# FIN 48 Compliance

## *It's More Than Just Judgment … And It Requires More Than Just Smart People*

By Michael H. Lippman

Tax is one of the most complex components of corporate finance. One only has to look at the number of tax-related material weaknesses and significant deficiencies reported by public companies in recent years to get a sense of the complex challenges faced by large, otherwise sophisticated companies in accurately accounting for taxes in their financial statements. In the income tax area alone, companies must grapple with difficult issues relating to federal, state, and foreign country taxation. The issues multiply as an organization grows, its business crosses more borders, and its legal entity structure is altered as a result of acquisition, disposition, and other reorganization activity. The need to accurately reflect taxes in financial statements was clearly a focal point in the passage of Sarbanes-Oxley (SOX) in 2002, and the subsequent rules promulgated by Public Company Accounting Oversight Board, or PCAOB. More recently, compliance with the income tax accounting rules has become even more paramount with the Financial Accounting Standards Board's (FASB) issuance of Interpretation Number 48, *Accounting for Uncertainty in Income Taxes*, or FIN 48.

FIN 48 is a sweeping interpretation of FAS 109, a decades-old accounting rule that sets forth the general framework for reporting income taxes in financial statements. FIN 48 introduces new, more standardized rules to assess the technical merits of uncertain income tax issues and to compute the related amount of tax that should be reported in the financial statements. It also introduces an array of new disclosure requirements, requiring companies to provide far more information about uncertain tax issues to its shareholders. While companies have always been required to evaluate and report on uncertain tax positions in their financial statements, the convergence of SOX and FIN 48 has created unprecedented demands for process, documentation, and controls in the corporate tax department. It also demands that companies consider the need to automate processes and workflows that until now have been managed primarily through a combination of manual procedures and spreadsheet applications.

### Traditional Approaches Are Falling Short

The natural and historical inclination of companies to meet the requirements of FIN 48 compliance might be to throw more bodies at the challenge. And, in some cases, this approach might be at least partially the right answer. As they implement FIN 48, corporate tax departments must make many difficult technical judgments and they might not be equipped to handle that added burden. However, compliance with FIN 48 requires much more than technical judgment. In fact, the addition of more technical decision makers into the process, while potentially reducing risks associated with technical judgments, might increase other risks (for example, risks associated with miscommunication; decisions made with knowable, but unknown facts; and risks associated with the absence of defined process and workflow).

In similar circumstances, other functions in the company have invested in enterprise-class software technology to reduce risk, improve visibility, and in general do more with less. But tax departments, to date, have generally relied on standard desktop toolsets such as email, shared network drives, and spreadsheets combined with disparate, often non-integrated tax software. These tools are starting to fall short of the new demands for rigorous audit trails and transaction history, documentation depth, transparency in disclosure and reporting, and defined and reliable internal controls.

### The Need for a New, Technology-Driven Approach

To meet the stringent requirements of FIN 48, corporate tax needs technology that's on par with the operational and reporting applications that have been applied to other areas of the business. Such technology must be able to automate the workflow, the non-tax technical aspects of decision making, and the documentation processes necessary to establish and ensure data integrity. The technology should also enable tax personnel to track positions and underlying units of account (i.e., subsets of tax positions) from period to period and year to year, in a controlled, accurate, and transparent fashion. If they are confident that the numbers underlying their decisions are accurate, current, and complete, tax departments are better able to manage and contain risk in a highly complex tax environment.

**Key Imperatives for FIN 48 Compliance:**

- Controlled process and workflow
- Information accuracy, granularity, and transparency
- Detailed audit trail of decisions and associated actions
- Detailed and summary data to support internal and external reporting and disclosure requirements

In the case of FIN 48, corporate tax needs technology that can help align tax processes with the internal controls framework of SOX. Technology should enable tax executives to:

- Establish processes and procedures that ensure certainty, continuity, and consistency for identifying, measuring, and disclosing potentially significant uncertain tax positions.
- Track data at a granular level and make it readily available to auditors.
- Demonstrate underlying units of account from period to period and year to year, and establish detailed audit trails.
- Create detailed and summary data to support both internal and external reporting and disclosure requirements.

### Now Is the Time: Today's Technology Solutions Can Aid FIN 48 Compliance

Similar to the applications that serve other areas of the company, enterprise-class software solutions are now available to help tax personnel manage complexity in just the ways regulators proscribe. Such solutions enable tax departments to operate with a "best practices" methodology that goes well beyond the capabilities of spreadsheets, providing tax with a streamlined, controlled framework that helps reduce risk, increase accuracy, improve efficiency, and ensure transparency. These solutions provide an integrated environment so companies can establish global coverage for all tax positions (that is, income and non-income) and share critical information and standards across all tax functions. In addition, today's solutions support the critical need for process and workflow, and are designed to adapt to a company's unique defined control guidelines.

Armed with enterprise-class software, highly valuable tax personnel are better equipped to implement a consistent, standardized, best-practices approach to streamline and automate the key steps in managing and reporting on uncertain tax positions. These key steps are:

- Identifying: Establishing procedures to confidently and consistently isolate and document all relevant, significant open tax positions on both a domestic and global basis.
- Evaluating: Rolling out a standardized evaluation methodology for each unit of account to ensure that the right individuals are making and reviewing decisions.
- Measuring: Applying the FIN 48 two-step recognition approach and documenting that approach, along with related approvals and calculations of interest and penalties at all jurisdictional levels.
- Reviewing: Ensuring visibility at a very detailed level into all global tax positions, including who made a particular decision and how that decision was arrived at and documented.
- Reporting: Providing both summary and detailed reports by period, entity, jurisdiction, or type—including positions taken with regard to company reserves and reserve analysis—to satisfy audit requests and meet disclosure requirements.

### Summary

Far-reaching rule making, such as FIN 48, is raising the importance of tax in financial statements to an unprecedented level, and as a result, adding many layers of complexity to the corporate tax function. Never before has it been more critical to arm valuable tax resources with advanced, enterprise-class technology that can help them establish controlled processes for managing tax positions and related uncertainty. And while technology will never replace the need for top, tax-technical talent, technology can help the tax organization create a secure, accurate, and reliable environment to reduce risk. Technology can help tax professionals efficiently and fully comply with the demands of an increasingly regulated environment, and it can ultimately help make tax a little less "taxing." ■

### About Liquid Engines

Liquid Engines provides Enterprise Tax Management software that helps corporate tax departments manage the multi-year tax impact of business and regulatory changes that occur on local and global levels. Used today by many of the world's leading tax organizations, Liquid Engines' in-depth applications provide tax professionals with the tools and insight needed to work more effectively, add greater strategic value, and reduce risk—across all tax functions. For more information, visit www.liquidengines.com or email info@liquidengines.com.

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