Worldwide tax reporting in the shared services age: seizing the opportunity and managing the risk

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Today's presenters

Ken Brown - Moderator
Cheryl Belles
Ashley Giles
Nicolas Kelpe
Tom Knoeller
Dan Williams
Worldwide tax reporting in the shared services age setting the stage

► Shared Service Centers (SSCs) can impact tax reporting in several ways:
  ► Become a centralized source of data or information
  ► Perform tax-related tasks or processes
► Expected benefits include potential cost savings and efficiency gains
  ► Centralize activities or processes
  ► Customer-facing processes
  ► Back-of-the-house functions
► Estimated 75% of Fortune 1000 companies utilize some form of SSC
Among the Top 10 future business risks

- Cost reduction pressures (ranked # 2)
- Expanded influence of government (ranked # 6)
- Increased burdens from regulation and compliance (ranked # 7)

Among the Top 10 future business opportunities

- Investment in process, tools and training to increase productivity and efficiency (ranked # 3)
- Global relocation of key functions to achieve process optimization (ranked # 5)
Ernst & Young global tax survey finding
SSC implementations may be side-stepping tax reporting

<table>
<thead>
<tr>
<th>Service</th>
<th>Excluded from initial scope, but added in later on</th>
<th>Included in transformations</th>
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</thead>
<tbody>
<tr>
<td>Statutory accounting and reporting</td>
<td>68%</td>
<td>28%</td>
</tr>
<tr>
<td>Income tax compliance</td>
<td>48%</td>
<td>46%</td>
</tr>
<tr>
<td>Tax provision preparation (annual or quarterly)</td>
<td>48%</td>
<td>44%</td>
</tr>
<tr>
<td>Indirect tax compliance</td>
<td>12%</td>
<td>52%</td>
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</table>
SSCs overview
Companies establish shared service organizations to provide services – both regionally and globally

What is an SSC?
- High-volume transaction processing centers servicing multiple operating/business units
- Centers of excellence that establish and enforce common practices and procedures
- Key attributes
  - Lower cost
  - High degree of specialization
  - Process focus with critical mass expertise
  - High quality service standards and measures
  - Performance-based incentives
  - Leading edge user of enabling technologies
  - Continuous improvement culture
  - Customer focused

Benefits of SSCs
- Cost reduction opportunities due to economies-of-scale and labor arbitrage
- Opportunities to increase quality and comparability of information
- Effective processing of cross-border transactions
- Single point of contact for customers
- Support information technology (IT) investments and implementation only once
- Enhanced flexibility for acquisitions and third-party business

Benefits of global shared finance service centers
- Significant cost reductions
- Improved information access and consistency
- Enhanced ability to refocus business units
- Significant consistency and quality improvements
- Enhanced flexibility for acquisitions and third-party business
Although macro trends can be identified, different companies are at different places in their evolution.

Shared services trends indicate a movement toward globalization with a focus on scope expansion, improved governance, further automation and end-to-end processing.

<table>
<thead>
<tr>
<th>Time</th>
<th>Through 1990s</th>
<th>2000–2010</th>
<th>2010 and beyond</th>
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<tbody>
<tr>
<td>Sector</td>
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<tr>
<td>Private sector</td>
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<td></td>
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<tr>
<td>Public sector</td>
<td></td>
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<td></td>
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<tr>
<td>Size</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>&gt; $5b revenue, &gt; 250 seats</td>
<td></td>
<td>&gt; $1b revenue, &gt; 75 seats</td>
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<tr>
<td>Technology</td>
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<tr>
<td>ERP standardization</td>
<td></td>
<td>Enabling technology</td>
<td>Global work flows</td>
</tr>
<tr>
<td>Functions</td>
<td></td>
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<tr>
<td>Basic finance and general admin</td>
<td></td>
<td>Expanded finance</td>
<td></td>
</tr>
<tr>
<td>IT</td>
<td></td>
<td>HR</td>
<td>Purchasing</td>
</tr>
<tr>
<td>Location</td>
<td></td>
<td></td>
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<tr>
<td>Country centralization</td>
<td></td>
<td>Global</td>
<td></td>
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<tr>
<td>Own or buy</td>
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<tr>
<td>Outsource IT operations</td>
<td></td>
<td>Outsource other functions</td>
<td>Outsource business processes</td>
</tr>
<tr>
<td>Captive shared services operations</td>
<td></td>
<td>SSC and BPO mix</td>
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<tr>
<td>Trends</td>
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<tr>
<td>Expanding from Private sector into Public sector</td>
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<tr>
<td>Increasing adoption by smaller scale operations</td>
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<tr>
<td>Optimizing investment in ERP and global technology</td>
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<tr>
<td>Extending up value chain adding functional breadth and global governance</td>
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<tr>
<td>Movement from local and regional to global service organizations</td>
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<tr>
<td>Dedicated selected sourcing based on value contribution</td>
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</table>
SSC hotspots at a glance

Along the time zone the hotspots regions can be divided into South America, Eastern Europe and Asia Pacific. However, some countries have overheated due to the SSC boom in certain areas, so that a closer look to the single regions and countries is necessary.
Companies frequently examine different shared services options when evaluating ways to evolve.

A shared services strategy can include elements of offshoring and/or outsourcing:

- Offshoring is putting shared services activities into a low cost location
- Outsourcing is achieving better results by sourcing and funding using an external partner
- Both must be carefully managed to achieve the anticipated results

- **Simplification** Improve by applying best practice
- **Standardization** Adopt best practices consistently across all business units
- **Shared services (with offshoring)** Leverage very low cost global locations
- **Shared services (with outsourcing)**
  - Use external supplier where beneficial
  - Leverage supplier economies of scale

Shared services:
- Capture economies of scale
- Focus on continuous improvement
Processes typically performed in an SSC are no longer strictly routine

While processes performed in an SSC are often routine, non-complex and IT-intensive, they are continually evolving and increasing in complexity, breadth and scope.

<table>
<thead>
<tr>
<th>Mostly shared</th>
<th>Often shared</th>
<th>Emerging shared</th>
<th>Unlikely shared</th>
</tr>
</thead>
<tbody>
<tr>
<td>▶ Accounts payable</td>
<td>▶ External reporting</td>
<td>▶ Integration with operational strategy</td>
<td>▶ Reporting and control</td>
</tr>
<tr>
<td>▶ Travel and expenses</td>
<td>▶ General accounting and closing</td>
<td>▶ Operations performance analysis</td>
<td>▶ Decision-making authority</td>
</tr>
<tr>
<td>▶ Accounts receivable</td>
<td>▶ Fixed asset accounting</td>
<td>▶ Tax policy strategy</td>
<td>▶ Risk management</td>
</tr>
<tr>
<td>▶ Cash application</td>
<td>▶ Cash management</td>
<td>▶ Management reporting</td>
<td>▶ Operations management</td>
</tr>
<tr>
<td>▶ Master data maintenance</td>
<td>▶ Tax compliance and reporting</td>
<td>▶ Perform special projects</td>
<td>▶ Plant manufacture</td>
</tr>
</tbody>
</table>
<pre><code>                                                             | ▶ Cost accounting                                |                                                  |                                                  |
                                                             | ▶ Production accounting                          |                                                  |                                                  |
                                                             | ▶ Billing                                        |                                                  |                                                  |
                                                             | ▶ Human resources policy and pay scales           |                                                  |                                                  |
                                                             | ▶ IT system maintenance and implementation       |                                                  |                                                  |
</code></pre>
Typical overall approach to implementing shared services

Phases

- Strategy and operating model design
- Detailed design/commercial due diligence
- Operating model design
- Design detailed solution
- Contractual BPO deal
- Final solution-agreed arrangement formalized
- Transition management
- Service delivery and governance

Objectives

- Communications and change management
- Program management

Program management

- Feasibility study decision to pursue off-shoring for service delivery
- Operating model and scope-agreed, service provider evaluation planning completed
- Final solution-agreed arrangement formalized
- If business process outsourcing (BPO), offshoring contract signed
- Service migrated to captive or service provider
- Services delivered with continuous improvement
### Record-to-report and balancing the need for local subject matter knowledge

#### Creating enterprise value

<table>
<thead>
<tr>
<th>Monthly processing</th>
<th>Fixed asset accounting</th>
<th>Intercompany accounting</th>
<th>Account reconciliation</th>
<th>Period close</th>
<th>Financial and managerial reporting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Receive inputs from various departments</td>
<td>Prepare monthly journals and inquire if needed</td>
<td>Prepare monthly journals, calculate depreciation</td>
<td>Prepare and post journal entries, prepare intercompany journal entries</td>
<td>Prepare trial balance to sub-ledger balances</td>
<td>Prepare US generally accepted accounting principles (GAAP) trial balances, financial statements and monthly close packages</td>
</tr>
<tr>
<td>Prepare and post journal entries</td>
<td>Run final depreciation with period close</td>
<td>Perform intercompany settlements</td>
<td>Perform review of reconciliations</td>
<td>Close sub-ledgers and reconcile to general ledger</td>
<td>Review and sign off on financial and managerial reports</td>
</tr>
<tr>
<td>Approve journal entries in ERP system</td>
<td>Correct escalated fixed asset journal errors</td>
<td>Perform intercompany settlements</td>
<td>Perform review of reconciliations</td>
<td>Perform consolidations</td>
<td></td>
</tr>
</tbody>
</table>

#### Statutory reporting

- Calculate tax accrual and reconcile provision-to-return data
- Implement standard adjustments for conversion of US GAAP to local GAAP/International Financial Reporting Standards (IFRS) trial balances
- Draft pro-forma annual financial statements
- Consult with subject matter team on GAAP-to-GAAP conversion and other technical requirements for local financial statements
- Review conversion to local GAAP/IFRS and pro forma statutory accounts
- Prepare directors’ report and coordinate board of directors signature

#### Statutory audit

- Communicate changes to accounting/tax rules
- Audit statutory financial statements and supporting transactional information
- Coordinate with group audit team for reliance and other support
- Host audit close meeting to review audit adjustments and recommend improvements for the following fiscal year
- Review and approve audit adjustments
- Support tax controversy and representation vis-à-vis local authorities

#### Corporate income tax

- Review content of direct tax pack
- Prepare annual corporate tax return
- Support tax controversy and representation vis-à-vis local authorities
- Review content of indirect tax pack
- Calculate VAT, GST and withholding taxes based on sales revenue and qualified purchases
- Support tax controversy and representation vis-à-vis local authorities

#### Value-added tax (VAT), withholding and other taxes

- Review content of indirect tax pack
- Calculate VAT, GST and withholding taxes based on sales revenue and qualified purchases
- Prepare VAT/GST/WHT returns

#### Statutory compliance

- Coordinate with group audit team for reliance and other support
- Host audit close meeting to review audit adjustments and recommend improvements for the following fiscal year
- Review and approve audit adjustments
- Support tax controversy and representation vis-à-vis local authorities

### Legend

- Shared services activities
- Activities requiring local subject matter knowledge
- Corporate headquarters

### EY

Quality In Everything We Do
Data management: changing data supplier changes when and how you get data

Service management office

Global process control – Streamline data gathering | Standardization of policies and procedures | Harmonization of deliverables | Global control of statutory accounting and compliance

- Record-to-report
- Processing of and process transactions and entries
- Period close
- Reconcile
- Provision of structured data
- Gathering of non-structured data
- Reconciliations, journal entries, payments

Indirect tax returns and declarations

- Data validation and exception reporting
- Data mapping and upload
- VAT ledger preparation
- VAT return preparation
- VAT return review
- VAT return submission
- Statutory reporting
- Corporate to Local GAAP conversion
- Trial balance prep
- Statutory financial statements preparation
- Statutory audit support
- Financial statements submission
- Corporate income tax compliance
- Tax prepayment calculation
- Tax provision calculation
- Tax return preparation
- Tax memo preparation
- Tax return submission
- Other compliance
- Other tax compliance preparation
- Other financial compliance preparation

Objectives for data management and reuse

- Standardization before centralization
- Efficient process for extraction of compliance and reporting data through standardized data formats and technology
- Optimized finance system and controls to support improved data quality
- Centralized management, analysis and exception reporting of compliance and reporting data
- Processes and systems capture “tax-sensitive” data at time of original processing.
- Collaboration tools allow a secure exchange of data between the SSC and subject matter professionals
- Improve tax data by sensitizing chart of accounts, general ledger and other source systems
- Implement reconciliation process for data exchanges between SSC and subject matter professionals
- Leverage tax tools (direct/indirect taxes) and data/business warehouse

Local filings | Centralized storage

- Controversy
- Identify local GAAP changes

Global process control

- Streamline data gathering
- Standardization of policies and procedures
- Harmonization of deliverables
- Global control of statutory accounting and compliance

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SSCs realign the people model. How will the tax compliance work get done?

Trends reported by the Ernst & Young global compliance and reporting survey:
Reduce or redeploy in-country finance and tax resources to global or regional centers.

► Almost 80% of companies have recently completed or will soon complete a finance transformation.

► There are limited efficiencies in building full finance and accounting capabilities in every country.

► Qualified internal resources struggle staying utilized due to the seasonal nature of many statutory compliance processes.

More than 60% of respondents indicated local resources are important to statutory compliance processes.

► Tax compliance processes support complex in-country filings and submissions.

► Changing regulations and aggressive tax enforcement heighten the need for sustainable access to local expertise.

► Over 80% of surveyed companies feel the lack of skilled resources limits their ability to adopt a more regional or global compliance and reporting model.

More than 60% of respondents indicated local resources are important to tax compliance processes.

Leading companies recognize that local expertise is essential for maintaining quality and reducing risk.
To support achieving an optimal balance, the SSC must be designed to address a number of challenges relating to effectiveness, efficiency and control for both the compliance and reporting processes.

- **Effectiveness**
  - Improve the finance service to the business
  - Improve the quality of data and reporting
  - Strengthen business decision-making
  - Be seen as a valued business partner

- **Efficiency**
  - End to end flow of data
  - Consistent processes
  - Appropriate technology
  - Skilled and experienced people
  - Leverage of investment

- **Control**
  - Global visibility
  - Quality, consistency and increased certainty
  - Stakeholder confidence
  - Risk management

---

**Corporate tax challenge: striking the right balance to maximize the compliance and reporting process**

Achieving the optimal balance:
- Improve the finance service to the business
- Improve the quality of data and reporting
- Strengthen business decision-making
- Be seen as a valued business partner

Efficiency
- End to end flow of data
- Consistent processes
- Appropriate technology
- Skilled and experienced people
- Leverage of investment

Control
- Global visibility
- Quality, consistency and increased certainty
- Stakeholder confidence
- Risk management

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**Achieving the optimal balance**

- High quality, high cost
- Business focused, high risk
- Back office focused

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**Ernst & Young**

*Quality in Everything We Do*
SSC–enabling compliance processing

Centralized

- Governance and management
- Finance and tax organization
- Technology environment

Local country

- Local quality assurance | regulatory updates | controversy
- Transition | retained finance and tax organization
- Globally connected | local technology tools

“Record”

Shared services center

Finance systems

Compliance processing and data distribution

Statutory audit

Draft financials and disclosures

Audited financials

Corporate income tax compliance

Other tax compliance (5471 and 1118)

Tax accounting, Fin 48 and uncertain tax positions

Withholding tax compliance

Statutory reporting

Statutory filing tax return

Service Level Agreement

Service Level Agreement

Statutory reporting

Other tax filings

Global tax provisos

Reportable and non-reportable transactions

Service Level Agreement
Complexities in global withholding tax (WHT) bases

A majority of countries require withholding regimes
Complexities in resident-to-resident withholding

A majority of countries require withholding not only on foreign suppliers … but also on their own residents
The importance of withholding tax under management

1. Withholding tax that is withheld from vendor payments
2. Other transactions that would be included within the withholding tax base – but for the following:
   ► Treaty exemption
   ► Sourcing rule
   ► Other similar statutory exemptions
3. These other transactions can be categorized further into two types:
   ► Reportable transactions
     ► Tax authority requires reporting on transactions either outside the normal withholding tax return or as a supporting schedule to the withholding tax return
   ► Non-reportable transactions
     ► These transactions are typically tracked for audit purposes

![Pie chart showing 20% other transactions requiring documentation and 80% withholdable transactions]
Risks, opportunities and leading practices to remember

**Risks:**
- Centralizing local subject matter and the potential turnover of hard-to-find resources
- Varied (and sometimes contradictory) tax rules and documentation requirements
- Maintaining and monitoring regulatory rule changes
- Lack of sponsorship due to required teaming across functions
- Managing the risk inherent to compliance processing vs. data distribution

**Opportunities:**
- Balance the right level of subject matter knowledge between central and local solutions
- Realize maximum benefit from investment in ERP systems and technology enablers
- Determine tax department support for the SSC
- Reduce in a material way the manual work (and error rate) in tax reporting
- Consolidate "best fit" tax processes in a single location – center of excellence

**Leading practices:**
- Get involved early in your company’s SSC strategy and understand what is going on
- Enable end-to-end data flow and promote “tax-sensitization”
- Focus on achieving a balance between control, efficiency and effectiveness
- Document local country processes and controls
- Determine balance of responsibility between SSCs and local countries
- Standardize tasks and processes, automate, and leverage third parties
Questions and answers
Thanks for participating