SOVOS

COMPLIANCE AT THE CORE

SAP® Central Finance and Digital Tax Compliance

Critical Prerequisites to Successful SAP S/4HANA Digital Transformation

Introduction

For some SAP customers planning a move to SAP Central Finance, tax compliance will not be a priority. Unfortunately, that will be a costly oversight. Today, those who fail to comply with global tax mandates face costly audits, financial penalties, decreased cash flow and damaged relationships with suppliers and customers. Non-compliance can even derail your Central Finance and S/4HANA migrations altogether. And in some countries, it can bring your entire business to a screeching halt.

In this document, learn what tax compliance barriers you may have overlooked and how to prevent roadblocks to your SAP Central Finance migration. Find out how tax compliance mandates affect SAP Central Finance migrations, and discover precise steps your business can take to ensure that a Central Finance rollout isn't derailed due to non-compliance. Finally, get a picture of what a successful rollout of SAP Central Finance looks like.

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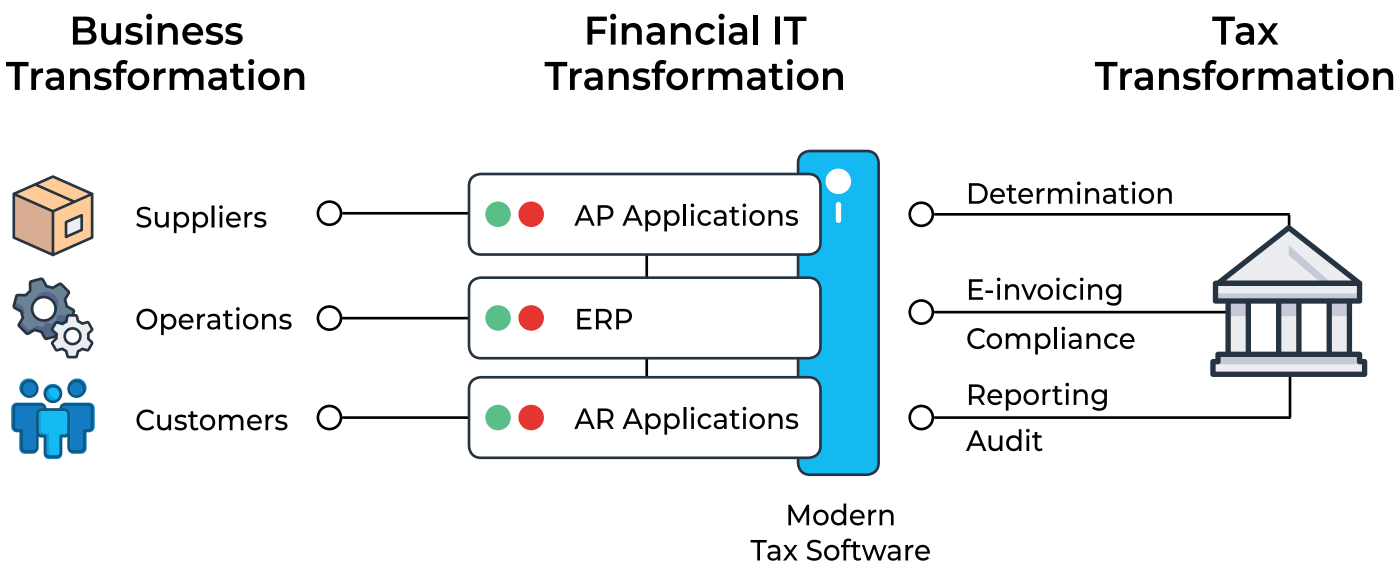
The “other” digital transformation

Governments around the world are embarking on their own form of digital transformation, seeking to capture billions in lost revenue by mandating real-time tax enforcement. This “other” digital transformation is having a significant impact on even the best-run businesses’ plans for SAP Central Finance and SAP S/4HANA migration.



Now that the technology exists to enforce continuous compliance, more governments are inserting themselves into every transaction a business makes and changing the requirements whenever they see the potential for more revenue.

The modern digital financial core has a new set of requirements. Multinationals need to isolate their core financial systems from constant regulatory disruption in order to meet compliance requirements, no matter where or how frequently mandates might change, so they can continue to do business in countries where governments have made digital tax a priority.

Major investment in SAP

Contrary to the rapid pace of change in tax mandates, major developments in SAP enterprise resource planning (ERP) systems are relatively few and far between. Many companies have just begun planning a move to SAP S/4HANA, the latest version of SAP’s massive ERP offering. But S/4HANA would be ancient in some software markets, having been available since 2015.

In fact, the SAP HANA data store on which S/4HANA is based is almost a decade old, dating back to 2010. Even more shocking is that the version of SAP’s flagship system many firms are looking to replace is SAP R/3, which made its debut in 1992, before Amazon or Google even existed and before the Mosaic browser or even the World Wide Web itself were available to the public.

So, when companies look to make a move to a new SAP system, it's not a move they can take lightly. SAP migration can have massive consequences, both positive and negative, not just because of the cost and resources involved but also because of potential disruptions—or improvements—to supply chains, manufacturing operations, financial systems and other ultra-critical pieces of underlying technology infrastructure.

The promise of SAP Central Finance

With SAP S/4HANA, SAP is offering something of an ERP holy grail: an entire suite of ERP functionality in one place with a single data store. Options to deploy in the cloud, on-premises or in a hybrid model also make SAP S/4HANA attractive, but the ability to run all ERP capabilities, both from SAP and non-SAP systems, from a single source represents delivery of a model IT professionals and SAP administrators have sought for years.

The trick, of course, is getting there. Moving massive swaths of data from disparate systems and sources -- many patched together with the integration equivalent of bandages and Scotch tape -- carries massive risk and demands an enormous number of resources, both in terms of capital investment and employee hours.

Seeking to create a tool to ease migration of financial functions and data, SAP developed Central Finance, a deployment mode through which companies can move critical data from existing systems into SAP S/4HANA. With SAP Central Finance, companies can create a single point of access for financial data from disparate accounts payable (AP), accounts receivable (AR) and ERP applications and bring that data into SAP S/4HANA at the company's chosen pace.

The biggest benefit of using the SAP Central Finance deployment option is that finance teams can leverage the benefits of SAP S/4HANA Finance without disrupting the processes in source ERP systems and without needing immediately to convert each back-end system to SAP S/4HANA. The ultimate value proposition is the elimination of the need and expense required to maintain multiple, often loosely connected systems, as well as the ability to make a change to data in one instance rather than multiple instances. (Note: Companies will need to maintain the source system and S/4HANA Central Finance until they migrate the entire business process into SAP S/4HANA).

Why SAP Central Finance exists

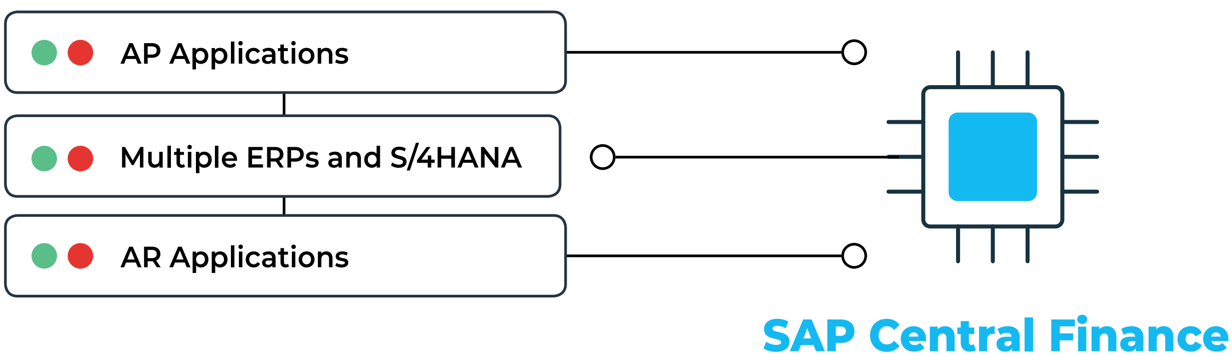
The need for Central Finance came about, in part, as companies tacked additions onto their core ERP systems to handle processes beyond those systems' capabilities. As AR became a more sophisticated operation, companies saw a need to supplement the capabilities of their ERP implementations with separate AR systems. Later, the same happened on the AP side. And as multinational companies expanded and acquired other businesses, they picked up disparate ERP systems along the way and ended up with a multitude of ERP implementations.

Most of the time, those disparate applications and ERP implementations did not share information. IT departments tied them together as best they could, but in many cases users still had to update data multiple times in multiple different systems. The notion of having a unified system with a single source of financial data seemed further out of reach as integrations proliferated.

But with Central Finance, SAP is offering a path to single-source financial data paradise in SAP S/4HANA, so planning, consolidation and business intelligence can directly interact with real-time finance data, through direct real-time access to Universal Journal. It's literally a development decades in the making.

The transition to SAP Central Finance amid the digital transformation of tax

It could take years for SAP shops to get where they need to go. In order to move to Central Finance, companies will need to install an instance of S/4HANA--no small project in itself--with Central Finance as part of the implementation. Then, they can begin feeding data into Central Finance from other sources, including AP, AR and other ERP systems. That will likely happen piecemeal, with companies transitioning their financial data from old systems after they completely extract data from them and move it into Central Finance.



But there's another potential threat to a successful migration to SAP Central Finance that lurks in the darker corners of most companies' operations: the digital transformation of tax. Failing to comply with complex, rolling global tax mandates could not only threaten migration to Central Finance, it could bring a business to a screeching halt in some countries around the world.

That's why compliance needs to be at the core of a move to SAP Central Finance -- not on the periphery. Companies that want the ability to migrate unhindered should consider moving tax determination to the cloud as a prerequisite, not an afterthought.

Local real-time tax challenges and the need for a modern tax solution

With more companies focusing on global integration, cross-border supply chains and expanding ecommerce, governments across the globe are introducing new ways to enforce tax rules on sales taxes, gross receipts taxes, excise taxes, shipping taxes and taxes on profits. The evolving global regulatory environment produces unique tax determination and reporting challenges in the United States and around the globe. These regulations can interrupt operations and impede growth for unprepared businesses.

SAP Central Finance is for centralizing finances. Sovos S1 is for centralizing compliance.

Sovos S1 will be compliant throughout the SAP Central Finance and SAP S/4HANA digital transformation. With S1, organizations can protect their multi-year digital transformations by using a unified system for compliance rather than local point solutions that might not be compliant by the end of the project. Organizations may still have to implement a new regulatory requirement in two places (the legacy ERP instance and the newer SAP instance with Central Finance), but they'll only need to solve it, configure it, and maintain it ONCE in the S1 cloud.

When tax determination is managed entirely in the cloud by the tax compliance vendor; compliance updates, investment in maintenance, infrastructure, and innovation offer savings in cost and personnel resources. Regulatory updates are delivered automatically, removing the manual intervention each time regulations change.

CTOs also avoid surprises of an unknown point solution running custom code in another region and impeding their migration to SAP Central Finance and ultimately SAP S/4HANA.

Tax Compliance Solution Checklist: Integration / Implementation

- ☐ Is it SAP S/4HANA certified?
- ☐ Can it be leveraged across all of your business systems whether integrated or not?
- ☐ Does it use flexible APIs?
- ☐ Can it use real-time and batch transaction processes to aggregate and analyze all transactions?
- ☐ Are there flexible support options to meet your specific needs and geographies?

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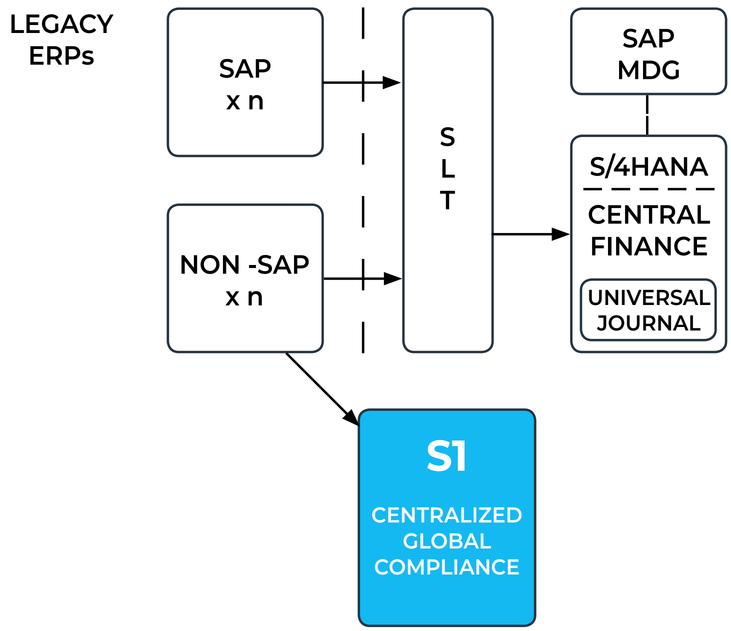
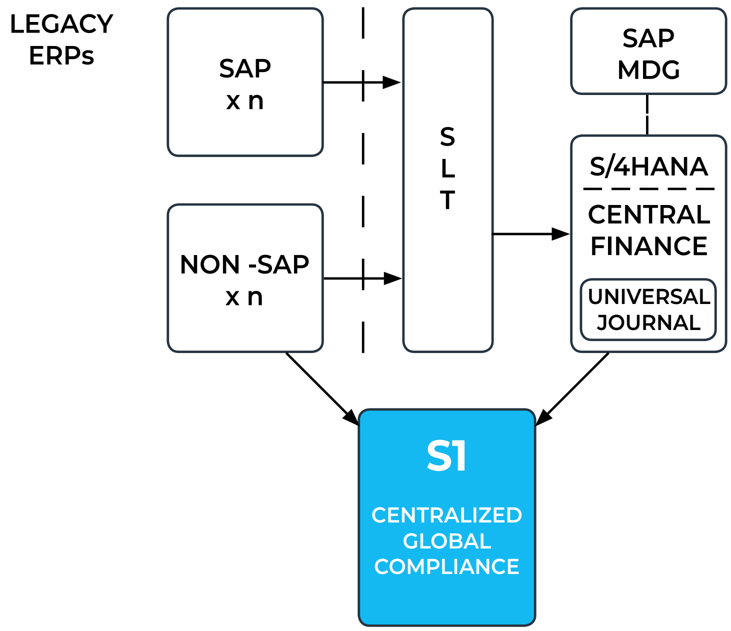
Protecting SAP Central Finance from global tax mandates - digital transformation visualization

1. Connect legacy systems to Sovos S1 for tax compliance.

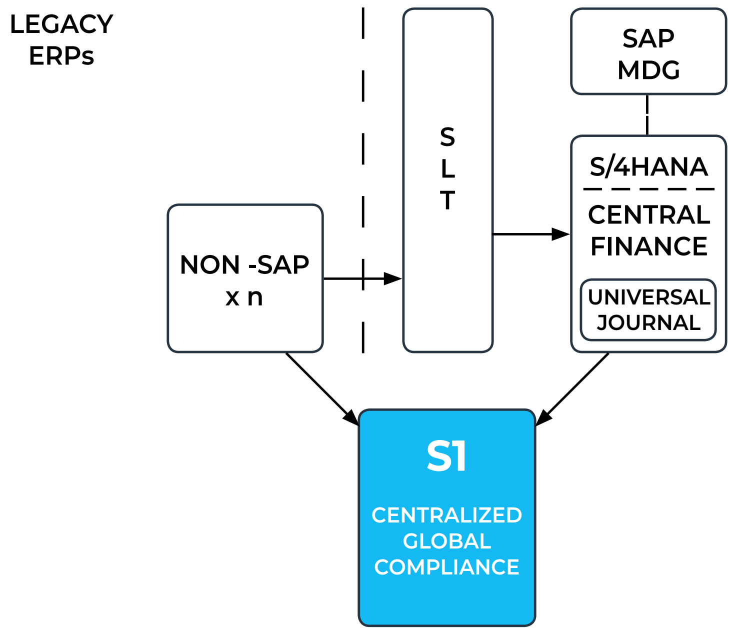


2. During transition solve tax compliance once & stay ahead of regulatory change.



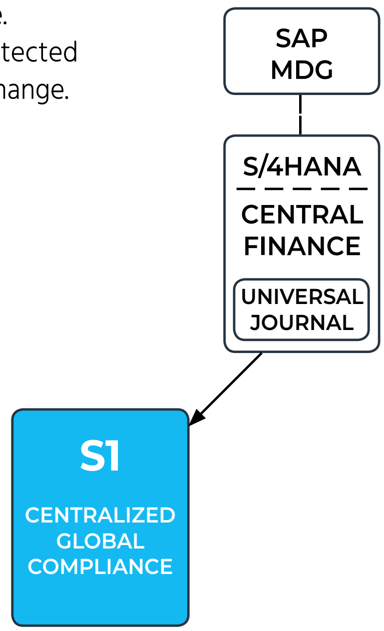
Protecting SAP Central Finance from global tax mandates - digital transformation visualization

3. Incrementally decommission legacy systems as they become redundant and migrated into SAP S/4HANA.



4. The digital transformation is complete, and ERPs are fully migrated to SAP S/4HANA.

This may take two to five years, as regulatory requirements will change during this time. However, your transformation will be protected from disruption by Sovos S1 during this change.



A global tax compliance strategy should be at the forefront of your SAP Central Finance project plans. Take inventory of your exposure, including local point solutions for digital tax determination, custom reporting built in-house, and SAP and third-party localizations. Consider the following functionality when evaluating solutions:

- A steady stream of compliance updates to prepare companies in advance of regulations;
- Data visibility for a central source of truth to ensure an understanding of all tax liability and avoid errors and unnecessary data manipulation across a patchwork of systems. Visibility empowers tax teams to easily find data — without burdening IT, to streamline audit defense, greatly reducing maintenance costs;
- Automation to reduce manual entry and ensure accuracy while meeting deadlines across geographies and compliance obligations;
- Seamless workflows that remove IT involvement and enhance operational efficiency across the business;
- Modern, flexible and comprehensive APIs to make applications easily available in your specific set of financial systems and workflows - and enable your systems to communicate to governments in the unique and changing data formats they require; and
- Reporting and analytics to enable tax teams to quickly identify and reconcile tax transactions with the general ledger and spot trends, discrepancies or flows in transactions that reveal errors creating challenges and gaps.

Tax Compliance Solution Checklist: Scale and Security

- ☐ Does it meet your company's security requirements?
- ☐ Can it run transactions in real-time without slowing down your users or customers?
- ☐ Is the solution capable of being scaled globally?
- ☐ How easy is it to add additional applications as requirements expand?
- ☐ Is there centralized visibility and control over internal processes and obligations?

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Benefits of moving tax compliance to the cloud as a prerequisite to SAP Central Finance

For SAP customers moving to Central Finance, given the massive scope of the project and the sensitivity of the data involved, tax compliance will likely start out as an afterthought in migration plans. But it shouldn't be. Global tax mandates are complex and change constantly, and they can be invasive in a company's business processes. Failure to comply not only courts potentially significant financial penalties, it can also seriously affect cash flow, as well as relationships with suppliers and customers.

Mandates also have the potential to disrupt and add cost and delay to SAP Central Finance and S/4HANA migration plans. For businesses that need to continue selling goods and services into countries where continuous compliance and tax enforcement are becoming increasingly complex, digital transformation of the financial core is paramount.

Perhaps the most striking examples are in Latin America, where real-time electronic invoicing is now the law in Brazil, Mexico, Chile, Colombia and Peru, with more nations planning to add themselves to the list. The movement is also expanding to Europe, with Italy having implemented real-time e-invoicing mandates. By mandating enforcement tactics such as e-invoicing and e-archiving, governments can track value added tax (VAT) payments in real-time and eliminate both fraud and errors that previously would have led to underpayment.

Tips for Success in Moving to SAP Central Finance:

- **Engage local and regional business teams.** SAP S/4HANA could impact data elements and business processes pertinent to compliance.

  Are you incorporating the insights and knowledge of your local finance, tax and accounting teams to identify tax, e-invoicing compliance and regulatory reporting requirements into your ERP migration planning meetings?

- **Harmonize with those teams.** Schedule carefully. As you try to leverage shared services and efficiencies of having global reporting and analytics for ERP, give the local teams time to address complex fiscal obligations within markets. Central Finance's predictive closing, for example, can be run in parallel with local period-end closing activities until the local business team has full confidence in the new reporting functionalities.

Replicating data to SAP Central Finance could also have the following challenges:

- **The implications of historic financial comparatives and GL reporting** (Trial balance reports or SAF-T): SAP allows summarized load from the FAGLFLEXT or ALL documents as of a point in time. You may need custom manual journal entries to selectively restate history. How does this impact archiving and audit requirements within jurisdictions?

- **The risks of statutory and parallel ledgers:** SAP Central Finance is focused on leading ledgers as a global strategy. This could be a risk for your opening balance sheet load on open items.

Tax Compliance Solution Checklist: Global Compliance

- ☐ Are determination and compliance reporting/filing provided for all the jurisdictions where your company operates? (U.S. and globally)
- ☐ Does it support VAT compliance everywhere you do business?
- ☐ Are your purchasing process and applications ready and able to create government mandated acknowledgments within required timelines?
- ☐ Will it handle cross-border supplies of goods and services?
- ☐ Can users access an audit trail when needed to simplify both post-audit and clearance model e-invoicing compliance requests?

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VAT enforcement in Mexico - another example of protecting SAP Central Finance from tax complexity

Consider Mexico's mandate for keeping companies honest. Failure to comply with Mexico's e-invoicing mandate can bring business in the country to a halt, with shipments sitting at ports and payments to suppliers never completed.

The Mexican mandate is subject to constant change. If a mandate like the e-invoicing regulation in Mexico changes during a transition to SAP Central Finance and a company that has relegated compliance to an afterthought is unable to adapt to it, the consequences on cash flow and relationships with suppliers can be severe. That's why having an adaptable system that can react to new and changing mandates is so important in the move to SAP Central Finance.

The process starts with the e-invoice itself. (In Mexico, it's called a CFDI.) This used to be a paper invoice, but the government now requires electronic invoices in a standard XML format. Companies doing business in Mexico must generate an electronic invoice in the standard format with information such as a tax ID number, description of goods, total amount of the invoice, taxes due and much more. The shipper has to submit that invoice and then receive a unique number called a UUID back from the government. Once the government generates the UUID, the company can ship its goods. This all happens in real time.

On the other side, companies receiving invoices must validate them with the government, matching information in the invoice with information stored in a government database. If the information matches, the company can take delivery of its shipment. If it doesn't, the government can see discrepancies and can delay reception of goods, and in some cases penalize the company for submitting incorrect data.

Tax Compliance Solution Checklist: Future Proof Process

- ☐ Can the solution adapt to your needs 5-8 years out?
- ☐ Does it support customized tax rules?
- ☐ Can it track in-progress government audits?
- ☐ Ability to transform incoming data into "tax ready" data before calculating tax obligations?
- ☐ Ability to "drill down" from category to individual invoices to individual line items in returns?

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But penalties are only part of the consequences of non-compliance. Delayed or cancelled shipments can quickly lead to frustrated customers and lost revenue. And then there are the tax implications themselves, which also have a strong financial component.

VAT is effectively what a company paid in invoices minus what it received. If a company collected more tax than it paid, it owes extra in VAT, but it receives a credit if it paid more than it collected. E-invoicing compliance, then, isn't just about staying out of trouble with shipments and government penalties; it can help put money back in a company's coffers and improve its cash flow. Failure to comply leads to the opposite--problems with cash flow, along with damaged relationships with suppliers and customers, and potential penalties from the government that can go as far as shutting the business down in Mexico and other Latin American countries.

E-invoicing is just the tip of the iceberg, as well. An e-archiving mandate requires companies to store their invoices in a specific format in order to be prepared for electronic audit by the government at any time. The process of cancelling an invoice, only recently created and likely to change at some point, is both complex and critical for staying in compliance.

Changing mandates in the move to SAP Central Finance

Change, in fact, is a common theme in VAT enforcement. Peru, Colombia and Chile have only recently come online with real-time e-invoicing mandates. Europe has begun adopting real-time invoicing and reporting models to recover its own VAT gaps. Italy has spearheaded the movement, with other nations to follow. In the UK, the 2019 Making Tax Digital (MTD) initiative is going live, and many member states, including France and Greece, are quickly ramping up initiatives to collect invoice and accounting data closer to the actual moment business transactions take place. But governments are constantly implementing and changing VAT-compliance mandates. In 2019, China, Singapore and Vietnam will also roll out new mandates. Colombia and Peru have already announced changes to their mandates for 2019, and Finland, Sweden, Germany and Portugal all have government reporting mandates on tap.

Every national tax administration has a different set of mandates, and those mandates can change quickly and with relatively short notice. (Peru launched a major mandate in 2018 and notified companies only six months in advance.) Mandates also vary widely in complexity and requirements, and tax compliance goes well beyond VAT enforcement into other areas, such as sales and use tax, and tax information reporting. Ultimately, it involves thousands of jurisdictions and perhaps tens of thousands of laws and mandates--or more.

Brown-Forman

Brown-Forman selected the Sovos e-invoicing compliance solution to simplify its compliance efforts in Brazil and Mexico. The company sought a solution that could help it cut down on human resource capital and technology investments, and Sovos' SaaS platform allowed it to accomplish that goal.

READ THE CASE STUDY

> "Because Sovos provides the network upgrades as well as the SAP ERP configurations, we have been able to work with one vendor across multiple countries and confidently manage the changes to Brazil's Nota Fiscal and Mexico CFDI's legislation."
>
> **- Randy Isdahl, Director SAP Process Architecture at Brown-Forman**

Failure to comply with any one mandate could cause major problems for companies doing business in that country. Keeping track of new mandates and building them into a financial system or set of systems as laws change is nearly impossible, and the danger of non-compliance is especially acute for companies moving to SAP Central Finance.

Migration to SAP Central Finance will take years, and over the course of those years, tax mandates will develop and change. A system that can't handle those changes dynamically could derail an entire digital transformation project. Beyond that, moving data into SAP Central Finance over a period of years without accommodating for changes in AP and AR processes as a result of changing mandates will create a single-source system that can't support digital transformation because it can't manage compliance.

Compliance at the core of a move to SAP Central Finance

Companies should proactively manage compliance as a prerequisite to any move to SAP Central Finance rather than push it to the periphery. **Tax compliance is the axle around which the wheel of digital transformation turns.** Governments will not stop innovating and undertaking their "other" digital transformation, so companies must keep pace to stay in compliance. Otherwise, the risks and costs of digital transformation multiply.

> **Tweet:**
> **Tax compliance is the axle around which the wheel of digital transformation turns.**

Of course, compliance is much more easily discussed than executed. The complexities of moving to Central Finance will be challenging enough without having to take on compliance in-house at the same time. Outsourcing compliance to a third-party in the cloud isolates systems from continuous disruption and enables a company's IT professionals to focus on other critical steps in the journey to Central Finance.

> **Recommendation:**
> **SAP recommends** tax calculations happen outside the SAP Central Finance system, in a source system such as Sovos S1, before reposting into SAP Central Finance.

Compliance modernization as an enabler of digital transformation

A third party such as Sovos with a cloud-based solution can isolate changes in tax mandates and automatically include them in AP, AR and disparate ERP systems, as well as in SAP Central Finance, as a company moves data to the new repository.

It makes no difference which system Sovos is interfacing with or how much the system changes during a migration; Sovos follows SAP best practices in coding on top of SAP. That practice ensures a compliant transition to SAP Central Finance. Sovos can connect directly to SAP or with third-party middleware without the need for a real-time connector.

Sovos and SAP:
Sovos is a long-term SAP partner and holds certifications for the SAP R/3, ECC and S/4HANA platforms. We worked with SAP to shape the future of tax software in the SAP S/4HANA Cloud solution, and Sovos and SAP have created an early adopter program for companies using Sovos Global Tax Determination and Sovos eInvoice.

With the Sovos S1 cloud, companies can perform digital transformation piecemeal without duplicating data in disparate systems because the Sovos S1 cloud maintains a single source of compliance information and processes. It's possible to run processes in two places without two e-invoicing or tax determination instances. They run identically, so companies can rule out any data or process differences due to using a different tax configuration or transactions clearing differently.

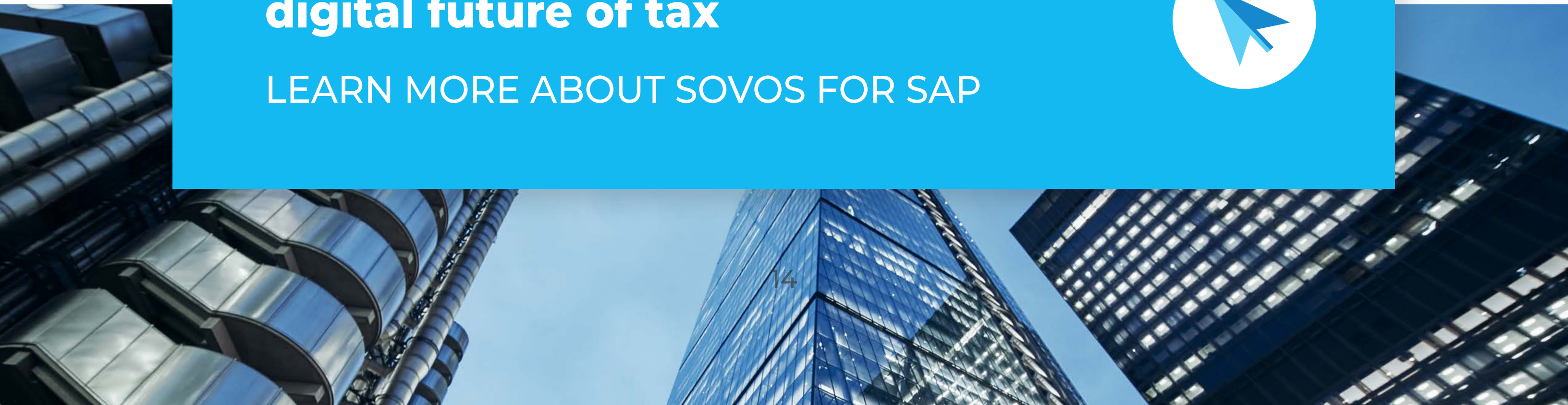
The promise of moving data to a single source in SAP Central Finance, and ultimately into SAP S/4HANA, is not complete without ensuring accurate sales and use tax determination, and global VAT and GST filing compliance. In the era of the "other" digital transformation, companies must now treat national tax authorities as major stakeholders in their core business processes--and keep pace with different formats and continually changing compliance requirements. The move to SAP Central Finance, then, becomes part of every company's quest to Solve Tax for Good.

What does the optimal solution for global compliance in SAP look like with Sovos?

- **Sovos Global Tax Determination** - Real-time and batch tax determination for VAT, GST and/or sales & use tax and related fees
- **Sovos Intelligent Reporting & Analytics** - Functionality within Global Tax Determination allows you to more efficiently summarize tax data for streamlined filing and audits, as well as gain insight into trends within your organization
- **Sovos Sales & Use Tax Filing** - Periodic, summary reporting and remittance for thousands of state and local jurisdictions in the US
- **Sovos VAT Reporting** - Reporting and remittance for VAT in digital and non-digital formats (Example: MTD, Intrastat, EC Sales List, SAF-T, SII, Peru Libros, Mexico e-accounting)
- **Sovos CertManager** - Sales & use tax exemption certificate management and verification automation
- **Sovos eInvoice** - A global solution for clearance, continuous controls and post-audit model e-invoicing compliance in 60+ countries where B2B businesses must validate invoices for VAT audit purposes

Prepare your SAP solutions for the digital future of tax

LEARN MORE ABOUT SOVOS FOR SAP



About Sovos

Sovos is a leading global provider of software that safeguards businesses from the burden and risk of modern tax. As governments and businesses go digital, businesses face increased risks, costs and complexity. The Sovos Intelligent Compliance Cloud is the first complete solution for modern tax, giving businesses a global solution for tax determination, e-invoicing compliance and tax reporting. Sovos supports 5,000 customers, including half of the Fortune 500, and integrates with a wide variety of business applications. The company has offices throughout North America, Latin America and Europe. Sovos is owned by London-based Hg.

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