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 regular KPMG Kundu.

Salary packaging for superannuation

by Karen McEntee, Director and Hellendra Maruse, Senior Manager

An important notice was very recently published by the IRC in the national newspaper setting out the IRC's view that salary packaging for superannuation by employees is not permissible. This view appears to differ from that implied in the IRC's taxation circular dated 2016 and updated in 2018 on salary or wages tax. We understand the notice has resulted from some recent audits undertaken by the IRC.

A salary packaging arrangement, as stated by the IRC, allows an employer and employee to prospectively mutually agree changes to the terms of the employee's employment contract reducing that employee's entitlement to cash pay in return for a non-cash benefit. To be an effective salary packaging arrangement the arrangement must be for the employee's future earnings rather than any salary, wages or entitlements they have already earned and must be in respect of such benefits that are concessionally taxed or are exempt. Typically employees' salary package for school fees or housing.

It appears that some employees have been salary packaging for superannuation by deducting superannuation from the employee's gross salary (per their contract) to arrive at the taxable pay on which salary or wages tax is calculated. The IRC stated in the newspaper notice that their view is that any such amounts are employee contributions which form part of the assessable pay and are subject to salary or wages tax. Unlike employer contributions which are not subject to salary or wages tax, employee contributions are deductible out of net pay and therefore come out of taxed income.

While the IRC indicated it is open to the employee and employer to renegotiate the terms of the employee's employment contract on a prospective basis, such that the gross per the contract is reduced and an employer superannuation contribution capped at 15% is separately provided for, we would imagine employees would be cautious about such an arrangement given this revised gross salary may then form the basis of bonuses, long service leave and superannuation contributions etc.

Salary packaging still remains a tax effective tool for reducing an employee's tax cost provided it is properly administered. We strongly recommend that employers review their salary packaging arrangements and policies particularly in relation to superannuation.

Rise of the 'accounting' machines

by Zanie Theron, Managing Partner

Over the past five years there has been increased speculation around the possibility of accountants eventually being replaced by technology. I have presented on this topic over the past two years at the annual CPA PNG conferences in Port Moresby and Lae.

The unavoidable topic of the 'rise of the machine' was certainly initially met with apprehension in PNG in 2017. It is very interesting and exciting to note that this perception has changed over the past twelve months and that the advent in increased technology is now, if not overtly welcomed across the accounting profession, certainly awaited with mostly positive anticipation and even a measure of eagerness.

This change is thanks to the profession taking upon themselves as individuals to increase their knowledge around the topic and removing the fear of the unknown.

There are three waves of technology-charged change already facing accountants:

- First is *robotic process automation (RPA)*, which optimises the execution of business processes. Melded with deep machine learning, which can identify patterns and continually monitor regulatory compliance rather than just conduct end-of-year audits, this will see organisations benefit from improved process quality and regulatory compliance at a lower cost.
- *Blockchain* (distributed ledger technology) is the next wave of automation impacting accountants. One of the first applications for blockchain is likely to be in large enterprises, which will share financial information across international or departmental silos. Given all transactions would be stored on an internal blockchain, there would be no need for account reconciliation.
- The third area identified is *smart contracts* that encode business and financial logic onto a blockchain, which is then dynamically executed.

In this edition we focus on RPA. The current definition talks about the use of a software robot or "bot" that replicates the actions of a human to execute tasks across multiple computer systems. The wide area of application opens up a world of possibilities in our profession.

KPMG welcomes the progress here as we are early adopters ourselves. In fact, in July 2018, Commonwealth Bank of Australia, Microsoft and KPMG have joined forces to create a new start-up called Wiise, which will challenge Xero and MYOB by expanding their software offering for small to medium-sized businesses and integrating banking features.

Wiise is owned by KPMG, and operate under a strategic partnership with CBA and Microsoft. The software provides not only accounting and financial management, but job costing, workflow scheduling and inventory management, payroll, sales and marketing, and customer relationship management.

The platform will provide SMEs with access to big-end-of-town technology, including Microsoft's artificial intelligence and voice recognition services, and high-grade cyber security protection with data to be stored in Microsoft data centres.

In terms of an accounting focus, i.e. the RPA side only, there are three levels of accounting that are not only ripe for automation but have in fact been firmly placed on the road thereto. They are:

- Process automation using structured data and basic rules.
- More sophisticated platforms that can deal with structured and unstructured data (for example, recognising a purchase order number on a scanned document and automatically processing it).
- Artificially intelligent platforms “where machines learn through algorithms”.

We suggest that the first two areas have been progressed and are functioning, and that we are now turning our attention to AI platforms next.

KPMG will continue to explore this brave new world we are facing and that our firm is looking forward to with great anticipation.

Trade wars: There are no winners

by Brendan Rynne, Chief Economist, Economics & Tax Centre

The domestic and global economy would be severely damaged if current US-China trade disagreements escalated into an all-out global trade war, new economic modelling by KPMG Australia, has found.

Involvement by a significant number of other countries in a trade war would cut Australian national income by approximately half a trillion dollars over 10 years – the equivalent of 40 percent of last year's total household disposable income. Around 60,000 jobs would be lost, and real wages pushed down by $16 per week for the average worker, KPMG Australia's paper Trade Wars: There are no winners, finds.

Globally, the effects of a substantial number of other countries introducing protectionist measures such as a 15 percent tariff on imports would be very significant. The world economy would contract by more than 3 percent.

The study models three scenarios:

- *Limited escalation, no contagion*: the restriction of the current trade war between the US and China to already announced tariff increases.
- *Full escalation, no contagion*: what is now proposed to occur in terms of the next step up in aggravation between China and the US – an escalation of tariffs to 25 percent between the two countries?
- *Full escalation, full contagion*: an all-out trade war, where a substantial number of other countries joined in and raised tariffs by 15 percent. This is close to the levels occurring now between US/China and US/Rest of World with respect to steel and aluminium.

The report shows that far from winning an all-out trade war, the US economy would experience a recession and a cumulative loss of GDP of 4.6 percent over 5 years.

While China would not fall into recession, its economic growth rate would slow to just 4 percent per annum and would stay below 5 percent per annum for around 5 years – China’s worst economic growth performance in almost three decades.

China's cumulative GDP loss over 5 years, compared to a situation where there was no trade war, would be approximately 5.3 percent.

By contrast, the KPMG Australia modelling finds that in the scenario where the US-China trade war were confined to those two countries, and were restricted to current announced measures, then the negative impact on the world economy would be kept to below -0.5 percent global GDP.

Australia's GDP will be cut by 0.3 percent over 5 years, with a loss of $36bn. The European Union and Japan will be affected less than Australia.

In the scenario where the trade war between the US and China escalated to a 25 percent tariff on all goods traded between them, both countries would end up with GDP 1 percent lower, but with China faring worse over time. Australia's GDP would be cut by 0.5 percent.

The lesson from KPMG's modelling is that no country would win from a global trade war and every country would lose. Even in the event of a full-blown trade war between the US and China, it is in the best interests of other countries to stay out of it. Policymakers in Australia and other nations would be well advised to resist the political pressure to impose or increase tariffs on goods imported from the US and China as they seek new markets.

Do all directors need to be accounting experts?

Being a director in PNG is a big responsibility. Directors have primary responsibility for the provision of useful and meaningful information for investors and other users of the financial statements. You and your fellow directors are required to declare that the financial statements are materially correct in accordance with the requirements of the Law.

While as a director you are not expected to be an accounting expert, you do need to be engaged and seek explanation to support the accounting treatments chosen and, where appropriate, challenge the accounting decisions applied in the financial statements. As a director it is also important that you seek advice and answers where a treatment does not reflect your understanding of the substance of an arrangement.

So, what level of financial expertise does each director need to have?

Directors do need to have sufficient financial literacy to understand, monitor and direct the organisation. In practice this means that every director should be able to read and understand the financial statements and to form a view on the accuracy, credibility and understandability of the information presented. Each director should understand the processes in place to prepare and review the financial statements.

Some practical ways that directors can fulfil their responsibilities for financial reporting include having the CFO prepare a comprehensive paper accompanying the draft financial statements which explains key decisions and judgements as well as an analysis of the financial results. Engaging in a discussion with the external auditor can also provide directors with relevant and appropriate insights into their financial reports and processes as well as how the organisation compares with others.

As business becomes increasingly complicated and accounting standards continue to change, how directors fulfil their responsibilities for correct and accurate financial reporting can be a challenge, but not one that is insurmountable.

IRC audit activity

We have seen an increase in IRC audit activity this year. IRC audits have included a focus on particular industries such as banking/finance and the motor industry as well as a focus on particular taxes such as foreign contractor withholding tax, salary or wages tax and business income payments tax and on taxpayers continuously lodging nil returns. It was with interest that we noted in recent weeks that the IRC are recruiting for additional IRC auditors - we take this as an indicator of their intention to continue their audit focus and perhaps even to increase this activity.

Our tax health-check services can be a beneficial method of getting a snapshot of the tax affairs of a business. This can assist the business to get its affairs in order now in the event of a future IRC audit.
