

The ultimate guide to payroll risk management

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No matter how you look at it, payroll is the engine room of an economy. If you ever want to check that statement, all you have to do is make a mistake.

It's felt at all levels.

For the business, one wrong entry on a spreadsheet can throw budgets off balance as they scramble to fix the issue; this is doubly true if they face a hefty penalty for their error.

But these mistakes can also be felt very personally. Pay is, of course, needed to put food on the table for staff. Miss-pay someone, and you'll see how quickly they'll head for the door.

On a broader scale, society considers being paid for a hard day's work as more than a legal contract; it's a moral right. That's why a business will be named and shamed in the press if the mistake is big enough. This high-profile embarrassment can happen even if you settle rather than get prosecuted.

It's unfortunate, then, that payroll is so easy to get wrong.

As many as 40% of small and medium businesses face a payroll penalty each year.

About this guide

This guide is designed to give you an overview of the risks you have when you take on payroll, either as an in-house task or a service provided to clients.

We'll go through many of the pitfalls as well as some of the solutions which can make life much easier for you and your team.

Here are just a few things you'll read about:

- Payroll and tax regulations
- Mistakes you can make throughout the payroll process
- Some universal issues that can affect payroll at any time
- Great strategies for handling risk
- How you can pick the right payroll software for your business
- What great looks like if you choose to outsource to payroll experts
- How IRIS can help you

Let's begin with one of the toughest compliance obstacles in payroll - ensuring you meet your tax obligations.

Compliance with tax regulations

There are many layers of payroll tax regulations, and each has its own moving parts.

Let's examine each of these layers, understand their complexity, and, where appropriate, highlight some of the things that happen when payroll goes wrong.

Federal taxes

Employers and employees pay federal taxes.

The IRS sets the rates and rules for these taxes, which are the same regardless of a business' location.

Here, the employer has to withhold any money staff owe from their wages and pay it to the government. Federal income tax withholding is based on the details employees provide on their W-4 form, like marital status and claimed dependents.

The business also pays a contribution to match. In addition, they pay Federal Unemployment Tax (FUTA) as a separate amount not deducted from staff wages.

Unfortunately, this is not a system you can set up, get perfect, and then rinse and repeat; compliance goalposts move. New federal rules (or changes to existing laws) can easily throw a pay run into disarray if they're not anticipated and planned for.

What happens if you make a mistake with federal taxes?

- **Underpayment penalties:** When a business misses their deadline, the IRS enforces an underpayment penalty, which is determined as a percentage of the outstanding tax amount.
- **Accuracy-related penalties:** An accuracy related penalty of 20% can be applied if tax is underpaid due to negligence or disregard of rules.
- **Failure to file:** Filing past the deadline without an extension has repercussions. The penalty is generally 5% of unpaid taxes for each month a return is late, up to a maximum of 25%.

At the federal level, payroll taxes contribute to Social Security and Medicare, which are considered key components of the U.S. social safety net.



State taxes

Some states don't have an income tax, and the rates and rules vary in those that do. The payroll team has to understand the different rules, use the right tax rates, and file on time.

It's important to remember that the rules are applied where the work is performed. All this additional complexity proves difficult for businesses operating in more than one state.

And in a world where remote and hybrid working is more and more the norm, a payroll team has to be extra vigilant.

But an employer's obligation doesn't stop at income tax. States also charge businesses unemployment taxes, which can change based on factors like an employer's history of layoffs or additional surcharges imposed but state Departments of Labor to fund training programs or budget shortfalls.

And, of course, it's always also important to bear in mind that the rules are subject to change.

California & employee protections

California is known for strict labor laws. For example, the state's final paycheck law mandates employers to pay final wages within 72 hours of termination or immediately if the employee gave at least 72 hours' notice. Non-compliance can lead to penalties paid to the employee for every day of delay, up to 30 days.

New York & wage theft

New York combats "wage theft" by heavily penalizing non-compliant employers. Businesses that break the rules risk paying back wages, facing fines, and incurring additional damages. One of the most famous cases is when Lyft and Uber were asked to pay \$328m to settle claims on pay and benefits. This hefty payout had to be made even though, in the settlement, they didn't have to admit fault.

State Paid Family Medical Leave programs

A majority of states currently have or are considering legislation to enact Paid Family Medical Leave (PFML) programs. These range from state-sponsored programs (CA & RI), state authorization for private insurers to offer PFML benefit plans (NH, TN, VT, VA), accrual plans to earn days based on hours worked (AZ, IL, NM), as well as employer- and/or employee-funded paid leave programs (CO, CT, DC, MA, NJ, NY, OR, WA). The requirements for these programs varies in what wages are taxable, the rates and limits, and portions of the "premiums" that are payable by the employer or employee.





Local tax laws

The most granular level of payroll taxation occurs at the local level, encompassing cities, counties, school districts, transit districts and other municipal jurisdictions.

Local taxes can get very specific. As their scope suggests, businesses might very easily face a maze of different tax rates and rules; it's very easy to have employees in different cities or counties, especially today with a highly mobile workforce and a myriad combination of remote and hybrid workers.

Of course, this gets even more complicated as your business gets bigger.

Local taxes support services and infrastructure directly impacting the community, such as schools, public safety, and public roads and services.

Business growth, payroll and increased risk

Expansion introduces a layer of complexity to payroll management.

As we've seen with tax, each part of the U.S. has a unique set of laws and regulations. So, it stands to reason that the more a business expands into new jurisdictions, the more it must navigate these varying regulations, increasing the risk of non-compliance.

Add international growth to this, and you not only mix in new tax and employment rules but also very different work customs from other cultures. This can include differences in standard working hours, holiday entitlements, and termination practices, all of which must be reflected accurately in the payroll. Currency also has a role to play. It's likely the business will pay someone in their local currency, and so the exchange rate will affect the business.



At a glance: mistakes you can make at each stage of payroll

Each part of your payroll duties presents challenges and associated risks. Here's an overview of this journey:

1. Employee classification

- **Challenge:** Correctly identifying workers as employees or independent contractors and determining exempt vs. non-exempt status for overtime.
- **Risk:** Misclassification can lead to penalties and owed back wages.

2. Determining gross pay

- **Challenge:** Accurately calculating hours worked, including overtime for eligible employees.
- **Risk:** Errors can result in underpayment or overpayment, impacting compliance and budget.

3. Calculating deductions

- **Challenge:** Properly deducting taxes, Social Security, Medicare, and benefits from gross pay (see the previous section for more).
- **Risk:** Incorrect deductions can lead to tax issues and dissatisfied employees.

4. Distribution of payments

- **Challenge:** Choosing the method of payment (direct deposit, paper check, or pay card) and ensuring timely delivery.
- **Risk:** Delays or errors can violate labor laws and erode employee trust.

5. Tax filings and compliance

- **Challenge:** Accurately reporting payroll taxes to federal, state, and local agencies in accordance with deadlines.
- **Risk:** Non-compliance can incur fines and legal complications.

6. Maintaining records

- **Challenge:** Keeping detailed payroll records as required by law.
- **Risk:** Poor record-keeping can complicate audits and result in penalties.

7. Regular updates and training

- **Challenge:** Staying updated on payroll-related legislation and ensuring systems are current.
- **Risk:** Outdated practices can lead to compliance failures and inefficiencies.

8. End-of-year reconciliation

- **Challenge:** Confirming all payroll activities throughout the year are accurately documented and reported.
- **Risk:** Discovering errors during reconciliation can be costly and time-consuming to correct.



...and some mistakes that can affect payroll at any point

Minimum wage: You have to comply with federal and state minimum wage laws and calculate overtime correctly.

Understanding the Fair Labor Standards Act (FLSA) and state laws is central to avoiding legal issues.

1. **Federal vs. state wage laws:** The FLSA establishes the lowest wage set by the government at \$7.25 an hour, but several states have a higher minimum wage. Employers must pay the higher wage if it applies.
2. **Overtime pay:** Employees must receive overtime pay at 1.5 times their usual rate for hours worked beyond 40 in a week if they fall under FLSA rules. Some states have extra rules for working overtime. Employers need to follow the rules that help the employees the most.

Payroll fraud: A perennial threat, payroll fraud encompasses a range of deceptive practices, from timesheet manipulation to rogue staff creating “ghost employees” so they can funnel money into their bank accounts.

Strategies for effective payroll risk management

Here's how businesses can safeguard their payroll processes.

Set clear procedures and regular checks:

It's vital for a company to have clear, detailed guidelines on how payroll should be handled. This includes regularly checking both your processes and your payroll calculations. That way, you can catch mistakes or inconsistencies early and fix them before they become bigger problems.

Divide responsibilities:

Nobody should have access to something in payroll unless their role demands it. This includes a clear policy on check-signing authority to prevent unauthorized transactions.

Leverage great software:

Modern payroll systems come with advanced features that can detect unusual activities, automate complex calculations, and ensure that payroll data is both accurate and secure. Essential features include data encryption, multi-factor authentication, and compliance with privacy regulations.

Integrate payroll with HR systems:

Linking your payroll with your human resources (HR) management system ensures that any changes in employee details, like promotions or salary adjustments, are automatically updated everywhere.

Ongoing education and support:

Keeping the payroll team informed about the latest payroll management practices and technologies is essential. Regular training sessions can help staff stay on top of new developments and better protect the company's payroll system.

Have open channels for reporting problems:

Encouraging employees to report any suspected payroll issues without fear of negative consequences can help in identifying and addressing problems early.



Issue regular policy updates:

The business world and its regulations are always changing, so it's important for companies to regularly review and update their payroll policies to ensure they remain effective and compliant with current laws.

Plan for the worst:

Having a plan in place for unexpected situations, like technical failures or natural disasters, ensures that the payroll process can continue smoothly, regardless of the circumstances.

Be selective when it comes to outsourcing:

For businesses that outsource their payroll, choosing a reputable service provider with strong security measures is crucial. Always do your homework, and don't be afraid to ask them some tough questions.

Take a reality check with reconciliation and audits:

Even if your payroll seems a success, it's still worth checking everything after the fact. It's advisable to compare the company's payroll records with bank statements to ensure the numbers match up. Conducting audits, meanwhile, allows companies to verify that their payroll system is compliant with laws and regulations.

Picking payroll software and outsourcing solutions

What indicators suggest that your software meets high standards or that you're working with an exceptional outsourcing company?

Let's take a look.

What good software includes

1. Capability for high-volume processing

Companies, particularly those handling payroll for numerous clients or managing a sizable workforce, require software that can seamlessly process high volumes of transactions. Even if you want software for smaller-scale payroll operations, its ability to handle large volumes provides assurance of how robust the solution is.

2. A user-friendly interface

Payroll is complex enough; you don't want cluttered software making things worse.

Pick a platform with an intuitive, user-friendly interface that's simple to navigate while you manage payroll tasks. The easier it is to use, the more time you save.

3. Comprehensive compliance and e-filing

Your payroll software should not only stay up-to-date with the latest tax regulations and requirements but also offer seamless e-filing capabilities. This minimizes manual paperwork and mistakes, ensuring your business stays compliant and fine-free.

4. It eliminates file importing or syncing

The best payroll software simplifies the process by eliminating the need for importing or syncing files. What you need is a system where everything happens within the platform itself, streamlining operations and reducing potential errors.



5. A comprehensive suite of products and services

There's more to employee management than payroll. It's important, then, to have other HCM tools at your disposal, including workforce management, applicant tracking and onboarding, and Affordable Care Act (ACA) compliance.

6. Amazing support

High-quality payroll software isn't just clever coding; its foundations include personalized support. This means having access to a dedicated client support representative that can provide resources, training, and ongoing consultation, instead of a call center

7. It's designed for growth

Your payroll software should not just meet your current needs but also support your business as it grows. Whether expanding your client base, increasing your employee count, or diversifying your services, the software should offer scalable solutions to accommodate.

What makes for good managed payroll services (outsourcing)?

Great payroll managed services drive efficiency, are flawlessly compliant and put you in control whenever you need to be.

Here are some of the things a top-tier outsourcing team will do to take the stress out of each pay run:

1. A comprehensive service

You need a complete solution that features the following:

- Streamlined payroll processing
- Direct deposit
- Federal payroll tax services
- State tax filing

Ultimately, it should feel like you're handing everything to the payroll outsourcing team. Beyond sign-off and your own checks, they take on the stress so you can focus on your day-to-day business.

2. Software integrations

The best payroll managed services feel like they are joined up with your operations. That means their work should integrate with your software, making information-sharing safe and seamless.

3. Payroll reporting

You need to know what's happening to your payroll. As part of their service, a payroll outsourcing solution should be able to provide reports that give you an overview of everything and also enable you to double-check your tax liabilities.

4. Data security

Everything a payroll outsourcing team does must have security measures. Whoever manages your account should be able to tell you what precautions are in place at each level of the business - from their office network to their payroll software and people-driven processes. When you have passed your data on to them, you should feel that everything is fully protected, 24/7.

5. Knowing your business

Great payroll managed services teams understand their customers because they've walked a mile in their shoes. They will ensure your deadlines (not just state and federal) are respected, and you still feel in control of the pay run. That means you get time to look at their work before it gets processed, and they will answer any questions you may have.

6. Be a proven success

An experienced payroll managed service provider should have a good track record. Can they refer you to happy clients? Can they demonstrate that they have worked with payrolls like the one you're responsible for?



IRIS: taking you from payroll pain to payroll payoff

However you approach it, you have to turn the chore of payroll into something that works for you, your business or your clients.

IRIS can help you with modern, powerful software or great outsourcing.

Powerful, advanced payroll software

As we've seen, a reliable payroll is everything.

Therefore, if you're taking on this task, you need software that's up to the job.

IRIS provides accurate, easy-to-use payroll and HR solutions that you can build around your operations as they grow.

And it's not just our cloud platform that you'll be pleased with; you'll also be impressed by our fantastic team of experts. We have payroll specialists, technical experts, and data professionals dedicated to delivering top-tier support.

With IRIS software, you can reduce your workload, save time and then put that energy where it adds the most value.

Outsourcing that provides global expertise and local precision

But what if you don't want to deal with payroll at all or deal with the risk non-compliance?

Let IRIS handle it accurately and professionally, whether you're paying people in the U.S. or across the world.

When you use our services, our specialists are just a call away, ready to help. So, that worry you had, or that last-minute change? Get in touch, and we'll take care of it.

That means you can get on with what you do best, whether that's advisory or business-as-usual.

The IRIS difference

For those seeking to streamline their payroll processes or let someone else take on the task, IRIS offers the technology, expertise, and support to make it happen. Discover how IRIS can be your ally in navigating the complexities of payroll management and compliance, whether that's domestically or across the globe.



Find out more about IRIS payroll solutions today.