Transparent and traceable

Rethinking expense allocations with blockchain
Allocated costs make up about 40% of the cost base of a financial institution (FI), according to Ernst & Young LLP research. And apportioning them among affiliates poses a significant challenge, as they are subject to a complex nexus of regulations and tax requirements.

Years after allocating its intercompany expenses, an FI can face retrospective examinations from transfer pricing and taxing authorities – presenting a formidable challenge in a Transformative Age requiring constant change on accelerated timelines.

In the complex and evolving regulatory and tax landscape, the ability to capture each moment in time – to pin down all the data and corresponding transactions, like in a photograph, to be filed away and easily retrieved when the time comes – would bring game-changing value to an FI.

That’s exactly what you can do with a technology that many FIs already have: blockchain. And the benefits don’t end there.

A tangle of data, systems and methodologies

Intercompany expense allocation is underpinned by arm’s-length legal agreements that articulate the entities’ governance and supervision rights, acknowledge their tax and regulatory obligations, and specify the methodologies used to apportion expenses. For a number of reasons, these allocations present FIs with several challenges.

For one, complementary data points are not always stored in an easily accessible database. Additionally, data can be voluminous, encompassing allocation methodologies, consumption measurements, underlying inter-affiliate agreements, cost transfer justifications, approvals from legal entity representatives and more. Such a database – and the information in it, like changes and approvals – also needs an auditable trail.

FIs also must be able to reperform the calculation of a specific allocation years after it was done originally, with the same result. This is often an insurmountable task due to the natural change that occurs in any organization over time, such as modifications to the organizational structure, revisions to the financial hierarchies, and adjusted taxonomy and refined apportionment methodologies.

The potential problems go deeper. For many FIs, there are three systems (or more) across the entire process: one to develop the costing, one to distribute and one to report. Differing taxonomies, methodologies, systems and data management protocols are typically in place across them. All these variables create reconciliation challenges, spawning operational inefficiencies and undermining the ability to leverage consistent, comprehensive cost insights and enterprise-wide spend control initiatives.
Addressing your challenges with blockchain

An intercompany expense allocation process requires many capabilities to execute effectively, such as data storage, calculation and simulation, reporting, and data integration and modeling.

When an expense allocation approach is enabled by blockchain, the system gains a permanent, immutable digital record of all network transactions and contract details, enabling complete transparency, data integrity and consistency across key network participants. The secure, tamper-proof database stores key data points – such as computation rules, input cost centers, allocation keys and inter-affiliate agreements – that are used to execute and justify the allocation of costs between legal entities.

Through smart contracts, a differentiating blockchain feature, FIs can leverage such digital records to recalculate allocated costs years after they were first performed, returning the exact original values – regardless of any updates to the organization, cost structure and various agreements.

Companies are equipped with a greater ability to withstand the scrutiny of tax and regulatory authorities, which are likely to perform retrospective examinations years after the apportionment has been calculated and the costs have been transferred. The fear of not being able to pass the deductibility test or justify the cost transfer pushes FIs to make overconservative assumptions on deduction claims – for instance, in transfer pricing and on sales taxes – that negatively impact the bottom line.

Blockchain also eliminates disputes between legal entities related to allocated charges, as approvals – by regional controllers or other designated approvers – are a prerequisite for generating a new entry in the database, and those approvals create an immutable audit trail with a permanent digital record.

A blockchain-enabled approach also offers other benefits that drive efficiency and cost savings:

- It has many use cases, within intercompany and beyond. The more you scale, the more benefits you gain. The application of blockchain can be extended across finance processes into loans, living wills, pricing of critical services, cost management, and financial planning and analysis. Reconciliations can be eradicated altogether, creating significant operational efficiency savings. Different groups won’t be performing their own calculation or referring to their own data set – there’s one truth, visible to all.

- It can have a lower total cost of ownership compared to other technologies. Blockchain should cost as much or perhaps less to implement than alternative platforms. But over the entire life cycle – including the run rate and maintenance – its cost significantly lower. Software might do part of what blockchain does, but there are associated annual license fees. With blockchain, there is only an in-house build, with help if you need it (or it can be provided to you as a managed service).

- It allows institutions to discontinue legacy systems and capabilities. A blockchain-enabled approach is executed to augment existing capabilities and has the potential to replace current functionalities, avoiding the maintenance costs of likely outdated and overly patched systems.
How we can help

Whether you’re just starting to explore blockchain, or if you have it already and want more out of it, EY teams have the skills you need at each part of the journey. We offer an Intercompany Blockchain platform, giving you the flexibility to expand the application into new use cases as you see fit, while leveraging our proprietary assets and experience to accelerate and de-risk the implementation.

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