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## Payroll Reform

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## Thought bubble: Payroll Reform

By Neil McCormick & Chris Andrews

Business is moving to a level of integrated data and analysis not considered possible twenty years or so ago. All of this data is, in some ways, valuable and, in others, nothing more than “clutter” distracting us from what we should be capturing and analyzing. The field of Human Resource Management is no different. We see a plethora of systems and solutions, offering a wide array of Data Gathering and Analysis. We are also in the midst of a significant push toward International and National Standards for Human Resource best practice. Before we head down the “rabbit hole” of data collection, monitoring, and analysis, we need to think through what data is significant and what fits this “clutter” category. We also need to ask that ubiquitous question; “Why do we do the things we do?”

To that end, the authors have looked for complexity in workforce management and human resource services and decided that there is one area that all businesses find at best, painful, and at worst dysfunctional and costly.

That particular area is Payroll.

*Why can't we adopt a national payroll standard that suits most organizations and provides standardized configuration across significant systems?*

Payroll is defined as the list of an organization's employees showing how much each earns, but it can also refer to payroll processing – the recording, calculation and money transfer to the people employed and other involved entities.

Tracy Angwin (2019) makes the excellent point that the payroll function is typically underestimated by those not working in it. When running well, it is rarely given consideration, but if something goes horribly wrong – such as a significant underpayment or a missed pay date – watch employee anger flash.

Payroll is an essential transaction process with closer ties to finance than human resources. Increasingly, business is cited as complacent concerning payroll underpayments (Marin-Guzman 2018) and payroll, in general, is a matter of significance in due diligence for corporate takeovers (Patty 2019). When it goes wrong, it can go wrong in a big way.

Payroll is beset by *needless variation*, introducing significant risk, making compliance more difficult than it should be and acting as a sea-anchor on business processing efficiency. Anyone planning to work on big data based on current organization and payroll data needs to know the information is accurate and timely. HR data quality, including payroll data quality, is still a big issue.

So, if we were to Start Again and reinvent the Payroll function – how would it look?

Audience warning: *payroll consultants need to turn away now as reading onward will just cause distress ...*

## **National Standard**

If every state had a different railroad gauge that would be a good example of *needless variation*. In payroll, we have hourly, weekly, bi-weekly or fortnightly, monthly, bi-monthly, and annual salaried employees. These often exist at the same time; their pay can be based on working hours per week, working days per month, working days per year (261\* one year, different another), weekly hours, fortnightly hours, monthly or annual hours (2080 or 2087 hours anyone?). The formula for getting from an annual salary to a weekly rate can vary anywhere between [annual divided by 52] to [annual dividend by 52.25]. Why the variation when a scientist can tell you what the correct answer should be?

Why can't we adopt a national payroll standard that suits most organizations and provides standardized configuration across major payroll systems?

## **Complex Systems that don't integrate**

If you have ever seen the struggle two merging entities have when they operate different payroll systems, you will understand the underlying issue of needless variation. Even getting integration between payroll modules and other HR-related software is a challenge. Configuration of a payroll system is a consulting task with an essential but mind-boggling array of possibilities. If configuration were streamlined through national standards, payroll risk would be reduced, and compliance increased. Technology companies working on integrations would also benefit from standards adopted uniformly.

## **Mathematics**

When working out Payroll configuration, there are some things that science can answer better than a payroll specialist. How do we convert an annual salary to a weekly amount?

Payroll might say there are 52.1786 weeks in a year based on either the working days or the working hours methods. In Australia, for instance, the default answer would be 52.1667 weeks.

Science will say that a mean calendar year consists of 365 days, 5 hours, 49 minutes, and 12 seconds – the decimal equivalent being 365.2425, giving a weekly conversion factor of 52.1775.

## **Little Data needs to be accurate before Big Data**

Business analysts and finance staff are typically modeling staff costs in MS Excel, which has a vast array of features designed to assist. MS Excel can easily cope with rounding rules, decimals, fractions, and percentages, but payroll systems generally can't replicate many of the same features.

Try putting a fraction into a standard pay system calculation! It generally needs to be converted to decimal but watch the rounding rules here. Payroll systems often round too early in a calculation.

## **Uniformity**

The first rule of payroll is that compliance is absolute – near enough is just not good enough. "Right first time" is the second rule - the time taken to rectify pays when errors occur is a significant blow to both efficiency and staff goodwill. Any step taken to reduce complexity and introduce standard formulas that are nationally sanctioned will encourage a technological shift from catering for needless variation to core simplicity, interoperability, and easier integration.

Why don't we just *standardize* on bi-weekly/fortnightly pay for regular workers, and weekly pay for the rest? Heresy I know, our configuration challenges would drop dramatically. Payroll managers

would breathe a sigh of relief. Compliance would be improved by having standardized formulas across industry, reducing needless variation for employers and employees.

### Conclusion

We can strive to be ‘agile’ in payroll and continue to tolerate maximum variation as we do now. The option of producing a National Payroll Standard which eliminates needless variation is an alternate future. The standard would be voluntary, but it will make such good business sense for industry to adopt we predict the standard will flourish by choice.

<b>National Standard</b>	<b>All Regular Workers</b>
Pay cycle	Bi-weekly or Fortnightly
Annual to fortnight divisor	26.0888
Implied working hours per year	2087.10
Additional pay – 27 pays in a year	1 every 11.2 years on average
Hourly rate accuracy	Six decimal points*

<b>National Standard</b>	<b>Irregular Workers</b>
Pay cycle	Weekly
Annual to weekly divisor	52.1775
Implied working hours per year	2087.10
Additional pay – 53 pays in a year	1 every 5.6 years on average
Hourly rate accuracy	Six decimal points*

What else would you want to see in a National Payroll Standard?

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### References:

Marin-Guzman, 2018, *Deloitte partner warns business ‘complacent’ over underpayments*, Financial Review, 2 Dec 2018

Patty, 2019, *Payroll Integrity now a factor in corporate takeovers after wage scandals*, Sydney Morning Herald, 24 June 2019

Gregorian Divisor: this method is based on the Gregorian calendar, a refinement to the Julian calendar, amounting to a 0.0011% correction to the calculation of the weeks in a year. This method is more exact – based on a year of 365 days, five hours, 49 minutes, and 12 seconds – the decimal equivalent being 365.2425.

\* In order to maintain annual salary accuracy to two decimal points the Sugden Model suggests we need to have six decimal places at the hourly level to maintain internal consistency.