White Paper

Planning Budgeting Forecasting Profitability Analytics Consolidation Reporting Tax

Corporate Tax Governance: What's the Problem?

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A Longview Whitepaper

Tax Governance

As tax professionals charged with managing the complex tax operations of today's multinationals, success used to require an undaunting focus on tax: staying current with federal, state and international tax laws, finding and implementing creative ways to apply those laws in order to reduce global taxation, identifying and managing the related tax risks and rigorously defending the company's tax positions. Accounting and reporting of global income taxes was simply an annual task, almost an afterthought and often not a strong skill of tax executives.

With SOX, that world was overturned. For now, the pendulum has swung for the global tax executive. Where he/she could hide in the corner office and focus solely on designing and implementing tax structures to minimize global income taxes, now he/she is more visible to the CFO, CEO and Audit Committee and must focus on accurately accounting for income taxes and the internal controls surrounding this process. Talk about night and day. It's no longer just the world of IRC section 482, 904(f), 861 allocations, check-the-box and listed transactions. It's now about FAS 109, FAS 5, SAB 99 and how to accurately account and report the affect of their company's global income tax position. What a difference a year and a couple of corporate governance scandals can make.

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This shift in focus has not come easy for today's tax executives. It requires a different skill set and mental approach. The old world was all about minimizing transparency so that their creative and legitimate application of global income tax laws withstood the scrutiny of taxing authorities. In the new world of SOX, Schedule M-3 and audit mania, transparency is king. The focus now is how to fix significant deficiencies (or material weaknesses) in tax internal controls and how to improve transparency. So, how is this done?

Problem-solving 101 states that in order to fix a problem's symptoms (weak tax internal controls and lack of transparency) you must pinpoint the exact cause of the problem. When you face a problem as broad and complex as the financial reporting of a global company's income taxes, it is understandably difficult to define, i.e. to "see the forest through the trees" so to speak. But to succeed in solving the problem, the global CFO, Corporate Controller and Tax executive must do just that. As a career tax executive, now Tax IT vendor, I've "been there, done that" (global FAS 109 reporting) and now see firsthand how corporate finance executives struggle with this problem definition and therefore, resolution. Based on our interactions with customers and prospects, they seem to agree on the symptoms:

1. "Not accurate enough" global income tax provisions
2. "Not accurate enough" deferred tax balances
3. Inefficient corporate income tax provision process (impacts quarter/annual close)
4. Unacceptably large return to provision true-ups
5. Lack of transparency (and understanding) as to what is driving the consolidated tax numbers
6. Weak tax internal controls

Most tax executives see the problem as a "tax" problem. One that can only be solved by experienced, high-level tax professionals who understand federal, state and international income taxes, US GAAP accounting in general and the application of the balance sheet method of accounting for income taxes to a company's results of operations. However, when you delve into the causal factors a little further, you find that it really is not a "tax" problem at all, but more suitably termed a "data" problem.

To produce accurate, timely and comprehensible global income tax provisions and required disclosures, every company takes its global financial *data* (in fact, reams of it), processes it according to all of its jurisdiction's *tax rules* and reports the outcomes in accordance with its financial *reporting standards*. So, there are three potential areas where the problem could arise: data, tax rules and/or reporting rules.

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Putting the data issue aside and for purposes of brevity let's assume that, as tax professionals, the problem is not in understanding and applying the tax rules. This has been the career focus of all tax professionals and, while very complex, most tax executives of today's multinationals are more than up to the task here. In addition to their tax expertise, they typically are insured via the advice and counsel of their outside tax advisors. In addition, when you consider that most tax laws, whether as promulgated under the US Internal Revenue Code or other country's tax codes, can be complied with via simple addition, subtraction, multiplication and division, the problem is not the complexity of the tax math. So, it is not a tax problem.

In the same way, while FAS 109 and Regulation S-X are complex, the rules have been around a while, are understandable and can be applied by most competent corporate controllers and tax executives. So, the problem is not with the accounting/reporting rules.

By process of elimination, then, the main problem causing the above symptoms is the data. Ask most Corporate Tax executives and they will tell you that their biggest problem is reconciling and manipulating book data just to get to an accurate *starting* point to compute their tax provisions. That is a data problem. A U.K. subsidiary's Controller has access to his local statutory accounts, his US GAAP accounts and his tax returns, but does not accurately track and roll forward his local temporary differences. That is a data problem. The typical corporate tax department takes 9.5 months to convert their company's book data to a fileable tax return format. The actual data is available immediately upon year-end close. The tax rules are known at or by the previous year-end. That, then, is a data problem. Data integrity, data accountability, data access and visibility and data currency. But how are these data problems solved? Well, that is where today's tax technology can help.

> *"Between the top internal and external tax talent at today's multinationals, it is a safe bet that if "tax" was the problem, they would have solved it a long time ago"*

Let's look at each of these data components and how they might be solved within the context of the corporate income tax process:

1. Data Integrity – This is the simple concept of garbage-in equals garbage-out. If the data entering the system is not accurate, then the resulting provision will also not be accurate. For example, inefficient methods of collecting and consolidating data can result in accurate source data being consolidated to the wrong legal entity. Another example is the likelihood of errors arising from using the typical manual, Excel-based data collection and tax provision solutions which by inherent design limitations, require multiple manual entries of the same data. Solution to Data Integrity Problem: Touch data once! Throughout the entire system, one person owns each data input and that is the only person who touches that data.

2. Data Accountability – This is an off-shoot of data integrity. In today's world of SOX the CFO must attest to the validity of the data reported in the annual report, including the global income tax provision and tax balance sheet accounts. To confidently do this, the CFO needs to know that the individuals in the field supplying the inputs are held accountable for their submitted data. Solution to Data Accountability Problem: Know and track each data owner's data touches.

3. Data Access & Visibility – Ultimately, someone at Corporate must compile all of the tax provisions and deferred taxes of each legal entity across the globe, pull it together, tie it out and draft the income tax footnote. In most cases this is a tax professional or group at Corporate. To be ultra efficient, that individual needs "click-through/drill down" access to the underlying book and tax data driving the footnote disclosures. In addition they need to see how these data inputs are processed in order to opine in the accuracy of the calculations. In the majority of today's Corporate Tax departments, this access and visibility is prevented due to obsolete technology. Solution to Data Access and Visibility Problem:
1) Use the same database for both the corporate consolidation and tax process.
2) Convert Excel-based data processing to today's click-through, drill-down technologies.

4. Data Currency – This speaks to the issue of changes to data inputs by data owners and how quickly the new outputs are available to end-users. Solution to Data Currency Problem: Whenever and as soon as data owners touch data, the tax outputs are available. That is, the data is dynamically translated, consolidated, eliminated, calculated and immediately available to all end-users within the context of their information needs. So when top-side late entries are booked, the tax department need only determine the permanent/temporary difference impact to get updated tax provisions.

To put these in context, let's look at a couple of real life examples using technology that automates and enables positive process change:

Example 1: Excel data collection (Data Integrity & Data Accountability)

The typical tax department utilizes Excel to collect a large amount of the data required for the quarterly and annual tax provision process. This method of data collection is one of the largest contributing factors to inaccuracies. The following describes a likely scenario:

LARGE CORPORATE tax department emails a "tax package", usually an Excel workbook, to 50 remote site-controllers through-out the world. The package consists of templates to collect financial information that can not necessarily be directly pulled from the ledgers or corporate consolidation system (e.g. non-deductible meals & entertainment, amount of accrued compensation to be paid within 2.5 months of year end, etc.)

The site controllers are responsible for completing the tax packages and sending them back to the corporate tax department for translation, consolidation and inclusion in the corporate provisioning model.

Technology is now available to tax departments that greatly reduces the likelihood of errors in the above process. For example, the technology would enable new processes as follows:

- The local site controller at a remote site signs into a web input screen to submit data directly to a centralized database.
- The input templates are pre-populated with validation points that ensure the submitted data reconciles to beginning and ending book balances, which ultimately tie-out to consolidated earnings (what a novel approach!).
- A SOX-compliant approval process requires the "sign-off" from the site controller. The corporate tax department can track the status of the data collection process at all sites via embedded workflow technology.
- The submitted data is dynamically translated, eliminated, consolidated and calculated in the corporate tax database and is immediately available for analysis. This is the exact same data that flows to the provision calculation and disclosures.

In addition to improving data integrity and addressing accountability issues, the technology greatly increases the speed and accuracy of global provisions and deferred taxes while reducing the burden on the corporate tax department AND site controllers. It eliminates hours, or even days, from the typical manual, resource intensive process of collecting, translating, consolidating and reconciling the tax data.

Example 2: Integrated Database (Data Integrity, Data Access and Data Visibility)

There is technology available today that can handle both the corporate consolidation process as well as the income tax provision process. Now corporate accounting and tax can actually use the same software, user-interface and database to complete their different tasks. This is click-through/drill down technology into the database of book and tax data as authorized by central system administrators. Technology and a database that allows you to start with the income tax footnote and drill through to the factors driving the provision. Technology that enables and enforces "touching the data once" and that allows senior non-tax financial management to drill down and see the math and data drivers behind their tax disclosures.

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Example 3: Automated Provision Calculation

During a recent provision implementation we experienced firsthand the stress placed on the finance and tax professionals responsible for their quarterly income tax provisions. It was at the end of quarter close (in fact, it was after quarter close) when late book adjustments came rolling in, some four entries in the span of three hours. New adjustments came before they even had completed the Excel processing of the previous tax provision changes.

After each adjustment, they went about the task of saving new versions of their Excel provision spreadsheets, updating all the different cells within them that required changes. All this was done as fast as they could manipulate their spreadsheets. Obviously there must be a better, less error prone way of doing this.

Today's tax technology can dynamically calculate provisions and deferred taxes as book adjustments roll in. The tax rules are in place ready to dynamically process any data changes that come down the corporate close pike. As soon as a data owner submits new data, it is automatically uploaded into the book-tax database, translated, consolidated and processed according to the companies tax rules yielding immediate drafts of the income tax footnote, schedule M-3's and 5471's.

Conclusion

Many more real life examples are out there and you probably have your own similar experiences all of which impact the tax governance problem, i.e. weak tax internal controls and lack of transparency. However, at the root, they are not "tax" problems, but rather "data" problems: data integrity, data accountability, data access and visibility and data currency. While the penalties for these data problems can be severe, they can be solved by today's process enabling tax technologies as summarized below.

Problem	Solution
1. Data Integrity	Touch the Data Once!
2. Data Accountability	Know and track each Data Owner's data touches!
3. Data Access and	Use the same database for both the Corporate Consolidation and Corporate Tax Provision processes and convert Excel-based data processing to today's click-through, drill-down technologies.
4. Data Currency	Whenever and as soon as Data Owners touch their data, the tax outputs are immediately available.

About Longview Solutions

Longview Solutions provides corporate performance management (CPM) and tax reporting software that leading companies such as Trustmark, Time Warner, Home Depot, Eaton, Welch's, and Integrys use to drive performance with speed, visibility and financial integrity. Since 1994, many of the world's most respected companies have been using Longview to create a single repository of financial truth from which all, or any one of the following key financial processes can be performed: Financial Planning, Budgeting, Forecasting, Modeling, Disclosure Management/XBRL Reporting, Statutory Consolidation, Management Reporting, Profitability Analytics, Tax Provisioning, Uncertain Tax Positions and Tax Data Warehouse. Longview is headquartered in Toronto, Canada with additional offices in Philadelphia, Chicago (USA) and London (UK). For more information visit www.longview.com.

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