

# Internal controls for payroll

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## Why?

**Internal controls are not just about fraud!**

- They help prevent errors
- Assist in eliminating duplicate processes
- Find flaws in the process flow and help maintain effective & efficient process operations
- Compliance with applicable laws & regulations
- Reliability of Financial Reporting
- Builds department creditability

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## Payroll Internal Controls

- Separation of Duties
- Reconciliation
- Authorization and Approval
- Management Policy
- Procedure Documentation

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### Control Activities

Control Activities answer the following questions:

- Why is the control in place?
- Who performs the control?
- What does the control do?
- How does the control work?
- Frequency of the control?
- Where is the control performed?
- Proof of control?

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### Control Activities - preparation

- Have a flow chart of your process including risks and controls
  - Identify the points in the process where the risk is and where the controls are
- Include record retention, audits, reconciliation and balancing
- Review security check points
- Approval levels

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### Control Activities - Preparation

- Data Entry
- Time and Attendance Collection (Recommend a separate flow chart)
- Error corrections
- Audit
- Approval

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**Control Activities - Process**

- Create System Edits, Control Reports
- Payroll Process
- Fringe Benefit computations
- Reconciliation reports
- Tax validation
- Create Agency files
- Transmission of files, US Treasury, bank, 3<sup>rd</sup> parties

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**Control Activities - Posting**

- Uploads, downloads and interfaces
- Tax reports/payments
- Funding
- Release of checks, pay stubs and employee self-service site
- General ledger
- Agency reports
- Sending 3<sup>rd</sup> party files and reports

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**Timing is everything!**

- Look for patterns
- Develop accountability

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### Separation of duties

#### Different people performing key payroll functions

- The same individual who authorizes a payroll action should not be the person to enter payroll transactions
- Cross training should be continuous
- Rotation of job duties

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### Separation of duties

- Payroll employees should not process actions affecting their own pay or benefits. Audit trail needed if allowed (one person payroll office)
- Validation of paper checks before distribution (random check of paycheck distribution to individuals should be performed)

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### Reconciliation

- Should be performed on a regular basis and retained to backup your payroll
- Do a pre and post payroll reconciliation
- Monthly perform Payroll GL and Bank Account reconciliations (bank reconciliations should not be done by payroll, but payroll can assist)
- Quarterly and monthly reconciliations should be done for General Ledger accounts, budget and taxes
- Gross to net every pay cycle

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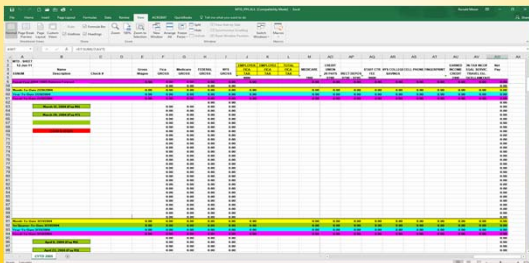
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### Sample tax reconciliation for Annual or Year-End Reconciliation of 941 to W-2's



The image shows a screenshot of a Microsoft Excel spreadsheet used for tax reconciliation. The spreadsheet has multiple columns, with some highlighted in yellow and others in purple. The columns represent data from Form 941 (Employer's Annual Federal Tax Return) and Form W-2 (Wage and Tax Statement). The spreadsheet is used to compare the data from the 941 to the W-2s to ensure accuracy.

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### Authorization and approval

- Rules and guidelines must be followed and management supported
- Payroll entries must be consistent with company policy
- Transactions must be authorized and documented
  - Today's system must have audit trail
- Audits need to be in place to ensure authorization and approval
- Are your approvers informed and trained on what the Risks and Controls?

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### Management Policy

- What is HR's role?
- What is Payroll's Roll?
- Do any policies or procedures conflict?
- Are any policies not in compliance with IRS, FLSA, DOL, EEOC, etc.

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### Procedure documentation

- Policies and procedures should be documented and updated timely
- Provide enough detail about the "why" to answer future questions should they arise; however, only document what is needed (the FACTS)
- Procedures documentation including flow charts can be useful. Retain any documentation changes due to audit or procedure.

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### Today's concerns

<b>Identity theft</b> <ul style="list-style-type: none"><li>• Employer and employee responsibility</li><li>• Who has access to social security number, date of birth? Should they?</li></ul>	Do you have internal and external controls for your employee self-service - <b>The Cloud is a Risk!</b> Be prepared and secure!	<b>Phishing Scams</b> – what have you done?
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### IRS Identity theft help sites

- Phishing Scams such as the W2 scam
  - [phishing@irs.gov](mailto:phishing@irs.gov)
- Employee data loss/stolen
  - [dataloss@irs.gov](mailto:dataloss@irs.gov)
- Alert States at:
  - [StateAlert@taxadmin.org](mailto:StateAlert@taxadmin.org)

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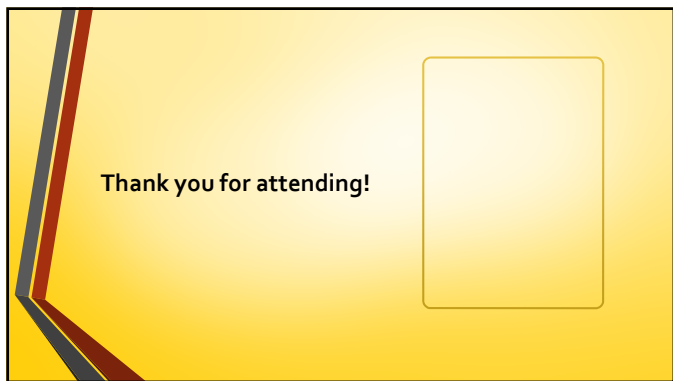
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