

Tax functions in leading Russian companies in 2017

Key findings

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Foreword



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Unlike the situation three or four years ago, the year 2017 is characterized by noticeable recovery of the global economy, revival of business activity and, in particular, improvement in the financial situation of Russian companies. Taxes serve as a powerful tool influencing businesses and investment climate of a country. Therefore, most recovery processes in any economy are naturally accompanied by changes in the national taxation system. As a result, much focus is being given to business transformation that is driven by changes in tax legislation and practices, which, in turn, stimulates companies' interest in improving efficiency of their tax functions.

There has never been a more critical time to move beyond just tracking government-initiated tax developments towards a reliable and comprehensive impact analysis of the changes already introduced to the taxation system, including forecasting the effect of the decisions that are being discussed or had been made.

I would like to note that the high level of interest in our research from companies goes to show the importance of further development of tax functions across businesses operating in Russia. In Tax functions in leading Russian companies in 2017 we give a comprehensive analysis of the following topics:

- Tax function's role in a company;
- Accounting system and automation;
- Electronic document management (EDM);
- Human capital;
- Controls and risks;
- and areas for development of in-house tax functions.

We would like to thank everyone who took part in our survey. We hope this report will be of interest to you.

Best regards,

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Survey goal

A detailed analysis of the current state of tax functions in Russian companies

Survey objectives

- Determine the role of tax functions in Russian companies
- Identify best tax function practices
- Identify areas for further development of tax functions

Target audience

Финансовые директора ведущих российских компаний, директора налоговых Departmentов, руководители подразделений, в чью ответственность входит управление налоговой функцией, представляющие ключевые сектора экономики страны

Methodology

Data was collected through an online questionnaire and personal interviews.

Our comprehensive analysis was based on the following approaches:

01. Identification and examination of general market trends;
02. Comparative analysis of data in meaningful subgroups (analysis of data differing significantly by subgroup and/or from the overall population);
03. Multivariate data analysis (an in-depth analysis of the results to identify hidden differences and incorporate the findings).

Sampling

The survey was performed on a random sample of respondents from a closed, highly-specialized population.

The final sample included 80 respondents who were divided into several industry groups.



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Net balances: the share of respondents who selected the “formalized” option excluding the share of those who selected the “not formalized” option.

Level: the weighted average of the responses received.

Tax function: the division/department/ employees/officials authorized to deal with all tax matters of a group/company.

Formalization (of goals, processes): existence of relevant guidelines (policies/regulations), documented rules of procedure and a hierarchy of roles and authorities within a tax function; employees are aware of those regulations and their rights and responsibilities for the handling of documents and trained in technological solutions used by the tax function.

Automation: use of specialized information systems other than Microsoft Office or similar products.

Quantitative measure of human capital (number of people): the total number of full-time employees.

Electronic document management (EDM): exchange of electronic documents over the intranet, Internet or otherwise; EDM shall be understood not only as document flow but also as paperless work flow including document registration and recording, document search, report generation, execution control, filing etc.

Tax processes: any organized activities of taxable businesses aimed at compliance with tax and legal regulations

Tax control: control over compliance with tax legislation and accuracy and timeliness of tax and other mandatory payments made by legal entities and individuals



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Tax function's role in a company

The level of formalization of tax function purposes in Russian companies is 0.33 out of 1.

- 22 percent of the companies surveyed have formulated and officially documented the purposes of their tax functions. 55 percent have formulated these purposes but have not documented them.
- The top 4 purposes cited include tax reporting, tax optimization, mitigation of tax risks and tax planning.

Tax function processes are formalized by 42 percent (on the scale of 0 to 100 percent).

- The majority of the companies told us they had formalized tax accounting and tax ledger preparation (87 and 76 percent respectively).

The level of interaction between tax and other functions in the companies surveyed is 0.78 out of 1.

- 67 percent of the companies said they had a well-functioning interaction in place.
- Tax professionals are most likely to be involved when a non-standard transaction is being planned (65 percent).
- Only 9 percent of the respondents indicated that each tax function in their organization had its own distinct regulations.

Deloitte comment:

A hierarchy of purposes demonstrates that Russian companies have a natural tendency to first and foremost comply with legislative requirements and protect themselves from challenges by tax authorities.

Deloitte comment:

We can acknowledge that the formalization level of tax processes (apart from the simplest ones such as tax accounting and tax reporting) remains relatively low. This correlates with the Key findings above and reaffirms that companies primarily strive to comply with formal legal requirements.

Deloitte comment:

One in three companies has hidden tax risks associated with its transactions. However, research findings show that businesses acknowledge the high relevance of the existing risks and/or take measures to identify them accurately and in a timely manner.

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Tax function's role in a company

Tax function: a snapshot from 2017

- Almost half of the companies surveyed (47 percent) have dedicated employees/ department in charge of the tax accounting methodology. Further 10 percent are planning to assign such an employee/ department in the near future.
- More than two thirds of the companies (68 percent) undertake the following activities: maintain and update a list of tax risks, maintain and update a list of tax reserves/ unused tax benefits and analyze the effective tax rate and identify opportunities to reduce it (70, 67 and 68 percent, respectively).
- The majority of the companies believe they need to improve their IT systems (71 percent), the efficiency of their tax processes (65 percent) and their tax methodologies (52 percent).

Deloitte comment:

It is very telling that the majority of our respondents say they lack dedicated specialists in charge of the tax function methodology in their organization.

The lack of such professionals in the companies surveyed confirms our earlier supposition that businesses do not pay adequate attention to tax risks. This, in turn, contradicts their own stated goals in our report (compliance with tax legislation and the like). In addition, respondents acknowledge they do not always

have a developed methodology in place and emphasize their commitment to improve their IT systems. If companies do implement and start using new IT systems, such conditions (i.e. underdeveloped tax methodology and processes) may negatively affect the efficiency of their tax functions.

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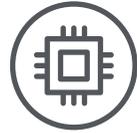
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Accounting system and automation

The level of tax process automation in the companies surveyed is 0.60 out of 1.

The level of tax control automation in the companies surveyed is 0.41 out of 1.

- 9 percent of the companies assess their automation level as 'high' and 37 percent as 'medium';
- The highest automation levels are demonstrated by the TMT sector (0.56).
- The most popular accounting systems include 1C (for tax accounting) and Contour (for tax reporting), as cited by 66 and 60 percent of the respondents, respectively
- Companies with revenues between RUB 10 and RUB 50 billion (44 percent of the respondents) tend to use 1C less.
- 17 percent of the companies use process control systems (to control data collection from subsidiaries, ensure timely filing of tax returns etc.). This share is set to almost double to 33 percent in the near future
- 56 percent updated their accounting systems in 2014 or later, with two thirds of them saying they did it last year

Deloitte comment:

Counterparty reconciliation tends to be the most automated process, with 39 percent of the respondents saying they have fully or partially automated this task. We believe this may be due to a decrease in the number of reliable counterparties after 2014.

Lower automation levels are generally observed for pricing management and control and control of income tax compliance of CFCs, even though these processes are very important for businesses.

Overall, existing tax process automation levels in Russian companies are rather low. This is due to both internal factors such as organizational structure and management and external factors such as rapid changes in the regulatory environment.

Deloitte comment:

It is quite natural that local products such as 1C and Contour are popular in Russia, especially given the general trends of cost reduction and import substitution. These solutions have enough functionality to enable full-scale accounting and reporting.

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Electronic document management (EDM)

Formalization of EDM processes is 0.64 out of 1

- Over **50** percent of the companies surveyed believe they have a medium level of EDM formalization (regulation)
- The overall automation level is above average but there are still areas for improvement
- The highest level of EDM formalization is demonstrated by the real estate sector (**0.83**), and the lowest one by the consumer sector (**0.55**)

The overall EDM maturity level is 11 out of 70

- Use of the EDM technology depends on a company's size
- Somewhat greater EDM maturity levels are observed among pharmaceutical and telecommunication companies (a score of **22** and **23** respectively)

Deloitte comment:

This suggests that despite their efforts to develop internal EDM regulations, document EDM procedures, raise EDM awareness of their employees and other similar activities, companies believe that they are not investing enough time to them.

Deloitte comment:

This suggests that companies are still inexperienced when it comes to using paperless technology. Their hands-on experience with EDM is limited to the number of their business processes already using EDM or the types of documents maintained electronically, or the number of document flow areas that have gone paperless.

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Electronic document management (EDM)

EDM usage by the respondents

- EDM has been adopted by **53** percent of the companies surveyed
- Paperless technology is most often used by the consumer sector (**73** percent) and is least popular with the pharmaceutical industry (**25** percent).
- The top-three types of paperless documents are:
 - Source accounting documents (**69** percent)
 - Bank documents (**44** percent)
 - Internal documents (**21** percent).
- The majority of companies surveyed (**72** percent) transfer electronic documents to government agencies upon request, using telecom channels. **44** percent of them use telecom channels to send soft copies (images) of e-documents electronically signed by the company
- However, a significant share of respondents (**44** percent) submit both hard copies and soft copies (images) signed by the company
- Only **5** percent of the respondents submit electronic documents only.

Deloitte comment:

The share of companies using EDM solutions will likely increase significantly (almost by half), so we may confidently say that EDM has a future in Russia.

Based on our research findings and own experience, we may add that cross-border EDM looks very promising in the nearest future across the Eurasian Union as well as in other countries. Paperless can be also expanded to include shipping documents, HR documents etc.

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Human capital

- Companies have an average of five people in charge of tax matters.
 - This figure is higher in the FSI and TMT sectors (more than **six** and **seven** people respectively);
- The three areas with the highest average number of employees:
 - Assistance during field and desk tax audits (**2.4** scores);
 - Communication with tax authorities, auditors and consultants (**2.1** scores);
 - Identification and analysis of tax risks, issue of risk mitigation recommendations, development of action plan to improve tax efficiency (**2.1** scores).
- Almost half of the companies surveyed (47 percent) conduct trainings for their tax professionals several times a year.
 - The CBT companies provide the most frequent training for their employees: **63** percent of them train employees several times a year.
- One in five companies (**21** percent) performs regular performance assessments of their tax professionals.
 - The CBT companies do it more often than the rest (**32** percent).
- **85** percent of the respondents do not have tax-efficiency based incentives for their tax professionals, and **90** percent of them do not even intend to introduce them.

Deloitte comment:

On average, tax functions have five employees. At first glance, one might think this is inconsistent with the reported allocation of designated individuals across various departments and processes. However, the figure above merely indicates that not all tax function employees are involved at this stage or, alternatively, this stage may involve employees from other functions. This emphasizes the importance of efficient time management and adequacy of current employees' capabilities to support in-house tax functions.

The incentive schemes in place are consistent with the levels of purposes formalization. These aspects are clearly interrelated: no purposes, no motivation. However, companies need to rethink their current approaches used to motivate employees and formalize tax function purposes.

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Controls and risks

The concept of “tax risk” is formalized by 38 percent (out of 100%)

- At present, most companies (69 percent) have developed some definition of tax risk.

The concept of “tax risk measurement criteria” is formalized by 14 percent (on the scale of -100% to 100%)

- Over a half of the companies surveyed (57 percent) have defined this concept and 43 percent have not done so, which is a large share as well.

The concept of “decision-making procedure” is formalized by -4% (on the scale of -100% to 100%)

- Almost half of companies (48 percent) have given some definition to a decision-making procedure.
- Decision-making on transaction acceptability

- 66 percent of companies have a division/employee/department in charge of tax risks
- 26 percent have assigned tax risk management to the head of the tax department and further 21 percent — to a dedicated employee of the tax department
- 16 percent of respondents have already formalized their tax risk management frameworks and this share may more than double to 38 percent in the nearest future

Deloitte comment:

We believe it is very important that almost a third of the companies surveyed have not developed a definition of tax risk and about half have not determined any criteria for assessing tax risks. This means companies can handle (i.e. identify and manage) tax risks solely based on the methodologies and reports in place. These, however, are not enough for other business areas (e.g. tax expertise is not leveraged adequately during transaction process and other business activities).

Therefore, companies might be unable to achieve their core objectives associated with tax liability management and tax compliance.

Automated methodology updates in accordance with the Russian and international legislation create an advantage. Where this is not possible, the task is performed manually. If a rather big company processes data manually, this creates discomfort for the management, slows up managerial decision-making, and sometimes leads to poor decisions and inaccurate tax assessments.

Overall, we find tax processes rather underformalized, which prevents the companies surveyed from efficient identification and management of tax risks..

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