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**Evaluating Tax Provision Solutions:
Breaking Through the Myths to Find
the Right Solution for Your Company**



Ever since the passage of the Sarbanes Oxley Act of 2002 (SOX), income tax accounting and tax provision have taken on increased importance and urgency for corporate finance departments and executives. As a result, “close” is no longer good enough. CFOs and auditors alike have placed increased focus on tax professionals to develop a supportable tax provision process and FIN 48 analysis that enables data confirmation, audit trails, sign-off and control capabilities.

That increasing pressure, combined with the efforts of some vendors to leverage fear into driving increased sales, has created considerable confusion in the market. This whitepaper attempts to dispel some of the myths and provide a framework for evaluating tax provision solutions, with the hope of enabling tax professionals to make an informed decision based on the unique needs of their organisations.

Gaining Control Over the Process

First of all, tax provision is a financial disclosure requirement, for example in the US it is a requirement of FASB and the SEC, not the IRS. This disclosure requires companies to model the company’s tax environment to provide materially accurate estimates based on the More Likely Than Not threshold for the current tax payables/receivables and deferred tax assets/liabilities for a specified time period. Companies can prepare tax provisions annually, quarterly, and in some cases, monthly. Tax professionals conduct a true up with the tax return and adjust the tax accounts to bring it back in sync with actual tax results, upon completion of the tax return (return to provision true-up). SOX requires that financial professionals maintain internal control over the process at all times, i.e. controlling who has access to the data and how data entry occurs.

Two Primary Options: Excel®-Based or Proprietary Software Solution

Until recently, customised Excel® spreadsheets developed by the tax or finance department were the only means by which to conduct an effective tax provision methodology. In the last few years, a variety of software providers have introduced proprietary software solutions, attempting to streamline and automate the process. The fact is that companies today are successfully completing the tax provision process in a variety of ways. That said, according to numerous TEI members interviewed this year, more than 85 percent of companies with tax provision needs still use Excel spreadsheets developed in-house and sometimes in conjunction with other tax and/or workpaper management software. The remaining 15% have purchased a proprietary tax provision package from a tax software provider, with varying degrees of success. Half of that 15% STILL use their existing Excel methodology, either due to running them in parallel for a year to validate and fine tune the proprietary package, or because the proprietary system was never fully implemented successfully.

The reasons vary, but a 50/50 chance of success is still just that. The fact remains that almost 93% of corporate tax professionals are still using Excel to manage all or part of their current provision process.

Assessing the Pros and Cons of Each Solution

Let's take a look at the benefits and shortcomings of each approach. First, the provision methodology is unique to the organisation. Tax provision packages and Excel spreadsheets all require customisation to be effective, and no "out-of-the-box" provision solution will perfectly fit your company's fact patterns or tax and financial situations without varying degrees of customisation. Whichever methodology you choose, the success or failure of the solution depends in large part on the skill of the tax professionals implementing the solution and their understanding of their corporate provision process.

Excel-Based Solutions: Reliable Workhorse or Risky Business?

Now let's examine how companies efficiently use customised Excel tax provision spreadsheets in conjunction with tax and workpaper solutions. A well-designed spreadsheet is a powerful tool. Many of the companies using Excel spreadsheets for their provision process today do so because they know their process intimately and feel confident in the results. Spreadsheets that are delivering reliable and accurate results today will likely continue to do so — unless they are changed.

The primary liability with Excel files lies in what auditors call "spreadsheet risk". Is the GL accounting data keyed into the provision spreadsheets, or imported? Who has access to the spreadsheets? Can you determine who last touched the data and what changes were made? How is data secured to ensure that nothing changes after sign off? Do spreadsheets contain links to other related spreadsheets? Do those links ever break? These are important questions and companies have found a variety of effective ways in meeting these requirements.

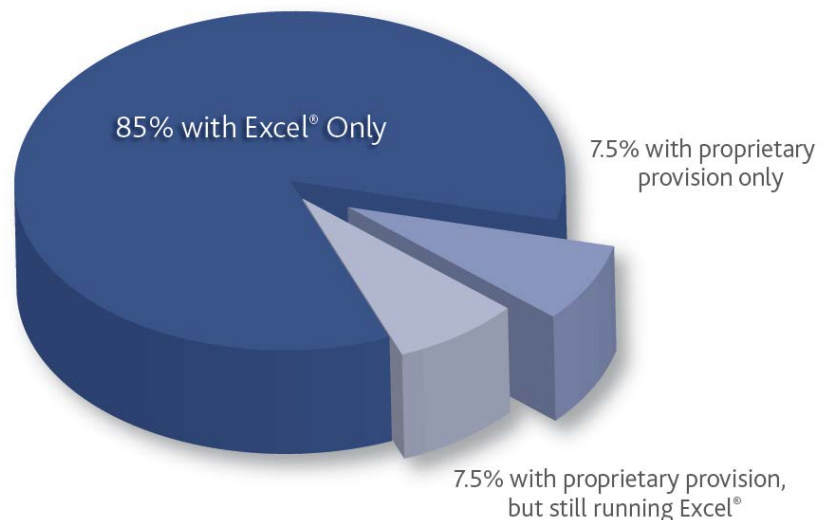
Many companies have partially addressed this weakness by "fortifying" vs. "controlling" their spreadsheets. Fortifying can include locking formula fields, improving data entry areas for better visual navigation as well as linking data and results whenever possible for increased accuracy. In addition, many companies have set aside individuals dedicated to the provision process. Others enhance security by using a software tool that allows them to control access, create a solid audit trail with journal entries to track workpaper history and sign-offs, and maintain linked spreadsheets without moving the files and breaking the links

In the end, a well-designed, secure Excel-based solution can meet the needs of a large majority of companies. As the market remains in flux, using a better process to control and manage your Excel-based worksheets can extend their useful life with known results and give tax & finance departments more time to make an informed decision that's best for the company in the long term. Some companies may decide to improve with their proven Excel-based solutions, while others may eventually move to a proprietary software solution.

Proprietary Tax Provision Solutions: Great Potential, but Worth the Up Front Investment?

As more proprietary tax provision solutions come to market, there is considerable industry excitement around what these solutions could be able to deliver in terms of time-savings, security and improved reliability. Vendors are actively selling their automated solutions, which promise to maintain process control and deliver accurate outcomes. With a variety of new vendors in the space, it's important to verify the claims being made before making the decision to buy. Talk with their customers to get a sense of the true experience of the solution, and be sure to ask how long it took them to get up and running with results they could have confidence in. Have they retired ALL of their spreadsheets? What about supplemental workpapers?

In theory, proprietary tax provision solutions are the ideal. Who wouldn't want full integration, data accuracy and a proprietary process that protects data integrity? In practice, however, all software solutions — just like Excel — will require customisation. The question is how much? Depending on the solution and your company's financial patterns and infrastructure, consulting and customisation fees could actually exceed the cost of the software itself. The risk of working with any new vendor or consultant is wondering if they are pulling the right information from the right sources. Do they understand YOUR company?



Today's Tax Provision Landscape

A Decision Framework: What's Best for Your Company?

The following is a framework designed to assist corporate tax & finance departments work through the important issues and select the right tax provision solution for their organisations.

✔ **What are your organisation's staffing resources?** — For many companies, the decision comes down to an issue of staff — not just tax & finance staff, but IT staff as well. Excel-based systems are most often developed independently within the tax department. Since they have usually been in place for years, they typically do not require significant amounts of additional IT support beyond standard maintenance. Proprietary solutions require integration to the organisation's Enterprise Resource Planning software and the general ledger.

✔ **How is your department doing?** Do you currently have the staffing resources necessary to implement a new proprietary solution in a timely fashion? If you lack the resources, do you have the budget to hire consultants to customise the package for you, in THIS economy?

✔ **How much confidence do you have in your current system?** — How confident are you in your own (or your staff's) experience with and knowledge of your organisation's tax provision process? Do you have confidence in your current system?

Here's a simple test that companies can conduct to determine how well their current tax provision system is operating: Simply analyse the size of true up adjustments and see what effect these adjustments have on cash tax payments or underpayment penalties. Are the true up's getting larger or smaller each reporting period? If your true up adjustments are minimal and you aren't incurring significant cash tax payments, there is a good chance that your current system is operating just fine. If not, a change could be warranted.

✔ **Is budget currently an issue?** — The current economic environment has placed considerable pressure on budgets everywhere. Tax and finance are no exception. Would you trade any of your current staff for the budget needed to implement a proprietary provision solution? When evaluating a tax provision solution, be sure to include not only software fees, but also the consulting, training and adoption costs required to customise the solution and get it running effectively.

✔ **Are you new to your company?** — Sometimes, it really seems easier to start over with a brand new system — especially if you've inherited a complicated spreadsheet designed by your predecessor. In these cases, it might make sense to consider automated options, but recognise that you will be relying on the expertise of outside software consultants who are even less familiar with your company's information than you are. To be sure, you should also consider a proposal for rebuilding your existing spreadsheets with an experienced consultant or staff member.

✔ **Are you prepared to run both systems for a full year or longer to make sure that the new system is accurate?** — As mentioned earlier, half of the 15 % of companies with proprietary provision systems are running their legacy Excel solutions as well. It's the only way to determine how well the new system is performing against a known value, while continuing to meet current reporting needs. Don't forget to include these overlap costs when considering budget.

✔ **Will you be able to completely remove spreadsheets from your tax provision process?** — Whether it's depreciation, gain & loss reporting or international supporting schedules, supplemental Excel spreadsheets will continue providing crucial details for the provision process until your accounting/ERP system can manage ALL the data effectively. A chain is only as strong as its weakest link. Taken as a whole, your current spreadsheet process may be far less risky than you thought.

✔ **Have you invested in Excel training lately?** — With Microsoft® Excel® being virtually a native language for accountants, stronger Excel skills would benefit every aspect of your tax and finance department workflow, regardless of the tax provision solution you use.

✔ **Does your tax provision workflow process meet SOX documentation requirements?** — Outside auditors are trying to provide an opinion on your financials with a high degree of confidence. Consider adding guide notes and using comment fields in your spreadsheets to make it easier for you and others to follow the process. Whether you continue using tax provision spreadsheets or adopt a proprietary solution, having the process clearly documented will increase audit confidence.

Conclusion: A Serious, but Manageable Problem

Deciding on the right tax provision solution is a serious issue for tax professionals today. Careful consideration of all the options makes it very manageable. Technology continues to improve and move towards a "single database" solution for accounting and finance. However, until ERP systems can manage ALL of the relevant data needed for tax, supplemental workpapers will continue to be part of the provision process. If a change in your process is warranted, when is the best time to make the change, minimising upheaval and transition risk while maximising the benefits for the company? For now, companies will need to take a hard look at the cost and benefits of today's available proprietary solutions compared with investing in improving their current Excel-based solutions, and ultimately make that decision for themselves.

Wolters Kluwer can help you evaluate and improve your tax provision process while continuing to meet the unique needs of your company. **To learn more, please contact your Wolters Kluwer Account Manager right away.**



When you have to be right

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