Finance and Accounting Outsourcing

Topic Gateway Series No. 8

Prepared by Jim Downey and Technical Information Service

Revised June 2008

About Topic Gateways

Topic Gateways are intended as a refresher or introduction to topics of interest to CIMA members. They include a basic definition, a brief overview and a fuller explanation of practical application. Finally they signpost some further resources for detailed understanding and research.

Topic Gateways are available electronically to CIMA members in the CPD Centre on the CIMA website, along with a number of electronic resources.

About the Technical Information Service

CIMA supports its members and students with its Technical Information Service (TIS) for their work and CPD needs.

Our information specialists and accounting specialists work closely together to identify or create authoritative resources to help members resolve their work related information needs. Additionally, our accounting specialists can help CIMA members and students with the interpretation of guidance on financial reporting, financial management and performance management, as defined in the *CIMA Official Terminology* 2005 edition.

CIMA members and students should sign into My CIMA to access these services and resources.

The Chartered Institute
of Management Accountants
26 Chapter Street
London SW1P 4NP
United Kingdom

T. +44 (0)20 7663 5441
F. +44 (0)20 7663 5442
E. tis@cimaglobal.com
www.cimaglobal.com

Finance and accounting outsourcing

Definition and concept

This is the definition of 'outsourcing' in general:

'Use of external suppliers as a source of finished products, components or services. This is also known as contract manufacturing or subcontracting.'

CIMA Official Terminology, 2005

Business Process Outsourcing (BPO) is:

'Contracting with an external supplier to provide part or all of a business process or function.'

Finance and Accounting Outsourcing (FAO) is:

'The outsourcing of one or more finance and accounting activities or processes.'

Source: Krell, E. (2007). *Outsourcing the finance and accounting functions.* Management Accounting Guideline, CIMA, AICPA and CMA Canada

Outsourcing the finance and accounting processes has recently become a strategic issue for many organisations. Businesses are under increasing pressure to improve performance and reduce costs. Although the emphasis has often been on reducing cost, there is a trend towards outsourcing to enable strategic change. The real value to be gained is that the retained finance function can focus on working more closely with the business to provide business partnering and help improve decision making.

Related concepts

Shared service centres; business process improvement; business process outsourcing; knowledge process outsourcing.

Terminology

The terms 'offshoring' and 'outsourcing' are often used interchangeably but have different meanings. Essentially, they distinguish between the location and control of a shared services centre that conducts business processes.

- offshoring – relates to the location where the work is performed. If control of the process is in the hands of in-house management the service centre is said to be 'captive'.

- outsourcing – refers to the management of a service centre, specific process or project by a third party, regardless of location.

Outsourcing can be further categorised into the following three groups:

- on-shore or local – work is performed by a third party provider in the company's own country.
- offshore – work is contracted out to overseas providers that are geographically distant from the company's home country. This is sometimes referred to as global or offshore outsourcing. e.g. India or Malaysia for North American or European enterprises.
- near-shore – business processes are relocated to cheaper, but culturally closer locations e.g. Mexico and Canada for US businesses, or Ireland and Eastern Europe for European companies.

Other more recently coined terms are:

- 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 sourcing strategy from a range of BPO service providers
- Knowledge Process Outsourcing (KPO) – a term used to describe outsourcing higher value expertise than routine business processes.

Overview

Most companies are wary of outsourcing. Where they have outsourced, IT and HR business processes have been outsourced more readily than Finance and Accounting processes. None core and high volume, low value processes have been the most likely to be outsourced.

More recently, some businesses have begun outsourcing at a more strategic level not just to reduce costs in non-core processes but to improve business performance. This is being driven by a number of factors:

1. Competitive and budgetary pressures
    - Decreasing budgets have forced businesses to evaluate strategies that reduce costs in non-core processes.
    - Businesses are then better able to focus their more limited resources on core competencies and activities which attract and retain customers.
2. Advances in technology and communications
    - Operations are more independent of location than ever before. This is due to rapid infrastructure improvements and cheaper communication costs.
    - Globalisation gives access to resources and talent world-wide.
    - The internet provides new opportunities to collaborate with other businesses on a global scale.
3. The need to transform the finance and accounting function
    - As an overhead, the finance and accounting function has come under scrutiny. It is challenged to become more efficient and more effective.
    - CFOs must demonstrate adherence to proper accounting principles and disciplines, and provide improved decision support capabilities.
    - Outsourcing can be used to reduce costs in routine back office processes and increasingly in higher value support services too.
    - Outsourcing can be used to achieve step changes and streamline unnecessarily complex business processes, systems and structures.

In terms of offshoring, India continues to lead the global market for outsourcing services. This is despite an apparent shortage of Indian graduates with the cultural compatibility to work in shared service centres which is causing salary inflation and attrition problems.

Locations in Eastern Europe and others such as China, Mexico and the Philippines are emerging given low cost and language advantages. The trend is likely to continue as the demand for knowledge workers in developed economies outstrips supply.

There has been a rise in near-shoring and on-shoring, particularly for customer facing processes by global companies. The UK's public sector has become a significant outsourcer, usually preferring onshore providers. For further information on providers, refer to the Brown-Wilson Group's annual publication, *The Black Book of Outsourcing.*

Application

Outsourcing the finance function in practice

In the past, companies pursued outsourcing as a means to achieve better service at lower cost. Today, many organisations are moving beyond this to achieve step changes in their performance and new, innovative business models.

Contracting out can transform not only accounting practices but also the managerial style of the company itself. Outsourcing financial operations can encourage businesses to be more innovative and focused on value creation.

A key consideration is which finance and accounting processes should be outsourced. Transactional processes (such as accounts payable, travel and entertainment, accounts receivable, billing, cash management, etc.) tended to be the most popular to outsource. More recently, with improvements in provider capabilities, there has been a move to outsourcing higher end or higher value services such as statutory/regulatory accounting, financial reporting and tax. In some cases, more strategic processes such as management accounting, budgeting & forecasting and financial analysis may be suitable for outsourcing.

Outsourcing is a major transformational change project for any organisation. A key lesson learned from the early experiences of companies who outsourced processes is that it requires the appropriate level of resources to ensure proper governance, project management and change programme management, otherwise it will not yield the intended benefits.

Reported benefits of outsourcing

1. Cost reduction

Outsourcing can deliver significant economies of scale by using standardised processes and leading-edge technology. Suppliers can perform finance and administration functions far more cheaply and efficiently than companies working on their own. Companies can reduce working capital, improve tax efficiency and avoid capital expenditure by outsourcing some or all of their operations.

2. Radical transformation

As a strategic move, outsourcing can enable broad structural change. This creates value while supporting corporate objectives.

3. Access to superior capabilities and expertise of the provider.

Businesses can develop long term strategic relationships or partnerships with their providers. They can benefit from superior capabilities, best practice expertise and new investment in resources that a specialist provider can bring to their business.

4. Release of capacity for remaining finance function to provide business partnering

Outsourcing of finance processes to providers with greater expertise and economies of scale can deliver large efficiency gains to the overall performance of the finance function. This allows the retained finance function to concentrate on their role as business partners, working more closely with the business to improve decision making.

5. Increased innovation

Low value, non-core processes and activities are moved to an external provider. Companies can release internal resources to focus on more strategic activities – a key source of competitive advantage. Businesses that deploy an outsourcing model can shift internal resources from operations to innovation [see also Risk to Innovation below].

Reported drawbacks of outsourcing

1. Loss of control

When businesses outsource their finance functions, they pass control of the process and the outcome to a third party. Businesses rely on external providers to input the right level of resource and skill required to meet their needs. Businesses which outsource need to develop expertise in managing outsourced services.

2. Outsourcing can cause disruption

Outsourcing inevitably leads to some level of short-term disruption, even if finance staff is transferred to the outsourcing provider. This can impact the whole organisation and can result in significant resistance to any outsourcing initiative.

3. Risk to proprietary data

Confidentiality and risk to intellectual property are often cited as key reasons why companies choose not to outsource to an external provider. Companies that outsource must provide sufficient security measures to limit the risk of intellectual property theft or breaches of confidentiality.

4. Risk to innovation

Over-reliance on external providers can lead to an erosion of internal knowledge and skills. Outsourcing can transfer the benefits of organisational learning to the service provider. Investment in internal research and development may be reduced.

5. Risk to succession planning

An in-house accounts department can be a training ground for future senior accountants and business managers. An outsourced function is less likely to be a source of talent in the future.

Key Developments in Finance and Accounting Outsourcing

Much of the initial wave of outsourcing was focused on reducing cost through wage arbitrage by using cheaper labour abroad. This approach made the relationship with the BPO service provider adversarial from the outset and often led to disputes and even litigation. In addition, the scale of the change programme and the level of project management resources required were often underestimated.

Finance and accounting outsourcing (FAO) has undergone major transformation over the last 10 years. The need to ensure their systems were Sarbanes Oxley compliant encouraged many US corporations to outsource. BPO service providers gained expertise and credibility in meeting this need.

The market for FAO has matured in terms of the type of work undertaken from routine, transactional work to delivering customised, complex and higher-value services (such as forecasting and planning and treasury).

Some companies are consolidating their outsourcing work, citing reduction in complexity, streamlining operations and increased efficiency as benefits, while others are still taking a multi-sourcing route based on particular provider expertise. A further development is the growing convergence between the procurement and FAO markets.

Globalisation of services opens up new opportunities for companies to outsource finance activities to service providers worldwide. Companies which choose to outsource one or more finance processes continue to benefit from global differences in wages, and they access new talent and expertise (such as in systems implementation and process improvement) to create further competitive advantages. However, some challenges remain.

Outsourced service providers have more expertise in negotiating deals than their clients, so they should engage expert consultants at this stage to help with:

- identifying the right provider and getting the right contract from the start
- measurement of performance in outsourcing contracts
- determining appropriate reward systems and pricing of outsourcing contracts (with a move towards more risk and reward sharing agreements).

More recently, the favoured approach has been one of a collaborative partnership, where benefits of business process improvements or new systems implementation are shared between the company and the provider. This appears to be yielding more satisfactory experiences of outsourcing for those involved, especially where change management and project management disciplines have been applied.

Despite this, many CFOs are still reluctant to consider outsourcing finance processes for many reasons, including management culture or risk considerations; particularly any processes that involve judgement or decision support. However, the efficiency of outsourced service providers and the quality of their service provides benchmarks against which the efficiency of in-house shared services should be considered.

References

Krell, E. (2007). *Outsourcing the finance and accounting functions.* Management Accounting Guideline, CIMA, AICPA and CMA Canada

Improving decision making in organisations: the opportunity to transform finance. (PDF 1.2MB). September 2007. CIMA Executive Report. London: CIMA. Available from: **www.cimaglobal.com/decisionmaking** Accessed 13 June 2008].

2008 market predictions: FAO, global sourcing, HRO, ITO, and PO markets. Everest Research Institute, October 2007

Further information

Articles

Full text available from Business Source Corporate through My CIMA **www.cimaglobal.com/mycima**

Barnes, P. *Good Going*. Reviews the trends and outlines key management issues for outsourcing the finance function. Financial Management, October 2004, p. 31. Available from: **www.cimaglobal.com/financialmanagement** [Accessed 10 October 2007].

Cooper, T. *SAS dares to win over SMEs*. CIMA Insight, May 2005. Available from: **www.cimaglobal.com/insight**
[Accessed 10 October 2007].

Hayward, C. *Out of site.* Financial Management, February 2002, p. 26. Available from: **www.cimaglobal.com/financialmanagement** [Accessed 10 October 2007].

Hayward, C. *Outsourcing: getaway drivers.* Financial Management, September 2003, p. 18. Available from: **www.cimaglobal.com/financialmanagement** [Accessed 10 October 2007].

Jetuah, D. *Finance function hunts for cheaper location.* Accountancy Age, 11/2/2006. p. 7

Likierman, A. Sir. *Prove your worth.* Accountancy Age, 11/9/2006, p. 13

Likierman, A. Sir. *Financial managers: prove that you are irreplaceable*. CIMA Insight, January 2005. Available from: **www.cimaglobal.com/insight** [Accessed 10 October 2007].

Nolan, P. *Giveaway signs,* Financial Management, October 2002, p. 26

Osheroff, M. *Outsourcing successfully.* Strategic Finance, December 2005, Volume 87, Issue 6, p. 23

Parker, S. and Doyle, J. *Outsourcing the finance function*. CIMA Insight, July 2003. Available from: **www.cimaglobal.com/insight** [Accessed 10 October 2007].

Reed, K. Research predicts finance is offshoring's next big thing. Accountancy Age, 9 March 2006, p. 11

Stevens, A. *A fair share.* Accountancy Age, 10/12/2006, pp 32-33

Valanju, S. *Site Unseen*. Provides an overview of the current offshore outsourcing trend with particular reference to finance and accounting. Financial Management, July/August 2005, p. 16. Available from: **www.cimaglobal.com/financialmanagement** [Accessed 10 October 2007].

Articles

Abstract only from Business Source Corporate through My CIMA
www.cimaglobal.com/mycima

Nicholson, B., Jones, J. and Espenlaub, S. *Transaction costs and control of outsourced accounting: case evidence from India*. Management Accounting Research, September 2006, Volume 17, Issue 3, pp 238-258

Books

Clements, S., Donnellan, M. and Read, C. (2004). CFO insights: achieving high performance through finance business process outsourcing. London: John Wiley

Heywood, B. (1996). *Outsourcing the finance function*. Milton Keynes: Accountancy Books

May, M. (2002). Transforming the finance function: adding company-wide value in a web-enabled environment. 2nd ed. London: Financial Times/Prentice Hall

Wood, D., Barrar, P. and Jones, J. (2001*). Finance function outsourcing in SMEs: a research report.* London: Institute of Chartered Accountants in England and Wales, Centre for Business Performance CIMA reports

Krell, E. (2007). *Outsourcing the finance and accounting functions.* Management Accounting Guideline. CIMA, AICPA and CMA Canada. Available from: **www.cimaglobal.com/mags**
[Accessed 19 March 2008].

CIMA Technical Services. *Contracting out the finance function.* August 2001. (PDF 192KB). CIMA Technical Briefing. London: CIMA. Available from: **www.cimaglobal.com/technicalreports**
[Accessed 12 October 2007].

Improving decision making in organisations: the opportunity to transform finance. (PDF 1.22MB). September 2007. CIMA Executive Report. London: CIMA. Available from: **www.cimaglobal.com/decisionmaking**
[Accessed 13 June 2008].

Other reports

2008 market predictions: FAO, global sourcing, HRO, ITO, and PO markets. October 2007. Everest Research Group

(2007). The black book of outsourcing: state of the outsourcing industry, 2007 survey results of service provider buyers, users and analysts. Clearwater, FL: The Brown-Wilson Group, Inc. Available from: **www.TheBlackBookOfOutsourcing.com** [Accessed 19 March 2008].

Websites

The CFO.com website has a number of useful articles on outsourcing the finance function. **www.cfo.com**

The Finance Function offers a range of services, from managing an existing finance function through to delivering a fully outsourced finance function. **www.financefunction.co.uk**

The OutsourcingCenter website is the publishing and marketing channel of Everest Group. It hosts a wealth of free research, case studies, database directories, and market intelligence on emerging trends and best practices in outsourcing. **www.outsourcing-finance-and-accounting.com**

The Outsourcing Institute is an international professional association. It collects together a range of articles and news on outsourcing. Access to the news and articles database is free but requires registration. **www.outsourcing.com**

National Outsourcing Association. Focused on promoting and sharing best practice in outsourcing. **www.noa.co.uk**

First published in 2006 by:

The Chartered Institute of Management Accountants
26 Chapter Street
London SW1P 4NP
United Kingdom

Printed in Great Britain