Foreword

As KPMG is the only professional services firm in PNG with dedicated in-house specialists in all of the following areas: internal audit/risk, visa migration, payroll, corporate finance, management consulting, IT advisory as well as tax and assurance, we are well placed to provide a truly multi-disciplined approach to business advisory. We hope you enjoy our regular KPMG Kundu.

Cyber security – More than a buzzword

by Anton van Tonder, Manager and Leonisa Bosimbi, Senior Consultant – IT Advisory

Nowadays with constantly changing and evolving technology, public and private sector entities must manage their cyber risks proactively. It is vital that senior management and business leaders understand their cyber strategy, the defences in place to prevent a cyber-security incident and their capabilities to recover from an incident.

Although most companies in Papua New Guinea cannot imagine being the victim of a cyber-attack, the fact that these kind of attacks are constantly evolving means that any business with an online presence could be targeted. All organisations need to be aware of the possible impact of an incident.

Unfortunately a determined adversary could succeed no matter how good an organisation's defences are. As a result all entities should have the capability to identify when an attack was successful or whether an attack is imminent.

However, it is important to understand that the fundamental control and governance principles to manage cyber security have not radically changed over the last 20 years. The basic combinations of technological and behavioural controls supported by a strong but agile governance framework are still the foundation that cyber security controls should be built upon.

Some organisations have not implemented these basics or are not enforcing the controls in a consistent manner. The key is to concentrate on operational resilience – focusing on the threats, assessing what the organisation is trying to defend against, and then aligning the objectives of its distinct levels of controls.

Start by asking: what stage is our organisation at in our management of cyber risk?

Too many companies either deny it is a problem for them or have false confidence in their processes. At the other end of the scale, there are business worriers who want as much security as possible – without realising the impact on day-to-day business. Neither of these extreme positions is helpful.

This is why organisations should keep the threats they face in perspective, by considering what cyber criminals might be after and how they could get it:

- Use credible attack scenarios to test the adequacy and integration of controls.
- Build buy-in from the organisation's leaders for controls to apply in a proportionate way across all areas of the business.
- Think about what your organisation needs to do to survive and rebuild after a major cyber-attack. The future of the business could depend on this.

Organisations must prepare for, protect against, detect and respond to breaches, cyber-attacks and cyber-crime. Far from a pure technical fix, the focus should be on an integrated approach that embeds cyber risk into all of the organisations activities.

The above considerations apply equally to organisations in PNG as elsewhere. We were recently asked by a PNG client to carry out a cyber-security assessment to determine whether the key principles and requirements have been implemented. Although the organisation had the necessary tools we found they did not have a monitoring framework to ensure the tools were actually being implemented. Unfortunately in our experience this is not unique amongst PNG businesses. In this particular case we assisted the client in putting together an intelligence-led cyber security framework with a robust monitoring plan.

By helping our clients build strong foundations, we enable organisations to move beyond fear and uncertainty, to a position where they are free to pursue new opportunities.

Individual tax residency rules

by Hellendra Maruse, Senior Manager – Tax

Of possible interest to Australians living in Papua New Guinea is the recent decision of the Federal Court of Australia in Harding v Commissioner of Taxation [2018] FCA 837. While the case is not binding in PNG, given PNG has a similar concept of tax residence, it may also be of interest to PNG domiciled individuals living overseas.

The Australian tax residency rules provide that an Australian domiciled individual can only cease Australian tax residence if they had ceased to reside in Australia under ordinary concepts and had also established a permanent place of abode outside Australia. This is similar to one of the PNG tax residence tests for PNG domiciled individuals.

Tax residents are taxable on their worldwide income and Mr Harding argued that he was not Australian tax resident and therefore not subject to tax in Australia on his earnings from Bahrain. In the Harding case the taxpayer accepted that he was an Australian-domiciled person. Therefore he could only cease Australian tax residence if he had ceased to reside in Australia under ordinary concepts and had also established a permanent place of abode outside Australia.

Mr Harding was an Australian citizen who had lived and worked in the Middle East for more than six years. During his time overseas he had lived in a number of fully furnished apartments within the same apartment complex in Bahrain.

The case focused only on one of the years of income during which Mr Harding lived in Bahrain. It was found that for this year Mr Harding had ceased to reside in Australia under ordinary concepts. However, in determining whether Mr Harding had also established a permanent place of abode in Bahrain, the case focused on his use of the apartments in Bahrain and on his intention to bring his family to Bahrain and to move out of the furnished apartment complex. Unfortunately Mr Harding and his wife divorced and his family did not move over. Factors taken into account in the analysis of 'permanence' included Mr Harding having purchased his own television and linen, but not having to pay for utilities.

Ultimately it was held that the taxpayer continued to be a tax resident of Australia on the basis he did not have a 'permanent place of abode' outside of Australia.

The Board of Taxation in Australia will be undertaking further consultation on residency rules of individuals and its recommendations are expected to be more in tune with current work and lifestyle practices. This is very timely particularly in light of the forensic approach applied in the Harding case.

New disclosures for corporates – Are you prepared to tell all?

by Herbert Maguma, Partner and Pieter Steyn, Director – Audit

Your first annual disclosures under the new standards are only a few months away – have you thought of the time and effort required to get everyone comfortable with the detail that you will need to provide?

If you haven't started yet, there will be no rest until after you have done your 2017 accounts. You will need to start planning the disclosures under the new revenue and financial instruments standards. Even if your headline numbers are not impacted, you will still need to make the disclosures. No one is exempt.

The requirements are more detailed than ever before and may force you to display your organisation's 'inner workings' in new and uncomfortable ways – so getting to grips with the exact requirements of each standard and how they affect you will be essential.

Revenue – Revealing sensitive information behind your top-line

While revenue has always been a KPI, companies have not had to provide detailed information about what lies behind the revenue number until now. Saying that information is "commercially sensitive" is not an acceptable excuse for omitting a disclosure.

Disaggregating your revenue streams, linking them to your segment note, giving information on payment terms, being explicit about the amount and when you expect to receive the revenue from open contracts – none of these things will come naturally. But that is what the disclosures require you to do. And this will provide others – including your competitors – with greater insight into how you run your business.

It is a big change from the old revenue standard, where entities typically gave one number broken down into a few line items in the notes. There will be many qualitative statements to make with judgements and estimates involved, particularly where contracts have variability built in.

It will be crucial to get it right in year one, because that will set expectations for future years.

Financial instruments – Extent of new disclosures depends on relevance

Then there is IFRS 9. For banks, the task will be considerable, adding many pages to the notes. But for corporates, the additional information needed will vary depending on the relevance of the different requirements to your business. So it is important to assess the additional requirements carefully.

For example, the new standard has extensive disclosure requirements about the effect of credit risk on the amount, timing and uncertainty of future cash flows, as well as about the effect of hedge accounting and related risk management strategies.

As management, here are some of things you need to be doing now

- Review contracts to evaluate the nature of performance obligations and other contract terms.
- Determine how to capture new and potentially sensitive information that may require disclosure.
- Determine transition and IAS 8 disclosures.

As Boards and Audit Committees, you should focus on the following

- Enquire from management how implementation decisions will be monitored to ensure they remain appropriate and validate them with the external auditor.
- Enquire from management how the IFRS disclosure requirements will be met and how will those disclosures facilitate comparability.
- Determine the level of assurance the entity will require on the adequacy of the transition and IAS 8 disclosures.

Audit Committees – Maximising the value of the relationship with your external auditor

by Alana Wessels, Director – Advisory

At our most recent PNG Audit Committee Institute meeting we discussed with Directors how to maximise the value of the relationship with the external auditor. A number of interesting points were discussed with different viewpoints provided from the participants. Some key recommendations for Directors coming out of the discussion included:

- Having a detailed conversation with the auditor upfront to understand what they will and will not be doing and to manage the expectation gap. Also understanding what level of detail the auditors are auditing to and their proposed approach.
- Asking the auditors to give feedback on the overall control environment within the organisation and how the organisation compares to others.
- Providing your own feedback and insight to the auditors on your view of key areas of risk within the business - this should be a two way conversation.
- Being involved in the audit fee setting process – there is increasing pressure on audit fees and on the profit models of audit firms so it is important that Directors make sure their company is getting the best audit which may not mean the cheapest audit. Be part of the fee setting process and understand who is actually doing the work e.g. are you getting a low fee because the auditor will allocate only junior resources to your job.
- Understanding the role of the auditor and that the audit will not find everything 'bad' in an organisation – auditors cannot provide you with absolute assurance.

- Organisations should expect to receive more than just the audit opinion from their auditors. Other reports organisations should request are an audit plan (prior to commencement of the audit), a report on audit findings and a management letter setting out any internal control weaknesses that did not necessarily affect the audit opinion.
- Focusing on just the numbers is not enough – for example accounting standards typically contain various options within them. Directors should understand, with insights from their auditors, where their organisation sits i.e. are they being aggressive or too conservative?

Our next Audit Committee Institute will be held later in the year. If you would like to attend please do not hesitate to contact us for further details.

OECD discussion draft on transfer pricing for financial transactions

The OECD has recently released a non-consensus discussion draft on transfer pricing for financial transactions and invited input from commentators. It is possible that there may be a number of changes before guidance is formally released.

A number of topics are addressed including intra-group loans, guarantees, cash pooling, treasury functions and captive insurance arrangements. The draft does however state that its observations are contingent on specific facts and circumstances

A number of general observations from the discussion draft are summarised below:

- They have emphasised the importance of delineating transactions to ensure economically relevant conditions are identified. They suggest consideration of the OECD five factors of comparability may assist with this exercise.
- By way of an example the draft raises the possibility of an advance of funds (or a portion of an advance) being re-characterised for transfer pricing purposes.
- Treasury activities will generally be considered a support service to the relevant main value-creating operation and would be remunerated on this basis.
- Consistent with the findings of the Chevron transfer pricing case, in determining economically relevant conditions (including a credit rating), the borrower should be considered not as an orphan but as a member of the multinational group. Implicit parent support and external funding policies may also be relevant in the determination of a credit rating and an appropriate interest rate.
- In establishing appropriate evidence, the discussion draft states that the use of bank opinions or quotes would generally not be considered sufficient evidence of arm's length terms and conditions.
- With respect to cash pooling arrangements, the guidance indicates that any 'group synergy' benefits (e.g. an overall decrease in interest paid) should be shared appropriately between cash pool participants.
- Guarantee fees could be supportable if the guarantee is binding and unconditional, if it can be demonstrated that the economic risk of the guarantor materially changes (or in other words, that there is a benefit to the recipient from the guarantee over and above any implicit parent support). The draft also provides a number of options that may be useful in determining or corroborating guarantee fee pricing.

The document raises a number of technical issues which are complex and if included in formal guidance could be challenging to substantiate with evidence.

Taxpayers should continue to ensure that appropriate evidence and documentation support is in place for their intra-group financial transactions.

Tax Tips

Provisional Tax

As a reminder the second instalment of provisional tax is due by 31 July 2018. The IRC will automatically impose penalties for late payment. If you have had an income tax return assessed since April the IRC may have re-assessed the provisional tax so it is advisable to ensure you have the updated provisional tax notice and not just rely on the assessment obtained in April. As previously advised in KPMG Kundu the IRC are retrospectively increasing the provisional tax due, and applying penalties retrospectively, where the latest tax return results in a higher provisional tax liability than the previous assessment. We have seen remission requests approved in the past month or so where we have assisted clients in seeking a penalty remission for retrospective penalties – but this can take time and the IRC usually insist the tax return is lodged first.

IRC Payments

As previously advised in the IRC's attempt to move to a full electronic payments method they had issued circulars in recent months stating they would only accept electronic payment or bank cheques/drafts and would no longer accept personal or company cheques. There was a short transitional period during which they were accepting personal or company cheques below K5,000. We can confirm that this has now ended and last week the IRC were refusing personal or company cheques of any amount. Where payments are made electronically it is important that an email is sent to the IRC at their specified email address so the payment and tax return can be matched correctly and efficiently.
