When Auditing an Expatriate Program, Focus on Key Points

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Whether a company has an informal policy or a well-designed and tested one for international assignments, human resource and expatriate administrators would do well to periodically conduct an audit of provisions and plans. Through an audit, the employer can avoid potential legal and financial exposure by ensuring that compliance rules are followed for both home-country and foreign jurisdictions. In addition, the organization should monitor pay packages to avoid mistakes such as overpaying employees, creating inequitable situations, maintaining a policy that no longer makes sense, and others.

To make the audit process easier, it is helpful to set up a task force of members who represent the key players who can provide feedback into the effectiveness of the policy – management, expatriates, and related departments (e.g., finance, payroll, legal). With the task force in place, the process would include reviewing each provision with care. And to be sure that the program is optimally effective and appropriate, take the following "hot spots" into consideration.

Home-Country Data: Has It Been Updated?

The balance sheet approach compares purchasing power in the home country and the assignment location at the same income level, and then makes any necessary addition or deduction. The starting point for this calculation is an analysis of how income is spent at home. Data for calculating expatriate spending patterns is derived from government studies on consumer expenditures and available in the home-country data and tax profiles provided by Mercer. Three areas of expenditure are analyzed:

- Goods and services spendable income, which indicates the typical amount spent on goods and services according to salary level and family size
- Housing norms, or the average combined expenditures for shelter and utilities by salary level, distinguishing between households of (a) family size 1 and 2, and (b) larger families
- Hypothetical tax and social security contributions according to salary level and family size

When new data becomes available with regards to these three areas, it is advantageous to implement it in order to bring assignees' pay packages up to date.

Compensation Data: Is It Mapped Correctly to Individuals?

Varying destinations and local conditions, family circumstances and obligations, job levels and responsibility, as well as economic factors, make each international assignment different from both the expatriate's perspective and that of the organization paying the bill. Thus, in general, it is often not reasonable — or cost effective — to use a one-size-fits-all compensation package, unless the organization has a small group of assignees operating within similar parameters. For those wanting to take a more accurate approach, the solution lies in determining which goods and services index offers the most suitable option (see Sidebar, "Matching the Index to the Assignment").

Pay: How Is It Delivered?

A split-pay method – where pay is provided partially in home-country currency and partially in host-country currency (as opposed to entirely in one currency) – avoids or minimizes risks, as follows:

- Particularly in economically volatile situations, split-pay neutralizes the effect of currency fluctuations so that assignees do not lose money that they normally expect to have available for goods and services in the host location.
- It ensures a stable number of local currency units for the host-location portion (needed for daily living) and home-country currency units for reserve and incentives.
- Assignees do not have to worry about the hassles and fees of converting currency into local funds, particularly since they do not need this portion overseas.
- It protects the portion of base salary (spendable income, not total pay) used to buy what assignees need in the host country, which protects their purchasing power and lifestyle.

- For those countries that restrict the amount of local currency that a repatriating assignee can take home, split-pay ensures that the employee is not left with an excess of host currency that they must leave behind (as they would if paid entirely in local currency).

Pay Packages: How Often Are They Updated?

Employers should implement new cost-of-living data no less frequently than twice a year (if delivering some pay in local currency) – or, every quarter (if delivering pay entirely in one currency). Using new data every three or six months minimizes the risk of either overpaying or underpaying assignees when the differential changes, and considers the following factors:

- *Purchasing Power*. Under the balance sheet approach, expatriates face neither a financial advantage nor disadvantage as a result of fluctuations in economic indicators in the home and host locations. Regular updates of cost-of-living data (goods and services) and accompanying differentials (that bridge the price gap between home and host locations) eliminate any gains and losses from price and currency movement – thereby maintaining the expatriate's purchasing power. This point is particularly significant in a volatile economic situation. Regularly updated indexes reflect changes in the relative cost of goods in the home and host locations, based on inflation and exchange rate movement over time. Consider:
  - What currencies are in play?
  - Is either the home or host-country currency volatile, subject to extreme increases or decreases?
  - If so, should the company implement some form of stop-gap measure to minimize the ups and downs of indexes and differentials?
- *Status Change*. Have base salaries and family sizes been updated? For example:
  - During an assignment, there may be an adjustment in family size through marriage, childbirth or adoption, enrollment of a child in college, or the less fortunate circumstances brought about by divorce or death.

Matching the Index to the Assignment

The following goods and services indexes work best in specific circumstances:

- Expatriate index for assignees who are usually less familiar with local purchasing in the foreign destination and prefer internationally recognized brands and outlets
- Efficient purchaser index (EPI) for those who can easily acclimate to the assignment location after discovering that changes in their choices of stores, restaurants, or even brands can produce savings while still offering the same quality and quantity
- Modified index for employers that provide (or subsidize) certain items that are normally covered in the goods and services spendable income — one or more cars, commuting allowance, medical care, furnished apartment, domestic servants, or tobacco and alcohol purchases
- International index for highly mobile employees who travel from one foreign destination to another without a clear link to any specific home country
- Higher income purchase index (HIPI) to compensate – but not overcompensate – higher-income assignees who mainly relocate from lesser-developed countries
- Multi-currency purchases index for situations where widespread shortages exist locally so assignees usually cannot obtain a complete array of goods and services in the host location and must shop either in another country or by catalog/internet
- Short-term data for assignments that last three months to a year, and are typically unaccompanied

- If the expatriate is performing the assigned job duties at or above an acceptable level, management is likely to reward this behavior with a merit increase, which boosts the individual's base pay.

Under the balance sheet approach, movement in either factor – salary level or family size – will affect spendable income and the accompanying differential:

- As income rises, the amount a family spends on goods and services also rises, but at a slightly decreasing rate.
- As family size increases, the family allocates a larger portion of income on goods and services – though not in direct proportion due to economies of scale and certain fixed costs independent of family size.

The use of regular updates enable the employer to capture any changes in base pay or family size.

- *Cost Control*. In tough economic climates, managers come under even more pressure to reduce unnecessary expenditures, and costly expatriate programs present prime targets. By legitimately reducing the differentials where currency movement indicates such an action is appropriate, an employer can save significant money, particularly if there is a large expatriate population in the same home-host configuration. More frequent updates provide periodic alignment of the individual's compensation to current market conditions, thereby minimizing periods during which the employer might "overpay" assignees if exchange rate conditions are already favorable for their purchasing.
- *Consistency*. No matter the job level, responsibilities, or host location, assignees expect fair treatment in terms of pay and benefits in exchange for good performance. Adjusting the differential on a regular basis allows the employer to protect the assignees' purchasing power – thus, supporting consistency of treatment for all expatriates, wherever assigned. Accompanying the implementation of consistent policy is the perception of equitable treatment. Regular communication with the expatriate – on HR matters and pay packages – along with responsiveness to evolving economic situations, reassures the employee that someone cares enough to monitor the situation.

Rent: Is It Time to Renegotiate the Lease?

In some locations, monthly rents may drop. Indeed, we have seen this situation occur in some of the highest-priced markets following the economic recession. If the company is paying host-country housing directly or uses out-of-date rental data when budgeting for housing allowances or developing housing norms, it may be overcompensating assignees. In developing appropriate foreign housing parameters in assignment locations surveyed by pricing agents, it is advantageous to use data on the costs, conditions, and availability of housing, along with utility costs.

Beyond the Initial Audit: What Comes Next?

While it is essential to take a close look at policy provisions and the use of data for developing pay packages, it is just as important to move the audit process from a general overview to a specific review.

Consider the assignment process itself through the early stages of candidate selection, approval, and initiation right through repatriation or re-assignment to another foreign country. And then consider auditing individual pay packages to ascertain that they are being correctly calculated.

Staying vigilant on all levels is requisite to prevent unnecessary overpayment, adverse assignee morale, and legal complications. It can uncover overlapping or conflicting provisions, especially if a number of policies are in place – for example, for long-term assignments, short-term assignments, developmental assignments, and so on. Simplify, streamline, and provide the best policies in line with the company's philosophy and overall strategy.

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