

King's Counsel

Tax and the boardroom

Corporate Governance
Series

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pwc

Overview

The King Committee on governance issued the *King Report on Governance for South Africa – 2009* (the 'Report') and the *King Code of Governance Principles – 2009* (the 'Code'), together referred to as 'King III' on 1 September 2009.

King III broadens the scope of corporate governance in South Africa and lifts the bar in terms of what can be regarded as an appropriate standard of conduct. Its core philosophy revolves around leadership, sustainability and corporate citizenship.

King III does not address tax directly. However, tax is one of the most important regulatory concerns of the CEO, and is driving demand for proper internal controls and robust financial reporting processes to satisfy regulators and stakeholders.

Tax is also under wider scrutiny from other external sources. Investors, for example, are increasingly aware of the importance of tax figures in the accounts and the impact on company valuations. Corporate citizenship trends and the need to ensure that companies are acting as 'good citizens' mean that tax is now being viewed as more than a legal requirement, but as a question of moral importance.

How is King III relevant to the tax function?

The essential focus of King III is that the board should 'exercise leadership to prevent risk management from becoming a series of activities that are detached from the realities of the company's business'. The board is held accountable for the governance of risk and should understand the risk exposure that it has, its ability to tolerate risk, and the risk that it is willing to take. Tax is potentially one of the biggest risk exposures for a company, both from a financial and reputational point of view. Tax issues are too often considered late in the company decision-making process, or are not high enough on the corporate agenda. That's why executives, the board, and other stakeholders need to understand the full value of the tax function. Getting them to appreciate and think about tax issues early can help manage tax risks, reporting requirements and compliance processes more effectively.

King III requires management to establish a formal process to assess and report on the effectiveness of internal controls on an annual basis. To adequately apply the King III recommendations, a control or combination of controls can be considered effective if the risk of material misstatement

is adequately reduced and, as a result, the financial statements are reliable. In our experience, tax can have a material impact on the financial statements and is generally regarded as an area of high risk. As such, the tax process and tax accounting and reporting controls should form an integral part of the internal control framework implemented and tested by management.

The board should ensure that the company complies with applicable laws and considers adherence to nonbinding rules, codes and standards. As such, all applicable tax laws, regulatory compliance obligations, rulings and applicable tax accounting standards need to be identified and incorporated into the company's compliance universe.

While corporate income tax is the most visible tax, it is only one of 21 possible taxes¹ that companies pay in South Africa and the risk and compliance burden of tax functions has to be considered against the organisation's total tax contribution.

Various stakeholders have an interest in the tax function. These include, inter alia, revenue authorities, investors, the board, external auditors, advisors, employees, customers and suppliers. It is the role of the board to govern these stakeholder relationships and the related risks and opportunities they present. Communication, stakeholder engagement and interaction between the tax function and these stakeholders should be determined by strategies and policies approved by the board.

1 PricewaterhouseCoopers Total Tax Contribution Survey for South Africa, 2008.

Applicability

King III applies to all companies regardless of their nature, size or form of incorporation. It operates within an 'apply or explain' governance framework, rather than from a legislative foundation. Entities are encouraged to tailor the principles of King III as appropriate to the size, nature and complexity of their organisation. This is good news for companies in South Africa as it avoids some of the pitfalls seen in the United States where a 'one size fits all' approach was initially adopted.

King III is effective from March 2010.

What companies should be doing

Coordinating tax and corporate governance requires clear, strategic oversight at board level. In addition, tax needs to be incorporated into broader enterprise risk management strategies. These strategies must address and respond to a wide range of technical, financial, commercial, and reputational issues.

Amid the growing pressures of tax regulation, companies cannot afford to take a passive approach in managing their tax risks. To better defend their tax filing positions, companies should make the tax function an integral part of the corporate governance agenda. This involves talking about the wider impact of tax on the company and the importance of compliance.

How PwC can help

PwC's Tax Management and Accounting Services (TMAS) can help manage tax risks in your organisation in a number of ways:

- By performing an assessment of the current status of the tax function;
- By assisting in the identification, assessment and monitoring of the tax risks in your organisation;
- By providing a benchmark for your tax risk controls against an optimal controls framework;
- By devising, reviewing or improving of tax controls.
- By reviewing existing tax risk documentation to ensure coverage of key tax areas;
- By facilitating the documentation of a strategic tax plan, which is aligned with the overall strategy of the organisation;
- By providing an external perspective on best practice for tax functions, focussing on the deliverables and enablers of the tax function;
- By advising on and implementing improvements to mitigate and reduce tax risk; and
- By providing advice and assistance in order to meet compliance requirements.

Contact us

To find out more, please contact PwC' Tax Management and Accounting Services:

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