Using intelligent data to improve intercompany global pricing decisions and drive cost savings

Stephen Day, Ernst & Young LLP
Brian Francis, Ernst & Young LLP
Karuna Mukherjea, SAP
Operational transfer pricing survey

Ernst & Young surveyed 23 mostly Fortune 100® multinationals across industries to help them understand how their peers manage their transfer pricing function.

Top operational transfer pricing issues

<table>
<thead>
<tr>
<th>Issue</th>
<th>% of respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accuracy/data quality</td>
<td>19%</td>
</tr>
<tr>
<td>Cross-functional teamwork and governance</td>
<td>17%</td>
</tr>
<tr>
<td>Technology enablement</td>
<td>16%</td>
</tr>
<tr>
<td>Allocation/utilization</td>
<td>15%</td>
</tr>
<tr>
<td>Resource</td>
<td>11%</td>
</tr>
<tr>
<td>Policy and procedures</td>
<td>9%</td>
</tr>
<tr>
<td>Work processes</td>
<td>5%</td>
</tr>
<tr>
<td>Skills/capabilities and teaming</td>
<td>4%</td>
</tr>
<tr>
<td>Clear vision and strategy</td>
<td>4%</td>
</tr>
<tr>
<td>Roles and responsibilities</td>
<td>4%</td>
</tr>
</tbody>
</table>

Percent of companies planning improvements

- Planning improvements: 9%
- Not planning improvements: 91%
The global supply chain presents significant tax savings opportunities

Achieving these savings requires processes and tools that help the organization to collaborate across supply chain, finance and tax as needed to achieve the desired tax effect.

Critical elements of these process and tools includes:

- **Tangible goods**: the value-add at each step of the supply chain to be accounted.
- **Intangible assets**: the value of using and/or benefiting from the intellectual property owned by a related company must be recognized and charged.
- **Financial transactions**: financial services are an important set of services, which carry value and must be charged.
- **Services**: similar to intangible assets, related parties benefit from centralized services and should be charged.

CTR 35%

CTR 28%

CTR 5%

CTR 35%

Physical flow of goods/services

Financial flow of goods/services

CTR  Corporate tax rate
Using intelligent data to improve intercompany global pricing decisions and drive cost savings
Using intelligent data to improve intercompany global pricing decisions and drive cost savings

Balancing and automating intercompany transactions are basic requirements

ECC 6.0 with EHP5 supports full automation of intercompany accounting, including accruals for stock in transit.

Intercompany invoicing is automatically triggered when title transfer between companies.

Inventory location by status, ownership and movement
User task performed in SAP
Title transfer point that triggers billing

Seller ships goods and retains ownership while in transit. Buyer confirms receipt, which automatically books goods issue and receipt to on-hand.

Seller retains ownership for part of transit time. POD at title transit point moves inventory to in-transit of buyer. Final receipt moves inventory to on-hand at buyer.

Intercompany sale recognized immediately at time of goods issue. Buyer holds inventory in-transit until physical receipt which moves inventory to on-hand.
ECC parallel valuation enhances control, creates visibility and enables the elimination process.

Local and consolidated costs are calculated and maintained for each material at a plant code level and stored on the material master. This supports calculation and management of unrealized profit in inventory.

- Valuation of unrealized profit in inventory
- Foreign exchange gain or loss

Source: SAP
SAP Profitability and Cost Management (PCM) supports intercompany billing of services and intangibles

SAP PCM

Use PCM to capture cost, perform allocation and create intercompany invoices in compliance with IRC 1.482-9. Sample requirements that can be built into PCM:

► Sub-department and cost center allocation methodologies according to business judgment rule
► Analysis of inbound services activities
► Comparability review for services by type for method and profitability
► Analysis of risks borne or undertaken by the services provider and impact on comparability and method
► Analysis of complexity of services and any quantitative measures of services value (e.g., cost savings).
► Selection of best method and elimination of all others (cost-plus, GSMM, SCM, CUSP, PSM, CPM, other)
► Establishment of mark-ups by function type, risks and value, with adjustments for differences in these factors
► Allocation of stock-based compensation
► Identification and measurement of reasonably identifiable increment of economic or commercial value to recipient

Inputs

► Revenue
► Asset
► Costs
► Legal entity information
► Addresses
► Roles
► Operating profit
► Headcount
► Functions
► Foreign currency exchange rates

Outputs

► Cost allocation results
► Intercompany invoices
► Control reports
► Simulation models
► Multi-dimensional analysis
<table>
<thead>
<tr>
<th>Report</th>
<th>Description</th>
<th>Purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transfer price monitoring profit/loss report</td>
<td>Shows operating income by company code, and cost of sales includes a breakdown of intercompany profit and the partner company code that originated the profit</td>
<td>Provides the ability to identify company codes that are out of margin tolerance and shows where to adjust transfer prices to bring them into compliance</td>
</tr>
<tr>
<td>Tax inventory provision report</td>
<td>Offers breakdown of intercompany profit held in inventory by the partner company that originated the profit</td>
<td>Provides the country of origin and amount of unrealized profit inventory as needed to calculate deferred tax asset adjustments</td>
</tr>
<tr>
<td>Unrealized profit in inventory</td>
<td>Reports book value of unrealized profit in inventory in comparison to value based on inventory quantity times cost</td>
<td>Provides a control mechanism to ensure book value reconciles to values based on cycle counts</td>
</tr>
<tr>
<td>Intercompany profit detail report</td>
<td>Reports intercompany profit at the level of general ledger line items</td>
<td>Provides detailed report that can be used for many purposes, including identification of shipments without receipts and ad-hoc analysis of results</td>
</tr>
<tr>
<td>Tax allocation report</td>
<td>Reflects cost allocation of intangibles and services across company codes, including transfer price and group cost</td>
<td>Provides detail support for cost allocation, markup basis and actual transfer prices</td>
</tr>
</tbody>
</table>

Using intelligent data to improve intercompany global pricing decisions and drive cost savings
Using intelligent data to improve intercompany global pricing decisions and drive cost savings
Questions?
Using intelligent data to improve intercompany global pricing decisions and drive cost savings

Ernst & Young
Assurance | Tax | Transactions | Advisory

About Ernst & Young
Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 167,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

Ernst & Young refers to the global organization of member firms of
Ernst & Young Global Limited, each of which is a separate legal entity.
Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit www.ey.com.

Ernst & Young LLP is a client-serving member firm of Ernst & Young Global Limited operating in the US.

About Ernst & Young’s Advisory Services
The relationship between risk and performance improvement is an increasingly complex and central business challenge, with business performance directly connected to the recognition and effective management of risk. Whether your focus is on business transformation or sustaining achievement, having the right advisors on your side can make all the difference. Our 25,000 advisory professionals form one of the broadest global advisory networks of any professional organization, delivering seasoned multidisciplinary teams that work with our clients to deliver a powerful and superior client experience. We use proven, integrated methodologies to help you achieve your strategic priorities and make improvements that are sustainable for the longer term. We understand that to achieve your potential as an organization you require services that respond to your specific issues, so we bring our broad sector experience and deep subject matter knowledge to bear in a proactive and objective way. Above all, we are committed to measuring the gains and identifying where the strategy is delivering the value your business needs.

It's how Ernst & Young makes a difference.

1305-1073445
ED 01-14

© 2013 Ernst & Young LLP.
All Rights Reserved
SCORE no.

©2013 by SAP AG. All rights reserved. SAP, R/3, SAP NetWeaver, Duet, PartnerEdge, ByDesign, SAP Business ByDesign, and other SAP products and services mentioned herein as well as their respective logos are trademarks or registered trademarks of SAP AG in Germany and other countries.