

Senior Accounting Officer sign off What does it mean in practice?



With the publication of the Finance Bill, the debate in the House of Commons and commentary emerging from HMRC we are now able to consider the practical implications of the Senior Accounting Officer (SAO) sign off.

First of all, it seems clear that Ministers are determined to press ahead with the enactment of the provisions, and the key issue of personal liability will remain. The clause was chosen by the Opposition for debate in a full House of Commons session on 13 May and some concessions were made, but there is no real possibility that this measure might go away completely or even be deferred.

Our technical analysis with commentary on how the Finance Bill may change following the Commons debate is attached as an appendix to this thought piece.

In policy terms the measure appears to be an extension of the 'Tax on the Boardroom Agenda' campaign, and gives teeth to the focus on risk assessment, systems and processes led initially by the Large Business Service and now Large & Complex Business divisions.

It is also clearly related to the new Deterrents & Safeguards provisions which address systems-driven issues, suspended penalties and in-year inspections. The measure is aimed squarely at Finance Directors in order to ensure that tax does get the highest level of attention, and it will not be possible for the SAO to delegate the responsibility.

Much of the commentary about the provision has described it as 'Sarbanes Oxley for Tax' in reference to s404 of that Act, which required companies and their auditors to give a view on the adequacy of internal controls over financial reporting. It's clear that this is not 'SOX for Tax' – it's not about financial reporting, and it has no requirement for auditors to do anything.

It does, however, require sign off by a senior person of systems and processes, which will involve controls, and critically it is seeking to achieve 'accurate calculations' rather than 'materially correct', the standard to which auditors work. It is likely the guidance will make clear that HMRC will not expect accuracy to mean 'calculated to the penny', but that it expects the business to take 'reasonable steps' to be (presumably reasonably) accurate. This was further discussed in the House of Commons in terms of 'correct and complete'. So Schedule 46 to Finance Bill 2009 is not really SOX for Tax, but it is important we learn the lessons from the implementation of SOX to avoid many of the mistakes that were made.

Despite the reaction from business and the accounting profession, HMRC and HM Treasury are adamant that the rules will not, and critically must not, create a significant burden for companies that already have adequate systems. There is no need, in their view, for business to automate every transaction with the aim of having 'touch of a button' tax returns by the first day of the new financial year. It is possible, they agree, to achieve 'accuracy' in many different ways, although we can expect both SAOs and the Audit Service to find certain minimum standards easier to accept – it's always going to be easier to get comfort around numbers that flow accurately from a high quality system involving great people, process and technology than a process that requires heroics to be performed at two minutes to midnight on the filing deadline.

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To deal with the practical application of the rules, guidance will be developed in consultation with industry and the profession, but it is likely that finance directors will still have to form their own views on some of the key concepts including 'appropriate accounting arrangements' and 'reasonable steps'. So, many finance directors and their tax teams will be wondering what shape their tax processes are in and whether they will pass the test. And what level of internal assurance and testing is likely to be adequate to allow SAOs to give their certification? All these questions will need thought before deciding what position should be taken on the certificate given to HMRC and whether more work is needed to give the SAO the right level of assurance.

The Deloitte view of 'good' tax processes is based on our knowledge across all taxes, bringing together learnings from controls standards, audit processes, technology issues, tax risk management and also good old fashioned experience of doing thousands of tax returns every year and handling tax enquiries. It's our view that the ideal process contains elements of strategic and governance oversight, risk identification and control, technology and process management and a high degree of tax technical competence and judgement. These can be broken down into a number of key risk areas, starting at the top of the business.

Strategy, risk and governance

Why should high level concepts like strategy and governance be included in an assessment of accounting arrangements' adequacy? Well, many failures in systems and processes have been ascribed to a lack of oversight and senior management buy-in to ensuring compliance with regulation and laws. Often described as 'tone at the top', the need for the most senior people in the organisation to be involved in ensuring taxes are properly managed is critical in ensuring that the rest of the business carries through with that strategy. So, a business where there is no real consideration of taxes outside the tax and finance function will find it difficult to state they have 'appropriate' processes in place, as it is likely that the lack of attention to tax in the operations themselves and/or in functions like Treasury, HR, shared services and IT will lead to tax mistakes in launching new products, managing financial instruments, dealing with reward and secondments, processing invoices and categorising tax sensitive assets.

'Appropriate' in this context probably means having a documented, board approved tax strategy, tax involvement in major business decisions and good communications and interactions with all major parts of the business. The CFO should be able to access a tax risk assessment which shows how business related risks are identified, measured and controlled.

People, technology, process and data

'Appropriate accounting systems' is likely to be held to mean all sorts of business processes, from people and their skills to ERP systems like SAP, PeopleSoft and Oracle, through spreadsheets, databases and even manual ledgers and handwritten reconciliations. The tax risks inherent in these processes, such as the general ledger, payroll system or invoicing system will need to have been identified. Probably the best test of accuracy is the ability of the business to produce accurate returns with data straight from the system. If lots of reworking is required, then this could still represent adequate control, but is less secure than tax data being right first time.

Key risk areas are likely to be around intercompany transactions, tax sensitive items like legal and professional expenses or other costs disallowable for one or more taxes, the reconciliation from management based accounting to statutory, GAAP conversions and complex employee rewards like share based payments. Key in assessing what is appropriate is understanding how the data is entered into the system in the first place by processing staff – ensuring they are trained and that the team is adequately resourced, that the system can deal with tax sensitive items, and that 'data mining' or another pre submission check is performed before filing the return to identify possible errors. Used well, a great deal of tax risk can be managed by greater use of systems, but systems and technology can also be a key source of risk.

Corporation Tax issues

Corporation Tax issues will always vary from group to group, but some key sources of risk are very common. HMRC will always focus on tax sensitive expenses and how they flow into the relevant tax returns. Other key issues include the management of transfer pricing – is there a policy, is it documented and accurately applied? Also top of the list are CFC, withholding taxes and foreign income, foreign exchange and loan relationships and other complex areas like pension contributions. Old favourites such as capital expenses in revenue are also a source of risk, and the way the business identifies and segregates such items is likely to be an area of focus.

Appropriate arrangements in corporate tax probably mean systems that provide the ability to properly track these sensitive items. Having sufficient trained tax staff or advisers are also the cornerstones of successful management in these areas. Robust tax calculation software is likely to be a key feature in large businesses, with spreadsheets reduced to a well controlled minimum. And with most corporate tax risks arising from outside the tax department, it's critical to have good relationships and information from key business areas.

VAT issues

Indirect taxes present a major challenge to the Finance Director and the tax department as they are inherent to most business transactions and are therefore an integral part of the business process. The level of transactional volume and complexity of rules, especially in transactions that are cross border or with other group companies mean that clarity and precision about determining, recording and reporting the right tax amount is vital. Many groups rely on the accounts receivable and payable systems to properly operate VAT, meaning that key decisions around changes and technology are in danger of being missed by the tax team. In addition, most groups who satisfy part of the SAO requirements through SOX controls will not have covered VAT, so there is no existing assurance process to build on. Appropriate arrangements for VAT may mean a wider oversight of these taxes than currently exists across the business, with VAT specialists being involved in key business decisions or systems changes. Delegating the management of VAT to labour intensive shared services is likely to create risk, unless well managed by the tax team and supported by strong data and analysis processes. With so much of VAT turning on accurate information about the nature and detail of the expense or income, and its timing, it is critical that the right data is accurately captured at the point the invoice or transaction reaches the business, and flows through the systems to the tax returns.

Employee taxes

Taxes on employment income and remuneration are often not wholly under the management of the head of tax, meaning that either the responsibility will have to change, or the SAO will be seeking input from more than one person. Even where employment taxes are managed by one group of people, the complexity of issues from payroll to short term visitors, organised versus ad hoc benefits in kind and expenses through complex remuneration such as share options and pensions mean that there is a wide range of risks and processes to manage. And employee taxes is a candidate for the first return most companies will file under the new rules – if a P45 is issued on Day 1! Defining ‘appropriate’ will no doubt include consideration of the existence and effectiveness of policies and procedures covering expenses, mobile employees, dispensations, share scheme documentation, IR35 management and termination payments. The HR, payroll and expenses systems should be able to track these items and produce reports which form the basis of the key returns, rather than expecting a high degree of manual collection of information and calculation. And there needs to be clear lines of communication between HR and tax to ensure the implications of new policies and rewards are understood and acted upon.

Other taxes and duties

The scope of the rules is very wide, and a completeness exercise is likely to be needed to identify all the taxes and duties that are affected. An obvious, but very complex area, which will be challenging, is Excise Duties, which are generally the subject of complex regimes involving warehouses, imports or physical stamps. These very old duties are rarely managed in a highly automated way, indeed many large payers of duties rely on regular visits by the HMRC officer as a key part of the control environment.

Withholding taxes on royalty income, foreign tax suffered, operational taxes in financial services and fund tax returns will all be major issues in certain industries and are probably already well managed. In other businesses, these will be small and unusual taxes, but given the scope of the rules will still need to be covered, and it may be the small points that provide the greatest challenge. With such a wide scope, it is difficult to say what appropriate looks like here, although there should be a clear view of all the taxes and duties covered by the business, their significance and lines of accountability, as well as a risk assessment of the issues involved in accurate calculation and management.

Next steps

It is difficult to know how SAOs, their businesses and HMRC will react when the rules actually apply, but it seems prudent to begin thinking about the impact as early as possible in case research needs to be done or changes need to be made or planned. ‘Reasonable steps’ is likely to include conducting a risk assessment and developing and sharing plans for fixing problem areas whilst still filing a ‘clean’ certificate.

A good starting point should be using Deloitte’s tax diagnostic Cube, which contains questions designed to allow business to grade their readiness for a clean sign off or highlight areas where work might need to be done. The Cube, which can take as little as one hour to run through, and covers all of the points discussed above, gives an immediate view of how the business compares to Deloitte’s view of ‘appropriate’, and will allow discussion of Sch 46 to move on from consideration of the legislation to its practical application.

To discuss these issues, or to arrange to use the Cube, please speak to your usual Deloitte contact or Alan MacPherson.

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Duties of Senior Accounting Officer of large companies

Appendix: summary technical analysis

Introduction

Further to Budget Notice 62, draft legislation (Finance Bill clause 92 and Schedule 46) was released on 30 April covering the duties of Senior Accounting Officers of large companies.

Further to various meetings with HMRC and the debate in the House of Commons on 13 May 2009, we have set out below our current understanding of the draft legislation and the intentions of government as presented by HMRC. There are still some uncertainties which exist particularly in relation to exactly which companies will fall within Schedule 46. However, we expect to receive a revised definition of what will constitute a 'large company' to be released as well as draft guidance within the next month. The guidance, to be issued by HMRC will help provide clarity in respect of the application of the provisions.

Main observations on the provisions and HMRC comments

- (1) Schedule 46 paragraph 18 defines a Senior Accounting Officer as being the director or officer of the company who has overall responsibility for the company's financial accounting arrangements. Thus in most UK groups there would be only one Senior Accounting Officer. We would therefore expect this to be the Finance Director.
- (2) For most large groups, one Senior Accounting Officer (SAO) will report in relation to the UK parent company and its subsidiaries. A company, which would otherwise be a 'large company', does not need its own Senior Accounting Officer if it is a member of a group headed by another UK 'large company' (Schedule 46 paragraph 17(1)(b)). NB. However, this paragraph is subject to change as part of the review of the 'large company' definition.
- (3) Based on the definition as to what is meant by 'company' within CA 2006 s1, any non-UK incorporated company would not fall within the definition of a company for the purposes of Sch 46 and would therefore not have any primary obligations under this legislation.
- (4) HMRC have confirmed that a 'company' should be interpreted to be a pure company, i.e. not other types of entity/vehicle that may have some requirement under the CA 2006. Therefore, branches, LLPs and Industrial and Provident Societies are not currently within the scope of Sch 46 as 'large companies'.
- (5) Based on this definition UK tax resident but non-UK incorporated companies, as well as non-UK incorporated companies with large permanent establishments in the UK (e.g. banks) would not be caught. However, HMRC have recognised that such companies are not necessarily intended to be outside the scope of these measures. As such, they may take this into account in redefining 'large company' for the purposes of Sch 46.
- (6) HMRC have indicated that they do not intend companies to require a Senior Accounting Officer simply because they are excluded by CA 2006 s467 from the Companies Act benefits of being small or medium.

In addition, UK 'large companies' (and their subsidiaries) each held directly by an overseas company appear to each require their own SAO (i.e. common ownership by an overseas company is not sufficient to create a grouping for SAO purposes).



Commencement

Schedule 46 has effect for financial years beginning on or after the day on which Finance Act 2009 is passed (expected to be by 21 July 2009). By way of example, for companies with a calendar year end, the provisions would cover the accounting arrangements from 1 January 2010 e.g. the VAT return for the month ended 31 January 2010 or quarter ended 31 March 2010. It will of course cover the Corporation Tax return for the accounting period commencing on 1 January 2010. The application to other filings which straddle 1 January 2010, e.g. P35 employer return, is less clear. The SAO will have to certify that the calculation and collection of PAYE and NIC is accurate for the tax months ended 5 January 2010 and subsequent and/or set out the 'reasonable steps' that are being taken to address the position.

During the 13 May debate, an amendment to the Finance Bill to defer the measure by 12 months, tabled by the opposition, was voted down.

Main duty of the Senior Accounting Officer ('SAO')

Sch46 Para1 states the SAO of a 'large company' must take reasonable steps to ensure that the company (and each of its subsidiaries, if any) establishes and maintains appropriate accounting arrangements. In particular, the SAO must take reasonable steps to:

- (i) monitor the accounting arrangements of the company and its subsidiaries (if any); and
- (ii) identify any respects in which those arrangements are not 'appropriate tax accounting arrangements'.

As noted above, guidance will be issued to help provide clarity regarding these provisions. Based on HMRC comments, Sch 46 is far reaching and covers the complete compliance process with focus on data entry, quality of staff and reliance on systems.

Which taxes and duties are covered?

Taxes and duties mean taxes and duties the collection and management of which is the responsibility of the UK Commissioners of Revenue & Customs and therefore includes the whole range of taxes including Corporation Tax, SCCT, PRT, VAT, NIC, PAYE, Income Tax, IHT, Stamp Duty, Stamp Duty Land Tax and Stamp Duty Reserve Tax, environmental taxes, and other excise and duties

What constitutes a 'large company'?

Company for Sch 46 purposes 'means a company within the meaning of the Companies Act 2006'. We understand that this is basically companies incorporated under the CA2006 i.e. it does not apply to non-UK incorporated companies even if they are UK tax resident, non-UK incorporated companies which have significant UK permanent establishments or non resident landlords. However, as noted above, HMRC are considering whether such companies should be capable of being a 'large company'.

Per FB2009, a 'large company' is defined, in relation to a financial year as one that:

- (a) does not qualify as small or medium-sized; and
- (b) is not, throughout the year, a member of a group headed by another company that satisfies (a) above.

For condition (a), above, broadly speaking a company will not be considered large if it does not exceed two of the criteria for a company in the table below.

In addition, a parent company cannot be regarded as medium if the group headed by it does not qualify as medium. This test is based on the figures detailed in the 'Group' column below. In this regard 'net' means after any set-offs and other adjustments to eliminate group transactions, and 'gross' means without such set-offs and adjustments.

Condition (b) confirms that we would not expect multiple certificates for UK companies which are subsidiaries of a 'large company'.

Criteria	Company	Group – gross (net)
Turnover	£25.9m	£31.1m (£25.9m)
Balance sheet total	£12.9m	£15.5m (£12.9m)
Number of employees	250	250 (250)

However, Stephen Timms, Financial Secretary to the Treasury, announced on 13 May 2009 that the scope of Sch 46 will be limited to 'those companies with a large business relationship with HMRC, and a Customer Relationship Manager (CRM) reflecting that'. Given that CRMs are appointed to companies by HMRC, some form of turnover/asset test will still be required.

What are the reporting requirements and potential penalties?

Paragraph 2 – explanation to auditors

The Finance Bill envisaged requiring a Senior Accounting Officer to provide an explanation (prior to the date of the auditor's report) to the company's auditor if the company (or any of its subsidiaries) does not have appropriate tax accounting arrangements at any time in the financial year carrying a personal penalty for failure on the SAO of £5,000 in respect of each financial year. However, it was announced by Stephen Timms that this requirement will be removed from the next draft of the legislation.

Paragraph 3 – Certificate for Commissioners

The Senior Accounting Officer must also provide the Commissioners with a certificate for each financial year of the company either stating whether the company (and its subsidiaries) has appropriate tax accounting arrangements ... and if it (or any of them) did not, provide an explanation.

The Finance Bill described two separate certificates. However, Stephen Timms, stated that only one would be required. The Finance Bill will be amended to reflect this.

Penalty for a late or an inaccurate/ careless return is a £5,000 personal penalty on the SAO.

Paragraph 4 – Notification of name of Senior Accounting Officer

For each financial year, a large company must notify the Commissioners of the name of each person who was its SAO at any time during the year. Penalty for failure to notify of £5,000 levied on the company.

Paragraph 5 – Failure to maintain appropriate accounting arrangements

In addition, if an SAO fails to take reasonable steps to ensure that the company (and each of its subsidiaries, if any) establishes and maintains appropriate accounting arrangements, then the SAO is personally liable to a penalty of £5,000. An SAO is not liable to more than one penalty per large company under this paragraph.

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