KPMG

July 2017

Across the Board

A newsletter for Australian Directors

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Across the Board July 2017

This edition of *Across the Board* shines the light on some of the key challenges and complexities of the current business landscape. We reflect on a range of issues including economic uncertainty, tax reform, regulatory change and technological innovation and the role directors play in steering organisations through the challenges that lie ahead.

We examine findings of the recent Australian Institute of Company Directors (AICD) and KPMG report, *Driving productivity from the top – A survey of Australian directors and governance leaders* and share with you details of the 4th Edition of KPMG's *Directors' Toolkit.*

We hope you find this edition of *Across the Board* of interest. If you would like to discuss any featured article in more detail, please contact me or your local KPMG partner.

Peter Nash
Australian Chairman
KPMG Australia

For feedback on *Across the Board* please **contact us**.

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Delivering to directors – KPMG at the AICD Summit

As directors gathered at the AICD Governance Summit 2017 to explore their role in today's complex business landscape, KPMG experts offered insights into preparing for the unknown, influencing policy reform and fostering innovation.

Boards cannot escape the complexities that are facing their organisations, and must have vast insight and foresight to steer companies through a variety of challenges and to seize opportunities.

The influence of Boards was explored at the Australian Institute of Company Directors (AICD) Governance Summit 2017, held in Melbourne in March. With its theme of *Directing in a complex environment*, the Summit brought together an impressive array of Australia's leading authorities on governance and directorship, with topics ranging from being prepared for disruption through to productivity, policy making and innovation.

It was made clear that Boards must look outward as much as they do within, and serve to raise awareness of global trends, major headwinds and the potential of technology, innovation and globalisation that their organisations could embrace.

Preparing for anything

Looking to the future was central to a discussion involving KPMG's Sally Freeman GAICD, Partner in Charge of Risk Consulting, along with Holly Ransom, CEO, Emergent, and Keith Suter FAICD.

Freeman said Boards must ask, 'What are the emerging risks?' and take steps to prepare for them.

"They must understand that constant change is the new normal," she said. "It is not something we can do in the margins – we need to mainstream it."

If Boards fail to recognise this, she warned that innovative and agile startups will "nip at our heels".

Ransom delved into the issue of Board demographics, reminding directors that young people will dominate our region, and that they hold immense consumer power.

"You need awareness of the younger generation in strategic conversations," she said.

Ransom also encouraged directors to engage in the "sheer pervasiveness of digital" and to rethink how they convene and communicate to reflect the pace of change.

Suter said Boards must ready themselves for "VUCA – a volatile, uncertain, complex and ambiguous future", with great cyber risk awareness. However, he also warned directors not to be "seduced" by the power of the internet at the expense of other opportunities. He encouraged Boards to engage in "blue sky thinking" and imagine countless versions of the future – both utopian and dystopian.

"You can't predict the future but you can reduce the risk of being taken by surprise," he said.

A role for Boards in policy change

Policy impacts all areas of business, but with political leaders constrained by short-termism, and reform for major issues such as tax and productivity tough to drive, directors can be left frustrated at a lack of change.

Peter Nash MAICD, Chairman, KPMG Australia, represented the views of business in a panel discussion on the topic, accompanied by Graham Bradley AM FAICD, The Hon John Brumby AO FAICD, Christine Hawkins FAICD, and Nick Greiner FAICD*Life*.

In a discussion ranging from trade terms to Trump, and tax equality to energy shortages, Nash said better communication is needed to help open debate on reform.

"Arguments around the benefits of global trade need to be repositioned to connect to the broader public," he said.

While tax reform was deemed urgent at the 2016 conference and little has changed since, Nash said business cannot be complacent about it.

"Tax is a critical lever of our economy – we can't simply sit by and lose our competiveness," he said.

Nash argued for incremental change – "even if it is not the grand tax reform that we might all like".

"You can create the broader view and framework and deliver incremental change into that," he said.

Hawkins added to this sentiment: "The community is screaming out for leadership on energy and we don't have it," she said.

Housing and infrastructure policy were also put forward as areas in need of reform.

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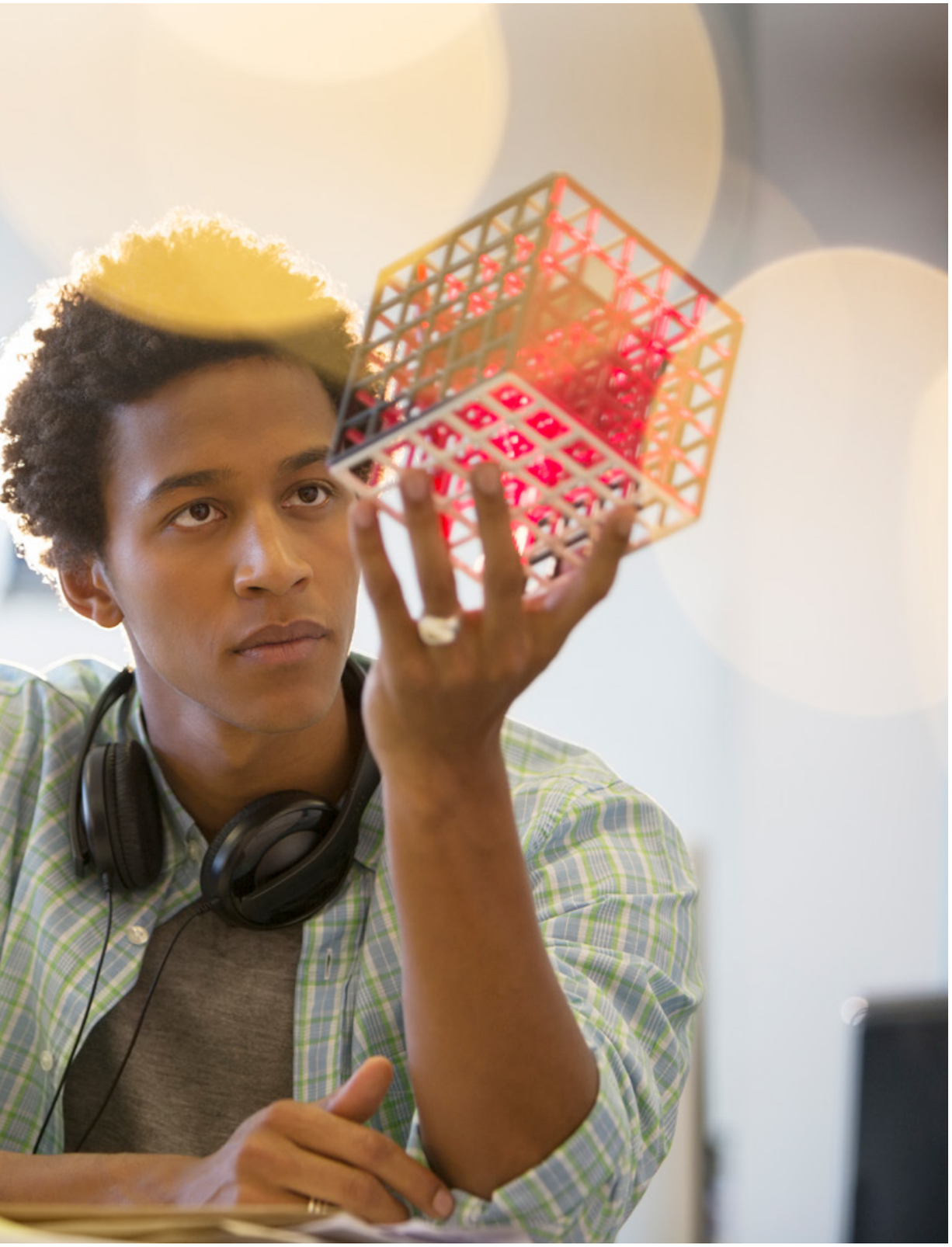

Building a culture of innovation

James Mabbott, Partner, KPMG Innovate, took directors into the world of innovation, and shared his insights on how they can foster this in their organisations. Joined by Amantha Imber, CEO, Inventium, the pair agreed that a sustainable rather than ad hoc approach to innovation is vital to remain relevant.

Mabbott raised that directors need to decide how committed they are to innovation and ensure it is part of the company strategy.

"Define innovation, have a sense of what it means to your organisation," he said. "How does innovation fit in your strategy? Innovation must not be haphazard but done with deliberate purpose."

Imber added that to avoid being an "innovation one hit wonder", it is essential to create a "culture where innovation thrives".

Top management support is vital to drive this – along with always putting the customer needs at the heart of new initiatives.

"It comes down to good scientific method," she said. "Why would customers pay for this idea? Create a minimum viable product and iterate accordingly."

Mabbott said directors should not be afraid to bring in fresh opinions and perspectives, to ensure that they are at the cutting edge and key to this is diversity.

The AICD Summit was attended by more than 1,000 delegates from across the country.

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Powering productivity – the role of directors

With Australia's productivity stagnant, it will take fresh thinking to shift it into gear. A new report from KPMG and AICD found that directors can play a part.

If there is one topic uniting business and government in 2017 it is productivity – and how to ensure Australia maintains its global competitiveness, standard of living, and builds equity of opportunity for all in years to come. It is an issue that must be addressed, as Australia's productivity has remained almost stagnant for 10 years, averaging just one percent growth each year.

The Australian Institute of Company Directors (AICD) and KPMG delved into the subject in a new report, *Driving productivity from the top – A survey of Australian directors and governance leaders.*

Based on a survey of 695 Australian company directors and governance leaders, the report reveals their viewpoint on Australia's productivity challenge, in particular highlighting their frustration at a "lack of political courage" and "short-termism" for a dearth of productivity policy.

Report co-authors – Sally Freeman GAICD, Partner in Charge, Risk Consulting, KPMG, Stephen Walters MAICD, Chief Economist, AICD, and Lucas Ryan GAICD, Senior Policy Advisor, AICD – discussed the findings and productivity more broadly on 2 March at the AICD Governance Summit 2017 in Melbourne.

Stephen Walters began by raising the complexity of defining and measuring productivity in today's technology driven world. He proposed that "we all need to work harder and smarter" to play our part.

"A lot of people think we can boost productivity by working longer hours," he says. "However it is a really complex situation, it is about all factors of production – capital, use of technology, innovation and agility."

Walters said 15 years of a mining and investment boom, along with high commodity prices, masked Australia's poor productivity. Also, while infrastructure has been developed, it is yet to prove fruitful.

"With lots of new inputs and no output – clearly your productivity suffers from that," he said.

He said productivity must remain firmly in focus, as it is "the one thing that will define our long-term living standards".

Lucas Ryan raised Australia's growing inequity, and considered if it was the responsibility of Boards to play a role in social cohesion and in turn help productivity.

"If we return to the idea of business – it was if we got together a cooperation of humans we could mobilise and generate wealth – the effect was the industrial revolution and a lot of people were lifted out of poverty," Ryan said.

Sally Freeman continued this theme, and said the survey shows that directors are aware that they need to engage with the broader stakeholder environment, and that social cohesion can help productivity.

"They understand that their social license to operate is within the community; that they need to be responsive to shareholder activists; they are accountable for the impact that they have on the environment, and the impact that they have on employees," she said.

Other key areas in the new report explore the value of training and skills, which directors believe could 'turn the dial' on productivity. It also shows that they think business has a clear role to play in driving productivity reform in Australia – although most tend to believe it requires a combined approached between the public and private sectors.

Key survey findings

- Directors feel that a lack of political courage is the key inhibitor of long-term productivity reform initiatives.
- Training and skills development requires a renewed focus and investment.
- Engaging in public debate on issues affecting productivity and implementing better practices in their own businesses are seen as the most important activities directors can undertake to influence public policy and champion reform.
- Directors acknowledge the business sector has a clear role to play in driving productivity reform in Australia, although most tend to believe it requires a combined approach between the public and private sectors.
- Half of respondents believe the social contract between corporate Australia and Australian society needs to be renegotiated.
- There is a clear recognition from directors that businesses must play a role supporting social cohesion.

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To read the full report

Driving productivity from the top – A survey of Australian directors and governance leaders.

Testing times for Boards on tax

David Linke
National Managing Partner, Tax

James Gordon
Director, Tax Transformation

General pressures and demands of Boards in Australia today are greater than ever and continue to expand. Although in the past directors may have been less involved in tax matters, these are now emerging as the latest addition to the Board agenda. Greater and more active Board oversight of tax is already a clear trend across Australia having become more necessary as the tax system and its administration undergo unprecedented change. A key aspect of this change is a greater focus on tax governance and transparency. This has already broadened tax's traditional stakeholder group and, in particular, what they expect of Boards on tax. Tax reputational risks are driving interest at Board level too.

Expanded Tax Governance Guide

The latest major development in this story is the ATO's release of a significantly expanded *Tax risk management and governance review guide* setting out their view on director's duties and acceptable practices by management on tax at large organisations.

The guide marks a paradigm shift in the way the ATO administers tax by holding Boards accountable for tax overall. It also shifts the burden of proof from the ATO identifying tax risks in reviews, onto taxpayers demonstrating with evidence that risks are identified and managed as part of a formal tax control framework. It sets out a clear view of better practice controls for Boards on tax including:

- endorsement of a tax strategy and tax risk appetite;
- having appropriate capability as a collective to oversee tax governance;
- receiving and reviewing tax updates, support and briefings; and
- obtaining assurance that controls are effective in managing tax risk in particular internal control testing.

In response, Boards across Australia are now reviewing their oversight framework to ensure tax is consistently and appropriately managed. Existing service and outsourcing arrangements are also being revisited to ensure responsibilities for key tax controls are considered and captured in end-to-end processes and data flows.

At a global level, Boards and Management of organisations have also recently approved outsourcing of significant aspects of their tax operating models. This is emerging as a key trend in tax in recent months. Although this may be seen by Boards as a way of conferring tax risk to another party, it should be noted that many regulators still consider Boards accountable for overseeing a holistic tax risk management framework across the organisation – including all service and outsource providers. Although much of the complexity can be outsourced, the overall risk remains with the Board.

ATO testing practical application from this year

The ATO is committed to ensuring that tax policies are operationalised through effective controls, testing and monitoring for which they are now taking more of an internal audit type approach. These demonstrable tax control frameworks underpin an initiative known as 'Justified Trust' – an effort by the ATO to enhance public trust in the corporate tax system. It covers two key areas:

1. Tax governance: Any inability to demonstrate the implementation of tax governance in practice will be an indicator of a higher risk taxpayer regardless of risk appetite statements in policies.
2. Tax risks: The ATO will seek to understand how the taxpayer has identified and managed tax risk areas in particular significant transactions, differences between economic and tax outcomes and specific tax risks they have flagged to market as being of concern.

The ATO are now undertaking 'Justified Trust' reviews of the top 1,000 taxpayers starting with the top 100 (and some others) this year. For these reviews, they will examine how taxpayers have assessed their tax governance maturity, and whether they have in place a demonstrable framework of controls and testing. Any control gaps they identify will be assessed, looking forward and back, to understand the potential tax risk and what additional work may be warranted. This includes testing the involvement of directors in overseeing tax risk per the Board controls of their *Tax risk management and governance review guide*.

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The ATO will revisit the taxpayers' risk rating and the ongoing relationship by reference to the outcomes of this review. Adoption of the Voluntary Tax Transparency Code, recommending more public disclosures of tax information including a qualitative explanation of the tax strategy as well as numbers in terms of taxes paid, is now also seen by the ATO as indicative of good governance, and may be tested as part of these reviews.

How to be prepared

The ATO respects that most organisations have gaps at present by reference to these new better practice principles. Although it is recognised that remediating any identified gaps may not be possible or appropriate in the short term, the lack of immediate preparedness in terms of an analysis of gaps and an action plan to respond over time will be viewed as a higher risk indicator. Boards should request this of management and be comfortable with the suggested way forward.

Understanding and benchmarking current practices versus peer organisations and the journey they are taking to mature their arrangements is also important. Remaining in line with the broader market will ensure you are not taking overly onerous steps too soon or missing key opportunities for change that may be driving competitive advantage at your peers.

KPMG has been benchmarking the tax operating models of our clients for several years. The data we have gathered from over a hundred respondents across industries shows that most organisations are early in the journey in Australia, but now very much taking steps to mature their tax control frameworks to be ready both for regulatory and Board interactions on tax.

Prior to commencing this journey, many organisations had gaps to consider by reference to the ATO's better practices:

- Just over 50 percent had documented a tax policy and, of those, a little over 21 percent had reviewed it in the prior year.
- Less than 26 percent of organisations reported to Board on tax matters under a framework which had been set by the Board.
- Only 20 percent had understood and documented their controls across entire end-to-end tax processes.
- Less than 36 percent undertook monitoring or testing more frequently than once a year.
- Of these, only 23 percent documented this monitoring/testing activity.

In today's changing world of tax, Boards are now a key stakeholder in any approach to transform tax governance and tax operating models. Boards should also be ensuring that the broader business transformation agenda and project planning and governance does not exclude tax. Reporting lines and tax content in Board meetings are being revisited as directors seek adequate but not excessive information on tax to discharge their duties effectively. Leading organisations are revisiting their tax skillset and capability including support to the Board. It will soon be put to the test.

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The new Directors' Toolkit – what to look out for

As the role of directors continues to evolve in light of refreshed risks and opportunities, KPMG has compiled a practical guide to help navigate the issues and consider the vital skills and key responsibilities needed to effectively govern in today's boardrooms.

In Australia, directors are increasingly called upon to be involved in and guide many aspects of a company's activities. Their role is being re-shaped by continued economic uncertainty, increasingly complex organisations, the fast pace of technological innovation and regulatory changes. They are also facing higher customer and stakeholder expectations, while being expected to operate transparently and be more accountable for their actions and decisions.

While it is impractical for boards to know every detail of a company's daily operations, there are vital areas that they need to oversee. From digital disruption to social media, economic compliance to succession planning, they must be efficient at determining not just opportunities, but preparing for and mitigating organisational risk.

To support directors in this challenging role, KPMG has launched the fourth edition of the *Directors' Toolkit*. The first edition launched in 2008 and it has now evolved into an interactive and searchable resource that captures the most pressing issues facing directors and boards. The toolkit provides company directors with a unique experience where they can easily navigate through a series of questions that they should ask, alongside a list of 'red flags' responses, that may impact their organisation's performance.

Led by Sally Freeman, KPMG Partner and National Head of Risk Consulting, the interactive and user-friendly tool has been expanded to cater for the current and future challenges for directors, along with updates to the fundamental requirements of the role.

Freeman says in the foreword that boards in this era of fast change and international competition "need to think carefully about their roles and functions and not meekly accept management agendas".

"Good corporate governance, with an appropriate balance between conformance and performance is the only response to the difficult and demanding business environment in which organisations now operate," she says.

The *Directors' Toolkit* does not provide a model for the optimum composition and conduct of a company board, but draws on KPMG's deep understanding of the corporate environment to help directors identify key risks and to offer advice on better management.

Two on-the-pulse new chapters

Two new chapters have been included in the 2017 edition – one exploring managing cybersecurity risks, the second looking at human rights risks in the supply chain.

Cybersecurity

Cybersecurity continues to rise up the board agenda with major incidents increasingly commonplace across a range of industries. This section highlights that in a world in which cyber criminals are smart, resourceful and well-motivated, businesses need to make cybersecurity a priority. This cannot be left to the technical specialists in Information Technology (IT) and cannot be addressed in isolation. Cybersecurity, if not already a board level issue, is destined to become one that the C-suite will need to tackle in the context of its wider digital business strategy.

Human rights in the supply chain

Human rights risk has been traditionally outsourced as part of the contract with suppliers of goods and services. This new section states that risk is now being brought back to the procurer as society and other stakeholders hold the company's brand and reputation to account for the human rights impacts that can occur at all of stages of a supply chain. Directors must be aware of the nature of this risk and its potential impact on their organisation.

Other key areas

In addition to the two new chapters, the *Directors' Toolkit* explores fundamental topics including the legal duties of directors, the different governance roles, accountability to shareholders and stakeholder engagement. It delves into helpful advice for establishing a new board, company leadership and conducting productive board meetings. Important areas of governance oversight are explored, including ethical culture, general risk management, private equity and receiving assurance.

Who is it for?

The fourth edition of the *Directors' Toolkit* is designed for directors of listed public companies and major private entities. However, it is also extremely relevant to those vested with governance responsibilities for small private companies, not-for-profits, incorporated associations, statutory bodies and sporting and community-based organisations.

The new version is easy to search and fast to navigate. It has space for easy note-taking and plenty of hyperlinks to relevant legislation ensuring further details are just a click away.

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For more information on the new *Directors' Toolkit* or to request a copy, visit:

Directors' Toolkit

KPMG's 2017 Global Audit Committee Pulse Survey – key findings

Audit committee challenges and priorities

KPMG recently released its *2017 Global Audit Committee Pulse survey* report, surveying over 800 Audit Committee members and chairs from 42 countries. The survey findings offer insights that audit committees around the world can use to sharpen the committee's focus, benchmark its responsibilities and practices, and strengthen its oversight.

Below are the six key takeaways identified in the report; for a full breakdown please visit our ACI website.

Six takeaways

Risk management is a top concern for audit committees. The effectiveness of risk management programs generally, as well as legal/regulatory compliance, cyber security risk, and the company's controls around risks, topped the list of issues that survey participants view as posing the greatest challenges to their companies. It's hardly surprising that risk is top of mind for audit committees— and very likely, the full board—given the volatility, uncertainty, and rapid pace of change in the business and risk environment. More than 40 percent of audit committee members think their risk management program and processes "require substantial work," and a similar percentage say that it is increasingly difficult to oversee those major risks.

Internal audit can maximise its value to the organisation by focusing on key areas of risk and the adequacy of the company's risk management processes generally. The survey results show that audit committees are looking to internal audit to focus on the critical risks to the business, including key operational risks (e.g., cyber security and technology risks) and related controls—and not just compliance and financial reporting risks. They also want the audit plan to be flexible and adjust to changing business and risk conditions.

Tone at the top, culture, and short-termism are major challenges—and may need more attention. A significant number of audit committee members—roughly one in four—ranked tone at the top and culture as a top challenge, and nearly one in five cited short-term pressures and aligning the company's short- and long-term priorities as a top challenge. Meanwhile, nearly the same percentage of audit committee members said they are not satisfied that their committee agenda is properly focused on those issues.

CFO succession planning and bench strength in the finance organisation continue to be weak spots. Forty-four percent of audit committees are not satisfied that their agenda is properly focused on CFO succession planning, and another 46 percent are only somewhat satisfied. In addition, few are satisfied with the level of focus on talent and skills in the finance organization. Given the increasing demands on the finance organisation and its leadership—financial reporting and controls, risk management, analysing mergers and acquisitions (M&A) and other growth initiatives, shareholder engagement, and more—audit committees want to devote more time to the finance organisation, including the talent pipeline, training, and resources, as well as succession planning for the CFO and other key finance executives.

Two key financial reporting issues may need a more prominent place on audit committee agendas: Implementation of new accounting standards and non-GAAP financial measures. Few audit committees say their companies have clear implementation plans for two major accounting changes on the horizon—the new revenue recognition and lease accounting standards. Given the scope and complexity of those implementation efforts and their impact on the business, systems, controls, and resource requirements, those efforts should be a key area of focus. In addition, audit committees ought to consider whether to increase attention to any non-GAAP financial measures, which are an area of significant attention and comment by regulators worldwide. Nearly a quarter of those surveyed say their role with respect to the presentation of those metrics is very limited.

Audit committee effectiveness hinges on understanding the business. Audit committee members say a better understanding of the business and the company's key risks would most improve their oversight effectiveness. They also view additional expertise in technology/cyber security as being key to greater effectiveness, since it would strengthen their ability to oversee those risks.

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You can read a copy of the full survey here

Further information

Recent publications

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Executive Remuneration Insights

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