September 2015

Across the Board

A newsletter for Australian Directors

Features

KPMG

cutting through complexity

Across the Board September 2015

In this edition, we feature KPMG's submission to Treasury on tax reform and our call for fundamental change.

We also explore Australia's corporate governance landscape, the impact of digital disruption on the role of the board and CIO and our views on the social media risks associated with the tax morality debate.

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

Peter Nash
National Chairman,
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For feedback on *Across the Board* please contact us.

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Tax reform:
A call for fundamental change

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In March, the Federal Government released its paper, *Re:think*, to encourage community consultation on the issue of tax reform. In the spirit of its call to conversation, KPMG submitted to Treasury more than sixty proposals for fundamental change.

At KPMG, we fervently believe that Australia needs long-term solutions that go to the very root of our tax system. Hence our submission to Treasury on taxation proposes far-reaching changes that meet the needs of the country we want to be in 2030.

Not only is our tax system inherently inefficient, it is beset by an array of problems we encounter as a federation, including vertical fiscal imbalance and a high degree of opaqueness. A number of taxes are inequitable and many are weighed down by complexity and a lack of transparency.

Our proposals range from the visionary to the prosaic. While many are hard to achieve, they should not be viewed as naïve. We believe they are truly realistic with strong political leadership. All of them, ultimately, are optimistic.

A principled approach

For each proposal, we asked the simple question: How will this fit into and shape the Australia we want in 2030? At the same time, we brought to bear eight principles of evaluation. These are: efficiency, equity, simplicity, sustainability, consistency, transparency, stability and gender.

We were further guided by a large number of consultation meetings that we held throughout the country at the senior executive and director level and a survey we conducted of company directors, executives and professionals.

Highlights of our submission include the establishment of a single administrator to collect all taxes, the replacement of the fringe benefits tax and stamp duty, and linking the income tax rate to average full time earnings (AFTE).

Like all of our recommendations, our proposal to establish a single tax collector is grounded in common sense. We believe that the Australian Tax Office (ATO) is ideally placed to administrate our taxation system, whether federal, state or local. With the aid of technology, including state-of-the-art data collection techniques, the one administrator could offer considerable efficiency benefits to individuals and business as well as the government.

Getting the states' buy-in for this measure is a potential challenge. To this end, we would suggest a voluntary mechanism with a carrot and stick approach. Those states that joined up immediately would be allocated a portion of the resulting productivity benefits and savings. Those that delayed would have to share in any detriment that resulted therein, so suffering a reduction in funding.

The promise to keep the same GST base and rate in the absence of unanimous agreement of the states and territories needs an expiry date.

Goodbye bracket creep

Using AFTE as a significant measure of our income tax rates also makes sense – while representing a fundamental transformation of our tax system.

People generally view what is fair and equitable based on 'what most people are getting'. We believe that linking personal income tax thresholds to AFTE, currently sitting at $80,000, meets this expectation. Based on our proposal, the resulting income bands would be: 15 percent, 25 percent, 35 percent and 45 percent.

This approach, in effect, drops the tax free threshold – a proposition that might cause initial concern. However, protection for low income earners would be assured through greater use of the Low Income Tax Offset (LITO) and a new Work Incentive Tax Offset (WITO).

WITO would offer the additional benefit of encouraging greater participation in the workforce among the low incomes, generally second incomes, in a family. The hope is that this would assist in increasing female participation.

A major shake-up

Other far-reaching recommendations include our proposed replacement of the fringe benefits tax, itself inequitable. Instead we would suggest a new, simpler system of personal benefits, entertainment benefits and non-personal benefits. Among other things, this system would mean that no fringe benefits tax return would need to be lodged.

Further, we recommend abolishing stamp duty on the transfer of residential and commercial property, instead combining rates, land tax, insurance taxes and emergency service levies into a new property services tax. This new, greater form of land tax would offer considerable efficiency for the fact that land is immobile. It could also be structured in such a way as to be progressive.

Tax reform: KPMG's submission to Treasury

Tax reform:
A call for fundamental change *(cont.)*

Simpler is indeed better. In regard to child care payments, we propose to conflate the current Family Tax Benefit A and B, Child Care Benefit and Child Care Rebate into two straightforward transfer payments:

- Child care assistance for all forms of child care, provided it is recognised as income by the child care provider (if an employee were to pay for the top-up costs they would be FBT exempt).
- A primary carer payment made on a per child basis with a cut-off at twice average weekly earnings.

Our simplified system would not be inexpensive as a short-term cost but would produce substantial long-term benefits. By minimising the disincentive within the tax-transfer system to remain outside the workforce, it would make a significant contribution to increased productivity in the future.

Company concerns

There is also good reason to adjust our corporate tax rate in view of international comparisons. We propose lowering the company rate to 28 percent in 2020 and 26 percent in 2023. This would create a differential of less than 10 percent with the current Hong Kong and Singapore headline – clearly a positive result. On the other hand, there would be a 19 percent differential with the proposed top marginal rate of 45 percent.

We would further suggest introducing three new company structures into Australian business. They are:

- a small business company, which would seek to duplicate the tax impacts of some but not all of the complex standard business structures currently in place
- an innovation company to assist in reducing the movement of innovative businesses offshore and provide much needed cash to pay salaries during the start-up phase
- a simplified collective investment company with the transparency features of our widely held trusts (including managed investment trusts) to assist in simplifying foreign investment into Australia.

Setting a use-by date

At the same time, we cannot afford to maintain the GST at 10 percent indefinitely. We recommend extending it to 15 percent while comprehensively broadening the base to include, among other things, all food, health and education.

We make this suggestion based on our strongly held view that the promise to keep the same GST base and rate in the absence of unanimous agreement of the states and territories needs an expiry date. Putting the *Intergovernmental Agreement on Federal Financial Relations* to one side, notice should be given to states and territories that the GST is subject to change from 2019.

The finer details

Our proposed reforms are conceived with an 8-year time frame in mind. Three years, 2015 to 2018, would be spent bedding down the details of the proposed reforms, including suitable compensation packages. The year 2018 would be the target for legislation, followed by a 5-year transition period to 2023 for implementation.

In light of the major changes required to the structure of the current tax system, we recommend the establishment of a 'Tax Reform Compensation Commission' to advise on permanent and transitional compensation.

We also recommend the creation of 'Combined Australian Governments Accounts' to further reform our system. These would be unprecedented in their transparency. They would disclose the federal, state, territory and local government's total revenue and expenditure by source and function, including internal contributions.

> We believe that the Australian Tax Office is ideally placed to administer our taxation system, whether federal, state or local.

Under our proposals, state budgets would be held in March to allow them to feed into these combined accounts to be released at the time of the federal budget in May.

We further propose that the federal budget produce new annual intergenerational accounts primarily at the combined government level, but also at the federal and state levels. The intergenerational accounts for Australian governments would seek to show the burden and benefits of the give and take with government across generations.

Stepping up to the challenge

But how would these visions for sweeping reform play out in our current socio-political environment? Is there the necessary will for fundamental change?

Unfortunately we face two traps in Australia. The first is an 'insularity trap': that our policy settings focus inwards rather than out towards the rest of the world. This is ultimately a path to declining living standards.

There is also an 'inaction trap'. Decisive actions may seem too hard in a partisan world with minimal public trust. Change is perceived as achievable only if it is furtive or the result of overwhelming consensus.

We hope our recommendations in response to the government's *Re:think* paper in some way assists our country to sidestep these two traps. While they dare to go beyond the norm, they are in no way extreme.

Rather, these proposals are attainable goals that can be realised if we bring to bear the necessary socio-political will. Certainly, we hope they encourage deep reflection about the very roots of our tax system.

KPMG's submission to Treasury can be found at:
Tax reform, KPMG's submission to Treasury.

Corporate Governance: Balancing Rules and Flexibility

Doing the right thing: Australia and the corporate governance experience

Sally Freeman
National Managing Partner,
Risk Consulting

Effective corporate governance (CG) can be critical in enabling boards and management to navigate their way through uncertainty in the international business arena. It should guide how a company sets the right strategy and manages risks.

Yet, a joint study *Balancing Rules and Flexibility* by ACCA Singapore and KPMG reveals a wide divergence in CG requirements across 25 markets, including; Australia, Singapore, Thailand, China and Brazil. This does not help promote cross-border trade, so the report calls on governments to work towards meeting global CG standards, which are based on the Organisation for Economic Co-operation and Development (OECD) principles.

The good news for Australia is that the survey rates us as a **world leader in corporate governance** – but there are still some challenges ahead that mean Australian boards need to recalibrate their approaches in some areas.

It's not surprising that achieving good CG is high on the agenda for Australian board members. It empowers individuals to perform to their highest potential; it builds productive and profitable cultures that deliver long-term value to stakeholders and shareholders; but it also has surprisingly significant effect at a macroeconomic level.

When implemented well, corporate governance builds confidence in capital markets. This is especially important in the context of high anticipated growth rates in many emerging economies such as those in the ASEAN region.

Understanding the relativities between countries when it comes to robust CG frameworks helps businesses and their boards understand how and where to trade effectively and profitably in an interconnected world.

This outcome is good for shareholders, businesses and the communities they serve.

Effective corporate governance and organisational integrity is now a key reputation issue, particularly for large multi-national companies. It is essential to understand how businesses are operating across borders and how corporate governance might be used as a competitive asset. But there is also a regulatory dimension.

Just as boards set the 'tone at the top' for the companies they govern, market regulators and policy makers do the same with the corporate governance instruments and requirements they set.

Australia in the leading pack

It's clear that Australian businesses are getting the message about the power of good corporate governance. Out of the 25 countries surveyed, Australia ranked equal fourth for its corporate governance regime, only outranked by the UK, the US and Singapore. This is particularly interesting given Australia does not have the regulatory overlay present in the UK or US markets. There is a significant commitment in Australia to reducing red tape around corporate governance and utilising a strong principles-based approach, which appears to be working well.

For the purposes of the survey Australia's CG was defined as consisting of three core elements – *Corporations Act 2001, ASX Listing Rules and ASX Corporate Governance Principles (2014)*; encouragingly, Australia has reviewed its CG principles three times since its introduction. We are strongly aligned with OECD principles – ranking fourth on this measure having adopted 63 percent of OECD related principles and 56 percent of better practice principles.

Effective corporate governance and organisational integrity is now a key reputation issue, particularly for large multi-national companies.

Strengths and opportunities

Against this backdrop, there are some key areas of strength that boards need to build on and some key opportunities for improvement. While Australia scored well in terms of board diversity, there is still a way to go on this front. According to the Australian Institute of Company Directors (AICD), the latest percentage of women on ASX 200 boards is 20.1 percent (31 July 2015)[1], so we're still a long way from the AICD's 30 percent target.[2]

Diversity goes beyond the inclusion of more women however. Securing the right blend in terms of age, ethnicity, experience and skill-sets are also important factors, in a global and digital world where customer bases can be more diverse and transient. Boards and executive teams entirely composed of individuals from similar backgrounds may not be ideally suited to understanding this evolving landscape, and can also succumb more easily to 'groupthink'.

Australia was also a high scorer in terms of remuneration committee activity and clarity around the role of the board. However, risk governance is a key area requiring improvement. Our companies need to demonstrate far more explicit disclosure of strategy, risks and going concern linkages; more detailed analysis of risk appetite considerations is required and businesses should consider governance reporting from a group perspective and disclosing material risks in joint ventures and associates.

Another key area that Australian business needs to strengthen relates to Directors' time and resources. Australia did not score particularly well on this measure. Some key things for boards to think about include: considering requirements to limit the number of concurrent directorships and strengthening disclosure around other commitments; being more explicit around the frequency of board meetings and the types of information required, including around board protocols and better training.

1. AICD Statistics.
2. AICD Media Release 9 April 2015.

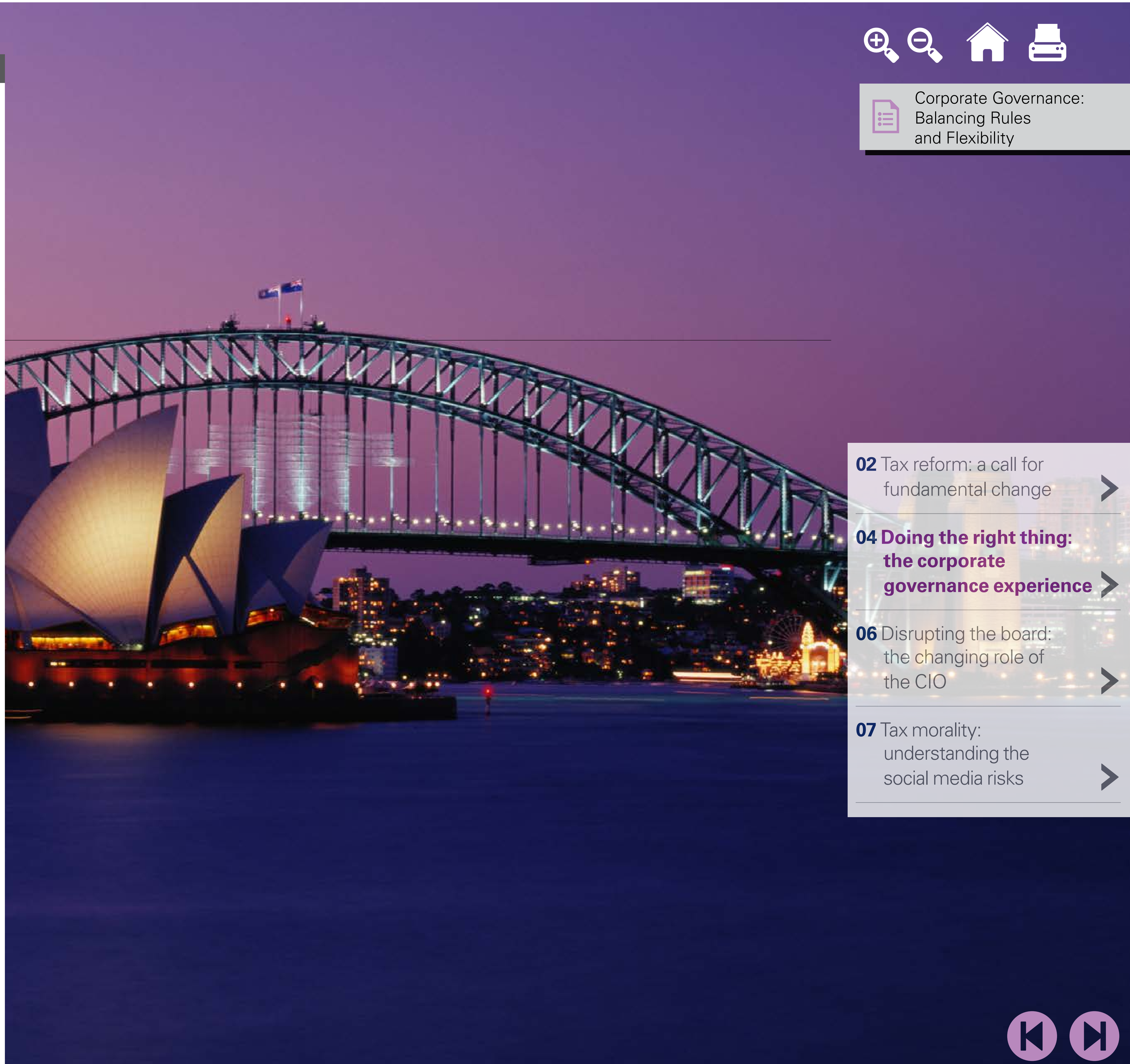
Doing the right thing: Australia and the corporate governance experience *(cont.)*

Finally, assurance levels can be enhanced in Australian companies. While external audit is mandatory, internal audit is not. Requiring an internal auditor to independently report to the audit committee would be a good step for Australian businesses. I believe an internal audit function that delves into core processes and has the required independence is a sign of real strength.

Introducing CEO/CFO assurance on risk management and internal controls system should also be on the agenda, along with being more transparent about evaluating and dealing with internal controls systems weaknesses. I would also like to see a more explicit approach to whistleblowing policies and systems.

It is pleasing to see Australia in a leading position when it comes to corporate governance. But we can't rest on our laurels. Regulators and policy makers must continue to review corporate governance requirements to help ensure they remain relevant, adequate and effective. As the business environment changes around us, we need to continually improve our own controls to maintain an efficient competitive edge.

There is a significant commitment in Australia to reducing red tape around corporate governance and utilising a strong principles-based approach.



Technology as an enabler of growth

Disrupting the board
The changing role of the CIO

Richard Marrison
Partner in Charge,
Technology

The impact of digital disruption on the role of the Chief Information Officer (CIO) is an issue that many organisations in Australia are currently exploring. As new technologies impact the nature of the relationship between the CIO and the business, they also have the potential to change the relationship between the board and the CIO and the board and the broader IT function.

The advent of cloud, mobile, the Internet of Things (IoT) and Big Data as key business enablers has meant far greater scrutiny on the IT function at board level, with both C-level executives and board members now requiring more from the CIO in terms of information and transparency. A dramatic increase in security and cyber threats has exacerbated this trend and created far more desire for engagement from the board.

In the *2015 Global Audit Committee Survey*, many audit committee members continued to express concern about the information they receive (at the audit committee and full board level) related to cyber risk and technology change, growth and innovation, and possible disruption to the business model. Tellingly, the CIO ranks lowest in terms of quality interaction and communication with the audit committee. In Australia, 18 percent of Australian survey respondents indicate that the quality of the communication with CIOs needs improvement, compared with only 3 percent for CFOs[2].

So what does this all mean for the board itself and for CIOs?

Boards need to embrace a digital culture

Given the strategic role of technology in delivering value and growth – and the scale of impact security and cyber threats can have across organisations – boards can no longer abrogate all responsibility for the IT function to the CIO. They need to understand how technology is enabling their business strategy, the business case for using certain technologies and how to embed a digital culture in their organisation. As our *2015 Global Audit Committee Survey* revealed, boards are alert to this need, with 60 percent of Australian respondents indicating they should spend 'more' or 'significantly more' time on the pace of technology change and 58 percent on cyber security, including data privacy and protection of intellectual property[3].

Companies that want to be innovative, digitise and integrate their processes, create a seamless customer experience across a range of channels and capture and analyse their customer data need board members that are willing to keep abreast of the latest trends and opportunities and to support the executive team to re-orient the organisation around technology.

At the very heart of creating a digital culture is the board's willingness to foster and facilitate cross-functional collaboration, both within and outside the organisation, to achieve the desired outcome. Transforming an organisation, creating value and growing via digital means a new level of collaboration within the business and with new and existing suppliers. It also means forging new relationships with customers and building new loyalty. There's some degree of risk involved in this kind of reorientation and the board needs to be fully committed and supportive.

Given the strategic role of technology in delivering value and growth... boards can no longer abrogate all responsibility for the IT function to the CIO.

Boards need to create safe environments for innovation

Innovation comes with a price and boards need to be willing to create a culture where the IT team and the CIO can fail safely – this is the only way their teams can test and learn properly. This does not mean extending carte blanche to the CIO and IT team to do whatever they want, but understanding the business case for pursuing a specific platform, channel or product innovation and then enabling the team to test appropriately.

Creating powerful engagement with the board

For CIOs, the changing digital environment and their changing vision means creating a new kind of relationship with the board. CIOs need to be able to communicate clearly with the board – and not get bogged down in technicalities, but focus on how various innovative solutions align with overall business strategies. It's paramount that CIOs learn to create powerful business cases and communicate in a language that resonates with the board.

This starts with a change of perspective from the CIO – CIOs need to see themselves as running a digital business, not an IT team. In terms of strategic impact, there is some good news. In recent years, we have seen the relevance of the CIO in the boardroom steadily advance[4].

As technology evolves, the conversation between the board and the CIO will also keep changing. CIOs must keep lines of communication clear and open – and not be afraid to either challenge the status quo – or be challenged.

2 & 3. 2015 Global Audit Committee Survey.
4. Harvey Nash CIO Survey 2015 in association with KPMG.

Tax morality: Understanding the social media risks

Stephen Callahan
Tax Management Services Leader

Greg Daniel
Director, KPMG Digital Consulting Services

Much of the recent debate around Tax morality – as opposed to Tax legality – has been driven and prolonged by social media commentary.

This social media and also the political focus on tax has firmly moved it into the public eye. Even the most highly technical of tax terms now find themselves being publically debated.

As a result it has become imperative for boards and management to comprehensively understand what is being said about their companies on this most powerful and pervasive of mediums – social media. Because it is there that the concept of a 'Social License to Operate' is being prosecuted most aggressively. It is where the reputations of companies are being called into question on a daily basis.

The latest challenge to corporate reputation is in relation to corporate tax paid in Australia. It is of little use arguing the legality of what a company has done in this regard – as many executives appearing before the *Senate Inquiry into Corporate Taxation* have discovered.

The public debate has already moved on to one about 'ethics', 'fairness' and corporate 'greed'.

The battleground for that debate is social media.

Business now operates in an environment where news travels at lightning speed.

Understanding social media risk

Business now operates in an environment where news travels at lightning speed, the latest information is at our fingertips, and every person has the power to make their voice heard. This spider web of collaboration and information exchange in social media is used to make and break news about an organisation. Even the best practices in governance, risk and compliance has left both regulators and corporations struggling to keep pace in managing their approach to risk, hanging on to outdated or uniformed thinking will only amplify this risk.

A 2013 survey by KPMG International, *Expectations of Risk Management Outpacing Capabilities – It's Time for Action*, of more than 1,000 C-level executives across multiple industries, revealed a real concern about the risks associated with social media, and the organisation's ability to respond.

More than 2 years later, this finding continues to be echoed time and again in conversations with Australian clients across all sectors.

To successfully manage social media risks, business should first seek to understand and establish if there is a distinction between social media marketing and social media risk management. Part of this process includes deciding at which point an issue on social media becomes risk.

Social media should be seen as a contemporary risk, an extension of traditional risk issues that businesses have been dealing with for decades. Of course, this modern risk presents new problems and challenges. However, it should be approached with the same rigour and considerations of other risks.

Social media risks can be internal, external or a mixture of both. Social media activity can accelerate risk but also arise from unintended or unplanned events such as product recall, supply chain risk, reputational damage or operational issues.

Management and boards need to understand the various impacts that social media can have on the organisation.

The management of social media risk does not stop at a review of social media controlled by the organisation, but must also include external, publically available information and commentary relating to the organisation and its operations across social media.

A business should have in place proper processes to identify emerging current social media risks facing the organisation, including a governance framework, incorporating a formal review of current external facing social media assets operated by the organisation.

Next, the business needs to ensure that the appropriate policies and procedures are put in place in order to appropriately manage ongoing social media risk. Management and boards need to understand the various impacts that social media can have on the organisation, not just from a brand and reputation perspective, but from one that encompasses broader risk categories.

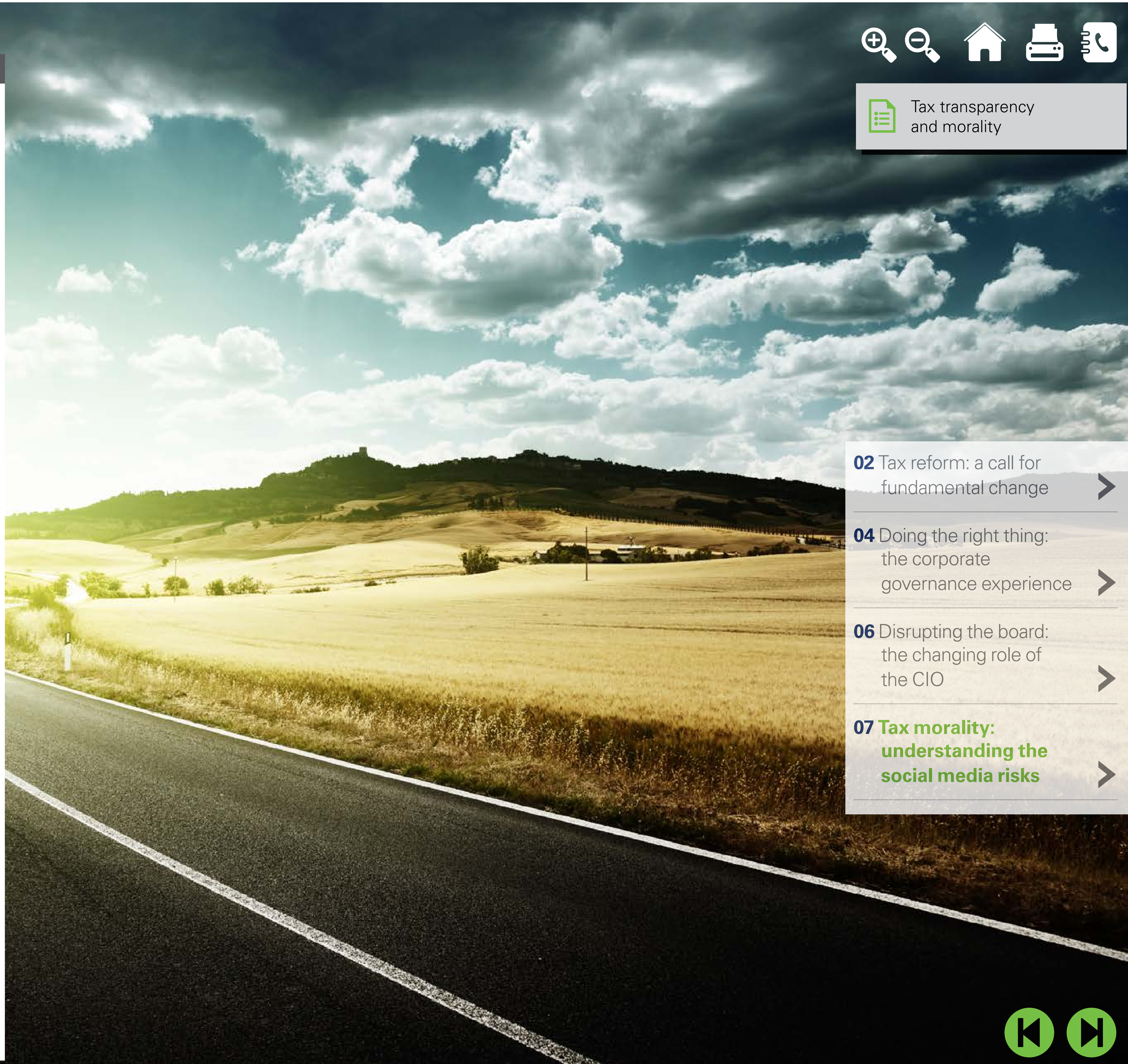
Social media has moved beyond a marketing tool or a gossip channel among friends, to a powerful and necessary component of governance, risk and compliance and reputation management.

The modern consumer and employee possess more computing power in their smartphone than in the original computer the size of a room 20 years ago. This increase in mobile computing power has given access to nearly limitless information and the ability to upload, share and publish in just about any location. The opportunities of this development are substantial, as are the risks.

The current debate about tax and the role social media will play in regard to the reputation of your company is one that cannot be underestimated.

The most common company response to the social media debate on tax is that organisations comply with the law, and pay the legally right amount of tax in all countries. In light of new ATO guidance on the subject, two key questions have emerged for boards which now have explicit responsibilities for tax governance and compliance:

1. How are you attesting that your business has the core internal foundations in place to file correct tax returns?
2. How do you ensure the design and operating effectiveness of these controls are being tested?



Tax morality *(cont.)*

Without this assurance, and especially if your tax returns are being amended or adjusted, the assertion of paying the legally right amount of tax could be subject to challenge.

The time to understand your own tax risk and compliance approach in Australia and beyond, including how to articulate it correctly and openly to your stakeholders, whether it be at the Senate, on social media or 'down the pub', is now.

About the authors

Stephen Callahan has over 20 years' experience with KPMG and was previously based with KPMG in the UK. He has held numerous roles at the global and ASPAC regional level with responsibilities in the areas of tax risk management and tax performance. He has significant experience in helping both large and small multi-nationals create sustainable improvements in global tax processes, and has undertaken tax SOX, governance and process improvement projects across all sectors and sizes of business.

Greg Daniel is one of Australia's most experienced marketing communications executives. He is at the forefront of KPMG's Digital Consulting Services. In 2008 he founded SR7, widely recognised as Australia's leading social media intelligence and research firm. With clients ranging across blue-chip listed companies, government, not-for-profit organisations and agencies, KPMG established a successful strategic alliance with SR7 mid-2012 which saw SR7 join KPMG early in 2014.

Further Information

Boardroom Questions

The challenges facing non-executive directors are wide ranging. KPMG's Boardroom Questions series captures some of the key issues for boards today, the questions board members should ask and the actions they can take to address them.

Newly released:

A sustainable approach to regulatory compliance – We look at the challenges being faced through regulatory compliance and how boards can become more proactive in this area.

Balancing third party risk and return – This paper discusses the types of risks incurred by third parties and the potential benefits and consequences for the organisation.

A global deal on climate change –This paper outlines the driving force behind the *Sustainable Innovation Forum 2015* (known as COP21).

The Directors' Toolkit

To support directors in their challenging role, KPMG has created *The Directors' Toolkit*. This guide, in a user-friendly electronic format, empowers directors to more effectively discharge their duties and responsibilities while improving board performance and decision-making.

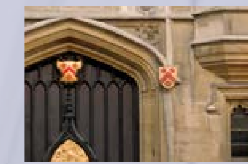
What's New

In this latest version, we have included newly updated sections on:

- **Government** – Responsibilities and expectations of government directors differ from those of their corporate counterparts.
- **Corporate Sustainability** – The emerging oversight responsibilities of directors in corporate sustainability.
- **Health & Safety** – Setting a well-designed health and safety strategy leads not only to an engaged workforce, but a productive one too.

To find out more about the toolkit please register to download it today.

KPMG's Audit Committee Institute



KPMG has established an Audit Committee Institute (ACI) to help committee members keep up with relevant business issues and generally enhance audit committee practices and processes.

The Institute:

- Conducts regular ACI Roundtables that function as a forum and ideas exchange for audit committee members.
- Publishes the findings of local and overseas surveys of audit committee practices.
- Produces the *Across the Board* newsletter for audit committee members and other directors.
- Hosts special interest workshops (e.g. financial reporting requirements).

Contact KPMG's Audit Committee Institute for more information.