

Global compliance: payroll's greatest challenge?



Tackling compliance issues in multi-country payroll can be a challenge, with unexpected difficulties at every stage of the cycle. By Keith Rodgers

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Managing international payroll presents major challenges for multinationals. Historically, most payroll operations have evolved on a country-by-country basis, focused on meeting local tax and government reporting requirements – and as a result, there’s typically been little standardization across countries, internal reporting is often slow and patchy, and corporate head offices tend to have limited visibility into their country functions. This lack of central control can have significant implications in terms of external and internal compliance, and exposes organizations to numerous risks, from financial penalties to fraud.

Compliance is one of the principal drivers for many multi-country payroll initiatives, which are designed to improve central control over international payroll operations and so help improve efficiency and effectiveness. But planning and executing an initiative – from assessing the initial business case, through selecting multi-country payroll vendors and into change projects – can be challenging. This article assesses the issues that emerge at each stage of the multi-country payroll cycle.

It’s no secret that many multinationals still struggle to answer the fundamental question of how many people they employ. How, then, do these same companies cope when it comes to managing their international payroll operations? How do they guarantee that they’re meeting their compliance obligations around the world in payroll functions that typically use country-specific rather than centralized IT systems and services, generate limited internal reports, are often run by managers speaking a foreign language and have a unique set of regulatory obligations?

The answer in many cases is simple: they don’t. For many multinationals, managing their disparate international payroll operations is a major challenge, generating a wide range of problems ranging from risk management to cost control. High among them, of course, is the issue of external compliance with tax and regulatory reporting requirements, and internal compliance with policies and procedures.

Just how big the compliance problem is depends on several different factors. Chief among them is the number and nature of the countries a multinational operates in – and specifically, the complexity of those countries’ tax and reporting requirements and the nature of the legislative environment.

This can vary widely. There's a huge difference in complexity between payroll requirements in a low-complexity country such as Singapore, for example, compared to somewhere such as the US, where payroll managers have to cope with a relatively complex tax and reporting environment at federal, state and city levels. At the same time, however, the US benefits from the fact that legislative changes are usually flagged up well in advance and there is a culture of consultation with industry – whereas in many other countries, tax and reporting changes can be imposed at extraordinarily short notice, requiring rapid adjustments to payroll systems that can prove extremely challenging.

As an extra complication, reporting requirements in some countries may be driven from a regional as well as national basis (although they will usually be implemented through national legislation). Payroll may be the corporate source of data for time and leave data, for example, and so in Europe, it may have to demonstrate that it's compliant with the European Union's Working Time Directive.

Structural faults

But the compliance challenge in international payroll runs deeper than country complexity, and is rooted in the way that payroll operations have typically evolved in multinational companies. Historically, payroll functions have tended to be set up and managed on a country-by-country basis to meet unique local requirements. From an external compliance perspective, this means calculating payroll in line with city, state, and national tax legislation, as well as meeting central and regional government reporting demands. Different payroll teams may be handling different pay cycles (weekly, bi-weekly and monthly) depending on local custom or regulation. And there will be a different mix of remuneration types – a manufacturing operation in one country may have a high proportion of hourly-paid employees, for example, while the payroll manager servicing a predominantly sales-led office in another country will likely be more concerned about dealing with complex commission schemes for salaried staff.

The structure of the payroll function itself will also vary. Payroll may be processed through a large shared services center in one country, while a small employee population next door may be handled by a part-time payroll administrator whose primary role lies elsewhere in Finance or HR. In some countries, there might be multiple payroll functions, particularly in highly-developed organizations that have grown through acquisition and tend not to centralize their back-office functions.

This mishmash of operations makes it hard – if not impossible – for head office functions to get visibility into their individual country payroll operations and ensure they're meeting their compliance obligations. From an internal compliance issue, meanwhile, lack of visibility into payroll operations makes it hard for corporations to detect fraud, such as excess payments or ghost employees. It's also difficult to assess operational risks in individual countries. How many countries are processing payroll on systems that are so old they're no longer supported by the vendor that developed them? How often is one country's subject matter expertise carried around in one person's head – and what happens if he or she doesn't turn up for work one day?

And these are just the compliance problems. This same lack of visibility has broader implications for the business, not least in making it hard for companies to measure how effectively each payroll operation is performing. Many organizations simply do not have access to country-by-country data on core payroll metrics such as accuracy and timeliness, or on cost metrics such as the ratio of payroll FTEs to employees served. Quality of service will vary from country to country – which is inevitable when there is no process standardization and limited effort to replicate Best Practices. And companies spend an inordinate amount of time managing a huge range of systems and service providers just to keep functioning.

These are some of the reasons why multi-country payroll is such a fast-growing discipline. It's based on the belief that while every legislative environment is different, the majority of the processes performed in a payroll operation – often cited as 70% or more – are common regardless of where they take place. Payroll data is prepared and submitted; gross-to-net calculations are made; payments are deposited; pay slips are issued; and relevant internal and external reports are completed. It's possible, therefore, to centralize and standardize different international operations to a large degree, while at the same time dealing with local regulatory requirements on a country-by-country basis. By doing so, companies can replicate best practices in all of their territories, cut the number of vendors they deal with, reduce operational and compliance risks, improve access to information, enjoy economies of scale, and potentially cut costs.

Business planning and compliance

Where, then, do you start to build a multi-country payroll strategy that will tackle these kinds of problems and help ensure that your organization meets its compliance obligations? In Webster Buchanan's experience, many organizations jump the gun, setting out prematurely on a search for a 'global' vendor before they've completed some of the fundamental planning. In order to work out the best fit of software and service providers for your own unique requirements, it's important to understand from the outset:

- How your international operations function today
- Where you want to get to in order to meet your business goals, be they to ensure compliance, improve controls, reduce risk, improve efficiencies or any other business drivers
- What approach will enable you to bridge the gap between the two most efficiently and effectively

Webster Buchanan identifies eight phases in the multi-country payroll journey, beginning with three business planning steps that address these issues. They consist of:

- Assessing how payroll is being managed today in each country. This analysis covers a wide range of factors including payroll structure; systems and software; how well payroll is performing in terms of accuracy, cost etc; identifying where you have compliance and control problems, how severe they are and how urgently they need to be addressed etc
- Analyzing your different strategic options. For example, you may choose to address your international operations on a regional rather than global basis, or you may take a 'tiered' approach (*see below*)
- Addressing the fundamentals of the business case. Compliance and risk reduction will be key components of your business case, but they may not be the sole drivers. For many companies, factors such as cost and process standardization will be significant, and issues such as the quality of reporting and management information will also feature. This means that compliance issues (such as SAS 70 Type II compliance) will need to be weighted in the context of other priorities when you come to select vendors

Once this initial business planning has been carried out, you will be better placed to begin a vendor selection process to choose one or more providers to support your initiative.

Understanding a fast-changing vendor landscape

Most multinationals today use a mix of in-house systems and outsourced services to process payroll in their individual countries. In-house, these range from spreadsheets for smaller country populations, through specialist domestic packages, and up to large-scale enterprise resource planning (ERP) systems.

Outsourced services, meanwhile, can be provided by anyone from a local accounting firm at one end of the scale, to a full-service Business Process Outsourcer at the other. And because there may be multiple legal entities as well as multiple countries, it's quite common to find a broad mix of systems and services. If you're operating in a dozen countries, you may easily be working with 20 suppliers or more.

Reducing the number of systems and service providers is usually one of the core priorities of a multi-country payroll initiative – and your choice of software provider or outsourcer will have a major impact on how effectively you can put a comprehensive compliance framework in place.

One challenge, however, is that the multi-country payroll vendor landscape is still relatively immature, especially when compared to the US domestic payroll market. There are a number of options to consider – and also a number of potential pitfalls **to be wary of**.

Firstly, it's not safe to assume that each vendor you approach will be capable of keeping you compliant in all of the countries where you operate. Vendors are still fleshing out their country coverage, and the leading cross-continent vendors focus on anything from 50 to more than 100 countries, out of the 200-odd recognized states around the world. Typically, the countries they've prioritized will be driven by a combination of their geographical legacy (where they initially began business) and customer demand. But

while the larger players are likely to cover most of the 'popular' countries targeted by multinationals, sometimes there are surprising gaps.

Secondly, there are a number of different approaches to market. For companies choosing to process international payroll in-house – which means directly managing their external compliance obligations – the choice of providers is relatively limited, but includes some of the biggest names in the business. Several ERP suites now boast international payroll engines designed to handle core payroll processing regardless of the location, with country-specific capability layered on top.

In addition, there is a small but growing number of Software as a Service (SaaS) offerings. Adoption of SaaS – a form of IT outsourcing where the provider manages the software on its own IT infrastructure and the customer processes payroll in-house – has lagged the HR sector to date, in part because of confusion about the model (see **From absence management to HRIT investment: assessing HR's priorities – A survey of HR directors and managers** published by Webster Buchanan Research June 2010), but interest is now ramping up.

For those looking to outsource their processing and related activities, the choice of vendors is more extensive. At the high-end, BPOs will take control of your full payroll function, either as a payroll-specific service or as part of a conventional multi-function deal. A number of vendors also provide conventional payroll managed services.

Where the multi-country payroll sector differs from domestic payroll, however, is in its use of an 'aggregator' model. With this approach, rather than building out its own country-specific capability, an outsourcer will partner with third party payroll providers in individual countries. The aggregator's role is to manage these in-country providers to ensure that payroll is processed to standard, and then pull all of the data into one place to give the customer a single view of their different country operations, ideally providing consolidated reporting. Typically, the aggregator will offer a single contract and Service Level Agreement. In addition, several international accounting firms and professional services companies now provide multi-country payroll services, linking together their different country operations – effectively a variant on the aggregator model.

In practice, there's a fair amount of mixing and matching between these models, with some outsourcers offering multiple types of service. Similarly, many multinationals take a hybrid approach to choosing vendors. As an example, some companies may process payroll in-house for their large country populations, where they already have an ERP system in place: at the same time, they may choose one or more outsourced service providers to handle their mid-sized country populations, while keeping very small populations with existing national providers. What this means from a compliance perspective is that regulatory and internal obligations will be met through a combination of in-house teams, multi-country outsourcers and country-specific providers.

Compliance issues in vendor selection

A large number of compliance issues need to be taken into account during the selection process. As an example, these include:

- How strong is the vendor's change control process, enabling it to handle regulatory changes? In some countries, tax and corporate laws can change at very short notice
- What reports come as standard (external and internal), and what costs are involved in creating custom reports?
- Do your compliance needs extend beyond payroll? National outsourcers that handle small employee populations often provide a wide range of services beyond conventional payroll (including operational HR, company secretarial etc). If they are replaced by a multi-country payroll provider, the non-payroll services may not be covered
- Is the vendor SAS 70 Type II compliant (an auditing statement for assessing internal controls) and if so, what controls are actually in place? Steven Naarden, a former multi-country payroll compliance manager, **points out that SAS 70** is a matter of opinion, not a statement of fact – and

since the controls are not standard, the value of one attestation is not necessarily the same as another

- Will all of the systems and services meet stringent Data Privacy regulations, both today and as they change? As a rule, it's often advisable to base Data Privacy policies on the highest country (or regional) standards

Above all, keep in mind that while you can outsource operational responsibility for compliance, you retain legal responsibility!

Change, controls and compliance

Having chosen one or more vendors to assist in your multi-country payroll initiative, the focus will shift to managing the transformational change – a phase that brings its own compliance challenges. Any change management program carries inherent risk, and international projects – with their greater scope for cultural clashes, the complexity of dealing with multiple organizational structures and the practical issues of dealing with languages and time zones - can be particularly challenging.

From a compliance perspective, potential issues include:

- Unplanned loss of key personnel during the change cycle, including subject matter experts with critical payroll knowledge in individual countries
- System or service downtime during a country transition, affecting both payment accuracy and government reporting
- Poorly specified Service Level Agreements
- Poor specification of reporting requirements, leading to internal compliance issues or cost overruns
- Failure to plan and implement a sustainable governance structure

How well these issues are managed will depend on a range of factors including the depth and breadth of the initial planning cycle; the chosen approach; the expertise of the project management team; and the level of senior management commitment.

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