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Outsourcing Accounting Functions: Risks and Benefits

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Abstract: *Accounting functions are the central source of all accounting information and firms make use of the outsourcing system as a strategy to enhance their performance. The aim of this study is to understand how accounting functions are outsourced and the risk and benefits associated with outsourcing accounting functions especially in the present-day competitive business world.*

Keywords—Outsourcing; Accounting Functions; Accounting Tasks

Introduction

Outsourcing is a practice of transferring the task of executing some specific business functions from an employee group to a non-employee group. Accounting outsourcing means transferring part of accounting functions to a third-party provider or a fully owned subsidiary in order to cut costs, gain access to scarce skills, or obtain competitiveness. Common examples of accounting outsourcing: payroll processing, general accounting, treasury, and cash management, invoice processing, accounts payable outsourcing, and other industry-specific processes. Previously, outsourcing was a system used by only large organizations, but recently it has become a new favorite among small-and-medium-sized companies (Evanson, 2010). Outsourcing labor became a popular concept, after the middle of the 20th century, especially, among US firms that were looking for credible solutions to help decrease manufacturing costs. Since Asian labor costs lower when compared with the USA, thus, setting up manufacturing facilities in Asian countries like china, japan, etc. became a solution to the issue. The adaptation of outsourcing has increased significantly in the last decade, there is a figure that shows that above two million people worked as an outsourced employee in 2013, and India and China are the most attractive destination to find outsourced employees (Selvaggio, 2014). Of recent, the reasons for outsourcing have evolved from achieving only savings cost towards other goals. Everaert, Sarens, and Rommel (2007) found that among Belgian SMEs most often the reason for at least partly outsourcing accounting function is the aim of achieving professional expertise. Similarly, according to Hätönen and Eriksson (2009), although saving cost is only one of the motives for outsourcing, it is not the most important. The decision to outsource is hence more strategic in nature. According to Lahiri (2015), firms make use of the outsourcing system as a strategy to enhance their performance however scientific evidence on the connection is still debated and rather under-researched. Thus, research on this connection is relevant and timely both practically and scientifically.

Statement of Problem

The challenges that are encountered in a bid to sustain a competitive advantage in the corporate world faced by a lot of businesses have become a major source of concern nowadays. Businesses are now adopting new cutting-edge technologies and skills and best practices to adapt to the rapid changes in the world. Various business and accounting functions are now being reengineered for this purpose. Today, the evolution of accounting like management accounting has made accounting functions to have more roles to play in any business. Furthermore, it has created an advantage for business competitiveness in the market. Hence, the need for outsourcing accounting functions has become greater and also the need to understand the benefits and risks of outsourcing accounting functions.

Objectives of the Study

1. To identify the benefits of outsourcing accounting functions
2. To identify the risk of outsourcing accounting function

Defining outsourcing

According to Heshmati (2003), no definition for outsourcing is 100% accurate and all studies on outsourcing give different definitions. Concurring to Dolgui and Proth (2013) it is important to discuss what outsourcing means when researching it. Kakabadse and Kakabadse (2000) define outsourcing as a means of acquiring either products or services from outside the firm(company). Dolgui and Proth (2013) further reinforce this approach by defining outsourcing as "an act of acquiring semi-finished products, finished products or services from outside the company, especially if these activities were traditionally performed internally". This definition translates to, the fact that a certain function done by an outsourcing vendor is only considered outsourcing if initially it was made internally. But Gilley and Rasheed (2000) referred to this kind of outsourcing as 'substituting'. According to them, this definition covers a scope that is in fact so broad that it ultimately covers any procurement of any kind of activities in the firm. Thus, for the purpose of better understanding, this study will adapt, a more distinct definition.

The main question that arises after looking at the above definitions is 'what is the difference between outsourcing and procurement'. The approach adopted by Gilley and Rasheed (2000) sheds a clearer light on this matter. According to them, in addition to substitution, outsourcing can also occur through abstention. Outsourcing through abstention "only occurs when the internalization of the good or service outsourced was within the acquiring firm's managerial and/or financial capabilities". In other words, the essential factor is if the purchased activity or service could be done within the firm or not. On the other hand, this means that outsourcing a function does not necessarily mean that it has had to be initially done in- house.

Reasons Companies Utilize Outsourcing

1. To improve the Company's Focus

Outsourcing helps establish a system where an outside expert assumes responsibility for some operational details. This leaves the management enough free time to focus on more important business issues related to customer service and marketplace demand.

2. To Obtain Top-Notch Capabilities

Because it is their area of specialization, outsourcing providers bring a more extensive and thorough skill set into the corporate environment.

3. To Share Risks

Outsourcing allows the management to turn over to its supplier's certain risks, like capital investments and demand variability.

4. To Free Up Corporate Resources

Outsourcing allows an organization to redirect essential resources from non- core activities to the activities that have the greatest impact on business performance.

5. To Control Operating Cost

Access to an outside provider, lower cost structure immensely thus, is one of the most compelling reasons for outsourcing.

Defining Accounting outsourcing

Accounting outsourcing means reassigning some part of accounting functions to a third-party provider or a fully owned subsidiary in order to gain access to scarce skills, to cut cost, or obtain competitiveness. Some examples of accounting outsourcing include accounts payable outsourcing, general accounting, payroll processing, treasury and cash management, invoice processing, inventory management, preparation of financial statements, and other industry-specific processes.

Once a company/firm makes a decision to outsource its activities, the process of selecting a partner or supplier must be implemented. Analytical thoroughness and careful insight are required in choosing the 'right' partner or supplier (Hatonen and Eriksson, 2008). According to Kakouris, Polychronopoulos, and Binionis (2006), the outsourcing process is considered a very critical stage. 'Make-or-buy' question which manufacturers ask themselves and the 'do it ourselves or buy it on' question asked by service providers should be answered by those responsible for the sourcing. Additionally, as highlighted by Hickey (2005), the current global economic factors that should be considered when making outsourcing decisions are cost projections, long-term productivity, long-term business, and employment stability, physical and data security, political agenda business continuity capability, and cultural differences. These factors are vital because outsourcing allows companies to easily leverage the global market place, to choose the type of work they want to perform, and where they want to perform the work in order to achieve the greatest profit.

Krell (2006) mentioned some components of accounting functions, which are suitable to be outsourced like internal services, general ledger, and financial reporting. The abstraction of elements of business outsourcing for operations finance and accounting services are as follows:

I. General accounting
II. Audit
III. Accounts payable
IV. Banking
V. Financial services solutions
VI. Credit services
VII. Insurance processing
VIII. Tax Services
IX. Billing systems
X. Accounts receivable
XI. Collections and credit
XII. Compliance
XIII. Management Reporting

Accounting Functions

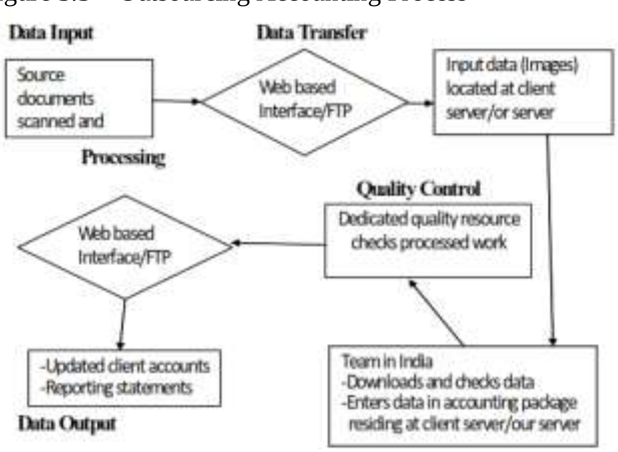
Accounting is the measurement, statement, or provision of assurance about financial information primarily used by managers, investors, and other stakeholders or decision-makers to make resource allocation decisions within companies, organizations, as well as public agencies. There are several types of accounting functions in business, Alan (2002) found that finance and accounting functions are ranging from account receivable, internal audit services, account payable, general ledger, lease administration, payroll, sales audit to tax, property accounting. Bamford and Bruton (2006) define accounting functions as follows:

I. Account receivable: The record of receivables is crucial not only for decision making on credit extension but also for billing accurately and maintaining good customer relations
II. Account payable: The record of liabilities which show what the firm owes the suppliers, facilities the take cash discount, and allow payment to be made when due are recorded here.
III. Inventory account: This account is essential for the control and security of inventory items. Inventory record supplies the information that is needed in maintaining adequate stock levels, making purchases, and computing turnover ratio.
IV. Payroll: This record shows the total salaries that have been paid and will be paid to employees and provide a base for computing and paying payroll taxes.
V. Cash record: This record shows all the receipts and disbursements that are necessary to safeguard cash. It provides essential information about cash flows and cash balances.
VI. Fixed asset account: This account shows the original cost of each asset and the depreciation taken to date, along with other information such as the condition of the asset

Accounting Process

The diagram below shows the process of outsourcing accounting. It started with Data Input, transfer of data, receiving of data, quality of control, and output.

Figure 3.3 – Outsourcing Accounting Process



Benefits of Outsourcing Accounting Functions

1. Minimizing costs

The idea of outsourcing some accounting functions to outside vendors originated from the need to save money and increase profit (Mueller, 2011). It makes it easier for companies/firms to be able to match the working hours or amounts of ongoing projects with business and clients needs, cut down on direct and indirect costs that are related to employment such as payroll taxes, insurance, social security benefits, workspace, unemployment taxes, office furniture, computer software, and hardware.

2. Energy savings

Outsourcing accounting function enables managers to save time and concentrate more on core activities and network-building activities which aid the company achieve its set goals. Besides accounting function, service provider companies deal with recruiting, hiring, retaining, and overseeing accounting staff on behalf of the company/firm, and this lets the company focus on crucial resources.

3. Expert services

Employees of outsourcing service provider companies are much more likely to be experts in their fields hence the best at their work, especially because they are not only dealing with the accounting needs of one company but a customer portfolio. Daily communication with their customers and continuously dealing with their accounting needs make them specialized in their choice of work, hence, this makes them experienced experts to get given projects done effectively and efficiently. It also helps them keep their skills updated thus increases the work quality day-by-day. This fact makes it quite alluring for companies to seek and rely on outsourcing service provider companies that their work is being handled in a truly professional level.

4. Contractual obligation

The liability rate is higher for service providers than in-house staff. And this means there is no big risk for the company/firm. Service providers are more likely to follow through on their duty because it's their sole responsibility. Furthermore, it is way easier to deal with the agreements or contracts of outside service providers than to deal with issues like employee management, hiring negotiations, and other human resources issues related to the employees.

5. Industrial accounting needs

Some accounting needs can be unusual and specified for a particular industry and hiring an internal accountant that possesses the right knowledge and technical know-how to deal with those needs would be very expensive especially for SMEs.

Risks of Outsourcing Accounting Function

1. Communication

This element is defined by both service time and distance. When a company has an internal accounting function, employees and managers can be responded to immediately after putting in a request for accounting service, while an outsourced accountant needs to be reached by telephone calls, emails, or social media (the internet) which are time-consuming. The same reason is valid for distance issue, as face-to-face communication is irreplaceable. Time difference due to different time zones of a service provider and an accounting firm is another challenge. Distance, too, increases the likelihood of outages disabling the communication infrastructure between the vendor and the outsourcing firm.

2. Language barriers

As earlier mentioned within the communication factor, when companies need to speak to their outsourced accountants, they can only do that via emails or calls, and in the case of using accounting services in a foreign country, the language barriers become an essential factor. Employees and managers of the companies may not be able to accurately describe the situation of their accounting needs appropriately in a foreign language. Furthermore, the outsourced accountants may also not have a sufficient understanding of foreign language to understand their customers. Furthermore, accent differences are another factor that cannot be overemphasized within this factor.

3. Less control:

Managers frequently complain about the loss of control they experience over the process and quality standards of the outcome when specific functions or services are outsourced. When duties that were previously executed by the company personnel are outsourced to outsiders, over whom the company/firm has little or no control over, production schedules may be disrupted, quality may suffer, or contractual disagreements may develop. If the outsourcing contracts incorrectly or inappropriately detail work specifications, outsourcers could be tempted to behave opportunistically. The geographic distance can also aggravate control issues, especially when the vendor is offshore. Supervising both performance and productivity can prove to be challenging, coordination and communication may also prove difficult with offshore vendors. The inability to brainstorm, engage in face-to-face discussions, or explore the problems could cripple a project’s flow.

4. Security risks

Accounting data is very important and expensive for any company since it covers all the necessary external, internal, operational and etc. knowledge about a company. Relying on this kind of data to a service provider may give rise to new risks, especially because of nature the industry which is fragile and data can be easily manipulated or stolen.

5. Loss of Innovation

Companies pursuing innovation strategies understand the need to hire and recruit highly qualified personnel, that will provide them with a long-term focus, minimal control, and appraise their performance for positive long-run impact. When certain support services like software development, IT, or materials management are outsourced, innovation may be impaired. Furthermore, when external providers are hired for purposes like gaining labor pool flexibility, cutting costs, or adjusting to market fluctuations, long-standing cooperative work patterns can be interrupted, which will in turn adversely affect the company’s/firm's corporate culture.

6. Loss of Organizational Trust

For many firms, a significant but non-quantifiable risk occurs because outsourcing, especially of services, can be identified as a breach in the employer-employee relationship. It raises questions bin the mind of the employees and they will begin to wonder which group or what function will be the next to be outsourced.

Conclusion

The need and use of accounting outsourcing are increasing throughout the world. Accounting outsourcing arrangements offer companies/firms opportunities to drastically reduce operating costs, access better technologies and skills, and also achieve other benefits like improving organizational focus on core competencies, and moving accounting professionals away from transactional duties, toward more strategic responsibilities and to achieve these opportunities.

Companies pursuing accounting outsourcing arrangements must avoid problems that damage relationships with the service providers and lower the returns on their accounting outsourcing investments.

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