CPA CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

Finance and Accounting Outsourcing

ASSESSING AND PLANNING FOR SUCCESS

Eric Krell

What is the issue?

Finance and accounting outsourcing has evolved and become more complex in recent years.

Why is it important?

Finance and accounting outsourcing relationships can help you to focus on your core business and become more competitive.

What can be done?

Understanding finance and accounting outsourcing will allow you to make informed and effective decisions in supporting your organization's strategic objectives.

GUIDANCE

CPA Canada
277 Wellington Street West
Toronto, ON Canada M5V 3H2
T. 416 977.3222 F. 416 977.8585
www.cpacanada.ca

Finance and Accounting Outsourcing

Like other forms of outsourcing, finance and accounting outsourcing (FAO) has evolved significantly in recent years. These changes center on three areas. First, the types of finance and administration processes companies are outsourcing has expanded beyond payables and payroll processing to include processes such as data analyses. Second, the management of the relationship between the FAO buyer and the FAO provider has become more effective. Third, the rise of cloud computing has added new wrinkles not only to FAO relationships, but also to the decision of whether or not to outsource.

More than two-thirds of global executives point to cloud computing as the technology that will exert the greatest impact on their future outsourcing decisions.[1] Cloud-based infrastructure and applications generally cost less than traditional, on-premise client-server infrastructure and applications. Cloud technology can help lower FAO costs in situations where supporting automation plays a key role. Cloud technology can also help lower the cost and complexity of moving finance and accounting processes to an FAO provider (or moving those same processes back in-house).

1 "Deloitte's 2014 Global Outsourcing and Insourcing Survey: 2014 and Beyond,"

The rise of cloud computing has also given small- to mid-sized companies more affordable access to leading finance and accounting technology. This availability may, for some companies, especially those that would have invested FAO as a means of accessing leading technology, make keeping finance and accounting processes in-house more effective, and cost-effective, than entering into an FAO relationship.

In the past, most FAO agreements were designed to generate cost savings for the buyer. Cost reduction, however, is no longer the sole driver for entering into FAO relationships. An increasing number of buyers use FAO to achieve additional benefits, such as:

- access to innovative and proprietary processes and technologies
- access to highly skilled personnel and expertise
- greater agility when ramping up or ramping down operations in new geographic areas (i.e., agile scalability)
- the ability to focus more time and resources on core elements of the business (i.e., areas that enable competitive differentiation)
- the ability to support major restructuring efforts or other types of business transformations

Generally speaking, the rigour of FAO oversight has intensified. Today, a hands-on management approach is widely viewed as a crucial component of outsourcing relationship success. Previous notions that outsourced processes could be "handed off" to vendors who then managed these processes independently have given way to new notions of partnership (i.e., jointly governed outsourcing processes). Additionally, FAO buyers and providers, armed with knowledge from past outsourcing arrangements and access to performance-monitoring software (which track important metrics in real time), are now able to manage outsourcing relationships with improved tools and processes.

Despite this evolution, the fundamentals of effective FAO decision making and FAO management have remained relatively consistent over time. The purpose of this guidance document is to present these fundamental practices, steps, and sub-steps to those charged with implementing and managing FAO relationships. Although this document is geared toward companies considering FAO, it does not assume that outsourcing is the best option. In many cases, keeping a process in-house (where it may be managed and improved more affordably) is a better option. The discussion and guidance in this document is intended to help companies identify the best options when deciding whether or not to outsource, choosing a provider, and how best to manage an FAO relationship.

This guidance is targeted to companies of all sizes. However, small- and mid-sized organizations typically approach outsourcing (including FAO) differently than large enterprises in some notable ways. Due to the scale

FAO PROS AND CONS

The following list of FAO advantages and disadvantages are based on the assumption that the FAO relationship a purchasing company enters into will be governed and managed effectively. Without effective and ongoing oversight of FAO relationships, the list of "cons" is long and the list of "pros" is devoid of any benefits.

PROS	CONS
Lower process and labour costs	Less control over process
Access to better process-management capabilities	Loss of internal process expertise and knowledge
Ability to scale up and down more quickly	Slower resolution when issues arise
Ability to focus more resources on core activities	Costs associated with layoffs and/or retraining
Access to leading technology	Cost of leading technology, via cloud, is decreasing
Business continuity management benefits	Less direct control of information security

of their business, larger enterprises are much more likely to operate formal procurement functions, staffed with sourcing experts with significant experience managing outsourcing providers. For these companies, the decision of whether or not to outsource can be relatively easy: they already manage numerous outsourcing partners, and the focus of their FAO decision centers more on which processes to outsource and which provider to select. Additionally, operating a shared services center — a centralized in-house process-management operation (sometimes referred to as "insourcing" or as a centre of excellence that can serve as an FAO alternative or precursor) — is only a viable option for companies of a certain size. While the discussion and decision tree related to evaluating "outsource ability" on page 10 of this document applies to all company sizes, the shared services option is not viable for many small- to mid-sized companies.

The motivations, or drivers of FAO, also vary by company (and, often, by company size). Certain FAO advantages and disadvantages are more relevant to smaller organizations (e.g., those related to cost or access to expertise) while others are more relevant to larger enterprises. For example, access to leading internal audit or financial planning and analysis capabilities may qualify as a major benefit to a small company that lacks the money or access to talent required to staff those functions in-house. Yet, the cost of bringing a poorly managed outsourced process back in-house would likely be much higher for a larger company than it is for a smaller enterprise.

Some FAO outcomes may qualify as either an advantage or a disadvantage (see the FAO Pros and Cons box on page 2). For example, an FAO relationship may offer greater security from a business continuity management (BCM) perspective: if a weather-related disaster strikes servers at company headquarters, the payroll data on an FAO provider's servers would be unaffected. However, a company with a best-in-class information technology (IT) security capability may be reluctant to share certain types of confidential data with a third-party vendor.

Certain forms of FAO relationships have existed for many years. The term "FAO" emerged in the late 1990s and early 2000s when companies achieved cost savings from such relationships largely through the labour arbitrage associated with outsourcing operations to India, China, and other countries with extremely low labor costs. These arrangements were enabled, in large part, by the rise of communications technology (e.g., fiber optic cables and the Internet) which greatly increased the supply of potential outsourcing providers. This guidance document deals with modern FAO, which typically involves outsourcing multiple finance and accounting processes over a longer term (i.e., in the range of three-, five-, or 10-year contractual commitments). FAO covers a wide collection of processes, ranging from high-volume transactional activities (e.g., accounts payable, accounts receivable, tax return preparation, and payroll) to processes that require greater expertise and analysis (e.g., treasury, tax strategy, and financial planning and analysis). Although the same processes can help manage the challenges, risks, and opportunities of both types of finance and accounting activities, there are typically greater risks associated with outsourcing finance and accounting activities that involve more expertise and analysis. As a result, outsourcing processes like financial planning and analysis or tax strategy require additional management discipline and oversight because decisions within these processes are less cut and dry, and require more judgment. The same discipline and oversight applies to finance and accounting processes with regulatory compliance and/or financial reporting requirements and implications.

In order to build an effective case for FAO, individuals responsible for FAO should:

- Document the rationale for the FAO decision, including the strategic objectives the arrangement enables and the intended benefits of the relationship. These objectives should be prioritized in order of importance to help evaluate trade-offs. For example, one vendor may offer a lower-cost service while another vendor may charge slightly more but provide access to better technology. If access to innovative technology is prioritized higher than the expected cost savings, the purchaser would likely select the latter vendor. Typical outsourcing objectives include access to innovative processes and technologies, access to highly skilled personnel and new knowledge, and an enhanced ability to quickly scale operations up or down.
- Recognize that cost reduction is only one potential outsourcing benefit and that an all-consuming focus to save money takes resources from other aspects of the FAO relationship, which may put the relationship in peril.
- Recognize that successful FAO relationships require an oversight investment by both buyer and vendor throughout the duration of the agreement.
- Strive for clear governance processes, a genuine spirit of partnership, and flexibility to respond to unexpected changes in the buyer organization, the provider organization, and the external business environment. Flexibility is particularly valuable given geopolitical uncertainty, macro-economic volatility, natural catastrophes, and increasingly interconnected global supply chains.
- Remain flexible since "rigidity" and "resistance to change" are the most frequent complaints FAO buyers levy against FAO providers. Many FAO providers have greatly improved the effectiveness and precision with which they adhere to their service-level agreements; however, with fast-changing business and market environments, FAO buyers need the flexibility to change service-level agreements.
- Understand that while measuring and monitoring outsourcing performance has grown more sophisticated and precise, flexibility and qualitative indicators of outsourcing performance are also important components of overall FAO performance.

Getting Started

As shown in Figure 1 on page 5, the FAO lifecycle is a variation of the Strategic Partnering Process presented in the *Strategic partnerships: Applying a six-step process: Guidance*. As described in this document, outsourcing represents one of several types of contractual agreements, and a contractual agreement represents one of three types of strategic partnerships (the others being equity investments and joint ventures).

FAO is a unique type of strategic partnership. In some cases, an FAO partnership may not be "strategic" at all: it may, instead, operate with the tactical objective of reducing costs. The FAO lifecycle begins with a strategic assessment and concludes with the termination of the partnership's legal agreement. The strategic partnerships guidance document presents six steps for entering into and managing a strategic partnership. The FAO lifecycle addresses the same six steps, but groups them slightly differently. For example, the FAO lifecycle begins with a strategic assessment, which blends with partnership planning to produce a decision of whether or not to outsource. The FAO lifecycle also contains numerous sub-steps, which do not necessarily follow the order outlined below. For example, a company that decides to outsource a collection of finance and accounting processes, and subsequently conducts a selection processes, may ultimately decide against outsourcing because it doesn't believe any of the marketplace providers can meet its needs.

KEY TERMS

Outsourcing: The transfer of internal process responsibilities to an external services provider that may or may not be located in a different country.

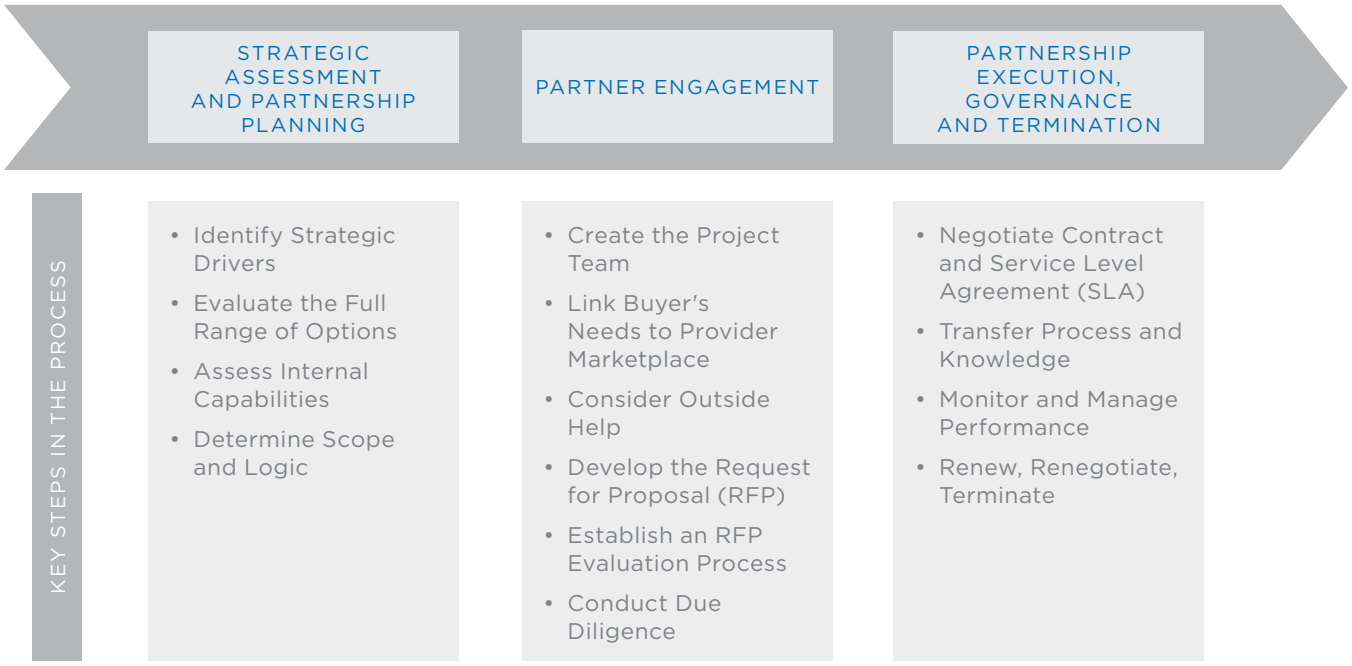
Finance and Accounting Outsourcing (FAO): The outsourcing of one or more finance and accounting activities or processes.

Shared Services: The centralization, across more than one department within a company, of internal transactions processing and, in some cases, corporate functions. Shared services are also referred to as insourcing, captive offshoring (when the shared services center is in a different country), and "centres of excellence."

Hybrid Models: The blending of traditional outsourcing and shared services elements. No standard exists for this arrangement; it is typically designed to fit the specific needs of the purchaser and capabilities of the outsourcing provider. For example, the FAO purchaser may manage the processes while using the outsourcing provider's supporting technology. The staff represents a 50-50 split between provider and purchaser employees.

Offshoring: This term, often misused, refers to the geographic relocation of processes (either conducted by an outsourcing provider or conducted internally through a shared services arrangement) to a country other than the country housing the company's headquarters (where the process originated).

FIGURE 1 The FAO Lifecycle



1. Strategic Assessment and Partnership Planning

Before moving a process or a set of processes to an outsourcing provider, an internal shared services center, or a hybrid model that blends elements of both approaches, decision makers should conduct several types of assessments (see the Key Terms box on page 5 for descriptions of these models).

The considerations outlined in the following four sub-steps will help ensure that the decision of whether or not to outsource aligns with the organization's strategy, objectives, capabilities, and plans.

1A: Identify Strategic Drivers

Organizations must understand and document the reasons it is considering finance and accounting outsourcing. This involves outlining how FAO will complement the overall corporate strategy and defining the role(s) the finance and accounting function will play.

The strategic benefits of FAO may be determined by the FAO provider and its ability to provide analytical insight beyond the capacity of the purchaser of the FAO services.

The following are examples of analysis from a provider:

- identification of more favourable approaches to global vendor management by standardizing discounting terms (based on analyses of spending data)
- identification of product improvements based on analyses of a manufacturer's warranty and effectiveness data
- identification of opportunities to reduce the purchaser's working capital requirements as a result of analyses of supply and demand data used to fuel improvements in material planning processes and inventory management[2]

2 "Next-Generation BPO: Are You Ready?" © 2011 Accenture.

The identification of strategic drivers can be conducted by addressing the following questions:

- Why is the company and its finance and accounting function considering FAO?
- How and to what extent do these reasons (i.e., drivers) support the company's strategic objectives, direction, and plans?
- How would this type of arrangement help the finance and accounting function better support or enable the company's strategic objectives?
- To what extent might the impacts of outsourcing the process (e.g., firing or reassigning staff, turning over the management of software applications to an external provider, or accessing better process knowledge) align with strategic objectives?
- Will the company or function be missing out on any significant opportunities if it opts not to outsource? How might any such missed opportunities support the company's strategic objectives, direction, and plans?

Some reasons for a company to consider FAO may include:

- reducing costs
- accessing innovation, better processes, and/or valuable knowledge
- achieving greater flexibility (i.e., being able to scale up or scale down operations faster)
- accessing better personnel
- addressing staffing issues or labour shortages
- accessing better technology
- improving processes and/or productivity
- mitigating risks associated with ineffective in-house processes
- reassigning employees to higher-value activities

Cost reduction has historically been the primary driver for all types of finance and accounting outsourcing (most notably, payroll processing). This is changing for many reasons, some of which include: rising labour costs in traditional offshoring hot spots such as India and China, better knowledge of total traditional outsourcing relationship costs, recent finance and accounting department efficiency gains, and the introduction of new, lower-cost (and often cloud-based) finance and accounting technology.

1B: Evaluate the Full Range of Outsourcing Options

With the exception of small organizations (in which shared services arrangements may not be viable), most companies have five outsourcing options to consider:

- leave finance and accounting (FA) processes in their current state
- improve FA processes within their current organization
- reorganize FA processes into an internal shared services model (or restore processes to a decentralized model if they currently exist in a shared services model)
- outsource FA processes to an external provider
- create a hybrid model that combines elements of internal shared services and traditional outsourcing

The first three options represent alternatives to working with external outsourcing providers. Before considering the final two options, decision makers should determine whether the company can achieve its goals with one of the first three internal options. For example, a company may decide that an existing finance and accounting process is too inefficient to be left in its current state. However, it may also determine that a process-improvement initiative (or the implementation of new supporting technology) may suffice. It is important to ensure all business processes are in functioning states (even if there remains room for improvement) before automating portions of certain processes or before transferring them to outsourcing providers. Automating and/or transferring dysfunctional business processes tends to drive up costs and prolong the struggle of the particular process.

Decision makers should consider the pros and cons (as well as the implications) of each outsourcing option during this evaluation. Moving processes from a decentralized model to a shared services model can be a helpful intermediary step before outsourcing, especially for large, multi-divisional corporations that operate in numerous geographic locations. Although a shared services model does not have to be the first step to outsourcing, it can provide an opportunity to "practice" managing a transition before attempting to manage a similar, but typically more complex, transfer to an external outsourcing provider.

Moving to a shared services model involves many of the same processes and challenges as outsourcing, including: identifying which processes to move, developing a transition plan, 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.

In recent years, a hybrid model has emerged, featuring a captive shared services model supplemented with human resources and/or technology systems from external outsourcing providers. For example, a company may rely on its shared services operations to manage the order-to-cash cycle while outsourcing the accounts receivable process (in which case, a shared services manager would likely manage that outsourcing relationship). This model sometimes proves more effective in meeting the outsourcing buyer's objectives and helps maintain a greater level of control over centralized FAO processes. The following conditions are not requirements for the use of a hybrid model; however, companies that operate hybrid FAO models typically:

- have an existing shared services center that performs FAO processes
- govern FAO processes in the shared services center effectively
- have effective relationships between their shared services management and their finance and accounting function
- possess the skills to oversee outsourcing providers

The following questions are designed to identify the gap between a company's current FA process and the FA process the company wants to achieve:

- What are the benefits and limitations of leaving the FA processes in their current state?
- What are the benefits and limitations of reorganizing the FA processes internally (either to a shared services or decentralized model)?
- What are the benefits and limitations of outsourcing the FA processes?
- What are the implications of outsourcing the processes on other parts of the business, including information technology?
- What, if any, investments in process improvements, staffing and/or technology has the company made in the last few years? Would the return on those improvements be diminished by outsourcing?
- What, if any, investments in process improvements, staffing and/or technology might the current processes require during the next five years? How do the projected costs of maintaining the process internally compare with the cost of outsourcing it?

1C: Assess Internal Capabilities

After evaluating the full range of outsourcing options, the organization must assess its internal capabilities. It is not sufficient to simply focus on the skills necessary to execute a specific FAO process. The skills required to (a) manage transferring a process to an outsourcing provider, and (b) monitor and manage the outsourcing relationship require consideration. In larger companies, expertise in managing outsourcing relationships and knowledge of outsourcing providers may exist in other parts of the business, such as human resources, IT, and procurement.

An effective internal capabilities assessment 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 (c) following an outsourced model. Questions to ask during this decision-making sub-step include:

- Does the company possess the expertise and personnel 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? What does the company need to do to retain essential staff?
- Does the company have the expertise and staff required to move to a different internal model (e.g., shared services)?
- Does the company have sufficient knowledge of the provider marketplace to select an appropriate outsourcing provider?
- 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 or applications integration) necessary to monitor and manage the outsourcing relationship through to its termination or renewal?

When evaluating responses to each of the above questions, decision makers should consider the time commitment associated with managing these processes internally and the degree to which management may already be inclined to use an external provider to reduce internal demands. Negative responses should generate another question: How practical would it be to correct the identified gap in expertise within the company deficiency?

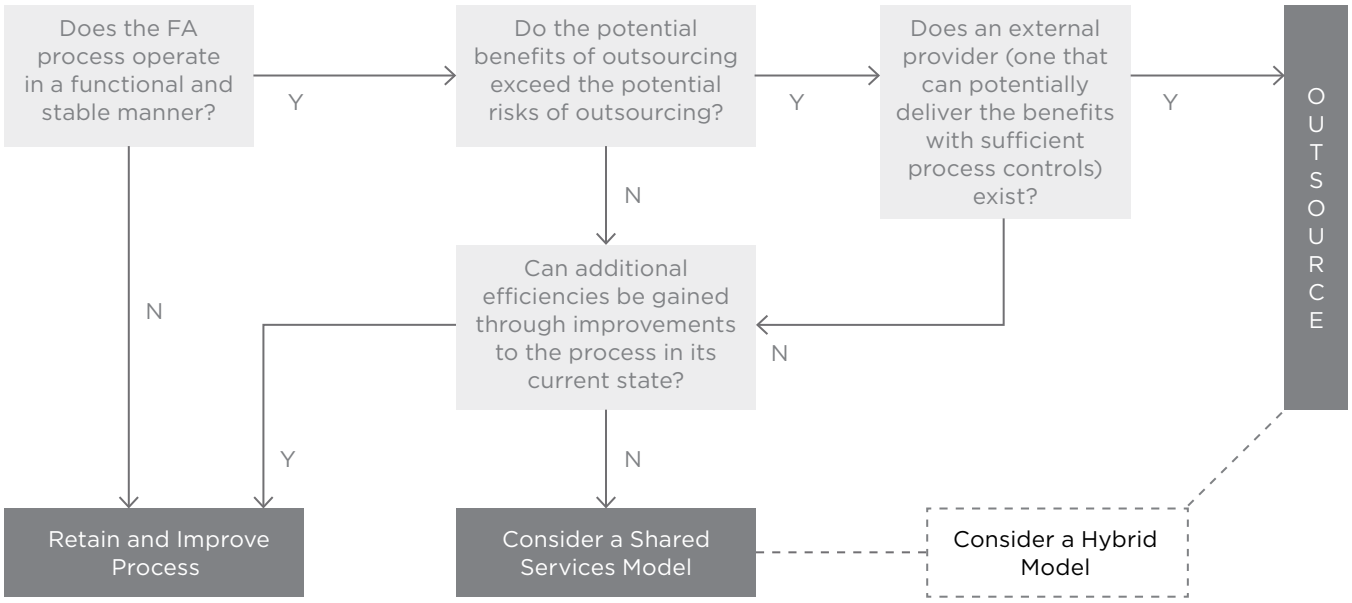
1D: Determine Scope and Logic

This assessment and planning step identifies which process(es) a company should outsource. Conventional wisdom suggests that only "non-core" or "tactical" FAO processes are ripe for outsourcing because core, strategic processes are too valuable to outsource. This is incorrect for two reasons. First, a process defined as "non-core" can still be highly important. 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, but errors in claim-processing, particularly those with high-value customer accounts, may cause customer dissatisfaction. Second, as outsourcing has evolved and become more common in recent years, more companies are outsourcing knowledge work, which had traditionally been considered too strategic or too core to outsource. For example, a company may outsource a portion of its financial planning and analysis function despite it being a core capability (and a source of competitive advantage) because an outsourcing provider's capabilities in analyzing external market factors (e.g., inflation, growth projections, and exchange rates) are superior to the organization's internal capabilities.

Evaluating the "outsourceability" of an FA process is more effective than simply making core vs. non- core distinctions. *Outsourceability* essentially describes the outcome of a key evaluation in the decision-making phase: How appropriate is an FA process or processes for outsourcing given our organization's strategy, capabilities, and other unique characteristics? The ability to outsource varies by company and requires a grasp of outsourcing benefits and risks. Outsourceability also fluctuates over time due to many factors including the level of in-house outsourcing expertise, process changes and larger organizational changes (e.g., mergers, acquisitions, spinoffs).

The following decision tree is useful in assessing outsourceability:

FAO DECISION TREE



The outcome of the outsourceability assessment should be summarized, documented and then presented to the individuals responsible for the next step in the FAO lifecycle: partnership engagement.

2. Partnership Engagement

An effective FAO decision-making process highlights issues that must be examined in the subsequent selecting or engaging of a partner. For example, if an assessment of internal capabilities reveals that a company does not possess sufficient expertise and resources to manage the transfer of one or more processes to an external provider, the search should extend to prospective outsourcing partners who have the expertise and resources to manage this transition.

Many other considerations must be addressed during the FAO provider selection process. These considerations must be prioritized and communicated, usually through a request for proposal (RFP), in such a way that enables the individual or team selecting the FAO provider to understand and easily compare the merits of each provider's proposal.

Some larger companies, likely with well-developed selection processes already in place, have positions or departments dedicated to the management of outsourcing relationships. The four sub-steps that follow will be most pertinent to companies that lack functions or managers dedicated to developing and managing outsourcing relationships.

2A: Assemble the Project Team

The project team should include people with finance and accounting expertise, legal expertise, procurement skills, and the ability to manage the transition and ongoing management of the outsourcing provider.

The team should fill all or most of the following roles:

- a project manager, preferably one with previous provider-selection experience, to lead the selection team
- at least one FA expert who understands how to manage, measure, and monitor the operation of each process to be outsourced

- an individual with negotiation experience (if possible, someone with experience negotiating outsourcing agreements)
- a legal expert to manage the development of the FAO outsourcing contract

Note: one or more of these project team members may work outside the company (e.g., the legal expert may work for the company's external legal firm and the FA expert may work for a public accounting or consulting firm).

It is valuable, and increasingly possible, for one or more of the project team members to have experience in selecting an outsourcing provider. If the outsourced processes significantly affect other areas of the company, such as IT (if a systems change is likely), companies should also consider including representatives from those areas on the selection team.

2B: Link Buyer's Needs to the FAO Provider Marketplace

The objective of linking needs to the FAO provider marketplace is for the project team to gain a high-level understanding of the degree to which the outsourcing marketplace can meet the buyer's FAO needs. This understanding will shape the subsequent development of an RFP and the evaluation of the FAO proposals.

In addition to discussions with peers, contacts, vendors, supply chain partners, and others with knowledge of the FAO provider marketplace, the project team can obtain data on market trends and current issues from FAO analysts, advisory firms, and providers. Some of this research can be obtained for free, while more comprehensive reports come with a price tag. In recent years, some of the research offerings from FAO outsourcing advisors has become highly targeted because it can help fill expertise gaps on the project team [e.g., an outsourcing advisor may provide an RFP template, help produce a service-level agreement (SLA), or provide advice on managing the partnership].

In addition to external outsourcing advice, the project team may consider legal firms specializing in outsourcing agreements and other FA consultants (e.g., those that assist with an outsourcing partnership's implications on IT systems, tax, and/or regulatory compliance requirements). The following questions can help the project team decide whether outside assistance may be helpful:

- Do the organization and the project team have previous experience selecting an FAO provider?
- Have members of the project team been involved with selecting an outsourcing provider for an arrangement of this scope, value, and complexity?
- Does the project team possess (or have access to) internal legal experts with experience crafting outsourcing contracts?
- Does the project team have any specific FAO knowledge gaps that should be addressed?

2C: Develop the RFP and Establish an RFP Evaluation Process

A request for proposal (RFP) can vary in length and should be tailored to the unique demands of the processes) to be outsourced. Some companies prefer to distribute a request for information (RFI) before developing an RFP.

The information collected in an RFI is designed to help an outsourcing buyer understand the capabilities of outsourcing providers in the marketplace. Outsourcing buyers tend to use RFIs more often when they are looking to outsource multiple processes and/or when the outsourcing buyer is unfamiliar with the outsourcing provider marketplace.

An RFP invites outsourcing providers to submit a proposal, including a bid, for taking over an outsourcing buyer's processes.

An effective RFP is written clearly and crystallizes the scope and logic behind the desire to outsource specific FA processes. An FAO RFP typically includes the following elements:

- **Objectives:** The buyer's intended partnership benefits.
- **Scope:** The services the provider is to deliver.
- **Performance Expectations:** The services the buyer wants to receive and what metrics buyer will monitor to determine the provider's performance. In some cases, the buyer and provider will explore how to jointly monitor performance. This section may also outline the composition of the management team (e.g., its size and the number and seniority of managers the provider intends to assign to the partnership) and how changes in scope are to be handled.
- **Governance Approach:** How the buyer and provider will collaborate to manage performance, identify issues, resolve problems, and reach mutually agreeable resolutions.
- **Pricing:** The pricing model to be used (along with how the model can be changed if the need arises).

While clarity is the most important quality of an effective RFP, consistency is the defining characteristic of an effective evaluation of the vendor proposals. Most evaluation processes consist of formal and informal communications with prospective vendors. FAO providers may contact the buyer to clarify the RFP or to seek other information that might give them an edge in their response. Responses to the questions from providers seeking additional information those questions and requests should be consistently documented by the buyer to ensure that the ensuing proposal evaluation is as free from bias as possible.

2D: Conducting Due Diligence

Consistency and objectivity should govern the evaluation of vendor proposals as well as any site visits the selection team conducts. Some FAO buyers, particularly those seeking a provider to manage multiple processes, prefer to meet with providers and conduct site visits before issuing the RFP. Doing so can help sharpen the RFP's clarity while limiting the number of prospective vendors the buyer will target. Other FAO buyers meet in person with prospective vendors and visit their sites after issuing RFPs, narrowing the field of candidates based on their evaluation of the proposals. The RFP should clarify which type of site visits the buyer will request during the bidding process so that all potential bidders have the same opportunity.

The purpose of due diligence is for the FAO buyer to confirm (or raise questions about) the validity of claims and information in the proposals it receives. This may involve contacting a vendor's current and former customers, employees, competitors, and outsourcing advisors.

3. Partnership Execution, Governance, and Termination

Outsourcing providers can execute FA processes more effectively and usually more efficiently than the outsourcing buyer because the provider has developed a specific capacity to deliver these processes. Because different processes require changes in behavior (e.g., the learning of new process steps) with the company that buys the outsourcing services, effectively managing that change, as well as the outsourcing relationship, requires careful attention to four sub-steps.

3A: Negotiate Contract and Service-Level Agreement (SLA)

Contract negotiations between the buyer and the outsourcing provider it chooses should cover the agreement itself (e.g., its terms, service-level agreements, and pricing), the transition process (e.g., the duration of the transition and, if necessary, how the buyer will shift technology and employees to the provider), and governance/oversight (e.g., performance expectations, performance-monitoring processes and technology, communications protocols, troubleshooting, and escalation processes).

A communications plan should identify individuals within each organization who will be charged with monitoring and managing the outsourcing relationship. It should also cover how the partners will identify, report, and resolve problems that arise throughout the agreement. FAO contracts vary in length and address these four areas:

1. **Description of services:** This area identifies the services the FAO vendor will provide and, in some cases, which services it will not provide. This section identifies which elements of the service process or processes will be changed to meet the provider's standards and which elements of a given process will remain the same.

2. **Service-level agreements:** The contract must identify the quantitative and qualitative measures the partner organizations will use to monitor and manage the relationship. How will vendor performance be measured? Which individuals or teams within the provider and buyer organizations will monitor performance? What is the process for addressing, resolving, and, if necessary, escalating performance problems that may arise throughout the agreement? What is the process for modifying the scope of services outlined in the contract?

3. **Pricing:** This section details the pricing model of the outsourcing agreement and outlines how changes that affect the execution of the process or processes will affect pricing. Changes may relate to the scope of the agreement (e.g., adding processes to outsource or bringing an outsourced process back in-house), transaction volumes, ownership changes (in either organization), or external changes such as new regulations that affect process performance.

4. **Terms and conditions:** An outsourcing agreement may be terminated for one of four reasons: contract expiry, for cause (e.g., poor service by the provider or non-payment by the buyer), for convenience (e.g., the purchasing organization experiences massive cost cuts, reducing the level of service needed and rendering the outsourcing arrangement uneconomical), or a change in control within either organization.

The contract should detail the termination process for each case (except contract expiry). For example, the contract should clearly define what constitutes "poor service." The purchasing organization should avoid terminating an outsourcing arrangement before the contract's expiration because doing so can be difficult and expensive. Bringing processes back in-house after the termination of an outsourcing agreement requires almost the same effort and actions 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 should typically begin nine to 12 months before the contract expires naturally.

3B: Transfer Process, Employees, and Knowledge

The transition of processes from one organization to another is a project and should be managed as such, bringing to bear project-management rigour 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 the service-level agreement should outline roles and responsibilities for the transition phase. The following questions can help the outsourcing organization determine such assignments:

- What processes, technology, and personnel will be transferred to the outsourcing provider? Is the transfer permanent or for a specific period of time?
- What are the implications of each of transferring each process (e.g., HR and benefits implications or IT-integration issues)?
- Who will be responsible for managing the transfer of processes, technology, and/or personnel?
- What process and/or technology documentation must be transferred to the outsourcing provider?
- Will the provider require any other organizational knowledge related to the outsourced processes?
- What are the most challenging change-management issues to be expected and what plans are in place to address those issues?

During the transition, the project team should apply traditional project management methodologies, including:

- establishing project plans, milestones, roles, and responsibilities
- creating a formal communication plan that considers the unique informational needs of different internal and external audiences

- terminating employees previously assigned to the outsourced processes, transferring them to the outsourcer, or reassigning them internally
- addressing potential negative fallout from employee transfers and terminations, which includes internal communications and, in some cases, external public relations and recruitment
- providing training and communications on how the outsourcing provider will deliver processes to end users
- implementing new technologies (e.g., monitoring and communications software)

3C: 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. The following managing and monitoring steps can help ensure the effectiveness of the relationship:

- identify individuals with sufficient authority within both the buyer and the outsourcing organizations to manage the relationship throughout the term of the agreement
- track quantitative and qualitative measures detailed in the service level agreement to monitor provider performance on a regular basis
- establish a formal process for conducting meetings between buyer and provider to discuss any issues that arise
- if possible, set up "exchange programs" where provider employees spend time working with their counterparts on the buyer's site and vice versa
- establish a formal troubleshooting 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 intervals throughout the agreement
- establish a process for modifying the agreement (e.g., adding or subtracting processes, revising performance objectives, or adjusting pricing)
- use quantitative and qualitative performance monitoring as the basis for any decision to renew, renegotiate, or terminate the agreement

3D: Renew, Renegotiate, Terminate

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

At least nine to eighteen months before a contract concludes naturally, the buyer should begin to consider its course of action upon expiration of the agreement. The buyer has three options:

1. Renew the contract with the current provider (this may or may not involve renegotiations).
2. Put the processes out to open competition again (in which case the current provider could re-bid on the work).
3. Bring the processes back in-house.

Given that most FAO agreements last for at least three years, the vendors, services, and prices available in the provider marketplace will likely change by the time the agreement expires. Equally impactful, marketplace and/or macroeconomic conditions may have also changed dramatically during the term of the agreement.

One of the most effective ways for the buyer to assess the current provider marketplace in the nine to eighteen months before the end of the FAO contract is to determine the willingness of the current vendor to extend the relationship. The buyer should also consider asking the current vendor to conduct and present a market analysis indicating how that provider's services and terms compare to comparable agreements that exist in the market.

Conclusion

FAO relationships offer companies opportunities to reduce costs, access better skills and technologies, heighten the scalability of operations, and support business transformation and restructuring.

Additionally, offloading processes to outside partners can help sharpen the finance function's focus on other core competencies and enable the company's strategic objectives and other high-value activities.

This publication is one in a series on *Finance and Accounting Outsourcing.* An Overview document is also available on our website. For additional information, please contact Carol Raven, Principal, Research, Guidance & Support at 416-204-3489 or email craven@cpacanada.ca

About the Author

Eric Krell has authored more than 1,000 articles on corporate finance and accounting, risk management, corporate governance, marketing, human resources, information technology and the management consulting profession. He is a contributing writer to *Consulting Magazine*, *HR Magazine*, and *Direct Marketing News*. He also advises companies on their content marketing and thought leadership strategies. His current areas of interest include marketing transformation, outsourcing, risk management and human capital management. His writing has also appeared in consumer outlets, including National Public Radio affiliate KUNC in Colorado, *Rolling Stone*, *Men's Journal*, *Cooking Light* and *Men's Fitness*. Krell holds a B.A. from the College of William and Mary.

CHARTERED
PROFESSIONAL
ACCOUNTANTS
CANADA

277 WELLINGTON STREET WEST
TORONTO, ON CANADA M5V 3H2
T. 416 977.3222 F. 416 977.8585
WWW.CPACANADA.CA