Monitoring of Regulations and Contract Agreements

Background

During 2006, a tax law was passed by a governmental body with jurisdiction over a subsidiary of The Brink's Company ("Brink's"). The law imposed an additional tax on services provided to customers operating in a specific industry. The tax expense is calculated as a percentage of revenue earned and therefore it should have been accrued as revenue was recorded in order to comply with US GAAP. However, because the finance department at the Brink's subsidiary was not aware of the 2006 tax law, the tax expense was recorded on a cash basis instead of being accrued as the related revenue was earned.

This incorrect accounting treatment was identified by the Brink's subsidiary finance department during 2012 when a large customer operating in the industry impacted by the tax law paid outstanding invoices for the previous 6 months, triggering an immediate payment of the related taxes. Upon identifying the large tax payment, the Brink's subsidiary finance department reviewed the accounting treatment of the tax expense and concluded that the subsidiary had not been complying with US GAAP. The inappropriate accounting treatment resulted in an understatement of liabilities / expenses in excess of $2.5 million.

Lessons Learned

New laws and regulations, or changes to existing laws and regulations, in jurisdictions where Brink's operates often have an impact on financial reporting. The Brink's subsidiary did not have procedures in place to identify and react to legal / regulatory changes. Brink's finance teams should implement formal processes to ensure that emerging legal / regulatory issues applicable to Brink's are identified. These processes should include regular and documented communication with local Legal, Tax and Human Resource departments. Once identified, finance teams are expected to evaluate the impact of the legal / regulatory changes on financial reporting and implement any required adjustments to local accounting policy / procedures in order to ensure the reporting within HFM is in accordance with US GAAP.

In addition to changes in the legal / regulatory environment, finance teams should consider the accounting implications of terms contained within customer and vendor contracts. Contractual terms and requirements can have a significant impact on the US GAAP treatment of transactions with the related customers or vendors. For example, customer contracts that meet the definition of multiple-element deliverable arrangements under US GAAP require specific accounting treatment for the recognition and measurement of revenue. Finance teams should implement formal processes to ensure that significant contracts are reviewed by finance team members in order to determine the appropriate accounting treatment. The reviews should be performed by personnel with sufficient knowledge and experience to evaluate the potential US GAAP impact of contract terms. The Corporate Accounting department can also be consulted.