CFO Insights
Opening the black box: Five questions for your tax executive

For many CFOs, tax is viewed as a black box. Due to the significant complexities of federal, international, state, and non-income-based taxes, the natural tendency of a finance leader may be to deal with the tax function at arm's length.

Yet, CFOs who take this approach may be increasing overall finance risk and diluting the value the tax function can bring to their organizations. Lack of continuous interaction and limited oversight of the tax function by the CFO may, in fact, lead to crisis-based interaction. Moreover, given the current uncertain state of fundamental tax reform and increasing frequency of turnover in tax leadership, CFOs need to be literate in critical tax issues and have in-depth understanding of certain operational issues faced by tax functions. The CFO also plays a leadership role in connecting tax within finance and with the rest of the business.

While a detailed technical understanding of tax is not realistic, there are certain strategic conversations that CFOs can have with their tax executives that will a) enhance the tax literacy of the CFO and the broader finance organization, b) offer a window into the operation of the tax function, and c) provide a foundation for CFOs to make effective current and future hiring decisions. In this issue of *CFO Insights*, we will identify those topics and discuss how these conversations can lead to a stronger partnership between finance and tax.

Five vital conversations

For CFOs, tax discussions typically revolve around two areas—reducing the effective tax rate and understanding tax policy—and with good reason. In the Q1 2013 *CFO Signals* survey, for example, 75% of CFOs claimed that corporate tax reform policies were having at least some impact on cash, investment, and hiring.[1] Given tax's day-to-day responsibility for these areas and the need to integrate the function more fully into finance, discussions with your tax executive should be more frequent, focused, and strategic— and include the following questions:

1. **What is the succession plan for specific members of your tax department—and yourself?** 1.
   Robust succession planning is a characteristic of high performing finance functions, yet tax is not always included in this process. The reason may be an assumption that tax is so highly specialized that when turnover occurs, the company has no choice but to go outside the organization to source that talent. Such thinking, however, leads to an inherent added cost to both the search and onboarding processes. To reverse that thinking requires engaging with tax to participate in structured succession planning, and introducing a plan that includes leadership and influence skills as well as technical competency. This can be a challenge, however, since tax professionals are highly valued for their technical competencies and become specialized as they progress in their careers. It is the CFO's role to work with tax to understand how to identify internal candidates with the balance of technical skills and the potential to both work with the rest of the organization and influence it. That succession plan should allow identified candidates to further develop their leadership and influence skills, and the CFO has a critical sponsorship role in promoting viable candidates within the company.

[1] *CFO Signals*, Deloitte U.S. CFO Program, Q1 2013.

2. **What are you doing to build sustainable processes around compliance and reporting?** Many tax functions are still working to create well-defined and adequately documented processes. It is important that tax is held accountable to meeting the same process standards as the rest of the organization. Part of the problem may be that it's unclear who's accountable for the controls in such situations. If tax processes are deemed inadequate, it is critical to hire or develop the skills to institute proper controls. For example, some companies hire Six Sigma black belts or retain external consultants. CFOs also have the option of designating a point person within finance to oversee the processes or give joint responsibility to the director of tax compliance and the director of accounting for income taxes. Given the risk of material weaknesses and financial statement restatements, having a point person is one safeguard against a possible deficiency in tax controls and processes that might otherwise only be revealed in a crisis.

3. **How is tax generating value?** CFOs need to have an appreciation of tax's value proposition so they can adequately communicate it across the organization. For example, CFOs should understand what items impact the effective tax rate, as well as the volatilities that could cause it to fluctuate. The value proposition could also be to reduce cash taxes, to reduce and manage risk, or to serve as an operationally efficient compliance cost center. Effective tax planning requires tax to engage the business appropriately, and the business to educate tax about strategic priorities. The CFO can function as an effective interface between tax and the rest of the business.

4. **How is tax leveraging the technology that the rest of finance uses?** CFOs need to understand if tax is fully utilizing the functionality within the existing finance technology platform. For example, how is tax sourcing data from the underlying ERP systems? A specific question is, how much of tax specific information is maintained outside the ERP system on spreadsheets? Others include: how much data manipulation is required within the tax function?; how is tax using management reporting and consolidation tools?; and finally, are tax-specific applications being deployed and utilized effectively? Tax professionals may sometimes request additional tax-specific technology applications when they are underutilizing functionality that already exists. The result is unnecessary time spent on data manipulation and unnecessary investment of resources in technology solutions. There is also an opportunity cost in terms of human capital since tax professionals are demotivated by spending much of their time in data manipulation. The outcome is poor morale and turnover.

5. **If the tax leader had additional resources, how could they be deployed?** Tax executives commonly express a desire for more resources, but may be ineffective at articulating the business case. Risk management is often used as a justification for additional headcount because tax is perceived as managing larger risks. This can cause friction with other functional areas within finance that are asked to do more with less. Instead, tax executives should create a holistic business case for deployment of tax resources, including people, process, technology, and data. In addition, tax executives should exercise judgment in making build versus buy decisions as resources are deployed. Together with tax, CFOs have an opportunity to drive down the "total cost of ownership."

The black box demystified

In our CFO Transition Labs, tax is often identified as an area of significant complexity, subject to misunderstanding. It is critical for CFOs to open the black box in order to unleash the value that tax can contribute to the company. Moreover, with turnover in tax leadership projected to increase due to retirements and the competitive market demand, CFOs should engage with tax in order to enhance tax literacy and develop future tax leaders. The place to start is by engaging your tax executives in a series of open and targeted conversations on everything from succession planning to the use of technology to the state of compliance processes. Equipped with these answers, CFOs can help foster a greater understanding of the tax function throughout the organization.

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