Board Matters Quarterly

Issue 1, 2023

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Issue 1, 2023

Board Matters Quarterly

Board Matters Quarterly offers thought-provoking perspectives and insights into leadership and governance issues for boards and audit committees, supporting them to navigate the increasingly complex business environment.

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How technology and automation can transform tax functions

In discussions among tax leaders and senior finance executives of large multinational corporations (MNCs) and corporates in Malaysia, the conversation is increasingly centered on the topic of technology and automation in taxation. The million-dollar question is, how can technology and automation be used to transform manual and time intensive taxation processes while complying with local and international tax obligations?

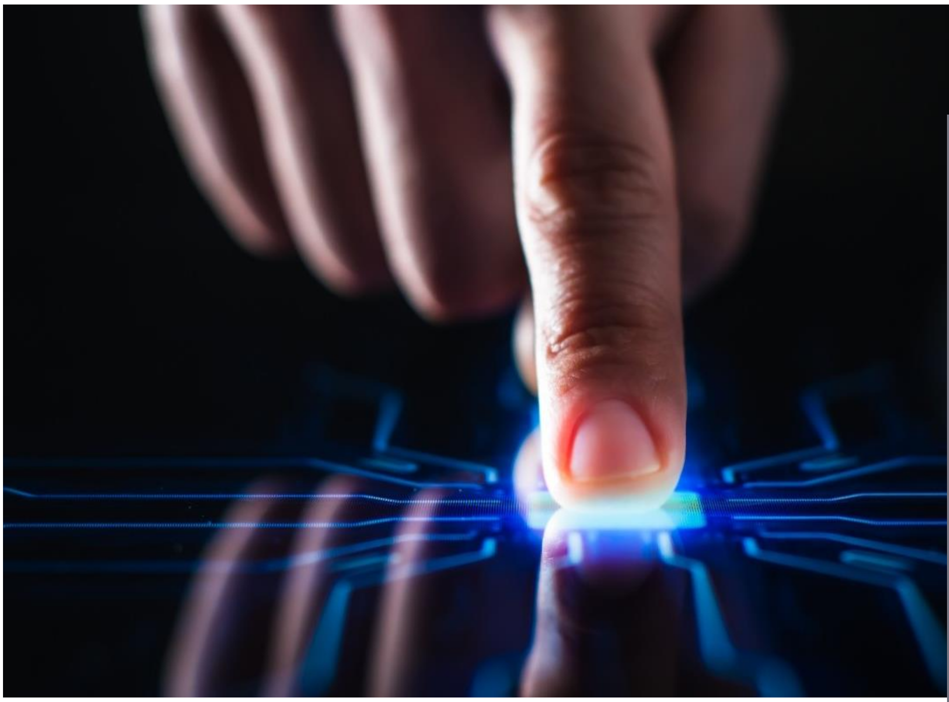
The complexity of the tax landscape has been accelerating, especially in the last few years. Managing the number of tax obligations effectively in an increasingly digitalized global economy, while maintaining a similar resource level and budget (i.e., doing more with less), is becoming a conundrum for businesses that operate globally or even regionally. It is also a challenge for the tax authorities.

To this end, technology and automation are seen as the means to alleviate an increasingly stressed tax function.

> “Digitalization is the seemingly obvious way to remove mundane data crunching activities while enabling tax functions to focus on more value-added activities such as tax planning. Unfortunately, most corporates have found that there is no easy fix, and tax technology projects cannot be implemented by merely installing a new software.

Automation and technology, including analytics tools can indeed help tax functions to evolve by making manual tax processes more efficient. However, the complexity of the tasks and resources needed to implement them properly, and ensuring they are fit-for-purpose, are frequently underestimated.

Digital tax administration



Before any discussion on tax technology and automation can take place, it is important to understand the thought process and focus areas of tax authorities around the world, including the Malaysian Inland Revenue Board (IRB). This will enable taxpayers to shape their technology roadmaps correspondingly and anticipate further requirements from the authorities. In a recent publication, *Tax Administration 3.0*, the Organisation for Economic Cooperation and Development (OECD) discussed the digital transformation of tax administrations as comprising of three core building blocks of enablers, to allow seamless integration between the systems of tax authorities and taxpayers. These building blocks are digital identification of taxpayers, automated connection between tax authorities and taxpayers' "natural" systems, and electronic invoicing.

Like taxpayers, tax authorities are increasingly leveraging technology to collect and manage tax data. They rely on sophisticated analytic processes to find anomalies and to select targets for tax audits.

Despite the inevitable differences in national approaches, a global review of tax digitalization practices highlights several similarities:

1 Tax authorities are moving compliance "upstream"

Rather than waiting for taxpayers to submit tax returns after the taxing event, tax authorities are looking to consider ways to support tax assessment in real-time or near-real-time by directly connecting with the taxpayers' systems. This has the benefit of accelerating the payment of taxes and provides tax authorities with immediate data to examine. As a result, taxpayers will increasingly need to focus on reviewing their data from a tax perspective before this data is sent on a real-time basis to tax authorities.

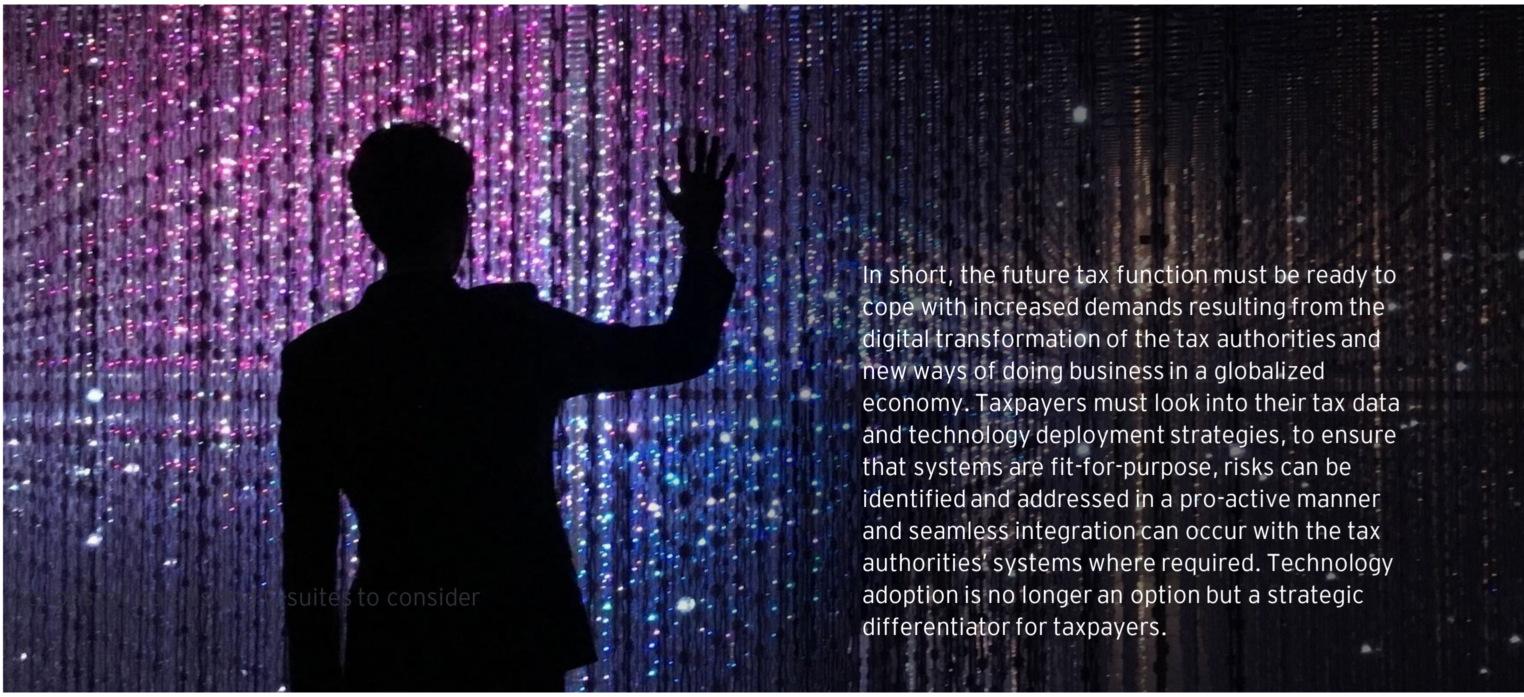
With similar objectives to capture more data electronically, we have observed that the Asia-Pacific region is accelerating the implementation of e-invoicing or an electronically delivered invoice in a specified standardized format designated by tax authorities. E-invoicing allows tax authorities to keep real-time information on taxpayers at a transaction level and is central to allowing compliance to be moved upstream. In Malaysia, the IRB is currently working on an e-invoicing initiative together with other regulatory authorities as part of a broader initiative to digitalize the country's processes in order to gain efficiencies and move up the value chain.

2 Tax authorities are increasingly asking for more information and data from you

New reporting and regulatory requirements with a tax angle are emerging such as digital tax filing requirements, environmental, social and governance (ESG) reporting, and the OECD's Base Erosion and Profit Shifting (BEPS) 2.0 initiatives, including the global minimum tax. These new requirements for MNCs to report their income and calculate the effective tax rate for each country in which they operate and the push for the "tax transparency" agenda in developed tax markets are driving change at an unprecedented scale and pace. Through various withholding tax, indirect tax and other transactional tax, tax authorities have significant taxpayer data. They are now bringing sophisticated analytics tools and data matching techniques to paint a detailed picture – not only of data-driven transaction flows but also of a group's risk appetite and overall tax planning efforts.

3 We are seeing heavy collaboration among national tax authorities, coordinated by the OECD as a new phase of work

The implementation of the BEPS 2.0 rules has been the result of many consultations between tax authorities in the key developing and developed markets, together with the OECD. Tax administrators have learnt the value of such collaboration from previous projects and are putting that experience to good use by sharing approaches and leading practices. In Malaysia, greater collaboration and sharing of data among the various tax and regulatory bodies, will enable much richer and deeper sources of data that can be used holistically for various audit and enforcement activities.



In short, the future tax function must be ready to cope with increased demands resulting from the digital transformation of the tax authorities and new ways of doing business in a globalized economy. Taxpayers must look into their tax data and technology deployment strategies, to ensure that systems are fit-for-purpose, risks can be identified and addressed in a pro-active manner and seamless integration can occur with the tax authorities' systems where required. Technology adoption is no longer an option but a strategic differentiator for taxpayers.

Actions for boards and C-suites to consider:

- Understand the proposed tax changes that would impact business in the coming years, especially where the business operates globally or regionally.
- Seek to understand the type of information and data needed for tax purpose in any master data project, which the business wishes to consider.
- Recognize if new finance transformation projects involving the implementation of new technologies such as SAP HANA upgrades will involve a tax component and whether such projects are implemented with tax in consideration.
- Push for more automation and implementation of tax technology projects to reduce manual labor, redundant activities and fundamentally increase efficiency and data quality.

Authors:
Julian Wong
EY Asean Global Compliance and Reporting Leader, and Partner,
Ernst & Young Tax Consultants Sdn Bhd
and
Dr. Ong See Yew
EY Asean Tax Technology and Transformation Leader

How a focus on sustainability and digital can help manage head winds

Riding on the changes triggered or accelerated by the pandemic, many business leaders are now laser-focused on turbocharging their transformation plans. *The EY CEO Outlook Pulse* study published in October 2022 found that executives remained resolute in transforming their organization and reframing their strategic agenda despite the current market disruptions.

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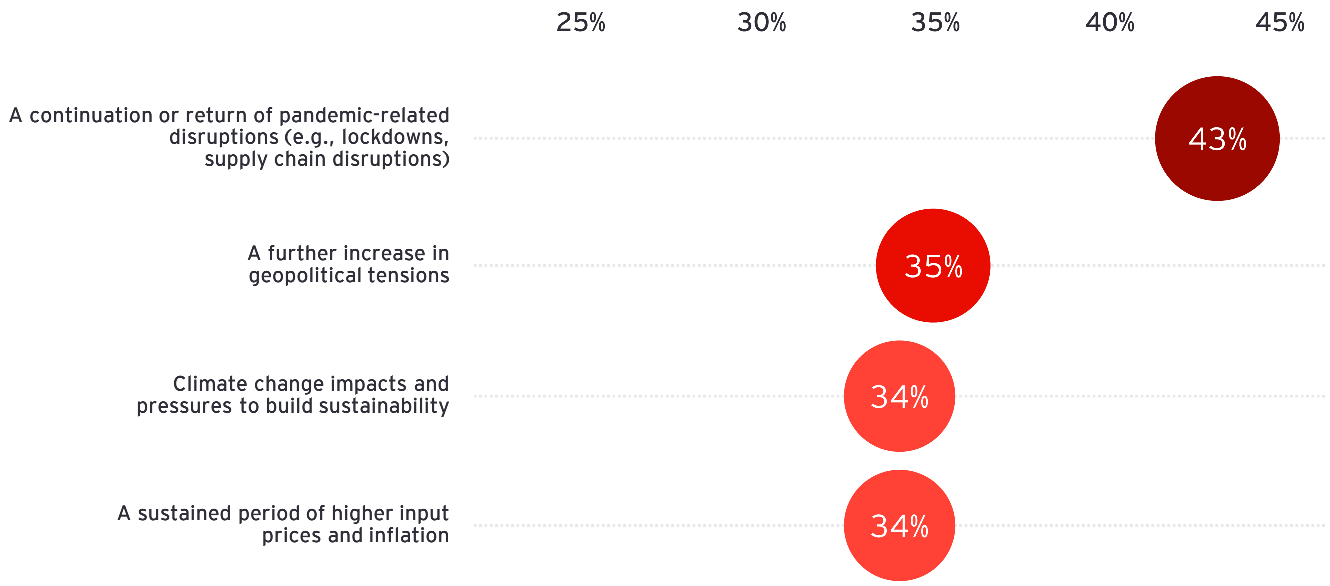
> CEOs worldwide were most concerned with a continuation or return of pandemic-related disruptions, with more than four in 10 (43%) viewing this as the greatest risk to business growth. This was followed by geopolitical tensions (35%), the impact of climate change and pressure to incorporate sustainability elements in the business (34%), and inflation (34%).
>
> *EY CEO Outlook Pulse Survey, October 2022*

Which of the following do you consider to be the greatest risks to the growth of your business?

Respondents selected up to top three priorities.



Source: *EY CEO Outlook Pulse Survey, October 2022*

How boards work with the executive team to navigate these complex challenges and opportunities even as they continue to evolve is critical. The duality of emphasis by shareholders and other stakeholders on both near-term performance and long-term value creation makes the task at hand all the more pressing.

Whatever growth strategy they undertake, business leaders must recognize that they cannot rely on the same assumptions and principles that drove results in the pre-pandemic era. The 760 CEOs surveyed indicated that they would undertake a range of strategic actions, with sustainability and the digital customer experience emerging as two main focus areas.

Sustainability: build trust and value

Many companies recognize the impetus for change in addressing the impact of climate change, not least because consumers and investors are increasingly demanding that businesses look beyond generating profits to focus on environmental, social and governance (ESG) factors to drive corporate sustainability.

Sustainability is increasingly becoming part of a value-based narrative for leading businesses, with the focus being how the company can create value for sustainability as well as how sustainability can create long-term value for the company.

A long-term view is inseparable from sustainability considerations. However, when it comes to the trade-off between short-term earnings and long-term value creation, a disconnect between investors and companies may exist.

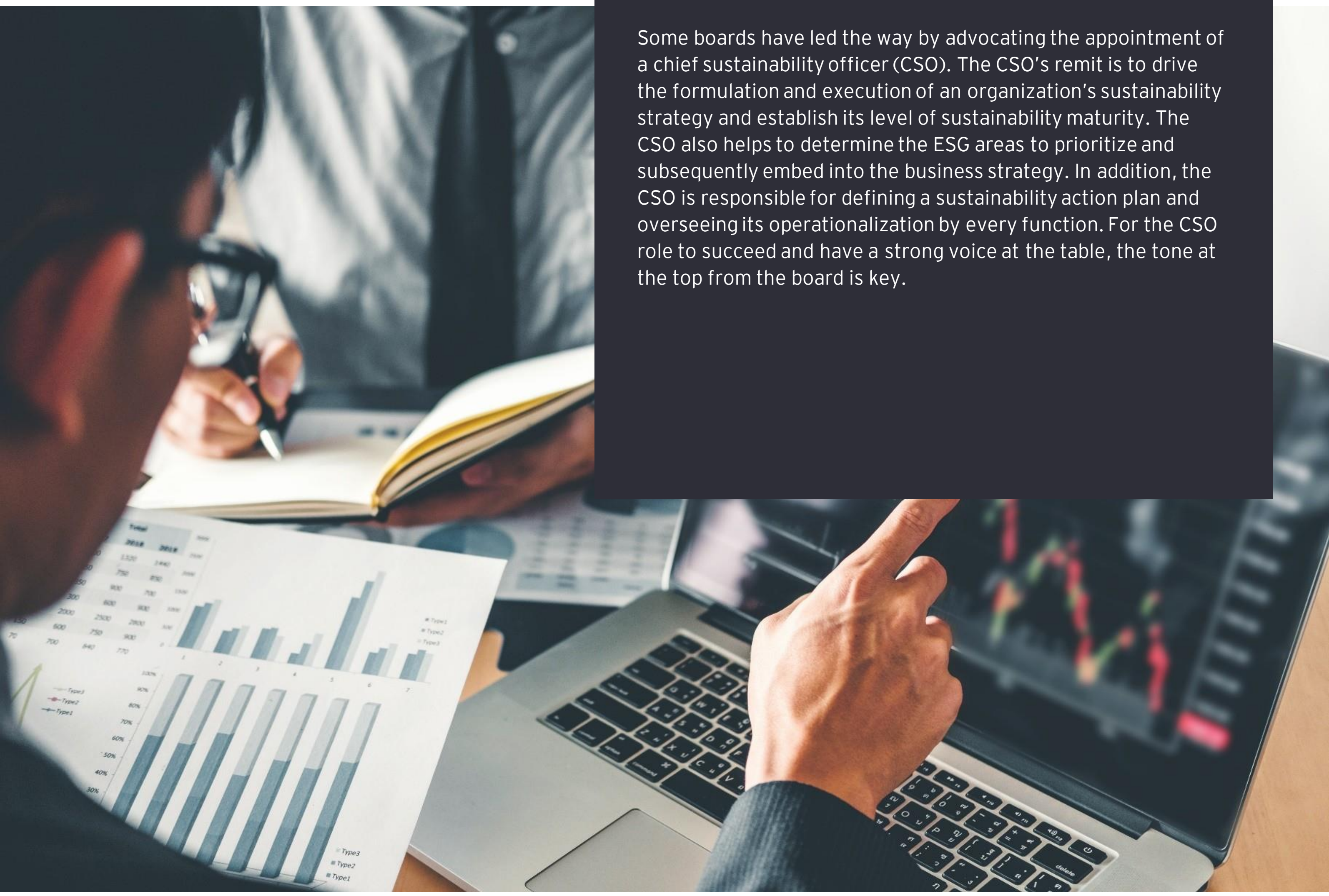
> Investors are much more likely to favor decisions that lead to sustainable, long-term value creation, even at the expense of short-term earnings. However, finance leaders are much less inclined to make that trade-off.
>
> The 2022 EY Global Corporate Reporting and Institutional Investor Survey

The research found that over three-quarters of investors think companies should make this trade-off, but only around half of the finance leaders are prepared to take this long-term stance.

Investors also felt strongly about not getting the reporting and data-driven insight required to evaluate a company's growth and risk profile as well as inform investment decision-making. If finance leaders do not share investors' appetite for prioritizing long-term, sustainable investments, it would be a challenge for disclosures to reflect what investors see as strategic priorities.

These ongoing mismatches between investors' expectations and sustainability disclosures could potentially create a trust deficit, which boards should be greatly concerned about. Where climate change is identified as material to the business, disclosures in board statements should include specific actions that the board has taken to consider climate-related risks and opportunities. They should also cover ways in which it oversees the management and monitoring of these factors. Boards must therefore exercise keener leadership oversight and push for greater transparency on companies' sustainability actions and disclosures.

Some boards have led the way by advocating the appointment of a chief sustainability officer (CSO). The CSO's remit is to drive the formulation and execution of an organization's sustainability strategy and establish its level of sustainability maturity. The CSO also helps to determine the ESG areas to prioritize and subsequently embed into the business strategy. In addition, the CSO is responsible for defining a sustainability action plan and overseeing its operationalization by every function. For the CSO role to succeed and have a strong voice at the table, the tone at the top from the board is key.



Digital investments: build, buy or partner

The pandemic has accelerated the adoption of digital on multiple fronts from both the business and consumer standpoints.

> More than ever, it is vital that companies make using technology to improve product suites and services as well as manage pricing a top strategic priority. Business leaders know this well. Customer acquisition, retention and experience will be among the top digital priorities over the next two years.

To achieve this, the board needs to work with the management to articulate a clear digital vision and roadmap for its digital transformation journey. Crucial actions include selecting the right mix of investment vehicles, measuring returns on digital investments and creating a culture that supports digital transformation.

Companies will need to decide whether to build internal capabilities or use inorganic investments. This affects how quickly they can bring products and services to market and deliver returns on digital investments. Inorganic investments offer several advantages, including easier access to capital as well as a faster pathway to access new technologies to fill capability and skill gaps.

> Boards should also challenge the management to consider how the company's core competence can be enhanced by utilizing ecosystems and whether to participate in an ecosystem as an orchestrator, partner or enabler.

Being part of an ecosystem drives benefits to enterprises in multiple ways. It helps accelerate the organization's digital transformation journey and facilitates effective resource-sharing among businesses and industries as they strive to create an integrated experience for consumers. These open up new revenue streams for business growth.

To achieve an optimal mix in their investments, companies should break down silos, synchronize the various investment types as well as align build, buy and partner decisions with their corporate objectives. A successful investment strategy requires alignment at the board level so that there is accountability when directing those investments.

Building fit-for-purpose boards

With the heightened focus on sustainability and digital, boards need to rethink their core operating model and whether enough time is dedicated to the sustainability and digital agenda, given the many demands on their time.

> Diversifying the board composition in terms of skills, experience, outlook and culture is also critical to having the combinative thinking required to rationalize multifaceted business decisions.

The board also needs to build its skills in sustainability and digital to ask the management the right questions. Besides including such skills as criteria when assessing new candidates for board appointments, other interventions can also help sharpen boardroom thinking and decision-making. For example, organizations can form advisory groups comprising academics or practitioners with a particular understanding of environmental or digital transformation issues.

To enhance oversight of the sustainability and digital agenda, boards should consider the following questions:

- Is sustainability a regular item on the board's agenda, and are clear management responsibilities assigned to drive and report sustainability matters?
- How is the board being apprised on regulatory, economic and societal developments related to sustainability, which could impact operations, risk and stakeholder support?
- How often do the board and management conduct portfolio reviews to identify growth opportunities and underperforming areas?
- Does the organization have a clearly defined digital strategy that spells out its current and projected digital spend, technology requirements and a coherent path to execute its digital transformation?

This article was adapted from EY Center for Board Matters: How a focus on sustainability and digital can help manage head winds

Contacts

Dato' Abdul Rauf Rashid
Malaysia Managing Partner,
Ernst & Young PLT

Tel: +603 7495 8728
abdul-rauf.rashid@my.ey.com

Ong Chee Wai
Malaysia Assurance Managing Partner,
Ernst & Young PLT

Tel: +603 7495 8776
chee-wai.ong@my.ey.com

Farah Rosley
Malaysia Tax Managing Partner,
Ernst & Young Tax Consultants Sdn Bhd

Tel: +603 7495 8254
farah.rosley@my.ey.com

Preman Menon
Malaysia Strategy and Transactions Leader,
Ernst & Young PLT

Tel: +603 7495 7811
preman.menon@my.ey.com

Chow Sang Hoe
Malaysia Consulting Managing Partner,
Ernst & Young Consulting Sdn Bhd

Tel: +603 7495 8696
sang-hoe.chow@my.ey.com

Ismed Darwis
Malaysia Markets Leader
Ernst & Young PLT

Tel: +603 7495 8749
ismed.darwis@my.ey.com

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