

Tax Memo

Not Just Another Accounting Exercise: Managing Change for the Tax Function

An unprecedented opportunity to make strategic changes to the tax function has been presented by the adoption of International Financial Reporting Standards (IFRS). While adjusting to IFRS, corporations can optimize the overall tax function and the value that it delivers. Thinking through what other changes you want to deal with at the same time as the transition to IFRS will make the process efficient and effective. It's not just another accounting exercise.

IFRS is a hot topic of discussion at meetings of boards of directors and senior executives, for all publicly accountable entities in Canada and most multinational companies. The transition is likely to pose a significant management challenge for many organizations, because in most cases the underlying financial data and increased level of disclosure in financial reporting will have to be overhauled.

The tax function will not be immune from these changes. In fact, IFRS may transform how a company measures and reports pre-tax income – the foundation of tax computations. For tax accounting and reporting, the implications are obvious. However, management must also address the impact on the other tax function deliverables, namely tax compliance, tax planning and audit defense.

We encourage management to consider the strategic opportunities that the transition to IFRS presents, notably to drive value added change in the tax function and institute leading practices at the outset. This article outlines several practical ideas in that regard. Comments are presented in the context of the PricewaterhouseCoopers Tax Function Effectiveness framework, which is the expression of the corporate governance model as it applies to the management of the tax function.

The framework assesses the tax function deliverables in the context of seven enablers (i.e., process, internal controls, data, technology, people, strategy and structure) that are required for the successful implementation of the tax strategy.

While each of these ideas can be implemented at any time, the adoption of IFRS provides an excellent impetus for change, in particular for the first five, which are discussed below.

1. Process

We expect that the process of completing each of these deliverables will be affected by the adoption of IFRS. The extent of the impact will vary for each organization and deliverable; however, it is important to identify changes early to plan accordingly and avoid surprises. As a result, we suggest that all tax processes be reviewed. Our experience suggests that most companies underestimate the time and resources needed to realign systems and processes, especially those with existing management systems or legacy systems from historical acquisitions that have not been integrated and are not geared to provide sufficient or appropriate data for the new and increased disclosure requirements.

Because process changes are inevitable, we encourage management to take this opportunity to improve current processes by looking to leading practices in the market that can optimize the effectiveness of the tax function. In particular, improving data flow and the use of technology should provide lasting benefit. The finance function must address its data requirements for the IFRS adoption, giving the tax function an opportunity to join existing projects.

2. Internal Controls

As noted above, adoption of IFRS will affect many processes within the tax function. Inevitably, this will require that management consider the effects on internal controls and, specifically, its key controls. This will give management an opportunity to address key controls in the tax function and potentially improve the overall control environment.

Two key benefits associated with an early assessment of processes and controls are the potential for a faster close cycle and a reduction in risk (i.e., no surprises).

3. Data

Within an organization, tax departments are large consumers of data. Unfortunately, they often suffer from having little input into the configuration and set-up of the underlying ERP and/or source systems from which they obtain data. Data can be difficult to obtain at the appropriate reporting level (e.g., legal entity, tax jurisdiction) and at the correct level of detail (e.g., transaction level). As a result, the tax department is forced to rely heavily on spreadsheets and manual data manipulation, which demand reconciliations that ought to be unnecessary. Ultimately, confidence in the quality of the data can be eroded, in respect of accuracy, completeness and validity.

Adoption of IFRS will directly affect data requirements for the finance function. This will cause many finance functions to initiate projects to reconfigure ERP and/or source systems to address their IFRS requirements. It is reasonable to expect that most financial systems already in use by large organizations will handle the multi-GAAP reporting. However, organizations using older versions can be expected to view the transition to IFRS as an impetus to upgrade. Regardless of the extent of change, tax should consider its data requirements and connect with finance and IT to determine the most effective method to source the data. If these issues are not

addressed, the switch to IFRS may create even greater dependence on spreadsheets, manual data manipulation and reconciliations.

To facilitate the request for assistance from the finance and IT departments, we suggest that the tax department create as detailed and thorough a list of their data requirements as possible. This can help to realize two key benefits. First, it will communicate to the finance and IT teams what data is required and will permit them to understand and address the needs of tax. Second, the tax team will have to consider each process and address and communicate the exact data required to complete its deliverables.

As noted above, finance staff will have to work with IT to adapt the accounting systems to capture and report the data that is required to adopt IFRS. We suggest that management take this opportunity to coordinate the finance, tax and IT teams to incorporate the tax requirements into the ERP and other source system designs. This will allow for the capture of “tax sensitive” data, such as:

- aligning entity structure with the ERP to allow tax to obtain pre-tax book income by legal entity as well as adjusted legal entity trial balance information for tax accounting and compliance;
- charting of accounts to provide an appropriate level of detail and tax attributes for each transaction to enhance automation of book-to-tax differences;
- configuring ERP fixed asset modules to provide appropriate reporting (e.g., defining asset classes, useful lives, defining tax requirements for the capture of capital asset information for tax);
- defining tax requirements for capturing revenues and expenses at the appropriate jurisdictional level for allocations; and
- defining tax requirements for intercompany transaction processing.

Automation of tax data collection can result in significant benefits for the company, including faster close cycles, improved controls and higher-quality data. Senior executives should reflect on the benefits of giving senior tax staff the time and resources to focus on value-added tax planning.

4. Technology

Most organizations in Canada have relied upon electronic tax schedules (usually spreadsheet-based) to produce their tax accounting deliverables. The transition from

Canadian GAAP to IFRS will require revisions to these existing spreadsheets to address differences in the computation and disclosure of taxes. The focus on internal controls in recent years highlighted the inherent risk of spreadsheets and the prevalence of errors. Accordingly, management should take this opportunity to review the spreadsheet design and build controls (e.g., checks, access controls, ability to track changes) into tax spreadsheets to improve the performance of these tools.

As an alternative to traditional spreadsheets, the adoption of IFRS will open Canadian companies to a range of third-party tax accounting technology solutions. The use and quality of these solutions has increased in recent years. Most assist with the automation of the data collection process and can be used to support the tax compliance process and ultimately, audit defense. In the correct circumstances, automation and the use of technology solutions can help to achieve benefits such as higher staff retention, improved quality of information, enhanced knowledge sharing and strengthened internal controls.

We encourage management to take this opportunity to address the use of technology within the tax function (whether developed internally or acquired).

5. People

The key to all effective change is people. The adoption of IFRS will add to the work load and pressure for staff throughout the organization, including the tax department. This is likely to strain tax functions which, in many cases, already are resource constrained. Implementing one or more of the suggestions noted above may assist management to manage the change effectively.

A common concern raised by management is that tax and finance do not communicate effectively. Effective communication is essential for an effective and efficient transition to IFRS. The adoption of IFRS can present opportunities to improve relationships and lines of communication. One opportunity is to include tax staff on the IFRS task force. In addition to providing opportunities to develop relationships, it is a best practice to involve a cross specialty team to ensure that various perspectives are considered. Another opportunity is to involve tax staff in all IFRS training sessions. Again, this serves a dual purpose. In addition to understanding the tax accounting standards, the tax staff will have to understand the impact on all of the organization's accounts to identify and address book-to-tax differences and identify implications for tax planning. Given the current demand for tax

resources, it is important for tax executives to invest in people to ensure that the tax function is prepared to meet the challenges presented by a conversion to IFRS.

Taking advantage of some or all of the opportunities noted above should help to alleviate this pressure, both short- and long-term, and provide lasting benefits.

Financial reporting in Canada and throughout most of the world is going through significant change that is far more than a financial accounting exercise. The transition to IFRS will have a pervasive effect on organizations. We encourage management to take this opportunity to drive positive change in the tax function and influence the outcome to its advantage. Among the numerous potential benefits are faster close cycles, reduced overtime, higher morale, improved communication, improved controls in tax and an opportunity to focus tax resources on proactive value-added tax planning and less on compliance.

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