

# MANAGING THE TAX FUNCTION THROUGH A WEAK ECONOMY



Ine-Lize Terblanche | Senior Manager | PricewaterhouseCoopers

PRICEWATERHOUSECOOPERS 

**T**he financial crisis and global recession have taken a significant toll on companies. Tax, like other enterprise-wide functions, faces close scrutiny during troubled times. For years, the tax function has been under tremendous pressure to execute against an ever-increasing inflow of regulatory requirements and challenges associated with 'low or no' investment in technology and process improvement. A steady increase in tax responsibilities coupled with a prolonged strict approach to headcount has, in some cases, led to internal control deficiencies, financial restatements, and in extreme cases a general loss of confidence in the tax function.



Given these competing challenges, how can senior executives effectively manage the tax function through a weak economy while waiting for economic conditions to restore corporate budgets?

When times are tough, companies rethink their businesses and recalibrate their resource and investment decisions. While the short-term benefits of budget and headcount cuts may seem attractive on paper, CFOs and tax executives may want to consider some other alternatives when evaluating their tax function.

#### Ring fence the tax function

Human capital costs represent a large number in the budget of a typical tax function so it's not surprising that headcount reduction is typically the knee-jerk response to cost containment in a down economy. In a rush to reap the short-term benefits of a reduction in force, companies often cut headcount without considering risks unique to specific functions and perhaps, more importantly, opportunities to realise untapped value with the same level of resources through strategic process and technology investments.

The ring fence approach rests on the premise that headcount reductions in tax should be avoided, and not simply expected, as part of a company-wide reduction in work force. The rationale is, quite simply, that most tax functions are already dangerously understaffed, and further reductions may lead to an increase in errors or an unnecessary increase in effective tax rate or cash taxes. This is particularly relevant given that a company's tax function continues to be the single-most frequently cited reason for material weaknesses in the Sarbanes - Oxley internal control audits.

This rigid approach to resource management favours a long-term investment in sound risk and resource management over the short-term benefit of headcount reduction and is a strategic option for companies today – especially those with a history of material weaknesses, financial restatements or amended returns.

#### Give and get

If headcount reductions are unavoidable, the tax function can opt to concede the inevitable in exchange for a reasonable budget to pursue process and technology enhancements to ultimately drive greater efficiencies. This option not only supports effective risk management, but also enables the tax function to free up staff. Most tax functions are redeploying or reinvesting that newly created capacity to high value tasks such as cash tax planning, forecasting, financial reporting, audits, tax policy and controls.

Historically, the tax function has tended to operate as a silo within the finance function. The result is that finance and IT leaders have become accustomed to either ignoring tax when looking at IT projects or bringing tax in so late in the systems development lifecycle that it is no more than a token step in the project plan. Similarly, in most companies, there is an expansive IT infrastructure that is not appropriately leveraged by the tax function.

Investments in and availability of new technologies may be unrealistic in the current environment, but companies should be able to realise some gains by making better use of their existing finance IT infrastructure, including ERP systems, business intelligence software, extract transform

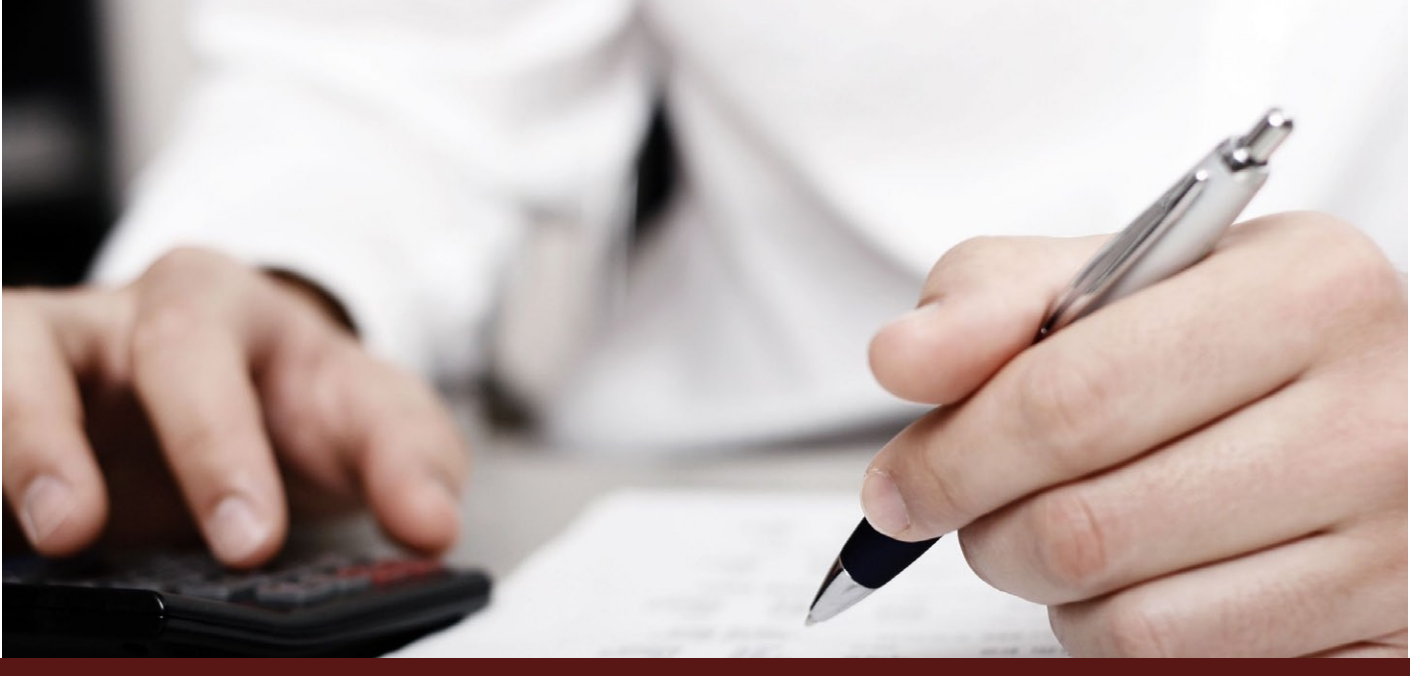
and load (ETL) tools, data warehousing systems and even Web portals.

#### Focus on spreadsheet remediation

Resource-strapped tax functions often rely on intricate spreadsheets (frequently lacking adequate data input, verification and processing controls) to drive processes and outputs. Unfortunately, for many companies, spreadsheet maintenance tends to consume much of the tax function's time, leaving less time for quality review, data analysis and process improvement.

Consequences of that inefficiency range from inaccuracies and missed internal deadlines to tax compliance risks, tax-related material weakness or significant deficiencies. By focusing on spreadsheet remediation, companies can focus on value add activities like improving the flow of information, ensuring the accuracy of source data and spending time in review, instead of spending significant time and effort adding to already overly complex processes. Improving the effectiveness and control of your spreadsheets could prove useful if you are experiencing one or more of these common symptoms:

- Just one or two people who really know how to use a critical spreadsheet.
- No current inventory of significant spreadsheets and the time it takes to execute them on a regular basis.
- A high degree of complexity in your spreadsheets (e.g., hidden cells, macros, internal and external links).
- A significant number of data inputs or other spreadsheets that feed the master spreadsheet.



### Sensitize tax ERP systems and differentiate high risk items.

First, tax must invest in training in the self-service tools available to gain ERP access, query and report critical information for tax reporting and planning. This includes the key tools around the ERP systems that allow tax to directly access information rather than submitting a request to the controller's group and waiting for results. It's likely the IT and/or finance functions will have deployed sophisticated ETL tools, consolidation programs, business warehouses and/or data mart applications that enable the finance function to carry out their complex financial reporting role. One of the first steps in a tax technology improvement project is to look inside the organisation, find these tools and applications and determine how they can be configured to deliver on many tax function data requirements in a cost-effective manner.

Although spending is curbed during an economic downturn, some companies still want to improve their enterprise-wide process/technology departments and tax needs to have a seat at the table in these discussions.

In a down economy, an effective model to manage the talent gap for tax technology initiatives is to approach the CFO or controller about temporarily sharing a finance or IT resource. Not only is a finance resource familiar with the chart of accounts, but a business case can be made based on the risk to the financial statements. Using any remaining budget, the tax accounting process consultant can vet issues after implementation with the company and its auditors.

### Deliver cash

One traditional cost-cutting measure is outsourcing which can be beneficial by helping a tax department scale its resources against fluctuating workloads, freeing up staffers to concentrate on strategic imperatives, and covering difficult staffing situations, like reorganisations or headquarters relocations. Outsourcing could also be used as the driver for needed technology and process improvements which may be too difficult to achieve internally.

From an operational point of view, the best opportunity to reduce fees spent globally for tax compliance and tax accounting support may be to concentrate some of the data collection and distribution process into an existing shared service center. Cost savings – achieved either through economies of scale, process efficiencies and/or wage cost arbitrage – can be dramatic. Concentrating the data collection and distribution processes in a shared service centre can reduce fees or present a better opportunity to leverage third parties for planning advice. Not only can this approach deliver cash, but it is also a preparatory move to support global tax compliance and accounting processes in an IFRS environment.

Management of the global compliance function can be a difficult and time-consuming process, particularly when a company must deal with multiple advisers. Many companies have chosen to consolidate their global tax compliance function with a single service provider. The selection of a single service provider in conjunction with an effort to centralise data collection and distribution efforts into a shared service centre could facilitate this change and result in additional efficiencies and cost savings for the company.

### What does this mean for your business?

In a down economy, increasing regular communications with the CFO (and likely the CEO as well) will be needed to ensure that company leadership is aware of and consulted on all major tax issues and that the tax function is aware of what is happening more widely in the business. Consistent communication with key stakeholders also creates a foundation for tax executives to garner support for investment required outside of the tax budget or activities requiring enterprise-wide involvement or support.

The overall perception from many non-tax people is that tax is a difficult and complex subject. Communication is further complicated by the existence of multiple stakeholder groups, each having different interests and agendas. Therefore, it's essential to anticipate the requirements of each stakeholder group and design the appropriate method of communication with each to enjoy more success, acceptance, flexibility and potentially, greater leverage in compromise.

Managing the economic challenges through 2009 and beyond will not be easy. Companies are rethinking their businesses and the tax function should be part of that innovative thinking. By taking a fresh look at tax as part of the broader enterprise and evaluating the range of strategic options (beyond simply cutting budgets and/or headcount), CFOs and tax executives can tap into unrealised cost savings to successfully manage through the weak economy and emerge with a tax function that is a value driver for the company.