How To Graduate From Your PEO

Namely HR for Humans

Introduction

Your headcount just crossed the 50 employee mark. When it comes to your company's growth, **few milestones matter more.**

But while compliance challenges are certainly part of the mystique of "fifty," there's more to this important chapter of your company's growth. How do you keep employees engaged? How do you set your business apart in a way that not only attracts potential recruits, but gets them to stay put as loyal employees?

Simply put, HR goes from a "nice-to-have" to a must. That means hiring at least one full-time HR team member—and parting ways with your professional employer organization, or PEO.

PEOs take on HR, payroll, and benefits administration for their clients, which are typically small businesses without an HR professional on staff. Clients enter into a "co-employment" relationship with the PEO, where the latter becomes their workforce's employer-of-record for tax and compliance purposes.

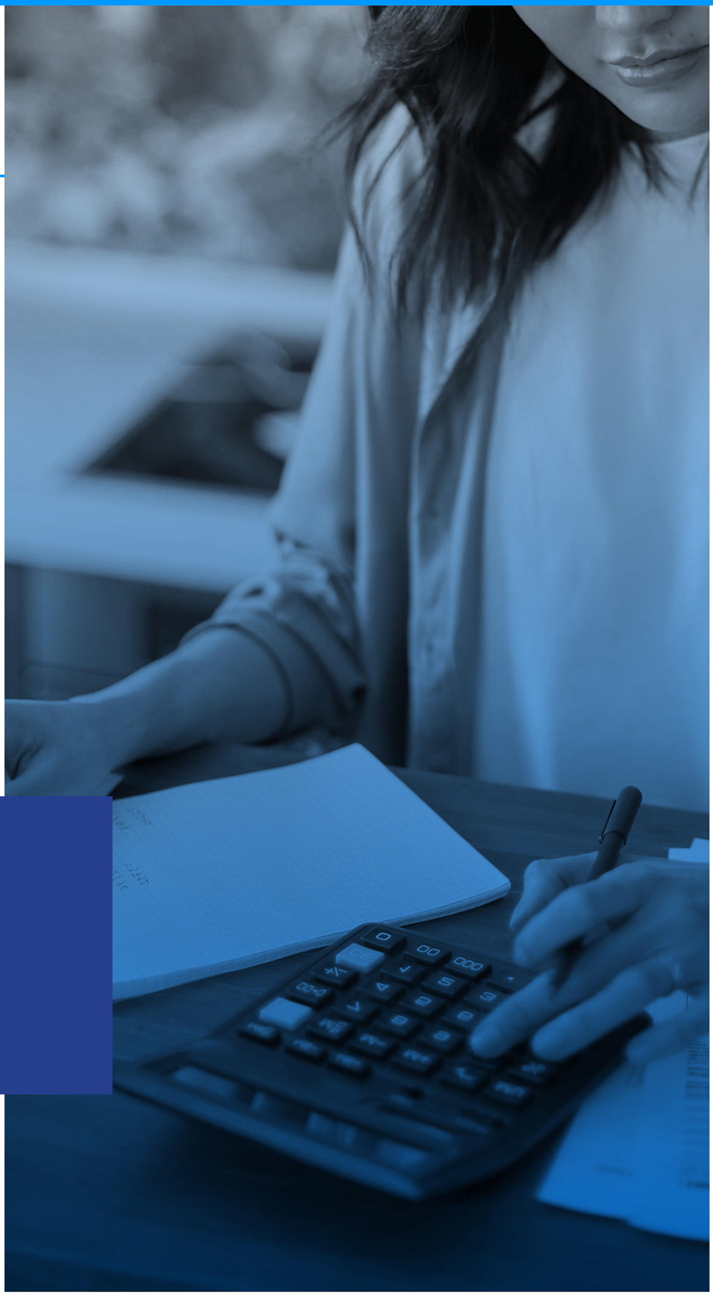
Sound complicated? It can be, which is why many companies feel intimidated by the thought of leaving. But as your company grows, it's the right time to take a closer look.

Here's how to make the leap.

WHY SHOULD **YOU LEAVE?**

Leaving your PEO is a decision that shouldn't be taken lightly. That said, once your headcount crosses 50 employees, making the jump becomes a necessity.

Why? There are a few reasons, cost being one of the primary ones. Below, we'll dive into why it makes sense for midsized companies to go it alone.



Costs

Most PEOs charge clients per employee, per month (PEPM). The bigger your company gets, the more expensive the relationship becomes. Typically, this "admin fee," as the industry calls it, hovers around $100. Depending on your provider, this number can be even higher—admin fees as high as $160 PEPM have been reported.

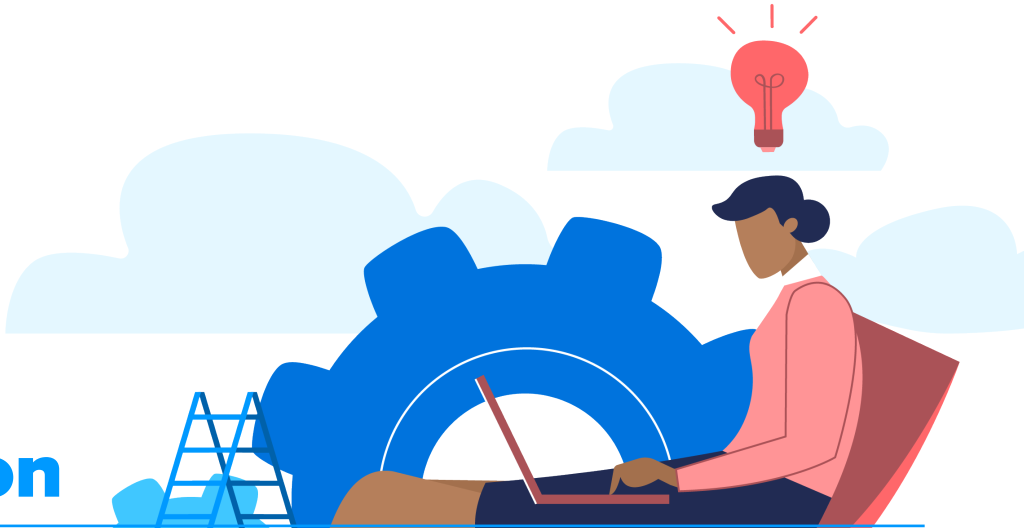
While this structure might make sense for budding companies without the time or resources to hire a full-time HR professional, it becomes more cost-effective to bring HR in-house once your headcount reaches 50 employees. To illustrate, let's run the numbers.

($100 PEPM x 50 employees)

x 12 months

= **$60,000** per year

Depending on the market you're operating in, that's enough to hire a full-time HR Generalist. And because the above doesn't take additional fees (like processing garnishments or off-cycle payrolls) into account, you might also be able to invest in a more affordable HR consulting service on the side.



The Myth of PEO Protection

Small businesses often think of the co-employment relationship as a shield, protecting them from potential HR compliance issues. It's tempting to believe that, especially since so many HR requirements kick in at the 50 employee mark.

In actuality, PEOs leave their clients holding the bag for many HR issues. Most contracts stipulate that clients are responsible for wage and hour compliance, correct overtime classification, and determine whether employees need to receive a Form W-2 or 1099.

In other words, your company is still left trying to make sense of the most complex parts of employment law.

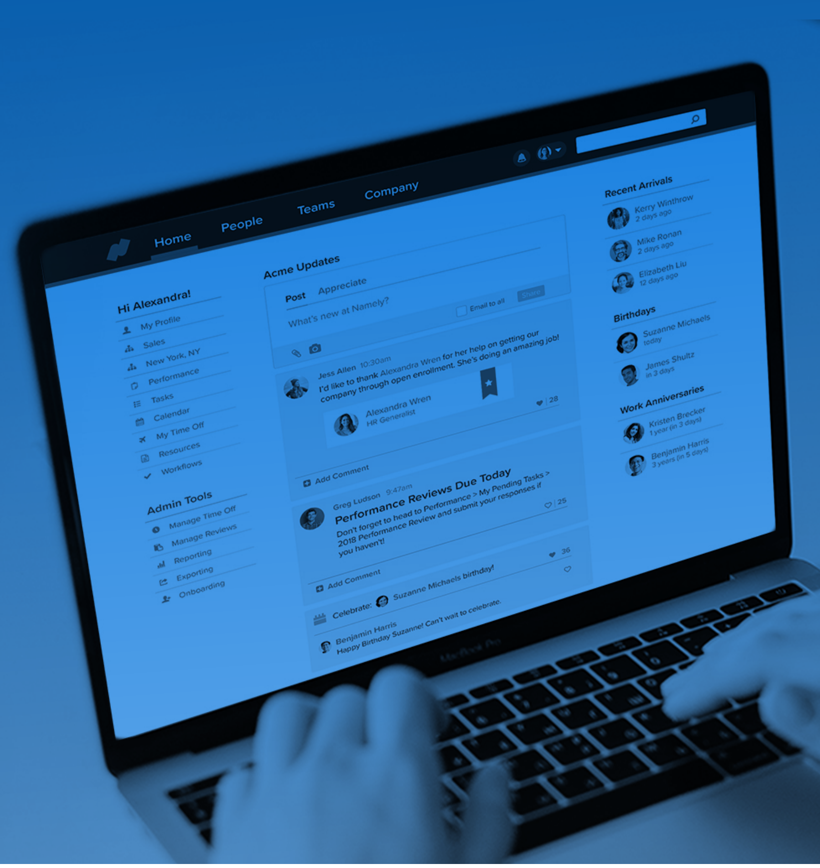
That's not to say that the model doesn't offer any protection. Client companies will receive something called employment practices liability insurance (EPLI), which offers some coverage from sexual harassment or discrimination claims. Unfortunately, even these plans have their limits—you'll need to first pay off your deductible, which can reach as high as $50,000 per incident or claim. Certain PEOs have been known to cap the benefit to as little as just $100,000 per year.

For reference, the average age, race, or sex discrimination claim costs employers about $125,000.

Technology

Unfortunately, PEO clients are often left on the outside looking in. Because co-employment has always been first and foremost about compliance and access to benefits, PEOs have historically invested little in their technology. Pulling a basic employee report from your PEO's HRIS might require a customer service call, and even then you'll be limited to a few standard reports.

Being able to make informed decisions about people becomes critical as you grow. At this stage, companies start focusing on metrics that go beyond just headcount, like **career path ratio and company demographics**. It's hard to fault them for not being able to offer these insights, as their services were never intended for anything but small teams.



Leaving Has Never Been Easier

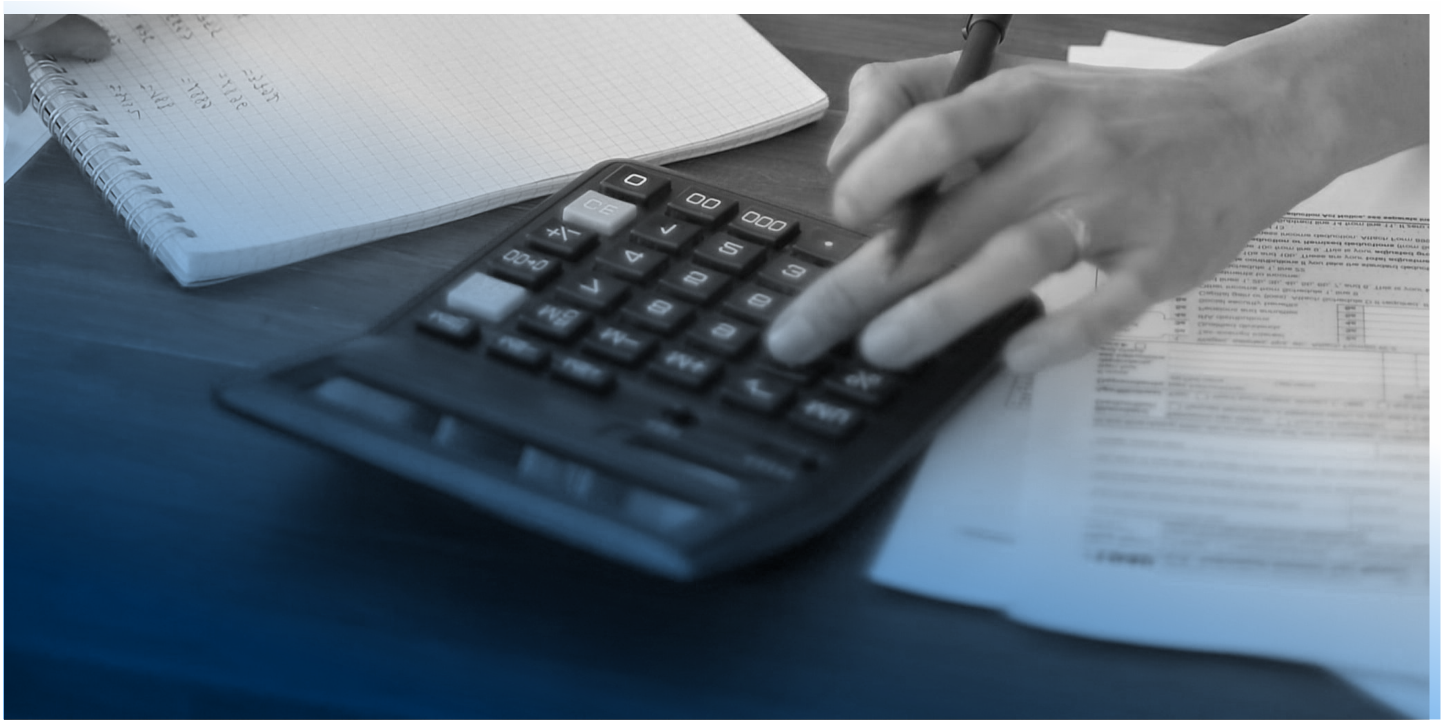
Historically, the decision to leave a PEO was one only made at year-end. Why? Because of how federal unemployment taxes work, businesses would often end up having to double pay taxes whenever they joined or left a PEO midyear.

Fortunately for employers, a new law has almost entirely eliminated that hiccup. The Small Business Efficiency Act (SBEA) created a program where PEOs can apply to become "CPEOs," or certified professional employer organizations. Businesses who work with CPEOs can leave at any point without having to deal with the type of tax reset described above.

Virtually all major PEOs are certified under the federal program. If you're unsure of whether yours is, just give them a call and ask.

EVALUATING **SOLUTIONS**

While your team will be taking on more responsibility post-transition, you can't simply sever ties with your PEO without having an HR solution in place. You'll need to carefully evaluate your options before making the leap.



Setting a Realistic Timeline

Migrating from your PEO to an HR technology solution isn't a process that happens overnight. Like all good things, it takes time.

On average, companies spend about 3 months researching and evaluating, so you want to start the process well before you intend to transition to your new system. Before kicking off your evaluation process, you'll want to consider factors that might influence your implementation date, like open enrollment, performance reviews, or the end of your fiscal year. With the proper planning, you can have an easy implementation, maintain your current processes, and ensure you have no gap in coverage.

All in all, evaluating HR software takes around 12 weeks. Check your internal calendar to account for your evaluation and implementation timeline so the transition to your new system doesn't occur at an inconvenient time for your company or team.

Involving the Right People

Create a small task force of members of your HR team and key stakeholders to help you throughout the decision-making process. They can help you create a list of what features and functionality you want from a new solution. Looping them in early on will ensure everyone's voice is heard and help you secure their support when it comes time to make a decision. You'll also want to include a few cross-functional teammates as well, like an IT specialist who would help you with implementation and integrating the new system with your existing technology. When you start having demos later in the process, you might want to loop in some other employees who can comment on usability and functionality from an employee's point of view.

Here are some potential individuals (outside of your HR team) that you might want to involve in the conversation:

- CEO
- CFO or finance team
- Payroll team
- Board members
- Information security team

Define Your Requirements

Before you start researching potential software providers, you need to take a step back and define exactly what you're looking for. You probably already have a general idea of what your team wants and needs, but putting your thoughts down on paper will help guide your research and evaluation process and ensure everyone's on the same page. Sit down with your team and any key stakeholders to build a list of your requirements and sort them by low, medium, and high priority. This will help you identify what features a vendor must have and what "nice to haves" your team is willing to compromise on. If a vendor doesn't meet the majority of your high priority requirements, strike them from your list and move on to another solution that can fulfill your needs better.

Be mindful of the future, too. If you think your company or HR team will expand soon, make sure you choose a system that can grow with your company.

Depending on the tool you're looking for, here are some functionality requirements you might be considering:

- Applicant tracking
- Benefits administration
- Core HR
- Compliance support
- Data and analytics
- Employee engagement
- Employee self-service
- Learning and development
- Mobile application
- Payroll processing
- Performance management
- Scalability
- Time and attendance

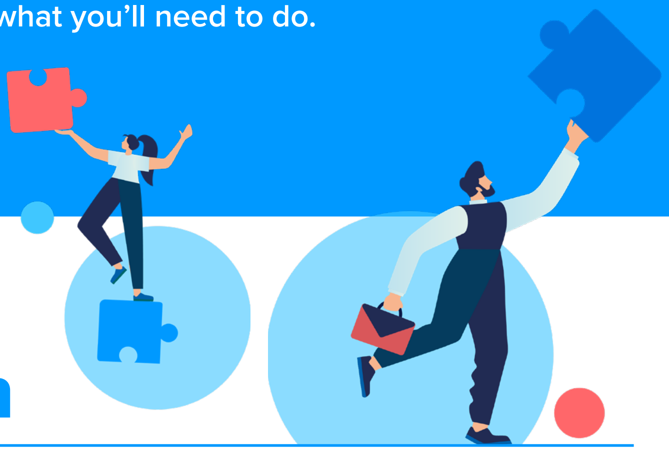
Speak With References

Find an unbiased source to tell you what they really think of the systems you're evaluating. Reach out to your professional network, ask for opinions on LinkedIn or industry forums, or ask the vendor to set up a call with a current client. Reference calls are the perfect opportunity to hear candid feedback and ask any remaining questions you have.

Current clients use the product every day, so they're the most qualified to answer all of your questions. Ask them to share their overall impressions with the vendor's product and customer service, as well as any frustrations and pain points.

MAKING THE SWITCH

Setting yourself up for success (and a smooth implementation process) means getting a few ducks in a row before taking the plunge. Because your PEO handled your company's HR, payroll, and benefits processes, there's a lot of sensitive information that needs to be transitioned over. Here's what you'll need to do.



Gather the Necessary Information

Think of leaving your PEO as a totally fresh employer start. Because of the way co-employment under a PEO works, it's like your employees are essentially leaving a previous job and have started anew with you. Their payroll will now be reported by a new entity.

Refreshing as the situation is, you'll still need some data on hand when transitioning. Implementation is all about the data. Be sure to prepare the following:

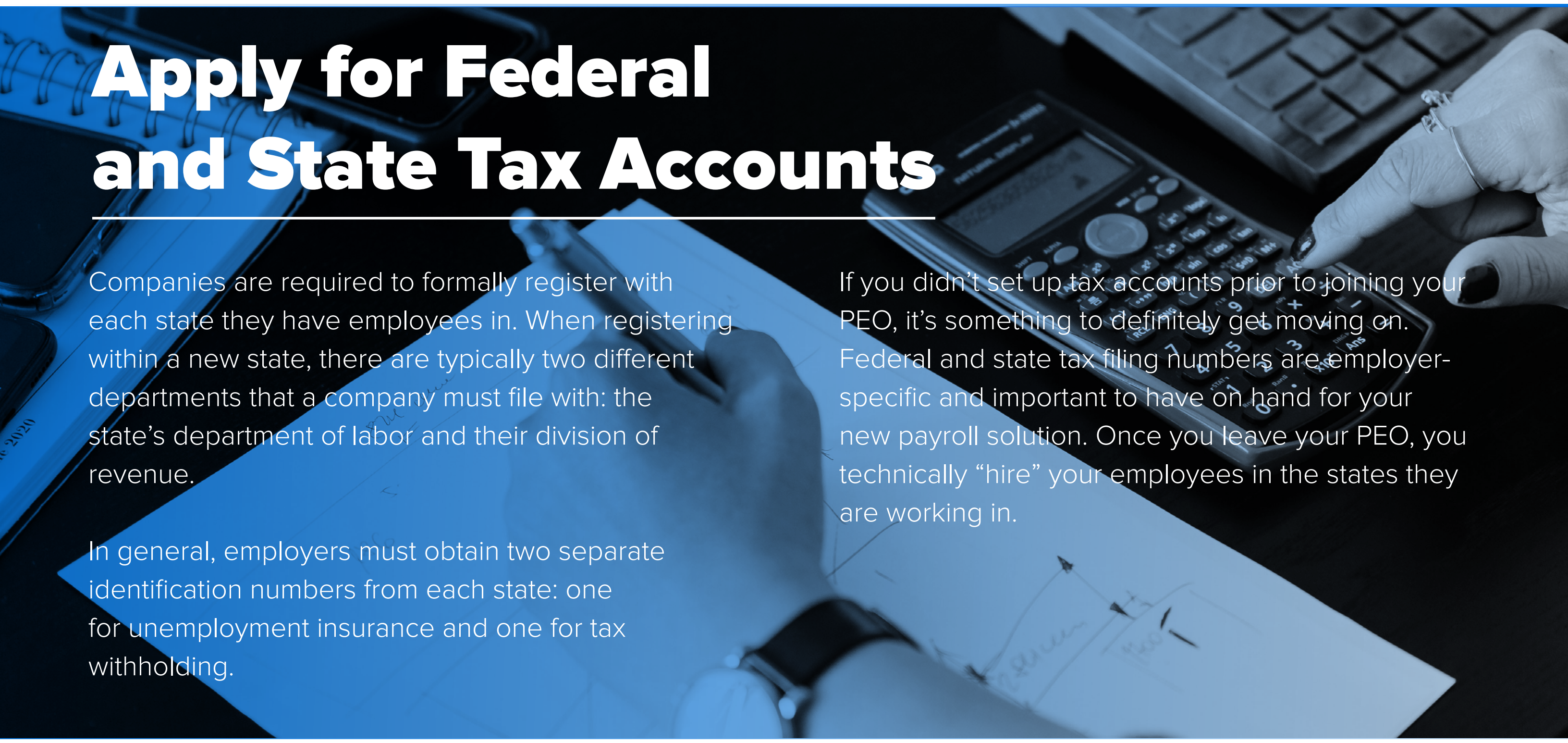
- Your EIN (employer identification number)
- Employee direct deposit information
- Employee names, addresses, marital statuses, and dates of birth
- Filing status for your employees
- Employee deductions and Form W-4s
- Federal and state tax filing numbers

The information you need will vary depending on what you're replacing your PEO with. Are you looking at just payroll and benefits solutions? Or something that's **all-in-one**? For a full listing of potential requirements, **click here.**

When gathering this information, see what information you can already get from your PEO via reports.

The requirements mentioned earlier are critically important for compliance and payroll reasons. But don't forget your benefits data, too. Up until this point, you received benefits through your PEO. As you evaluate potential brokers and benefits solutions, be sure to have the following on hand as well:

- Your most recent PEO invoice
- Employee census information including existing coverage
- Plan summaries that highlight your benefits offerings
- A breakdown of your rates and contributions split, or what you and your employees both pay for benefits



Apply for Federal and State Tax Accounts

Companies are required to formally register with each state they have employees in. When registering within a new state, there are typically two different departments that a company must file with: the state's department of labor and their division of revenue.

In general, employers must obtain two separate identification numbers from each state: one for unemployment insurance and one for tax withholding.

If you didn't set up tax accounts prior to joining your PEO, it's something to definitely get moving on. Federal and state tax filing numbers are employer-specific and important to have on hand for your new payroll solution. Once you leave your PEO, you technically "hire" your employees in the states they are working in.

Refile Employee Onboarding Forms

As the new employer of record, you will need to "onboard" your workforce once again. That means getting employee sign-off on two very important HR compliance forms.

Form I-9

The Form I-9 has been a hallmark of employee onboarding since the eighties. **This mandatory form** is used to confirm an employee's eligibility to work in the U.S. If you've ever started a new job and were asked to bring documents to confirm your identity, like a passport or social security card, you've filled out an I-9. The form is divided into three sections, each with a distinct purpose, signer, and deadline.

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Form W-4

The Form W-4 is a required part of the employee onboarding process, as it determines how much federal income tax should be withheld from an employee's paycheck.

Individuals are asked to fill out a "personal allowance worksheet" based on their marital status, whether their spouse works, and other personal factors. The more allowances specified, the less income tax is withheld from regular pay.

Prepare a List of Employee Wage Garnishments

Employers are held liable for wage garnishments. Start by asking your PEO to provide a report of current employee wage garnishments. If they aren't forthright with that information, you can also ask that employees go to their garnishers and request the documents be sent to your company instead. Asking employees to help will save you from contacting every garnisher yourself.

Run Two Parallel Payrolls

Here's where your new payroll provider can help you out. See if they can run your new payroll against your old PEO's payroll run to spot any differences and reconcile them. Once you know for certain that everything's working, you'll be able to walk away clean.

Looking for more on payroll? Click here to read our payroll guide that covers everything from pay cycles to federal and state taxes.

Conclusion

Sooner or later, businesses need to make HR a top priority. As startups grow into midsized companies, the list of challenges they face goes beyond what the one-size-fits-all co-employment model provides. At this stage, your company isn't just trying to stay afloat and meet compliance minimums—it's beginning to take an interest in employee engagement, HR analytics, and strategy. In other words, exactly what modern HR is all about.

You don't have to take those first steps alone. Namely has helped hundreds of companies make the transition from outsourcing HR to building award-winning workplaces.

Schedule a call and see how.

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