Keys to Success for Tax Automation & Outsourcing

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Introduction

Tax season seems to be getting worse every year. Last minute changes to the tax code, delayed tax software updates, workload compression and a shortage of experienced tax professionals continue to exacerbate what is already a grueling season for many accounting firms. Client fee pressures are forcing firms to figure out how to get more productivity out of their existing staff while not burning staff out and while still maintaining a high level of staff engagement.

Yet some firms have been showing strong growth and even increased work-life balance. To understand how these firms were bucking the general trends, we interviewed a variety of them to see if we could identify the secret to their success. The primary answers we found: increased tax automation and outsourcing.

Outsourcing Integral to Long-Term Success

One of the most common outcomes expected when applying technology is that the process you're working with will be "automated"—which generally means that the technology will do what was previously done by humans. However, as we conducted the interviews, we found that we needed to add the use of "outsourcing" to the study because firms were not only automating their internal processes, but often actually outsourcing much of the preparation of a return.

When the preparation of a return is outsourced, whether in part or as a whole, there is at least a human (that works for the service provider) involved in the process. The human involvement may be as minimal as the review of the accuracy of the numbers read by the Optical Character Recognition (OCR) software from the forms that were scanned and submitted. Or, in a fully outsourced return, a human performs the initial preparation of the return before it is provided back to the accounting firm for partner review and sign-off.

It is also important to note that outsourcing does not necessarily mean off-shoring. A tax outsourcing service provider may either utilize staff within the U.S. ("on-shore") or outside of the U.S. ("off-shore"). Use of on-shore vs off-shore outsourcing varied when discussed with interviewees and there was no clear preference for on-shore vs off-shore. The primary criteria for either seemed to be whether the firm thought the taxpayer would be comfortable using off-shore resources and would sign the firm's Section 7216 consent letter.

Firms that had longer term success in this area used a mix of both tax automation and outsourcing, so we included both automation and outsourcing in the definition of the keys.

Keys to Success for Tax Automation and Outsourcing

Four years ago we did research focused on audit automation. That research confirmed what we already knew to be best practices for technology adoption for general software implementations. We named these the "Keys to Excellence: Audit Automation"[1]. Our initial hypothesis was that these eight keys would also help ensure the success of tax automation. Interestingly, we found that hypothesis to only be partially true. The original eight keys for audit automation and the adjustments we had to make for tax automation are shown below in blue.

	Audit Automation	Tax Automation and Outsourcing
1	Appoint an Audit Excellence Officer	Appoint a Tax Automation Officer
2	Understanding Your Audit Process is Critical	Understanding Your Tax Preparation Process is Critical
3	Adopt Incrementally to Ensure Long-term Success	Adopt Incrementally to Ensure Long-term Success
4	Use a Proof-of-Concept to Build Your Business Case	Use a Pilot to Build Your Business Case
5	Manage Expectations; Don't Over Sell It	Manage Expectations: Attitude and Transparency are Important
6	Adopt Organically, but Make It Mandatory	Keep a Continual Improvement Mindset
7	Provide Training to Reduce Resistance to Change and Increase Adoption	Provide Training to Reduce Resistance to Change and Increase Adoption
8	Leverage Time Savings to Generate More Revenue	Adopt Value-Billing to Ensure Revenue Continuity

Through the rest of this paper, we'll explain the keys to success for Tax Automation and Outsourcing, and share other interesting insights we gleaned from the interviews.

Key #1: Appoint a Tax Automation Officer

As with any other system rollout, tax automation and outsourcing requires a focused and structured effort. However, unlike other system rollouts where a tool can just be made available to staff if they want to use it, the annual cyclical nature of tax season and the volume and intensity of activity during the season requires that tax automation or outsourcing be a well-planned and coordinated initiative.

To ensure success, assign one person to be the Tax Automation Officer (TAO) to spearhead the initiative. This person is responsible for ensuring that the returns that go through the automation or outsourcing process are properly handled and managed in accordance with the rest of the tax department's workload. The TAO should have enough bandwidth to help educate and support professionals using the output from automation or outsourcing, especially in the proof-of-concept and early adoption phases. This person also needs to be able to triage problems occurring with the process or output from the automation.

In the firms that we spoke with, the position of the person filling the TAO role varied quite a bit, but it was always a hands-on role. In smaller firms it was a tax partner or tax manager. In larger firms, it was: (a) a seasoned admin person who coordinated all of the tax return assignments, (b) tax managers with a process focus (rather than a technical focus), (c) a tax manager who oversaw all of the returns that were going through the proof-of-concept, or (d) the person responsible for overall tax operations.

The primary responsibility of the TAO is to figure out what was working or not working related to the automation or outsourcing. If something wasn't working, this person had to identify what was causing the problem (e.g. badly scanned taxpayer source documents) and enact a corrective action for subsequent returns that were then put through the same process (e.g. verify quality of scans before submitting to service provider). Only if the issues were so severe it was going to impact the quality of the return or cause excessive downstream impact was automation allowed to be abandoned on that return. Because of the annual nature of tax preparation, it was important to work through issues within a season as much as possible rather than defer it to the next season.

At the end of the primary busy season, the TAO should also facilitate a lessons learned session and identify the improvements to be implemented for either extensions or the next tax season. If automation or outsourcing proved to be a poor fit for the firm (either in whole or in part), then this person would be the one to validate the reasons for non-adoption, confirm the cancellation of the rollout with the partners, and ensure proper archive or export of any data left in the system.

If the TAO is not a partner, then the TAO should have direct access to a partner that will provide the executive level support for the initiative. Either the TAO or the partner should communicate results and progress to the other tax practice leaders to ensure the transparency of the initiative at the partner level. Progressive firms found that this helped to eventually win over any skeptical partners and achieve buy-in.

Key #2: Understanding Your Tax Preparation Process is Critical

Having a detailed understanding of the tax preparation process was critical to the firms that had long-term success with automation and outsourcing. Firms with broad adoption (adoption throughout the tax department) also cited the importance of understanding their own processes first at a very detailed level, and then figuring out where automation or outsourcing would impact those processes, and for which returns. One interviewee commented: "[it is] really important to understand what your processes are before you get to adding [automation or outsourcing]. We didn't have to re-invent the wheel because we knew what the basic process was…and everyone knows what they're supposed to do at what point."

Process documentation generally took the form of flowcharts or detailed procedural documents, and included who was responsible for what tasks and when. When developing process documentation it is important to capture the flow of the tasks and their interdependences. This will help you to identify critical paths in your tax processes and can eventually allow you to predict whether a return will be completed before the deadline or need to be put on extension. Insight into these critical paths is also essential if you are trying to reduce the overall cycle time for a return (i.e. the elapsed time from when a client submits all their forms to you, to the finalization of the return and close out of the engagement).

Tax automation and outsourcing vendors should be able to provide you with some assistance in this area. At a minimum, they should provide you with a flowchart of how their software or service works and where it will require input or interaction with your firm's staff. Vendors should also provide you with tips on how other customers have successfully incorporated their software or services into their firm's processes and procedures. A good vendor will actually help you map out, in a mid-level of detail, what your process will look like with their software or services incorporated when implemented. You can then use that as the basis for developing your detailed procedures and internal workflows.

Remember too that process improvement benefits can come in two primary forms: (1) efficiency gains and (2) effectiveness gains. For a tax return, *efficiency gains* equate to the ability to complete the return with less direct staff effort, which generally equates to lower cost to prepare the return. In the grander scheme, it may also mean that you're able to complete more returns with the same staffing or provide greater work-life balance during busy season. *Effectiveness gains*, on the other hand, means that you've improved your quality of service—perhaps by being able to complete a return instead of having to extend it, or by allowing professionals to spend more time on either more complex returns or those with highly technical issues, to ensure that the return is prepared correctly. Tax automation initiatives can be focused on one or both of these benefits.

Key #3: Adopt Incrementally to Ensure Long-term Success

Because a tax department is often dealing with a high volume of returns, incremental adoption is a good strategy for tax automation and outsourcing. Consider using a phased/incremental approach to help mitigate the impacts of the change to your processes and firm budget. With this approach, a full rollout is divided into logical increments or "smaller chunks".

The incremental adoption approach allows a firm to identify which of its return characteristics make it good candidate for automation or outsourcing. Here are some of the logical increments to consider:

- **Type of engagements:** Firms should look at the broad categories of individual and business returns, and then distinguishing characteristics within the category of each return. Especially if processes are not yet documented (see Key #2), the approach of starting first with a single type of engagement where the process is the same for all the returns, reduces the amount of prep work you have to do to ensure the success of each increment.

- **Complexity of engagements:** Consider selecting less complex engagements first so that staff can focus on learning how the automation helps them or changes their tasks. Conversely, some firms may choose to roll out a tool to more complex engagements first because the benefit to the more complex engagement may be greater than in a less complex one. For example, several firms mentioned starting with "kiddie returns" because of their simplicity. On the other hand, another firm started first with returns with a high volume of forms (e.g. W-2s, K-1s) because that was what that took staff a long time to input, so outsourcing the data entry for these returns allowed the returns to be completed faster.

- **Phase of the engagement:** Tax automation has four primary phases: (1) Taxpayer Document Scanning—to replace data entry and possibly includes verification of data, (2) Return and Workpaper Preparation & Review, (3) Return Delivery, and (4) Electronic File Storage (e-Storage)—to replace all of the paper files of the completed return and supporting documents with electronic records. Tax outsourcing usually means that the entire return preparation is performed by the vendor with just the review, and possibly client follow-ups, performed by your firm. By far, firms seemed to have started with moderate volumes of Scanning, sometimes combined with smaller volumes of Outsourcing. There was also the general pattern that once comfortable with Scanning, firms then moved on to try Outsourcing within a year or two. We found e-Storage to have the most variable level of adoption, except for one firm that didn't have enough room to store their tax files in-house. For them e-Storage was the first solution they deployed department-wide since it eliminated the need to request boxes from their external storage (and the associated cost).

- **Engagement staffing:** The attitude of staff toward automation and outsourcing can impact how quickly and broadly it is adopted. For example, rolling it out to staff who are more skeptical may result in them finding more problems and amplifying the negative aspects of the initiative. Instead roll it out first to staff who are more open to working through the problems and who are willing to help determine the characteristics for what returns are good candidates for automation or outsourcing. This increment can be combined with another increment option to isolate the impact to the firm too. For example, all 1040s for a particular manager may be included in the initiative. In a larger firm, this may also be an office by office rollout.

There is no "right" answer to how to best choose an increment. Each firm has different factors to consider in its engagements, staffing, processes, and workload in making this decision. Remember that the main objective is to identify smaller "chunks" of the firm's workload, where scope and impact of change can be better controlled and risk better managed to increase the probability of success of the rollout over time.

When looking at full tax return preparation outsourcing, one firm provided an insightful criterion that makes a lot of sense: returns that don't have significant changes from the previous year are outsourced. Their reasoning was that the prior year return could be used as a benchmark, so this made the return itself less risky and the review easier, despite not having the person who worked on the return there to answer questions. The limitation of this approach is that you may not be able to determine which returns can be automated or outsourced until after the client submits their documents or at least until they have been contacted to determine if significant changes are expected.

Key #4: Use a Pilot to Build Your Business Case

When possible, use a pilot—a controlled "test drive" with a sampling of the firm's clients/engagements using a particular automation or outsourcing service. When tax automation and outsourcing services are sold in a "per unit" pricing model, it lends itself very nicely to applying this key since you can purchase a set quantity of units from a vendor to try out their product or service.

Some people may note that we changed the key from "proof of concept" to "pilot". This is to stress that this needs to be more than just a small experiment. One major difference between a tax automation pilot and other projects where you may use a proof-of-concept, is that because tax season has annual cycles, you really need to ensure that you are able to get a good feel for the product or service within a season. Otherwise it will take years to get the pilot to full adoption. So you need to push a fairly significant amount of returns though the pilot.

The objective of the pilot is to gather lessons learned and determine how best to use the automation or service before rolling it out to the entire firm. Since usage procedures and process changes can be identified and tested with a smaller group, this will help to minimize the disruption that a tool may cause, and also ensure a smoother adoption when rolled out to a larger population of returns.

Using a pilot approach provides several benefits. It will allow those participating in the pilot to:

1. Become familiar with how the automation or service works before having to use it on a lot of engagements. As previously mentioned, this also allows the characteristics that make a return a good candidate for automation or outsourcing to be identified. The population of candidate returns can then be identified and the volume of service to purchase can then be determined.

2. Determine what changes will need to be made to tax return processing procedures and timing. If necessary, procedural documentation and staffing schedules can also be updated to factor in the automation or outsourcing impacts.

3. Quantify the benefits of the tool. Many firms don't have a feel for the true cost of their manual processes. Have people track the actual time it takes them to perform the manual process for a sampling of engagements. Pilot teams should also track the actual time spent performing the same process when leveraging the automation or outsourcing. In the case of a recurring client, the time taken to prepare previous years' returns can be used as a benchmark. These two metrics can be compared to estimate the benefit that could be realized by automating a larger volume of returns.

4. Quantify the total cost of full adoption. Once the key characteristics for the various types of returns are identified, and the impact in hours required to complete returns estimated, the firm can determine how much of its workload can be automated or outsourced next tax season. This can be used to drive staffing decisions or whether to accept or decline additional work.

5. Determine the ROI or payback period. Sometimes cost savings may not be realized in the first year due to up-front implementation and learning costs. However, future periods should have increased efficiencies. Remember to also include the potential for increased revenue or staff productivity in the analysis, which can greatly increase the ROI or decrease the payback period.

Be sure to include a good diverse sample of clients and engagements in the pilot so that you can determine if different situations need to be handled differently or have different benefits/costs. This will also help to ensure that cost and benefit estimates also extrapolate well to the full population of clients and engagements.

Again the "sample" chosen for the pilot should be a fairly significant amount. Consider an amount that is manageable by the TAO in the event there are issues. As you'll read in the next key, it's really about pushing through and learning how best to leverage the vendor. Remember, because tax season is an annual process, you will need to push through the pilot and figure out what is making it work, or not work; so that you can adjust it next season—otherwise it will take years to complete your rollout.

The result of the pilot phase, should be a business case by the champion of the initiative, describing the outcomes realized by the engagements in the pilot and an analysis of the costs and potential benefits of the pilot itself, as well as for the firm as a whole. Lastly, the champion should provide a recommendation for whether to, and how to proceed with a department-wide rollout.

Key #5: Manage Expectations: Attitude and Transparency are Important

Usually with technology initiatives, we always have to remind their champions that everyone hates it when a vendor totally oversells the benefits of their products—so don't oversell the benefits or make wild promises of how the initiative will be so much better. However, initially none of the firms that we talked with said that they worked actively to manage expectations via the normal change management techniques.

The commonality that we found though, was that all of the firms went into their first tax automation initiative with a commitment to make it work. So rather than the expectation being a particular workload benefit or profitability increase, the expectation was that they would make the initiative successful one way or another. Many of them also shared that they went into the initiative knowing it was going to be "painful". One interviewee explained that it was all about attitude: "If you *get it*, you're open minded and explore it. If you don't *get it,* forget it. Once you *get it* and you make a system that you can best utilize in your firm, then it's just a matter of monitoring it. Get broad ownership across the firm and it will work really well."

All of them also had partner-level support and effectively kept the partner group informed of what was working or not working, and how they were moving forward. Even partners who were skeptical were still kept informed of the progress. One interviewee shared that in one case the partner that was the biggest skeptic was turned into a believer because the turnaround time for the automation was faster than the internal staff, so he started pushing returns that he wanted back faster through the automation rather than assigning them to staff.

Key #6: Keep a Continual Improvement Mindset

You're probably tired of hearing repeatedly that identifying the characteristics of good candidate returns are they key to tax automation or outsourcing. But that was definitely a consistent and strong message from all of the interviewees. "Trial and error" was mentioned quite frequently with interviewees citing that they weren't experts in the automation technology and that there wasn't an easy way to predict what would work or didn't work.

Firms that had longer term success had identified their sets of criteria and applied them to all of their firm's returns before the start of the season. In some cases, they even applied them after the completion of the last tax season to determine initial quantities for the following year. This allowed them to take advantage of vendor promotional pricing for early purchase commitments. Improvements in automation capabilities were also assessed each year and criteria adjusted as needed again at the start of busy season. Additionally, firms with longer histories of automation and outsourcing included process improvement discussions as part of their post-busy-season debriefs.

The key takeaway is that to maximize the value derived from automation and outsourcing, continual improvement of the process and refinement of the criteria to identify candidate returns is required.

Key #7: Provide Training to Reduce Resistance to Change and Increase Adoption

As emphasized in Key #2, detailed process documentation is the extremely important for tax automation and outsourcing. When done correctly, process documentation can be leveraged to develop procedural manuals and for staff training. Especially when transitioning an initiative from proof-of-concept or pilot to broader use, it is important to train the staff on how the *process* for the preparation of returns will change based on the automation or outsourcing.

Training strategies varied quite a bit among interviewees. Some used the vendor's training, others developed their own training modules. Some did tax department-wide training, and some only trained people on the parts of the process that were relevant to them. The primary outcome of all of the training approaches was that people were made aware of how the automation or outsourcing was going to impact the work flowing to or from them. This created the awareness of the changes that were being enacted and established how each person was expected to fulfill their part in the new process.

As noted above, part of the purpose of a proof-of-concept is to figure out how to rollout the initiative to different types of returns. Use the learning from the proof-of-concept to develop cheat sheets and to document internal best practices that guide staff through the new processes. Consider using the vendor's self-paced learning to help staff understand general concepts of automations, then follow-up with firm-specific training, showing how the firm's internal processes and procedures have been adapted to leverage automation or outsourcing.

Key #8: Adopt Value-Billing to Ensure Revenue Continuity

While value-billing wasn't used by all of the firms, many of those that haven't yet adopted it were either planning to move toward it or considering it. In some cases, firms were passing on the automation or outsourcing cost as a technology or service fee with a markup. Additionally, since automation often results in staff spending less time on a return, if you aren't using value billing then there is also potentially a drop in revenue. Sometimes a price reduction might be the strategy if you are automating to try to remain competitive—however, many value billing advocates will tell you that you're selling your firm short if are you just competing on price.

Since most tax staff are exempt employees, what most firms don't realize is that to fully realize cost savings from tax automation there actually needs to be a reduction in staff. Some firms shared that rather than terminations, they realized cost saving by not replacing staff that left and also by not bringing in as many seasonal hires for busy season.

Alternatively, tax automation and outsourcing can also help a firm to grow its revenues if it uses the staff time that is freed up by the automation to take on additional clients or provide additional value-added work (like tax planning) to its existing clients. Again, since most tax staff are exempt employees, the cost base remains the same, but in this case revenue, as well as profitability, is increased.

Another strategy that was used by some firms was to shift the initial data entry work usually done by professionals to admin staff or interns. This made staff that was not normally billable, now revenue generating, which helped grow top line revenue. Both of those staff classes also usually cost less than professional staff, so the cost base for the same function is also lower, which results in higher profitability.

However, revenue growth or profitability wasn't necessarily the only driver for many of the firms. Many saw automation and outsourcing as ways to help decrease staff workloads and improve work-life balance during busy season. In the bigger picture, this should also help with staff retention and indirect costs that come with turnover like recruiting, on-boarding, and training expenses, which academic studies estimate to be between 150% to 241% of a staff's annual salary[2].

Leverage the Keys to Maximize Your Success

When considering a tax automation or outsourcing initiatives, care must be taken to ensure that the initiative doesn't make an already grueling busy season worse. Leverage the eight keys above to maximize your success, and to minimize the risk of negative impacts. You don't have to use all eight keys for every initiative. Generally, five to six keys will be applicable in a first initiative. Apply additional keys as you evolve or expand the initiative for future tax seasons and, as Keys #3 and #6 say, iteratively increment and continually improve, to ensure long term success.

Remaining fully manual is no longer an option. Tax automation and outsourcing is the way of the future—is the path to start on now. Firms who just started their automation and outsourcing initiatives are applying the keys to ensure that they are able to emerge from busy season with happy clients and staff. Firms who have longer standing automation and outsourcing initiatives have seen increased margins, improved staff work-life balance, and have grown their practices.

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If you are interested in participating in future research, please contact us at research@intraprise.us.

About the Author

Donny Shimamoto, CPA/CITP, CGMA, is the founder of IntrapriseTechKnowlogies LLC, a CPA firm focused on organizational development and advisory services for the middle market. An active CPA, Certified Information Technology Professional (CITP), and Chartered Global Management Accountant (CGMA), Donny helps many organizations by bridging accounting and IT to strengthen organizational governance and risk management, improve business processes through IT, and increase the effectiveness of decision making through business intelligence.

Donny also serves as an outsourced IT Audit "Partner" and advisor for smaller regional/local firms and internal audit departments who lack in-house IT management and IT audit expertise, helping with IT risk assessments and enabling increased staff proficiency with IT tools supporting internal and client engagements.

Donny is the immediate past chairman of the AICPA's Information Management & Technology Assurance (IMTA) Executive Committee, and former member of its Governing Council and Assurance Services Executive (ASEC) Committee. He has worked on several international collaborations between the AICPA and CIMA related to business intelligence and is also a frequent speaker on how management accountants can help add-value to their organizations.

Donny was recognized as one of the Top Thought Leaders in Public Accounting by CPA Practice Advisor from 2012 to 2016, Top 100 Most Influential by Accounting Today in 2013 and 2014, received the 2009-2010 President's Award from the Hawaii Society of CPAs, and was named to CPA Technology Advisor's 40 Under 40 list in 2007, 2009 and 2014.

Endnotes

1 "Automation is Key to Improving Efficiency and Effectiveness of Audits"; Donny Shimamoto; CPA.com (formerly CPA2Biz); 2012

2 "Accounting for the costs of recruiting and training"; Linda Twiname, Helen Smujh, and Steven Rae; Waikato Management School, The University of Waikato, New Zealand; 2011