Optimising Intercompany Transactions: Strategies for Efficient End-to-End Processing

Quite often, intercompany transaction's end-to-end processing has been built over time without a comprehensive analysis of the impact on each part contributing to the entity. The company has grown organically over the years; businesses have expanded to new areas or locations, or the organisation has undergone restructuring or acquisitions.

What are intercompany transactions?

The exchange of goods, services or assets between entities belonging to the same group of companies is called an intercompany transaction. The core purpose of intercompany transactions is to facilitate coordination, resource sharing, utilisation of economies of scale and efficient cooperation within the group of companies.

- An intercompany transaction occurs between legal entities forming a larger enterprise.
- An intracompany transaction occurs within the same legal entity.

Intercompany transactions are separate from the transactions that companies perform with their external stakeholders, customers and suppliers, that are independent from the corporate structures. Proper documentation and accounting for intercompany transactions are crucial for financial transparency, regulatory compliance, and accurate reporting of the overall financial performance of the entire corporation.

Scenarios in intercompany:

- ✓ Recharges
- ✓ Corporate Allocations
- ✓ Financing
- ✓ Internal trade

Intercompany transactions occur in various supporting processes throughout the organisation. Providing financing or guarantees to a subsidiary requires the recording of intercompany transactions. Or a service agreement on centrally provided services like company-wide IT and other administrative services, where once occurred costs are recharged from subsidiaries. Transferring intellectual property rights like royalties or patents to another entity within the same group of companies generates intercompany transactions. Allocating expenses like management costs across the entities of the whole corporation will generate the need to produce intercompany invoices. Internal trade refers to the exchange of core products between entities within the same corporation.

Most interesting are the transactions at the core business processes in the long chain of actions that take place at the full length of the globally operated supply chain, from purchasing through warehouse functions to production until selling to end customers. This set of business capabilities is of special interest as it is the revenue-generating value flow that touches many areas of an organisation. Due to this, it forces close cross-functional collaboration, with ERP system capabilities playing a central role in the process.

Why do intercompany transactions matter?

Non-structured intercompany transaction processing can have substantial costs. If data has to be collected and consolidated manually or eliminations are incomplete, the company may end up incurring unnecessary taxes or faceing penalties for faulty or delayed reports.

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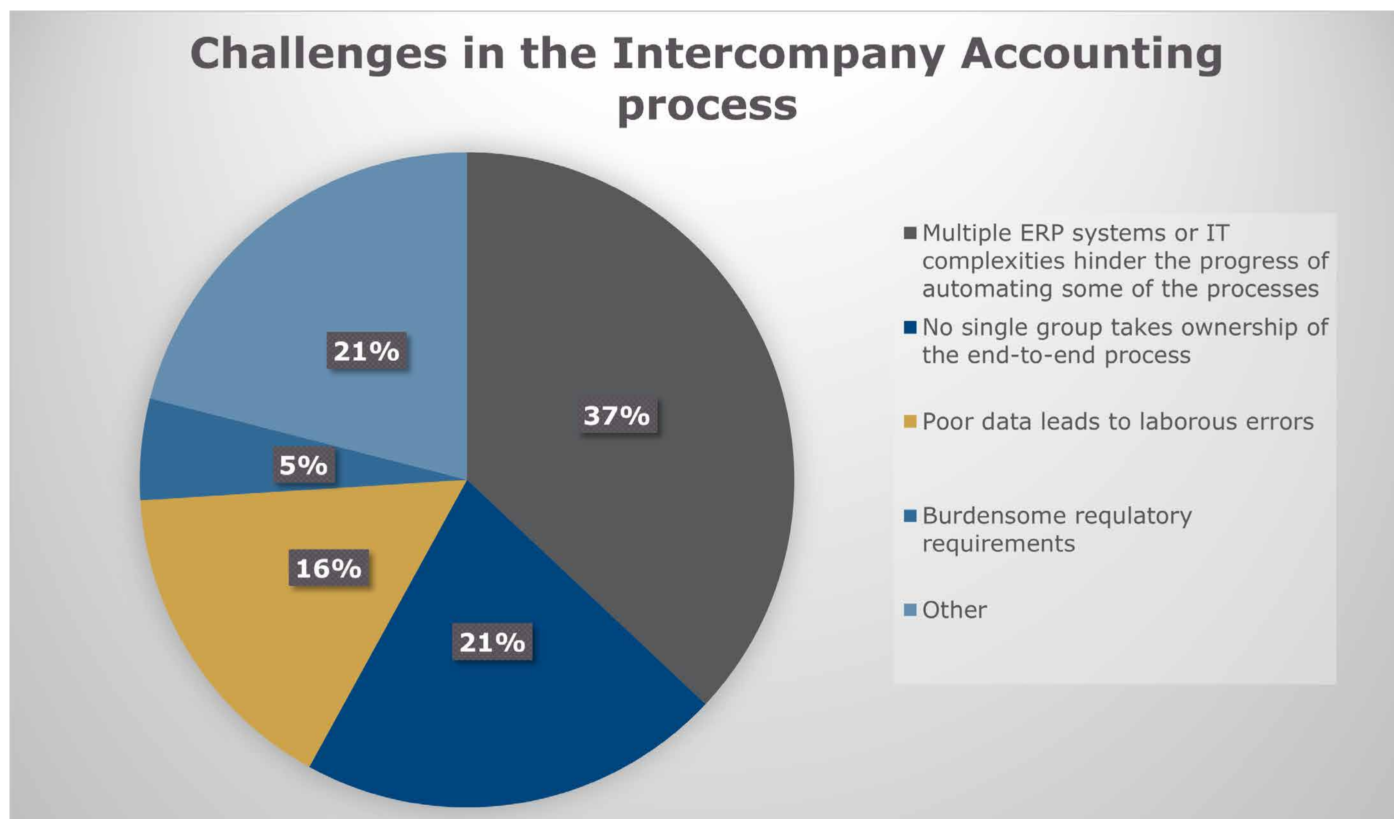
The internal effort spent on dispute management reoccurring because root causes have not been fixed, reconciling receivables to payables that have not been generated in sync, and non-integrated multiple ERP systems, challenge the data consistency and increase effort for consolidation. The absence of harmonised guidelines for periodical netting between corporate entities and undefined currency policy add challenges to cash flow forecasts and risks for foreign exchange losses. All of these are actions which do not add value to customers, nor does it pay off or is even possible to automate disparate processes and tools.



Picture 1. Source: Peeriosity.com, 2019

The tightening tax regulations and protectionism bring their demands for organisations operating in multiple countries. OPEC's country-by-country reporting (BEBS act 13) addresses the issue of tax avoidance and aims to bring more transparency to multinational enterprises' finances. Large multinational corporations are required to prepare a yearly country-by-country report with aggregate data on the global allocation of income, profit, taxes paid, and economic activity among tax jurisdictions in which it operates.

Best practices for intercompany process design

A statement of strategic intentions and organisational alignment is a baseline for designing efficient intercompany processes. Where is the value captured? What are the financial and taxation risks to be avoided? How are operations (production, purchasing, sales) located and incentivised to cooperate for the whole corporation?

Commonly agreed policies and procedures for processing end-to-end intercompany transactions are required and must be followed with appropriately defined KPIs (key performance indicators).

Additionally, intercompany transactions require discipline in data definitions, maintenance, and timely distribution. Functions need to agree on how rules are applied in the processes. For managing intercompany transactions, appropriately defined materiality thresholds and authorities across the long end-to-end process, as well as mechanisms to solve conflicting interests, are needed.

Technological capabilities would be suitable in assisting in pre-configured controls for automatic transactions and exception reporting, as well as providing a centralised data repository and enabling timely reporting. It pays to follow the standard processes of the chosen ERP system and enhance those capabilities with 3rd party tools rather than start customising company-specific solutions. Modern technological capabilities host user-friendly interfaces for maintaining trading relations and rules, automating the elimination process, and tracing approvals.

When designing an intercompany end-to-end process, efforts should be focused on automating high volume and value flows while balancing the complexities of the long end-to-end process. An integrated ERP system with standardised data structures and discipline supports the automation of intercompany transaction processing. However, it's good to bear in mind to keep the financial and physical material flows integrated to avoid challenges in demand forecasts or fulfilling customs requirements of cross-border transactions.

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The role of transfer price

Defining the transfer pricing rule is key to distributing the profits in the required way across several entities. When different legal entities of a multinational corporation exchange goods or services (or intellectual property), the cross-border exchange must appropriately credit or debit each subsidiary involved in the transaction. Transfer pricing is determined for the transactions between companies in the same corporate group. There are several methods to define appropriate transfer pricing rules. The choice depends on the transaction's nature and reliable data availability. Used transfer pricing is of interest to local authorities who conduct assessments on transactions between linked companies to investigate whether appropriate profit is left to the country (BEPS Act 13 targeted to mitigate this challenge).

For example, a company executing a customer project for several years, where multiple business units across the globe contribute to the result and the project follows the cost-to-cost revenue recognition rule plus has a financing plan with headquarters, has a bit more complicated environment to determine transfer pricing. In comparison, a company assembling highly consistent components and end products sold through various sales offices across the globe has more possibilities to standardise and pre-configure transfer pricing rules. In both cases, designing an optimal intercompany process requires participants from several organisational functions. It's important to note that transfer pricing that meets compliance requirements may not always generate the KPIs necessary for managing the enterprise and its units effectively.

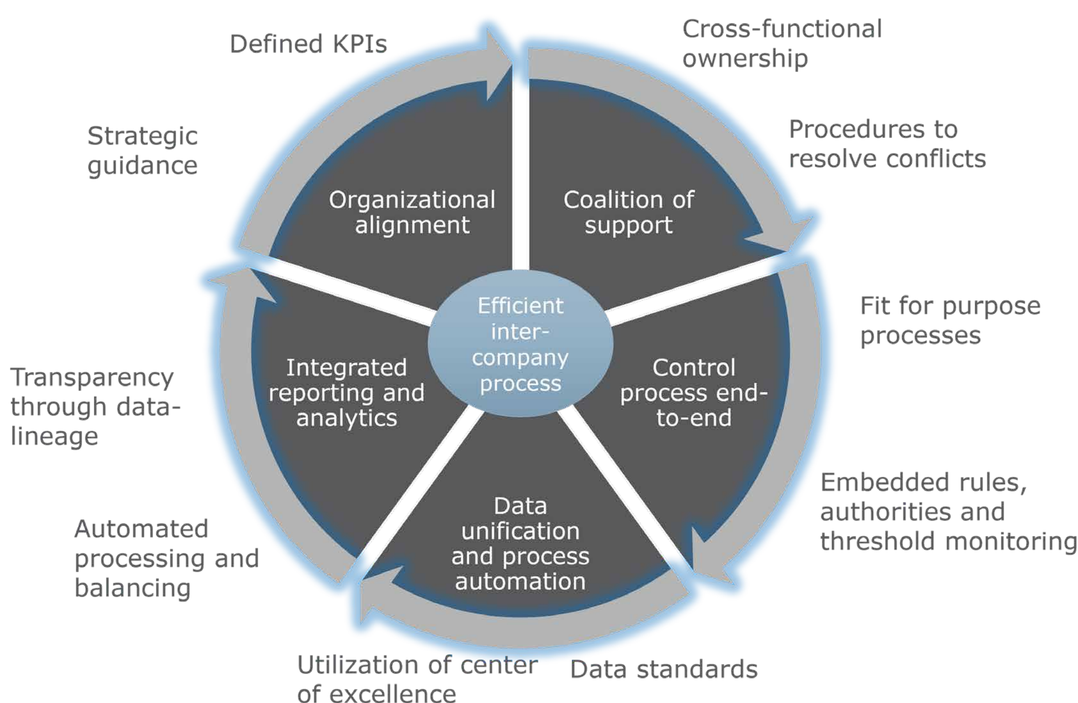
Intercompany process ownership

Quite often, intercompany process ownership is within the finance function as the reconciliation, elimination, and reporting are their responsibility. But when thinking of where the transactions are generated, where the data is coming to accounting and where the challenges lie, it leads to thinking a wider responsibility would be beneficial.

Tax, legal and group finance departments are key in determining corporate rules for intercompany transactions, including appropriate transfer price models. Business and legal unit management, as well as a procurement function, has to align with the strategic approach of intercompany processes, how to benefit from cross-cooperation, and which way to monitor the unit's performance.

Data stewardship is crucial in defining elements of separating internal transactions from those with external partners. At operations, a discipline must apply for the defined approach to correctly record the transactions when they are originated. If these approaches are followed, the finance function is left to automate intercompany reconciliation and eliminations, drive the settlement process regularly for better cash flow reporting and adopt a continuous closing process for internal transactions instead of periodical processing. Finally the financial statements to subsidiaries, consolidated results for the whole corporation and appropriate tax reports to authorities can be compiled in timely manner. This ensures all stakeholders have access to accurate and up-to-date financial information.

When the target intercompany process design is done, a center of excellence with the right authority over the process can continue improvements, automation and assist in error management and dispute handling.



Picture 2. Elements of efficient intercompay process

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In a quest for efficiency

The vision of a broader organisation and end-to-end intercompany accounting process requires common alignment to achieve optimal outcomes. This would inspect the impacted processes, governance models, people operating within intercompany end-to-end processes, and technology choices.

Intercompany transactions do not add value to the organisation but can incur significant costs due to errors, manual work, and disputes. Therefore, it is worthwhile to streamline and standardise the intercompany processes and acknowledge the importance of an efficiently executed, well-oiled process for releasing the organisation's resources to the tasks that will generate more revenues or save obvious costs.

Many organisations are currently updating their legacy ERP systems. This is an excellent opportunity to review the end-to-end intercompany process and other supply chain or finance processes. When a baseline for further improvement actions is generated, it enables companies to automate, implement RPA components and start investigating opportunities for AI within intercompany processes.

As per Gartner's finance executive priorities survey (2023), key focus areas in building autonomous finance functions in the coming years are digital outsourcing and utilising data-lineage-enabling technologies in reporting. Uniform processes and high-quality data are the prerequisites for efficient automation initiatives.

Midagon's offering

We can help organisations align targets across the end-to-end intercompany process, support the selection of appropriate solutions, coordinate target process design and implementation across several functional areas, and identify automation possibilities along the way.

By combining extensive project management expertise with deep knowledge of supply chain, finance, and change management, we can guide you to reaching your transformation targets.

Learn more: Midagon finance transformation services

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