Intercompany accounting refers to a set of procedures a parent company uses to eliminate transactions between its subsidiaries. If one subsidiary sells goods to another, it is not a valid sale transaction for the parent company because it was an internal transaction.

As a result, the sale has to be removed from the pools when the parent company prepares its consolidated financial statements, so it does not appear.

Intercompany transactions can be flagged within an organization’s accounting
system at the origination point so they can be removed from balance sheets and other financial reports when needed. But, if the accounting software lacks a flagging feature, the transactions must be identified manually – a process that’s both time-consuming and has a high potential for error.

Because of globalization, industry consolidation, and multinational value chains becoming increasingly complex, more companies are running into costly intercompany accounting issues.

The lack of proper and sufficient intercompany accounting practices are part of the problem. The biggest challenges, according to Deloitte research, are:

- Disparate software systems in different legal entities
- intercompany settlement
- complex intercompany agreements
- transfer-pricing compliance
- foreign exchange exposure.

Multinational companies have to treat their internal business with as much structure and control as they treat external business peer in by establishing and best practices. A company can reduce the complexity created by hundreds of thousands of transactions booked across their systems.

That said, enter company accounting issues aren’t seen just in large multinational corporations. Companies with ten or fewer subsidiary companies can also have significant problems when proper accounting practices are ignored.

Intercompany reconciliation can cause a bottleneck when closing a parent company’s books, so it crucial to streamline the intercompany process as much as possible.

https://planergy.com/blog/accounting-for-intercompany-transactions/
Create Standardized Global Policies for All Critical Areas Organization-Wide

The majority of companies generally have a couple of high-level policies in place for intercompany accounting. Though it seems like enough to guide decisions and keep the process streamlined, the reality is there is a lack of detail and depth to cover the necessary type of coding to coordinate with enterprise resource planning (ERP) systems across the globe.

Critical Area 1: Data Management

A critical area to address in standardize global policies is data management. This makes it easy to identify intercompany transactions and deal with them across platforms with common charts of accounts. Any integrated reporting capabilities that meet finance, statutory, and tax requirements should also support the integrated transaction flow. All of this, combined with dashboard visibility, demonstrates performance metrics that require little manual intervention. Trading partner data to isolate intercompany transactions for elimination and reporting must be controlled and clearly identified.

Critical Area 2: Transfer-Pricing

A standardized global transfer-policy needs to clearly state how a company achieves proper transaction pricing worldwide. Ideally, the tax and finance functions need to use integrated transaction-level pricing and analytics, while working closely with one another.

In the United States and the majority of other developed countries, tax laws mandate that transactions between related parties or related companies must occur at “arm’s length pricing,” which is the same price unrelated parties would
transact as well.

To ensure compliance with regulations, the policy must clearly state how the company satisfies this standard. As a result of perceived abuse with pricing, the Organization for Economic Cooperation and Development (OECD) developed the Base Erosion and Profit Sharing (BEPS) initiative focused on cross-border pricing rules.

In certain situations, the determination of an arm’s length price has been changed, and companies are now required to disclose even more about their intercompany transactions and financial results. The IRS recently released the finalized regulations adopting the BEPS recommendation of country-by-country reporting requirements for multinational companies earning more than $850 million in revenue every year. These rules require disclosure of related-party and untreated revenue, people, earnings, capital, and taxes paid for entities within each tax jurisdiction of residence.

Critical Area 3: Foreign Exchange and Currency

As foreign transactions increase, so does the rise in foreign-currency reporting. The more countries a company does business in, reporting becomes more complex. The ASC 830 states that a company’s functional currency is the currency of the primary economic environment where the entity operates. It is the currency in which the entity generates revenue and spends cash. It is not the local currency of the country where the foreign entity resides.

When a company has transactions in a currency other than its functional currency, it must be converted (and measured in) the functional currency. Changes in the expected currency cash flows caused by changes in exchange rates are included in the net income for the period. Financial statements of foreign entities also need to be translated.

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The policy needs to be stated in simple terms so that all accounting staff can easily understand what needs to be done.

**Develop a Master Data Management Program to Execute the Standardized Policies**

With a master data management program, new and acquired accounts are set up to align with policies, and all intercompany transactions are processed with the same, standardized method. This involves using technology solutions to integrate transaction flow across platforms and control activity across multiple ERP systems.

Whatever solution is used, it should inventory and categorize the transactions by type and process them based on the standardized procedure. Transactions between entities also need to incorporate automated approval routing and dispute resolution. Centralized service charges and corporate allocations also need to follow standardized methods using standard calculations for efficient and consistent processing.

Options include:

- An accounting hub to centralize the accounting database. It is rules-based and codes transactions in a central repository.
- In-memory computing to store more data in a central location while ensuring the information remains quickly and easily accessible.
- Applied robotics/automation to perform rules-based routine activities, such as routing transactions through an approval process, producing invoices, matching transactions, and checking amounts and currencies.

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Organize a Center of Excellence

A center of excellence is a group of IT, finance, tax, and treasury experts within the company. They, on a global level, understanding all the accounting and technology involved with intercompany accounting. Intercompany accounting must be part of evaluating for members of the group because they take on enforcement of the standardized global policy and the tools and capabilities to maintain it.

*Building a cross-functional team of experts from these key areas of the company ensures compliance with all policies across an organization.*

Outline a Cash Management Strategy to Net and Settle Transactions

Under this policy, companies may wish to consider implementing a multilateral netting program as this ensures each entity’s intercompany payables and receivables are imported from their respective ERP solutions. From there, all payables are netted against their receivables to determine a single net settlement amount.

This approach includes invoices in other currencies outside of the functional currency - which allows them to be translated at a consistent exchange rate to arrive at a single payable or receivable amount in their functional currency.

For the most effective netting and settlement, the multilateral approach needs to be based on a cash management strategy that clearly defines when settlements require accounting entries vs. cash transactions.

Developing a cash management strategy helps you reduce bank fees, and the
amount of cash left sitting in accounts that are not bearing interest. It also gives information to make it possible for the organization to hedge currencies effectively.

**Use a Third-Party Reconciliation Tool to Match Transactions**

Reconciling accounts payable and accounts receivable is a resource-intensive and time-consuming part of accounting, especially when transactions must be pulled from multiple ERP software systems.

To help simplify the accounting process, companies should use software designed to match transactions from one entity to another and can flag single transactions when problems occur so that manual intervention can resolve the issue.

Ultimately, automating repetitive and time-consuming tasks reduces staff risk and labor throughout the process, enabling them to focus time and effort on cross-functional activities that add strategic value.

Investing in technology to streamline the intercompany accounting process is well worth it when financial reporting accuracy improves.

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