Tony Santiago

Buyer Beware

The Big4 Want to Run Your Tax Function - This is Why You (Probably) Shouldn't Let Them

Outsourcing Update October 2020

Executive Summary

The coronavirus pandemic has given the Big4 a convenient pretext to promote their managed services outsourcing model as a novel, client-driven solution. All the rage in the late 80s and early 90s, it's pretty telling that none of the large, complex companies that initially entered into those arrangements are still doing so today.

As we discussed in our original white paper on the subject, [What the Big Four Don't Want You to Know About the Latest Outsourcing Trend], there are two key reasons these initiatives are generally doomed to fail.

- **Misaligned KPIs**

  When a former in-house tax professional joins a consulting firm as part of an outsourcing agreement, the performance metrics change overnight. One day, they're focused on shareholder value and risk mitigation; the next, they're tasked with benchmarks based on billable hours, realization and utilization percentages. This strategic disconnect often results in unplanned 'out of scope' consulting costs, as well as an increase in compliance and risk issues.

- **Inevitable Loss of Critical Legacy Knowledge**

  As noted above, most of the managed services deals involve the transference of much of the company's current tax department staff over to the accounting firm as consultants. While most will accept the offer in lieu of a pink slip, it doesn't mean they'll stay, taking their deep understanding of the processes and their history with them. What's more, when audits come up, most companies struggle to reconstruct the information because no one involved in the transactions at the time is still around.

These outsourcing programs were not intentionally designed as loss leaders, as the firms had hoped to turn a profit on larger projects in the future. However, when economic corrections such as the aftermath of COVID-19 occur, clients typically have a limited appetite for additional consulting services. Inevitably, these managed service agreements will drain valuable financial resources from the professional accounting firms, while also taking the focus away from their traditional subject-matter-expert business model. Unfortunately, history indicates accounting firm consultants do not satisfy most clients' needs, nor do they provide the firms with value-added work. In addition, as noted, these same initiatives already failed in the late 80s and 90s. (continued next page)

So why are they trying it again?

- **Pursuit of Recurring Revenue**

  Automated auditing processes sent the Big4 scrambling to find new revenue streams, and the coronavirus pandemic has made it even more critical that they define their place in the new economy. Enter outsourcing, a concerted marketing effort with the goal of instituting a loss leader in the hopes of being first in line to realize other, more-profitable opportunities down the road.

- **Naive Overconfidence**

  While the Big4 are great advisors, their willingness to enter into these engagements on the presumption that they can learn to run a tax department on the fly belies a lack of appreciation for how difficult that really is.

Many tax functions are struggling with increased workloads and shrinking budgets, however in all but a few outlier situations, we believe outsourcing is not in the best interest of most companies or their shareholders. Rather, there are more cost-effective and flexible solutions that can be achieved by utilizing the Talent Economy.

The Inevitable Downsides of Outsourcing Your Tax Function

Outsourcing Update October 2020

The coronavirus pandemic has given the Big4 a convenient pretext to promote their managed services outsourcing model as "the next big thing."

While co-sourcing, the redistribution of a specific function within a tax department -- usually compliance, sales and use, property, or indirect taxes -- to an internal shared services group or third-party consulting company can be a viable solution for short-term challenges, it's important to note that these managed service propositions are far more zealous. Rather, outsourcing with a public accounting firm results in the complete transference of a company's tax operations and a portion of their tax planning support to a third party.

Nonetheless, the complications of the CARES Act and ever-changing tax laws, along with the challenges of remote work and far-flung teams, have placed additional strain on most already overburdened tax departments. Along with efforts to cut in-house budgets even further, there's a lot at stake and pressures are mounting. Is it time to consider handing your entire tax function over to the professional service firms?

In most cases, the answer is no. Outsourcing a tax function may seem like an effective, cost-saving idea on the surface, in all but a few outlier situations, most of the time the reality falls short of the promises. In addition to the historical failures of past tax outsourcing initiatives, the underlying reasons the professional consulting firms are heavily promoting outsourcing aren't as organic or altruistic as they would have you believe. (continued next page)

History Repeats Itself

Since signing a renewable five-year agreement and transferring over their lawyers, accountants and tax advisors, word has it one of the most-touted, post-tax reform outsourcing contracts is in the midst of renegotiation due to mutual dissatisfaction.

We also know of another large outsourcing engagement that has been struggling to keep up their end of the bargain. In this case, after the departure of their first leader, the public accounting firm brought in one with both corporate in-house and professional services experience. However, the newly recruited individual became so frustrated by the problems caused by the misaligned KPIs that they quickly left the role, as well.

As bystanders, we saw this coming. All the rage in the late 80s and early 90s, it's important to note that none of the large, complex companies that moved to full tax-outsourcing solutions back then have remained in that format.

As we discussed in our original white paper on the subject, What the Big Four Don't Want You to Know About the Latest Outsourcing Trend, there are two key reasons these initiatives are generally doomed to fail.

1. Misaligned KPIs
2. Inevitable Loss of Critical Legacy Knowledge

---

1. Misaligned KPIs

In our earlier article, Outsourcing Update 2020 - Insiders Speak Out, we cited an anonymous tax professional who had gone from being part of a corporate in-house tax department to consulting for a Big4 firm as part of a managed services arrangement. He noted that "the consulting firm is going to interpret the scope of work that they're engaged to do as narrowly as possible. There's also a different mentality as far as getting the information on the return correct or defending the return. Rather than a concern for accuracy with respect to those details, the accounting firm is thinking, "How can we bill for this?'"

With one side looking for opportunities to create costs and the other looking for ways to cut them, these opposing ambitions are destined to clash. Also at odds are the career goals of the newly minted consultant. When a former in-house employee joins a consulting firm, their performance metrics do a 180. One day, they're measured on shareholder value and risk mitigation; doing everything they can to protect those two areas. Overnight, they're tasked with benchmarks based on billable hours, realization and utilization percentages.

2. Inevitable Loss of Critical Legacy Knowledge

There is currently a profound shortage of experienced tax professionals in the marketplace, and talented individuals will go where they please. (continued next page)

Simply put, if a former in-house employee had wanted to work for a Big4 firm, they would have already been doing so. Talent will vote with their feet, and when those experts move on, they will take their critical legacy knowledge with them.

Outsourcing is a loss leader, and in order to get these arrangements to shake out financially, the firms have had to leverage work down to lower-level people. Assigning critical work to junior people results in increased risk, as they lack the experience necessary to understand whether a transaction is being executed correctly, as well as the understanding of how to report and defend it.

Inexperienced consultants are also incapable of identifying the shareholder value of opportunities to the degree an in-house team would be there, and nature of outsourcing prevents them from developing deep relationships with cross-functional corporate groups or business units. Thus, these consultants don't understand the value proposition of having a close connection with general counsel, FP&A and corporate development, as well as the treasury function. In most cases, when the head of a business group approaches with a profitable idea with a potentially bad tax position, they are met with an inflexible 'no.' In contrast, an in-house person understands the company – not just the tax codes – and would find a way to restructure and make the proposal work.

Why the Reboot?

Outsourcing is nothing new, and while it's being promoted as a novel, client-driven solution precipitated by the coronavirus pandemic and rapidly shifting technology demands, it's unclear how this reboot is any different from past efforts.

So why are they doing it? While there may be several reasons behind this outsourcing recharge, two are abundantly clear:

1. Pursuit of Recurring Revenue
2. Naive Overconfidence

1. Pursuit of Recurring Revenue

To hear them tell it, this intense focus on outsourcing is an organic response to client demand. A recent article on AccountingToday.com quoted Doug Thomas, a managed services platform leader at PwC, as saying "We actually started the managed services business as a result of that (GE) transaction a few years ago. We've been able to grow that into a business. We actually have several clients that have done the exact same thing. The number of people that we brought over from GE has only grown from the transactions we have done with other clients." (continued next page)

To a certain degree, the offering could even be viewed as altruistic, with Thomas noting "For individual companies to be able to bear that cost burden to comply with all the global requirements, that's a high bar to meet, so to be able to share those costs across larger economies of scale gives clients and companies the deep technical expertise that they need."

But have technological challenges or pandemic-fueled fears driven demand for 'new' outsourced business solutions, or is something else behind this push?

In reality, this sudden uptick in managed tax service offerings is an attempt to create a new income stream, one that is more sustainable than the traditional, one-off consulting model of "kill it, eat it and kill it again." The idea of recurring revenue is very attractive to the professional service firms, particularly when one considers the financial challenges they were already facing long before the pandemic hit. Increasingly, technological advances and automation have streamlined the auditing process, greatly reducing the Big4's cornerstone revenue stream based on billable hours. What's more, in recent years there has been tremendous pressure to decrease the hourly rates charged by their consultants.

Unfunded pensions at the Big4 have added to the already immense financial pressures. In fact, we have been told that one of the accounting firms is about to approach the threshold where the pensions distributed to retired partners is capped. Although these former executives were promised big money for the remainder of his or her lives, only so much can be paid out and everyone will soon take the hit.

2. Naive Overconfidence

While there's currently a great deal of traditional tax consulting work available due to pandemic-related challenges and potential changes, the firms have spent the last few years shifting their energies in other directions, taking critical resources and refocusing them on managed tax services and technology initiatives.

What's more, most consulting firm partners have never held in-house leadership positions, so there's a lack of functional understanding as to what a corporate tax department requires to be successful.

Along with the fact that most Big4 consultants and leaders have never worked in-house, with their recent push to reinvent the traditional consulting model, the firms have put themselves in the difficult position of trying to morph into technology companies.

While technology has been notably disruptive to many traditional industries, we have yet to see traditional brick-and-mortar retailers like Sears and J.C. Penney able to transform into an Amazon. Nor have any car manufacturing companies turned into an Uber nor any global property management companies become an Airbnb. That's because it's not the tools, clothes, taxis, or real estate -- nor the knowledge of how to manufacture them -- that drove these transformations, but the technology that makes it work. (continued next page)

In other words, while the Big4 are subject-matter experts in their field, they are not technology experts. Even if development and tech talent is hired from the outside, the experienced leadership required to manage such massive endeavors isn't in place. Rather, we propose that technology experts should be consulting with tax experts to build the best possible solutions.

What's Next?

The Big4 are working through a challenging and stressful time as they struggle to find their footing. Do they want to be a software company? Do they want to be a managed services provider? While the challenges they face are relatable and their efforts to develop new revenue streams understandable, the bottom line is that managed service solutions are still not in the best interest of most tax functions. Risk is increased, shareholder value creation opportunities go by the wayside, and the cost savings the firms predict never occur.

However, the major accounting firms are not being intentionally misleading. The lack of significant in-house experience at the leadership level coupled with excitement over the potential recurring revenue fees has the Big4 making strategic decisions in what is essentially a vacuum.

Managing Pandemic-Related Challenges While Maximizing Your Budget

Full-scale outsourcing's main value proposition lies in short-term, situational scenarios, such as spinoff companies looking to fill the gap before being re-acquired, or company mergers involving multiple service providers. Unless such circumstances are anticipated, and with respect to the checkered history of outsourcing tax functions, there is nothing to indicate these solutions are advisable.

There was already an urgent need for the professional service firms to create new revenue streams, and nothing could have been worse for them than COVID-19 hitting at the same time. The firms were already in trouble, and the pandemic has accelerated it.

While this latest sales pitch is understandable, rather than outsource, we feel our clients will be best served by optimizing their consulting budgets themselves utilizing the Talent Economy. The coronavirus pandemic has added increased burdens to many elements of everyday life, but it has also created a unique opportunity for tax departments. For example, the sudden stay-at-home orders revealed the ease with which projects can be completed by remote teams.

Partial co-sourcing has many valuable applications. Along with access to top-tier talent, departments utilizing the Talent Economy enjoy a dramatic decrease in cost and greater optimization of their consulting budget. Companies such as TaxForce screen and match seasoned tax professionals with projects requiring their knowledge and experience. Engagements can be right-sized to both budget and workload, ranging from part-time, short-term engagements to carefully crafted teams that return year after year as predictable demand requires. (continued next page)

Access to remote talent across the globe is a game-changer, and along with the ability to hyper-target for the specific skills and experience a project requires, the TaxForce talent pool far exceeds that of all four of the professional services firms combined.

When addressing everything from seasonal workloads to unexpected medical leaves, financial leaders are no longer limited to traditional solutions. Instead of the managed services outsourcing solutions offered by the public accounting firms, tax leaders are able to utilize the talent economy to improve efficiency and optimize their consulting budget, while at the same time reducing risk, maintaining authority, increasing shareholder value, and all at a much reduced cost.

Seeking a macro-overview or targeted insight into managing your own outsourcing effort? Contact Stephanie Conley at 843-216-6664 to arrange a mutually convenient phone appointment with TaxTalent president, Tony Santiago.

RELATED COMPANIES

BUILDING AND MAINTAINING WORLD-CLASS TAX DEPARTMENTS SINCE 1987

TaxSearch, Inc. has been building and maintaining world-class tax departments since 1987. With a team of expert consultants and recruiters, TaxSearch, Inc. works to serve two primary markets in the tax profession. The being Tax, Finance, and HR leaders who have a proactive interest in aligning their tax function to the business goals and objectives of the companies they serve, and the second Tax professionals who have a serious desire to invest in their career growth and leadership development.

Learn more about TaxSearch, Inc. or contact us today.

OPTIMIZING TAX CONSULTING BUDGETS WITH JUST-IN-TIME TALENT

TaxForce is at the forefront of optimizing tax consulting budgets with just-in-time talent. The world's most successful companies turn to TaxForce as they trust they will client tax solutions that will help solve challenges that arise within their tax department.

Learn more about TaxForce or schedule an appointment today.

ACCURATE, RELEVANT AND TIMELY DATA FOR TAX PROFESSIONALS AND THE DEPARTMENTS THEY LEAD

For nearly 20 years, TaxTalent has provided accurate, relevant, and timely data for tax professionals and the departments they lead. As the world's largest online tax network, TaxTalent offers valuable career resource and performance-based services to its members for free.

Learn more about TaxTalent or join our online community today.

Looking for the Perfect Candidate? Click Here to learn more about our Job Board!

For Additional TaxTalent Publications, Visit Articles and Insights.

Additional Publications

2020 Global Tax Market Assessment
2019 Global Tax Market Assessment
2019 Tax Hiring Outlook
More Reports & Studies

Contact Us

3850 Bessemer Rd. Suite 110
Mount Pleasant, SC 29466
1-843-216-7444