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An orchestrated future for tax and finance

Drive enterprise value by increasing tax-finance integration

If you've ever heard an orchestra whose percussion and strings are out of synch or whose horn section is flat, you know the value of harmony. Within organizations, the need for functional alignment is similar. When closely tied functions are not effectively integrated with each other, or with the rest of the enterprise, the result can be competing goals, disjointed objectives and foiled initiatives.

For many organizations, the discord between tax and finance is a major barrier to managing liquidity and meeting performance expectations. The CFO is centre stage, tasked with directing how tax and finance work together – and with the organization – as an operational and strategic unit focused on achieving the right balance between cost rationalization and cash flow optimization.

This is a challenging but critical task. Corporate tax is costly and ubiquitous. Globally, corporate income tax can represent as much as 20% – 30% of an organization's net income. In addition, transaction taxes such as sales tax, withholding tax, mining tax and payroll taxes can add up to a substantial expense and considerable cash outflow. Moreover, virtually every business decision made by an organization has a tax impact and the potential for tax optimization. Tax-impacting transactions initiated outside the immediate tax function include establishing new business and product lines, corporate reorganizations, expansion into new jurisdictions, cross-border transactions, intercompany transactions, and human resource decisions.

Despite the clear importance of managing corporate taxes and tax-related operational decisions, the tax function is often seen as merely a subset of the finance function. Our experience, however, suggests that it should be viewed as a distinct function with a specific service offering. Beyond elevating its stature, tax also needs to be integrated more closely with finance, and both need to be integrated with the broader enterprise to maximize their mutual value.

To achieve full integration between the tax and finance functions, organizations need to undertake two key initiatives: create a more robust, unified enterprise infrastructure; and redefine the position of tax and finance in the organization.

Build a synergistic infrastructure

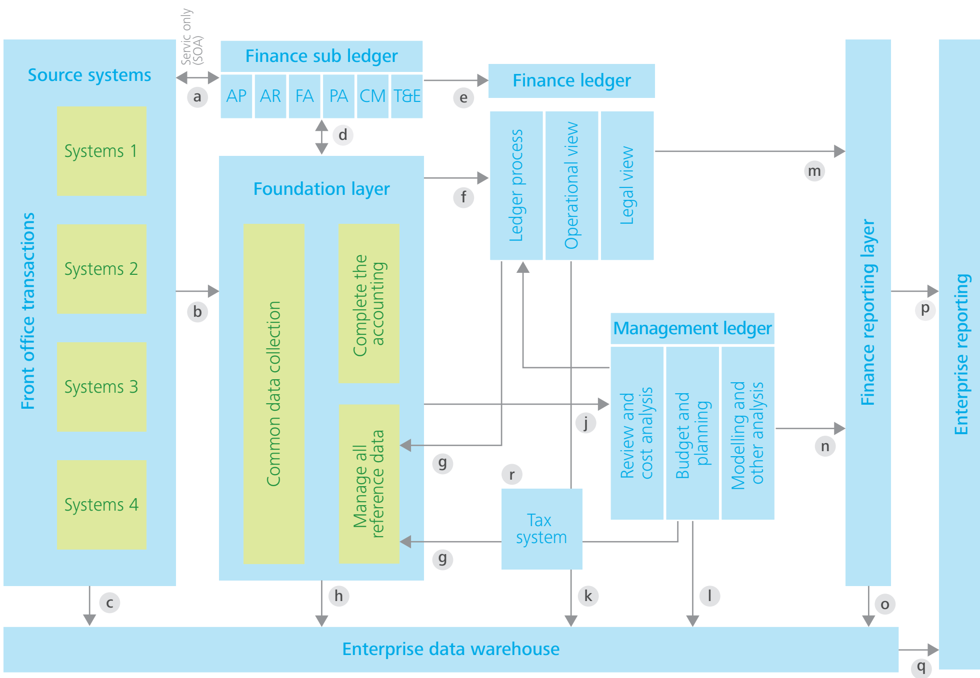
Tax relies heavily on the finance function's architecture – including both data and systems – to provide accurate, complete and timely tax compliance, financial reporting and analysis. Despite sharing many platforms, experience suggests that the two functions tend to operate in silos, with tax as an "add-on" in the finance infrastructure.

Additionally, the finance architecture is itself not fully integrated with the rest of the business. Remedying these relationships requires taking an inventory of enterprise-wide architecture touch points and then implementing integrative measures, this process involves close collaboration with the CIO.

To begin with, technology solutions must be used consistently across the business to produce information that is accurate, transparent and has integrity. Locating data synergies between finance and tax, and identifying strategic business data flows, supports straight-through processing and optimized data movement. The target architecture should include a unified set of interfaces with a single set of reference rules to translate the raw transactions into accounting and tax-sensitized balances.

One problem in developing these synergies is the data requirements of each function. Tax requires a legal-entity view, but most organizational data systems maintain an operational/management view, these differing data views can result in information reconciliation issues. A unified architecture can alleviate this. Streamlined, reliable data helps you adopt tax provision and other tax technology tools to minimize manual tax reporting and compliance activities and reduce the current pervasive reliance on complex spreadsheets.

Figure 1: Architecture



Legend

a,b	Through a series of service only (SOA) rules, transactions within the front office are transferred to the finance sub ledgers and foundation layers, and translated within their respective silo's.
d,e	Based on rules within the foundation layer, the relevant data is taken from the sub ledger and source systems, and processed for accounting.
f,j	Whether it is for planning, budgeting, reporting and/or analysis, the foundation layer will be the main supplier of information for both the finance and management ledgers. Information is consistent and controlled from the back-end to the front-end, reducing operational risk.
g	Two way flow of information between the ledgers and foundation layer ensures that the data and standards are consistent with the reference data, rules, etc. that have been created for accounting purposes. Straight-through processing allows for transparency and data coordination rather than data duplication.
i	Information from the management ledger is shared with the financial ledger for comparison and reporting purposes (e.g., plan/budget figures).
m,n	Financially organized data accessed through a finance specific reporting tool - providing an intuitive understand of finance structures, concepts and terminology (e.g., chart of accounts, calendar, balance types, etc.)
p, q	For enterprise reporting, information is collected based on data stored in the enterprise data warehouse as well as schedules created within the finance reporting layer.
c, h, k, l, o	All data from the source systems, layers and ledgers is stored within an enterprise data warehouse.
r	The tax system is an intuitive intelligence maintained within tax regulations. It also houses the tax accounting and includes an additional subset of data (e.g., customer location, contract purpose). The tax system communicates with the foundation layer financial and management ledger and the reporting layer leveraging the unified data across all the layers.

When tax and finance data requirements are fully integrated you can leverage the "golden copy" of data through the same processing application with common interpretation. Simplifying the architecture and orchestrating the data achieves cost efficiencies by eradicating data duplication and reducing the cycle time between the receipt of final financial data by tax and the delivery of the tax provision to meet financial reporting requirements.

Adapt your processes

Along with aligning data requirements, achieving architecture synergies requires changes to the underlying processes by which information is gathered and used. Tax and finance processes in many organizations have been developed and subsequently adapted on an ad hoc basis. Accordingly, process optimization can only be achieved by dissecting current practices and redesigning them to effectively leverage the revised architecture.

Impacted processes can include those within the tax and finance functions, the upstream processes controlled by finance (e.g., accounts payable and receivable) and broader organization-wide practices. Experience suggests, however, that integration of all of these processes is generally non-existent, yielding a clear opportunity for forward-thinking companies. By taking a full inventory and developing a better understanding of tax and finance requirements, you can enhance business processes to deliver more accurate finance and tax-sensitized data earlier in the process.

When developed with collaborative input from both functions, organization-wide processes will fully incorporate tax and finance specific considerations and support the seamless flow of relevant tax optimization data. For example, global supply chain locations can benefit from a tax-advantaged network optimization model that reduces costs and increases incremental tax benefits. Opportunities for enhanced tax-finance business unit collaboration processes extend well beyond procurement initiatives to include large-scale, enterprise-wide transformation projects, strategic transactions, routine budgeting process re-design and planning functions.

Despite this synergistic promise, COOs admit that tax is not well understood and existing strategic processes do not allow for a full analysis of tax optimization opportunities. This is a lost opportunity. A business-focused architecture and strategically-driven approach can achieve enhanced benefits. You can coordinate information engines and processing tools to deliver cost efficiencies; make common information readily available for timely decision making; streamline processes to achieve tax-optimized transactions; and build specific tax and finance requirements into shared data warehouses for improved analytics. With a more integrated and automated environment, internal resources can substitute redundant activities with value-add pursuits, and as succinctly put by a recent convert to infrastructure and process recalibration, the organization can cultivate efficiencies by design and not exception.

Re-define the position of tax and finance in the organization

The second part of the integration challenge involves the relationship between the tax and finance functions. It affects the way both are viewed by the overall organization as well as the level of integration in day-to-day and strategic business activities.

In general, the positions of tax and finance within an organization can be seen on a continuum (the “relationship continuum”), with “service provider” at one end and “strategic business partner” at the other. It is important to position tax on the strategic side of the equation. As a service provider, the tax function is:

- **Characterized** as a commoditized services provider
- **Informed** of business decisions after they are completed
- **Viewed** as a compliance centre passively delivering only value protection
- **Considered** an obligatory organizational cost
- **Considered** merely a part or a subset of finance

In this capacity, it is generally assumed that if finance is consulted during the decision-making process, then tax is automatically represented. As such, tax need only be informed after decisions have been made. As a strategic business partner, however, the tax function is:

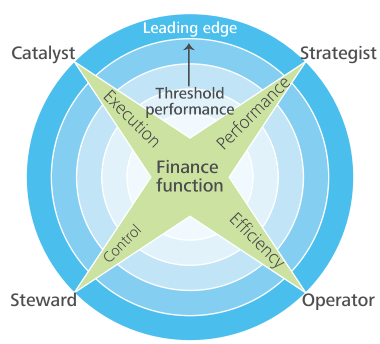
- **Consulted** about all business decisions during the early planning phases
- **Charged** with a mandate that includes both value creation and value protection activities
- **Considered** a critical member of strategically-focused business teams

Tax executives across all sizes of organizations and in a wide range of industries want their tax function to be seen as a strategic business partner. When the tax function is considered just a service provider it can result in unnecessary cash outlays and unmitigated tax risks. It can also lead to missed opportunities to optimize tax benefits arising from business transactions, such as procurement activities, mergers and acquisitions and shared services adoption strategies.

Finance functions are increasingly becoming strategic business partners, as CFOs work to implement and embed their roles as catalyst, strategist, steward and operator. Tax functions, however, have lagged behind in this transformation.

Figure 2: Four faces of the CFO

The modern CFO is expected to deliver in four key roles: steward, operator, strategist, and catalyst. To succeed in these roles, the CFO must create a finance function that exceeds stakeholder expectations, achieves desired performance levels and drives value throughout the organization.



Steward - Protect and preserve the assets of the organization

Operator - Balance capabilities, costs and service levels to fulfill the finance organization’s responsibilities

Strategist - Provide financial leadership in determining strategic business direction and align financial strategies

Catalyst - Stimulate behaviors across the organization to achieve strategic and financial objectives

With the finance function already fulfilling its strategic promise, moving the tax function to the same end of the relationship continuum means enhancing alignment between tax and finance. Developing an effective governance model and an optimal human capital structure are two key ways to achieve this.

Governance

Mirroring the CFO's role, the tax executive needs to drive organizational value and be a vital contributor to overall corporate success. The CFO has a pivotal responsibility to champion tax, prioritize the various types of tax affecting the organization and drive the integration process. This means tax must be involved early in key business decisions and coordination with finance must be enhanced.

The CFO and the tax executive should work together to define the appropriate requirements then leverage the CFO's role to implement them. With the CFO's patronage, the organization can better optimize the tax results of its business endeavours.

There are several different approaches to ensure that tax is viewed as important to the organization. These include a direct, tax executive-to-CFO reporting relationship and representation by the tax executive or a qualified designate on key boards and committees, such as the risk committee.

> Robust corporate governance practices including "tone at the top" and the organization's goals and objectives seek to ensure transparency and accountability.

In addition, as income tax is still identified as "accounting" for approximately 27%[1] of reported material weaknesses, the CFO can team with the head of internal audit to champion more active involvement by the tax function in key governance activities.

Tax function integration can only be effective if these goals are front and centre in a defined, documented tax strategy and vision. This should include goals, objectives, key performance indicators and key integration points within the business, and it should also address non-traditional organizational goals such as corporate social responsibility. The CFO and tax executive should act as catalysts, ensuring that both functions collaborate to develop consistent tax and finance strategies that augment the ability of each to deliver organizational value.

Human capital

Developing an optimal resourcing structure for tax and finance means reviewing the vision and overall governance structure of each function and the overall organization. This will allow you to identify the capabilities, accountabilities and key integration points needed to support the business strategy and meet regulatory and reporting requirements.

In traditional tax and finance functions, resource roles and responsibilities have been defined by out-dated technical compliance and financial reporting roles. Internal resources with specific tax and financial training or professional designations are not always incorporated as part of the core team, and resources are expected to be generalists, with neither a defined tax specialization nor a specialized focus on compliance, financial reporting or strategic planning. With this approach, the human capital structure is generally not aligned to an established strategy, as described in the governance section.

Organizations should consider non-traditional resource roles focused on integrating the tax function with finance and ultimately with the broader business. Such resources could:

- **Identify** key integration points and synergies between tax, finance and the broader business to enhance identification of value optimization opportunities
- **Liaise** between tax, finance and the broader business to develop relationships, facilitate knowledge sharing and implement required infrastructure for teaming
- **Perform** the "translator" role to demystify technical tax concepts and clearly articulate tax benefits around cash flow and other important metrics
- **Develop** integration roadmaps for effective project management of all aspects of transactions, including performance of the key pre- and post-implementation activities required to realize tax benefits

Lack of integration between tax and finance is not restricted to any one industry or to any particular company size. Small organizations may lack sufficient resources or capabilities to implement integration while larger, complex companies may have difficulty focusing resources on the right activities. Consider size, position and organizational need when identifying potential non-traditional roles. Larger organizations may require specific, dedicated resources while smaller, less complex organizations may simply need to redefine the roles and responsibilities of existing resources.

Consider all possible alternatives as you build your tax and finance human capital model, including the optimal use of external service providers. External vendors can perform a wide variety of tasks, and they can be fully integrated – for example, as a co-sourcing partner – or considered completely independent advisors. Two alternatives are to:

- **Outsource** compliance and maintain value-added activities in-house. Day-to-day value protection activities such as compliance are prepared and/or reviewed by external service providers, enabling in-house resources to focus on value creation activities.
- **Outsource** strategic transaction advice and maintain compliance in-house. Technical and accounting expertise goes to external service providers while in-house resources focus on ensuring all compliance and financial reporting requirements are met.

Internal knowledge sharing is a key part of tax-finance integration. Joint development of tax and finance staff can reduce confusion around tax requirements within the finance function and make sure you never hear the phrase, "We don't know why we do this, but we have to do it for tax."

The path forward

While integration between tax, finance and the broader business is a goal for most organizations, many do not take action to realize it. A pre-defined roadmap is essential to ensure that integration is strategically determined and tactically implemented.

This roadmap should include:

- **Activities** – Identified through collaboration between tax, finance and affected areas of the business to ensure effective integration.
- **Milestones** – Key performance indicators that let you mark achievements, monitor progress and address issues in a timely manner.
- **Timelines** – Realistically set recognizing that integration is not achieved overnight.

Once the roadmap has been developed, you need buy-in from key stakeholders prior to commencing the project. This buy-in should include:

- **Top-down** – Tax executive, C-suite (including CFO, COO and CIO), board of directors, audit committee and others where a direct reporting relationship exists. If the "tone at the top" does not align with the initiative, it will not succeed.
- **Bottom-up** – Tax, finance and affected business functions must fully understand any change and its impacts if they are to participate enthusiastically in required and supporting activivvties.

Orchestrate the future

Achieving a best-in-class performing organization means seamlessly integrating tax with finance and ultimately with the broader business. Orchestrating this level of collaboration is not easy, and developing stakeholder consensus is a major hurdle. You need the sheet music – a documented strategy and vision to drive the adoption of transformational initiatives. If successful, the benefits can be profound and include: an enterprise-wide architecture that achieves cost efficiencies through straight-through processing and a reduction in manual data manipulation; optimization of transactional tax benefits arising from an increasingly complex, integrated global economy, where people, goods and intellectual property move regularly between tax regimes; and a fundamental shift in the business's core strengths, with tax and finance becoming a true orchestrator of strategic value creation.

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Endnote

[1] Deloitte. (January 2011). *Material weaknesses and restatements: Is tax still in the hot seat?* Retrieved on July 3, 2012 from http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Tax/us_tax_materialweaknesses_012011.pdf.