

Provision Automation - The Time is Now!

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The Perfect Storm in the Tax Department

The corporate tax department workload has been steadily growing over the last 10 years. And, unfortunately, the pace is about to accelerate. Expected global tax and accounting regulatory reforms combined with static hiring trends and reduced use of outside consultants has left the tax department in the eye of a perfect storm. These trends will affect all aspects of global tax operations but none more so than the tax provision process.

Unprecedented Regulatory Changes

Before Enron and SOX, tax professionals focused on compliance, effective rate minimization, and audit defense. For most tax professionals, tax accounting was an afterthought. After SOX, that world was turned upside down. Tax accounting became “job one”, followed by compliance, then audit defense, and finally tax planning, if you had any time left. About that time the IRS began its transparency push with e-file and Schedule M-3 (and is continuing this trend with the new and unpopular Schedule UTP). And the FASB issued FIN 48. Then in 2005 the EU adopted IFRS which impacted your CFC tax provisions. Now the SEC is on the verge of adopting IFRS and, regardless of when it may happen, the FASB is issuing major US GAAP exposure drafts at an historic pace as it converges with the IASB over the next year. With the governments of the United States as well as countries around the world touting massive tax reform to address their sovereign debt problems, there is simply no end in sight to the regulatory changes on the horizon. And every one of those changes will increase the workload for corporate tax departments and increases the complexity of the tax provision process.

Global Expansion

While global expansion took a breather during the recession, as the economy begins growing again, businesses will continue to expand globally, which adds complexity to the tax department workload and the tax provision process. Upon entering a new country, you must adjust to new tax plans, new personnel, new tax laws, new tax returns, and new transfer pricing transactions. All of these have an impact on a company’s tax provision process. You need to calculate a local country, local currency provision based on that country’s statutory accounting and tax rules. Then that needs to be converted to US GAAP. It also needs to be translated. True-ups are then required after filing the tax returns. And uncertain tax positions must be reviewed and booked. The net result is that global expansion has a significant impact on the tax provision process. And if it is not addressed appropriately, it creates tax exposure.

¹ Source: 2010 ACT Provision Survey

² Source: 2010 Ernst & Young, LLP, Fifth Annual Domestic Tax Conference

Limited Resources

But as regulatory change and global expansion continues to increase, tax department resources are not keeping up. A survey of tax professionals in early 2010 reveals that 94% of companies have limited, or cut entirely, the use of outside tax consultants. And hiring trends in the corporate tax department are reportedly flat.¹ In a survey done by Ernst & Young at this year’s annual tax conference 67% of the respondents said their operating budgets will be the same as last year, and 60% said their use of third party consultants will remain at the same levels.² So workloads are increasing, and staffing and consulting levels are staying the same. Tight resources with increasing complexity and workloads creates an environment ripe for errors. Tax departments desperately need to improve productivity, but how? With the current constraints on hiring and outside consultants, the only option is to improve productivity through automation.

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A Formula for Success

As can be seen above, calculating the tax provision has become an exceedingly complex process for today’s multinational corporations for a number of reasons – the complexity of calculations, the increasing pace of regulatory changes, the disparity of data sources, and the unyielding deadlines. In light of current trends, accurately determining a company’s consolidated income tax balances and expense in a timely manner will require a perfectly orchestrated combination of the following:

- 1) The requisite expertise in financial accounting
- 2) Access to the right data
- 3) A calculation and consolidation engine with the required algorithms, and
- 4) An efficient workflow

The Spreadsheet's Fatal Flaws

The most significant improvement opportunity lies with automating the fundamental process of data collection and calculation. Currently, one third of companies still manage the provision process manually, without any automation.³ This spreadsheet-only approach is fraught with a number of limitations that impact not only the efficiency of the process but the very integrity of the data and outputs. Following are just a few of the spreadsheet's fatal flaws when it comes to doing the tax provision:

- Lack of structured controls and documentation around the development and changes to spreadsheets create an environment that is ripe for errors in calculations and outputs.
- With uncontrolled access to spreadsheets, the formulas, rows, columns, and data can be changed knowingly or otherwise.
- Since there are typically no controls around the importing or inputting of data into the various spreadsheets, the calculations may all be based on inaccurate data.
- While provision spreadsheets can start out as standard templates, they can quickly become non-standardized by various users. This introduces the risk of error into the calculations and takes away the ability to automate consolidation.
- It's very difficult to track the various versions of provision spreadsheets used across the global enterprise.
- Individual spreadsheets can't be used simultaneously by more than one person.

In addition to the above inherent risks of the spreadsheets themselves, the process also contributes to errors and delay. The typical process is to send and collect provision spreadsheet packages via email, and then manually review them to validate the data inputs and calculation outputs. These are typically prepared in the non-US entity's functional currency. This must be done for each spreadsheet before attempting to translate and consolidate. These manual steps are time consuming and error prone.

Lastly, spreadsheets do not offer the reporting and analysis capabilities of today's enterprise technologies. At the end of the day, spreadsheets simply require too much manual effort to ensure accuracy and thus while spreadsheets may be perceived as a process improvement they actually introduce inefficiencies that current tax technology can address.

A Formula for Success, cont'd

Sophisticated Accounting Expertise

Since the starting point of calculating the consolidated tax provision is consolidated GAAP pretax income, tax professionals must have a command of all areas of financial accounting that went into the calculation of worldwide pretax income under generally accepted accounting principles, whether US GAAP or IFRS, used by their company. This includes:

- Revenue recognition accounting
- Pension accounting
- Accounting for financial instruments
- Fair value accounting
- Purchase accounting
- Accounting for equity based compensation
- Investment accounting and more

They also need to know the statutory accounting or local country GAAP methods for each country in which the company has a subsidiary. On top of that, they need to know the tax laws that are unique to each of those countries and local taxing jurisdictions. They need to understand currency translation and how to account for foreign exchange gains or losses in each country. They need to understand their company's transfer pricing practices and agreements. With all of this information, they then need to understand what tax positions are likely to be upheld or denied so that they can properly account for tax reserves and uncertain tax positions. In addition to all of the above, they need to track any changes to all of the company's tax returns over the period that those returns are subject to adjustments by their respective tax authorities.

Access to Data

But accounting and tax expertise is only part of the formula. Accurate calculation of the provision requires a combination of data from disparate sources within a company, including:

- Legal entity trial balance data from the company's various ERPs
- Asset and depreciation data from fixed asset systems
- Tax specific data from numerous spreadsheets, and
- Various other data from ancillary systems that support the balances in the ERPs

Not only is access to this data a challenge, but the data is constantly changing over the course of the close period. This means tax people have to continually validate that the data ties out to the consolidated results. Otherwise, their calculations will be incorrect.

³ Source: 2010 ACT Provision Survey

A Formula for Success, cont'd

A Robust Calculation Engine

It's no surprise, then, that the majority of corporations have begun some kind of automation of the tax provision process. In a 2010 survey of tax professionals, 68% indicate they have taken steps to automate the provision process. The reason? Survey respondents reveal the biggest challenge isn't staying on top of business changes and tax law changes, it's the need to standardize and improve the efficiency of the provision process.⁴ The focus is on long term solutions for improved productivity and process efficiency.

An automated solution offers tax professionals a streamlined way to improve the speed, accuracy and control of their accounting for income tax process. Through this automation and standardization, efficiency gains can be realized across the compliance and audit defense processes as well. And while the calculations handled by such applications are complex, the basic rule of "garbage in/garbage out" applies. The sophistication of the tax provision calculator is irrelevant if the tax database is not up to date with changes to all of the various rules, including:

- Changes to your consolidated GAAP accounting rules
- Changes to each country's statutory accounting rules
- Changes to tax rules and rates for every jurisdiction around the world

Efficient Workflow

The final piece of the formula is workflow. Tax professionals do not naturally think in terms of workflow. But, by defining and reviewing how your tax provision tasks get accomplished you'll likely uncover areas where the "work does not flow" efficiently.

Ideally, prior to year-end close, all participants who have a hand in calculating the consolidated tax provision should be trained on the company's accounting for income tax policies and procedures.

- They should know their closing calendar and their deliverables within the tax provision process.
- They need to understand and be able to use their tax provision technology and related tools.
- They should also be aware of the various current year tax and accounting rule changes that will impact their provisions.

⁴ Source: 2010 ACT Provision Survey

To the extent possible, all tasks that can be addressed prior to year-end closing should be finalized.

- Automation formulas for tax law changes
- Updated tax rates
- New entity and account maintenance, and
- The downstream mapping impact to the provision technology

It's similar to tuning up your car in preparation for race day. You want to be in a position to simply import closing trial balances for all entities, let the solution crunch the numbers, and review the outputs both at a legal entity level as well as a consolidated reporting level.

To maximize the speed and efficiency of this process requires planning, accounting and tax knowledge, access to the various data sources, and a robust calculation engine. Without that you could be setting yourself up for missed deadlines at best, and a material weakness in your tax internal controls at worst.

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Automation is the Solution

So as workloads are increasing, and staffing and consulting levels are staying the same, tax departments are turning to automation solutions to improve efficiency and accuracy.

There are lots of areas of the provision process that can be automated, all of which will improve the speed and accuracy of the overall provision.

- By automating the import of legal entity trial balances, the need to manually input and validate every company's pretax income is virtually eliminated.
- By setting up repeatable formulas for automating both GAAP to statutory adjustments and/or GAAP to tax adjustments, you can reduce those precarious and uncontrolled spreadsheet calculations to those items that are too complex to automate, like the Section 199 or 263A adjustments. And any automated temporary adjustments will automatically flow from the current provision calculation to the cumulative temporary difference rollforward and ultimately the deferred tax disclosures in your footnote.

Automation is the Solution, cont'd

- At the same time, the translation of your non-US entity's provisions can be automated and consolidated with your US entity provisions.
- Then, when you've reviewed each entity's tax provision, you can automate the tax journal entry and much of the account reconciliation and rollforward process.

Compliance and Audit Improvements

In addition to increased accuracy of the provision, an automated solution will set up further efficiency gains downstream in the compliance and audit defense process. The tax staff will already have the same trial balances, the same automated book-tax adjustments and the same documentation needed for the tax returns. They will now have the luxury of limiting their focus to those few areas that require tax judgment or account reviews.

The Time is Now

The unprecedented wave of regulation in combination with increasing business complexity and an overburdened tax staff sets the stage for tax management challenges unlike any we've seen before. Taking steps to improve efficiency in the tax process is no longer a good idea, it's a survival tactic.

With today's provisioning technology, previously manual processes can be automated to greatly improve the efficiency and accuracy of not only the provision process but also the compliance and audit defense process. Ultimately, with improved visibility and reporting these efficiency gains will yield improved enterprise-wide decision making and tax risk management.

Provision Automation Yields Significant Benefits

Improved efficiency

- Less time spent gathering, translating, and reconciling data from disparate sources
- Standardization of processes for ongoing efficiencies

Improved accuracy

- More accurate provision calculation based on data from additional sources
- Reduced errors from manual data entry and calculation

Improved compliance & audit defense process

- More efficient data collection allows more time for analysis and critical thinking
- Provision and compliance integration streamlines returns once provision is finalized
- Fewer reconciliation adjustments required
- Better audit trail from automated reporting

Better enterprise-wide decision making

- Improved visibility and more robust reporting for enterprise-wide decision making

About Vertex Inc.

With more than 30 years of experience, Vertex Inc. is the leading provider of corporate enterprise tax solutions and process management services worldwide.

Vertex solutions help companies streamline and integrate tax provision and compliance processes, and leverage information to discover new strategic tax savings across every major line of business tax, including income, sales, consumer use, value added, communications, and payroll. To serve its customers, Vertex works in partnership with the world's leading providers of ERP software and related services.

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