Automating the VAT Reconciliation Process

7 May 2015
What we will cover today

Setting the scene

Step 1 – Understanding the problem

Step 2 - Identifying the fixes required

Step 3 – Implementing the change
Setting the scene

- Reconciling indirect tax submissions is considered the most important control by both auditors and tax authorities.

- Core reconciliations are:
  - [Diagram showing reconciliations between VAT Return, GL VAT Accounts, EC Sales List, VAT Return, Intrastat, and VAT Return]

- Lots of other additional local reporting requirements and therefore reconciliations to consider (e.g., Spesometro in Italy).

- <5% of businesses have fully automated reconciliations.

- There is no silver bullet – successful automation is based on understanding and improving the data sources and processes.
The importance of getting it right

Are your reconciliations fit for purpose?

[UK authority expectations (SAO):]

- Utilise the “right people, processes and systems to manage taxes against policy/obligations”
- Work with wider finance and internal audits to ensure the process is being reviewed and tested
- HMRC challenging businesses on whether they have taken ‘reasonable steps’

[Other local authorities:]

- Turnover reconciliations are becoming standard practice during VAT audits
- Tax authorities requesting source ERP data
- Authorities seek to use data mining software (IDEA, ACL, SAS) to automate much of the process
Frequency of tax authority audits in 2014

Priority 1
- High
  - France ("FEC")
  - Germany ("GDPdU")
  - Portugal (~SAF-T)
  - Luxembourg (~SAF-T)

Priority 2
- Medium
  - Austria
  - Belgium
  - Finland
  - Hungary
  - Ireland
  - Poland
  - Spain
  - UK
  - Czech Rep
  - Denmark
  - Netherlands
  - Norway
  - Slovenia
  - Sweden
  - Switzerland

Priority 3
- Low
  - Bulgaria
  - Cyprus
  - Greece
  - Italy
  - Latvia
  - Lithuania
  - Malta
  - Romania
Tax authority audit data requests

Growing trend (particularly EU) of re-working reconciliations by authorities

<table>
<thead>
<tr>
<th>Data Type</th>
<th>Data Definition</th>
<th>Examples of data fields</th>
</tr>
</thead>
<tbody>
<tr>
<td>Master Data</td>
<td>GL Account</td>
<td>GL Account Number, GL Account Description and GL account class</td>
</tr>
<tr>
<td>Master Data</td>
<td>Customer Master</td>
<td>Customer ID, Customer Name, Customer Country and Customer VAT Number</td>
</tr>
<tr>
<td>Master Data</td>
<td>Vendor Master</td>
<td>Vendor ID, Vendor Name, Vendor Country and Vendor VAT number</td>
</tr>
<tr>
<td>Master Data</td>
<td>Tax code</td>
<td>Tax Code ID and Tax Code description</td>
</tr>
<tr>
<td>Master Data</td>
<td>Journal Category</td>
<td>Journal Code, Journal Label (Invoice, Payment, FA, Manual)</td>
</tr>
<tr>
<td>Balances</td>
<td>GL Account Balance</td>
<td>Fiscal Year, GL Account Number, Opening balance, Total Debit, Total Credit, Ending Balance</td>
</tr>
<tr>
<td>Balances</td>
<td>Customer Balance</td>
<td>Fiscal Year, Customer ID, Customer Opening Balance, Customer Ending Balance</td>
</tr>
<tr>
<td>Balances</td>
<td>Vendor Balance</td>
<td>Fiscal Year, Vendor ID, Vendor Opening Balance, Vendor Ending Balance</td>
</tr>
<tr>
<td>Transaction</td>
<td>GL journals</td>
<td>Fiscal Year, Fiscal Period, Journal Code, Journal Name, Journal Date, GL account number, Journal Description</td>
</tr>
<tr>
<td>Transaction</td>
<td>Invoices/Credit Notes</td>
<td>Fiscal Year, Invoice Number, Invoice Date, Invoice Gross amount, Invoice Tax Amount, Vendor/Customer ID, Tax Code</td>
</tr>
<tr>
<td>Transaction</td>
<td>Payments</td>
<td>Fiscal Year, Payment Number, Payment Date, Payment Amount, Vendor/Customer ID</td>
</tr>
</tbody>
</table>
Our experience of moving towards automation
3 step approach

Step 1 – Understand the problem
• Which individual parts of the technology or processes are causing issues?
• Review the process

Step 2 - Identify a fix or solution for each item
• ERP and data fixes
• Workpaper fixes
• Process fixes

Step 3 – Implement the changes
Step 1 – understand the problem
Understanding the problem
Technology & ERP Systems

Challenges

- Multiple source reports
- Source data granularity
- Incomplete/incorrect source reports
- Valuation discrepancies
- Access to source reports
- Journal entry controls

ERP Systems
Understanding the problem

Processes

Many problems are caused by off-system processes:

- Deemed transactions
- Management of offline manual adjustments
- Post close entries
- Adjustment of VAT accruals
- Often created and amended to support return preparation
- Voluntary disclosures
- Growth of unwieldy spreadsheets
- Requirements for tax technical expertise
Understanding the problem

External Factors

- Maintaining an appropriate level of visibility e.g. outsourcing VAT compliance
- Adapting to business changes
  - New countries, entities etc.
  - New systems and data sources
- Legislative changes e.g. SAF-T
Example problem
Partial exemption posting

1. **Approach 1**
   - GST amount is posted against GST GL account without restricting recovery

2. **Approach 2**
   - GST amount which is partially recovered (i.e. GST expensed to P+L)

   **Invoice is posted**

   **Offline GST recovery calculations**

   **Journal entry to adjust GST balance**
Step 2 – Identifying the fixes
Identifying the fixes
ERP Configuration

Adjusting the Balance Sheet structure to better facilitate automated reconciliation:

- Control account
- Automated AP/AR VAT accounts
- Manual AP/AR adjustment account
- Feed of legacy/source systems
- Special purpose accounts:
  - Foreign input VAT
  - Other indirect tax accounting
  - Blocked input VAT
Identifying the fixes
ERP Configuration

Improve the GL taxonomy:

• Minimise the amount of offline VAT calculations
• Application at country-wide or regional basis
• Create local tax codes to meet local VAT and statutory reporting from the same source

Improve the quality of source reports:

• Identify key data fields
• Deploy standard source reports
• Determine how to use data once reported
Identifying the fixes
ERP Configuration

ECSL/ECPL improvements:
  • Update VRNs to ensure they are complete and accurate
  • Specific EU sales and purchases tax codes

Intrastat improvements:
  • Weights and commodity codes included on inventory/material master data
  • Plants abroad (SAP) and Own-goods rules (Oracle) for movements of own goods
  • ENGR dashboard (SAP) reporting
Identifying the fixes
Building a framework

- Make reconciliation check a specific point in the return sign off
- Run periodic reports to check VAT balances and work with Finance to clarify issues e.g.
  - Unexpected manual journals
  - Monthly EC Sales reconciliation to VAT/revenue GL balances
- Training & documentation e.g. VAT guidance
- Prepare VAT and statutory returns in tandem rather than delivering them separately (before realising they do not reconcile)
Identifying the fixes

Processes

- Reconciliations require working manipulated data back to source
- Important to make data manipulation as transparent as possible
- Multiple source systems will likely require multiple reconciliation stages
- Reconciliations limited by the effectiveness of spreadsheets
- Third party tools designed to support both preparation and checking of return preparations
Identifying the fixes
Workpaper functionality

- Reusing Files from Prior Years
- Missing Tax Rates
- Formatting Issues in Spreadsheets
- Last Minute Changes to Spreadsheets
- Large/Unwieldy Spreadsheets
- Similar Process for Disclosures
- No Control on Preparation/Review
- Similar Spreadsheets/Entities
- Timely Repetitive Checks
- Managed Roll Forward Templates
- Information Moved to Separate Spreadsheets
- Formulae Robustness Review
- Comprehensive Audit Trail
- Streamlining/Categorisation/Navigation Improvements
- Data Flow Automation
- Workflow Improvements
- Standardised Templates
- Built-in Checks
Identifying the fixes

Workpapers – best practice example
Identifying the fixes
Working with Finance

Understand the risk areas by working with finance to automate system controls:

- Tax sensitise product/account codes
- Validation/warning messages
- Configure tax logic in the AP/AR process
Identifying the fixes
Outsource to transform?

• Is the ‘as-is’ fit for purpose?
• Broader finance outsourcing projects can offer a route to improve technology and processes
• Ensure outsourcer understands the reconciliation process
• Agree the deliverable
• Establish roles and responsibilities
Step 3 – Implement the change
Implementing the change

- Try to break it down into small projects
  - Workpaper improvements
  - Tactical ERP and data improvement
  - Analytics
- For larger projects timing can be key - initiatives such as Finance Transformations create an opportunity to implement changes
- Do you need a business case?
- Who are the stakeholders?
- Testing and training is key to avoid disruption to business as usual
Key points

• Most businesses struggle with this. There is no ‘silver bullet’ to address the entire reconciliation approach

• Increasing automation requires:
  • Understanding the pinch points
  • Tactical fixes to address them
  • Implementing changes at the right time

• Tackling issues one by one will offer a greater chance of overall success

• Simple changes to the reconciliation process can still make a significant difference – it doesn’t have to be a big project.
Questions?