Tax provision process and technology trends
Why and how to continually improve
Disclaimer

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young LLP is a client-serving member firm of Ernst & Young Global Limited located in the US.

This presentation is ©2013 Ernst & Young LLP. All rights reserved. No part of this document may be reproduced, transmitted or otherwise distributed in any form or by any means, electronic or mechanical, including by photocopying, facsimile transmission, recording, rekeying or using any information storage and retrieval system, without written permission from Ernst & Young LLP. Any reproduction, transmission or distribution of this form or any of the material herein is prohibited and is in violation of US and international law. Ernst & Young and its member firms expressly disclaim any liability in connection with use of this presentation or its contents by any third party.

The views expressed by panelists in this session are not necessarily those of Ernst & Young LLP.
Circular 230 disclaimer

Any US tax advice contained herein was not intended or written to be used, and cannot be used, for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code or applicable state or local tax law provisions.

These slides are for educational purposes only and are not intended, and should not be relied upon, as accounting advice.
Today’s presenters

Joan Schumaker — *Moderator*
Daren Campbell
Kathy Ford
Mike Kent
David Kovar
Your panelists

► Joan Schumaker — Moderator
► Daren Campbell
► Lydia Couch
► Melanie Dowling
► Martin Fiore
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
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
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
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
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
## Tax-related material weaknesses and restatements

<table>
<thead>
<tr>
<th>Year</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Material weakness</td>
<td>215</td>
<td>206</td>
<td>157</td>
<td>168</td>
<td>116</td>
<td>94</td>
<td>75</td>
<td>65</td>
</tr>
<tr>
<td>Restatements</td>
<td>104</td>
<td>111</td>
<td>68</td>
<td>76</td>
<td>56</td>
<td>34</td>
<td>33</td>
<td>24</td>
</tr>
</tbody>
</table>

* Total for calendar year.

### Primary cause of tax material weaknesses and restatements

<table>
<thead>
<tr>
<th>Category</th>
<th>Cause</th>
</tr>
</thead>
<tbody>
<tr>
<td>People</td>
<td>Personnel with insufficient technical knowledge, experience and training in tax accounting, process or internal controls</td>
</tr>
<tr>
<td></td>
<td>Lack of investment, resources and focus in tax reporting</td>
</tr>
<tr>
<td>Process and controls</td>
<td>Lack of adequate policies and procedures to ensure the completeness, accuracy, preparation and review of the income tax provision</td>
</tr>
<tr>
<td></td>
<td>Lack of documentation</td>
</tr>
<tr>
<td></td>
<td>Lack of timely reconciliation of tax accounts</td>
</tr>
<tr>
<td></td>
<td>Improper recording of valuation allowances</td>
</tr>
<tr>
<td></td>
<td>Inadequate monitoring of significant transactions and new reporting requirements</td>
</tr>
<tr>
<td></td>
<td>Poor control design, operation and monitoring</td>
</tr>
<tr>
<td></td>
<td>Financial close and work compression</td>
</tr>
<tr>
<td></td>
<td>Estimation errors and valuation and measurement of deferred income taxes and uncertain tax positions (UTPs)</td>
</tr>
<tr>
<td>Data and technology</td>
<td>Lack of data integrity</td>
</tr>
<tr>
<td></td>
<td>Lack of tax sensitization of enterprise resource planning (ERP), chart of accounts (COA) and sub-systems</td>
</tr>
<tr>
<td></td>
<td>Inter-company and legal entity accounting issues</td>
</tr>
<tr>
<td></td>
<td>Complex spreadsheets and spreadsheet errors</td>
</tr>
</tbody>
</table>
## Areas to improve — what companies are doing

<table>
<thead>
<tr>
<th>Areas of focus</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>People</strong></td>
</tr>
<tr>
<td>► Create a tax operating model designed to effectively manage global tax risk</td>
</tr>
<tr>
<td>► Train personnel globally in ASC 740 technical rules and processes</td>
</tr>
<tr>
<td>► Develop competency development plans focused on building skills and experience</td>
</tr>
<tr>
<td>► Build hiring road map and consider co-sourcing with external provider to manage risk</td>
</tr>
<tr>
<td>► Improve communication between tax and other areas to ensure tax is aligned with finance and the business</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Process and controls</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>► Build the mechanisms to institutionalize processes and controls into tax life cycle</td>
</tr>
<tr>
<td>► Create a continuous improvement model challenging the prior year process</td>
</tr>
<tr>
<td>► Reestablish quality in existing numbers (tax basis balance sheets)</td>
</tr>
<tr>
<td>► Develop and implement formal, written tax accounting policies) and procedures</td>
</tr>
<tr>
<td>► Refresh Sarbanes-Oxley processes and controls — documentation/execution</td>
</tr>
<tr>
<td>► Address technical issues early and prepare white papers for consideration by management and external audit</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Data and technology</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>► Build an effective data management strategy using a tax technology framework to support entire tax life cycle</td>
</tr>
<tr>
<td>► Improve data collection on legal entity basis for forecast and interim reporting</td>
</tr>
<tr>
<td>► Automate tax effects of intercompany profits by working with finance</td>
</tr>
<tr>
<td>► Develop tax “self-serve” data collection competencies</td>
</tr>
<tr>
<td>► Ensure proper controls over technology applications comprising the overall provision model</td>
</tr>
</tbody>
</table>
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
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
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
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
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
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
Overview of a typical FIN 48 process

<table>
<thead>
<tr>
<th>Record</th>
<th>Gather and analyze</th>
<th>Report</th>
</tr>
</thead>
<tbody>
<tr>
<td>Position templates</td>
<td>FIN 48 model</td>
<td>Balance sheet change</td>
</tr>
<tr>
<td>International issues</td>
<td></td>
<td>Discrete impact</td>
</tr>
<tr>
<td>Cumulative translation adjustment (CTA) rates</td>
<td></td>
<td>Footnote disclosures</td>
</tr>
<tr>
<td>State apportionment factors</td>
<td></td>
<td>CTA</td>
</tr>
<tr>
<td></td>
<td>FIN 48 tracker</td>
<td>Interest change</td>
</tr>
<tr>
<td></td>
<td></td>
<td>NOL after UTP</td>
</tr>
</tbody>
</table>

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
An improved FIN 48 process

<table>
<thead>
<tr>
<th>Process</th>
<th>Current method</th>
<th>Improved method</th>
</tr>
</thead>
<tbody>
<tr>
<td>CTA calculation</td>
<td>Manual</td>
<td>Automated</td>
</tr>
<tr>
<td>Discrete analysis</td>
<td>Manual linkage</td>
<td>Automated calculation</td>
</tr>
<tr>
<td>Footnote and consolidation</td>
<td>Manual consolidation</td>
<td>Automated report generation</td>
</tr>
<tr>
<td>Data collection templates</td>
<td>Few controls</td>
<td>Automated roll-up for each reporting period</td>
</tr>
<tr>
<td>Calculation of interest</td>
<td>Manual interest calculations</td>
<td>Federal and state interest calculations automatically calculated</td>
</tr>
<tr>
<td>Statute of limitations</td>
<td>Manual updating of statute of limitations</td>
<td>Automatically reverses UTP positions, if statute of limitations date has been reached</td>
</tr>
<tr>
<td>Federal/state with apportionment factors</td>
<td>Manual process</td>
<td>Apportion federal issues to each state based upon imported apportionment factors</td>
</tr>
</tbody>
</table>
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
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
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
We are now at a point where an integrated tax environment vision is possible with commercial tools.
## Case study
New technologies for tax

<table>
<thead>
<tr>
<th>Trend</th>
<th>Many new technologies for tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Driver</td>
<td>Desire for paperless office, more automation and task management</td>
</tr>
<tr>
<td><strong>Marketplace tools</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>► Workflow/document management/collaboration/portal</td>
</tr>
<tr>
<td></td>
<td>► Microsoft SharePoint</td>
</tr>
<tr>
<td></td>
<td>► ONESOURCE WorkFlow Manager and Data Flow</td>
</tr>
<tr>
<td></td>
<td>► Corptax Workspace</td>
</tr>
<tr>
<td></td>
<td>► New data-centric provision tools</td>
</tr>
<tr>
<td></td>
<td>► Hyperion Tax Provision (HTP)</td>
</tr>
<tr>
<td></td>
<td>► Longview</td>
</tr>
<tr>
<td></td>
<td>► Growing use of enterprise technologies by tax</td>
</tr>
<tr>
<td></td>
<td>► Hyperion/HFM</td>
</tr>
<tr>
<td></td>
<td>► SAP BI tools</td>
</tr>
</tbody>
</table>
## Case study

**Improvements with workbooks**

<table>
<thead>
<tr>
<th>Trend</th>
<th>Improvements with workbooks used by tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Driver</td>
<td>Excel still extensively used by tax, but continuing desire for greater standardization, control and connection with data and tax tools</td>
</tr>
<tr>
<td>Marketplace tools</td>
<td>Thomson Reuters ONESOURCE Active Workpapers, DataFlow and Excel Add-In</td>
</tr>
<tr>
<td></td>
<td>Corptax Office and data exchange</td>
</tr>
<tr>
<td></td>
<td>Other third-party tools that allow Excel to be locked down</td>
</tr>
<tr>
<td></td>
<td>Longview for Excel</td>
</tr>
</tbody>
</table>
## Case study

**Finance transformation including tax**

<table>
<thead>
<tr>
<th>Trend</th>
<th>Finance transformation including tax</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Driver</strong></td>
<td>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</td>
</tr>
</tbody>
</table>
| **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. |
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
Tax process and technology framework
Leading practice tax reporting

**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

---

**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

---

**Gather and analyze**

- Excel/manual extract
- Compliance software
- Provision software
- Data repository

**Record**

- General ledger
- Consolidation
- Other

---

**Report**

- Online filing
- Tax compliance
- Tax accounting
- Other regulatory filings
- XBRL

---

**Business units**

- SSC

---

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

---

**Effective controls over tax processes, which are documented, integrated with business and continuously monitored**
## Case study
### Improved integration with tax tools

<table>
<thead>
<tr>
<th>Trend</th>
<th>Improved integration of provision and compliance with tax tools and processes</th>
</tr>
</thead>
</table>
| 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 |
Thanks for participating