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Auditing Payroll Burden Costs

We wrote last time that we have been asked repeatedly to write a definitive article on how to audit the costs of payroll burden. This is the third of three discussions on that subject. While the subject may seem simple, because of the complexity of the various parts and pieces, it is far from simple to describe how to calculate. Nevertheless, here is an attempt, but there is much that is not covered in this writing. Also, keep in mind that each company does not have only one payroll burden rate. Most construction companies have both salaried and hourly employees and each group has its own very distinct payroll burden cost profiles. Also within groups, the cost profile can change dramatically, such as between regular pay and overtime pay. So any company trying to sell you one burden rate for all three types of cost is typically doing so for a reason, and it is not for your benefit.

First, is a definition of the subject matter, payroll burden. Payroll burden is a commonly used term, but other terms that are also used to connote the same thing are labor burden, payroll fringe costs, PT&I, PTIB, and labor fringe cost. These all typically consist of three distinct types of costs, payroll taxes, payroll related insurance, and employee benefits. These costs are all mentioned in Article 7.2.4 of the AIA A102 contract. Below is a discussion of third of these elements.

Payroll Benefits – Employee benefits typically include all of the benefits that a construction company gives to their employees, however this may be modified if your construction contract limits certain benefits, like profit sharing. Benefits are defined usually in the contract, but basically can be defined as all of those contributions made by a company for their employees that are not classified as wages. We typically associate health insurance, vacation, holiday pay, and retirement costs with the term benefits, but certain other items may be included, like life and dental insurance. In some cases employee benefits are paid by the construction company to a union rather than to the employees directly or to an insurance company. Benefits usually do not include anything that an employee would not consider in their evaluation of pay and benefits. Therefore, a benefit to the employee would be tuition costs reimbursement but not safety training, a uniform allowance but not small tool expense. A short course in each typical group of benefits is discussed below.

Health Insurance – Companies buy health insurance through an insurance company like Blue Cross and Blue Shield, as an example. Most medical insurance policies differentiate employer coverage costs by groups such as employee only, employee and spouse, employee and family, etc. Also most construction companies require their employees to contribute some of the total cost through a payroll deduction. Medical costs typically are therefore not specifically related to how much an employee earns. The company cost to cover an employee is the same if the employee makes $25,000 a year or $100,000. To determine an average cost per employee earnings, one must determine the average costs per month to the construction company per typical employee and reduce that amount by the employee contribution. Then the average net cost per month must be divided by the average employee monthly salary. A similar calculation should be done if one is trying to determine the average percentage rate for an hourly employee. One key element to keep in mind is that not all employees elect insurance coverage. The percentage of employees electing to not have health insurance is inversely proportional to employee pay and age. Additionally, most companies have some waiting period before an employee is eligible, but this fact is usually not significant unless there is a high turnover. Also, as may be obvious, no additional health benefits are incurred by a construction company if the company incurs any O/T expense. Therefore, no additional payroll burden is typically calculated on O/T pay.

If the contractor or subcontractor is affiliated with a union, the union benefits costs are specified in the union agreement. These costs can be expressed as a rate per hour worked, a percentage rate per dollar earned or a combination of the two. Obtain a copy of the union agreement to make the proper determination.

Vacation Pay and Other Paid Time Off – Most companies offer some paid time off to their employees. For salaried persons this benefit can typically include two to three weeks vacation (on average), 6-8 holiday days and several personal days that may include sick pay. Some companies elect to include this benefit in their calculation of payroll burden and some elect to charge the actual days, when taken, directly to job cost. It is important to confirm that both costs are not being charged, as it is common. The correct calculation of the burden percentage to be used is to calculate the total average paid days (not the total allowable days) and subtract that number from the total available work days in a year (5 days X 52 weeks) or 260. Then divide the total paid days by the average chargeable days to determine the correct paid time off percentage. The calculation is the same for both salaried and hourly employees, yet care must be shown in determining the actual paid benefit. Most companies have a higher degree of turnover among the hourly group and therefore some benefits do not accrue to those employees at the same degree as to salaried. Again, no additional paid time off is incurred by the construction company for OT paid.

Retirement Cost – Many companies have some level of retirement benefits. The benefit can be minimal, 1%-2%, or substantial, 10% - 15%. Almost all companies have some waiting period before an employee can enroll in the retirement plan and therefore before the company begins incurring costs. The waiting period can be as little as three months or as long as one year. Companies also do not generally have to pay benefits if an employee leaves in the middle of a plan year. Therefore a company could offer a benefit of 15% retirement on eligible wages, but the average actual cost could be half of that amount. Also, another key consideration is the vesting period. Vesting is the calculation of what amount of the employer contribution actually belongs to the employee. If the employee leaves before they are fully vested, sometimes the other employees get a bonus of that employee's unvested amounts. In other cases the construction company can effectively reclaim the unvested portion, thereby reducing the overall effective cost of retirement. To derive the true average retirement percentage, one must determine the actual employer contribution for a given year and divide that sum by the total of all wages. All wages here is not the same as all eligible wages, as previously noted.

Retirement plans vary, but one common version is the 401K plan, where the employer matches some level of contribution from the employee. An example is where the company matches up to 50% of the first 6% an employee puts into the retirement plan. In this example, if everyone on your job is enrolled in the plan (meaning that they have met the minimum eligibility requirements of being employed at least 1000 hours for example) and if every person that is eligible saves at least 6%, then the actual contribution will be 3%. As you can imagine, not everyone is usually eligible and not everyone contributes at all, not to mention the full 6%. The salaried group of employees is more likely to try to maximize this company benefit and the hourly group often does not see the true value, since to them; a dollar today may be more valuable than $1.50 in the future. Therefore, it is not uncommon for the actual cost to the company to be 50% to 75% of the maximum cost which assumes all employees are eligible and contribute to the max level.

Re-Rentals from Affiliated Entities

Some CM's seem to have no shame. We have seen several that are not content just to rent tools from an affiliated company, and act as if the arrangement is at arm's length. Recently we have seen these affiliated companies charging for tools they don't have and services that they don't provide. How? They rent from a real rental company and then mark up the rental cost and charge to the CM as a re-rental, or they contract for services, like dumpsters and haul off, mark up the cost, and re-invoice the CM for the service. We think this is the definition of easy money.