Spotlight: Defining Success

What KPIs are driving the Tax function today?
Welcome to our second publication of *Tax Function of the Future – A Focus on Today*, a new series that spotlights topics relevant to Tax with a focus on what Tax needs to do now to operate successfully in an increasingly complex tax and business environment.

The Tax Function of the Future series predicts challenges and offers solutions that Tax functions may face in the future. Prior papers presented insights on new legislative and regulatory challenges and the resulting impact on risk management; discussed the need for Tax to focus on data analytics and to play an integral role in broader Finance transformation initiatives; highlighted the importance of enhancing income tax reporting processes; and examined critical and rapidly emerging trends for Tax—the robust and expanded use of enterprise performance management (EPM), business intelligence (BI), analytics tools and capabilities, and Robotic Process Automation (RPA). Our most recent publication discussed important predictions related to the Tax professional of the future—focusing on the need for Tax professionals to stay relevant, adapting to changing times and the requirement for technology and other expanding skill sets. For more information on our predictions for the Tax Function of the Future, please visit [www.pwc.com/taxfunctionofthefuture](http://www.pwc.com/taxfunctionofthefuture).

In this paper, we invite you to pause and reconsider what success means for your Tax function. How should success be measured? We will explore established as well as new, innovative key performance indicators (KPIs) that organisations can use to evaluate how well the Tax function is performing in today’s environment. We also will provide examples of KPIs that may be relevant for specific activities or tax function areas, including corporate and indirect taxes, transfer pricing, and deals/corporate transactions. Finally, we will explain how to get started on a path to defining and measuring success for Tax.
Defining Success

Tax and Finance leadership may have different ideas about what constitutes success for Tax. In part, this ambiguity is because Tax is a broad and complex function that spans direct and indirect taxes and includes controversy, compliance and financial reporting, and transfer pricing, with numerous tax administration stakeholders at global and local levels.

Although Tax functions may have different areas of focus at various points in time, it is important to identify the key factors that will be measured in determining success. Without this high level view of what is important – key success factors – it is difficult for Tax to establish the right objectives to achieve and to convey value within the organisation.

Key success factors for Tax

By any definition of success for Tax, certain factors are important in determining the effectiveness of the function. These broad considerations are the basis on which Tax should establish benchmarks and objectives that can be measured. Key success factors for Tax are the following:

- Tax cost
- Tax risk (financial and reputational)
- Efficiency and effectiveness
- Sustainability.

Cost Risk Efficiency and Effectiveness Sustainability

Understanding these success factors and associated KPIs is essential for defining and measuring Tax’s success. Some KPIs are well known and have been used by Tax for many years; however, as times change and requirements for the function become more complex, Tax must re-evaluate its measures and consider nontraditional ways of gauging performance. Furthermore, some KPIs may apply more directly to certain tax areas (e.g., indirect tax, transfer pricing, and corporate transactions) than to others.

Based on a 2016 PwC global survey, the three most important measures of performance of the tax function are:

- Tax risk management (1st)
- Management of the effective tax rate (ETR) to reduce the rate (2nd)
- Management of the ETR to ensure a sustainable long-term ETR (3rd).

Finance should be positioned as forward looking, versus looking through the rear view mirror. KPIs are crucial because in an environment of restricted budgets, these measures provide clarity on what’s important, if designed in a way that is consistent with an organisation’s strategy.
Tax KPIs

Let’s examine highlights of each success factor along with specific examples of related key performance indicators.

Managing tax cost

Seeking to minimise the financial statement tax impact has always been a goal of the function; therefore, much attention is directed to the income tax provision – often one of the more significant items on the income statement. It is becoming increasingly clear, however, that there is a relatively large tax cost associated with other direct and indirect taxes, including property, sales and use taxes, goods and services tax (GST), and value added tax (VAT). Which KPIs should the Tax function use now to measure its effectiveness in managing tax cost?

Effective Tax Rate (ETR)

The ETR remains the primary KPI for Tax as it is prominent in financial statements and is the most apparent measure of how well the organisation is managing its tax cost. In evaluating success using the ETR, organisations should measure against a benchmark for their industry as standards differ, particularly for those operating globally.

The ETR could also be tied to measures of process and technology enhancements. For instance, Tax functions having a focus on technology enhancements to enable better quality data can support tax positions and avoid audit adjustments that directly impact the ETR.

Cash taxes

There has been attention in recent years not only to evaluating financial statement tax impact, but also to considering the actual cash expenditures that affect an organisation’s cash position. For this measure, Tax should evaluate indirect tax cost in addition to direct tax expenditure due to the significant volume of transactions and payments being made to multiple taxing authorities. Is the correct amount of property tax being paid based on assessed value? Are there overpayments of use tax or VAT? Specific indicators may include:

• Total taxes paid versus forecast provided to Treasury
• Tax prepayments as a percentage of income tax liability or pre-tax book income

PwC predictions

• Many jurisdictions will legislatively require the adoption of a tax control framework that follows guidelines similar to Sarbanes-Oxley and COSO (Committee of Sponsoring Organizations of the Treadway Commission).
• Enhanced stakeholder scrutiny and reputational risk will force companies to continuously re-evaluate their tax decisions.
• Strategic focus on jurisdictional reporting and documentation of business activities, including transfer pricing, will be critical to managing the increased tax controversy resulting from transparency initiatives.
What measures should Tax use now to measure risk?

**Financial**

The financial measurement of risk is a typical approach for Tax as these metrics are readily available and impact earnings per share (EPS) and other broader financial measures.

Traditional measures include:
- Increase or decrease in reserve for uncertain tax positions
- Increase or decrease in non-income related reserves such as use tax
- Frequency and magnitude of audit adjustments.

**Reputational**

Concerns around corporate image and reputation continue to surround the Tax function. Negative press or any public mention of an organisation’s tax positions may cause damage to brand with financial consequences to the business.

In addition, the public’s focus on “tax morality” is growing. Is the organisation perceived not to be paying its fair share of taxes despite abiding by the law? To proactively prepare for these challenges and appease internal and external stakeholders, Tax should develop measures for potential reputational risk. These could include:
- Frequency or lack of public statements or concerns pertaining to the organisation’s tax positions
- Measures of Total Tax Contribution (TTC) by country or globally—total direct and indirect taxes paid and other contributions to society, including job creation.

**Quality and controls**

KPIs that identify whether there is excessive risk or failure of controls and that could affect other success factors (cost, efficiency/effectiveness, sustainability) include:
- Magnitude of return to provision adjustments
- Levels of late filing or error penalties

**Managing efficiency and effectiveness**

To be successful in this increasingly complex environment, Tax should seek to flawlessly execute the tax lifecycle. The KPIs deployed will need to assess whether technology, processes, and people are working well together, efficiently and effectively delivering desired results.

**Technology and related processes**

Is Tax making the best use of internal or external technology to access data or perform required tax activities? With the emergence of artificial intelligence...
and machine learning capabilities such as Robotic Process Automation (RPA), Tax should consider whether its current technology and related processes are now the most effective and whether the Tax function is keeping up with the broader organisation in such technology enhancements.

Measures of Tax’s use of technology for efficiency and effectiveness could include:
- Frequency of process and technology enhancements
- Levels of adoption of existing enterprise technology for Tax
- Levels of technology training
- Level of innovation – technology applied to effectively enhance existing processes.

Tax needs to revisit the way it operates. Finance and other enterprise functions are embracing the shift toward shared services, centers of excellence (CoEs), and managed services. These operating models, as well as co-sourcing or outsourcing of compliance, have the potential to streamline operations and reduce overall cost.

A related consideration is whether higher-paid employees are properly matched with higher-valued activities. Are higher-risk activities aligned to higher compensation cost? Is Tax working effectively with other enterprise functions in other areas – sharing information, demonstrating value, and leveraging technology and resources? 

Collaboration with the enterprise while leveraging an effective operating model could lead to overall organisational efficiencies. In addition, organisations that are performing efficiently are more likely to be agile and ready to handle change.

Measures used to monitor Tax organisation process efficiency and effectiveness could include:
- Level of participation in Finance/enterprise shared service or CoE structures and outsourcing arrangements
  - Number of full-time equivalents (FTEs) — corporate versus shared services
  - Measure of office space utilised by Tax relative to other Finance functions
  - Number of dedicated Tax FTEs versus third-party service providers
- Amount of time spent on compliance and financial reporting versus strategic activities
  - Amount of time and supplemental spend required to implement major tax or regulatory changes, e.g. BEPS
  - Amount of time and supplemental spend required to integrate significant acquisitions
- Total operating cost relative to other enterprise functions and budget
- Level of Tax involvement in the business (number of resources assigned to/embedded in the activities of the business).
The example below describes actions taken by a Tax organisation to improve efficiency and effectiveness through collaboration with other functions. Availability and adequacy of such processes to pro-actively build relationships, share information, and gain business insights beyond the Tax function is a KPI that should be deployed and closely monitored.

**Example of cross-functional collaboration**

**Background**

A US-based business (the “Company”), with an extensive portfolio of on-line travel brands and over 200 travel booking sites in over 75 countries, has experienced significant M&A activity over recent years which necessitated significant collaboration across functions and geographies.

**Actions and benefits**

The Company’s Tax team took the lead to build robust collaboration processes that facilitate good working relationships with its internal business partners, including travel brands, Legal, Treasury, and Procurement. A “Tax Awareness” process was implemented to help business units understand tax considerations for their brand or function, and when Tax should provide input. Key actions taken include:

1. Developing a presentation that describes the Tax organisation, its activities, and how Tax can help the business. This presentation was shared with key business units to initiate the education process.

2. Assigning a Tax business partner lead for each business unit to serve as a trusted advisor, engage with the business, understand its objectives and activities, and provide tax insights.

3. Initiate and lead periodic cross-functional meetings with the business leaders to stay abreast of business developments and provide relevant tax updates. Legal, Treasury, Accounting, and other functions are invited to provide input depending on the topic agenda.

Robust collaboration processes allow the Company’s Tax organisation to be efficient, and proactively look forward rather than back with quick access to information needed for planning, contemporaneous documentation, and decision making.

“Success for Tax is about embracing an inclusive culture and a connection to the business that is understood all the way through the organisation. This alignment with other functions will provide access to the right information needed to meet objectives.”

—PwC Tax professional
A closer look

**People**

As highlighted in our recent publication, *The Tax Professional of the Future, Staying relevant in changing times*, people are an organisation’s greatest assets. Without measures in place to monitor and address the evolving needs of the workforce, it is doubtful that an organisation could operate as efficiently and effectively as it should.

The considerations related to people and performance are broad, ranging from the sourcing/hiring process to training and development, rewards and recognition, and career progression. The effectiveness of Tax leadership should be measured based on ability to interact with and influence the overall business, successfully execute a strategy for Tax, and attract, develop, motivate, and retain diverse skilled talent.

Possible measures related to people include:

- Levels of job satisfaction and engagement based on employee surveys
- Level of reward and recognition
- Employee turnover in Tax relative to overall corporate turnover
- Existence of formal and relevant training (tax technical, technology, soft-skills/relationship, communication, process improvement, and project management)
- Quality and availability of development programs (cross-functional rotations, mentoring)

**Sustainability**

The process of defining KPIs and measuring performance against them will be minimally useful if success is achieved only in the short term. The challenges that Tax faces are likely to become more complex; therefore, defining success with an intention to sustain performance into the future is the preferred approach. As such, diligence is required in carefully monitoring KPIs and making the necessary adjustments to operations. The KPIs themselves should be evaluated on a periodic basis to ensure that they are in fact appropriately measuring the factors that drive success for the function.

An approach to measuring sustainability is to set longer term objectives (3-5 years as an example), adjusting measures as appropriate during this time frame, and looking back to measure sustainability over the defined period. Examples of KPIs that may work well for longer-term measures of sustainability include:

- The ETR—ability to sustain the targeted rate over defined period
- Risk—number of audits closed and significance of assessments over time
- Number of Advanced Pricing Agreements (APAs)
- Technology—ability to deliver planned technology innovation
- Efficiency/Cost—ability to sustain targeted cost reductions while maintaining or improving quality
- Job satisfaction/engagement—ability to sustain targeted improvements over defined period.

Now, tax authorities are focused on transparency and the substance of a company’s tax structure and affairs; therefore, heads of Tax need to think about what the business needs and engage in the practicality of getting things done. For this to work, the head of Tax has to be interested in a lot more than perhaps historically expected.

"Years ago, the CFO’s quarterly and annual agenda was always “no surprises and a low tax rate”. In recent years, the pendulum has swung to risk and other success factors. Organisations are increasingly looking for certainty and sustainability,"

— PwC Tax professional
Below are examples of KPIs that may be applied to specific Tax function areas.

**Indirect taxes**

Because of the high volume of transactions related to indirect taxes, specific measures can be used to determine effectiveness. Are sales tax, GST, or VAT collected and remitted appropriately? Is the correct use tax being paid? Indicators of performance in this area could include:

- Number of Accounts Payable holds
- Number of customer tax-related complaints
- Number of sales or use tax account adjustments (based on reviews/assessments).

**Transfer pricing**

Similar to indirect taxes, transfer pricing is transactional, requiring analysis of volumes of data. Also, it is especially prone to controversy and risk since intercompany pricing is routinely challenged by taxing authorities. As organisations seek certainty with respect to tax positions, effectiveness in transfer pricing can be measured by the number of audits and the magnitude of adjustments in addition to:

- Level of innovation pertaining to transfer pricing analytics
- Number of APAs.

**Corporate transactions**

There is much at stake when organisations engage in corporate transactions. Mergers or acquisitions require involvement from all functions before and after the transaction closes. What measures (including ETR and cash flow) should Tax use to assist with the identification of potential targets? Is Tax assisting with due diligence and structuring to identify risks and to facilitate the most efficient result from a tax perspective? Measures of Tax’s performance pertaining to deals include:

- Tax’s level of involvement and relationship with Corporate Development and other business functions
- Level of disruption pertaining to Tax activities after the deal closes (target should be no disruption on Day 1)
- Level of synergy capture based on predetermined targets.

“Tax needs to understand the tax consequence of an activity before the business does anything, understand the tax consequence of what the business actually does, and report the tax obligation correctly—all with quality data.”

— PwC Tax professional
Below are examples of traditional and nontraditional KPIs. Tax should evaluate which measures work best to achieve objectives.

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<th>Nontraditional Measures</th>
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<td>Management of reputational risk /Measures of TTC</td>
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<td>Participation in Finance/other shared service centers or centers of excellence</td>
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<td>Magnitude of tax savings against target</td>
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A closer look

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Establishing a tax strategy

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**Tax should define the “tax strategy”—this is different from a supporting mission statement or goals and objectives developed to operationalise the strategy.**

**Secure stakeholder buy-in**

Establishing a tax strategy that addresses key success factors aligned to the organisation’s goals ensures that all key stakeholders are on the same path. Tax should engage internal stakeholders such as Finance, IT, and other impacted enterprise functions in developing its strategy and should seek C-Suite and key stakeholder buy-in prior to execution. Securing stakeholder agreement is critical to demonstrating Tax’s value and achieving ultimate success.

**A strategy drives performance for Tax. It is needed so that all functions are on the right path and achieving the overall goals for the organisation.**

**Align with business strategy**

Implementing key performance indicators and measuring success achieved in key areas is an important aspect of defining success for Tax; however, establishing and meeting annual goals and objectives is not enough. Tax first needs to establish a comprehensive strategy for the function that is aligned to the overall organisation’s strategy. Based on the business’ objectives, Tax can make decisions that focus attention more directly on the key factors that best drive success within the scope of the organisation’s overall strategy.

**Associate appropriate KPIs**

With a strategy in place, Tax should assess processes and existing measures to ensure ability to determine performance and success in the areas identified. KPIs implemented should be clearly defined and, where possible, objectively driven by metrics.

**Engage the Tax professional**

An approved Tax strategy should not remain only with Leadership. All of Tax needs to be engaged, understanding the overall

business strategy, its impact on Tax strategy, and their specific roles in achieving success for the function and the organisation. Each Tax professional should have goals and objectives that represent individual measures of the key success factors that drive value for the function.

**Tip**

If reducing ETR is a key area of focus, assign Tax teams and individuals specific tax savings goals.

**Monitor and adjust**

Adapting to change is essential in this environment. Tax needs to stay close to the business, understanding trends and transactions that will impact its strategy. The ability to be nimble in evaluating modifications and executing change is perhaps even more important. Data analytics and visualisation technology tools are now available for Tax to facilitate efficient analysis of data to assess performance.
Tax’s role in the organisation is becoming increasingly complex. Success will not happen by chance. Tax needs to be proactive and disciplined in ensuring that it focuses on what matters to the business now. A strategy for Tax needs to be developed with the input and buy-in of internal stakeholders, and with KPIs implemented and carefully monitored to ensure success.

In evaluating performance against established KPIs, Tax may find that changes are needed in the way the function operates. KPIs may help identify whether, in this rapidly changing environment, the Tax organisation’s operating model is still adequate in meeting the needs of the function and overall business.

“Over the years, the drivers of success have changed. There is more focus on cash today than there was in the past. Cost efficiency has come into hyper-focus due to corporate transactions. Priorities can shift even with a long-term strategy in place. Tax needs to be aware and ready to adapt.”

— PwC Tax professional (former member of Tax leadership at GE)
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