Solve Inter-Company Transfer Pricing Challenges Using Oracle Advanced Pricing

OAUG Cost Management SIG

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Prepared by:

Peter Belter
Peter Belter

- **Professional Summary**
  - 17 years of experience implementing, maintaining enhancing Oracle EBS Applications
  - Participated in 20 projects in Europe, Southeast Asia, North and South America
  - Creator of several unique Oracle enhancements, including More4Apps “Excel Out” a concurrent request that takes SQL query as parameter and produces nicely formatted Excel report

- Some of my solutions are documented at [www.piotrbelter.blogspot.com](http://www.piotrbelter.blogspot.com)

- Spyglass Corporate Services provides back office and administration to businesses in the PCB industry, extending Cloud-like services coupled with direct business management (Accounting, IT, HR).
Learning Points

- Learn how to manage transfer pricing between your domestic and international subsidiaries

- Adjust your pricing for intercompany invoicing by managing margins per product line and subsidiary, rather than detailed item specific price list

- Take advantage of different tax rates in foreign jurisdictions to manage your tax liability
Agenda

- Overview of intercompany transaction types
- Intercompany pricing practices
- Setting up efficient, semi automated intercompany pricing solution
- Potential tax advantages in foreign tax jurisdictions
Intercompany Transaction Flows
Common intercompany transaction types

- **Internal Requisition/ Internal Sales order (IR/ISO)**
  - France OU requisitions material to replenish their warehouse from an US OU facility

- **Internal Drop Shipment**
  - France OU sells items directly from a US warehouse

- **Global PO**
  - Ireland OU purchases materials in Hong Kong to be shipped to US OU
IR/ISO

US cost $100

Shipping
US OU

Transfer price $125

Receiving
France OU

Shipment

AR IC Invoice

AP IC Invoice
Internal Drop Shipment

Shipping
US OU

US cost $100

Transfer price $125

AR IC Invoice

Selling
France OU

AP IC Invoice

Customer

AR Invoice $130
Global Procurement

Procuring Ireland OU

AR IC Invoice
Transfer price $125
AP IC Invoice

Purchase Order

Supplier (China)

AP Invoice $100
Shipment

Receiving US OU
Multi-node transaction flows

Shipping US OU

Cost $100

Markup 0%

AR IC price $100

AP IC price $100

Ireland Financial Hub OU

Markup 25%

AR IC price $125

AP IC price $125

Selling France OU

AR Invoice $130

Customer
Intercompany Pricing Common Practices
Common intercompany pricing practices

- Static item price list from item cost
- Item costs change, new items may be added daily, old items are made obsolete
- Maintenance can become very complex

<table>
<thead>
<tr>
<th>Number of subsidiaries</th>
<th>Number of items</th>
<th>Number of price lists</th>
<th>Total lines</th>
<th>With extra IC node</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>10,000</td>
<td>2</td>
<td>20,000</td>
<td>40,000</td>
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<td>4</td>
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<td>6</td>
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<tr>
<td>50</td>
<td>250,000</td>
<td>2450</td>
<td>612,500,000</td>
<td>1,500,625,000,000</td>
</tr>
</tbody>
</table>
Issues with static price lists

- Virtually impossible to maintain manually, especially as new items are added on ongoing basis
- Custom maintenance programs
- Pricing exceptions, primarily PPV, due to timing
- Pricing exceptions due to maintenance program exceptions
- Need to reconcile/fix exceptions
- Need to oversee the process
- Performance issues

**Bottom line**
- Intercompany transactions are never company’s core business and should not take resources, time and money away from other activities
Intercompany Pricing – Deploy and Forget
How it should work

- One price list with one line -> Item Price = cost
- Intercompany markup set separately as a modifier, different per destination country
- Standard setup only – no customizations
- No maintenance, other than the annual markup review
- No exceptions due to timing or customizations
- Works for all 3 major IC flows

<table>
<thead>
<tr>
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<th>Total lines</th>
<th>With extra node</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Static Prices</strong></td>
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<td></td>
<td></td>
</tr>
<tr>
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<td>250,000</td>
<td>2450</td>
<td>612,500,000</td>
<td>1,500,625,000,000</td>
</tr>
<tr>
<td><strong>Cost based</strong></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>50</td>
<td>250,000</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
</tbody>
</table>
List of needed setups

- Shipping Networks: required
- Intercompany Transaction Flows: required
- Create custom responsibility for Intercompany pricing: optional but highly recommended for easiness of use
- Profile options: required
- Mapping cost as price, converted to transaction currency: required
- Create dynamic formula to calculate cost in price list currency: required
- Map ALL Items for IC Pricing: required
- Create Intercompany Price list: required
- Map additional pricing attributes: optional
- Update INTCOM pricing entity: optional, highly recommended
- Create Markup Modifiers: optional, but usually needed
- Map additional qualifiers: optional, required if logical intercompany transaction nodes are present
- Custom pricing phases: optional
Shipping Networks & Intercompany transaction flows

- The complete setup is outside of scope of this presentation
- The intercompany Currency Code for IC invoice settings are executed after the intercompany price is calculated
- It is irrelevant which currency code is selected for the intercompany invoice, all intercompany prices can be calculated using a single price list in USD
Custom IC pricing responsibility

- The same as the existing Oracle Pricing Manager but with different profile options
Profile option definition changes

Only for Oracle installations done before 2010
Responsibility level profiles

- All price lists and modifiers created using this responsibility will work only for Intercompany transactions and will not be accessible when pricing sales orders and other customer transactions.

<table>
<thead>
<tr>
<th>Profile Option Name</th>
<th>Site</th>
<th>Application</th>
<th>Responsibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>QP: Pricing Transaction Entity</td>
<td></td>
<td></td>
<td>Intercompany Pricing</td>
</tr>
<tr>
<td>QP: Source System Code</td>
<td></td>
<td></td>
<td>Intercompany Transaction</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Oracle Inventory</td>
</tr>
</tbody>
</table>
Site level profiles

- CST: Transfer Pricing Option - Yes, Price As Incoming Cost (read more about other settings)
- INV: Advanced Pricing for Inter-Org Transfers - Yes
- INV: Advanced Pricing for Intercompany Invoice - Yes
- INV: Always suffix inter-Company AP Invoice number – Yes (optional)
- INV: Inter-Organization Currency Conversion – Corporate
- INV: Intercompany Currency Conversion - Corporate
- INV: Intercompany Invoice for Internal Orders – Yes (optional)
Mapping cost as price, converted to transaction currency

Create & Link new COST pricing context in the Intercompany Entity
Mapping cost as price, converted to transaction currency
Mapping logic preparation

- To get item cost we can use the standard API:
  - `cst_cost_api.get_item_cost(1, inventory_item_id, ship_from_org_id, null, null)`

- This would be sufficient if all of our companies were operating in single currency. If we have warehouses storing costs in multiple currencies we need to find the currency of the item cost using:
  - `csd_cost_analysis_util.get_GLCurrencyCode(p_operating_unit_id)`

- The warehouse inherits cost currency form the set of books assigned to the operating unit. The OU owning the warehouse can be different than the order OU and needs to be derived:
  - `qa_moac_pkg.derive_ou_id(p_ship_from_org_id)`
Mapping Logic

- Knowing the currency code of the warehouse cost we can find exchange rate to the IC transactional currency:
  - `gl_currency_api.get_rate (p_from_currency, p_to_currency, p_conversion_date, p_conversion_type)`
- Combining those 4 get APIS we get item cost in our currency:
Dynamic Pricing Formula

- Cost and exchange rate are separate attributes to improve troubleshooting transparency
Create Intercompany Price List

- Use Custom Intercompany Pricing Responsibility
- Define 1 line per each base UOM
- Assign formula
Create Intercompany Markup Modifier

- The modifier will apply 5% surcharge on all laptops, 4% on all other computers and 2% for all other items
Qualifiers

- The markups will be applied when
  - items are transferred from US to France (group 1, IR/ISO)
  - or French operating unit is selling items shipped from a warehouse belonging to the US operating unit (group 2, IC Drop Shipment)
Summary

- Intercompany transactions priced using cost based dynamic pricing formulas:
  - Do not require any customizations
  - No maintenance other than changing markups when needed
  - Do not have performance issues
  - Derive the IC price only when the IC transaction occurs rather than calculating all possible static combinations up front
  - Do not have any “hiccups” when new items are added or costs changed
Multi node IC pricing – case study
The Business Process Background

- Vision Operations has multiple subsidiaries in Europe
- The main centre of European operations is located in Ireland to take advantage of the 12.5% corporate tax rate there
- France is an important source of revenue for Vision Operations
- All products are manufactured in the US and shipped directly to French customers on sales orders placed in the French OU, or shipped from US to warehouses in France
- Due to significant pricing pressure from Asian competitors, Vision has lowered prices in France, resulting in lower margins. Prices may continue to drop.
- Vision plans to increase net profitability by lowering its overall tax liabilities in Europe
The Plan

- Vision plans to continue shipping products directly to France, to both customers and distribution centers, but wants to introduce a logical IC node in its Irish European HQ, to channel some of the profits and take advantage of lower taxation.

- All sales to France will logically or virtually go through Ireland, with substantial portion of margin moved from France to Ireland.

- All profits in French OU are subject to **30% tax**

- All profits in Irish OU are subject to **12.5% tax**
Current flow, Internal Drop Shipment

US cost $100
Shipping US OU

Transfer price $100
AR IC Invoice

Selling France OU

AP IC Invoice

AR Invoice $130
France OU Gross profit = $30

Customer

<table>
<thead>
<tr>
<th>US Cost</th>
<th>Sells to France</th>
<th>France sells to Customer</th>
<th>Profit in FR</th>
<th>Tax in FR 30%</th>
<th>Vision Gross Profit</th>
<th>Net profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>$100</td>
<td>$100</td>
<td>$130</td>
<td>$30.0</td>
<td>$9.0</td>
<td>$30</td>
<td>$21.0</td>
</tr>
</tbody>
</table>

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Planned Flow

Cost $100

Shipping US OU

Markup 0%

AR IC price $100

AP IC price $100

Ireland Financial Hub OU

Markup 25%

AR IC price $125

AP IC price $125

Selling France OU

Ireland OU Gross profit = $25

France OU Gross profit = $5

AR Invoice $130

Shipment

Customer

<table>
<thead>
<tr>
<th>US Cost</th>
<th>Sells to Ireland</th>
<th>Profit in IR (12.5%)</th>
<th>Sells to France</th>
<th>France sells to Customer</th>
<th>Profit in RF (30%)</th>
<th>Vision Gross Profit</th>
<th>Net profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>$100</td>
<td>$100</td>
<td>$25</td>
<td>$125</td>
<td>$130</td>
<td>$5.0</td>
<td>$1.5</td>
<td>$30</td>
</tr>
</tbody>
</table>
Savings

- Today, total tax = $9

<table>
<thead>
<tr>
<th>US Cost</th>
<th>Sells to France</th>
<th>France sells to Customer</th>
<th>Profit in FR</th>
<th>Tax in FR (30%)</th>
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</table>

- After introducing the Irish OU node, total tax = $3.13+$1.5 = $4.63
- Tax liability reduced form $9 to $4.63 or roughly 50%, net profit up by 20%
- No difference in delivery lead times, seamless from customer perspective
Key Takeaways

- It is possible to use the standard functionality of Oracle Advanced Pricing to calculate complex inter-company transfer prices. With the potential to manage total global tax liability.

- It can be achieved with standard setups and no customizations.