How Payroll Can Benefit from the Budgeting Process

The start of the annual budgeting cycle is usually good for groans all around, particularly from payroll who must provide most of the labour costs information the accounting staff needs to do their budgeting. One reason for the bellyaching is the typical perception among payroll staffers at how little meeting accounting's needs does to benefit them. But in my view, that perception is misplaced. Budgets can, in fact, be an important tool within payroll. Used properly budgeting can be part of the controls with which payroll accuracy is verified.

Building a Spreadsheet

I've written before about how building a spreadsheet to define changes in earnings, deductions or benefits between the current and prior pay periods serves at least 2 important purposes:

Validating changes in earnings or deductions between the current and prior pay periods

There are 2 different techniques you can use. One, each changed amount has to be reconciled back to the setup that produced the change. In this scenario, you don't stop until you can successfully explain each earning, deduction or benefit difference. Two, you just test large or unusual changes for reasonableness. The second might be applied to deduction or benefit values while the first would be recommended for earnings.

Validating the YTDs produced by your payroll system

I've seen this before, but I'm now working with a system, which due to the heavy customization from the vendor's standard code, certain reports aren't considered reliable and must be tested against another source for the same data. Having a spreadsheet, where you record the current results from each pay period allows these pay period values to be summed and tested against the system generated YTDs.

Implementation Techniques

Similar techniques can be applied to budget data and provide another means of testing the accuracy of payroll processing values. Ideally, your HR or payroll system supports entering budget data and there are reports available in payroll that compare current or YTD payroll against entered budgets.

Even if that’s not the case, you can do the same thing using spreadsheets. When I build spreadsheets like this, I use one tab to load data from payroll, another tab for the entered budget data and a third tab to compare payroll actuals to budget.

Using either of these techniques, the best practice is to compare:

- Payroll actuals against payroll budget data for the current pay period; and
- YTD payroll actuals against the equivalent budget values.

Accountants use the term variance to describe the difference between budgeted and actual values. If the comparisons above show a variance from budget, these variances can either be shown in percentages, i.e., in period 4 of a semi-monthly pay period YTDs should normally be 16.67% of the annual budget but actuals for overtime are 18%, or can be in dollars or hours, i.e., the budget shows the current pay period should have 5,000 regular hours when the actual values for the current pay period are 4,500.

Another alternative is to compare payroll actuals to revenue for the same period. In this technique payroll costs are shown as a percentage of revenue for the current pay period, month or YTD. This can be useful when the volume of activity is subject to seasonal changes. For example, many retailers earn a large percentage of their revenue during the last quarter of the year. Comparing payroll costs against the expected revenue for the fiscal period concerned can be a reasonableness test of these payroll results as well as an important technique in gauging how well the organization is doing.

You can also do the same with prior year values. For example, you could compare:

- Current pay period actuals to the same values in the prior year; and
- YTD actuals in the current year versus YTDs in the prior year, as at the same period.

While payroll can use these techniques to compare payroll actuals to budget or prior year values, there’s more opportunity for validating payroll accuracy when line or business unit managers are held accountable for their labour costs. If payroll can report payroll cost variances and managers are held responsible for these, they will have a heightened interest in examining the payroll costs charged to their accounts. Payroll can make this process easier if managers are given not only the General Ledger account detail for their areas of responsibility but also the equivalent portion of the payroll register. In effect, this means another set of eyes examining payroll results for accuracy.

Alan McEwen *is a Vancouver Island-based HRIS/Payroll consultant and freelance writer with over 25 years’ experience in all aspects of payroll. He can be reached at armcewen@shaw.ca or (250) 228-5280. If you like these articles, please sign up to my email list to be notified of future postings.*