

**Top Five  
HR Compliance  
Issues for  
Small Businesses**

# 1

Small business owners spend a great deal of time molding and shaping their organization so that it retains a laser-like focus on key business goals: beating the competition, finding new customers, and boosting bottom-line revenue. Unlike their large-company counterparts, they lack the time and resources to build infrastructure and processes that don't relate directly to these objectives.

Still, with all of this focus on generating revenue, entrepreneurs may be overlooking one of their most potentially serious and costly issues – human resource compliance.

This paper examines the top five HR compliance issues for small businesses, determines their potential impact, and evaluates possible solutions.

## The Challenge of the Generalist

The human resource “department” for a small business is usually not more than one person—and often *only* one person who wears many hats. This person may be responsible for any or all of the following:

- Compensation and benefits (job analysis, evaluation and grading, payroll)
- HR management (policies and procedures, budgeting, strategic planning)
- Labor relations (discipline, discrimination, harassment, absenteeism, conflict resolution)
- Legal issues (firing, legislation, workers' compensation)
- Staffing (employment contracts, recruitment, retention, selection)
- HRIS (employee portals, implementation of HR systems, product/vendor selection)
- Training (orientation, needs assessment, evaluation)

While an HR generalist may know a bit about everything, “learning on the job” is a scary prospect given the constant presence and oversight of entities such as the Internal Revenue Service (IRS), the Department of Labor (DOL), or the Equal Employment Opportunity Commission (EEOC). The old adage “ignorance of the law is no defense” certainly applies when a company is faced with an audit, an investigation by a government agency, or even litigation.

In fact, an HR generalist who makes the wrong decision about a crucial employee issue – even something as simple as asking the wrong question in an interview – can result in significant consequences.

### Possible Solutions

Large companies have the revenue to hire in-house specialists or keep on retainer a bevy of consultants and attorneys. Few small businesses can afford this luxury. Besides, keeping up with all this thorough independent research often falls into the “nights and weekends” environment, which becomes both costly and time consuming.

Alternatively, the small business owner can send the HR staff to training in specific areas. This can be a good option if the company has the requisite revenue to devote to employee education. If this option is chosen, however, it's important to have a "back up" employee at the company who can also become a source of knowledge about key issues – because if the HR generalist leaves the company, the acquired knowledge goes out the door.

## 2

### Exposure to Workplace Litigation Not Being Addressed

In 2003, the EEOC reported a total of 81,293 charges claiming multiple types of discrimination. Race and sex discrimination are the first and second most prevalent forms of discrimination. With those numbers, it is not surprising that in the 2004 survey by NFIB (National Federation of Independent Business) Research Foundation of over 4,600 small businesses, about half the owners surveyed were either "very concerned" or "somewhat concerned" about the possibility of being sued.

Yet despite the possibility of being sued, small business owners are not addressing the problem head on. For example, only 23% of small businesses provide employment discrimination and/or sexual harassment training (based on a random survey of 300 privately held businesses conducted by Chubb Group of Insurance Companies).

Employee turnover contributes to employer liability by creating potential wrongful-termination cases. According to the DOL, half of all new hires leave their jobs within the first six months. Studies show that a company's legal costs in a wrongful termination lawsuit can run up to \$85,000, and that winning plaintiffs receive judgments averaging \$500,000.

#### Possible Solutions

Employment practices liability insurance (EPLI) can cover the cost of an employee lawsuit. But with the premiums for EPLI starting at about \$10,000 per year, it is no wonder that only 25% of small businesses carry this type of insurance.

A company's HR staff can turn to the Internet for guidance. The EEOC has a website with an overwhelming amount of information, including a list of what constitutes discrimination. If an HR generalist has the time and focus, he or she can become an "expert" in employment law. Again, though, it's important that these laws are well and truly understood, because without costly EPLI insurance backing the company up, there's no other protection in the event of an employee lawsuit.

### 3

## Current Benefit Regulations and Laws Not Being Followed

The cost of compliance with workplace regulation is often a bigger burden for small companies, primarily because the associated overhead expense is spread over a smaller workforce. According to a U.S. Small Business Administration survey, small companies spend up to 80% more per employee on federal regulatory compliance than large companies. Poor management of personnel-related tasks can make compliance even more costly. For example, businesses pay more if 401(k) deductions are not segregated to an employee's account as soon as reasonably possible.

For the small business owner who offers retirement and health and welfare benefits, keeping up with all the regulations and laws can be daunting. The required tests must be conducted, plan provisions must be properly applied, required notices and documents must be provided to employees, and all required government filings must be completed.

In addition, the entrepreneur must keep abreast with all new federal and state regulations.

Here is just a sampling of some recent federal and state regulations that have been issued and will become effective within the first quarter of 2005:

- The Working Families Tax Relief Act of 2004 provides a uniform definition of "child" that changes taxation of dependent coverage under health and accident plans effective January 1, 2005.
- The newly issued final rules applying to COBRA notice obligations become effective on the first plan year beginning on or after November 26, 2004 (i.e. January 1, 2005 for group health plans following a calendar year).
- The American Jobs Creation Act of 2004 (H.R. 4520) (the "Act") contains drastic new restrictions on deferred compensation that generally go into effect on January 1, 2005. The penalties on deferred compensation arrangements that fail to comply with the law include a 20% tax on the deferred compensation in addition to regular income tax.
- The Department of Labor has issued a final regulation on automatic rollover of mandatory cash-outs to individual retirement plans. Plan sponsors should be prepared to implement these new rules for mandatory cash-outs made after March 28, 2005.

### Possible Solution

As with employment law issues, the small business owner can find a wealth of information on the Internet. However, small business owners not only must be aware of all the new laws and regulations, but also determine which ones apply to their specific retirement and/or health and welfare plans.

## 4

### Duplication in Paperwork Causing Data Entry Errors

With every new hire comes a mountain of paperwork. If a company doesn't have access to online services and must deal with hard copies, here are just a few of the forms that must be tracked, organized, and filed for each employee according to the law:

- Form 1-9
- Form W-4
- Medical enrollment form
- Dental enrollment form
- 401(k) enrollment
- Flexible spending account forms

In order for the collected data to be correctly organized and filed, quality assurance must be met at each step. For example, employees complete a 401(k) enrollment form stating the percentage (or dollar figure) to be deducted, as well as their investment choices. An HR staff person must transfer that data and provide it to payroll (who may or may not be in-house). Payroll must complete the transaction by sending a tape to the recordkeeper. The recordkeeper then transfers the information to the investment company.

Similarly, what happens when an employee enrolls in benefits? Payroll must ensure that the adequate deductions are made. When an employee undergoes a Life Status Change and alters his or her benefits selections, benefits and payroll must be adjusted accordingly and within the legally required timeframe. All of these administrative processes tend to "live" in different parts of the organization, and yet they're utterly dependent upon one another.

At each step, when information is transferred from one HR process to another, there is a chance of error. Multiple this possibility by the number of employees and the reams of paperwork, and that possibility starts looking like a probability.

Errors take both time and money to correct. In addition, mistakes cause employees to focus on the errors rather than appreciating the benefits that HR delivers them. So instead of saying how great it is to get top-quality benefits and flexible spending accounts, employees are complaining that the wrong deductions were taken out of their paychecks.

### Possible Solution

The Internal Revenue Service has developed a program called Employee Plans Compliance Resolution System (“EPCRS”), by which employers can voluntarily correct plan failures with little or no fees and sanctions. EPCRS is divided into three basic elements:

- Self-Correction (SCP) – In general, a plan sponsor can correct insignificant operational failures for a 401(k), 403(b), SEP, or Simple IRA plan at any time without paying any fees or sanctions. Operational failures are qualification failures that arise solely from failure to follow plan provisions.
- Voluntary Correction with IRS Approval (VCP) – Any time before a plan is under audit, an employer may pay a limited fee and receive the Service’s approval for correction of a 401(k), 403(b), SEP, or Simple IRA plan.
- Correction on Audit (Audit Cap) – If a failure (other than a failure corrected through SCP or VCP) is identified on audit, the employer may correct the failure and pay a sanction. The sanction imposed will bear a reasonable relationship to the nature, extent, and severity of the failure, taking into account the extent with which correction occurred before audit.

Under EPCRS, a correction is not deemed a correction unless there has been made a full correction with respect to all participants and beneficiaries, and for all taxable years. However, even with the advent of this user-friendly program developed by the IRS, being proactive and getting it right the first time is a much better strategy for the small business owner.

## 5

### HR Functions Not Being Coordinated

As demonstrated above, in order for the correct amount of deductions for benefits to be taken out of an employee’s paycheck, accurate information must flow to and from payroll. Payroll data and benefits recordkeeping need to work in sync. Otherwise, payroll deductions can be wrong. When that happens, employees notice and valuable time is wasted to implement corrections.

If different vendors are employed for the payroll and benefits recordkeeping function, the small business owner is the one who must ensure that everything is coordinated and running smoothly. This entails fielding calls back and forth from the vendors, while trying to understand the technicalities of the different systems.

An alternative to contracting a payroll vendor is to purchase one of the myriad of payroll software now available. However, having software still does not address the need to integrate the payroll and benefit functions. So now, in addition to making sure the software runs correctly, owners still need to communicate and transmit the information to their benefits recordkeeper. On top of that, the payroll software must be continually upgraded.

## A Single Solution - HR Outsourcing

These potential HR landmines can be solved with a single solution – outsourcing the problems to experts. Here is a look at how outsourcing can take care of each of the five critical areas that this paper has addressed.

### **Experienced HR Support**

Outsourcing can provide a full range of on-site HR support and assistance. These experts add value in regards to policies and procedures, recruitment and staffing, compensation and benefits, culture development, and high-level employee relations.

In addition, company employees may have full access to customer service representatives who are trained to answer a wide range of benefits and payroll questions. These resources prevent the need to educate a poorly equipped (and overworked) HR generalist, and ensure that critical HR guidance is accessible upon request.

Because of the different options available in the outsourcing arena, employers should clearly define what they require when assessing the market players. A boutique or niche player proven in a particular industry may be just what is needed. Other services delivered through an outsourcing provider may include:

### **Employment Law Training**

Outsourcing provides training in areas such as workplace harassment, management strategies, and employee conflict resolution. These risk management services may include skilled HR consultants, who will come in to train employees or even settle a dispute. This proactive approach mitigates the chance of costly employee lawsuits.

### **Benefit Compliance Ensured**

Outsourcing can ensure that the small business owner stays compliant in regards to ever-changing federal and state benefits and payroll regulations. This means the entrepreneur is not only notified of any legal changes, but the applicable plan documents are amended as well.

### **Elimination of Paperwork**

If the outsourcing firm's HR administrative processes are done via the Internet, employees no longer have to fill out paperwork and hassle HR staff for routine administrative matters. Everything they need is available via any desktop browser. For example, employees can go online and adjust their payroll information or view their 401(k) amounts. In addition, they can read summaries of plan provisions and get frequently asked questions answered – all without having to contact a company's in-house staff. This frees up a company's HR people to concentrate on more strategic issues.

### **Integrated Systems**

Ideally, small business outsourcing is done via a provider that can integrate benefits and payroll on a single platform. That means no more being the middle man between two vendors, trying to sort out conflicting systems. Data entry errors are virtually eliminated since the payroll and benefit systems are perfectly linked.

A few years ago, only large companies could consider outsourcing as an option. But nowadays, outsourcing has become an economical choice for even small businesses as productivity gains in operational efficiencies by the larger organizations reach the smaller markets.

### **What's Coming Next in Outsourcing**

With the expansion of the business of outsourcing comes the expansion of new services including:

- learning management;
- compensation planning; and
- round-the-clock customer service centers.

Small businesses may not have access yet to all the customized services offered by Fortune 500 companies. However, due to market saturation at the top-tier level and the large percentage of U.S. workers that are employed by small businesses, outsourcing firms are beginning to cater to this burgeoning market and offering the same standardized services utilized by large companies.

Small business entrepreneurs owe it to themselves to take a look at outsourcing and see all that it has to offer them.

Sources:

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