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Finance's role in Pillar Two enablement

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As international tax regulations evolve, chief accounting officers (CAOs) are central to implementing Pillar Two of the Organization for Economic Co-operation and Development (OECD) and Base Erosion and Profit Shifting (BEPS) initiative within their organizations. This implementation requires a shift in operational models regarding legal entity reporting and calls for robust cross-functional collaboration. Addressing these challenges and developing action strategies are crucial steps for CAOs in fostering organizational compliance and adaptation.

In a recent webcast, *Finance's role in Pillar Two enablement*, a panel of KPMG specialists highlighted the wide-reaching impact of Pillar Two on the finance and accounting functions of organizations, urging timely assessment and a cross-functional approach to compliance.

Panelists discussed the following topics:

- An overview of Pillar Two
- CAOs readiness for Pillar Two
- Implications for finance and accounting
- A roadmap for accounting

An overview of Pillar Two

Pillar Two forms part of the OECD's initiative to address tax challenges arising from the digital economy. Its primary target is multinational enterprises with annual consolidated revenues exceeding 750 million euros. The initiative involves implementing a global 15 percent minimum tax, and the two-pillar solution addresses issues related to BEPS. With the model rules launched in December 2021, further guidance continues to roll out.

Three methods of achieving the policy objective under Pillar Two are:

- Qualified domestic minimum top-up tax allows the local authority to ensure it can collect any type of tax that is owed as a result of the Pillar Two initiative on their local operations.
- Income inclusion rule (IIR) rule allows a direct or an indirect parent of an entity to collect the top-up tax if the effective rate of tax as measured under the Pillar Two rules is less than 15 percent in the jurisdiction where the entity is located, and if that jurisdiction has not enacted a local minimum tax.
- The undertaxed profits rule (UTPR) in Pillar Two allows jurisdictions to collect additional taxes on profits from entities not fully taxed under the IIR.

CAOs readiness for Pillar Two

A recent survey among CAOs and high-level executives from various multinational entities revealed key insights into awareness and readiness regarding Pillar Two.

The KPMG survey found that while over a third of respondents were heavily involved in Pillar Two compliance, a significant two-thirds were at varied stages of understanding or even were completely unaware of these new measures. CAOs are concerned about handling intercompany transactions, the implementation of multilateral strategies, and managing jurisdiction-level financials.

Additionally, less than 10 percent of respondents felt thoroughly prepared for Pillar Two. The survey calls for enhanced awareness and preparation, and proactive measures to address Pillar Two requirements.

Implications for finance and accounting?

The global shift in tax, triggered by the Pillar Two initiative, significantly impacts the finance and accounting functions of organizations. The initiative requires a thorough understanding and strategic actions for timely compliance with Pillar Two.

Cross-functional approach: Building a cross-functional team is vital for strategically handling the implications of Pillar Two. This collaborative approach helps ensure comprehensive understanding and effective management of jurisdictional impacts, regulatory compliance, and challenges such as legal entity rationalization and country-level consolidation.

Emphasis on accurate calculations: Accurate calculations are essential for Pillar Two compliance related to BEPS initiatives. A gap analysis can help identify data needs and system development, or dedicated enterprise resource planning ledgers may be necessary for effective data management.

Understanding stakeholder roles: Implementing Pillar Two demands significant inputs from varied stakeholders. The legal team plays a pivotal role in maintaining organizational charts, which are critical for implementing the IIR. Emphasizing transparency and accurate information sharing across jurisdictions is also essential.

Addressing operational challenges: Pillar Two initiates changes in operational processes including ledger recording, accessing adjustments, and consolidation needs. Understanding its impact on operational models across processes, data, technology, people, and governance aids in devising effective strategies.

Impact on controllership function

Parent entity GAAP and local GAAP: Pillar Two requires companies to understand net income at the parent entity level. A significant shift entails converting local GAAP to the parent's GAAP for each jurisdiction at the legal entity level, irrespective of materiality.

Consolidation and aggregation at country level: Country-level consolidation and aggregation, including the unraveling of intercompany transactions and enabling jurisdiction-level eliminations, pose significant challenges for many businesses.

Pushing down topsides to entity level: Pushing topside adjustments to the legal entity level within a jurisdiction is vital as it influences net income and ultimately the calculation that could potentially impact actual cash flow.

Record-to-report lifecycle: Capturing new data points at transaction inception, including purchase accounting and pension accruals adjustments, is vital. Here are the effects of Pillar Two's record-to-report lifecycle:

- **Subledgers:** Fixed assets subledger and local tax books hold key data points, playing a crucial role in Pillar Two reporting for statutory requirements.
- **General ledger**: Accurate Pillar Two calculations, based on specific general ledger balances, rely significantly on the processes and technology used for recording statutory transactions.
- **Financial consolidation**: Effective Pillar Two reporting requires appropriate topside adjustments and filling the prevalent gap in companies' ability to aggregate and consolidate data at a country level.
- **Period-end reporting:** To ensure aligned and accurate financial reporting for Pillar Two, calculations based on statutory balances must be completed early, potentially involving local auditors in the process.

Impact on the accounting operating model

Pillar Two may significantly alter different facets of an organization's accounting operating model. This includes changes across the following areas:

- **Process**: To accommodate Pillar Two, changes or additions may be necessary in the processes for generating legal entity reporting in the general ledger, handling intercompany transactions, and accessing particular adjustments such as purchase accounting and pension accruals.
- **People and service delivery model**: With Pillar Two, cross-functional collaboration becomes critical. It's crucial to understand who within the organization is primed to perform the work and how different departments can collaborate to meet its requirements.
- **Data and technology**: To meet Pillar Two requirements, prioritizing reliable and sortable data quality is crucial. Understanding data sources, employing the right technology, and performing a data gap assessment to identify and close gaps are key for compliance.

A roadmap for accounting

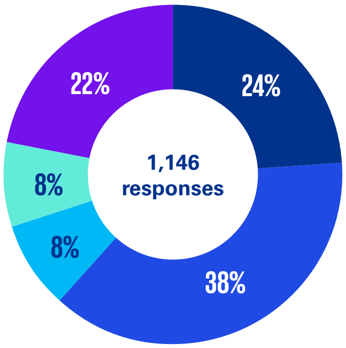
Potential actions that organizations must consider while determining the next steps for accounting operating model include:

- **Process adjustments**: Start by assessing process gaps in your existing financial and accounting practices. Identify changes needed to facilitate legal entity reporting, manage intercompany transactions, and access crucial adjustments in the general ledger.
- **Legal entity rationalization**: Consider embarking on a legal entity rationalization project. Simplifying the legal entity structure can help to manage jurisdictional compliance more effectively.
- **Documentation development**: Create detailed process documentation, especially for local teams, outlining how to access necessary data and perform key tasks for calculations and reporting.
- **Governance approach**: Enhance your governance approach by forming a cross-functional committee. Form a committee comprising representatives from tax, finance, accounting, IT, and legal departments to ensure a coordinated approach to Pillar Two reporting.
- **Data gap assessment:** Start with a data gap assessment to understand what data is currently available, where gaps may exist, and how to fill those gaps. This will be invaluable in informing the data strategy and ensuring you can meet the new reporting requirements.
- **Technology and data management**: Given the increased data requirements, reviewing your present technology is an essential action. Assess if your current technology can oversee Pillar Two's increased data load, support automation, and ensure data quality and security.

Navigating a strategic future

In addressing Pillar Two compliance, CAOs should lead a cross-functional effort involving tax, IT, legal, and accounting teams. This approach should encompass managing country-level consolidations, adjusting topsides down to the entity level, and harmonizing financial reporting standards across various GAAPs. Enhancing data strategies and refining financial systems and processes are also critical to provide accurate information for Pillar Two calculations, thus ensuring the organization's preparedness for future regulatory requirements.

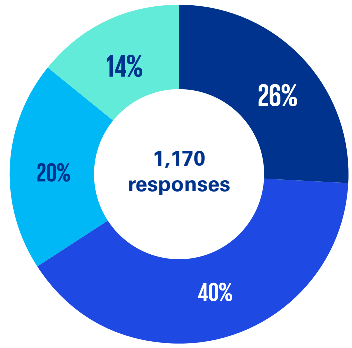
In which phase of the assessment stage is your organization?



- Aware of the rules
- Beginning to understand
- Completed an assessment
- Identified implications
- Other

Note: Percentages may not total 100 percent due to rounding.

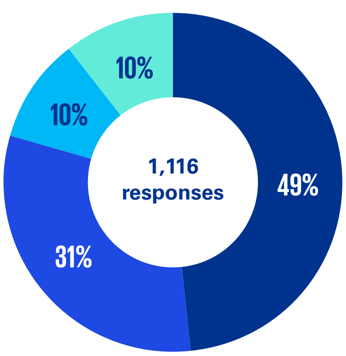
Is your organization considering a cross-functional team to support meeting Pillar Two requirements?



- No, Tax is predominately driving
- Unsure
- Yes, multiple teams outside of Tax are helping to support
- Yes, the Accounting team is looped in and supporting, but it is just the Accounting team

Note: Percentages may not total 100 percent due to rounding.

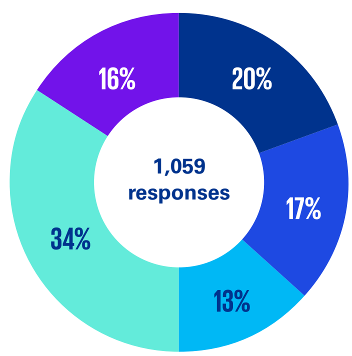
Does the Accounting team in your organization have a clear understanding of how they will help to support Pillar 2 enablement?



- Not yet
- Somewhat, we have talked about it at a high-level
- Yes, we know what the Tax team specifically needs from us, and we know how to get the information
- Yes, we know what the Tax team specifically needs, but are unsure how we will obtain the information

Note: Percentages may not total 100 percent due to rounding.

Which area of impact for represents the biggest challenge for the Accounting team at your organization?



- Consolidation & Aggregation at a country level
- Control environment & disclosures
- Getting to Net Income in Parent Entity GAAP & Local GAAP
- Other
- Pushing topsides down to entity level

Note: Percentages may not total 100 percent due to rounding.

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