




MANAGING RISKS IN HRO & PEO CONTRACTS: REDUCING COSTS AND RAISING PROFITABILITY

Webinar

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JOINTLY PRESENTED BY:
**JAMES RIVER CONSULTING LLC AND INTEGRATED
STAFFING INC.**



YOUR SMALL BUSINESS HUMAN RESOURCES DEPARTMENT

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MANAGING RISKS IN HRO & PEO CONTRACTS

James River Consulting LLC www.jamesriverllc.com

Expertise in IT and business-to-business services contracts

Former general counsel and in house lawyer for corporations

- Wrote and administered employee manuals, sales compensation programs
- Administered co-employment for medium size IT services company

Integrated Staffing Inc. www.integratedstaffing.com

Founded 1998

Payroll administration and human resources consulting services

Expertise in all models of HR, employer and administrative outsourcing

Expertise in State and Federal compliance

MANAGING RISKS IN HRO & PEO CONTRACTS

Industry Figures

- HR outsourcing to the small market is a staggering \$44 billion per year¹
- 5% of U.S. small businesses with 50 or fewer employees utilize a PEO for managing their HR administration¹
- Companies outsourcing HR can reasonably expect 10-20% cost savings according to IDC analyst Linda Rowan

¹ IDC Special Study, "HR BPO and PEO Outsourcing Options for the Small Market" (IDC #205128; January 2007)

MANAGING RISKS IN HRO & PEO CONTRACTS

Spectrum of Outsourcing Relationships

Outsourcing Contract Layers Analysis	PEO	HRO	ASO	HR Consulting & Staffing
GOALS	Cost, Risk Management, Non Core Function	Cost, Risk Management, Improve Operation	Cost	Knowledge Transfer, Maintain Operation
MODELS	Co-Employment of Workforce	Business Process Outsourcing	Computing & Administrative Services	Services
GOVERNANCE	Partnership Roles & Respon.'s, Business Impact	Joint Management, SLAs	Requirements	Supervision
PERSONNEL	Trans. Employees, HR Function	Replace HR Person., Some/All Processes	Systems Admin. Personnel	Retain
INFRASTRUC.	Data, Systems, Insurance, Benefits Assets	Data and Systems or Access	Data	N/A
TERMS	Pricing Scheme, Allocation of Risk	Pricing Scheme, Scope	Commodity Pricing	Hourly Rates

1997 Microsoft Stock Options Case

MANAGING RISKS IN HRO & PEO CONTRACTS

Four Major Service Areas

PAYROLL ADMINISTRATION

Prepare and distribute payroll checks	Direct deposit of wages to bank accounts	Year end W2s and W3s
Payroll data maintenance	Federal, state and local withholding and tax deposits	Payroll related record keeping, audits, inquiries and verifications
Response to I-9 inquiries	Reporting and job costing	Time clock management
Vacation and sick leave tracking	Payroll software management and accounting (GL) entries	Tax changes administration

BENEFITS ADMINISTRATION

Plan communications to employees	Benefits handbook creation and distribution	Annual enrollments and adds/drops
Eligibility tracking	COBRA compliance and administration	Plan discrimination testing
Flexible spending accounts (FSA) administration	Carrier payments and account audits	Annual plan cost reviews
401K administration, company matching and plan testing (highly compensated)	Section 125 (pretax) premium audits	Life Insurance (if offered) plan administration
Employee assistance plans (EAP) administration	Short term disability plan administration	Long term disability plan administration

WORKER'S COMP ADMINISTRATION

Claims review and administration	Safety plan creation, administration and training	Report and document accidents
Work Comp billing reconciliation	Safety audits and reviews	OSHA Compliance
Annual policy cost reviews	Dividend plan reviews and audits	NCCI mod rate reviews

HR ADMINISTRATION

Legal assistance establishment and retainers	Review, draft and communicate employment policies	Create and publish legally valid employee handbooks
Manage insurance for Employment Practices Liability (EPL)	Employment posters and notices	Unemployment claims administration
Background checks	Audit compliance with Wage and Hour (FLSA)	Audit compliance with ADA – Disability Act
Audit compliance with EEOC	Audit compliance with OSHA	Attendance audits
Employment applications	Applicant interviewer training practices	I9 compliance

KEY DRIVERS

Adapted from Materials Posted on Staffmarket.com

MANAGING RISKS IN HRO & PEO CONTRACTS

Risk Management Issues

Pricing

- Schemes-PEO, HRO
 - **Percentage of Payroll**
 - **Bundled Fixed Price Per Employee**
 - **Fixed Price Baseline with Increase Charges/Reduction Credits**
 - **Others: Unit Pricing-ASO, Hourly Rate-Staffing**
- Guiding Principles:
 1. **Fixed prices** benefits customers, depending on what is included.
 2. **Cost based pricing and hourly charges** benefit vendors and are justified in limited situations, E.g., lift and shift unique processes, lack of data on which to calculate price
 3. **Volume and usage based pricing** are more closely related to value and should be used whenever possible, E.g., assessment and operations data, standardized and automated services

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Risk Management Issues

Costs

Two Key Q's: 1) What is included?
and 2) What can be controlled?

Direct Costs-PEO, HRO

- **Pass Ons:** What costs are passed on under the outsourcing model? E.g., withholdings, insurance premiums, benefit administration costs
- **Cost Adjustments:** Are future cost increases built into the pricing? E.g., insurance premiums What about future cost decreases?
- **Extraordinary Fees:** Are there extra fees for non-recurring work? E.g., turnover
- **Late Payment Charges:** Are there penalties for customer's failure to meet responsibilities? E.g., late payroll
- **Carve Outs and Backsourcing:** Can individual HR features be carved out or brought back inside the company? E.g., Workers Comp insurance

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Risk Management Issues Costs

Administration Costs-PEO, HRO

- **Transition** What are the estimated costs of the outsourcing? E.g., training on new HR processes, IT systems integration
- **Account Management** Who monitors performance and handles complaints? E.g., Timely processing of new employees, unpaid sick leave
- **Termination**

Indirect Costs-PEO, HRO

- **Legal and Professional Services** Who pays third party professional fees? E.g., advice, audits, investigations, administrative hearings, litigation

Gray Area

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Risk Management Issues

Liabilities-PEO, HRO, ASO, Staffing

Allocation of Risks: Indemnification, Liability Insurance Limits, Specific Events

Liabilities-PEO and HRO

Government and Legal Compliance: Customer Liability Continues

- IRS
- FLSA, FMLA, State Wage Laws
- State Workers Compensation and Unemployment Claims
- EEOC
- OSHA
- ERISA

Liabilities-PEO Only

Customer's Customer's Claims: E&O, IP & Data Theft and Loss, Unauthorized Disclosure, Security Breach

Employee Contracts and Policies: Non-Disclosures, Non-Competes, Outsourcing Customer Claims

Internal Threats: EPLI Claims (Employees Claims Against Employers)

External Threats: Poaching, Labor Organizations

MANAGING RISKS IN HRO & PEO CONTRACTS

EEOC "WHO IS AN EMPLOYEE?" LIST OF FACTORS

- The employer has the right to control when, where, and how the worker performs the job.
- The work does not require a high level of skill or expertise.
- The employer furnishes the tools, materials, and equipment.
- The work is performed on the employer's premises.
- There is a continuing relationship between the worker and the employer.
- The employer has the right to assign additional projects to the worker.
- The employer sets the hours of work and the duration of the job.
- The worker is paid by the hour, week, or month rather than the agreed cost of performing a particular job.
- The worker does not hire and pay assistants.
- The work performed by the worker is part of the regular business of the employer.
- The employer is in business.
- The worker is not engaged in his/her own distinct occupation or business.
- The employer provides the worker with benefits such as insurance, leave, or workers' compensation.
- The worker is considered an employee of the employer for tax purposes (i.e., the employer withholds federal, state, and Social Security taxes).
- The employer can discharge the worker.
- The worker and the employer believe that they are creating an employer-employee relationship.

Excerpted from EEOC Compliance Manual Section 2: Threshold Issues



What is employment practices liability insurance (EPLI)?

EPLI covers businesses against claims by workers that their legal rights as employees of the company have been violated.

The number of lawsuits filed by employees against their employers has been rising. While most suits are filed against large corporations, no company is immune to such lawsuits. Recognizing that smaller companies now need this kind of protection, some insurers provide this coverage as an endorsement to their Businessowners Policy (BOP). An endorsement changes the terms and conditions of the policy. Other companies offer EPLI as a stand-alone coverage.

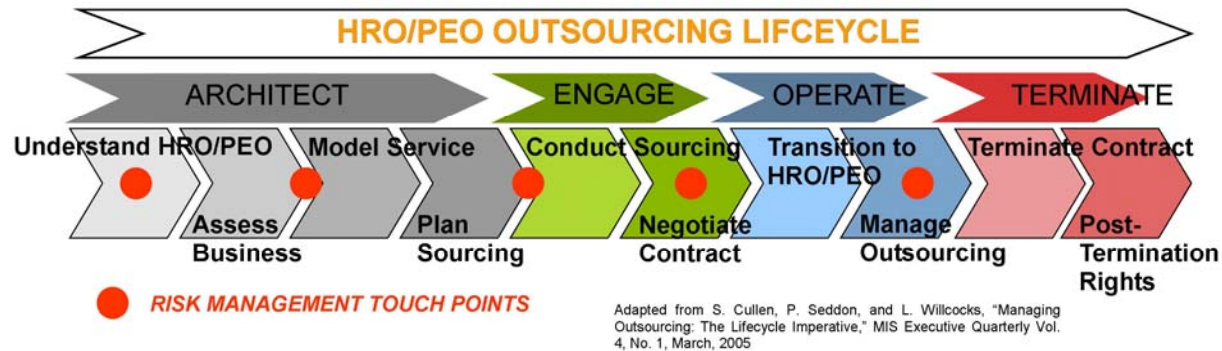
EPLI provides protection against many kinds of employee lawsuits, including claims of:

- Sexual harassment
- Discrimination
- Wrongful termination
- Breach of employment contract
- Negligent evaluation
- Failure to employ or promote
- Wrongful discipline
- Deprivation of career opportunity
- Wrongful infliction of emotional distress
- Mismanagement of employee benefit plans

The cost of EPLI coverage depends on your type of business, the number of employees you have and various risk factors such as whether your company has been sued over employment practices in the past. The policies will reimburse your company against the costs of defending a lawsuit in court and for judgments and settlements. The policy covers legal costs, whether your company wins or loses the suit. Policies also typically do not pay for punitive damages or civil or criminal fines. Liabilities covered by other insurance policies such as workers compensation are excluded from EPLI policies.

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Risk Management Touchpoints Lifecycle



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Risk Management Touchpoints Touchpoints

1. **Understand HRO & PEO** → *Is outsourcing something the company wants?*
 - Relationship Alternatives and Features
 - Risks

2. **Internal Assessment** → *Will the benefits of HRO and PEO outweigh the risks?*
 - Feasibility Analysis: Management, Employees, Customers, Regulators, Investors
 - Cost Analysis: Hard, soft, management
 - Model: PEO, HRO “Lift and Shift” or Standardized Services, ASO, Staffing
 - “Must Have” Terms, E.g., Compliance indemnity, fixed price

3. **Sourcing** → *Which HRO or PEO vendor best fits the risk objectives?*
 - Vendor Qualifications, E.g., Offerings, pricing schemes, conflicts of interest
 - Vendor Assessment of Customer, E.g., HR management (policies, processes), personnel records, historical data (turnover and accidents)
 - Online PEO Brokers?

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Risk Management Strategies

Risk Touchpoints

4. **Negotiation** → What are the key risk management terms HRO or PEO contracts?
– Major “Gives and Takes”

Division of HR Activities
Takeaway: Not completely giving up HR functions can actually reduce overall risk for the customer.

Allocation of Risk Absorption and Deterrence
Takeaway: Risk absorption and deterrence are more in the control of the parties than actual liability.

Calculation of Cost/Price Basis
Takeaway: Not addressing future costs and indirect costs in pricing will offset expected ROI.



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Risk Management Strategies

Risk Touchpoints

5. **Management** → How can risks during HRO or PEO services be best managed?
 - SLAs and Transparency

Payroll Input Timeliness	Percentage of payroll files that are provided by Client to Service Provider by the payroll processing cut-off time for the applicable payroll cycle	# payroll files provided on time/ Total # of payroll files provided
Payroll Accuracy	Percentage of payroll activities that are completed without errors	# of salary payments paid without error/ Total # of salary payments paid within the period
Payroll Input Accuracy	Percentage of employee payroll files that are provided by Client to Service Provider without errors	# of payroll files that are submitted to the Provider without errors/ Total # of payroll files submitted to the Provider
Legal Directive Timeliness	Percentage of Legal Directives that are complied with by Service Provider within the required time frames	# of Legal Directives that are complied with within the required time frame/ Total # of Legal Directives complied
Payroll Reconciliation Accuracy	Percentage of General Ledger and bank account reconciliations that are completed correctly and in accordance with policy	# of GL and bank account reconciliations that are completed without error/ Total # of GL and bank account reconciliations that are completed in the measurement period

Source: S Lepeak Et. Al., The Issue: How to Design and Tailor Effective SLAs for HR Outsourcing (2007, EquaTerra)

MANAGING RISKS IN HRO & PEO CONTRACTS

Conclusion

- Know your company, E.g., activity based costing, assessed operations, value opportunities
- Know what you want, E.g., HRO, PEO, a la carte
- Give providers transparency into company including “skeletons”
- Risk management happens before, during and after the outsourcing contract
- Contracts must spell out everything, don’t leave issues to chance
- Know what you are still legally responsible for