



# **Payroll Processing and the Entrepreneur**

## **The Impact on Employers and Employees**

This white paper outlines the complex world of payroll for smaller businesses, and the rewards of a consistent, accurate payroll for business owners and their employees.

## Executive Summary

When it comes to running a new business, most entrepreneurs learn as they go. There's a certain pride in the do-it-yourself approach. But when that business grows sufficiently to require additional personnel, the entrepreneur becomes an employer, and issuing payroll becomes a necessity.

Processing a payroll is a detail-oriented task that contains numerous potential pitfalls. Calculating wages and dealing with different taxes, deductions, and other allocations can be a daunting prospect. The chances for error are high, and mistakes can be costly—ranging from lost time to penalties from enforcement agencies.

The upside of a consistently accurate payroll is rewarding. It helps employees feel confident in their employer. Business owners who deliver accurate payrolls avoid the complications that come with correcting errors or correcting compliance problems. This provides more time for management to pursue what they like and do best . . . the revenue-generating activities of their enterprise.

Business owners who deliver accurate payrolls avoid the complications that come with correcting errors or correcting compliance problems.

## Business Growth Requires a Shift

For some entrepreneurs the adventure of starting a business provides an alternative to corporate life, and for others it may be the fulfillment of a long-held passion. As early ventures grow, however, the thrill of the start-up can eventually yield to periods of tedium and frustration, as entrepreneurs transform into employers.

The reason for this unexpected pain: more administration. The following scenario happens thousands of times each week to small-business owners throughout the country.

*With a handful of employees to help handle business growth, late at night each pay period, a small-business owner pores over employee attendance records, writes payroll checks, and arranges income-tax deposits. With each passing week, she finds the task to be time-consuming, and at times, difficult. And yet, she is resigned to doing it and believes it comes with being a business owner. She started out doing it with a calculator, graduated to a computer spreadsheet, and recently has begun using her accounting software to do it. Even with the new tools, payroll is an added burden in an already busy week.*

... forty-eight percent of the business owners who were assessed payroll tax penalties admitt[ed] that penalties they received were valid.

This small-business owner knows two things firsthand:

- Employees highly value an accurate presentation of their compensation each pay period. In fact, along with factors such as job security and employment benefits, pay is consistently among the top-rated aspects of employee job satisfaction.<sup>1</sup>
- Processing payroll can be a painful exercise with many pitfalls. Each paycheck requires multiple calculations, including Social Security, Medicare, federal, state, and in some cases local taxes (in addition to unemployment taxes). In fact, many small businesses will file a minimum of 32 tax deposits and 16 returns each year. This degree of complexity increases risks for error, with forty-eight percent of the business owners who were assessed payroll tax penalties admitting that penalties they received were valid.<sup>2</sup>

Attempting to focus on the revenue-producing aspects of the business—products, services, and customers—many business owners find that they don't have the ability or experience to make the entrepreneur-to-employer shift.

Small-business owners may have one or more primary goals in mind—for example, to maximize profit, spend less time on administrative tasks, or grow their businesses. That employee satisfaction has an impact on business performance is a given, but the way owners address the administrative details of employing people is too often inadequate. Employees depend on the business for their livelihoods and look to owners in ways that many entrepreneurs haven't experienced before.

There is a danger that an owner may see employees as a necessary component of the business rather than trusted colleagues who not only do the work that's needed, but also are the face of the business to customers and prospects. Talented employees can often achieve much higher levels of productivity and profit than businesses with a lone owner-worker can. As a result, it's beneficial for owners to learn as much as they can about the care and nurturing of employees—starting with the very first one.

Employee relations work both ways, however. There is a downside. Loss of employee trust can be devastating to a business, and when it happens, it can be a major contributor to poor employee performance.

### Increased Productivity and Happiness

The benefits of timely, accurate payroll cannot be overestimated. Once business owners establish a trusted source or method for payroll processing and are fulfilling their obligations as an employer, they can return to the projects and tasks that define them as an entrepreneur.

There are financial advantages to dependable and accurate payroll. These include the reduction of financial errors and the time it takes to track and correct them. Avoiding a tax penalty is decidedly in a company's financial interest. Recruiting a replacement for a disgruntled employee who leaves a business can be an expensive proposition.

So, when business owners arrange for timely, accurate payrolls, they are acknowledging that they wish to fulfill their role as entrepreneur and chief architect of the business and are empowering employees to help execute business plans and accomplish the day-to-day objectives of the enterprise. In short, they value their employees, wish to promote workplace morale and productivity, and understand the potential negative impact of poor compliance with tax and employment laws.

### Pay Is a Top Concern for Employees

There is no workplace issue that is more important to workers than their pay. Benefits and compensation have been repeatedly rated as leading job-satisfaction measures in surveys of employees. And yet, many business owners treat employee payroll as a distraction—something to get done in the late-night hours when all other priorities are done for the day.

For employees, pay is of paramount importance. It is the main reason they come to work, and it is a motivator for performing well. It's not just getting paid and the amount of the paycheck, it's the accuracy of the transaction that concerns employees. Lack of precision brings lower trust and has a likely impact on job performance and morale. The end result may reach customers and clients, and can threaten the bottom line of the business.

### Payroll Errors Create Bigger Problems

Because payroll is really a set of interwoven financial transactions, one mistake can cascade into an unforeseen set of problems. In addition to employee pay, it extends to federal and state employment tax payments and other deductions that individual employees may require. If payroll mistakes are significant and happen often enough, they could lead to closer scrutiny by the IRS or state authorities, and in the worst cases, to financial penalties.

For all of these reasons, payroll is a crucial part of small-business operations, and a major consideration in the transition from entrepreneur to employer. The key for employers is to maintain a balance between the entrepreneurial spirit that sparked the business, and the mechanisms that must function well so that the business reaches its goals.

Because payroll is really a set of interwoven financial transactions, one mistake can cascade into an unforeseen set of problems. In addition to employee pay, it extends to federal and state employment tax payments and other deductions that individual employees may require.

## The Complex World of Payroll

Business owners who process payroll themselves quickly learn that the procedure is not limited to just writing a check or even a series of checks. It's a complex function that starts with tracking employee time, and includes a range of intricate employment-tax obligations.

Employment-tax obligations	
<b>Federal</b>	<ul style="list-style-type: none"> <li>• Income tax—scaled according to anticipated annual pay, and factoring in exemptions for marital status, dependents, and more.</li> <li>• Social security tax—6.2 percent of the employee's gross wages, withheld until the employee makes \$106,800 for the year.</li> <li>• Medicare taxes—1.45 percent of the employee's wages.</li> <li>• Federal unemployment insurance—.8 percent of an employee's pay until it reaches \$7,000 for the year.</li> </ul>
<b>State</b>	<ul style="list-style-type: none"> <li>• Income tax—at rates according to the laws of each state.</li> <li>• State unemployment insurance—varies by state; in Georgia, for example, new employers pay 2.7 percent of an employee's wages until they reach \$8,500 in wages for the year.</li> <li>• Workers' compensation insurance—determined by the workers' compensation board in each state, and paid according to worker classification.</li> <li>• State disability insurance—according to the laws of each state.</li> </ul>

The government requires employers to calculate each tax on a per-pay-period basis. On the fifteenth of each month, or often more frequently, employers must make a federal tax liability payment, which includes Social Security, Medicaid, and federal income tax amounts.

Employers must also file quarterly federal and state returns (and local returns if applicable), and they must produce yearly W-2 forms that report employee earnings, along with 1099 forms for contractors. Federal unemployment taxes must be paid quarterly or annually using Form 940.

All told, the average small business will file 32 tax deposits and 16 returns each year. Some businesses may be required to produce even more.

Compensation methods can further complicate an employer's payroll obligation. This relates to whether an employee is paid on an hourly basis, is a salaried employee or a piece-rate worker. Employers also must track and compensate for overtime pay, holiday pay, vacation pay, and at times other special circumstances.

In fact, each paycheck requires a complicated combination of calculations, and even one incorrect entry can cascade into a series of errors throughout the payroll and into the company's general ledger. Given the many details involved with payroll processing, it's understandable that every year thousands of businesses receive penalty assessments from the Internal Revenue Service because of inaccuracies in the remittance of their employment taxes.<sup>3</sup>

## About Paychex

Founded in 1971, Paychex, Inc. is a leading provider of payroll, human resource, and benefits outsourcing solutions for small- to medium-sized businesses. The company has more than 100 offices and serves over a half million payroll clients nationwide.

The company offers comprehensive payroll services, including payroll processing, payroll tax administration, and employee pay services like direct deposit and check signing. Human resource services include 401(k) plan recordkeeping, employee handbooks, job descriptions, workers' compensation administration, section 125 plans, time and attendance applications, administrative services organization solutions, and other administrative services for business.

Professional employer organization options are available from Paychex Business Solutions, Inc. (PBS).

Paychex Insurance Agency, Inc. makes a full range of business insurance options available, including group health insurance from more than 150 highly rated carriers.

## Contact Information

To find out more about how Paychex can help businesses with human resource administration, visit [www.paychex.com](http://www.paychex.com) or call 800-322-7292.

## Sources

1. Society for Human Resource Management. *2009 Employee Job Satisfaction: Understanding the Factors That Make Work Gratifying* (Alexandria, Virginia: SHRM, 2009), 11-12.
2. Actionable Research. *2009 National Payroll Study* (Laguna Niguel, CA: Actionable Research, 2009).
3. United States Internal Revenue Service. *Internal Revenue Service Data Book, 2009* (Washington, D.C.: Department of the Treasury, Internal Revenue Service, 2009), table 17.

© 2011, Paychex, Inc.

Paychex, Inc., 911 Panorama Trail South  
Rochester, New York 14625  
800-322-7292  
[www.paychex.com](http://www.paychex.com)

Professional employer organization (PEO) services are sold and provided by Paychex Business Solutions, Inc. (PBS) and its affiliates, which are registered and licensed as required to sell and provide PEO services, including in Florida. PBS FL license numbers are GL7, GM46, and GM14.

Insurance available through Paychex Insurance Agency, Inc. (formerly Paychex Agency, Inc.), 150 Sawgrass Drive, Rochester, NY 14620. California license #OC28207.  
877-266-6850