November 2015

Across the Board

A newsletter for Australian Directors

Features

KPMG

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Across the Board November 2015

What role does trust play in Australia's taxation system? Following the Senate Inquiry into Corporate Tax, we explore the implications.

In this new edition we also view the trend towards 'de-cluttering' among ASX200 companies. We unveil key findings from the recent Global KPMG Audit Committee Institute survey on boards, and get you prepared for the ATO's release of tax paid by companies with turnover of $100 million-plus.

If you would like to discuss any articles in more detail, please contact me or your local KPMG partner.

We hope you find this edition of *Across the Board* gives you the extra insight you need.

Peter Nash
National Chairman,
KPMG Australia

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

Tax reform: KPMG's submission to Treasury

Trust and the Senate Inquiry on Corporate Tax

Grant Wardell-Johnson
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At Davos in 2009 an Indian economist, Montek Singh Ahluwalia, said "confidence grows at the rate that a coconut tree grows, but confidence falls at the rate that the coconut falls".[1] And so it is with trust. Particularly trust in a taxation system.

There is a trap that many developing countries face acutely, but is part of the fabric of our own society. It is about people's propensity to pay tax: the compliance rate. Most people are happy to pay tax if they believe that other people are paying theirs and the tax collected is properly spent. If these conditions are not satisfied, not paying tax may be seen to be rational or at least rationalised.

What seems rational for an individual can be very harmful for society: clearly less revenue for health, education and infrastructure, but also through flow-on effects to other ethical domains in society.

Trust lies at the very heart of our taxation system.

In a fundamental way the Senate Economics Reference Committee Inquiry into Corporate Tax Avoidance is about trust. The inquiry arose following the release of a report in September 2014 on the tax collected from the ASX 200. It was written jointly by the Tax Justice Network and the trade union, United Voice which was formerly the Liquor, Hospitality and Miscellaneous Workers Union.

The Senate Inquiry has received 123 submissions. There were four hearings in April and one in July, with interviews of the ATO, Treasury, ASIC and the OECD, 18 corporates, two trade unions and a faith group, three umbrella organisations including the BCA, four academics and the Big 4 accounting firms.

A report was released on 18 August 2015[2], variously described as an interim report or Part 1. It contains a subtitle, 'you cannot tax what you cannot see'. Many of the 17 recommendations deal with transparency and disclosure. There is a dissenting report from the government.

Further hearings took place on 18 November 2015 involving nine oil and gas companies, Uber and Airbnb and the Big 4 accounting firms. The final report is due on 26 February 2016. We are told that the final report will focus primarily on transfer pricing and profit shifting, with a secondary focus on:

- excessive debt loading
- foreign companies avoiding permanent establishment in Australia
- the use of tax havens
- exemptions from general purpose accounting
- the role of private accounting firms in tax avoidance.

This timing of the final report will coincide with the release on the ATO website of the accounting income, taxable income and tax payable of public companies with a turnover of greater than $100 million.

Significant publicity will abound. This brings us back to the role of trust.

In one sense the report is ostensibly about enhancing trust in our taxation system. However, there is a significant risk that the commentary surrounding it will undermine community trust in a bald and un-nuanced manner giving rise to broader damage with adverse impacts to the compliance rate that will damage us all.

Trust in the taxation system is a delicate egg and each of us must treat it with care.

For business, it means dealing honestly and clearly with the public and media and avoiding spin without substance. Decisions need to be made with broader stakeholder interests in mind. Some invoke a narrow concept - often taught by finance personnel in business schools - that the fiduciary duty of management is merely to maximise short-term shareholder returns. If it still exists in the boardroom, it needs to be replaced with broader strategic thinking. This is particularly true given so many business models are dependent on public trust.

For civil society, there is an obligation to use statistics with integrity and not in a manner designed to sensationalise through misleading data.

For advisors, it is imperative that they think beyond the confines of black letter law and bring reputational issues into their paradigms for providing advice.

For politicians, it is important that they consider the nuances and practicalities of the business world in which we operate and the veracity of most of us in it. Politicians need to make a genuine, considered and measured effort to look for solutions to nuanced problems. And not themselves be a salvific solution in search of a problem.

With each of us playing our part we will see greater growth in our coconut tree of trust. With the alternative, we all lose.

Trust in the taxation system is a delicate egg and each of us must treat it with care.

1. http://blogs.reuters.com/davos/2009/01/31/of-confidence-and-coconut-trees/
2. www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Corporate_Tax_Avoidance/Report_part_1

A new era in corporate reporting – ASX200

A new era in corporate reporting

Annual financial reports have finally become understandable!

Bernie Szentirmay
Partner, Audit and Assurance, KPMG

KPMG recently released its survey of *Corporate reporting and de-cluttering trends among ASX 200 companies*. While our equivalent survey in the prior year revealed that the de-cluttering of financial reports had started to take place in the market, this year's survey revealed that a significant number of companies had embraced the move to enhancing financial report structure and clarity. Companies including Downer EDI, Amcor, Origin Energy, Asciano and Transurban all restructured the presentation of accounts disclosures and streamlined report content.

Key changes to the annual financial report of companies that have embraced de-cluttering include:

- grouping of notes into a more common-sense structure which better explains the company's financial performance and risk management disclosures
- removal of immaterial or duplicated disclosures
- use of section descriptions and call-out boxes to help better explain key information including critical accounting judgements and estimates.

Feedback from management, directors and other stakeholders has been very positive. This is not surprising given important financial information is more clearly presented, and the length of the financial report and/or number of notes generally significantly reduced. With many more organisations planning to de-clutter their annual financial report in the current reporting period, we suspect that those companies that stick with the status quo run the risk of being compared unfavourably to comparator organisations that have embraced de-cluttering. With both ASIC and the AASB publicly supporting the concept of financial report simplification, there is nothing stopping companies from getting on board this market trend.

What's next?

Companies are now turning their minds to other forms of corporate reporting that is in need of de-cluttering, simplification or re-alignment. These include:

- The remuneration report, which in many cases has ballooned in length as boards attempt to explain remuneration strategies to sceptical investors. The average length of the remuneration report within the ASX 200 is 18 pages, and there is opportunity to better articulate key issues such as the basis of short-term and long-term remuneration, and how this is linked to overall company performance. KPMG is talking to a number of companies who intend to review their 2016 remuneration report structure and content in this regard.
- The Operating and Financial Review, particularly where the focus is on compliance with ASIC Regulatory Guide 247 rather than explaining the company's performance, strategies and risks in a more coherent and consistent manner.
- Other forms of corporate reporting including the remainder of the annual report, analyst presentations and market releases. The key here is consistency of approach, presentation and messaging.

We encourage companies that have or are de-cluttering their financial report to think beyond just the financials in order to maximise the benefit that de-cluttering provides. We also note that the concept is also relevant to entities other than listed companies including private companies, large not for profit entities and member owned entities such superannuation and health care funds. Any attempt to better articulate entity performance, use of funds and the way risks are managed can only be a step in the right direction.

Key results

50% of organisations have financial reports that are shorter in length than the prior period. This is genuinely a noteworthy achievement given increased disclosure from new accounting standards.

37% have reduced the number of notes to the financial statements, while others have clarified and re-ordered those notes to focus attention on the key items of disclosure.

Why not try the 3 Rs to cut the clutter?

Remove immaterial or irrelevant financial report disclosures that have built up over time.

Re-order and re-label accounting policy and detailed notes so that they better reflect the key financial measures and focus areas of most relevance.

Re-write technical wording into plain English, whilst still fully complying with relevant accounting standard and regulatory requirements.

With both ASIC and the AASB publicly supporting the concept of financial report simplification, there is nothing stopping companies from getting on board this market trend.

Related videos
> Making tax a priority for boards
> Reputational risk: Boards need to focus on tax

Tax in the spotlight

Is your company tax ready?

Stephen Callahan
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The Australian Tax Office (ATO) is at the forefront in the debate on tax administration and corporate governance. The release of its *Tax risk management and governance review guide ('Guide')* in July 2015 provides guidance to large organisations on the best practices the ATO believes underpin good tax management. Additionally, the ATO will publish revenue, taxable income and taxes paid by all public and inbound companies in Australia with over $100 million in turnover. This will add to the confluence of factors already bringing companies under scrutiny on tax.

The dynamic and changing tax environment is transforming the approach companies are taking to manage tax and shedding new light on tax risk, with a growing focus by boards on reputation and brand risks. The implications are potentially far-reaching with more conservative tax risk appetites becoming a commonplace requirement boards now set for management.

What does the ATO '*Guide*' mean for boards?

The ATO's *'Guide'* has detailed specific responsibilities around tax for boards, including:

- the board is responsible for defining the company's tax risk appetite
- the tax risk appetite is to be articulated from both a strategic and operational perspective, defining an acceptable level of tax risk for day-to-day operations and appropriate escalation practices
- the board oversees testing of the tax control framework to ensure that it is operating effectively
- there is a suggestion that the board be transparent about the company's tax risk appetite, including a statement in the company's annual report attesting it has effective policies and processes in place to manage tax risk.

Although the '*Guide*' is not compulsory, boards should consider the brand and reputational impact of not considering and/or complying with the benchmark it sets, as the local and global focus on tax transparency of not only taxes paid but of tax governance itself ramps up in the months ahead.

How can boards be 'tax ready'?

Board's need to ensure they are 'tax ready' to respond to the increased transparency of tax data, as well as the new ATO *'Guide'* which will increasingly become a reference point for good stewardship of tax matters as tax payments by corporates come under the spotlight.

Inevitably, gaps against the *'Guide'* will exist for most organisations. Developing a framework which defines an organisation's tax objectives and tax risk measures within the context of the organisation's strategic and commercial objectives is essential. It needs to engage all areas of the organisation and effectively define and manage all tax risks affecting the organisation, from the traditional regulatory risks to the emerging but significant reputational and brand risks. The allocation of responsibilities for tax risk under a board-endorsed framework is also critical to effectively manage known and hidden or unknown risks as they come to light.

The *'Guide'* is also specific in mentioning operational risks. These risks differ to the more traditional strategic risks around uncertain tax positions, and instead go into the nuts and bolts of making sure the numbers and information feeding into the various tax returns are complete and accurate. These risks can be significant for transactional tax areas. They are also not usually the realm of the Tax Function, and so need to be explicitly managed alongside other tax risks with board oversight.

The publication by the ATO in December of companies' tax information – revenue, taxable income and taxes paid – will be reported heavily by traditional media outlets and discussed at length on social media. Even if an organisation's numbers 'look good', it doesn't necessarily translate to a negligible tax risk. Questions may be asked around local versus global margins and also why peer companies have larger margins locally. Boards should be well-prepared for questions on this topic and carefully monitor developments during and after publication including if and when to provide additional supporting information.

Responding to the ATO *'Guide'* is one way to help enable an organisation to prepare, and is a positive point of reference for companies to demonstrate they are doing the right thing. Boards also need to ensure they have a clear plan in place to respond to stakeholders, be they customers, employees, the media or shareholders. Senators recently coined the term 'passing the pub test' as a benchmark for paying tax. The personal reputations of Non-Executive Directors are also at stake as individuals are asked at parties, barbecues or down the pub whether the organisations they represent are paying their fair share of tax.

Lack of clarity from organisations, even when the numbers do 'look good', can sometimes result in misinterpretation. Keeping track of this on social media, before the matter escalates, can enable companies to engage with stakeholders early on and set the record straight. Companies should monitor all related media, in particular social media where the tax debate has already become highly topical. In October, Australian videos naming and shaming a number of brands on tax have already gone viral with one video having been so extensively shared online, it had been viewed over two million times on Facebook alone in less than a fortnight.

Although the board and many stakeholders perceive tax as a single 'black box' concept, in reality it is multifaceted, diverse and complex and requires a clear approach from the top down. Regulators are doing more to encourage good tax risk management and new stakeholders such as the media and public are holding companies to account for what they pay with increasing demands on transparency. This is transforming the environment and presenting new risks Tax Functions and organisations at large are not accustomed to managing. The time for boards to get tax ready is now.

Calibrating strategy and risk

A Board's eye-view

Chris Hall
Co-Chairman, KPMG's Audit Committee Institute

Paul McDonald
Co-Chairman, KPMG's Audit Committee Institute

Corporate boards are deepening their involvement in company strategy and refining their oversight of the critical risks facing the company, according to a recent global survey from KPMG, [Calibrating strategy and risk: A Board's-eye view]

The survey of over 1000 company directors and senior executives globally revealed how boards are helping their organisations calibrate strategy and risk, where they are deepening their engagement and where the biggest challenges and concerns are.

More than half of respondents said their board has increased its involvement in the formulation of strategy alternatives and sharpened their oversight of the critical risks facing their company as global volatility rises.

Rather than an annual decision by management and the board, strategy is becoming an ongoing discussion, with continual assessment, evaluation and adjustment as conditions change.

Notwithstanding, significant challenges remain, including linking strategy and risk, and addressing growing cyber security risks.

The survey revealed:

- **Boards continue to deepen their involvement in strategy – including execution.** Some 80 percent of survey respondents said in the past 2 to 3 years there had been an increase in consideration of strategic alternatives, monitoring execution, devoting more time to technology issues (including cyber security), and recalibrating strategy as needed.
- **Effectively linking strategy and risk continues to elude many boards.** As most board members and business leaders will agree, strategy and risk go hand-in-hand; without risk, there's no reward. However, according to most respondents, considering the two together continues to be a challenge. Only half of respondents are satisfied that strategy and risk are effectively linked in boardroom discussions. Risk-related decisions, many said, would be most improved by more closely linking strategy and risk, as well as having a more clearly-defined risk appetite, better assessment of risk culture, and giving greater consideration to the 'upside of risk taking' (versus risk avoidance).
- **Better risk information and access to expertise are (still) top of mind.** Many boards have recently taken steps – or at least discussed ways – to strengthen their oversight of risk, mainly by improving risk-related information flowing to the boards. Other measures include taking on independent views, refreshing board/recruiting expertise, coordinating (and reallocating) risk oversight responsibilities among the board's committees, and/or changing the board's committee structure.
- **Cyber security may require deeper expertise, more attention from the board, and potentially a new committee.** Engaging third-party expertise and more advanced technology expertise on the board would improve oversight of cyber security, survey respondents said. Nearly one in three respondents said cyber security needs to have more time on the full board's agenda, despite the increased focus on cyber security as a critical business priority. Around a quarter of respondents said formation of a new committee to address technology/cyber risks would be beneficial.
- **Oversight of key strategic and operational risks could be more effectively communicated among the board and its committees.** The potential for fragmented oversight – with critical risks falling through the cracks – continues to pose challenges, particularly given the scope and complexity of risks facing companies.

Views on the quality of committee reports were mixed, ranging from more perfunctory than substantive to 'increasingly robust'. Nearly half of respondents suggest there is room to improve the communication and coordination among the full board and its committees on oversight of the company's key strategic and operational risks, for example:

- CEO succession
- talent
- regulatory compliance
- cyber security and emerging technologies
- supply chain issues.

Many boards are striving to better coordinate their risk oversight activities, with definition of their responsibilities, regular communication among standing-committee chairs, and overlapping committee memberships or informal cross-attendance.

The findings from this Global survey are consistent with the discussions KPMG Australia is having with directors around the country, as boards look to keep pace with the increasing complexity of the business and risk environment.

With volatile markets, technological advances and cyber threats rife, boards are drawing on their expertise more than ever to balance strategy and risk.

Calibrating strategy and risk *(cont.)*

Key findings

Q. In what areas (if any) has the board's involvement in strategy increased over the past 2 – 3 years?

- **53%** Formulation of strategy alternatives/ consideration of strategic alternatives
- **47%** Monitoring execution
- **35%** Recalibrating strategy
- **33%** Devoting more time to technology issues, including cyber risk

Q. How satisfied are you that risk and strategy are effectively linked in boardroom discussions?

- **44%** Satisfied
- **31%** Somewhat satisfied
- **14%** Not satisfied
- **10%** More than satisfied

Q. What would most improve the company's risk-related decision making?

- **53%** Closer linkage of strategy and risk
- **41%** A more clearly defined risk appetite
- **35%** More effective promotion and assessment of a company's risk culture
- **33%** Greater consideration of the 'upside' of risk taking (versus risk avoidance)

Q. What would most improve the board's oversight of cyber security?

- **51%** Greater use of third-party expertise
- **40%** Deeper technology experience on the board
- **30%** Full board devoting more agenda time to cyber risk
- **23%** Formation of a new committee (to address cyber and technology risk)

Q. How satisfied are you with the communication and coordination between the board and its standing committees regarding oversight of activities around the company's key strategic and operational risks?

- **44%** Satisfied
- **31%** Somewhat satisfied
- **11%** More than satisfied
- **11%** Not satisfied

Q. What steps has the board discussed or undertaken recently in light of the increasing complexity of the business and risk environment?

- **61%** Improving risk-related information flowing to the board
- **35%** Better coordination of risk oversight activities among the board and its committees
- **25%** Hearing more third-party/independent views on the company's risks
- **19%** Changes to the board's committee structure/ creating new committee(s)

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.

Now available:

- A global deal on climate change
- A sustainable approach to regulatory compliance
- Balancing third party risk and return
- Cyber security – what does it mean for the board?
- Are you the disrupter or being disrupted in your industry?
- Strategy – where to play and how to win
- Talent management… or talent risk
- Transform or wither: Change is the new normal

The Directors' Toolkit

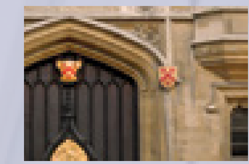
To support directors in their challenging role, KPMG has created *The Directors' Toolkit*. This guide, in a user-friendly electronic format, empowers directors to more effectively discharge their duties and responsibilities while improving board performance and decision-making.

Key topics:

- Duties and responsibilities of a director
- Oversight of strategy and governance
- Managing shareholder and stakeholder expectations
- Structuring an effective board and sub-committees
- Enabling key executive appointments
- Managing productive meetings
- Better practice terms of reference, charters and agendas
- Establishing new boards

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.