THE EXTENT OF COMPLIANCE WITH INCOME TAX PRESENTATION AND DISCLOSURE REQUIREMENTS IN THE FINANCIAL STATEMENTS OF COMPANIES IN SOUTH AFRICA

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ABSTRACT

Over the last few years a number of changes have been noted in the South African accounting profession. An improvements project was undertaken by the International Accounting Standards Board that changed a number of International Financial Reporting Standards (IFRS). These changes to international standards were also effected by the South African Institute of Chartered Accountants (SAICA) to South African accounting standards. SAICA also undertook a project to align the South African standards with IFRS. South African Statements of Generally Accepted Accounting Practice (SA GAAP) is now an exact replica of IFRS. The South African standard on income taxes has also been aligned with the international standard on income taxes. The objective of this study was to determine the extent that companies listed on the JSE Limited complied with the income tax presentation and disclosure requirements in their annual financial statements. The outcome of this study was also compared with a similar study conducted in 2002. The results of the study show that companies do comply with presentation and disclosure requirements to a great extent. There is, however, definite room for improvement. In some cases the extent of compliance has improved since the study conducted in 2002. In other cases it has worsened.

KEYWORDS

Deferred Tax
Disclosure
IAS 12
IFRS
Income Tax
Presentation
SA GAAP

1. INTRODUCTION AND BACKGROUND

Knowledge obtained in the past has indicated that presentation and disclosure requirements play an important part in good corporate governance. Disclosure requirements, even if it is not complied with from the start, encourage directors to improve controls to ensure that disclosure requirements are complied with. This in turns ensures better performance in the long run for the companies (National Association of Corporate Directors, 2002).

A number of corporate failures during the past few years have changed our financial reporting environment significantly. This has not been helped by the fact that there have been a number of restatements of financial statements which have harmed the trust that the users of financial statements have in the financial reporting process. To ensure that capital markets remain strong, it is important that financial reporting remain trustworthy and clear. Management, external auditors and the audit committee have an important role to play to improve the financial reporting process (Andersen, Deloitte & Touche, Ernst & Young, KPMG, PricewaterhouseCoopers & American Institute of Certified Public Accountants, 2002:1,10).

In the US a law has been passed in an attempt to re-establish the confidence of users in the financial reporting process and to improve corporate governance. This law, the Sarbanes Oxley Act of 2002, was drafted by Senator Paul Sarbanes and US Representative Michael Oxley in 2002 (Knowhow University). The Act sets out new standards for corporate accountability as well as penalties for non-compliance. Two of the aims of the Sarbanes Oxley Act are to ensure that financial statements reflect all required disclosures and that corporate governance is completely transparent (SOX-online).

Chanetse (2006) believes that the Sarbanes Oxley Act had the required outcome in the United States. This can be seen in the increase in the number of restatements since the Sarbanes Oxley Act was passed in 2002. In 2001 there were 270 restatements, 330 in 2002, 514 in 2003 and 619 in 2004. It is estimated that the number of restatements in 2005 will be 1200. This is all as a result of the possible consequences of non-compliance. In the past, prior year

errors would just have been corrected in the current year and the company would move on from there. Errors now need to be investigated further to understand why it happened. These reported restatements include errors with regards to deferred tax, foreign currency and interest rate swap hedging and joint ventures. From the above it seems as if the US is on the right track and that South Africa can learn from them.

In South Africa the King Report sets out the Code of Corporate Practices and Conduct. This applies, but is not limited to, "companies with securities listed on the JSE Securities Exchange South Africa" (King Report, 2002:20). One of the JSE Limited's (JSE) Listing Requirements is that companies need to state to what extent the company complied with the King Code and any reasons for not complying (JSE Limited Listing Requirements: §8.63). According to the King Report (2002:8), a prior report by an investor indicated that South Africa is in the top 5 of the 25 emerging markets with regards to corporate governance, but doesn't perform well when it comes to "disclosure and transparency". The King Report (2002:160) further states that there is a number of advantages when it comes to disclosure. For example, when certain disclosure regarding benefits to senior management or directors or other conduct is required, it can prevent excessive benefits being paid or transactions taking place. This is one way of preventing misconduct in companies. Disclosure is also a way of showing the users of financial statements where malpractice has taken place so that they can take action against it. It also suggests that other regulators should encourage more disclosure apart from that required by the Companies Act in South Africa (King Report, 2002:160). It is important for countries to have a good reputation when it comes to transparency and corporate governance. This will enable the countries to attract foreign investments (Lamberti, 2002).

Although both the Sarbanes Oxley Act of the United States and the King Report of South Africa, indicates that more and more focus is placed on corporate governance and disclosure, the world as we know it is a truly global village. Companies are expanding and gaining access to markets all over the world. With the different reporting frameworks, this process can be very difficult, as a comparison of the financial statements of different companies, with different reporting frameworks, are very complex and can be costly. Investors also experience this problem, as they want to invest their capital all over the world (DiPiazza & Eccles, 2002:17-18).

A study was undertaken in 2004 to determine which accounting bases the top ten companies listed on the JSE used. Of the ten companies, only 5 reported under South African Statements of Generally Accepted Accounting Practice (SA GAAP) or International Financial Reporting Standards (IFRS). Four of the companies used United Kingdom Generally Accepted Accounting Practice (UK GAAP) and the remaining company used Swiss Generally Accepted Accounting Practice (Swiss GAAP) (Van Zyl, 2004:14). This gives one a total of 4 different accounting bases used by these 10 companies. The reason for this is that companies that have dual listings, with the primary listing overseas, are not required to report under SA GAAP or IFRS if certain criteria are met (Van Zyl, 2004:14). Concerns are raised regarding the effect that different reporting frameworks used by companies listed on the JSE will have on the decision making of South African investors or foreign investors that want to invest in South Africa (Van Zyl, 2004:14). The problem mentioned is not just a problem in South Africa. This problem is experienced worldwide (DiPiazza & Eccles, 2002:33). To overcome this problem, a need exists for a single set of high quality financial reporting standards that are used globally. The increased use of IFRS is one step closer to this (DiPiazza & Eccles, 2002:16). The European Commission has required all listed companies to fully implement IFRS by January 2005 (Gower, 2004). The biggest obstacle that must be overcome to successfully implement financial reporting standards that are used globally is to ensure that United Stated Generally Accepted Accounting Practice (US GAAP) and IFRS converge (DiPiazza & Eccles, 2002:16). The Financial Accounting Standards Board[1] (FASB) and the International Accounting Standards Board[2] (IASB) has worked together since September 2002 in an attempt to converge IFRS and US GAAP (United Nations, 2005:7). The difference between US GAAP and IFRS is that US GAAP is much more rule orientated, while IFRS is more focussed on principles (DiPiazza & Eccles, 2002:40).

The global process that is currently being undertaken to create a single set of high quality international standards will ensure that investors can "compare apples with apples, instead of oranges with bananas" (Gower, 2004).

2. IMPORTANCE OF THIS STUDY

For financial periods beginning before 1 January 2005, companies listed on the JSE were required to present financial statements in accordance with SA GAAP or IFRS (JSE Limited Listing Requirements, §8.62) and for

[1] The accounting standards setting organisation in the US (Reh, 2006).
[2] The standard setting authority for IFRS.

periods beginning on or after 1 January 2005 in accordance with IFRS only (Doel, 2004). The aforementioned is not applicable if the company have a primary listing overseas and these companies will have to consult with the JSE in order to determine what basis will be acceptable (JSE Limited Listing Requirements, §18.5). In September 2002, the GAAP Monitoring Panel was formed. This panel was formed by the JSE with the help of The South African Institute of Chartered Accountants (SAICA) to monitor the compliance to one of these two frameworks (Everingham and Kana, 2004:x). If this panel finds that a company has not complied with SA GAAP or IFRS, the JSE has the discretion to censure such an issuer and instruct the issuer to re-issue or publish any information that the JSE requires (JSE Limited Listing Requirements: §8.65). From this it is clear that compliance with these Standards is of the utmost importance. The GAAP Monitoring Panel issued a report, "Omissions and Errors: September 2002 – December 2005 which details common areas of non-compliance to IFRS and SA GAAP for each standard (GAAP Monitoring Panel, 2006). The findings of the GAAP Monitoring Panel on non-compliance with income tax presentation and disclosure requirements are compared to the results of this study in paragraph 7.3.

This study focused on the extent of compliance with the presentation and disclosure requirements. A study was conducted in 2002 by Stiglingh and Kotze (2002:3.3) on the presentation and disclosure of income taxes in the financial statements of companies. It was evident from their study that not all companies have in the past complied with the income tax presentation and disclosure requirements.

Since this study in 2002, the income tax presentation and disclosure requirements that apply in South Africa have been revised and also aligned with IFRS. A number of significant changes were also noted in the accounting profession and corporate environment since the study done in 2002. It is, therefore, necessary to revisit the extent of the compliance of the income tax disclosure requirements.

3. OBJECTIVE

The main objective of this study was to determine to what extent South African companies listed on the JSE comply with the income tax presentation and disclosure requirements in their annual financial statements. As a similar study has been conducted in 2002, the results of this study have been compared to the outcome of the study in 2002.

4. SCOPE OF THE STUDY

This study focused on the extent of compliance with the income tax presentation and disclosure requirements in the financial statements of companies and did not include an evaluation of the quality of these disclosures.

Only companies listed on the JSE were used to evaluate the extent of compliance with the income tax presentation and disclosure requirements and this was further limited to companies reporting under SA GAAP or IFRS. Any disclosure requirements relating to Secondary Tax on Companies (STC) were excluded.

5. RESEARCH METHODOLOGY

A control list was prepared detailing presentation and disclosure requirements. A content analysis was performed. This was done by comparing the income tax presentation and disclosure, provided by the companies in their financial statements, with the control list, in order to determine the extent of compliance. Finally, the results of the content analysis were evaluated and this is presented in paragraph 7. The findings of the study are concluded on in paragraph 8.

6. INCOME TAX PRESENTATION AND DISCLOSURE REQUIREMENTS

Before the alignment of the South African standards with IFRS, a SA GAAP reporter had to prepare income tax disclosure in terms of AC 102 - Income Taxes and an IFRS reporter in terms of IAS 12 - Income Taxes. With the alignment of the standards, SAICA has taken a decision to issue the IFRSs in South Africa without amending the text (SAICA, 2003a:3). For easy reference, SAICA uses a dual numbering system, stating the international reference, as well as the South African reference. The standard on Income Taxes is numbered as follows: IAS 12 (AC 102) (SAICA, 2004:10). For this study we have selected IFRS and SA GAAP reporters. The IFRS reporters will need to comply with IAS 12 and the SA GAAP reporter with IAS 12 (AC 102). As IFRS and SA GAAP is exactly the same, references in this study will only be made to the international standard.

All disclosure requirements in IAS 12 - Income taxes, IAS 7 - Cash Flow Statements, IAS 1 - Presentation of Financial Statements and the Fourth Schedule[3] are set out below:

CONTROL LIST

Balance sheet and related notes	Paragraph reference
1. Tax assets and tax liabilities should be presented separately from other assets and liabilities in the balance sheet.[4]	IAS 12 par 69, 4th Schedule par 16(b)
2. Deferred tax assets and liabilities should be distinguished from current tax assets and liabilities.[5]	IAS 12 par 69, 4th Schedule par 16(c)
3. When an enterprise makes a distinction between current and non-current assets and liabilities in its financial statements, it should not classify deferred tax assets (liabilities) as current assets (liabilities).[6]	IAS 12 par 70
4. An enterprise should offset current tax assets and current tax liabilities if, and only if, the enterprise: (a) has a legally enforceable right to set off the recognised amounts; and (b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.[7]	IAS 12 par 71
5. An enterprise should offset deferred tax assets and deferred tax liabilities if, and only if: (a) the enterprise has a legally enforceable right to set off current tax assets against current tax liabilities; and (b) the deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority on either: (i) the same taxable entity; or (ii) different taxable entities which intend either to settle current tax liabilities and assets on a net basis, or to realise the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.[8]	IAS 12 par 74
6. The amount (and expiry date, if any) of deductible temporary differences, unused tax losses, and unused tax credits for which no deferred tax asset is recognised in the balance sheet;	IAS 12 par 81(e)
7. The aggregate amount of temporary differences associated with investments in subsidiaries, branches and associates and interests in joint ventures, for which deferred tax liabilities have not been recognised.[9]	IAS 12 par 81(f)
8. In respect of each type of temporary difference, and in respect of each type of unused tax losses and unused tax credits:	IAS 12 par 81(g), 4th Schedule par 16(c)

3 The Fourth Schedule above refers to the disclosure requirements that need to be complied with in terms of the Companies Act No. 61 of 1973 in South Africa.
4 This requirement has subsequently been deleted from IAS 12 and included in IAS 1 par 68(m).
5 This requirement has subsequently been deleted from IAS 12 and included in IAS 1 par 68(n).
6 This requirement has subsequently been deleted from IAS 12 and included in IAS 1 par 70.
7 A company will not be allowed to offset a current tax asset/(liability) of a local entity against a current tax (liability)/asset of a foreign entity. Only if tax is levied by the same tax authority, and it has been agreed by them that these two amounts can be offset and will be paid simultaneously, can tax assets and liabilities be off-set (Vorster et al., 2005:160). It is rather difficult to determine from the financial statements whether an agreement has been entered into with the tax authorities or what the intention of the company was. Twenty one companies disclosed current tax assets and current tax liabilities separately. Two companies didn't have a current tax asset or liability and the other 40 companies only showed either a current tax asset or a current tax liability. It is uncertain whether all the companies in the group had either tax assets or tax liabilities, or whether the tax assets and liabilities met the requirements above for offsetting. This requirement is therefore not analysed further.
8 The same requirements as discussed under requirement 4 are applicable for deferred tax assets and deferred tax liabilities. Eight of the companies specifically disclosed in their accounting policies or in the deferred tax note that deferred tax assets and liabilities are only offset if it is levied by the same tax authority or if it is within the same legal entity. Forty companies disclosed the deferred tax asset and liability separately. Twenty two companies only showed either a deferred tax asset or a deferred tax liability. One company disclosed in the note that it has deferred tax assets and liabilities, but the amounts were off-set it in the balance sheet. Maybe offsetting was appropriate for this company.
9 Paragraph 39 of IAS 12 determines that a deferred tax asset or liability for temporary differences relating to investments in subsidiaries, joint ventures, branches and associates should be recognised, except if certain conditions are met. As it is very difficult to determine from the financial statements whether these conditions have been met, this requirement was not evaluated.

(i) the amount of the deferred tax assets and liabilities recognised in the balance sheet for each period presented; (ii) the amount of the deferred tax income or expense recognised in the income statement, if this is not apparent from the changes in the amounts recognised in the balance sheet;	
9. An enterprise should disclose the amount of a deferred tax asset and the nature of the evidence supporting its recognition, when: (a) the utilisation of the deferred tax asset is dependent on future taxable profits in excess of the profits arising from the reversal of existing taxable temporary differences; and (b) the enterprise has suffered a loss in either the current or preceding period in the tax jurisdiction to which the deferred tax asset relates.[10]	IAS 12 par 82
10. An enterprise discloses any tax-related contingent liabilities and contingent assets in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. [11]	IAS 12 par 88
11. Where changes in tax rates or tax laws are enacted or announced after the balance sheet date, an enterprise discloses any significant effect of those changes on its current and deferred tax assets and liabilities.	IAS 12 par 88
12. There shall be stated: (a) the estimated tax effect of tax losses available for set off against future taxable income, before and after they have been applied to reduce deferred taxation; and (b) the total unprovided net timing differences separately stating those relating to the current year.	4th Schedule par 48
Income statement and relates notes	
13. The tax expense (income) related to profit or loss from ordinary activities should be presented on the face of the income statement.	IAS 12 par 77
14. If no provision for taxation has been made, that fact and the reason therefore shall be stated.	4th Schedule par 45
15. The major components of tax expense (income) should be disclosed separately. Components of tax expense (income) may include: (a) current tax expense (income); (b) any adjustments recognised in the period for current tax of prior periods;	IAS 12 par 79-80 a-h 4th Schedule par 42 (d)[13] 4th Schedule par 42 (d)

10 This requirement was not evaluated. This is because it is very difficult to determine whether the various subsidiaries in the group have suffered losses in the current or prior financial year from the consolidated financial statements to meet the requirements of (b).

11 This requirement can only be evaluated if the appropriate information is disclosed. Eight companies disclosed disputes with taxation authorities. The requirement was considered not applicable to the other companies as no information to the contrary was provided.

12 This requirement has subsequently been changed to the following as a result of the changes to IAS 8 Accounting Policies, Changes in Estimates and Errors: “the amount of tax expense (income) relating to those changes in accounting policies and errors that are included in profit or loss in accordance with IAS 8, because they cannot be accounted for retrospectively.” This revised requirement is not applicable for this study as the effective date of the revised standard was for periods beginning on or after 1 January 2005 (IAS 8 par 54).

13 Requirements (a), (b) and (d) are required by both IAS 12 and the fourth schedule.

(c) the amount of deferred tax expense (income) relating to the origination and reversal of temporary differences; (d) the amount of deferred tax expense (income) relating to changes in tax rates or the imposition of new taxes; (e) the amount of a benefit arising from a previously unrecognised tax loss, tax credit or temporary difference of a prior period that is used to reduce current tax expense; (f) the amount of benefit from a previously unrecognised tax loss, tax credit or temporary difference of a prior period that is used to reduce the deferred tax expense; (g) deferred tax expense arising from the write-down, or reversal of a previous write-down, of a deferred tax asset in accordance with paragraph 56; (h) the amount of tax expense (income) relating to those changes in accounting policies and fundamental errors which are included in the determination of net profit or loss for the period in accordance with the allowed alternative treatment in IAS 8 Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies.[12]	4th Schedule par 42(e)
16. Tax expense (income) relating to extraordinary items recognised during the period;[14]	IAS 12 par 81(b) and 83
17. The aggregate current and deferred tax relating to items that are charged or credited to equity;	IAS 12 par 81(a)
18. An explanation of the relationship between tax expense (income) and accounting profit in either or both of the following forms: (i) a numerical reconciliation between tax expense (income) and the product of accounting profit multiplied by the applicable tax rate(s), disclosing also the basis on which the applicable tax rate(s) is (are) computed; or (ii) a numerical reconciliation between the average effective tax rate and the applicable tax rate, disclosing also the basis on which the applicable tax rate is computed;	IAS 12 par 81(c)
19. An explanation of changes in the applicable tax rate(s) compared to the previous accounting period;	IAS 12 par 81(d)
20. In respect of discontinued operations, the tax expense relating to: (i) the gain or loss on discontinuance; and (ii) the profit or loss from the ordinary activities of the discontinued operation for the period, together with the corresponding amounts for each prior period presented;	IAS 12 par 81(h)
Cash flow statement and relates notes	
21. Cash flows arising from taxes on income should be separately disclosed and should be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities.	IAS 7 par 35
22. When tax cash flows are allocated over more than one class of activity, the total amount of taxes paid is disclosed.	IAS 7 par 36

7. CONTENT ANALYSIS

7.1 SELECTING THE SAMPLE

This study was limited to the top 200 companies listed on the JSE. This was determined based on the market capitalisation of these companies as per the Financial Mail on 6 May 2005. A sample of 63 companies was selected using probability sampling. The sample of 63 was determined based on a population of 200 (Stoker, 1981). The

14 The above requirement has subsequently been removed as a result of the changes to IAS 8 and IAS 1 par 85 that specifically prohibits the disclosure of items as extraordinary. This IAS is also applicable for year-ends beginning on or after 1 January 2005 and was not applicable for the year-ends that were examined.

companies included in the sample were then randomly selected, using simple random sampling. As the aim of this study was mainly to focus on SA GAAP and IFRS, any company selected not using one of these frameworks was rejected and a new one was selected.

The selection was made by listing the top 200 companies on the JSE in Microsoft Excel, from the company with the highest market capitalisation to the one with the lowest market capitalisation. These were then numbered from 1 to 200. Using the sampling function in Microsoft Excel, 63 numbers were randomly generated. The 63 companies associated with those numbers were used in this study. The following process was followed in Microsoft Excel to select the sample. Selected "Data Analysis" from the "Tools" Menu. Selected "Sampling". The cells where the companies were numbered were entered as the "Input Range". Selected "Random" for the sampling method and entered 63 as the number of samples to be selected. Sixty three numbers were then generated in Microsoft Excel.

Of the original 63 companies selected, only 2 companies did not use IFRS or SA GAAP. Two new companies were, therefore selected. The year-ends of the companies selected ranged from March 2004 to March 2005. These year-ends were determined based on the available financial statements as they appeared on the companies' websites at the beginning of this study.

7.2. METHOD OF EVALUATING RESULTS

The control list was used to determine the extent of compliance with the presentation and disclosure requirements. The extent of compliance was not tested for comparative amounts and was only tested based on the Group results. If it was evident from the information provided in the financial statements of a company that a certain requirement was not applicable to that company, this has been indicated in the "Not Applicable" column. For example, companies are required to disclose the fact and reason if no provision for income taxes has been made. If the company didn't have an assessed loss in the current year, this requirement will not be applicable. The percentage of companies that complied with the requirements was also determined on a basis which excludes the companies for which the requirement was "not applicable". In instances where the disclosure requirement tested in this study (2005 study), was also tested in the study conducted by Stiglingh & Kotze (2002: 3.3) (2002 study), a comparison was made between the two studies.

The evaluation of results is set out in paragraph 7.3 and divided into the following three areas: balance sheet and related notes, income statement and related notes, and cash flow statement and related notes.

7.3 EVALUATION OF RESULTS

BALANCE SHEET AND RELATED NOTES

1. *Tax assets and tax liabilities should be presented separately from other assets and liabilities in the balance sheet.*

97% (2002: 100%) of the selected companies complied with this requirement. It was not applicable in two instances as the two companies had assessed losses for the current and previous year. The percentage of compliance is slightly less than it was for the study conducted in 2002. One of the 2 companies that didn't comply showed the tax payable separately on the balance sheet, but the prepaid tax was included with trade and other receivables. The other company showed both the prepaid tax and tax payable with trade and other receivables and other current liabilities respectively.

2. *Deferred tax assets and liabilities should be distinguished from current tax assets and liabilities.*

In all cases (100%) deferred tax assets and liabilities were shown separately from current tax assets and liabilities. This was consistent with the 2002 results (100%).

3. *When an enterprise makes a distinction between current and non-current assets and liabilities in its financial statements, it should not classify deferred tax assets (liabilities) as current assets (liabilities).*

	Complied with	Not complied with	Not applicable	Percentage compliance
2005 study	56	1	6	98%
2002 study	10	0	0	100%

One of the companies failed to comply with this requirement, as the deferred tax asset was included in current assets. This is worse than the 2002 results when all companies met this requirement. The companies that this was not applicable for, either didn't recognise deferred tax or didn't distinguish between current and non-current assets.

6. *The amount (and expiry date, if any) of deductible temporary differences, unused tax losses, and unused tax credits for which no deferred tax asset is recognised in the balance sheet.*

	Complied with	Not complied with	Not applicable	Percentage compliance
2005 study	27	9	27	75%
2002 study	8	2	0	80%

If no information to the contrary was disclosed, the above requirement was considered not to be applicable (27 companies). Only 8 of the 27 companies that disclosed the amount that was not recognised disclosed any information regarding the expiry dates. The expiry dates are only required if there are any. In South Africa assessed income tax losses do not expire, but unused section 6quat credits expire after seven years. The section 6quat credits refer to rebates in respect of foreign taxes on income (Income Tax Act No 58 of 1962). The 9 companies that did not comply with this requirement showed deferred tax not recognised in the income tax reconciliation indicating that this requirement is applicable.

The GAAP Monitoring Panel (2006: 2) also found that certain companies do not disclose the amount of unused tax losses for which no deferred tax asset is recognised.

8. *In respect of each type of temporary difference, and in respect of each type of unused tax losses and unused tax credits:*

		Complied with	Not complied with	Not applicable	Percentage compliance
(i) the amount of the deferred tax assets and liabilities recognised in the balance sheet for each period presented	**2005 study**	58	2	3	97%
	2002 study	9	0	1	100%
(ii) the amount of the deferred tax income or expense recognised in the income statement, if this is not apparent from the changes in the amounts recognised in the balance sheet	**2005 study**	32	28	3	53%
	2002 study	-	-	-	-

(a) Only 2 of the companies did not disclose the deferred tax asset and liability for each type of temporary difference. These 2 companies only gave a breakdown of the net deferred tax liability, splitting it into deferred tax assets and deferred tax liabilities. One of the 2 companies did, however, provide a detailed breakdown of the charge to the income statement as required in (ii) above.

(b) Thirty two of the 63 companies either specifically disclosed the amount recognised for each type of temporary difference (17 companies) in the income statement, or it was easily identifiable from the movement in the balance sheet amounts (15 companies). Seventeen of the 28 companies that did not comply with this requirement showed the movement in the type of temporary difference, but this was not the amount recognised in the income statement. The other 11 companies showed the movement through the income statement as a single amount, and did not separately disclose the components of this movement for each type of temporary difference. The reason that the movement in the balance sheet items did not equal the charge through the income statement is, amongst others, as a result of amounts recognised directly in equity.

The GAAP Monitoring Panel (2006:3) also found that companies do not sufficiently comply with this disclosure requirement.

11. *Where changes in tax rates or tax laws are enacted or announced after the balance sheet date, an enterprise discloses any significant effect of those changes on its current and deferred tax assets and liabilities.*

On 23 February 2005, the Minister of Finance reduced the corporate tax rate from 30% to 29% and that applied for all financial year-ends ending after 1 April 2005. The 23rd of February is considered to be the date that the tax rate has been "substantively enacted" (PriceWaterhouseCoopers 2/2005).

Thirteen of the companies selected had year-ends before 23 February 2005 and approved their financial statements after the date that the change in the corporate tax rate was announced. None of these companies disclosed any information regarding the effect that the change will have on the current and deferred tax assets and liabilities. The companies might have considered the 1% change not to be "significant".

12. *There shall be stated:*

		Complied with	Not complied with	Not applicable	Percentage compliance
(a) the estimated tax effect of tax losses available for set off against future taxable income, before and after they have been applied to reduce deferred taxation; and	**2005 study**	16	40	7	29%
	2002 study	9	0	1	100%
(b) the total unprovided net timing differences separately stating those relating to the current year.	**2005 study**	0	2	61	0%
	2002 study	7	0	3	100%

(a) Sixteen companies disclosed the assessed losses that are available to reduce taxes in future, before and after reducing the deferred tax liability. For 17 of the 40 companies that didn't comply, it was clear that the company had assessed losses, but no further disclosure was given. The other 13 companies specifically disclosed the assessed losses either before or after the deferred tax liability had been reduced, but not both. The remaining 7 companies either had no assessed losses, or no information was disclosed regarding unutilised assessed losses.

(b) Sixty one of the companies didn't provide any disclosure with regards to net timing differences not provided. One company who did not comply disclosed the total net timing differences not provided, but didn't disclose the amount arising in the current year. The other company that did not comply disclosed the amount not provided in the tax rate reconciliation, but didn't make any further disclosures.

INCOME STATEMENT AND RELATED NOTES

13. *The tax expense (income) related to profit or loss from ordinary activities should be presented on the face of the income statement.*

As has been the case with the 2002 study, this is a requirement that all the selected companies complied with (2005 study – 100%, 2002 study – 100%).

14. *If no provision for taxation has been made, that fact and the reason therefore shall be stated.*

This requirement was only applicable for 5 of the 63 companies. One of these companies did not disclose the fact and the reason, giving a percentage compliance of 80%. This requirement was not applicable in 2002.

15. *The major components of tax expense (income) should be disclosed separately. Components of tax expense (income) may include:*

"Major Components"	Study	Complied with	Not complied with	Not applicable	Percentage compliance
(a) current tax expense (income);	**2005**	60	0	3	100%
	2002	10	0	0	100%
(b) any adjustments recognised in the period for current tax of prior periods;	**2005**	47	1	15	98%
	2002	10	0	0	100%
(c) the amount of deferred tax	**2005**	0	60	3	0%

expense (income) relating to the origination and reversal of temporary differences;	**2002**	8	2	0	80%
(d) the amount of deferred tax expense (income) relating to changes in tax rates or the imposition of new taxes;	**2005**	7	7	49	50%
	2002	3	0	7	100%
(e) the amount of a benefit arising from a previously unrecognised tax loss, tax credit or temporary difference of a prior period that is used to reduce current tax expense;	**2005**	0	0	63	N/A
	2002	6	1	3	86%
(f) the amount of benefit from a previously unrecognised tax loss, tax credit or temporary difference of a prior period that is used to reduce the deferred tax expense;	**2005**	2	30	31	6%
	2002	8	1	1	89%
(g) deferred tax expense arising from the write-down, or reversal of a previous write-down, of a deferred tax asset in accordance with paragraph 56;	**2005**	1	1	61	50%
	2002	2	0	8	100%
(h) the amount of tax expense (income) relating to those changes in accounting policies and fundamental errors which are included in the determination of net profit or loss for the period in accordance with the allowed alternative treatment in IAS 8 Net Profit or loss for the Period, Fundamental Errors and Changes in Accounting Policies"	**2005**	0	0	63	-
	2002	-	-	-	-

As can be seen from the table above, most of the requirements relating to the "major components" of tax expense were disclosed:

a) This requirement to disclose the current tax expense was met in 100% of the cases for which it was applicable. This is in line with the study conducted in 2002.

b) There was a slight decrease in the percentage of compliance for the disclosure of prior year adjustments from 100% in 2002 to 98% in 2005. This is as a result of one of the companies not including the prior year adjustments in the detail provided for the tax expense. The information was, however, included in the reconciliation between the actual tax charge and the tax charge at the standard rate.

c) The total deferred tax expense was disclosed for the 60 companies that had a movement in the deferred tax balance. However, the requirement is that the deferred tax expense for originating temporary differences and the reversal of temporary differences need to be disclosed. This was not disclosed for any of the companies.

d) Only 7 companies disclosed information with regards to changes in tax rates. Seven other companies had rate changes as reconciling items in the tax rate reconciliation, but didn't disclose it separately as a component of the income tax expense. It was assumed that this requirement was not applicable for the other companies as nothing to the contrary was noted. Two of the 7 companies that complied with this requirement, included the information in the deferred tax note under the heading "income statement movement". This was considered to be sufficient disclosure.

e-f) Requirement (e) and (f) will be discussed together as companies didn't disclose sufficient information to determine if the utilisation of an assessed loss was used to reduce deferred tax or current tax. Only 2 of the

companies clearly met requirement (f). The one company divided the deferred tax charge to the income statement in the deferred tax note between the normal movement and the deferred tax asset now recognised. The other company disclosed it separately in the income tax note. None of the other 30 companies included the amount of the benefit in the income tax note. It was clear from the tax rate reconciliations that this requirement is applicable for some of the companies, as 32 of the companies showed in the reconciliations "utilisation of assessed losses" or "deferred tax previously not recognised".

g) Only 50% of the companies for which the requirement to disclose the deferred tax expense arising from the write-down, or reversal of a previous write-down, of a deferred tax asset was applicable complied with the requirement. As can be seen from the current study and in the prior study, this requirement is normally not applicable: 92% in 2005 (80% in 2002).

h) This requirement will only be applicable for companies that reported under IFRS, as the allowed alternative treatment in IAS 8 was not allowed in AC 103. IAS 8 (AC 103) will only be applicable from 1 January 2005 and, therefore, companies reporting under SA GAAP are still using AC 103 (SAICA, 2004:7). Only 2 of the 63 companies selected reported under IFRS. As these companies did not use the alternative treatment for changes in accounting policy, this requirement was not applicable at all.

16. *Tax expense (income) relating to extraordinary items recognised during the period.*
None of the companies selected had an extraordinary item and, therefore, the percentage of compliance with this requirement could not be evaluated.

17. *The aggregate current and deferred tax relating to items that are charged or credited to equity.*
The percentage of compliance with this requirement has decreased from 100% in the 2002 study to 67% in the 2005 study. For the 20 companies that complied with this requirement, the amount of tax that relates to the items that were charged to equity, was either shown in the statement of changes in equity or in a note. Ten companies did not comply with the above requirement, although 6 of these companies disclosed either in the accounting policies that the tax effect of items that are directly charged to equity is also charged to equity or that the amounts in the statement of changes in equity are net of tax. These 6 companies, however, did not disclose the aggregate amount as is required.

18. *An explanation of the relationship between tax expense (income) and accounting profit in either or both of the following forms:*

(i) a numerical reconciliation between tax expense (income) and the product of accounting profit multiplied by the applicable tax rate(s), disclosing also the basis on which the applicable tax rate(s) is (are) computed; or

(ii) a numerical reconciliation between the average effective tax rate and the applicable tax rate, disclosing also the basis on which the applicable tax rate is computed.

One company didn't give a reconciliation. This company had an assessed loss and didn't recognise a deferred tax asset. This is a decrease in percentage of compliance from 100% in the 2002 study to 98% in the 2005 study. All the other companies gave a reconciliation to explain the relationship between the tax expense and the accounting profit. Seven of the companies gave the reconciliation in amounts and 55 companies gave rate reconciliations.

The GAAP Monitoring Panel (2006:1) found that the reconciliations were not performed properly. This study did not evaluate the quality of the reconciliation.

19. *An explanation of changes in the applicable tax rate(s) compared to the previous accounting period.*
All the companies had a year-end on or before 31 March 2005 and the tax rate used to determine the current tax for the current and previous year remained unchanged. With regards to deferred tax, 23 February is considered the date that the tax rate has been "substantively enacted" and companies with a year-end of 28 February 2005 have to determine deferred tax at 29%. Eight companies had 28 February 2005 year-ends. Three of these didn't disclose any rate changes. Only one (12.5%) company stated that a new tax rate was announced. Nine companies with year-ends other than 28 February 2005 showed changes in tax rates.

20. *In respect of discontinued operations, the tax expense relating to:*
(i) the gain or loss on discontinuance; and
(ii) the profit or loss from the ordinary activities of the discontinued operation for the period, together with the corresponding amounts for each prior period presented.

This requirement was applicable for 10 of the 63 companies selected. Only 2 of the companies disclosed the tax effect of the gain or loss on discontinuance as per the first requirement (20%), whilst 7 of the companies disclosed the tax expense relating to the profit or loss from the ordinary activities of the discontinued operation as per the second requirement (70%).

CASH FLOW STATEMENT AND RELATED NOTES

21. *Cash flows arising from taxes on income should be separately disclosed and should be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities.*

An improvement can be seen in this requirement from 90% in the 2002 study to 98% in the 2005 study. One company didn't comply as the company combined the taxes paid with dividends paid. Two of the 63 companies had an assessed loss in the current and prior financial year and did not pay any taxes.

22. *When tax cash flows are allocated over more than one class of activity, the total amount of taxes paid is disclosed.*

The 61 companies that paid tax during the year, disclosed the total tax paid for the year under operating activities, making this requirement not applicable.

During the study conducted in 2002, companies were required by AC 118 par 40 to give reconciliations between the income tax charge for the year in the income statement and the tax paid (Stiglingh, 2002: Annexure 1). Only 60% of the companies complied with the requirement then. Of the 61 companies selected for the 2005 study that paid taxes during the year, 53 showed reconciliations between the tax paid and the tax as disclosed in the income statement. Although this is not a requirement, it is clear from the above that companies consider this valuable information for the users of financial statements.

8. CONCLUSION

The main objective of this study was to determine to what extent South African companies listed on the JSE comply with the income tax presentation and disclosure requirements in their annual financial statements.

It is clear from the above study conducted on a sample of 63 of the top 200 companies listed on the JSE, that these companies comply to a great extent to the presentation and disclosure requirements as required by IAS 12. In some cases an improvement can be seen in the extent of compliance with these requirements since the study conducted in 2002, whilst in other cases it has worsened

The information as disclosed in the balance sheet, was mostly in line with the requirements. It is, however, in the notes to the balance sheet where significant improvement is required. Disclosure with regard to deferred tax needs to improve. Sufficient information is not disclosed with regard to temporary differences, unrecognised deferred tax assets and unused tax losses. It was noted that most of the companies (54 out of 60) still disclose reconciliations between the opening and closing balances of deferred tax assets and liabilities, although this is not required by IAS 12. This can either be as a result of companies being in the habit to disclose this information, or as a result of the fact that it is considered to provide useful information to users of financial statements.

For the income statement it is also in the notes where the companies need to improve. As was seen in the balance sheet, it is disclosure with regards to deferred tax and temporary differences that is not up to standard. In 2002, 100% of the companies provided the required disclosure with regards to amounts recognised in equity. In 2005, however, only 67% complied with this requirement. Definite improvements are required in this area.

In 2002, the area where an improvement in disclosure was required, related to the cash flow statement. In the current study only one company didn't fully comply with the requirements.

As can be seen from the study, not all requirements were 100% complied with. The effect of this on the users of financial statements has not been evaluated and provides an opportunity for further research in this regard.

The King Report (2002:9) quoted Arthur Levitt, the former Chairperson of the US Securities and Exchange Commission, to stress how important good corporate governance and good disclosure is for a country: *"If a country does not have a reputation for strong corporate governance practices, capital will flow elsewhere. If investors are not confident with the level of disclosure, capital will flow elsewhere. If a country opts for lax accounting and reporting standards, capital will flow elsewhere. All enterprises in that country – regardless of how steadfast a particular company's practices may be – suffer the consequences.*"

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