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MANAGEMENT ACCOUNTING GUIDELINE

Outsourcing the Finance and Accounting Functions

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OUTSOURCING THE FINANCE AND ACCOUNTING FUNCTIONS

INTRODUCTION

The use of finance and accounting outsourcing (FAO) continues to rise throughout the world. The FAO market, as measured by the number of contracts signed for large FAO agreements (those that include five or more processes and/or have a contract value of at least $50 million) has increased steadily since 2000, and by more than 45 percent since 2005 (Fersht). A March 2007 IDC (Interactive Data Corporation) report forecasts that the global FAO market will exceed $47.6 billion in 2008. Although the United States will remain the largest segment of the FAO market, the fastest-growing region includes Europe, the Middle East, and Africa (EMEA) (Bingham).

In the past 18 months, several large outsourcing agreements covering multiple finance and accounting processes were finalized. Earlier this year, the world's top personal paper products manufacturer, Texas-based Kimberly-Clark Corporation, entered into a five-year contract with FAO provider Genpact. Genpact will operate Kimberly-Clark's global accounts payable, travel and entertainment expense management, pricing administration, accounting-to-reporting, and supply-chain accounting processes. Late last year, Aktiebolaget SKF hired outsourcing provider Capgemini to manage multiple finance and accounting processes for several of the Swedish ball bearings

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EXECUTIVE SUMMARY

Throughout the world, the use of finance and accounting outsourcing (FAO) by small, medium and large enterprises is rising. The number of large FAO contracts (those that cover five or more processes and/or have a contract value of at least $50 million) increased by 45 percent from 2005 to 2007. Most CFOs and other finance and accounting managers can count on having to weigh the pros and cons of outsourcing; many will play key roles in managing outsourcing relationships with external providers. This management accounting guideline (MAG) provides guidance on managing FAO opportunities, challenges, and risks. This guidance – which targets CFOs, finance and accounting managers, and others responsible for selecting, implementing and managing FAO relationships – centers on what might be done at each stage of the FAO lifecycle to create and manage a successful FAO initiative.

maker's European operations. A few months earlier, the British Broadcasting Corporation (BBC) signed a 10-year, $160 million deal with outsourcing provider Xansa, which will manage much of the BBC's purchasing and sales transaction processing, financial management and project accounting, payroll processing, and other finance and accounting processes. The BBC reported that the arrangement will help it save more than $375 million over the course of the relationship (FAO Today News).

The use of modern multi-process FAO began with a 1990 meeting in a London hotel between a BP CFO and a partner at the consulting firm now known as Accenture. The two men discussed the severe challenges the oil company confronted: plummeting oil prices, new, highly agile competition, and a burdensome cost structure. The discussion produced an innovative idea: rather than simply providing advice on how to make the CFO's function more efficient, Accenture would take over the CFO's entire accounting function, with the exception of control and financial policy. The following year, more than 300 BP employees from numerous locations transferred to Accenture's outsourcing center in Aberdeen, Scotland. There they performed forecasting, payment processing, joint venture accounting, and other processes that Accenture designed and managed.

BP reduced the costs of the outsourced processes by an estimated 50% over the term of the agreement, which has been renewed several times and continues today, a time when the oil giant spends an estimated $1 billion annually in outsourced services of all types with various vendors.

Between BP's pioneering FAO venture in 1991 and 2002, the worldwide growth of multi-process FAO progressed at a slow pace. During that period, the vast majority of companies pursuing FAO focused on single-process arrangements. Since 2003, however, the use of multi-process FAO has surged, growing by roughly 30 percent (from year to year) during each of the past four years, according to The Everest Group and Deloitte Consulting.

Despite the growth of all forms of outsourcing relationships – those involving finance and accounting and, even more so, those involving human resources (HR) and information technology (IT) processes – dissatisfaction has remained surprisingly high among buyers, according to numerous surveys of business executives involved in outsourcing relationships. Fifty-four percent of a group of 228 global CFOs (two-thirds of these CFOs work for companies with more than $1 billion in annual revenue) indicated that outsourcing does not deliver the benefits promised by the media and outsourcing vendors. However, 73 percent of those same respondents asserted that they would be interested in outsourcing from a few processes up to every process "that's not core," (CFO Research Services, 2006).

Together, those seemingly contradictory attitudes – a strong willingness to outsource and skepticism about outsourcing's benefits – suggest that:

a) Outsourcing promises valuable opportunities but poses formidable challenges and risks; and
b) A significant number of outsourcing agreements have been mismanaged; and
c) The outsourcing market is still relatively immature.

The outsourcing market is however maturing, thanks to the discipline's growth, the growing experience of outsourcing buyers, and the current effort to develop professional standards similar to those that apply to accountants and lawyers (The Wall Street Journal). These standards, if and when finalized, may facilitate more effective and valuable outsourcing relationships. To date, research on the effectiveness and perception of the value of outsourcing relationships strongly suggests that mismanagement of the outsourcing relationship by both providers and users of the services represents a primary source of dissatisfaction. This mismanagement can occur from the initial decision to outsource all the way to the end of the relationship.

For example, when 120 finance and accounting executives whose North American companies had entered into large FAO agreements were asked to identify the most challenging aspects of FAO, the third most frequently cited response (among 14) was "not sure/don't know" (EquaTerra, 2005). Finance and accounting professionals familiar with the old saw "you can't manage what you can't measure" would agree that a company also cannot manage what it does not understand. A more recent and highly detailed 30-page study on the evolution of outsourcing concludes that three specific areas of the discipline are in greatest need of improvement:

1. monitoring and managing the benefits ;
2. selecting the outsourcing provider; and

3. involving the "right people" and culturally aligning the outsourcing buyer and provider (KPMG, 2007).

Improving each of those areas, as well as effectively managing the overall outsourcing relationship from inception through conclusion, can be achieved by understanding and addressing the challenges and risks that cause mismanagement. The purpose of this guideline is to provide a framework for guidance on managing FAO's opportunities, challenges and risks, that is, what might be done at each stage of the FAO lifecycle to enhance the probability of a successful FAO initiative.

This guidance qualifies as "good practices", because "best practices" have not yet emerged as modern FAO continues to mature. In fact, given the unique circumstances of each organization, a clear set of "best practices" may never emerge. These good practices can support the development of solutions or responses to such unique circumstances.

The ***target audience*** of this guideline is buyers of FAO services and those charged with implementing and managing FAO relationships. CFOs and other finance and accounting managers dominate that population:

Executives Primarily Making FAO Recommendations

Title	Percentage
Finance Executives and Senior Management	56 %
CEO	13 %
Board of Directors	7 %
Business Unit Executives	7 %
COO	4 %
Other Staff Function Executives	4 %
Shared Services Leader	4 %
Others	5 %

(EquaTerra)

This guideline can be applied to the outsourcing of a single finance and accounting process as well as to multi-process outsourcing.

Although certain forms of FAO have existed for many years, this MAG deals with modern FAO, which typically involves multiple finance and accounting processes and longer term relationships (in the range of five-year to ten-year contractual commitments). These FAO relationships share many characteristics with the large information technology outsourcing (ITO) and human resources outsourcing (HRO) agreements that have grown increasingly common during the past 10 to 20 years.

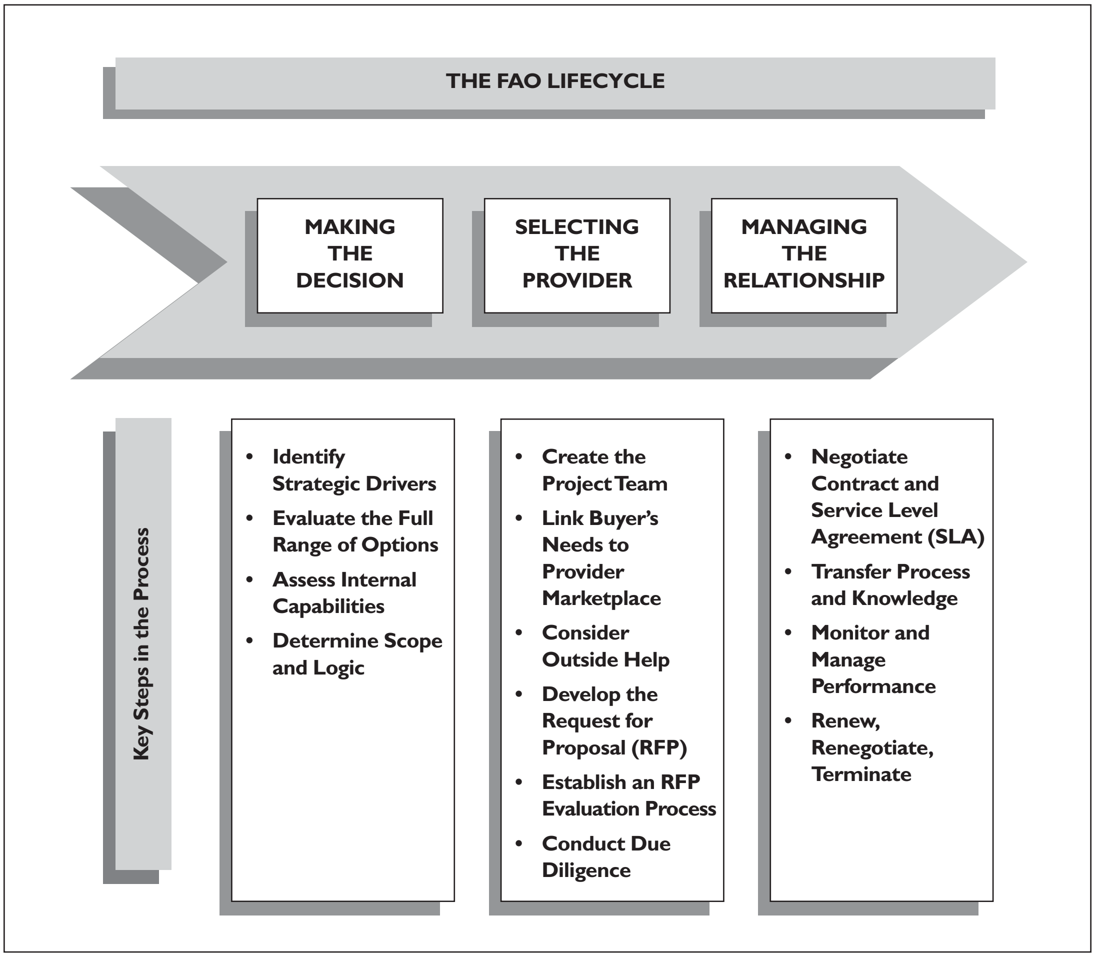
To date, the worldwide use and volume of FAO trails behind ITO and HRO. Much of the guidance in this MAG is both based on and can be applied to ITO and HRO relationships. As a North American finance executive at a global software company told a business publication last year, "Finance executives can walk over to the IT function and ask, 'How did this work for you?'"

FAO covers a wide collection of processes, ranging from highly transactional activities such as accounts payable, accounts receivable and payroll, to processes that require greater and more complex degrees of knowledge and analysis (e.g., treasury, tax strategy, or financial planning and analysis). Although the same processes can help manage the challenges, risks and opportunities of both sorts of finance and accounting activities, the risks associated with knowledge- and analysis-based FAO are greater, and therefore require greater management discipline.

How well an outsourcing arrangement is managed matters more than where the outsourcing services are provided. That point has at times been obfuscated by politically charged discussions and articles that examine the pros and (more frequently) the cons of off-shoring. "Off-shoring" can be performed by an external outsourcing vendor or within a company that establishes "captive" shared-services operations in other countries. The geographic location of an FAO provider does matter, and its potential implications should be addressed during the selection of a provider; however, the location of the outsourcing services matters less than how well the FAO buyer manages and monitors the relationship. This guideline focuses squarely on the latter challenge.

To that end, this guideline identifies processes for managing the challenges, risks and opportunities associated with FAO within each of the following steps and sub-steps of the FAO lifecycle.

As shown in the following graphic, the steps do not necessarily start and stop in a cut-and-dry fashion. For example, managing the relationship with outsourcing providers technically begins during the provider selection process, when a request for proposal (RFP) initiates communications with the eventual provider. Similarly, a company that decides to outsource a collection of finance and accounting processes, and then conducts its selection processes, may ultimately decide against outsourcing the processes because of what it learns about the provider marketplace.



Key Terms

Outsourcing: The transfer of responsibility for conducting internal processes to an external services provider. That external provider may or may not be located in a different country than its customer's headquarters.

Finance and Accounting Outsourcing (FAO): The outsourcing of one or more finance and accounting activities or processes.

Human Resources Outsourcing (HRO): The outsourcing of one or more human resources activities or processes.

Business Process Outsourcing (BPO): The outsourcing of business processes; the term is frequently used to describe both HR and F&A outsourcing, and to differentiate those activities from information technology outsourcing.

Information Technology Outsourcing (ITO): The outsourcing of one or more information technology activities or processes.

Shared Services: The centralization within a company of responsibility for conducting internal transactions, processes and, in some cases, corporate functions. Shared services are also referred to as **in-sourcing** or **captive off-shoring** (when the shared services center is located in a different country).

Off-Shoring: This term, often misused, refers to geography only; it refers to the movement of processes – those conducted by an outsourcing provider or those conducted internally through a shared services arrangement – to a country different from the company's home base. Two derivations of the phrase, **near-shoring** (moving processes to an adjacent or nearly adjacent country) and **same-shoring** (moving processes to a central location within the same country) also refer exclusively to geographic location. Two other more recently coined terms, **right-shoring** and **best-shoring**, refer to quality of location – choosing the optimal location for outsourced and/or shared services processes with respect to a company's unique needs.

Multisourcing: A term used to describe a company's overall in-sourcing and outsourcing strategy. The phrase is defined as "the disciplined provisioning and blending of business and IT services from the optimal set of internal and external providers in the pursuit of business goals" in the book "Multisourcing" (Cohen and Young, 2006). The appearance and use of the term, along with more references to outsourcing and in-sourcing as "sourcing" (Sourcing Interests Group) signify the maturating of the outsourcing discipline.

1. MAKING THE DECISION

Before outsourcing a process or a set of processes, finance and accounting leaders should conduct four different, but frequently overlapping, evaluations to ensure a sound outsourcing decision (whether positive or negative) that aligns with corporate strategy, objectives, capabilities, and plans.

Those four evaluations include:

- **Identify Strategic Drivers** – Identifying the company-specific strategic drivers for the outsourcing decision is essential to keep everyone on the same page throughout the process;
- **Evaluate the Full Range of Options** – A thorough evaluation of the full range of options includes consideration of shared service arrangements, as well as all potential "sourcing" and "shoring" possibilities;
- **Assess Internal Capabilities** – Assessing the internal capabilities of each sourcing option must include an honest evaluation of systems and controls as well as the skills necessary to transfer and effectively manage the outsourced process or processes; and
- **Determine Scope and Logic –** Determining the scope and logic is an essential element of building and finalizing the business case for an FAO decision.

Before examining those evaluations in greater detail, it is useful to review why companies outsource finance and accounting processes.

Organizations use outsourcing, including FAO, to achieve one or more of the following benefits:

1. Reduce costs;
2. Gain access to better talent;
3. Address staffing issues and labor shortages;
4. Gain access to better technology;
5. Improve processes and productivity;
6. Reduce risks associated with ineffective in-house processes; and
7. Re-assign employees to higher-value activities.

Research on outsourcing benefits suggests that cost reduction remains FAO's primary motivation. By far the most important criteria for selecting a finance and accounting outsourcing provider among North American companies are price and the deal's overall economic proposition; the FAO provider's "transformational capability" represented only the 12th (out of 18) most important provider-selection criteria (CFO Research Services). The most frequently outsourced finance and accounting processes are (in priority) accounts payable (A/P), accounts receivable (A/R) and payroll. Turning over those processes to an outside vendor rarely delivers transformational benefits; rather, the primary objective is cost reduction. This may reflect the number of years that FAO outsourcing has been occurring; other criteria may evolve as the process matures, as has happened to some degree with IT outsourcing.

The benefits associated with finance and accounting outsourcing are similar to those associated with both HR and IT outsourcing:

> *"Take … all of the work within a finance department involved in maintaining its company's books: reviewing and verifying receivables and payables, making deposits, reconciling bank statements, entering updates into the company's financial system, and producing timely reports for management (the internal customer of the process). Outsourcing this type of work within a finance department has produced real benefits for many companies. They gain significant savings by leveraging the scale and scope of the provider's operation. They gain access to a more flexible workforce, one that can be ramped up for quick quarterly and year-end processing and then regulated back down for the rest of the year. The company can tap specialized financial skills it only needs occasionally. All of the work of recruiting and staffing personnel and dealing with day-to-day operational issues are assumed by the service provider. As a result, internal skills can be freed, making more time available for financial planning, what-if analysis, and forecasting,"* (Corbett, 2004).

Many outsourcing providers tend to emphasize that final point – the reallocation of finance employees to higher-value tasks – when describing FAO's potential benefits. The value of that benefit is difficult to measure, however. To date, there is little if any data that measures the degree to which companies succeed and/or benefit from reassigning finance and accounting staff from transactional activities (such as A/P or general accounting), to financial planning or other, more knowledge- and analysis-intensive endeavors. Rather, the evidence of those sorts of benefits tends to be anecdotal.

For example, when the CFO of Phoenix-based OpenWorks, a small commercial cleaning franchise company, grew tired of investing too much money in collections activities that generated disappointing results, he hired an external firm to handle the company's accounts receivable A/R processes. The decision to outsource A/R stemmed from difficulties in hiring and retaining A/R professionals. The business case — send A/R to a provider who can perform the process better and for less money — resonated with the rest of the company because it paralleled the pitch OpenWorks makes to clients who invest in the company's janitorial services. The company purposefully selected a provider with U.S. operations; the CFO believed that the location would prevent the company from receiving local criticism for sending jobs overseas and ease the management of the relationship, since the provider was only one time zone away.

OpenWorks' CFO points to two benefits – only one of which he could track on a spreadsheet – that the outsourcing relationship delivered within eight months of transferring A/R to the provider. First, the company reassigned its three A/R clerks to new positions where their knowledge of customer organizations came in handy. One of the A/R clerks now conducts audits of customer contracts to ensure that OpenWorks and its customers adhere to the contractual terms. Second, the A/R outsourcing significantly improved the effectiveness of collections. Prior to hiring the outsourcing firm, 45 percent of the company's current month's bills (all of which go out on the first of the month) were collected by the end of each month. Within eight months of outsourcing A/R, that figure climbed to 60 percent.

Despite its small size and the limited scope of its FAO (one process), OpenWorks' successful experience demonstrates the value of making an outsourcing decision after conducting four important evaluations. The company identified a driver: existing A/R activities were too expensive and ineffective. The company chose to evaluate two options for addressing the situation: leave A/R in its current state or outsource it to a same-shore or offshore provider (a shared-services option was not viable given the company's small size). The company assessed its internal capabilities as ineffective. The company then used those conclusions to finalize its business case (the CFO's baseline and follow-up measurements also illustrate crucial steps in managing the outsourcing relationship, which will be addressed later in this guideline).

Much larger companies considering finance and accounting outsourcing agreements of a much larger scope should work through similar evaluations. The following decision-making steps, which do not necessarily have to be taken in this order, should be part of the FAO decision-making process:

Identify Strategic Drivers

The purpose of this evaluation is to identify why the company is considering outsourcing – and to understand and document those reasons and how they complement overall corporate strategy. If, after working through the three other evaluations within the decision-making step, the company decides to move forward, the answers to this "why" question should help determine the subsequent steps of the FAO lifecycle, including (a) the finalization of the business case, (b) the selection of the outsourcing provider(s), and (c) how outsourcing relationships are monitored and managed throughout the agreement.

Questions to ask as part of this evaluation include the following:

– Why is the company considering FAO?
– How and to what extent do those reasons (i.e., drivers) support the company's strategic objectives, direction and plans?
– To what extent might the impacts of outsourcing the process — such as firing or reassigning staff, or turning over management of software applications to an external provider – align with strategic objectives?
– Might the company miss out on any significant opportunities if it opts not to outsource? If so, what are those opportunities, and how do they support the company's strategic objectives, direction and plans?

Evaluate the Full Range of Options

Most companies (with the exception of small organizations in which shared services arrangements are not viable) have three options when considering whether to outsource. They can (a) leave their processes in their current state, (b) improve the processes or reorganize them into an internal shared services model (or restore the processes to a decentralized model if they are currently in a shared services model), or (c) outsource the processes.

The second option, which involves varying types of process improvement and/or reorganization, covers a wide area. A company may decide that an existing finance and accounting process cannot be left in its current state due to inefficiencies or other problems. Once that decision is reached, the company may consider a range of process-improvement approaches (such as Six Sigma or implementing new technology to help improve the process) along with in-sourcing and outsourcing. The pros and cons as well as the implications of each of those options should be considered during this evaluation.

For example, a company may want to reduce costs by outsourcing travel and expense (T&E) management. However, if the company recently purchased and implemented a new T&E management software application (and invested time and money training end users on the new system), those investments should figure into the evaluation.

Research indicates (and many outsourcing advisors agree) that moving processes from a decentralized model to a shared services model can be a helpful intermediary step before outsourcing. To be sure, it is not a necessary first step; however, the transition can provide an organization with an opportunity to "practice" managing a transition within the confines of its own four walls before attempting to manage a similar but typically more complex transition of processes to an external firm.

Moving to a shared services model involves many of the same processes and challenges as are found in outsourcing: identifying which processes to move, developing a plan to perform that transition, understanding the implications of the shift, establishing service level agreements, and developing a framework for monitoring and managing the relationship between the service provider and customers, to name a few.

A March 2006 study by The Hackett Group suggests that the use of shared finance and accounting services, located domestically or off-shore, may be even more prevalent among global companies – for the time being. The study is based on information collected in 2005 or earlier. The study projects that 22 percent of the cost of finance will be either outsourced or moved to an overseas shared services center within the next three years (The Hackett Group, 2006).

One of the primary competitors to existing FAO providers in coming years will be companies that develop their own captive off-shoring centers. According to FAO Research, more large North American companies are also beginning to either (a) staff and/or train their procurement functions with more advanced outsourcing expertise; or (b) develop internal "outsourcing functions" to lead the selection and governance of sourcing arrangements, whether those arrangements are managed internally or externally.

As noted earlier, shared services is not a necessary precursor to outsourcing. It is, however, one of several options finance and accounting leaders should consider during this evaluation phase (see **Evaluation Case Study** side bar).

Questions to address within this area include the following:

– What are the benefits and limitations of leaving the processes in their current state?
– What are the benefits and limitations of reorganizing the processes internally (either to a shared services or decentralized model)?
– What are the benefits and limitations of outsourcing the processes?
– What, if any, investments in process improvements, staffing and/or technology has the company made in the last three years?
– What, if any, investments in process improvements, staffing and/or technology might the current processes require during the next five years?

Assess Internal Capabilities

The majority of companies that opt to outsource one or more finance and accounting processes assess internal capabilities early in their decision-making. To be effective, however, assessments must be complete. It is not sufficient to focus only on the skills necessary to execute a specific process. Other capabilities, such as the skills required to (a) manage the possible transfer of a process to an outsourcing provider, and (b) monitor and manage the outsourcing relationship, also require assessment. Those two needs – managing both the transition and the ongoing relationship – require distinct skills and, as a result, routinely require different experts and staffs.

An effective assessment in this evaluation area requires an understanding of the skills required to operate the process (a) in its current form, (b) following a different internal model (e.g., shared services), and (b) following an outsourced model.

Questions to ask during this evaluation include the following:

– Does the company possess the expertise and staff required to operate the process in its current form?
– What is the likelihood of retaining the expertise and staff required to operate the process in the future?

- Does the company have the expertise and staff required to move to a different internal model (e.g., shared services)?
- Does the company have the expertise and staff required to select an outsourcing provider (i.e., knowledge of the provider marketplace)?
- Does the company have the expertise and staff required to manage the transition of the process(es) to the outsourcing provider?
- Does the company have the expertise and staff required to monitor, manage (and troubleshoot) the outsourcing relationship through to its termination or renewal?
- Does the company have the technology (e.g., communications networks, applications integration) that may be required to monitor and manage the outsourcing relationship through to its termination or renewal?

When evaluating responses to each of the above questions, negative responses should generate another question: *How easy or practical would it be to correct the deficiency?*

Determine Scope and Logic

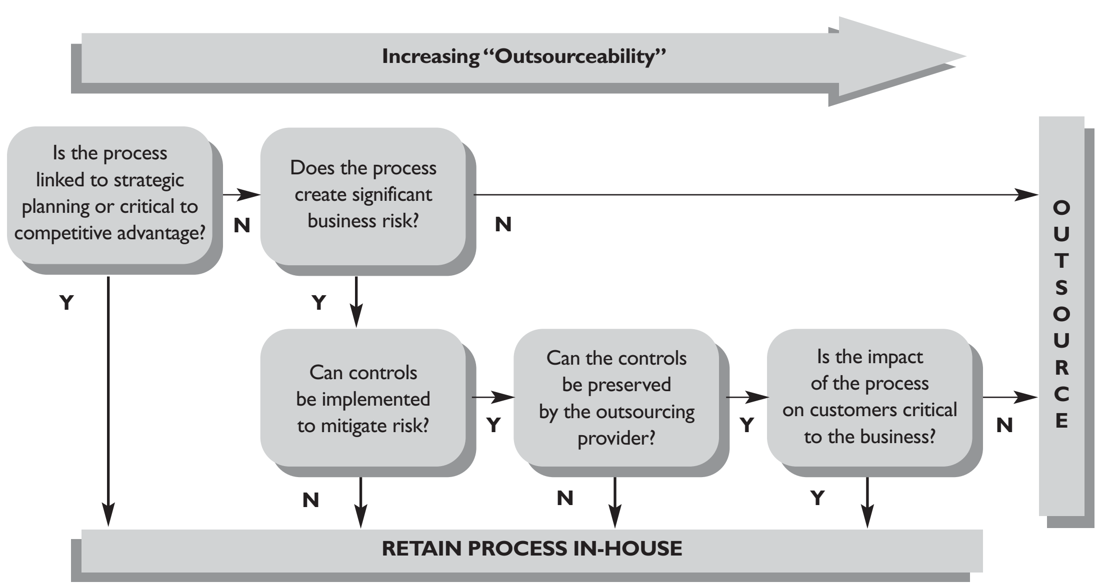
This decision-making step includes finalizing the business case for outsourcing, and identifying which process(es) to outsource. The analysis conducted in the previous decision-making step should contribute to the decision made in this step. This evaluation is frequently integrated with the next step of the FAO lifecycle, the selection of the outsourcing provider(s).

A common notion repeated in the business press is that "non-core" operations are ripe for outsourcing (although some companies also outsource processes they deem "core"). That description is imprecise: a process defined as "non-core" can still be highly important or strategic. For example, an insurance company may define claim processing as "non-core" because it is simply a transaction – one that numerous outsourcing providers can perform at a lower cost. Yet errors in claim-processing, particularly those with high-value customer accounts, can cause major problems. Similarly, fixed-asset accounting may be a prime candidate for outsourcing at a company with a small infrastructure, but a much less likely outsourcing candidate at a large-infrastructure company.

Evaluating the "outsourceability" of a process is more effective than simply making core vs. non-core distinctions. The term "outsourceability" has appeared in white papers and presentations from consulting and outsourcing advisory firms. It describes the essence of the result of a key evaluation in the decision-making phase: *How appropriate is a process or processes for outsourcing given our organization's strategy, capabilities and other unique characteristics?*

All of the questions presented previously are designed to help finance and accounting leaders answer that question. The following decision tree is also useful:

FAO Process Decision Tree



Adapted from Booz Allen Hamilton (2005)

In this decision tree, the consulting firm breaks down the finance and accounting processes a company is likely to decide to outsource or keep in-house after working through the questions:

Outsourced	Performed In-House
• Accounts Payable • Payroll • Travel & Expense Management • Bank Reconciliation • Finance & Accounting IT Support • General Accounting; and • Fixed Asset Accounting	• Corporate Controllership • Financial Planning & Analysis • Business Finance • Treasury Operations • Tax • Strategic/Key Account Collections

This breakdown of outsourced vs. in-house processes contains *general* guidance on decisions that are appropriate for some, but not all, organizations. Finance and accounting executives should use the above decision tree while determining the scope and logic during the decision-making phase of the FAO lifecycle. Depending on their unique characteristics, the same finance and accounting process will pose different magnitudes of risk and strategic importance for different companies. As a result, an FAO process that one company may determine is highly "outsourceable" may be designated as one that should be performed internally by a different company.

The defining characteristic of effective FAO decision-making should be its completeness. The potential benefits of outsourcing are attractive, but those objectives need to be evaluated in the context of many other dynamics, including (a) the company's strategic objectives, (b) recent investments in finance and accounting processes earmarked for possible outsourcing, (c) other options that might deliver similar benefits (e.g., shared services), and (d) the degree to which the company possesses the capabilities necessary to operate the process, as well as to manage and execute the different outsourcing phases.

Finally, if the evaluations within the decision-making process are to prove beneficial, they should be summarized, documented and understood by the individual or individuals responsible for the next step in the FAO lifecycle: selection.

Evaluation Case Study

Sunnyvale, Calif.-based Juniper Networks accounting managers visited India in 2004 to meet with three large outsourcing providers and assess their A/P services. The vendors were helpful in providing information about the process and potential pitfalls. After returning home, the accounting managers and their bosses decided against outsourcing, but in favor of setting up their own shared services A/P operations in India.

The primary driver of that decision was a staffing-management issue: Juniper Networks believed it could exert greater control over staffing issues that would directly affect the value of the arrangement.

The company established some engineering operations in Bangalore about six months prior to searching for a lower-cost approach to A/P processing. The accounting managers believed that they could address certain risks, like employee turnover, better through a captive off-shoring arrangement. The company's commitment to efficiency and internal controls were key enablers of that decision. It also helped that the A/P function was already automated, in the form of an A/P application that could be used at the Bangalore A/P center. Juniper Networks maintained some A/P support at its operations in the U.S., Asia and Europe, but those investments would have been necessary even if Juniper had hired an outsourcer.

A key difference, however, is the schedule the Bangalore-based employees maintain. Although many India-based outsourcers operate support centers around the clock to compensate for the time zone difference, Juniper opted against night shifts. That means slower responses in some cases, but that is offset by the local A/P support and a rock-bottom turnover rate (no turnover in two years), which translates to more productive employees and better service. Since the Bangalore A/P center opened, Juniper Networks' cost of A/P transactions has dropped by 40 percent.

2. SELECTING THE PROVIDER

The success of the process of selecting an outsourcing provider depends largely on the rigor and comprehensiveness of the outsourcing decision-making process that led to the search.

An effective decision-making process will highlight important issues that need to be examined in the selection process. For example, if an assessment of internal capabilities reveals that a company does not possess sufficient expertise and resources to manage the transition of multiple processes to an external provider, the search should extend to prospective outsourcing partners who possess that capability.

Many other considerations need to be addressed during the selection process if it is to result in a successful choice and a beneficial relationship. Those considerations and needs must be prioritized and communicated, usually through the RFP, in a way that enables the individual or team responsible for selection to understand and compare the merits of each outsourcing provider's proposal with the greatest possible consistency (i.e.: compare apples to apples). The need to prioritize selection criteria and to conduct thorough due diligence exists even when a company seeks to outsource a single finance and accounting process, as U.S.-based Susquehanna Trust & Investment Co. demonstrated.

The company, a financial holding company's subsidiary that provides tax-processing services to financial institutions and financial services companies, sought to outsource tax services. They did this primarily to address difficulties in recruiting qualified staff to handle the highly specialized back-office tax work the company conducts. The company's senior vice president of risk, compliance and tax led the selection process, which identified the following four key criteria on which she and her staff focused while comparing and analyzing prospective outsourcing partners:

- **Size of Outsourcing Firm:** The vice president believed her company would enhance its chances of receiving excellent service by "making sure that we weren't the biggest fish in the pond or the littlest fish in the pond" compared to the rest of the provider's customers.
- **Reliability and Flexibility:** The vice president wanted to make sure the outsourcing provider could continue to deliver service if Susquehanna Trust & Investment encountered any major systems issues, entered into any mergers or acquisitions, or converted to a new accounting system. Similarly, if significant external changes occurred, such as a major tax law being passed in the last quarter of the year, Susquehanna Trust & Investment wanted assurances that the provider's finances were sufficient to accommodate any programming or staffing changes that might become necessary.
- **Potential for Change in Ownership.** Susquehanna Trust & Investment did not want an outsourcing partner that might undergo a change in management, which the vice president feared might negatively affect service levels. (This concern explains why most outsourcing contracts allow for termination of the relationship upon a change in control at either the buyer or provider's company.)
- **Quality of Work Output.** This factor, of course, represents a priority in every selection process, and quality is typically evaluated by speaking with current customers. The outsourcing provider that Susquehanna Trust & Investment ultimately selected was a firm the company had worked with in the past – a positive experience that figured into the final decision.

The vice president compares the selection process to the due diligence that the company conducts before selecting a consulting firm or an enterprise software vendor. "I made a list of all the things I had forgotten to ask in similar situations before," she notes. "And then it was a matter of sorting out the information so that we were comparing apples to apples."

The same objective should guide the selection of outsourcing providers, even for arrangements that are much more expensive and involve multiple finance and accounting processes. Once the documentation from the decision-making stage has been completed and reviewed, the selection process should begin by taking the following steps:

– **Create the Project Team** – Creating a project team responsible for guiding the selection process and for making the final selection decision – or recommendation (if the decision requires approval from a higher-ranking executive or the board of directors);

– **Link Buyer's Needs to Provider Marketplace** – Developing an understanding of the current outsourcing provider market-place to allow the buyer to more effectively target potential providers most likely to meet their needs;

- **Consider Outside Help** – Considering whether it makes sense to hire an outsourcing advisor (i.e., consultants and/or lawyers with extensive knowledge of and experience with outsourcing agreements and relationships) to assist with the selection an outsourcing provider and the subsequent negotiation process;
- **Develop the Request for Proposal (RFP)** – Developing and distributing requests for proposals (RFPs) and, in some cases (often when multiple processes are involved), requests for information (RFIs);
- **Establish an RFP Evaluation Process** – Establishing a process to review RFPs and/or RFIs (including a standard approach to responding to questions from prospective vendors during the selection phase) and conducting that review;
- **Conduct Due Diligence** – Conducting additional due diligence that may include site visits to a prospective outsourcing provider's location, presentations by outsourcing providers, and calls to outsourcing providers' current customers or references.

Each of these steps entails addressing a number of considerations; the following section examines those considerations:

Create the Project Team

Among the different types of functional outsourcing, finance and accounting outsourcing appears to depend to a greater extent on the relationship between the outsourcing provider and the leadership of the function whose processes are outsourced (in this case, finance and accounting):

> *In FAO relationships, the interaction is typically between the service provider and the personnel within the finance department and, in some instances, procurement. Overall, it is less complex for service-level agreements and accountability metrics to be built into contracts, the outcome measurements are easier to quantify, and the overall governance of the contract is simpler to administer than those that have typically been experienced with HRO contracts. HRO usually impacts the entire staff within an organization; as a result, many HRO deals are challenged [by internal staff] from the onset,* (Fersht, 2006).

This underscores the need for finance and accounting expertise and staff to be represented on the buyer's teams responsible for selection, as well as transition and ongoing management. The selection teams should consist of all or most of the following individuals (some of whom may contribute more than one area of expertise):

- A project manager to lead the selection team;
- At least one expert from the finance and accounting department who understands how to manage, measure and monitor the operation of each process to be outsourced;
- An individual with negotiation experience (if possible, experience negotiating outsourcing agreements);
- A legal expert who will manage the creation of the contract.

If the outsourced processes significantly affect other areas of the company (particularly highly important areas, such as key customer relationships), companies should consider including representatives from those areas on the selection team. For example, if A/R is outsourced, a sales and/or service manager responsible for key accounts might be considered for inclusion.

The selection team is responsible for conducting each of the subsequent steps in the selection phase described above: reviewing the provider marketplace, considering an investment in external outsourcing advisory services, developing and reviewing RFPs, interacting with prospective providers, and performing other forms of due diligence. In addition to equipping the team with the skills necessary to perform those steps, other qualitative criteria can be used to appoint members to the selection team, including:

- Motivation to participate;
- A record of delivering on promises;
- Strong communication skills;
- An ability to think creatively and strategically;
- Solid performance evaluations; and
- Breadth of experience outside the organization (Greaver).

Link Buyer's Needs to Provider Marketplace

The next step of the selection process call for the project team to link insights generated during the decision-making phase to the realities of the outsourcing provider marketplace. The objective of this step is for the team to gain a high-level understanding of the degree to which the marketplace can meet the FAO needs of the buyer. That understanding will shape the subsequent development of an RFP (and RFI, if necessary) and the evaluation of the proposals.

After Susquehanna Trust & Investment Co. completed the decision-making phase that identified the need to outsource tax services, the vice president who guided the selection process examined the insights generated during the decision-making evaluation and then *identified four priorities that figured prominently in the evaluation of providers by her team*.

Understanding which outsourcing providers are most likely to fulfill those priorities can contribute to a more efficient selection process by more effectively targeting RFPs to appropriate providers. The primary challenge in cultivating that understanding is the continued evolution of the FAO provider marketplace.

That continual change reflects the low barriers to entry for many FAO services: "The FAO industry has a level playing field across the established global outsourcers, the upcoming Indian providers, and the niche FAO specialists," (Fersht, 2006). Additionally, many FAO providers serve both mid-sized and large companies. Given the changing nature of the FAO provider market, it makes sense for an FAO customer to request their provider to conduct and present a market analysis that supports how and why their offering remains competitive (and, therefore, should be considered for renewal).

Companies entering into FAO relationships for the first time do not have the luxury of requesting market reports from providers; however, they can create and distribute RFIs. Doing so adds time and cost to the selection process, but can sharpen the selection team's understanding of the provider market resulting in a stronger ultimate selection.

Consider Outside Help

As the use of IT and HR outsourcing soared in the mid- to late-1990s, outsourcing advisory firms emerged as frequent participants in the selection of outsourcing providers when the scope and cost of the work was large enough (roughly five or more processes and a contract value of at least $50 million). Some larger consulting firms also offer outsourcing advisory services. Outsourcing advisors generally define their value as helping to level the playing field between the outsourcing buyer and the outsourcing provider, since the latter generally has much more experience in negotiating agreements. As the use of business process outsourcing has increased in the past decade, however, outsourcing buyers are no longer as inexperienced as they may have been 10 years ago.

Outsourcing advice is not the only external expertise the selection team may consider if the size and complexity of their outsourcing are substantial enough. A number of legal firms also operate practices that specialize in outsourcing; those practices tend to focus on the negotiation and formation of contracts. And, finally, finance and accounting professionals (including external consultants and accountants, auditors and related experts) can bring their expertise to bear on assessing the regulatory fitness of a prospective outsourcing provider's processes.

The assessment of internal capabilities during the decision-making phase, as well as the selection team's assessment of the external market, should shed light on whether it is advisable to consider hiring an outside advisory firm and/or an outside legal firm to assist with the selection, negotiations, and finalization of the contract. To make this decision, the selection team should ask the following questions:

- Do the organization and the selection team possess previous experience selecting an outsourcing provider?
- Have members of the team been involved with selecting an outsourcing provider for an arrangement of this scope and value?
- Does the selection team possess, or have access to, internal legal experts who have experience crafting outsourcing contracts?

If the answer to any of those questions is no, or if the selection team lacks confidence that it can perform its responsibility without outside help, an external advisor should be considered. An outsourcing advisor can improve the selection process and help create the foundation for a more valuable relationship after the contract is signed; they also add cost and time to the selection process. Outsourcing advisors have been used to assist with single-process outsourcing and multisourcing, although they are used more frequently to assist with the latter arrangements.

Some outsourcing advisors may also steer buyers toward certain providers while neglecting others. For this and other reasons, a company that elects to hire an outsourcing advisory firm should address the following questions:

- **Does the firm provide any service offerings that extend beyond the finalization of the agreement?**

  Many outsourcing advisory firms also assist with the transition of processes, the change management demands that accompany the *transition, and in some cases ongoing vendor management. Outsourcing advisory firms that provide these services tend to have a greater incentive to ensure the workability of the outsourcing arrangement well beyond the finalization of the contract.*

– **How well does the outsourcing advisory firm know all of the vendors on the FAO market?**

  The FAO provider market continues to change, sometimes dramatically. An effective FAO advisory firm should provide a current snapshot of the complete FAO provider market.

– **Which FAO providers has the outsourcing advisory firm recommended to past clients, and why have they made those recommendations?**

  Occasionally, an outsourcing advisory firm may cultivate a bias for a particular outsourcing firm or set of firms. Buyers should identify if and why that is the case.

– **Which individuals will serve on the advisory team?**

  Outsourcing advisors typically staff their teams with a project manager, a consultant, and a subject matter expert in the process or processes being outsourced. That subject matter expert should know the finance and accounting processes inside-out.

Develop the Request for Proposal (RFP)

Best practices that define the exact scope, length and development process for an RFP have not yet emerged. Finance and accounting practitioners who have helped craft RFPs agree that the document should be tailored to the unique demands of the process or processes to be outsourced.

Despite the lack of definitive FAO RFP standards, a number of generally agreed-upon components should be included in most RFPs (which can range in length from 15-30 pages to 100-200 pages). It should be noted that some outsourcing providers decide to send out an RFI before an RFP.

Each of the two documents seeks feedback from outsourcing providers, but is designed to achieve different objectives. An RFI is designed to collect information that helps an outsourcing buyer (a) understand the capabilities that outsourcing providers in the marketplace possess; and (b) compare the capabilities of different buyers in an "apples to apples" fashion. RFIs tend to be used more frequently when an outsourcing buyer intends to outsource multiple processes, and/or the outsourcing buyer is unfamiliar with the outsourcing provider marketplace. As mentioned, the RFI often precedes the RFP, and helps to educate the prospective buyer about the provider marketplace.

An RFP invites outsourcing providers to submit a proposal, including a bid, for taking over a company's process or processes. The outsourcing buyer requests the prospective providers to include specific information in their proposals. This information frequently includes company background, financial information, and descriptions of the service provided (the work to be performed). That description should be based on the needs identified during the decision-making process.

An effective RFP crystallizes, in a clearly written form, the scope and logic behind the desire to outsource finance and accounting processes that was established during the decision-making phase of the FAO lifecycle. Doing so will promote responses from providers that can be easily analyzed and compared.

With regard to pricing, companies typically must wait until narrowing the field to two or three final candidates before receiving a specific price quote:

> *It is difficult in most proposals for large complex transactions for the provider to provide a firm price without substantial investigation… Unless you are looking for an absolute firm price in the proposal (in which case, this should be stated), getting a reasonable estimate should be enough to screen the proposals to the few providers who deserve to be included in the short list of competition* (Greaver).

In some cases, particularly when the scope and logic of the desired outsourcing arrangement deviates from the norm for any number of reasons, (e.g., the buyer's distinctive organizational structure, specific regulatory risks, or unique staffing concerns), the RFP may initiate a collaborative process with one or more providers. The purpose of that process is to finalize a more specific RFP and, eventually, a contract and service level agreement that addresses the unique needs of the relationship.

Communications with prospective providers after the RFP has been finalized, but before final selection, should be sensitively managed according to a process laid out during the development of the RFP.

The categories of information an RFP should contain include the following:

Key Elements of a FAO Request for Proposal (RFP)

Category	Description
Logic	Explain why the company wants to outsource the process(es). This gives providers an opportunity to differentiate their pitches based on the buyer's specific needs.
Scope	Clearly identify what services the provider is being asked to deliver throughout the relationship. It is also important to describe what is not included. Although the description will be written at a high level, RFP writers should take pains to avoid ambiguous and uncertain descriptions; this can help discourage providers from figuring uncertainty into their ultimate price.
Provider Qualifications	What qualifications are important to the outsourcing purchaser (e.g., industry experience, flexibility, geographic location, the use of a preferred accounting software system, customer service, etc.)?
Performance Standards	The outsourcing buyer should communicate its service-level expectations and how it plans to monitor performance.
Pricing	Whether the company prefers a pricing model (e.g., cost plus, fee for service, fixed price, shared risk and reward, or others; see Appendix 2).

(Adapted from Greaver)

Establish an RFP Evaluation Process

Although clarity is the most important quality of an effective RFP, consistency is the defining characteristic of an effective evaluation process. Most evaluation processes, which begin in earnest as soon as the RFP is released, consist of both formal and informal communications with prospective vendors. FAO providers may contact the buyer to clarify the RFP and/or to seek other information that might give them an edge in their response.

Responses to any and all "off-line" questions and requests should be performed consistently. Doing so offers two benefits. First, it helps ensure that the ensuing proposal evaluation is as free from bias as possible. Second, it establishes a healthy communications protocol that can be followed when the actual FAO relationship begins. Additionally, it is good practice to pass on to all potential bidders any responses or information provided to any one recipient of the RFP, so that all bidders continue to work with the same information.

Ground rules or guidelines – or what Cohen and Young describe as an "interaction plan" – can help establish that consistency. Those guidelines should answer the following questions:

– Which member or members of the evaluation team will serve as the contact point for prospective vendors?
– How will information be exchanged with prospective providers (e.g., via e-mail, instant message, telephone, fax or hard-copy documents)?
– What schedule will be adhered to (i.e., what are the specific dates when the RFPs will go out, when are proposals due, when will any subsequent in-person presentations be conducted, and when will a final selection occur)?
– How many (and which) prospective FAO providers will receive the RFPs?
– What are the consequences for prospective vendors who seek an advantage by not following the communications ground rules?

(Adapted from Cohen and Young)

The final question may sound surprising, but it is a necessity:

> *You can be sure that, deliberately or accidentally, a service provider will call the wrong person while trying to get information or will test the waters with senior executives. Keep in mind that these actions reveal the character of the service providers you are evaluating. It is the first test of trust in the relationship – a provider that tries to go above the heads of the selection committee will go above the heads of the relationship manager and other governance personnel once a deal is signed. So, in this interaction plan, you need to explain to the providers the consequences of not adhering to the interaction plan,* (Cohen and Young).

Similar consistency and objectivity should govern (a) the evaluation of vendor proposals and (b) any site visits selection teams conduct before or after completing an RFP. Some FAO buyers, particularly those seeking a provider to manage multiple processes, prefer to meet with providers and conduct site visits before completing the RFP; doing so can help sharpen the RFP's clarity and also limit the number of prospective vendors that receive the RFP. Other FAO buyers meet in person with prospective vendors and visit their sites after issuing RFPs and narrowing the field of candidates based on their evaluation of the returned proposals. The RFP should clarify what type of site visits will be permitted during the bidding process so that all potential bidders have the same opportunity.

The underlying objective of the evaluation is the conduct by the selection team of an unbiased and thorough analysis of how well each prospective provider would meet the company's FAO needs. That analysis will be more effective and efficient if it is easy to compare different vendors' suitableness from reviewing their proposals. Selection teams can promote the ease of vendor comparisons (and strengthen the selection process as a whole) by:

– Setting the dates for the evaluation to begin and end.
– Defining the outcome and deliverable of the evaluation. For example, will the selection team recommend finalists to executive management or the board? If so, how many finalists will be recommended? How will the information on which the evaluation is based be presented (e.g., a scorecard, matrix, or report)? Who will review and approve the selection team's evaluation?
– Developing the process and/or documentation for comparing the proposals. Although effective RFPs will help generate proposals that can be easily compared, proposals frequently need to be summarized and re-stated to facilitate apples-to-apples comparisons among different vendors. Matrices and scorecards (see "Provider Selection Case Study" side bar) that weight each factor used to evaluate all proposals are two common documents for doing so.
– Ensuring that the selection team understands and applies the same importance or weighting to different selection criteria.
– Highlighting major differences among the different proposals.
– Deciding whether selection team members will conduct their evaluations individually or as a group.
– Establishing a consistent process for checking and assessing the information contained in the RFPs.

Conduct Due Diligence

The purpose of due diligence is to confirm or raise questions about the validity of claims and information contained in the RFPs. This work may involve calls and discussions with the vendors' current and former customers, former employees, competitors, outsourcing advisors, and other consultants.

Site visits, which may include in-person presentations from the vendors, represent a final form of due diligence. The process by which selection team members conduct any site visits should be consistent across all prospective FAO providers.

Although the provider-selection phase of the FAO process may sound exhausting, it should definitely be *exhaustive*. A comprehensive understanding of the marketplace followed by thorough scrutiny of prospective FAO vendors will lead to a better match, a more effective negotiation process (which follows) and, ultimately, a better finance and accounting outsourcing decision.

Provider Selection Case Study

Orange Business Services, the Amsterdam-based subsidiary of French Telecom, adhered to a scorecard mentality when evaluating FAO providers in 2005. Following a previous move to finance and accounting shared services, the data network operator decided to outsource the majority of its transactional finance and accounting processes, including travel and expense management, cash management, accounts payable, fixed assets, general ledger, and accounts receivable.

Before reaching out to prospective vendors, Orange Business Services' FAO selection team, led by the company's head of global financial shared services, listed the qualities it sought in a provider: a global reach, numerous FAO clients, FAO clients who operated in the same industry as Orange Business Services, and sufficient expertise and resources related to the finance and accounting processes the company wanted to outsource.

The selection team opted to visit about a dozen outsourcing providers around the world prior to requesting proposals, which it did only after narrowing the field of candidates to two finalists, based on the site visits to vendor locations in India and Central Europe.

To review the detailed proposals, the selection team developed a scorecard that contained five criteria and numerous sub-criteria. The five criteria were weighted according to their importance in the selection decision:

Company Profile (16 percent): size, business history, number of sites and global reach;

Location of Operations (12 percent): the geographic locations of the service centers where each vendor recommended conducting the work;

Human Resources Capabilities (18 percent): capabilities related to recruiting, retention and HR policies;

Delivery of Service (29 percent): a detailed examination of how each provider would manage the transition, document processes and meet business continuity management needs, among other sub-criteria; and

Contract and Pricing (25 percent).

Conclusion: Orange Business Services' FAO decision-making phase began in November 2004, the contract with the selected provider was finalized in December 2005, and the agreement's implementation began in November 2006 (Coomber, 2007).

Keep in mind that the decision remains open at this point. Executives responsible for the FAO decision can change their minds and decide to retain in-house processes earmarked for outsourcing, if an in-depth selection process indicates that is the most prudent course of action. The head of an outsourcing advisory firm recently reported that about one in three client companies decide not to outsource after evaluating the FAO marketplace and specific providers (The Wall Street Journal).

3. MANAGING THE RELATIONSHIP

According to *The Wall Street Journal* article cited above, as many as one-third of selection teams decided to keep their processes in-house even after investing significant time and money in evaluating potential providers. They did this because the teams decided their companies were not prepared for the magnitude of change required by a transition to an outsourcing relationship.

Underestimating the amount of resources, energy and time that change management activities require represents one of the most commonly reported pitfalls of outsourcing relationships. "Choose a supplier that has a solid change management process and mechanism, one that can integrate into your corporate change management process," warn two prominent outsourcing advisors in a recent issue of the Chartered Institute of Management Accountants' (CIMA) "Excellence in Leadership" series. The primary reason outsourcing providers can execute F&A processes, particularly transactional activities, more efficiently than the outsourcing buyer is because the provider executes the process differently. That difference requires employees with the company investing in the outsourcing services to interact with the outsourced processes (and the outsourcing provider's workforce) in different ways. In other words, it requires employees to change.

How well an outsourcing arrangement successfully deals with that need to change depends on the parameters governing the outsourcing relationship. Those parameters, including change-management considerations, are established during the contract negotiations and continue until the agreement ends at a predetermined date (or earlier if one of the parties exercises the early termination clause).

The sections that follow discuss useful steps to follow during contract negotiations,

– **Negotiate Contract and Service Level Agreement (SLA)** – Negotiating the contract and Service Level Agreement (SLA) is the culmination of the vendor selection process and the beginning of the ongoing management of the outsourcing relationship.
– **Transfer Process and Knowledge** – The transfer of process and knowledge to the outsourcing provider is a major change initiative that requires significant project management expertise to clarify roles and responsibilities, and to establish key milestones and deadlines.
– **Monitor and Manage Performance** – Active involvement and monitoring of both qualitative and quantitative characteristics are key to the successful management of outsourcing performance.
– **Renew, Renegotiate, Terminate** – Long lead times and the potential impact on the organization of "repatriating" or moving previously outsourced processes to a new provider requires anticipating and articulating provisions for renewal, renegotiation, or termination in the outsourcing contract.

How an outsourcing buyer evaluates potential providers, cements the union, and then manages the relationship moving forward is frequently compared to a marriage. Two outsourcing advisors, for example, recently organized the FAO lifecycle according to the following phases: introspection, courtship, dating, marriage and commitment (Fersht, Getty).

The parallel is useful to keep in mind; the success of an outsourcing relationship, like the success of a marriage, hinges on the quality and flow of communication between two distinct entities, as well as both parties' ability to work together to resolve problems and improve the relationship over time.

Negotiate Contract and Service Level Agreement (SLA)

The primary issues that should be discussed and agreed upon during negotiations and the finalization of a contract with the final outsourcing provider candidates include:

– Service levels and descriptions;
– Transition costs;
– Master services agreement;

– Pricing schedules;
– Employee transition (to the outsourcing provider) and/or staff-reduction plans and costs;
– Technology transition (if necessary);
– Process improvement expectations;
– Governance modeling;
– The term of the agreement;
– A communications plan; and
– Market pricing and service comparisons.

(Adapted from Fersht and Getty)

Of those discussion points, the communications plan warrants significant time and consideration. The communications plan should identify those within each organization responsible for monitoring and managing the relationship. It should also cover the process that will be used to identify, report and resolve problems that crop up throughout the agreement (such as those related to service levels or the failure of the outsourcing buyer's workforce to adhere to the outsourcing provider's process design). In case those trouble-shooting steps do not resolve the problem, the agreement should identify if and how the issue will be elevated to mediation and/or arbitration before resulting in the termination of the contract and/or legal action.

These discussions should guide the selection team in finalizing its decision, while setting the groundwork for negotiations and the finalization of the contract with the selected vendor. Although FAO contracts vary significantly according to the types and number of outsourced processes and the unique needs of the outsourcing buyer, the majority of FAO contracts range from 20 to 150 pages and address four areas:

A description of services: This area of the contract identifies what services the FAO vendor will provide and, in some cases, which related services it will not provide. This section of the contract will also identify for both parties which elements of the process or processes will be changed to meet the provider's standards, and which elements of a given process will remain the same.

Service level agreements: The contract must also identify the quantitative and qualitative measures to be used to monitor and manage the relationship. How will vendor performance be measured? Which individuals or teams within the provider and buyer organizations will monitor the performance? What is the process for addressing, resolving and, if necessary, elevating performance problems that may crop up during the agreement?

Pricing: This section of the contract details the pricing model and also lays out how changes that affect the execution of the process or processes during the agreement will affect pricing. Changes may relate to the scope of the agreement (additional processes may be added, or a process originally part of a multi-process arrangement may be brought back in-house), transaction volumes, ownership changes (to either party) or external changes, such as the appearance of new regulations that affect how a process is performed.

Terms and Conditions: An outsourcing agreement terminates for one of four reasons:

1. The contract expires;
2. For cause (e.g., poor service or non-payment);
3. For convenience (e.g., the purchasing organization experiences massive cost cuts, reducing the level of service needed and, as a result, the outsourcing arrangement no longer makes economic sense); or
4. A change in control at either of the organizations.

The process by which termination is effected in the last three cases should be detailed in the contract. Terminating outsourcing arrangements before contract expiry, like ending a marriage, can be messy and expensive affairs to avoid at all costs. Bringing processes back in-house after a termination requires almost as much effort, and similar steps, as moving the processes to the outsourcing firm in the first place. Sudden terminations can also exert great pressure on the buyer organization to select a new outsourcing provider – a process that typically begins at least nine to twelve months before the contract expires naturally.

Outsourcing contracts frequently are difficult to negotiate, finalize and manage, due to their size and complexity. Those difficulties can be reduced by crafting contracts that:

1. Focus to a greater extent on the process of managing the ongoing relationship between providers and buyers (i.e., devoting more attention in the contract to performance standards, the transition process, change-management issues, and the processes used to address problems and to resolve disputes between the buyer and provider);

2. Emphasize the value proposition on which the relationship is based; and
3. Are written in Plain English so that the relationship managers on both sides of the agreement can refer to the contract, when necessary, without needing to consult legal experts to translate the terms.

(Hamilton and Mummery, 2006).

That said, it is the SLA and the individuals responsible for monitoring and managing that agreement that should be most heavily relied upon to ensure the health of the relationship on a daily and long-term basis; relying on the contract alone to manage the relationship is a sure-fire way to limit the effectiveness and value of the agreement.

Transfer Process and Knowledge

In the survey (mentioned in the introduction of this Guideline) of 120 finance and accounting executives with FAO experience, respondents identified the transition and implementation phase as the most challenging aspect of finance and accounting outsourcing (EquaTerra). The challenge derives from the scope of the project – removing processes from one organization, implementing them in another, and helping the employees who interact with and rely upon the outsourced processes to adjust to all of the changes the shift creates.

In some ways, outsourcing resembles surgery: the opening up of an organization and the removal of an organ or organs. For that reason, the process may represent a traumatic event for the employees affected by the change (those whose roles are being outsourced as well as those who need to adapt to the changes brought on by an outside provider).

Above all, the transition of processes is a project and should be managed as such, bringing to bear project-management rigor and discipline. For large, multi-process FAO transitions, the individuals responsible for transition should possess project management experience.

To the greatest extent possible, the contract negotiations and SLA should lay out roles and responsibilities for the transition phase. The following questions can help determine those assignments:

– What processes, technology (if any) and people (if any) will be transferred to the outsourcing provider?
– What are the implications (HR and benefits considerations or IT-integration issues, for example) of each of those transfers?
– Who will be responsible for managing the transfer of each of the above categories (process, technology and people)?
– What process and/or technology documentation needs to be transferred to the outsourcing provider?
– Does any other organizational knowledge related to the outsourced processes need to be transferred to the provider?
– What are the most challenging change management issues we can expect to encounter, and how can we address those issues?

During the actual transition, the project team should apply traditional project-management discipline and methodology, including:

– Establishing a project plan, milestones and roles;
– Creating a formal communication plan that considers the unique informational needs of different internal (upper management vs. employees whose jobs or roles are eliminated or affected vs. the rest of the workforce) and external (shareholders, the media) audiences;
– Terminating the employment of, transferring to the outsourcer, or reassigning internally, employees previously assigned to the outsourced processes;
– Addressing potential negative fallout from terminations. This consideration includes internal communications efforts and, in some cases, external public relations and recruiting efforts. There is one other dimension to consider as well. High-value employees – both within the affected process areas and in other process areas and departments – may perceive that their developmental opportunities and potential for advancement are limited by the outsourcing decision and, as a result, begin to look for work outside the organization. Even high-value employees in other areas of the company may believe they "see the writing on the wall," and start job-hunting. An effective communications plan should include tactics for addressing this potential human capital risk;
– Identifying and providing training and communications to end users related to the way in which the outsourcing provider will execute the processes; and

– Implementing new technology, if necessary (e.g., communications infrastructure to support ongoing management of relationship).

Monitor and Manage Performance

Although the transition phase of the FAO lifecycle requires a project-management mindset, the ongoing management of the relationship requires more of an operational mindset.

Relationships tend to please buyers to a greater degree when the management and monitoring of the relationship includes the following practices and qualities:

1. The buyer views the FAO provider as a business partner;
2. Financial metrics on provider performance are tracked and reported;
3. All performance metrics are defined and documented;
4. Managers on the buyer's side visit the provider's work sites during the course of the relationships; and
5. Qualitative reactions to the provider's performance and service are tracked and reported, (CFO Research Services, 2006).

The following managing and monitoring steps can help ensure the effectiveness of the relationship:

– Identify appropriate individuals with sufficient authority at both the buyer and the outsourcing provider to be responsible for managing the relationship throughout the length of the agreement.
– Track quantitative and qualitative (where possible) measures detailed in the SLA to monitor outsourcer performance.
– Establish a formal process for meetings between buyer and provider to discuss issues.
– Establish a formal trouble-shooting process for solving and escalating problems as they arise.
– Set a schedule for representatives from the buyer organization to visit the FAO provider's work site(s) at regular (once a year or once every two years) during the agreement.
– Establish a process for changing the agreement (adding or subtracting processes from the original agreement; revising performance objectives, and adjusting pricing).
– Use quantitative and qualitative performance monitoring as the basis for any decision to renew, renegotiate or terminate the agreement.

Renew, Renegotiate, Terminate

Plans to terminate a contract with an FAO provider should be made long before actual termination. Transitioning processes back in-house or to another outsourcing provider requires time; how much time depends on how many processes are outsourced and the degree to which they have changed since the outsourcing agreement began.

To date, there have been few, if any messy divorces involving large finance and accounting outsourcing relationships. That's fortunate, because bringing back ("repatriating") previously outsourced processes following an agreement's termination can be as time-consuming and difficult as the initial outsourcing transition. The termination and repatriation of a $400 million, seven-year HR and IT outsourcing agreement between Irvine, Calif.-based computer maker Gateway and outsourcing provider ACS contains lessons for finance and accounting executives should their FAO relationship head to divorce court.

The Gateway-ACS termination occurred only a year after the agreement began, due to Gateway's massive cost-cutting following the most recent recession. The staff reduction made the arrangement unprofitable for ACS, and the two parties mutually agreed to end their arrangement.

The Gateway HR executive who oversaw the repatriation dropped nearly all of his other responsibilities to focus full-time on the repatriation. He describes his role as a "communications strategist" who continually repeated the business rationale for the shift while ensuring that the necessary talent, systems and other logistics (e.g., chairs and desks) were in place. He also described the process as an outsourcing transition in reverse, noting that nearly the same timelines and project milestones from the initial outsourcing transition were re-used.

The repatriation process at Gateway involved the following steps:

Diagnosis: The project team identified the scope of the repatriation by inventorying the processes, technology and staff that were returning to the organization – and defining the process management and governance structures necessary once the transition concluded.

Collaboration: An accurate diagnosis required insight from finance (to understand and forecast the costs of the shift), IT (understanding and planning technology requirements), and corporate communications (communications planning). Repatriation may also require additional input from external legal advisors and consultants. The most important collaboration took place between Gateway and ACS, which was motivated to assist because (a) it, too, wanted to end the agreement; and (b) doing so effectively and helpfully might inspire Gateway to serve as a customer reference.

Communication: The Gateway HR executive stresses that communications represented one of the most important ingredients of the repatriation's success. Communications to upper-level management focused more on the business case for the repatriation; communications to the rest of the workforce focused on how the reintroduced processes would be performed and how any changes would affect them.

People Management: Gateway re-hired several key employees who had been hired away from the computer maker by ACS during the original outsourcing transition. As a result of that approach and internal reassignments, Gateway needed to bring in only a few new employees.

Process Management: Thanks to an effective outsourcing selection and transition, the processes generally functioned very well before they were returned to Gateway. Strong documentation helped ease the reintroduction of the processes at Gateway.

Managing technology can also be a challenge, although it was not much of one in Gateway's case because there was no need to switch enterprise software or other major applications. Addressing these areas helped overcome change management hurdles, which the Gateway HR executive described as the most challenging aspect of the outsourcing repatriation.

At least nine to eighteen months before a contract concludes naturally, the buyer should begin to decide what it will do once the termination date arrives. There are three options:

1. Renewing the contract with the current provider (which may or may not involve renegotiations);
2. Putting the processes out to bid again (or re-competing, in which case the current provider could re-bid on the work); or
3. Bringing the processes back in-house

Since most FAO agreements last for at least three years and can last as long as seven to ten years, the vendors, services and prices available in the provider marketplace have likely changed over the course of the current agreement.

One of the most effective ways to get an early assessment of the current provider marketplace, and the willingness of the current vendor to extend the relationship, is by asking the current vendor to conduct and present an analysis of the market that indicates how that provider's services and terms compare to similar agreements.

CONCLUSION

The use of finance and accounting outsourcing is increasing throughout the world. FAO arrangements offer companies opportunities to significantly reduce costs, access better skills and technologies, and achieve other benefits. These include sharpening the organization's focus on core competencies, or moving finance and accounting professionals away from transactional duties and toward more strategic responsibilities. To achieve those opportunities, companies pursuing FAO arrangements must avoid problems that damage relationships with providers and lower the returns on their FAO investments.

FAO should be of significant interest to finance and accounting professionals due to the discipline's growing use, its risks and benefits, and its growing importance to a finance and accounting department. As the CFO of a $2 billion U.S. manufacturing company notes, outsourcing is practically a "ticket to the game" for finance executives and their organizations. "We have to be competitive on every front," she says, "and outsourcing is one way to get there," (CFO Publishing Corp.)

This guideline has identified steps throughout the FAO lifecycle to help finance and accounting executives and others get from the initial outsourcing decision to its effective conclusion. These steps can help prevent FAO investments from succumbing to problems that have limited the effectiveness of IT and HR outsourcing. By following these steps, FAO buyers can improve the likelihood that the outsourcing relationships they enter into achieve their objectives and, in doing so, help strengthen the competitiveness of their companies as a whole.

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SUGGESTED READING

Book and Journal Recommendations

In *Multisourcing: Moving Beyond Outsourcing to Achieve Growth and Agility* (Harvard Business School Press/Gartner Inc., 2006) co-authors Linda Cohen and Allie Young examine the next phase of outsourcing's development. Cohen and Young present four themes: 1) Companies must have an overall outsourcing – or "multisourcing" – strategy; 2) Multisourcing governance is the single most important determinant of success; 3) A key component of effective multisourcing governance is understanding that relationships – not transactions – determine success; and 4) Meaningful measurements are crucial. The goal of the book, the co-authors emphasize, is to be a "guide to enterprise sourcing issues for executive management, not a 'sourcing for dummies' type of offering." The book also contains several sections with useful advice to first-time purchasers of outsourcing: how to evaluate and select service providers (chapter 5); how to negotiate contracts (chapter 6); how to measure (and thus manage) the outsourcing relationship's effectiveness (chapter 7) and the introductory chapter, which presents a list of outsourcing myths and a four-step breakdown of multisourcing strategy. If you invest in only one outsourcing book, this one should be a candidate.

Atul Vashistha, the CEO of neoIT, emphasizes that the development of outsourcing "is only in the early innings." In keeping with the baseball analogy, few if any outsourcing experts know the discipline's players (global outsourcing providers) better than Vashistha. He and co-author Avinash Vashistha share their extensive global-sourcing knowledge in *The Offshore Nation: Strategies for Success in Global Outsourcing and Offshoring* (McGraw-Hill, 2006). The book details the rise of "borderless services," provides a candid assessment of the successes and failures of global sourcing to date, and then lays out a roadmap for off-shore outsourcing. The book contains particularly helpful advice on how to manage offshore outsourcing arrangements. A 10-page chapter provides an overview of offshore risks. The discussion focuses on the operational risks within the outsourcing supplier's organization; checklists identify specific risks potential customers of offshore providers should bear in mind. The appendices alone make this book a worthwhile purchase. The first appendix provides two *Consumer Reports*-esque tables that compare countries based on their IT outsourcing (ITO) and BPO suitability. Other appendices contain information on additional industry and legal resources, as well as neoIT's "Offshore 100" – several lists of top outsourcing providers based on location and offerings.

Douglas Brown and Scott Wilson's *The Black Book of Outsourcing: How to Manage the Changes, Challenges, and Opportunities* (Wiley, 2005) is a comprehensive resource. The book details every aspect of implementing outsourcing projects, from assessing cost, benefit and risk to navigating contracts, and also includes chapters on what to do if your job is outsourced, and opportunities in outsourcing management. It also includes a vendor directory for finding top outsourcers in various fields. Although the book is a bit light on F&A guidance, the authors note the growing importance of F&A outsourcing. The book also examines why companies pursue F&A outsourcing (cost savings, sharper focus on core competencies and process improvements); explores the pros and cons of same-shoring, near-shoring and off-shoring arrangements; advises readers on producing the most effective service-level agreements, and includes a list of outsourcing-related web sites.

Longtime outsourcing authority Michael F. Corbett's *The Outsourcing Revolution: Why it Makes Sense and How to Do it Right* (Kaplan Business, 2004) offers a high-level view of outsourcing – from its history to the advent of business process outsourcing (BPO) and projections for the future. It contains formulas for and discussions about determining the value of BPO arrangements, and a few fairly comprehensive real-world case studies of different types of BPO in action (although none specific to F&A outsourcing). The book also offers guidance on developing teams, navigating the vendor marketplace, building the business case for outsourcing, contract negotiations, and managing the people and change aspects of BPO.

Essentials of Business Process Outsourcing (Wiley, 2005), by Thomas N. Duening and Rick L. Click, serves as an easy-to-read primer with practical advice on a team-based approach to overseeing and minimizing risks in a BPO initiative. There is little in this book specific to F&A outsourcing. The book focuses on the initial "do we or don't we" outsourcing decision, vendor selection and cost management, change management, and infrastructure challenges. Duening and Click's eight-step selection process reflects an approach many other outsourcing experts also describe, and the process helpfully identifies questions that request for information (RFI) documents should contain: What are the vendor's core capabilities?

What metrics does the vendor use to evaluate its effectiveness? How many clients is the vendor currently serving? Does the vendor have unused capacity or will it have to grow to serve new clients? Where is the vendor investing its resources? How well does the vendor rate with its current customers? Does the vendor fit with the company's buying culture? The book also provides sound advice on risk mitigation: "Risks associated with outsourcing range from lack of data security to a loss of organizational learning. Each specific risk can be mitigated, but there is no way to remove all risk from a BPO project. Thus, organizations need to weigh the risk of undertaking the project against the risk of not doing it."

Maurice F. Greaver's *Strategic Outsourcing: a Structured Approach to Outsourcing Decisions and Initiatives* (AMACOM, 1999) represents an early and thorough collection of outsourcing guidance. Greaver reminds readers that "outsourcing" predates the creation of the term by the business trade press during the late 1980s. During World War II, for example, the U.S. government outsourced facilities management to service providers. The book's data on outsourcing adoption and growth is outdated, of course. Most of the data was collected in the mid-1990s, which feels more like a generation ago given the dramatic geopolitical and economic changes of the past five years. However, much of the book's guidance remains surprisingly relevant today. Few experts would take issue with the methodology laid out in Chapter 2 that identifies seven steps of successful outsourcing. The notion of an "oversight council" discussed in Chapter 20 and the problem-solving advice presented in Chapter 21 remain highly applicable. The book is also carefully organized; a highly detailed table of contents will help readers locate guidance on just about every facet of the decision-making and relationship management.

CIMA's "Excellence in Leadership: Business Process Outsourcing" is a periodical, although its 15 articles on different facets of finance and accounting outsourcing could form the chapters of a useful reference book. The issue (Number 1, 2007) is dedicated to FAO, which is examined according to the following categories: key trends, assessing readiness, risk and security, performance management, and regulatory, compliance and legal issues.

White Paper Recommendations

Numerous white papers and articles are available at no cost (or, in exchange for contact information) on the Web sites that follow below. Five of these reports bear special mention:

Booz Allen Hamilton's "Outsourcing and the CFO: The Balanced Delivery Model for Finance and Accounting" earns distinction, if you read one white paper on FAO, this is it. The five-page discussion is packed with useful guidance that focuses primarily on the selection process: steps to identify which processes are best suited for outsourcing and which outsourcers are best equipped to take on those processes.

"Outsourcing the Back Office: The Path Toward Sustainable Benefits" (© 2006, CFO Publishing Corp.) is the most recently published research cited in this Management Accounting Guideline and also one of the most comprehensive. Based on a survey of nearly 300 senior finance and accounting executives, the report examines how "back-office outsourcing" (which is not limited to finance and accounting, but also includes IT and HR) has changed in the past year or so and how it is likely to change in the future. The survey results identify why companies outsourcing finance and accounting processes, how they manage outsourcing relationships, and why they terminate the relationships. Three outsourcing case studies are included; the case study on Freescale provides rare insights into the process of repairing a damaged (IT) outsourcing relationship. An appendix contains outsourcing advice from Capgemini.

Alan Healey's article "Reducing Outsourcing Risk: A CFO Perspective" (© 2004, Accenture) presents a high-level outline of outsourcing risks that finance executives should recognize and address. The global sourcing risks may be less of a concern today than they were two years ago. The rest of the information contained in this dense two-page "point of view" serves as a strong introduction to FAO risks and the steps that mitigate them.

"The Role of Business Process Outsourcing in Transforming Finance and Accounting" (© 2005, EquaTerra) presents 12 pages of analysis based on a survey of 120-plus finance and accounting executive managers throughout North America. The survey results and analysis show how FAO decision-makers select FAO providers and provide insights into challenges that companies have encountered during the course of their FAO relationships.

A July 2006 *Journal of Sourcing Leadership* article, “A Diamond in the Rough,” makes a strong case for a new approach to forging contracts that govern the outsourcing relationship. The article’s authors, law firm Latham & Watkins’ outsourcing experts Alex Hamilton and Dan Mummery, propose their new methodology, which seeks to focus negotiations and the language contained in the contract on governance issues that drive a healthy ongoing relationship between buyer and provider.

Online Resources

Associations

http://www.outsourcing.com/

http://www.outsourcingprofessional.org/firmbuilder/

http://www.sourcinginterests.org/

Publications

http://www.sourcingmag.com/

http://www.faotoday.com/

http://www.tpi.net/about/journal.aspx

Research Firms

FAO Research Inc. currently is the only independent research firm worldwide focused on the FAO market:

http://www.faoresearch.com

APPENDIX 1: FAO COST BREAKDOWN

Outsourcing research and advisory firm NeoIT offers the following breakdown of FAO costs, based on FAO activity in 2005:

Cost Category for FAO	Percentage of Total Cost
Wages and benefits	44 %
Communication systems	5 %
Physical infrastructure	15 %
Transition and governance costs	9 %
Resource redeployment	2 %
Resource redundancy	2 %
Training and productivity costs	13 %
Disaster recovery	3 %
Advisory and other fees	2 %
Travel costs	3 %
Exchange rate changes	2 %

Source: neoIT

APPENDIX 2: FAO PRICING MODELS

In *Multisourcing: Moving Beyond Outsourcing to Achieve Growth and Agility* (Harvard Business School Press/Gartner Inc., 2006), co-authors Linda Cohen and Allie Young identify different pricing frameworks according to their efficiency, risk to buyer, risk to provider, and other factors. The following table is adapted from their analysis:

Pricing Model	Description	Efficient	Buyer Risk	Provider Risk
Cost Plus	Buyer pays provider's cost plus a percentage	Yes	Medium	Low
Fee for Service	Variable pricing set according to amount and/or quality of service delivered	Yes	Medium	Medium
Fixed Price	Price set to specific service level and does not vary	Yes	Low	High
Shared-Risk-Reward Pricing	Flat rate pricing with potential for additional payments tied to specific outcomes	No	High	High
Business Outcome Achievement	Provider does not receive payment unless predefined outcome is achieved	No	Medium	High

(Adapted from Cohen and Young)

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