Managing Transfer Pricing on a day to day basis: insight into practical examples and best practices

Transfer Pricing Symposium
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Agenda

► Introduction
► TP survey results
► Practical examples
The transfer pricing landscape is changing…

Internal influences:
- Internal controls
- Headcount reductions
- Business performance
- Accelerated financial close
- Business competition between intercompany models
- Year end true ups
- Standardise, simplify and systemise

External influences:
- Tax law changes
- Taxing authority audits
- Base Erosion and Profit Shifting
  “solutions to counter harmful regimes more effectively, taking into account factors such as transparency and substance”
- Action 13 – Large amounts of previously undisclosed data made available to tax authorities …

CBCR - Country by Country Reporting

Managing TP on a day to day basis
Signs that you have an **intercompany problem**

Your arm’s-length margins were set at the roulette wheel.

Your are faced with material year-end adjustments.

For the CFO BEPS is the acronym for Business Excellence Profit Sharing.

Internal transfer pricing discussions can only be tackled by hiring the New-Zealand rugby team.

Your finance department hired 10 FTE to monitor the transfer prices on a day to day basis.

The responsible managers of the contract manufacturing plants are remunerated based on country net operating profit level.
Intercompany Effectiveness: Survey demographics

Industry

- Financial Services: 1
- Other Services: 4
- Technology, Communication and Media: 4
- Consumer Products: 4
- Retail: 1
- Pharma: 5
- Chemicals and chemical products: 6
- Automotive (incl suppliers): 10
- Other Industrial products*: 8
- Energy: 2

* Includes Healthcare, agricultural, machinery and other industrial products

Group revenue (EUR)

- Less than 500 m: 4
- 500 m - 2,5 b: 17
- 2,5 b - 10 b: 16
- Above 10 b: 8

Employees

- Below 5 000: 12
- 5 000-15 000: 18
- 15 000-25 000: 5
- Above 25 000: 10

Headquarter locations

- Switzerland
- Germany
- Netherlands
- Denmark
- United Kingdom
- Norway
- Japan
- USA

ERP System

- 79% SAP
- 12% Other
- 9% Oracle

Total respondents

45
Intercompany Effectiveness: **Overall survey results**

![Average maturity for population diagram]

- **Current State**
- **Future State**
- **Leading Practise**

Managing TP on a day to day basis
Intercompany Effectiveness: **Overall survey results**

**Maturity ranked for each element**

- **Leading**
  - Technology & Data: 2.3
  - Process & Controls: 2.4
  - Policies & Guidelines: 2.6
  - People & Organization: 2.6
  - Transactions: 2.7
  - Pricing: 2.8
  - Legal Structure & Framework: 3.0
  - Operational Strategy & Performance Measurement: 3.0

- **Advanced**

- **Established**

- **Developing**

- **Basic**

Managing TP on a day to day basis
Where do we see the biggest challenges?

- Technology & Data, Process & Controls and People & Organization score lowest
- 40% basic or developed
- Strong correlation scores for the three areas
- Main observations around the areas:
  - Organizational structure
  - Process of setting transfer prices
  - Process for monitoring transfer prices
  - Technology support

Basic or developed score for T&D, P&C and P&O on average
Basic or developed score for all three elements (T&D, P&C and P&O)
The organizational structure

7.4: To what extent are key business functions such as operations, finance, legal and business development aware of transfer pricing related…

7.5: To what extent is transfer pricing training provided for management and other key business functions which may impact intercompany…

7.7: To what extent does the organizational structure enable effective execution and control of transfer pricing?

Are transfer pricing roles and responsibilities clearly defined within your company?
People and organization: organizational challenges

 ► People
   ► Lack of resources
   ► Cross functional talent
   ► Difficulty finding or retaining people
   ► Part-time vs full-time
   ► Sustainability of training and development path
   ► ……

 ► Organization
   ► Multiple stakeholders involved
   ► Lack of shared vision and strategy
   ► Misaligned metrics and / or competing priorities
   ► Unclear roles and responsibilities
   ► ……
### RACI

<table>
<thead>
<tr>
<th>Process / Activity</th>
<th>CFO</th>
<th>Tax/TP</th>
<th>Legal</th>
<th>BU</th>
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<tbody>
<tr>
<td>Initiate a new intercompany (“IC”) transaction</td>
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<td>Establish transfer pricing policy for a new IC transaction</td>
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<td>Put IC legal contracts in place</td>
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<td>Reset target transfer prices annually</td>
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<td>Change transfer prices during the year</td>
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<td>Invoice intercompany transactions</td>
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<td>Reconcile intercompany accounts</td>
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<td>A</td>
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<tr>
<td>Reconcile actual results to transfer price policy</td>
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<td>R</td>
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<td>Make year-end adjustments to intercompany accounts</td>
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<td>R</td>
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<td>Determine transfer pricing exposure reserves</td>
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<td>R</td>
<td></td>
<td>C</td>
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<td>Local country documentation and compliance</td>
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<td>R</td>
<td>C</td>
<td>A/R</td>
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<td>Transfer pricing controversy – strategy / response</td>
<td>C</td>
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</table>

Roles and Responsibilities must be clearly defined:

- Responsible
- Accountable
- Consulted
- Informed
Process mapping
The process of setting transfer prices

5.1: To what extent are the pricing methods for the various transaction categories standardized?

4.12: To what extent is there a standard process to calculate the transfer price in the budgeting phase?

4.9: To what extent is there a standardized process for loading transfer prices into the ERP?

2.6: To what extent are the Key Performance Indicators (KPIs) of legal entities or business units standardized?

Does your company factor in the Transfer Pricing policies when setting the IC prices for the budget?

44%

Of the companies do not have a formal process or a process at all for calculating transfer prices in the budgeting phase.
The process of **monitoring and adjusting transfer prices**

5.4: To what extent are transfer prices monitored?

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<td>21</td>
<td>5</td>
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4.8: To what extent is there a standardized process for monitoring and adjusting transfer prices to ensure compliance with policies and guidelines and to what...

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**55%**

Relies on non-standard, ad-hoc excel worksheets with a lack of spreadsheet controls
Transfer pricing technology enablement and support

8.4: To what extent is technology used to support transfer pricing monitoring for…

8.1: To what extent is forecast data available to support transfer pricing analyses?

8.2: To what extent is forecast data reliable?

Key stats

► In general very limited support from technology. The element with the lowest average score

► Most companies rely on own developed excel based templates without any formal controls

► For 72% forecast data is not sufficient to support a transfer pricing analysis at the right level of detail

2% use third party or own developed TP tools in monitoring and adjusting TP.
## Setting and Monitoring IC Prices: Trends

<table>
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<tr>
<th>Current</th>
<th>Future</th>
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<tbody>
<tr>
<td>Year-end-adjustment</td>
<td>Prospective pricing adjustments</td>
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<tr>
<td>Legal entity level</td>
<td>More detail in TP analyses</td>
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<tr>
<td>Manual</td>
<td>(Semi-) Automated</td>
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<tr>
<td>Excel</td>
<td>Leverage from IT (ERP) tools in your company</td>
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</table>
Establish an effective intercompany margin management process

- Chemical company
- >20 countries
- Large volume of IC transactions
- Challenges with managing profit margins routine functions
- Year-end adjustments creating issues for Customs duties
- Manual process, inconsistent, HERO dependant, complex Excel files
- No access to financial data required to manage TP proactive
Price & Margin Management: Case study

Feasibility workshop
TP user requirements
Business case

Functional design
User requirements
Business case

Technical design and build

Deploy, test and expand scope

SAP Source System / Non-SAP Files Data
- SAP R3 6.0

Extractors
- Std. SAP Extractors

SAP Business Warehouse
- SAP BW

SAP Analytical Layer
- SAP Business Objects
- SAP BEx analyzer

Customer Data
Materials Data
Legal Entity
Customer/Vendor Data
Plant
GL Accounts

Non-SAP data

Billing Headers
Billing Line Items
Actual Costing
Prod. Orders-Header
Prod Orders Line Items
GL Txns
Purchase Orders
Material Movements
CO-PA module

Budget/Forecast

Staging Layer
DSO
Transaction Data
Master Data

Transformation Layer
DSO
Budget
Transfer Pricing Configuration Module

Reporting Layer

Report Pricing Reports, Dashboards:
- Segmented P&L
- Drill Down
- Prospective pricing adjustments

Future state:
SAP embedded Transfer Pricing Solution

Managing TP on a day to day basis
### Price & Margin Management: Case study

#### Typical challenges
- Group versus Local accounts
- Inventory effects
- Budget data
- Granularity data
- Data quality
- Complex IT landscape
- Other priorities stakeholders

#### Success factors
- Solid business case
- Identify and align stakeholders
- Prioritize requirements
- Be precise on functionality required
- PATIENCE and PERSISTANCE

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<th>Line Of Business</th>
<th>Material</th>
<th>PLI Low</th>
<th>PLI Median</th>
<th>PLI High</th>
<th>Actual Result For PLI</th>
<th>Actual PLI Value Over/Under Median Target</th>
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Key takeaways

► Managing TP goes much further than TP documentation: the TP CYCLE
► Multidisciplinair – tax only does not work
► Relevance of IT for TP is increasing
► Proactive instead of reactive – now is the time to look at implementation