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Evaluating Payroll Options For Your
Mid-Sized Business: In-house,
Outsourced, or a Blend of Both?

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Introduction

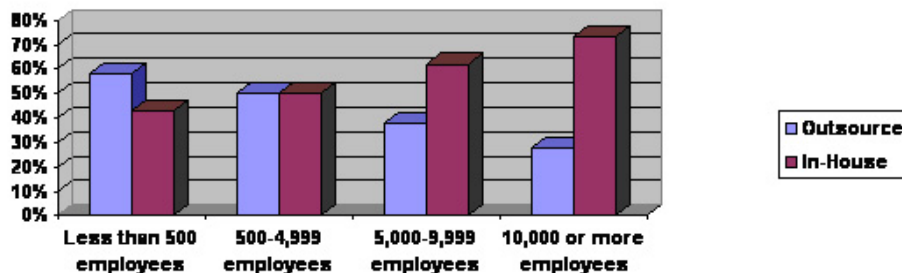
Providing employees with their paychecks on time and without error is a mission-critical aspect of your business. Because payroll is one of the most visible business processes to your employees, a payroll solution that is accurate, efficient, and right for your particular business is essential. It's an important contributor to employee satisfaction, and fundamental to your company's success. Payroll is so fundamental that it's frequently a given, and its strategic importance is often understated.

By choosing the appropriate payroll solution for your company's unique needs and culture, you can boost efficiency, reduce costs, and better manage the payroll process, all of which can contribute to the bottom line in a positive way. For example, if one of your corporate objectives is to provide better financial information to internal customers, and your current payroll process isn't meeting this objective with flexible reporting options, implementing a new system may be just the answer you're looking for.

With the many payroll options available, selecting the appropriate solution for your business can seem a difficult task. Options include outsourcing your payroll to a service bureau, processing payroll with an in-house payroll software application, as well as the option of blending both outsourced and in-house payroll. That's why it's important to arm yourself with good information, and know the right questions to ask.

Options for Payroll Processing

Overall, companies are split down the middle when it comes to outsourcing payroll vs in-house payroll processing. According to a 2004 study by PricewaterhouseCoopers, companies between 500 and 4,999 employees choose to outsource just as equally as they choose to use in-house payroll applications. Companies with less than 500 employees show a tendency to slightly prefer outsourcing payroll.



Source: PricewaterhouseCoopers

With companies so equally divided between in-house and outsourced payroll, there are obviously some very compelling reasons for choosing each option.

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In-House Payroll

When considering in-house payroll, most companies turn to commercial software that runs on a PC or server and allows them to run their own payroll and manage all of their payroll processes in-house, including check printing, reporting, forms, and managing direct deposits and payroll taxes. Commercial in-house software typically involves a one-time software license purchase and annual support contract for software enhancements, tax table updates, and technical advice.

Companies that choose to process payroll in-house do so for a variety of reasons. It offers a great deal of flexibility, and many companies prefer the solid return on investment they can realize by a commercial payroll solution that involves a one-time software purchase, rather than a monthly fee. In addition, processing payroll in-house gives companies the ability to protect information they consider private, including wage and salary details, from outside sources. It also allows for maximum control and flexibility over last-minute changes that need to be made prior to a payroll run or off-cycle checks, without incurring additional fees.

Outsourced Payroll

Payroll is often considered one of the most widely outsourced business functions among companies of all sizes. Outsourced payroll is often attractive to companies that do not wish to maintain a high degree of internal payroll competency in-house, and would prefer to let another source be the "expert" on this function. It allows companies to reduce the need for expertise in certain aspects of the payroll function, such as the management of tax filing and payments. A payroll service bureau's services include calculating payroll and tax obligations and handling direct deposit of checks, as well as processing W-2's and other year-end forms.

Regardless of whether a company chooses to process payroll in-house or outsource it, they are ultimately responsible for the timelines and accuracy of their payroll. For example, the company must ensure that salary administration is managed accurately, and verify that time worked and time off are collected and entered correctly into the payroll system or communicated to the service provider. In addition, the company is responsible for a number of other functions, such as benefits, deduction arrangements, and administering shift differentials and premiums. Whether you choose in-house or outsourced payroll, these responsibilities remain and must be assigned to an internal resource.

Blending In-House and Outsourced Payroll

An option that can offer the best of both worlds is blending in-house and outsourced payroll functions. This approach can work well for companies that want to process payroll in-house, but would prefer not to deal with managing payroll taxes. Tax filing and payment services will typically support all filing, including federal, state, and local

payroll taxes, SDI and SUI filing, and other services including W-2 and 1099 printing and W-2 electronic filing.

Assessing Your Company's Needs

Companies choose to evaluate new payroll options for a variety of reasons. You may have outgrown the functionality of your existing in-house payroll software, or you may be dissatisfied with your current payroll service provider. Determining which payroll option is right for your company can be a difficult decision. Assessing the factors impacting your company can make it easier to choose a solution.

Your Current Solution – Often, companies prefer to stick with the type of solution that's familiar to them. If you've been processing payroll in-house for some time and are comfortable continuing to do so, there may be no reason to consider outsourcing. If you currently outsource payroll, and do not have the expertise to bring the function in-house, it may make sense to narrow down the choices to outsourced payroll offerings only. Before switching from in-house to outsourced payroll, or vice versa, evaluate whether there are compelling reasons to do so.

Management Philosophy – The personal preference of executive management could have a large role to play in whether a company opts to go with outsourced or in-house payroll. Many CFO's and CEO's have their own ideas about how they want to go about processing payroll. Management that is comfortable maintaining a higher degree of internal payroll competency will often push for an in-house software application, while those whose preferences dictate that payroll should not be an internal competency will often want to go with outsourced payroll.

Tax Compliance – Tax management is a major part of payroll processing. Keeping up to date with changing tax regulations and filing taxes in a timely manner is a task that some companies are uncomfortable with, while others would prefer to have complete control over this responsibility. In addition to ensuring that standard and supplemental tax tables are updated regularly, tax compliance also requires the filing of tax returns and making tax payments, as well as management of pre-tax deductions, electronic media reporting through the Electronic Federal Tax Payment System (EFTPS), and tracking liabilities and tax deposits for federal, state, and local taxes. Errors or missed deadlines can result in stiff penalties.

If you're considering in-house payroll, it's important to decide whether you are comfortable managing tax compliance internally. Software applications can make this easy if they offer automatic tax table updates, support of EFTPS, and alerts that remind you of important due dates. If your company wishes to mitigate tax compliance risks, outsourcing your payroll to a company that assumes liability for filing errors and late filings may be the answer. However, ensuring that all payroll data is accurate and timely is still the responsibility of the company. Payroll service

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providers do not accept liability for incorrect or late payroll data provided by the company.

Tax compliance is an area where a blend of in-house and outsourced payroll can be a very good option for some companies. If the idea of processing payroll in-house appeals to you in many ways, but you'd prefer to mitigate tax compliance risks, consider in-house payroll with outsourced tax filing. This combination will allow you to outsource specific functions, including federal, state, and local tax filings, SDI and SUI filing, electronic and manual funds transfers, W-2 and 1099 printing and delivery, and W-2 electronic filing to the Social Security Administration.

Organization – Consider the stability of your organization when deciding between in-house and outsourced payroll. If your company is relatively stable and you don't foresee major organizational changes, in-house payroll is often a good choice. However, some companies choose to look at outsourcing payroll as part of a change management strategy if they are currently experiencing or anticipate large organizational changes in the future. Outsourcing payroll can allow companies to move fixed costs to variable costs, increase their ability to handle heavy volume fluctuations, and help facilitate mergers, acquisitions and divestitures.

System Integration – Consider your system integration requirements. When complex or multiple integrations, such as ERP, accounting, time collection, and/or job costing are required, in-house payroll offers a lot of flexibility and is a better choice than outsourced payroll. On the other hand, when little or no system integration is required, outsourced payroll may also fit.

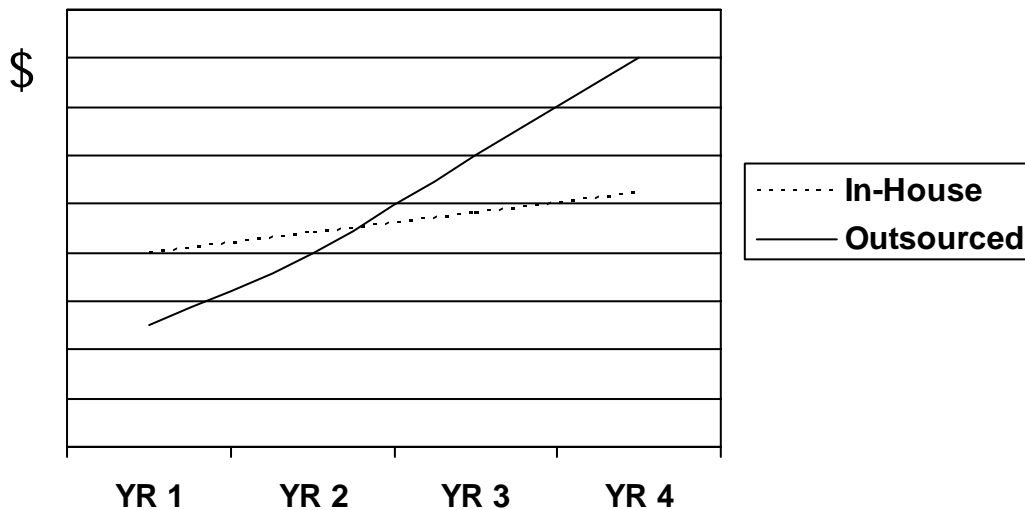
Customization – Take a look at the complexity of your organization and pay cycles to determine the level of customization that would be needed in a new payroll solution. Payroll services tend to be less flexible than payroll software, because they rely on processes that are standardized for volume. Customers must adapt to these processes in order to successfully use the service. If little or no customization is required by your company, outsourcing payroll could be a good choice. If, on the other hand, your organization must track a variety of pay rates, shift differentials, overtime, pay cycles, and other variation on a regular basis, you could be a better candidate for an in-house system. In-house systems are usually better equipped to handle customizations such as paycheck stubs that need to include the names of time-off plans or medical benefits. With an in-house system, you could also customize your general ledger account numbers to better meet the needs of your accounting system, track secondary jobs, and create templates to import and export information from other databases.

Data Control and Security – Another factor to think about is whether you feel comfortable sharing private employee information, including social security numbers and salaries, with a third party. It's often a matter of corporate culture. Companies that outsource their payroll typically don't mind yielding this sensitive information to a

payroll service. Additionally, keep in mind that when outsourcing payroll, you are relying on the data security of the providers' system. Using an in-house payroll solution means that your data security is controlled by your corporate IT department's network security.

Investment/Cost – The investment required and the total cost of each option is a very important consideration. In-house payroll software often requires an up-front investment in hardware, software, and training, along with yearly maintenance fees for technical support, upgrades, and enhancements. Lease financing is also available for many software purchases, enabling firms to purchase the software and spread the payment out over a fixed timeframe. On the other hand, outsourced payroll requires a perpetually recurring monthly fee for as long as you use the service. The fees also fluctuate based on changes in check volume and specific services requested.

In-House vs. Outsourced Payroll Cost Comparison
Cumulative Cost Over Time



Both models appeal to companies for different reasons. The total return on investment of an in-house system is often greater than that of a payroll service. By outsourcing your payroll, you'll be paying for the service indefinitely, and you could pay far more over time than you would if you purchased an in-house solution. On the other hand, your company may find that after weighing the pros and cons, you prefer the flexible monthly fee of a payroll service, instead of the capital investment required by an in-house payroll software purchase.

Other Things to Keep in Mind When Choosing a Payroll Solution

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Regardless whether your company decides on an in-house, outsourced, or blended solution, there are several other considerations to keep in mind when choosing which payroll option you'll go with.

Integrated HR/Payroll Capabilities

An important trend in payroll solutions is integration with HR applications. For progressive organizations, the strategic alignment of payroll and human resource departments is no longer a "nice-to-have" but rather a "must-have." HR, Payroll and Benefit functions have tremendous overlap and sharing the data ensures that all systems are in sync and using the most recent and accurate data. There are many benefits of having integrated HR capabilities with the payroll software or service, including:

- No duplicate data entry – Changes made to the common HR and payroll database need to be entered only once. This eliminates errors and the need for duplicate entry of employee, pay rate, benefits and deduction information.
- Less paperwork -- With payroll and HR data stored in the same database you can reduce unnecessary paperwork. For example, if HR enters a new benefit for an employee, the payroll deduction amount can be automatically established as part of the benefit plan. There is no need to submit another paper document to the payroll department.
- Integrated Reporting -- Consolidated reporting is valuable to management, but is virtually impossible without an integrated database and reporting tools. For example, management needs a report outlining each employee's "total compensation package." This report must contain employee information, benefits data from HR and compensation data including regular, overtime, vacation, bonus, commission, etc. from payroll. You can only create this type of consolidated reporting with an integrated solution.

Payroll Automation with Employee Self-Service

Another notable business trend is the move towards streamlining the payroll process using web-based employee self-service (ESS) technology with integrated workflow features. Automating payroll processes with ESS disperses routine tasks back to the employees. This strategy can lower payroll costs without taking anything away from employees, making it a very attractive cost-containment strategy.

The key benefits of payroll with ESS that can contribute to the company's bottom line are:

- Reduced payroll call volume – Employees have direct access to a greater amount of their payroll information, so they can request changes online and answer most of their own routine payroll-oriented questions.
- Reduced transaction costs – Partially or completely replacing paper-based paycheck distribution with direct deposit and ESS reduces (or eliminates) the time

and physical costs associated with payroll distribution. Direct deposit with ESS eliminates the need to print and mail direct deposit advices. Employees can receive their pay stubs online and print them out if they wish. ESS can also reduce the costs of copying, routing and filing paper forms. For example, employees can request W-4 changes online.

- Elimination of manual data entry – Data, such as time cards, can be entered by employees online, relieving payroll staff members from manually entering data. This improves productivity and reduces errors.

When searching for a payroll solution, consider the integrated HR and ESS capabilities the solution offers, and how your company can benefit from them now and in the future.

The Company Behind the Product

Last but not least, once you decide whether to process payroll in-house, outsource it, or choose a blend of both, deciding on a vendor is one of the most important decisions you'll make in the process. When choosing a payroll solution, it's important to select an established and experienced vendor with a proven track record in offering excellent products and services to its customers.

Here are key questions to ask when evaluating the reputation and service of a potential payroll software or service provider:

- How long has the company been in business, and how many clients use the software/service?
- What industries does the company serve?
- What size businesses does the company serve?
- Can you speak with other clients who use the software or service?
- Does the company stay consistently up-to-date on all tax tables and governmental reporting changes?
- How, when, and where is user training provided?

Conclusion

When deciding between payroll software, a payroll service, or a blend of both, there are many factors to take into consideration, including choosing a vendor known for experience in the payroll industry. Sage Software offers leading business management software and services that support the needs, challenges and dreams of more than 2.4 million small and mid-sized business customers in North America. Its parent company, The Sage Group plc (London: SGE.L), supports 4.5 million customers worldwide. For more than 25 years, Sage Software has delivered easy-to-use, scalable and customizable software for accounting, customer relationship management, human resources, time tracking and the specialized needs of

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