KPMG

# Kundu

# November 2020

## Foreword

This month we have a very interesting read.
At the time of writing this month's newsletter the outcome of the court case is not yet known and the implications for the 2021 Budget recently handed down is not yet clear. Pending these uncertainties, we have included below an extract from our KPMG 2021 Budget Commentary, the full details of which may be viewed on our LinkedIn page.

We also discuss the importance of corporate strategy, the considerations of an interactive internal audit plan, and some thoughts around 2021 IRC activities to look out for.

KPMG in PNG has dedicated in-house specialists in all of the following areas: internal audit/risk, visa migration, corporate finance, management consulting, IT advisory, fraud investigation as well as tax and assurance. As such we are well placed to provide a truly multi-disciplined approach to business advisory.

Please enjoy this month's Kundu and reach out to us at +675 321 2022 if you would like to see KPMG cover specific topics in future editions.

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## Budget 2021 commentary

At the time of writing this month's newsletter the outcome of the court case is not yet known and the implications for the 2021 Budget recently handed down is not yet clear. Pending these uncertainties, we have included below an extract from our KPMG 2021 Budget Commentary, the full details of which may be viewed on our LinkedIn page.

The 2021 Budget was delivered unexpectedly on the 23rd of November, 2020 with the usual Budget Lockup and briefing not occurring. In contrast with previous years, the budget documents were not distributed in the usual manner. This has certainly been a year of firsts, and against the backdrop of the global pandemic, very little would surprise business in this land of the unexpected.

The "Consolidation for Growth" message this year under the existing main theme of "Take Back PNG", focuses on the need to consolidate the vision in times of crisis. In this regard the Treasurer's speech makes specific reference to the country having been in an economic crisis since May last year and the effects of the current COVID-19 pandemic. On a positive note the 2021 Budget is described as a responsible and steady approach to debt and deficit levels, while demonstrating growth prospects, and the path to exit the current areas of crises.

The 2021 Budget is comprised of elements of the 2020 Supplementary Budget released in response to the COVID-19 impact and sets the stage for fiscal consolidation over the medium term. This Budget is once again a high deficit budget. In our commentary last year, we referred to the projected 2020 deficit of K4,631m as “eye-catching”, and this was certainly exacerbated by the Supplementary Budget deficit of K6,630m.

The K6,612m deficit projected for 2021 is perhaps more realistic if achieved, and in line with the actual outcome for 2020. This challenging deficit budget is comprised of revenue of K12,995m and expenditure of K19,607m. This will increase the level of public debt (excluding valuation changes and outstanding arrears) to K46,464m which is 51.5% of GDP. On a percentage basis, the planned revenue growth exceeds the expenditure increase by around 5%, and this element of claw back is consistent with the ‘consolidation for growth’ theme.

On the revenue side, the K12,995m budgeted is funded through mainly local tax collections of K11,110m and international donor aid of K1,008m. It is noted that international donors may have increased governance and fiscal requirements to provide facilities, such as SOE reforms. On the tax collection front, a point to note is the expected lag in revenue which is highly dependent on the timing of the start-up of resource projects, a point which is acknowledged by the Treasurer. There is therefore very little dependency on the resource sector as a major source of tax revenue over the next two years. It is notable that the Budget is silent on the potential introduction of a Production Sharing Contract regime and its effect on the investment appetite of resource majors.

On the expenditure side total expenditure rises from K18,726m to K19,607m. Health, education, and law and justice are the focus areas as in the past, with the increases attributable to COVID-19 and local debt arrears funding requirements. The payment of outstanding government accounts is vital to get the private sector up and running and availability of forex will continue to be important. The recently established Arrears Verification Committee appears to have made positive progress to start clearing long outstanding local business debt, which will serve to restore some trust in government and improve its ability to source goods and services. To date K143m of a thus far verified K657m in arrears had been repaid. In this vein, Government appears positive that the recent changes to the Central Banking Act will enable it to further improve cash flow management.

During the previous Budget it was noted that the public services wages bill, which is significant, continues to increase year on year. It is evident that a fundamental decision at the institutional level will have to be made in the coming years. It is telling that there is no mention of right-sizing the public service in the 2021 Budget although the compensation of employees cost projections to 2023 show a reduction which may be an indicator of some reform in this sector.

There are no real surprises on the tax front as certain expected tax reforms have again not been implemented. For example, not taken up were the proposal to abolish stamp duty on leases and hire purchases, tailored SWT filing and payment obligations, and mandatory EFTPOS use for sales exceeding K1,000 to avoid GST leakage. The only reform to be implemented is around the collection of prescribed royalty withholding tax directly from resource developers. As in previous recent Budgets there has been another reprieve from the introduction of capital gains tax and also of the rewritten Income Tax Act.

As in the past, with a deficit of this size, stakeholders and businesses need to understand how the deficit will be funded. K4,613m (c. 70%) is expected to be funded through external debt, with debt funding of K2,404m already secured, and the remaining 30% to be funded internally by issuing Government Securities and Bonds. The government appears to have identified potential sources of external debt funding for the remaining K2,209m yet to be funded. The resultant 52.5% debt to GDP ratio is catered for by the amendment to the fiscal responsibility legislation which moved the upper limit of this ratio to 60% from this year. The target has been set to return the debt ratios to below 40% by no later than 2030.

Generally, the government is very optimistic about an expected K18,000m increase in the economy over the next two years from the non-resource sector, and significantly boosted by the agriculture sector. Year on year growth of at least 10% per year is expected over the next two years, with an aspirational goal of becoming a K100bn economy in the not too distant future.

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## The right strategy is key to the success of any PNG organisation

### by Wayne Osterberg, Director, Advisory Services

Too many businesses and organisations in Papua New Guinea operate without a clear strategy. Whilst many entities have achieved success with a clearly defined and implemented strategy, you are likely to find that they have one, but it is just not well defined or communicated. In order for any organisation to have the best possible chance of success a strategy plan is essential.

A clear strategy is the pinnacle of the success pyramid of any entity. It sits atop the organisation and provides an intent and an overall game plan for the organisation to follow to achieve its objectives. It generally consists of a vision for the entity; a mission statement, which sets out how the vision will be achieved; and then the core values of that organisation, which will guide it in its internal and external interactions.

The strategy provides a framework for the next layer of the pyramid – the leadership of the organisation. It provides context for the board and the executives to base their decisions upon and to cascade down into operational matters.

That is the next layer of the pyramid – the policies and procedures of the organisation. These are the engine room of any entity – they provide the policies that are needed to guide behaviour and action. The procedures follow from the policies and provide the 'operational manuals' for its staff. The policies and procedures cover all aspects of human resourcing; technology, financial controls, limits of authority, and the like and are essential for a successful operating entity.

It is important to note that none of these layers are static or fixed. Just as the operating environment changes over time, so an organisation must revisit its layers for success to ensure that they adapt to meet the changed conditions. The corporate strategy should be revisited every three to five years. Leadership needs constant attention and renewal and refreshment. Policies and procedures are more dynamic and require annual refreshment to ensure they are robust and relevant.

The other aspects of a successful organisation flow from the implementation of the above three layers and, if implemented correctly, will generate key performance indicators for the entity which will encompass and address the following factors which are critical for success:

- Financial strength
- Service delivery
- Team motivation
- Client or stakeholder engagement
- Public perception

Generating a clear strategy for an entity involves five steps:

1. Consider the environment in which you operate. This requires the identification of all the external factors that could impact your organisation. Commonly considered through a PESTLE analysis (Political, Economic, Social, Technological, Legal and Environmental).
2. Have a critical analysis of your organisation. What are your strengths and weaknesses? Be honest and be detailed. What threats does your entity face and what opportunities can it take advantage of?
3. What are your competitors doing? What is their strategy and how do you want to position yourselves relative to them?
4. From these previous three steps, you will be able to articulate what you as an organisation want to achieve. What is your vision, mission and guiding values? What opportunities do you want to take advantage of? How will you counter the threats you have identified? How will you leverage and develop your strengths? How will you minimise your vulnerability to the weaknesses?

The final step is arguably the most important one in terms of translating strategy into success. This is the implementation plan. How you translate your strategy into specific objectives. How you determine who will take responsibility for each piece of the implementation. What are the specific objectives, who will be responsible for them, how will success be measured and when? The devil, as always, is in the detail.

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## Internal audit planning – is your audit plan interactive?

### by Eugene Michelo, Manager, Advisory Services

Historically, Internal Audit was viewed as out to catch people. Internal Audit was process and product driven and staff were viewed as guilty and had to prove themselves innocent. There was little focus on risk and employees were viewed as workers rather than employees.

Over the years, organisations have evolved with increasing process and product automation and people have become the core of their success. With its people having more influence on service and product quality, business risks such as fraud, operational losses and inefficiencies, and market failure etc have also evolved and become more complex.

As Internal Audit would need to provide assurance on the current and emerging risks, they would need to ensure the annual Internal Audit plan considers all key risks and stays relevant. Therefore, Internal Audit managers could consider taking an interactive approach to ensure their Internal Audit reviews offer value to the business.

Internal Audit managers could consider the following;

- Engaging all key executives and heads of functions within the business on a frequent and continuous basis. This would enable the Internal Audit managers to have a current view of activities within the business and they would be more equipped to anticipate risks and prioritise areas of focus.
- Review all major risk incidents within the organization such as fines, fraud, operational losses etc. This would give them a view of risk trends and would provide input to the audit plan.
- Internal Audit managers would need to ensure all key processes and activities within the business are current and update the audit universe. Having an updated audit universe would ensure Internal Audit managers have a top view of the business and would make the Internal Audit plan more focused.
- Available resources to execute the plan should be considered. A realistic plan that is achievable would enable Internal Audit to provide quality assurance to its stakeholders.

Internal Audit managers should avoid scope creep and stick to the plan. However, in the event of significant changes, there should be an allowance for flexibility to adjust the plan to keep it relevant.

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## Projections for IRC activity in 2021

The recent 2021 Budget projected c. 85% of revenue to come from tax take next year. To achieve this the IRC will need to focus heavily on revenue collection and IRC audits during 2021. This year saw their activities hampered by the Covid 19 pandemic however we have already seen an uptick in IRC activity in recent weeks with IRC officers sent out to the provinces for three weeks on a data and revenue collection exercise. It is strongly recommended that taxpayers get their tax returns and payments up to date and ensure their tax processes are in order.

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## Our social media presence

As usual, you may access our regular multi-disciplined thought leadership pieces, newsletters and updates on our KPMG PNG LinkedIn page. Also connect via our webpage www.kpmg.com.pg and Facebook https://www.facebook.com/pngkpmg/

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