Key performance indicators driving indirect tax value

Getting down to business with indirect tax

KPMG International

kpmg.com/indirecttax

Most global companies keep a close eye on metrics like the effective tax rate to monitor their performance on income taxes. But only a minority of them give the same attention to how they're performing where indirect taxes are concerned — which is a surprise given the huge amounts of working capital tied up in indirect tax processes. With tax authorities increasingly shifting their focus to consumption taxes like VAT, businesses are becoming more aware of the need to manage risk and ensure that they have robust indirect tax processes in place. However, even faced with these challenges, many indirect tax teams may be missing opportunities to prove their value and make the case for investment to improve cash flow, reduce costs, upgrade business processes and manage this risk.

Shift toward indirect taxes continues

Current trends suggest that the impact of indirect taxes will continue to increase. As competition for foreign investment intensifies, many countries are reducing their headline corporate tax rates and offering generous income tax incentives for intellectual property development and innovation. To replace revenues from taxes on profits, most countries are shifting their reliance to taxes on consumption and realizing the benefits of indirect taxes in delivering stable, sustainable and near-real time sources of tax revenue. Once India, China and the Gulf states have their value added taxes/goods and services taxes (VAT/GST) in place, over 160 countries (except the US) will have centrally administered indirect tax systems.

As part of this global shift, tax authorities are putting more priority on ensuring collections are thorough and complete, and they are investing heavily in electronic processes for collecting, analyzing and benchmarking taxpayers' indirect tax accounts and transactional data. Tax authorities are looking not only for accurate, timely filings but also for indications that organizations have effective management and governance in place.

With the coming wave of tax changes resulting from the global project to address tax base erosion and profit shifting, many companies are working to contribute to tax policy development so the needs of business are taken into account (see related article by KPMG Global Indirect Tax Services, *Don't underestimate BEPS' impact on indirect tax*[1]).

Income taxes remain top priority

While KPMG International research[2] shows this shift toward indirect taxation has been going on for more than a decade, most organizations have kept their traditional focus on the hard costs associated with income taxes. Effective tax rate is a widely used and recognized metric that is simple to calculate and benchmark against peers.

Few companies have set equivalent metrics for indirect taxes. In response to a recent KPMG survey,[3] only 25 percent of companies say their company has specific indirect tax metrics. Most of these measures relate to basic compliance, rather than activities that could improve the bottom line and drive cash flow improvement. Given that indirect tax involves the third largest cash flow of organizations (after sales and cost of sales), then senior management appear to lack visibility over the movement of large sums of money in and out of the business and assurance that they are being well managed. In this regard it is important to appreciate that we are not looking at the net payable or receivable with the tax authority but the gross indirect tax flows; that is VAT included in payments to vendors and receipts from customers.

Of those companies that do have metrics, the top two measures — timely and accurate submission of indirect tax returns and minimization of interest and penalties — are unlikely to affect the company's cash position. The third most important metric, rated by only 14 percent of respondents, is managing indirect tax cash flow, which is arguably the only one of the top three that could generate value for the organization by improving working capital.

[1] Don't underestimate BEPS' impact on indirect tax, KPMG International, 2016
[2] 2015 Global Tax Rate Survey, KPMG International, 2015
[3] 2015 Global Benchmark Survey on Indirect Tax and Trade Compliance, KPMG International, 2015

Breaking the vicious cycle

Without clear, commonly understood key performance indicators (KPI), indirect tax teams have a hard time measuring and demonstrating their worth and making a case for investment in new technologies and process efficiencies to derive value from indirect tax processes. Furthermore, indirect tax teams often struggle to effectively embed and execute controls to manage the risks associated with VAT. And without investment, a vicious cycle is created as indirect tax teams are unable to pursue opportunities to reduce costs, manage risk and add value.

Companies tend to allocate investment based on an expected return. Many chief financial officers, heads of shared service centers, and even some heads of tax have little knowledge of indirect tax matters, let alone the value it can bring or the risk that such a large throughput inherently carries. Clear measures and targets make it possible to quantify the value indirect tax teams bring and to succinctly communicate to stakeholders the added value that a certain amount of investment could produce.

Delivering against stakeholders' priorities — what matters most?

Thus the most powerful KPIs look beyond the indirect tax function to address what matters most to the organization and each of the indirect tax function's stakeholders. These KPIs are designed to deliver against stakeholders' priorities and to communicate how the indirect tax function can help drive the objectives that its stakeholders are measured by and are trying to achieve.

This approach involves identifying the KPIs of the organization, finance function and other business partners and determining where indirect tax can make a direct impact, recognizing that different stakeholders have different goals and needs.

For example, CFOs are motivated to improve the operating cash flow and may be inclined to invest in indirect tax people, processes and technologies that are projected to produce a quantifiable amount of cash flow savings. By contrast, heads of shared service centers (SSC) are often under pressure to reduce costs. They may respond well to a pitch, for example, that a certain amount invested in indirect tax technology and automation could reduce the SSC's head count by a certain percent. The trick lies in identifying a small set of fundamental KPIs that can show results that are compelling to a range of stakeholders.

KPIs for indirect tax will vary by industry. Different industries may at different times place an emphasis on certain matters over others. For example, financial services companies, which are often VAT-exempt and so unable to recover indirect taxes paid, are likely to focus on measuring cost reductions in the first instance. Companies in other sectors will be more interested in indicators that show the value of compliance efficiencies and improved recoveries through indirect tax planning.

Quality versus quantity — focus on what's 'key'

Indirect tax executives should strive to develop five or six performance indicators that line up with what the organization aims to achieve and show how the indirect tax team is supporting those aims. Having too many KPIs can cloud the bigger picture and lead to box-ticking instead of monitoring performance fundamentals and highlighting the dividends of change. A strong set of KPIs will focus on:

1. value and risk
2. efficiency and effectiveness
3. qualitative and quantitative measures.

The methodology that follows shows step-by-step how indirect tax teams can demonstrate the value they bring to the organization and build their case for investing in people, processes and technology. This methodology is based on the successes of indirect tax professionals with KPMG member firms worldwide in helping international companies developing performance evaluation systems for their indirect tax functions.

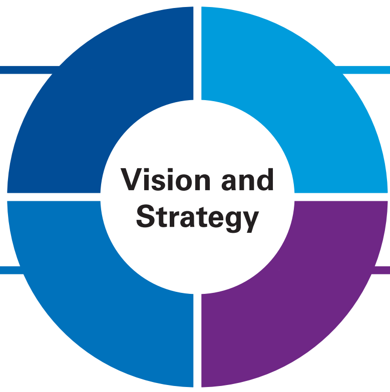
Defining KPIs: the strategic planning methodology

KPIs

Measure progress against strategic objectives and goals

Objectives

Set by function and aligned to corporate vision



Strategies

To close gap between goals and performance

Goals

Top down to drive achievement of functional objectives

Source: KPMG International, 2016

Defining KPIs: the strategic planning methodology (cont.)

1. **Review vision and strategy:** Start by examining the overall vision and strategy of your organization and function (e.g. finance) and how your indirect tax function can support them. What aspirations are driving your indirect tax team's performance? For example, your team's vision might strive to be 'brilliant at the basics' on one hand while delivering 'strategic value' to the organization on the other.

2. **Identify objectives:** The next step is to identify the functional levers that can directly affect the indirect tax team's ability to achieve or support the achievement of this vision. What objectives would bring you closer, for example, to being "brilliant at the basics"? Appropriate objectives could be:

   — running an efficient, cost-effective indirect tax function

   — paying the right amount of tax on time

   — meeting group and statutory requirements

   — being an effective business partner.

   Objectives that could boost your team's delivery of strategic value might include:

   — optimizing indirect tax cash flow

   — minimizing irrecoverable indirect tax across the global business

   — managing indirect tax risk across business processes

   — influencing and contributing to indirect tax policy.

3. **Goals:** For each objective identified, you can then outline how the objective would be achieved. In order to run an efficient, cost-effective tax department, for example, a goal could be to maximize the efficiency of the indirect tax return preparation process. In order to influence and contribute to indirect tax policy, a goal could be to increase participation in the work of industry associations and working groups.

4. **KPIs, targets and strategies for achieving them:** The final steps involve setting KPIs with clear targets that will allow you to assess progress toward achieving specific goals. As an objective measure of your organization's efficiency in preparing indirect tax returns, the KPI could look to the number of returns prepared per full-time employee (FTE) currently and set an aspirational target for increasing that number by a certain amount (e.g. 14 per FTE). A more qualitative example is to build sustainable relationships with stakeholder in a coordinated fashion through KPIs that would look at measures such as successful execution of an indirect tax communications plan. Of course, setting KPIs won't generate value on its own. You'll also need to identify a strategy that bridges the current and target states and provides a road map for realizing each KPI's target. A strategy for improving the productivity of indirect tax return preparers could involve increased use of technology for indirect tax processes. Increased technology use could also form part of a strategy for influencing indirect tax policy, by freeing time that would otherwise be spent on compliance for more strategic work.

Mix qualitative and quantitative measures for a better view

Having a mix of qualitative and quantitative metrics is important for achieving a well-rounded view of an indirect tax function's performance. Quantitative measures provide a concrete, objective means of determining base levels and setting clear targets. For example, the value of the efficiencies in indirect tax return preparation can be quantified in terms of wages saved as a result of the FTEs' greater productivity or cash savings identified.

Qualitative measures round out the picture by enabling more subjective evaluation of indirect tax activities. For example, net promoter scoring could be used to gain internal customer feedback on the indirect tax team's effectiveness as a business partner, and polling committee chairs and members through interviews and questionnaires can help evaluate the impact of efforts to influence government policy.

Regardless of the nature of the KPI (i.e. qualitative or quantitative) it is important to strive for hard targets around softer goals which may be slightly less structured to ensure the ability to show progress.

Monitoring, analysis and continuous improvement

In addition to identifying your KPIs, you need to build a process for collecting data, assessing your progress against them, and evaluating your KPIs' effectiveness in producing useful information and driving better performance. KPIs can quickly become meaningless without a strict governance policy for monitoring, analyzing and improving them. KPIs should be reviewed and updated regularly as the business, economic and regulatory environment and other variables change.

Consider engaging third-party advisors to help guide your KPI-setting process. If you are at the beginning of the process, external advisors can help you review what measures are in place and define what measures are needed to track progress toward achieving objectives, and suggest generic KPIs and leading practices specific to your industry that can be tailored to your activities. If your indirect tax organization already has performance measures in place, third-party advisors can help you assess whether refined or new KPIs could present a clearer view of what's working well, where improvements are needed, and whether additional investment could reduce costs or add value.

Many organizations are only just beginning to set a framework to derive real performance improvement in global indirect tax management. Measurement drives performance and informs leadership of the effectiveness of the indirect tax function. Realizing these benefits in practice requires a clear focus on the most critical KPIs and how they can be improved within the business over time.

By engaging widely within the organization to identify key business objectives and future direction and by helping the organization deliver on its goals, indirect tax teams will have a stronger voice in strategic decision making and build their profile as valued business partners.

Contacts

Tim Gillis
Head of Global Indirect Tax Services
KPMG in the US
Partner
T: +1 202 533 3700
E: tgillis@kpmg.com

Authors

Gary Harley
Head of Indirect Tax Services,
KPMG in the UK
Partner
T: +44 77 8872 8683
E: gary.harley@kpmg.co.uk

Emmie Nygard
Senior Manager
KPMG in the UK
T: +44 20 7311 3643
E: emmie.nygard@kpmg.co.uk

kpmg.com

kpmg.com/socialmedia

kpmg.com/app

Download on the App Store

Designed by Evalueserve.
Publication name: Key performance indicators driving indirect tax value
Publication number: 133702-G
Publication date: July 2016