

Intercompany Financial Management

An Essential Discipline for Multinational Corporations

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The Intercompany Financial Management Challenge

ISG Research defines intercompany financial management (IFM) as a discipline for structuring and handling transactions within a corporation and between its legal entities designed to maximize staff efficiency and accounting accuracy while optimizing tax exposure, minimizing tax leakage and ensuring consistent tax and regulatory compliance. IFM addresses a significant (if often unrecognized) problem for many companies because performing IFM well requires the ability to execute the minutiae of statutory and tax accounting details effectively to support the achievement of high-level corporate objectives.

This is especially the case in any organization that operates in multiple countries, uses multiple ERP systems and has even a moderately complex ownership structure. ISG Research asserts that by 2027, 60% of organizations with 10,000 or more employees will have implemented IFM to achieve tax, risk management and financial close benefits.

Dealing with IT, Accounting and Tax Issues

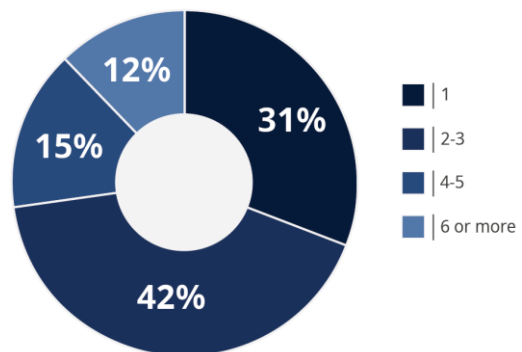
The degree to which companies are challenged by intercompany financial dealings is a function of two main factors that drive IT complexity and accounting and tax complexity. The first factor is the number of ERP systems and instances used by the corporation. Our research found that 69% of organizations with more than 1,000 employees use ERP systems from multiple vendors and 27% have four or more—some with dozens or even hundreds. It is common for there to be multiple instances of a vendor’s ERP system, each with its own chart of accounts. This fragmentation of record keeping systems challenges finance and accounting departments when handling intercompany transactions.

The second main factor is corporate structural complexity, notably the number of legal entities and ownership relationships, including joint ventures, partnerships and crossholdings. Larger corporations can be made up of hundreds or thousands of legal entities, which introduce tax and regulatory considerations into intercompany transactions. This is especially true when transactions span multiple jurisdictions.

ERP Fragmented in Large Companies

Two-thirds have systems from multiple vendors

ERP vendors used by companies with 1,000+ employees



Source: ISG Research
Next-Generation ERP Benchmark Research
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Fragmented and inconsistent data makes it difficult to quickly and accurately connect the strands of intercompany transactions to address multiple requirements beyond that of statutory accounting (which can be readily managed with financial consolidation software). Beyond minimizing value-added tax (VAT) leakage, many companies can benefit from more evolved capabilities in areas such as tax accounting, tax compliance and the use of analytics to optimize total tax incidence across multiple legal entities. Simply minimizing tax expense is no longer an option because of local anti-tax base erosion measures and country-by-country reporting requirements, which make it necessary to justify the fairness of tax payments. Additional factors complicating accounting and tax requirements are likely to emerge in coming years because of increasingly complex trading, regulatory and tax environments.

Moreover, in many organizations the effort and time required to handle intercompany accounting lengthens the accounting close period. Our research found that one-half of companies with 1,000 or more employees take seven days or longer to complete their close compared to the widely agreed benchmark of one business week. More effective IFM eliminates one cause of a close process that takes too long.

IT complexity is an issue for many corporations because the internal mechanics of creating, selling and delivering products and services often involve transactions between multiple parts of an organization, each of which may be a distinct legal entity and use a different ERP system. For example, several business units, each with their own ERP system operating in distinct tax jurisdictions produce components or provide services for a division that

assembles and sells the finished good or service. Each of the component or service business units bill that final product division and that final sales division turns around and pays its internal suppliers. To achieve the objectives of IFM, corporations must be able to automatically pull together all transaction data from multiple systems into a coherent whole to support consistency and accuracy in tax compliance and analysis.

One basic issue that arises when multiple ERP systems record transactions between internal business units is the matching of both sides of the transaction. Software that manages intercompany matching is now commonplace, and our research shows that 65% of organizations now use software to handle reconciliations. However, transaction matching, even on an international scale, is not the same as intercompany financial management.





IFM goes further by enabling finance and accounting departments to enhance accuracy while optimizing tax exposure, minimizing tax leakage and ensuring consistent tax and regulatory compliance. Both parties to an intercompany transaction must apply the correct accounting treatment because this can affect tax and regulation when there are two separate legal



“Global” thinking recognizes that allowing each business unit to optimize its results can drive sub-optimal corporate performance.

entities involved, especially in cross-border transactions. They also need to automate the process of correctly applying tax rates and facilitate digital tax filing and any required regulatory reporting related to exports and imports. This is conceptually simple but difficult to execute.

Large corporations must think globally while acting at the local level in all their jurisdictions. “Global” thinking recognizes that allowing each business unit to optimize its results can drive sub-optimal corporate performance. For example, measures taken to minimize local tax expense may result in higher tax payments at the corporate level or create reputational risk. At the same time, all businesses are governed by

local administrations and business customs with unique laws and regulatory requirements. So, while the purpose of intercompany financial management is to optimize globally, local requirements must be observed. This requires local knowledge and expertise—skills and knowledge that are likely siloed deep within the organizational structure.

A Broad Set of Benefits Across a Corporation

An ironic aspect of IFM is that, as a rule, those at the top of the organization who stand to benefit the most from improved IFM are not aware that the corporation is not executing IFM as well as it could be. Better IFM can have a meaningful impact on the bottom line, improve financial control and reduce reputational and other risks. But few within the organization recognize that IFM is a systemic issue that must be tackled holistically. An uncoordinated approach to IFM built on inconsistent and incomplete data poses the risk of ongoing potential legal, regulatory and tax compliance issues, tax leakage and imperfect visibility that translates into gaps in financial control. To the extent that transactions involve anything more than simple chargebacks to a specific cost center, IFM can automate that process for improved accuracy, speed and consistency.

Done well, IFM can benefit a broad set of people and roles in a company through efficiency gains, better management of tax costs and greater control of risks. Tax departments in particular benefit from more effective worldwide tax management as this allows them to detect and prevent tax leakage, reduce workloads and develop stronger audit defense capabilities. In multinational organizations where people, products and services routinely cross legal entities and borders, HR, sourcing and supply chain managers can gain a better



understanding of total costs and how best to manage them. And for corporations that use acquisitions strategically, IFM can streamline the post-merger financial integration process.

IFM Requires More Than Software

Performing intercompany financial management competently requires an integrated approach to the people, process, information (data) and technology (software) elements of the discipline. The following information technology components are essential:

- An accurate, timely and consistent set of corporate-wide data encompassing all relevant intercompany transactions. This requires automating the ongoing extraction of this data from multiple ERP and other systems of record to create this pan-corporate data source.
- Technology, in the form of application programming interfaces (APIs) and robotic process automation (RPA), makes it possible to automate data movements to ensure the integrity of the data in the pan-corporate data source.
- Automated invoice processing to ensure accuracy and efficiency.
- A global billing and payments capability that provides speed and accuracy and that supports a high level of granularity.
- A tax rules engine that accurately applies rates to individual line items and is capable of compliance with the rising requirement for digital tax filings.

While the use of information technology is necessary, it is not sufficient by itself. People with expertise acquired through education, training and experience are the most important ingredient because of the ambiguities and complexities inherent in tax and accounting done on a global scale. Having staff with this capability ensures that issues are resolved quickly and correctly.

Mastering IFM Must Be a Priority

Corporations with even a modestly complex legal entity structure that operate in more than a handful of tax jurisdictions and with ERP systems from multiple vendors will likely find measurable benefits from adopting intercompany financial management. Doing so enables them to address the problems created by an uncoordinated approach to intercompany transactions built on inconsistent and incomplete data. But IFM goes beyond the simple reconciliation of accounting entries by creating and applying global process consistency to ensure the application of best practices everywhere. Mastering IFM must be a priority. When properly deployed, it can substantially reduce (and maybe eliminate) tax leakages—especially in value-added taxes—and it can make a shorter accounting close possible with no sacrifice to accuracy or control.



About ISG Software Research and Advisory

ISG Software Research and Advisory provides market research and coverage of the technology industry, informing enterprises, software and service providers, and investment firms. The ISG Buyers Guides provide insight on software categories and providers that can be used in the RFI/RFP process to assess, evaluate and select software providers.

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