



The black box of business

A guide to understanding payroll risk



A study by Ernst and Young showed that only 6% of organisations consider risk when it comes to implementing a payroll system.¹

¹ Ernst & Young. *Global Payroll: Myth or reality?* April 2013.

Furthermore, 52% stated their payroll system was not built to suit their needs and operated as it did because of historical practices.²

Does your payroll system measure up? Do you clearly understand the risks associated with payroll and whether or not your system can effectively manage them? If not, it's time to open the black box of payroll.

This guide will help you see and mitigate the risk in your payroll before it becomes a major problem for your whole organisation.

² Ernst & Young. *Global Payroll: Myth or reality?* April 2013.



7 major risks to payroll

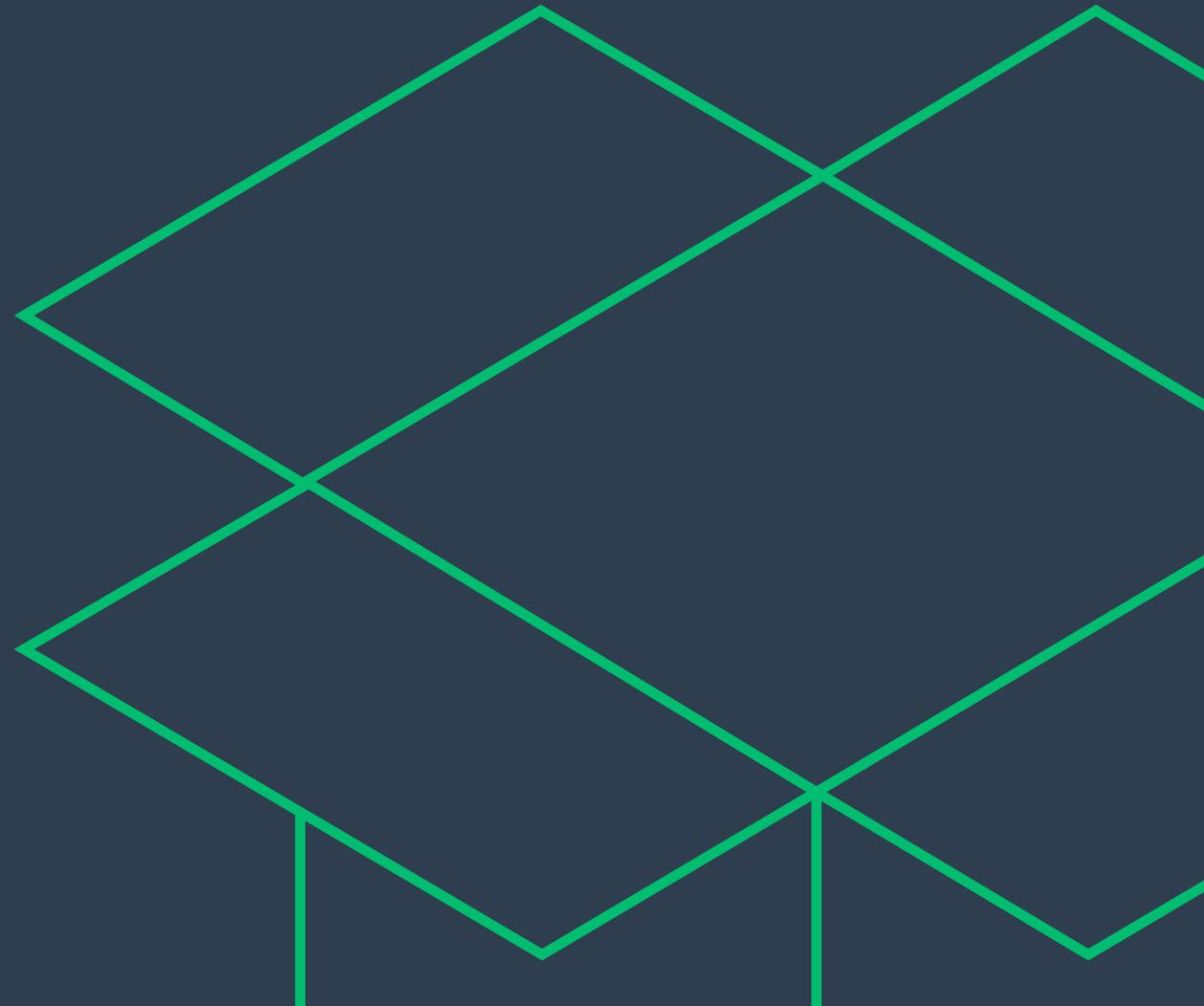
Payroll has historically been seen as a low risk function, generally automated or outsourced and where issues rarely trouble the higher levels of management. That needs to change.³

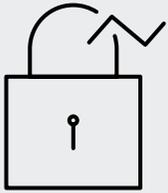
It's important to know what's happening in your payroll. Doing so will help you avoid major challenges due to fraud, non-compliance, loss of a key resource or worse.

As we discuss the seven areas of payroll risk, you'll be presented with key questions that will help you re-evaluate the way in which you approach payroll management.

Now let's open the black box.

³ PwC. *Making Payroll Pay*. March 2017.





Major risk 1

Security breaches

Your payroll holds the most confidential data in your organisation. It holds the most risk if there is a breach, whether it comes from inside or outside of your organisation. That's why security is important.

Technology is important in maintaining security, but even more critical are the security measures in place at both a system and staff level.

This is something Snapchat learned the hard way.

A technology brand that prides itself on privacy and data security, Snapchat has an incredible reputation around the world for its technology. However, a simple phishing email from someone pretending to be the CEO provided confidential employee data to an external source.

'Snapchat's payroll department was targeted by an isolated email phishing scam in which a scammer impersonated our Chief Executive Officer and asked for employee payroll information. Unfortunately, the phishing email wasn't recognized for what it was – a scam – and payroll information about some current and former employees was disclosed externally.'⁴

As you can see from the Snapchat example, if not treated correctly, data security can be easily breached. Only strong, risk averse processes can alleviate this.

⁴ The Guardian. *Snapchat leaks employee pay data after CEO email scam*. March 1, 2016.

Questions you should be asking

- + What processes are in place for your payroll department in regards to how they share their data?
- + Do your processes on managing employee data match the privacy expectations of your employees?
- + Who has access to the data and how often is your user access audited?
- + Are logins used by more than one person, limiting your ability to know who is accessing the system at any one time?
- + Are your employees trained to spot out-of-process events which could be attempts to gain access to data?
- + Are you doing everything you can to keep staff's data completely safe?



Major risk 2

System or data loss

Backup and Disaster Recovery processes are extremely important when it comes to managing the risk of system or data loss. However, implementing these processes isn't enough. Organisations need to be aware of what processes are in place and have them tested to ensure that no matter what happens they can continue paying staff.

If your data is currently stored in the cloud, you may be thinking it's secure and there is nothing to worry about. You probably also have backups and DR processes to recover the data if it's ever lost. However, according to a Symantec survey, 66% of organisations who were operating in the cloud saw data recovery operations fail.⁵

Organisations with an on-premise data solution are also at risk. Disasters such as the Christchurch earthquakes or the Queensland floods exposed a lack of preparedness by businesses for such events. Servers were damaged or trapped in buildings that were inaccessible, so data that was vital to doing business was lost, either temporarily or permanently. Hard lessons were learnt about the need for off-site backups and remote access.

Questions you should be asking

- + Is your payroll data backed up?
If so, where?
- + What are your disaster recovery processes for your payroll?
- + If your current plans fail, how would you recover your data and systems?
- + Can you operate your payroll technology remotely?

⁵ Symantec. *Avoiding the hidden costs of the cloud*. 2013



Major risk 3

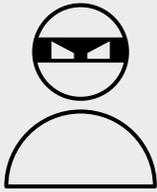
Loss of corporate knowledge

In most organisations, the payroll staff is critical to ensuring everybody gets paid smoothly. This is a key resource risk because only a small number of people know how your specific payroll function works. Without them, your payroll department can't function and you also risk losing the knowledge of how your payroll technology was configured.

So when it comes to corporate knowledge, what your people know about your business and your processes can't be taken for granted.

Questions you should be asking

- + How many people in your business know how to run payroll?
- + Why is your payroll system configured the way it is?
- + What ongoing maintenance is required for your payroll system?
- + Are your payroll processes documented?
- + If your payroll manager left tomorrow, would their replacement be able to immediately run payroll successfully?



Major risk 4

Fraudulent activity

Fraudulent activity in payroll is a massive concern for organisations. An online search of “payroll fraud” will provide you with millions of examples in which companies from around the world have been victims. In Australia, 13% of fraud experienced by companies is through their payroll.⁶

⁶ PwC. *Global Economic Crime Survey: The Australian Story*. 2014.

⁷ The Courier Mail. Sep 28, 2016.

The Courier Mail

A SENIOR Woolworths payroll clerk with a “love of the high life” who secretly siphoned off \$238, 294 was busted just days before she tried to snatch a further \$404,000 and flee to the US.

Melissa Yates, 37, yesterday appeared in the District Court in Brisbane where prosecutor Russell Hood told the court that it was likely she was about to “flee” to the US when she was arrested last October after “extracting as much funds as possible” from Woolworths using her specialised knowledge of the payroll system.

She stole the money by making it look like Woolworths was paying former staff members - when in fact the cash was going directly into her own private bank account.

Mr Hood said Woolworths’ own systems were “not sufficient to pick up her offending” until she forgot to “lock” an accounting document.

“If she hadn’t have made that mistake (the entire \$640,000 fraud) wouldn’t have been detected,” Mr Hood said.⁷



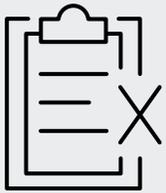
What can be done to prevent instances such as these?

Fit-for-purpose, risk aware processes need to be created, embedded and evolved as your company grows. They need to cover things like segregation of duties, multiple approvers for payments and regular audits.

Without these processes, leaders in a business do not have the tools required to catch potential fraudsters.

Questions you should be asking

- + When did you last audit or review your payroll for indicators of risk, including payments to employees who have now left the business?
- + Is the same person responsible for creating new employees in your payroll system also responsible for paying them?
- + Is the person who pays staff also responsible for approving what they are paid?
- + When bank account details are changed, does your system alert someone other than the person who runs the payroll software?
- + Is your payroll large enough that a significant overpayment would not stand out?
- + Do you have a mechanism to prevent time theft or leave leakage?
- + Who audits the auditors?
- + Would you know if someone has or is committing payroll fraud in your company?



Major risk 5

Non-compliance

Tax compliance is a major focus for organisations when selecting a payroll system. This often leads to the belief that the solution will always keep you compliant with Australian legislation and awards. However, if your system requires manual processes and isn't designed to meet your tax compliance needs, how can you rely on it?

There are many stories of companies who have deliberately payed their staff incorrectly, but there are others who have done so accidentally and fallen foul of regulations. This can happen for several reasons.

If an organisation relies on manual processes it increases the risk of making a mistake or manipulating data. Rekeying, duplicates, accidentally missing records, using the wrong Excel formula – the list goes on.

Perhaps the system implemented isn't fit-for-purpose. Did the evaluation process uncover any limitations of the vendors' systems? Did the team running the implementation correctly replicate the organisation's workflows? There's also the possibility workflows weren't reviewed before they were built into the system.

Maybe the system wasn't updated to reflect new laws. Whatever the reason, it can have a negative impact on an organisations finances and reputation.



The Sydney Morning Herald

Nearly 200 staff at George Calombaris' restaurants have been underpaid \$2.6million, with the celebrity chef blaming "historically poor practices" for the bungle.

– Sydney Morning Herald, April 4, 2017.

The University of Wollongong revealed it is set to repay \$10 million in unpaid entitlements, interest owed and potential penalties after discovering longstanding failures in its payroll system. It is aiming to update its payroll systems by the end of this financial year.

– Sydney Morning Herald, April 5, 2017.

THE AGE

The Queensland Health payroll system failed spectacularly, resulting in thousands of healthcare workers being underpaid, overpaid or not paid at all.

– The Age, April 4, 2016.

Questions you should be asking

- + Is your payroll system compliant with current tax legislation and awards? How accurately are you paying your employees in line with their associated awards and agreements?
- + Does your existing system provide automated interpretation and apply calculations based on a specified set of rules? Or are your line managers and payroll team manually calculating the payments?
- + If your team makes manual calculations, what checks are in place to ensure accuracy?
- + How does your payroll team keep you compliant if tax legislation suddenly changes? For example, how did your business handle the multiple changes in 2016?
- + Are you absolutely confident you're paying employees in complete accordance with your obligations?



Major risk 6

Soft costs

Do you know what your payroll cost you last year?

Some organisations will do a quick calculation by working out the total amount they paid their employees last month and multiplying by twelve. Others produce a quick report from their system. A few will even tell you the cost of the payroll, plus the cost of payroll staff and the annual cost to run the payroll technology they use. However, not many businesses can tell you the 'soft costs'. These are costs created by payroll processes not designed to maximise the operational efficiencies of your workforce. These costs can't be seen but your profit line feels their impact.

Examples of soft costs

Diversion from core role to admin

Managers are key people. They ensure operational efficiency, recruit, develop and retain staff, and report back to the business. By asking them to follow processes which are manual or not fit-for-purpose, we're diverting them from their core role. The average person spends two weeks a year on manual processes in their organisation, and your organisation could be incurring this cost.

Poor data management

Instead of leveraging a fit-for-purpose system to manage data information, many organisations use spreadsheets or email. This produces unreliable data, which is then handled multiple times, stored in different spreadsheets, emails and word documents across the business, and then used to report critical information back to leaders in the business. Managers and executives in the business are then using potentially incorrect data to make critical business decisions.

No true cost of operation

If your organisation mostly employs salaried employees, then your payroll will only reflect the standard cost of those employees and not the time they are taking to do their roles. Perhaps they are taking longer to complete tasks than you realise. Lack of insight into your staff's performance means you're missing out on opportunities to drive efficiencies in your organisation.

Timely visibility into consequences of decisions

Your labour costs will be one of the highest cost centres in your business but often organisations have no visibility into the financial implications of their staff decisions. Managers do not know how much a shift has cost the business until it's too late. Often these staffing and workforce decisions are made quickly and under pressure. Your staffing requirements can be costlier than they need to be.

Businesses don't realise that they can provide information about staffing costs, whether for full-time or casual employees, enabling the manager to make the most prudent choice rather than going with the most convenient option. The cost of these staffing decisions can often go undocumented because of the weeks it takes for costs to hit your General Ledger. Without strong, fit-for-purpose processes giving you in-depth payroll reporting, you may never get the full picture of what your staffing decisions may be costing your business.

Leaking time

Many organisations suffer from time or annual leave theft. Some of this may be attributed to dishonesty, but most is accidental and caused by the processes and systems that are built for time capture. Time and annual leave management processes are often built for those in head office processing the information, and not for those who are using them every day to record their time.

This creates challenges when completing forms and reviewing the information. This may mean an exec cannot accurately determine how many annual leave days their staff are taking out in the field or the hours they are on site, and therefore has no way to reduce or prevent this potentially high soft cost.

Material costs

Payroll as a function is like any other in the business, to operate it requires the support of shared services. Your payroll staff is a cost centre, utilising office space, furniture, desks and computers, as well their share of any other facilities and equipment.

If you have an onsite deployment, your payroll system and data will need IT infrastructure and support. As these resources are given to the payroll function, you need to invest further to provide them to other areas of the business. It's a necessary and unavoidable cost of doing business.

Cost of growth

When a business expands, and hires new employees, it will often have to scale up its payroll department to meet the increased needs of this larger workforce. This is a cost of growth. If a company with manual processes or systems that are not fit-for-purpose grows significantly and doesn't hire more payroll talent, they are putting their payroll at greater risk due to increased human error caused by a faster pace of work to accommodate the necessary volume and burnout of payroll staff.

A business leader who is serious about expanding their business could eliminate this cost of growth by building processes and investing in systems that enable business growth without needing to grow the personnel in the payroll team.

Questions you should be asking

- + Is your time capture process complicated, therefore taking your talented staff away from their core role?
- + Are you relying on your line managers to undertake ad hoc admin tasks for time management or payroll?
- + Do your managers and payroll team receive requests from different areas of the business for the same information?
- + Where do your managers get their information? Are they self-serving from multiple spreadsheets in multiple locations by multiple authors?
- + If line managers must hire staff at short notice, are they presented with a list of costed choices so they can match these against their budget? Or are they left to make the most convenient choice?
- + Are you planning to grow your business over the next few years? Have you accounted for growing the payroll function?
- + How do you currently measure your payroll soft costs?





Major risk 7

Business fit

An organisation's payroll processes and systems tend to remain in place and unchanged for years. Companies are still doing things the same way they did years ago, even if their needs have changed. A system or process that is no longer fit for your business means you'll be unable to effectively manage labour costs, increase profits, improve your efficiency and seize opportunities.

Questions you should be asking

- + Think back to your first day in the business. How have your payroll processes changed since then?
- + When were your payroll systems and processes built? Have they been evaluated since?
- + Is the payroll function meeting the expectations of the business?
- + Have other functions in your business evolved their processes to meet commercial requirements? Why hasn't payroll?
- + Are the skills in your payroll department fit for purpose?
- + When implementing new software that affects your staff, do you consider the payroll function?
- + What is the business rationale for not reviewing payroll processes and technology?



It's time to undertake a risk assessment

If you don't know the answer to any of the questions in this guide, a risk assessment is highly recommended to help protect your organisation.

Risk assessments can be undertaken internally or externally, however an external assessment is recommended. An external person will have no inherent bias, no reasoning as to why something is done the way it is, and, most importantly, should have strong knowledge of payroll best practice in your industry and in your company size bracket.





Need to talk payroll risk?

Protect your business against the many risks that may impact your payroll.

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