Deloitte.

Effective integration, enhanced decision making

The Risk Intelligent tax executive

Risk Intelligence series

Contents

Preface

This publication is part of Deloitte's series on Risk Intelligence — a risk management philosophy that focuses not solely on risk avoidance and mitigation, but also on risk-taking as a means to value creation. The concepts and viewpoints presented here build upon and complement other publications in the series that span roles, industries, and business issues. To access all the white papers in the Risk Intelligence series, visit: www.deloitte.com/risk.

Open communication is a key characteristic of the Risk Intelligent Enterprise™. We encourage you to share this white paper with your colleagues — executives, board members, and key managers at your company. The issues outlined herein will serve as useful points to consider and discuss in the continuing effort to increase your company's Risk Intelligence.

Tax Risk Intelligence: A strategic opportunity in turbulent times

No one ever said a tax executive's life was easy. Simply staying current with the vast and ever-evolving number of international, national, and local tax and related financial accounting rules is a perennial challenge. Working with tax authorities around the world requires high-level negotiation skills. And because tax processes often occur outside existing enterprise-wide platforms, tax controls and governance can lag behind those in the more established environment of financial reporting systems. Moreover, colleagues within the business sometimes view the tax executive's role and department simply as an exercise in compliance and reporting with little value add.

In addition to all this, intense public- and private-sector scrutiny and demand for increased transparency have pushed tax risk squarely into the spotlight. According to a report issued by Audit Analytics, tax accruals/deferrals have been the most prevalent U.S. GAAP accounting area of failure in auditor attestation reports for the most recent three years, including 2008 results at 30 percent.[1] Recent developments, such as tax technical and accounting issues related to unrecognized tax benefits, further highlight the importance of effectively monitoring and managing tax risks and exposures.

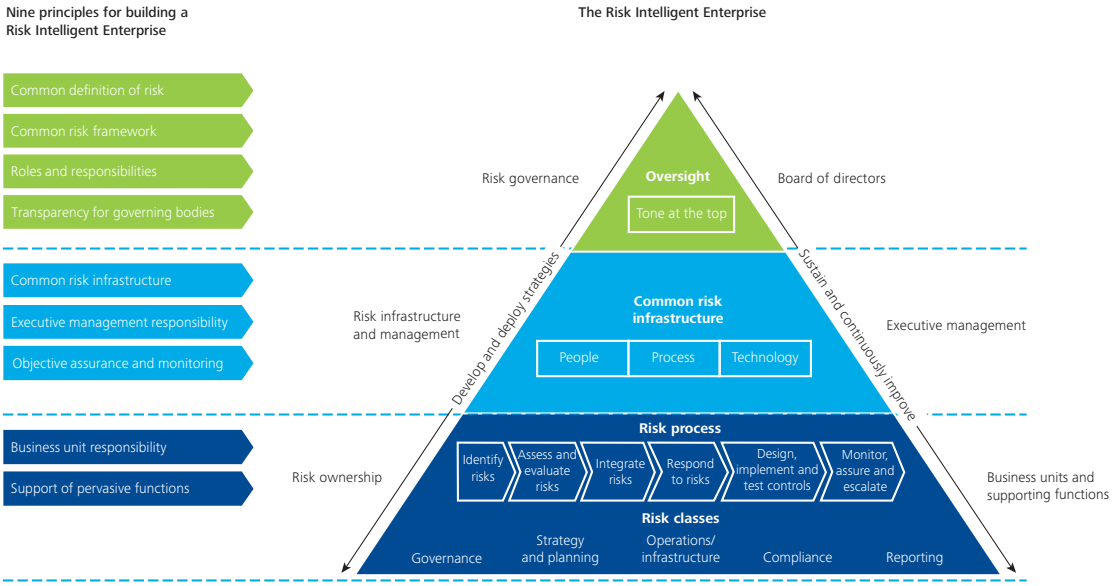
The C-suite and board alike need reassurance that their organization's risk management infrastructure encompasses all areas of risk, including — and, perhaps, especially — tax risk. In this paper, we discuss why tax risk is now, and will continue to be, at the forefront of business risk and how Risk Intelligent business leaders can embrace the value that tax has to offer in managing risk overall.

The Risk Intelligent approach outlined here represents a sea change from the traditional view of tax as a functional silo operating in a discrete area of risk measured only in terms of avoiding tax penalties, assessments, overpayments, and the like — classic "unrewarded" risks that offer little perceived upside business value in exchange for taking them. Risk Intelligent executives and boards consider tax to be a common thread running through and affecting many business risks. This perspective focuses on both potential downside tax implications and the potential value of rewarded risk-taking (the value gained through appropriate tax planning). According to this view, pursuing value through appropriate tax planning around strategic business initiatives is a vital risk management goal.

Although many tax risks arise from general business operations, tax executives are not always invited to discuss risk in the context of overall business strategy or to help set risk management priorities. Leaving tax out of such discussions, however, can severely compromise the enterprise's ability to effectively manage business risks. The absence of response to tax risk challenges — or, worse, a response that adversely affects a key outcome by failing to consider the tax impact — may result in lost opportunities and diminished financial results as well as regulatory or legal expense, fines, and penalties. The bottom line: Until an organization appropriately integrates tax into its approach to risk management, the job is incomplete.

[1] "404 Dashboard — Year 4 Update," Audit Analytics, December 2008.

Figure 1. The Risk Intelligent Enterprise™ framework



External factors are increasing the stakes

External forces are exerting considerable pressure to further elevate the consideration given tax risk. Rapid globalization, for example, calls for changes in tax operational strategy and execution across multiple jurisdictions. Accounting improprieties and fraudulent investment schemes highlight the need for high-quality data and transparent information. The recession and credit crisis make appropriate tax planning to conserve and manage cash a priority for all types of taxes — income, property, payroll, excise, and transaction-based taxes. Additionally, budget shortfalls are focusing government attention on tax policy, cross-border cooperation, and enforcement. Combine these factors with intense investor scrutiny of risk management in general, and the importance of tax risk management to enterprise value becomes indisputably clear.

Tax and the Risk Intelligent Enterprise

We believe that forward-looking tax executives should seek to position themselves as an integral part of what we call the Risk Intelligent EnterpriseTM. Briefly, a Risk Intelligent Enterprise views calculated risk-taking as essential to value creation, since virtually any activity that seeks to increase value also carries some degree of risk. Effective risk management, therefore, is essential to the organization's efforts to create and protect value. However, effective execution requires engagement and alignment at all levels of the organization, from the board through the executive management team down into the business units and functions, as illustrated in the Risk Intelligent Enterprise framework pyramid shown in Figure 1. (See page 19, Appendix 1 for a more detailed explanation of the chart.)

Getting to tax Risk Intelligence

How does all this translate into a tax executive's day-to-day job? In practical terms, it means that a Risk Intelligent tax executive:

- Effectively determines that tax compliance and reporting risks are well understood, updated, and addressed through appropriate controls and processes throughout the enterprise, while also managing operational and cash-flow risks (such as not paying more tax than necessary)
- Proactively seeks out, analyzes, and understands which business decisions throughout the enterprise have significant tax implications
- Brings the analysis of tax risk to the business units, corporate executives, and boards in a way that helps them make better business decisions

By fulfilling these expectations, the Risk Intelligent tax executive helps the business adopt a holistic view of tax and related risks — both unrewarded and rewarded. A Risk Intelligent tax executive understands that allowing business unit leaders to make decisions without proper tax input is a fast track to missed opportunities. To counter that possibility, he or she actively collaborates with the business to bring tax savings to the bottom line — savings that, perhaps, can help fund strategic projects. Moreover, he or she proactively embraces opportunities to assess and address tax risk — for instance, by scrutinizing internal audit and SOX 404 findings.

Implicit in these expectations is a close working relationship between the Risk Intelligent tax executive and the CFO. In many organizations, in fact, tax executives report directly to the CFO, making the CFO's support a prerequisite for the success of a Risk Intelligent approach to tax. Fortunately, two sets of research[2] [3] conducted by CFO Research Services in collaboration with Deloitte Tax LLP indicate that CFOs and other non-tax executives do indeed want the tax function to play a greater role in general business activities and to contribute more substantially to business decision-making. This research confirms that both finance and tax executives believe that, once the basics are covered, the corporate tax function needs to step up its contribution to decisions about major transactions and overall operations. Furthermore, CFOs in the study indicated that they believe that a strong combination of both technical and managerial skills is increasingly important to the success of tax leaders. The desired result is a more active tax executive who advocates for greater awareness of the tax implications of business decisions, creates and pursues opportunities to persuade fellow members of management to adopt proactive tax planning, and provides resources to execute.

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[2] *Driving a More Valuable Contribution from the Corporate Tax Function,* CFO Research Services, Boston, Massachusetts, in collaboration with Deloitte Tax LLP, November 2007. CFO Research Services is the sponsored research group within CFO Publishing Corporation, which produces *CFO magazine* in the United States, Europe, Asia, and China. CFO Publishing is part of The Economist Group. Available online at http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/US_Tax_CFOsurvey_111507(1).pdf.

[3] *What Do Companies Want from the Corporate Tax Function?,* a report prepared by CFO Research Services, Boston, Massachusetts, in collaboration with Deloitte Tax LLP in November 2006. CFO Research Services is the sponsored research group within CFO Publishing Corporation, which produces *CFO magazine* in the United States, Europe, Asia, and China. CFO Publishing is part of The Economist Group. Available online at http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/us_tax_cfo_what_companies_want_161106.pdf.

Four steps to a transformed role

How can a tax executive move his or her enterprise closer to tax Risk Intelligence? We suggest a four-step process to start challenging the old culture of tax's peripheral role. All four steps are designed to increase the tax executive's relevance throughout the pyramid. They position the tax executive as an important member of the executive team who designs and implements a "common" risk management infrastructure, acting as a bridge from the business units to the C-suite, the board, and other governing bodies that need to be apprised of specific strategic, operational, and compliance risks.

Step zero: Continue doing what you are doing really well

Before a tax executive can begin to expand or strategically fine-tune his or her role, he or she needs to gain the enterprise's confidence in the tax department's basic effectiveness, including its ability to assess and communicate information about existing tax risks. Although every tax department faces different issues, tax executives can employ several broadly applicable tools, such as a "risk map," that can help provide a snapshot of tax risk in an easy-to-understand format. (See page 16 in Appendix 2, "Creating a tax risk management framework," for more information on using a risk map to help build a tax risk management framework.)

Step one: Find out where the value is

Understanding the company's strategic priorities can help tax executives better align tax with the business. Frequent conversations with business leaders can help tax executives stay up to date with current and planned initiatives, and the annual report, analyst call transcripts, regular meetings, location visits and plant tours, and other teaming efforts can provide valuable insights and conversation-starters.

Once the tax executive understands the company's current initiatives and upcoming strategic decisions, he or she should focus on the ones most likely to benefit from greater tax insight. One or two "quick wins" can help build broader support for the concept of taking a Risk Intelligent approach to tax. The smooth integration of tax into a strategic decision in a way that nets tax benefits will garner credibility that a tax executive can leverage in future strategic discussions and decisions.

In addition to the examples already shared, we find that the following areas often present potential opportunities for tax to add value:

Tax losses

The global financial crisis has left many companies deep in losses, but pockets of losses are common even in thriving concerns. Realizing the full tax benefit of operating losses, however, is not always easy. For losses sustained in the downturn, for instance, the tax executive will need to consider how to offset them appropriately against profits generated in the recovery, and verify that book losses are flowing through to tax returns. A variety of events and initiatives could put such losses at risk, including corporate restructuring, changes in shareholders, and shifts in business strategy. The tax executive should work with the CFO to improve the CFO's understanding of the bottom-line benefits of preserving and utilizing these losses as well as the types of future actions that could jeopardize that utilization. In addition, because markets are changing at unprecedented speed, transfer pricing models should be examined for alignment with the current environment.

Supply-chain strategy

A Risk Intelligent tax executive can establish tax's role in supply-chain strategy by identifying potential issues and opportunities as they arise. The location of warehoused inventory, for instance, is an important operating consideration that can have significant tax implications. Often, tax receives information about inventories only at year-end when tax returns are due. A Risk Intelligent, tax-aligned approach, however, can help companies make cost-effective decisions about where inventory is located, which corporate entity should take ownership during the manufacturing process, and how inventory should be valued — before the company commits itself to actions that have negative tax consequences.

A sustainable approach to appropriately representing tax in supply-chain activities may require changes to the company's infrastructure and/or organizational structure. For example, one company, a computer equipment manufacturer, undertook an SAP implementation that included the redesign of various business processes, including the supply chain. One risk in this type of business transformation is the risk of missing opportunities to improve the company's tax position; fortunately, this

Three case studies illustrate need for tax integration — across the enterprise

The following three case studies illustrate the impact tax risk can have on overall risk management effectiveness at all three levels of the Risk Intelligent Enterprise. In all three cases, the tax risk arises from activities taking place outside the tax function itself, highlighting the need for effective integration of tax risk into the organization's broader risk management program.

Risk governance: The Risk Intelligent board partners with tax to provide top-down guidance

A multinational energy company was struggling with an inconsistent set of global tax control processes and the absence of a global tax risk profile. This lack of standardization across the global tax function not only contributed to inefficiencies, but kept tax from focusing on value-adding tax opportunities or proactively managing the criticism the tax function was receiving from a disparate group of external stakeholders.

To drive greater standardization, the company developed global tax governance policies, controls, and procedures that drew on a benchmarking analysis of current corporate practices in tax policy, information, and risk management disclosure to both internal and external audiences. After seeking and obtaining approval from the board and other major stakeholders, including tax authorities, the company then developed a tax operating model to execute the new governance policies, controls, and procedures. This model articulated how the various groups in the global tax function would work together to execute their defined responsibilities, prescribing processes and tools to help the tax function connect with essential people, processes, technologies, and tax data, including tools to help identify and evaluate value-adding tax planning ideas.

The benefits of the company's effort included:

- An agreed-upon tax risk management program that enhanced the board's confidence in tax risk management effectiveness
- Greater tax function efficiency due to enhanced access to essential high-quality information, people, and tools, as well as increased task standardization
- Improved clarity around accountabilities and delegations of authority
- Enhanced ability to identify and pursue value-added tax opportunities for the business

Risk infrastructure and management: Addressing tax risk by collaborating with information technology (IT)

IT acquisitions and implementations can be complex, costly, and disruptive. They are often also carried out under high pressure, as many corporate leaders demand meaningful return on IT investments in relatively short timeframes. Yet despite the emphasis on results, the tax implications of IT initiatives — which, if properly addressed, can yield tax efficiencies and savings — are all too often ignored.

The potential value of involving tax in IT initiatives is illustrated by the experience of a leading retailer, which was experiencing continued issues with state and local income and franchise tax planning due to inadequate enterprise financial systems and processes. The company had difficulty producing legal entity and jurisdictional accounting sufficient to support tax positions during increasingly aggressive state and local audits. These operational difficulties contributed to an increase in audit defense costs as well as greater pressure on the overall state effective tax rate.

The company addressed these issues by implementing a new enterprise financial system that:

- Assessed tax intersections and dependencies and their associated risk and value
- Added appropriate tax/IT integration resources throughout all project phases

To fulfill the business case for the new system, the project team designed the system to accommodate critical tax data requirements, support improved tax processes, and, in many cases, automate important tax attributes. The outcome was a tax-efficient upstream finance and accounting platform that allowed the company to explore, execute, and defend a much wider range of tax planning scenarios while addressing the needs driven by growing business complexity and size.

Risk ownership: Gaining control of global tax compliance and reporting
A global power generation firm, whose 100-plus legal entities in multiple geographies were collectively subject to nearly 3,000 required tax filings, was facing an increase in compliance and tax audit risk. Because leaders lacked appropriate visibility into tax activities, the company ran a high risk of penalties from missed or inaccurate statutory filings. Tax audit risk was also on the rise due to recent initiatives by European tax authorities focusing on data and compliance processes. To address these risks, the company faced a twofold challenge: establishing effective corporate control and oversight of a geographically dispersed and very decentralized tax function, and improving the efficiency of local tax compliance, risk management, and communication processes.

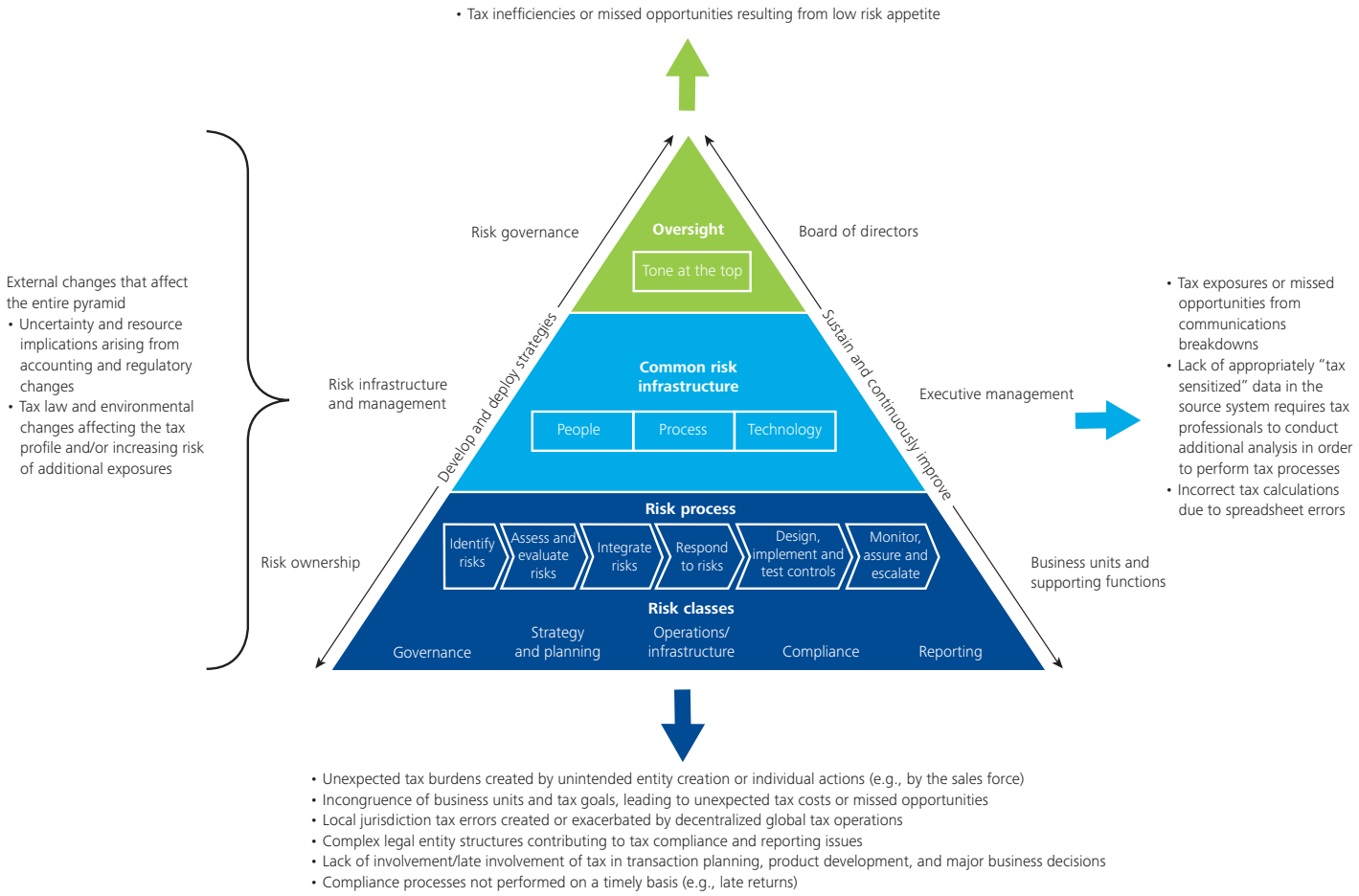
The company's approach was to document filings requirements in each jurisdiction, establish controls to properly manage global tax compliance, and design operating processes and procedures to strengthen control over the compliance process and more effectively manage risk. An important part of this effort was the development of a standardized database of global tax compliance requirements — including information about roles and responsibilities, due dates, risk rating, and associated workflow steps — that fed into the company's enterprise-wide governance, risk, and compliance (GRC) software application.

As a result of this effort, the company gained greater transparency and visibility into tax activities and potential risks worldwide. This not only allowed the company to better manage compliance and operational risks, but enhanced the ability of the tax and finance departments to coordinate proactive tax risk management.

Business leaders are discovering a tax corollary at every turn, well beyond the downside risk of non-compliance. Figure 2 illustrates several of what we consider to be severe tax-related risks at every level of the Risk Intelligent Enterprise.

Many potential tax benefits associated with IT implementations (e.g., asset tax basis, training grants, VAT calculations, state and local tax incentives, and thorough analysis of reporting requirements) are time sensitive. If they are not considered early, these opportunities can be lost forever.

Figure 2. Tax risk can arise at all levels of the Risk Intelligent Enterprise; below are examples of tax risks pertaining to the various parts of the enterprise.



company realized that the project had the potential to drive tax benefits. By establishing a regional principal company whose tax and operating models were integrated into the SAP process design, the company established a more centralized operating structure that generated a sustainable and scalable low tax rate on the company's non-U.S. profits.

Indirect taxes

More and more companies are coming to appreciate the importance of appropriately addressing indirect tax refund opportunities. One major challenge is that non-tax professionals often manage the day-to-day responsibility for indirect tax compliance. When tax department involvement is limited to tax authority audits, as is often the case, companies are at risk of overpaying; our recent experience in this area shows that such overpayments can total up to two to three percent of sales, with multiples expected as other indirect taxes are considered. It is also common for insufficient compliance processes to create tax return errors, late returns, and penalties.

One technology company realized that it was running a significant risk of indirect tax-related penalties from either late submissions or return errors in several European jurisdictions. To better manage the risk, the company moved indirect tax reporting to its service center where it could be supported by a common tax return and working paper automation tool that included tax rules for multiple countries. The company also introduced specific indirect tax transaction analytical tools and recruited tax and finance specialists to support indirect tax reporting. The resulting increase in standardization and professional skill levels, as well as the greater data consistency enabled by cross-checks that eliminated double counting and enforced reconciliation, helped the company more effectively manage indirect tax compliance risk across multiple jurisdictions, improved its ability to address tax authorities' requirements, and refocused priorities on reducing return errors.

Asset planning

The material amount of fixed assets on many balance sheets can represent significant tax opportunities, but outdated technology systems and poor-quality data often keep companies from taking action. For example, many companies still track a number of common fixed asset compliance adjustments (e.g., bonus depreciation, cost segregation studies, and other calculations) separately from the enterprise's common fixed asset compliance system, which can be a very time-consuming process and give rise to unnecessary errors and inconsistencies. Migrating these adjustments into the ERP system can yield a sustainable solution and the resulting cash tax benefits can often potentially offset a portion of the cost of the migration. We have seen similar reviews of fixed asset systems generate immediate cash flow opportunities through better tax-sensitized coding, which can enable more accurate, accelerated tax depreciation deductions.

Business performance management software for tax

Companies routinely upgrade their ERP and consolidation software, such as Oracle® Hyperion®, SAP BusinessObjects, and IBM Cognos®, to better manage their financial operations. Historically, such systems and their related outputs have been of limited use to tax departments: Information is typically captured at the wrong level of detail to support tax requirements, and many tax departments lack the relevant software experience to correct this limitation. Newer versions of these tools, however, have reduced the limitations of prior versions, enabling tax to interact directly with general ledger systems without burdensome file transfers or manipulations and without adversely affecting other corporate functional needs. Furthermore, tax provision, workflow, and compliance software have advanced to the point where an integrated tax department — one that is connected with, and applies the same tools and data used by, other corporate functions — can be a reality. This, in turn, may result in more accurate data, faster processing times, and more time spent on value-added activity.

Tax information reporting

Within the United States, tax authorities are placing increasing emphasis on information reporting and withholding as a means of closing the tax gap (the difference between the amount of taxes paid and what a government estimates is owed). With the classification of foreign withholding tax and information reporting as a Tier 1 issue, thereby elevating U.S. Internal Revenue Service (IRS) audit activity in this area, the risk for companies required to comply with these requirements has increased.

If a U.S. company pays interest, dividends, royalties, rents, or payments for personal services to non-resident aliens, it is subject to certain information reporting and withholding tax requirements. Compliance with these rules is a complex process that requires companies to:

- Obtain documentation to determine domicile of income recipients
- Withhold tax based on type of income, country of payee, and whether a treaty benefit has been claimed
- Make payments to the IRS
- File appropriate reports

Often the company's entire process for complying with these requirements is manual, creating potential exposure for underwithheld taxes, interest, and penalties. In one case, a financial services organization was facing a potential tax assessment, interest, and penalties associated with inadequate documentation for information reporting obligations. The company's remediation effort included collecting documentation for thousands of both past and current payments subject to withholding taxes, as well as developing processes, procedures, and written guidance to confirm that the company had an effective system for determining, paying, and reporting the proper withholding taxes.

Step two: Be proactive and build bridges to the business

To some extent, the complexity of tax requirements and compliance issues around the world — and the degree of technical specialization required to fully grasp, interpret, and evaluate the rules — can hinder understanding and appreciation of tax risk implications at all levels of the organization. Yet such an understanding is essential to increasing the linkage and integration of tax with decision-making across the entire enterprise.

It is up to the tax executive, with the CFO's backing, to take responsibility for making tax and its role in value creation easier to understand. By using non-technical terms to share his or her initial findings on where tax might add value, a tax executive can begin to make a clear case for tax's involvement in value creation. With the CFO's support, initiating the information exchange with the rest of the organization should be relatively easy: Review the departments affected, prioritize opportunities with the CFO, and begin the dialogue. The objective is to engage other department heads in tax risk assessment by explaining exactly how tax might positively influence their operating results.

War story: Always read the fine print

Even actions that seem innocuous can have significant tax implications, highlighting the need for effective collaboration between tax and other parts of the business. In one instance, the marketing department of a financial services company modified product documentation to make it more acceptable to customers. However, as it turned out, the deletion was a disclaimer required by tax authorities. Removing the disclaimer language resulted in the interest that had been paid to now be subject to withholding tax. The financial services company, having already distributed the money, became responsible for the taxes that should have been withheld plus penalties.

Granted, this new collaborative effort may require some fundamental change in behavior. As in most relationships, the effort to build bridges between tax and the business is a two-way street. Colleagues in other functions may welcome closer collaboration with tax and greater tax support in management decision-making — but to deliver these benefits, the tax executive must bring a solid understanding of the core business to the table. To build this understanding, tax executives may want to intensify or create new avenues for interacting with colleagues outside of tax, which can be valuable. Examples include walking the halls more, taking plant tours, and initiating regular lunches with counterparts in the business units. Remember, even though a tax professional's technical knowledge is his or her comfort zone, his or her success also depends heavily on relationships and the ability to navigate realms outside of tax. As a tax executive learns more about other business units, it is important that he or she freely share insights and knowledge in turn — and in plain language.

Embedding tax considerations into business decisions demands a joint approach to opportunity assessment and problem-solving. (See sidebar on pages 10-11, "Aligning CFO and tax executive objectives around Risk Intelligence.") Ultimately, a tax executive's success in building bridges will come down to proactively engaging senior management's interest and cooperation. Technical competence and relevance are important; these qualities will cultivate the confidence needed to elevate the importance of the mission — all the way up to the C-suite.

Step three: Make the case for tax in value realization

After connecting with the business units, the next step is to prepare a plan for specific tax actions that can have a positive effect on the enterprise's ability to realize the potential upside value of the strategic risks it takes after appropriate tax consideration. It is important to start with any low-hanging fruit — decisions where tax can have a large and obvious impact — in order to establish credibility quickly.

One effective way to communicate the impact of specific tax planning opportunities is to use a tax risk decision tool called a "decision web." (See sidebar on page 13, "Creating transparency with a tax decision web.") This tool creates a transparent visual representation of the tax risks associated with a particular tax planning proposal, helping stakeholders understand, assess, and manage the risks associated with tax planning in a controlled and effective manner. (See sidebar, "Creating transparency with a tax decision web.") The use of such a tool can not only open the door to greater understanding and buy-in from the entire team, but also better enable and encourage both tax and non-tax professionals to generate value-added tax ideas.

While engaging with fellow department heads, a tax executive should stress the importance of integrating tax implications *early* in the business planning process. Where possible, the tax executive should reinforce this point with relevant examples of cases where timely tax planning allowed the company to capitalize on tax opportunities. The tax executive should clearly communicate — both to his or her peers and upwards to the CFO and other higher-ranking business leaders — that effective tax involvement can not only reduce the possible downside cost of tax risks, but drive significant upside value. After all, greater tax efficiency in any area of the organization can translate into more funding for other projects.

Again, engaging the CFO is the lynchpin to success in this area — he or she has the broad view at all times and will know of any decision that involves a significant corporate investment. Once the CFO is convinced of tax's value in key decisions, he or she can be instrumental in integrating tax into the decision-making process, no matter where in the business a strategic decision is about to happen.

Finally, and importantly, the bridge-building process is not a one-off exercise. By meeting regularly with key leaders throughout the enterprise to discuss relevant tax planning ideas, a Risk Intelligent tax executive can continually increase both the tax department's credibility and its ability to deliver business value.

Step four: Deliver

A Risk Intelligent tax executive must not only catalyze effective tax planning throughout the business; he or she must also support execution with the right type and balance of resources. Placing staff with appropriate skills in key positions is key, as is involving the right people in critical activities. If money for resources is tight, alternative resourcing options (e.g., shared service centers, outsourcing, or supplementing internal resources with outside service providers) can round out requirements until more budget becomes available.

Typically, a tax department that can effectively pursue cost-effective tax operations while sustaining the desired levels of quality and performance will possess the following four attributes:

- Organized. The tax department focuses on the right work — and maintains a workload that is consistent with the company's goals and operating strategy.
- Utilized. The department aligns the technical requirements of each type of work it performs with staff skills and allocates workload appropriately. If an activity requires technical knowledge or experience that is not tax-related, tax leaders look for opportunities to perform that work outside of the tax department.
- Engaged. Tax staff members have clear job descriptions, a sense of career progression possibilities, and a robust training plan for their further development. This will help attract and retain the best people.
- Empowered. Tax leaders focus on countering tax employee concerns about potential boredom, career stagnation, or unrewarded effort by including key people in important meetings, providing challenging stretch goals that require individual effort and contribution, demonstrating trust by delegating decision-making authority, and following through on training commitments.

To execute effectively, it is also imperative to constantly monitor tax's alignment with the company's overall risk management goals. The business landscape is constantly changing in ways that can affect the company's risk profile and leadership's risk appetite. The tax executive must stay on top of internal and environmental matters that can affect tax risk planning and management. Failure to keep up to date and in tune with how the management team and board assess risk can compromise tax's ability to help the enterprise take a Risk Intelligent approach to tax value creation.

Finally, the tax executive should develop a plan for measuring progress in elevating tax risk as a strategic concern throughout the enterprise. This plan should include an ongoing assessment of how tax's efforts are contributing value to the enterprise in the ever-shifting business landscape. Additional components of the measurement process can include mechanisms for evaluating the alignment of tax results with specific business objectives, tracking the number of solid relationships established with non-tax business leaders, monitoring receptiveness to tax presentations at management and board meetings, and assessing the degree to which the outreach effort has enhanced the tax department's image in the organization. Ultimately, the Risk Intelligent tax executive's goal is for every business unit leader, C-suite executive, and board member to recognize him or her as a strategic partner who can contribute significantly to a stronger, better, more successful company. We urge tax executives to gauge every step by that standard, and spend as much time as possible looking forward — not back.

The goal is to have every business unit leader, C-suite executive, and board member recognize the tax executive as a strategic partner who can contribute significantly to a stronger, better, more successful company.

Aligning CFO and tax executive objectives around Risk Intelligence

A crucial step for any Risk Intelligent tax executive is to enlist the CFO as an ally in linking tax risk/reward management with the rest of the organization. Fortunately, because the CFO's breadth of responsibility and authority in most companies today has grown much more complex, and certainly more demanding, over the last decade, many wise CFOs themselves are focusing on building strong relationships with both internal and external stakeholders — including the tax executive. Hence, the CFO may welcome the opportunity for greater collaboration with tax, especially once he or she understands that — in the current environment of intense regulatory scrutiny — tax opportunities that made sense even two years ago may be stay-awake issues today.

By embodying distinct leadership and organizational skills around a framework we call the "Four Faces of the CFO" (Figure 3),4 Risk Intelligent tax executives can more effectively contribute to the CFO's efforts to fulfill strategic and financial objectives throughout the organization. Deloitte's Four Faces of the CFO framework asserts that CFOs play four critical roles:

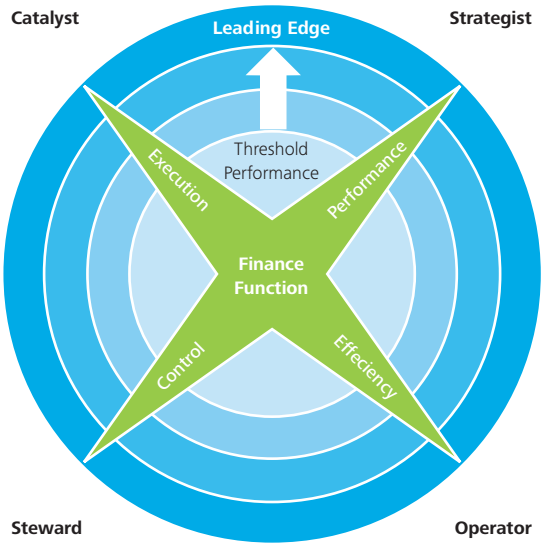
1. Strategist — Providing financial leadership in determining strategic business directions vital to the future performance of the company
2. Operator — Balancing capabilities, talent, costs, and service levels to efficiently fulfill the finance organization's core responsibilities
3. Steward — Protecting and preserving the critical assets of the organization and accurately reporting on financial position and operations to all stakeholders
4. Catalyst — Driving behaviors across the organization to execute strategic and financial objectives while at the same time creating a Risk Intelligent culture

A Risk Intelligent tax executive can add value to all four of the CFO's "faces." As a protector of value, a Risk Intelligent tax executive employs effective stewardship of compliance requirements and guides efficient tax function operations. As a creator of value, he or she embraces the strategic thinking and planning that contribute to organizational success and acts as a catalyst for others to do the same. By appropriately balancing efforts and allocating resources among all four areas of responsibility, a Risk Intelligent tax executive can help drive exceptional results.

Figure 3. The Four Faces of the CFO

Catalyze behaviors across the organization to execute strategic and financial objectives while at the same time creating a Risk Intelligent culture

Provide financial leadership in determining strategic business direction, M&A, financing, capital market, and longer-term strategies vital to the future performance of the company



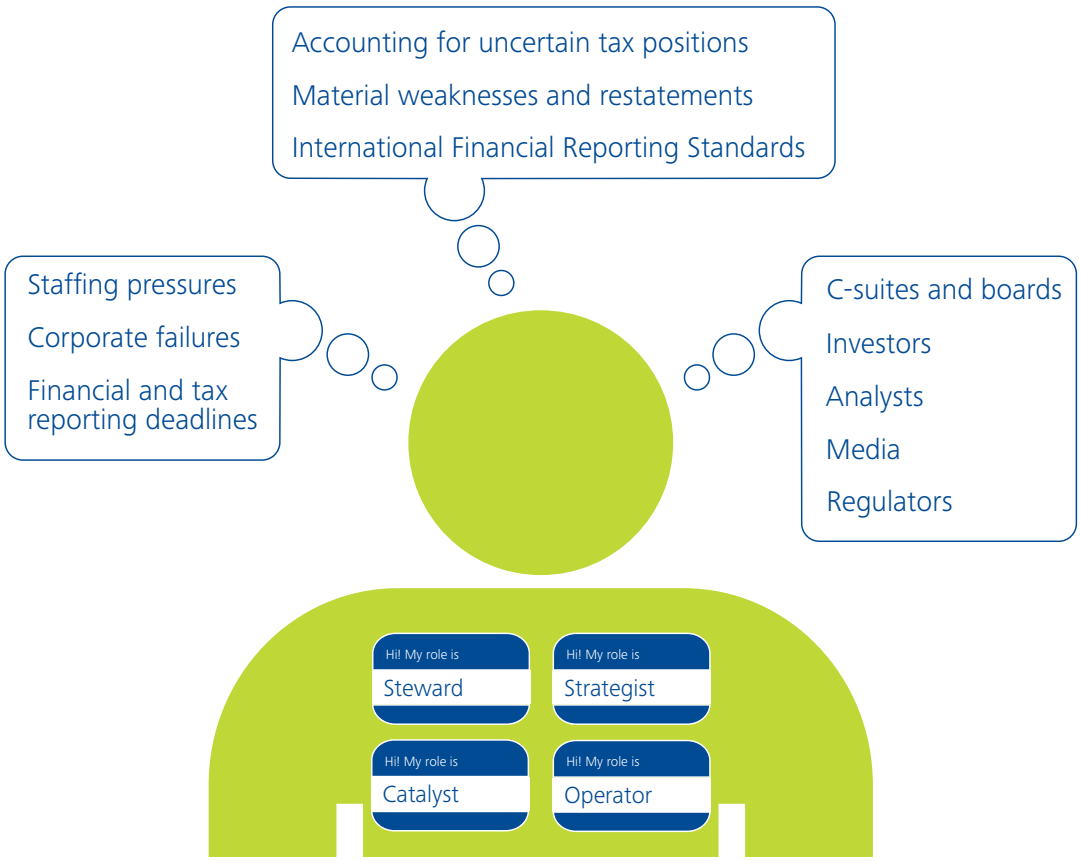
Protect and preserve the critical assets of the organization and accurately report on financial position and operations to internal and external stakeholders

Balance capabilities, talent, costs, and service levels to fulfill the finance organization's core responsibilities efficiently

The Risk Intelligent tax executive seeks to create value

Successful companies see risk as an important and unavoidable part of doing business, and they view effective risk management as essential to achieving the desired results. A Risk Intelligent tax executive can play a leading and compelling role in helping executives throughout the organization deal with both the upside and downside aspects of risk management. By creating the appropriate level of risk transparency, opening the dialogue on the tax implications of strategic risks, and fostering the view of risk as a potential tool for value creation, tax executives can help move their companies toward a truly Risk Intelligent approach — one that treats tax risk management with the attention and respect that its potential for creating and protecting enterprise value deserves.

Tax is on the rise as a key risk management force. Just as IT progressed from being a discrete function to a ubiquitous presence throughout most organizations today, so too is tax becoming an integral part of how smart business is done — from strategy to execution to measuring success. Now is the time for tax, under the leadership of an informed and empowered Risk Intelligent tax executive, to drive home the message that effective tax risk management means embedding consideration of tax risk in strategic decisions made by every area of the business. Ultimately, it is about elevating tax risk assessment and management as tools for creating value — and coming to the view that a missed tax opportunity might be the greatest risk of all.



Creating transparency with a tax decision web

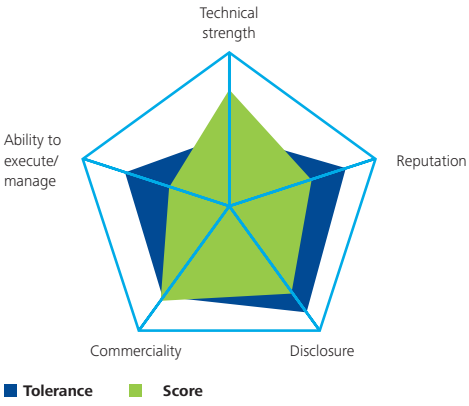
Using a tax decision web can allow even stakeholders who are not familiar with tax policies and laws to play an informed role in tax risk assessment and decision-making. Several multinational companies have used such a tool to define their tax risk tolerance and clarify roles and responsibilities around tax planning and risk management.

A tax decision web displays the factors that influence a tax decision and plots a given proposal against these and the organization's risk profile. The risks associated with each tax planning decision is separated into a number of decision factors that are depicted as a set of axes — one for each decision factor — forming a multidimensional "web" (see Figure 4 below). Tax leaders and senior business executives then collaboratively assign a risk tolerance level to each decision factor. These tolerance levels should reflect the collective risk tolerance of all business and tax stakeholders affected by the decision and are subject to regular review and adjustment to maintain alignment with any changes in stakeholders' risk appetite levels. The stakeholder team then assigns a score to each decision factor that represents the amount of risk with respect to that factor that would likely result from the tax decision under consideration. Plotting both the tolerance levels and the actual scores along the axes in the decision web yields a clear visual representation of the tax proposal's alignment with the stakeholder group's risk appetite. If any decision factors have scores that fall outside the limits prescribed by the agreed-upon risk tolerances, the team should reevaluate the tax decision itself, the organization's tax risk appetite, and/or the feasibility of mitigating the risks associated with those factors until all scores fall within the risk tolerance limits.

In this example, the two out-of-bounds scores would suggest that tax should take additional steps to mitigate risks related to the proposal's technical strength and commerciality before moving forward.

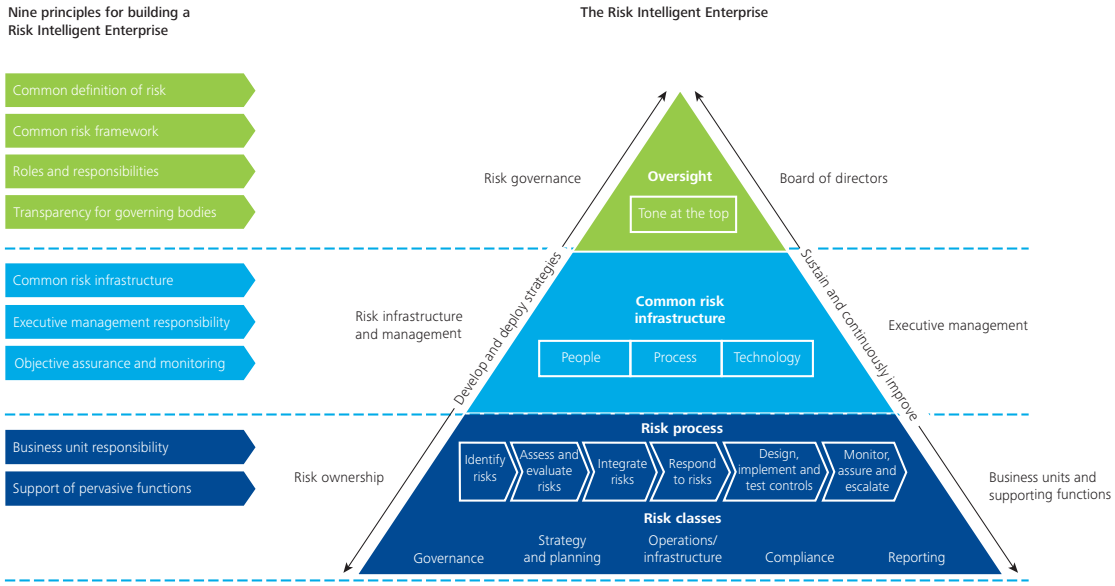
Figure 4. Sample tax decision web

Decision factors	Tolerance (1–10)	Score (1–10)
Technical strength: the strength of the technical analysis of the tax planning proposal	6	9
Reputation: the level of reputational risk for a range of stakeholders, both internal and external to the organization	8	6
Disclosure: the level of uncertainty relating to the accounting treatment and disclosure requirements associated with the tax planning proposal	7	6
Commerciality: the extent to which the proposal's commercial benefits equal or exceed its tax benefits	6	7
Ability to execute and manage: the ability to mount the resources required to implement and maintain the tax planning proposal	8	5



Appendix 1: The Risk Intelligent Enterprise framework

Figure 5: The Risk Intelligent Enterprise framework



A Risk Intelligent approach to tax seeks not only to manage tax compliance risks, but also to build appropriate tax planning benefits into specific operational strategies and initiatives. These initiatives are constantly taking place in every part of the enterprise; developing new products, redesigning the supply chain, expanding the sales force, and establishing new plants, stores, and offices are just some of the possible activities to which tax can add significant value. Accordingly, decision-makers across the enterprise, both within and outside the tax function proper, must understand how and when tax plays into strategic business activities and decisions and use that understanding to make tax-effective choices that enhance enterprise value on an after-tax basis.

As illustrated in the Risk Intelligent Enterprise framework (Figure 5), effective risk management depends on solid leadership in three areas:

- *Risk governance,* including strategic decision-making and risk oversight, led by the board of directors
- *Risk infrastructure and management,* including designing, implementing, and maintaining an effective risk program, led by executive management
- *Risk ownership,* including identifying, measuring, monitoring, and reporting on specific risks, led by the business units and functions

The traditional view that tax is concerned only with managing downside risks may relegate tax risk management to tax compliance and reporting activities in the risk ownership realm, placing tax in its own silo at the bottom of the risk pyramid. However, if the failure to capture value not realized due to a suboptimal tax outcome is also considered a risk, then it becomes clear that many significant risks arise from a failure to address tax considerations properly in all strata of the pyramid.

A great deal of tax risk can arise within the risk infrastructure and management segment of the framework, which encompasses the people, process, and technology elements needed to run an effective enterprise risk management program. Embedding tax into these three infrastructure elements can help a company run its risk program in a way that takes both income and non-income tax risk into account. Tax professionals should be knowledgeable about the business as well as technical specialists; processes should exist to inform them of enterprise risk management efforts; and the technology supporting tax processes should be integrated into enterprise-wide risk management platforms.

At the apex of the Risk Intelligent Enterprise framework, the risk governance structure should give tax appropriate weight as a risk management concern. This involves clearly defining the company's risk appetite and risk tolerances with regard to its tax positions. Equally critical, boards and senior executives should set a tone at the top that cultivates the expectation that tax be consulted in strategic business decisions, and that confirms that appropriate connections exist between the various business units and functions and the tax department.

Moving the enterprise toward a Risk Intelligent approach to tax may require a substantial investment of time and effort, but both tax executives and their organizations should find the investment worthwhile. Applying the Risk Intelligent Enterprise framework to tax can allow senior executives and boards to breathe easier, comfortable in the knowledge that tax is using tools that help effectively communicate and address tax risks and rewards throughout the enterprise. When tax is successfully integrated into a Risk Intelligence program, tax risk management should become more transparent to stakeholders, and tax executives should have more energy and attention to focus on driving tax value and contributing to strategic business decisions overall.

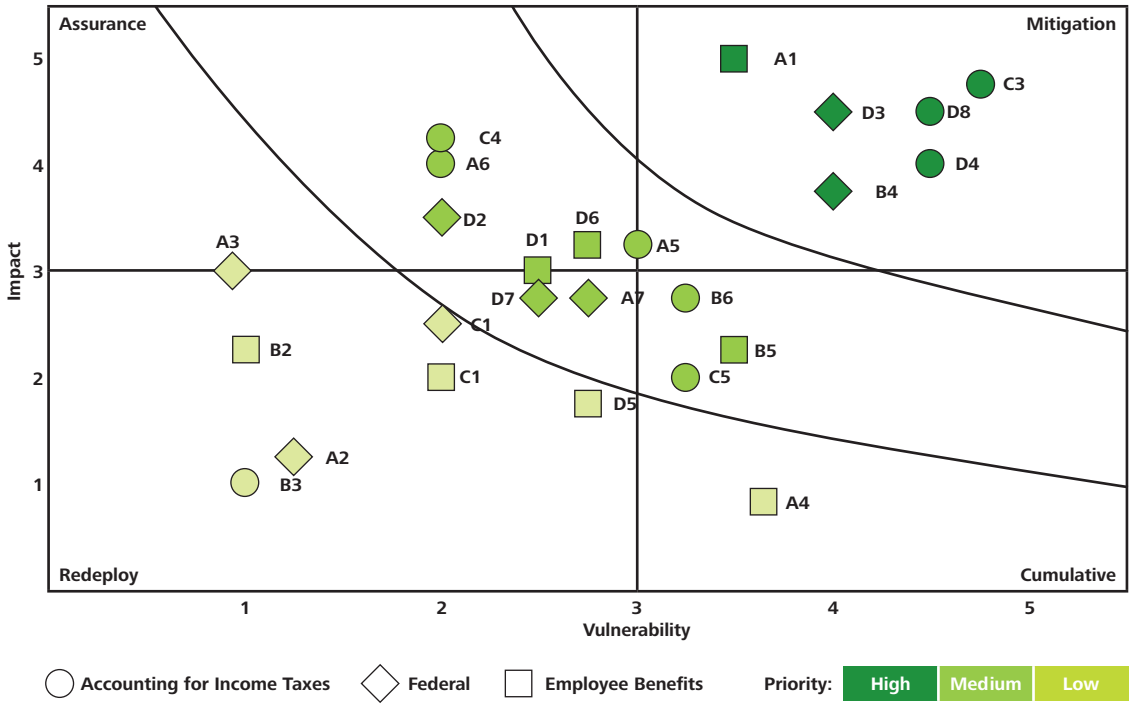
Appendix 2: Creating a tax risk management framework

A strong framework for tax risk assessment and management can give CFOs and tax executives a comprehensive snapshot of specific tax risks, looking both backward and forward. An in-depth framework sets guidelines, establishes metrics, and prescribes processes that potentially can help leaders:

- Assess existing tax risks across the enterprise
- Prioritize existing tax risks so that appropriate attention and resources can be focused on critical areas
- Determine a detailed, appropriate response for each priority risk area
- Communicate tax risk management activities in appropriate language to the C-suite and the board
- Establish an agreed-upon framework for evaluating future tax planning opportunities based on the organization's risk tolerance, with supplemental approval required for future activities that do not meet the criteria established

The use of an effective tax risk management framework can help companies develop policies, procedures, and processes that support the appropriate vetting of tax issues and help the tax department effectively communicate tax issues to the C-suite and board. A strong tax risk management framework also actively supports efforts to achieve sustained compliance with tax-relevant laws and regulations, such as the Sarbanes-Oxley Act of 2002. Risk Intelligent tax executives can use the results of a tax risk assessment to prepare for regular (at least annual) meetings with the board, which some leading-edge companies are instituting as part of their overall enterprise risk management program. (See page 20, Appendix 4 for a sample meeting agenda.) The ultimate goal is to foster a culture of awareness about tax risk management along with appropriate processes and controls, which improves trust, integrity, and transparency across the organization.

Figure 6. Sample risk map illustrating the organization's impact and vulnerability to specific tax risks



Periodically, assessing tax risks and explaining how and why certain risks have become more or less significant is a leading practice in establishing and maintaining an effective tax risk management framework. By sharing this information with the executive team and the board, a tax executive can potentially help leaders better understand tax resource issues and the demands the tax department is facing beyond managing tax compliance. One effective approach to structuring a tax risk identification effort is to consider risks related to the following six areas:

1. Operational: planning and strategy
2. Compliance: process, technology, and positions
3. Legislation: governance and budget
4. Deals: corporate events and major transactions
5. Corporate structure: international tax presence
6. Operations: day-to-day processes, automation, and management decisions

A risk map, such as portrayed in Figure 6, can provide a simple-to-understand view of existing tax risks that can make it much easier for tax to communicate tax risk considerations to their non-tax colleagues. Helping the business understand the organization's level of vulnerability to a tax risk, as well as the potential impact of the risk event should it actually take place, makes it possible to determine which areas may be in need of *mitigation* and which areas may have resources that might be available for *redeployment*.

In addition to mapping each individual risk, a risk map can use shapes and colors to categorize the risks by tax type, department, or entity, which adds further clarity and enhances the tool's flexibility in evaluating, measuring, and communicating about risks.

Using a risk map to perform regular tax risk assessments can help the Risk Intelligent tax executive monitor the effectiveness of risk management activities as risks move across the risk map's quadrants.

After identifying pressing risks, the tax executive can work with appropriate business leaders to consider mitigation strategies, weighing the costs of remediation against such overall risk factors as:

- Tax risk category
- Potential impact
- Likelihood
- Urgency
- Mitigation strategy
- Mitigation benefit (ROI)
- Estimated cost to mitigate (as available)
- Resources

The result: a systematic blueprint for tax risk mitigation that incorporates perspectives from both tax and the business and that is aligned with the enterprise's overall risk management strategy.

Appendix 3: Tax's perceived role in value creation

Informal surveys of both finance and tax executives from two similar but separate August 2009 forums provide some insight into the perception of tax's role in value creation and its level of integration with the rest of the organization.

Finance executives

In which area of your organization is the tax department best assimilated?	
Votes received: 1342	
Supporting major operating/transaction decisions	20.1%
Contributing to company-wide risk management efforts	9.3%
Collaborating with others on finance and accounting	38.9%
None of the above	7.8%
Don't know/not applicable	23.8%

How often do you meet with your tax department outside of discussing the tax provision?	
Votes received: 1394	
Frequently (at least once a month)	18.7%
Periodically (a few times a year)	40.7%
Never	12.8%
Don't know/not applicable	27.8%

When enterprise risks are being discussed and a tax executive is not represented, do you:	
Votes received: 1388	
Postpone the meeting until tax is represented	19.2%
Proceed without tax's representation	27.4%
I am not aware of these conversations occurring	22.3%
Not applicable	31.1%

Are the board, executive team, and tax function at your company in agreement on what is an appropriate level of tax risk?	
Votes received: 1310	
Yes	38.8%
No	10.2%
Don't know/not applicable	51.0%

Where do you see the best opportunities for leveraging tax expertise in managing risks?	
Votes received: 1246	
Better integration of tax reporting and compliance needs in enterprise-wide systems	14.3%
Better collaboration between tax and other business units	21.4%
Better integration of tax into strategic or operating decisions	39.5%
Other	3.4%
Don't know/not applicable	21.4%

Tax executives

In which area of the enterprise is the tax department best assimilated?	
Votes received: 1235	
Supporting major operating/transaction decisions	27.4%
Contributing to company-wide risk management efforts	13.7%
Collaborating with others on finance and accounting	42.0%
None of the above or not applicable	16.8%

How often do your tax executives make a presentation to the board?	
Votes received: 1331	
More than once a year	20.0%
Annually	14.2%
Every other year	0.9%
Infrequently, as issues arise	21.3%
Never	12.3%
Unsure/not applicable	31.3%

When your company's CFO brings his or her confidants to the table to discuss enterprise risk and a tax executive is not represented, does the CFO:	
Votes received: 1365	
Postpone the meeting until tax is represented	13.7%
Proceed without tax's representation	26.4%
I am not aware of these conversations occurring	33.7%
Not applicable	26.2%

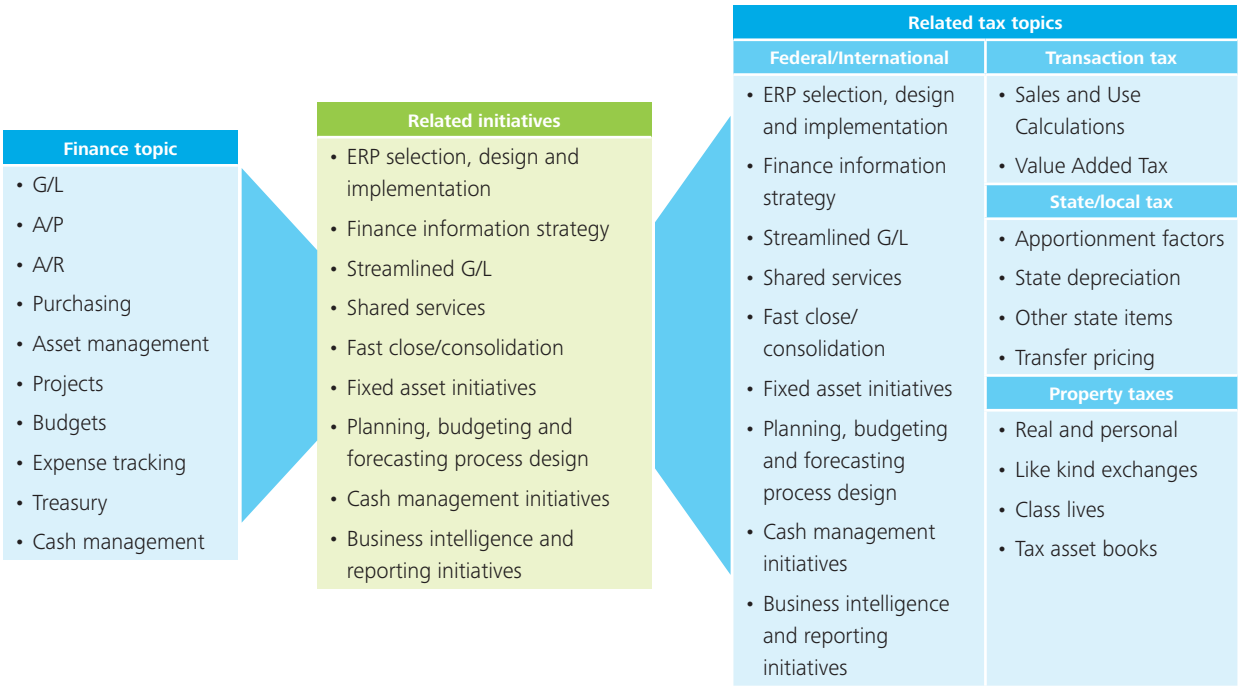
Are the board and tax executive in agreement on what is an appropriate level of risk?	
Votes received: 1319	
Yes	34.8%
No	9.1%
Not sure/not applicable	56.1%

Where do you see the best opportunities for leveraging tax expertise in managing risks?	
Votes received: 1238	
Better integration of tax reporting and compliance needs in enterprise-wide systems	16.2%
Better collaboration between tax and other business units	22.0%
Better integration of tax into strategic or operating decisions	43.1%
Other or not applicable	18.7%

Appendix 4: Sample tax agenda topics for meeting with the board

Regulatory environment
Tax risk areas
Financial highlights
Cash tax requirements
Effective tax rate drivers
Unrecognized tax benefits
Valuation allowance considerations
Financial statement disclosures
Tax audit activity
Tax planning projects
Legislative and regulatory developments

Appendix 5: Relationship among tax, finance, and ERP systems



Nine fundamental principles of a Risk Intelligence program

1. In a Risk Intelligent Enterprise, a common definition of risk, which addresses both value preservation and value creation, is used consistently throughout the organization.
2. In a Risk Intelligent Enterprise, a common risk framework supported by appropriate standards is used throughout the organization to manage risks.
3. In a Risk Intelligent Enterprise, key roles, responsibilities, and authority relating to risk management are clearly defined and delineated within the organization.
4. In a Risk Intelligent Enterprise, a common risk management infrastructure is used to support the business units and functions in the performance of their risk responsibilities.
5. In a Risk Intelligent Enterprise, governing bodies (e.g., boards, audit committees, etc.) have appropriate transparency and visibility into the organization's risk management practices to discharge their responsibilities.
6. In a Risk Intelligent Enterprise, executive management is charged with primary responsibility for designing, implementing, and maintaining an effective risk program.
7. In a Risk Intelligent Enterprise, business units (departments, agencies, etc.) are responsible for the performance of their business and the management of risks they take within the risk framework established by executive management.
8. In a Risk Intelligent Enterprise, certain functions (e.g., Finance, Legal, Tax, IT, HR, etc.) have a pervasive impact on the business and provide support to the business units as it relates to the organization's risk program.
9. In a Risk Intelligent Enterprise, certain functions (e.g., internal audit, risk management, compliance, etc.) provide objective assurance as well as monitor and report on the effectiveness of an organization's risk program to governing bodies and executive management.

Contact us

To learn more about Deloitte's governance and risk services or to contact one of our global leaders, please visit: www.deloitte.com/risk.