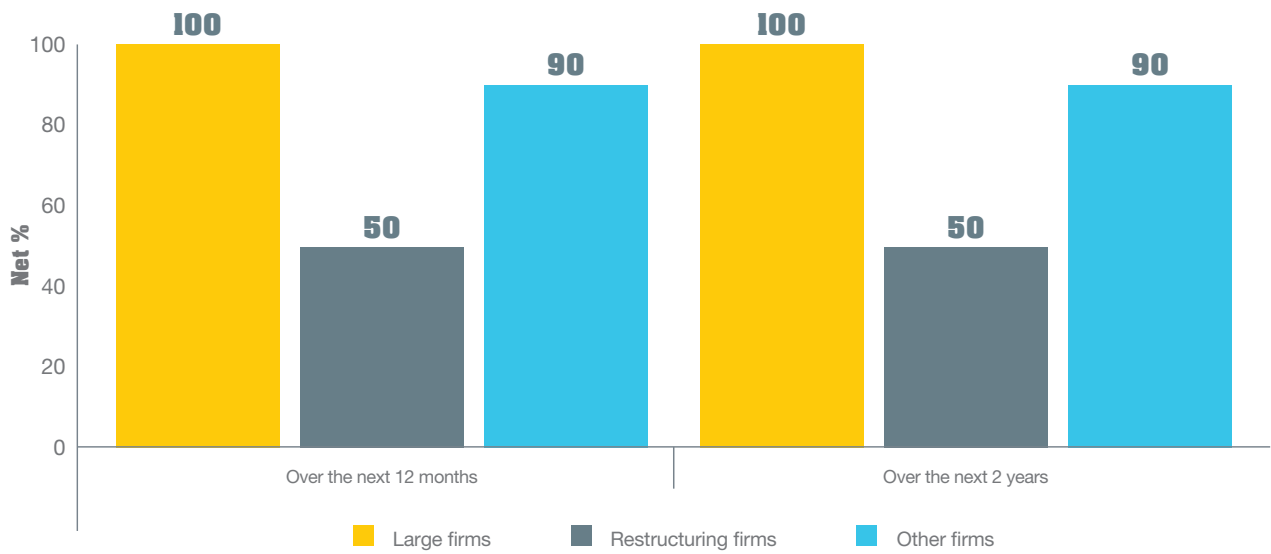
Revenue from non-accounting services

Non-accounting services contribute to over 10% of firm revenues.



Changes in revenue from non-accounting services

The majority of firms expect revenue from non-accounting services to increase.



Further information

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