Making payroll pay

Managing risk and compliance in an unprecedented era of change

pwc

Global megatrends

Demographic and social change

Shift in global economic power

Rapid urbanisation

Climate change and resource scarcity

Technological breakthroughs

The world is changing. Major economic, cultural, social and scientific changes are having a significant impact in the world. These changes are known as megatrends. PwC's Network Leadership identified five megatrends that will impact the future of both PwC and its clients over the next decade and reshape the global marketplace. We believe these megatrends will impact the payroll function and process.

Contents

Payroll errors cost the average FTSE 100 company between £10M and £30M per annum. Tax legislation in the UK requires a Board member or Officer of the company to take personal responsibility for the company's tax reporting. More legislative change is on the way, including the introduction of individual taxpayer accounts and the move to payroll of benefits in kind. Isn't it time you took a closer look at your payroll?

Overview

The objective for payroll has always been a simple one – pay your employees accurately and on time. Payroll has historically been seen as a low risk function, generally automated (or outsourced) and where issues rarely trouble the higher levels of management. To that extent you probably haven't given it a great deal of management time or attention. That needs to change because employment taxes are now globally the largest source of government income, contributing on average 38% of the total tax take, and its coming under government and tax authority scrutiny like never before.

Tax authorities increasingly see the payroll function as their primary tax collection agent, transferring an ever greater burden of responsibility on employers particularly when set against the backdrop of continuous legislative and regulatory changes. Global megatrends such as technological breakthroughs, rapid urbanisation,

demographic shifts and social changes are combining to drive radical changes in the way we live our lives. For example:

- How, where, when and for whom we work.
- How, where and when we access information.
- How organisations use technology to record, analyse and report data.

This means employment turnover rates are higher than ever before as is greater workforce mobility and flexibility – all putting an increased strain on the tracking of accurate data for payroll reporting.

Organisations need to face up to the challenges facing payroll. The financial and reputational risks of processing payroll late and/or incorrectly, not adhering to evolving data privacy and protection regulations and the disconnect between finance, HR and payroll systems, create a countdown to a potential disaster.

In this paper we look at the payroll function and process through a number of lenses based upon the external challenges that organisations currently face.
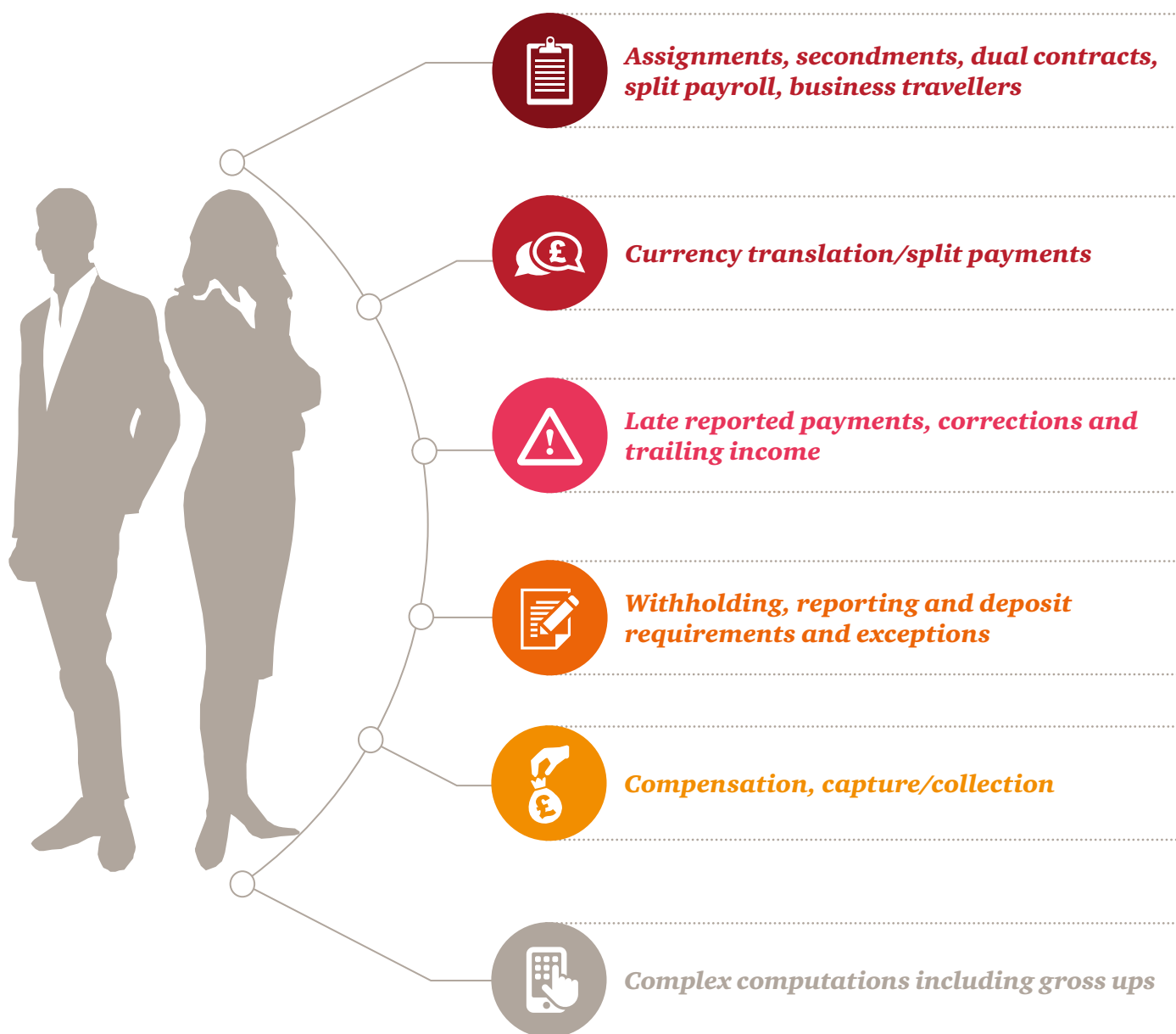
- Globalisation and the impact on payroll operations.
- Payroll technology in the Digital Age.
- Risk management.
- Regulation and Compliance.

These challenges may be replicated in many locations so our view and how we help our clients is not confined to the UK. Our focus is not simply on the compliance aspects of the payroll process but making sure that the payroll function has strong governance and controls, supported by the right technology.

Globalisation and the impact on payroll operations

As organisations increasingly look beyond domestic boundaries, so the complexity of their payroll operations grow. In a recent PwC survey of 193 organisations, 89% expect international mobility to increase, but much of this will be through short term assignments and international business travellers, rather than more traditional long term assignments. Tracking individuals to determine taxability on a country by country basis is already one of the hardest challenges that organisations face in order to be fully compliant with tax withholding rules.

Global mobility adds complexity to the payroll process

Assignments, secondments, dual contracts, split payroll, business travellers

Currency translation/split payments

Late reported payments, corrections and trailing income

Withholding, reporting and deposit requirements and exceptions

Compensation, capture/collection

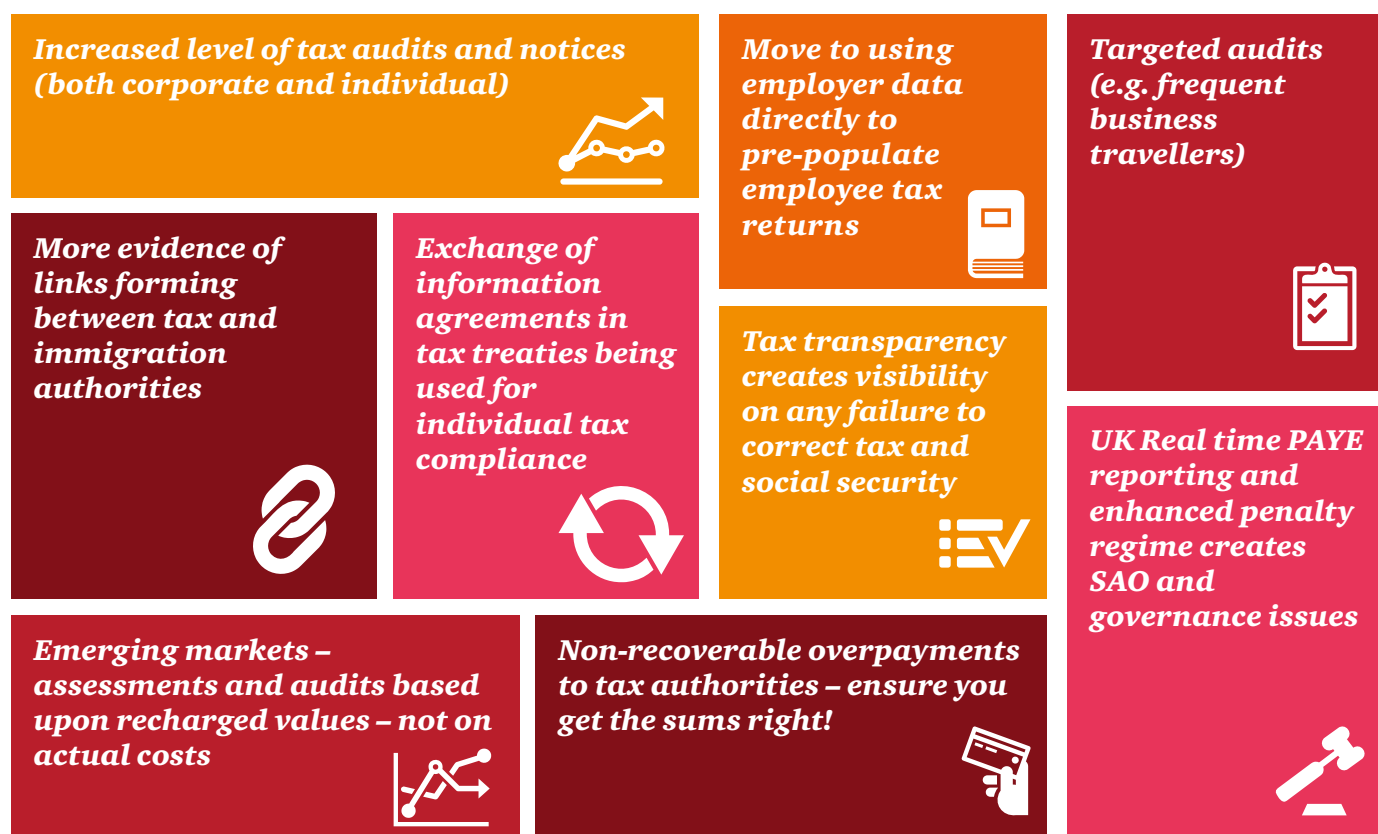**Complex computations including gross ups**

As emerging market economies evolve, so does the level of payroll tax sophistication. This is evidenced by the growth in social security systems and emergence of Provident Funds in countries such as Brazil, China and India. At the same time, organisations are increasingly dealing with changed workforce demographics and flexed working arrangements. Employees on zero hours contracts, contractors, part-time and job sharing arrangements all place additional burden on the payroll function. Who they are responsible for payment to, how much should be paid and for which period of time? This is made more complex when these work patterns extend across geographic boundaries.

The movement to Real Time Information (RTI) reporting in the UK, requires employers to gather details of foreign paid compensation as it is delivered in the home location overseas. While the UK HMRC provides a relaxation to the RTI system in the UK where the employer registers a Modified PAYE arrangement, this type of more 'relaxed' PAYE system has not been replicated by other countries. Therefore, the pressure remains to gather data in real time for processing across multiple jurisdictions. In Africa, payroll is the source of tax filing data in many countries – i.e. individuals do not file tax returns, so if the payroll isn't right, it's the employer who will be audited by the tax authority.

Global payroll challenges

Increased level of tax audits and notices (both corporate and individual)

Move to using employer data directly to pre-populate employee tax returns

Targeted audits (e.g. frequent business travellers)

More evidence of links forming between tax and immigration authorities

Exchange of information agreements in tax treaties being used for individual tax compliance

Tax transparency creates visibility on any failure to correct tax and social security

UK Real time PAYE reporting and enhanced penalty regime creates SAO and governance issues

Emerging markets – assessments and audits based upon recharged values – not on actual costs

Non-recoverable overpayments to tax authorities – ensure you get the sums right!

[1]   Moving People with Purpose – Modern Mobility Survey, PwC, October 2014

Questions to ask

- How do you currently identify and track internationally mobile employees?
- How do you know when frequent business travelers have triggered withholding tax thresholds?

- As your international operations have grown have you developed a multi territory payroll strategy (e.g. retained a single global provider, or are you managing a network of local providers)?
- How do you deal with multi-currency arrangements?

- How do you deal with Modified PAYE arrangements in the UK and shadow payroll arrangements outside the UK – and where you bear the tax on behalf of your employees, is the tax and social security contribution being engrossed correctly?

Our view

Organisations are struggling with the increasing complexity and global nature of payroll. Compliance is a key driver, particularly for clients where they have small employee populations outside their key established locations. Managing payroll for mobile employees and dealing with cross border issues needs payrolls to be managed in a coordinated way, such that home and host country issues can be addressed simultaneously.

Payroll technology in the digital age

> *Rapidly advancing technology in the Digital Age means organisations are increasingly moving their technology away from ERP based systems to cloud based solutions.*

In the past, digital meant ecommerce. But the landscape has changed; the rapid rise of social media, smart devices, big data and cloud computing has opened up avenues for improvement. At the same time, employees are changing through demographic change, increased expectations and empowerment. Technology and social media are making employees better informed, more connected and more vocal – get their payroll wrong and with the power of social media you and the wider world will very quickly get to know about it!
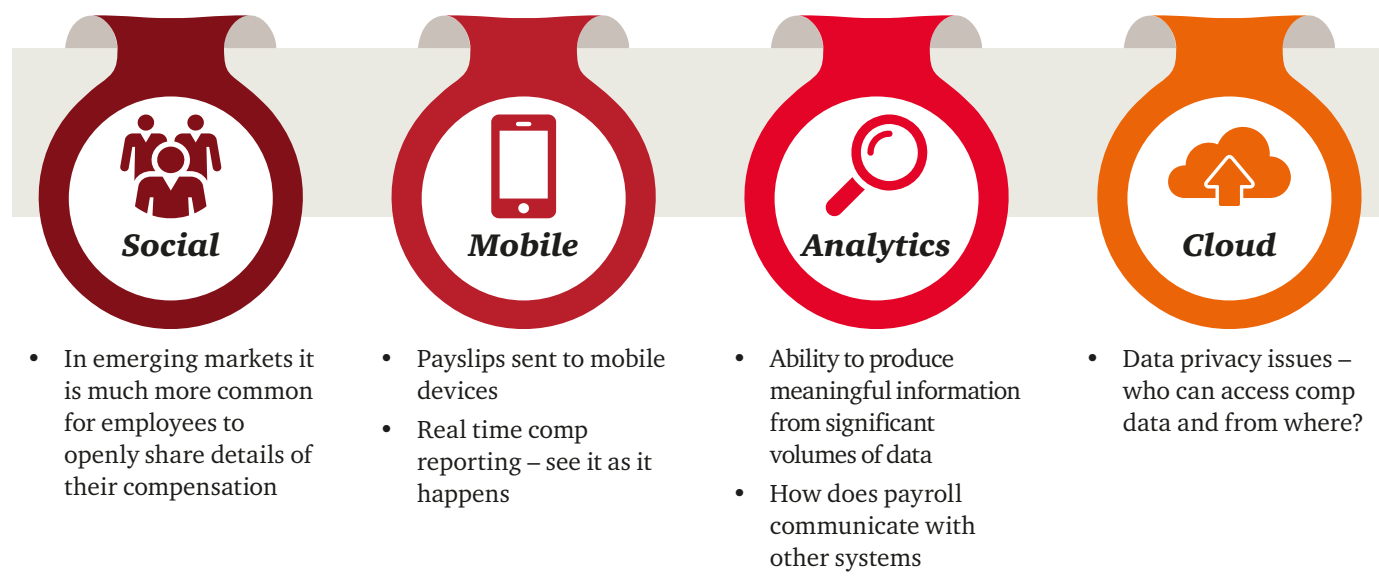
For many organisations the payroll system (or interface with an outsource providers system) remains separate from the HR and finance systems which drive payroll inputs and manage the outputs. Very few organisations are operating cloud based payroll systems, interlinked with their other cloud platforms. Confidential data may be passed via email or other non-secure data exchanges.

With an increasing number of payroll systems available, organisations are faced with difficult decisions in selecting the right fit for the business. Making the right decision based on the organisation's risk appetite, understanding of the broader IT and business strategy is vitally important for payroll systems.

Having good data is increasingly important to ensure good governance and control over systems and processes. At the same time, your employees expect you to act responsibly with their personal information and to respect their right to privacy. UK Data Protection Act and forthcoming European Data Regulation law demands this too. Failure to comply with the law can lead to serious legal and financial consequences and significant operational challenges, such as business disruption, financial loss and damage to brand and reputation.

Managing your cost base – traditionally payroll systems have been managed through the in-house IT teams. With increasing dependencies on outsourcing and use of emerging technologies such as Cloud, organisations are moving from a Capex to Opex model where billing is performed by the provider. This places an increased reliance on the provider to ensure billings are performed accurately.

Digital technology trends

Social

- In emerging markets it is much more common for employees to openly share details of their compensation

Mobile

- Payslips sent to mobile devices
- Real time comp reporting – see it as it happens

Analytics

- Ability to produce meaningful information from significant volumes of data
- How does payroll communicate with other systems

Cloud

- Data privacy issues – who can access comp data and from where?

Questions to ask

- Does your current payroll system fit into your overall technology strategy?
- If your HR system is cloud based – what interface do you have to your payroll system and how do the outputs link to your finance system?

- Have you analysed the cost of running your global payroll systems and number of vendors?
- Do you have confidence that your outsource provider can deliver an end to end payroll solution?

- Is your payroll data secure and have you performed penetration testing or tested ISO compliance with ISO 27001 (whether you operate the payroll internally or via an outsource provider)?
- How can you take advantage of cloud technology to enable a more resilient and efficient payroll environment?

Our view

Having a coherent technology strategy is critical to deal with the increased complexity of payroll operations and the increased compliance and regulatory environment. The top three criteria for selecting a global payroll vendor are cost, geographic/global capability and technology platform. Often the decision to implement a system is made based upon cost alone, without thought to how the technology will fit with broader technology strategy.

Risk, regulation and compliance

It remains rare for a payroll system to fail completely, but there have been well publicised examples of companies failing to process their payroll on a timely basis and the consequent impact across the workforce. With increased technology and complexity comes the greater risk that your payroll team will not be able to keep up with all of the technical and regulatory changes affecting them. It is estimated that annually, there are more than 35,000 tax and social security logic and other parameter changes needed to operate payroll in compliance with local regulations around the world. For an organisation operating in multiple jurisdictions, that is a significant number of changes that need to be made to systems and possibly processes as well.

Tax authorities increasingly regard the employer as their tax agent, transferring the obligation to collect and account for taxes and social security contributions in real time.

Two examples of this changed approach which is increasing the burden on employers:
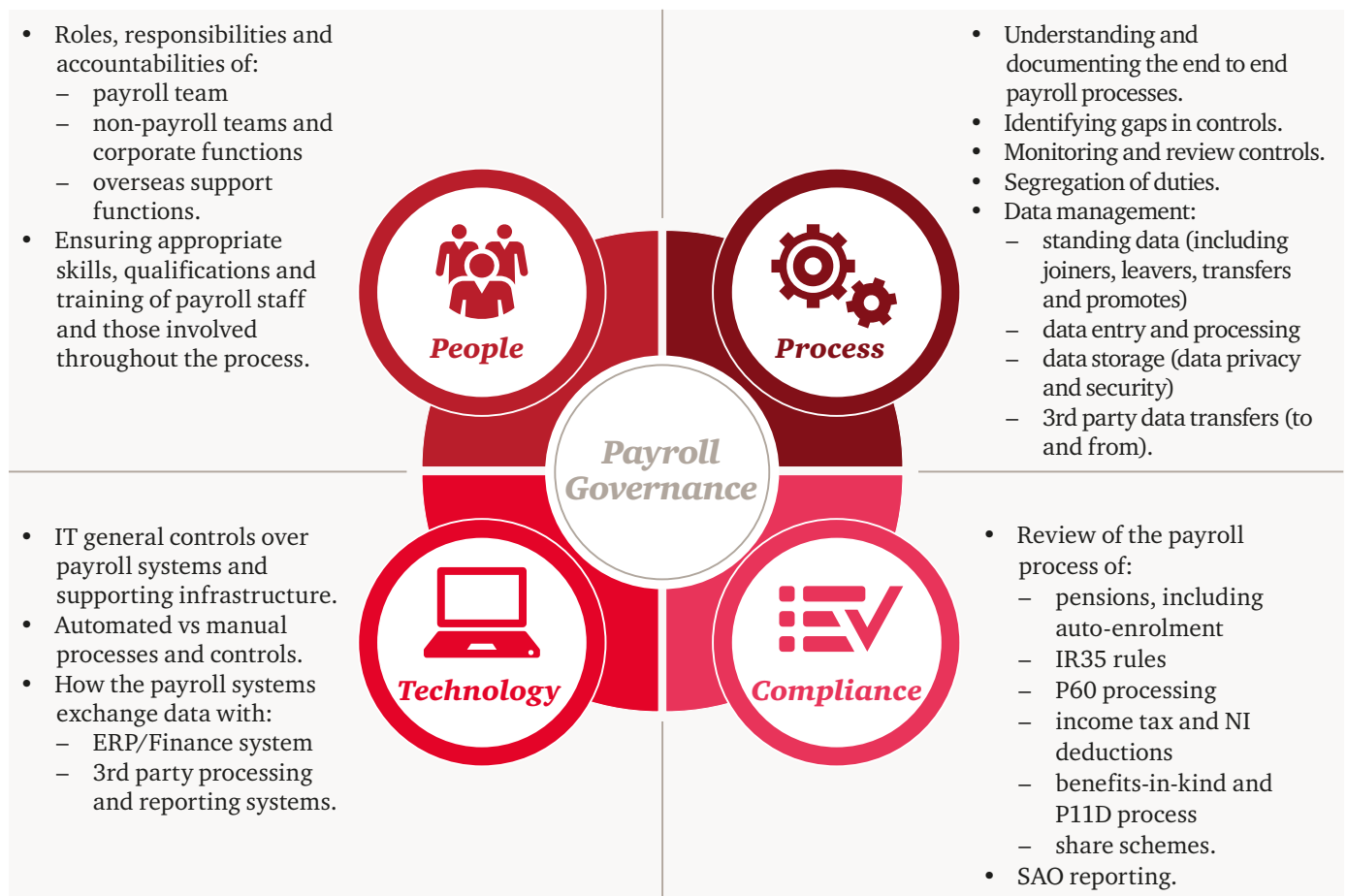
- HMRC in the UK is taking the first steps in extending PAYE to the collection of tax on non-cash benefits in kind from April 2016 and has announced the replacement of the Self Assessment tax system with digital taxpayer accounts within the next five years.

- Nordic countries are publishing tax returns online for all citizens which means employer provided compensation data is publically available and needs to be accurate (in Denmark 98% of the population are no longer required to file a tax return).

In addition many more countries (including several US state tax authorities) are moving towards real time filing, electronic deposit and collection of taxes, with significantly increased penalties for inaccuracy. With further changes on the horizon, many organisations are reaching a tipping point in terms of their ability to keep up with and accommodate more changes. Investing time now to review the capacity and capability of your payroll function will ensure it is resilient enough to deal with these ongoing changes.

From an internal perspective, organisations are struggling to obtain visibility of the end-to-end payroll processes and effectiveness of controls, and find it challenging to maintain clarity in the roles and accountabilities. Having a comprehensive understanding of the payroll related risks to the organisation and defining how to address those risks through an effective payroll governance framework, is central to building a sustainable and resilient payroll function.

Understanding payroll risks

- Roles, responsibilities and accountabilities of:
  – payroll team
  – non-payroll teams and corporate functions
  – overseas support functions.
- Ensuring appropriate skills, qualifications and training of payroll staff and those involved throughout the process.

People

Process

- Understanding and documenting the end to end payroll processes.
- Identifying gaps in controls.
- Monitoring and review controls.
- Segregation of duties.
- Data management:
  – standing data (including joiners, leavers, transfers and promotes)
  – data entry and processing
  – data storage (data privacy and security)
  – 3rd party data transfers (to and from).

Payroll Governance

- IT general controls over payroll systems and supporting infrastructure.
- Automated vs manual processes and controls.
- How the payroll systems exchange data with:
  – ERP/Finance system
  – 3rd party processing and reporting systems.

Technology

Compliance

- Review of the payroll process of:
  – pensions, including auto-enrolment
  – IR35 rules
  – P60 processing
  – income tax and NI deductions
  – benefits-in-kind and P11D process
 – share schemes.
- SAO reporting.

Questions to ask

- Have you assessed the competency of your payroll team members, particularly if you have recently changed technology or been through a merger/acquisition transaction?
- Do you have confidence in the resilience of the systems and processes that manage payroll data?

- Have you tested whether your payroll meets current local compliance obligations? Does your payroll function have the capacity/ability to take on the increasing reporting burden likely to be placed on it over the next 3-5 years?

- Do you have sufficient visibility on the level of reputational and compliance risks some of your payroll arrangements might attract?
- Do you have confidence in the security of your payroll data?

Our view

Organisations need to take a holistic view of the payroll function based on a framework that provides overall governance over payroll and related activities, through the 'lenses' of People, Process, Technology and Compliance.
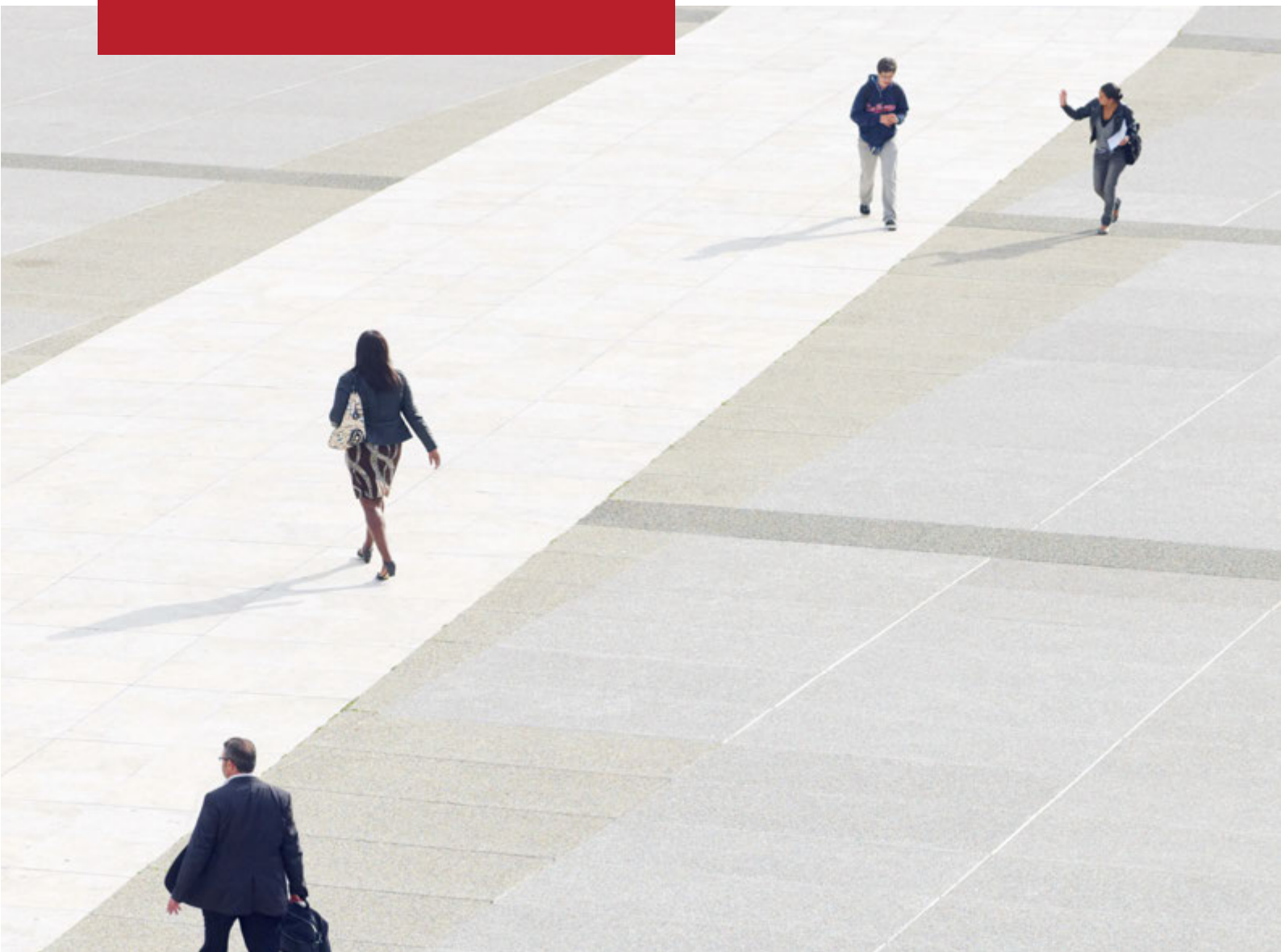
Making payroll pay

As the payroll function has to cope with more complexity, becomes more global and requires increasingly sophisticated technology applications, the need to review and assess the function and process effectiveness becomes more critical. PwC has a range of services to help organisations assess the strengths and weaknesses of the payroll function and to provide managed payroll services (both for domestic and expatriate employees). We provide managed payroll services to clients in more than 145 countries, ranging from single employee payrolls, to many thousands of employees.

We help organisations to develop a technology strategy for payroll that fits with their broader business and technology strategy, including advice on vendor and application selection, implementation and operation.

We help organisations to assess the reasons for payroll failures, investigate potential fraud situations and provide risk assurance to evaluate the effectiveness of the payroll function and efficiency of payroll processes. Our focus is on providing an end to end service to clients to ensure your payroll is not just fit for today, but the function is future-proofed to ensure it is capable of dealing with the increased complexity and regulations coming in future years.
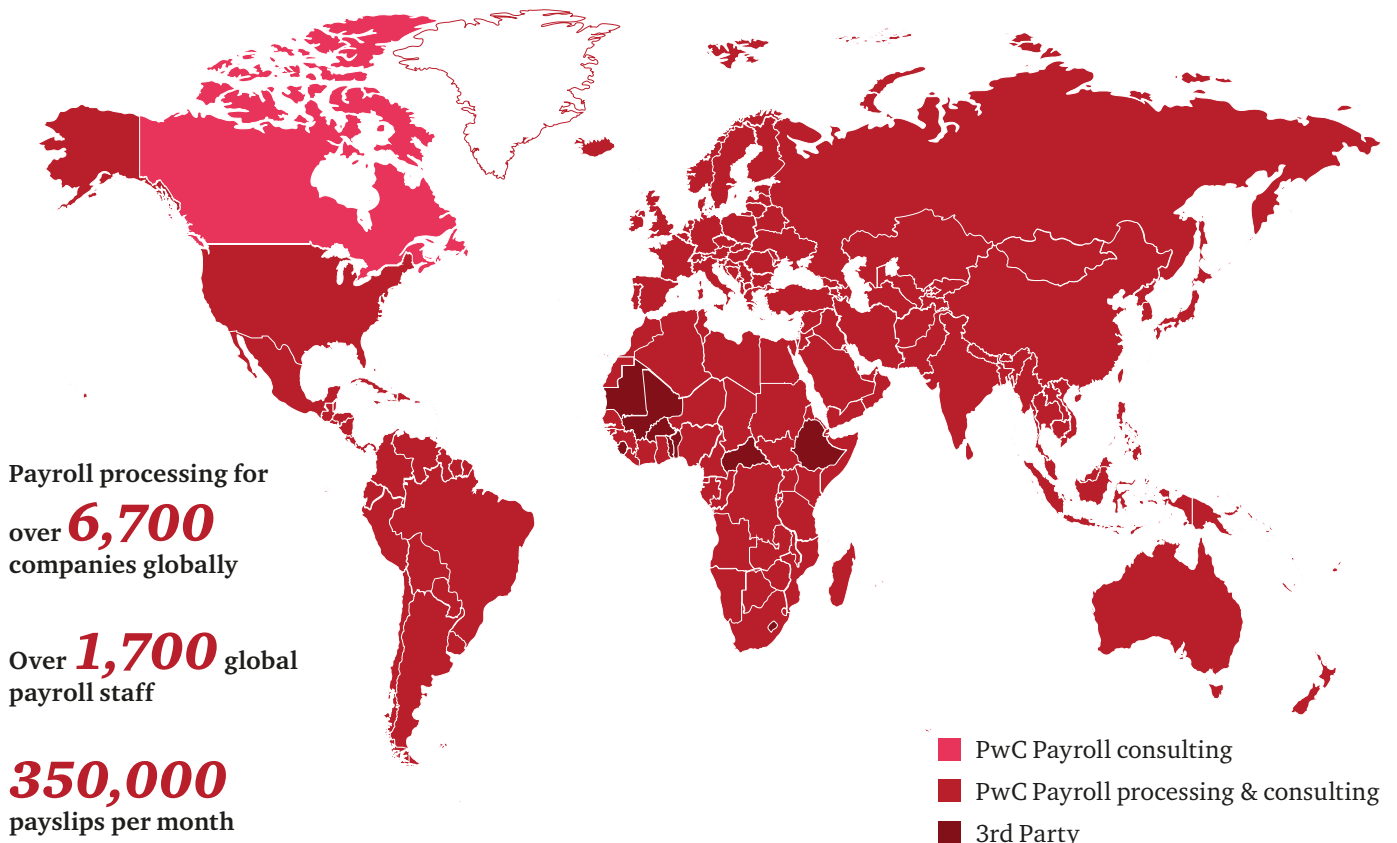
If you would like to discuss any of the aspects in this paper, please contact your usual PwC contact or any of the team listed below.

Payroll managed services

Payroll technology services

Payroll risk and compliance services

Payroll analytics and assurance services

Payroll processing for
over **6,700** companies globally

Over **1,700** global payroll staff

350,000 payslips per month

■ PwC Payroll consulting
■ PwC Payroll processing & consulting
■ 3rd Party

Contacts

Alan Johnson
Global compensation consulting

T: +44 (0)20 7212 2043
M: +44 (0)7843 368694
E: alan.k.johnson@uk.pwc.com

Chris Watt
Managed payroll services

T: +44 (0)28 9041 5534
M: +44 (0)7595 609636
E: christopher.watt@uk.pwc.com

Pritesh Patel
Assurance and technology

T: +44 (0)20 7804 2493
M: +44 (0)7711 194575
E: pritesh.patel@uk.pwc.com

Christian Verri
Pay, performance and risk

T: +44 (0)20 7804 2208
M: +44 (0)7714 567086
E: christian.verri@uk.pwc.com