

PAYROLL AND BENEFIT REVIEW – SERVICE PROVISION

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INTRODUCTION

The Office of the City Auditor completed three of the four objectives outlined in the terms of reference for the Review of the Payroll and Benefits and reported those results 2001. Those reports related to the following objectives:

1. To confirm the existence, assess the effectiveness and check the continuity of internal controls over the input, processing and output (including pass off) of payroll and benefits transactions.
2. To provide assurance that adequate controls are in place for complete, accurate and timely processing for payroll and benefits for DATs drivers.
3. To assess whether the OCA recommendations relating to Direct Deposit have been addressed satisfactorily.

The fourth and final objective is to determine and compare the costs and benefits of providing payroll and benefits services internally and externally, this report provides the results of this objective.

The history behind the initial review is that in 1999, major upgrades to the Human Resources Information System (HRIS) were implemented. Those changes introduced some areas of the City to new technologies and methodologies for processing time entry. These initiatives together with changes required by HR to meet the goals set during the City '97 project resulted in personnel reductions in HR during 1999. The risks associated with staff reductions and reengineered processes were significant, as a result HR requested that an audit of the payroll and benefits processes be included in the Office of the City Auditor Annual Plan.

BACKGROUND

The Payroll services area (Employee Service Centre or ESC) is responsible for the coordination of all payroll, benefit, pension, and HR transactional activities in the corporation. This unit is responsible for the following:

- Providing payroll and benefits administration for all city employees
- Consulting with employees regarding pay, benefit and pension issues
- Managing all employee pay and benefit information (records)
- Conducting new employee sign-on procedures and orientations
- Providing immediate access for employees to payroll/benefit information through the ESC

Refer to Exhibit 1 for a functional (input, processing and output) layout of the City's complete Payroll and Benefits Process.

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SCOPE

To determine and compare the cost/benefits of providing payroll and benefits services internally and externally. The scope of the review is limited to payroll and benefits costs and transactions processed during 2001.

METHODOLOGY

Analysis and evaluation was carried out as follows:

1. Analysed quantitative statistics received from ESC.
2. Determined the current in-house service level and the costs for that service.
3. Compiled and analysed the data received from other municipalities and organizations. (Refer to Appendix 1)
4. Analysed contracted services and as possible, obtained the associated costs to compare with internal services. (Refer to Appendices 2 and 3)
5. Reviewed positive and negative qualitative factors associated with external vs. internal service provision. (Refer to Appendix 4)

SUMMARY OF RESULTS

The following observations were made:

- The current in-house cost of providing payroll and benefit services, Peoplesoft business support, and IT Peoplesoft maintenance is approximately \$2.4 million annually. It is difficult to compare the costs with other cities and organizations against the costs incurred by the City for these services since, in most cases, the financial data is unavailable or is not directly comparable because of varying staffing models.

Other municipalities have as many as 126 staff members providing payroll and benefit services and time entry. This number includes the field operational staff members who do time entry and pass off, but are classified as payroll employees.

- The comparable Canadian cities surveyed also provide their payroll services internally. Some cities have considered outsourcing as an alternative, but found through their research and consultation that outsourcing was more suited to small to medium businesses (that is, less than 500 employees).
- Some Canadian municipalities have contracted portions of their payroll activities, such as the automated gross to net pay process, which is the process most easily automated. One large public sector organization has externally contracted the IT maintenance portion of Peoplesoft, but they experienced no corresponding reduction in FTE costs. The net effect was higher total cost to that organization.
- A cursory comparison of processing payroll internally vs. externally through a payroll service provider indicated that the City would need to retain a central processing centre to maintain employee earnings and deductions in addition to providing remote input for

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timecards. The City would be required to provide gross pay to any service provider, which means the bulk of the work involved in labour distributions would still have to be done internally. External payroll service providers typically perform only the final stage calculation of gross pay to net pay, which is essentially an automated process.

- In discussions with one external provider, they indicated that they understood that the City's implementation of Peoplesoft is somewhat customized as a result of Union Agreement requirements, resulting in a strong possibility of higher than average maintenance costs. According to City sources, the City's implementation of Peoplesoft has been customized to accommodate the complexity of Union agreements, virtually guaranteeing higher than average system maintenance costs, whether performed internally or externally.

Estimated costs for contracted Gross to Net and Peoplesoft maintenance were obtained from two major organizations. Based on the data received from these two organizations, the OCA estimated the minimum probable cost to the City for external services. As identified in Appendix 2, the estimated average cost to provide the services externally instead of internally would be \$2.7 million vs. \$2.4 million. Based on costs alone, external service provision of payroll and benefit services is not expected to be beneficial to the City.

Some of the qualitative factors to consider in evaluating internal vs. external service provision are highlighted in Appendix 3.

CONCLUSION

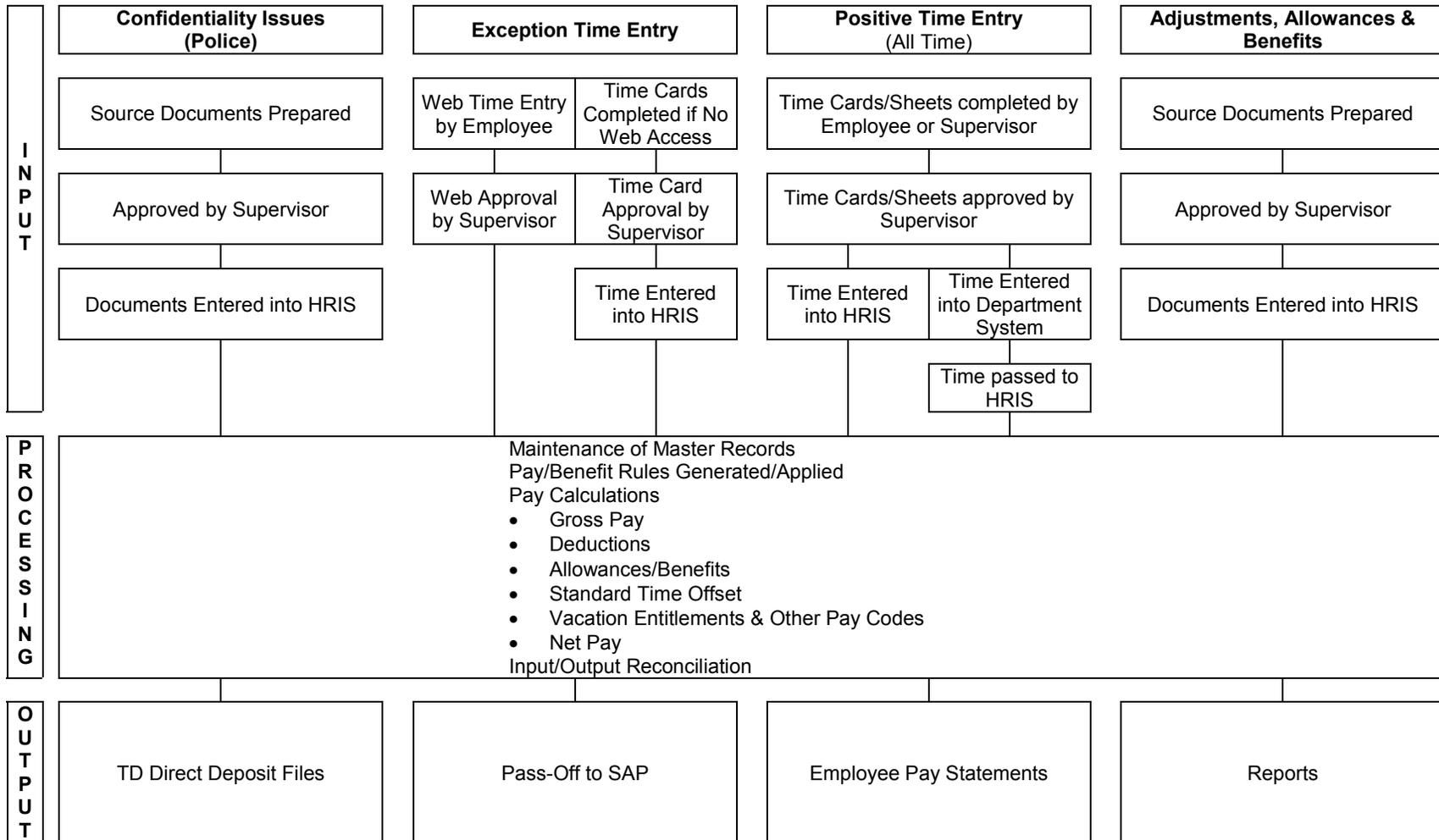
Based solely on the cost comparisons of internal vs. external service provision, it is not likely that contracting for payroll and benefits services would be cost-effective. However, the Administration still needs to address some fundamental questions relating to the achievement of organizational strategies in order to pursue a more comprehensive decision. In determining the direction the City wishes to take, questions such as these need to be answered:

- Would external service provision better support the achievement of the City's strategies and values as stated in the Corporate Business Plan, the Corporate Mission, Vision and Values Statement, the Working Relationship Agreement, etc.?
- Does the organization wish to obtain strategic value beyond any potential of reduced costs?

If the answers to these questions lead toward further consideration of the option of using the services of an external service provider, then considerations such as quality, price, reputation, flexibility of contract, scope (pension, payroll and benefits), location, cultural, and boundaries (e.g., whether or not Police and Library service are to be included) would need to be further explored. If the decision is then made to proceed, implementation and management processes would then need to be considered in detail (e.g., contract monitoring, communication, and motivation of the employees to adapt to these changes within the organization). These steps would need to be undertaken only if the City decides to pursue a relationship with an external service provider for other than economic reasons (e.g., as a means of transitioning from one payroll system to another without hiring additional staff for the short term).

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Exhibit 1



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APPENDIX 1 – SURVEY RESULTS FROM OTHER ORGANIZATIONS

	City of Edmonton	City A	City B	City C	Educ. Org.	Gov. Sector
City Population	650,000	860,000	630,000	730,000	N/A	N/A
Number of Employees/FTE's	10,500 (8,400 Regular)	12,570 (10,456 Regular)	9,700	16,250 FTE's	10,000	43,000
# of Empl. coordinating Payroll/ Benefit - Centrally	41 not including field time entry	126 including field time entry staff	32 (12 +20 Emp. Ben. Board)	75	52 no impact on FTEs	N/A
Contracted Activities	NO	NO	NO	YES	YES	YES
Activity Contracted	N/A	N/A	N/A	Gross to Net Pay \$1.0 M	IT - Mtce. of People-Soft \$4.0 M	Gross to Net and IT -Mtce. of People
Operating Costs	\$2.4 M*	N/A	N/A	N/A	N/A	N/A

* Includes Costs and FTE's for the *Employee Service Centre* = \$1.4M plus *Business Peoplesoft support, IT Peoplesoft support, and Peoplesoft maintenance contract* = \$1.0M

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APPENDIX 2 – COST COMPARISON OF INTERNAL VERSUS EXTERNAL

INTERNAL COSTS		
1. Direct Personnel Costs including overheads	\$1,968,000	
2. Direct Non-Personnel Costs	\$ 432,000	
3. Total Internal Costs		\$2,400,000
EXTERNAL COSTS		
4. Estimated contractor Costs		
• Gross to Net	\$500,000 to 1,000,000	min. \$500,000 max. \$1,000,000 avg. \$750,000
• Peoplesoft IT Support	\$1,600,000	\$1,600,000
5. Contract Administration Costs @ 1.17% (conservative)	(500,000 + 1,600,000) X 1.17 = \$2,457,000 (Min.) (1,000,000 + 1,600,000) X 1.17 = \$3,042,000 (Max.) (750,000 + 1,600,000) X 1.17 =\$2,749,500 (Avg.)	
6. One-Time Conversion costs		\$?
7. Off Setting Revenues		\$?
8. Total Projected External Costs		Min. \$2.5 million Max. \$3.0 million Avg. \$2.7 million
DECISION CRITERIA		
9. Cost Comparison: Total Internal Costs (3) / Total External Costs(8) = \$2.4/\$2.5 = 97% at lowest estimated cost \$2.4/\$3.0 = 79% at maximum estimated cost \$2.4/\$2.7 = 87.2% at average estimated cost		
Usually a Percentage at Line 9 equal to or greater than 110% supports a recommendation to further consider external service provision.		
<p>Contractor Costs are the total costs a contractor would charge for performing the target services</p> <p>Contract Administration Costs can be defined as all those activities that take place from the time a decision is made to use the services of an external service provider until the contract is fully executed and final payment is made. Contract administration costs include procurement, contract negotiations, contract award, the processing of amendments and change orders, the resolution of disputes, the processing of contractor invoices, and contract monitoring and evaluation. An industry standard and reasonable estimate of contract administration cost for municipal contracting is between 10% and 25% averages 17%.</p> <p>One Time Conversion Costs: One-time costs are sometimes incurred when converting a target service from in-house to contract service delivery. Examples of one-time conversion costs include: personnel related costs, material related costs, other costs (terminating rentals and transition costs).</p> <p>Total Contract Costs:: When contractor costs, contract administration costs, and one-time conversion costs are combined and reduced by any offsetting revenues, the resulting dollar amount represents the cost of contract delivery.</p>		

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APPENDIX 3: CONTRACTED SERVICES ESTIMATED COSTS

	Provider A	Provider B	Provider C	Provider D
Gross to Net Pay	√	√	√	√
Direct Deposit	√	√	√	√
T'4's and T4A's	√	√	√	√
Vacation/Sick Day Accrual Tracking	√	√	√	√
Payroll Stubs	√	√	√	√
Payroll Reports	√	√	√	√
Payroll Data download	√	√	√	√
Year end reset and adjustments	√	—	√	√
IT Peoplesoft Maintenance	—	—	√	√
User Help Desk (not for employees)	—	—	√	√
Estimated Contractor Costs:	\$10K per pay period	\$15.8K per pay period	Unable to provide as they are aware the City has a customized version of Peoplesoft, thereby, possibly resulting in much higher costs than a quote can provide.	
Estimated Total Contractor Costs:	\$312K for 1 year plus support costs	\$495.6K for 1 year plus support costs	Estimated at least \$1 million	

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APPENDIX 4 – POSITIVE AND NEGATIVE FACTORS ASSOCIATED WITH EXTERNAL SERVICE PROVISION

Qualitative	Internal	External
Positive		
	Lower Operating costs	Upgrade costs for Peoplesoft may be shared with others
	Increase focus and assistance to other areas	Technology upgrade costs may be shared with others
	Free up resources for use in other areas	Training and recruiting costs are borne by contractor
	Avoid some future costs of upgrading technology	
Negative		
	Organizations are usually required to compile and provide gross pay to External contractor, which is the bulk of the work	The cost of high services levels i.e., 24/7 in system availability will be costly
	Time will have to be spent making current city payroll services more standardized , that is, limiting pay frequencies, # of pay days, # of payment methods, etc	Difficulty in knowledge transfer (over 400 payroll codes, complexity of 13 Union Agreements, and difficulties managing pass off systems)
	Decreased employee support/ morale/dedication/expertise	Due to customized approach to Peoplesoft in the City, costs to maintain by external contractor are likely to be higher than internal service provision
	Increased contract costs (such as critical fixes) due to customization of Peoplesoft	
	Decreased personnel retention	
	Increased costs associated with monitoring and evaluating the contract	
	Decreased data confidentiality (Police)	