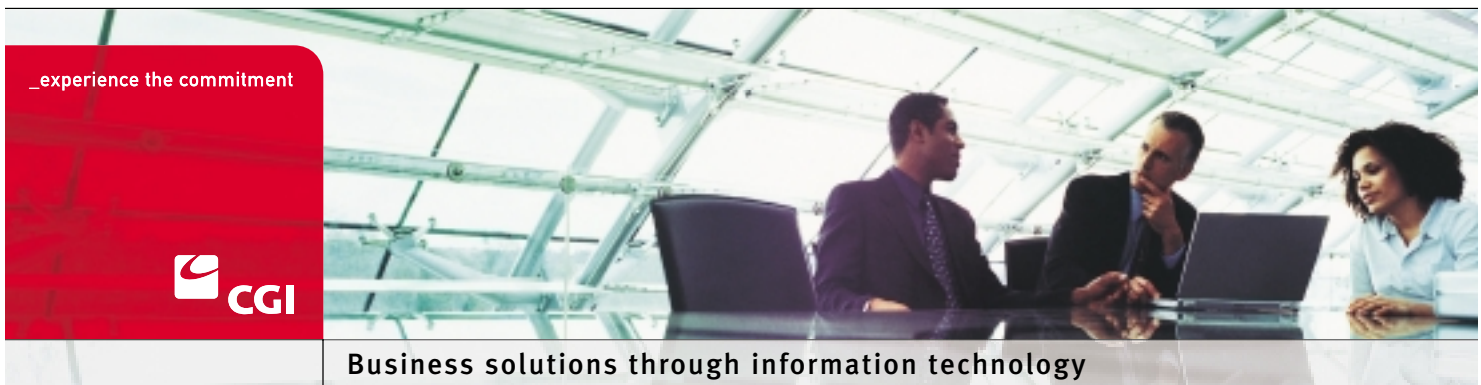


# Upstream goes outside: A business case for finance and accounting outsourcing in the upstream oil and gas sector



Business solutions through information technology

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Finding and producing oil and gas in the most efficient, reliable and affordable way possible is the core mission of the upstream oil and gas industry. The challenge is to fulfill this mission in an intensely volatile market environment—one marked by unpredictable price fluctuations, costly and onerous regulations, intense competition, mergers and acquisitions, and ongoing pressure to address health, safety and environmental concerns.

Success in the upstream business demands large investments of capital, ingenuity and agility in exploration and production, and strategic cost containment. To meet these demands, upstream companies in the early 1990s focused on reorganizing their operations, reengineering their business processes and investing in new technology. In the late 1990s, they moved toward consolidation. Large-scale mergers and acquisitions and joint ventures abounded as upstream companies sought to create synergies, gain economies of scale and increase shareholder value.

While consolidation continues today, oil and gas executives are exploring other strategies to improve the bottom line, including business process outsourcing (BPO). Finding it increasingly difficult and expensive to manage every business function, upstream companies are handing non-core areas of their business, including finance and accounting, over to outside service providers.

Finance and accounting BPO is on the rise as finance executives strive to add more strategic value to their companies. This paper explores the key drivers behind this growing trend in the upstream sector and provides guidelines for implementing a successful BPO strategy.

### **Why outsource?**

A key driver for many upstream companies in outsourcing finance and accounting functions is cost reduction. In the face of tight margins, upstream companies are under tremendous pressure to cut their costs. Companies that have measured their outsourcing gains have reported general and administrative cost reductions of 30-50 percent.

Outsourcing reduces headcount and associated costs, including wages, benefits and office space. In addition, it maximizes efficiencies and drives down costs by simplifying, standardizing, centralizing and automating finance processes through the use of best practices and advanced technology. Outsourcers also pass on cost savings through economies of scale by offering similar services to a wide range of clients.

Cost reduction, however, is not the only motivation behind finance and accounting BPO. A number of other strategic advantages are attracting oil and gas companies to outsourcing.

### ***Greater focus on core competencies***

The routine, low-level tasks involved in running a finance operation can be all consuming, taking management focus away from more strategic decision-making. By outsourcing mundane functions such as payables, joint interest billings, receivables and revenue distributions, finance managers can devote more time, energy and efforts to value-add initiatives such as analysis, budgeting, forecasting and strategic planning.

Outsourcing also gives executives the opportunity to reevaluate and reengineer their operations with the help of outside expertise. An experienced outsourcer can provide the insight and discipline needed to identify and revamp outdated business processes, a job that might otherwise be delayed due to a lack of senior management time, focus and objectivity.

### ***Improved regulatory compliance***

Complex business arrangements and strict government oversight impose an enormous administrative and compliance burden on oil and gas companies. Keeping up with changes to finance, tax and reporting regulations at the state and federal level is a constant challenge requiring a high degree of expertise and diligence.

Noncompliance can be costly, resulting in damaged reputations, huge fines, decreased shareholder confidence and even business failure. Senior executives, in particular, are facing intense pressure to ensure strict regulatory compliance. The Sarbanes-Oxley Act of 2002 holds CEOs and CFOs personally liable for the completeness and accuracy of corporate finance information.

Through outsourcing, upstream companies gain access to experts who work exclusively with the Minerals Management Service and with state regulatory bodies. These experts have in-depth knowledge of complicated tax calculations, reporting policies and deadlines. Often, the outsourcer can audit historical payments and reports to ensure that clients did not overpay or underpay their taxes. In addition, outsourcers provide highly defined processes and sophisticated technology solutions designed to improve the accuracy, timeliness, reliability and transparency of financial data and analysis.

### ***Access to the best minds and technology***

A declining talent pool is a major challenge facing the upstream oil and gas industry. Staff turnover, attrition and downsizing, coupled with an aging workforce, has resulted in a shortage of skilled workers. Finance, in particular, is a hard hit area. The number of graduates from petroleum accounting schools has dropped steadily over the years due to a consolidating industry that no longer holds the promise of long-term career security.

Through outsourcing, upstream companies avoid the pressure and cost of recruiting and retaining their own talent. Instead, they benefit from the expertise of finance and accounting specialists who are typically at the top of their profession in terms of education, training and experience. Because these professionals work with a host of clients facing similar challenges, they are adept in responding to the myriad issues an oil and gas company must deal with on a daily basis. This level of expertise ultimately results in the delivery of services that are higher in quality and lower in cost than in-house services.

Keeping pace with the rapid advance of technology is also an ongoing struggle for upstream companies due to the complexity and expense involved. Selecting, implementing, integrating, upgrading and maintaining finance software systems and the IT infrastructures required to support them are major hurdles to clear. Outsourcing, however, overcomes these challenges by providing the expertise, methodologies, tools and solutions needed to address an upstream company's unique and evolving requirements. As a result, the company can avoid a steep investment in hardware, software, training and staff and redirect that capital into its core business.

Growing companies need to be able to quickly ramp up their infrastructure scalability. Adding manpower is not always the answer, especially when inconsistencies in systems and processes further complicate growth. New organizations, spin-offs or companies expanding into new geographies or new technologies should consider the benefits of outsourcing from the very start. A predictable cost structure, driven by client volume, benefits both growing and downsizing companies.

### **Making outsourcing work**

Successfully transitioning a major business area such as finance and accounting over to an outside service provider is a decision that requires careful deliberation, planning and execution. To reap the full value of outsourcing, upstream companies should consider the steps outlined below.

#### ***Step 1: Counting the cost***

Many executives worry about whether outsourcing will actually cost their companies money. An in-depth cost analysis should be conducted to ensure the cost of outsourcing does not exceed the expected value. Three cost scenarios should be compared: 1) the current cost of

managing back-office finance and accounting functions; 2) the cost of conforming in-house processes with best-of-breed standards, practices and technology; and 3) the cost of back-office outsourcing.

Baseline in-house costs include such tangible costs as staff, infrastructure and IT applications management, as well as the intangible cost of lost focus. Data related to hardware, software, IT support, staffing and current business objectives should be gathered and fed into an open and configurable model that allows an organization to calculate its baseline costs.

“Ideal” in-house costs reflect what it would take to achieve the level of quality and performance expected from an outsourcer. It enables organizations to take into account the hidden cost benefits of outsourcing such as reduced risk, less downtime and greater availability.

The third metric involves an estimate of outsourcing costs for the specific processes and service levels required. This estimate should clearly specify items that are included and excluded to avoid the risk of hidden costs.

### ***Step 2: Building consensus***

Outsourcing affects every level of a company from top executives to front-line managers and employees. Initial reactions to the idea of outsourcing may be negative due to the major changes it will bring. Executives concerned with strategic fit and shareholder value may view outsourcing as a risky investment. Front-line managers may fear a loss of control and a diminishing of their roles and responsibilities. Lower-level finance and accounting staff will likely fear the loss of their jobs.

Building consensus at every level of the company is critical to the success of an outsourcing strategy. Forcing outsourcing on an organization makes it difficult, if not impossible, to establish an effective partnership with the service provider. Outsourcing must be accepted, not imposed, to succeed. To gain company-wide acceptance, benefits must be demonstrated and fears must be alleviated.

A thorough cost analysis will help to address the bottom-line concerns of executives. Outsourcing should also be presented at the executive level as a standard industry practice, not as something innovative.

Front-line managers who fear a loss of control should be persuaded that outsourcing is actually a form of enhanced control. Instead of investing valuable time in controlling day-to-day processes and employees, they are freed to focus completely on controlling results and the strategic direction of their organizations.

As a cost-cutting measure, outsourcing may involve layoffs. However, in some cases, finance and accounting jobs are moved over to the service provider. The career advantages of this transition need to be communicated to employees. By working for a company whose core business is focused entirely on their chosen profession, transitioned employees typically have more career advancement opportunities, as well as greater career challenges.

### ***Step 3: Choosing the right partner***

Choosing the right partner in an outsourcing arrangement requires extensive due diligence. Doing homework prior to any negotiations eliminates the risk of costly surprises down the road and helps to ensure a long-term, mutually successful relationship. Below is list of key criteria to consider in selecting a candidate.

- **Client references:** Conduct candid interviews with a cross-section of the provider's clients. Speak to at least three clients with similar needs and elicit detailed and honest feedback in response to the following questions: How long have you been a client? Why did you choose this provider over other vendors? How satisfied have you been with the provider?

Have there been any problems? If so, what types of problems have you encountered and how have they been resolved? How would you characterize the provider's strengths and weaknesses? How does the provider monitor service levels?

- **Experience and expertise:** In assessing the depth and breadth of an outsourcer's experience and expertise, consider the following questions: How long has the outsourcer been in business? How many clients does it serve? How many professionals does it have? What are its concentrated areas of expertise? What services does it offer? What types of solutions does it provide? Were these solutions developed in house? Are these solutions scalable? Can they be customized?
- **Service levels:** Customer service is the single most important criteria to evaluate in choosing a potential provider. Here are key questions to ask: Does the provider offer explicit service level agreements backed by financial guarantees? Does it have a record of delivering on time and on budget? Does it provide flexible change management processes? Does it adhere to rigorous quality assurance standards? What access will you have to help desk support?
- **Infrastructure:** Make sure to visit the prospective provider's facilities to gain a clear picture of its physical infrastructure and management expertise. Ask the following questions: What type of systems does the provider use? Are these systems proprietary or dependent on other technology companies for maintenance and support? Are there metrics demonstrating the systems' reliability, availability and scalability? Does the provider manage its own data centers or rely on a third-party ASP company? How experienced are its data center managers? How long have the managers been with the provider? What security measures and disaster recovery plans are in place? What are the provider's current and future infrastructure investment plans?
- **Financial health:** The financial health of a service provider is critical, particularly if it is less than 10 years old. The ideal candidate should have a track record of profitability and growth, a strong cash flow, large capital reserves, low debt and a diverse client base.

#### ***Step 4: Negotiating the contract***

Developing a good working relationship is the first goal of the negotiation process. Ideally, building a flexible partnership based on mutual trust and respect will be the guiding force in the parties' relationship, rather than a rigid enforcement of contractual terms. Even so, it is essential that the contract reflect concurrence on all issues—most importantly, those related to scope of services, performance and pricing.

The outsourcing agreement should contain a detailed description of services to be performed in a “Service Schedule” or “Statement of Work.” Without this, disputes will arise as to whether a particular request is within the scope of services to be provided. Services, service levels and deliverables should be carefully documented.

Performance incentives and penalties are also a vital component of any outsourcing agreement. The contract should clearly stipulate penalties for failing to meet service level requirements, as well as financial rewards for exceeding expectations. In addition, a provision allowing either party to terminate the agreement in a worst-case scenario is advisable.

Procedures should be laid out for changing the scope of services. Issues to address include the cost ramifications of changes and the personnel authorized to request changes for the client and approve changes for the vendor. In addition, if continuous improvement is a priority, definitions, measurements and pricing for such should be specified in the contract.

The best way to minimize disputes is to craft a contract that promotes a long-term relationship through the use of short-term service level agreements. Despite the parties' best intentions for forging a solid relationship, problems will inevitably surface. An effective gover-

nance provision that defines the steps to take in problem escalation and conflict resolution should be included in the contract.

#### ***Step 5: Ensuring continued value***

After the contract is signed, the outsourcer will be responsible for providing the contractually agreed services, but the client's management team, accustomed to managing people, must now oversee the work performed under the contract. Continuous supervision is critical to long-term success.

Some companies fail to invest the time and effort required to effectively manage an outsourcing relationship, or they relinquish management responsibility to the outsourcer. In either case, the outsourcer will begin to operate in a vacuum and service levels may deteriorate as the outsourcer loses touch with the company's business objectives.

Conversely, other companies make the mistake of continuing to closely manage the outsourced function. As a result, they fail to achieve the efficiencies outsourcing promises. Management of the outsourcing relationship is important, not the duties performed within it.

Applying contractual metrics is the wisest approach to keeping the relationship on track. Quantitative measures should be used to evaluate performance, as well as qualitative input from internal customers. Appointing an individual or group to handle all interactions with the outsourcer as a single point of contact is an effective means to ensure that the needs of both the client and the outsourcer are met on an ongoing basis.

The rapport between those responsible for managing the relationship on both sides should be positive and respectful. Viewing each other as committed partners is essential to building the mutual trust required to maintain a long-term relationship.

#### **Conclusion**

The pressure to drive down costs remains unabated within the upstream oil and gas sector. Upstream companies that have made the leap to finance and accounting outsourcing have not only discovered an effective tool for maximizing efficiencies and reducing costs but also much more. Through outsourcing, upstream companies are gaining a wealth of other strategic advantages to address their complex and evolving business challenges. With a good understanding of what it takes to succeed at outsourcing and a well-planned strategy, upstream companies will achieve the bottom-line results they need to stay competitive in an ever-dynamic market environment.

For more than 20 years, CGI has helped upstream oil and gas companies focus more on their core business and less on their back offices through business process outsourcing (BPO). To learn more about our oil and gas BPO expertise and experience, visit [http://www.cgi.com/web/en/library/solutions/oil\\_gas/74059.htm](http://www.cgi.com/web/en/library/solutions/oil_gas/74059.htm).

#### **About CGI**

Founded in 1976, CGI has worked with clients in a wide range of industries to help them leverage the strengths of information technology (IT) to optimize their business performance and produce value-driven results. We also offer a comprehensive array of business process outsourcing (BPO) services, enabling us to help manage and improve our clients' day-to-day business processes while freeing them up to focus more on strategic decision making. Our consulting, systems integration and outsourcing services provide a total solution package designed to meet our clients' complete business and technology needs. We approach every engagement with one objective in mind—to help our client win and grow. CGI provides services to clients worldwide from offices in Canada, the United States, Europe and Asia Pacific, as well as centers of excellence in India and Canada. Learn more at [www.cgi.com](http://www.cgi.com).