Centralized & Streamlined; A Modern Approach to Intercompany Transactions

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Why BlackLine's Intercompany Hub is Imperative for Financial Automation

Introduction

It is one of the most time-consuming and burdensome tasks confronting Finance & Accounting, a responsibility that has grown as companies extend their global footprints. Few manual exercises are as demanding or as taxing, and in many organizations, more than 100 people are responsible for its completion. The "It" is intercompany transaction accounting, reconciliation and settlement.

Intercompany transactions—internal transactions between two or more associated companies that file a consolidated tax return or financial statement—are the primary consumer of both cost and time within Finance & Accounting. From a reporting standpoint, the process is rife with human errors, especially for businesses with immense data volumes, non-standard procedures and insufficient automation.

In this era of globalization, the volume and complexity of intercompany transactions have increased immeasurably. Different entities within organizations often produce hundreds of thousands of transactions in different ways using diverse systems that entail disparate processes. With entities located across the world, transactions typically involve a wide range of currencies and tax treatments. Using multiple ERP, general ledger and other systems, transaction settlements are disconnected, fostering out-of-balance positions that are material to financial statements.

Revolutionary automation is now at hand to standardize, systematize and control intercompany transactions, freeing Finance & Accounting from the time expended in these arduous pursuits to put their intellectual capital to more strategic finance needs.

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PART 1

Misery Compounded

Let's take a look at the abysmal condition as it now exists in most companies with regard to their labyrinth intercompany transaction accounting, reconciliation and settlement processes. Leveraging a real example, the company is a large, U.S.-based global manufacturer and distributor of beverages, with more than 1000 entities worldwide selling its products across numerous country borders.

Altogether, these various entities have a range of general ledgers, work on several ERP systems, use different currencies and are subject to dissimilar value-added tax (VAT) laws (in Europe) and treatment. Not all the entities are permitted to conduct business with each other; as in most organizations, intercompany transactions are bound by an array of strict internal governance rules.

During the course of business, the following intercompany transactions occur:

- The New York office transfers money to the London office for payroll purposes.
- The Munich office absorbs some IT expenses that need to be shifted to the New York office for reimbursement.
- The London office transfers a consultant to the Los Angeles office at a paid rate of 100 pounds per hour for a period of one month.

These intercompany transactions are complicated from a reconciliation standpoint by several factors. For instance, some of the entities are wholly owned subsidiaries, but not all. Say several European entities are wholly owned. This creates challenges for their intercompany transactions because in certain European countries a VAT is due on the transaction, whereas in others this is not the case.

Since Finance & Accounting is responsible for reconciling, netting and settling the various transactions, problems ensue. Chief among them is getting all the transaction counterparties system-wide to agree to the actual cost of the transaction, the currency translation values and variances, and the VAT and royalty issues. Enormous complications arise because there are no standard processes, however.

For example, let's imagine that the transacting entity in Munich booked a particular transaction amount in its system using euros, while the counterparty in New York booked the same numerical amount, albeit in dollars—100 euros versus 100 dollars. At the end of the month, the intercompany transaction amounts will be out of balance; they will not net to zero. Significant tax exposures from the open balance are sure to thwart the financial close-to-disclose process.

Here is another all-too-common situation, this one involving IT expenses, an intricate type of intercompany transaction because IT generally supports the entire organization through corporate. In other words, the company bills each of its entities for the overall cost of IT, based on their respective usage. There is a problem, however—the organization has 300 people staffed in IT, ten residing in the Munich office. While three percent of the cost would normally be allocated to Munich, there are complications—the business also has a data center in EMEA populated by people who are ostensibly IT professionals, but do less work and have fewer responsibilities than traditional IT staff engaged in more labor intensive work.

Munich now has requested that the New York office reimburse it for additional IT expenses. Despite the rules in place governing IT needs, there is no way to police how much each entity should receive and actually does receive. Without standardization and an automated rules engine, Finance & Accounting must sort through all the intercompany transactions after the fact, rather than the far more prudent method of handling these requests at the front end.

At the same time that Finance & Accounting is in the thick of this spadework, they also are sifting through intercompany transactions involving the recruitment of one entity's consultant by another entity. The Los Angeles office has retained a consultant from the London office. The requester normally would go through the various validation and workflow approvals required by the company, but neglects to put in the effort this time. This is more common than one would think—many executives still perceive intercompany transactions as a form of borrowing—moving money merely from the left pocket to the right.

Unfortunately, the requester actually is not permitted to recruit a consultant from London. This is not discovered until Finance & Accounting detects this error of judgment in the journal entries that the counterparties created in their respective systems. All the previously-stated challenges—agreement on the consultant's fee, currency translation variances, and royalty and VAT issues—now come into play, requiring after the fact remediation.

Let's look now at the problems created when a company has multiple, disconnected general ledger systems. The processes for creating journals in each system are different, making it impossible to compare the journals for validation purposes. For example, say Abbie someone books a journal in her general ledger system, but she accidentally books it to Entity C instead of Entity B, whom she had talked with. Perhaps this person in Entity B, let's call him Tom, booked the journal properly. Unfortunately, there are no checks and balances to be sure both Abbie and Tim did the right thing

A similar muddle occurs when Abbie books her journal on October 31st and Tom books his on November 2nd. Obviously, one entity is booked at the period close, the other is not. Since the end of the period was October 31st, when the accounts are consolidated, they are out of balance because Tom's entry won't show up until the following month. This timing discrepancy obliges Finance & Accounting to sort through tens of thousands of transactions at settlement to determine the problem and remedy it.

Are these messy scenarios any way to account for intercompany transactions, much less reconcile and settle them? Certainly not in this age of Modern Finance, where world-class enterprises are freeing Finance & Accounting from the toil of spreadsheet-based manual processes to assist the CFO as true strategic partners. Fortunately, there is now a way to automate intercompany transactions, reducing the time and cost expended in these labors, while settling intercompany balances with greater clarity and confidence.

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PART 2

A Needed Nexus

BlackLine's' Intercompany Hub is a clearinghouse of intercompany transactions that eliminates after-the-fact manual reconciliations and settlements. The Intercompany Hub centrally interfaces with all of a company's core ERP systems and other systems, collecting and distributing intercompany transactional data on a centralized basis. This provides the means for a single process for reconciling, netting and settling intercompany transactions in real time.

Issues over currency values, transaction amounts and tax implications are eradicated, as the clearinghouse appreciates these complexities through its internal rules engine, which is based on the company's intercompany transaction governance guidelines. The transactional information flows into the clearinghouse, and it doesn't matter if this data is brought in from other systems or originates in the Intercompany Hub itself.

Leveraging the example of the global beverage manufacturer and distributor, the New York office needs to transfer money to the London office for payroll purposes. Using the clearinghouse, the New York office right clicks on the London entity. Up pops an icon called Intercompany Relationships. It has already been pre-populated with every type of intercompany transaction the company typically conducts, bound by the organization's internal governance rules regarding different entity dealings. In the case of the New York-London transaction, the transfer occurs without a hitch. Issues over currency variances are eliminated, as the system dictates that the transaction must occur in dollars.

These validation rules ensure that expenses stay in line. For example, the consultant recruited from London to Los Angeles incurs travel expenses that are to be booked to the requesting entity. In the past, this might fall between the cracks, with London absorbing the cost. No longer: Each intercompany request is documented by company-selected descriptors—the specific transaction type, date, amount, currency, and relevant VAT and royalty fees. The requester in Los Angeles simply populates the appropriate field with the relevant descriptors and submits the transaction.

Let's take this a step further and establish that the validation rules for the requester in Los Angeles require that travel expenses by a non-entity employee be no more than $2000. As the London consultant's travel is booked, the cost exceeds $2500. The request will be automatically rejected. Indeed, there is no limit to the number and type of descriptors a company may want to include in its intercompany clearinghouse, testifying to the system's flexibility.

Going back to the example of Abbie and Tom and their disparate general ledger systems, BlackLine makes sure that journals are created for all general ledger systems automatically—no matter where they are located or how disconnected they are. Journal creation is accomplished without errors and without any timing problems.

Another feature of the Hub is its ability to receive transaction outputs from multiple automated systems and even manually created spreadsheets. What goes out of the clearinghouse is equally flexible—pushing journals to the Accounts Payable system instead of to the general ledger, for instance. What happens at the back end of the system is equally constructive. Many accountants invest an enormous amount of time doing the same thing over and over every month with slightly different data. A case in point is journal entries.

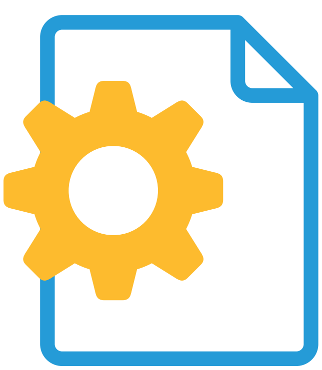
Within the clearinghouse's validation rules is designed to eradicate this repetitive process. Rather than manually create journal entries one after another, the system automatically creates "bulk journal" functionality, i.e., the rules engine looks at the data and creates journals from this information. Not only does this simplify the drudgery inherent in the journal entry process, it correspondingly reduces the risk of human error. Thanks to the enhanced visibility of the system, accountants can drill into each intercompany transaction to peruse the underlying journals. This functionality is unique and in many ways exemplifies the remarkable value presented by the clearinghouse concept.

Added features include the ability to designate that a particular bulk journal definition will apply only to specific intercompany transaction systems. Another is the ability to group bulk journals by a particular account. Let's say a particular entity has 50,000 transactions. Rather than create 50,000 separate journal entries, the system can summarize all of them in one bulk journal at the header level without impeding the ability to determine who created or assigned each journal. Instead of spending time unproductively engaged in repetitive processes, accountants can direct their attention to the exceptions—the transactions that do not net at the end of the month.

By eliminating labor-intensive tasks across multiple processes, the Intercompany Hub is a game-changer. For decades, Finance & Accounting has scoured the globe for an automated solution to their time-consuming manual spreadsheet-based tasks. This quest has at long last come to a definitive end.

Why continue with the antiquated process of reconciling, netting and setline intercompany transactions? Why risk human errors by having multiple people “touch” every single transaction because all the journals have been created by hand? Why inherit stiff tax liabilities, which are sure to increase as more countries intensify their enforcement of existing laws? Why waste the intellects of the human beings in Finance & Accounting, when their broad talents can be productively applied to more strategic finance needs?

The time has come to automate intercompany transactions, reducing company costs and making work more meaningful and satisfying for Finance & Accounting. Finally, they can join the CFO at the front of the corporate ship, steering the enterprise forward.



The BlackLine Intercompany Hub

Intercompany transactions from general ledger clearance accounts can be brought into the Intercompany Hub and reconciled using various matching rules. The solution matches intercompany accounts to identify net balances, helping companies create necessary adjustments that arise from discrepancies. Net balances owed to or from different entities can be reviewed, approved and posted back to the entity general ledger accounts.

Alternatively, companies running legacy or multiple ERP systems can standardize this divergence using the Intercompany Hub's controlled divergence using the Intercompany Hub's controlled, template-oriented functions when posting intercompany transactions. Validation rules ensure that the postings are not rejected from the target accounts due to entry errors. Companies also can create, review, approve and certify inter-company journal entries, which can then be posted to the entity's general ledger clearance accounts.

Altogether, the Intercompany Hub reduces a substantial amount of non-value added work in the intercompany accounting process. This includes:

- The manual effort in resolving imbalances.
- Researching aged items between entities.
- Rectifying possible control issues.
- Settling disputes between business units regarding imbalances.

The result of this clearinghouse approach is not only sizable improvements in inter-company processing efficiency—especially when dealing with multiple financial systems—but also reduced risk and improved controls.