

Deloitte.

Mind the GAAP.

Best practice tax reporting in a changing environment

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Introduction

Tax reporting in financial statements probably receives more attention today than ever before. The adoption of IFRS has led to movements in effective tax rates and more comparability of tax information internationally. At the same time, international tax authorities are becoming much more interested in the systems and processes businesses use to produce and record tax information and in assessing the risk inherent in the business. Meanwhile, new ways for companies to deliver on their tax reporting obligations are emerging – including technological advances enabling automated tax accounting systems.

Against this backdrop Deloitte has commissioned market research to assess how large businesses in the UK are managing the challenges of tax reporting. We have added our own voice to the debate around what is ‘fit for purpose’ in this new environment, and present the findings and our recommendations in this report.

Some of the facts we uncover may be surprising. Tax directors and managers lack confidence in their company figures, and many are concerned that small errors in brought forward balances may eventually lead to material errors. There is a high level of discomfort with the technical requirements of the accounting standards, and accounting systems appear not to support requirements of the tax function – making it difficult to get the numbers right.

Throughout the report we give our view of tax reporting best practice, and conclude that many large businesses in the UK have some distance to travel in order to be able to meet the standards now expected. Some businesses will already have achieved our benchmark. These are the organisations that have access to highly trained tax accounting professionals, or can produce tax basis balance sheets, or calculate their tax charge on a monthly basis.

We hope that all will find insight in the comments and feelings of their peers and in the practices we describe as being ‘fit for purpose’.



Alan Macpherson
Partner, Tax Transformation, Deloitte



Executive summary

2006 was the year that many companies delivered their first full IFRS financial statements. As part of our overall approach to tax reporting we have brought together the views of our experts and conducted research to find out how company tax directors and managers perceived this move.

The research uncovers some surprises. The key issues identified are:

- **Financial system inadequacies**

Only 20% of company tax professionals believe that their financial systems adequately meet GAAP requirements, yet few have plans to improve and upgrade those systems.

IFRS and US GAAP increasingly require more detailed analysis and disclosure of the treatment of tax balances. Financial reporting systems will have to accommodate the increasing volume of data collection – unless inherently risky and time-consuming manual processes are to continue. To achieve this, the tax department will need to be more involved in the decision to upgrade financial systems and, in the meantime, may need to adopt some short-term tactical remedies.

- **Errors in brought forward balances**

Alarming, 43% of companies are concerned that small errors in brought forward balances may eventually lead to material errors. So there is clearly a need for companies to validate brought forward balances to reflect their true position.

- **Inadequate resources**

In many cases, it would appear that tax departments do not have sufficient time or resources to comfortably meet tax reporting requirements. In 57% of companies, increasing workloads brought about by IAS 12 have resulted in longer hours for existing staff. And in 49% of companies it is perceived that the morale and motivation of tax staff have been affected.

- **A lack of technical knowledge**

Only half (50%) of in-house tax professionals believe that their personal knowledge of IAS 12 is adequate. Furthermore, only 12% of companies believe that their staff responsible for the tax reporting process are fully trained in relevant accounting standards.

Companies need to ensure that their people receive more training and support, and that they use specialist external advisors, particularly for new areas and those where judgement is required.

- **Increased pressure on audit**

The vast majority (72%) of in-house tax professionals admit to feeling more exposed due to recent regulatory changes which have restricted auditors' involvement in companies' accounting practices. The changes have also led to a notable increase in the number of differences of opinion between companies and their auditors in relation to the interpretation of particular accounting standards. There has also been increased pressure to provide the auditor with more detailed documentation and evidence.

Why 'wait and see' is not an option

Nearly half (47%) companies believe that the pace of regulatory change will stay the same or increase. This sense of continued uncertainty has led many companies to adopt a 'wait and see' approach, holding back from investment in tax accounting systems and training until the picture is clearer – an understandable response, but a high risk one.

The convergence of UK GAAP, IFRS and US GAAP is accelerating, and companies that fail to act now to update accounting systems and processes will fall behind. Moreover, companies are being scrutinised as never before by the market, regulators, media and other stakeholders, and executives are being held personally accountable for misrepresentation of their company's financial position.

It is essential to have a tax reporting process fit for this radically different and shifting landscape. However, the skills required to deliver it are often beyond the traditional remit of the tax department.

“Many tax directors and managers do not believe that tax is currently a major driver of accounting systems, and there is a strong consensus that it should play a much more influential role in future. It's vital that their tax concerns are firmly on the boardroom agenda now.”

Alan Macpherson

Getting to a 'fit for purpose' year end

We discuss the changing landscape, what is best practice now and what best practice may look like in future, defining a 'fit for purpose' year end. That is, a year end to which we believe all companies can aspire and a framework for benchmarking improvement in every aspect of a company's tax reporting cycle.

The application of some key principles can bring noticeable improvements to data quality and to the efficient production of year end tax disclosures:

- **Use of tax basis balance sheets** to track potential temporary differences to ensure completeness and accuracy. The creation of the tax basis balance sheet for each entity in the organisation may require a significant amount of time and effort, particularly where historic documentation is difficult to locate. However, once in place, they reduce the time required to maintain deferred tax balances for each period and provide additional audit evidence.
- **Full quarterly (or monthly) tax reporting** to ensure that issues are identified earlier in the period, and to help the tax reporting process become more efficient and embedded within the organisation. More accurate tax information will also be available for management purposes and decision-making. The impact on the finance function and their reporting calendar needs to be taken into account.
- **A real time audit** which concludes on the tax reporting impact of significant transactions, as they happen, to enable the early identification of material issues. This, and involving the auditors at the same point, can reduce the pressure at year end. And it will ensure that management gives sufficient time to those areas that require their judgement.
- **Sufficient tax department resourcing.** The requirements of tax reporting can justify that approximately 30% of the tax department's resources should be wholly focused in this area. In the short term, this may result in the diversion of in-house resource or the use of external personnel. In the long term, expansion or outsourcing may need to be considered.
- **Automated data collection.** Information in financial systems should be 'tax sensitised' as far as possible in order that the same information can be used to produce an accurate tax provision and tax return without substantial re-working. A major benefit of this will be to reduce the number of prior year adjustments. The ultimate goal may be to collect tax information once only and store it in a tax data warehouse, available for all reporting and compliance requirements.
- **The elimination of spreadsheets.** Ad-hoc, uncontrolled spreadsheets should be replaced with more robust systems that link financial information without the need for re-keying. This will increase the level of control over the process, increase numerical accuracy and reduce the amount of time wasted in roll-forward and maintenance.

The research

'Tax directors' and managers' knowledge and perceptions of regulatory change on the tax accounting process'

In September 2006 Deloitte commissioned an independent company to research the knowledge and perceptions of regulatory change as demonstrated by tax professionals in some of the most well known companies in the UK.

The researchers conducted 20 in-depth interviews with tax professionals from FTSE 250 and AIM listed companies. Following this qualitative research, 197 telephone interviews were conducted with UK based tax professionals of whom a third (33%) were tax directors. Of the respondents, 19% came from FTSE 100 firms, 45% from the FTSE 250 and 36% from other companies (including AIM listed and UK subsidiaries of overseas companies).

In this report, all references to research statistics refer specifically to this research unless otherwise indicated.

Deloitte online survey

As a separate exercise, Deloitte also conducted, in September 2006, an online survey on the same topic and received over 100 responses from UK based tax professionals from a broad range of organisations (of which 37% were FTSE 100 and 16% were FTSE 250 companies). Of the respondents, 41% were tax directors or heads of tax.



1. Interpreting the rules

New developments in tax accounting have created a major challenge for companies, particularly given recent restrictions limiting the amount of help they can get from their auditor in assessing their tax provisions.

Our research suggests that tax directors and managers lack confidence in their company figures. Yet data integrity is a business-critical issue and inaccuracies can lead to material errors further down the line.

1.1 Auditor independence

The challenge

Regulatory change has had a far-reaching impact on the way companies prepare their tax financial disclosures. As a result, companies need to make their own judgements and involve the auditors at a later stage, once they have come to their own views. Not surprisingly, this puts businesses in an uncomfortable position: 72% of in-house tax professionals admit to feeling more exposed due to the reduced involvement of their auditor.

One consequence of this renewed emphasis on auditor independence is a large increase in differences of opinion in the interpretation of relevant accounting standards. In fact, almost half (49%) of companies claim to have had differences in opinion with their auditors on the interpretation of IAS 12.

A consequence of reduced auditor involvement is that auditors have less insight into the calculations and judgements made by companies, and therefore they require more detailed documentation and evidence to supplement their reduced knowledge. This is particularly true in the areas of deferred tax calculations, uncertain tax positions and tax disclosures (where the greatest judgement and potential for errors exists).

“Almost half (49%) of companies claim to have had differences in opinion with their auditors on the interpretation of IAS 12.”

Recommendations

One way to minimise the impact of differences in views with auditors, is to have ‘fit for purpose’ workings, calculations and documentation which fully support any judgements made.

The recommendations below will assist in providing audit comfort:

Maintain a full, tax-basis balance sheet

IAS 12 and SFAS 109 require deferred tax to be calculated using a balance sheet approach, comparing book basis to tax basis to identify temporary differences. As in most cases these balances will not remain constant from period to period, this can involve a detailed tracking exercise. Where this is done on an ad hoc basis there is a danger of overlooking potential differences, especially where they relate to underlying items that are not included on the balance sheet.

“72% of in-house tax professionals admit to feeling more exposed due to the reduced involvement of their auditor.”

In the current environment a full tax basis balance sheet should be maintained to track all temporary differences – including un-provided amounts, which still need to be disclosed in some cases. Tax bases should be tracked for each potential method by which the underlying asset may be recovered e.g. by disposal, by use etc. Evidence suggests that it is becoming more common for auditors to request a tax basis balance sheet as the best way to evidence the completeness of deferred tax provisions.

Document all significant provisions and judgements

The tax balances will often include amounts which are a matter of judgement, such as uncertain tax positions, deferred tax asset recognition and interpretation of accounting standards. Since these judgements are often made on an informal basis, there is scope for inconsistency and lack of transparency for the auditors.

We suggest that all significant tax provisions and judgements should be fully documented, and a clear policy in relation to judgement areas should be set and documented to ensure consistency. Policies should be reviewed at least annually to ensure that they continue to be relevant.

Review tax disclosures

If tax disclosure preparation becomes a ‘number-crunching’ exercise, the bigger picture may be lost. Tax disclosures should flow automatically from the reporting tools to ensure less scope for human error, but should be reviewed by the tax function for reasonableness, given their knowledge of the affairs of the company. Management should consider future events as well as historic ones in deciding what to disclose.

Put ‘grey’ areas to a disclosure committee

While accounting standards have to be written in general terms to cover a wide range of businesses and issues, nearly all companies will find scenarios in their organisation that do not fit within the terms of the standard. With the change in levels of auditor involvement these issues are becoming more difficult to decide.

‘Disclosure committee’ arrangements (where a panel of external or internal advisers reviews the treatment of complex areas) are the best way to conclude on these issues. While the final decision is always management’s to make, external consultants can advise on how to interpret the standards.

It is becoming more common for auditors to request a tax basis balance sheet as the best way to evidence the completeness of deferred tax provisions.

1.2 Cleaning up the past

The challenge

With large, unallocated tax provisions a thing of the past and differences in opinion with auditors becoming more prevalent, there is a clear need for companies to validate brought forward balances to reflect their true position. Despite this, only 40% claim to conduct a fair assessment of their brought forward balances.

Companies will need to devote more attention to this reconciliation to the position submitted in the tax returns, particularly as errors in brought forward balances account for a large proportion of audit adjustments. Alarmingly, 43% of in-house tax professionals are concerned that small errors in brought forward balances may eventually lead to material errors.

Why is this? Only 51% are confident that local staff sufficiently understand what is in the opening balances for the local entity. The reason for this lack of confidence may be that the local staff are finance personnel who are not tax trained, or because they are trained in local GAAP rather than in the GAAP used for group consolidation.

Recommendations

There are a number of ways to help flush out any local errors and provide comfort that the starting position is accurate:

Perform regular true-up exercises

The review relating to brought forward balances to identify any adjustments to prior year provisions can be carried out in advance of the year end. So that only an update exercise is required during the more time-pressured reporting cycle.

If this update only involves considering changes that have occurred in the period since the last reporting cycle, there is a danger that carried forward amounts are hiding historic errors or judgements that may no longer be appropriate. This is especially the case where an event giving rise to an adjustment is not flagged by an actual activity – such as the expiration of a statute of limitations rather than a closure notice being received.

“Alarmingly, 43% of in-house tax professionals are concerned that small errors in brought forward balances may eventually lead to material errors.”

True-up exercises should be performed on a regular basis (well in advance of the reporting cycle) and based on a detailed understanding of what is contained in brought forward balances, rather than just a monitoring of ‘in-year’ changes. Brought forward balances should be capable of stratification into actual payments/refunds or provisions by year and type.

Push adjustments down to entities

Adjustments required by group tax may highlight issues or problems with current processes. If not dealt with swiftly, these errors may recur. Also, if adjustments are not reflected in the relevant entity, there may be errors in the brought forward balances.

Errors and issues identified (and potentially adjusted for) during the reporting cycle should be followed up after reporting has been completed to identify and correct the cause of the error or issue. Adjustments made centrally should be reflected in the relevant entities to ensure that the following period’s brought forward balances are correct.

1.3 A changing world

The challenge

With the transition to IFRS, the comfort derived from the accumulated history and experience under UK GAAP is fast dissipating. And although some feel that we have seen more change in the past five years than in the previous 15, there is a widespread belief that much more is yet to come – almost half (47%) of in-house tax professionals believe that the pace of regulatory change will stay the same or increase.

The recent publication of FIN 48 in the US and the forthcoming exposure draft from the International Accounting Standards Board including uncertain tax positions are testament to this change. Most also accept that convergence between UK, US and international standards will happen. This would lead to more change in future, and possibly to a more prescriptive, rules based approach requiring greater documentation and proof.

Experience shows that pressure on the tax department is amplified when work relating to changes gets end-loaded into already busy periods – by which stage there may be insufficient time to deal with any issues. Despite this year end headache and the incessant regulatory change, 57% of companies have no current plans to update their systems – nearly half (48%) of these claim to be waiting for a more settled regulatory environment. But if the pace of change continues, can companies afford to do nothing?

Recommendations

The recommendations below focus on dealing with the bulk of the additional work around change as it arises, rather than end-loading this work into already busy periods. This will also ensure that issues do not arise when there is insufficient time to deal with them.

Monitor and document GAAP differences

Many groups report their tax numbers under more than one GAAP. Where judgements are made under each GAAP in isolation, inconsistencies may appear and GAAP differences may arise where there should not be any.

All differences in reported GAAPs should be analysed and documented. The tax function should also regularly monitor discussion documents issued by the accounting standards boards, especially where this will affect known GAAP differences or create new ones.

Consider future GAAP changes

GAAP is constantly evolving, and as such may give rise to changes in historic tax provisions. Future changes to GAAP should be considered as soon as they are announced to ensure that any adjustments to previously recognised/provided tax balances are identified in advance of the year end.

“57% of companies have no current plans to update their systems – nearly half (48%) of these claim to be waiting for a more settled regulatory environment.”



2. People, process and technology

There is no ‘magic bullet’ technology that can make a company best practice. The accounting standards are, after all, written to cover general conditions, not specific circumstances, and so expose companies to an element of interpretation – a process demanding constant vigilance, skilled judgment and reassessment. But with the right infrastructure, a company can significantly improve its tax reporting.

2.1 People

The challenge

Regulatory change has had a perceptible impact on in-house tax teams in terms of workload. Three quarters (76%) say that IAS 12 has increased their workload – resulting in longer hours for existing staff (57% of companies) and resource being diverted from other areas (64% of companies).

Given the pressure on resources, it’s perhaps not surprising that nearly half (49%) of companies believe that the morale and motivation of their staff has been affected. Demands from the finance function to shorten the time taken to report at period end (with some tax teams even being asked to work nightshifts) also appear to be taking their toll.

There appears to be a high level of discomfort with the technical requirements of the accounting standards, a situation that is worsened by insufficient training. Whilst most understand the basics of the updated GAAP, many companies are unaware of the complexities of treatment and disclosure in certain situations, and only half (50%) of tax directors and managers feel that their knowledge of IAS 12 is adequate.

Only 12% of in-house tax professionals* say that individuals in their organisations with responsibility for the tax reporting process are fully trained in all relevant accounting standards. The same research shows that more than a third (38%) believe that individuals providing data for the tax reporting process are not sufficiently trained in relevant accounting standards. Not only is this surprising given that senior personnel risk dismissal over tax accounting errors of which they may have been unaware, but it is also concerning given that judgements and technical uncertainties are no longer entirely referable to the company’s auditors.

“Only half (50%) of company tax professionals feel that their knowledge of IAS 12 is adequate.”

Successful organisations approach tax reporting from the ‘top-down’, as well as from the ‘ground-up’, so that balances are framed against finance policy and against the operational risks inherent in that organisation.

Recommendations

The balance of work undertaken by the tax department is shifting towards compliance and reporting. However, unless knowledge is shared more widely and more effectively, the organisation will spend excessive resource in investigating the information from their business units.

The most successful organisations also approach tax reporting from the ‘top-down’, as well as from the ‘ground-up’, so that balances are framed against finance policy and against the operational risks inherent in that organisation. This approach, where an inventory of risks is considered across functions, also serves as a test for both completeness and reasonableness.

Key recommendations are:

Plan for dedicated tax reporting resources

Reporting cycles are busy times and are subject to tight deadlines, meaning that there is often insufficient resource available. This puts extra pressure on the tax reporting team, who may miss tax issues or be unable to perform a full review in the time available.

Evidence suggests that short term measures, such as increasing hours for existing staff and even night working, often seriously damage morale and motivation levels.

Approximately 30% of the tax function’s time should be spent on tax reporting activities. Tax directors should ensure that sufficient resources are in place to complete a thorough review at each reporting cycle, either by diverting people from other areas (such as tax planning departments) or by bringing in temporary or external resource. As with tax compliance, the tax director can decide to outsource or co-source reporting to a third party provider.

Determine accountability for tax figures

Tax reporting is acknowledged to be one of the most complex aspects of financial reporting. The complex reporting aspects further combine with the underlying intricacy of corporate income tax regimes. For this reason the finance function may not be best placed to prepare or review the tax balances and may not identify issues which a tax expert would identify.

We believe that the tax function should have accountability for all aspects of the tax balances in the financial statements. This may mean that the tax function has a greater input into the finance function’s decisions regarding timetables and process/system design. Ideally, the tax function should be deeply involved in the design of the tax aspects of financial systems.

* Deloitte online survey, September 2006

Implement a review process

Given the increasing importance of the tax balances at a boardroom level, and the experience of US companies following regulatory reviews of tax controls, there is a particular focus on tax reporting from senior personnel, the media, regulatory bodies and analysts. This means that the review function is of increasing importance and a valuable control.

The head of tax should be closely involved in the year end reporting process and have the final review of all significant aspects following a 'top-down' approach. The members of the group tax function should understand the tax balances from the 'bottom-up', i.e. on an entity-by-entity basis.

Implement a training programme

To prepare accurate tax balances and disclosures, personnel at group and local level need to understand not only the relevant tax accounting standard (IAS 12, FAS 109 etc) but also other accounting standards that can affect how tax balances are calculated. Examples of this include share-based payments, business combinations and interim reporting.

Everyone involved in the tax reporting process should be trained in the relevant tax accounting standards and have an understanding of other accounting standards as appropriate. Where this is not possible, the company should use external resources. Training should be updated at least annually in response to changes to the relevant GAAPs.

Use a disclosure committee

Although the personnel responsible for preparing tax provisions may have a good understanding of the general principles of GAAP, this may not be sufficient for dealing with complex, unusual or significant transactions or events. In many cases, GAAP may not apply in the way one would expect.

We are now seeing the use of 'disclosure committee' type arrangements where a panel of internal or external advisors reviews the treatment of any complex or significant transactions. We believe that this approach should become best practice and will link to real time audits (mentioned in Section 2.2)

The tax function should have accountability for all aspects of the tax balances in the financial statements. This may mean that the tax function has a greater input into the finance function's decisions regarding timetables and process/system design.

2.2 Process and technology

The challenge

Too often changes to accounting systems do not fully consider the requirements of the tax function, making it difficult to get the tax numbers right and resulting in missed tax planning opportunities. In fact, less than half (41%) of company tax professionals feel that their accounting systems collect adequate information for calculation and tax disclosure. A finding which might explain why only 20% believe that their systems adequately meet GAAP requirements.

With a joint HM Revenue & Customs – Companies House filing facility in the pipeline, companies may wish to consider the need for a more integrated tax accounting and compliance processes. If companies can achieve this, there are likely to be benefits from a regulatory perspective (hastening the closure of the enquiry window), and a commercial perspective (better management of resources within the tax department).

Where it comes to updating their technology systems, companies have been slow off the mark. Only 31% have plans to update their systems or implement new ones. It seems that this hesitancy is symptomatic of the pace of regulatory change which has left companies waiting for a more settled environment before investing in change. We know, for example, that of those companies who do not have immediate plans to make changes to their systems, approximately half (48%) are adopting a 'wait and see' approach to the interpretation of IAS 12 before making the leap. This is an understandable reaction. But whilst the pace of change continues, these organisations are likely to find it more and more difficult to comply with the accounting standards.

We are now seeing the use of 'disclosure committee' type arrangements where a panel of internal or external advisors reviews the treatment of any complex or significant transactions.

Recommendations – process

The pressure of the reporting cycle often prevents the tax function from standing back and assessing the process. As reporting cycle deadlines accelerate, this pressure increases. So it's important to review the process and understand what information can be gathered outside of the normal cycle, in a more real-time manner (such as when forecasting taxable profits for payment on account purposes). Management should also consider whether running a different process for interim or quarterly reporting is a help or a hindrance.

Mind the GAAP

Best practice tax reporting in a changing environment

Key actions might include:

Implement quarterly reporting cycles

The tax function may be required to have a picture of what the effective tax rate, tax balances and expected tax payments will be for various management reporting, fundraising and forecasting activities of the group. This information may not need to be as extensive or accurate as that required for the financial statements. Regular updating of the tax reporting balances also ensures that issues are brought to light at an earlier point in the year, reducing time pressure during the reporting cycles.

Companies should move towards running their tax reporting process at least quarterly, if not monthly where appropriate, to identify issues earlier in the year.

Include tax numbers in interim reporting

Both iGAAP and US GAAP require interim tax calculations to be based on full year forecast effective tax rates. Some companies still use actual, interim period effective tax rates as an estimate of the full year rate, which can lead to errors and therefore differences between full year and interim tax rates.

Interim reporting packs should be designed to collect full year forecast profit and tax charge information. When reporting under iGAAP, this information should be capable of disaggregation as far as possible on a jurisdiction, type-of-trade or type-of-income basis as appropriate.

Report tax numbers from computations

Traditionally, the tax return finalisation process happens after the tax reporting process. This may lead to duplication of effort, and detailed work at a later stage to prepare the tax return may reveal errors in the estimated numbers for the financial statements.

Current year reported numbers should be based on finalised tax computations (as far as possible) rather than estimated numbers, which may be significantly different to submitted numbers. The tax return impacts of significant transactions in the year should be dealt with at this time, rather than being left until after the year end. The finalisation of the tax charge will therefore be reduced to a roll-forward of Month-12 results.

Move to real time audits

Significant and unusual transactions often cause the biggest problems at reporting time, leading to both tax and reporting judgements being made during a tight and tense period.

The reporting implications of significant transactions should be considered and decided upon at the time of the transaction. The auditors should be involved at the same time.

Reconcile group and divisional reporting

In the majority of cases, groups prepare their consolidated numbers before local GAAP accounts have been prepared. This can cause issues in calculating the tax provision as the local tax calculation is driven by local GAAP accounts. In addition, in many cases the consolidation entities do not equate to legal entities, which further complicates this issue.

In order to calculate accurate tax provisions, a reconciliation of consolidation entity to legal entity, and of consolidation GAAP to local GAAP, should be prepared. In many cases, this can be achieved by instigating a formal process which highlights the common areas of difference to ensure these are identified at each reporting cycle. Tax information collection packages should be prepared on a legal entity basis.

Current year reported numbers should be based on finalised tax computations as far as possible.

Implement a reporting process for local entities

If local entities return late or inaccurate tax reporting packs, an already tight timeframe will be squeezed still further.

Processes should be designed so that operating units report into the group tax function as soon as possible after the period close, to give group tax time to review all material entities. These processes should be user friendly and include validity checks to ensure that the information received is complete and accurate.

“Less than half (41%) of company tax professionals feel that their accounting systems collect adequate information for calculation and tax disclosure. A finding which might explain why only 20% believe that their systems adequately meet GAAP requirements.”

Stabilise the tax balances

Any volatility in the tax balances after the initial consolidation has been completed may highlight problems in the process and controls used.

Tax balances should be stabilised before the auditors commence their audit procedures. There should be no significant changes to the tax numbers once the audit is underway. Group tax should not be relying on auditors to provide advice in relation to areas of judgement. Therefore, significant judgements will need to be decided and documented internally or with the guidance of external advisors.

Link to other reporting processes

Tax judgements may be influenced by knowledge of other commercial, structural or financial factors around the group. If other departments do not notify the tax function of actual or intended events, this can lead to incorrect decisions being made.

The tax function should be involved at the start of the process for all actual or intended transactions. The tax function should be one of the key functions in the sign-off process prior to implementing an intended transaction.

The reporting implications of significant transactions should be considered and decided upon at the time of the transaction. The auditors should be involved at the same time.

Ensure information tracking

US GAAP and iGAAP in particular are becoming more and more complex. Certain aspects require large amounts of information to be gathered and monitored, and this is often done outside of the normal tax accounting system. In particular, companies are struggling to manage their share based payments, uncertain tax positions, investments in subsidiaries, business combinations and financial instruments information. Where this is not tracked in a manageable format there is a high possibility of errors, particularly where an event causes circumstances to change, resulting in the firm taking a different position.

Accurate, historic and ongoing information should be tracked within bespoke systems. Using cumbersome spreadsheets and relying on other departments (such as HR, company secretarial etc) may not be sufficient in these complex and often significant areas. Specific programs designed to hold information relating to all potential future scenarios should be used and updated on a real-time basis.

Recommendations – technology

As the pace of change continues, organisations will find it more and more difficult to comply with the accounting standards. The tax department will need to be more involved in the decision to upgrade financial systems. This has been recognised by the providers of ERP systems as shown by the recent launch of SAP's Governance, Risk and Compliance (GRC) module.

Large scale, strategic changes to accounting systems are slow to happen and the tax function can often feel it has little influence. However, tactical solutions that leverage off existing technology used in the tax function are also possible:

Review design of reporting packs

Most companies use a bespoke, spreadsheet-based reporting pack to collect tax information relevant to the calculation of the tax balances and disclosures required for the financial statements. In many cases these packs were originally based on UK GAAP requirements but are now used to collect iGAAP information. As a result they may contain errors or outdated requests, or be incomplete. Identifying potential errors adds to the workload of the group tax team.

Reporting packs should be designed to collect all the information necessary for full calculation and disclosure of tax balances under all relevant GAAPs.

The packs should be mapped to all required disclosures to ensure that there are no omissions. In addition, the packs should be designed to assist local personnel to complete the request with minimum effort and should contain a maximum amount of assistance.

Link reporting and consolidation systems

In order to produce consolidated tax balances and disclosures, the underlying entity information collected needs to be included within the consolidation system. Where this involves manual input of the data or the development of further spreadsheets, there is a risk of error, and at the very least the group tax function will require considerable additional time.

Where possible, source data should be linked into the consolidation system via an automated process.

Link to tax compliance process

The basis of the underlying current tax balances is the individual entity tax computation. Where this is a separate process there will be a duplication of effort to some extent.

Tax compliance systems should link directly into the reporting system where appropriate. This may become even more beneficial when tax filing deadlines move closer to reporting deadlines. Tax compliance packages should be capable of producing accounting disclosure where appropriate.

Large scale, strategic changes to accounting systems are slow to happen and the tax function can often feel it has little influence.

Update tools for changes to GAAP

UK GAAP, iGAAP and US GAAP are all evolving over time, and interpretations of the accounting standards and accounting practice are changing and developing. This will mean that reporting packs and accounting systems may soon become out of date.

Reporting packs and accounting systems should be reviewed at least annually to ensure that any changes to the relevant GAAPs have been incorporated. Tax reporting updates should be scheduled into other IT upgrade plans, and where resources are not sufficient for these purposes, external resource should be obtained.

Develop a tax data warehouse

The finance function has often benefited from the use of large-scale accounting systems and business intelligence techniques to centralise and analyse finance information from across the organisation.

Such finance systems can be extended, or a separate global tax data warehouse can be created for the tax function, containing relevant financial and tax information, for example, it could cover losses, uncertain positions and asset bases. This repository of tax information from across the organisation can facilitate the tax financial and statutory reporting processes, and enhance the tax function's ability to forecast key tax performance indicators.

3. The way forward

We expect that the issues discussed here will be familiar to the tax and finance functions of most organisations, following their own experience of year end tax reporting processes.

Tax disclosures have recently been the focus of attention by the Financial Review Reporting Panel and a number of journalists. As the disclosures are the end-product of the whole tax reporting process, it is important to ensure that tax accounting systems are robust from the bottom-up. An initial risk review of the entire end-to-end process may highlight specific areas of weakness or a more fundamental issue.

The journey to a 'fit for purpose' year end tax process may start with small steps. A tactical review of one aspect of the deferred tax calculation can bring immediate short term benefits and lead to the bigger challenge of streamlining the year end process.



4. The authors

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Designed and produced by The Creative Studio at Deloitte, London.

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