Tax provision process and technology trends

Why and how to continually improve

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Today's presenters

Joan Schumaker — *Moderator*

Daren Campbell

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Your panelists

- Joan Schumaker — *Moderator*
- Daren Campbell
- Lydia Couch
- Melanie Dowling
- Martin Fiore

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Tax provision process improvement
Agenda

- Why the need for continued focus:
  - Regulatory developments
  - Internal challenges
  - Broader trends
- Areas to improve:
  - What companies are doing overall
  - Internal controls
  - Enhancing provision workbook
  - Redesign workbooks used for components of the provision
  - Observations and trends in provision technology
- Integrating tax processes through technology

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PCAOB – Inspections – Income taxes

- PCAOB observation for auditors consistent with income tax restatement causes
  - Deferred tax assets
  - Valuation allowance
  - Tax contingency reserves
  - Existence, completeness, and/or valuation of other income tax accounts

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Regulatory developments

- SEC focus areas:
  - Transparency of the effect of foreign earnings on effective tax rate
  - Treatment of foreign earnings and related disclosures of amounts indefinitely reinvested
  - Intra-period tax allocation between continuing operations, discontinued operations, other comprehensive income (OCI) and extraordinary items
  - Realizability of deferred tax assets, including timing of release of valuation allowances, key assumptions and forecast of future taxable income
  - Judgments around unrecognized tax benefits

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Internal challenges

- Data availability:
  - Foreign jurisdictions/tax packages
  - Deferred tax detail for jurisdictional netting purposes
  - Forecast data
- Tax account support:
  - Uncertain tax positions
  - Return to provision analysis
  - Fixed asset book-tax differences
  - Payable validation/proof
- Intercompany profit elimination
- Integration of financial reporting and tax department
- Involvement with significant transactions
- Short-close cycle

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Other dynamics and trends

- Increased globalization
- Finance transformation
- Use of shared service centers
- Cost reduction plans advising to decrease the number of resources in finance functions, including tax

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Tax-related material weaknesses and restatements

Year	2005	2006	2007	2008	2009	2010	2011	2012
Material weakness	215	206	157	168	116	94	75	65
Restatements	104	111	68	76	56	34	33	24

* Total for calendar year.

	Primary cause of tax material weaknesses and restatements
People	► Personnel with insufficient technical knowledge, experience and training in tax accounting, process or internal controls ► Lack of investment, resources and focus in tax reporting
Process and controls	► Lack of adequate policies and procedures to ensure the completeness, accuracy, preparation and review of the income tax provision ► Lack of documentation ► Lack of timely reconciliation of tax accounts ► Improper recording of valuation allowances ► Inadequate monitoring of significant transactions and new reporting requirements ► Poor control design, operation and monitoring ► Financial close and work compression ► Estimation errors and valuation and measurement of deferred income taxes and uncertain tax positions (UTPs)
Data and technology	► Lack of data integrity ► Lack of tax sensitization of enterprise resource planning (ERP), chart of accounts (COA) and sub-systems ► Inter-company and legal entity accounting issues ► Complex spreadsheets and spreadsheet errors

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Areas to improve — what companies are doing

	Areas of focus
People	► Create a tax operating model designed to effectively manage global tax risk ► Train personnel globally in ASC 740 technical rules and processes ► Develop competency development plans focused on building skills and experience ► Build hiring road map and consider co-sourcing with external provider to manage risk ► Improve communication between tax and other areas to ensure tax is aligned with finance and the business
Process and controls	► Build the mechanisms to institutionalize processes and controls into tax life cycle ► Create a continuous improvement model challenging the prior year process ► Reestablish quality in existing numbers (tax basis balance sheets) ► Develop and implement formal, written tax accounting policies) and procedures ► Refresh Sarbanes-Oxley processes and controls — documentation/execution ► Address technical issues early and prepare white papers for consideration by management and external audit
Data and technology	► Build an effective data management strategy using a tax technology framework to support entire tax life cycle ► Improve data collection on legal entity basis for forecast and interim reporting ► Automate tax effects of intercompany profits by working with finance ► Develop tax “self-serve” data collection competencies ► Ensure proper controls over technology applications comprising the overall provision model

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Internal control considerations

- Internal controls important within income tax process
- Key considerations:
  - Understanding the process and identification of risk / control points
    - Sources of information
    - Third parties (reliance, review, data)
    - Unique, non-routine, infrequent classes of transactions

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Internal control considerations (cont.)

- Key considerations (continued):
  - Understanding controls
    - Who, when, what and how of the controls
    - Control owner has appropriate authority and competence
    - Management review/reconciliation controls – precision, sensitivity evaluation, level of operation
    - Controls ability to generate questions, identifying errors
  - Data / communication
    - Completeness and accuracy
    - Accuracy of underlying reports
  - Documentation

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Enhancing provision workbooks

- Despite the growing trend toward commercial software, Excel continues to be the most widely used tax provision software.
- The top challenges companies are facing with their Excel workbooks include the following:
  - Lack of controls (i.e., version, formulas, sign-off)
  - File consolidation or breakout
  - Data and formula validation
  - Template consistency

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Case study

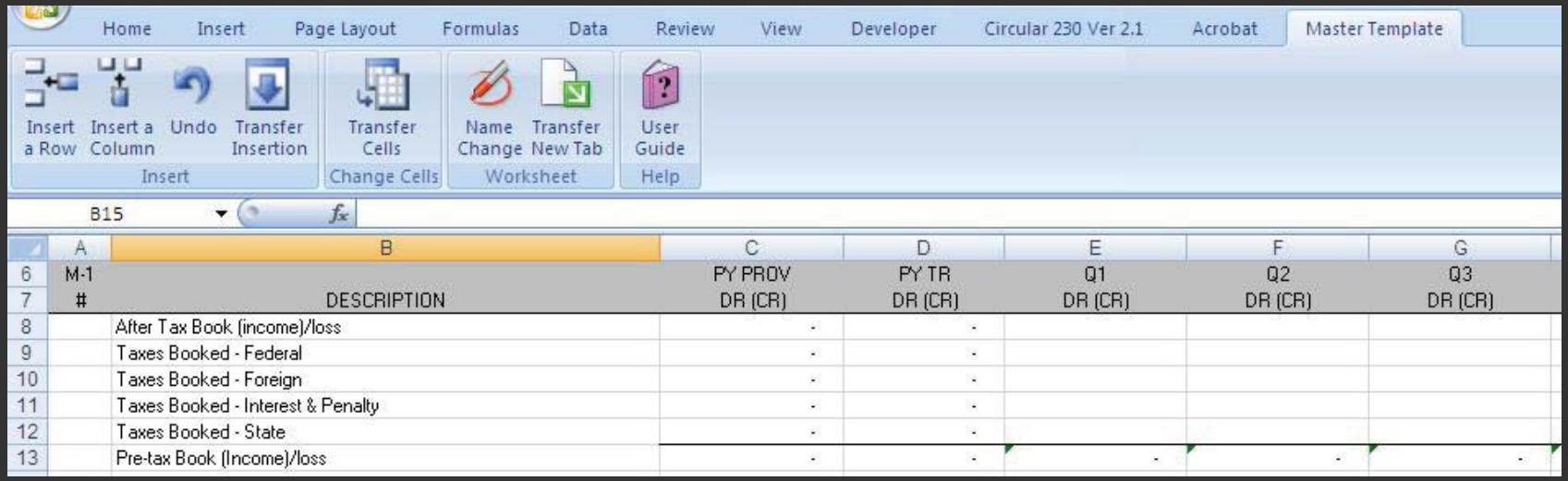
Using a “master template” to improve accuracy

Challenge

- Hundreds of separate entity workbooks
- Hundreds of hours required to make changes to schedules and to validate and review format and formulas

Solution

- Established a master template to quickly and accurately make changes to all underlying workbooks
- Created reporting to review underlying workbooks for broken links and formula consistency



	A	B	C	D	E	F	G
6	M-1		PY PROV	PY TR	Q1	Q2	Q3
7	#	DESCRIPTION	DR (CR)	DR (CR)	DR (CR)	DR (CR)	DR (CR)
8		After Tax Book (income)/loss	-	-			
9		Taxes Booked - Federal	-	-			
10		Taxes Booked - Foreign	-	-			
11		Taxes Booked - Interest & Penalty	-	-			
12		Taxes Booked - State	-	-			
13		Pre-tax Book (Income)/loss	-	-	-	-	-

Redesign of complex tax provision calculations

- Many companies continue to build custom Excel schedules to handle complex tax provision calculations, such as for:
  - FIN 48
  - Tax basis balance sheets and deferred tax analyses
  - Fixed asset book to tax reconciliations
  - NOL tracking
  - APB 23
  - Intercompany profit elimination

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FIN 48 calculations — an increasing need

- Current FIN 48 landscape
  - Many FIN 48 processes have not been updated since initial adoption
  - Use of cumbersome manual spreadsheets for tracking unrecognized tax benefits that often lack controls and lead to errors
  - Difficult, time-consuming and uncontrolled process for consolidating computations and creating the necessary tabular roll-forward schedules, including CTA adjustments for foreign positions
  - Existing software packages do not address process issues
  - Companies are spending weeks preparing their FIN 48 computations

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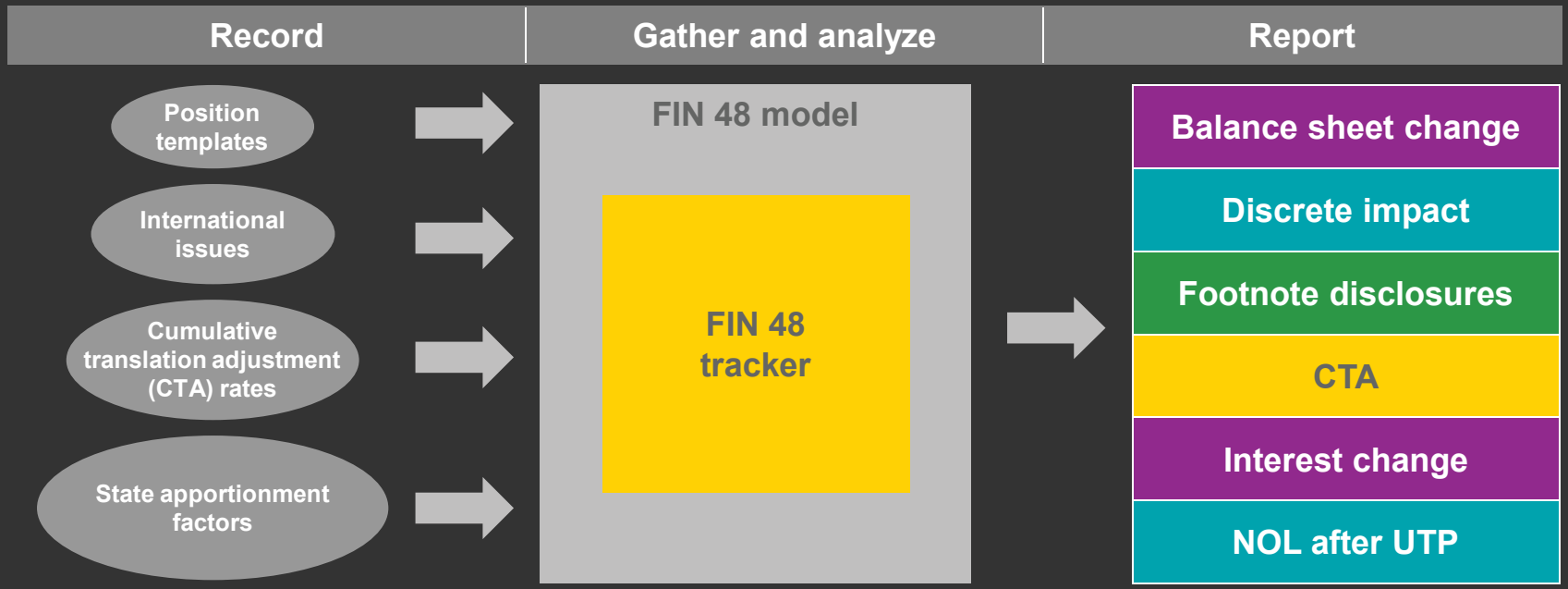
Overview of a typical FIN 48 process



Summary of benefits:

- A controlled repeatable process that reduces the risk of calculation errors
- Significant time savings in the preparation of the UTP workpapers for both the provision and financial reporting
- An easily auditable workpaper package that is consistent from period to period
- The ability to customize report formats for easy import into financial reporting and provision software
- Controlled data collection process that is customizable and allows for direct consolidation within the model
- State and federal interest computations are included within the model

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An improved FIN 48 process

Process	Current method	Improved method
CTA calculation	Manual	Automated
Discrete analysis	Manual linkage	Automated calculation
Footnote and consolidation	Manual consolidation	Automated report generation
Data collection templates	Few controls	Automated roll-up for each reporting period
Calculation of interest	Manual interest calculations	Federal and state interest calculations automatically calculated
Statute of limitations	Manual updating of statute of limitations	Automatically reverses UTP positions, if statute of limitations date has been reached
Federal/state with apportionment factors	Manual process	Apportion federal issues to each state based upon imported apportionment factors

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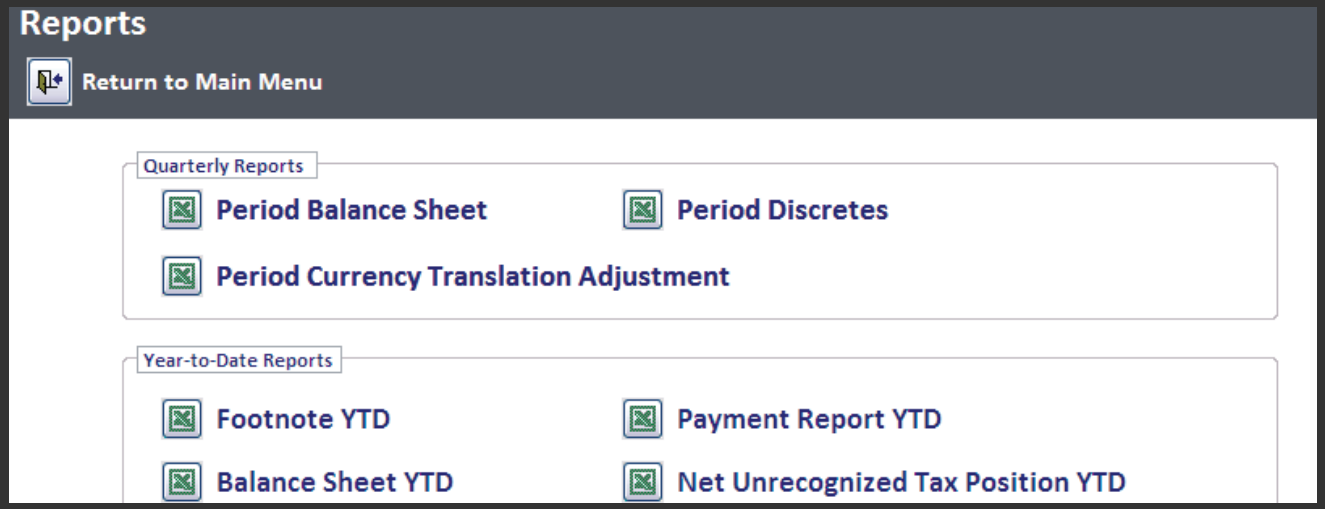
Case study
Redesigning FIN 48 work papers and reports

Challenges:

- Complicated manual spreadsheets for tracking uncertain tax positions (UTPs) that lack controls and lead to errors
- Difficult, time-consuming and uncontrolled process for consolidating computations and creating the necessary tabular roll-forward schedules including cumulative translation adjustments (CTAs) for foreign positions

Solutions:

- Created a repeatable process that reduces the risk of calculation errors
- Saved time in the preparation of the UTP work papers for both the provision and financial reporting
- Prepared easily auditable work paper package that is consistent from period to period



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Other dynamics and trends

- Increased globalization
- Finance transformation, includes tax
- Use of shared service centers
- Cost reduction initiatives result in a decrease in the number of resources in finance functions, including tax

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Observations and trends in provision technology

- Most tax departments have one G/L feed, while five to six feeds may be needed to automate 80% of book/tax differences
- Often companies have data warehouses unused by tax
- Surveys of the Fortune 1000 indicate that more than 50% use Excel spreadsheets to calculate and consolidate their provision
- Tax departments explore workflow and collaboration tools
  - Tax life cycle management
  - Imbed internal controls into tax processes
  - Work flow management
  - Document and data management
  - Data visualization
- New technologies

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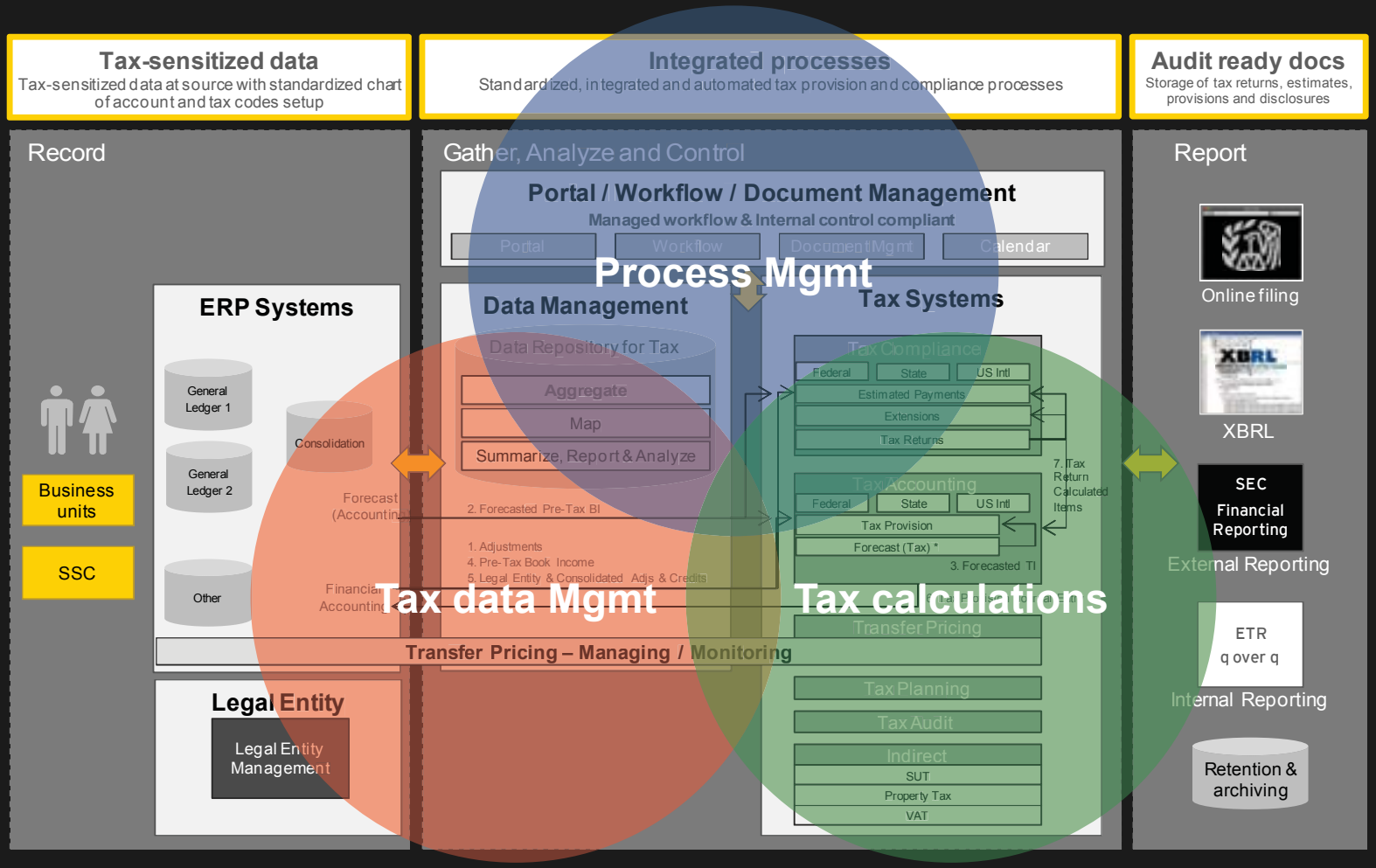
We are now at a point where an integrated tax environment vision is possible with commercial tools



Case study
New technologies for tax

Trend	Many new technologies for tax
Driver	Desire for paperless office, more automation and task management

Marketplace tools	► Workflow/document management/collaboration/portal
	  ► Microsoft SharePoint
	  ► ONESOURCE WorkFlow Manager and Data Flow
	  ► Corptax Workspace
	► New data-centric provision tools
	  ► Hyperion Tax Provision (HTP)
	  ► Longview
	► Growing use of enterprise technologies by tax
	  ► Hyperion/HFM
	  ► SAP BI tools

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Case study
Improvements with workbooks

Trend	Improvements with workbooks used by tax
Driver	Excel still extensively used by tax, but continuing desire for greater standardization, control and connection with data and tax tools
Marketplace tools	► Thomson Reuters ONESOURCE Active Workpapers, DataFlow and Excel Add-In ► Corptax Office and data exchange ► Other third-party tools that allow Excel to be locked down ► Longview for Excel

Case study
Finance transformation including tax

Trend	Finance transformation including tax
Driver	With tax provision data going into financial statements and increasing numbers of material weaknesses and significant deficiencies due to tax, finance departments are realizing that tax requirements need to be factored into finance transformations
Solutions	► Tax departments need to provide specialized tax resources that understand the business and can compile tax requirements and validate that they are appropriately implemented. This is considered tax sensitization. ► One of the outputs of an exercise like this is that tax still needs to map the book tax to tax systems in some type of tax data management system. All the major tax vendors (OS, CTX, Longview and Hyperion) are addressing this need.

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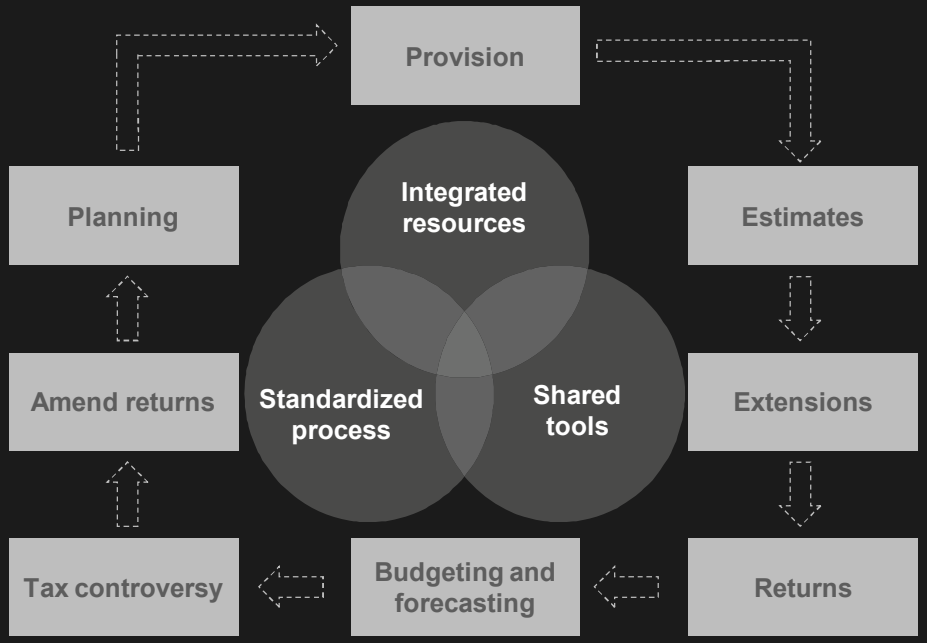
Integrating processes over the tax life cycle



Lower cost and cycle times

Enhanced quality

Reduced risk

Organization and people

- Local, regional and global structures with the right people and skills in the right locations
- Responsibilities defined for key stakeholders in finance, internal audit, IT and business
- Program for building talent and succession planning

Process and policy

- Tax data reuse across processes, including using provision as starting point for tax return
- Consistent standards and resource efforts focused in the right areas
- Standard, centralized and automated processes across key geographies to support review
- Audit-ready documentation standards and procedures

Technology and data

- Tax systems architecture and tools to enable high automation of tax activities
- Tools that support tax provisions and tax returns
- Data standards for financial systems to provide "tax sensitive" data

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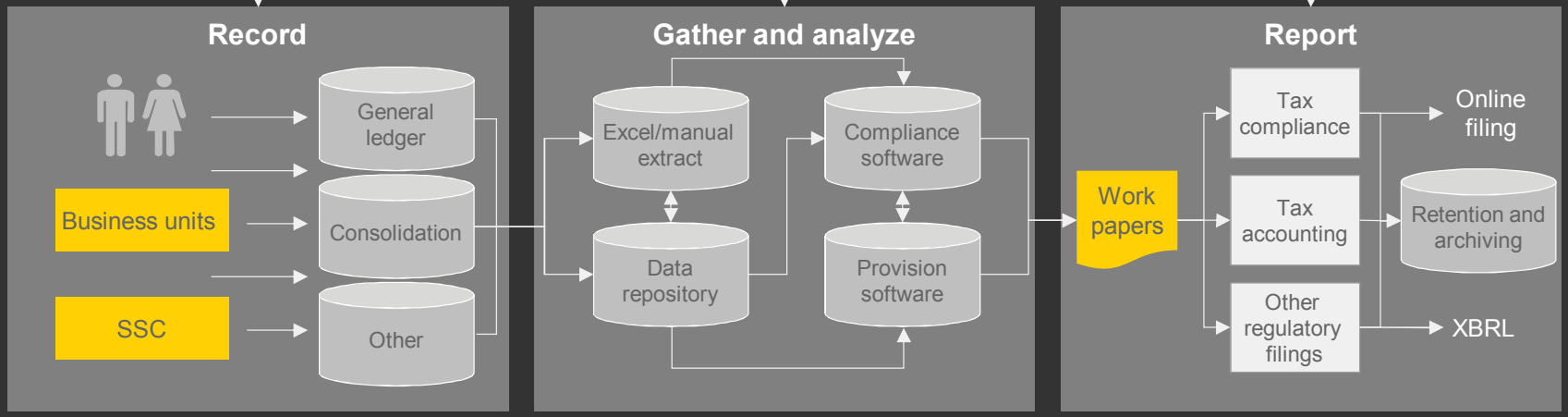
Tax process and technology framework

Leading practice tax reporting

Tax-sensitized data
Tax-sensitized data at source with standardized chart of account and tax codes setup

Integrated processes
Standardized, integrated and automated tax provision and compliance processes

Audit-ready documentation
Centralized storage of tax returns, estimates, provisions and other disclosures ready for audit defense



Managed workflow
Defined roles and responsibilities with visibility and control over all tax processes with centralized access to data

Internal control compliant
Effective controls over tax processes, which are documented, integrated with business and continuously monitored

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Case study
Improved integration with tax tools

Trend	Improved integration of provision and compliance with tax tools and processes
Driver	► Desire to do more with less ► Strategic desire to reuse data ► Vision that provision and compliance are part of one data life cycle
Marketplace tools	Push/pull data ► Thomson Reuters ONESOURCE DataFlow, WorkFlow Manager (OWM) ► Corptax Data Exchange and Corptax Workspace ► SharePoint ► HFM's FDM ► Longview for Excel

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Thanks for participating

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