



# OUTSOURCING your payroll

## Managing the process for the best outcome

By Ian Turnbull

**O**utsourcing part or all of the payroll process is a common and misunderstood practice for many organizations in Canada.

What does outsourcing the payroll function mean? It has different meanings in different situations. In some cases, it is the total sub-contracting of the payroll function to an external provider including all personnel. In most cases, it means contracting with a service bureau to provide electronic processing of the pay cheques, the bank transfers and the government remittances and the production of reports.

Because outsourcing is common practice for payroll, the input of the payroll professional is crucial. The fact is that the payroll function is rarely completely outsourced.

Even if some payroll activities are outsourced, the responsibility still lies with the organization and not with the service

provider. Having trained payroll professionals on staff to deal with the complex issues that can arise is essential. Payroll service providers cannot do their job without receiving timely, accurate information from the companies they are supporting. This is one more reason why payroll professionals need to keep current on the changes that affect payroll.

Any payroll outsourcing review also requires that you consider, as part of your assessment, retaining the whole function. This raises another series of alternatives in terms of payroll software that is stand-alone or part of an accounting package, a human resources system, or an enterprise-wide solution.

This article on outsourcing has a special emphasis on the payroll processing technology. Is outsourcing this component the right choice for your organization? Read this article and determine options for your organization.



### **Outsourcing is defined as:**

**“having an external organization provide, on a recurring basis, a service that would normally be performed inside the client organization.”**

That is, pay some other organization to do part or all of it for you.

Payroll processing is one of the most common functions to be outsourced. In days gone by, most Canadian banks offered payroll processing. However, those banks sold their payroll processing businesses to one of the two dominant players in North America – ADP Canada and Ceridian Employee/Employer Services.

There are a few much smaller organizations, but these two companies have captured about equal portions of the Canadian market. Together, ADP and Ceridian Canada pay more than 5 million Canadian employees - that's about 40 per cent of the total Canadian workforce. It is estimated that 20 to 30 per cent of all Canadian companies outsource their payroll processing to organizations such as ADP and Ceridian. Both of these companies also offer software for human resources and various ancillary services.

### **THE ASP MODEL**

The line between an “outsourcing provider” and an Application Service Provider (ASP) is hard to draw. In most cases, payroll outsourcing is limited to electronic processing of the calculation of the gross and net amounts, generating electronic deposits and/or producing paper cheques, and producing pay slips. This is really more a rental of computer processing than outsourcing most of the functional activity, since all the key data elements still come from the client in the first place. Although it is therefore more technical than functional in nature, the decision is usually made by payroll management, not Information Technology (I/T).

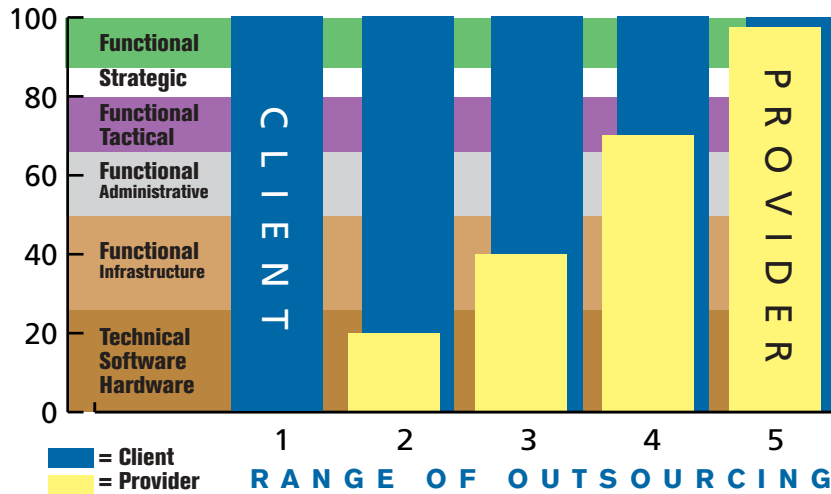
The ASP model implies something more than the traditional model. It is impossible to state that there is any standard offering by ASP providers, because the field is relatively new and every provider's offering is different. Also, the range of services offered can be so tailored to individual client firms, that there is no one clear model. That said, ASP providers “typically” offer access to application software as well as to the associated I/T infrastructure and support services. In this model, “outsourcing” can be complete, starting with policy development, building procedures, capturing time, processing, managing exceptions, and handling the payment process.

### **WHY OUTSOURCE?**

Why do organizations outsource? The list of reasons usually looks like this:

- Economies of scale
- Improving standards/quality
- Drawing on wider shared experience
- Makes focus easier
- HR and/or Finance switching software
- Technical issues/outdated architecture
- I/T going in new technical direction
- Improving efficiency
- Raising skill levels
- Stick to core competency
- Cuts cost
- Provide security/privacy
- Vendor withdrawing support
- Labour intensive processes

## RANGE OF OUTSOURCING



Are these reasons valid? It depends on the organization of course, but often the initial desire to outsource is more basic. Few (other than the payroll staff themselves) have any interest in the machinations of the payroll process. It represents all of the fears about mathematics that rose in our heads from grades 3 through 12. They don't understand it; and they don't want to. *Just make sure that the right amount (or more) of money is in my account on time.*

### THE BIGGER PICTURE

Outsourcing has become a popular management technique with a multitude of functional and technical opportunities for each organization. There are many organizations that outsource entire functional areas. Dupont, for example, outsourced its entire I/T department worldwide. In Canada, only one (the senior vice-president) of 100 I/T staff is a Dupont employee. The rest work on-site at Dupont, but are employed by Computer Sciences Corporation (CSC). That places Dupont's outsourcing of I/T at the right side of the above graph.

Along with payroll, information technology is a common choice for organizations to outsource. Make a comparison. I/T requires highly specialized knowledge and while executives know that it is essential to the well-being of the organization, they don't understand it, and don't ever want to. They just want I/T to do

what needs to be done. Sound familiar?

Other examples of outsourcing abound. HR departments almost always outsource benefits and pension administration, and employee assistance programs (EAP) are usually outsourced for reasons of confidentiality. Many specific training programs are designed by third parties and often delivered by third parties. Placement firms (recruiters/head hunters/executive search) are used to some extent by most organizations, while some organizations place all staffing activity in the hands of a third party. Organizations may also look outside for executive compensation, negotiating, or labour relations services.

As the graph below shows, the project-

ed growth of outsourcing various functionality is huge.

Does your organization have a prevailing outsourcing strategy? Does it have a standard contract format? The answer to these questions is usually, no, it doesn't. Many organizations that outsource do so without the necessary management processes in place. If outsourcing is, or is about to be, a common practice, then the organization would do well to consider the practice of outsourcing from a strategic and tactical level, then embark on common methods of assessing the opportunity, and then manage it.

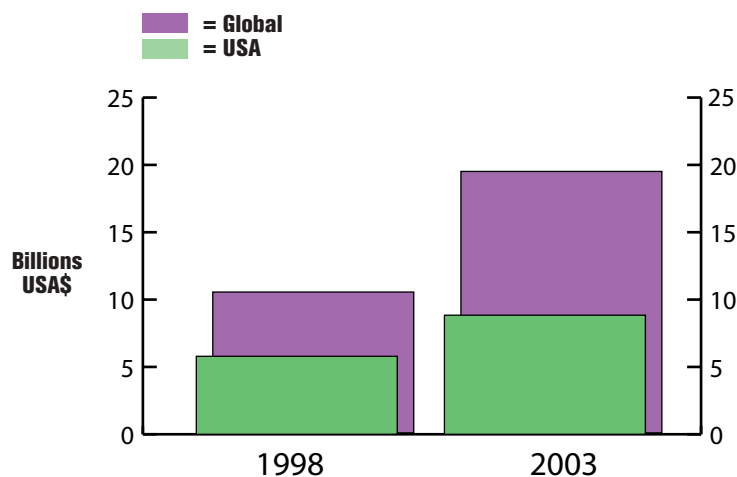
Organizations that outsource one function at a time often find themselves with a massive job of oversight. While the functional content (detailed scope of work) and associated standards of performance are different in each instance, there can and should be a common approach to the overall outsourcing process.

### LOOK BEFORE LEAPING

Before an organization should outsource anything, it needs to be able to define exactly what is being outsourced. What is payroll? It is a set of activities that calculates pay for employees, but where do those activities begin? Is it with the employment contract? Does it include employee schedules or time capture? As the chart illustrates (page 19), payroll

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## HR OUTSOURCING MARKET



| ACTIVITY                 | DESCRIPTION   | FUNCTION RESPONSIBLE |
|--------------------------|---|----------------------|
| Employment contract      | Either a letter of offer, OR a union agreement  | HR                   |
| Benefit package, plus    | The pre-determined benefit plan(s) plus other policies/ procedures  | HR                   |
| Job rate of pay          | As set by the compensation plan, usually established by job evaluation  | HR                   |
| Individual rate of pay   | Specific amount offered to an individual  | Supervisor and/or HR |
| Organization structure   | The organizational unit to which an individual is attached<br>Usually reflects a G/L code   | HR<br>Finance        |
| Work Schedule            | The schedule of work for an individual  | Supervisor           |
| Time Worked              | The time actually worked by an individual; may be "total hours"; may contain more detail  | Supervisor           |
| Time Not Worked          | Leave(s) – paid and unpaid  | Supervisor & HR      |
| Time reconciliation      | Resolve problems with time report from supervisor   | Supervisor & Payroll |
| Deduction amounts        | Taxes and liens<br>Specific employee payments for benefits  | Government(s) and HR |
| Calculation of Gross Pay | Determined by applying all of the above elements. This may be determined by organizations before any data is sent to the outsourcer, or, may be calculated by the outsourcer.   | Payroll              |
| Calculation of Net Pay   | Determined by applying benefit and government-supplied tax deductions against the gross pay. It is this activity which is most often the core of an outsourced payroll service. | Payroll              |
| Reports                  | Management and legislative reporting  | Payroll              |
| Payment                  | Electronic deposit or cheque (normally an organization's funds flow through the outsourcer to the primary bank which issues electronic pay directives to other banks)           | Payroll via Bank     |
| Record of Payment        | Pay stub  | Payroll              |

begins with organization structure and policy, gets modified by supervisory scheduling, and needs to reflect paid/unpaid time at and away from work.

## SHOULD YOU OUTSOURCE PAYROLL?

I have no idea. It may work well for your organization. Or, it may be a terrible decision!

But remember that **while the performance of the task can be outsourced, the responsibility for the result cannot be.** That may seem obvious to you, but it is a mistake made by many managers and organizations.

Outsourcing does not mean that you have stopped being accountable for the results, just that you are accomplishing the tasks with resources external to your organization rather than from within. In a scenario where managerial responsibility is also outsourced, the manager/supervisor working for the outsourcing vendor may actually work at your site on a regular, if not full-time, basis (as with the Dupont I/T example). Even in that scenario, however, responsibility for the end result – in this case, correct pay in a timely manner – is the responsibility of the internal manager to whom the outsourcer reports.

As the chart above shows, many of the activities that go into the final payroll calculation are not performed by payroll. So which activities are being outsourced when you outsource “payroll”? Regardless of the answer, without a detailed list – a

scope of work, and specific expectations regarding standard of performance – it will be impossible for an organization to write an effective agreement for the appropriate service levels.

*What is your organization's profile?* Is it experiencing rapid growth? Is that growth resulting in multiple sites spread across a wide geographic area? Is it growing by acquisition and/or merger? Are employees being added to existing job categories (and salary ranges, benefit plans, etc.), or do they require considerable work to establish new job categories and associated administrative burden? In all of these circumstances, the task of growing the payroll function to keep pace with the organization may be so onerous that a payroll service is the best short-term solution, if not long-term.

Or is your organization very small (under 100)? Is it not growing, not concerned about labour distribution, and not offering any complex pay strategies (commission, team performance pay, etc.)? In these circumstances a payroll service may also be the best choice.

*Exactly what is to be done?* Traditionally organizations have collected time and forwarded the data to an outsourcer for the gross-to-net calculation. Report and pay slip generation are also traditional products of an outsourcing arrangement.

How complex is your payroll? If it is all standard with rare or no exceptions, then it is relatively simple. But few payrolls meet that test. Most are a blend of salary



and hourly; multiple overtime payment and banking options; individual pay rates above (rarely below) range, etc. The more complex your payroll, the more exceptions to the standards that exist, the more your organization needs staff on-site to manage the process.

*What measures will be used to target and to measure performance:* quality or quantity? Are there delivery date and time ranges; are there error rate ranges? Are there performance penalties (or rewards)?

*Do you have payroll metrics* that can be used to develop a cost/benefit analysis of the outsourcing option, and that can be used to establish standards of performance for the outsourcing vendor? Payroll metrics is an article on its own, but in



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brief, do you measure: cost per employee? cost per payroll staff member? cost per cheque? To do that there need to be processes and tools in place to provide the data needed. Analysis of this data can provide an assessment of the effectiveness and efficiency of internal and external payroll services.

## SELECTING THE VENDOR/PROVIDER

Assuming that you have made the decision to outsource some portion of your payroll operation, how do you select the vendor? The list should include:

- Services offered – a payroll outsourcing provider should offer the range of services you require. Don't assume that they do.
- Software used – if you currently use certain software for payroll, human resources, time capture, etc., you may want a payroll outsource provider who uses the same system, or a provider that uses software that you may want to use in future.
- Access offered – what kind of access to the data and reports does the provider offer to you? Can you access the data via the Web?
- Standards of Performance – is the provider offering a set of measurable, applicable standards? Will they consider your list of measures? Do they offer guarantees backed up by specified penalties?
- Interface/integration – how will your data be transferred to/from the provider?
- Security – how will they keep your data secure?
- Backup – how will they backup your data?
- Price – what do they charge? For the primary service? For secondary services? Are there built-in annual price increases (and can you limit them – to the Stats Canada Cost-of-Living Index, for example).

**Important Note:** Most outsource providers charge several secondary fees such as: \$0.xx per employee pay processed; \$0.xx per cheque processed; \$X.xx per report, \$X.xx per T4, etc. Insist

on a detailed estimate based on your organization's specific demographics and the number of pay cycles, cheques, etc. The final cost may be several times what the primary service fee is.

Organizations that use many part-time or casual employees should be extra careful. Many providers charge as much for processing a casual employee as for a full-time employee, so don't use total FTEs as a basis for calculation; use total number of individual employees.

When you sign a contract with the provider, make sure that the standards of performance are included, as are any other promises made by the sales person. Oral promises may be legally valid, but they are very hard to prove, and sales people tend to have high turnover.

## SUMMARY

The concept of outsourcing is an excellent one. As with most management concepts, the final value is derived from the quality of the implementation of the idea, not from the idea itself. Whether outsourcing the most basic administrative task, or the entire function – including strategic direction – the key is to know exactly what services are to be performed. Without clear

task definition, and without agreed on levels of performance, there will be problems and constant dissatisfaction. With those ingredients in place, and actively managed on an ongoing basis, outsourcing can be extremely worthwhile.

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*Note: the opinions expressed in this article are those of the author alone and do not necessarily represent the position of the Canadian Payroll Association. ■*

