Managing Global Compensation: The Quest for Compliance

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INTRODUCTION

Employees on international assignment present a challenge to HR and payroll functions in organizations. There is increasing scrutiny and enforcement from tax authorities, the length and structure of assignments are changing, and businesses continue to demand a return on their investment in talent.

This report brings together the views of internal mobility functions working across 17 industry sectors. Combined, they manage over 20,000 international assignees worldwide, and in common, they face various challenges to achieve robust, compliant and cost-effective assignee compensation processes. It provides a timely refresh of our report, “Managing global compensation: time to take control?” published in 2013.

The survey focuses on three key themes: What are the priorities in reviewing the global compensation model for international assignees? How have these priorities changed over the last 12 months? What action has been taken to address these priorities?

THE GLOBAL COMPENSATION CHALLENGE-ONE YEAR LATER

In 2013, EY undertook a comprehensive benchmarking survey to explore what actions the global business community is taking to tighten the control over their management and reporting of global assignee compensation. One year later, we asked: has anything changed?

Twelve months ago, when presented with a number of business challenges pertaining to global compensation, participants who took part in our survey indicated that establishing effective global processes and controls ranked as the number one challenge for mobility teams.

In 2014, while the picture is similar overall, employers have shifted their focus to challenges related to compliance with country payroll reporting and withholding obligations.

Q. What are your organization’s top three business challenges in managing assignee compensation?
“The results reflect the increasing focus by revenue authorities on employer reporting. Global mobility is one area of particular scrutiny that requires a robust response,” said Matthew Blaker, EY Global Compensation Services Leader, EMEIA.

ENSURING COMPLIANCE WITH COUNTRY PAYROLL REPORTING AND WITHHOLDING REGULATIONS

In 2014, the focus on compliance has intensified. It ranks as the number one global compensation challenge faced by our survey respondents. This is likely due to the increasing intervention by tax and revenue authorities, who consider payroll for international assignees an area of relatively weak compliance.

It does, however, appear that employers’ heightened attention to compliance is paying dividends.

Just over a third (35.9%) of 2014 survey respondents have experienced queries and findings related to payroll omissions as a result of local tax authority audits. These include:

- “Deferred compensation sourcing has not been accurately reported.”
- “Net income is not grossed-up correctly.”
- “Compensation elements have not been reported correctly.”

This represents a reduction compared with the results of our 2013 survey, which showed that 59% of respondents had experienced audit queries related to payroll. This reduction suggests that successful measures have been taken to reduce the number of findings.

Driving the trend of further reducing compliance risk, respondents identify a number of internal and external initiatives they have implemented or are considering, including:

- Training for payroll teams to understand the nuances of international compensation issues
- Greater collaboration between the home and host payrolls as to the application, tracking and sharing of data
- Operational level training
on own policy and tax issues, as well as understanding the impact of non-compliance

- Adopting hypothetical income and social security taxes for all assignments, thereby simplifying the question of whether tax paid has been borne by the employee or employer

In today’s regulatory environment, tax authority audits are likely to continue to increase, so the sustained focus on compliance by our survey participants is warranted.

However, the compliance risk does not simply encompass taxation: visa and immigration processes are also likely to be a key factor. Fast-tracking the immigration process to meet a pressing business requirement often results in the subsequent need to temporarily exclude that individual from the payroll. This cycle of risk will lead to heightened visibility to the authorities and potential enquiries, immigration delays, fines and possible entry refusal.

“Governments around the world are increasingly placing emphasis on the protection of their domestic labor market,” said James Egan, EY Global Immigration Leader. “One tool is to facilitate enhanced information sharing between tax and immigration authorities. As a result, tax non-compliance can leave assignee populations directly vulnerable to greater immigration scrutiny—resulting both in penalties and more severe future processing obligations.”

Regulatory audits are just one source of risk: the picture is similar when respondents are asked about internal audit. An internal audit finding or omission is a warning sign that an organization’s payroll controls and processes may need to be reviewed and revised.

Nearly 40% of respondents have experienced internal audit exposure and report the following findings:

- Overpayments to employees caused by lack of payroll coordination where a split payment arrangement was in place
- Insufficient clarity on payroll instructions leading to poor processing and revisions
- Internal control gaps and lack of coordination
- Missing and incorrect compensation across home and host payrolls

Sixty percent of respondents believe that local payroll and mobility teams do not have sufficient knowledge of assignee payroll reporting. Concerns raised by the survey participants include:

- “Most local payroll administrators have limited global responsibilities. Managing a single expatriate is difficult.”
- “Local payroll in certain countries is challenged with timely reporting and grossing up for taxes.”
- “Local payrolls do not have to manage the payroll for many assignees, so don’t always understand the implications of the decisions they take.”

This response mirrors that in our 2013 survey, when almost 60% (59.4%) indicated that their local teams were not sufficiently knowledgeable of the payroll reporting process. Participants’ awareness of this issue means that a number of central initiatives that can increase knowledge and understanding have been identified. Examples include:

- Applying a more consistent approach to compensation gathering, sharing and processing, and a more consistent approach with regards to hypothetical tax
- Demanding more support from in-house technical advisors within the corporate tax department
- Assigning a global payroll leader who would enforce the assignee payroll process globally, and for all local payrolls to have a subject matter expert for assignees
Some are also in the process of implementing change:

- “We are currently reviewing our payroll processes, resulting in better monitoring and control measurements in the countries.”
- “We are currently providing training for our HR and payrolls to assist with the existing capability and knowledge gaps.”

Q. In the past 12 months, which countries present the greatest challenges with assignee compensation?

In 2014, these are ranked:

1. China and the United Kingdom (joint first)
2. United States
3. United States
4. Brazil
5. Germany
6. France, India and Russia (joint sixth)
7. Switzerland
8. Argentina

The response to this question will have been partly driven by the number of assignees in those countries, as well as the level of compensation complexity per country.

China and the UK are ranked the most challenging countries for our response group, with the United States, Brazil and Germany also featuring high on the list for survey participants.

“Payroll taxes present challenges that are different to other taxes. Particularly in the UK, accountabilities and responsibilities are often unclear, and frequently span different functions (HR and finance, most commonly) and geographical territories,” said Sue Robinson, Partner, EY Total Reward, London. “It is no accident that both external and internal audits are increasing in this area.”

“German employers often struggle to follow the ‘home net plus approach’ through their payroll. In particular, gross-up calculations and negative compensation are difficult to process because of the limitations of some payroll software,” said Jochen Reinig, Executive Director, EY Global Compensation Services, Mannheim.

“The U.S. rules regarding residency, the frequency of reporting and state variations all increase the complexity of the U.S. compensation collection and reporting process, emphasizing the need for efficiency, robust data management and effective controls,” said Sean Watts, Partner, EY Global Compensation Services, Dallas.

“Brazil’s domestic legislation on labor affairs is not sympathetic to the execution of international assignment programs,” said Oliver Kamakura, Partner, EY Mobility Services, São Paulo. “Not only has the level of compliance requirements increased over the last few years, but the release of eSocial—a cross-checking platform adopted by local authorities—has required a new approach on how to manage payroll and HR events. The traditional HR competencies are no longer sufficient enough to keep companies out of trouble.”

“Constant changes in China’s tax filing and reporting requirements makes compliance more challenging,” said Caroline Lu, Partner, EY Global Compensation Services, Beijing. “Changes can be announced with very short notice, leaving little flexibility for transition, and as a result, it is crucial to have strong control over timely payroll data collection (especially non-cash benefits) to ensure a fluent data flow for compensation accumulation and tax preparation.”

China (ranked joint first)

China is considered a complex country from an assignee compensation and compliance perspective, and the monthly tax return process varies in each city. Strict filing and payment deadlines apply, usually without extension, requiring accurate (not estimated) compensation and taxable income...
reporting. Further, the ambiguity of some tax regulations means that local authorities interpret the rules and put them into practice in different ways. Limits on transferring funds from China to foreign bank accounts also apply, and the recent strengthening of the foreign exchange control process makes compensation and compliance reporting more challenging, as it requires multi-level approvals with different local authorities, supported by extensive documentation each month.

**United Kingdom (ranked joint first)**

Over 60% of the UK’s tax take is in relation to payroll taxes. Unsurprisingly, the tax authorities therefore focus on compliance in this area. The enhanced ability to track employees and their payroll and expenses spend has raised expectations that global employers will monitor and control this spend and the tax associated with it.

**United States (ranked third)**

United States is a comparably complex country from a compensation reporting perspective due to numerous factors. The distinction between residents and nonresidents introduces the first level of complexity. Residents are taxed on their worldwide income, while nonresidents are taxed on their income connected to the U.S. A second contributing factor is the differing state reporting requirements. Lastly, year-end reporting, tax estimate and gross-up processes must be tailored to adapt to various assignment types and facts. In addition to state differences, periodic payroll reporting responsibilities require organizations to collect compensation throughout the year and implement a robust reporting protocol to payroll.

**Brazil (ranked fourth)**

Brazilian law requires certain fixed local payments to be made in order to comply with immigration prerequisites and, in such a scenario, depending on the type of entrance visa, the assignee should also have a local employment contract. In relation to Brazilian nationals seconded abroad, legislation enacted in 2009 recommends the maintenance of the employment contract in Brazil during the assignment period, generating a new approach for the assignment structure. Moreover, a number of gray areas over global compensation, e.g., FGTS (employer obligations regarding severance and redundancy pay), limits companies’ ability to accurately forecast costs and mitigate against risk.

**Germany (ranked fifth)**

Germany is considered a complex country due to its local reporting requirements. Certain income that is not taxable is taken into account when determining the tax rate on German taxable income. This inclusion rule is called the “tax exemption under progression clause.”

**MANAGING GLOBAL COMPENSATION: THE QUEST FOR COMPLIANCE**

On a daily basis, businesses face a number of areas where compliance with and adherence to external regulations and internal guidelines must be managed. This includes immigration and employment law, data security, policy, income and social security tax withholdings and intercompany charging/transfer pricing to name a few.

For mobility functions, operating in a cross-border environment simply brings these issues into greater focus. A significant effort is often required to maintain compliance in all countries, and substantial penalties and fines may be imposed if a company is not compliant with both home and host payroll regulations.

Each organization taking part in our survey recognizes the issues related to non-compliance.
However, each one will face different challenges and pressures, internally and externally, to manage these as effectively as possible in a commercial environment. There is no single solution to these challenges; employers must choose the best approach based on company operating model and business need.

**Home, host or split—setting the scene for payroll compliance**

A fundamental element of assignee compensation is the method chosen for payment delivery. Choosing how to apportion pay across the home and host location sets the tone for complexity with regard to compliance, cost and process efficiency, and assignment satisfaction and success.

Most survey respondents indicate that assignees are paid via the home country payroll. Regional and geographic differences aside, this remains the most common payment method and the most transparent to assignees. But it could leave assignees managing currency transfers and associated risks themselves.

The second most common method is to split home and host payments, with nearly 29% of participating organizations opting for this either through fixed or flexible approaches. This approach addresses any exchange rate challenges, but is more complex to manage and control.

**Highlights:**

- Over a third of survey respondents (nearly 36%) indicate that assignees are paid via the home country payroll.
- Almost 90% of respondents do not use a global HR or other system to share payroll setup data.
- Thirty-nine percent of survey respondents state that they do not have separate assignee and domestic payrolls.
- Forty-seven percent identify the work permit and visa application process as the main reason for delays in setting up payroll for a new assignment.

"Organizations that opt for home or host pay should consider factoring in exchange rate protection for assignees seconded to countries prone to volatile currency activity," said Siobhan Cummins, Executive Director, EY Mobility Performance Improvement.

**Q. How is information shared with host payroll to ensure accurate set-up?**

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*Managing Global Compensation: The Quest for Compliance*  
*Journal of Compensation and Benefits* • March/April 2015

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The almost 90% (88.9%) of respondents who cannot rely on a global HR or other system to share payroll setup data indicate an equal split between deploying a standardized initiation process and a flexible or ad hoc approach.

In the absence of a global HR system, a standard instruction form, as used by 44.4% of participants, should be considered a “best practice” approach. This supports consistent information sharing across all home and host countries, and subsequently assists the ongoing processing of complete and accurate compensation data in both locations.

However, the remaining respondents indicate that their method of sharing information with host payroll at setup stage varies, with 25.1% stating that it depends on the location and 19.4% using ad hoc means. The more inconsistent the approach is, the greater the risk of errors and process inefficiencies—which can ultimately lead to greater cost for the employer.

Q. In which countries do you have a separate assignee and domestic payroll?

Almost 39% of survey respondents state that they do not have separate assignee and domestic payrolls to facilitate assignee pay. A further 17% are unsure which countries ring-fence the assignee payroll from the domestic payroll.

Respondents who indicate “Other” elaborate:

- “It depends on the country. We would like every country to separate domestic and assignee payroll, but that is not always possible — or within our scope — to push upon payrolls.”
- “Assignee and domestic
payroll is separate in most countries, for confidentiality reasons and as processes differ.”

Keeping assignee and domestic payroll separate is, in some jurisdictions, a regulatory requirement. But even when not strictly necessary, a separation can be beneficial. Assignee payroll is generally more complex and requires different processes and treatments to that of domestic payroll. A separation of the two can allow for greater focus, bringing process efficiencies as payroll teams’ familiarity with the complexities of assignee pay increases. In turn, such focus and familiarity can help flag inconsistencies and risk areas, leading to enhanced compliance.

Q. Where you experience delays in setting up payroll for a new assignment, what is the main reason for the delay?

Nearly half of respondents (47.2%) identify issues with work permits and visa applications as the cause for delays in setting up payroll for new assignments. Enhancing the tracking and reporting throughout the immigration process can help reduce approval and turnaround times, as can gaining a thorough understanding of local requirements in advance of the assignment setup.

Employers are encouraged to consider creative, strategic approaches to achieve an improved “speed to deployment.” By considering factors such as skills, experience and corporate need alongside employee nationality, regional mobility agreements and enhanced entry treaties in the host location, organizations could significantly reduce delays with assignment initiation.

A significant number of survey respondents (22.2%) state that delays with payroll setup occurs not for technical reasons, but due to inefficiencies in the stakeholder notification process. In most cases, rectifying this issue would require only a review of current communication procedures and could be a quick, non-disruptive process improvement.

ESTABLISHING A COMPLIANT GLOBAL PROCESS

Establishing a consistent, compliant approach to assignee compensation globally can be challenging. A good starting point is to evaluate current processes and identify which specific elements are presenting significant issues that can have an adverse effect on compliance and operational efficiency.

Survey respondents were asked to consider the diagram opposite, which lists the typical process steps required in a compliant, monthly assignee compensation cycle.
Highlights:

- Nearly 30% rank the compensation data gathering process as the most difficult step to achieve as part of the monthly assignee pay cycle.
- Providing meaningful reporting and analytics is also a top challenge for respondents as businesses demand greater insight from their mobility data.
- The majority of respondents lack a consistent operational process for ongoing communication with local payrolls of tax and social security requirements.

Q. Which steps do you consider the most difficult to achieve?

![Chart showing steps of the compensation process](chart.png)
The data gathering process is considered the most difficult step to achieve, with the majority of respondents ranking it first. This is not a surprising result—it is one of the fundamental complexities with assignee compensation due to the wide variety of sources from which data is collected and validated. It is nevertheless a vital first step—without a comprehensive clean data set, all other requirements are likely to either fail or be sub-optimal.

This is recognized by a number of respondents, who give examples of initiatives that would improve their internal data gathering process, including:

- “Establishing a process to gather data where we know we have gaps.”
- “Implementing a consistent format to how and when compensation data is gathered.”

Once established, gathering information from local sources will allow for a global compensation overview. This data can then be aggregated before being used by local payroll for processing, or for other analysis and validation.

The second most challenging step, with the largest number of first and second ranks combined, is the final stage in the compensation cycle—reporting and analytics.

Businesses are increasingly demanding greater value and insight from their data. As a result, mobility functions are expected to provide meaningful analysis and reporting that can drive future decisions regarding mobile populations—whether it is total costs reporting, workforce planning initiatives or supporting the wider talent agenda.

“In an increasingly global competitive market for skills, new forms of mobility analytics can provide a vital link between compensation, talent and market benchmark data,” said Nathan Sasto, Executive Director, EY Mobility Services Data Analytics.

For example, costs and benefits of moving critical talent pools around the globe can be rapidly assessed relative to alternative HR execution strategies such as local hiring or outsourcing.

Q. How do you inform payroll of tax and social security requirements?

Most respondents apply a standardized method to inform host payrolls at the setup stage of international assignments. However, the ongoing operational process appears to be less formalized.
The majority lack a consistent operational process for communicating tax and social security requirements to local payrolls. A third of respondents indicate that this is done via ad hoc means, and a further 27.8% state that the method of sharing this information depends on country combinations and locations.

The payroll process relies on local knowledge to assess local obligations and, given the pressures on mobility functions, it is understandable that there is more devolution of responsibility to local teams. However, without a common approach, local payroll teams can become detached from the assignment program’s fundamental aims.

This means not only potentially sharing information inefficiently between teams, but also creating compliance gaps and a lack of overall control of costs.

A standardized process, as indicated by 28% of respondents, can provide greater certainty that all income is reported and shadowed for tax purposes, that tax and social security contributions are paid according to the countries’ regulations, and that withholdings are applied correctly.

“Incorrect withholdings can be costly for the business in terms of duplicate payments and interest or penalties—but the knock on detrimental effect on the assignee experience should not be overlooked, with potential impact on social benefit entitlements for not only the individual, but also their dependents,” said Mike Kenyon, EY International Social Security Leader.

**CONTROLS, CHECKS AND BALANCES**

The monthly compensation process needs a proactive, built-in controls framework to maximize compliance across multiple jurisdictions. These controls should be automated as far as possible to allow for any errors and inconsistencies to be corrected.

**Q. How do you check that the correct payment instruction has been followed?**

**Highlights:**

- Sixty percent of survey participants have no control mechanisms in place to check that pay instructions have been followed.
- Forty percent of respondents report that they have no formal process in place for validating that all compensation is being reported through payroll.
- While 40% of respondents have systems in place to check that the correct payment instruction has been followed, either through pay slip review or from information available in a central database, 60% of survey participants have effectively no
established control mechanisms.

Twenty-six percent only review the payment instruction if they receive an employee complaint. In general, employees are more likely to raise underpayments and errors with their compensation rather than overpayments or incorrect tax reporting. As a result, organizations that rely on employee complaints as opposed to automated control methods may run the risk of:

- Negatively impacting on assignee satisfaction, as the employee is unable to reconcile their pay
- Unknowingly and repeatedly overpaying their assignees
- Mis-reporting income for tax and social security compliance

Fourteen percent of respondents only check that correct payment instructions have been followed if an error results in non-compliance or double taxation, and a further 20% are unsure as to how, if at all, payment instructions are checked.

Q. How do you validate that all compensation is being reported through payroll?

Forty percent of respondents report that they have no formal process in place for validating that all compensation is being reported through payroll. Globally, tax authorities want employers to be able to articulate the controls they have in place to ensure robust reporting of all compensation items, and a lack of process to do so may leave organizations at greater risk of non-compliance. In response, some survey participants call for:

- Consolidation of global payroll for the mobility population
- Definition of internal guidelines in order to coordinate all parties involved, and definition of roles and responsibilities
- A genuine link between the tax services provider and the compensation services provider

The remaining 60% of respondents indicate that they do have a process in place to check that payments and withholdings are actually carried out by payrolls as instructed. Within many organizations, a formalized validation procedure is also a requirement for internal audit purposes.

CONCLUSION

With payroll compliance now firmly on the radar for tax authorities worldwide, mobility teams are focusing their attention on the accuracy of local payroll reporting and withholding obligations.

While the majority of our survey respondents report that they have not experienced internal and external findings and omissions, there remain considerable concerns that local pay-
rolls lack sufficient knowledge of assignee payroll reporting.

Validating payroll data at the outset, improving communication with local payrolls and comparing pay instructed with pay delivered could, for many organizations, bring significant clarity for local payroll teams and improve compliance as a result.

The quest for compliance—practical steps to achieve robust global compensation reporting

1. Establish appropriate data validation and controls

Starting out with a complete and accurate data set is critical to the success of each of the subsequent stages in the compensation cycle. It also provides confidence that compliance and cost is managed across the assignee population, as a robust validation process will identify any incorrect or missing payments before they are delivered to employees.

Moreover, tax authorities and internal auditors are increasingly seeking reassurance that controls are in place to actively manage payroll compliance, and the effectiveness of these must be demonstrated.

Take action

To establish a robust data collection and validation process, take the following steps:

- Set up regular training to improve local payroll and HR team knowledge of global assignee payroll reporting.
- Agree and communicate ultimate accountability and responsibility for assignee payment and tax compliance in the home and host countries.
- Put more checks and controls in place, review all data sources and establish company guidelines. Controls should include comparing collected data against assignment policy, and reviewing against prior months and across the assignee population.

2. Communicate assignee tax and social security positions

Significant time and resources are spent within organizations to confirm the correct tax and social security position of their assignees, such as applying certificates of coverage and scheduling arrival and departure meetings to establish tax residence. However, this effort could be wasted if these instructions are not effectively communicated to the local payroll.

Clear payroll instructions are even more important for teams who lack sufficient knowledge of assignee payroll reporting. Without accurate and clear instructions, local payrolls run the risk of making incorrect payments to assignees or to local revenue authorities.

Take action

Reduce the risk of error by providing local payrolls with complete process information on all tax positions each month. Consider local payroll guides for each location that include reporting and withholding obligations, taxability and processes, as well as clear instructions for assignees who continue to pay social security in their home country.

3. Carry out post-payroll analysis

By making post-payroll analysis part of the monthly compensation process, any issues or omissions can be addressed quickly in the next payroll cycle. This can include identifying any out-of-policy or duplicate payments delivered locally in addition to those instructed centrally. It also provides a control mechanism to confirm that tax and social security positions have been followed.

Take action

Compare payroll output files to payroll instructions each month to identify any variances and take corrective action. Such
checks can be largely automated, provided they are set up correctly and wage types are clearly understood.

4. Seek continuous improvement through reporting and analytics

Harnessing global compensation information for analysis and reporting purposes can contribute greatly to an organization’s understanding of the fundamentals of their mobility program. Oversight of total program and individual country cost, or the ability to drill down to specific grade and policy components, can help identify areas for cost savings. It can also give an indication of the overall value for money generated by assignments. This, in turn, can inform strategic decisions, for example to explore alternative options to secondments such as localization, local hires or outsourcing to fill skills gaps.

Take action

Add greater detail to the data gathering process by including breakdowns of, for example, shipping invoices and non-taxable items such as vendor fees. Such minor changes will enhance the value of the data to allow analysis of costs. Make use of data analysis techniques and technology to spot trends and identify areas of high-cost or potential savings.