PEO INSIDER®

PUBLISHED BY THE NATIONAL ASSOCIATION OF PROFESSIONAL EMPLOYER ORGANIZATIONS®

THIS MONTH'S FOCUS

FINANCE & PROFITABILITY

PERFORMANCE METRICS

PROFITABLE GROWTH

BEST PRACTICES

COVER STORY

NAPEO GIVES BACK

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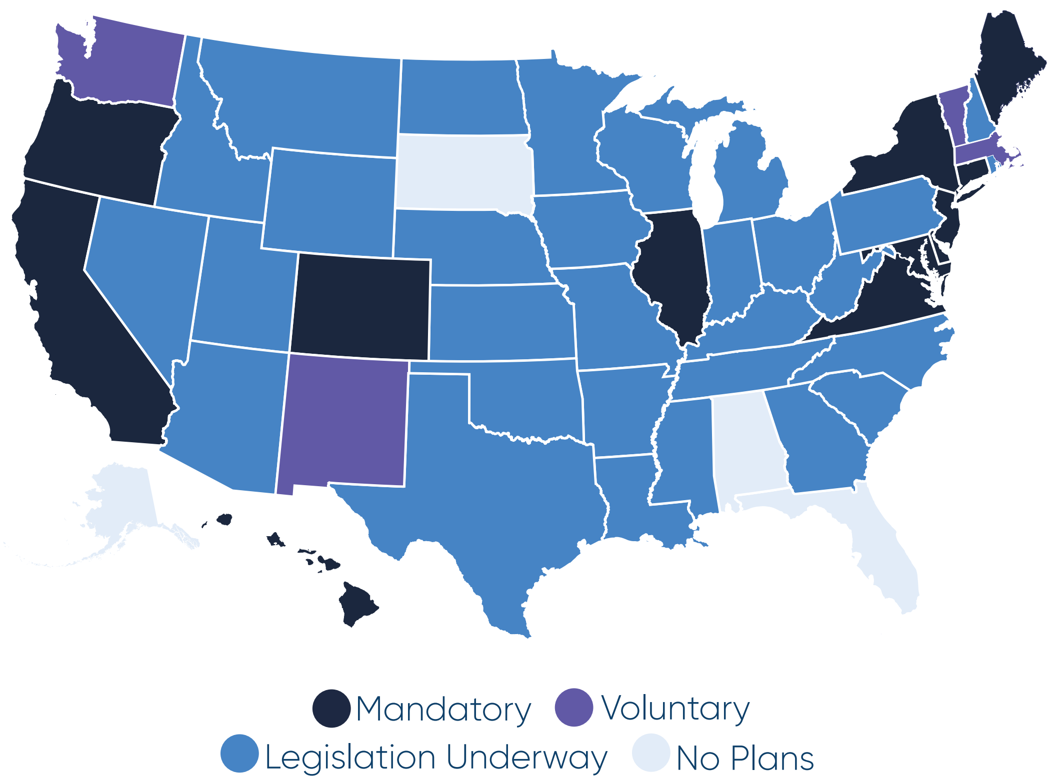
VOL. 27 ISSUE 5

JUN/JUL 2023

State Mandated Retirement Plans for Small Businesses



Source: Georgetown University for Retirement Initiatives

Is your PEO ready?

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THIS MONTH'S FOCUS: FINANCE & PROFITABILITY

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JUNE/JULY 2023

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MEMORIES IN THE MAKING

BY KRISTEN J. APPLEMAN

You might ask what my favorite part of PEO Capitol Summit was and I admit it is hard to have just one. The content was on point. Seeing our members, catching up on their lives, sharing a baseball game – simply said, being together.

Witnessing the collaborative spirit of our members take the Hill at our PEO Capitol Summit reiterated to me the commitment to our industry and to advocate for what matters most to our clients. SMBs depend on us each and every day. We showed up and showed out! A huge congratulations to our marketing team and committee for the inaugural National PEO Week. From the moment you landed at the airport you were greeted with a wrapped wall. All over social media were posts about the power of the PEO. T-shirts and hats with our National PEO Week logo were on full display. I personally witnessed the pride of my own team with their social posts. There is purpose in what we do, and it showed through!

You might ask what my favorite part of PEO Capitol Summit was and I admit it is hard to have just one. The content was on point. Seeing our members, catching up on their lives, sharing a baseball game – simply said, being together. We are rooted in people, human lives, and connection. Our multiple guest speakers provided something for everyone. The energy was electric. Thank you to our NAPEO staff who planned and executed a fantastic event!

While memories were made in May, summer is ahead and provides respite to gear up for the back half of the year. Personally, I am enjoying every minute with Abby before she goes off to college in mid-August. Where did the time go? I have heard and spoken with many of you that have gone through, or are going through, the process of your child taking this next big step of their lives. Yes, it is a wee bit scary for us both. For Abby, the reality of college is hitting. It felt so far away for her and now that it is here, the moments of anxiety have occurred. Will she like her roommate? Will she like her classes? What if she doesn't end up liking it there? How does she know she will be successful? These probably sound familiar, and I can remember being in her same spot. As a mom, I want to be there for her, give her a listening ear and reassurance she can do this.

With several college orientations and preparation underway, the Appleman family is sticking to the States this summer. I am looking forward to it getting hotter (I know I will regret saying that later) and blowing up the tubes and floating down the Chattahoochee River. My 16 year old son, David, will be spending a week at a Florida State University (Go NOLES!) Band Leadership camp in July. He gets to experience the college life for a week and secretly I am hoping he loves the campus. My mom is a FSU alum, as am I. What you might not know was my mom was a Marching Chief and played the trombone. Take a wild guess what David plays…you guessed it, the trombone. Needless to say, Grandma is excited to see him experience the campus too!

Regardless of where your summer plans take you, enjoy making memories and refueling your personal energy tank. As the saying goes, "the tans will fade but the memories will last forever."

Cheers to you and yours for sunny memories in the making! ■

KRISTEN J. APPLEMAN

2022-2023 NAPEO Chair
SVP, Health, Wealth, Tax, Compliance & Business Development
ADP TotalSource
Alpharetta, GA

SAVE THE DATE

JOIN US IN ORLANDO FOR NAPEO'S CFO & PAYROLL SEMINAR: JULY 19-20

NAPEO's 2023 CFO & Payroll Seminar will be in Orlando, Florida from July 19-20! Sessions will focus on accounting, finance, and payroll topics that provide practical insight. Industry experts will lead these sessions, so all the information delivered is designed to be applied to PEO operations. You'll also benefit from learning alongside peers who face the same challenges and obstacles as your business.

Plus, there will be plenty of time for networking and fun. Registration will open soon so check napeo.org/events for more details. We look forward to seeing you in Orlando!

LCFS

MARK YOUR CALENDARS FOR OUR SUMMER LCFS

If you're looking to hit the road this summer and connect with PEO colleagues, make sure to attend our Leadership Council Forums. These small-group events focus on state and regional issues affecting PEOs and the industry. It's an opportunity to hear from local leaders and connect with peers in your region. We have several planned for this summer, so mark your calendars! You can learn more and register at **napeo.org/lcf.**

- New England, June 6
- Georgia: July 11
- Heartlands: August 9

ACQUISITION NEWS

EMPLOYER FLEXIBLE ACCQUIRES STREAMLINE CXO

NAPEO member STREAMLINE CXO recently announced that it has been acquired by Employer Flexible, a NAPEO member based in Texas. This marks the second acquisition for Employer Flexible in as many years. Joe Daniel, founder & president of STREAMLINE CXO, will continue to be a part of the larger organization and will assume the role of market president for the state of Alabama. "We are proud to offer our robust technology platform, with tools for employee self-service through our mobile application, to our clients in four different states," said Michael Hopkins, CEO of Employer Flexible. "We are excited to now be offering these services to businesses all across the state of Alabama."

CONGRATULATIONS

SYNDEO WINS CLEARLYRATED'S 2023 BEST OF HR SERVICES AWARD FOR SERVICE EXCELLENCE

NAPEO member Syndeo Outsourcing recently won ClearlyRated's Best of HR Services Award for providing superior service to their clients. 2023 Best of HR Services winners have a Net Promoter® Score twice as high than the industry average. Syndeo received satisfaction scores of 9 or 10 out of 10 from 90.2% of their clients, significantly higher than the industry's average of 49% in 2022. "Humbled beyond words. It is truly a pleasure to serve the clients who trust us to help them accomplish their mission," said Syndeo President & CEO Bill Maness.

WELCOME

FARRAH FIELDER JOINS NAPEO AS CHIEF OPERATING OFFICER

Last month we bid farewell to Melissa Viscovich as she left NAPEO after 26 years. Fortunately, we were able to quickly conscript a NAPEO alum, Farrah Fielder as NAPEO's new Chief Operating Officer (COO). In short, we are thrilled. Farrah is no stranger to NAPEO or PEOs. She previously served as our General Counsel from 2015 to 2019. Both before and after her time as GC, Farrah worked in the industry. She knows the PEO space inside and out. We are lucky to have her back on the team.

As COO, Farrah oversees many important aspects of the association: Finance, events, and member services fall under her purview. She is also an important part of the senior management team that steers the ship. It's an important role that ensures operational excellence and keeps everyone moving in the right direction for you, our members.

"We are so happy to welcome Farrah back home," said NAPEO CEO Pat Cleary, "She's smart, knows the industry and she's just plain fun to have around."

Welcome, Farrah! She can be reached at **ffielder@napeo.org.**

KUDOS

TRINET WINS MULTIPLE STEVIE AWARDS

NAPEO member TriNet recently announced it has won four Stevie Awards from the 21st Annual American Business Awards. The awards were given for TriNet PeopleForce, TriNet's annual conference focused on business resiliency, transformation, agility and innovation for SMBs." TriNet PeopleForce began as a virtual conference during the height of the pandemic to help SMBs rebuild, reimagine and move forward. It has become a much-anticipated annual gathering featuring a wide variety of critical topics and the SMBs that are the heart of our nation's economy," said Michael Mendenhall, senior vice president at TriNet. "I am proud that TriNet PeopleForce continues to expand and evolve into the premier event for SMBs."

WELCOME

MEET THE NEW NAPEO STAFF

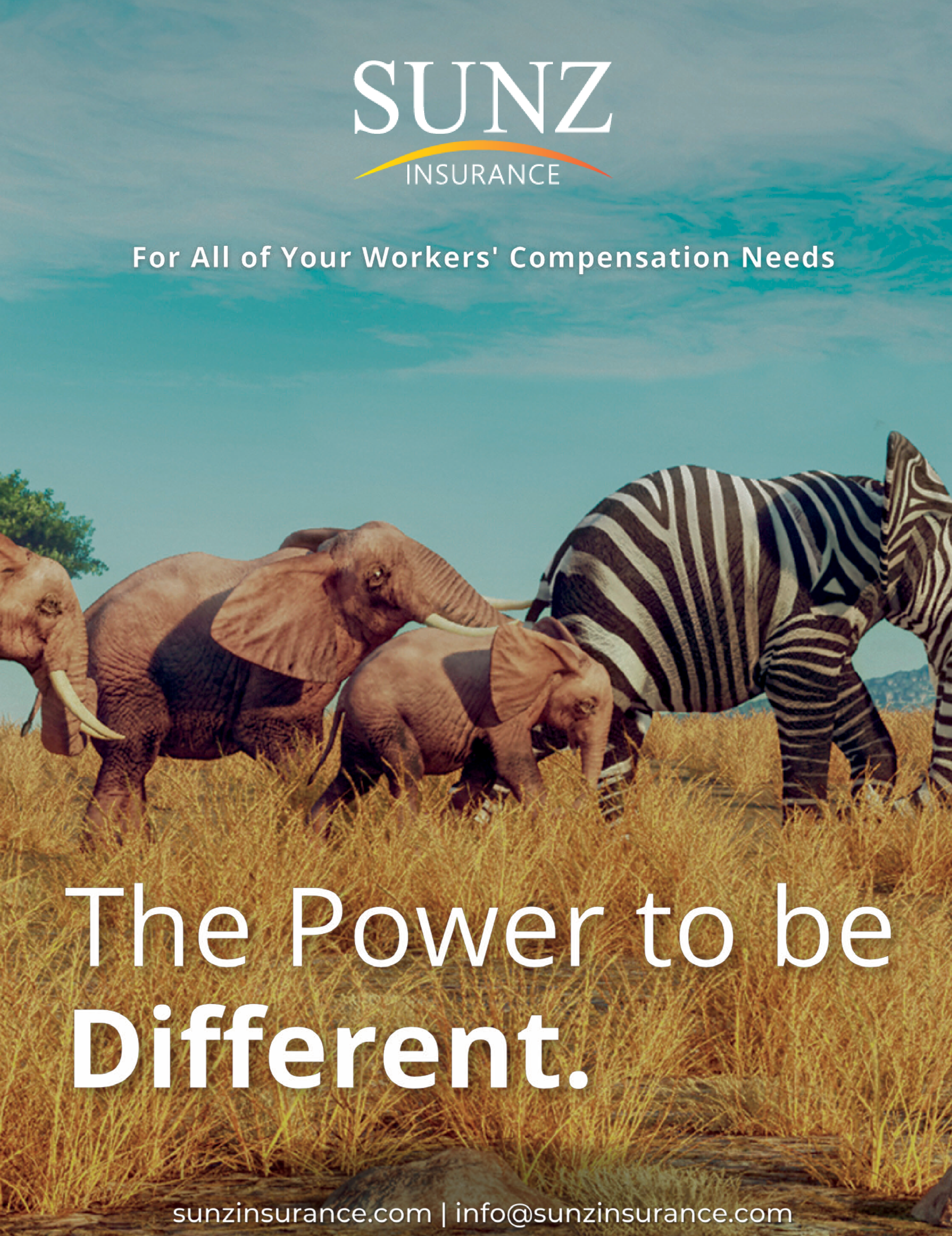
It's an exciting time for PEOs, and our team at Global HQ is energized to promote, grow, and serve this awesome industry. Since the beginning of the year, several new members have joined the NAPEO team. Join us in welcoming them!

- Farrah Fielder, Chief Operating Officer
- Hannah Walker, Senior Director of State Government Affairs
- Alex Milliken, Director of Federal Government Affairs
- Evan Fallor, Director of Communications
- Blake Waravdekar, Manager of Events
- Cass Likouris, Member Services Coordinator

CONGRATULATIONS

VENSURE WINS TWO STEVIE AWARDS

NAPEO member Vensure Employer Services recently announced that VensureHR has won two Stevie Awards from the 21st Annual American Business Awards. It received a silver award for "Company of the Year - Business & Professional Services - Large" and a bronze award in the "Fastest Growing Company of the Year - 2,500 or More Employees" category. "Our team is thrilled to have won multiple Stevie Awards this year, recognizing our rapid growth and commitment to serving SMBs," said Michelle Lanter Smith, chief marketing officer for VensureHR. "I'm incredibly proud to share this award with the VensureHR team, as their collective efforts enable us to deliver at such a high level." ■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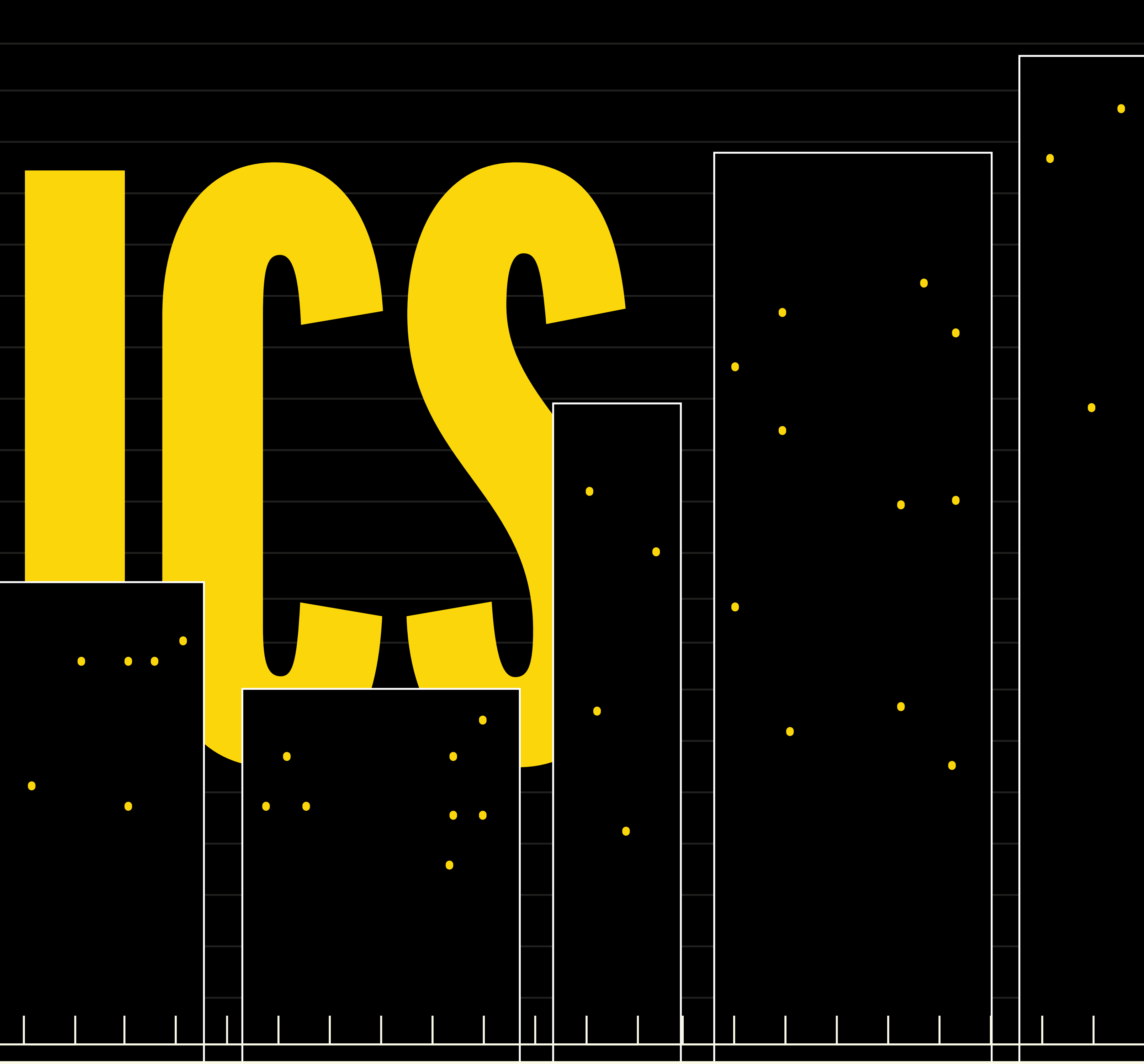


SIFTING THROUGH THE NOISE

Spotting Key Performance Metrics

BY JULIE LONG

Performance metrics can provide valuable insights into different aspects of your business from financial health to client satisfaction. However, it can be challenging to determine which metrics are essential and which ones are merely background noise.

Performance metrics are the key performance indicators (KPI) that track and measure the effectiveness of the services your business provides, your strategy, the growth of your business, or how satisfied your clients are with the partnership. By tracking and analyzing performance metrics, your business can identify areas of improvement and optimize services to deliver maximum value to your clients.

When selecting the metrics to track, consider their relevance to your business goals, as well as their consistency over time. Some metrics, like revenue growth rate or client retention may be relevant regardless of your business strategy. These metrics provide insights into the company's financial stability and client satisfaction which are critical factors for any business.

So don't throw out the metrics that have provided you with consistency no matter where your business has been or where it is going. There are things you want to monitor through KPIs or performance metrics no matter the strategy. Sometimes the consistency of the metrics tells the story.

The story is told from the different aspects of your business including financial, operational, risk compliance, and sales and marketing metrics. Then as you determine your strategy each year, develop new performance metrics to tell you if the strategy is working or if you need to redirect. Each teams' goals should align with the business strategy and should have their own performance metrics. Metrics are not always easy to develop and do not always provide the whole landscape so make sure you monitor regularly to determine if a shift in the information needs to happen so your assessment is objective.

Here are some examples of performance metrics that could assist your company:

Financial metrics:

- Revenue per Employee
- Revenue Growth Rate
- Gross Profit per WSE
- Number of Internal Staff to WSE's
- Operating Expenses as a percentage of Gross Profit
- Client Retention
- Fixed vs. Variable SG&A expenses
- SG&A expense allocation (where are you spending your money, marketing, personnel, facilities, etc.)
- Financial Ratios (Quick Ratio, Current Ratio, Debt to Equity, Working capital, etc.)

Operational Metrics:

- Productivity (production output)
- Quality (Accuracy of service provided)
- Errors
- Customer Complaints
- Net Promoter Score (NPS)

Sales and Marketing Metrics:

- Cost to Acquire a Client (CAC)
- Customer lifetime value (CLTV)
- Customer satisfaction score (CSAT); focuses on customer acquisition and sales techniques aimed at generating revenue
- ROI

When selecting the metrics to track, consider their relevance to your business goals, as well as their consistency over time. Some metrics, like revenue growth rate or client retention may be relevant regardless of your business strategy.

As you continue to explore your performance metrics and what your business needs are, here are a few thoughts to help you understand the importance of creating the full story.

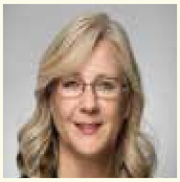
Create performance metrics that help create accountability within an organization. When employees have clear KPIs tied to their roles and responsibilities they are more likely to understand what is expected of them and be motivated to achieve their targets. KPIs also help managers hold employees accountable for their performance and provide feedback and coaching as needed.

Create performance metrics that allow decision making to be quick and accurate. KPIs provide data and insights that can support decision making at various levels of an organization. They help leaders make informed decisions based on actual performance data rather than relying solely on subjective opinions or intuition.

Create performance metrics that allow for continuous improvements in your organization. These KPIs can be used to drive a culture of continuous improvement within an organization. By regularly reviewing and analyzing KPI data, organizations can identify areas for improvement, implement changes, and track the impact of those changes over time. It can help improve the effectiveness and efficiency of your organization.

Create performance metrics that allow your organization to mitigate risk. Compliance risk involves assessing the likelihood and potential impact of non-compliance with laws, regulations, policies, and industry standards within an organization.

Performance metrics may be numbers, ratios or percentages of something but in the end, they help you read the story of how your organization is performing, staff are performing, or goals are being met. The numbers can tell you anything but make sure they are telling you the right things so you don't get lost in the numbers. ■



JULIE LONG

CFO
Tilson HR, Inc.
Greenwood, IN

CLIENT-LEVEL Financial Analysis

BY FRANK HUANG

If you asked someone in the PEO space what he or she thought of actuarial science a positive response might be reserve analyses or accruals. A negative response might be collateral calls or rate increases. Naturally, the varied reactions stem from whether there is positive or negative news coming from the work of the actuary. Yet, one of the most helpful projects an actuary can perform for a PEO, eliciting either positive and negative reactions, is a client-level financial analysis.

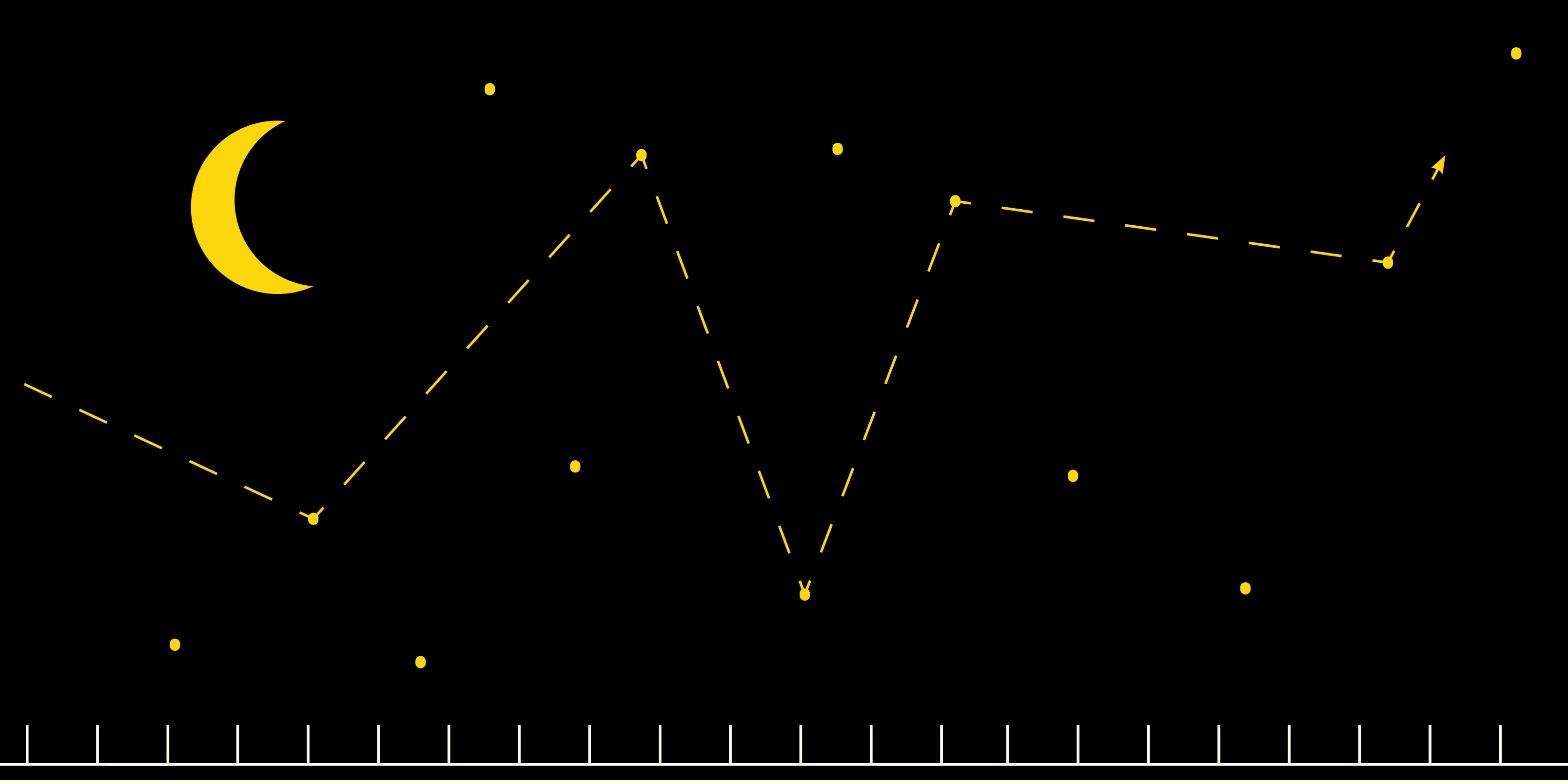
The goal of this article is to show you what such an analysis does and why it's important. Ultimately, you'll see that it doesn't take an actuary to perform this type of analysis although having one might save you some choice words.

WHAT IS A CLIENT-LEVEL FINANCIAL ANALYSIS?

A client-level financial analysis shows the financial status of a PEO client over the entirety of the partnership. It reflects all revenue and cost sources across the entire PEO business. When performed for every client, the PEO has the ability to understand its overall financial status, and, just as important, is able to drill down to see which business groups or sets of clients contribute more or less to the overall financial health of the PEO.

You should be forewarned that while this sounds straightforward, there are two main difficulties in performing this analysis. Data gathering and preparation is the biggest challenge. Often times, PEOs will be able to get one side of the balance sheet attributable at the client level, but not the other. For the analysis to work, both revenue and cost must be identifiable and accurate at the client level and for each separate time period. Without the proper matching of revenue versus cost over the same time periods, the resulting numbers and conclusions may not be accurate.

The second main difficulty is estimating the insurance-related liabilities. Workers' compensation liabilities take years if not decades to fully settle. This would be more easily dismissed if such



liabilities were a small portion of a PEO's balance sheet, but often they are material, and as such their estimation plays a significant role in a client-level financial analysis. Overestimating workers' compensation liability may lead to the conclusion that the PEO and its individual clients are not on solid financial footing, whereas underestimating the liability may lead to a more favorable but inaccurate perspective.

WHY IS THIS IMPORTANT?

If you can get through the aforementioned difficulties, the benefit of having such information at your fingertips cannot be overstated. With such an analysis, a PEO can evaluate the performance of each individual business group or group of clients over time. This opens lines of sight that are only limited by the time and curiosity of PEO leadership. For example, the PEO can now quantifiably evaluate how the workers' compensation program is performing over time and which segments of the client population is impacting that performance. Similarly, the PEO can now quantifiably evaluate which groups of clients are performing well in group health but not in workers' compensation and vice versa. Considering client demographics like size, geography, industry, and distribution channel to the PEO opens even more ways to evaluate the PEO's book of business. Say goodbye to ephemeral gut feelings and dated metrics and say hello to tangible concrete numbers on a client's financial status.

One of the most rewarding parts of being in the industry is to help people get excited about making more informed data-driven decisions. A great example in this case is with a firm that had assumed for quite some time that providing price concessions was helping maintain their client retention levels, and minimize client churn. When the client-level financial analysis was conducted, they quickly looked into this assumption and to their surprise realized that the results were counter to that assumption. Clients that they provided price concessions to actually stayed a shorter time with them than those that they didn't. Naturally, it opened up a new set of conversations around how to utilize such concessions but the veil had at least been mostly lifted from their eyes regarding these long-held practices.

TAKE-AWAY

While it does take some work to get the data prepared properly, which may warrant having an experienced in-house resource manage the process and/or seeking help externally, PEOs have found client-level financial analyses to be helpful in understanding the financial status of individual clients, segments of clients, and across the different business groups of the PEO. While benefits abound, the biggest benefit is the ability of a PEO to better understand every part of their business. That may be worth a few choice words along the way. ■

FRANK HUANG

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PROFITABLE GROWTH

PROFITABILITY ABCs: IT IS AS EASY AS 1-2-3

BY DAN MCHENRY

For all of the music lovers out there let's start with a stroll down memory lane. Back in 1970, the Jackson 5 released their second album titled "ABC" which included performances on live television on the American Bandstand, the Ed Sullivan Show, and later in 1971 on the Flip Wilson Show. Here's our PEO pardoy of one of the classic stanzas from this pop hit.

PEO Parody of Stanza of Jackson 5's ABC (1970)

Profitability ABCs
Easy as one, two, three
Ah, simple as Do Re Mi
Profitability ABCs, one, two, three
PEO Profitability for you, just wait and see

Over the years, I have written many articles related to PEO operations, scalability, and profitability. Yet, it is common to see distractions (as a former operator I am aware of the infinite number!) that may cause PEOs to spend much of their time focusing on just getting through the week. The desire to please causes many to run their companies with a philosophy of being "all things to all people," thus displacing opportunity on the profit scale.

The article provides some simple guidance for streamlining operations (thus reducing selling, general, and adminstriave (SGA) costs) and increasing gross profit contribution from their existing client base. For the purpose of this article, we are only exploring pricing strategies that affect client profitability and operating efficiency items that impact select SG&A cost categories. Business development and organic growth are excluded from this discussion.

PROFITABILITY ABCS

AUTOMATION

Over the years, our firm has advised approximately 175 companies in this market space from PEOs, private equity, carriers, brokers, and other advisors. The PEOs have ranged from start-ups to large publicly traded entities. One common challenge in many PEOs is that they may not be utilizing the full capabilities of their existing PEO HRIS system – for all types of reasons. The impact of not fully leveraging the capabilities of your company's PEO HRIS system can result in higher payroll costs, a reduction in capacity, and reduced quality control.

The top three areas that we have observed opportunities to leverage existing resources and capabilities include, but are not limited to the following:

1. Onboarding, open enrollment, and benefit administration.
2. Client Reporting: Any Client Reporting that requires a manual process (especially those required every pay cycle) should be avoided.
3. Tax set-up and configuration especially as it relates to ASO clients.

As a final note as it relates to automation, we suggest that you poll your service delivery operations, accounting, and finance departments to determine if your company is fully leveraging the automation of your system for all your clients and that the tax operations are running smoothly with no regulatory errors and correspondence.

BASIC WELL-DEFINED PROCESSES

Surprisingly, many PEOs do not have a complete set of well-defined processes which are consistently applied. Usually, this is the result of organizational capability and a PEO's desire to be "all things to all people." We recommend a simple set of processes focused on the following three areas:

- **Client Rules** – much like our children, our clients are much happier and thrive with a set of well-defined rules. Examples of such rules can range from (a) deadlines for submitting payroll to (b) deadlines for submissions for terminated employee paperwork. Without client rules, service operations can be chaotic, stressful, and costly. Keep in mind that this is a tough item to manage. Think about it: we ask our client service people to "do whatever it takes" to keep clients happy and engaged yet may sound hypocritical when stipulating client rules. It is a difficult balance, but necessary for profit optimization. Your "client rules" will depend on your chosen business model, client expectations, and value proposition offering.
- **No Salesperson Promises** - monitor and avoid undisclosed

"One common challenge in many PEOs is that they may not be utilizing the full capabilities of their existing PEO HRIS system – for all types of reasons. The impact of not fully leveraging the capabilities of your company's PEO HRIS system can result in higher payroll costs, a reduction in capacity, and reduced quality control."

salesperson promises requiring deliverables that are outside your desired framework. Examples include reports that must be prepared manually and therefore lead to operational efficiency degradation.

- **Processes Surrounding Benefit Administration** – these processes are critical to effective client service in a PEO operation. Effective benefit administration processes and set-up are even more imperative for PEOs that are performing benefit administration on client-based benefit plans. This is one of the most problematic areas of operations for the small and middle market sized PEO. If your company is struggling in this area, seek immediate solutions as benefit administration can be an area of significant cash leakage within your P&L.

CLIENT STRATIFICATION, PRICING METHODOLOGY, AND RE-PRICING: MANAGE YOUR BUSINESS WITH DATA.

The key to PEO profitability includes knowing and understanding your client portfolio. My recommendation is that every PEO perform an annual (at a minimum) client stratification profitability analysis. The results will allow a PEO to generate, view and understand the information needed to conduct a strategic analysis of the profitability of its client base, and more importantly, to determine what re-pricing should be performed to enhance the value of its client portfolio. Regarding this topic, we recommend the following:

Pricing Methodology

Convert to a percentage of payroll (POP) pricing methodology.

- Most Americans are well aware of how high inflation has negatively impacted their personal pocketbooks. It has impacted business in the same way. Historically, PEOs have primarily charged a POP for their management (administrative) fee. However, in the past ten years, there has been an increasing trend to charge a flat fee format such as a per check charge (PCC) or a per employee per month (PEPM) management fee.
- For those PEOs using primarily a PCC or PEPM management fee methodology, profitability will decline as wage and technology costs continue to rise vs retail pricing.
- For those using a POP pricing methodology, these PEOs are likely to maintain their profitability.

However, using this pricing methodology does not mean that the PEO's client portfolio is adequately priced.

Client Stratification

PEOs should generate a client stratification and profitability analysis on an annual basis. Such stratification should include an analysis of the following cohorts by:

- Service model (PEO, ASO, or Other)
- Industry
- State (and/or market)
- Salesperson
- Year (client start date)
- Tier Bands (Highest to lowest) – Can be by GP or WSE Count
  - (e.g. Top 1 – 10, 11 – 20, etc.)

We recommend that client stratification should be built into the standard profit management process and monitored closely for changes.

Client Re-Pricing

We recommend that PEOs perform price increases on an annual basis by utilizing the information provided in the client stratification detailed above.

It will become supremely clear to you what clients need re-pricing and which ones do not!

To provide context, the average client size of a PEO in the 2022 NAPEO FROS Survey was 22.3 WSEs. If a PEO performed an annual average price increase across its client base of $100 per WSE, what is the risk of attrition? Would a client leave the PEO for an increase of $ 2,230 per year? Unless there are other chronic service issues, I doubt it. I would argue that a client's transfer cost to change would be much higher than the price increase.

Sample PEO Pro forma Per WSE ($) using 2022 FROS Data

	2022 NAPEO FROS (a)	ABC Adjustments	Pro forma 2022 FROS
Gross Revenue	53,595	100(b)	53,695
Payroll	46,726		46,726
Net Revenue Per WSE	6,869	100	6.969
Gross Profit Per WSE	1,568	100	1,668
Compensation Costs	617	(31)(b)10(c)	596
Other G&A Costs	616		616
SG&A Costs Per WSE	1,233	(21)	1,212
EBITDA Per WSE	335	121	456

(a) The 2022 PEO NAPEO FROS P&L was calculated from the 2022 NAPEO FROS – All Respondents. Amounts used in this P&L were calculated using the elements of this FROSEBITDA is 21.4% of Net Revenue is $335. SGA is computed as delta between Gross Profit and EBITDA. Author assumption based upon his experiences that PEO Compensation costs at 50% of SG&A.
(b) Used $100 per WSE price increase and 5% efficiency reduction in compensation costs as referenced in Section C above.
(c) Author assumption that $100 per WSE price increase would result in a $10 increase per WSE in commission costs.

PROFITABILITY ABCS: POTENTIAL FINANCIAL IMPACT

So what is the potential financial outcome of implementing these ABCs? Using the 2022 FROS results and the assumptions in section C above, we provide this information in the chart above.

THE RESULTS ARE IN

As you can see in the sample PEO financial illustration above, the impact of implementing these simple recommendations above has increased the bottom line from $335 per WSE to $456 per WSE (or $121 improvement per WSE to your bottom line).

This is a 36% increase in profitability!

If your PEO is not performing at or near the 2022 FROS median statistics, please include these recommendations in your next financial planning strategy session. It may not be a goal that can be accomplished all at one time, but now is the time to begin that journey. ■

DAN MCHENRY
Business Advisory Group Practice Leader
McHenry Consulting, Inc.
Windermere, FL

The isolved Network is hitting the road!

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ROAD SHOW

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MERGERS & ACQUISITIONS IN 2023: CASH FLOW, VALUATION, DEAL TERMS

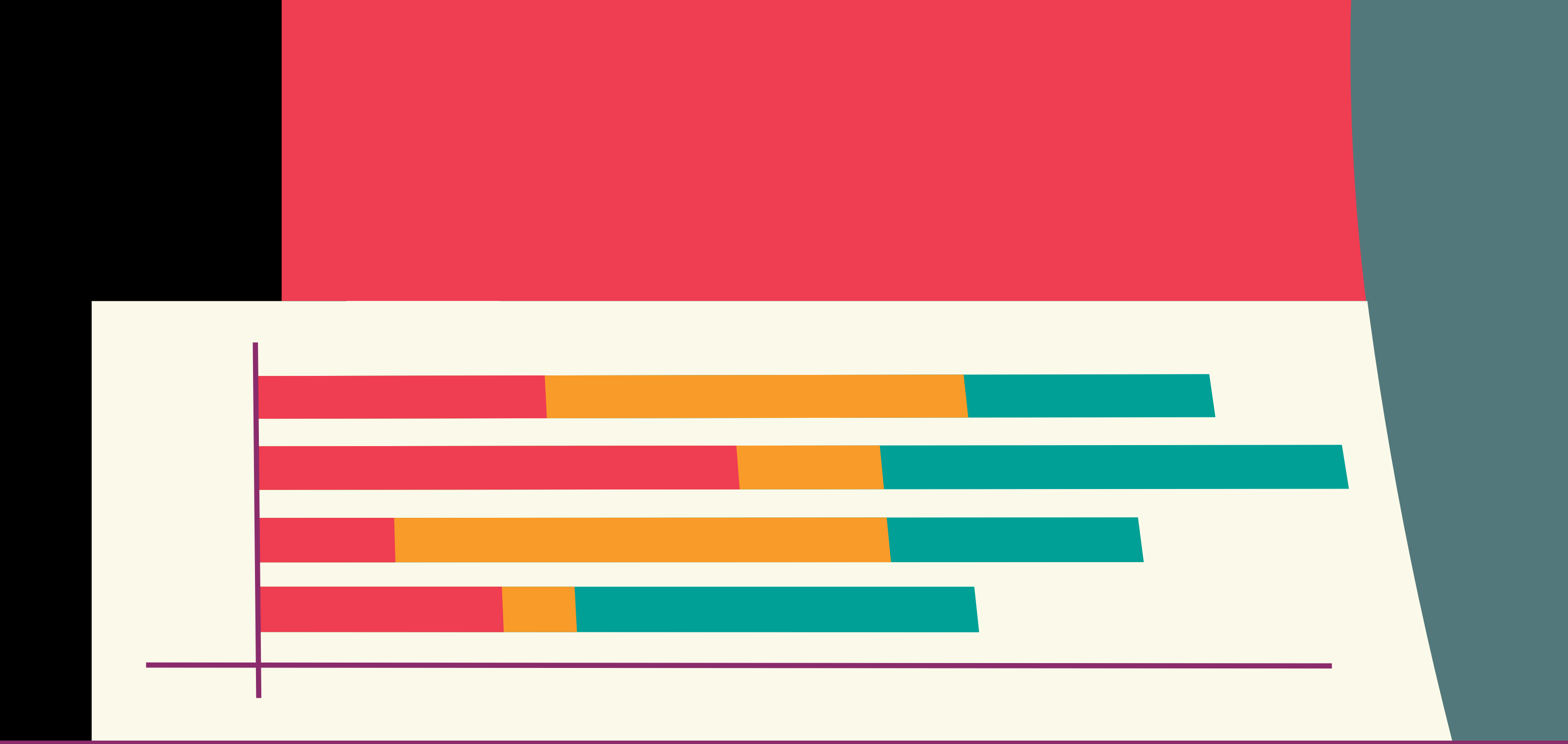
BY WANDA J. SILVA

Among the many determining factors in PEO transactions, profitability is one of the most important. I like to call these factors "Pieces of the Puzzle" in this very complex 2023 world of M&A. Let's go through some basic concepts first.

- We can all agree there is no inherent value in your PEO unless there is a buyer/investor who wants what it is you have to sell. So the enterprise value consists of exactly what that buyer or investor is willing to pay.
- Each buyer/investor examines the investment to determine the probability and size of the return on investment (ROI) that he/she is likely to receive in return from the investment. Think about it: how could a buyer/investor put their money at risk if not certain of a gain on that investment?
- For buyers, ROI has an agreed upon definition: cash flow. The PEO acquisition should deliver additional monies or cash flow to the buyer in the first year of ownership and into the future. For the majority of investors, cash flow is defined as adjusted/recast earnings before interest, tax, depreciation and amortization (EBITDA) Typically, EBITDA is measured by the audited PEO financials over several years before the investment, but most importantly the most recent year or the latest twelve months.
- Adjusted EBITDA, as calculated from your company's financials, is then increased for any true nonrecurring expenses such as salaries to officers in excess of "market rates" and other nonrecurring expenses. And to be fair, EBITDA will decrease to take into account any cost items where the seller benefits by not paying the full market cost of a cash flow item. A "sweetheart" lease arrangement would be one example. Once we finish with "add backs" and "add-ins" we get to a true and legitimate recast EBITDA or cash flow.
- Total valuation/price is determined by adjusted EBITDA times an appropriate market multiple. A very simple way I like to explain this is to answer this question, "How many years' worth of a PEO's cash flow will someone pay the PEO shareholders in order to take ownership of the right to that cash flow heading into the future?"
- Transaction terms or the way the deal is structured, will be determined by the answers to many of the above questions.

While there are many more pieces of the puzzle, these are a few basics. Now let's take a look at some of the M&A influencers in the spring of 2023. We are in a time of uncertainty and I think we will be for a while. We are in a new geopolitical era, a new economic era, and a technological revolution. We see lots of mixed signals at a macroeconomic level. On the one hand the growth of our economy is dicey (down in first quarter to an annual rate of 1.1% from 2.6% in the 4th quarter of 2023.) On the other hand – our economy has proved to be remarkably resilient. Businesses are hiring, people are getting raises, and families are spending. This makes putting together the puzzle pieces rather complex in today's environment.

What does this mean for M&A? Right off the top, we will not see the same



> "For buyers, ROI has an agreed upon definition: cash flow. The PEO acquisition should deliver additional monies or cash flow to the buyer in the first year of ownership and into the future."

amount of M&A activity in 2023 as we did the last two years. We will not see the same valuations/pricing as we saw in the last two years. And from a deal perspective, I see four things coming into clearer focus.

1. Buyers/investors will focus on flexibility in valuation and transaction deal structures. For example, with the cost of capital more expensive due to rising interest rates, perhaps we will see less cash or guarantee for the seller.
2. We will see an increase in a more well-defined & sophisticated due diligence process to ensure the pricing and structure are buttoned up. We will see more third party due diligence involvement. For example more objective Q of E (Quality of earnings) reviews by consulting firms who are not PEO operators.
3. There will be greater appeal in deal structures where the shareholders/founders maintain meaningful interest in the PEO and stay involved in operations. Somewhat of a "We are in this together as buyer and seller – we will share in the upside and swim with the sharks together if the waters get tough."
4. And there will be an increased focus on the underwriting for any risk borne by the selling PEO. For example and cash flow items that are impacted by arbitrage.

The good news is great high quality PEO companies are always marketable. As those companies come on the market, I think it will spur continued competition among eager buyers and investors.

My advice: be ready today for whatever many happen tomorrow. Understand your value proposition and cash flow in detail, be flexible and ready to pivot quickly as the puzzle pieces continue to change, move and shift. After all, it is only by trying different puzzle pieces that you actually see the full and final picture come together. ■

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BEST PRACTICES

THE 5 Ws OF PEO GENERAL LEDGER RECONCILIATIONS

BY JEAN GOLDSTEIN, CPA

General ledger reconciliation is a key control to help maintain timely and accurate financial statements in any business. If you speak to accounting or finance professionals in the PEO industry, they will agree that general ledger balance sheet reconciliations are the most telling and critical tools in analyzing a PEO's fiscal position. Failure to reconcile balance sheet accounts timely and accurately can lead to material losses to the PEO. Let's explore the 5 W's of PEO ledger reconciliations.

WHAT

The timely, complete, and accurate preparation of general ledger account reconciliations.

WHY

Reconciliations are fundamental tools in protecting the PEO's financial health. They are a crucial step in the monthly closing process and the preparation of an accurate reporting package. Monthly financial statements are utilized by owners to make important decisions about their business. Annual and sometimes quarterly statements are necessary to comply with PEO state licensing laws, bank covenants, investor requirements, insurance companies and workers' compensation carriers review to name a few. An ESAC certified PEO must submit quarterly and annual financial data while a certified PEO must provide annual statements to the Internal Revenue Service.

WHEN

Ideally, reconciliations should be performed monthly but, for certain accounts, an alternate cadence may be needed.
For example:

- Certain payroll tax liability accounts such as federal withholding, state unemployment or federal unemployment may be reconciled quarterly to coincide with regulatory filing requirements.
- Some accounts may be verified monthly for collections from employees and clients as well as payments to carriers but can only be truly reconciled upon completion of an annual audit by the carrier. This includes accounts such as FSA or workers' compensation liabilities.

WHO

Because much of the data in the general ledger flows from the payroll processing of wages, taxes, benefits, workers' compensation, etc., it is often debated who is responsible for the reconciliation of certain accounts. Ultimately accounting is responsible for preparing and presenting the financial results, but the department can rely on the input of professionals within the organization who are responsible for specific functions, to participate in the reconciliation process. Some of the material reconciliations that could be supported outside of accounting include:

Benefits

Benefit reconciliations are probably the loss leader when it comes to write offs due to late or unidentified discrepancies. While accounting can prepare the reconciliation, a benefits professional should be responsible to clear all differences and make the appropriate changes either with the vendor or in the employee payroll/client billing.

Payroll Taxes

Taxes are arguably the next loss leader when reconciliations are not performed timely and accurately. The payroll tax function generally reports into accounting but in some cases, this flows through payroll or operations. Regardless of where the function lies, reconciliations are crucial to detect errors and avoid government notices that often lead to material fines and penalties.

Reconciliations are fundamental tools in protecting the PEO's financial health. They are a crucial step in the monthly closing process and the preparation of an accurate reporting package. Monthly financial statements are utilized by owners to make important decisions about their business.

Garnishments
Like payroll taxes, this function may flow through payroll or operations and should be handled just as payroll tax reconciliations.

WHERE

All reconciliations should be completed, reviewed, approved, and stored where accessible. Many times, these can be performed in the PEOs accounting software system, but other accounting professionals must prepare their reconciliations utilizing Microsoft Excel or another financial spreadsheet system. Regardless of where the reconciliation is completed, the results must be stored for future access either within the accounting system, if available, or on the PEO's intranet. Be sure that controls exist for access to reconciliations that may include sensitive or confidential data.

HOW

The method by which accounts are reconciled will depend upon multiple factors including company policy, technology and internal resources, but the following should be considered:

Create standard operating procedures (SOPs) for the reconciliation of critical accounts, at a minimum. Review, test and update processes periodically (annually at a minimum).

- Ensure a segregation of duties between those processing certain transactions and those performing reconciliations with access to post adjusting entries.
- Set a formal review and approval process for all completed reconciliations.
- Be sure that appropriate source documents are used when performing any reconciliation. Source documents include carrier invoices for benefits, bank statements for cash, tax filings such as 940 & 941 forms, state unemployment returns or state and local withholding returns for payroll taxes. Specifically for benefit reconciliations, PEOs often perform their reconciliation only between a vendor invoice and a deduction register out of the operating system. What is missing is the reconciliation to the balances that exist in the general ledger which often differ from the other two (2) sources. At the end of the day, the general ledger balance is what matters in any benefit reconciliation.

Once the balance sheet accounts are reconciled, it becomes much easier to perform a thorough analytical review of the business' profit and loss accounts.

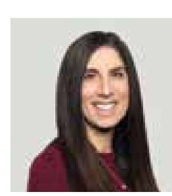
FOR FURTHER CONSIDERATION

Outsourcing
With the volume of transactions, many PEOs outsource repetitive tasks to a third party. Consider if outsourcing non-critical, back-office tasks is a viable option for your company.

Alternative tools
Investigate if tools such as creating a database reconciliation program or utilizing artificial intelligence would add value and or/reduce the cost of the reconciliation process.

Reconcile all accounts
Don't pass over a balance sheet account because the balance is small. Often, transactions that should have flowed to revenue or expense wind up in the balance sheet. What appears to be an immaterial balance could consist of a large debit offset by a large credit. If one side of that transaction is reclassed to the income statement, the remaining balance could be material. Additionally, auditors will review certain accounts because of large balances and others because of the type of account, regardless of the balance. Auditors may question material journal entries so be prepared to provide documentation for these as well.

A reconciled general ledger including fully reconciled accounts, completed according to Generally Accepted Accounting Principles (GAAP), is the cornerstone to understanding your company's financial activity, spotting inaccuracies and potential losses and improving a company's overall financial health. ■



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THE POWER OF SOPs: THE KEY TO BUSINESS EFFICIENCY, CONTINUITY, AND GROWTH

BY ANTHONY LAPORTE

Every business, and indeed every PEO, is a vibrant tapestry of moving parts. In my years of steering such intricate organizations, I've found the key to streamlined operation lies in an often underestimated powerhouse: standard operating procedures, or SOPs.

Think of SOPs as the secret recipe to your organization's success, an atlas mapping out your strategy, and an insightful guide leading your team toward growth. More than just documentation, they are the backstage crew in the grand performance of your business, ensuring every act unfolds smoothly.

SOPs are not just tools for enhancing compliance or trimming down training time – they are the catalysts for supercharging your efficiency, the quiet engine powering your operations, and the blueprint for navigating routine tasks with precision.

They don't step in for rare, one-off situations. Instead, they're the conductors guiding the orchestra of daily tasks, helping every team member strike the right note, every time. They are the silent yet powerful drivers of regularity, allowing your team to tackle day-to-day activities with confidence and efficacy.

As you adopt SOPs into your PEO's DNA, remember you're embracing more than a set of instructions. You're welcoming a culture of coherence, precision, and foresight, elements that not only enhance efficiency, but also paint a vivid picture of your organization's future trajectory.

THE MULTIFACETED ADVANTAGES OF SOPs: FROM BUSINESS CONTINUITY TO KNOWLEDGE RETENTION

Standard operating procedures could change your company's trajectory in ways you may not even imagine. But what do they bring to the table? Why do businesses of all shapes and sizes swear by their effectiveness?

Below are just a few key benefits associated with implementing company-wide SOPs:

Safeguarding Business Continuity: Imagine a ship that continues to sail smoothly, even when the captain is away. That's the power of SOPs. They keep your crucial tasks on track, regardless of who is available.

Upholding Quality and Trimming Errors: Mistakes can sneak in when there's a gap in information or inconsistent application of knowledge. SOPs serve as your sentinels, minimizing these slip-ups and preserving your business's quality standards.

Speeding Up Employee Onboarding: Think of SOPs as your business's welcoming committee. They swiftly guide new hires through their roles, giving them a head start in supporting business continuity.

Locking in Knowledge: Picture SOPs as your organization's memory bank. As seasoned staff move on or change roles, SOPs ensure their knowledge doesn't walk out the door with them.

Legal Protection Ensured: SOPs are not just guides; they are the company's shield. By documenting and reviewing critical processes, SOPs offer a substantial layer of legal protection, ensuring adherence to industry standards when required.

In the dynamic landscape of a small business, employee turnover can sometimes feel like a game of musical chairs. When the music stops, the sudden departure of a critical person can leave a void filled with guesswork and reinvention. But with SOPs, there's a written legacy of task mastery, and business continuity is maintained.

Larger companies, too, find great value in SOPs. Picture a challenging task that different teams have approached in various ways over time. Once an effective method is found, it's akin to discovering a winning strategy. Documenting this in an SOP becomes a reference point, a shared victory in the form of a best practice that drives future success.

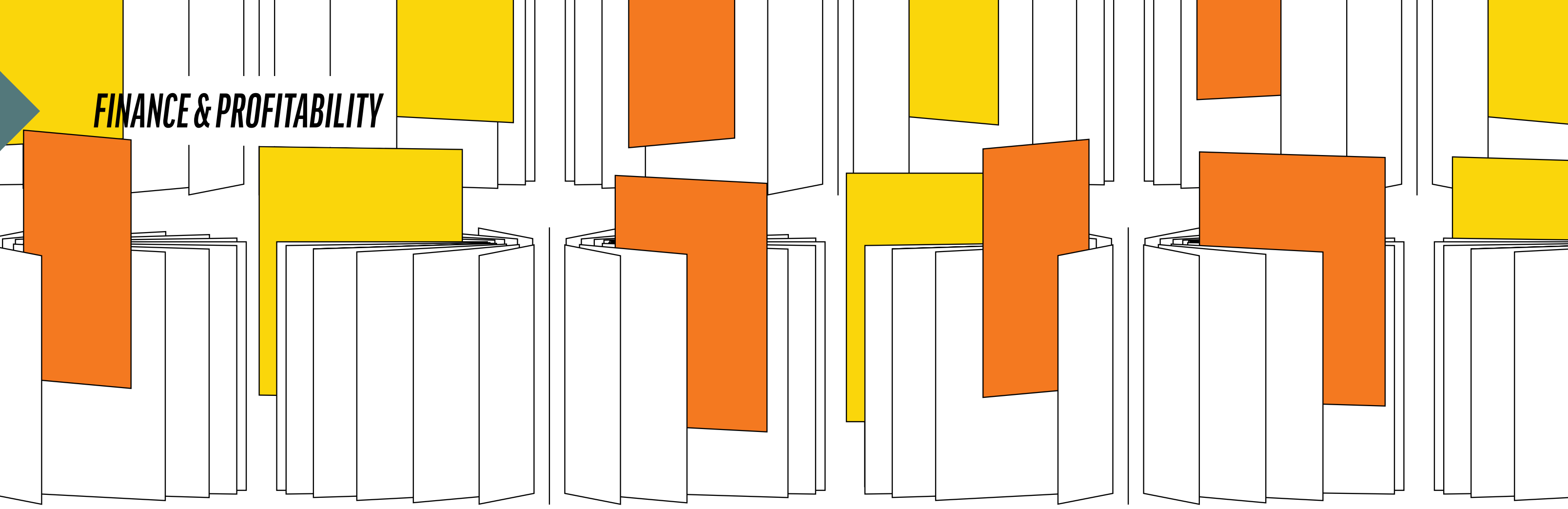
CHARTING YOUR COURSE: A GUIDE TO CREATING EFFECTIVE SOPs

Embarking on the journey of creating SOPs begins with a keen observer who can capture the nuances of tasks, their execution, and the resources involved.

Like a conductor who knows every instrument in the orchestra, this individual should understand the complexities of each task, its interplay with different roles, and clearly identify who does what. This careful documentation will be the foundation for more comprehensive SOPs encapsulating your day-to-day business operations.

Below are the essential elements of effective SOPs:

Nail Down the Purpose: Knowing the task at hand inside out is vital. Don't just draft an SOP – craft it with a clear goal in mind, turning it into a powerful driver of productivity.



SOPs are not just tools for enhancing compliance or trimming down training time — they are the catalysts for supercharging your efficiency, the quiet engine powering your operations, and the blueprint for navigating routine tasks with precision.

Know Your Users: Just as a playwright knows his audience, you should know the users of your SOP. It's all about ensuring the SOP speaks their language, making their tasks simpler and more efficient.

Embrace Collaboration: SOPs aren't made in isolation – they're team achievements. Make sure everyone's on board during creation, making the SOP not just a document but a representation of team spirit and cooperation.

Keep It Uniform: Consistency is critical across all SOPs. It's about making life easier for everyone by sticking to an easily recognizable and understood format.

Implement a Review Cycle: SOPs aren't set in stone – they should grow and adapt with your organization. Set a schedule to revisit and update them, ensuring they always reflect the best practices and keep pace with your business evolution.

Creating an SOP needn't be daunting – you have a world of resources at your fingertips. Online platforms, including Microsoft Office, offer ready-to-use templates that can help streamline your SOPs. But remember, there's room for customization. You can tailor these templates or create your own from scratch if that aligns better with your requirements.

However, irrespective of your chosen format, there are key components that every effective SOP should encompass: Name of the procedure; general principle of the procedure (purpose and other associated procedures); resources (forms, other SOPs, budget considerations); supplies; step-by-step layout of the procedures with clearly defined roles (timelines, completion expectations); sign-offs for all stakeholders, and revision dates if applicable.

These integral elements form the backbone of any comprehensive SOP, lending it credibility and making it a valuable tool for all involved.

SOPs: NOT A ONE-TIME ENDEAVOR BUT AN ONGOING COMMITMENT

Keep in mind the dynamic journey of creating and developing SOPs. It begins with the crafting phase and then moves to the trial run, using this essential tool as an opportunity for team collaboration and solution discovery.

Visualize this: Once an SOP has been penned, it's passed onto a relatively new employee. Can they duplicate the required outcome armed solely with the SOP? This becomes the test. This stage encourages them to identify any potential gaps or ambiguities within the procedure, which they can report to their superior.

Yes, training for new or existing staff members can be a lengthy endeavor that strains supervisory roles. However, SOPs offer a unique platform for team-building exercises, fostering collaboration, and ensuring smoother adherence to both internal and industry-wide regulations.

Imagine the ripple effect of creating comprehensive, well-articulated SOPs. They'll become the foundation of your staff retention strategy, an effective training tool, and the blueprint of your business processes as your organization expands and thrives. The crafting of SOPs is not just a task to be checked off your list but a perpetual journey that enhances your business' growth trajectory.

In summary, SOPs serve as the driving force behind streamlined operations, enhanced collaboration, and a culture of continuous improvement. By embracing effective SOPs, your organization gains the tools to seamlessly navigate obstacles, optimize processes, and unleash the full potential of your team. So, make SOPs a cornerstone of your business strategy, and watch as your company flourishes. ■

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NAPEO GIVES BACK: THE POWER OF MANY

BY CHRIS CHANEY

If you have attended a recent Annual Conference & Marketplace then you witnessed the power of many. Former NAPEO Board Chair Barron Guss launched the NAPEO Gives Back initiative in 2019 to encourage NAPEO members to harness the power of many to leave our conference host cities better off than when we arrived. Over the last four years, NAPEO Gives Back has supported charitable organizations in Austin, Texas; Marco Island, Florida; San Antonio, Texas; and Palm Desert, California. To date, NAPEO members have contributed more than $460,000 through NAPEO Gives Back.

Each year the NAPEO Gives Back committee chooses an organization (based in the conference host city) to support. We are pleased to share that our 2023 NGB partner is Orlando, Florida-based Give Kids the World. The organization, a 501(c)(3) charity, aims to create happiness, optimism, and hope for critically ill children and their families. Give Kids the World provides opportunities for these families to laugh together, play together, and create priceless memories during customized dream vacations in an accessible nonprofit resort. The 89-acre resort provides weeklong, cost-free vacations to "wish kids" from around the world.

We will share more information about ways you can support Give Kids the World closer to our 2023 Annual Conference & Marketplace. We have the chance to help put smiles on the faces of kids and parents struggling through very tough times. We know that you will once again answer the call and support a very deserving organization.

> *We are truly overwhelmed by the incredible generosity of everyone at NAPEO. Their contributions will make a profound impact on the support Soldiers' Angels is able to provide to local veterans in the San Antonio area."*
> *Amy Palmer, Soldiers' Angels President and CEO*

POWER OF A SHOWER

In 2022, we supported the Coachella Valley Rescue Mission (CVRM) in Palm Desert, California. CVRM is a non-profit organization that provides short and long-term aid to the homeless population of the Coachella Valley region. In addition to their residential programs, CVRM operates with an outreach team that provides showers to homeless individuals using a portable unit.

NAPEO members contributed nearly $200,000 to CVRM through NAPEO Gives Back. CVRM used this donation to purchase a new mobile shower unit to provide the comfort of a shower to those in need. The new shower trailer is branded

Erik and Zack of the CVRM Outreach Team with the new shower trailer.

This donation will have an exponential impact on our students, helping us keep them engaged, out of trouble, and focused on their path to college." Dylan Jones, Executive Director of Anthropos Arts

with the NAPEO logo, a small sign of the lasting impact on the organization.

In addition to making donations, NAPEO members also donated their time by assembling 500 hygiene kits and 500 food kits to distribute those who depend on CVRM for support. We presented a check to CVRM during the conference, and the team expressed their gratitude for our support. We were also very fortunate to be honored by State Senator Melissa Melendez who presented NAPEO with a proclamation of recognition from the California State Senate.

In a sign of the generous spirit of our industry, each year participation grows in NAPEO Gives Back. Many people have been positively impacted by your support. Here's a brief look back at the other organizations we have partnered with.

2021

With the site our 2021 annual conference being in Military City USA, San Antonio, we partnered with Soldiers' Angels, which provides aid, comfort, and resources to the military, veterans, and their families. We raised more than $138,000, enough to fund Canteen Gift Cards for one full year, feeding more than 11,000 vets as they pass through the VA hospital system in San Antonio.

2020

In 2020, we partnered with Marco Island, Florida-based Our Daily Bread Food Pantry, which distributes food to more than 30,000 residents annually. These

The check presentation to CVRM at the 2022 Annual Conference & Marketplace.

> *We are wowed by this tremendous outpouring of support by NAPEO and its members. Even though they just met us, they have opened their hearts enthusiastically to help our families in need and they have made a lasting impact. Liz Pecora, Vice President, Our Daily Bread."*

folks, who depend on the tourism and hospitality industries for their livelihoods, were significantly impacted by the pandemic, taxing the resources of the food pantry. Despite being on a virtual platform as opposed to in person, we raised $79,470, which enabled Our Daily Bread to purchase a long-desired walk-in freezer. The freezer allows them to store and distribute more food to more residents.

2019

In the first year of NAPEO Gives Back, the association raised more than $52,000 for Anthropos Arts, an Austin-based charity that provides mentoring and musical instruction for low-income students. Our donation made a substantial and lasting impact on the group, creating longevity and the ability to help a broader group of kids in the Austin area.

You can view the lasted information about NAPEO Gives Back at napeo.org/napeogivesback. ■

CHRIS CHANEY

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NATIONAL PEO WEEK:

TAKING OUR MESSAGE TO CAPITOL HILL

This year's annual PEO Capitol Summit brought more than 200 members together for a week of legal education, networking, and advocacy. Yet, this year's conference was an extra special one. For the first time ever, our PEO Capitol Summit coincided with National PEO Week. That's right. A whole week dedicated to recognizing the amazing work that PEOs do to support small businesses and their employees. We have a great story to tell, so we told it far and wide.

Palpable enthusiasm surged through the crowds as we boarded busses and headed to Capitol Hill to meet with lawmakers. Members met with Congressmen and legislative staff in nearly 80 meetings. Hallways and meeting rooms across congressional office buildings were filled with NAPEO members moving from office to office touting the good news about PEOs.

We also spoke about the challenges many PEO clients have faced with receiving employee retention tax credit (ERTC) claims. The IRS backlog of forms surged to more than 1,000,000 just before we met with lawmakers. This unprecedented delay in processing forms has resulted in many PEO clients struggling. The good news is that our months-long grassroots advocacy campaign has paid off. Congress has taken notice of the issue. We pressed our message again to ensure pressure is maintained on the IRS to clear the backlog.

We were lucky to have seven members of Congress address our group: Reps. Wesley Hunt (R-TX), Beth Van Duyne (R-TX), Mike Thompson (D-CA), Claudia Tenney (R-NY), Drew Ferguson (R-GA), Suzan DelBene (D-WA), and Erin Houchin (R-IN). Each one reflected on the importance of supporting small businesses. It's a unifying theme in an otherwise divided town. That seven members of Congress, in the middle of tense negotiations over the debt ceiling, took time to speak to us reflects how our industry has raised its profile.

Of course, National PEO Week was celebrated across the country. Several states issued proclamations recognizing it, and PEOs hosted events and launched social media campaigns. It was an exciting week to celebrate the impact that PEOs make.

The week also featured a strong line-up of legal education sessions from topics like restrictive covenants and data privacy laws to case law and ethics. These may not be the most exciting issues to talk about, but they are very important. Our speakers did a typical outstanding job sharing their expertise and insight with the group. For those lucky (or brave) enough to attend, Jeanine Driver delivered an electric session on body language. She had the audience up and moving, actively participating, and engaging with one another. She challenged misconceptions and provoked new thinking. Do you see crossed arms as defensive? No, she said, the person is actually thinking through a tough problem. Does the shape of your table make a difference? Yes, she said, the shape and size of a meeting table affects the attitudes of the participants.

In the midst of learning and advocacy we found time for fun, too. Tuesday night the group, decked out in National PEO Week t-shirts and hats, ventured to Nationals Park to watch Major League Baseball's Washington Nationals take on the Sand Diego Padres. It was the perfect way to unwind from a long day.

If you missed this year's conference, or missed the chance to celebrate National PEO Week, mark your calendars for the third full week in May each year. We'll be back. ■


2023 PEO CAPITOL SUMMIT
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NATIONAL PEO WEEK


NATIONAL PEO WEEK
NATIONAL PEO WEEK


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NAPEO

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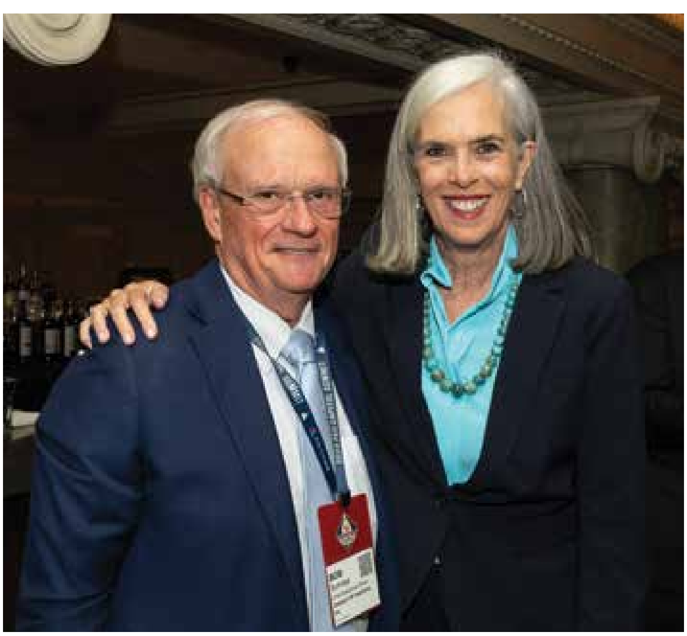

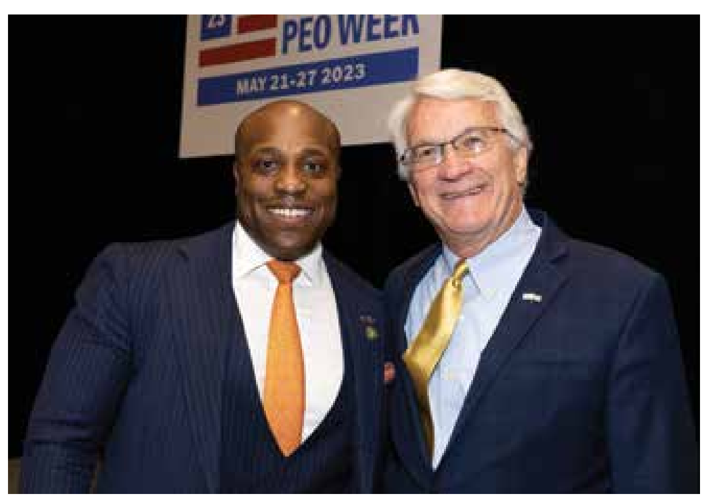
PEO WEEK
MAY 21-27 2023

NAPEO ADVOCACY DAY IS A HOME RUN

BY THOM STOHLER

There's an energy around the PEO industry this year that's palpable. Nowhere is that more true than in Washington DC, where we are starting to make our mark as a strong contributor to the vitality and success of the backbone of the economy: small and mid-size businesses. We've got a great story to tell. Help us tell it.

Those were the first words on our registration site for PEO Capitol Summit and they proved quite true this year. The industry is starting to make its mark—as proved by our efforts to clear out the ERTC backlog. And the PEO story—contributing to the success of small businesses—was successfully spread throughout Capitol Hill.

Easy, right? Only if you count a change of strategy, hiring an outside lobbyist, investing in technology, bringing additional employees into NAPEO, and a year plus of relationship building.

This year's Advocacy Day was reflective of our overall change in lobbying strategy, which is to build relationships on Capitol Hill, educate members of Congress about the PEO industry, and to proactively promote an agenda that benefits the industry and our small business clients.

It wasn't always this way. In 2012 (my first year at NAPEO), a few members went to Capitol Hill to talk about the Small Business Efficiency Act (SBEA)—the bill that created the CPEO program. Initially, there was opposition to having NAPEO members even do this. Nonetheless, we continued to expand the industry's lobbying efforts as a part of PEO Capitol Summit and by 2014, made Advocacy Day a permanent part of this event.

After the passage and implementation of the SBEA, Advocacy Day became an opportunity to educate Congress about the PEO industry and why we are important to their constituents (it still is). Starting in 2017, we began talking about regulatory and legislative issues impacting PEOs, as actions by Congress and the Administration had the potential to harm the industry. In 2020, when the guidance for Payroll Protection Program (PPP) loans initially required a small business to provide an IRS Form 941 to qualify for these loans, it took all NAPEO's lobbying efforts and the relationship Brent Tilson of Tilson HR had developed over the years with Sen. Todd Young (R-IN) to make PEO clients eligible for PPP loans.

Years of fighting off industry threats, plus attrition among our industry's Congressional champions, made it very clear that NAPEO could not continue to be reactive in its federal lobbying efforts. A different approach was necessary.

As a (relatively speaking) young industry that is disrupting traditional marketplaces, PEOs were bound to draw attention from regulators, legislators, and the industries we are competing against. PEOs provide employer-sponsored benefits, payroll, tax, HR compliance, safety and health, workers compensation, and unemployment insurance services. Each of these functions has established trade associations, coalitions, and lobbyists operating in Washington, D.C. on behalf of the companies providing these services. Combine the many issues we handle with the industry quadrupling in size since 2011, and the need for a proactive education and issue-based lobbying campaign in Washington, D.C. becomes quite apparent.

We were fortunate that when we changed our strategy on federal government relations that Kerry had done a great job of marketing and building awareness of the PEO industry. In doing so, she provided the "air cover" for the new "ground game" NAPEO was adopting. Plus, her work gave us off-the-shelf messaging and educational material that could be used for federal lobbying and educational purposes.

A key component of our new lobbying strategy was the hiring of Mehlman Consulting. They formed a strategic partnership with NAPEO to assist us in building relationships with members of the House and Senate tax committees, as well as Congressional leadership. They also helped us grow our Political Action Committee (NAPEO PAC) and make better use of its contributions.

In addition to hiring Mehlman, we have invested in software that allows for simple, direct communications between NAPEO members and Congress. That has given us the ability to have more than 500 NAPEO members and 1,000 PEO clients write their elected officials in

Washington to have them pressure the IRS to clear out the backlog of Employee Tax Retention Credits (ERTC) claims. We have also invested in software that will allow us to determine how many PEO clients reside in legislative districts, which in turn will allow us to better target "PEO" districts in Congress and the state legislatures.

We have also hired additional staff to support our increased advocacy. Evan Fallor—hired as part of Kerry's team—has been responsible for generating the successful grassroots campaign on the ERTC. Most recently, we have brought Alex Milliken onboard to expand NAPEO's reach on Capitol Hill and in the DC business community.

For the past year, I have been meeting with Members of Congress and their staffs who serve on the tax committees, providing educational material on the PEO industry, its presence in their state/district, and the impact we have on their constituents. Through the PAC, we have supported candidates who support the PEO industry. We have also been meeting with Congress on the ERTC; supplying "questions for the record" and background information on how the delays are harming small businesses. And finally, we executed a grassroots letter writing campaign that personalized the harm that IRS processing delays are causing small businesses.

For the past year, I have been meeting with Members of Congress and their staffs who serve on the tax committees, providing educational material on the PEO industry, its presence in their state/district, and the impact we have on their constituents.

A year plus of lobbying, educating, grass roots activities, and relationship building laid the foundation for a successful Advocacy Day.

How successful was Advocacy Day? We made more visits and heard from more members of Congress than ever before. NAPEO members attended 73 separate meetings on Capitol Hill—the largest number in our history. We had six members of Congress—five of which serve on the House Ways and Means (tax) Committee address our Capitol Hill luncheon, plus Rep. Wesley Hunt (R-TX) address our kick-off breakfast. Declaration of National PEO Week gave us the messaging framework to talk about the PEO industry, and the timing of Advocacy Day worked perfectly with our grassroots lobbying efforts on the ERTC delay.

This year's Advocacy Day represents the new way forward for the PEO industry, based on a strategy of proactive engagement, education, and promotion of legislation that benefits small businesses. This course of action allows us to engage on issues that directly benefit the PEO industry, and puts the industry in a much stronger position to handle the next inevitable crisis that will occur. ■

THOM STOHLER

VP, Federal Government Affairs
NAPEO
Alexandria, VA

NAVIGATING THE CHANGING LANDSCAPE OF EMPLOYEE COMPENSATION AND BENEFITS

BY MATT MCFARLANE

Rewards and benefits are a core part of the HR and People functions at any organization. As the Senior Director of People Experience at Oyster HR, a global employment platform with employees in 70+ countries, my team and I are responsible for the experience of our employees from the day they sign their offer letter to their last day with the company. That includes managing performance, progression, and total rewards.

Traditionally, companies have viewed employee benefits and compensation through the narrow lens of salary, bonuses, and equity. But, with new workplace dynamics, changing norms, and employee needs at play, there is a noticeable shift in how companies are compensating and rewarding their employees.

WHAT'S DRIVING AN EVOLUTION IN EMPLOYEE BENEFITS AND COMPENSATION?

At a macro level, we're seeing seismic shifts in both the makeup and drivers of our workforces.

As Baby Boomers are closing out their careers, Gen X and Millennials now make up the majority of workers. Simultaneously, Gen Z has entered the workforce with an entirely new sentiment about what role work plays in life. This demographic change will likely accelerate a shift toward “‘working to live” instead of “living to work”, and continue to drive an evolution in total rewards philosophy.

Oyster’s own report on employee disillusionment found that 50% of workers surveyed said their number one priority in life is their mental health, while career advancement ranked low, at number five.

From a compensation and benefits standpoint, this underscores the importance and value of wellbeing support for a generation of workers that is increasingly interested in safeguarding their mental health and wellbeing.

From the employer perspective, economic headwinds have meant that the tech sector is seeing the start of what appears to be a move away from cash-related components of its total rewards offering to employees. For many companies, this means maintaining a competitive advantage through non-cash benefits like equity and employee flexibility.

WELLBEING, CAREGIVER SUPPORT, AND FLEXIBILITY

Employees’ needs have transformed at a remarkable pace over the past few years, accelerated in part by the pandemic. Gone are the days when there was a clear delineation between home and work and employees spoke little about their personal, professional, or wellness needs.

This increased willingness to voice and act on individual needs has a number of employee benefits implications. Companies will need to shift focus to benefits that encompass wellness in ways that protect the wellbeing of their employees, offset the stress and strain of home and work life, and build healthier environments where employees can thrive and do their best work.

While the news has largely focused on the recent wave of return-to-office mandates, we’re also seeing increased experimentation with the 4-day workweek or 9-day fortnight as companies explore ways to provide flexibility without hurting the bottom line.

Another trend to watch is a rise in workplace flexibility that expands to include paid time off to enjoy key stages of life (or recover from them) — think childbirth, bereavement, adoption, volunteering, and mental health time off.

For working parents and caregivers, it’s clear that flexibility is a key enabler. One dimension to consider is that caring for family members isn't as linear as parents caring for young children, and often this can expand to children caring for their parents, or any number of other cross-relational caring needs borne by your employees.

Caring for others should be generalized more broadly when it comes to how a company supports and enables its team members to care for the people that are important to them so that they're able to be more fully present during the times they're focused on work.

THE ERA OF HYPER-PERSONALIZATION

An increasingly common approach that I believe will persevere is adopting individualized flexibility when it comes to the makeup of the total rewards package. In practice, this may mean, rather than joining a company with a pre-defined compensation, equity, and benefits mix, the employee could choose to adjust this in a way that suits them and their own goals or needs.

This could be as simple as trading down on compensation in order to increase an equity pool, but the sky is the limit here, and technology solutions are increasingly giving organizations the capability to provide this option without having to deal with the administrative headache on the backend.

COMPENSATION AND TRANSPARENCY

Without a doubt, the biggest trend when it comes to compensation is the increasing move toward pay transparency. As transparency becomes enshrined into legislation across regions and markets, companies who aren't thinking about how to approach this run the risk of being caught flat-footed.

For example, a company that now needs to share salary ranges in their job ads, but never shared that information with existing teams, may start to receive questions from their existing workforce if they're found to be paying inconsistently.

Companies that are starting from zero should have a clear compensation philosophy that articulates why they pay what they pay. They can then ensure they are paying fairly across the business by doing a pay equity review. Internal transparency around compensation can be done in a couple of easy ways, such as sharing with individuals the target salary for their role and, reporting broadly on whether they pay fairly across the org on dimensions like gender and role type.

Financial wellbeing programs may also become a new frontier as a means of education, planning, and supporting overall financial wellness, particularly in a short term rife with inflation and reducing appetite for large cash awards to employees. People are now, more than ever, in need of basic financial literacy skills that will help arm them for the challenges this will create on the home front.

BENEFITS IN THE NEXT ERA OF WORK

More and more, companies will need to be thoughtful in how they create a mix of benefits and compensation that balances the needs and limitations of their business, with the changing priorities of their workforce.

> *This increased willingness to voice and act on individual needs has a number of employee benefits implications. Companies will need to shift focus to benefits that encompass wellness in ways that protect the wellbeing of their employees, offset the stress and strain of home and work life, and build healthier environments where employees can thrive and do their best work.*

To remain competitive, the makeup of these benefits will need to incorporate wellness, flexibility, and even hyper-personalized programs and structures that support the full and often complex lives of employees. ■

MATT MCFARLANE

Senior Director of People Experience
Oyster

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ASK THE EXPERT: A Q&A WITH PAUL NASH OF BEAZLEY

BY PAUL HUGHES

Paul Nash is an employment practices liability (EPL) underwriter with Beazley. He is the EPL and Safeguard product leader for both the UK and US teams and was instrumental in developing the first SAM/SML policy issued by Beazley in 2006. He has more than 30 years of experience in the insurance. He recently spoke with Paul Hughes of Libertate Insurance about the state of the EPLI market, how he has seen the PEO industry evolve and more. *PEO Insider* captured their conversation.

Paul Hughes: Insurance. Probably not something you dreamt about as a kid. What got you into the industry?

Paul Nash: It definitely wasn't. No, I wanted to be the next Jackson Pollock. Believe it or not, I was an art student, and it obviously didn't work out that way. After being unemployed and hungry for a few months, my mum, who works in insurance, as does my dad, or did, asked me if I wanted to work over Christmas after graduating to get some pocket money. So that was really what got me into it. I sort of fell into it and probably like a lot of my generation in London, not many people of my generation at least dreamt about working in insurance and a lot of my generation just fell into it. But I'm glad I did.

PH: Yeah, so I would be one of those that fell into it myself. What role do you play at Beazley and how does that affect the PEO industry?

PN: I am the Employment Practices Liability and Safeguard Focus Group Leader, so overall Product leader in the UK for Beazley. Most of what we write and most of what we have written for over two decades now is primary monoline EPL. We can and do consider package policies for private companies, but most exclusively, it's primary monoline EPL. It's 100% written by Beazley. It's not syndicated, which is quite unusual because most other classes in London, especially in Lloyds, are syndicated, but this is a class that historically has not really been written by many other syndicates at Lloyd's.

PH: So you mentioned a couple of decades. When did you start in the industry? What drove you into the PEO space?

PN: How I originally cut my teeth? I mentioned my mother. That was on a claims run-off operation in the early 1990s. I started off doing US medical malpractice claims which was actually pretty interesting and then I got involved in some product liability claims such as tobacco litigation and the tainted blood claims involving hemophiliacs. That was pretty interesting also. And then in 1999, a friend of mine in the broker community in London told me that an underwriter he was working with was looking for a new colleague and that was Andrew Cutler who was one of the pioneers of casualty underwriting in London. And so I started working with him in 1999. And then within two years we joined Beazley and that's how we got into the EPL space. As far as the PEOs are concerned, we had

I am the Employment Practices Liability and Safeguard Focus Group Leader, so overall Product leader in the UK for Beazley. Most of what we write and most of what we have written for over two decades now is primary monoline EPL.

until 2006 written a handful of some of the larger PEOs, but that was more by luck than design. And then in 2006, Donna Davis, who's obviously very well known in this industry, went from AIG to becoming a broker or an intermediary. The introduction was made and that's what really, that's how we really started writing a lot more through introductions, essentially.

PH: So back when you first started with PEO compared to today, any impression of the differences?

PN: Well, I'll tell you, Paul, when I first met you at that NAPEO conference, which was at least 15 years ago, what really struck me was how collegial everyone is in the industry. Whether you're looking at agents or brokers or insurers or different service providers. That really struck me that everyone was a pretty friendly bunch and willing to share ideas and just socialize. I found that fascinating because essentially a lot of you are competing against each other. So, I found that really interesting. Obviously over the years, the two things that struck me more than most are there's obviously been a lot of consolidation in in both the PEO space and within the broker space. But it's really struck me as well that EPL has become a lot more important to the industry than maybe what it was 15, 20 years ago. That's one of the big things that struck me. I definitely think like insurance as a whole, it's definitely becoming more sophisticated, more professional, dare I say it. And I know we're going to come on to that later. But that they're the things that have really struck me so far.

Right now…People feel more emboldened to come forward now. So, whether that's movements such as Black Lives Matter or Stop Asian Hate. I think overall people feel, as I say, more empowered to come forward if there's a situation within the workplace. People are definitely coming forward now more than ever before, as they should do, but that that also drives claim severity which is definitely increasing.

PH: So, employment practices liability, I guess, in terms of an industry is still kind of in its infancy stage. And I'm curious for specifically that line of insurance over your career, have you seen a lot of twists and turns in terms of coverage types, retentions, limits?

PN: Yeah, it's very interesting. In preparing for this call I made some notes yesterday on the train on the way home, and I was sort of smirking to myself thinking about how things have changed. So, I mean, I really started in the early 1990s and became a sort of product in the mid 1990s. But when I think back to when I first started underwriting coverage enhancements which are now given in forms such as third-party coverage or punitive damages coverage, when I started underwriting in 1999, they were, they were added on by endorsement for additional premium. So that's one of the first things that struck me, thinking back to the early days and of course over the years as the product became more mature and more market started writing EPLI, the coverage became broader and broader. And that's exactly what happens with any new product. As underwriters and insurers, insurers become more comfortable with the product and gain premium and understanding claims. As the competition increases, the coverage increases and enhances, which is obviously a plus for ultimately the insurers. Thinking back over the years, wage and hour crept as a defense cost sub-limit in the mid 2000's and then we started looking at other areas such as privacy, employment event, IRCA, all these enhancements or tweaks to coverage which were all to a greater or lesser extent meaningful. They're not smoke and mirror coverages.

We've also seen a recession. When the actual last recession in 2008 hit, we saw mass layoffs, of course, which meant more claims. That drove more questions from insurance companies and underwriters, so more supplemental apps. I'm thinking back to some of the unknown exposures that ultimately end up tagging policies. For the Fair Credit Reporting Act, claims tagged a couple of policies for a while, which they really shouldn't do. It's a compliance risk. And then more recently, of course, the world reported biometric claims, especially in Illinois, and they become quite costly for some carriers. And they've simply tagged these policies because as the policies have become broader, the definition of wrongful conduct or inappropriate employment conduct is so broad now it includes things such as invasion of privacy. And that's where these compliance type risks can end up tagging a policy. Going back to the recession, there's obviously a clear correlation between unemployment and claims frequency. As one increases, so does the other.

PH: So I remember a long time ago discussing venue with you and I forget the exact words, but I think you said, you know, in London we look at the US like 50 different insurance markets because every state is different in terms of the laws and venues and how the courts react, etcetera. From an EPL standpoint, is there that big of a difference due to the state of hire?

PN: Yeah, the short answer is yes, absolutely. And it's becoming, more polarized, I think. So, everyone talks about California, they should, but It's always been a difficult state. Not only to litigate, but as an employer, because the state laws and sometimes the city laws are more onerous for an employer, more complicated than the federal laws. So, California is one example, incredibly difficult to litigate within, and the tensions keep increasing in that state, as does the pricing differential. The difference now between an insured in Los Angeles and an insured in Wisconsin is that premium differential is greater now than ever. And so, it's not only California, but Florida. Florida's a fairly tough state, New York, obviously, and Illinois, too. And the other point to make is that the local or state EEOC offices or the state equivalent can also vary wildly, not only in their staffing capabilities, but also how zealous they are when it comes to enforcing employment actions.

PH: You know, as a broker in that regard, we've been trying to educate our clients on jurisdiction and risk management. Also, with the increase of retention, trying to give them some fiscal guidance on budgeting. Could you point anyone in a direction to help them manage what their risk is within the retention they decide to take?
PN: When you speak to either risk management specialists or claims people or even defense lawyers, the overriding theme is documentation. So, having that paper trail, making sure that advice is sought in tricky situations.

PH: Agreed. Let's talk about Paul Nash, the person, right? What's the perfect day in your life? I'm guessing it's not going into Lloyd's?
PN: I've got two answers. I've got one sort of day-to-day and one less so. And you're probably laughing at this because I'm just going to sound like an old man now…
PH: We're the same age, kid.
PN: If I'm at home, I love a Saturday morning. So obviously you've been working all week. You can have a bit of a lie-in and have some nice breakfast. And then I like, this is where I sound really old, sit in my conservatory drinking tea, and watch the wildlife in my garden. Then taking the dog for a walk you know, ending up at a nice country pub not far from here, having some nice lunch with family and friends. I mean, when the weather's good, that's a really nice way to decompress. That would be sort of a n ideal day at home. But also, you know, I like to travel a lot, so I like being in foreign countries, different cities, you know, different vibes, different cultures, different food, different wine, you know, art galleries, all that stuff. That's what I like doing. So, whether it's, you know, New York or Mumbai, that's, that's really what floats my boat. So, I do like to travel. ■

PEOS REMAIN OPTIMISTIC
DESPITE ECONOMIC CONDITIONS

The results of NAPEO's PEO Pulse Survey for the first quarter of 2023 show that PEOs, while currently optimistic, are more reserved about the extent of future growth. NAPEO's Pulse Survey is generously sponsored by SUNZ Insurance.

Here are some of the survey's highlights:

Revenue increased for most PEOs in Q1 of 2023, while WSE wages and WSE counts remained stable.

- PEO revenue growth remained strong in Q1, with 73% of PEOs experiencing growth vs. Q1 of 2022. Only 4% of respondents reported that revenue decreased, while 23% had about the same level of revenue.
- WSE wages showed a slight uptick from most recent quarters. Wages "increased somewhat" for most (56%) PEOs, and 27% reported no change in WSE wages vs. a year ago.
- The size of PEO clients (based on WSEs per client) remained mostly steady, though more than usual reported their clients are larger now than a year ago.
- PEO client counts lost momentum and dipped to the lowest amount of growth in 2 years.

Profits continue to grow.

- In the first quarter of 2023, gross profits once again achieved the most year-over-year growth since 2018.

* The Expected Growth Index is based on the average score on a five-point scale: 1 = Significant Decrease / 3 = No Change / 5 = Significant Increase.

NAPEO's Pulse Survey was developed by the Accounting Practices Committee in 2016 and is conducted quarterly among members to take the pulse of the PEO industry through a series of easy-to-answer questions. For more information about NAPEO's Pulse Survey, please contact Rach Komatireddy at **rkomatrieddy@napeo.org**. The survey is sponsored by SUNZ Insurance.

NAPEO QUARTERLY PULSE SURVEY—Q1 2023 RESULTS:

WSEs per Client **23**

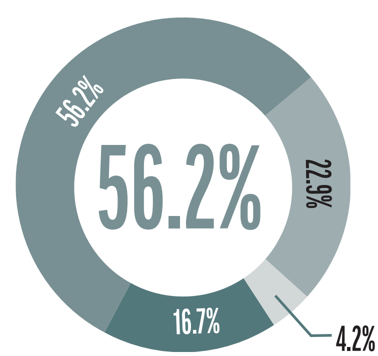
Clients per FTE* **7**

WSEs per FTE* **153**

HOW DID THE FIRST QUARTER OF 2023 COMPARE WITH THE FIRST QUARTER OF 2022?

PEO REVENUE

INCREASED SOMEWHAT



RESPONSE COUNT **48**

- 75% of respondents indicated that their gross profit increased in Q1. 10% reported a slight decline, and 15% said that they stayed about the same.
- Growth in operating profits was very similar to gross profits. Operating profits were up for 75% of PEOs, 15% noted no change, and 10% reported a decrease.

PEOs continued their elevated hiring trend from 2022.

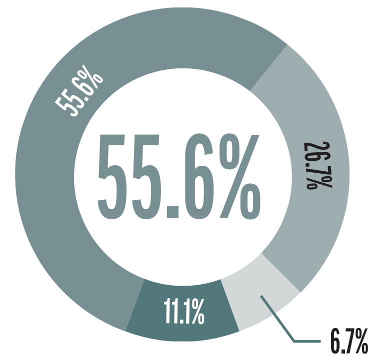
- 45% of PEOs have more internal staff now than a year ago, with 9% having significantly increased their internal headcount.
- Only 2% of PEOs have less internal staff than a year ago.
- The amount of workers compensation claims reported to insurance carriers remained steady, with only 14% seeing more claims and 21% with fewer claims.

Confidence about the future lost momentum in Q1.

- While 86% of PEOs are still planning for some growth over the next 12 months, the percentage is down from most recent quarters.
- 17% of PEOs expect "significant growth" in the next 12 months, compared with 30% or more in most recent quarters.
- The PEO Expected Growth Index* for Q1 is 4.00, which is the lowest index rating since Q4 of 2020. The historical average of the index over the past 6 years is 4.10. ■

AVERAGE ANNUAL WAGE PER WORKSITE EMPLOYEE (WSE)

INCREASED SOMEWHAT

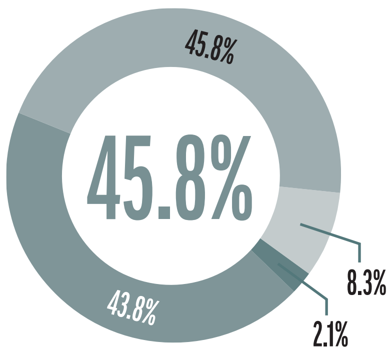


RESPONSE COUNT **45**

PEO GROWTH

AVERAGE NUMBER OF WORKSITE EMPLOYEES (WSES) PER CLIENT COMPANY

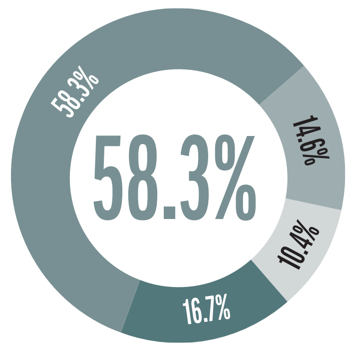
INCREASED SOMEWHAT



RESPONSE COUNT **48**

GROSS PROFIT

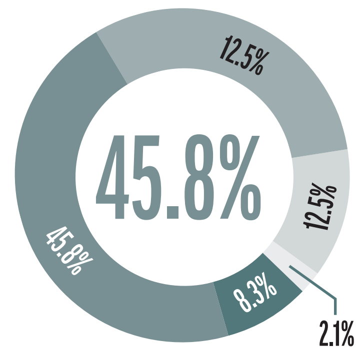
STAYED ABOUT THE SAME



RESPONSE COUNT **48**

NUMBER OF CLIENTS

INCREASED SOMEWHAT



RESPONSE COUNT **48**

- Increased Significantly
- Increased Somewhat
- Stayed About the Same
- Decreased Somewhat
- Decreased Significantly

AD INDEX

Boldface type indicates NAPEO Medallion Partner

A SHIP IN HARBOR IS SAFE

BY PAT CLEARY

Long time AFL-CIO President Lane Kirkland, a merchant seaman, had a plaque on his desk that captured the ethos of his trade. "A ship in harbor is safe," it read, "But that's not what ships are for." I was a young man when I first heard of the legend on his famous plaque, and I embraced it then and have embraced it ever since, through my time here at NAPEO. Indeed, as our PEO Capitol Summit and the inaugural National PEO Week came to a close, the words rang truer than they ever have before.

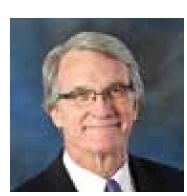
When I first arrived at NAPEO, the industry was far less well-known than it is today, but our association was also not well known. While at the National Association of Manufacturers (NAM), I chaired or co-chaired every workplace coalition in Washington, and had never heard of NAPEO. It was intentional. It was a strategy to lay low and keep a low profile, avoid the gaze of legislators and regulators. The strategy might have made sense in our earliest days when survival was our most basic concern. But as the industry grew, it was time to let go of that strategy. But it wasn't easy. There was a very vocal minority of members who wanted to stay in harbor, but time and the market had passed them by. In fact, early on, in our first Capitol Hill day, a few members pushed back on the idea, fearing our members would get in over their heads, engaging with Hill staff in debates about the arcana of ERISA. They clearly had never participated in a fly-in. And so we launched.

The fruits of that move were seen in spades during Cap Summit. We had probably 150 people come to Capitol Hill for PEO Advocacy Day. One member of Congress—Rep. Wesley Hunt of TX—schlepped across the Potomac River to Virginia to kick us off. Then we made our way to Capitol Hill, to the Speaker Pelosi Caucus Room and were visited by six members of Congress (see page 37 for a full recap). It was a testament to our growth and our strategy. Along the way we have tended to our PAC, spending nearly $150,000 last cycle alone. And we have used the PAC to cultivate friends on both sides of the aisle on relevant committees: House Ways & Means and Senate Finance. At the end of the day, we can count.

We said in the early days that it didn't make sense to have a trade association if we weren't going to engage. And so little by little we have engaged; encouraged and buoyed by our members. We are part of a vibrant, growing industry. We needed to hold our heads high and tell our story – and we did.

As I come down the home stretch of my time at NAPEO, I am most proud of the culture we've created, I'm proud of the tremendous growth in the industry. And I am proud of the fact that we shook off the doubts of the naysayers and launched out of the harbor to the open waters of engagement and advocacy. Seeing our members bedecked in their "National PEO Week" paraphernalia on Capitol Hill and throughout the week was so heartening. "How far we've come," I thought to myself on more than one occasion that day.

How far, indeed. ■



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