Internal Control for Payroll

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At the end of this session, the participant will be able to -

• Define the payroll process

• Recall components of internal control

• Recite best practices for payroll within a strong internal control framework
What is Payroll?

The principle purpose of any payroll department is to pay the organization’s employees.
Employee Earnings

• Determined by agreement between employer and employee
• Salary schedule
  – Type of position
  – Steps and years of experience
• Employees pay examples:
  – Annual salary/prorated over pay periods
  – Hourly rates
• Pay periods vary—monthly, semimonthly, biweekly or weekly
• FLSA—150% regular rate for +40 hours with certain exemptions

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Employee Earnings

• Time sheet
  – Basis of periodic payroll
• Contents of time sheet
  – Employee name and number
  – Pay period
  – Dates worked
  – Number of hours worked
  – Account distribution
  – Signatures
    • Employee
    • Employer
Payroll Journal

• Special Journal
  – Sometimes call Payroll Register

• Common contents:
  – Name of employee
  – Expenditure/expense classifications
  – Gross payroll
  – Adjustments to gross payroll
  – Adjusted gross payroll
  – Net payroll
Payroll Deductions

- Social security tax
- FIT
- SIT
- Deferred compensation
- Pension plans
- Insurance
- Other miscellaneous
## Recording the Payroll

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<tr>
<th>Description</th>
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<th>CR</th>
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<tbody>
<tr>
<td>Expenditure Control</td>
<td>$ 24,648</td>
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<tr>
<td>FICA Payable (liability)</td>
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<td>Pension Retirement Payable (liability)</td>
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<tr>
<td>Cash in Bank (asset)</td>
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<td>12,324</td>
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<table>
<thead>
<tr>
<th>Description</th>
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Payroll and Internal Control
What Are Internal Controls

**COSO**
Process effected by an entity’s **board of directors**, management and other personnel designed to provide reasonable assurance regarding the objectives relating to operations, reporting and compliance

**GREEN BOOK**
Process effected by an entity’s **oversight body**, management, and other personnel that provides reasonable assurance that the objectives will be achieved.

- Operations
- Reporting
- Compliance
INTERNAL CONTROLS

Protect Resources
• Assets
• Employees

Ensure Accuracy and Reliability
• Prevents/Detects Errors and Misuse
• Financial Statements Accurate

Ensure Compliance
• State/Federal Law Requirement
• GAAP/GASB Compliance

Evaluate Levels of Performance
• I/C Present and Functioning
How Is Internal Control Organized?

Components of Internal Control

Levels of organizational structure
Objectives for Payroll

- Preapproved/authorized transactions
- Payroll transactions recorded in proper period (cutoff)
- Transactions accurate, agree with source documents, and recorded in timely manner
- Recorded P/R transactions represent events that occurred and are in accordance with management’s authorization
- P/R and employee records are controlled and restricted to authorized personnel
- Duties are assigned so that no one individual can control recording and processing transactions
Control Environment and P/R

- Control environment affects payroll by establishing protocols:
  - Published **code of ethics** communicated with employees
  - Personnel hired that possess the **knowledge and skills** to accomplish P/R tasks
  - Employees should be **supervised** by qualified personnel
  - Job descriptions that provide for proper **segregation of duties** for responsibility and authority
Control Environment and P/R

• Control environment affects payroll by establishing protocols:
  ▪ **Written procedures** that cover all phases of payroll
  ▪ Adequate **training policies** that communicate roles and responsibilities in the P/R area
  ▪ **Management should exhibit commitment** for ongoing **training** of employees in the P/R area
Objective No. 1: Authorization

Risks:
- Hiring an unapproved employee
- Overspending budget
- Hiring an unqualified employee
- Incorrect classification for benefits could result in higher costs
Objective No. 2: Safeguarding Assets

Risks:
• Errors in payroll process due to hiring unqualified employee
• Interest and penalties
• Fictitious employees added to payroll system
• Incorrect employee classification
• Leave taken not properly reported

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Objective No. 3: Accurate, reliable and timely information

Risks:
- Salary/Pay rate not correct
- Hours/pay period inaccurately entered
- Deduction entered improperly
- Not posted to G/L

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Objective No. 4: Duties are assigned to individuals in a manner that ensures that no one individual can control both the recording function and the procedures relative to processing a transaction.

Segregation of duties
Segregation of Duties

"Until we implement a complete segregation of duties solution the auditor said we will need to press the 'enter' key together"
## Duties to be Segregated

### Authorization
- Approval of new hires
- Approval of pay rates
- Signing of checks

### Custody (Access to Asset)
- Access to payroll checks/bank accounts (EFT)
- Mailing or delivering checks

### Record Keeping
- Preparing source documents
- Maintaining journals, ledgers, or other files
- Preparing performance reports

### Reconciliations (Accountability)
- Preparing bank reconciliations
- Preparing payroll liability reconciliations
- Reconciling wage classifications (Federal, State, Social Security, Medicare)
Control Activities for Payroll

Four Categories of Control Activities

• Hiring
• Documentation
• Authorization
• Reconciliation

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Control Activities for Payroll

• Written process for hiring
  – Budget approval
  – Authority to advertise
  – Appropriate applicant information
  – Established selection process
  – Formal job offering (Letter)
    • Pay rate
    • Benefits provided
    • Status
    • FLSA classification

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Control Activities for Payroll

• Documentation—complete the forms
  – Personal data
  – Form I-9 (Employment Eligibility Verification)
  – Form W-4 (Federal Tax Withholding)
  – Form G-4 (State Tax Withholding)
  – Benefit forms
  – Retirement plan forms
  – Other forms

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Control Activities for Payroll

• Authorization
  – Required to ensure that only valid transactions are entered into payroll system
    • Time sheets signed by employee and supervisor
      – Supervisor’s approval = authorization to pay and certifies time recorded is actual time worked.
    • Payroll should be authorized by supervisor
      – Verify that all supporting documentation is present prior to approving payroll
      – Could be manual or electronic approval

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Control Activities for Payroll

• Reconciliations
  – Hours worked on time sheets = summary of hours worked in payroll system
  – Adjusted Gross Salary - No variations unless adjustments to pay
  – Taxable Wages - Adjusted gross wages less pre-tax deductions
  – Benefits and Deductions
  – # of employees

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Control Activities for Payroll

- Checklist easy way to show completed tasks
- Also need to reconcile general ledger accounts after withholdings are paid
Information/Communication and P/R

• Examples:
  ▪ Enrollment periods for benefits
  ▪ Pay periods and dates (cutoff)
  ▪ Holidays
  ▪ Furlough days
  ▪ Personnel policies and procedures
  ▪ Salary information
  ▪ Benefits payable due dates
  ▪ Tax withholding due dates
Monitoring and P/R

• Supervisory activities:
  - Initial and date face of reconciliations
  - Review all changes to employee information/forms for accurate and timely posting
Resources

• Internal Control
  – Committee of Sponsoring Organizations (COSO)
    • [http://www.coso.org/guidance.htm](http://www.coso.org/guidance.htm)
  – Standards for Internal Control in the Federal Government (Green Book)
  – GFOA
    • [http://www.gfoa.org/](http://www.gfoa.org/)