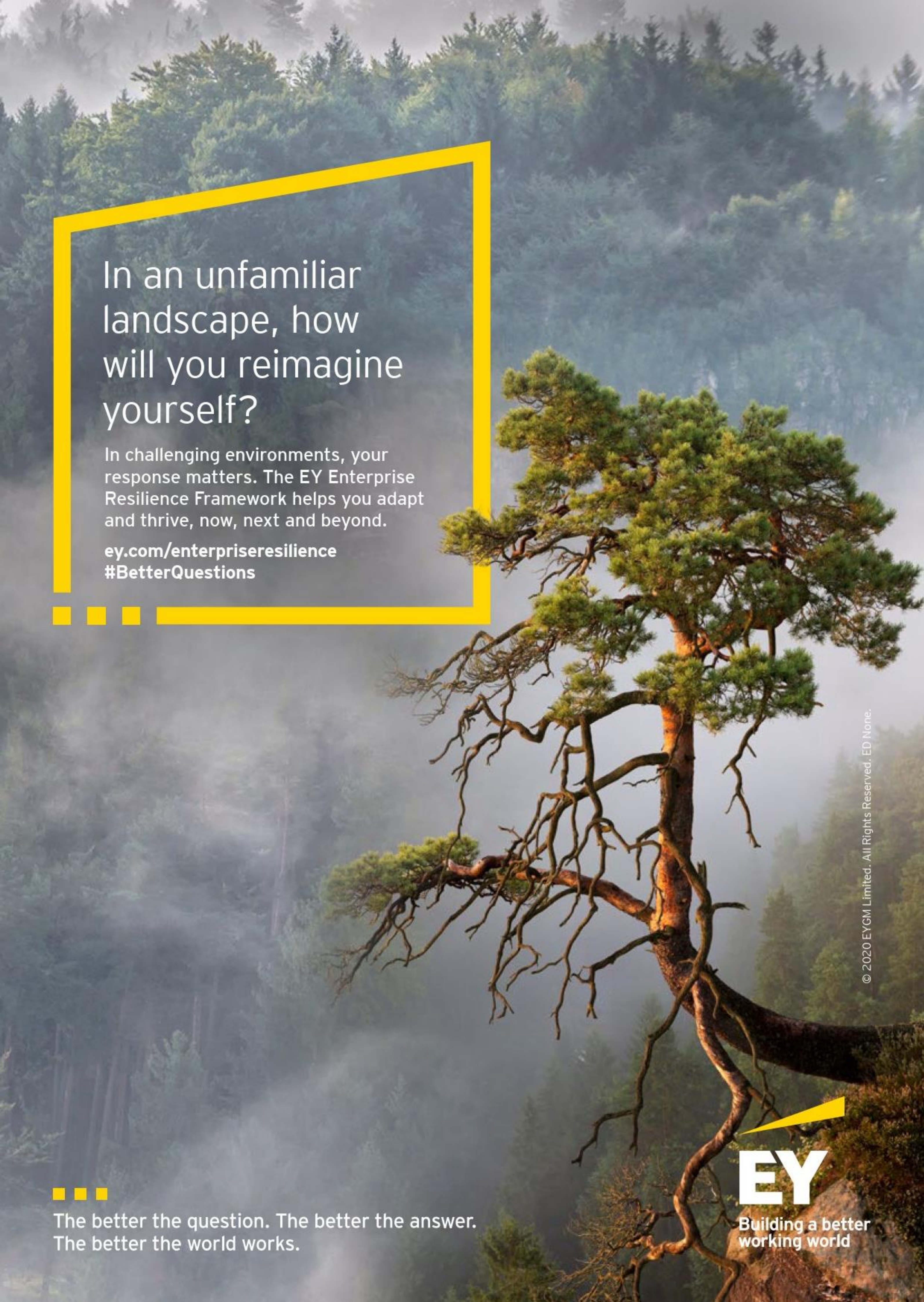
Board Matters Quarterly

Issue 3, 2023

Building a better working world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Board Matters Quarterly offers thought-provoking perspectives and insights into leadership and governance issues for boards and audit committees, providing support to navigate an increasingly complex business environment.

1

Why proper tax reporting and governance is key to a sustainable tax system

2

How to make the transition to governance for good

Why proper tax reporting and governance is key to a sustainable tax system

Tax reporting is now more important than ever. Governments around the world are looking at plugging tax revenue leakages and focusing on the need to increase tax collections, especially as countries look to overcome the tax collection shortfall caused by the COVID-19 pandemic and repay borrowings taken to fund pandemic support.

Tax corporate governance is a means to ensure sustainable tax reporting and the meeting of tax obligations in an organized and systematic manner. To encourage better tax risk management, foster a mutually beneficial relationship and build an environment of trust and transparency, the Inland Revenue Board of Malaysia (IRBM) introduced the Tax Corporate Governance Framework (TCGF), which was issued on 11 April 2022 and supplemented by the Guidelines to the TCGF on 27 July 2022. A year later, many companies have established or are looking to establish governance arrangements on taxation matters to ensure accountability and manage tax risks, whilst taking pro-active measures to address or mitigate any tax risks noted.

To have good tax governance, businesses need to formulate and operationalize clear strategies and processes in managing their tax affairs. Governance policies should be developed based on the specific profile and circumstances of the organization – there is no "one size fits all" approach. Having good tax governance also results in having better support for timely decision making in tax matters.

1 Oversight and accountability

For effective tax corporate governance, roles and responsibilities need to be determined, and clear protocols and processes need to be in place. These show that tax obligations are understood and that the relevant parties are taking appropriate actions to ensure compliance to tax requirements. Additionally, prompt action in addressing issues need to be taken by the personnel responsible. The structuring of the processes and procedures must be done from the offset and strict adherence to the protocols must be ensured.

2 Understanding tax issues and risks

Tax rules and regulations change constantly, thus it is crucial to keep abreast with the latest developments and understand their potential impact on business transactions. An organization with good tax corporate governance will be able to manage tax issues and ensure compliance with the tax requirements.

Having a good awareness of the tax consequences of a particular action or transaction will enable organizations to document the tax matter, carry out an appropriate review process and escalate accordingly as necessary. Where tax issues are identified, plans and actions should be in place to escalate, mitigate and address the matter. This includes documenting or having a plan to ensure key transactions are reviewed and the tax risks are managed.

3 Seeking advice and opinions when positions are unclear

Documenting issues and escalating them accordingly are also key elements of good tax corporate governance. The process and procedure to seek further advice need to be put in place. This may be an internal escalation to upper management or reference to an external party, when there is a need to obtain external advice to support the tax position or determine the appropriate tax position to be taken.

Complex business transactions can lead to ambiguity in tax treatment, hence seeking external professional advice will enable the organization to obtain an independent view of the tax treatment and provide assurance that adequate care has been taken when evaluating the tax position to be adopted.

4 Transparency in reporting

As part of good tax governance, business records must be maintained and processes need be developed and executed in a transparent and equitable manner. Systems and controls must be implemented to ensure accuracy in reporting. In addition, regular periodic reviews must be conducted to ensure controls remain effective and relevant in light of business and economic developments.

In any good governance process, the availability of records to support the transactions and the tax positions is critical. Records and documentation need to be produced in any query by the tax authorities and failure to maintain documentation may create additional tax risks to the organization.

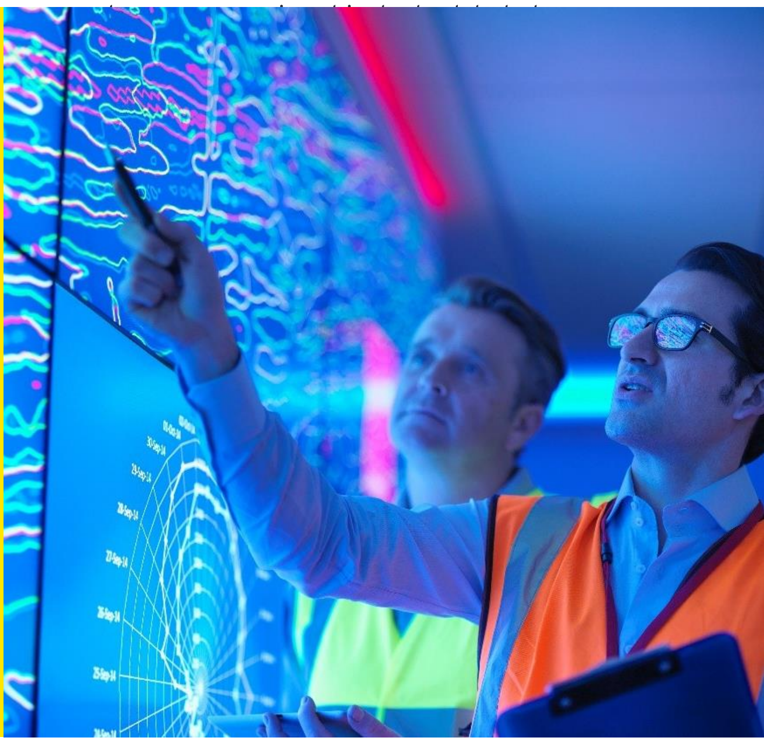
5 Mutual understanding and good cooperation

An open, honest, transparent relationship with the tax authorities and mutual respect are key in a successful tax corporate governance model. Any tax issues should be discussed openly with the aim to obtain a mutually beneficial resolution for both parties. Having effective tax governance will achieve the aims of accurate reporting, ensuring accountability, avoiding errors and ensuring records are in order and properly kept.

Good tax corporate governance will enhance trust, encourage cooperation, reduce tax evasion and build a more sustainable tax system for the country. Over the longer term, tax leakages can be avoided and tax compliance costs to the government can be reduced, whilst companies can reduce risks and reduce or eliminate potential penalties. Tax corporate governance will encourage close cooperation between tax authorities and taxpayers and yield benefits such as encouraging better tax compliance, creating good understanding of the tax rules and regulations, as well as nurturing greater awareness of tax obligations.

Actions for boards and C-suite executives to consider:

- Ensure that your organization has a clear protocol in place for prompt and precise decision-making by the relevant team members or departments.
- Understand the latest developments in the ever-changing tax rules and regulations to deal with tax compliances and consequences.
- Seek advice from an external professional firm, if needed, especially when clarity is needed on certain tax matters or where the transaction is complex or large
- Maintain tax records and conduct regular reviews to ensure the effectiveness of the tax control mechanisms in place.



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How to make the transition to governance for good

Globally, stakeholder capitalism — the idea that businesses have a responsibility that extends beyond their shareholders — has gathered significant momentum over the last few years. Consequently, boards and management teams have been prompted to rethink the role of their organizations in terms of who they serve, what contributions they can make to society and what constitutes long-term value.

More traditional strategies that narrowly focus on financial output have become increasingly risky. Long-term value is not just about immediate financial returns. It's asking what will drive or destroy value for the business in the next era.

Organizations will need to look at value from three pillars.

Customer value:

- Customer satisfaction
- Trust and loyalty

People value:

- Engagement
- Employee loyalty
- Diversity and inclusiveness
- Health and wellness

Societal value:

- Sustainability
- Total economic impact
- Carbon footprint and ethics.

With the increasing emphasis on long-term value, governance for good, or a strong focus on ethical, responsible and sustainable decision-making, must be at the heart of corporate governance.

1

How to make the transition to governance for good

How can boards better lead their organizations on a path toward creating long-term value?

It first starts with defining and embedding the organization's purpose. Purpose is the organization's north star — the reason for which it exists. Once this purpose is defined, it should underpin all decision-making. The board will need to define what stakeholder capitalism means to the organization and formalize it through the corporate purpose and strategy.

Second, organizations should adopt a discipline in integrating environmental, social and governance (ESG) considerations into the board agenda. To that end, some companies have a dedicated sustainability committee, while others assign the responsibility to an existing committee, such as the risk or audit committee. Depending on the complexities of the business, an agile board operating model — not a one-size-fits-all one — is essential.

It's not just about having the right board structure. Effective governance also means devoting sufficient time to sustainability matters. In the EY Europe Long-Term Value and Corporate Governance Survey released in March 2023, 200 European corporate directors and senior leaders surveyed were split into two groups: "experts" and "beginners", depending on how they scored on sustainability governance.

The survey found that a vast majority of the "experts" were effective at managing the board agenda so that long-term ESG risks and opportunities were always discussed in addition to near-term business issues. In contrast, only half of the "beginners" did the same.

Boards also need the right competencies and awareness of the key trends in ESG issues. This means it is important to include sustainability skills as criteria when assessing new board candidates or consider setting up external advisory boards that include scientific and academic expertise.

> “Having the right board structure and sustainability skills as well as devoting adequate time to sustainability matters are key ingredients of effective governance.

Third, diversity in the composition of the board and senior management is important. Effective governance requires being intentional about bringing new perspectives to the table. The more diverse your board composition is, the better you can identify, anticipate and manage the universe of risks, including ESG ones.

Fourth, organizations should be authentic with material and credible disclosures. Leading companies not only embed ESG into their strategy, but also put ESG-linked KPIs in place to manage the business. These companies know what ESG factors are material to their business and therefore what needs to be measured. With such clarity, they also better navigate evolving ESG regulations.

What’s crucial in the reporting is authenticity. Authenticity is not just about sharing targets and successes, but also about the challenges and difficulties encountered along the way. Greenwashing or greenwishing will only create more reputational and confidence issues.

Finally, governance will not be complete without accountability. Making a real impact requires a shift in mindset and actions. To incentivize the management to work toward long-term value creation, the board should consider how to link sustainability to executive remuneration. Making such a move is a bold step. The key is for boards and remuneration committees to be pragmatic and agile when setting such sustainability-based KPIs, which will continue to evolve as the business evolves.

2

Good for the planet, society and business

The emphasis on ESG in governance is not just a feel-good philosophy; it also makes good business sense. For example, an EY research found that companies that took the boldest steps in climate action were 2.4 times more likely than their peers to report significantly higher-than-expected financial value as a result of their climate initiatives. They also achieved higher emissions reductions.

This dispels the myth that there is an insurmountable trade-off between financial and nonfinancial impacts. While priorities may need to shift, what's good for the planet and society can be good for business too.

It is fair to say that governance for good can be an ambitious goal. There will be tough calls to be made, cynics to be convinced, and obstacles and risks to overcome. Yet, the results will be immensely rewarding: resilient organizations that can better weather challenges; stronger relationships with employees, customers and communities; and sustainable value for the long term.

> After all, will there be a "next" if governance only focuses on the "now"?

This article was sourced from EY Center for Board Matters: How to make the transition to governance for good

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