Meeting the VAT e-audit challenge
We are living in a digital age. Technological advances in extracting and analyzing data are having a big impact on how businesses operate. Tax administrations around the world are now catching onto this trend as they gather, exchange and use more taxpayer data than ever before and as they develop their electronic auditing capabilities. How can taxpayers prepare to meet the challenge?

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Electronic data extraction for VAT/GST: EY 2014 survey results

In April 2014, EY published a survey providing a snapshot of the VAT/GST electronic data collection, invoicing and archiving rules in 86 countries. It showed that EY advisers in 69 of the countries surveyed expect their tax administrations to use electronic data extraction to carry out VAT/GST audits (as shown in Figure 1). This is already a very high number and seems likely to increase, given the wide availability of data analytic software, the increased use of risk-based audits and the increased focus by tax administrations on VAT/GST compliance. In many markets, tax administrations are specifically adding data requirements to facilitate digital audits, and they are recruiting data specialists to boost their capabilities.

A global trend

As long as accounting entries are booked using computerized support, audits performed by the tax authorities will tend to follow the same path: pencils, erasers and calculators have largely vanished in favor of computerized tax audits. “Electronic data processing audits” (also called “e-audits”) generally have two objectives: (1) to carry out an analysis of the organization’s computer and information systems to evaluate the integrity of its production systems and potential security weaknesses and (2) to undertake a tax audit based on data analytics.

In the EU, the tax authorities tend to demand provision of computerized accounting data in electronic form in order to perform off-site audits. Many EU tax authorities are using private or publicly available data analysis software (such as ACL, IDEA and ACCESS) to carry out effective e-audits. Historically, e-audits focused mainly on indirect taxes (such as VAT), but that trend is changing with transfer pricing and other direct taxes also being examined using data analysis software.

More generally, in the beginning of the 2000s, the Organisation for Economic Co-operation and Development (OECD) published guidance for its members, advising them to standardize a norm for a computer file that allows the easy export of a predefined set of accounting records in a commonly readable format. The resulting Standard Audit File for Tax (SAF-T) also makes it easier for taxpayers to provide their electronic records to tax administrations to support their tax returns and for auditors to review accounting records. In 2010, the OECD updated its guidance note describing the processes needed in business and accounting software to attain a sufficient level of reliability for electronic records kept to support tax returns during the retention periods prescribed by the tax legislation in individual countries.

The OECD has suggested to tax authorities that they should implement the SAF-T by legislation or by voluntary agreement. Certain EU tax authorities have introduced the SAF-T (such as Portugal and Luxembourg), while other EU tax authorities have introduced variants of the SAF-T model to have a systematic e-audit approach (for instance, France, Germany and the Netherlands).

With a view to combating VAT fraud, the European Commission is now thinking about using data analysis tools or models comparable to the SAF-T in the framework of the mutual cooperation implemented between EU Member States, whereby they are exchanging more and more electronic data.

Why is VAT specifically attractive to e-audits?

The essence of VAT is data because it is a tax that applies to every single transaction undertaken by an enterprise (based on multiple invoices, which are the main means for assessing and recovering the amount of VAT due). The invoices on which the VAT system stands are just a combination of data (created from tables such as lists of client name and address, list of goods/services, list of VAT rates, lists of prices and rebates, etc.). This factor, combined with the increasing size of businesses operating internationally, means that, in most cases, companies must use robust systems to assess VAT correctly on every single transaction. For most modern organizations, issuing and recording invoices manually is no longer an option. So, if data is paramount for businesses in achieving effective management of indirect taxes and ensuring real-time, accurate VAT compliance, it makes sense that the tax authorities will also look to data analytics tools to perform quicker and more accurate tax audits.

The areas of the business where VAT e-audits may be performed are multiple and almost infinite. The following chart provides an overview of some of them, using practical examples, but this list is by no means exhaustive:

1. VAT/GST electronic filing and data extraction, EY global survey, EY, 2014 (EYG no. DL0935).

Indirect Tax Briefing – December 2014
The business perspective: difficulties facing businesses in e-audits

Up until now, most businesses, especially the largest organizations, have found it difficult and uncomfortable to undergo an e-audit even though they are used to managing indirect taxes (especially VAT/GST) electronically through their Enterprise Resource Planning (ERP) systems. What is causing this gap? Several reasons may help to explain it:

- First, the corporate departments responsible for information may not perceive that there is a need to store and retrieve data in an accessible form to facilitate tax audits. The data required to audit VAT is a bundled set of accounting data (e.g., book entries) and management data (e.g., details of customers, products, logistic information). This data is generally centrally managed and is the responsibility of the IT department (not the VAT or finance function). The perception of many IT departments is that there is little return on investment for the costs that must be incurred in storing and retrieving financial information (or for giving tax auditors access to electronically stored financial information), compared to the frequency of e-audits. In the past, perhaps this perception was justified, but now the reality is that e-audits are becoming widespread across the world.

- Second, difficulties often come from the e-audit procedure itself. Each country (even within the EU) individually defines the way it will carry out an e-audit; there is no uniform procedure and no uniform sets of data have to be provided to the tax administration in the numerous countries that have not adopted the SAF-T norm. Getting prepared for e-audits in advance is thus rather complicated.

- Another main reason for difficulties is that the in-house tax or VAT department may not sufficiently take control either of the way the ERP manages VAT (VAT settings) or of the data requested before it is provided to

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the tax authorities. For example, the electronic information provided to the e-auditor may go beyond the scope of the audit, or the e-auditors may disagree on the information access provided and they may wish to obtain more information. Further, the data provided could reveal “formal” VAT issues that are simply due to a mistake in the extraction program or to the absence of archiving of certain pieces of data. Therefore, it is becoming more critical than ever for the taxpayer to reach an understanding with the auditor about what is expected and what the auditor is looking for, especially as the audit is now often performed off-site. Since data can be easily manipulated and interpreted in multiple ways, the business must ensure that the electronic information is properly processed by the tax auditor to avoid misinterpretations.

- Last but not least, any changes in the IT systems or the supply chain may have consequences for the framework of future tax audits. Therefore, it is vital that any reorganization in the way that information is accessed is communicated to the tax or VAT department. In particular, if the company is moving to a new ERP system, it is crucial that the archiving requirements for e-audit purposes are duly taken into account when the old systems are retired and the information is migrated.

**Good practices for a relaxed e-audit**

Accepting that e-audits are now the current state and not the future state of tax audits permits the business to anticipate and prepare — as one is almost certainly coming soon! It does not matter what ERP system the business uses or which industry it operates in, good practices for getting prepared for an e-audit are pretty much the same. They include:

- Identifying the technical setup of the ERP system (VAT settings) and the fields/tables required from which data will have to be retrieved: this information is generally requested by the tax administration at the beginning of the e-audit.
- Determining which information is important for VAT purposes: this information is not restricted to accounting data and invoices; it includes details from the customer, supplier and products databases, as well as the algorithm for attributing VAT codes.
- Establishing a methodology for retrieving data in the manner and format requested by the tax authorities.
- Identifying specific tools in the case of large data sets to be able to audit and process the data extracted before delivering it to the tax authorities.
- Most fundamentally, archiving all the data! Most e-audits are difficult to manage because the data is not available. Since the statute of limitations differs from one country to another – as do the statutory archiving periods for elementary data, treatments and IT documentation – a country-by-country approach may be preferable to a global one. The format of the archive also varies between countries (certain countries authorize “online” keeping of data, but not all of them). Businesses should, nevertheless, consider the opportunity of using the SAF-T norm of the OECD as a starting point to set up a “VAT archive,” which should fit most purposes.

**Conclusions**

As e-audits become increasingly common around the world, taxpayers cannot ignore the implications. They must be aware of their obligations and of the sorts of demands that tax administrations are likely to place on their systems.

VAT data generally consists of large amounts of accounting and management information spread throughout the ERP or IT system. Getting prepared for an e-audit is therefore vital to managing future VAT audits. Key questions include: Where is our data located? How can I get access? What does it contain?

These demands may also logically influence the introduction of data analytics tools for use by in-house VAT functions to allow businesses to manage VAT more effectively and to prepare themselves for future e-audits. Having the same knowledge as the tax administrations about these new audit weapons will certainly help businesses to be more compliant before inspections and therefore more relaxed about the audit process when the time comes!
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