

# UNIVERSITY OF TOLEDO INTERNAL AUDIT DEPARTMENT

## PROCESS PAYROLL

### Control practices

The following control objectives provide a basis for strengthening your control environment for the process of processing payroll. Below are objectives and a list of the associated business risks and control practices. That information can serve as a checklist when you begin reviewing the strength of your current process controls.

This business risk and control information can help you assess your internal control environment and assist with the design and implementation of internal controls.

### Effectiveness and efficiency of operations

- A. Payroll disbursements and critical records are safeguarded.
- B. Payroll is processed in a cost-effective manner.
- C. Payroll is distributed in a cost-effective manner.
- D. A quality payroll service is provided for employees.
- E. Payroll information is provided to relevant personnel to satisfy management information needs.

### Reliability of financial reporting

- A. Employee record changes are properly authorized and accurately recorded.
- B. Payroll costs are accurately calculated from authorized sources and recorded on a timely basis.
- C. Recorded payroll balances are substantiated.
- D. Recorded payroll balances are evaluated.
- E. Payroll disbursements are accurately processed and recorded on a timely basis.
- F. Payroll changes, costs, and disbursements are reliably processed and reported.
- G. Performance measures used to control and improve the payroll process are reliable.

### Compliance with applicable laws and regulations

- A. The University complies with payroll laws and regulations.
- B. The University complies with taxation withholding requirements.

# UNIVERSITY OF TOLEDO INTERNAL AUDIT DEPARTMENT

## PROCESS PAYROLL

Effectiveness and efficiency of operations

### **A. Payroll disbursements and critical records are safeguarded.**

#### **Business risks**

- Misappropriations and fraudulent payments will occur.
- Records will be destroyed or lost, thwarting preparation of reliable financial and operating reports.
- Unauthorized personnel will alter computer programs.
- Processing capabilities, particularly computer processing capabilities, will be lost, destroyed, or altered by unauthorized individuals.
- Records will be misused or altered by unauthorized individuals, to the detriment of the University or its employees.

#### **Control practices**

1. Install security procedures that restrict additions and deletions of employees to or from the database.
2. Ensure payroll processing systems and written information is subject to physical security.
3. Ensure adequate controls over payroll checks exist (for example, implement controls to account for spoiled checks, restrict access to checks, require written approval to process checks, use pre-numbered checks, restrict access to check-signing equipment, secure checks and direct deposit advices until distributed to employees, obtain signed receipts from individuals who receive checks for distribution, or return unclaimed wages to the treasury function).
4. Ensure adequate controls over payroll cash exist (for example, build controls to implement written procedures regarding access to cash or require or encourage strongly direct deposit of funds via bank transfer).
5. Ensure adequate controls over critical records exist (for example, implement written procedures regarding access, use safes and locked cabinets or off-site storage, install access controls over computerized records, or restrict access to master files).
6. Require written approval to grant cash payments and employee advances.
7. Ensure adequate controls are in place to maintain the integrity of payroll system programs, including standing data. (Note: If the University performs changes to its payroll software application, then General Computer Controls such as authorization for program changes and security controls should be evaluated by a SPA professional.)
8. Ensure adequate access controls such as user ID's and passwords are used and specific to each payroll application.
9. Segregate duties between payroll preparation and authorization, bank account reconciliation, check signing, and check distribution.
10. Audit payroll distributions on a test basis.
11. Reconcile bank accounts with reconciling items traced to bank statements.
12. Confirm bank accounts periodically.
13. Avoid cash wages at all costs; require signed receipts when wages are paid in cash.
14. Require employee identification and signature, where practical, to receive a paycheck.

# UNIVERSITY OF TOLEDO INTERNAL AUDIT DEPARTMENT PROCESS PAYROLL

## **B. Payroll is processed in a cost-effective manner.**

### **Business risks**

- The University will incur excessive processing costs.

### **Control practices**

1. Compare in house payroll processing costs to outsourcing costs periodically.
2. Group employees into different pay cycles to balance the processing efforts each month.
3. Follow up with each exception to normal payroll processing to determine the root cause.
4. Permit expense advances only in very special circumstances.
5. Analyze payroll process workflow to identify bottlenecks and opportunities for improvement.
6. Simplify the payroll system by minimizing the number of fields and options per field.

## **C. Payroll is distributed in a cost-effective manner.**

### **Business risks**

- The University will not use the lowest-cost distribution method available.
- The distribution method will not satisfy the employees and will cause complaints or low employee morale.

### **Control practices**

1. Move employees to fewer pay cycles (for example, once or twice a month).
2. Encourage all employees to move to a direct deposit payroll system.
3. Devise relevant performance measures to monitor the efficiency of payroll distribution (for example, payroll department cost per employee, number of employees on a monthly payroll cycle, percentage of employees paid by direct deposit).

## **D. A quality payroll service is provided for employees.**

### **Business risks**

- Incorrect payments and/or failure to address queries on a timely basis will lead to employee dissatisfaction.

### **Control practices**

1. Build controls to ensure timely and accurate payments.
2. Provide a designated point of contact for employee queries.
3. Devise relevant performance measures to monitor the quality of the payroll service (for example, number of queries raised by employees or time to respond to queries).

# UNIVERSITY OF TOLEDO INTERNAL AUDIT DEPARTMENT PROCESS PAYROLL

**E. Payroll information is provided to relevant personnel to satisfy management information needs.**

**Business risks**

- Management information needs with respect to payroll will not be defined.

**Control practices**

1. Identify ways payroll information can be used by the University to satisfy management objectives and report information accordingly.

# UNIVERSITY OF TOLEDO INTERNAL AUDIT DEPARTMENT

## PROCESS PAYROLL

Reliability of financial reporting

### **A. Employee record changes are properly authorized and accurately recorded.**

#### **Business risks**

- Unauthorized payments will occur and/or funds will be misappropriated (for example, fictitious employees will be placed on the payroll and terminated employees will not be removed from the payroll).
- Incorrect information in the payroll master file will result in incorrect payments and withholdings.
- Inadequate security will result in the destruction or loss of payroll records, unauthorized review or disclosure of confidential information, or unauthorized changes to payroll files and records.
- Payroll records, including the payroll master file, will be lost or destroyed.
- Confidential information will be reviewed or disclosed without authorization.
- Unauthorized changes will be made to the payroll master file.
- Unauthorized and/or unreasonable pay rates will result in excessive payroll costs.

#### **Control practices**

1. Require written approval for changes to employee information, such as additions and deletions, changes to salary and wage rates, and authorized payroll deductions.
2. Use properly authorized input forms to document changes to employee information.
3. Maintain appropriate hard copy records for employee record changes.
4. Compare electronic employee records periodically with selected information in personnel files.
5. Ensure computer systems have access controls in place to preclude unauthorized access to employee records.
6. Require managers to notify human resources immediately of terminated and transferred employees or any other payroll changes so that employee records can be updated in a timely manner.
7. Authorize, approve, and document properly all special payments made by the payroll function, such as relocation costs, tuition fees, and bonuses.
8. Use standardized policies and procedures when hiring employees.

## **UNIVERSITY OF TOLEDO INTERNAL AUDIT DEPARTMENT PROCESS PAYROLL**

**B. Payroll costs are accurately calculated from authorized sources and recorded on a timely basis.**

### **Business risks**

- Gross payroll will be calculated incorrectly. Improper disbursements will not be detected or corrected.
- Accruals for pensions, vacations, and bonuses will be incorrect and/or unrecorded.
- The payroll tax liability will be incorrect and/or unrecorded.
- Period-end cutoffs for labor distribution and payroll accruals will be incorrect, resulting in inaccurate information recorded in the general ledger.
- Withholdings will be inaccurate.
- Capitalization and expense codes will be inaccurate.
- Applicable deductions will be incomplete.
- Payrolls will not be summarized and posted on a timely basis.
- Inputs for preparation of journal entries will be inaccurate.
- The University will fail to comply with union contracts and other relevant laws and regulations.
- Discrepancy will exist between hours worked, hours reported, and hours paid.
- Incorrect amounts will be disbursed to employees.
- Inaccurate management reports and employee earnings records will be prepared.
- Bonus, vacation and sick pay, overtime and other nonstandard items will not be properly reported and recorded.
- Information or documents will be lacking or lost.

# UNIVERSITY OF TOLEDO INTERNAL AUDIT DEPARTMENT

## PROCESS PAYROLL

### Control practices

1. Verify that source documents such as timecards are received for all employees.
2. Use batch totals before processing is completed and the totals are compared to post input/update reports for systems that input time recording into a temporary file before sub-ledger updates.
3. Maintain back-up records of employees' time in case source documents are lost.
4. Approve all time records prior to input.
5. Review and approve time records for unusual or non-standard hours and for overtime.
6. Prepare and verify control totals for time record input to ensure all records have been accurately entered.
7. Devise computer validation routines to verify the accuracy of time record data (for example, verify employee number, hours worked, and department code).
8. Devise computer validation routines to match time records for the payroll period with employee records.
9. Devise computer validation routines to verify the completeness and accuracy of deductions applied.
10. Implement processing controls to ensure that all payroll source data is valid and authorized and duplicate source data is not processed.
11. Require that the payroll supervisor reconcile payroll earnings records with payroll check and direct deposit registers.
12. Require that the payroll supervisor review payroll withholdings to ensure the propriety of amounts, compliance with applicable governmental requirements, timely remittance to the appropriate entity, and timely reconciliation to the general ledger accounts.

# UNIVERSITY OF TOLEDO INTERNAL AUDIT DEPARTMENT PROCESS PAYROLL

## **C. Recorded payroll balances are substantiated.**

### **Business risks**

- Unauthorized transactions will remain undetected.
- Errors in the processing, summarization and recording of payroll transactions will remain undetected.
- Labor services provided will not be recorded.

### **Control practices**

1. Require the payroll department to analytically compare recorded amounts with budgeted amounts and prior period amounts.
2. Perform a one-to-one check at period end to ensure payroll expenses through the reporting period are properly recorded and any accruals, if appropriate, are accurate.
3. Ensure an appropriate official reviews sufficient supporting documents before approving and making input changes and adjustments to standing data.
4. Reconcile gross earnings records periodically with the general ledger.
5. Reconcile payroll disbursements and deductions with the payroll register, which is reconciled to the general ledger, and actual disbursements.
6. Reconcile cash payments to the general ledger.
7. Reconcile sub-ledgers (such as accrued payroll and withholding accounts) to the general ledger on a regular basis.
8. Confirm payroll register information periodically with employees.
9. Compare reports of payroll payments to the approved list of active employees who performed work or services.
10. Ensure reports of missing, duplicate, and outstanding checks are periodically produced by the payroll system and reviewed by management.

## **D. Recorded payroll balances are evaluated.**

### **Business risks**

- Recorded balances will not reflect realistic evaluations under conditions existing at a particular date.

### **Control practices**

1. Review and approve periodically the formulas used for accruals.



# UNIVERSITY OF TOLEDO INTERNAL AUDIT DEPARTMENT PROCESS PAYROLL

## **E. Payroll disbursements are accurately processed and recorded on a timely basis.**

### **Business risks**

- Fraudulent and unauthorized payments will be made.
- Payments will be made to the wrong people.
- Disbursements will be recorded for the wrong amount because of clerical or mechanical errors.
- Cash disbursements will not be summarized correctly and posted on a timely basis.
- Significant payroll errors or unauthorized transactions will not be detected prior to payroll distributions.
- Inputs for preparation of journal entries will be inaccurate and/or incomplete.
- Payroll expense will be understated.
- Cash will be misappropriated.

### **Control practices**

1. Devise computer routines that automatically generate payroll checks or electronic funds deposits based on the amounts recorded in the payroll register, calculate total value of disbursements, and post accounting entries to the related ledgers.
2. Use batch totals before processing is completed and the totals are compared to post input/update reports for systems that input payroll payments into a temporary file.
3. Use an imprest or zero balance payroll bank account.
4. Require the payroll manager to review the payroll register after processing for reasonableness prior to distribution and research and correct any unusual results as necessary.
5. Require that the payroll supervisor review amounts in recurring entries from one period to the next for reasonableness.
6. Reconcile payroll disbursements with the payroll register, and reconcile payroll deductions per the payroll records with actual disbursements.
7. Perform reconciliations between payments sent to the bank for direct deposit and the amounts deposited into employees' accounts.

# UNIVERSITY OF TOLEDO INTERNAL AUDIT DEPARTMENT PROCESS PAYROLL

## **F. Payroll changes, costs, and disbursements are reliably processed and reported.**

### **Business risks**

- Unauthorized changes to programs will cause unauthorized processing results.
- Use of unauthorized versions of files and/or programs will result in unauthorized or incorrect business transactions.
- Files (transaction, reference, or master) will be lost, altered, or damaged, resulting in inefficiencies, lost assets, and/or incorrect transaction processing.

### **Control practices**

1. Implement controls to maintain the integrity of payroll systems programs (such as authorization for program changes and security controls).
2. Use only authorized versions of programs and master files for transaction processing.
3. Ensure employee names and other applicable information (such as address or bank account) for EFT or actual check processing is pulled by the system from the Employee Master File.
4. Prohibit employees who update payroll computer programs from authorizing or preparing payroll or printing checks.
5. Perform a one-to-one check of adjustments input into the payroll system via a comparison of post-input reports to the adjustment source data.
6. Ensure suspended or invalid data are listed on reports that are periodically reviewed and followed up within the current reporting period.

## **G. Performance measures used to control and improve the payroll process are reliable.**

### **Business risks**

- Inaccurate measurements will create erroneous perceptions about process performance, resulting in inappropriate decisions.

### **Control practices**

1. Collect performance assessment data and compare it to past performance internally and to current performance externally among competitors and other universities.

# UNIVERSITY OF TOLEDO INTERNAL AUDIT DEPARTMENT PROCESS PAYROLL

Compliance with applicable laws and regulations

## **A. The University complies with payroll laws and regulations.**

### **Business risks**

- The University will incur fines or other penalties for noncompliance.
- The University will have labor relations problems if it fails to comply with union rules.

### **Control practices**

1. Require that the legal and human resources departments develop payroll procedures that comply with relevant laws and regulations (or have at least reviewed procedures for compliance).
2. Maintain an up-to-date policy and procedures manual that addresses legal and regulatory compliance and distribute copies to those who administer payroll.
3. Designate a legal officer to oversee legal and regulatory compliance as it relates to payroll.

## **B. The University complies with taxation withholding requirements.**

### **Business risks**

- The University will incur fines or other penalties for noncompliance.
- Liabilities will not be recorded.

### **Control practices**

1. Use an outside payroll-processing bureau that has a withholding tax service.
2. Install a fully tested tax-withholding processing module to the payroll system.
3. Use a timeline and checklist for withholding tax payments and filing tax forms.
4. Mail annual summaries of wages and withholdings to employees in accordance with applicable government requirements.
5. Ensure special payments processed by payroll comply with tax requirements.
6. Request that legal or department periodically review the adequacy of withholding procedures.
7. Review payroll tax rates regularly against current standards and regulations.