CCH
a Wolters Kluwer business

CCH Integrator™

The Power of Process: Understanding the Value of a Balance Sheet Process in Global Tax Provisions

Robert L. Lapotaire, MBA and Cindy L. Frank, CPA

When it comes to income tax provisions, corporate tax departments, large and small, walk a tightrope between meeting reporting deadlines and delivering accurate results.While the disclosures are required by law and financial reporting standards, specific software solutions and tools are not required. By and large, most companies still manage their provision process with labor-intensive, error-prone Excel® spreadsheets and are reluctant to change to proprietary solutions due to limited resources, lean staffing, and spotty track records of success. For those that have attempted an automated provision system, not even half have succeeded in leaving their legacy Excel® templates. The result for many departments is long hours and sleepless nights at each quarterly close, the annual close and when the tax returns are due. Each quarter, they vow to find a better way, but without time to change, the same broken process is repeated, quarter after quarter.

FAS 109 (now ASC 740) imposed a "balance sheet approach" to tax provisions, but it didn't spell out how to produce those disclosures. So, corporate tax professionals are often left choosing between the Excel® spreadsheets they know and automated provision solutions that they don't. This white paper reviews what goes into a successful global tax provision solution and highlights the power of having a fully-supported Balance Sheet Process vs. merely taking a balance sheet approach.

A Closer Look at the Provision Process

FAS 109 (ASC 740) prescribes a "balance sheet approach" to account for deferred income taxes, focusing on the proper determination of deferred tax assets and liabilities and their impact on the balance sheet. Under this approach, future tax consequences are identified through the calculation of deferred income taxes and the resulting deferred asset or liability is reported on the company's balance sheet, with the goal being greater transparency in financial reporting.

To calculate these deferred income taxes, corporate tax department provision models have grown into complex multi-layer Excel® models that systematically attempt to capture all book/tax differences, quantify the tax impact, and provide required disclosures. No two models are alike.

A corporate tax department that applies a **Balance Sheet Method** in their provision effort begins the process by identifying tax sensitive data in their balance sheet and incorporating it into the tax provision model. Each permanent and temporary difference is calculated, usually in sidebar Excel® workpapers, and manually entered into the tax provision system. These differences are accumulated and used to calculate current and deferred tax expenses with these current period changes used to update the deferred tax balances. As the complexities of FAS 109 and ASC 740 have become clearer, tax professionals have often responded by layering on more detailed Excel® calculations to arrive at the deferred tax balances, but are still lacking a comprehensive method or results. "Same As Last Year" is a very risky posture to take with these calculations and disclosures, but often ends up being the basis for many tax decisions when time is short and deadlines are near. With business and legal environments becoming increasingly challenging, adopting a comprehensive balance sheet process is more valuable than ever for delivering reliable results.

Balance Sheet Approach: A Report or a Process? Why Does it Matter?

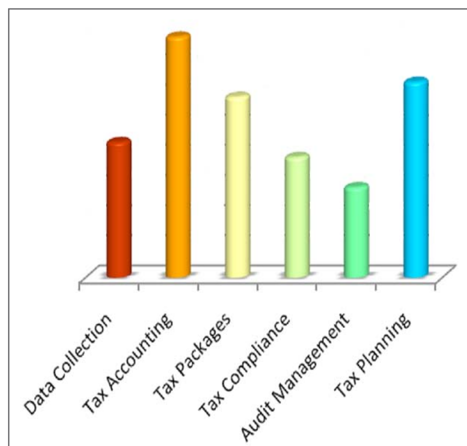
At the core of the tax provision challenge is **Risk**. While the goal of SOX compliance is to minimize risk, it tends to deal with known risk within packaged systems and processes, not the flow of data between them. However, it's often what tax departments don't know that generates the greatest danger and the most sleepless nights.

Although Excel® is a powerful tool, it is roundly criticized for being a risky system due to manual entries, potential undetected formula changes, broken links between cells and calculations, lack of audit trails, and roll-forward problems at the start of every reporting period. Companies often turn to a proprietary system with the belief that it will resolve all of their potential for error and create a risk-free process. However, provision software will provide results that are only as accurate as the information used and how it was entered. As such, the process of gathering the data is paramount.

The Challenge of Data Collection

Data collection is often a serious pain point for large global organizations, primarily because it can be difficult to evaluate completeness and enforce data quality. When it comes to data collection, it's often said, "Garbage in, garbage out." Manual entries, summarized data, inadequate training and experience, disparate accounting systems, and other issues all contribute to risk that is often overlooked until a significant error finally surfaces.

Adding to this challenging environment is the fact that most global organizations have multiple profit and cost centers combined with siloed Tax Provision, Tax Compliance, Audit Management and Tax/Strategic Planning roles or functions. Data comes in from around the globe and it is usually the responsibility of the tax team to figure out how to align the data. Tax departments can often see the value of having a single data source, but have difficulty seeing past their silos to identify the path to success.



The Challenge of Data Collection: Siloed Functions and Data

The Problem with Summarized Data

In addition to data silos, many tax departments are forced to use summarized data for their provision process, namely tax sensitive account totals. Accounts are tax sensitive when there is a likelihood that the tax treatment of the item differs from the book treatment. While this may seem logical, the results are highly dependent on ALL tax sensitive accounts being indentified and totaled accurately. At each subsidiary, who is responsible for tagging tax sensitive items, and are they tagging all new general ledger accounts correctly? If you only see summarized reporting totals for tax sensitized accounts, it is difficult, if not impossible to know for sure if anything was overlooked. If an omission occurs, you may never find it in the provision process but it will almost always surface in the tax return. With tax returns based on full trial balance reporting, new accounts and omissions are less likely to occur and provision errors will be uncovered when it's too late.

The other weakness with data collection concerns how the data gets into the provision system. Is it imported or manually entered from accounting reports? Manual entry further disconnects the data from its source and makes it impossible to drill down to the supporting detail. If you can't drill down to the lowest level of detail, once again, how do you review and sign-off for accuracy? Visibility and transparency to the source data is critical to having full confidence in any accounting or tax provision system. While manual entry is always considered risky, most companies routinely re-key their summarized tax data into their spreadsheets, and surprisingly, often re-key data into their proprietary tax provision system.

Addressing these significant weaknesses requires a Balance Sheet Process, which we will now explore further.

The Power of a Balance Sheet Process

Today, every major tax provision software provider adheres to FAS 109's required "balance sheet approach." It should be noted, however, that a balance sheet approach in itself does not speak to the visibility or transparency of data, assure data accuracy, or necessarily contain a process sourced by detail. Achieving these goals requires a **Balance Sheet Process**. A robust Balance Sheet Process is the foundation of a tight and accurate provision system that makes accounting errors easy to identify and correct before completing each provision.

As a practical matter, tax provisions are rolled forward each reporting period and often become a repetition of prior year assumptions. Hidden errors can remain undetected for years, and if material, could force a restatement. With a Balance Sheet Process, the company's balance sheets are scrubbed for errors and provide a continuous opportunity to what may be missing from the tax provision calculations.

Tax basis balance sheets are always readily available in a system based on a balance sheet process, while they're often lacking and sometimes impossible to produce in other proprietary systems.

Book and tax basis balance sheets are the starting point for the provision calculations, rather than being cobbled together after the provision is completed. Prior period closing balances are rolled forward to create the Beginning of Period opening balances for book and tax bases. Then, full General Ledger (GL) trial balance details for each legal entity are used to import closing book balances and the GL accounts are mapped to the tax provision chart of accounts, providing the preferred level of provision reporting detail. At the start of each provision period, it's critical to review the latest import for new accounts and properly map them as needed, whether they're tax sensitive or not. If summary information was used instead, it would be impossible to know whether every account was properly included. The analysis process starts by examining the book balance sheet to find accounts where book and tax may differ. When differences are identified, temporary or permanent differences are calculated to provide the tax basis balance sheet. Once this analysis is performed, the new permanent or temporary difference accounts are set up and ready. Then the book differences/movements are automatically compared with tax differences/ movements for each provision grouping line and "squeezed" to automatically produce the Net Temporary Tax Differences. This will usually provide about 70% of the temporary differences in the provision without any manual entries required, while the remaining items typically require further analysis to determine the correct tax basis. Although individual tax differences are usually manually entered from offline calculations, the best practice uses supporting Excel® workpapers that are attached and linked to each provision detail line. This delivers complete drill down support to the mapped trial balance account details and analysis, achieving greater transparency with a faster, more precise process. Going further, fixed assets schedules — where provision errors almost always occur — can use additional imported tax balances for complete book to tax reconciliation with edit checks, incorporating tax gains/losses as well. Accounting errors are easily pinpointed and can be quickly identified and corrected for confident results.

Fully detailed and mapped trial balances support the balance sheets, P&L and fixed assets schedules in the provision system, allowing thorough edit checks to confirm that all book-to-tax differences are fully explained and reconciled with the accounting system. Once the current and deferred tax items are calculated by the provision system, the totals are compared with the GL trial balance totals and necessary tax journal adjustments to the accounting system are quickly totaled, exported and ready to post back to the accounting/GL system for each period. By performing more frequent provision analysis with a balance sheet process, all tax differences are completely explained with nothing left to chance, resulting in much smaller return-to-provision true-ups each year. Surprises and tax risk to current earnings are held to an absolute minimum.

	USA GAAP					Tax					STI
	Opening Balance	Movement (P&L)	Movement (Non P&L)	Currency Translation Adj.	Closing Balance	Opening Balance	Movement (P&L)	Movement (Non P&L)	Currency Translation Adj.	Closing Balance	Temporary Tax Adj.
Liabilities											
Current Liabilities											
Accounts payable (150.00)	(1,617,325)	(1,391,907)			(3,009,232)	(1,617,325)	(1,391,907)			(3,009,232)	
Accrued Salaries		(20,000)			(20,000)		(20,000)			(20,000)	0
Accrued Vacation	(29,000)	(6,000)			(35,000)	(29,000)	5,000			(24,000)	11,000
Accrued Warranty Expense	(150,000)	(12,000)			(162,000)		80,000			80,000	92,000
Unearned Revenue	(4,000)	(1,000)			(5,000)	0	0			0	1,000
Mortgage, notes, bonds payable < 1 yr. (153.00)		(5,776,900)			(5,776,900)		(5,776,900)			(5,776,900)	

Balance Sheet Process: Tax Movement *less* GAAP Movement = Temporary Tax Difference

How to Evaluate a Tax Provision System

Whether your company is a domestic operation or complex and global, or if you are evaluating an automated tax provision system, the following questions are designed to help you consider your organization's needs as they relate to the data collection process:

☑ **How many times are you gathering data?** Do you find yourself gathering data multiple times for different purposes? Or, do you gather data once and then use that data for all tax-related activities? In a siloed environment, data is collected for each role and need. It is not uncommon to have multiple data sets for different purposes, making it difficult to keep them in synch and achieve consistent reporting. How accurate is it? How can you know for sure?

With a good tax process management system, organizations gather the data once and reuse it; eliminating redundant data collection and re-keying that can often lead to mistakes. A single data source can provide the necessary foundation for the tax provision, tax compliance, audit & defense and tax planning, eliminating the risk of using competing or incorrect data sets.

☑ **Are you using summarized or detailed data?** Running a Balance Sheet Process performs best when using a full trial balance with detailed account balances. Collecting full detail provides greater visibility and transparency with assurance that someone outside the tax department isn't incorrectly filtering or overlooking critical tax data. Some financial packages utilize report writers to produce highly summarized financial data. This results in the tax department's reliance on summarized supporting documentation from disparate sources for the tax provision process rather than being able to drill down to account detail for analysis and review. It presents major hidden tax risk and requires far more time to review, if it's even possible.

Any time data needs to be "massaged," a significant amount of additional risk is added to the process. Importing detailed data directly from the source is a much safer alternative. A full balance sheet process allows the user to see the source data for verification vs. trusting an automated solution that stops short at the summary level.

☑ **Who is deciding which tax sensitized data you see?** Tax preparers often rely upon accounting departments for the data they have available for the tax provision process. Without a Balance Sheet Process, someone else may edit the data for the tax department, deciding what information they need to do their jobs. How do you know they are providing the right data? Do you have the ability to verify if anything was overlooked? The ability to verify data at its source is essential for an effective global tax provision process.

☑ **Is your company changing or growing? Did you miss new accounts? How do you know?** A changing or growing company creates additional challenges for the tax department. Suddenly, last year's estimates are less relevant to current experience. If the company is growing, how do you know the automated reporting program is providing the right and most accurate data? Companies working solely with pre-determined tax sensitive data may only be getting part of the picture, adding risk to the process.

☑ **Do you import data from the source or do you enter data manually?** As stated earlier, manual data entry is inefficient and adds risk to the process. Solutions that import data directly from the source enable organizations to streamline their process while ensuring data accuracy.

☑ **How do you handle international reporting?** International reporting and tax provisions often place an exponential multiplier on the difficulty level of data collection and integration. Even though many companies are implementing domestic tax provision solutions, very few have moved away from Excel® for their international needs. Look for solutions that can truly support the complexity of global operations, including IFRS and multi-GAAP reporting.

☑ **Is your Proprietary System still the right one for you?** With less than half of proprietary provision installations considered successful, many users cite too much time and money invested to consider a change. Just as your company uses ROI measures for continued operations and decisions, shouldn't your tax provision and compliance processes be reviewed for ongoing cost/benefit results? What you've invested to date can't be changed, but what you'll continue spending on your current system and manpower vs. the results you're getting can be.

Identifying the Right Tax Provision Solution for Your Organization

The key to an effective tax provision process lies in gaining control of the calculation through the use of a **Balance Sheet Process**. Using a robust balance sheet process is the foundation of a tight and accurate provision system, making accounting errors easy to identify and correct before the provision is completed. Detailed source data supports complete transparency and verification, streamlining the process and providing greater peace of mind around the quality and accuracy of the provision. Finally, the risk of tax and earnings surprises can be virtually eliminated.

CCH Global Integrator is a global tax management platform that uses a **true balance sheet process** for tax provisions that delivers complete domestic and international reporting on a single platform. Data collection, tax provision, tax compliance, transfer pricing, audit support and tax planning are all managed with a single web-hosted solution, including seamless domestic and international tax compliance integration.

CCH recognizes change is the one constant in your business. Standard on-screen schedules and reporting can be modified as needed, and user-definable schedules/reporting can be added, delivering complete flexibility and user self-reliance. To make sure that you're up and running successfully, take advantage of CCH training and implementation programs tailored to your needs, along with our Preferred Implementation Partners for tax accounting and best practices expertise.

From the largest multinational corporations down to one person tax departments, Global Integrator offers a scalable, end-to-end tax management solution that can match your needs perfectly. To learn more about **Global Integrator** and the rest of the **CorpSystem® Suite of Income Tax and Workflow Solutions**, please contact your CorpSystem Account Manager right away.

BDO

CCH
a Wolters Kluwer business

866-513-CORP (866-513-2677)
CCHIntegrator.com