

Senior Accounting Officer sign off – the draft guidance Does it square the circle?



From the day of the Budget announcement of a new responsibility for Senior Accounting Officers (SAOs) to sign off on the quality of systems underlying the production of tax returns, there have been many points of debate between HM Treasury and HMRC on the one hand and business and the accounting firms on the other. Possibly the most sensitive has been the extent to which this measure created a new (unnecessary) burden on business, leading to additional cost.

From the very first round of discussions between the government and business it has been clear that HMRC were trying hard to square a circle – to implement the policy objectives of the measure without creating an additional burden on compliant businesses.

During post Budget debate, Ministers have made clear that this new measure is designed to protect tax revenues in difficult times, ensuring that tax compliance is on the Boardroom agenda, and that all business takes seriously the need to have systems and processes that can calculate and file accurate tax liabilities. Ministers and senior HMRC officials have said that they do not see that this will create any additional work for “responsible” businesses, even though they have introduced a powerful and unprecedented new penalty for failure – a £5,000 fine to be charged personally on the SAO.

It appears that the hope and intention of Ministers and HMRC is that SAOs simply sign the appropriate certificate on the understanding that things are probably well managed and that they have faith in their CRM to treat them fairly and in accordance with HMRC’s strategic objectives of having open, trusting and risk based relationships with taxpayers.

It appears therefore that the Government want to have their cake and eat it – to enforce close attention to tax systems through a powerful sanction, but at the same time to give comfort that business probably doesn’t have to do any more than it is currently doing. Since the Budget, HMRC has been drafting guidance with contributions from business representatives and the accounting profession which has now been published in draft.

The guidance will be finalised at the end of July in time for the operation of the rules beginning in August for July year end companies.

Has the draft HMRC guidance succeeded in squaring the circle for Ministers? And what is the outlook for how the guidance will operate in practice once CRMs and businesses engage using the revised legislation and guidance? It is Deloitte's view that the draft guidance leaves a number of questions unanswered and hasn't succeeded in avoiding the SAO measure becoming a new compliance burden. This is largely because the key points of the policy leading to the legislation fundamentally and practically change the rules of the tax compliance game. However, HMRC has had to write the guidance on the basis that it does not, and that not much has changed. This was always likely to be Mission Impossible.

The policy objectives

Whether or not it is right that CFOs should take personal responsibility for accurate tax returns, the fact is we now have personal liability to certify that fact. Nearly 90% of CFOs surveyed by Deloitte (see www.deloitte.co.uk/sao) said that incurring a penalty would be a serious blow to their reputation and career prospects, notwithstanding the fact that they would ask their employer to pay the £5,000 penalty. This risk means that CFOs will require, almost without exception, that more work is done to assure them of compliance than was done in the past.

Scope and coverage

The rules have been amended to catch only those companies who have a CRM in place, as to operate the regime it is necessary to rely on the judgement and experience of the senior officials who lead the relationship between HMRC and taxpayers. The CRM programme is seen as key to implementing HMRC policies such as the 'Varney' measures (the output from the 2006 Review of Links with Large Business chaired by Sir David Varney, the former Chairman of HMRC) and is being gradually extended to smaller businesses.

It seems logical that over time the definition of 'qualifying company' will change to include smaller groups and companies and potentially those other forms of business, notably LLPs and branches of foreign companies, which are currently excluded.

Who is the Senior Accounting Officer?

It remains clear from both the legislation and the guidance that the SAO should be the CFO. In complex situations, especially inbound businesses with many points of entry into the UK, there is provision for this to be someone other than the group CFO, and one person can take responsibility for more than one division where this reflects reality. The draft guidance does contain the words "as appropriately delegated". This appears to allow HMRC to say that a business could not delegate the responsibility where that was not "appropriate" e.g. it could only be the Financial Controller if the CFO was not actually responsible for the financial systems. Overall, the policy objective of putting tax responsibility on the Boardroom agenda has not changed, but flexibility has been introduced where this is needed.

Commencement

The guidance introduces an apparent concession – whilst there is no transitional period, all the SAO appears to have to do in year one is begin to consider if the business has appropriate arrangements. If the business does not have appropriate tax accounting arrangements, the SAO should declare this on the certificate. Although apparently a concession, this is unlikely to be a popular option for many. The personal penalty for failure to meet the main duty would not be triggered but the adverse reputational impact of confirming that the company's tax accounting arrangements were inadequate would remain. Also, such a disclosure would potentially have adverse implications for the company's risk rating and would certainly mean that HMRC would need to consider whether to impose penalties on the company under the normal penalty regime. Given the potential downside, few will want to make such a declaration and so the effect is still likely to be that systems have to be good during year one.

Appropriate arrangements and reasonable steps

The guidance uses examples of what might be seen to be "good" or "bad", and in themselves these are helpful. However, the examples are clearly not exhaustive or applicable to every business. The guidance has tried to give a "sense" of what is expected, and then allow business and CRMs to make up their own mind in their own context. This inherent uncertainty will be one of the hardest issues to deal with in the SAO regime, especially at a time when the Risk-based approach is still developing and CRMs themselves are still getting to grips with applying the new guidance regarding 'Governance and Delivery'.



Business needs certainty, and for this to happen there needs to be a benchmark against which the SAO can test his or her processes. In its current form therefore, the guidance will have to iterate substantially to deal with the many unanswered or subjective questions. Business will ask their auditors to give them assurance that they are compliant – the auditors (internal and external) will ask to what standard they should be testing. If HMRC do not produce a robust benchmark then business will have to do it for them.

Its easy to see why this was resisted in the development of the guidance –HMRC is genuinely trying to avoid the measure causing significant burden. However, the measure will cause extra compliance costs and efforts, and all parties should recognise that this will happen. Most business, their advisers and auditors will be thinking about what forms of documentation will be necessary to give assurance and allow sign off and testing. HMRC has not given an opinion on whether they feel documentation of processes and systems is a useful thing. Most businesses will almost certainly seek to document the critical processes and risks, and create a sign off process as, in reality, this is how risk management and audit processes work. At the very least, the guidance should give a view to CRMs on whether documentation is an indication of good accounting arrangements.

Accurate in all material respects

What does this mean? The guidance is clear that it does not mean audit materiality, and the consequence of this is that it is still the case that SAOs need to recognise that they cannot rely on the testing their auditors perform. HMRC say that this is not a new standard – tax returns have always needed to be accurate, and of course this is true. The consequences of getting this wrong though have become much more acute however, and the natural risk based response of business will be to do more testing and build in greater assurance over critical processes.

The examples in the guidance are helpful in this area, although of course subject to interpretation by CRMs and business alike. The interpretation of “in all material respects” is likely to be both quantitative (i.e. is it a significant number in the context of the transaction, tax and business) and qualitative (i.e. is this something the business really should have got 100% right without excuse).



Tax Compliance Risk Management Process

The area of the guidance where the interaction with TCRM is covered is possibly the most disappointing. There is no guarantee that a low risk rating equals SAO compliance. HMRC should give more weight to the work that both business and CRMs have already done in risk assessment and formally treat a “tends to reduce risk” rating for the “Delivery” area as a clearance to sign off the SAO certificate. Most importantly for future operation of the new regime, there is no discussion of how SAO will work with the penalties regime, and the guidance does not appear entirely consistent with messages regarding systems errors included within the Compliance Handbook (eg CH81145) .

Key questions remain – for example, where an audit or enquiry discovers an underpayment, the penalty regime requires consideration of the systems and processes and the capability of suspending the penalty. If the tax at stake is worth charging a penalty on, or the error is “careless”, does that guarantee a £5,000 SAO penalty? Arguably it could, as the return would surely not be accurate, and the business was careless as opposed to taking reasonable steps. In that case, we can expect a very high number of SAO penalties to be issued. That outcome doesn’t appear to be HMRC’s intention however, so how will the CRM distinguish between something careless and something worthy of being deemed to result from inappropriate systems? Many other questions remain about the interaction of enquiries, audits, penalties and the new SAO regime. Unless there is clarity in the SAO guidance and in the Compliance Handbook, CRMs and business will be confused.

Further developments needed

The guidance as it stands represents the best efforts of HMRC, assisted by business to square the circle of implementing a high impact policy in a low impact way. In some areas, it provides helpful commonsense assistance. It seems likely though that revision will be needed as businesses, CRMs and others use it in reality. The pressure to change will be rapid and immediate as soon as CRMs start considering imposing career threatening penalties on the CFOs of UK businesses – both sides are likely to ask for something more to help them decide where they stand. The inconsistencies between the SAO guidance, the TCRM and the penalties regime will need to be resolved. The scope of the legislation will also most likely broaden and deepen to include smaller and other forms of enterprise, either unofficially or officially. Internal auditors will have another key area of business risk to provide assurance on, and tax will be added to existing business risk and sign off frameworks, albeit operating a different level of materiality.

We believe that forward looking businesses will use the effort of compliance to optimise their ability to manage information, allowing them to manage taxes more efficiently, the savings from which will outweigh the cost. But in the meantime it remains the case that this measure will cause businesses to do more work and increase the compliance burden associated with managing tax in the UK.

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