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, 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 first KPMG Kundu for 2019.

Audit committee – on the 2019 agenda

by Carsten Goebel, Senior Manager and Leonisa Bosimbi, Senior Consultant

Audit committees can expect their company's financial reporting, compliance, risk and internal control environment to be put to the test in the year ahead. Among the top challenges and pressures: long-term economic uncertainty (with concerns about global mounting trade tensions, resurging debt and market valuations), technology advances and business model disruption, cyber risk, regulatory scrutiny and investor demands for transparency and political swings and policy changes in the US, UK, and elsewhere.

Drawing on insights from our interactions with audit committees and business leaders over the past 12 months, we have highlighted ten items that audit committees should keep in mind as they consider and carry out their 2019 agendas:

- Take a fresh look at the audit committee's agenda and workload.
- Sharpen the company's focus on culture, ethics, and compliance.
- Understand how the finance team will reinvent itself and add greater value in this technology and data-driven environment.
- Monitor management's progress on implementing new International Accounting Standards Board standards.
- Reinforce audit quality by setting clear expectations for the auditor.
- Give non-GAAP financial measures, other key operating metrics, and cybersecurity disclosures a prominent place on the audit committee agenda.
- Focus internal audit on the company's key risks beyond financial reporting and compliance, e.g. tone at the top, culture, cybersecurity, legal/regulatory compliance, global supply chain etc.

- Board composition – is the talent in the room aligned with the company's strategy and future needs.
- Quality and content of the audit committee reports.
- Focus on cyber risk and security.

Reach out to Carsten, Senior Manager, Internal Audit for more information or to attend our regular audit committee institute meetings.

Earn-outs and their role in M&A transactions

by David Wessels, Director and Cayllan Boeha, Consultant

There is often a difference between price and value when a willing buyer and willing seller are negotiating a transaction. Failure to bridge the gap between what a buyer is willing to pay and what the seller believes the business is worth can result in the parties walking away from a deal.

In these instances, an earn-out provision in the sale purchase agreement can often bridge this difference and achieve a successful transaction outcome. An earn-out can also be attractive to both the seller and the buyer as it can offer the seller the potential to receive a higher price, whilst allowing the buyer to mitigate future short term risk that may not be easily reflected in, say, the earnings multiple or the seller's estimate of forecast earnings.

If the sale agreement requires the seller to remain in the business in a management or director capacity, an earn-out provides a strong incentive to ensure the business meets the performance hurdle to trigger the earn-out.

Deal negotiations can often be complex, intensive, time consuming and draining on both parties. The addition of an earn-out simply adds more complexity. It is therefore imperative that the selected performance hurdle is measurable and achievable so that it does not end in disappointment and potential dispute. Below are some points to consider when negotiating an earn-out provision and the resulting performance hurdle:

- Simplicity – earn-outs should be based on easy to understand goals or outcomes. These could be an earning metric such as EBITDA, a level of sales growth or securing a new key customer. The use of a complex financial model or formula which is based on objective inputs may lead to significant disagreement.
- Length of time – the concept of an earn-out is that the seller maintains some 'skin in the game', however the length of the 'game' needs to realistic. Consideration therefore needs to be given to the purpose of the earn-out. If it is intended to achieve a short term objective, then the length of the earn-out needs to be tailored to this objective.
- Attainable – a seller agreeing to an unrealistic performance hurdle is unlikely to end well so both parties need to be in alignment on the performance hurdle required to trigger the earn-out.
- Expenses and capital expenditure – the business may be acquired by a larger entity which allocates corporate overheads across the group structure. Similarly, investment may be required in the business by the buyer to achieve the performance hurdle; what happens if this investment does not materialise. This needs to be clearly documented.
- Accounting – the sale purchase agreement needs to be very specific and clearly document the accounting treatment required to measure the performance hurdle, and therefore the earn-out. Changes in accounting standards can have a significant impact on the financial statements of a business.

In summary, for a deal to succeed, the seller needs to be largely satisfied with the purchase price that they will receive on completion, and that the potential earn out is an added incentive or benefit.

Sellers should also be cognisant that on completion of the transaction, they go from controlling the business to running it at the direction of someone else. This can often lead to friction or even a dispute between the buyer and seller. Therefore the parties should properly negotiate and articulate in detail the terms of the earn-out clause and clearly set out the requirements to achieve the performance hurdle, whilst also addressing potential areas that could give rise to a dispute.

Demystifying financial modelling
by Peter Kazacos, Executive, KPMG Australia

Financial modelling for businesses has become increasingly popular as a tool for high level analysis of critical outputs and future business scenarios, ultimately providing management with improved business insights. A financial model is a powerful communication tool that illustrates the performance of a company to management and stakeholders.

A financial model is built off a combination of management and industry specific assumptions to develop quantitative outputs based on key business drivers. Typical financial models generate an integrated set of financial statements as well as key charts analysing future business profitability, cash flows and debt repayment structures. By providing interactive dashboards, we are able to understand future financial performance of businesses given differing opportunities and risks.

Using these business drivers and historical management accounts, we develop monthly and annual integrated financial statements, which automatically adjust outputs based on changes to the underlying business assumptions. In this way we are able to critically analyse and stress test financial outcomes for given changes in the company's performance horizon.

KPMG provide business specific financial models, tailored to individual client needs to assist in monitoring financial performance and provide clarity around future strategies and decision making. Typically companies who don't have detailed financial performance charts, effective benchmarking tools or detailed forecasts engage our specialised financial modelling team to provide these services. Depending on the detail and complexity of financial models, they can often take between 3 weeks and 8 weeks to develop a comprehensive business model. Growth in financial model usage is directly linked to their powerful business clarity and communication abilities for management and key stakeholders.

IPA updates

A reminder that the IPA are no longer accepting paper filings from 1 January 2019 by:

- Individuals authorised to file documents for more than ten entities.
- Registered corporate entities authorised to file documents on behalf of another entity.
- Proposed or registered entities with foreign owners or directors and/or shareholders.
- Proposed or registered overseas business entities or its authorised representative.

Tax updates

Tax amnesty for salary sacrificing for superannuation payments

We advised last year of the IRC's position that salary or wages tax should be operated on salary sacrificed superannuation contributions. The IRC have issued a notice providing an amnesty from penalties in relation to underpaid salary or wages tax on such contributions from 1 January 2014. Disclosure and payment of the underpaid tax must be included with the February 2019 SWT return and made by 7 March 2019. The IRC have advised they will be undertaking specific issue audits during 2019 in relation to this matter and penalties of 20% flat tax plus 20% interest per annum will be applied to underpayments identified by them.

Non-resident insurer withholding tax

From 2019 non-resident insurer's withholding tax must be returned to the IRC as a monthly withholding tax – previously the payor had to register for income tax as an agent for a non-resident insurer and lodge an income tax return.

Form NRI-M has just been issued by the IRC in order to return the non-resident insurer's withholding tax due for 2019.

Country by country reporting

As we informed some of our clients in December 2018, the IRC suspended the reporting requirements for country by country reporting due in 2018 for 2017 due to administrative issues although notification requirements continue to apply. The official notice was published on their website in January.

GST on invoices to resource companies

A brief reminder that GST applies from 1 January 2019 on supplies to resource companies.
