Risky Business

How to Beat the Inefficiencies of Tax Compliance on Purchases

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asug

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In business, there may be consequences that we have no idea are about to happen until they are staring us in the face.

In a 2013 opinion piece[1] for *Forbes* magazine about her book *Brave*, Margie Warrell detailed a few relevant insights about risk, including the idea that we discount or deny the cost of inaction and sticking with the status quo.

This point is particularly potent for an emerging business problem like tax compliance on purchases. It can speak both to those who may be a little overconfident about their compliance and to those who are simply unaware of the risks involved in this space. In business, there may be consequences that we have no idea are about to happen until they are staring us in the face. But ideally, of course, we want to recognize potential dangers before they happen and be able to adapt to them.

PREPARING BEYOND CLEAR AND PRESENT DANGER

The future is always a little uncertain when it comes to enterprise technology, specifically SAP technology. Digital transformation and the need for real-time insights bring with them a certain degree of risk. Large, geographically distributed companies are often challenged to balance innovation and speed with accuracy, as well as the longer view of solutions that can help them with complicated and rapidly changing regulatory obligations like tax compliance. Executives and employees want to streamline and accelerate their processes. The tax compliance and finance departments want to ensure these processes are done right.

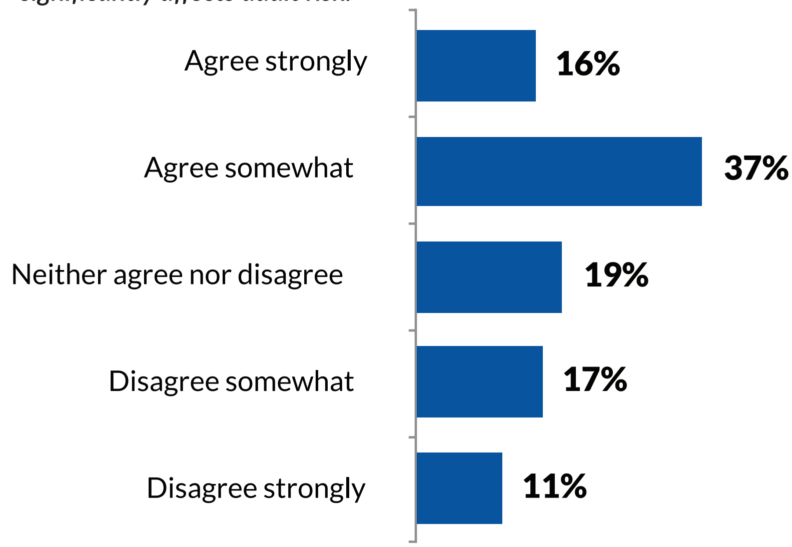
This naturally leads to a few key business decisions and related questions. Am I making the right choices during digital transformation? How do I ensure my data is accurate and will be protected when I do? Will I be sacrificing quality for speed in my transactions? Will a new or revised process result in more errors and put me at risk for penalties, either through noncompliance or a tax audit?

[1]Forbes.com - "Take a Risk: The Odds Are Better Than You Think," Warrell, Margie. June 18, 2013.

All of these are pertinent questions. Still, are we asking them regularly, or are we placing our hopes on someone to help us answer them when it's time?

WHAT WE DISCOVERED: RISK AWARENESS AND SENSITIVITY

FIG 1: Agreement that incorrect sales/use tax significantly affects audit risk.



Americas' SAP Users' Group (ASUG) and Sovos worked together on survey research to understand the awareness of potential risks related to sales and use tax and how it affects the procure-to-pay (P2P) process. Our initial hypothesis about risk awareness and sensitivity was confirmed by the research: A substantial portion of SAP finance users are unaware of or downplaying their audit risk. Over half of these users correctly find incorrect sales/use-tax issues to significantly increase their audit risk, and just over a quarter of these ASUG members have seen their audit scrutiny increase within the past three years. (This number goes up to around 50 percent among manufacturing companies, according to previous research by Aberdeen[2].). Not surprisingly, this audience has a heightened alertness to potential tax issues on purchases, particularly when these purchases are bigger in size and when they take place at companies with more-complex purchasing processes. It also means, however, that there is a sizable section of this audience that may be blissfully unaware of the tax compliance risks and audit penalties they could be facing.

The audience that does recognize incorrect sales and use tax as a significant challenge to audit seems to be much more aware of their surroundings. Ninety-one percent of companies that have seen an increase in audit scrutiny are also seeing an increase in the effort needed to manage tax compliance. The two go hand in hand: You must put in the work to reduce the risk.

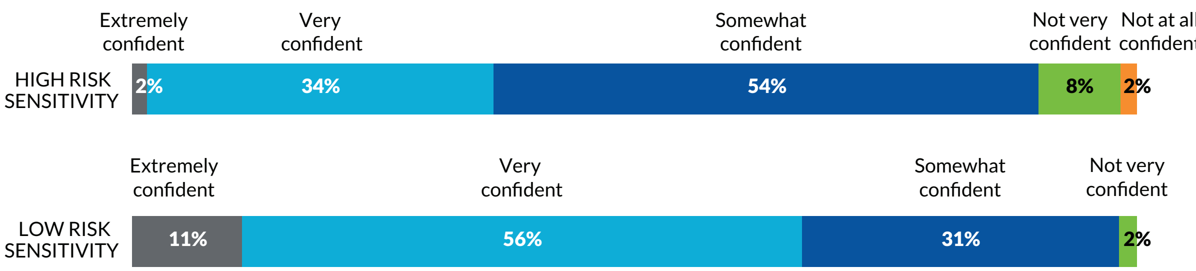
These concepts are also tied to issues with incorrect tax being perceived as an audit risk. Those who find this to be a more-significant issue (the "high risk sensitivity" respondents) report greater increases in audit scrutiny (34 percent versus 19 percent) and greater increases in their effort to maintain tax compliance (62 percent versus 23 percent) compared with those less likely to find tax issues to increase the risk of an audit (the "low risk sensitivity" respondents). Odds are that segment is the group that has been subjected to a recent audit and has a greater understanding of

[2]https://learn.sovos.com/manufacturing/sovos-aberdeen-sut-compliance-report-for-manufacturers

all related issues, having seen the ramifications of overcharges by their vendors or missed use-tax self-assessments.

This “high risk sensitivity” group, not surprisingly, is also a little more cautiously optimistic than their “low risk sensitivity” counterparts. When asked how confident they are that they are filing taxes in all jurisdictions that they should, only 36 percent of the “high risk” group is extremely/very confident that they are filing correctly. The “low risk” group? Sixty-seven percent of them are extremely/very confident in their filings. This means that the low-risk companies are either significantly more adept at understanding the tax compliance landscape, or they are a bit more trusting of their analysis than perhaps they ought to be.

FIG 2: Confidence in correct filing – by risk sensitivity

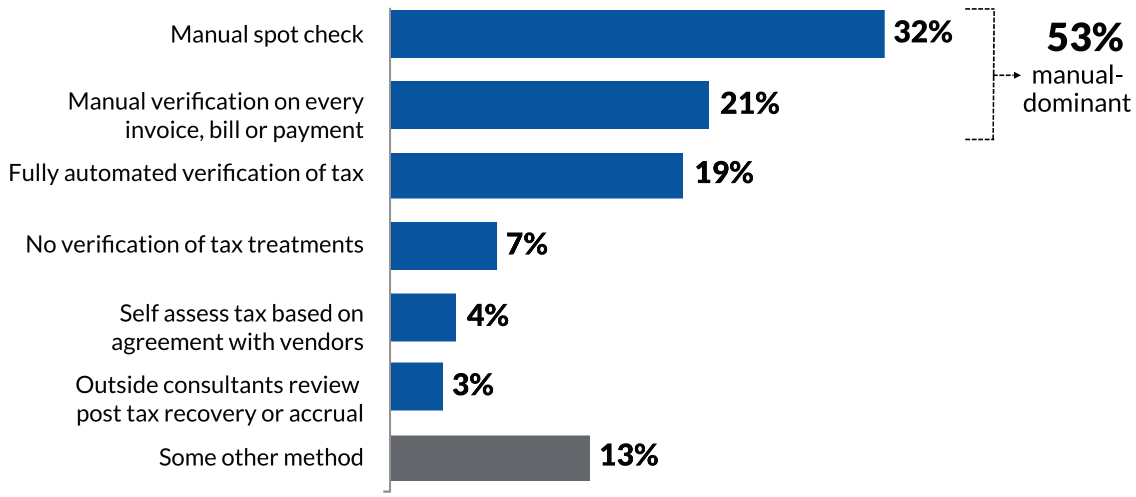


So, if managing sales and use tax on purchases is a somewhat tenuous situation for most companies (whether they are aware or not), what can be done to improve the process? How can companies be more assured that taxes charged on their purchases are at least being calculated correctly, so they are not leaving significant dollars on the table due to tax errors? And how can they reduce their risk of enduring an audit?

WHERE THE PROCESS CAN SLOW DOWN

One of the easiest ways to detect inefficiencies is if you are spending large amounts of time on processes that could be replaced with automation. When it comes to tax compliance, this seems to be exactly the case. When asked about their process for ensuring P2P tax compliance, more than half of the surveyed audience stated that they use a mostly manual process, while less than one in five use a fully automated process for calculation and verification.

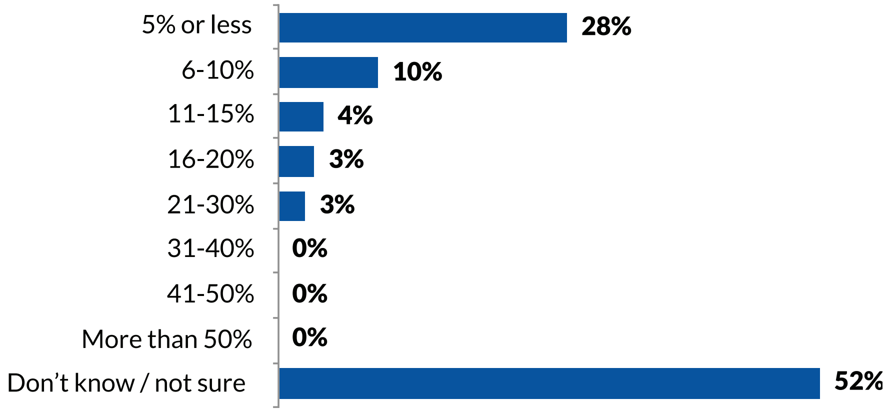
FIG 3: Current process for P2P tax compliance



And only 28 percent of these respondents report using some kind of tax automation software as part of their technology within the P2P process. This means that nearly three-fourths of those who deal with taxes are trusting the native capabilities in their core ERP system, an internally built tax solution, or manual spreadsheets and spot-checking invoices to ensure compliance. These options are extremely limiting in trying to properly manage the increasing complexity of tax rates and rules as they apply to their purchases. And the costs are numerous:

- The cost to build and maintain such a solution (if using an internally built tax solution).
- The cost of maintenance of the internal solution (either core ERP or a special tax solution). This can also include the cost of continual compliance research needed to monitor changes in regulations and keep systems up to date.
- The time spent manually conducting a review of internal and external invoices, including reverse audits.
- The money lost on overcharges by vendors if they are not caught on invoices.
- The potential penalties incurred if audit determines a use-tax obligation on a purchase where the vendor did not charge tax.

FIG 4: Frequency of tax errors on supplier invoices



These penalties can be significant if the percentage of errors on supplier invoices is high and they are not caught and corrected before filing. In fact, prior research by Aberdeen shows that manufacturers denote potential audit penalties as the number-one challenge to tax compliance. In ASUG's research, 20 percent of the audience reported sales and use-tax errors on more than 5 percent of its supplier invoices, with 10 percent reporting tax calculation errors of 11 percent or more. Five to ten percent may not seem like a lot, but when businesses are buying millions of dollars of materials, supplies, and fixed assets, and processing thousands (or tens of thousands) of invoices every month, significant overpayments and audit risk can occur. With the increasing use of P-Cards in the purchasing process, larger numbers of purchases are happening with no formal validation of tax obligations at all. Even more alarming? Fifty-two percent of users dealing with tax compliance have no idea how many supplier invoices have tax errors. This can lead to significant overpayments and underpayments. When your books are under review, "I don't know" is the last answer you want to give to an auditor.

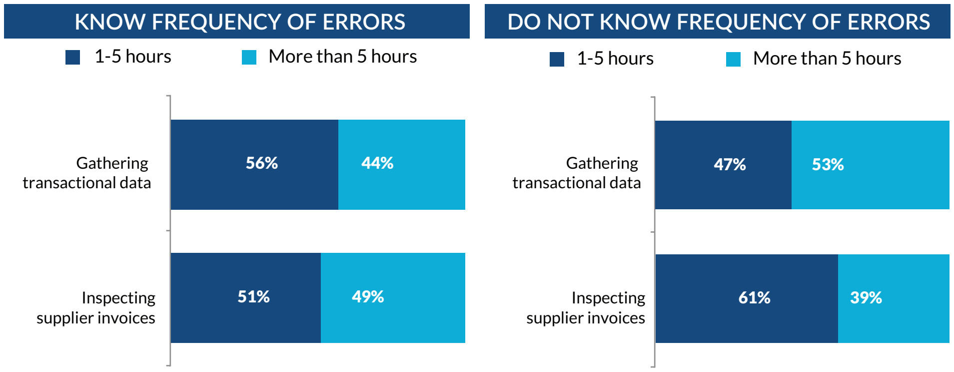
It doesn't have to be this way. Those not using an automated tax solution are three times more likely to be above this 5 percent threshold. To put it conversely, using an automated tax solution can lower the risk of significant invoice tax errors by two-thirds.

GET TIME BACK ON YOUR SIDE

Tax automation doesn't just reduce risk. It also saves time. The number-one challenge for those dealing with tax compliance is "time to verify accuracy of tax charged on vendor invoices." With the large number of people executing this process in a manual format, this is not surprising. It also makes sense given that much of this data is coming from disparate systems, potentially across multiple company locations. Those who use automated tax software across their system, however, are 25 percent less likely to state this as a challenge. Improving this process can reduce the initial time investment and keep you from having to continually go back and make corrections to subsequent invoices from offending vendors. Automated systems can improve vendor accuracy in the future by highlighting errors, so you can proactively work with vendors to improve your process. Software can also help recognize certain purchases and enhance data for proper application of use tax, so your accruals and filings are as accurate as possible. While automated software isn't necessarily a substitute for every process, it is a tool that can effectively minimize this problem.

Automated tax software also can reduce ignorance about the volume of tax-related errors on invoices. This directly affects the issues of both lowered risk and saved time. Those in the 52 percent of respondents who don't know the frequency of invoice errors spend significantly more time gathering their own transactional data and significantly less time inspecting supplier invoices. The implication is that these users are spending so much time gathering, manipulating, and consolidating their purchase data (something tax automation can aid) that they don't have the time to thoroughly inspect their suppliers' invoices. Inspecting none or only a few of your vendors' invoices can increase both audit risk and the risk of overpayments—which, depending on the size of the purchases and the volume of vendors, could be significant. If you can cost-effectively eliminate this problem and give your tax team full visibility into all purchases with an easy way to spot errors in vendor calculation or the need for use-tax self-assessment, why wouldn't you?

FIG 5: Time spent on P2P tax process – by awareness of error frequency



AUTOMATED + CENTRALIZED SYSTEMS = FLEXIBLE RISK REDUCTION

There are several advantages that moving to an automated, centralized technology can give your business. First, it can bring together all purchase data in one database regardless of purchase channel or type for accurate tax calculation. Automation can also help to enhance purchase data to ensure the proper tax calculations are made for comparison to vendor charges.

Second, it can enable your tax team to spend less time accurately evaluating invoices every month. The team can have complete visibility to discrepancies in what a vendor charged and what the actual tax should be, handling each case as it comes along instead of hoping the invoice they decide to check is reflective of the others yet to be processed.

Finally, an automated system can help your company create rules and best practices for how to handle the core system as new adaptations and needs arise within the tax department. Establishing key performance indicators (KPIs) that are specific, yet flexible will enable your tax system to grow while maintaining a strong balance between speed and accuracy.

STEPS TO REDUCE YOUR RISK

So, what should you do now? First, get your tax team together to determine where your team falls within this data set. If there is high confidence in the results the team is producing, then you can confirm that each of the questions raised in this paper has been answered to your satisfaction, and that the tax department has the information needed to get through a potential audit.

If you uncover inefficiencies, take the time to examine some automated tax solutions to see if they can help reduce or eliminate these challenges for your team. These solutions frequently are cheaper than potential incurred penalties or tax overpayments caused by a manual, inefficient process. If you are already using an automated tax solution, great! Make sure you are using it to its full potential for all purchase transactions and that it provides satisfactory answers to the issues discussed here as well.

Warren Buffett once said, “Risk comes from not knowing what you’re doing.” Benjamin Franklin said, “An investment in knowledge pays the best interest.” These two quotes provide the road map to navigating this tricky tax compliance space. Take the initiative to know what you’re doing, and you will have a greater chance of doing it right the first time, once, for every location, before risk rears its ugly head.

Risk comes from not knowing what you’re doing.

~Warren Buffett

ABOUT ASUG

Founded in 1991 by four pioneers who understood the potential of SAP software, the Americas' SAP Users' Group (ASUG) today is the world's largest independent SAP user group with 2,400+ corporate members. ASUG's mission is to help our members maximize the value of their SAP investments. So no matter where you are on your SAP journey, ASUG is here to help you navigate every step of the way. Find membership information at www.asug.com/join.

ABOUT SOVOS

Sovos is a global leader in tax compliance and business-to-government reporting software, safeguarding businesses from the burden and risk of compliance around the world. As governments go digital, businesses face increased risk and complexity. The Sovos Intelligent Compliance Cloud combines world-class regulatory analysis with a global cloud software platform to create an adaptable, connected, and global compliance solution that keeps businesses ahead of the ever-changing regulatory environment. Sovos supports 4,500 companies, including half of the Fortune 500, and integrates with a wide variety of business applications. Based in Boston, Sovos has offices throughout North America, Latin America, and Europe. For more information visit www.sovos.com and follow us on LinkedIn and Twitter.

The survey research used throughout this white paper was conducted in January 2018 by ASUG and sponsored by Sovos. It consisted of 115 respondents involved in the P2P sales and use tax process, largely from the manufacturing, wholesale, retail, financial services, and software industries.

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~Benjamin Franklin

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