The Business Value of e-Invoicing

A new look at the challenges, trends and opportunities in the global marketplace

Sterling Commerce
An IBM Company

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Executive summary

There are tens of thousands of companies that do business outside of their own borders. These multi-national companies are required to comply with the local legislation of the countries in which they do business. For many countries around the world, such as Australia, Canada, Hong Kong, New Zealand, South Africa and the member states of the European Union, this includes understanding and complying with Value Added Tax (VAT) or other similar indirect taxes.

By automating manual, paper based accounts payable and accounts receivable invoice processes, companies can reduce costs, improve customer relationships, take advantage of term discounts and reduce the risk of being found non-compliant with local tax legislation, along with the associated risk of fines and penalties.

In early 2010, Sterling Commerce commissioned Forrester Consulting to execute a study to determine the cost of manual and electronic invoice processes, associated errors, and VAT audits. The survey was conducted across 169 respondents in accounts payable, accounts receivable and tax management functions in enterprises with annual turnovers in the range of $250 million to $5 billion, in the United States, Germany, UK, France, Netherlands, Sweden, Spain and Italy. The study looked at enterprises in the manufacturing, retail/wholesale, communications/media and distributions/logistics industries.

The survey found that by moving from manual, paper-based invoice processes to fully automated, electronic invoice processing, businesses can achieve:

- Cost savings of 90 percent on the accounts payable (AP) side
- Cost savings of 44 percent in the accounts receivable (AR) departments
- Error reduction of 37 percent on all types of invoices.
- Storage costs savings (with over 40 percent of companies retaining archives for up to 10 years, savings of up to 67 percent on AP and 32 percent on AR invoices were realized)

(For more detail on the study see page 5, Sterling e-Invoicing business value.)

Situation overview

In many countries around the world, the invoice is considered a legal document for VAT purposes. It has traditionally been a requirement to retain it in paper form to facilitate tax audits. Processing and archiving paper invoices has been very difficult for companies, as it requires manual processes to create paper invoices, and long term storage, up to 11 years in some cases, of paper invoices in warehouses across the world.

Paper invoice processes cost companies hundreds of thousands of dollars each year, just for the privilege of being able to administer tax collection for various countries. In today's global economy all companies are looking for ways to increase effectiveness and competitiveness while reducing costs. Automating manual invoice processes is a near term opportunity to accomplish all of these objectives.

This is all now possible because jurisdictions such as the European Union countries that used to require paper invoices have passed legislation allowing e-invoicing. In 2001 the European Commission issued a directive to enable businesses to automate invoice processes and use electronic representations of invoices to fulfill their VAT reporting and audit needs. This directive was 2001/115/EC, which has since been updated by directive 2006/112/EC.

Authenticity and integrity are fundamental to compliance

The goal of the directives is to simplify, modernize and harmonize the conditions laid down for invoicing with respect to value added tax within the EU. For all jurisdictions with e-invoicing requirements, there are two concepts that are fundamental to compliance: authenticity and integrity. Companies must be able to prove the authenticity of an invoice (i.e. that it is from whom it purports to be from) and the integrity of an invoice (i.e. that its contents have not been altered.) They must be able to do this not just during the transit of the invoice from supplier to buyer, but also during the lifetime of the archive.

Although the EU directive was designed to provide clarity, in reality it has been implemented in a fragmented and uncoordinated manner. Each EU member state has its own e-invoice requirements and legislation, a model which has been replicated in other countries, making it extremely difficult to make sense of them as a whole. It is impossible for IT departments to be expert in the requirements of every country in which they operate, and the requirements are typically defined from a legal/ tax perspective rather than a technical one. This introduces significant additional complexity and ambiguity for those who are attempting compliance.

There are two key approaches to compliance that are specified in the directives, including advanced electronic signatures and electronic data interchange (EDI). Note that in the context of e-invoicing legislation EDI does not simply refer to the use of an EDI standard such as EDIFACT or ANSI X.12, but rather to "the use of an agreement relating to the EDI exchange which provides for the use of procedures guaranteeing the authenticity of the origin and integrity of the data." Guaranteeing the authenticity and integrity in this way requires storing and maintaining process and technical documentation for up to 11 years.

The best option for proving validity is advanced electronic signatures

Sterling Commerce believes the best option is advanced electronic signatures. Electronic signatures have three major advantages over other techniques to ensure integrity and authenticity:

- Electronic signatures can drastically reduce the compliance footprint on an e-invoicing system, thereby enabling users to quickly and flexibly respond to changes in the business and legal environment
- Electronic signatures benefit from a separate, mature legal framework in all countries
- Electronic signatures provide very user friendly audits

By 'user-friendly audits' we mean that when a company is actually audited for VAT compliance the advanced electronic signature approach can enable a tax auditor to confirm authenticity and integrity of an invoice, typically within minutes. In most cases, the tax auditor can leverage a Web-based user interface to quickly and easily re-validate the signature that was originally applied. This takes very little time and is again done through an online user interface. The alternative is sorting through piles of paper documentation.

In July 2010, the European Union agreed to new amendments to the legislative environment surrounding e-invoicing, which will come into force in 2013. The amendments free companies to choose the means by which they prove the integrity and authenticity of invoices to a tax administration, rather than specifying the use of EDI or electronic signatures. However, the requirement to be able to prove authenticity of origin and integrity of contents still remains. Each company must still ask themselves, for every single transaction, how they will prove what occurred in that transaction not just in a year's time, but in up to 11 year's time.

In some countries, like the UK, tax authorities typically adopted a fairly liberal approach. However, for the vast majority of member states the tax administration has traditionally sought conclusive evidence of invoice validity—often regardless of the pain and cost inflicted on the taxable person—and in those member states companies will need to think twice before relying only on their business processes for proving invoice validity many years ago.

The concern every company must have about their processes is not about how good they are now. The concern is that after 6–11 years and much iteration of people, duties, processes, B2B technologies and lines of business—will the evidence for each transaction in the distant past be sufficient to satisfy the tax authorities?

At its essence the question is still "how can businesses gain legal certainty of long-term verifiable authenticity and integrity?" The best answer to this question still remains "digital signatures."

		EDI (without electronic signatures)	Electronic signatures
Geographic availability and relevance		**Incomplete.** Even within the EU, the Invoicing Directive requirement for member states to have an effective EDI option is not always honored. In non-EU countries (such as Switzerland, Mexico and Brazil) that only accept e-signatures for compliant e-invoicing, additional measures will always need to be taken.	✔ **Full.** Not only do all EU member states recognize e-signatures for e-invoicing compliance, this technique also complies in countries with similar objectives in VAT or other law—such as Switzerland. Other countries may not have an explicit e-signature requirement in compliance with local law will set a high level of trust vis-à-vis tax authorities. For countries that do not require any security for e-invoices, an e-signature can simply be omitted.
Types of invoicing transactions for which the compliance option is available.		**Some.** Only end-to-end automated B2B (for example, browser-based Web-EDI, pull systems, manual self-billing procedures may not qualify).	✔ **All**
Requirements differ per country		**Yes**	✔ **Yes**
Requirements are clearly defined in each country		**No**	✔ **Yes**
Can I easily get compliance certainty prior to going live with e-invoicing?		**No.** Often the only way to be sure is to obtain an advance ruling, if available, from tax authorities in each relevant country. This is an expensive process.	✔ **Yes.** No advance rulings required if signature requirements are met.
Integrity and authenticity guarantee level offered by the technology	De facto	**Partly.** Only point-to-point, not in storage. Need for additional procedure measures outside secured pipe.	✔ **Yes**
	Durable audit-ability	**No.** Need for additional procedural measures outside secured pipe and in storage.	✔ **Yes.** Data level, regardless of transport or archive security. (This requires use of modern signature formats with, for example, time stamps and packaging of validation data).
Requirements for additional summary statements, in paper or electronic format		**Yes.** Requirements for summary statements differ per country in terms of production, filing and storage.	✔ **Yes**
Interchange/trading partner agreements describing at least parties' security procedures		**Mandatory.** Often have to be based on a specific EU model with stringent security requirements.	✔ **Voluntary**

Keeping the auditor happy

Sterling Commerce offers a "black-box e-signature solution" that handles the regulatory requirements of over 40 countries, with more countries added each year. IBM® Sterling e-Invoicing takes an "audit-centric" approach, in which the solution guides users to follow the specific procedures and provides exactly the right information that is preferred by the tax authority in question.

A tax inspector in Italy, after all, is not likely to care whether an invoice met the standards for e-invoicing set out by tax authorities in some other country. What matters with e-invoicing is to make the audit is as simple as possible for the tax inspectors by

Sterling e-Invoicing brings the benefits of invoice automation to the table for the first time while removing the complexity of meeting disparate e-invoicing compliance requirements. Benefits to the business include:

- **Reduce risk**—by lowering your chance of incurring penalties for non-compliance with each country's regulations. In some cases, this can include fines, forfeiture of the buyer's right to reclaim input tax, as well as the risk of criminal investigation for fraud

- **Reduce costs**—by cutting in half the amount of time associated with audits from regional tax authorities and reducing processing costs by automating manual processes

- **Simplify**—enabling both buyer (procurement/purchasing) and seller (sales) compliance in a single solution that supports multiple countries, eliminating the need to support multiple solutions across different geographies

presenting them with the information they wish to see in the format that they expect. The objective of every company is to get the tax inspector out of the door as soon as possible—this level of audit-ability is what Sterling e-Invoicing achieves better than other solutions that merely seek to comply with form requirements from primary law. By satisfying the auditor in this way, companies can minimize the risk of being fined or suffering other financial penalties associated with non-compliance.

Sterling Commerce uses state-of-the-art technology for invoice signing and validation. The solution is continuously updated with the latest regulations via an on demand compliance map, so you do not have to keep abreast of changes in e-invoicing legislation. In addition, we offer an archive service which ensures you are compliant with individual country VAT storage regulations.

Sterling e-Invoicing business value

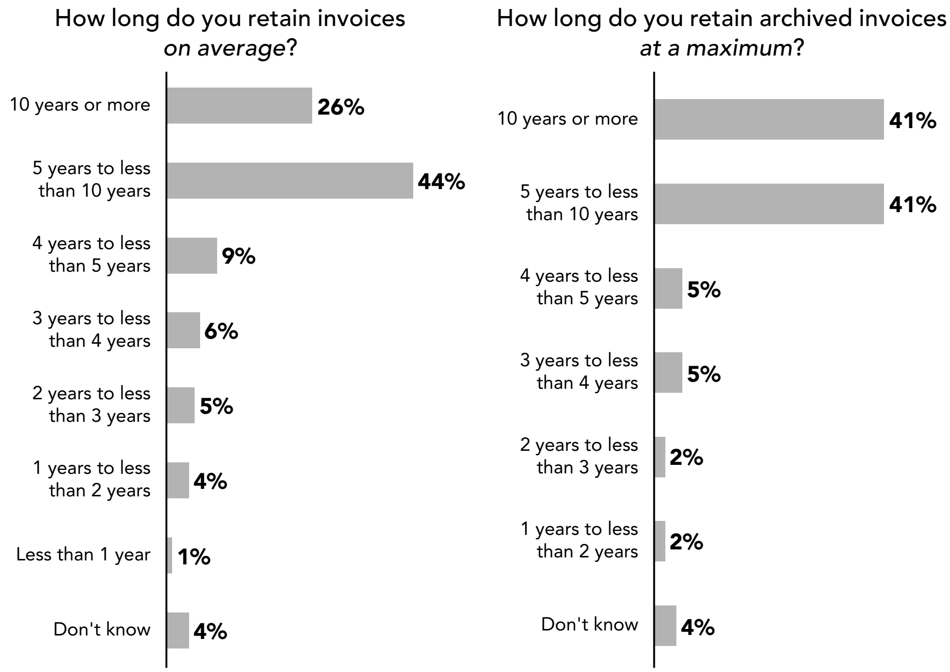
Sterling Commerce commissioned Forrester Consulting to conduct a global study that examines how companies manage the complexity of cross-border invoicing. The purpose of the study was to highlight the cost savings to be gained by automating the processing, archiving and auditing of cross-border invoicing; notably through the elimination of error-prone manual processing and the reduction of associated penalties and fines.

The survey was undertaken across 169 respondents in accounts payable, accounts receivable and tax management functions in enterprises with annual revenue ranging from $250 million to $5 billion. Enterprises were surveyed in France, Germany, Italy, the Netherlands, Spain, Sweden, the United Kingdom and the United States, and across the manufacturing, retail, communications/media and distributions/logistics industries.

The survey found that by moving from manual, paper-based invoice processes to fully automated, electronic invoice processing, businesses can achieve:

- Cost savings of 90 percent on the AP side, as manually-processed invoices cost, on average, $30 per invoice to process, while fully automated invoices average only $3.50 per invoice to process
- Cost savings of 44 percent in the accounts receivable (AR) departments, where manually-processed invoices cost, on average, $4 per invoice and fully automated invoices $2.25 per invoice to process
- Error reduction of 37 percent on all types of invoices
- Storage costs savings—With more than 40 percent of companies retaining archives for over 10 years, these will be significant
  - Savings amount to 67 percent on AP and 32 percent on AR invoices, with fully electronic invoices of all kinds costing on average $1.30 to store, while paper AP invoices cost $3.90 and paper AR invoices $1.90 each to store

Retaining Invoices



Base: 169 respondents in Accounts Payable, Accounts Receivable, and Tax Management roles

Source: A commisioned study conducted by Forrester Consulting on behalf of Sterling Commerce, June, 2010

In addition to process automation cost savings, there are reductions in error rates and associated error processing and correction costs. The survey found that, on average:

- Each paper invoice error costs companies $53.50 to rectify
- Accounts payable (AP) departments receive 35 percent of invoices in paper form
- Only 25% of invoices are sent via a fully automated electronic method

From an audit perspective, approximately half (49 percent) of companies experienced two audits or more over the previous three years. Of the companies surveyed that had experienced VAT audits:

- 34% incurred fines from tax authorities
- Average fines by tax authorities amounted to over $76,000 per year
- 24% incurred fines for not being compliant with customer mandates
- Average fines by customers amounted to almost $70,000 per year

Case study

In an effort to help companies determine their return on investment and potential cost savings, the Forrester study results have been used to create an e-invoicing savings calculator, which is available at: www.sterlingeinvoicingsavings.com.

The calculator is a simple, three step process to determine potential cost savings that can be achieved through automation of either accounts payable or accounts receivable invoice processes. Companies select a role, enter some basic invoice, tax and audit information and can then register to receive a detailed report.

To give you an example of potential savings, let's consider the following scenario:

The Supplier Company, Ltd. in the manufacturing industry with revenues of $500M–$1B has 500 customers. They exchange 57,500 manual invoices per year. The Supplier Company, Ltd. has an annual input tax of €300,000 and an annual output tax of €450,000. The Supplier Company, Ltd. currently pays €75,000 each year in fines or penalties due to non-compliance with e-invoicing regulations.

Based on this information, The Supplier Company Ltd. could reduce costs associated with annual invoice processing in five key areas:

- Processing Automation—increasing process automation and eliminating manual processes reduces the labor required to process invoices and provides an audit trail
- Archiving—improving archiving capabilities to take into account to specific country requirements, and third party systems improves information visibility and reduces the risk of non compliance
- Error Rates—fewer errors means less time reconciling and resolving those errors
- Auditing—Improved auditing capabilities accelerates the audit process, making them simpler and quicker, reducing the resource required to conduct them
- Fines/Penalties—reduced penalties and fines from customers and tax authorities has a direct impact to the bottom line, customer satisfaction and brand reputation

The table below shows how much The Supplier Company Ltd. could save by moving to electronic invoicing:

Cost savings area	30% electronic invoicing	65% electronic invoicing	100% electronic invoicing
Processing costs	€16,500	€35,749	€54,999
Archiving costs	€28,500	€61,750	€95,000
Error costs	€22,200	€48,100	€74,000
Audit costs	€12,859	€27,862	€42,864
Fines/penalties	€22,500	€48,750	€75,000
Total Annual Cost Savings (in euro)	**€69,560**	**€150,712**	**€231,865**

The Supplier Company Ltd. currently has 13% automated invoices. By moving to 30% automation, it is estimated The Supplier Company Ltd. can save almost €70,000 annually. If they can achieve 65% automation, this increases to over €150,000 per year and at 100% full automation they can save over €231,000 euro per year. These numbers demonstrate a huge opportunity for cost reduction and improved customer relationships.

Conclusion

Cost concerns resulting from the tight economy of recent years, plus the need to drive process improvements in support of growth initiatives and customer service, are causing many enterprises to re-evaluate how they support their invoicing processes. Process automation has been for many years (and continues to be) a huge opportunity for process improvements and cost reduction for enterprises of all sizes. As companies seek to further automate accounts payable and accounts receivable business processes, they will be forced to address a new layer of added challenges around increasing electronic tax compliance, especially in cross border invoicing situations.

Although there are still challenges associated with implementing electronic invoicing, both Sterling Commerce and many B2B analysts and experts believe that significant benefits can be achieved, and this is confirmed by the recent research study and associated Forrester Consulting findings.

About Sterling Commerce

Sterling Commerce, an IBM® Company, helps organizations worldwide increase business agility in their dynamic business network through innovative solutions for selling and fulfillment and for seamless and secure integration with customers, partners and suppliers. More information can be found at **www.sterlingcommerce.com.**

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