

Q&A



LEGAL ENTITY MANAGEMENT

Tackling legal entity issues before they become critical

Whether they were inherited through mergers and acquisitions or formed to meet specific financial and operational goals, legal entities accumulate quickly and the effects of an overly complex structure are often overlooked. Tax planning, legal requirements, and shifting regulatory demands also increase operational complexity and open the door for misstatements, incorrect application of trading models, missed filing deadlines, and duplicate legal entities.

Companies are becoming increasingly complex in order to meet the demands of the business and shareholders. Many organizations are looking for ways to minimize tax and trading model inefficiencies while maximizing legal protection and shareholder value. What is often overlooked in these schemes is the increasing cost and complexity that accounting and finance must deal with as a result of organizational development. Most organizations completely overlook the implicit increases in both costs and expertise that a finance organization should incur as a direct result of organizational complexity and complicated transaction structuring.

As organizations face growing pressure to streamline processes and tighten the purse strings, MorganFranklin recognizes the efficiency and cost savings that can be achieved through legal entity management. By actively managing legal entities and streamlining or eliminating transactions that no longer add value, organizations can reduce compliance and processing costs while also lowering their risk profiles. Instead of waiting for a crisis, businesses can obtain immediate benefits by proactively tackling legal entity issues before they become critical.

Benefits of Legal Entity Management:

- Reduce cost of compliance and reporting
- Reduce various administrative, governance, and compliance duties
- Decrease risk profile by managing a tightly controlled group of entities
- Simplify operations and implement process enhancements
- Eliminate costs associated with overdue filings, rework, and adjustments

Q How can I determine if my legal entity structure is creating issues?

Many businesses never identify legal entity management as a challenge in and of itself. However, the symptoms of a complex or out of control business model are easily identifiable. Being able to not only ring-fence the symptoms but also articulate the challenge and accurately diagnose the root cause will go a long way in resolving the issue.

Telltale signs that your legal structure or transaction flow is creating real issues include:

- Deferred tax assets, liabilities, and reserves are difficult to calculate
- Statutory filings are late and/or working through the information with the auditors is more time-consuming than expected
- Reconciliation between the various filings (consolidated reporting, statutory, tax) is extremely cumbersome or not possible
- Moving cash around the organization seems like reinventing the wheel each time

Over time, however, these factors may change and functionality that is sitting on the shelf may become a perfect solution to your problem. The challenge is relearning what your ERP package can do.

Q Why are my deferred tax assets, liabilities, and reserves difficult to calculate?

Deferred tax positions and provisions are a function of quantifying the timing differences between accounting records and tax returns. In determining the value of deferred amounts, it can be difficult to ascertain if some of the differences that exist are permanent or caused by timing. This issue becomes more complicated if the consolidated filing is done using one set of accounting standards (e.g., U.S. GAAP) while the local filing is done using another accounting standard (e.g., IFRS). Determining the value and correct period when the timing differences are cleared drives the deferred tax current and establishes long-term calculations.

If your company does not maintain clear legal entity books and records and prepare timely reconciliations between local and consolidated reporting, determining deferred tax positions can be difficult and risky. This issue is becoming even riskier for the management team, as more and more tax jurisdictions and filings require personal affidavits citing the accuracy and validity of the information in the return. Frankly put, amending tax filings is becoming more costly, which puts an emphasis on understanding the transactions and tax in order to book differences more thoroughly and completely.

Q My statutory accounts are often filed late. Why is working through the information with the auditors more time-consuming than expected?

Preparing and filing statutory accounts is a thankless job. Organizations do not typically have dedicated groups or personnel who ensure that these reports are filed in a timely manner. Firms that complete consolidated audits typically sign up for the statutory audits, however, they rarely use the same teams or resources to do both. Even more complicated is the fact that most companies manage their business product lines at the macro level rather than

at the legal entity level. Without legal entity level budgets, few global organizations can explain year-to-year P&L fluctuations at a legal entity level, let alone determine if the P&L swings make sense or are reasonable.

Statutory audits do not typically take high priority for auditors or internal resources, so if the information used to support the stand-alone entity is not clear and straightforward, there is often an endless e-mail volley of open questions, audit adjustments, and issues to be cleared. Answers to these questions only bring more questions—and worst of all, more fees, more expenses, and more delays.

Q Why is reconciliation between the various filings and external reports (consolidated reporting, statutory, tax) cumbersome and sometimes impossible?

Adjustments happen! They are part of reporting. Each external report has a different target audience and area of focus. The complexity around reporting ensures that adjustments are funneled back through the accounting process to the base data so that the adjustments and changes are corrected or considered in other filings. Failure to push adjustments back through the accounting records leads to disconnects and permanent differences that have the potential to create larger issues.

Good companies ensure that all filings can be reconciled back to the figures used for consolidated reporting. This requires proactive energy to capture, track, and record the adjustments that result from preparing the statutory accounts, filing the tax return, and truing up all the accrual accounts and provisions on a timely basis.

Another complexity that has become increasingly important over the past few years is understanding and fully supporting GAAP adjustments for local reporting. As IFRS and U.S. GAAP move toward one standard, local and consolidated GAAP differences should effectively disappear—and not create permanent differences or disconnects. You must be proactive and have an appropriate level of professional skepticism about GAAP differences that do not make sense or resolve themselves through timing.

Q Why does moving cash around my organization feel like reinventing the wheel?

Eleventh hour transactions never seem to go away. How many times has the late-night plan to resolve an issue ended up creating a dozen more headaches?

Does your organization have a transaction plan for funding operations? How about returning capital to the parent? Does your company have contingency plans in case of emergency?

If you're not already proactively thinking about these questions, it is likely that your company is not utilizing the most efficient method to move funds around the organization. Companies need to think about how to preserve capital. Often this means contemplating local tax rates and tariffs, cross-border charges, foreign exchange gains and losses, and bank fees. Becoming more proactive about how and when transactions or funding should occur can save significant dollars. There are no shortcuts to proactive planning.