Phoslock Environment Technologies Limited (ASX:PET)

Half year results – 30 June 2020

Friday, 29 January 2021

Phoslock Environment Technologies Limited release the final audited results for the half year (interim) ended 30 June 2020, today.

The prior announcement and Appendix 4D released on 26 August 2020, included unreviewed interim financial report.

Subsequent to the release of the Appendix 4D, as a result of a Board investigation of the Group's China operations detailed in the interim report for the half year ended 30 June 2020, the Group undertook a thorough review of its financial position and related party relationships in order to identify, quantify and account for transactions connected with the noted activities. The outcome of this review resulted in a number of adjustments and therefore restatements to the Group's financial statements for prior periods and prior reported unreviewed financial report for half year ended 30 June 2020.

The outcome of the changes to the half year ended 30 June 2020 is detailed below:

	30-Jun-20 Interim Report	**30-Jun-20 Unaudited** (Prior Reported)
	$000's	$000's
Revenue	2,090	1,232
Net Operating Profit/(Loss) after Tax	(21,612)	(5,101)
Add: income tax (benefit)/expense	(36)	(36)
Add: Finance costs	105	105
Add: Impairment of receivables	9,804	-
Add: Impairment of assets	7,536	-
Add: Share-based expense expense/(reversal)	(30)	(30)
Add: Foreign exchange (gains)/losses	(79)	(79)
Underlying Earnings Before Interest and Taxes ('Underlying EBIT')*	(4,312)	(5,141)

*Underlying EBIT is a financial measure which is not prescribed by Australian Accounting Standards ('AAS') and represents the profit or loss under AAS adjusted for the add back of income tax, finance costs and certain non-cash income and expense items that are deemed to not have an ongoing affect to the underlying performance of the business. The Company believes that presenting Underlying EBIT provides a better understanding of its financial performance by facilitating a more representative comparison of financial performance between financial periods.

Phoslock Environmental Technologies Limited

ABN 88 099 555 290

Interim Report (Reviewed) - 30 June 2020

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Dear Shareholders and other company stakeholders,

The past few months have been surprising disappointing and challenging for all.

At the request of the Company, the securities of PET were suspended from quotation on 17 September 2020. The Company subsequently announced on 21 September 2020 that an investigation was underway into apparent accounting irregularities relating to PET's China operations. Suspected accounting irregularities were first discovered during an internal review of controls instigated by the new corporate head office management team. These were brought to the attention of our lawyers, Arnold Bloch Leibler, who then initiated an investigation by KPMG Forensic, into the identified concerns.

The Company engaged additional independent consultants to assist with these investigations and support the business during this challenging time. While investigations continued, the Board – on 30 September 2020 – received and accepted the immediate resignations of two non-executive directors, Deputy Chairman Mr Zhigang Zhang, and board member Mr Ningping Ma.

The Company has released several market updates on the progress of the investigations in China. In summary, the Board has confirmed fraudulent activities relating to areas including accounting and falsification of invoices and service contracts; improper tax reporting; potential misappropriation of funds, including improper payment of bonuses; and undisclosed related party transactions.

These matters are confined to the Company's China operations only and reflect disturbing and unacceptable behaviour on the part of a few individuals. Several of those individuals were employed by PET China or were otherwise associated with the Company. I would like to make it clear that the Company reserves its rights to take further action against all implicated individuals and to seek compensation for their misconduct and all related costs.

As a result of these matters, the Company has taken an appropriately conservative position in its review of the financial implications on both the full financial year ending 31 December 2019 and the half year to 30 June 2020. It is extremely disappointing to report that restatements for those periods total approximately $3 million and write-downs and impairments (non-cash impacts) of approximately $17 million. The notes to the accounts include an explanation of the financial impacts of those findings. I would encourage you to read in full the notes to the accounts.

While the accounting and financial impact is significant – as are the costs associated with these investigations and remedial actions - the financial position of the Company remains sound. As at 31 December 2020, the Company had cash and cash equivalents totalling $30.5 million and no debt.

It is important for shareholders to recognise that the current senior management team - in particular, CEO Lachlan McKinnon, who assumed Managing Director responsibilities on 25 May 2020, and Chief Financial Officer, Matthew Parker, who also joined the Company in May 2020 – took actions to identify and respond to these matters and have the full confidence of the Board as they lead the structural, cultural and strategic change necessary to reset our business.

Lachlan will outline the new strategy for the business to shareholders and other stakeholders over coming weeks.

Faced with the realities of the events in China, and what the related investigations have revealed, the Board has re-committed to higher standards of governance and transparency in the business.

We are well advanced with the recruitment of new directors and, as a first step, we have announced the appointment of Barry Sechos as a director. Barry brings relevant skills and experience and will make an important contribution at Board level. Our refreshed Board and management team are committed to revitalising value for our shareholders going forward.

KPMG has disclaimed its opinion on the accounts. The Company has expended significant efforts and costs in responding promptly and comprehensively to the matters identified in China. The Company has endeavoured to work in alignment with our auditors, KPMG in order to achieve a different outcome in relation to the accounts. That we were unable to secure an audit opinion for the accounts for this financial period, despite the effort, work and cost expended is a disappointing outcome.

The fact that our revised accounts are not accompanied by a review conclusion leaves the Company in a difficult position and unable to resume trading on the ASX at this time. We will continue to pursue a qualified audit opinion, as well as ASX and ASIC consent, to enable our shares to resume trading. This is likely to take some time and we will keep shareholders updated on progress.

Nevertheless, the directors have satisfied themselves, based on extensive efforts and reviews, that the restated accounts give a true and fair view of the Company's affairs as at the relevant balance dates.

I would like to thank our legal team at Arnold Bloch Leibler and the FTI Consulting Group which has assisted us on the ground in China, our dedicated and hard-working management team and employees, led by Lachlan and Matthew, who have all contributed significantly to guiding us through this difficult period. Of course, that hard work continues – it is not yet at an end.

In closing, let me say that I remain extremely confident in the future for our business. We have a proprietary product with proven efficacy and the opportunity to access and address global markets where water quality problems are endemic and continue to arise. Despite the set-backs, the Company has a strong balance sheet and cash position and is well positioned to capitalise on the opportunities ahead.

Yours Sincerely

Laurence Freedman AM , Chairman

Dear Shareholders and other company stakeholders,

My focus over recent months has been to oversee the investigations relating to the China operations; to immediately implement changes that will safeguard against any similar events in future; and to stabilise the business and execute our diversification and growth strategy.

While the investigations into the matters in China progressed, we moved quickly to:

- Review all current China contracts and contractual arrangements with third parties, including sub-contractors and distributors, to help provide a sound basis for re-evaluating the company's near and mid-term expectations for revenue generation in China;

- Commissioned an independent market review of the waterways remediation market in China to help assess our opportunity in the region and better inform decisions relating to organisation, structure, location etc; and

- Implemented changes which will strengthen PET China's financial reporting procedures, delegated authority policies and general risk management framework.

In addition, we updated and strengthened company policies and procedures which included disseminating formal delegated levels of authority and dual / cross border authorisation for all banking transactions. And to be able to better identify and assess potential risks such as financial, operational, environmental, and legal risks the Company conducted a deep dive review that enabled the production of detailed risk management strategies and business continuity plans.

These responses – together with the requirement to liaise closely with our auditors, legal advisors and the various consultants we have retained to assist us through this period – have involved an inordinate amount of time, effort and stress on the part of the small senior management group that has picked up the reigns of this business since May of last year and helped bring these matters to light.

It has been a very difficult period, but the support of our current Board members, our various advisors and consultants, my management team and PET employees around the world have ensured that we are now in a position to move forward with confidence as we attend to the priorities of the business in both the short and longer term.

Those priorities include completing the restructure and review of our China business; investing in additional resources that will enable the acceleration of our geographic diversification strategy; and expanding our marketing and stakeholder engagement programs.

Despite the distractions over recent months, we have been able to make positive progress on all of those fronts.

- Our independent market review in China is well advanced and is already informing decisions we have taken to restructure our sales organisation and change our go-to-market strategies. We have taken the decision not to proceed with a second manufacturing plant in China and we are reviewing options for locating our second production facility elsewhere. We are also well progressed in the search for a new General Manager for our Chinese business.

  Given the outcome of our investigations in China, it is now clear that China will not contribute previously anticipated revenues over the short to medium term. However, China will remain a priority market for PET and we will continue to pursue opportunities, albeit with the benefit of lessons learnt and the important changes made in the way we conduct business in China.

- We have established a new legal entity in the USA, where we have recently appointed an experienced commercial lead to identify and secure new sales opportunities. We are also investing in additional resources and support in Canada and Europe and looking closely at building out our organisation in South America. We remain confident that our products and services will attract new customers in each of these markets.

- And we have adopted a broader approach to the positioning and marketing of the business, engaging with stakeholders who have shared objectives around the remediation of waterways and looking at mutually beneficial partnerships.

Together with the Board, I understand the substantial task we have in regaining the trust and confidence of our shareholders. But I am genuinely excited about the future prospects for the business and I look forward to engaging closely with shareholders and other stakeholders over coming months as we communicate the details of our plans and expectations.

Yours faithfully

Lachlan McKinnon
Chief Executive Officer

The directors present their report, together with the financial statements, on the consolidated entity (referred to hereafter as the 'Group') consisting of Phoslock Environmental Technologies Limited (referred to hereafter as the 'Company' or 'parent entity') and the entities it controlled at the end of, or during, the half-year ended 30 June 2020.

Directors
The following persons were directors of Phoslock Environmental Technologies Limited during the whole of the financial half-year and up to the date of this report, unless otherwise stated:

Laurence Freedman AM
Brenda Shanahan AO
Lachlan McKinnon (appointed on 25 May 2020)
Robert Schuitema (retired on 25 May 2020)
Zhigang Zhang (resigned on 30 September 2020)
Ningping Ma (resigned on 30 September 2020)

Board changes
On 30 September 2020, the Board accepted the immediate resignation of the Deputy Chairman, Mr Zhigang Zhang and non-executive director Mr Ningping Ma. A recruitment process has commenced to attract experienced and skills-relevant candidates for these Board positions.

Principal activities
The principal activities of the Group during the period were selling and marketing of the patented product "Phoslock®" and providing design, engineering and project implementation solutions for water related projects and water treatment products to clean up lakes, rivers, canals, wetlands and drinking water reservoirs. The Group devotes significant resources on the evaluation and development of new water treatment products and technologies through in-house development, licensing arrangements or acquisition.

Review of operations
The loss for the Group after providing for income tax amounted to $21,612,000 (30 June 2019 (restated): profit of $1,076,000).

Reconciliation of earnings before interest and taxes follow:

	Consolidated	
	30 Jun 2020 $'000	30 Jun 2019 Restated $'000
Revenue	2,090	9,803
Net Operating Profit/(Loss) after Tax ('NPAT')	(21,612)	1,076
Add: income tax (benefit)/expense	(36)	702
Add: Finance costs	105	19
Add: Impairment of receivables	9,804	-
Add: Impairment of assets	7,536	190
Add: Share-based expense expense/(reversal)	(30)	-
Add: Foreign exchange (gains)/losses	(79)	(13)
Underlying Earnings Before Interest and Taxes ('Underlying EBIT')*	(4,312)	1,974

* Underlying EBIT is a financial measure which is not prescribed by Australian Accounting Standards ('AAS') and represents the profit or loss under AAS adjusted for the add back of income tax, finance costs and certain non-cash income and expense items that are deemed to not have an ongoing affect to the underlying performance of the business. The Company believes that presenting Underlying EBIT provides a better understanding of its financial performance by facilitating a more representative comparison of financial performance between financial periods.

Operating results
Revenue for the period was $2,090,000 down 79% on the $9,803,000 generated in the prior corresponding period. The business faced considerable headwinds during the first half, including flooding in China and COVID-related impacts which contributed to project delays throughout the period.

Coronavirus (COVID-19) impacted the business though the reporting period via restrictions imposed in key markets to slow the spread of the virus. Restrictions in Beijing caused challenges in business development as key personnel could not visit strategically important clients and sites. China sales were delayed through the period as government officials reprioritised short term emergency resources away from project such as lake restoration towards immediate health resources. In Europe, several projects were impacted by COVID-19 related delays. In those instances, authorities with which PET has contracted remediation works have cited more pressing expenditure priorities associated with supporting local communities during the pandemic. While these projects have been delayed, none have been cancelled.

Gross profit was $1,120,000 for the six months (6 months to 30 June 2019: $6,465,000 restated). The gross profit margin was 54% for the six months (6 months to 30 June 2019: 66% restated). The gross profit margin decreased as a result of increased settlement discounts provided to customers to stimulate early payment, increased project application costs and unfavourable movements in currency and raw materials.

Underlying EBIT for the period was a loss of $(4,312,000) compared to a profit of $1,974,000 in the prior corresponding period (restated). Lower sales revenue and gross margin along with higher operating expenses contributed to the result. The increase in expenses is primarily as a result of higher employee costs, occupancy and professional fees. Employee costs included those associated with the transition of the new Managing Director/CEO and Chief Financial Officer and the retirement of former managing director, Robert Schuitema. One-off severance payments to outgoing senior executives also contributed to the increase in the period.

NPAT for the group for the six months amounted to a profit/(loss) of $(21,612,000); (6 months to 30 June 2019: $1,076,000). The period include one time non cash adjustments to recievables, inventory, plant property & equipment and right of use assets. The rational of each is detailed in the notes of this report. Within the period, the business added to existing tax losses in Australia that will be utilised against forecast profits in future periods.

Subsequent to 30 June 2020, the Group identified accounting irregularities with respect to its Chinese operations. The results arising from Board Investigation activities resulted in the restatement of prior period comparatives. Further details regarding the outcome of the Board Investigation and resulting restatements is set out below in the “Board Investigation” section below and in note 4.

Cash Flows
Operating Cash Flow for the six months period was a cash outflow of $(8,387,000) (6 months to 30 June 2019: inflow of $10,827,000).

Cash payments from customers for the six month period was $3,674,000 (6 months to 30 June 2019: $18,617,000). Cash payments to suppliers and employees for the six month period was $12,306,000 (6 months to 30 June 2019: $7,213,000). The increased cash outflow relates to higher employee payments, lower payables and higher inventory levels as the manufacturing plant built safety stocks (in the COVID environment).

New plant, equipment, and intangibles for the six months to 30 June 2020 totalled $31,000. This was mainly for the Chinese manufacturing facilities.

Financial position
Current assets of the Group as at 30 June 2020 were $42,225,000, made up of cash ($35,245,000); trade and other receivables ($1,572,000) and inventories ($4,487,000) and other assets ($921,000).

Current liabilities of the Group as at 30 June 2020 were $4,061,000 made up of trade / other payables, lease liabilities and employee liabilities.

The net assets of the Group were $35,284,000 as of 30 June 2020, an increase of $8,665,000 from 31 December 2019 The increase in net assets was due primarily to the capital raising undertaken during the reporting period which resulted in the Company receiving a total of $30,004,000 (before capital raising costs). This was partially offset by impairment actions detailed in the notes of this report. The new equity via three traches of capital raising activities as follows:

(i) 2020 Institutional Placement which issued 24,000,000 ordinary shares raising a total of $12,000,000 before issue costs;
(ii) 2020 Share Placement to ordinary shareholders: The Company issued 38,308,815 ordinary shares raising a total of $15,154,000 before issue costs; and
(iii) 2020 Share Placement: The Company issued 5,700,000 ordinary shares to Directors and other key management personnel raising a total of $2,850,000 before issue costs.

As a result, cash and cash equivalents increased to $35,245,000 as at 30 June 2020 (31 December 2019: $14,959,000).

The half year financial statements have been prepared on the going concern basis of accounting, which assumes, the continuity of normal business activities and the realisation of assets and the settlement of liabilities in the ordinary course of business, supported by the Group's strong cash position (as above) and net current asset position of $38,164,000 as at 30 June 2020 (2019: $24,503,000 restated). At balance date, the Group had no external loan facilities.

In response to the accounting irregularities identified in the Group's Chinese operations (discussed in further detail below in the section titled "Board Investigation"), the directors and management have taken a number of significant measures to stabilise and rebase the business. Whilst the Group expects to utilise some of its available cash reserves to support its operating activities in the short term, and settle amounts due to external advisors arising from the Board Investigation, the Group's current cashflow forecasts indicate that the cash held by the Group will be sufficient to support its operating activities and pay creditors as and when they fall due for no less than 12 months from the date of this directors report.

Significant changes in the state of affairs

In February 2020, a new wholly owned subsidiary, Phoslock Canada Inc. was incorporated.

On 17 April 2020, as part of the 2020 Institutional Placement, the Company issued 24,000,000 ordinary shares raising a total of $12,000,000 before issue costs.

On 7 May 2020, as part of the 2020 Share Placement, the Company issued 38,308,815 ordinary shares raising a total of $15,154,000 before issue costs.

On 3 June 2020, as part of the 2020 Share Placement, the Company issued 5,700,000 ordinary shares to directors and other key management personnel raising a total of $2,850,000 before issue costs.

In June 2020, a new wholly owned subsidiary, Zhejiang Phoslock Environmental Technologies Ltd was incorporated.

On 17 September 2020 the Group requested a trading halt on the Australia Securities Exchange (ASX). On 21 September 2020 the Group was suspended from quotation under Listing Rule 27.2, pending the outcome of investigations associated with the Group's Chinese operations. The current status of these matters is discussed below in the "Board Investigation" section of this Directors' Report. As at the date of this Directors' Report the Group remains suspended from quotation.

The financial statements included within this half year report reflect the outcome of relevant investigations as they relate to the half year ended 30 June 2020 and comparative period.

There were no other significant changes in the state of affairs of the Group during the financial half-year.

Environmental Issues

The Group's operations are subject to environmental regulation of the territories in which it operates. Details of the Group's performance in relation to environmental regulations are as follows:

The Group commits to comply with all regulations governing the use and application of its water technology products both in Australia and internationally. In Australia, Phoslock® is imported from a manufacturing operation in China that has received NICNAS certification. The certification is renewed annually.

Phoslock® has been awarded the North American Drinking Water certification (NSF/ANSI 60) since 2011. The certification is renewed annually.

In January 2019, the Company's existing Changxing factory received the following accreditation from TÜV Rheinland, a German engineering accreditation agency:

- ISO 9001 – certification stating that the Company's Quality Control and Documentation of all procedures meets international standards set by ISO – International Standards Organisation for Quality Management Systems;
- ISO 14000 – Environmental Management Standards Certification; and
- OSHA 18000 - Health and Safety Management Systems.

Phoslock® has been certified by the Chinese Research Academy of Environmental Sciences (CRAES). Phoslock® is classified as a general environmental substance. It is neither hazardous nor harmful to the environment. Phoslock® has low risk to the hydro-ecological system.

In June 2019 Phoslock® was accredited by the Chinese Ministry of Water Resources (MWR) as an approved phosphorus absorption product in the Ministry's official gazette. MWR administers over 100,000 lakes and drinking water reservoirs in China.

In Europe, the product is legally imported and sold under REACH regulation for the region.

Phoslock® has been certified by IBAMA (the Brazilian Ministry for the Environment) for import, sale and use in Brazil. Internationally, the Group is committed to comply with all local regulatory authority requirements.

The Group is continuing to assess certain regulatory compliance and operational matters associated with excess wastewater discharge connected with its Chinese manufacturing operations which may result in penalties or the Group incurring additional costs associated with rectification activities from regulatory bodies such as environmental authorities. As at the date of this financial report it is not possible to measure the contingent obligation with sufficient reliability as it remains subject to the outcome of future events not wholly within the control of the entity. The Group will recognise a liability for these amounts if and when the contingent obligations are confirmed and can be reliably measured.

Other than in respect to the Group's Chinese operations, the Directors are not aware of any breaches of environmental regulations by the Group in any of the other regions in which the Group operates.

Board investigations

Suspected accounting irregularities in China were first discovered during an internal review of controls – instigated by corporate head office. In addition, whistle blower complaints received in relation to the Chinese Sales organisation, concurrent to the internal review of controls, revealed further matters requiring investigation.

In response to the identification of these matters the Board brought them to the attention of PET's auditor (KPMG) and initiated an investigation with the assistance of external advisors, including:

- Forensic review performed by KPMG Forensic team – focused on the Chinese sales organisation (Phoslock (Beijing) Ecological Engineering Technology Co., Ltd (China) "PBEE" and Beijing Ecosystime Environmental Science and Technology Co., Ltd (China) "BEST").
- Operational and forensic review performed by FTI – focused on the Chinese manufacturing operations and interim management of all Chinese operations (Phoslock (Changxing) Water Solutions (China) "PWSC".

In respect of KPMG's appointment to provide forensic accounting services, the Board was satisfied that appropriate safeguards were in place, including separation of the audit and forensic teams. Further, the Board was satisfied that the nature of the allegations and scope of work, which included investigating and establishing facts in connection with the allegations, did not present a risk to auditor independence. In accepting the appointment, KPMG's engagement letter detailed that it conducted relevant acceptance procedures, including an evaluation on audit independence risks.

Following the KPMG forensic review the Board has identified fraudulent activities relating to areas including accounting and falsification of invoices and service contracts, improper tax reporting, potential misappropriation of funds including improper payment of bonuses, certain payments to third parties where the ultimate beneficiary was unclear, or which are otherwise suspect and undisclosed related party transactions.

Following the FTI forensic review the Board has identified certain payments to third parties where the ultimate beneficiary was unclear, or which are otherwise suspect. It also identified certain payments which had been capitalised as assets where there was no evidence of future economic benefit or unfulfilled performance obligations.

As part of the investigations undertaken by the Board, total payments estimated to be $2,200,000 were identified spanning the previous 30 months from January 2020 where the ultimate beneficiary remains unclear. The results of the Board Investigations suggest that these payments have a heightened risk of being associated with possible fraud and other illegal activity. These amounts have been recognised as an expense within the statement of profit or loss and other comprehensive income in each respective period, reflecting the economic loss to the Group arising from the outflow of economic benefits associated with these payments.

In response to these matters, the Group undertook a thorough review of its financial position and related party relationships in order to identify, quantify and account for transactions connected with the above noted activities. The outcome of this review resulted in a number of adjustments and therefore restatements to the Group's financial statements for prior periods. These outcomes are reflected in note 4 Restatement of comparatives. The Group's financial report for 1 January 2019, June 30 2019 and 31 December 2019 will also be restated as part of the process of reporting the Group's results for the year ending 31 December 2020.

The financial impacts arising from the above noted activities on each of the periods presented within this half year financial report are disclosed in note 4. The directors believe that the provision of this information is important to assist in understanding the effects of the above noted activities on the Group's financial performance, reflecting the best information available to the directors as at the date of this financial report.

As part of the process of reporting the Group's results for the half year ended June 30 2020, the amounts disclosed as comparatives for 31 December 2019 will also be restated. Further, the Group has already:

- Commenced a restructuring of its organisation in China, with a number of senior and middle management employees terminated;
- Commenced a comprehensive and systematic review of all current China contracts and contractual arrangements with third parties, including sub-contractors and distributors, to help provide a sound basis for re-evaluating the Company's near and mid-term expectations for revenue generation in China;
- Commissioned an independent market review of the waterways remediation market in China to help assess our opportunity in the region and better inform decisions relating to organisation structure, location etc;
- Implemented changes which will strengthen PET China's financial reporting procedures, delegated authority policies and general risk management framework;
- Updated and strengthened Company policies and procedures which included disseminating formal delegated levels of authority and dual / cross border authorising of all banking transactions; and
- In order to be able to better identify and assess potential risks such as financial, operational, environmental and legal risks the Company conducted a deep dive risk review that enabled the production of detailed risk treatment strategies and business continuity plans.

Employee share options

In June 2017, a total of 65 million share options were approved for issue by the Board and Company shareholders. Of this balance:

- 20 million share options were approved to be issued to employees and directors of Phoslock (Beijing) Ecological Engineering Technology Co Ltd (PBEE), a wholly owned subsidiary of the Company. As part of the forensic investigation, it was identified that the process for allocating the options lacked governance oversight and the process for measuring the performance of vesting conditions was unclear and subject to judgement. Of the options issued, 10.4 million were ultimately exercised by parties other than PBEE employees and directors, including employees of Beijing BHZQ Environmental Engineering Technology Co., Limited (BHZQ) (a previously undisclosed director related party of Mr Zhigang Zhang, and one of the Group's largest customers), in contravention of the conditions of the share options;
- 30 million share options were approved to be issued to China Environmental Corporation Australia Pty Ltd (CEC) (a previously undisclosed director related party of Mr Zhigang Zhang and Mr Ningping Ma). The options were allocated to shareholders of CEC, the majority of whom also worked for or had an indirect shareholding in BHZQ (a previously undisclosed director related party of Mr Zhigang Zhang, and one of the Group's largest customers). The options were subject to the same performance conditions as the 20 million options discussed above, however there was no service condition attached. As part of the forensic investigation, it was identified that the process for allocating the options lacked governance oversight and the process for measuring the performance of vesting conditions was unclear and subject to judgement; and
- the remaining 15 million options were appropriately issued to employees of the Group and subject to the same vesting conditions as the 20 million options discussed above. As part of the forensic investigation, it was identified that the process for measuring the performance of vesting conditions was unclear and subject to judgement.

The accounting fair value for the 65,000,000 options of $3,458,391 was expensed by the Group over the period from 16 July 2017 to 30 June 2019. 100% of the options were exercised between 27 November 2018 and 12 September 2019. The Group has no recourse in relation to options that vest which have been exercised.

In December 2019, an additional 20,000,000 share options were approved for issue by the Board and Company shareholders to PET Chinese employees. As part of the Board investigation, it was identified that the process for allocating the options lacked governance oversight. These options have not vested and are unlikely to meet their vesting conditions so are likely to expire.

In response to these circumstances and events the chairman of the remuneration committee has commissioned a full review of the long term incentive schemes of the company to confirm with best practise to be better aligned with shareholder interest.

Extended reporting and lodgement deadlines

Pursuant to subsection 340(1) of the Corporations Act 2001, the Group was permitted to lodge its 30 June 2020 Half Year Report with ASIC by 31 January 2021.

Rounding of amounts

The Company is of a kind referred to in Corporations Instrument 2016/191, issued by the Australian Securities and Investments Commission, relating to 'rounding-off'. Amounts in this report have been rounded off in accordance with that Corporations Instrument to the nearest thousand dollars, or in certain cases, the nearest dollar.

Auditor's independence declaration

A copy of the auditor's independence declaration as required under section 307C of the Corporations Act 2001 is set out immediately after this directors' report.

This report is made in accordance with a resolution of directors, pursuant to section 306(3)(a) of the Corporations Act 2001.

On behalf of the directors

Lachlan McKinnon	Brenda Shanahan
Managing Director	Non-Executive Director - Chairman of Audit Committee

29 January 2021

Lead Auditor's Independence Declaration under Section 307C of the Corporations Act 2001

To the Directors of Phoslock Environmental Technologies Limited

I declare that, to the best of my knowledge and belief, in relation to the review of Phoslock Environmental Technologies Limited for the half-year ended 30 June 2020 there have been:

i. no contraventions of the auditor independence requirements as set out in the *Corporations Act 2001* in relation to the review; and

ii. no contraventions of any applicable code of professional conduct in relation to the review.

KPMG

KPMG

Sarah Cain

Sarah Cain

Partner

Melbourne

29 January 2021

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Liability limited by a scheme approved under Professional Standards Legislation.

Phoslock Environmental Technologies Limited
Consolidated statement of profit or loss and other comprehensive income
For the half-year ended 30 June 2020

	Note	Consolidated 30 Jun 2020 $'000	Consolidated 30 Jun 2019 Restated $'000
Revenue			
Sales revenue		2,090	9,803
Cost of sales		(970)	(3,338)
Gross profit		1,120	6,465
Other income	7	150	415
Interest revenue calculated using the effective interest method		44	45
Expenses			
Distribution		(64)	(99)
Marketing		(217)	(250)
Occupancy		(93)	(50)
Director, listing and professional fees		(1,025)	(1,637)
Administration		(4,148)	(2,902)
Impairment of receivables	9	(9,804)	-
Impairment of assets	8	(7,536)	(190)
Share-based expense reversal		30	-
Finance costs	8	(105)	(19)
Profit/(loss) before income tax (expense)/benefit		(21,648)	1,778
Income tax (expense)/benefit		36	(702)
Profit/(loss) after income tax (expense)/benefit for the half-year attributable to the owners of Phoslock Environmental Technologies Limited		(21,612)	1,076
Other comprehensive income			
Items that may be reclassified subsequently to profit or loss			
Foreign currency translation		1,145	105
Other comprehensive income for the half-year, net of tax		1,145	105
Total comprehensive income for the half-year attributable to the owners of Phoslock Environmental Technologies Limited		(20,467)	1,181
		Cents	Cents
Basic earnings per share	18	(3.69)	0.21
Diluted earnings per share	18	(3.69)	0.21

Refer to note 4 for detailed information on Restatement of comparatives.

The above consolidated statement of profit or loss and other comprehensive income should be read in conjunction with the accompanying notes

Phoslock Environmental Technologies Limited
Consolidated statement of financial position
As at 30 June 2020

	Note	Consolidated 30 Jun 2020 $'000	Consolidated 31 Dec 2019 Restated $'000
Assets			
Current assets			
Cash and cash equivalents		35,245	14,959
Trade and other receivables	9	1,572	12,443
Inventories	10	4,487	4,726
Other assets		921	848
Total current assets		42,225	32,976
Non-current assets			
Property, plant and equipment	11	109	1,566
Right-of-use assets	12	521	699
Intangibles		199	196
Total non-current assets		829	2,461
Total assets		43,054	35,437
Liabilities			
Current liabilities			
Trade and other payables	13	3,123	6,864
Lease liabilities		439	352
Income tax		238	708
Employee benefits		261	549
Total current liabilities		4,061	8,473
Non-current liabilities			
Lease liabilities		3,693	326
Other liabilities		16	19
Total non-current liabilities		3,709	345
Total liabilities		7,770	8,818
Net assets		35,284	26,619
Equity			
Issued capital	14	92,549	63,387
Reserves		1,722	607
Accumulated losses		(58,987)	(37,375)
Total equity		35,284	26,619

Refer to note 4 for detailed information on Restatement of comparatives.

The above consolidated statement of financial position should be read in conjunction with the accompanying notes

Consolidated	Issued capital $'000	Option reserves $'000	Foreign currency translation reserves $'000	Accumulated losses $'000	Total equity $'000
Balance at 1 January 2019	59,901	5,198	808	(41,911)	23,996
Restatement of comparatives (note 4)	-	-	-	(446)	(446)
Balance at 1 January 2019 - restated	59,901	5,198	808	(42,357)	23,550
Profit after income tax expense for the half-year	-	-	-	1,076	1,076
Other comprehensive income for the half-year, net of tax	-	-	105	-	105
Total comprehensive income for the half-year	-	-	105	1,076	1,181
Transactions with owners in their capacity as owners:					
Options exercised	2,362	-	-	-	2,362
Balance at 30 June 2019	62,263	5,198	913	(41,281)	27,093

Consolidated	Issued capital $'000	Option reserves $'000	Foreign currency translation reserves $'000	Accumulated losses $'000	Total equity $'000
Balance at 1 January 2020	63,387	30	532	(34,015)	29,934
Restatement of comparatives (note 4)	-	-	45	(3,360)	(3,315)
Balance at 1 January 2020 - restated	63,387	30	577	(37,375)	26,619
Loss after income tax benefit for the half-year	-	-	-	(21,612)	(21,612)
Other comprehensive income for the half-year, net of tax	-	-	1,145	-	1,145
Total comprehensive income for the half-year	-	-	1,145	(21,612)	(20,467)
Transactions with owners in their capacity as owners:					
Contributions of equity, net of transaction costs (note 14)	29,162	-	-	-	29,162
Lapsed option reversal	-	(30)	-	-	(30)
Balance at 30 June 2020	92,549	-	1,722	(58,987)	35,284

The above consolidated statement of changes in equity should be read in conjunction with the accompanying notes

Phoslock Environmental Technologies Limited
Consolidated statement of cash flows
For the half-year ended 30 June 2020

	Note	Consolidated 30 Jun 2020 $'000	Consolidated 30 Jun 2019 $'000
Cash flows from operating activities			
Receipts from customers (inclusive of GST)		3,674	18,617
Payments to suppliers and employees (inclusive of GST)		(12,306)	(7,213)
Government grants and incentives received		489	-
Interest received		30	45
Interest and other finance costs paid		-	(19)
Income taxes paid		(274)	(603)
Net cash from/(used in) operating activities		(8,387)	10,827
Cash flows from investing activities			
Payments for property, plant and equipment	11	(21)	(27)
Payments for intangibles		(10)	(36)
Net cash used in investing activities		(31)	(63)
Cash flows from financing activities			
Proceeds from issue of shares	14	30,004	-
Proceeds from exercise of options		-	2,362
Share issue transaction costs		(842)	-
Repayment of lease liabilities		(904)	(101)
Net cash from financing activities		28,258	2,261
Net increase in cash and cash equivalents		19,840	13,025
Cash and cash equivalents at the beginning of the financial half-year		14,959	4,878
Effects of exchange rate changes on cash and cash equivalents		446	(11)
Cash and cash equivalents at the end of the financial half-year		35,245	17,892

The above consolidated statement of cash flows should be read in conjunction with the accompanying notes

Note 1. General information

The financial statements cover Phoslock Environmental Technologies Limited as a Group consisting of Phoslock Environmental Technologies Limited and the entities it controlled at the end of, or during, the half-year. The financial statements are presented in Australian dollars, which is Phoslock Environmental Technologies Limited's functional and presentation currency.

Phoslock Environmental Technologies Limited is a listed public company limited by shares, incorporated and domiciled in Australia. Its registered office and principal place of business is:

Level 16
1 Collins St
Melbourne, VIC 3000

A description of the nature of the Group's operations and its principal activities are included in the directors' report, which is not part of the financial statements.

The financial statements were authorised for issue, in accordance with a resolution of directors, on 29 January 2021.

Note 2. Significant accounting policies

These general purpose financial statements for the interim half-year reporting period ended 30 June 2020 have been prepared in accordance with Australian Accounting Standard AASB 134 'Interim Financial Reporting' and the Corporations Act 2001, as appropriate for for-profit oriented entities. Compliance with AASB 134 ensures compliance with International Financial Reporting Standard IAS 34 'Interim Financial Reporting'.

These general purpose financial statements do not include all the notes of the type normally included in annual financial statements. Accordingly, these financial statements are to be read in conjunction with the annual report for the year ended 31 December 2019 and any public announcements made by the Company during the interim reporting period in accordance with the continuous disclosure requirements of the Corporations Act 2001.

The principal accounting policies adopted are consistent with those of the previous financial year and corresponding interim reporting period, unless otherwise stated.

New or amended Accounting Standards and Interpretations adopted

The Group has adopted all of the new or amended Accounting Standards and Interpretations issued by the Australian Accounting Standards Board ('AASB') that are mandatory for the current reporting period.

Any new or amended Accounting Standards or Interpretations that are not yet mandatory have not been early adopted.

Going concern

The half year financial statements have been prepared on the going concern basis of accounting, which assumes, the continuity of normal business activities and the realisation of assets and the settlement of liabilities in the ordinary course of business, supported by the Group’s strong cash position and net current asset position of $38,164,000 as at 30 June 2020 (2019: $24,503,000 restated). At balance date, the Group had no external loan facilities and no litigation matters currently against the Group.

Note 3. Critical accounting judgements, estimates and assumptions

The preparation of the financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts in the financial statements. Management continually evaluates its judgements and estimates in relation to assets, liabilities, contingent liabilities, revenue and expenses. Management bases its judgements, estimates and assumptions on historical experience and on other various factors, including expectations of future events, management believes to be reasonable under the circumstances. The resulting accounting judgements and estimates will seldom equal the related actual results. The judgements, estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities (refer to the respective notes) within the next financial year are discussed below.

Note 3. Critical accounting judgements, estimates and assumptions (continued)

COVID-19 pandemic
Judgement has been exercised in considering the impacts that the COVID-19 pandemic has had, or may have, on the Group based on known information. This consideration extends to the nature of the products and services offered, customers, supply chain, staffing and geographic regions in which the Group operates. Other than as addressed in specific notes, there does not currently appear to be either any significant impact upon the financial statements or any significant uncertainties with respect to events or conditions which may impact the Group unfavourably as at the reporting date or subsequently as a result of theCOVID-19 pandemic.

Impairment of non-financial assets other than goodwill and other indefinite life intangible assets
The Group assesses impairment of non-financial assets other than goodwill and other indefinite life intangible assets at each reporting date by evaluating conditions specific to the Group and to the particular asset that may lead to impairment. If an impairment trigger exists, the recoverable amount of the asset is determined. This involves fair value less costs of disposal or value-in-use calculations, which incorporate a number of key estimates and assumptions.

Incremental borrowing rate
Where the interest rate implicit in a lease cannot be readily determined, an incremental borrowing rate is estimated to discount future lease payments to measure the present value of the lease liability at the lease commencement date. Such a rate is based on what the Group estimates it would have to pay a third party to borrow the funds necessary to obtain an asset of a similar value to the right-of-use asset, with similar terms, security and economic environment.

Note 4. Restatement of comparatives

Suspected accounting irregularities in China were first discovered during an internal review of controls – instigated by corporate head office. In addition, whistle blower complaints received in relation to the Chinese Sales organisation, concurrent to the internal review of controls, revealed further matters requiring investigation.

In response to the identification of these matters the Board initiated an investigation. External advisors were appointed to assist the Board including:

- Forensic review performed by (KPMG) Forensic team – focused on the Chinese sales organisations (Phoslock (Beijing) Ecological Engineering Technology Co., Ltd (China) “PBEE” and (Beijing Ecosystime Environmental Science and Technology Co., Ltd (China) “BEST”).
- Operational and forensic review performed by FTI – focused on the Chinese manufacturing operations and interim management of all Chinese operations (Phoslock (Changxing) Water Solutions (China) “PWSC”.

Following the KPMG forensic review the Board has identified fraudulent activities relating to areas including accounting and falsification of invoices and service contracts, improper tax reporting, potential misappropriation of funds including improper payment of bonuses, payments to third parties where the ultimate beneficiary was unclear, or which are otherwise suspect and undisclosed related party transactions.

Following the FTI forensic review the Board has identified certain payments to third parties where the ultimate beneficiary was unclear, or which are otherwise suspect. It also identified certain payments which had been incorrectly capitalised as assets where there was no evidence of future economic benefit or unfulfilled performance obligations.

As part of the investigations undertaken by the Board, total payments estimated to be $2,200,000 were identified spanning the previous 30 months from January 2020 where the ultimate beneficiary remains unclear. The results of the Board Investigations suggest that these payments have a heightened risk of being associated with possible fraud and other illegal activity. These amounts have been recognised as an expense within the statement of profit or loss and other comprehensive income in each respective period, reflecting the economic loss to the Group arising from the outflow of economic benefits associated with these payments.

During the period the Group undertook a thorough review of its financial position, financial performance and related party relationships in order to identify, quantify and account for transactions connected with accounting irregularities related to the Group’s Chinese operations. Consequently, the company identified transactions within cost of goods sold, marketing expenses and administration expenses where the source documentation was either not evident or cannot be relied upon to support the economic substance of the transaction or identify the ultimate beneficiary of the transaction.

Note 4. Restatement of comparatives (continued)

Where appropriate, the Group has reversed certain transactions in the current period and restated prior period comparatives in relation to these matters (discussed further below). However, where the Group has incurred cash outflows or an economic loss, such transactions have remained recorded as an expense to reflect the economic cost of these transactions to the Group, based on the best knowledge of the directors with respect to the nature and substance of the underlying transactions.

In respect to prior periods, the Group has made the following adjustments which impact:

- The comparative statement of financial position as at 31 December 2019
- The opening statement of financial position of the comparative period as at 1 January 2019
- The comparative statement of profit or loss and other comprehensive of the Group for the six months ended 30 June 2019
- The comparative statement of profit or loss and other comprehensive of the Group for the year ended 31 December 2019

The following adjustments were made:

(1) Reversal of revenue for various sales transactions recognised within the 2019 financial year where the performance obligation associated with the sale (delivery and application of Phoslock product) had not been satisfied prior to 31 December 2019. These errors arose due to fictitious documentation created to incorrectly recognise revenue. These adjustments resulted in:
-the reversal of revenue previously recognised;
-re-recording of inventory previously recognised as cost of goods sold;
-recognition of a contract liability related to funds received in advance of work performed; and
-the reversal of accrued freight costs.

(2) Recognition of an expense and liability for the period ended 31 December 2019 to reflect payments of employee bonuses made to a third party which were ultimately paid to employees of the Group and potentially other external parties where the ultimate beneficiary is unclear and suspect. Fictitious documentation was produced in relation to this transaction.

(3) De-recognition of a prepayment held as at 31 December 2019 and recognition of an expense for the period ended 31 December 2019 resulting in payments made in connection with waste water treatment activities in China, where no services appear to have been received and where there is no future economic benefit. This payment was made to a third party where the ultimate beneficiary is unclear, or otherwise suspect.

(4) De-recognition of property, plant and equipment held as an asset as at 31 December 2019 and recognition of an expense for the period ended 31 December 2019 in connection with items which have no future economic benefit.

(5) Investments in plant and equipment purchased in September 2019 rendered ageing equipment obsolete, thus requiring the impairment of obsolete assets.

(6) Adjustments to income tax payable associated with the treatment of certain deductions and research and development activities. The Board and management have determined that a more conservative approach than that previously adopted in relation to “High-Tech Enterprise Status” (as per the Group’s announcement on 28 October 2019), is appropriate in relation to certain elections, characterisations and other tax planning matters in this regard in relation to the Group’s Chinese sales entities (PBEE and BEST). This has the effect of adjusting the corporate tax rate in relation to historic and future profits earned by these subsidiaries from 15% to 25%. The group has estimated the late fees associated with this adjustment recognized in the tax payable account. These adjustments may result in penalties or the Group incurring additional costs associated with rectification activities in future periods. As at the date of this report, no amount has been provided for such costs as it is not possible to measure the contingent obligation with sufficient reliability as it remains subject to the outcome of future events not wholly within the control of the entity.

(7) Reversal of Equipment subsidy for plant, property and equipment held as deferred revenue as at 30 June 2019 and 31 December 2019 and recognition of subsidy at June 2019 as associated asset did not provide a future economic benefit.

(8) Adjustments to historic employee bonus expenses to the Group’s Chinese employees which have been recognised in the incorrect reporting periods.

(9) Reclassification of the nature of certain expenses with related parties based on determination of the true nature of costs incurred. Fictitious documentation and false accounting have been identified in relation to these related party transactions. This resulted in a reclassification from director, listing and professional fees to administration

Errors in prior period related party disclosures have been also been identified. Refer to note 17 related parties for details relating to transactions with related parties which were previously not disclosed.

Note 4. Restatement of comparatives (continued)

In addition, the Group identified an amount of $830,645 within accounts payable as at 31 December 2019, which relates to a contractual obligation to pay a third party connected with transactions under investigation in connection with the Group's Chinese operations. As the obligation is contractual in nature, a balance of $177,926 continues to be held as at 30 June 2020 and will continue to be held until such time that the Board completes its investigation activities and/or the obligation can be legally extinguished. The Board intend to make no further payment until its investigation activities are completed.

The effects of these adjustments on the impact on the statement of financial position and the statement of profit or loss an other comprehensive income for 31 December 2019 comparative period and 31 December 2018 opening statement of financial position were as follows:

	As at 31 December 2019				As at 31 December 2018			
	Assets increase / (decrease) $'000	Liabilities (increase) / decrease	Equity (increase) / decrease	Profit increase / (decrease)	Assets increase / (decrease)	Liabilities (increase) / decrease	Equity (increase) / decrease	Retained earnings increase / (decrease)
Adjustment 1	(2,323)	17	(36)	(2,342)	-	-	-	-
Adjustment 2	-	(499)	(8)	(507)	-	-	-	-
Adjustment 3	(124)	-	(2)	(126)	-	-	-	-
Adjustment 4	(20)	-	-	(20)	-	-	-	-
Adjustment 5	(174)	-	(2)	(176)	-	-	-	-
Adjustment 6	-	(374)	77	(297)	-	(83)	-	83
Adjustment 7	-	88	1	89	-	-	-	-
Adjustment 8	-	94	366	460	-	(363)	-	363
Adjustment 9	-	-	-	-	-	-	-	-
	(2,641)	(674)	396	(2,919)	-	(446)	-	446

The effects of these adjustments on the statement of profit or loss on the comparative period 30 June 2019 and year ended 31 December 2019 were as follows:

	Half year ended 30 June 2019				Year ended 31 December 2019			
	Revenue increase / (decrease $'000	Gross profit increase) / (decrease) $'000	Operating profit increase / (decrease) $'000	Profit after tax increase / (decrease) $'000	Revenue increase / (decrease) $'000	Gross profit increase / (decrease) $'000	Operating profit increase / (decrease) $'000	Profit after tax increase / (decrease) $'000
Adjustment 1	-	-	-	-	(4,779)	(2,342)	(2,342)	(2,342)
Adjustment 2	-	-	-	-	-	-	(507)	(507)
Adjustment 3	-	-	-	-	-	17	(126)	(126)
Adjustment 4	-	-	(22)	(22)	-	1	(20)	(20)
Adjustment 5	-	-	(190)	(190)	-	12	(176)	(176)
Adjustment 6	-	-	(1)	(1)	-	-	(297)	(297)
Adjustment 7	-	-	94	94	-	-	89	89
Adjustment 8	-	188	188	188	-	315	460	460
Adjustment 9	-	-	-	-	-	-	-	-
	-	188	69	69	(4,779)	(1,997)	(2,919)	(2,919)

Note 4. Restatement of comparatives (continued)

These transactions have been corrected by restating each of the affected financial statement line items for the prior periods as follows:

Consolidated statement of financial position	31-Dec-19 Reported $'000	Increase/ (decrease) $'000	31-Dec-19 Restated $'000	31-Dec-18 Reported $'000	Increase/ (decrease) $'000	31-Dec-18 Restated $'000
Assets						
Current assets						
Cash and cash equivalents	14,959	-	14,959	4,878	-	4,878
Trade and other receivables	17,149	(4,706)	12,443	17,762	-	17,762
Inventories	2,342	2,384	4,726	2,408	-	2,408
Other assets	972	(124)	848	449	-	449
Non-current assets						
Financial assets	-	-	-	26	-	26
Property, plant and equipment	1,761	(195)	1,566	1,466	-	1,466
Right-of-use assets	699	-	699	-	-	-
Intangibles	196	-	196	136	-	136
Deferred tax assets	-	-	-	358	-	358
Total assets	38,078	(2,641)	35,437	27,483	-	27,483
Liabilities						
Current liabilities						
Trade and other payables	6,477	387	6,864	2,115	363	2,478
Lease liabilities	352	-	352	72	-	72
Income tax	334	374	708	871	83	954
Employee benefits	549	-	549	388	-	388
Non-current liabilities						
Lease liabilities	326	-	326	-	-	-
Other liabilities	106	(87)	19	41	-	41
Total liabilities	8,144	674	8,818	3,487	446	3,933
Equity						
Issued capital	63,387	-	63,387	59,901	-	59,901
Reserves	562	45	607	6,006	-	6,006
Accumulated losses	(34,015)	(3,360)	(37,375)	(41,911)	(446)	(42,357)
Total equity	29,934	(3,315)	26,619	23,996	(446)	23,550

Note 4. Restatement of comparatives (continued)

Consolidated statement of profit or loss	Half-year ended 30 June 2019 Reported $'000	Increase/ (decrease) $'000	Half-year ended 30 June 2019 Restated $'000	Year ended 31 Dec 2019 Reported $'000	Increase/ (decrease) $'000	Year ended 31 Dec 2019 Restated $'000
Sales revenue	9,803	-	9,803	24,536	(4,779)	19,757
Cost of sales	(3,526)	188	(3,338)	(11,125)	2,782	(8,343)
Gross profit	6,277	188	6,465	13,411	(1,997)	11,414
Other income	321	94	415	576	89	665
Interest revenue calculated using the effective interest method	45	-	45	-	-	-
Distribution	(99)	-	(99)	(159)	-	(159)
Marketing	(250)	-	(250)	(643)	-	(643)
Occupancy	(50)	-	(50)	(129)	-	(129)
Director, listing and professional fees	(1,668)	31	(1,637)	(2,916)	48	(2,868)
Administration	(2,848)	(54)	(2,902)	(6,388)	(771)	(7,159)
Impairment of assets	-	(190)	(190)	-	-	-
	(4,549)	(119)	(4,668)	(9,659)	(634)	(10,293)
Finance costs	(19)	-	(19)	(73)	-	(73)
Exchange gains/(losses)	-	-	-	2	-	2
Option expenses	-	-	-	(30)	-	(30)
Income tax expense	(702)	-	(702)	(953)	(288)	(1,241)
	(721)	-	(721)	(1,054)	(288)	(1,342)
Profit after income tax	1,007	69	1,076	2,698	(2,919)	(221)
	Cents Reported	Cents Adjustment	Cents Restated	Cents Reported	Cents Adjustment	Cents Restated
Basic earnings per share	0.20	0.01	0.21	0.53	(0.57)	(0.04)
Diluted earnings per share	0.20	0.01	0.21	0.53	(0.57)	(0.04)

Whilst the statement of profit or loss for the year ended 31 December 2019 is not presented within this half year financial report, the directors have included this information to provide users with an understanding of the impact of the restatements on the most recent annual results, which will be presented as comparative financial information in the Group's 31 December 2020 annual report.

The restatements noted above has no impact on the statement of cashflows.

Note 5. Operating segments

Identification of reportable operating segments
The Group is organised into four operating segments based on geographical areas: Australia/NZ, Europe/UK, US/Canada/Brazil and China. These operating segments are based on the internal reports that are reviewed and used by the Board of Directors (who are identified as the Chief Operating Decision Makers ('CODM')) in assessing performance and in determining the allocation of resources. There is no aggregation of operating segments.

The CODM reviews EBIT (earnings before interest and taxes). The accounting policies adopted for internal reporting to the CODM are consistent with those adopted in the financial statements.

The information reported to the CODM is on a monthly basis.

Note 5. Operating segments (continued)

Intersegment transactions
Intersegment sales were made at an internally determined transfer price. The price is based on what would be realised in the event the sale was made to an external party at arm's-length. Intersegment sales are eliminated on consolidation.

Corporate charges are allocated to reporting segment based on the segment's overall proportion of revenue generation within the Group. The Board believes this is representative of likely consumption of head office expenditure that should be used in assessing segment performance and cost recoveries.

Intersegment receivables, payables and loans
Intersegment loans are initially recognised at the consideration received. Intersegment loans receivable and loans payable that earn or incur non-market interest are not adjusted to fair value based on market interest rates. Intersegment loans are eliminated on consolidation.

Major customers
During the half-year ended 30 June 2020, approximately 46% of the Group's external revenue was derived from sales to three customers (30 June 2019: approximately 43.2% of the Group's external revenue was derived from sales to the Group's largest customer).

Operating segment information

Consolidated - 30 Jun 2020	Australia/NZ $'000	Europe/UK $'000	US/Canada/ Brazil $'000	China $'000	Eliminations $'000	Total $'000
Revenue						
Sales to external customers	-	74	500	1,516	-	2,090
Intersegment sales	176	96	17	-	(289)	-
Total revenue	176	170	517	1,516	(289)	2,090
EBIT	(3,157)	(114)	282	(1,425)	102	(4,312)
Foreign exchange gain						79
Share-based expense reversal						30
Impairment of receivables						(9,804)
Impairment of assets						(7,536)
Finance costs						(105)
Loss before income tax benefit						(21,648)
Income tax benefit						36
Loss after income tax benefit						(21,612)
Assets						
Segment assets	50,966	491	-	11,428	(19,831)	43,054
Total assets						43,054
Liabilities						
Segment liabilities	1,776	1,263	-	7,892	(3,161)	7,770
Total liabilities						7,770

Note 5. Operating segments (continued)

Consolidated - 30 Jun 2019 Restated	Australia/NZ $'000	Europe/UK $'000	US/Canada/ Brazil $'000	China $'000	Eliminations $'000	Total $'000
Revenue						
Sales to external customers	18	526	763	8,424	-	9,731
Intersegment sales	620	-	8	369	(997)	-
Total sales revenue	638	526	771	8,793	(997)	9,731
Other revenue	-	72	-	-	-	72
Total revenue	638	598	771	8,793	(997)	9,803
EBIT	(976)	80	(28)	2,872	26	1,974
Foreign exchange gain						13
Impairment of assets						(190)
Finance costs						(19)
Profit before income tax expense						1,778
Income tax expense						(702)
Profit after income tax expense						1,076
Consolidated - 31 Dec 2019 Restated						
Assets						
Segment assets	24,201	600	-	28,034	(17,398)	35,437
Total assets						35,437
Liabilities						
Segment liabilities	1,372	1,284	-	8,677	(2,515)	8,818
Total liabilities						8,818

Note 6. Revenue

Disaggregation of revenue
The disaggregation of revenue from contracts with customers is as follows:

	Consolidated 30 Jun 2020 $'000	Consolidated 30 Jun 2019 Restated $'000
Geographical regions		
Australia/NZ	-	18
Europe/UK	74	598
US/Canada/Brazil	500	763
China	1,516	8,424
	2,090	9,803
Timing of revenue recognition		
Goods transferred at a point in time	2,090	9,731
Services transferred at a point in time	-	72
	2,090	9,803

Note 6. Revenue (continued)

Seasonality of operations
The Group's sale of goods segment is subject to seasonal fluctuations as a result of weather conditions. In particular, the sales and application of Phoslock® in northern China and European regions are affected by the winter weather conditions, which occur primarily from November to February.

Note 7. Other income

	Consolidated	
	30 Jun 2020 $'000	30 Jun 2019 Restated $'000
Net foreign exchange gain	79	13
Net gain on disposal of property, plant and equipment	1	-
Research and development grants	-	287
Government grants (COVID-19)	43	-
Other income	27	115
Other income	150	415

Government grants (COVID-19)
During the COVID-19 pandemic, the Group has received JobKeeper support payments from the Australian Government which are passed on to eligible employees. These have been recognised as government grants in the financial statements and recorded as other income over the periods in which the related employee benefits are recognised as an expense. The JobKeeper payment scheme in its current form runs for the fortnights from 30 March until 28 September 2020 and has now been extended until 28 March 2021. The Group is eligible for JobKeeper support from the government on the condition that employee benefits continue to be paid.

Note 8. Expenses

	Consolidated	
	30 Jun 2020 $'000	30 Jun 2019 Restated $'000
Profit/(loss) before income tax includes the following specific expenses:		
Depreciation		
Office equipment	126	1
Land and buildings right-of-use assets	426	142
Office equipment right-of-use assets	4	58
Total depreciation	556	201
Amortisation		
Patents and trademarks	3	1
Total depreciation and amortisation	559	202
Impairment of assets		
Inventories	2,067	-
Plant and equipment	1,417	190
Rights-of-use assets	4,052	-
Total impairment	7,536	190
Finance costs		
Interest and finance charges paid/payable on lease liabilities	105	19
Leases		
Short-term lease payments	100	50
Superannuation expense		
Defined contribution superannuation expense	132	87

Note 9. Current assets - trade and other receivables

	Consolidated	
	30 Jun 2020 $'000	31 Dec 2019 Restated $'000
Trade receivables	10,819	11,995
Less: Allowance for expected credit losses	(9,347)	-
	1,472	11,995
Grant income receivable	100	448
	1,572	12,443

Allowance for expected credit losses
The Group is party to a trade receivable balance due from Beijing BHZQ Environmental Engineering Technology Co., Limited ('BHZQ') totalling $2,567,000 as at 30 June 2020 (31 Dec 2019: $2,549,000) (note 17). BHZQ is a related party of Mr Zhigang Zhang, who was a director of Phoslock Environmental Technologies Limited until his resignation on 30 September 2020.

Note 9. Current assets - trade and other receivables (continued)

As at 30 June 2020 the receivable from BHZQ was past due, with the probability of collection deemed remote, notwithstanding the Group's continued efforts to recover the amount in an orderly manner. In light of these circumstances, the Group has recognised a loss of $2,121,000 for the period ended 30 June 2020 for the amount outstanding from BHZQ at the date of this report.

As noted in note 4 and note 13, the Group has identified an amount of $177,926 within accounts payable as at 30 June 2020 ($830,645 at 31 December 2019), which relates to a contractual obligation to pay a third party connected with transactions under investigation in connection with the Group’s Chinese operations. The Group is party to a contemporaneous sales contract on the Xingyun Lake Project. Due to concerns regarding the interdependency of the two contracts related to the Xingyun Lake Project, the Board concluded that the recoverability of outstanding accounts receivable in relation to this contract is uncertain, notwithstanding that the terms of the contract do not require payment until March 2021. The Board therefore concluded to impair the outstanding balance recognising an allowance for expected credit losses of $6,403,000 as at 30 June 2020 in relation to this contract.

Note 10. Current assets - inventories

	Consolidated	
	30 Jun 2020 $'000	31 Dec 2019 Restated $'000
Raw materials - at cost	949	1,052
Finished goods - at cost	5,508	3,674
Less: Provision for impairment	(1,970)	-
	3,538	3,674
	4,487	4,726

Subsequent to 30 June 2020, the Group concluded that its inventory holding significantly exceeded short term demand in light of the continued impacts of COVID-19 and reduced business activity in China following the Board Investigation conducted during the period. Whilst directors believe there is a limited risk of its inventory (both raw materials and finished goods) becoming obsolete or expiring, based on the factors outlined above, the board concluded to impair all inventory that has not been sold post 30 June 2020 or is not currently associated with a committed order.

Note 11. Non-current assets - property, plant and equipment

	Consolidated	
	30 Jun 2020 $'000	31 Dec 2019 Restated $'000
Plant and equipment - at cost	2,419	2,506
Less: Accumulated depreciation	(795)	(712)
Less: Impairment	(1,515)	(228)
	109	1,566
Motor vehicles - at cost	66	66
Less: Accumulated depreciation	(66)	(66)
	-	-
	109	1,566

Note 11. Non-current assets - property, plant and equipment (continued)

Impairment
As at 30 June 2020 the Group identified an indicator of impairment with respect to the Group's property, plant and equipment, arising from the operating loss incurred by the Group during the period. In light of this, the Group undertook an impairment assessment which resulted in the recognition of an impairment loss which reduced the carrying value of Phoslock (Changxing) Water Solutions (China) (a subsidiary of the Group) plant, property and equipment assets at to $nil.

The recoverable amount of the CGU associated with the Group's Chinese operations was estimated based on the present value of the future cash flows expected to be derived from the CGU (value in use). The recoverable amount of the CGU was lower than the carrying amount of the assets within the CGU and therefore an impairment loss has been recognised on property, plant and equipment as outlined above.

This impairment loss reflects the uncertainty regarding the future operating performance of the Group in light of the loss incurred in the current year, volatile market conditions associated with COVID-19 and uncertainty regarding the future performance of the Group's Chinese operations.

In accordance with accounting standards, an impairment loss on property, plant and equipment assets can be reversed where there is evidence that the conditions that resulted in the impairment loss are no longer present. The Group intend to reassess the position adopted at future balance dates with reference to current and future trading performance at that time.

Note 12. Non-current assets - right-of-use assets

	Consolidated	
	30 Jun 2020 $'000	31 Dec 2019 Restated $'000
Land and buildings - right-of-use	4,731	998
Less: Accumulated depreciation	(368)	(309)
Less: Impairment	(3,863)	-
	500	689
Office equipment - right-of-use	28	14
Less: Accumulated depreciation	(7)	(4)
	21	10
	521	699

The Group leases land and buildings for its office and factory facilities under agreements of between 3 to 10 years with, an options to extend. On renewal, the terms of the leases are renegotiated.

The Group also leases office equipment under contract of 4 years.

Reconciliations
Reconciliations of the written down values at the beginning and end of the current financial half-year are set out below:

Consolidated	Land and buildings right-of-use $'000	Office equipment right-of-use $'000	Total $'000
Balance at 1 January 2020	689	10	699
Additions	4,099	15	4,114
Exchange differences	190	-	190
Impairment of assets	(4,052)	-	(4,052)
Depreciation expense	(426)	(4)	(430)
Balance at 30 June 2020	500	21	521

Note 12. Non-current assets - right-of-use assets (continued)

Impairment
As at 30 June 2020 the Group identified an indicator of impairment with respect to the its China Operations right of use assets, arising from the operating loss incurred by the Group during the period. In light of this, the Group undertook an impairment test which resulted in the recognition of an impairment loss which reduced the carrying value of the right of use asset to $nil.

The recoverable amount of the CGU associated with the Group's Chinese operations was estimated based on the present value of the future cash flows expected to be derived from the CGU (value in use). The recoverable amount of the CGU was lower than the carrying amount of the assets within the CGU and therefore an impairment loss has been recognised on right of use assets as outlined above.

This impairment loss reflects the uncertainty regarding the future operating performance of the Group in light of the loss incurred in the current year, volatile market conditions associated with COVID-19 and uncertainty regarding the future performance of the Group's Chinese operations.

In accordance with accounting standards, an impairment loss on fixed assets can be reversed where there is evidence that the conditions that resulted in the impairment loss are no longer present. The Group intend to reassess the position adopted at future balance dates with reference to current and future trading performance at that time.

Note 13. Current liabilities - trade and other payables

	Consolidated	
	30 Jun 2020 $'000	31 Dec 2019 Restated $'000
Trade payables	2,009	5,992
Accrued expenses	523	505
Other payables	591	367
	3,123	6,864

The Group identified an amount of $830,645 within trade payable as at 31 December 2019, which relates to a contractual obligation to pay a third party connected with transactions under investigation in connection with the Group's Chinese operations. As the obligation is contractual in nature, a balance of $177,926 continues to be held as at 30 June 2020 and will continue to be held until such time that the Board completes its investigation activities and/or the obligation can be legally extinguished. The Board intend to make no further payment until its investigation activities are completed.

Note 14. Equity - issued capital

	Consolidated			
	30 Jun 2020 Shares	31 Dec 2019 Restated Shares	30 Jun 2020 $'000	31 Dec 2019 Restated $'000
Ordinary shares - fully paid	625,000,509	564,991,694	92,549	63,387

Note 14. Equity - issued capital (continued)

Movements in ordinary share capital

Details	Date	Shares	Issue price	$'000
Balance	1 January 2020	564,991,694		63,387
Issuance of shares institutional placement	17 April 2020	24,000,000	$0.50	12,000
Issuance of shares share purchase plan	7 May 2020	30,308,815	$0.50	15,154
Issuance of shares to key management personnel	3 June 2020	5,700,000	$0.50	2,850
Transaction costs		-	$0.00	(842)
Balance	30 June 2020	625,000,509		92,549

Ordinary shares
Ordinary shares entitle the holder to participate in any dividends declared and any proceeds attributable to shareholders should the Company be wound up, in proportions that consider both the number of shares held and the extent to which those shares are paid up. The fully paid ordinary shares have no par value and the Company does not have a limited amount of authorised capital.

On a show of hands every member present at a meeting in person or by proxy shall have one vote and upon a poll each share shall have one vote.

Share buy-back
There is no current on-market share buy-back.

Note 15. Equity - dividends

There were no dividends paid, recommended or declared during the current or previous financial half-year.

Note 16. Contingent liabilities

The Group is continuing to assess certain regulatory compliance and operational matters connected with its Chinese operations which may result in penalties or the Group incurring additional costs associated with rectification activities. These include income tax and other associated tax matters as well as environmental matters. As at the date of this financial report it is not possible to measure the contingent obligation with sufficient reliability as it remains subject to the outcome of future events not wholly within the control of the entity. The Group will recognise a liability for these amounts if and when the possible obligations are confirmed and can be reliably measured.

As set out in note 4, the Group identified certain adjustments associated with historical income tax deductions, research and development activities and withholding tax matters which resulted in the restatement of prior period comparatives. These adjustments may result in penalties or interest in future periods. As at the date of this report, other than items detailed in this interim report, no amount has been provided for such costs as it is not possible to measure the contingent obligation with sufficient reliability as it remains subject to the outcome of future events not wholly within the control of the entity. These matters may require amendments to previously lodged income tax returns and therefore create an uncertain tax position in relation to the tax authorities' views in relation to these corrections. In addition, these adjustments may result in penalties or interest in future periods.

Note 17. Related party transactions

Parent entity
Phoslock Environmental Technologies Limited is the parent entity.

Note 17. Related party transactions (continued)

Transactions with related parties not disclosed previously
During the period the Group identified that members of Key Management Personnel (Mr Zhigang Zhang, Mr Ningping Ma and Mr Tingshan Liu) had relationships with the following entities that rendered them to be related parties of the Group, which had not been previously disclosed:

Entity	Relationship
Beijing Hualijia Environmental Engineering Technology Co., Ltd ('BHEET')	100% directly owned by Mr Zhang
Beijing BHZQ Environmental Engineering Technology Co., Ltd ('BHZQ')	27.19% indirectly owned by Mr Zhang 2.81% indirectly owned by Mr Ma Both are directors of BHZQ
Beijing Kelin Haohua Environmental Technology Development Co., Ltd ('BKHETD')	80% directly owned by Mr Zhang 15% directly owned by Mr Liu Both are directors of BKHETD

The following are the transactions with the above related entities:

Transactions	Entity	Half year ended 30 June 2020 $	Half year ended 30 June 2019 $	Year ended 31 December 2019 $
Sales of zeolite and volcanic rocks (Xinfeng Wetland PPP project)	BHZQ	-	-	1,157,481
Sales of bacteria agents (Xinfeng Wetland PPP project)	BHZQ	-	-	127,471
Sales of phoslock and bacteria agents (Xinfeng River Ecological Remediation)	BHZQ	-	-	1,392,387
Sales of aeration machines (Xinfeng River project)	BHZQ	191,120	-	-
Purchase of consulting service (Car rental service)	BKHETD	-	9,452	12,546
Purchase of consulting service (Car rental service)	BHEET	4,895	9,452	9,409
Purchase of consulting service (Venue hire service)	BHEET	6,118	11,816	25,484
Service fee of bacteria agent expansion	BHEET	209,976	-	208,460

Note 17. Related party transactions (continued)

Receivable from and payable to related parties not disclosed previously
The Group had the following receivable from and payable to related parties which were previously not disclosed.

	30 June 2020		31 December 2019	
	Trade and other receivables $	Trade and other payables $	Trade and other receivables $	Trade and other payables $
BHEET	1,648	209,976	1,637	208,460
BHZQ	2,567,475	-	2,548,932	-
Impairment of BHZQ Receivable	(2,121,336)	-	-	-
BKHETD	-	-	-	-
	447,787	209,976	2,550,569	208,460

As part of the Group's review of its financial position, certain transactions were identified with the above noted parties that involved false accounting, falsification of invoices and service contracts. Transactions of this nature that were initially recorded and reversed within the half year to 30 June 2020 are not presented in the table above as they are no longer reflected within the financial statements.

Likewise, transactions of this nature that were recorded in prior periods and were corrected as part of the restatement presented in note 4 are not presented in the table above.

As at 30 June 2020 the receivable from BHZQ was past due, with the probability of collection deemed remote, notwithstanding the Group's continued efforts to recover the amount in an orderly manner. In light of these circumstances, the Group has recognised a loss of $2,121,000 for the period ended 30 June 2020 for the amount outstanding from BHZQ at the date of this report.

Transactions with related parties previously disclosed
The following transactions occurred with related parties:

	Consolidated	
	30 Jun 2020 $	30 Jun 2019 $
Payment for services provided by relatives of key management personnel:		
Margaret Schuitema - part-time employment**	91,509	65,365
Martin Schuitema - part-time employment**	-	12,223
Yolanda Winks - part-time employment***	20,001	26,146
Venus Ho - part-time employment****	11,253	17,967
Payment for services provided by companies related to key management personnel:		
Payment for rent - Link Traders (Aus) Pty Ltd*	57,216	57,948
Payment for investor relations fees - Serenity Holdings Pty Ltd*	67,579	74,730

* related party of Laurence Freedman
** related party of Robert Schuitema
*** related party of Andrew Winks
**** related party of Chris Hui

Receivable from and payable to related parties
Other than the receivable and payable to related party which were previously not disclosed presented above, there were no trade receivables from or trade payables to related parties at the current and previous reporting date.

Loans to/from related parties
There were no loans to or from related parties at the current and previous reporting date.

Note 17. Related party transactions (continued)

Terms and conditions
All transactions outside of China were made on normal commercial terms and conditions and at market rates.

Board investigations
During the course of the Board Investigation, it was identified that a number of transactions with related parties were not conducted on arms-length terms, were not supported by reliable source records and resulted in payments to related parties where the ultimate beneficiaries were unclear. In light of these circumstances, the Board undertook a review of relevant transactions and, where applicable, have recorded and disclosed transactions in the current period in a manner which reflects their economic impact on the Group. Likewise, comparative information has been restated to reflect transactions of this nature that occurred in prior periods.

Whilst the economic substance of these transactions (i.e. the purpose of the transaction and ultimate beneficiaries) remains under investigation as part of the Board's ongoing investigation activities, the Directors believe the financial statements accurately reflect the financial impact of the transactions on the Group with reference to the best available information regarding contractual terms and conditions with respect to amounts that remain receivable or payable as at 30 June 2020 (i.e. where cash flows have not occurred).

In response to these matters, the Group has implemented the following changes with respect to the identification and approval of related party transactions:

- Supplied training to all relevant directors and senior executives of relevant legislation and listing rules related to notifiable interests, material personal interests and related partied declarations;
- Overhauled monthly board reporting to include explicit Director Declarations & Disclosure of Interests requirements; and
- Required all directors to acknowledge and sign specific Directors' notifiable interests, material personal interests and related partied declarations.

Note 18. Earnings per share

	Consolidated	
	30 Jun 2020 $'000	30 Jun 2019 Restated $'000
Profit/(loss) after income tax attributable to the owners of Phoslock Environmental Technologies Limited	(21,612)	1,076
	Number	**Number**
Weighted average number of ordinary shares used in calculating basic earnings per share	584,917,983	501,416,773
Adjustments for calculation of diluted earnings per share:		
Options over ordinary shares	-	8,410,025
Weighted average number of ordinary shares used in calculating diluted earnings per share	584,917,983	509,826,798
	Cents	**Cents**
Basic earnings per share	(3.69)	0.21
Diluted earnings per share	(3.69)	0.21

Note 19. Share-based payments

The following share option plans are outstanding as of 30 June 2020. The Group derecognised $30,000 share-based payment expense as management believe that the vesting conditions will not be achieved.

Share option plan	Grant date	Number of options	Exercise price	Vesting conditions	SBP expense
Options granted to CEO**	27 Nov 2019	1,500,000	$1.25	-PET Group record sales more than $120,000,000 for the period from 1 January 2020 to 31 December 2021 -Remain employed beyond the vesting date.	$30,000 reversals
Options granted to CEO**	27 Nov 2019	1,500,000	$1.35	-PET Group record sales more than $200,000,000 for the period from 1 January 2020 to 31 December 2022 -Remain employed beyond the vesting date.	$nil
Options to PET Chinese employees*	23 Mar 2020	20,000,000	$1.00	-From 1 January 2020 to 31 December 2020 PET China record sales of: (a) more than $40,000,000 (entitled to 3,000,000 options) (b) more than $50,000,000 but less than or equal to $60,000,000 (additional 4,000,000 options) (c) more than $60,000,000 but less than or equal to $70,000,000 (additional 3,000,000 options) (d) more than $70,000,000 but less than or equal to $80,000,000 (additional 3,000,000 options) (e) more than $80,000,000 (additional 7,000,000 options) -Remain employed beyond the vesting date	$nil
Options to PET International employees**	24 Mar 2020 25 Mar 2020 9 Apr 2020	4,150,000 800,000 50,000	$1.00	-From 1 January 2020 to 31 December 2020 PET International record sales of: (a) more than $15,000,000 but less than or equal to $20,000,000 (entitled to 1,500,000 options) (b) more than $20,000,000 but less than or equal to $25,000,000 (additional 1,500,000 options) (c) more than $25,000,000 (additional 2,000,000 options) -Remain employed beyond the vesting date	$nil

* As part of the Board investigations, it was identified that the process for allocating the options lacked governance oversight. These options have not vested and are unlikely to meet their vesting conditions so are likely to expire.

** While these are issued, based on current forecasts the performance hurdle will not be achieved.

Note 19. Share-based payments (continued)

In June 2017, a total of 65 million share options were approved for issue by the Board and Company shareholders. Of this balance:

- 20 million share options were approved to be issued to employees and directors of Phoslock (Beijing) Ecological Engineering Technology Co Ltd (PBEE), a wholly owned subsidiary of the Company. As part of the forensic investigation, it was identified that the process for allocating the options lacked governance oversight and the process for measuring the performance of vesting conditions was unclear and subject to judgement. Of the options issued, 10.4 million were ultimately exercised by parties other than PBEE employees and directors, including employees of Beijing BHZQ Environmental Engineering Technology Co., Limited (BHZQ) (a previously undisclosed director related party of Mr Zhigang Zhang, and one of the Group's largest customers), in contravention of the conditions of the share options;
- 30 million share options were approved to be issued to China Environmental Corporation Australia Pty Ltd (CEC) (a previously undisclosed director related party of Mr Zhigang Zhang and Mr Ningping Ma). The options were allocated to shareholders of CEC, the majority of whom also worked for or had an indirect shareholding in BHZQ (a previously undisclosed director related party of Mr Zhigang Zhang, and one of the Group's largest customers). The options were subject to the same performance conditions as the 20 million options discussed above, however there was no service condition attached. As part of the forensic investigation, it was identified that the process for allocating the options lacked governance oversight and the process for measuring the performance of vesting conditions was unclear and subject to judgement; and
- the remaining 15 million options were appropriately issued to employees of the Group and subject to the same vesting conditions as the 20 million options discussed above. As part of the forensic investigation, it was identified that the process for measuring the performance of vesting conditions was unclear and subject to judgement.

The accounting fair value for the 65,000,000 options of $3,458,391 was expensed by the Group over the period from 16 July 2017 to 30 June 2019. 100% of the options were exercised between 27 November 2018 and 12 September 2019. The Group has no recourse in relation to options that vest which have been exercised.

In December 2019, an additional 20,000,000 share options were approved for issue by the Board and Company shareholders to PET Chinese employees. As part of the Board investigation, it was identified that the process for allocating the options lacked governance oversight. These options have not vested and are unlikely to meet their vesting conditions so are likely to expire.

In response to these circumstances and events the chairman of the renumeration committee has commissioned a full review of the long term incentive schemes of the company to confirm with best practise to be better aligned with shareholder interest.

Set out below are summaries of options granted under the plan:

	Number of options 30 Jun 2020	Weighted average exercise price 30 Jun 2020
Outstanding at the beginning of the financial half-year	28,000,000	$1.03
Vesting conditions not met/lapsed*	(1,000,000)	$1.00
Outstanding at the end of the financial half-year	27,000,000	$1.03
Exercisable at the end of the financial half-year	-	$0.00

* employees ceasing employment during the period

Note 20. Events after the reporting period

Since 30 June 2020, the Group’s operations have continued to be impacted by the Covid-19 pandemic and related government actions imposed in key markets to slow the spread of the virus. As the global outbreak of Covid-19 continues to progress and evolve, it is extremely challenging to predict the full extent and duration of its impact on the Group’s business activities.

Note 20. Events after the reporting period (continued)

The effects of these conditions on the Group have been compounded by the identification of suspected accounting irregularities in China (as discussed in note 4) and the resulting Board investigation and related actions taken by the Group to address the matters identified. As noted on note 4, as part of the investigations undertaken by the Board, total payments estimated to be $2,200,000 were identified spanning the previous 30 months from Jan 2020 where the ultimate beneficiary remains unclear. These amounts have been recognised as an expense within the statement of profit or loss and other comprehensive income in each respective period, reflecting the economic loss to the Group arising from the outflow of economic benefits associated with these payments.

On 17 September 2020, the Group requested a trading halt and then on 21 September 2020 a voluntary suspension effective until such time that an investigation and resulting report from its external advisors could be completed. On the 30 September 2020, the Board accepted the immediate resignations of the Deputy Chairman, Mr Zhigang Zhang and non-executive director Mr Ningping Ma. On 12 November 2020, the Group provided an update to the market advising that it had a basis to conclude the review of its financial statements for the half year ended 30 June 2020, with restatement adjustments also expected to be made to the financial statements for the year ended 31 December 2019. The financial statements included within this half year report reflect the outcome of relevant investigations as they relate to the half year ended 30 June 2020 and comparative periods.

Post 30 June 2020 the Group has continued to operate, albeit under challenging conditions brought about by COVID-19 as noted above. For the six months to 31 December 2020, the group has recorded net cash outflows of $4,500,000 and has $30,487,000 of cash on hand as at the date of this report. Further details can be found in the Appendix 4C submitted to the ASX on 28 Jan 2021. As detailed in recent ASX announcement, post 30 June 2020 trading results continued to perform below prior forecast as result of continued impact of COVID 19 and the China Investigation explained above.

On 11 January 2021 the Group signed a lease modification with their landlord in relation to the PETZ factory which reduced the lease term, square footage and overall cost. This is part of the ongoing effort to right size our business as a result of the investigation findings and current trading conditions.

On the 28 January 2021, the board announced the appointment of Mr Barry Sechos effective 1 February 2021.

No other matter or circumstance has arisen since 30 June 2020 that has significantly affected, or may significantly affect the Group's operations, the results of those operations, or the Group's state of affairs in future financial years.

In the directors' opinion:

- the attached financial statements and notes comply with the Corporations Act 2001, Australian Accounting Standard AASB 134 'Interim Financial Reporting', the Corporations Regulations 2001 and other mandatory professional reporting requirements;

- the attached financial statements and notes give a true and fair view of the Group's financial position as at 30 June 2020 and of its performance for the financial half-year ended on that date; and

- there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

Signed in accordance with a resolution of directors made pursuant to section 303(5)(a) of the Corporations Act 2001.

On behalf of the directors

Lachlan McKinnon	Brenda Shanahan
Managing Director	Non-Executive Director - Chairman of Audit Committee

29 January 2021

Independent Auditor's Review Report

To the shareholders of Phoslock Environmental Technologies Limited

Disclaimer of Conclusion

We were engaged to review the accompanying ***Interim Financial Report*** of Phoslock Environmental Technologies Limited.

We do not express a conclusion on the accompanying Interim Financial Report of the Group.

Because of the significance of the matters described in the Basis for Disclaimer of Conclusion paragraph, we have not been able to obtain sufficient appropriate evidence to provide a basis for a review conclusion on the Interim Financial Report.

The ***Interim Financial Report*** comprises:

- Consolidated statement of financial position as at 30 June 2020
- Consolidated statement of profit or loss and other comprehensive income, Consolidated statement of changes in equity and Consolidated statement of cash flows for the Half-year ended on that date
- Notes 1 to 20 comprising a summary of significant accounting policies and other explanatory information
- The Directors' Declaration.

The ***Group*** comprises Phoslock Environmental Technologies Limited (the Company) and the entities it controlled at the Half year's end or from time to time during the Half-year.

Basis for Disclaimer of Conclusion

Note 4 Restatement of comparatives and Note 19 Share-based payments describe the matters related to the Board Investigations undertaken regarding the identification of activities such as falsification of invoices and service contracts, improper tax reporting, potential misappropriation of funds including improper payment of bonuses, payments to third parties where the ultimate beneficiary was unclear, or which are otherwise suspect, undisclosed related party transactions, certain payments which had been incorrectly capitalised as assets where there was no evidence of future economic benefits as these impairment risks were previously falsely characterised and transactions with unfulfilled performance obligations related to the Group's Chinese operations. Further, Note 17 Related party transactions observes certain transactions with related parties involved false accounting, falsification of invoices and service contracts, and a number of transactions that were not conducted on arms-length terms and were not supported by reliable source records which resulted in payments to related parties where the ultimate beneficiaries were unclear.

Note 4 describes the Restatement of comparatives arising from these Board Investigations, and Note 2 references matters of context to the Group's assessment of continuing to be a going concern, both of which we consider to be fundamentally important to users of the interim financial report.

From accessing the Board Investigations, we note concerns are raised regarding a wide variety of source records, including contracts of sale, supply contracts, labour and compensation arrangements,

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inventory cost models, employee bonus calculations, and business expenditures. In performing our procedures on the underlying records as they relate to amounts recorded in the interim financial report, including restated amounts, we identified concerns regarding the reliability of these sources, as evidence, incremental to those disclosed by the Group in Notes 4, 17 and 19. Our concerns include source records with indicators they may be fictitious records, non-arms-length transactions, transactions and contracts not representing their actual economic substance, falsification of records, explanations or representations in particular regarding expected use of assets/future economic benefits, fulfilment of contract obligations and identification of related party transactions, and concealed illegal activity. The Group have been unable to provide information to alleviate our concerns, either by way of reconstructions of accounting records, clear documentation of complete transaction trails, or alternative confirmation of the economic substance of underlying transactions.

These concerns, combined with the nature and volume of source records, and the quantums they represent to the interim financial report, including restated amounts, have material and pervasive negative impacts on our ability to gather persuasive evidence to form a conclusion. Further details of the reasons for our inability to gather sufficient appropriate evidence are provided below, as they relate to certain significant interim financial report line items.

Income statement - Sales revenue

Amounts are recognised as Sales revenue in the interim financial report, including those restated for the 31 December 2019 year ended. For a significant number of these transactions and contracts reviewed, particularly those with previously undisclosed related parties, we identified concerns regarding the reliability of these sources, such as indicators they may be non-arms-length transactions, transactions and contracts not representing their actual economic substance, and fictitious documentation. To determine the appropriateness of recording the amounts as Sales revenue, the accounting standards require evaluation of the economic substance of the transaction, in particular whether the characteristics of revenue are met. In the absence of the Group providing information to alleviate our concerns we consider to have not gathered sufficient appropriate evidence regarding the characterisation of these transactions as true and fair Sales revenue.

Income statement – Cost of sales

Amounts are recognised as Cost of sales in the interim financial report, including those restated for 30 June 2019 half year and 31 December 2019 year ended. For a significant number of these transactions reviewed, including supplier contracts and labour arrangements, we identified concerns regarding the reliability of these sources, particularly those with previously undisclosed related parties, such as indicators they may be non-arms-length transactions, transactions and contracts not representing their actual economic substance, fictitious documentation, payments to third parties where the ultimate beneficiary was unclear or otherwise suspect, or contain concealed illegal activity. In the absence of the Group providing information to alleviate our concerns we consider to have not gathered sufficient appropriate evidence regarding the characterisation of these transactions as true and fair costs of sales.

In addition, during our review of a sample of transactions recorded as cost of sales we identified concerns for a significant number regarding the reliability of the underlying source records, such as indicators they may contain concealed illegal activity. We note the Group has not disclosed the total amount or nature of this issue in the current period or restated, which we consider to be a material omission of information relevant to users of the interim financial report. It is impracticable for us to determine this disclosure. In the absence of the Group providing information to alleviate our concerns we consider to have not gathered sufficient appropriate evidence regarding the final quantum and characterisation of these transactions as true and fair cost of sales expenses.

Income statement – Marketing expense and Administration expense

Amounts are recognised as Marketing and Administration expenses in the interim financial report, including those restated for 30 June 2019 half year and 31 December 2019 year ended. Our review of a sample of these transactions identified marketing and administration expenses recorded in the 30 June 2020 half year which should have been recorded in the 31 December 2019 year ended. The quantum and scale of the misstatement identified from our sample was sufficiently high that estimating an expected misstatement across all marketing and administration expenses, using the error rate from the sample, could not be determined without the Group performing a full reconstruction of the contents of their marketing and administration expense records. In the absence of the Group providing information by way of reconstruction of accounting records to alleviate our concerns, we consider to have not gathered sufficient appropriate evidence regarding the accuracy of marketing and administration expenses.

In addition, during our review of a sample of transactions recorded as marketing and administration expenses, we identified concerns for a significant number regarding the reliability of the underlying source records, such as indicators they may contain concealed illegal activity. We note the Group has not disclosed the total amount or nature of this issue in the current period or restated, which we consider to be a material omission of information relevant to users of the interim financial report. It is impracticable for us to determine this disclosure. In the absence of the Group providing information to alleviate our concerns we consider to have not gathered sufficient appropriate evidence regarding the final quantum and characterisation of these transactions as true and fair marketing and administration expenses.

Further, amounts are recognised as Administration expenses in the interim financial report, including those restated for 30 June 2019 half year and 31 December 2019 year ended narrated in the records as related to employee bonuses. For a significant number of these transactions we identified concerns regarding the reliability of the underlying source records, such as indicators that payments have been made not to employees but to third parties where the ultimate beneficiary was unclear, or which are otherwise suspect. In addition, we note that the Group has not recognised a liability for potential employee taxes owing to tax authorities in the event that these payments are accurately characterised in tax filings. In the absence of the Group providing information to alleviate our concerns we consider to have not gathered sufficient appropriate evidence regarding the characterisation of these transactions as true and fair Administration expenses.

Amounts are recognised as Administration expenses in the interim financial report, including those restated for 30 June 2019 half year and 31 December 2019 year ended. For a significant number of these transactions, particularly those with previously undisclosed related parties, we identified concerns regarding the reliability of the underlying source records, such as indicators they may be non-arms-length transactions, transactions and contracts not representing their actual economic substance, fictitious records, or expenses for matters unrelated to core business operations. In the absence of the Group providing information to alleviate our concerns we consider to have not gathered sufficient appropriate evidence regarding the characterisation of these transactions as true and fair administration expenses.

Income statement – Director, listing and professional fees expense

Amounts are recognised as Director, listing and professional fee expenses in the interim financial report, including those restated for 30 June 2019 half year and 31 December 2019 year ended. For a number of these transactions we identified concerns regarding the reliability of the underlying source records, such as indicators they may be payments to third parties where the ultimate beneficiary was unclear, or which are otherwise suspect or contain concealed illegal activity. In the absence of the Group providing information to alleviate our concerns we consider to have not gathered sufficient appropriate evidence regarding the characterisation of these transactions as true and fair Director, listing and professional fees.

Income statement – allowance for expected credit loss (Impairment of Trade Receivable) – Director related entity (BHZQ) – Note 9

Amounts are recognised in relation to purchase ($46,069) and sale ($191,120) of Aeration machines in the interim financial report, impacting the categories: Sale revenue for the contract for sale with the related party BHZQ (Note 17 *Related Parties*), and associated Accounts Receivable, and Costs of sales for the purchase contract, and the associated cash outflow payment. The Group has recorded an allowance for expected credit loss of $191,120 in relation to this transaction, deeming the collection of the receivable as remote. In relation to this previously undisclosed related party, we identified concerns regarding the reliability of the sources of evidence, such as indicators they may be non-arms-length transactions, transactions and contracts not representing the core business of the Group and therefore their actual economic substance. To determine the appropriateness of recording the amounts as Sale revenue, and consequential receivables and allowance accounting, the accounting standards require evaluation of the economic substance of the transaction, in particular whether the characteristics of revenue are met. In the absence of the Group providing information to alleviate our concerns we consider to have not gathered sufficient appropriate evidence regarding the characterisation of these transactions as sales revenue, and therefore the consequential receivables and allowance accounting.

Statement of financial position – Cash and cash equivalents

The Group's recorded Cash and cash equivalents at 30 June 2020 include an amount totalling $1,955,764 in relation to holdings in certain Chinese subsidiary bank accounts. We have been unable to obtain a written confirmation from the relevant counterparty regarding the quantum and terms and conditions of cash and cash equivalent holdings. We consider to have not gathered sufficient appropriate evidence regarding the Group's cash and cash equivalent holdings.

Statement of financial position - Inventory – Note 10

Amounts are recognised as Inventory in the interim financial report, including those restated for 30 June 2019 half year and 31 December 2019 year ended. For a number of these transactions recorded within the inventory costing we identified concerns regarding the reliability of the underlying source records, such as indicators they may contain concealed illegal activity. In the absence of the Group providing information to alleviate our concerns we consider to have not gathered sufficient appropriate evidence regarding the characterisation of these transactions as relating to the costing of inventory and therefore the accuracy of the inventory recognised as at those dates.

Statement of financial position – Trade and other payables – Note 13

An amount of $209,976 is recognised as Trade and other payables, narrated in the records as a related party for service fees of bacteria agent expansion (as disclosed in Note 17 Related parties) and contained in the Cost of sales expense item at 30 June 2020 and $208,460 restated 31 December 2019. For these amounts we identified concerns regarding the reliability of source records, such as fictitious records, indicators the transaction may be a non-arms-length transaction, and contracts not representing their actual economic substance with the related party. In the absence of the Group providing information to alleviate our concerns we consider to have not gathered sufficient appropriate evidence regarding the characterisation of these transactions as related to valid and legal liabilities and therefore the accuracy of the trade and other payables balance amounts, associated costs recorded in Cost of sales expenses, and related party disclosures.

In addition, an amount of $830,645 is recognised as Trade and other payables at 31 December 2019, reduced to $177,926 by 30 June 2020. Note 4 and Note 12 describes this amount as a contractual obligation to pay a third party connected with transactions under investigation in connection with the Group's Chinese operations. For this contract, we identified concerns regarding the reliability of source records, such as indicators they may contain concealed illegal activity. In the absence of the Group providing information to alleviate our concerns we consider to have not gathered sufficient appropriate evidence regarding the characterisation of the transactions as relating to valid and legal liabilities and therefore the accuracy of the trade and other payables balance and associated historical expense amounts.

We conducted our review in accordance with ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity*. We were unable to satisfy ourselves by alternative means in relation to the above matters. Therefore in aggregate we have not been able to obtain sufficient appropriate evidence.

As a result of all these matters, we are unable to form a conclusion whether firstly, the Directors Declaration statement regarding the interim financial report giving a true and fair view of the financial position and its performance complying with the Australian Accounting Standards and *Corporations Act 2001* is appropriate, and secondly, determine whether the possible effects of undetected misstatements require adjustment in respect of recorded amounts in the interim financial report. We note the possible effects may be across various items making up the statement of profit or loss and other comprehensive income, the statement of financial position, the statement of cash flows, and the statement of changes in equity in the Interim Financial Report.

Given the material and pervasive impacts of this to the Interim Financial Report as a whole, we are therefore unable to conclude on the Interim Financial Report.

Responsibilities of the Directors for the Interim Financial Report

The Directors of the Company are responsible for:

- the preparation of the Interim Financial Report that gives a true and fair view in accordance with *Australian Accounting Standards* and the *Corporations Act 2001*
- such internal control as the Directors determine is necessary to enable the preparation of the Interim Financial Report that gives a true and fair view and is free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Review of the Interim Financial Report

Our responsibility is to conduct a review of the Group's Interim Financial Report in accordance with ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity*. However, because of the matters described in the Basis for Disclaimer of Conclusion section of our report, we were not able to obtain sufficient appropriate evidence to provide a basis for a review conclusion on the Interim Financial Report. We are independent of the Company in accordance with the auditor independence requirements of the *Corporations Act 2001* and the ethical requirements of the *Accounting Professional and Ethical Standards Board's APES 110 Code of Ethics for Professional Accountants (including Independence Standards)* (the Code) that are relevant to our audit of the annual financial report in Australia. We have also fulfilled our other ethical responsibilities in accordance with the Code.

KPMG

KPMG

Sarah Cain

Partner

Melbourne

29 January 2021