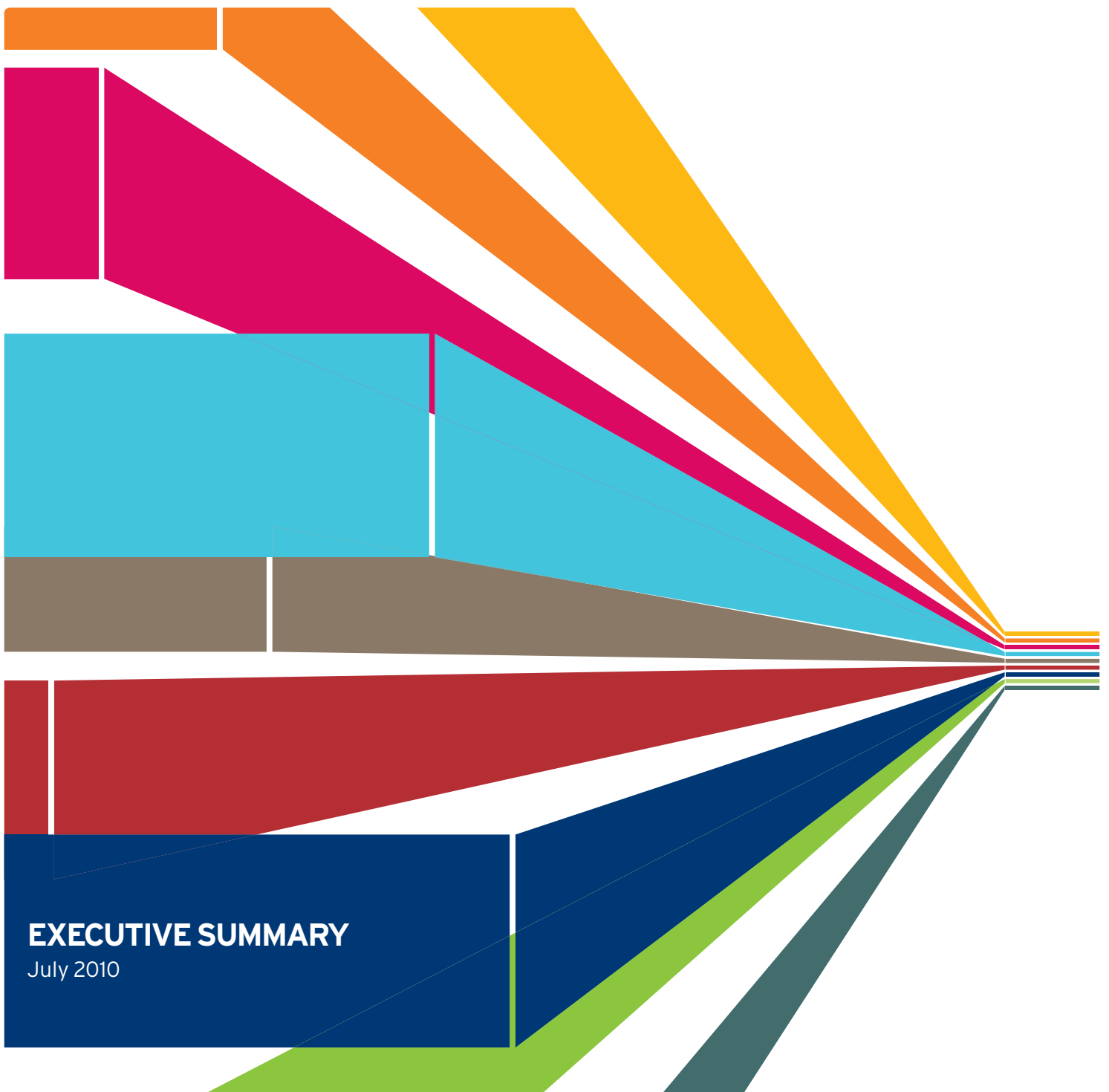


Lost in Transaction 2010

basware

Research
Report



EXECUTIVE SUMMARY

July 2010

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Executive Summary

The 2010 Lost in Transaction research, commissioned by Basware, explores the relative strengths and weaknesses in the financial processes behind Accounts Payable (AP) departments across Europe, America and Australia. The report goes on to describe the characteristics of best practice financial departments and offers recommendations for companies looking to improve this aspect of their business.

With direct control over cash flow, finance professionals are under growing pressure to strengthen controls, drive out costs and to increase process efficiency. They have a number of tools at their disposal to achieve this but the research shows that they are not always using these to best effect.

Research Methodology

The Basware Lost in Transaction research features insight from 550 Heads of Accounts Payable respondents, across USA (100 interviews), UK (100), Scandinavia (100), Germany (100), Australia (50), Benelux (50) and France (50). Interviews were conducted by telephone during May and June 2010.

The research was conducted by Loudhouse Research, an independent research agency based in the UK.

The key findings of the Lost in Transaction survey can be summarized as follows:

Turning up the heat on finance

- 59% think the AP department as a finance function is becoming more strategic
- 59% believe that the AP department has a positive effect on profitability
- Almost half (48%) of respondents think that AP performance is being monitored more closely than a year ago

Costly finance errors

- Weaknesses in finance processes are resulting in additional costs in some cases - 30% of respondents state having missed early payment discounts and 27% have incurred late payment fees in the past 12 months
- 24% of respondents know of instances where their organization has not been paid due customer / external finance department errors and 35% know of suppliers who have not been paid due to internal finance department errors
- Respondents also state that 7% of purchase invoices contain errors, equating to more than 6,000 erroneous invoices per year in a typical enterprise from the study

Human error

- Human errors whether by the AP (58%) or the procurement department (53%) is identified as the biggest cause of AP errors
- Lack of communication between AP and procurement departments is highlighted as a cause of AP errors in a quarter (24%) of companies

Lost in process

- Invoice scanning / data entry is identified as both the most time consuming (38%) and the most error-prone (41%) element of inbound invoice processing
- 4 in 10 invoices are not based on purchase orders (POs) and one third (32%) of finance departments have difficulty reconciling invoices with POs

- 61% of respondents think invoice processing could be speeded up and 56% think it could be more accurate

The automation imperative

- There is much reliance on manual methods to match POs against invoices - only 1 in 4 companies use specialist invoice processing applications and there is low adoption of purchase-to-pay products (5%)
- Automation tends to be partial in most areas - highest in issuing POs (47%), tax accounting (47%) and approving payments (45%) and lowest in supplier interaction (29%) and contract management (31%)
- Companies, however, recognize that automation can improve matters - 60% think increasing automation is a reliable method for removing payment and accounting errors from the business
- 62% of respondents believe that moving towards higher levels of automation will improve profitability

The Basware 2010 Cost of Control research, conducted in April, depicts an enterprise landscape seeking to engineer profits in a tough revenue growth environment. Against this backdrop, it is vital that all elements within the finance function work together to streamline processes, minimize error and optimize profitability.

The Cost of Control survey highlighted that there have been some finance process improvements over the last 12 months - 56% of processes surrounding spending are now automated, against 50% in 2009, and 46% of indirect spending is now captured in PO systems, up from 42% last year.

The Lost in Transaction survey however shows that the engine room of corporate cashflow is some way from the automated, error-free status it desires. There remains a reliance on manual methods of invoice processing leading to significant amounts of time and money being wasted when pushing cash through the business.

In summary

Finance departments occupy a unique position in companies with the potential to truly influence a company's financial performance. The research depicts finance departments about to reach a tipping point, where costly errors and inefficiencies can no longer be tolerated as companies search out additional cost savings and hunt for profit. Despite huge advances in invoice processing technology, many companies have been slow to adopt end-to-end tools, opting instead for operational systems that still rely on considerable manual processes.

Cash constantly flows through organizations and mirroring this, finance departments need to be dynamic and flexible in their processes. Against this backdrop, finance automation should not be avoided because of the perceived cost, but instead regarded as an ongoing evolutionary investment that brings order to chaos, and ensures finance is concerned with profit margins and not inhibited by avoidable margins of error.



Turning up the heat on finance

Finance departments operate on the frontline of an organization's cash flow and in the current economic climate are well placed to positively influence profit margins. Indeed, as shown in **Figure 1**, 59% of finance professionals think the AP department is becoming more strategic and the same proportion (59%) agree that the AP function has a positive effect on profitability.

Finance departments are processing an average of 93,000 invoices per year - on average these take 18 days to process (**Figure 2**). The Cost of Control survey, conducted earlier in 2010, revealed an average of around 50 days sales outstanding (DSO) before invoices are settled. Taking the difference between these two figures shows that there are around 32 days unaccounted for across the lifecycle of an invoice, when cash is quite literally "in the wild".

Against a backdrop of cost cutting and profit hunting, finance departments have been thrust under the corporate spotlight with 48% thinking that AP performance is being monitored more closely than a year ago.

FIGURE 2: Description of average participant in Lost in Transaction research 2010

- Has **11** full time employees involved in AP invoice processing
- Processes **93,000** invoices per year
- Takes **18 days** to process an invoice (receipt to payment)
- **12%** of invoice handling time spent managing exceptions
- **1 in 5 (19%)** of incoming invoices are e-invoices
- **7%** of incoming invoices contain errors
- **58%** of incoming invoices are based on POs

FIGURE 1: Attitudes to finance strategy



Costly finance errors

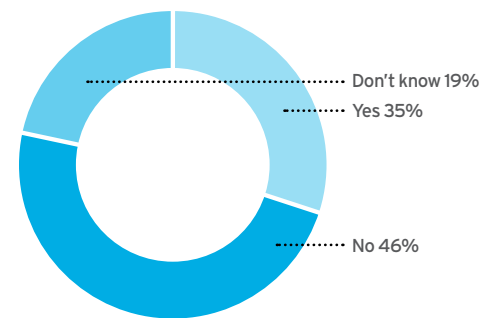
In theory invoice processing should involve matching invoices with POs and logging payments on a system, striking the perfect balance between keeping suppliers on side and optimizing internal cash flow. In reality, invoice processing does not, of course, operate quite so smoothly.

Indeed, the Lost in Transaction survey reveals some worrying statistics around the actual amount of time and money lost in processing accounts. **Figure 3** shows the proportion of finance departments experiencing problems on a regular or occasional basis. Whilst 32% of companies struggle to reconcile invoices with POs, itself a time consuming and therefore costly issue, the more concerning findings are that money is quite literally seeping out of organizations because of financial inefficiencies and oversights. Most notably, 30% of companies have missed early payment discounts and 27% have incurred late payment fees. Other issues also have cost, time and supplier goodwill implications - 26% of finance departments, for example, have paid the wrong supplier whilst 1 in 10 routinely pay for goods that are not actually received.

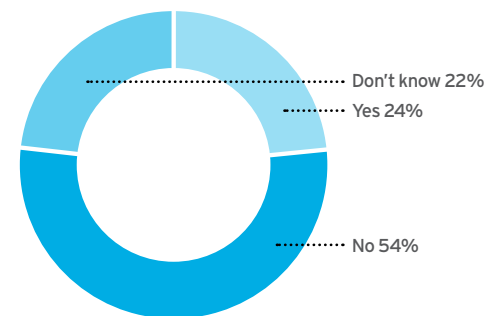
Part of the problem is down to invoices containing errors. On average, 7% of invoices are found to contain errors, equating to more than 6000 erroneous invoices per year in a typical enterprise in this study. Furthermore, 24% of respondents know of instances where their organization has not been paid due to customer / external finance department errors and 35% know of suppliers who have not been paid due to internal finance department errors, as shown in **Figure 4**.

Finance departments are making a catalog of errors that come about either through invoice misinformation or through invoice mismanagement. This situation is clearly unsustainable and must be addressed for companies to be in the best possible position to return to profit.

FIGURE 4: Awareness of instances where supplier or organization has not been paid due to AP errors



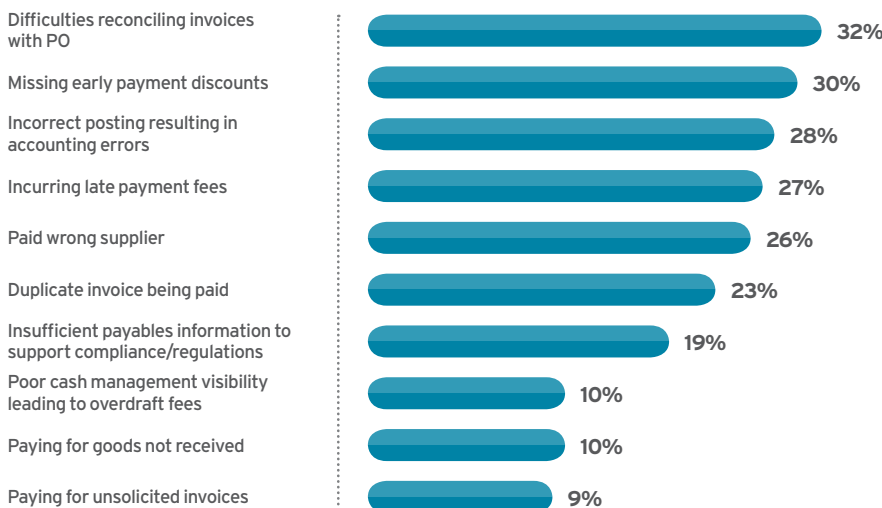
Instances where SUPPLIERS have not been paid due to internal AP errors



Instances where YOUR ORGANIZATION has not been paid due to customer external AP errors

FIGURE 3: Frequency of AP events

% of AP departments experiencing often/sometimes...



Most notably,
30%
of companies have missed early payment discounts and
27%
have incurred late payment fees



Human error

Having established that there are costly inefficiencies within many finance departments, it is important to identify the root cause of these inefficiencies if they are to be effectively addressed.

Figure 5 shows the most likely causes of data errors in accounting within organisations. Human error, whether by the AP department (58%) or by the procurement department (53%), accounts for by far the most finance errors within organisations. In contrast, finance errors are far less likely to be attributed to difficulties with accounting systems.

Strong linkages between finance and procurement departments are vital within organisations if they are to effectively reconcile financial transactions. 6 in 10 (58%) of finance respondents consider that finance and procurement

are tightly integrated and there is a sense that cooperation between the AP and procurement functions is better now than before the downturn amongst 41% of respondents. Although almost half (47%) claim that when there is a disputed invoice, procurement is effective in identifying and resolving errors, lack of communication between the two departments are implicated as a cause of finance errors by a quarter of companies (**figures 5 and 6**).

It is not really surprising that human error is so much to blame for accounting difficulties given the fact that there remains a heavy reliance on manual accounting tools. Automation is one way that human error can be mitigated, but is likely to be most effective alongside reviewing the whole accounts payable process and culture within an organization.

FIGURE 5: Most likely causes of AP errors

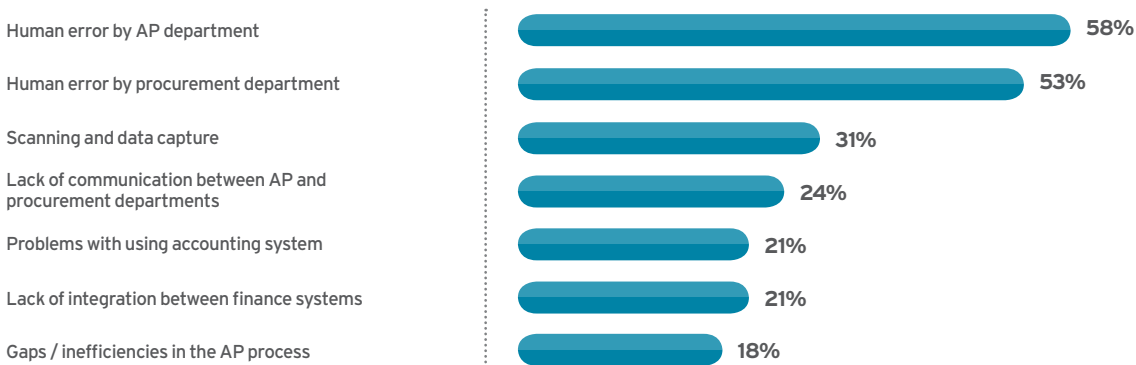
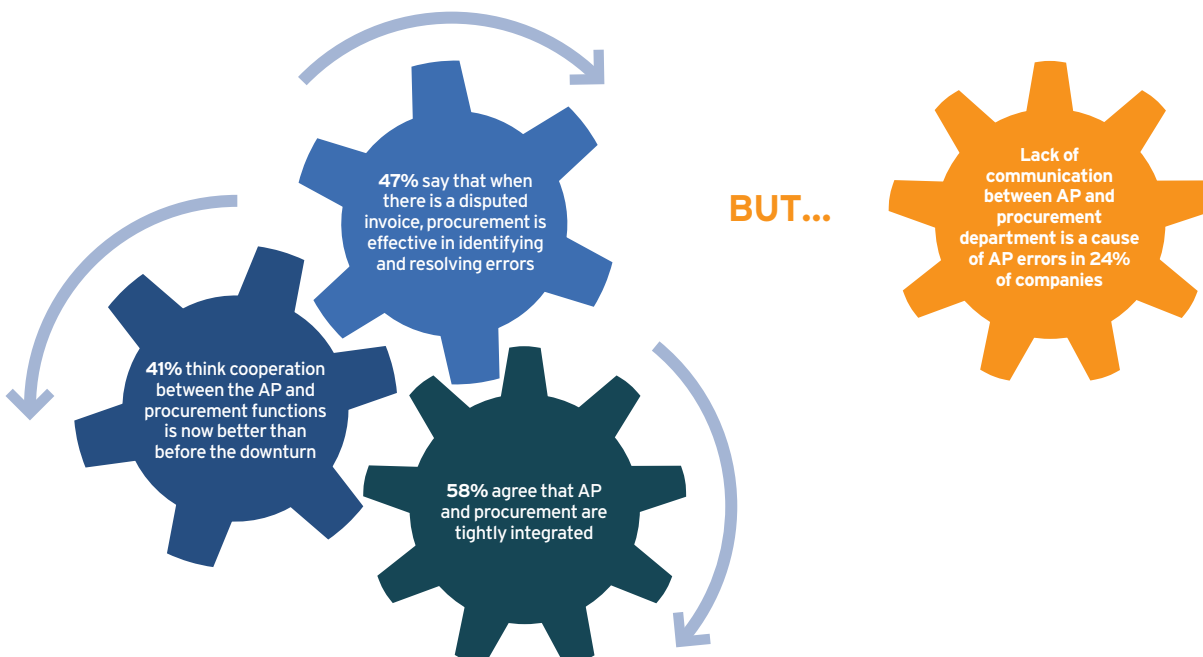


FIGURE 6: AP attitudes towards procurement



Lost in process

In 2010, 4 in 10 invoices are not based on purchase orders (POs) and one third of finance departments (32%) have difficulty reconciling invoices with POs. **Figure 7** shows the main discrepancies between POs and invoices.

Discrepancies between purchase orders and invoices arise for a host of different reasons, most commonly incorrect pricing information (49%) and incorrect goods / quantity (38%). On average 12% of invoice handling time is spent handling exceptions such as these - much of which involves trying to find the correct person to handle the exception (39%), isolating and identifying the exception (33%) and seeking clarification / assistance from procurement (32%). This is all time that could be better spent on more strategic activities that serve to add, rather than subtract, value from the business.

Invoice processing consists of many discrete, yet interlinked, elements - all of which take time and carry a certain risk of error. **Figure 8** shows which elements are considered to absorb the most time and to be most prone to errors / discrepancies. Clearly, those areas that are very time consuming and error-prone are those that need to be tackled with a greater sense of urgency. **Figure 8** shows that invoice scanning and data entry is the one area that scores highly on both these fronts, followed by reviewing and approving invoices.

Paper invoices may well be consigned to history before too long as 44% of respondents believe that electronic invoices in B2B will fully replace manual, paper-based invoice handling in the next five years. Alongside this, encouragingly there is recognition amongst respondents that finance could operate more efficiently and more accurately - indeed, 61% think invoice processing could be speeded up and 56% think it could be more accurate.

FIGURE 7: Main discrepancies between POs and invoices

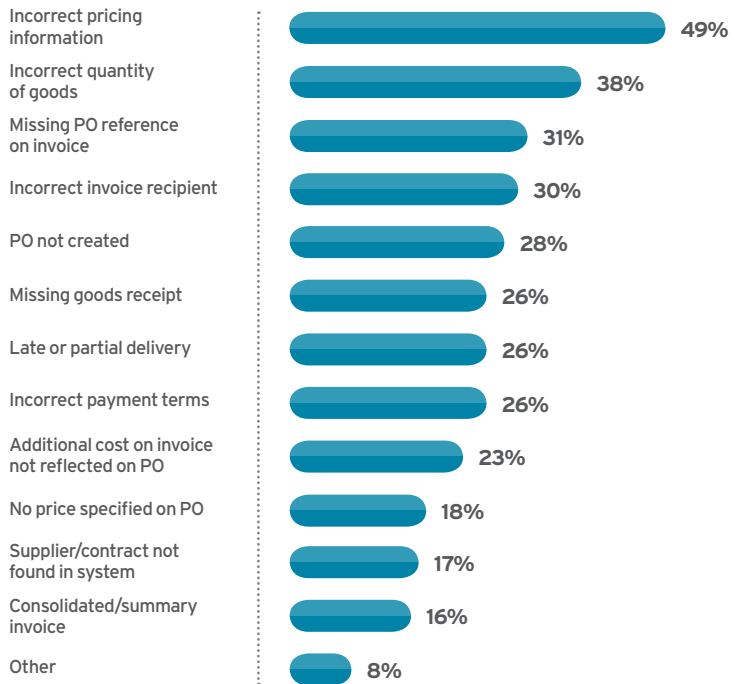
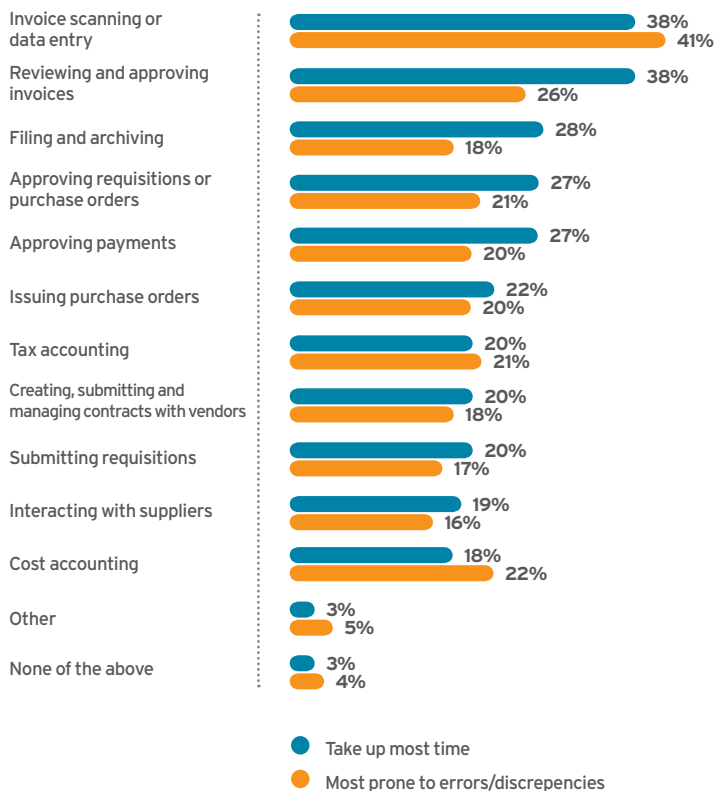


FIGURE 8: Elements of inbound invoice processing that take up the most time and are most prone to errors/discrepancies





The automation imperative

Despite enormous strides in the technology available to support the finance function, in 2010 there remains a surprising reliance on manual methods of finance management. **Figure 9** shows that companies are reluctant to discard their old ways of working and embrace an automated, error free approach to matching POs with invoices. Only 1 in 4 companies (25%) use a specialist invoice processing application and just 5% use an integrated Procure-to-Pay (P2P) product.

Where there is automation it tends to be in one or two areas rather than integrated across the finance function. **Figure 10** shows that levels of automation are highest in issuing POs (47%), tax accounting (47%) and approving payments (45%), and lowest in supplier interaction (29%) and contract management (31%). Interestingly, invoice scanning and data entry is one of the lowest areas of automation (41%) but also the most time consuming and error prone part of the invoice process.

On average, 39% of invoicing is handled automatically with an electronic invoice workflow solution.

With more than 6000 erroneous invoices coming into companies and huge amounts of time and money being absorbed by invoice processing, the time is ripe for a change in how things are done.

Automation is increasingly recognized as offering a solution to these challenges. 60% of companies recognize that increasing automation is a reliable method for removing payment and accounting errors from the business. More fundamentally, 63% of respondents believe that moving towards higher levels of automation will improve profitability. Automation is not a cure for all accounting problems, it is more of an evolutionary process that helps finance departments in their quest for more control, more visibility and ultimately better business performance.

FIGURE 9: Matching invoices against POs

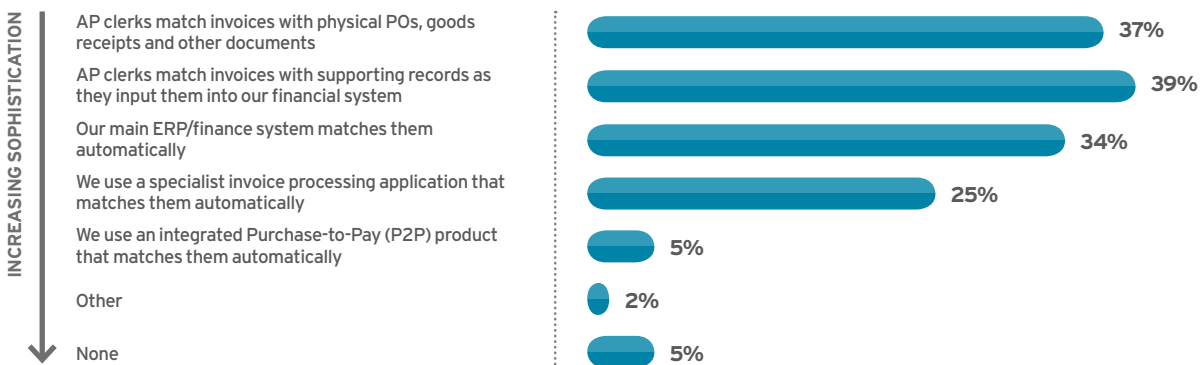
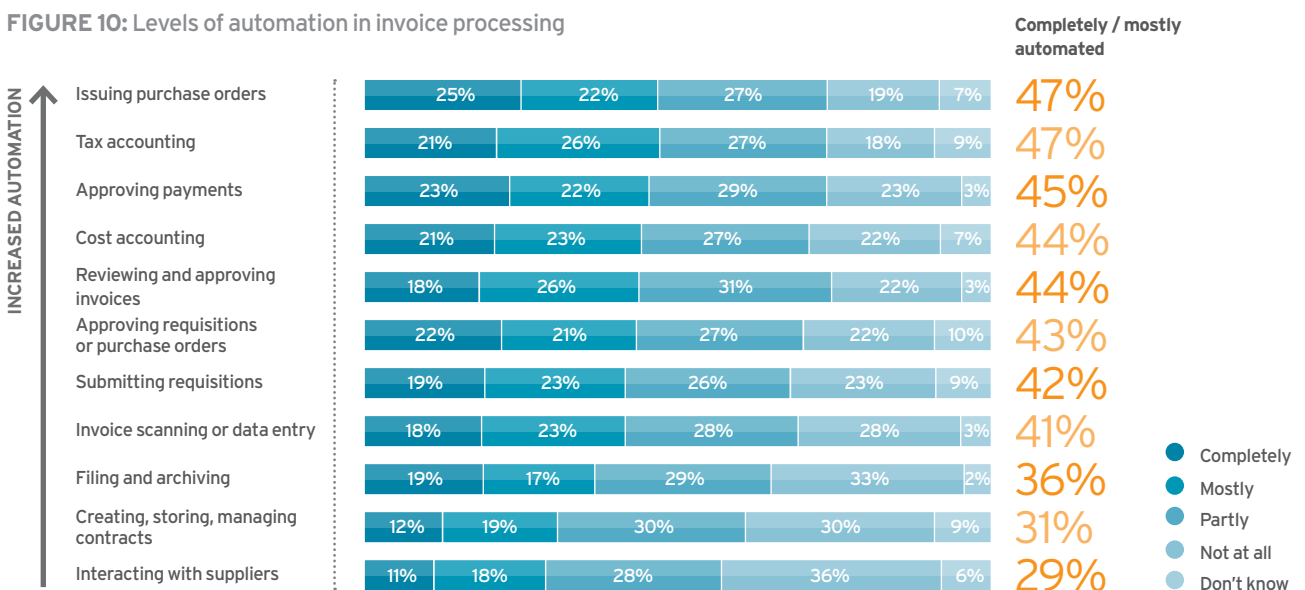


FIGURE 10: Levels of automation in invoice processing



Conclusion

The Lost in Transaction research provides a reality check that reveals finance departments around the world are under growing pressure to increase levels of control and visibility as companies search for internal sources of financing to support business operations. Expectations of improvement remain high and full process automation is an evident goal for many businesses, but the research shows the distance left to run for the majority of respondents in realizing these longer term aims.

Traditionally, companies have tried to collect payables as early as possible whilst “stretching” their own payment cycles, but internal inefficiencies mean that many companies are losing out on early payment discounts and potentially jeopardizing supplier relationships if this tolerance is abused. Most companies are still reliant on time consuming, manual processes that increase the potential for error - the fact that a typical organization has to deal with more than 6000 erroneous invoices every year is testament to the levels of financial disorder currently tolerated within both invoice generation and settlement in companies.

Add to this the fact that most accounts payable errors are attributed to human error rather than any issues relating to accounting systems and it becomes increasingly obvious that much of this error can be mitigated once appropriate controls are put in place. Finance departments can no longer afford to be a source of financial leakage themselves and must become bastions of control, visibility and growth.

The payables landscape is changing and industry has embarked upon a road of e-invoices and dynamic discounting where the need to seamlessly exchange transaction related information and funds is becoming increasingly urgent. Automation is recognized as an area offering significant potential for not only generating bottom-line improvements, but also a greater ability to monitor and manage cash flow and strengthen supplier relationships. It is not, however, a “big bang” initiative, but instead a migration where people, processes and technology combine to enable finance departments to set a best practice example to the rest of the organization.



Recommendations



FINANCIAL AUDIT

Is the money your business loses through process inefficiencies acknowledged within the organization? Identify the level of losses created through unforced errors. More importantly, identify the principle causes and whether the trend in these areas is improving or deteriorating.



AUTOMATION WHEELS

The process of improving automation is rarely linear. It involves a continually changing landscape of systems and operational activity. Planned increases in automation must account for this as targets and milestones are rarely fixed. This may require the setting of expectations of what reasonable improvements can be made and establishing an ongoing culture of improvement and review.



ACCOUNTABLE ACCOUNTING

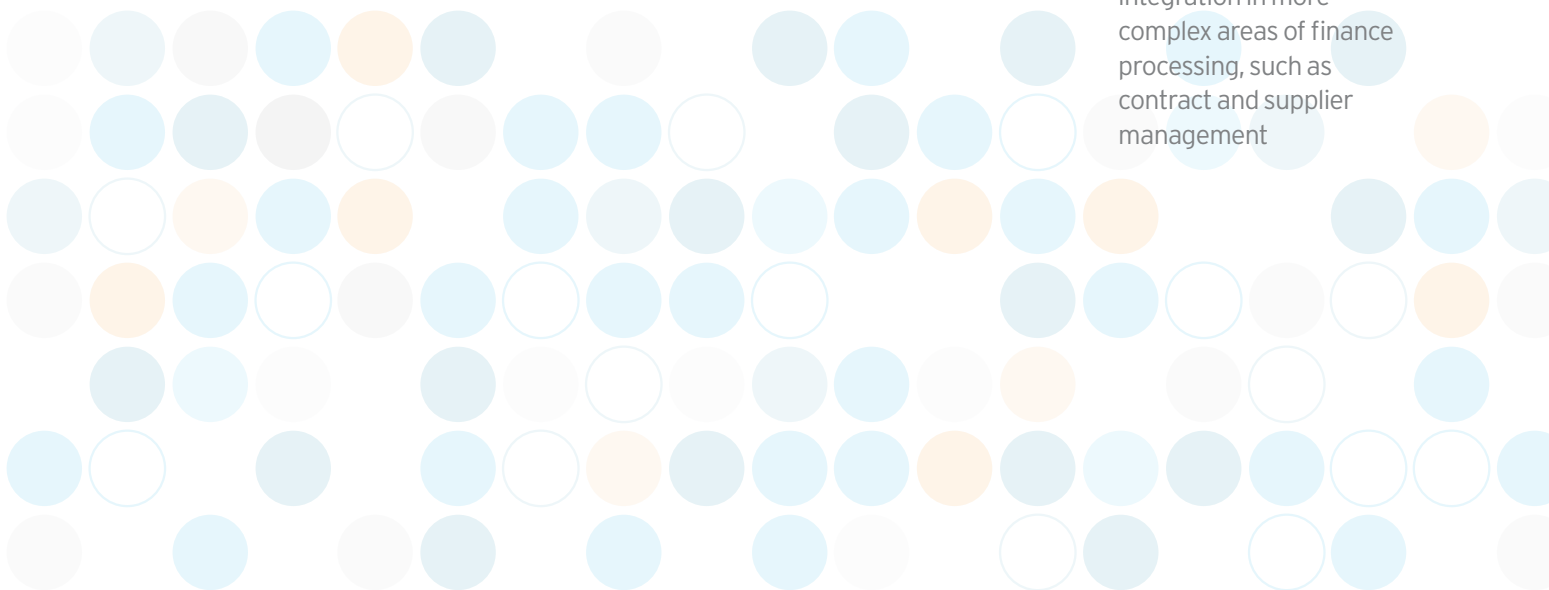
Despite the changing nature of automation improvements, accounts payable departments have a highly auditable matrix of processes available for review. Whilst complex in nature, demonstrating tangible improvements in processes is well within reach for the majority of enterprise-level finance departments.



DEMONSTRATING VALUE

A framework of improvement for accounts payable departments is evident within the findings of the data. It can be structured in the following areas, all of which can deliver efficiency and cost saving benefits to the business:

- Identify and avoid unnecessary financial loss through process errors
- Reduce levels of human intervention in areas of simple financial administration that can be automated
- Increase levels of integration in more complex areas of finance processing, such as contract and supplier management



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