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Show me the Money!

In my article "So you've hired a worker, what happens next?" we covered how to classify your workers as either a subcontractor or an employee. So now if you have an employee how do you pay them?

I can hear crickets right now! You must be thinking, 'Well, you give your employees a check'. (The 'Duh!' is implied!) And you are correct; you give your employees a check. But how does the check get calculated and who is going to do it?

There are three common options for how you will pay your employees. The first is the old DIY. The second option? Using a Professional Employer Organization or PEO. The third is using a payroll company to do the work for you. Each one of these options comes with advantages and draw backs. We are going to cover each one.

So you have employees and you have decided to go the DIY route to paying them. Ok, I am with you. You purchase software like QuickBooks, fumble around in it and get everything set up. Fantastic! Then each pay period you go in and cut those pay checks and move on with the running of your business. Right? Wrong!

Once you have entered your pay information into payroll software you still need to make sure that the taxes withheld from the employees' checks and the employer taxes are paid. Most tax agencies now require that employers pay these taxes electronically. You will be responsible for the set up and for transferring these taxes as they become due to the proper tax agencies.

And you will quickly discover that there are many confusing things that you have to track with payroll. From tax forms to locate, to tax tables that need to be updated and reports that need to be submitted. You may find that you have entered an area that requires you to know deadlines, follow unforgiving tax agency rules and that

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the tax agencies are not necessarily there to help you understand the process. Not to mention that if you make a mistake the process is not forgiving and you will more than likely be assessed penalties and interest for any tax remittance mistake you make. The average penalty amount being paid by those who are doing it themselves is $872.00 per year. That can become quite costly.

And speaking of costs, the average cost of doing payroll yourself is immeasurable. What opportunities have you lost by performing a clerical duty? What business could you have gained during this time? Why are you doing this instead of doing what you do best with your scarce time and energy? You should really outsource this function, you and your business will benefit. Create and grow your business and leave the payroll headaches to someone else.

One option of outsourcing is using a Professional Employer Organization (PEO) to pay staff through. Notice I did not say *your* staff! Here is why. A PEO is a company that puts your workers on their books and then leases those employees back to you. The theory behind using a PEO is that it would eliminate the hassles employers face for workers compensation plans, withholding payroll taxes and having to cut paychecks for their employees.

The benefits of using a PEO is that if you are in an industry with a high employer rate for worker's compensation you may get a better rate with a PEO as they have the ability to offer high deductibles and multiple workers' compensation categories to choose from. Most PEO companies also handle worker's claims efficiently and put a lot of effort into verifying those claims so that fraudulent claims are not paid out.

Another benefit to using a PEO is that they do extensive background checks. Most of the time consuming issues that employers face when hiring an employee are handled through the PEO, eliminating the time, expense and aggravation of the hiring process. A PEO also offers all of your employee benefits and can do so from health and dental insurance to retirement plans and employee deferrals.

Once you have started using a PEO you would no longer need to process payroll, produce tax payments and file payroll tax returns. The PEO would take care of this on your company's behalf.

So this sounds great so far, but what are potential drawbacks? There are some disadvantages in using a PEO. One is that the PEO can drop your worker’s compensation category due to the risk involved with your industry. This can leave you in the same position you were in before using a PEO, having to deal with the high cost of Worker’s Compensation. Most companies choose to use a PEO due to the high risk nature of their business only to find out that their PEO is not required to renew their worker's compensation policies on an annual basis.

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The other fall back to using a PEO is that your company does not have its own history of worker's compensation claims. This becomes an issue because worker's compensation rates are complied in part by your company's claim record. The modified rates are based on a three year claim history. Maintain a safe working environment, educate your employees on safety issues, keep claims to a minimum and you can expect to pay less. If you use a PEO and then decide to go back to your original employee structure you will be forced to apply for worker's compensation on your own. Since your company has no current history of worker's compensation claims you can expect to pay the base rate and not have access to a modified rate for three years.

Another reason some company's do not use a PEO is because they lose control of their hiring practices. You may find a job candidate that you would like to hire, only to have that person turned down by the PEO. If the PEO is not comfortable with the candidate's background they can refuse to hire that individual. This is a two sided issue. On the one hand you may have to pass up the perfect candidate, on the other you may have missed something in your screening processes that your PEO has caught on your behalf. Either way, the days of using your best judgment are over. You must now rely on the judgment of a third party to figure out who would be the best employee for your company.

The final thing to consider is whether or not the PEO you choose is in a strong financial position. Get back ground on their other clients. Find out their cash flow. Ask about how your money is handled? Is it reconciled back to you? You need to be 100% sure that the employees you leased from the PEO are getting paid and paid timely.

A PEO is not the perfect solution for every company. If your company is considered a high risk category for worker's compensation insurance and you are having a hard time finding insurance coverage at a reasonable cost a PEO might be the right answer for you.

The third way to pay your employees and to outsource the process is to use a payroll company. Companies use payroll companies to process their payroll for five major reasons: cost, convenience, functionality, accuracy and compliance.

With a payroll company you can usually outsource payroll for half of the cost of what it takes to do payroll in-house or in a DIY situation. Payroll companies are able to do this because they are set up to process payroll in bulk. So they have all of their systems set up to be able to process in an efficient manner for hundreds of clients. The cost of the systems and expenses is spread over all of their clients. Unlike a DIY situation where you have to pay the expense of software, updates and have to individually file all of your returns.

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Convenience comes in the form of simply calling your payroll company, telling them what hours your employees worked and your job is mostly done. You have three more steps in your process after this. Get the package from your payroll company, hand out the checks to your employees, and make sure you have enough money in your bank account to cover the checks and the taxes associated with that payroll.

There are different methods to reporting your payroll to a payroll company. You can process payroll online if it suits your needs and busy schedule. You can email the data, send a spreadsheet, or fax in your payroll. This is part of the functionality of a payroll company. The other part is that payroll companies also handle items for you such as retirement plan administration, provide direct deposit, calculate manual checks for you if you forgot to pay an employee with your regular payroll and prepare W2s for your company at the end of each year. There are a lot more functions a payroll company can provide for your company. You can check out the company's website to see what they offer or call your provider to see how they can be of help to you.

The other important area in any payroll, whether done in house, by a PEO or with a payroll company is accuracy. The only difference with a payroll company is that they know they have to do an accurate job with your payroll in order to keep your business. They also have to stay current on all tax law changes that take place throughout the year to make sure your payroll is processed accurately. This is a big motivating factor in client retention and your company will benefit from this diligence.

The final reason that you would use a payroll company is for making sure that everything is run properly and is compliant with the current tax laws. Payroll processing and the taxes withheld are complicated in that there are multiple sets of rules that must be followed. Not only does the Federal government have rules and tax obligations that must be dealt with but there is also State and Local compliance issues that need to be handled. These vary from State to State and from Local municipality to Local municipality. Most entrepreneurs do not go into business to become Federal, State and Local tax experts. But entrepreneurs who own payroll companies go into business just for that reason. This is their field of expertise. So let the experts handle the compliance and legal issues associated with payroll.

Some of the drawbacks of using a payroll company are that you have less control over the process and have less flexibility for when you pay. With a payroll company you are going to have a set time that payroll is due and a set check date. So if you forget to pay your employees you cannot call your payroll company at midnight and expect to get checks the next day. You will have to work within the confines of the payroll company's business hours and their internal deadlines.

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Another drawback can be being a small fish in a big pond. The top two national providers of payroll are looking for large companies to work with; it is their bread and butter. So if you have less than 500 employees you may not be on their radar. Chose your payroll company carefully if you chose to outsource to make sure that you will be treated well regardless of whether you have 5 employees or 500 employees on payroll. There are many regional firms that can do an excellent job, treat you with respect, and help you understand the process of payroll and how to use their service to your best advantage.

No matter what method of paying your employees you chose, just don't chose to do it yourself. I cannot stress that enough. As Julie Taylor is fond of saying, "Focus on what you do best then PLEASE…whatever you do…outsource the rest!"

About the author

Meg Eynon is the Vice President of The Payroll Factory and has over sixteen years of experience working with businesses to help them come up with simple ways to make their employees' lives easier through the process of producing payroll.

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