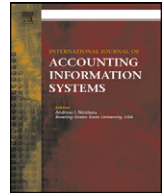




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Outsourcing accounting information systems: Evidence from closed-end mutual fund families☆☆☆



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ABSTRACT

This study examines the factors associated with the decision of closed-end funds to outsource their accounting information systems. Using data from 2010 and 2011, we find that the outsourcing decision is made by groups of funds with common service providers (called “fund families”), rather than by individual funds. Our results indicate that fund families containing a larger number of funds and older fund families are less likely to outsource their accounting functions. These types of fund families may have greater internal economies of scale, diminishing the potential cost savings from outsourcing. We also find that fund families with more good-faith-valued assets are less likely to outsource accounting information systems than those with more market-valued assets. Valuing these good-faith-valued assets is both an important investment-management process and a key accounting task, reducing the need to outsource accounting to focus managers on their core competency. This study is of potential importance to investors and regulators in evaluating closed-end funds' decisions on outsourcing accounting functions.

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☆☆ Data availability: data are publicly available from sources identified in the paper.

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1. Introduction

There is a rich literature on hiring outside parties to perform various business functions (i.e., outsourcing), especially in the areas of information technology, human resources, and logistics.² More limited research has examined outsourcing of accounting processes, with most of these accounting outsourcing papers examining factors related to internal audit outsourcing (e.g., Carey et al., 2006), and how internal outsourcing may affect the external audit process (e.g., Desai et al., 2011).³ Other papers in this area have been non-empirical descriptions of the potential benefits of, and hindrances to, accounting system outsourcing (e.g., White, 2001; Duganier, 2005; Krell, 2008; Desai and McGee, 2010) or predictions about accounting outsourcing (e.g., Robertson et al., 2004).

A few studies have examined the outsourcing of accounting processes other than internal auditing, such as financial reporting or payments functions (e.g., Everaert et al., 2010; Kamyabi and Devi, 2011a). Many of these papers are based on relatively small samples and/or case studies (e.g., Nicholson et al., 2006; Hamzah et al., 2010; Maelah et al., 2010) as a result of the limited public disclosure related to outsourcing issues for most companies. Most of these studies also examine the outsourcing of certain accounting processes, but not the entire accounting process.

Closed-end mutual funds often outsource their entire accounting information system, including information technology (IT) processing and financial reporting.⁴ For these funds, the accounting information system's principal task is to determine the fund's net asset value (NAV) based on the fair value of the assets held by the fund. Mutual funds are also required to disclose the names of organizations providing services to the fund, including the fund's administrator and/or the accounting agent for the fund.⁵ In most other industries, there are no consistent disclosure requirements by which outsourcing can be reliably measured (Premuroso et al., 2012). The closed-end mutual fund industry is also sufficiently large to empirically test predictions about the antecedents of accounting systems outsourcing.

The objective of our study is to adapt existing theories of outsourcing to the outsourcing of accounting information systems in the closed-end fund family setting. We then develop empirical models to test these theories in the closed-end fund environment. The closed-end fund family setting is appropriate to test factors related to outsourcing because many of these funds outsource all of their accounting processes. Also, these funds frequently invest in less liquid securities (Cherkes et al., 2009), which we posit may be related to the likelihood of outsourcing accounting systems.

Some of the principal rationales for outsourcing are the potential for cost savings, and the preservation of capital and managerial attention which can be focused on core competencies (Bradsher, 1996). From a cost saving perspective, we expect smaller fund families to be more likely to outsource their accounting processes, as outside service providers may enjoy greater economies of scale (e.g., Barrar et al., 2002) than a smaller fund family. These economies of scale would enable the outside service provider to charge fees smaller than the costs the fund family would incur to perform accounting in-house. Consistent with this expectation, we find a negative relationship between the number of funds in the fund family and likelihood of outsourcing.

From a core competency perspective, we expect older fund families may be less likely to outsource their accounting systems as they have had more time to develop financial reporting expertise and IT/control systems. These older fund families may also have more capital available to invest in the development of in-house accounting processes. Consistent with this idea, we find a negative relationship between the age of the fund family and the likelihood of outsourcing.

² Literature reviews in each of these area can be found in Lacity et al. (2009) for information technology outsourcing; Cooke et al. (2005) for human resources outsourcing; and Razzaque and Sheng (1998a,b) for logistics outsourcing.

³ See Bierstaker et al. (2013) for a broader discussion of the potential effects of outsourcing on the auditing process.

⁴ Beasley et al. (2009, p. 81) also note that information system outsourcing can encompass not just IT, but also IT "enabled processes, such as accounting...".

⁵ Note that all mutual funds outsource their accounting information system in the strictest sense of the word "outsource" as these funds usually have no employees (AICPA, 2012, § 1.17), but instead hire organizations to perform services on their behalf. When discussing outsourcing among closed-end funds, we are referring to whether the organization performing the accounting processes is affiliated with the investment advisor/portfolio manager (in-house) or independent of the investment advisor/portfolio manager (outsourced).

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