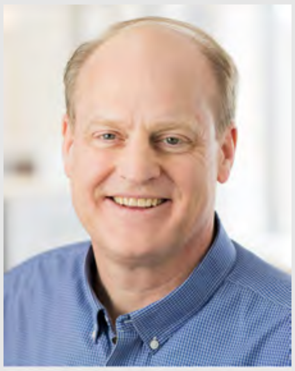
Analyze This: Putting Performance Before Analytics

by Michael J. Bernard



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In this article, the author evaluates tax departments' use of data analytics and argues that it should be guided by establishing specific performance indicators to ensure efficiency.

Although five centuries old, the warning to avoid putting the cart before the horse remains as relevant today as it did to 16th-century farmers. Twenty-first-century tax executives should note a timely twist on the proverb concerning tax functions' embrace of tax data analytics: Don't put tax data analytics before key performance indicators (KPIs).

Over the past decade or so, a growing collection of tax management experts have promoted the benefits of tax data analytics. "Data analytics allows tax professionals to transition from performing time-consuming, manual processes to simply having access to useful information and conclusions on demand," asserts a 2017 *Tax Executive* article.[1] "The tax department has an opportunity to deliver value in this new era of digital tax by embracing enterprise initiative and transformation that facilitate enhanced data management," a 2019 EY report notes.[2]

To be sure, there are legitimate and compelling reasons for these calls to action. Tax functions need to keep pace with tax authorities deploying data analytics capabilities to increase collections, sniff out compliance lapses, and increase their efficiency. Also, corporate tax departments generally lag behind other organizational functions and groups in leveraging data analytics to help drive business value. Equally compelling, CFOs increasingly expect their tax leaders to harness tax data to deliver forward-looking insights on the impact of future regulations and rules changes as well as to contribute to strategy planning activities.

However, before tax functions can harness data analytics to deliver additional value, they should be able to measure their own performance and value. "Without this high-level view of what is important — key success factors — it is difficult for tax to establish the right objectives to achieve and to convey value within the organization," a 2017 PwC report states.[3] Those key success factors are the same as KPIs. It is important that these measures of the tax function's value and performance be clearly defined and continually updated to reflect business priorities and related tax function objectives. When tax function KPIs are in place, they can serve as helpful guideposts for tax data analytics capabilities.

A Tax Data Analytics Avalanche

The growing demand for tax data analytics capabilities seems like a natural and inevitable product of the data analytics trend that began shortly after the turn of the 21st century.

U.S. academic Thomas Davenport was among the first to zero in on the business value analysis that large data sets can generate. His January 2006 *Harvard Business Review* article, "Competing on

[1] "Data Analytics for Tax: A Primer," *Tax Executive*, Feb. 2, 2017.

[2] EY, "How Data Analytics Is Transforming Tax Administration" (May 27, 2019).

[3] PwC, "Defining Success: What KPIs Are Driving the Tax Function Today?" (Sept. 2017).

Analytics," showed how leading companies were transforming a "supporting tool into a strategic weapon." These "analytics competitors" were "crunching their way to victory," Davenport explained, while noting that business processes throughout a company's many functions "are among the last points of differentiation."[4]

A decade later, McKinsey Global Institute confirmed that "data and analytics are changing the basis of competition" while reporting that the era of analytics was well underway. The McKinsey report also indicated that the most formidable "barriers companies face in extracting value from data and analytics are organizational; many struggle to incorporate data-driven insights into day-to-day business processes."[5]

Since then, organizations in most industries have made major strides in their use of analytics. Corporate functions, such as sales and marketing, finance and accounting, and human resources, have leveraged data analytics to create significant business value. Tax functions remain among the last adopters of full-fledged data analytics capabilities.

The lagging status and global tax authorities' growing interest in, and use of, data analytics has generated more pressure on tax functions to up their analytics game. "Tax authorities are increasingly investing in new technology to proactively collect financial data in real time," according to a 2018 KPMG report. "New data and analytics technology enables tax authorities to quickly sort through millions of records to identify issues, risk-assess taxpayers and reduce timeframes for tax audits. . . . As tax authorities embrace tax digitalization, it's never been more important for companies to understand every detail of the story their tax data tells, while ensuring accuracy and consistency. Companies that take a data-driven approach to tax are in the best position to meet tax authorities' demands globally and prevent costly errors."[6]

While the call for tax departments to adopt tax data analytics has grown louder, many of those entreaties — at least until recently — have been vague and thin on practical guidance. Five years ago, it was not uncommon to come across arguments to adopt tax data analytics that promoted the need for new mindsets, data-driven decision-making, the need to slice and dice data, data visualization, and to be candid, not much else by way of specificity.

This is not to take away from the benefits that tax data analytics can deliver. To be fair, more recent guidance on the adoption of tax data analytics tend to demonstrate much greater specificity. The KPMG report details eight actions that global and analytically savvy tax functions can perform, including identifying the main tax attributes and risks across the corporation, optimizing working capital by analyzing VAT data and the timing of payments, and using automated analyses to prevent or fix errors related to tax laws and regulations.

That said, whenever tax leaders read about the need for tax data analytics, they should evaluate the specificity and usefulness of that guidance: How helpful would this type of analytics capability (or individual analysis) be to our tax function's performance? "Big data is one of the most important advances the business and consumer sectors have seen since the dawn of the internet," notes the *Tax Executive* article. "But what does big data mean for tax? What doors can it open?"[7]

When these types of questions are addressed it becomes clear that tax functions need to have a firm grasp on how they measure the value they contribute to the business. To do so, tax functions need to have in place a relevant and continually evolving set of KPIs.

KPIs Are Your Compass

KPIs hardly qualify as a new concept. Yet, as more tax functions of all sizes strive to increase the strategic value they deliver, it is important to recognize several KPI considerations, including the following:

[4] Thomas H. Davenport, "Competing on Analytics," *Harv. Bus. Rev.*, Jan. 1, 2006.

[5] Nicolaus Henke et al., "The Age of Analytics: Competing in a Data-Driven World," McKinsey Global Institute (Dec. 7, 2016).

[6] KPMG, "Tax, Data and Analytics — Moving From Control to Transformation" (Jan. 10, 2018).

[7] *See supra* note 1.

- *Tax functions of all sizes should measure their performance.* Much of the analysis and guidance concerning the power and benefit of tax data analytics understandably targets large company tax functions with the resources to invest in supporting technology and technology expertise. Yet tax functions of all sizes should monitor their performance and be able to measure their value. Resources, such as the Sales Tax Institute's "Important Concepts in Sales Tax Administration" paper, contain useful tax management guidance that can easily be adapted into specific KPIs (related to areas such as sales tax registration, customer returns, invoice presentation, exemption certificates, and more).[8]
- *While several categories of performance indicators apply to all tax functions, each tax group should select KPIs tailored to company strategy and related factors.* Most tax function KPIs will relate to tax cost (that is, effective tax rate and cash taxes), control and compliance, risk, process efficiency, and a few other forms of effectiveness. Tax groups in small to mid-sized companies may emphasize compliance and the management of audit risks. Multinational tax functions likely will have a larger collection of KPIs, including some that address transfer pricing.
- *KPIs change over time.* Like all organizational functions, the tax group's performance hinges on its ability to help achieve the company's strategic objectives while effectively executing its specialized mandate. Because strategic objectives change in response to numerous internal and external factors, some of the tax function's KPIs should change in response. For example, as the Supreme Court's *Wayfair*[9] decision has generated high levels of volatility in state-level tax policy and rulemaking, the sales tax function's ability to influence state departments of revenue and their legislative partners has become an increasingly pivotal — and valuable — activity. "The KPIs themselves," the 2017 PwC report says, "should be evaluated on a periodic basis to ensure that they are in fact appropriately measuring the factors that drive success for the function."[10]
- *Monitoring and managing KPIs requires the right supporting technology.* KPIs and tax data analytics both require data as well as the supporting technology required to access and process that data in a convenient and accurate manner. "The process of data analytics would be fairly straightforward if there was one static source for financial data, however, for the majority of corporations this is not the case," a 2016 *FEI Daily* article cautions. "In these corporations, data comes from many sources and in various formats — from multiple ERP systems, accounting software, best-of-breed software solutions, and manual spreadsheets."[11]

When it comes to identifying specific KPIs, a tax department should begin with the company's effective tax rate. This metric provides insights into the effectiveness of the function's tax planning, especially when it is compared with the effective tax rates of other companies in the same industry.

PwC's 2017 report, which takes a close look at tax function's KPIs, organizes performance metrics into four categories:

- tax cost (effective tax rate);
- tax risk;
- efficiency and effectiveness; and
- sustainability (which equates to measures of longer-term performance).

The report, which serves as a highly useful primer on the topic, identifies numerous KPIs — both quantifiable and qualitative in nature — in each of those four performance categories.

Another recent report, Deloitte's 2019 Global Tax Management Survey, offers useful guidance on KPIs. Deloitte conducted interviews with 20 CFOs and chief accounting officers in large global

[8] "Important Concepts in Sales Tax Administration," YETTER Tax and Sales Tax Institute white paper (Oct. 2018).

[9] *South Dakota v. Wayfair Inc.*, 138 S. Ct. 2080 (2018).

[10] *See supra* note 3.

[11] "Achieving Clean Data: The Tax Data Analytics Challenge," *FEI Daily*, July 5, 2016.

companies. While the sample size is relatively small, and the insights generated from the interviews are qualitative, they remain instructive from a performance measurement perspective. The interviews identified four primary expectations that finance leaders have of their chief tax officers:

- managing risks by avoiding audit issues and related financial penalties and reputation hits;
- delivering efficiency via cost reduction, while showing demonstrable returns on tax technology investments;
- collaborating with business partners by dispensing proactive tax planning advice and sharing their perspectives on regulatory changes coming down the pike; and
- keeping the effective tax rate low while delivering strategic and commercial tax advice.[12]

Those four expectations can also serve as sound starting points for developing tax function KPIs.

The interviews also produced information that tax leaders should heed as they develop, manage, and periodically update their function's KPIs. CFOs and chief accounting officers indicated that many tax leaders are not consistently meeting expectations of tax to collaborate with business partners on strategic matters. One reason for this shortcoming, the finance leaders said, was that tax seems to get "buried in the technicalities of the data."

The same shortcoming tends to materialize when tax functions rush into creating tax data analytics capabilities without first getting — and keeping — their KPIs in order.[13] ■

[12]Deloitte, "2019 Global Tax Management Survey" (2020).

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