

Provision as a Process

Implementing a Continuous and Sustainable Approach to FIN48

By David Deputy



Today, more than three years since it was issued, FIN48 remains the bane of many tax departments' existence.

FIN48, also known as Financial Accounting Standards Board Interpretation 48, "Accounting for Uncertainty in Income Taxes," still poses many unanswered questions regarding compliance, audit risk and management. Introduced in June 2006, FIN48 calls for the recognition and measurement of all tax positions taken or expected to be taken by U.S. GAAP reporting companies.

In addition to determining the risk of a given tax position, FIN48 ultimately provides a "roadmap" of every tax position taken with the IRS (or other taxing authority) – putting companies at a disadvantage in the chess game that is corporate tax. However, it also provides a unique opportunity for tax departments to elevate corporate taxation to a manageable process that puts it on par with other financial reporting processes.

New Rules Drive New Approaches

The advent of FIN48 effectively marked the end of the tax "cushion" — a cash reserve typically set aside in the event a tax authority questioned a return position. Today, instead of having this malleable margin in pocket to lessen

the impact of EPS fluctuations, corporations are burdened with mandated reviews of every material uncertain tax position ever taken.

Under FIN48, positions are evaluated in a two-step process. The first involves recognition — an assessment of whether a tax position will be sustained upon review by the taxing authority. The second step, measurement, involves the creation of a "cumulative probability matrix," which incorporates and weighs possible outcomes. This must be accomplished not on a position-by-position basis, but rather on a "unit of account" basis.

What might appear as a single position may need to be split into separate units of account — and determining how to parse a single position into separate units of account requires consideration of internal company filing practice as well as anticipating the approach of tax authorities during examination.

The added complexity imposed by the FIN48 evaluation process spurred a flurry of consulting activity among the Big Four and regional tax practices. Now that this initial frenzy has subsided, companies must determine how to best manage UTPs on an ongoing basis — ensuring a sustainable, efficient process devoid of any new financial reporting risks.

Additionally, in light of the current impasse between U.S. GAAP and IFRS, how do companies best ensure compliance with the approach that is ultimately adopted as part of the future IFRS conversion?

Elevating Provision to a Process

The concept of a continuous tax process — as opposed to interim/quarterly activity — is gaining favor as a best practice among savvy tax departments. By treating tax like other financial processes, companies can lessen their training requirements, avoid extensive "ramping up" cycles preceding the exercise, minimize spikes in manpower requirements, close communication gaps between geographies, and ensure the consistency and integrity of data.

In the wake of FIN48, many companies have centralized their UTP identification, recognition, measurement and administration processes. This approach provides comfort to the C-level executives, who rely on local resources to discuss tax issues. However, with the status of identified positions changing over time and the creation of new positions, companies are struggling to build the same level of integrity and control provided in the identification stage into the ongoing process. Creating a sustainable approach to UTP management is still a challenge.

One way to ensure integrity and control is to reject the centralization trend and delegate compliance decisions to those on the local level. Enabling local personnel to furnish UTP information in a manner they understand — and preferably as part of an established process — bridges cultural divides and eliminates the need for extensive retraining or hiring.

Resistance to this approach typically comes from those who argue that the local compliance staff fails to grasp basic U.S. GAAP principles, let alone concepts such as “Cumulative Probability Matrix.” However, training can address this issue if it is delivered in a timely, localized manner.

While the compliance process may seem like a logical candidate for expansion to include collection of UTP information, the disparate nature of systems and approaches used for compliance across geographies actually makes it a poor choice. Provision, meanwhile, can be deployed globally as a consistent process and therefore is a better platform for UTP management.

It is important to realize that existing provision processes are not always a natural fit for UTP extension, as they require interim steps to ensure consistency and control. Before entrusting UTP accounting to local personnel as part of the provision process, corporations must take action to build a cohesive accounting approach that embraces local-level support.

Baseline measures including familiarizing local personnel with the existing positions and processes before turning it over, maintaining central control of new positions and new units of account creation, adopting a single global provi-

sioning technology to ensure consistency, and implementing Web-based, on-demand, local-language training.

Solutions to Support a Sustainable Process

Leveraging technology for provision is an essential part of the solution and can provide a central point for overall UTP process management. In evaluating available technologies, tax departments are best served by avoiding the temptation to hastily adopt the “flavor of the month,” and instead taking time to evaluate and test-drive the available options with their specific business needs in mind.

For many tax departments, the technology of choice for FIN48 balance sheet accounting has been basic spreadsheets, because they are readily available, easy to use, and have had little perceived audit risk to date. However, given the uncertainty of how aggressively positions will be scrutinized going forward, and in light of the need to integrate accurate reporting or UTPs across multiple locations, more robust tax software tools with advanced local functionality are required.

The most advanced tools on the market today are easily deployed, Web-based and require only a browser. Tight integration with existing ERP systems

further elevates the concept of tax-as-process. Functionality, such as the ability to create a local provision separate from the U.S. GAAP or IFRS basis of corporate reporting, can encourage local adoption. These support local tax processes, and create simple local returns directly in the provision system. Moreover, these capabilities, and more, are incorporated into the feature sets of today’s most advanced systems, and eclipse the functionality of any spreadsheet.

Now that the initial confusion and anxiety surrounding FIN48 has subsided, companies are charged with streamlining and automating UTP accounting. The prospect of integrating FIN48 and other tax position management into the provision process, and allowing for management by local personnel, are the next key milestones in this evolution. As is the case throughout the enterprise, technology stands ready as the enabler. To this end, existing tools can make this possible, but must be carefully evaluated to dovetail with company-specific requirements and phased in over multiple accounting periods.

David Deputy is director of tax data management at Vertex Inc.

