

Outsourcing by legal practitioners

By the Financial Forensic Investigations Unit of the Attorneys Fidelity Fund

Outsourcing of services, products or functions has become prevalent in today's contemporary business. This practice has proven to be effective, but it also brings risks that must be recognised and managed. It has become a key component of many businesses including law firms, partnerships and sole proprietors. With the rapidly changing political, economic, sociological, technological and legal environment, most entities outsource their services, products or functions to third parties or vendors *vis-a-vis* using in-house solutions. Practitioners in the legal fraternity are not an exception to this practice.

Following on our previous article in 2015 (July) *DR 29* titled 'Find the problem before it finds you', it is our intention to start tackling certain areas of the practices with the aim to assist practitioners with those areas of their businesses that require attention, and specifically to assist newly qualified practitioners who intend practising or just started practising for their own account. This article tackles the area concerned with outsourcing of certain functions/activities.

What is outsourcing?

There are many definitions given to outsourcing, but the following definitions have found favour with us:

Investopedia (www.investopedia.com/terms/o/outsourcing.asp, accessed 11-8-2015) defines outsourcing as: 'A practice used by different companies to reduce costs by transferring portions of work to outside suppliers rather than completing it internally'.

The Business Dictionary (www.businessdictionary.com/definition/outsourcing.html, accessed 11-8-2015) on the other hand defines outsourcing as: 'The contracting or subcontracting of noncore to up, personnel, time, and facilities for activities in which a company holds competitive advantage'. It goes on to reflect further on the concept of outsourcing to say: 'Companies having strengths in other areas may contract out data processing, legal, manufacturing, marketing, payroll accounting, or other aspects of their businesses to concentrate on what they do best and thus reduce average unit cost'.

In outsourcing, the company effectively relies on someone else, outside of the company, to run certain functions/activities on its behalf. The expansion of outsourcing over the years, and the anticipated continued existence and expansion, as well as the risks associated with outsourcing, have necessitated the publication of this article.

While outsourcing in broad terms can go through a spectrum of functions/activities, including portions of the core functions of a business, we intend to deal mainly with the non-core functions/activities of the legal business in this article. Outsourcing has mainly been noted in the areas of information and communication technology (ICT) and accounting services (AS) within law firms and practitioners. The former includes services such as e-mail accounts administration, systems and software user support services, files or records management services, among other services. T Kern & L Willcocks 'Exploring relationships information technology outsourcing: The interaction approach' (2002) 11 *European Journal of Information Systems* 3 defined 'information systems outsourcing' as 'a process where an organisation decides to contract out or sell the firm's IT assets, people and/or activities to a third party supplier, who in exchange provides and manages assets and services for an agreed fee over an agreed time period'. The latter may include accounting services that comprise of the preparation of financial statements and other related accounting records, including trust accounting records. Looking at the foregoing paragraphs, it is clear that when a firm outsources some of its functions/activities, the third party runs with that portion of the outsourced function, however, the responsibility and accountability cannot be outsourced, and remains with the practitioner. For example, outsourcing of ICT does not absolve the practitioner of his or her responsibility to maintain a trusted system with integrity in order to produce reliable information, nor does an outsourced party become responsible for preparation of proper and reliable accounting records. Instances have been found where a practitioner will blame incorrectness of records on an outsourced party, this should not be the case. This, therefore, reflects that the risks associated with the functions/activities are not outsourced and remain the risks of the outsourcing party, the practitioner. This requires of practitioners to carefully consider the benefits and risks that the outsourcing arrangement may bring for them. The below paragraphs address some of the elements that practitioners should consider when deciding whether or not to outsource.

Who can and when to outsource?

Practitioners mainly outsource certain functions/activities in order to pay more attention to the core business and to grow their businesses. Any legal practice can outsource some of its functions/activities, more especially the non-core functions, irrespective of its size. Legal practices' main focus should be in providing legal services to its clients. However, in doing so, some functions become necessary in order to ensure compliance with legislation, rules and regulations. For example, while a practitioner is mainly concerned with providing the legal services, the practitioner is also required by legislation and rules and regulations to maintain and extract accounting records on the trust account, while other legislation may also requires preparation and issuance of annual financial statements for the business. The practitioners make use of information technology (IT) systems to adhere to the requirements of these pieces of legislation.

The environment in which any practice operates comprises of the internal and external factors. This requires of practitioners to do a strengths, weaknesses, opportunities and threats (SWOT) analysis. Strengths and weaknesses are internal to the practice, while opportunities and threats are external. This analysis is a step towards identifying risks and opportunities for the practice. Risks are events that can negatively affect the objectives of the practice, while opportunities are those events that can enhance the achievement of the objectives.

Merits and demerits of outsourcing

As the saying goes 'every side of a coin has another side', and so outsourcing has its merits and demerits, which require consideration in making a decision on whether to outsource or insource.

Merits of outsourcing

- Where practitioners do not have the necessary expertise to run the IT function or any other function within the practice they may hire third parties/vendors with such expertise to carry out the function on their behalf. Since these vendors possess the necessary skills, knowledge and competences, their use may result in effective and efficient completion of the tasks at hand. For instance practitioners that prepare accounting records using outdated accounting packages may opt to contract third parties that host efficient and modern accounting packages.
- Outsourcing certain non-core functions may enable the practice to focus on its core activities.
- Outsourcing may reduce overhead costs associated with running operations within the practice. The practice may save on time, effort and infrastructure hence ultimately reducing overhead costs.

- When operations of a practice become uncontrollable due to capacity constraints or any other reason, outsourcing may help to overcome such challenges. Where the practice is growing or its client base is growing amid infrastructure constraints, then outsourcing may salvage it from such constraints.
- If ICT and AS are outsourced, the practitioner gets a level of comfort regarding the independent preparation of accounting records. For this comfort to be realised, collusion between in-house staff members and third parties should be carefully managed.

Demerits of outsourcing

- Outsourcing of services could result in exposure of confidential information. This could adversely affect the reputation and therefore requires close management.
- Outsourcing may be viewed to limit the growth/development prospects of internal staff.
- Outsourcing, if not properly managed, may create an environment of redundancy within the practice staff, which could result in other employees losing interest and ultimately affecting the quality of their work.
- Poorly constructed outsourcing contracts could cost the practice instead of bringing benefits for the practice. Contracts may not contain confidentiality and/or penalty clause where the service provider fails to provide the required level of service.
- Poor administration of outsourcing contracts and over-reliance on service providers.
- Practitioners may outsource to unreliable third parties who have a long-standing relationship with them and therefore conceal the wrong-doings of the practitioner/practice, thus misleading the users of the information coming out of the reporting.

It is imperative that each practitioner carefully studies the requirements of the practice in order to decide whether or not to outsource its functions/activities.

What are some of the key considerations for a practitioner deciding on whether to outsource or not to outsource function/activities?

- Is the practice finding it difficult to meet its clients' needs and other stakeholder's needs due to resources being tied up in non-core functions? Is this difficulty posing a threat to client and stakeholder satisfaction? In other words, are products/service offerings compromised?
- Does the practice have growth ambitions or is the practice experiencing growth in terms of their service/product offerings and/or coverage? Is the firm therefore experiencing capacity constraints?
- Is the practice's staff not well equipped and/or empowered to perform the duties effectively and efficiently?
- Is the practice experiencing challenges based on operational and/or administrative issues?

- Does the practice lack the expertise necessary to ensure growth of the practice?
- Does the practice engage in important non-recurring projects/service/product generation but no resources to handle them?
- Is it financially non-viable for the practice to employ in-house resources to deal with non-core functions?
- Does the practice find itself in an environment where it is difficult to compete for client base?
- Does the practice have the appetite for risks that may be posed by outsourcing?

If the answer to the above questions is yes, then the practitioner may consider outsourcing certain components of its business, thereby releasing some of the tied resources to focus on the main service offerings. The list of considerations is endless, and the practitioner should consider as many factors as possible within the context of the environments in which they operate in making the decision.

It is important that management of the practice manage their third party contractual obligations and relationships in outsourced functions/activities. The following considerations should be made in this regard –

- practitioner(s) should ensure proper oversight over the outsourced functions/activities, the responsibility and accountability for the functions remains theirs;
- practitioner(s) should conduct in-depth due diligence reviews on third parties or vendors to determine their competence and suitability. The due diligence should, among others, ascertain by how far the third party understands the legal fraternity, the legislation governing it, the requirements of that legislation and applicable rules and regulations, other clients that the third party has serviced in the past and currently servicing, the reviews of other clients of the third party, etcetera;
- document service level agreements outlining duties, obligations and responsibilities of each of the contracting parties;
- alignment of service offerings by the third party with internal policies and procedures, which in turn, should not be in conflict with applicable legislation;
- a clear understanding of whether the contracted party will render the services themselves or if they would further source a service provider as that would have an impact on the cost of outsourcing;
- confidentiality agreements between the parties as practitioners are bound by legislation to maintain confidentiality; and

- ongoing oversight of third parties and their activities. This may become vital where third parties engaged by practitioners are implicated in activities that may damage the image of the practice.

The considerations suggested in the foregoing paragraphs should form part of the risk assessment that the practitioner should perform in engaging third parties. Practitioners are referred to 2015 (July) *DR* 29, dealing with the key components of Enterprise Risk Management. Readers are further referred to 2015 (July) *DR* 23 dealing with the Legal Process Outsourcing.

In conclusion, challenges faced by practices are different, and therefore the responses to these may also differ. In employing the best solution to suit your circumstances, each practitioner should consider their own environment, the risks posed by those environments, the possible solutions and their potential to fail. It is not always feasible for a practitioner to do everything, outsourcing options are there to be explored and carefully managed to yield the anticipated returns.

Outsourcing can be good or bad, your decision must be informed.

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