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### **Deferred Tax & Finance Act 2007**

The Finance Act 2007 became 'substantively enacted' for IFRS and UK GAAP purposes on 26 June 2007. IFRS 12 and FRS 16/19 require tax provisions to be based on tax rates that have been enacted or substantively enacted by the balance sheet date.

This is important because of the potential impact of the changes in corporation tax rates from 1 April 2008. Therefore for final accounts for the year ended 30 June 2007 or interim accounts for the year ended 31 December 2007 the deferred tax provision will need to take account of the new rates. Any movement will need to be traced back to income or equity as appropriate.

In addition, disclosure of the effect of the rate changes may be required for 31 December 2006 or 31 March 2007 year ends as a non-adjusting post balance sheet event under FRS21 or IAS10.

The key changes that will impact tax reporting are:

- rate reduction in the mainstream rate of corporation tax of 2% to 28% from 1 April 2008 and the 1% increase in small company rate from 1 April 2007 and the further 1% increases from 1 April 2008 and from 1 April 2009; and
- withdrawal of balancing capital allowance adjustments from 21 March 2007.

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### **Money Laundering Reporting and HMRC's Offshore Disclosure Facility**

The ICAEW Tax Faculty has issued useful guidance on whether a Suspicious Activity Report ("SAR") to SOCA is required in respect of HMRC's Offshore Disclosure Facility.

Before making a SAR we must consider whether:

- legal privilege applies and, if it does,
- whether the crime/fraud exception applies.

If legal privilege applies and the crime/fraud exception holds, then it will be a breach of client confidentiality to make a SAR.

In deciding whether to report a client to the MLRO and the MLRO deciding whether to make a SAR, professional judgement is needed to decide:

1. ***Whether the client intended to defraud the Exchequer and knew that he had.*** If "No", then no report is required since error or negligence is not criminal. If the answer is "Yes" then 2. below needs to be considered.
2. ***Whether the knowledge came to us in circumstances covered by legal privilege.*** If the client came for advice on, for example, where they stand under the law or what they should do, then legal privilege will apply subject to 3 below. However, if the client deliberately omitted the income with the intention of defrauding the Exchequer and instructs us to make disclosure to HMRC then legal privilege does not apply and a SAR is probably required. Obviously clients should be encouraged to ask for advice!

3. ***If legal privilege applies, whether the crime/fraud exception applies.*** If the client or potential client behaves in a way that makes us suspicious that he intends to use the advice to further or better conceal his evasions then a SAR could be required. If an existing client decides to do nothing and asks about a trust structure to hold the offshore funds, the crime/fraud exception probably applies and a SAR should be made. If a potential client goes away, having been given the advice to disclose, never to return we will need to consider whether he was seeking advice to further his evasions. The fact that he has not returned is not of itself sufficient to suspect that he was using the advice to further his evasions. In such circumstances the matter should be referred to the MLRO together with the reason why we consider the crime/fraud exception applies or not. The MLRO should record in writing why they reached the conclusion that a SAR was or was not required and take legal advice if unsure.

As can be seen, the need to make a SAR is not clear cut and, as has already been said, making one where legal privilege applies is a breach of client confidentiality.

Because of the judgements involved it is probably safest to make a Report to the MLRO in all circumstances where the answer to 1 above is "Yes", so the decision whether or not legal privilege applies is held on record.

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### **Money Laundering Regulations 2007 – An Introduction**

The EC 3<sup>rd</sup> Directive on Money Laundering has to be implemented by 15 December 2007. It will be implemented by the Money Laundering Regulations 2007, which are currently in a near final draft form.

The main thrust of the directive is to:

- make it clear that the anti-money laundering regime must be applied to terrorist funding. Money Laundering Manuals will have to focus on Counter-Terrorism Funding ("CTF");
- make the application of the money laundering regime more risk sensitive in its approach; and
- tighten the rules on the identification of the beneficial owners of companies and trusts, and of the source of funds.

Client due diligence will need to concentrate on 4 aspects, namely to:

- identify the client and verify the client's identity on the basis of documents, data or information from a reliable and independent source;
- identify the beneficial owner. In the case of companies this will mean the individuals ultimately controlling it. In the case of trusts it will involve understanding the ownership and control structure and identifying the settlor, beneficiaries who hold a 25% or more interest in the trust, trustees and anyone passing instructions to the trustees. In all cases the beneficial owner identified must be a natural person. Where the beneficial owner(s) cannot be identified a SAR should be made;
- obtain information on the purpose and intended nature of the business relationship including the source of funds invested in companies and settled into a trust; and
- conduct ongoing monitoring. This is a new requirement and is discussed further below.

The due diligence procedures must be conducted on a risk-sensitive basis. Where simplified due diligence can be carried out is very narrow and is basically limited to listed and FSA (or equivalent) regulated entities. Otherwise enhanced due diligence (similar to present requirements) must be conducted. A new high risk category of person, called a Politically Exposed Person ("PEP"), is defined and any PEP and their connected persons have to be identified. A PEP is essentially a person holding public office anywhere in the world. Also specifically defined as higher risk are non face-to-face situations where we do not meet the clients.

Existing clients cannot be overlooked and certainly clients that were previously exempted from identification (such as long-standing clients), will have to be identified if they start a new venture or trust, and will be subject to ongoing monitoring.

Ongoing monitoring will mean inter-alia:

- for each client carrying out an annual review of risk and keep a copy on permanent file;
- identifying all new directors or shareholders controlling 25% or more of a company, or new trustees or beneficiaries entitled to 25% or more of the assets or income of a trust or persons who exercise significant control over 25% or more of the assets or income of a trust. The beneficiaries of a discretionary trust will not have to be specifically identified; and
- identifying complex and unusual transactions which have no apparent economic or visible lawful purpose and that could be likely to be related to money laundering or terrorist financing.

Money Laundering Manuals will need to be updated to cover the above (including risk assessment, risk management and compliance management procedures) before 15 December 2007. A lot of guidance will be issued by JMLSG, FSA, SOCA, the Law Society, and the CCAB bodies over the next few months to assist with this.

Because of the ongoing monitoring requirements it might be advisable to subscribe to one of the commercially available electronic client identification systems such as those provided by 192.com or Call Credit (which will link to, inter-alia, Bank of England & United Nations Sanctions lists) to cut down the amount of work required.

Further guidance will be provided in future months.

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### **Findings Of Audit Inspections by the Professional Oversight Board**

The Professional Oversight Board has recently published its Report on findings from their Audit Inspection Unit's audit quality inspections for 2006-07.

Whilst the AIU considers the quality of auditing in the UK to be fundamentally sound it has made a number of recommendations to improve standards. These recommendations include:

- ensuring partner and staff appraisals are completed on a timely basis.
- ensuring safeguards are in place in relation to long involvement with an audit client, including hot review.
- improving documentation of ethical issues, particularly those relating to the provision of non-audit services. This includes adequate documentation of who "informed management" is and why they qualify as such.
- in the case of listed companies, not providing accounting services. The AIU considered re-drafting notes to the accounts to be prohibited as accounting services.
- improving the clarity and sufficiency of documentation of significant audit judgements including inter-alia those relating to acquisition accounting, revenue recognition, goodwill impairment, pension valuations and deferred taxation, as well as judgements relating to the audit approach adopted such as the extent of testing controls.
- improving documentation and assessment of internal controls.

- improving assessment and documentation of audit risk. Examples of issues identified in this area are:
    - Inadequate assessment of the magnitude or likelihood or potential impact of risks identified;
    - Inadequate distinction on file between significant and other risks;
    - No or inadequate evaluation of the design and implementation of controls relating to significant risks;
    - Poor linkage between significant risks and the procedures designed to assess them including those in relation to linking risks identified at group level to the work at subsidiary or divisional level;
    - The risk of fraud relating to revenue recognition not identified as a significant risk, nor the presumption that it is a significant risk rebutted on the audit file;
    - Inadequate consideration of the risk of management override;
    - Inadequate communication of significant risk to subsidiary auditors; and
    - Inadequate documentation of fraud risk discussions with audit team members.
  - setting of expectations in advance of performing analytical substantive procedures and corroborating management explanations.
  - improving preliminary analytical review as a risk assessment tool.
  - improving assessment of quality of subsidiary auditors and the documentation thereof.
  - ensuring subsidiary auditors comply with group audit instructions.
  - improving the assessment and documentation of the competence and objectivity of experts such as actuaries and valuers, even where large or established firms of valuers were used.
  - improving the quality of communication with Audit Committees.
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