Payroll Administration

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University of Georgia  
Carl Vinson Institute of Government  
Financial Management Programs  
Governmental Training, Education, and Development

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CHAPTER 1
THE FAIR LABOR STANDARDS ACT:
INTRODUCTION AND OVERVIEW

OBJECTIVES

This chapter provides information regarding the Fair Labor Standards Act (FLSA) and the special rules that are applicable. After completing this chapter, the participant should be able to:

• Recall the Fair Labor Standards Act and its role in payroll issues
• Identify if an individual is an independent contractor or employee
• Distinguish between exempt versus nonexempt employees
• Recall rights of exempt employees

INTRODUCTION

The Fair Labor Standards Act (FLSA) is a federal labor law of general and nationwide application. The Fair Labor Standards Act establishes minimum wage, overtime pay, record-keeping, and child labor standards affecting millions of employers and full-time and part-time workers in the private sector and in federal, state, and local governments.

The Wage and Hour Division (Wage-Hour) administers and enforces FLSA with respect to private employment, state and local government employment, and Federal employees of the Library of Congress, U.S. Postal Service, Postal Rate Commission, and the Tennessee Valley Authority. The Office of Personnel Management is responsible for enforcement with regard to all other Federal employees. Laws and topics covered by the Wage and Hour Division include the minimum wage, overtime pay, recordkeeping, child labor and special employment, family and medical leave, migrant workers, lie detector tests, and worker protections in certain temporary worker programs.

Special rules apply to state and local government employment involving fire protection and law enforcement activities, volunteer services, and compensatory time off in lieu of cash overtime pay.
The FLSA has been amended on many occasions since originally passed in 1938. The amendments that apply specifically to state and local employees are as follows:

- In 1966, Congress amended the FLSA to extend coverage to state and local government employees engaged in the operation of hospitals, nursing homes, schools, and mass transit systems.

- In 1972, the Education Amendments further extended coverage to employees of public preschools.

- In 1974, the FLSA Amendments extended coverage to virtually all of the remaining state and local government employees who were not covered as a result of the 1966 and 1972 legislation.

STATE AND LOCAL GOVERNMENTS UNDER THE FLSA

State and local government employers consist of those entities that are defined as public agencies by the FLSA. “Public Agency” is defined to mean the Government of the United States; the government of a state or political subdivision thereof; any agency of the United States, a state, or a political subdivision of a state, or any interstate governmental agency. The public agency definition does not extend to private companies that are engaged in work activities normally performed by public employees.

The FLSA requires employers to:

- pay at least the Federal minimum wage to all covered nonexempt employees (entitled to overtime pay) for all hours worked

- pay at least one and one-half times the employees’ regular rates of pay for all hours worked over 40 in the work week

- comply with the child labor standards and recordkeeping requirements

Under certain prescribed conditions, employees of state or local government agencies may receive compensatory time off at a rate of not less than one and one-half hours for each overtime hour worked, instead of cash overtime pay. Police and firefighters, emergency response personnel and employees engaged in seasonal activities may accrue up to 480 hours of compensatory (comp) time; all others, 240 hours.

Some states may not recognize or permit the application of some or all exemptions; however, employers must comply with the most stringent of the state or Federal provisions. Because the Federal law is more stringent than Georgia law, an employer who is in compliance with the Federal law will be in compliance with the current Georgia law.
FIRST THINGS FIRST: WHO ARE YOUR EMPLOYEES?

For federal tax purposes, this is an important distinction. The courts have considered many facts in deciding whether a worker is an independent contractor (receive 1099 at end of year) or an employee (receive W-2 at end of year). These relevant facts fall into three main categories: behavioral control, financial control, and relationship of the parties. In each case, it is very important to consider all the facts – no single fact provides the answer. Carefully review the following definitions.

**Category 1 - Behavioral Control.** These facts show whether there is a right to direct or control how the worker does the work. A worker is an employee when the business has the right to direct and control the work. The business does not have to actually direct or control the way the work is done – as long as the employer has the right to direct and control the work. For example:

- **Instruction** - if you receive extensive instructions on how work is to be done, this suggests that you are an employee. Instructions can cover a wide range of topics such as:
  - how, when, or where to do the work
  - what tools or equipment to use
  - what assistants to hire to help with the work
  - where to purchase supplies and services
  - what work must be performed by a specified individual
  - what order or sequence to follow

The amount of instruction needed varies among different jobs. Even if no instructions are given, sufficient behavioral control may exist if the employer has the right to control how the work results are achieved. A business may lack the knowledge to instruct some highly specialized professionals; in other cases, the task may require little or no instruction. The key consideration is whether the business has retained the right to control the details of a worker’s performance or instead has given up that right.

- **Training** - if the business provides you with training about required procedures and methods, this indicates that the business wants the work done in a certain way, and this suggests that you may be an employee.

- **Evaluation** - if an evaluation system measures the details of how the work is performed, then these factors would indicate an employee.

**Category 2 - Financial Control.** These facts show whether there is a right to direct or control the business part of the work.

- **Significant Investment** – if you have a significant investment in your work, you may be an independent contractor. While there is no precise dollar test, the
investment must have substance. However, a significant investment is not necessary to be an independent contractor.

- Expenses – if you are not reimbursed for some or all business expenses, then you may be an independent contractor, especially if your unreimbursed business expenses are high. Fixed ongoing costs that are incurred regardless of whether work is currently being performed are especially important.

- Opportunity for Profit or Loss – if you can realize a profit or incur a loss, this suggests that you are in business for yourself and that you may be an independent contractor.

- Services Available to the Relevant Market – an independent contractor is generally free to seek out business opportunities. Independent contractors often advertise, maintain a visible business location, and are available to work in the relevant market.

- Paying the Worker – an employee is generally guaranteed a regular wage amount for an hourly, weekly, or other period of time. This usually indicates that a worker is an employee, even when the wage or salary is supplemented by a commission. An independent contractor is usually paid a flat fee for the job. However, it is common in some professions, such as law, to pay independent contractors hourly.

**Category 3 - Relationship of the Parties.** These are facts that illustrate how the business and the worker perceive their relationship.

- Employee Benefits – if you receive benefits, such as insurance, pension, or paid leave, this is an indication that you may be an employee. If you do not receive benefits, however, you could be either an employee or an independent contractor.

- Written Contracts – a written contract may show what both you and the business intend. This may be very significant if it is difficult, if not impossible, to determine status based on other facts.

- Permanency of the Relationship – if you engage a worker with the expectation that the relationship will continue indefinitely, rather than for a specific project or period, this is generally considered evidence that your intent was to create an employer-employee relationship.

- Extent to Which Services Performed are a Key Aspect – if a worker provides services that are a key aspect of your regular business activity, it is more likely that you will have the right to direct and control his or her activities.

Here are some examples of when relationships may be considered independent contractor and when they might be considered an employee relationship with the government.
<table>
<thead>
<tr>
<th><strong>Independent Contractor</strong></th>
<th><strong>Employee</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>An attorney or accountant who has his or her own office, advertises under &quot;Attorneys&quot; or &quot;Accountants,&quot; bills clients by the hour, is engaged by the job or paid an annual retainer, and can hire a substitute to do the work.</td>
<td>An attorney or accountant who is employed by a firm to handle their legal affairs or financial records, works in an office at the firm’s place of business, attends meetings as needed, and the firm bills the clients and pays the attorney or accountant on a regular basis.</td>
</tr>
<tr>
<td>An auto mechanic who has a station license, a resale license, buys the parts necessary for the repairs, sets his or her own prices, collects from the customer, sets his or her own hours and days of work, and owns or rents the shop from a third party.</td>
<td>An auto mechanic working in someone’s shop who is paid a percentage of the work billed to the customer, where the owner of the shop sets the prices, hours, and days the shop is open, schedules the work, and collects from the customers.</td>
</tr>
<tr>
<td>Dance instructors who select their own dance routines to teach, locate and rent their own facilities, provide their own sound systems, music and clothing, collect fees from customers, and are free to hire assistants.</td>
<td>Dance instructors working for a Parks and Recreation department where the department sets hours of work, the routines to be taught and pays the instructors from fees collected from the customers.</td>
</tr>
<tr>
<td>A repairperson who owns or rents a shop, advertises the services to the public, furnishes all of the tools, equipment, and supplies necessary to make repairs, sets the price for services, and collects from the customers.</td>
<td>A repairperson working in a shop where the owner sets the prices, the hours and days the shop is open, and the repairperson is paid a percentage of the work done.</td>
</tr>
</tbody>
</table>

Keep in mind that the more control possessed by the employer (especially over the means of accomplishing a task rather than the end result), the more likely a worker is an employee. **Control, in this instance, is defined as the level of legal right to direct rather than the level of direction actually provided.** If a government still isn’t certain of the status of a worker after reviewing the categories discussed above, IRS *Form SS-8*, can be used when there is a controversy in determining a worker’s status. Governments need to document what facts were used to make the determination.

On the next page is a tool to aid in helping identify which relationship exist.
## Identifying Factors

### Control factors:

<table>
<thead>
<tr>
<th>Control factor</th>
<th>Contractor</th>
<th>Employee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employer provides training to worker</td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Worker works on-site</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Worker works off-site</td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Company supervises worker's job</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Worker has regular work hours</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Worker has irregular work hours</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employer sets work hours</td>
<td>x</td>
<td></td>
</tr>
</tbody>
</table>

### Financial factors:

<table>
<thead>
<tr>
<th>Financial factor</th>
<th>Contractor</th>
<th>Employee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Worker is salaried</td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Employer sets hourly rate</td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Employer provides tools/equipment to worker</td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Worker invests in tools/equipment for use in job</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Worker receives benefits from employer</td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Worker has ability to have profit or loss from job</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Worker pays own expenses</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Relationship factors:

<table>
<thead>
<tr>
<th>Relationship factor</th>
<th>Contractor</th>
<th>Employee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Worker and employer have contract for services or products</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Worker can hire others to complete a task</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Worker and employer have long-term work relationship</td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Work relationship relates only to contract work</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Worker performs similar projects for other companies</td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Worker works only for company</td>
<td></td>
<td>x</td>
</tr>
</tbody>
</table>

## EMPLOYMENT RELATIONSHIP UNDER THE FLSA

As stated above, any worker who receives compensation for services is either an independent contractor or an employee. An employment relationship under the FLSA must be distinguished from a strictly contractual one. That employment relationship must exist for any provision of the FLSA to apply to any person engaged in work which may otherwise be subject to the Act.

In the application of the FLSA an employee, as a matter of economic reality, follows the usual path of an employee and is dependent on the business which he or she serves. The employer-employee relationship under the FLSA is tested by “economic reality” rather than “technical concepts.” It is not determined by the common law standards relating to master and servant.
The U. S. Supreme Court has on a number of occasions indicated that there is no single rule or test for determining whether an individual is an independent contractor or an employee for purposes of the FLSA. The Court has held that it is the total activity or situation which controls. Among the factors which the Court has considered significant are:

1. The extent to which the services rendered are an integral part of the principal’s business.
2. The permanency of the relationship.
3. The amount of the alleged contractor’s investment in facilities and equipment.
4. The nature and degree of control by the principal.
5. The alleged contractor’s opportunities for profit and loss.
6. The amount of initiative, judgment, or foresight in open market competition with others required for the success of the claimed independent contractor.
7. The degree of independent business organization and operation.

When it has been determined that an employer-employee relationship does exist, and the employee is engaged in work that is subject to the Act, it is required that the employee be paid at least the Federal minimum wage, - $7.25 an hour effective July 24, 2009 – and in most cases time and one-half of the employee’s regular rate of pay for all hours worked in excess of 40 hours per week. Many states also have minimum wage laws. In cases where an employee is subject to both the state and federal minimum wage laws, the employee is entitled to the higher of the two minimum wages.

**EMPLOYEES: EXEMPT VERSUS NONEXEMPT**

Now that the nature of the relationship has been determined and the relationship is in fact an employee-employer relationship, the status of the employee is the next step. Employees whose jobs are governed by the FLSA are either “exempt” or “nonexempt.” Nonexempt employees are entitled to overtime pay. Exempt employees are not. Most employees covered by the FLSA are nonexempt, however, some are not.

Some jobs are classified as exempt by definition. For example, “teachers” are exempt if their primary duty is teaching, tutoring, instructing or lecturing in the activity of imparting knowledge, and if they are employed and engaged in this activity as a teacher in an educational establishment. Exempt teachers include, but are not limited to, regular academic teachers; kindergarten or nursery school teachers; teachers of gifted or disabled
children; teachers of skilled and semi-skilled trades and occupations; teachers engaged in automobile driving instruction; aircraft flight instructors; home economics teachers; and vocal or instrument music teachers. The salary and salary basis requirements do not apply to bona fide teachers. Having a primary duty of teaching, tutoring, instructing or lecturing in the activity of imparting knowledge includes, by its very nature, exercising discretion and judgment.

For most employees, however, exempt or nonexempt status depends on (a) how much they are paid, (b) how they are paid, and (c) what kind of work they do.

With few exceptions, to be exempt an employee must (a) be paid at least $47,476 per year ($913 per week), and (b) be paid on a salary basis, and also (c) perform exempt job duties. Most employees must meet all three “tests” to be exempt.

1. **Salary Level Test** - Employees who are paid less than $47,476 per year ($913 per week) are nonexempt. Employees who earn more than $134,004 per year are almost certainly exempt.

2. **Salary Basis Test** - Generally, an employee is paid on a salary basis if the employee has a “guaranteed minimum” amount of money that will be received for any work week in which “any” work is performed. This amount need not be the entire compensation received, but there must be some amount of pay the employee can count on receiving in any work week in which work is performed.

   Some “rules of thumb” indicating that an employee is paid on a salary basis include whether an employee’s base pay is computed from an annual figure divided by the number of paydays in a year, or whether an employee’s actual pay is dictated by the actual number of hours worked. However, whether an employee is paid on a salary basis is a “fact,” and thus specific evaluation of particular circumstances is necessary. Whether an employee is paid on a salary basis is not affected by whether pay is expressed in hourly terms (as this is a fairly common requirement of many payroll computer programs), but whether the employee in fact has a “guaranteed minimum” amount of pay the employee can count on.

   The FLSA salary basis test applies only to reductions in monetary amounts. Requiring an employee to charge absences from work to leave accruals is not a reduction in “pay” because the monetary amount of the employee’s paycheck remains the same. Similarly, paying an employee more than the guaranteed salary amount is not normally inconsistent with salary basis status because this does not result in any reduction in the base pay.

   With some specific exceptions, the base pay of a salary basis employee may not be reduced based on the “quality or quantity” of work performed (provided that
the employee does “some” work in the pay period). This usually means that the base pay of a salary basis employee may not be reduced if the employee works less than normal, if the reason for that is determined by the employer. For example, a salary basis pay employee’s base pay may not be reduced if there is “no work” to be performed (such as a slow period), and a salary basis employee’s base pay may not be reduced for partial day absences. If the employer makes deductions from an employee’s predetermined salary (i.e., a slow period), that employee is not paid on a “salary basis.” If the employee is ready, willing and able to work, deductions may not be made for time when work is not available.

Deductions from pay are permissible when an exempt employee is absent from work for one or more full days for personal reasons other than sickness or disability; for absences of one or more full days due to sickness or disability if the deduction is made in accordance with a bona fide plan, policy or practice of providing compensation for salary lost due to illness (as for example if the employee has no accrued sick leave); to offset amounts employees receive as jury or witness fees, or for military pay; for penalties imposed in good faith for infractions of safety rules of major significance (for example, smoking around a gas tank); or for unpaid disciplinary suspensions of one or more days imposed in good faith for workplace conduct rule infractions. Also, an employer is not required to pay the full salary in the initial or terminal week of employment, or for weeks in which an exempt employee takes unpaid leave under the Family and Medical Leave Act.

Isolated or inadvertent improper deductions will not result in loss of the exemption if the employer reimburses the employee and makes a good faith commitment to comply in the future. The employer will lose the exemption, however, if it has an “actual practice” of not paying employees on a salary basis. Factors to consider when determining whether an employer has an “actual practice” include, but are not limited to: the number of improper deductions, the time period involved, the number and geographic location of both the employee whose salary was improperly reduced and the managers responsible, and whether the employer has a written policy permitting or prohibiting improper deductions. If an “actual practice” is found, the exemption is lost during the time period of the deductions only for employees in the same job classification working for the same managers responsible for the improper deductions.

If the employer has a clearly communicated policy prohibiting improper deductions, reimburses employees and makes a good faith commitment to comply in the future, the employer will not lose the exemption for any employees unless the employer willfully violates the policy or continues the improper deductions after receiving complaints.

3. **Duties Tests** - An employee who meets the salary level tests and the salary basis tests is exempt only if s/he also performs exempt job duties. These FLSA exemptions are limited to employees who perform relatively high-level work.
Whether the duties of a particular job qualify as exempt depends on what they are. Job titles or position descriptions are of limited usefulness in this determination. (A secretary is still a secretary even if he or she is called an "administrative assistant", and the chief executive officer is still the CEO even if he or she is called a janitor.) It is the actual job tasks that must be evaluated, along with how the particular job tasks "fit" into the employer's overall operations.

There are three typical categories of exempt job duties, called "executive," "professional," and "administrative."

**Exempt Executive Job Duties**

Job duties are exempt executive job duties if the employee…

- regularly supervises two or more other employees, and also
- has management as the primary duty of the position, and also
- has some genuine input into the job status of other employees (such as hiring, firing, promotions, or assignments).

Supervision means what it implies. The supervision must be a regular part of the employee's job and must be of other employees. Supervision of non-employees does not meet the standard. The "two employees" requirement may be met by supervising two full-time employees or the equivalent number of part-time employees. (Two half-time employees equal one full-time employee.)

"Mere supervision" is not sufficient. In addition, the supervisory employee must have "management" as the "primary duty" of the job. The FLSA Regulations contain a list of typical management duties. These include (in addition to supervision):

- interviewing, selecting, and training employees
- setting rates of pay and hours of work
- maintaining production or sales records (beyond the merely clerical)
- appraising productivity; handling employee grievances or complaints, or disciplining employees
- determining work techniques
- planning the work
- apportioning work among employees
- determining the types of equipment to be used in performing work, or materials needed
- planning budgets for work
- monitoring work for legal or regulatory compliance
- providing measures for a safe and secure workplace
Determining whether “management” is the primary duty of a position requires case-by-case evaluation. A "rule of thumb" is to determine if the employee is "in charge" of a department or subdivision of the enterprise (such as a shift). One handy clue might be to ask who a telephone inquiry would be directed to if the called asked for "the boss." Typically, only one employee is "in charge" at any particular time. Thus, for example, if a "sergeant" and a "lieutenant" are each at work at the same time (in the same unit or subunit of the organization), only the lieutenant is "in charge" during that time.

An employee may qualify as performing executive job duties even if he or she performs a variety of "regular" job duties as well. For example, the night manager at a fast food restaurant may in reality spend most of the shift preparing food and serving customers. He or she is, however, still "the boss" even when not actually engaged in "active" bossing duties. In the event that some "executive" decisions are required, he or she is there to make them, and this is sufficient.

The final requirement for the executive exemption is that the employee has genuine input into personnel matters. This does not require that the employee be the final decision maker on such matters, but rather that the employee's input is given "particular weight." Usually, it will mean that making personnel recommendations is part of the employee's normal job duties, that the employee makes these kinds of recommendations frequently enough to be a "real" part of the job, and that higher management takes the employee's personnel suggestions or recommendations seriously.

**Exempt Professional Job Duties**

The job duties of the traditional "learned professions" are exempt. These include lawyers, doctors, dentists, teachers, architects, and clergy. Also included are registered nurses (but not LPNs), accountants (but not bookkeepers), engineers (who have engineering degrees or the equivalent and perform work of the sort usually performed by licensed professional engineers), actuaries, scientists (but not technicians), pharmacists, and other employees who perform work requiring "advanced knowledge" similar to that historically associated with the traditional learned professions.

Professionally exempt work means work which is predominantly intellectual, requires specialized education, and involves the exercise of discretion and judgment. Professionally exempt workers must have education beyond high school, and usually beyond college, in fields that are distinguished from (more "academic" than) the mechanical arts or skilled trades. Advanced degrees are the most common measure of this but are not absolutely necessary if an employee has attained a similar level of advanced education through other means (and perform essentially the same kind of work as similar employees who do have advanced degrees).
Some employees may also perform "creative professional" job duties which are exempt. This classification applies to jobs such as actors, musicians, composers, writers, cartoonists, and some journalists. It is meant to cover employees in these kinds of jobs whose work requires invention, imagination, originality or talent; who contribute a unique interpretation or analysis.

Identifying most professionally exempt employees is usually pretty straightforward and uncontroversial, but this is not always the case. Whether a journalist is professionally exempt, for example, or a commercial artist, will likely require careful analysis of just what the employee actually does.

**Exempt Administrative Job Duties**

The most elusive and imprecise of the definitions of exempt job duties is for exempt "administrative" job duties.

The Regulatory definition provides that exempt administrative job duties are:

(a) office or non-manual work, which is

(b) directly related to management or general business operations of the employer or the employer's customers, and

(c) a primary component of which involves the exercise of independent judgment, and discretion about

(d) matters of significance.

The administrative exemption is designed for relatively high-level employees whose main job is to "keep the business running." A useful rule of thumb is to distinguish administrative employees from "operational" or "production" employees. Employees who make what the business sells are not administrative employees. Administrative employees provide "support" to the operational or production employees. They are "staff" rather than "line" employees. Examples of administrative functions include labor relations and personnel (human resources employees), payroll and finance (including budgeting and benefits management), records maintenance, accounting and tax, marketing and advertising (as differentiated from direct sales), quality control, public relations (including shareholder or investment relations, and government relations), legal and regulatory compliance, and some computer-related jobs (such as network, internet and database administration).

To be exempt under the administrative exemption, the "staff" or "support" work must be office or nonmanual, and must be for matters of significance. Clerical employees perform office or nonmanual support work but are not administratively exempt. Nor is administrative work exempt just because it is financially
important, in the sense that the employer would experience financial losses if the employee fails to perform competently. Administratively exempt work typically involves the exercise of discretion and judgment, with the authority to make independent decisions on matters which affect the business as a whole or a significant part of it.

Questions to ask might include whether the employee has the authority to formulate or interpret company policies; how major the employee's assignments are in relation to the overall business operations of the enterprise (buying paper clips versus buying a fleet of delivery vehicles, for example); whether the employee has the authority to commit the employer in matters which have significant financial impact; whether the employee has the authority to deviate from company policy without prior approval.

An example of administratively exempt work could be the buyer for a department store. He or she performs office or non-manual work and is not engaged in production or sales. The job involves work which is necessary to the overall operation of the store -- selecting merchandise to be ordered as inventory. It is important work, since having the right inventory (and the right amount of inventory) is crucial to the overall well-being of the store's business. It involves the exercise of a good deal of important judgment and discretion, since it is up to the buyer to select items which will sell in sufficient quantity and at sufficient margins to be profitable. Other examples of administratively exempt employees might be planners and true administrative assistants (as differentiated from secretaries with fancy titles).

Merely clerical work may be administrative, but it is not exempt. Most secretaries, for example, may accurately be said to be performing administrative work, but their jobs are not usually exempt. Similarly, filing, filling out forms and preparing routine reports, answering telephones, making travel arrangements, working on customer "help desks", and similar jobs are not likely to be high-level enough to be administratively exempt. Many clerical workers do in fact exercise some discretion and judgment in their jobs. However, to "count" the exercise of judgment and discretion must be about matters of considerable importance to the operation of the enterprise as a whole.

Routinely ordering supplies (and even selecting which vendor to buy supplies from) is not likely to be considered high-level enough to qualify the employee for administratively exempt status. There is no "bright line." Some secretaries may indeed be high-level, administratively exempt employees (for example, the secretary to the CEO who really does "run his life"); while some employees with fancy titles (e.g., "administrative assistant") may really be performing nonexempt clerical duties.
RIGHTS OF EXEMPT EMPLOYEES

An exempt employee has virtually "no rights at all" under the FLSA overtime rules. About all an exempt employee is entitled to under the FLSA is to receive the full amount of the base salary in any work period during which s/he performs any work (less any permissible deductions). Nothing in the FLSA prohibits an employer from requiring exempt employees to "punch a clock", or work a particular schedule, or "make up" time lost due to absences. Nor does the FLSA limit the amount of work time an employer may require or expect from any employee, on any schedule. ("Mandatory overtime" is not restricted by the FLSA.)

Keep in mind that this discussion is limited to rights under the FLSA. Exempt employees may have rights under other laws or by way of employment policies or contracts.
CHAPTER 1 SUMMARY

1. The Fair Labor Standards Act requires employers to pay at least the Federal minimum wage to all covered nonexempt employees for all hours worked; pay at least one and one-half times the employees’ regular rates of pay for all hours worked over 40 in the work week; comply with the child labor standards; and comply with the recordkeeping requirements.

2. To determine whether a person can be classified as an independent contractor, you must review the entire working relationship between the government and the person, and arrive at a decision based on the complete body of facts. There are three categories of facts to consider: behavioral control, financial control, and relationship of the parties.

3. Facts concerning behavioral control define a person as an employee when the government has the right to direct and control how the person does the task for which he was hired.

4. Facts concerning financial control demonstrate whether there is a right to direct or control the business part of the work.

5. Facts concerning relationship of the parties illustrate how the business and the worker perceive their relationship.

6. There is no single rule or test for determining whether an individual is an independent contractor or an employee for purposes of the FLSA. Rather, it is the total activity or situation which controls.

7. Employees whose jobs are governed by the FLSA are either “exempt” or “nonexempt.” Nonexempt employees are entitled to overtime pay; whereas, exempt employees are not.

8. Generally, employees must meet all of the following “tests” to be exempt: salary level test, salary basis test, and duties test.

9. Employees who are paid less than $47,476 per year are nonexempt.

10. Generally, an employee is paid on a salary basis if s/he has a “guaranteed minimum” amount of money that will be received for any work week in which “any” work is performed.

11. An employee who meets the salary level tests and the salary basis tests is exempt only if the employee also performs exempt job duties.

12. There are three typical categories of exempt job duties, called “executive,” “professional,” and “administrative.” Teachers are exempt, but other school personnel are not.
CHAPTER 1 EXERCISE

Circle the correct answer.

1. The FLSA requires employers to:

   A. Pay at least the Federal minimum wage to all covered nonexempt employees (entitled to overtime pay) for all hours worked.
   B. Pay at least one and one-half times the employees’ regular rates of pay for all hours worked over 20 in the work week.
   C. Ignore the child labor standards.
   D. Not comply with the recordkeeping requirements.

2. An independent contractor can be someone:

   A. Over whom you have the right to control what will be done and how it will be done.
   B. Who works on-site under guidelines issued by the employer.
   C. Who works at home under guidelines issued by the employer.
   D. Who has control over the means and methods of producing his work.

3. When determining whether someone is an independent contractor, you would not review this category of facts:

   A. Behavioral control.
   B. Quality control.
   C. Financial control.
   D. Relationship of the parties.

4. An employee that is exempt under the FLSA must meet the following test(s) (Select all that apply):

   A. Salary Level Test.
   B. Duties Test.
   C. Salary Basis Test.
   D. Salary Duties Test.
5. This category of facts demonstrates whether there is a right to direct or control how the worker does the work:
   A. Behavioral Control.
   B. Financial Control.
   C. Relationship of Parties.
   D. Quality Control.

6. This category of facts demonstrates whether there is a right to direct or control the business aspect of the work:
   A. Behavioral Control.
   B. Financial Control.
   C. Relationship of Parties.
   D. Quality Control.

7. This category of facts demonstrates how the business and the worker perceive their relationship:
   A. Behavioral Control.
   B. Financial Control.
   C. Relationship of Parties.
   D. Quality Control.

8. The salary level test threshold for determining nonexempt employee status is:
   A. Less than $47,476.
   B. Greater than $47,476.
   C. Less than $100,000.
   D. Greater than $100,000.

9. Job duties are exempt executive job duties if the employee:
   A. Rarely supervises one or fewer other employees.
   B. Has management as the secondary duty of the position.
   C. Has some genuine input into the job status of other employees.
   D. Has no input into the job status of other employees.
10. The three categories of exempt job duties includes:

A. Executive, paraprofessional, administrative.
B. Senior, paraprofessional, clerical.
C. Senior, paraprofessional, administrative.
D. Executive, professional, administrative.
CHAPTER 2
THE PAYROLL PROCESS

OBJECTIVES

This chapter will review the process from the time an employee is hired to the information needed to process the employee’s first pay check.

After completing this chapter, the participant should be able to:

• Recall the steps involved in the payroll process
• Recognize the basic documents for new hire packages
• Identify the documents maintained in a personnel file
• Recall how to document payroll changes

THE PROCESS: AN OVERVIEW

This section provides a summary for an in-house, computerized payroll process. While some of these steps will not apply to every local government, the information provided will leave you with a “behind the scenes” view of how the payroll process is completed.

Step #1 - Set up new employees - All new employees are required to complete payroll-specific forms that should be part of the hiring process. Some examples include the W-4 form and other payroll deductions such as medical insurance. Detailed information about the new hire package is provided later in this chapter. This information is usually entered in the payroll system so that it is included in the next payroll.

Step #2 - Time card information - Employers must collect information about hours worked for nonexempt employees. This information can be gathered through having employees scan a badge through a computerized time clock, punch a card in a stamp clock or manually filling out a time sheet.

Step #3 - Verify information - The payroll staff must verify that time cards have been collected by all departments/divisions and that the proper signatures are present on time cards and usually a batch card. A supervisor’s signature indicates that the time card has been reviewed and that the supervisor is in agreement with the time recorded by the employee.
Step #4 - Data input - While this process certainly varies for each government, most payroll programs calculate payroll by multiplying the number of hours worked by an employee’s standard wage rate. The process can be complicated by overtime and wage changes in the middle of the payroll period. Additional information is covered on this step in the Compensation chapter.

In addition to time card input, employees may ask to have changes made to their paychecks. These changes can include insurance, tax exemptions, medical deductions, etc. These changes are also entered in the payroll system.

Step #5 - Calculate taxes - The IRS provides tax tables to manually calculate tax withholdings. However, most payroll systems will automatically calculate taxes based on the amount of wages earned, tax allowances taken and wages earned year-to-date. In addition to federal tax tables there are state withholding tax tables. Changes to these tables occur at different times throughout the year so keeping the most up to date information is very important.

Step #6 - Calculate wage deductions - Deductions are categorized as voluntary and involuntary. Included in the voluntary category are payments into pension and medical plans. An example of involuntary deductions is garnishments, bankruptcies or IRS liens for unpaid income taxes. The payroll staff is responsible for tracking payments in order to know when to stop making deductions when required totals have been reached. Review of court orders is extremely important in this process.

Step #7 - Separate manual payments - There are usually instances during every pay period that a manual paycheck is issued to an employee. The amount of each manual check should be included in the regular payroll.

Step #8 - Create a payroll register - This is where the wage and deduction information for each employee is summarized. Usually, this information is used to compile a journal entry for inclusion in the general ledger, to prepare tax reports and for general research purposes. This document is almost always automatically generated from the payroll input.

Step #9 - Verification - A cross-check should be conducted for all wage calculations and deductions for accuracy.

Step #10 - Print checks - This process usually takes place on a computer printer, using a standard format for all checks and direct deposits.

Step #11 - Journal entries - Using the information from the payroll register, journal entries should be generated. Detailed information regarding these entries is provided in Chapter 7.
Step #12 - Send out direct deposit notifications - Information regarding direct deposits is usually provided to a local bank several days before the actual pay date normally through upload transmission processes.

Step #13 - Deposit withheld taxes - In order to avoid penalties, governments must comply with the IRS’ deposit schedule and format for payroll tax deductions and employer-matched taxes. Additional information is provided in Chapter 5.

Step #14 - Issue paychecks - The payroll staff should require a signature from all individuals picking-up departmental paychecks. The individual handing out checks should be someone who is able to recognize and know the name of each employee.

Step #15 - Issue payroll reports - The government requires several payroll-related reports at regular intervals which require information on the payroll register to complete.

THE MECHANICS: NEW HIRE PACKAGES

When a new employee is hired, the person or staff responsible for human resources will go over a variety of paperwork with the person and forward to the payroll person any items required by the payroll staff to calculate the person’s wages, taxes and other deductions. In smaller governments the human resources person and the payroll person are one in the same so more controls are needed since a segregation of duties does not exist with the same person doing both tasks. Though some forms may be specific to an individual government, the following forms will be found in most cases:

- **Checklist** - At the front of each new employee packet or folder should be a checklist that itemizes all documents contained in the packet. By using it to verify that a package is complete, there is minimal risk that new employees will not be issued critical information. It is also useful to include the latest form release date on this sheet to verify the document dates contained in the packet.

- **Government go-to list** - A new employee has no idea whom to approach regarding basic daily issues, such as phone and network problems, pension plan enrollments, expense reports, and so on. This list should itemize which people he or she should approach about each type of problem.

- **Government directory** - The phone list for the government divided in department sections as well as an alphabetical listing of each employee is very helpful to a new hire. It is also increasingly customary to include e-mail addresses on this list. With the growing use of internet, sometimes these are not forms, they are instructions on how to find the information the employee needs on the internet.
• **Insurance enrollment forms** - Enrollment forms for a variety of insurance types can be issued to a new employee at a later date if there is a waiting period before they go into effect. A better approach, however, is to issue these forms at the same time that an employee receives all other paperwork, so there is no chance of the forms being missed. Enrollment forms can cover medical, vision, dental, life, supplemental life, and short- and long-term disability insurance.

• **Employee manual** - There should be a comprehensive employee manual in the new-employee packet that includes a tear-out acknowledgment of receipt. The employee signs this receipt to indicate that he or she has received and read it; the receipt goes into the employee’s personnel file. This is useful in case of an issue regarding employee benefits or rights arising at a later date, and an employee claims to have no knowledge of the issue, even though it is stated in the employee manual.

• **Form W-4** - Every employee must fill out IRS Form W-4, in which they claim a certain number of allowances and, possibly, additional tax withholdings. This information is needed in order to compute their income tax withholdings. To obtain the latest version of Form W-4, go to [www.irs.gov](http://www.irs.gov), Forms and Publications.

• **Georgia Form G-4** - Every employee must fill out Georgia Form G-4, in which they claim a certain number of allowances and, possibly, additional tax withholdings. This information is needed in order to compute their income tax withholdings. To obtain the latest version of Form G-4, go to [https://dor.georgia.gov/sites/dor.georgia.gov](https://dor.georgia.gov/sites/dor.georgia.gov).

• **Form I-9** - The U.S. Citizenship and Immigration Services (USCIS) requires all new employees to fill out Form I-9, which is the “Employment Eligibility Verification” form. This form serves two purposes. First, it requires the employer to establish the identity of a new employee which can be done with a driver’s license, a variety of government identification cards, a voter’s registration card, or a Native American tribal document. Second, it requires the employer to establish that a new employee is eligible to work which can be done with a Social Security card, birth certificate, Native American tribal document, or an unexpired employment authorization document. These two requirements can be satisfied with a single document, such as a U.S. passport, or several other documents that are specified on the form. To obtain the latest version of Form I-9, go to [https://www.uscis.gov](https://www.uscis.gov).

To complete the I-9 form, the employee fills out the Employee Information and Verification information in Section I. This section must be signed by the employee; it may also require a preparer’s or translator’s signature if such a person assisted with the document. The employer fills out Section 2 which requires the examination of one or more original documents, as previously noted and as described on the second page of the form. The reviewing person must then
sign at the bottom of Section 2. Section 3 of the form is used only to update the information if an employee subsequently changed names or quit and was rehired within three years of the original completion of the form, or has obtained a new work authorization. Since verification of the employment eligibility of new hires became law in 1986, the Form I-9 has been the foundation of the verification process.

The USCIS operates an electronic verification system called E-Verify. E-Verify allows participating employers to electronically verify employment eligibility of their newly hired employees by use of the Internet. The internet-based system is a part of the Systematic Alien Verification for Entitlements (SAVE) Program initiative that allows businesses to determine the eligibility of their employees to work in the United States. State law requires all counties to post their E-Verify user identification number and date of authorization on their website. If a county does not maintain a website, this information must be published on the Carl Vinson Institute of Government website. The Georgia Security and Immigration Compliance Act requires among other provisions that public employers with the State must verify the status of newly hired employees by using E-Verify.

Participation in the E-Verify program does not exempt an employer from the obligation to obtain a completed Form I-9 from new hires. To register for E-Verify, please click to the link below to the website:

E-Verify Website.

- **Georgia New Hire Reporting Form** - Georgia statute 19-11-9.2 requires all Georgia employers, both public and private, to report to the New Hire Reporting Program for all newly hired, rehired, or returning to work employees. This program was designed to speed up the child support income withholding order process to allow child support to get to children quicker. Information about new hire reporting and also to complete this report online can be found at [https://ga-newhire.com](https://ga-newhire.com) and should be done within 10 days of the hire date. There are a number of allowable methods for reporting including both electronic and manual options. Visit the above website to review alternatives.
CREATING THE PERSONNEL FILE

When a new employee starts work, the human resources staff should create a personnel folder in which all employee-related documents are stored. Information can be grouped in a variety of ways within the folder; here are some common subsets of information to consider:

- **Deduction information** - One block of information will be the deductions related to all types of benefits, such as medical, life, and dental insurance. This means that the sign-up or waiver sheets for each type of insurance should be included in the folder.

- **Employee correspondence** - Employees may communicate with the human resources department for a variety of reasons. If these communications are in writing, they should be included in the folder. If they are verbal, the person receiving the information may include them in a memo, if the matter appears sufficiently important, and store them in the folder.

- **Employee reviews** - All employee reviews should be kept in the folder. They are particularly important if employees later file suit against the government in the event of a termination, since the government must be able to prove that an employee was terminated for cause. Also, note whether both the reviewer and the employee have signed a review; if either one is missing; obtain these signatures as soon as possible.

- **Garnishment information** - If there are court orders for garnishing an employee’s pay for any reason, (e.g., tax levies, creditor levies, child support, or alimony) include a copy of each one in the folder.

- **Tax-related information** - Tax deductions can only be made from an employee’s wages if prior written authorization has been made by the employee. The employer should retain proof of these requests in the folder.

It is essential that the entire set of personnel files for all employees be kept under the strictest security at all times both physically and electronically. These files contain potentially damaging information about employees, such as job reviews, medical information, or court orders that could be embarrassing or job-threatening if the information were to become public knowledge. Employees rely on the employer to keep this information confidential, and the employer should meet this expectation.

PAYROLL CHANGES

There will be changes in employees’ lives that require them to ask for alterations to the information used to create their paychecks. For example, an employee may have a baby which requires an alteration in that person’s medical insurance. This change will
probably require a different payroll deduction for the employee’s portion of the insurance expense which must be reflected in his or her paycheck. The payroll staff must have a procedure in place for handling these types of scenarios. One approach is to create a form, a payroll change form, which summarizes these changes as shown on the following page.

The employee change form can be used as the source document for new employees as well as for each incremental change requested by existing employees. In the latter case, enter just the information relating to a specific request; then have the employee sign it to confirm the transaction, and submit it to the payroll staff for processing. Finally, file the completed form in the employee’s personnel folder.

Set up of new hires is extremely important. If set up is inaccurate or incomplete it can create issues further down the road for the government to deal with. Attention to details on the front end will be well worth the effort expended in the payroll administration.
The Employee Change/New Form

Employee Name: ______________________ Social Security #: _______________
Reason: _________________________________________________________________

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<tr>
<td>Phone</td>
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<td>Gender</td>
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<tr>
<td>Birthdate</td>
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<td>Hire Date</td>
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<tr>
<td>Term Date</td>
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<td>Title</td>
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<tr>
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<tr>
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<td></td>
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<tr>
<td>Supp Life</td>
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<td></td>
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<td>401K% or $</td>
<td></td>
<td></td>
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<tr>
<td>Dependent Flex Deduction</td>
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<td></td>
</tr>
<tr>
<td>Medical Flex Deduction</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Direct Deposit</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Routing#/account#</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Comments:
______________________________________________________________________________________
______________________________________________________________________________________
______________________________________________________________________________________
______________________________________________________________________________________

Completed by: ______________________ Date: ______________________
CHAPTER 2 SUMMARY

1. There are a number of steps included in the payroll process. These steps include, but are not limited to, set up of new employees, collecting time card information, verifying information, data input, calculation of taxes, creating a payroll register, printing checks, journal entries, issuing payroll checks, and payroll reports.

2. The new hire process involves a variety of forms necessary to facilitate the set-up of new employees in the payroll system. These forms include, but are not limited to, a checklist, government go-to list, government directory, insurance enrollment forms, employee manual, W-4, G-4, and I-9.

3. The human resources staff should create a personnel folder in which all employee-related documents are stored. Subsets of information can include deduction information, employee correspondence, employee reviews, garnishment information, and tax-related information.

4. A government should be diligent in ensuring that all personnel files are kept under the strictest security at all times both physically and electronically.

5. There should be a procedure in place to document and process payroll related changes. In many instances, an employee change form can be used as the source document for new employees as well as for each incremental change requested by existing employees.
CHAPTER 2 EXERCISE

Circle the correct answer.

1. A payroll change authorization by an employee is needed to:
   
   A. Verify that they accept a wage increase.  
   B. Ensure that time records are being accumulated properly.  
   C. Reduce the number of data entry errors.  
   D. Create proof that the employee wanted a change to be made.

2. Adding an employee to the payroll system does not include the following step:
   
   A. Summarize the hours worked on the employee’s time card.  
   B. Complete the Form I-9.  
   C. Complete the Form W-4.  
   D. Create an employee record in the payroll system.

3. During the timecard information collection process, comparing submitted timecards to an employee master list is needed to:
   
   A. Verify the spelling of employee names.  
   B. Protect against buddy punching.  
   C. Determine who is authorized to work overtime hours.  
   D. Determine who has not yet submitted a timecard.

4. You would not update the following item in the employee personnel (master) file:
   
   A. Change of employee name.  
   B. Change of hours worked.  
   C. Change of employee active/inactive status.  
   D. Change of employee pay rate.

5. Every employee must fill out IRS Form W-4, in which they claim a certain number of allowances and, possibly, additional tax withholdings. Withholding allowances affect:
   
   A. The amount of social security taxes deducted from employee pay.  
   B. The amount of Medicare taxes deducted from employee pay.  
   C. The amount of gross pay.  
   D. The amount of income taxes withheld from employee wages.
6. A government can verify that a new employee is eligible to work in the United States by verifying that the employee has:

A. A driver’s license.
B. A voter registration card and social security card.
C. Native American tribal document.
D. Social Security card.

7. The payroll register is *not* used:

A. As a source document for the Form 1099-MISC.
B. As a source document to compile a journal entry for inclusion in the general ledger.
C. To investigate wage and deduction information for each employee.
D. As a source document to prepare tax reports.

8. Every employee must fill out Georgia Form G-4. This form is used to:

A. Claim a certain number of allowances and, possibly, additional tax withholdings.
B. Calculate the amount of social security taxes deducted from employee pay.
C. Enroll the employee in the unemployment tax database.
D. Calculate the amount of Medicare taxes deducted from employee pay.

9. Georgia statute 19-11-9.2 requires all Georgia employers, both public and private, to report to the New Hire Reporting Program for all newly hired, rehired, or returning to work employees. This reporting should be done within:

A. Ten days of the hire date.
B. Twelve days of the hire date.
C. Fifteen days of the hire date.
D. Thirty days of the hire date.

10. The following is an example of a voluntary deduction:

A. Garnishments.
B. Bankruptcies.
C. Payments into pension and medical plans.
D. IRS liens for unpaid income taxes.
CHAPTER 3
COMPENSATION

OBJECTIVES

This chapter covers many issues surrounding employee compensation, with emphasis on the types of compensation that are taxable income to employees. Chapter 1 covered the guidelines for determining whether an employer can designate someone as an employee or contractor. The majority of this chapter is devoted to a discussion of a variety of compensation types as well as several forms that are used to report employee and contractor income. After completing this chapter, the participant should be able to:

- Calculate pay based on the hourly rate plan, partial periods and overtime
- Identify which reimbursements/benefits are considered income to employees
- Recall paperwork associated with compensation including the W-2 and the 1099

CALCULATING PAY BASED ON THE HOURLY RATE PLAN

This plan is most commonly used and is simple to calculate. It involves multiplying the wage rate per hour times the number of hours worked during the workweek. However, the simple calculation can be made complicated by shift differentials, overtime, merit increases, etc.

Example

Hourly Rate Plan Calculation - Assume J. Alexander works the second shift for the police department, where he earns an extra $0.50 per hour as a shift differential, as well as a base wage of $16.00 per hour. He worked a standard 40 hours in the most recent workweek. The calculation of his total wages earned is:

\[
(16.00 \text{ base wage} + 0.50 \text{ shift differential}) \times 40 \text{ hours} = 660 \text{ weekly pay}
\]
CALCULATING PAY FOR PARTIAL PERIODS

Some salaried employees begin or stop work partway through a pay period, so the payroll staff must calculate what proportion of their salary has been earned. This calculation is also necessary when a pay change has been made that is effective as of a date partway through the employee’s pay period. A common approach for determining the hourly rate is to divide the total annual salary by 2,080 hours, which is the total number of hours in a year.

Example

Partial Pay Calculation - Assume Lee County pays its employees on the fifteenth and last day of each month, which amounts to 24 pay periods per year. One employee, J. Alexander, has been hired partway through a pay period at an annual salary of $40,500. He starts work on the twentieth of the month, and there are seven business days left in the pay period. The payroll staff first determines his hourly rate of pay, which is $40,500/2,080 hours, or $19.47. They then have to calculate the number of hours left in the pay period, which is 8 hours a day x 7 working days, or 56 hours. Therefore, Mr. Alexander’s pay for his first pay period will be $19.47 x 56 hours, or $1,090.32.

CALCULATING OVERTIME PAY

In the state of Georgia, overtime is a pay premium of 50 percent of the regular rate of pay that is earned by employees on all hours worked beyond 40 hours in a standard workweek. When doing the calculation for overtime, the employer does not have to include in the 40 hours vacations, holidays, sick time, etc.

Example

Overtime Calculation - Assume J. Alexander works 50 hours during a standard workweek at an hourly wage of $20 per hour. The overtime premium paid will be 50 percent of his hourly wage, or $10. The calculation of his pay is as follows:

\[
\begin{align*}
50 \text{ hours} \times \text{regular pay rate of $20/hour} & = $1,000 \\
10 \text{ hours} \times \text{overtime premium of $10/hour} & = $100 \\
\text{Total pay} & = $1,100
\end{align*}
\]

Assume J. Alexander worked 33 hours during the four-day workweek following Memorial Day. He will be paid for 41 hours worked (8 hours of holiday time plus 33 hours worked). However, since eight of the hours were not actually worked, there will be no overtime paid.
BACK PAY

An example of back pay is when an employee is terminated and through some process, the termination is overturned. The employee is due those wages that he or she would have earned had they been employed. In most cases, back pay is treated as regular wages for tax withholding purposes.

EXPENSE REIMBURSEMENTS

Expense reimbursements include costs to travel to and from government destinations using personal vehicles, lodging, meals and incidental expenses during travel and could include living costs for employees which are relocated. Frequently, employees will submit an expense statement requesting reimbursement for funds spent to conduct business. This reimbursement is not considered income to the employee because they are submitting an expense statement. This is called an accountable plan in the eyes of the IRS as this employee is documenting his expenses and that is why it is not treated as income to the employee. Most governments have a very detailed travel policy that employees must adhere to during travel such as meal limits, lodging limits, mileage rates, etc. So that the reimbursement is not taxable to the employee, the government should adhere to rules of the IRS as to what constitutes an accountable plan. To be an accountable plan, the reimbursement or allowance arrangement must require government employees to meet all three of the following rules:

1. They must have paid or incurred expenses while performing services for the government.
2. They must substantiate these expenses to you within a reasonable period of time.
3. They must return any amounts in excess of substantiated expenses within a reasonable period of time.

If an employee lives away from home for less than one year on business, the living costs paid to the employee for this period are not considered taxable income. However, once the duration exceeds one year, the employee is considered to have permanently moved to the new location, rendering all future payments taxable income to the employee.

TUITION REIMBURSEMENT AND QUALIFYING EDUCATIONAL EXPENSES

The IRS deems tuition and qualifying educational expenses as tuition, books, supplies, equipment, and certain travel and transportations costs for graduate or undergraduate level courses. If expenses for tuition/education reimbursement are related to his or her current job and will either serve to maintain or improve the person’s skills for conducting that job, the reimbursement is not considered income to the employee. However, the payments are income if the education is pursued to promote the person or shift them into
an unrelated position requiring different skills. For more information related to tuition reimbursement see www.irs.gov, Forms and Publications, IRS Publication 970.

EMPLOYEE AWARDS

Employee achievement awards, such as safety awards, are not included in an employee’s gross income. However, the awards have to be tangible property, given in recognition of length of service with the government or for safety achievement and as part of a meaningful presentation. This exclusion is up to $400 per year.

Exceptions are made ($1,600) if the awards are made under a written plan that does not favor highly compensated employees. However, the total exclusion for both types of awards is $1,600, not the combined total of $2,000. IRS publication 5137 covers employee awards if more information is needed on the subject. Visit www.irs.gov to view this publication.

Example

*Employee Award* - Assume J. Alexander receives a safety award during the year for his impeccable driving record. He receives **$100** during a formal achievement ceremony. This payment is taxable gross income to him because it is a cash award instead of a tangible award.
LIFE INSURANCE

Group term life insurance paid by the employer is not considered taxable income for the first $50,000 of the life insurance purchased. Any amount over the $50,000 must be included in employee income and is defined as imputed income. Imputed income is the addition of the value of cash or non-cash compensation to an employee’s taxable wages. This income is only subject to Social Security and Medicare taxes. You may, at your option, withhold federal income tax. The IRS Fair Market Value Multiplier table should be used to determine the fair market value of group term life insurance per $1,000 of insurance for a range of age brackets.

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<td>$0.05</td>
</tr>
<tr>
<td>Age 25-29</td>
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</tr>
<tr>
<td>Age 30-34</td>
<td>$0.08</td>
</tr>
<tr>
<td>Age 35-39</td>
<td>$0.09</td>
</tr>
<tr>
<td>Age 40-44</td>
<td>$0.10</td>
</tr>
<tr>
<td>Age 45-49</td>
<td>$0.15</td>
</tr>
<tr>
<td>Age 50-54</td>
<td>$0.23</td>
</tr>
<tr>
<td>Age 55-59</td>
<td>$0.43</td>
</tr>
<tr>
<td>Age 60-64</td>
<td>$0.66</td>
</tr>
<tr>
<td>Age 65-69</td>
<td>$1.27</td>
</tr>
<tr>
<td>And 70 and above</td>
<td>$2.06</td>
</tr>
</tbody>
</table>

Example

Life Insurance Calculation - Assume group term insurance in the amount of $60,000 is purchased for a 57-year-old employee who contributes $2/month to this benefit. The first $50,000 of this amount is excluded from the employee’s gross income. You then take the remaining $10,000 and divide it by $1,000 and multiply the result by $0.43 (from the table). You take the result and subtract the employee’s contribution and then multiply the result by 12 months.

$10,000/$1,000 = 10 x $0.43 = ($4.30 - $2.00) x 12 = $27.60

The $27.60 should be reported in Boxes 1, 3, and 5 of form W-2 which makes it taxable for federal, FICA and Medicare and it is also taxable for state income tax purposes and will show up along with other taxable state wages in Box 16. Also, show this amount in Box 12 with code "C".

GOVERNMENT VEHICLES

There are several tax rules that apply to employees that drive government vehicles for personal use. The basic rule is that the use of the asset is taxable income to the employee.

- If the vehicle is a specialty one, such as a dump truck driven by a sanitation worker, then there is an assumption that no personal use will occur, so using this type of vehicle will never result in taxable income to the employee.

- If the employer requires the employee to use the vehicle to commute to work, an enforced company policy prohibits the vehicle from all other personal use, and the employee is not a highly compensated employee, director, or officer, then the employee will be charged $1.50 of taxable income for each commute in each direction. For example if an employee uses the car five days a week and commutes home and back, then $15 would be added to the employee’s weekly gross pay. That would be $3 per day times 5 days.

- If the employee documents the reason for the trip, dates and mileage, all remaining miles are assumed to be for personal use. In this case, the income charged to the employee is calculated by multiplying the IRS mileage reimbursement rate (2018 – 54.5 cents) less 5.5 cents per mile if the employee purchases fuel. This approach is acceptable only if the vehicle fair market value is approximately $27,300 or less ($31,000 for trucks and vans) and the vehicle is driven at least 10,000 miles annually (Source – Internal Revenue Bulletin: 2018-2).

  - If the situation exceeds these restrictions, the alternative approach is to multiply the proportion of personal miles used on the vehicle by its annual lease value. This value is a percentage of a vehicle’s fair market value, as supplied by the IRS. This amount is recorded as personal income to the employee. To view the IRS handbook that is specific to federal, state and local government employees, visit, www.irs.gov, forms and publications, Publication 5137.
ANNUAL PAPERWORK ASSOCIATED WITH COMPENSATION

There are several documents that the payroll staff must issue or process at the end of a calendar year associated with compensation.

- Give a completed W-2 form to all employees by the end of January.

- Give a completed 1099 form to all qualifying vendors by the end of January. Oftentimes this is done by accounts payable personnel instead of payroll if the local government has different staff performing payroll and accounts payable.

- Send Copy A of all completed W-2 forms to the Social Security Administration by the end of January.

- Send Form 1003 to the Georgia Department of Revenue along with W-2s by the end of January. If the government is required to file electronic payments through the GTC (Georgia Taxpayer Center), the W-2s and form 1003 must be electronically uploaded to the GTC.

- Send a copy of all completed 1099 forms to the IRS with a transmittal Form 1096 by the end of January. If the government files over 250 Form 1099’s, filing must be done electronically.

- Verify that all Forms W-2 and W-3 sum up to the totals listed on the Form 941, or be aware of the differences between the two sets of numbers.

Example

**Calculation of FMV Approach** - The Public Safety Director for a local government drives a county vehicle that has a value more than $28,000. Therefore, the employee must record as personal income the proportion of the personal use of the car multiplied by its annual lease value of $7,750 (This amount comes from the annual lease value table in Publication 15-B). The proportion of his personal use was 80%, so the government must record 80% of $7,750, or $6,200, as his gross income associated with his use of the car.
**W-2 Form**

The W-2 form contains the information needed by employees to file their annual income tax returns with the government. It itemizes the various types of income paid by the employer to the employee during the past calendar year.

The W-2 form must be sent to the employees no later than January 31 following the year for which the form is being provided. Copies of these completed forms must also be sent to the Social Security Administration, along with a transmittal form. For the latest W-2 form visit [www.irs.gov](http://www.irs.gov) Forms and Publications.

The employer fills out the form by listing the employer’s name, address, and identifying information in the upper left corner of the form, followed by the same information for the employee in the lower left corner. The right side contains many numbered blocks in which the various types of wages paid are listed. The following list describes the most commonly used boxes in the form:

- **Box #1 - Wages, tips, other compensation** - Include in this box the total amount of all wages, salaries, tip income, commissions, bonuses, and other types of compensation paid to the employee.
- **Box #2 - Federal income tax withheld** - The federal income taxes withheld by the government from the employee’s pay are recorded here.
- **Box #3 - Social Security wages** - The total amount of compensation paid that is subject to Social Security taxes should be listed here.
- **Box #4 - Social Security tax withheld** - List the total amount of Social Security taxes withheld for the calendar year in this box.
- **Box #5 - Medicare wages and tips** - The total amount of all compensation paid during the year should be listed here. Unlike Social Security, there is no upper limit on the wages on which Medicare taxes are paid, so in most cases, the number listed in this box will be the same as the one listed in Box 1.
- **Box #6 - Medicare tax withheld** - List the total amount of Medicare taxes withheld for the calendar year in this box.
- **Box #12c - Cost of group term life insurance over $50,000** - As explained earlier in the “Life Insurance” section, the value of all life insurance purchased by an employer on behalf of its employees in excess of $50,000 must be reported as income.
- **Boxes 15-20** - State and local wage and income tax withholding information is listed across the bottom of the form and is to be reported in these boxes.
The **1099 Form**

The 1099 form is issued to all suppliers/vendors to whom a business/government pays:

……at least $600 in rents, services (including parts and materials), prizes and awards, other income payments, medical and health care payments, crop insurance proceeds,…

This form must be issued to suppliers no later than January 31 of the year following the reporting year. This form is not used for wages paid to employees or for business travel allowances paid to employees. If there are travel related expenses that are under a non-accountable plan (no receipts, forms, etc. turned in) then the best treatment is most likely taxable wages for the employee on the W-2. Form 1099 is also not used for payments made to tax-exempt organizations. For a sample form 1099-MISC, visit [www.irs.gov](http://www.irs.gov) Forms and Publications.

The 1099 form is similar to the W-2 form in that the upper left corner of the form contains employer contact information and the lower left corner contains supplier contact information. The right side of the report contains a number of boxes for itemizing the types of payments made to suppliers. The most commonly used box is number 7, “Nonemployee compensation,” which is a catchall for the majority of payments made, unless they are specified in one of the other boxes. Box 4 is also needed if a tax identification number cannot be obtained from a supplier. If this is the case, the government must withhold 28% on payments made and report the withheld amount here.
CHAPTER 3 SUMMARY

1. There is a variety of compensation types as well as several forms that are used to report employee and contractor income.

2. The most simple and commonly used plan to calculate payroll is the hourly rate plan.

3. Calculation of pay using the hourly rate plan can be complicated by shift differentials, overtime, merit increases, etc.

4. A common approach for determining the hourly rate is to divide the total annual salary by 2,080 hours, which is calculated by multiplying 40 hours/week time 52 weeks in a year.

5. Overtime is a pay premium of 50 percent of the regular rate of pay that is earned by employees on all hours worked beyond 40 hours in a standard workweek.

6. Overtime pay is calculated based on physical hours worked and does not include vacation, holiday, sick time etc.

7. Back pay is wages that an employee would have earned had they been employed. In most cases, back pay is treated as regular wages for tax withholding purposes.

8. Expense reimbursements include costs to travel to and from government destinations using personal vehicles, lodging, meals and incidental expenses during travel and could include living costs for employees which are relocated.

9. Expense reimbursements to employees, for incurred expenses, while performing government services that have been properly substantiated within a reasonable period of time are not considered income to the employee by the IRS. There are two types of plans, accountable and non-accountable plans.

10. Tuition/education reimbursements related to an employee’s current job that either serve to maintain or improve the person’s skills for conducting that job are not considered income to the employee.

11. Typically, employee awards are not included in an employee’s gross income. Awards have to be tangible property and part of a meaningful presentation. If a government has a written plan that does not favor highly compensated employees then the exclusion can be up to $1,600; however, the norm is up to $400 per year.

12. Employer paid group term life insurance is not considered taxable income for the first $50,000 of the life insurance purchased. Imputed income must be calculated for any amount over the $50,000 and included in employee income. The imputed income is taxable for federal, FICA, Medicare, and state income tax purposes.
13. The basic rule for government vehicles is that the use of the asset is taxable income to the employee. However, there are exceptions to the rule.

14. There are several documents that the payroll staff must issue or process at the end of a calendar year associated with compensation. These include, but are not limited to, the W-2, 1099, Form G1003, 1096, and W-3.
CHAPTER 3 EXERCISE

Circle the correct answer.

1. The Carl Vinson Institute of Government (CVIOG) has just hired a new public service faculty assistant, at an annual salary of $56,000 per year. The Institute pays its employees on a biweekly schedule, which is 26 pay periods per year. The new employee starts work on the 8th day of March, which leaves four business days remaining in the pay period that he will work. Calculate the employee’s partial period compensation. (Hint: You are calculating pay for a partial period; therefore, convert the salary rate to an hourly rate.)

A. $107.68
B. $861.44
C. $969.12
D. $872.44

2. Assume J. Alexander works 55 hours during a standard workweek at an hourly wage of $25 per hour. Calculate the total compensation paid to Mr. Alexander.

A. $1,562.50
B. $1,375
C. $1,581.25
D. $1,621.50

3. The Carl Vinson Institute of Government is holding an employee awards ceremony. During the ceremony, certain employees receive a $250 Wal-Mart gift card in recognition of their respective achievements. The gift-card to the employee is:

A. Included in taxable gross income.
B. Not included in taxable gross income.
C. Reported to the employee on a 1099.
D. Not reported at all.

4. Assume group term insurance in the amount of $80,000 is purchased for a 58-year old employee who contributes $3/month to this benefit. The calculated imputed income is (refer to the table on page 3-5):

A. $113.80
B. $154.80
C. $118.80
D. $164.80
5. The calculated imputed income from #4 above would be taxable for which boxes of the W-2:

A. Boxes 1, 3, and 5  
B. Boxes 1 and 5  
C. Boxes 1 and 3  
D. The imputed income is not taxable.

6. An employee who uses a government vehicle for the following purpose(s) is not taxable:

A. Specialty use vehicle.  
B. Personal use vehicle  
C. A vehicle used for personal use occasionally  
D. A company car.

7. This form is used to report taxable income to employees:

A. W-3.  
B. 1099.  
C. W-2  
D. 1096.

8. This form is used to report nonemployee compensation:

A. W-3.  
B. 1099.  
C. W-2.  
D. 1096.

9. This form is used to transmit W-2s by the end of January to the Georgia Department of Revenue:

A. W-3.  
B. 1099.  
C. 1096.  
D. 1003.

10. This form is used to transmit W-2s by the end of January to the Social Security Administration:

A. W-3.  
B. 1099.  
C. 1096.  
D. 1003.
CHAPTER 4
BENEFITS

OBJECTIVES

There are a number of payroll issues related to payroll deductions, the taxability of benefits received and the reporting of those benefits to the IRS. This chapter addresses the issues of benefits as they relate to cafeteria plans, various types of medical insurance, leaves of absence, life insurance, pension plans, sick and disability pay and Workers’ compensation insurance. After completing this chapter, the participant should be able to:

- Calculate taxable income with cafeteria plans
- Recall insurance benefits
- Identify pension plan benefits
- Recall sick/disability pay
- Identify workers’ compensation benefits

CAFETERIA PLANS/BENEFIT BANKS

A cafeteria plan allows employees to pay for some benefits with pretax dollars so that the amount of taxable income to them is reduced. A comprehensive cafeteria plan includes a Flexible Spending Account (FSA) that allows employees to have money withheld from their pay on a pretax basis and stored in a fund, which they can request to reimburse their medical or dependent care expenses.

By having funds withdrawn from their pay prior to the calculation of taxes, employees will not pay any taxes (e.g., federal or state income taxes, Social Security taxes or Medicare taxes) on the withdrawn funds.

Example

Cafeteria Plan - J. Alexander is planning on having surgery this year that he knows will require out-of-pocket expenses of $800. Accordingly, at the beginning of the year, he elects to have a total of $800 deducted from his pay in equal installments over the course of the year. When he pays a co-payment, he keeps the receipt and forwards it to the payroll department or third party administrator which reimburses him.
Employees are only allowed to choose the total amount of their annual cafeteria plan deductions at the beginning of the plan year. They cannot change it again until the plan year has concluded unless there is a qualifying event. A qualifying event includes changes in an employee’s marital status, number of dependents (including adoptions) or the status of those dependents, change in residential address affecting eligibility for coverage, or the employment status of the employee or a spouse or dependent. The process when changes can be made by all employees is defined as open enrollment.

A problem for employers offering an FSA cafeteria plan is that employees may legally make claims against the fund that exceed the amount they have thus far contributed to the plan and then quit their job. When this happens, the government cannot seek recompense from the individual for the difference between the amount contributed into the fund and the amount paid out. A government is not allowed to alleviate this potential problem by forcing employees to accelerate the amount of their contributions beyond the present amount.

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**Example**

*Continued* - Assume J. Alexander earns **$50,000** per year. The total of all taxes taken out of his pay, including federal and state income taxes, Social Security and Medicare taxes is **27%**. His net take-home pay, after also taking out **$800** for the previously described medical expenses, is **$35,700**, which is calculated as **(($50,000 \times (1-27\%)) - $800)**. When he enrolls in the cafeteria plan and has **$800** removed from his pay on a pretax basis to pay for the medical expenses, his take-home pay, net of medical costs, increases to **$35,916**, which is calculated as **(($50,000 - $800) \times (1-27\%))**. The increase in his take-home pay of **$216** is entirely attributable to the removal of medical costs from his pay before tax calculations and deductions made.

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**Example**

*Continued* - Assume J. Alexander only had **$500** in out-of-pocket expenses related to his surgery. Consequently, he wants to reduce the amount of the cafeteria plan deductions being removed from his pay. He claims that there has been a change in his status because he changed residences midway through the year. This claim is denied by the person in the government who handles the health insurance because the change in residence did not alter his eligibility for coverage under the terms of the underlying medical insurance plan. Change of residence is not a valid reason to make the change outside of the open enrollment period.
INSURANCE BENEFITS

Insurance benefits may include medical, dental, vision and life insurance. The contribution made by the government to defray the cost of medical insurance is not considered income to employees.

COBRA - Under the terms of the Consolidated Omnibus Budget Reconciliation Act (COBRA), employees of private sector, state and local governments who lose their jobs have the right to accept continuing health insurance coverage, as long as the former employer had 20 or more employees in the prior year. If an employee is terminated, then he or she can accept coverage for an additional 18 months. If an employee becomes entitled to Medicare coverage or becomes divorced, then the coverage period extends to 36 months. If a spouse or dependent child of an employee loses coverage due to the death of an employee, then they can obtain coverage for up to 36 months.

An employer is required to give notice of potential COBRA coverage to employees within 14 days of a qualifying event. The affected people then have up to 60 days to elect to take COBRA coverage.

Click on the link United States Department of Labor Website for Frequently Asked COBRA Questions.

Life insurance - A common benefit offered to employees is group term life insurance. As discussed earlier, if the amount of the life insurance benefit exceeds $50,000, the government must report the incremental cost of the life insurance over $50,000 on the employee’s W-2 form as taxable income.

Leave of absence - The Family and Medical Leave Act (FMLA) entitles employees at private companies with 50 or more employees and all governmental agencies to take up to 12 weeks of unpaid leave (which may be taken sporadically) each year for a specified list of family and medical reasons. Only those employees who have worked for the employer for a total of at least 12 months and for at least 1,250 hours in the last 12 months are covered by the act. Valid reasons for taking the leave of absence include the birth or adoption of a child, serious illness, or caring for a family member with a serious illness.

During their absence, an employer must continue to provide medical insurance coverage if it had been taken by the employee prior to the leave of absence, though the employee can be charged for that portion of the expense that had been deducted from his or her pay prior to the leave. If the employee does not pay this portion of the expense within 30 days, the insurance can be cancelled for the remainder of the leave (15 days written notice must be provided), but it must be restored once the employee returns to work. If the terms of the medical insurance plan are changed by the government during the leave of absence, then the new terms will apply to the person who is on leave. Only medical insurance is subject to these provisions; other types of insurance, such as life and disability insurance, do not have to be maintained during the leave of absence.
Because of the large number of provisions of the FMLA and its cost impact on both the employer and employee, it is recommended that the employer fill out a formal, detailed response to a request for a leave of absence, copies of which should go into the employee’s file as well as to the employee. The Department of Labor has issued Form WH-382, Designation Notice (Family and Medical Leave Act) that covers the key provisions of the FMLA. Visit www.dol.gov, Agencies, Wage and Hour Division, Employers, Forms, DOL Forms, and Forms by Form Number to obtain a copy.

Upon returning from a leave of absence, an employee must be given the same or equivalent job, with the same level of pay and benefits that he or she had before the leave. However, no additional leave or seniority accrues during the term of an employee’s leave of absence.

PENSION PLAN BENEFITS

There are a variety of retirement plans available to governments, each of which has a slightly different treatment under the tax laws, resulting in varying levels of investment risk to the employee or different levels of administrative activity.

Qualified Retirement Plans - This plan is designed to observe all of the requirements of the Employee Retirement Income Security Act (ERISA), as well as all related IRS rulings. By observing these requirements, an employer can immediately deduct allowable contributions to the plan on behalf of plan participants. Also, income earned by the plan is not taxable to the plan. Participants can exclude from taxable income any contributions they make to the plan, until such time as they choose to withdraw the funds from the plan. There are two types of qualified retirement plans, which are as follows:

- Defined Contribution Plan - The employer is liable for a payment into a specific plan, but not for the size of the resulting payments from the plan to participants. The participant bears the risk of the results of investment of the monies that have been deposited into the plan. The annual combined contribution to this type of plan by both the participant and employer is limited to the lesser of $55,000 for
2018 or 100% of the participant's compensation. An example of a defined contribution plan is a 401(k) plan. Withdrawals from a 401(k) are intended to be upon retirement or the attainment of age 59 1/2, but can also be distributed as a loan (if the specific plan document permits it) or in the event of a disability or death.

- Defined Benefit Plan - This plan itemizes a specific dollar amount that participants will receive, based on a set of rules that typically combine the number of years of employment and wages paid over the time period that each employee has worked for the employer. An additional factor may be the age of the participant at the time of retirement. Funds received by participants in a steady income stream are taxed at ordinary income tax rates and cannot be rolled over into an IRA. The employer bears the risk of unfavorable investment returns that may require additional payments into the plan in order to meet the fixed payment obligations.

**Nonqualified Retirement Plans** - An example of a nonqualified retirement plan that many governments offer is the 457 plan which allows participants to defer up to $18,500 (for 2018) of their wages per year. It is restricted to the use of government and tax-exempt entities. Distributions from the plan are usually at retirement but can also be at the point of the employee’s departure from the organization, or a withdrawal can be requested on an emergency basis. A key difference between the 457 plan and the qualified retirement plans is that the funds deposited in the trust by the employer can be claimed by creditors, unless the employer is a government entity.

**SICK/DISABILITY PAY**

A typical plan allows for the accrual of a fixed number of sick days per year. When an illness forces an employee to stay home, the sick time accrual is used in place of work hours, so an employee is compensated for a normal number of working hours during his or her time off. Once all the accrued sick time is used up, an employee can use any remaining vacation time in order to continue being paid, but thereafter must take an unpaid leave of absence.

Additional wages may be paid from either short-term or long-term disability insurance plans, which are generally offered through third-party insurance providers. If the employer pays the entire cost of these insurance plans, then any benefits received from them by employees are taxable income to the employee. However, if the employees pay some portion of the cost of these plans with after-tax dollars, then only the employer-paid portion is recognized as taxable income to them. Alternatively, if employees pay for their share of these plans through a cafeteria plan, then they are doing so with before-tax dollars, which makes the proceeds from the insurance taxable.
Under a third-party liability insurance plan, if the insurance carrier transfers this responsibility to the employer, then the employer must report the amount of taxable liability income received by an employee on its W-2 form at year-end.

WORKERS’ COMPENSATION BENEFITS

Governments obtain Workers’ compensation insurance which provides their employees with wage compensation if they are injured on the job. The insurance may be provided by a state-sponsored fund or by a private insurance entity. The key issue from the payroll perspective is in calculating the cost of the Workers’ compensation insurance. This calculation occurs once a year when the insurer sends a form to the employer asking it to list the general category of work performed by the various groups of employees as well as the amount of payroll attributable to each category.

Example

Assume an employee is out on short-term disability and is being paid $350/week. The employee had been paying 40% of the cost of short-term disability insurance, with the employer paying the remainder of this cost. Of the $350, 60% (amount of premium paid by employer) will be recognized as taxable income, which is $210/week.
CHAPTER 4 SUMMARY

1. A cafeteria plan allows employees to pay for some benefits with pretax dollars so that the amount of taxable income to the employee is reduced.

2. A Flexible Spending Account (FSA) allows employees to have money withheld from their pay on a pretax basis.

3. Employees are only allowed to choose the total amount of their annual cafeteria plan deductions at the beginning of the plan year.

4. Employees may legally make claims against their FSA that exceed the amount they have thus far contributed to the plan and then quit their job. A government is not allowed to accelerate employee contributions beyond the present amount.

5. Insurance benefits include medical, dental, vision and life insurance. Employer contributions made to defray the cost of medical insurance is not considered income to the employees.

6. The Consolidated Omnibus Budget Reconciliation Act (COBRA) provides for the continuation of health insurance coverage for employees who have lost their jobs or terminated employment. Normally, the coverage is for 18 months; however, coverage can be extended to a total of 36 months under certain limited circumstances.

7. Group term life insurance is a common benefit offered to employees. A problem with group-term life insurance that is paid for by the employer is that the IRS requires the employer to report as taxable income to the employee the amount of the benefit that exceeds $50,000 of life insurance (imputed income).

8. The Family and Medical Leave Act (FMLA) entitles employees at private companies with 50 or more employees and all government agencies to take up to 12 weeks of unpaid leave each year for a specified list of family and medical reasons. To be eligible an employee has to have worked for the employer for a total of at least 12 months, including a minimum of 1,250 hours in the last 12 months.

9. There are a variety of retirement plans available to governments, each of which has a slightly different treatment under the tax laws, resulting in varying levels of investment risk to the employee or different levels of administrative activity.

10. There are two types of retirement plans, qualified and nonqualified. A qualified plan is a plan that meets all of the requirements of the Employee Income Security Act (ERISA), and Section 401(A) of the Internal Revenue Code. Examples of a qualified plan include a defined contribution plan and a defined benefit plan. An example of a nonqualified plan is a 457 plan.
11. An employee may receive sick pay when an illness forces them to stay home. Once all accrued sick time is used up, an employee can use remaining vacation time, but thereafter must take an unpaid leave of absence.

12. Sick pay may include both short-term and long-term benefits and is usually a percentage of an employee’s regular wages. Typically, sick pay benefits are taxable income to the employee; however, it depends upon who is paying the premiums (employer/employee) and if the premiums are paid with before or after-tax dollars.

13. Workers’ compensation is a wage benefit governments provide to their employees if they are injured on the job.
CHAPTER 4 EXERCISE

Circle the correct answer.

1. A comprehensive cafeteria plan includes a Flexible Spending Account (FSA) that is available for:

   A. Commuting expenses.
   B. Dependent care expenses.
   C. On-the-job training expenses.
   D. Educational expenses.

2. A benefit of a cafeteria plan is that it allows employees to: (Select all that apply)

   A. Reduce their federal and state taxable wages.
   B. Reduce their Social Security and Medicare taxable wages.
   C. Make less money.
   D. Purchase meals at a reduced rate.

3. An employee is allowed to choose the total amount of their annual cafeteria plan deductions:

   A. At any time during the year.
   B. Only at the beginning of the plan year or open enrollment.
   C. Open enrollment and during the year for a qualifying event.

4. In the event an employee makes claims against his or her flexible spending account that exceeds amounts thus far contributed to the plan and then terminates employment, the employer:

   A. Should accelerate the employee’s contribution beyond the present amount and withhold the full amount due from the employee’s last check.
   B. Should promptly notify the third party administrator that the employee is no longer entitled to the benefits and inactivate the flexible spending account.
   C. Should work out a payment plan with the employee to recover the claims in excess of payroll contributions.
   D. Should consult with legal counsel and notify the IRS.
5. Employees of state and local governments that have terminated their employment have the right to accept continuing health insurance coverage under the:

A. ERISA Act.
D. Consolidated Omnibus Budget Reconciliation Act.

6. An employer, under federal law, is required to give notice of continuing health insurance coverage to terminated employees:

A. Within five days of a qualifying event.
B. Within seven days of a qualifying event.
C. Within ten days of a qualifying event.
D. Within fourteen days of a qualifying event.

7. What qualifies an employee for benefits under the Family and Medical Leave Act?

A. At least 12 months working with the employer, with 1,250 hours worked within the last 12 months.
B. 1,250 hours worked within the last 12 months.
C. At least 24 months working with the employer, with 1,250 hours worked within the last 12 months.
D. 1,000 hours worked within the last 12 months.

8. How many weeks of unpaid leave must an employer let an employee take under the FMLA?

A. Six weeks.
B. Eight weeks.
C. Ten weeks.
D. Twelve weeks.
9. Assume an employee earns $50,000 per year. The total of all taxes taken out of his pay, including federal and state income taxes, Social Security and Medicare taxes is 27%. The employee has the following cafeteria plan deductions: Medical Insurance - $1,200, FSA - $600, Dental Insurance, $350, and Vision Insurance $175. Additionally, the employee has $600 in garnishments and $26 in United Way deductions. Calculate the employee's net take-home pay for the year:

A. $34,802.75  
B. $34,345.77  
C. $34,176.75  
D. $33,549.00

10. A cost paid by the employer to cover an employee work related injury is:

A. Unemployment insurance.  
B. Health insurance.  
C. Workers’ compensation insurance.  
D. Hazard insurance.

11. Assume an employee is out on short-term disability and is being paid $500/week. The employee had been paying 40% of the cost of short-term disability insurance, with the employer paying the remainder of this cost. Calculate the taxable amount of the benefit to the employee:

A. $500/week.  
B. $200/week.  
C. $300/week.  
D. Disability income is not taxable.

12. An example of a nonqualified retirement plan is a:

A. 401 (k)  
B. 401 (a)  
C. 457  
D. All of the above.

13. In 2018, a 457 plan allows participants to defer wages up to:

A. $12,500 per year.  
B. $15,000 per year.  
C. $15,500 per year.  
D. $18,500 per year.
14. The employer bears the risk of unfavorable investment returns in a:

A. Defined contribution plan.
B. Defined benefit plan.
C. Nonqualified retirement plan.
D. 457 plan.

15. This plan itemizes a specific dollar amount that participants will receive, based on a set of rules that typically combine the number of years of employment and wages paid over the time period that each employee has worked for the employer.

A. Defined contribution plan.
B. Defined benefit plan.
C. Nonqualified retirement plan.
D. 401 (k).
CHAPTER 5
PAYROLL TAXES AND REMITTANCES

OBJECTIVES

Calculating and remitting a variety of payroll taxes is a function central to the payroll department. This chapter covers the purpose and instructions for filling out several tax-related IRS forms, as well as the remittance instructions for federal and state income taxes, Medicare taxes, and Social Security taxes. After completing this chapter, the participant should be able to:

- Recall how to fill out the W-4 form
- Calculate Social Security taxes, Medicare taxes and State income taxes
- Recall the process for remitting federal taxes
- Identify the 941 form

W-4 FORM

When an employee is hired, he or she is required by law to fill out a W-4 form which can be done either on paper or in an electronic format. An employee uses this form to notify the payroll staff of his or her marital status and the number of allowances to be taken; this information has a direct impact on the amount of income taxes withheld from the employee’s pay. If the employee is filing exempt from withholding status, a new W-4 is required every year by February 15. For reference to a Form W-4, go to Chapter 2 for previous discussion.

There are two pages associated with the Form W-4. In the middle of the first page is a personal allowances worksheet; the actual form is at the bottom. The second page is used by only those taxpayers who plan to itemize their deductions, claim certain credits, claim adjustments to income on their next tax return, or two-earners/multiple job situations.
**W-4 Employer Safety Tips**

1. Don’t give tax advice to employees - give the employee a copy of IRS Publication 919: How Do I Adjust My Tax Withholding?

2. Do not accept an invalid W-4 form from an employee. If the employee refuses to present a valid W-4, the employer must either:
   - Keep withholding according to the most recent valid W-4 form on file for the employee;
   - If the employee is a new hire, withhold as if the employee were single with zero withholding allowances (IRS Publication 15).

3. A percentage makes the W-4 invalid (Publication 15).

4. Don’t take tax payments from employees.

*Source: Rockhurst University Continuing Education Center, Inc.*

**PAYROLL TAXES**

**Federal Income Taxes**

An employer is required by law to deduct income taxes from employee pay. If the employer calculates payroll internally and manually, then the employer needs the wage bracket tax tables published by the IRS. These tables are contained within Publication 15, Employer’s Tax Guide (Circular E), which can be downloaded from the IRS website at [www.irs.gov](http://www.irs.gov), Forms and Publications. These tables are published for a variety of scenarios, such as for single or married employees, a variety of payroll periods, and for withholding allowances numbering from 0 to 10.

**Sick Pay**

In general, sick pay made to employees requires all of the Social Security, Medicare and income tax withholdings that are calculated for normal wages; however, there are few exceptions. For example, if an employee dies and sick pay is made to his or her estate in the following calendar year, this amount is not subject to any of the usual payroll withholdings or taxes. The same rules apply if sick payments are made to an employee who has been absent from work for at least six months. See IRS Publication 15-A, Employer’s Supplemental Tax Guide.
Social Security Taxes

The Federal Insurance Contribution Act (FICA) requires governments to withhold part of an employee’s earnings. Employers are required to withhold 6.2 percent of each employee’s pay, which is forwarded to the government Social Security fund. The employer must also pay 6.2 percent, so the total remittance to the government is 12.4 percent. This withholding applies to the first $128,400 (for 2018) of employee pay in each calendar year, though this number increases regularly by act of Congress.

Example

*Calculation* - Assume J. Alexander earned $150,000 in calendar year 2015. He wants to know how much Social Security tax will be deducted from his pay in that year, so he can budget cash flow. The calculation is as follows:

<table>
<thead>
<tr>
<th>Total annual pay</th>
<th>$150,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total annual pay subject to the Social Security Tax</td>
<td>$128,400</td>
</tr>
<tr>
<td>Tax rate 6.2 percent</td>
<td></td>
</tr>
<tr>
<td>Social Security taxes to be withheld</td>
<td>$7,961</td>
</tr>
</tbody>
</table>

Medicare Taxes

In addition to the Social Security tax, employers are required, under the FICA, to withhold 1.45 percent of each employee’s pay, which is forwarded to the government Medicare fund. The employer must also match this amount, so the total remittance to the government is 2.9 percent. This withholding applies to all employee earnings during the year, with no upper limit. However, in addition to withholding Medicare tax at 1.45%, you must withhold a 0.9% additional Medicare tax from wages you pay to an employee in excess of $200,000 in a calendar year. There is no employer share of additional Medicare Tax. Moreover, all wages that are subject to Medicare tax are subject to additional Medicare tax withholding if paid in excess of the $200,000 withholding threshold.

State Income Taxes

The state of Georgia requires income tax withholdings from its employees. O.C.G.A. 48-7-102 requires employees to complete and submit Form G-4 to the employer in order to have state taxes withheld from employee wages. By correctly completing this form, employees can adjust the amount of tax withheld to meet their tax liability. If an employee fails to submit a properly completed Form G-4, the employer should withhold taxes as though the employee were single with zero allowances. Employers are required to mail any Form G-4 claiming more than 14 allowances or exempt from withholding to

5-3
the Georgia Department of Revenue for approval. Employers should honor the form as submitted pending notification from the Withholding Tax Unit. Upon approval, such forms remain in effect until changed or until February 15 of the following year. Instructions for accessing Form G-4 are found in Chapter 2.

Article 2 of Chapter 2 of Title 48 of the Official Code of Georgia allow the commissioner to require any payment of $500 or more for sales tax, withholding tax, or motor fuel distributor tax electronically. The Georgia Taxpayer Center, (GTC), has been established for electronic submissions of payroll tax related returns as well as to accept electronic payments to fulfill this element of the law.

REMITTING FEDERAL TAXES

Once Social Security, income tax and Medicare taxes have been withheld from an employee’s pay, they are essentially the property of the federal government; the employer is merely holding them in escrow until the next required remittance date. Taxpayers are required to deposit all depository taxes electronically using the Electronic Federal Tax Payment System (EFTPS). Employers can enroll in EFTPS online at www.eftps.com. Assuming that an employer processes its own payroll, it must then determine the frequency with which it remits tax deposits to the federal government. Deposits can be made in three ways:

1. On a monthly basis - Under this approach, employers must deposit its payroll taxes no later than the fifteenth day of the month following the reporting month. This method can be used only if the total amount of deposits during the lookback period is less than $50,000. The lookback period is the four previous quarters during which deposits were reported on Form 941, beginning with July 1 and ending on June 30 of the previous year. Included in the total amount is all Social Security, federal income and Medicare taxes withheld during the lookback period.

2. On a semiweekly basis - The government makes it mandatory to use the semiweekly deposit schedule if the dollar volume of taxes during the annual lookback period exceeded $50,000. Semiweekly refers to two possible dates in each week by which deposits must be made if a payroll payment date falls within that week. If a payment date falls on a weekend, Monday or Tuesday, then the deposit must be made by the following Friday. If the payment date falls on a Wednesday, Thursday or Friday, then the deposit must be made by Wednesday of the following week. One additional business day is added to this schedule if the day by which a deposit is required falls on a banking holiday.
3. **$100,000 Next-Day Deposit Rule** - If you accumulate $100,000 or more in taxes on any day during a monthly or semiweekly deposit period, you must deposit the tax by the next business day, whether you are a monthly or semiweekly schedule depositor. If you are a monthly schedule depositor and accumulate a $100,000 tax liability on any day, you become a semiweekly schedule depositor on the next day and remain so for at least the rest of the calendar year and for the following calendar year.

### Federal Tax Deposit Penalties

The IRS imposes significant penalties if a business does not make its tax deposits on time or makes insufficient deposits. The penalty structure is:

- 2 percent penalty if deposits are made from one to five days late
- 5 percent penalty if deposits are made 6 to 15 days late
- 10 percent penalty if deposits are made more than 15 days late
- 10 percent if paid directly to the IRS or paid with your tax return
- 15 percent penalty if funds have not been remitted at least 10 days after the IRS sent a payment warning notification

Penalties can be avoided for very small payment shortfalls. Penalties will not be applied for depositing less than 100% if the deposit shortfall does not exceed the greater of $100 or 2% of the amount of taxes otherwise required to be deposited, and the deposit shortfall is paid or deposited by the shortfall makeup date. The makeup date for monthly depositors is the due date of its next Form 941. A semiweekly depositor must deposit by the first Wednesday or Friday (whichever comes first) that falls on or after the 15th of the month following the month in which the shortfall occurred or the due date of the next Form 941.

If an employer does not file its quarterly Form 941 in a timely manner, it will be penalized 5 percent for the amount of all net unpaid taxes shown on the return for each month during which the form is not filed. This penalty is capped at 25 percent, which essentially means that a business will be penalized for the first five months during which it does not file a Form 941.
EMPLOYER’S QUARTERLY FEDERAL TAX RETURN

Form 941 must be filed by employers on a quarterly basis with the federal government. This form identifies the amount of all wages on which taxes are withheld, the amount of taxes withheld, and any adjustments to withheld taxes from previous reporting periods. Taxes to be reported on this form include income taxes withheld from wages, including tips, supplementary unemployment compensation benefits and third-party payments of sick pay, plus Social Security and Medicare taxes. Visit [www.irs.gov](http://www.irs.gov), Forms and Publications, Form 941 to obtain the form as well as instructions for completion.

Form 941-X should be used for prior period adjustments to income, Social Security and Medicare taxes reported on Form 941. Form 941-X is not used for current period adjustments.

If an employer is making a payment with Form 941, it must use the Form 941-V Payment Voucher to accompany the payment. It is often a good idea to compare all four quarters of the 941’s with the W-2 reports in the payroll computer system before issuing W-2s to handle any reconciliation problems timely.
CHAPTER 5 SUMMARY

1. The Form W-4 is completed by each employee, preferably every year, and it contains the number of withholding allowances that they want to claim. Every employee should complete a W-4 when hired; however, if they do not complete the form then the government would withhold income taxes as though the person were single, with zero withholding allowances (which results in the maximum possible income tax withholding).

2. If an employee is filing exempt from withholding status, a new W-4 is required every year by February 15.

3. Generally, sick pay is reported as taxable income to the employee; however, there are a few exceptions. If an employee dies and sick pay is made to his or her estate in the following calendar year, the amount is not subject to any of the usual payroll withholdings or taxes. Moreover, the same rules apply if sick payments are made to an employee who has been absent from work for at least six months.

4. The Federal Insurance Contributions Act (FICA) governs the social security tax rate. Presently, employers are required to withhold 6.2% of each employee’s pay. The employer must also pay 6.2 percent, so the total tax remitted to the government by the employer is 12.4 percent. The social security tax rate is only applied to a person’s wages up to the amount of the wage base cap. This amount changes regularly by an act of Congress and is $128,400 for tax year 2018.

5. The Medicare tax rate that is paid by an employee is 1.45 percent (plus matching of the same amount by the employer), so the total remittance to the government is 2.9%. There is no upper limit; therefore, everyone must pay the tax, irrespective of the amount of money that they earn. In addition to withholding Medicare tax at 1.45%, you must withhold a 0.9% additional Medicare tax from wages you pay to an employee in excess of $200,000 in a calendar year. However, there is no employer share of additional Medicare tax.

6. The state of Georgia requires income tax withholdings from its employees. The Form G-4 is used by an employee to adjust the amount of tax withheld to meet their tax liability. Failure to submit a completed Form G-4, results in the maximum possible income tax withholding. A Form G-4 claiming more than 14 allowances or exempt from withholding is required to be submitted to the Georgia Department of Revenue for approval.

7. Social Security, income tax and Medicare taxes that have been withheld from an employee’s pay are essentially the property of the federal government. All taxpayers must deposit all depository taxes electronically using the Electronic Federal Tax Payment System (EFTPS). A government that processes its own payroll must determine the frequency with which it remits tax deposits to the
federal government (i.e., monthly basis, semiweekly basis, $100,000 next-day deposit rule).

8. The IRS imposes significant penalties if a business does not make its tax deposits on time or makes insufficient deposits. The penalty structure ranges from 2 percent to 15 percent of the tax liability.

9. Form 941 must be filed by employers by the last day of the month following the calendar quarter to which it applies. This form reconciles an employer’s total tax liability with deposits remitted.

10. Form 941-X should be used for prior period adjustments to income, Social Security and Medicare taxes reported on Form 941. Form 941-X is not used for current period adjustments.
CHAPTER 5 EXERCISE

Circle the correct answer.

1. Which employment tax is not required to be withheld from employee paychecks?
   A. Federal income tax.
   B. Social Security.
   C. Medicare.
   D. State unemployment tax.

2. What is the maximum amount of earnings that are subject to Social Security tax in calendar year 2018?
   A. $106,800.
   B. $128,400.
   C. $125,000.
   D. $130,200.

3. What are the three federal employment tax deposit schedules?
   A. Monthly, semi-annual and $100,000 Next-Day Deposit Rule
   B. Semi-weekly, semi-annual and $100,000 Next-Day Deposit Rule
   C. Monthly, semi-weekly and $100,000 Next-Day Deposit Rule
   D. Weekly, monthly and $100,000 Next-Day Deposit Rule

4. What is the period used to determine whether an employer pays employment taxes on a semi-weekly, monthly or $100,000 Next-Day Deposit Rule basis?
   A. The lookback period.
   B. The payback period.
   C. The loopback period.
   D. The payloop period.

5. A “monthly schedule depositor” refers to:
   A. How often a business pays it employees.
   B. How often a business is required to make tax deposits.
   C. The set of deposit rules that apply to an employer.
   D. The date on which an employer pays its employees.
6. The combined rate for the social security tax and the Medicare tax to be withheld from each employee’s gross wages up to $128,400 in 2018 is:

A. 7.65%.
B. 5.65%.
C. 4.2%.
D. 1.45%.

7. The 2018 rate for the social security tax (excluding the Medicare tax) that is withheld from employee wages up to a specific annual amount is:

A. 5.65%.
B. 7.65%
C. 6.2%.
D. 1.45%.

8. The monthly deposit schedule is designed for an employer that:

A. Reported more than $50,000 of taxes during a lookback period.
B. Reported $50,000 or less of taxes during a lookback period.
C. Pays its employees once a month.
D. Uses direct deposit to pay its employees.

9. If an employer makes a tax deposit 10 days late, the penalty amount is:

A. 5%.
B. 2%.
C. 10%.
D. 15%.

10. If an employee is filing exempt from withholding status, a new W-4 is required every year by:

A. January 15.
B. January 31.
C. February 15.
D. April 15.
11. An employer has computed the following amounts for its employee J. Alexander during a week in February 2018: gross wages $500; FICA tax w/h $38.25; federal income tax w/h $67.25; state income tax w/h $20.00; unemployment taxes $24; workers’ compensation insurance $5.00. Compute the amount of J. Alexander’s net pay:

A. $345.50.
B. $350.50.
C. $374.50.
D. $355.50.

12. The government’s total expenditure for its employee J. Alexander based on the information in question 11 above is:

A. $505.
B. $529.
C. $567.25.
D. $557.50.

13. If an employee fails to submit a properly completed Form G-4, the employer should withhold taxes as though the employee:

A. Were single with two allowances.
B. Were single with zero allowances.
C. Were single with one allowance.
D. Not withhold taxes until a completed Form G-4 is received.

14. The form that identifies the amount of all wages on which taxes are withheld, the amount of taxes withheld, and any adjustments to withheld taxes from previous reporting periods is:

A. 941-X.
B. 941.
C. G-4.
D. W-9.

15. Monthly and semiweekly schedule depositors must use the next-day deposit rule if they accumulate a tax liability:

A. Greater than $50,000.
B. Less than or equal $50,000.
C. Greater than or equal to $100,000.
D. Less than or equal to $100,000.
16. W-4 Employer Safety Tips include:

A. Provide tax advice to employees.
B. Do not take tax payments from employees.
C. Withhold as if the employee were single with zero withholding allowances in the event that the employee does not provide a valid W-4.
D. Do not take tax payments from employees and Withhold as if the employee were single with zero withholding allowances in the event that the employee does not provide a valid W-4.
CHAPTER 6
PAYROLL DEDUCTIONS

OBJECTIVES

There is a wide array of possible payroll deductions, most of which are at the behest of employees, but some required by court order. This chapter covers several possible payroll deductions; it gives an overview of each item, discusses the problems associated with each, and offers an example of how several might be administered. After completing this chapter, the participant should be able to:

• Calculate garnishments such as child support and unpaid taxes

• Recall how different deductions are handled such as advances

• Identify how to document payroll deductions

WHAT IS A GARNISHMENT?

A garnishment is the withholding of a specified amount from a person’s wages in order to satisfy a legal claim or an obligation to a creditor. A garnishment order usually relates to either child support, unpaid taxes, or unpaid student loans. Title III of the Consumer Credit Protection Act limits the amount of an employee’s earnings that may be garnished and protects an employee from being fired if pay is garnished for only one debt. However, Title III does not protect an employee from discharge if employee’s earnings have been submitted to garnishment for a second or subsequent debt.

Title III applies to all employers and to those individuals receiving personal earnings, for example, wages, salaries, commissions, bonuses, or other income—and includes earnings from a pension or retirement program. Tips are generally not considered earnings for the purposes of the wage garnishment law. The law applies in all 50 states, the District of Columbia, and all U.S. territories and possessions.

Title III also provides definitions for key terms used in the garnishment process. One of those terms is disposable earnings. Understanding what makes up disposable earnings is crucial in determining the amount of garnishment that can be withheld from an employee’s paycheck.

The maximum wages that can be deducted for child support orders, creditor garnishments, and student loan garnishments are based on an employee’s disposable
earnings. Disposable earnings are defined as the amount of earnings left after legally required deductions have been made. Examples of these legally required deductions include federal, state and local taxes, social security, unemployment insurance, and state employee retirement systems.

Those deductions not required by law, such as union dues, health and life insurance, and charitable contributions are not subtracted from gross earnings when the amount of disposable earnings for garnishment purposes is calculated. However, it is important to note that Title III’s restrictions on the amount of wages that can be garnished do not apply to certain bankruptcy court orders and debts due for federal and state taxes. Nor do they affect voluntary wage assignments, i.e., situations where workers voluntarily agree that their employers may turn over a special amount of their earnings to a creditor or creditors.

**Example**

<table>
<thead>
<tr>
<th>Gross Wages</th>
<th>$500</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less:</td>
<td></td>
</tr>
<tr>
<td>Federal Tax</td>
<td>(120)</td>
</tr>
<tr>
<td>Social Security and Medicare Tax</td>
<td>(50)</td>
</tr>
<tr>
<td>State Unemployment and Disability Insurance Tax</td>
<td>(20)</td>
</tr>
<tr>
<td>State Employee’s Retirement</td>
<td>(10)</td>
</tr>
</tbody>
</table>

**Disposable Earnings** $300

Gross Wages includes all wages and salaries, as well as, non-cash compensation such as meals and lodging and cash value of automobiles and gas provided by employer.

Under the Consumer Credit Protection Act, the maximum percentage of disposable earnings that can be deducted to satisfy a creditor garnishment is 25 percent of the employee’s disposable earnings for the week or the amount by which the employee’s disposable earnings for the week exceed 30 times the federal hourly minimum wage of $7.25, or $217.50. If a state’s laws are more favorable to the employee by requiring lower maximum amounts to be withheld from disposable earnings, the lower amounts would have the force of law.

Title III of the Consumer Credit Protection Acts is administered by the Wage and Hour Division of the U.S. Department of Labor’s Employment Standards Administration. The Wage and Hour Division has no authority with regard to garnishments. For example, questions regarding the priority given to certain garnishments over others are not covered by Title III and should be referred to the court or agency initiating the garnishment action.
If you receive a garnishment order, you should complete the following steps:

1. Return a response form, stating whether you can begin the garnishment and the amount to be paid.

2. Use the garnishment calculation worksheet that accompanies the order to determine the amount to be garnished. There is a cap on the amount of an employee’s wages that can be garnished. Federal law limits the sum of all garnishments to 25 percent of an employee’s disposable pay. Moreover, there is a base amount of income that is protected from garnishment that is based on the minimum wage earned per week.

3. Set up the garnishment transaction in the payroll system with a stop date that is based on either the termination date listed in the order, or on the date when the garnishment amount (goal amount) is paid in full.

4. Set up a procedure to notify the accounts payable staff when garnishments are to be paid, the amount to be paid, and to who they are to be paid.

The payroll department of a larger government may have a considerable number of active garnishment orders. With the advent of technology and sophisticated payroll processing systems, the management of garnishments should not be as labor intensive as once before. Regardless, the payroll department should ensure that a system of checks and balances is in place to maintain a schedule of these orders, itemizing the remaining balance on each one, the amount deducted in each successive payroll, and the date when each garnishment amount is completed.

The payroll department is responsible for ensuring compliance with garnishment orders in all aspects. For example, if the net pay of an employee changes, payroll personnel must alter the amount of the related garnishment accordingly. If the payroll staff fails to do so, the government may be liable to a third party for any wages that should have been garnished. Therefore, the payroll department should schedule a periodic internal audit review of garnishment payments to third parties, to ensure that there is a robust process of making the correct payments in a timely manner.

It is important to note that priorities and calculations differ among garnishment types. Let’s explore a few together.

**Child Support Garnishment**

The payroll staff will most likely see child support withholding orders at some point during his or her career. Tightly enforced federal laws require employers to withhold various amounts from the pay of employees. Garnishments must be handled immediately upon receipt. It cannot wait for the dozens of other tasks that may have come before it. Garnishments are time sensitive and failure to process the garnishment within the allotted time frame can lead to penalties for the government.
If an employer receives a document to withhold child support from a noncustodial parent’s (NCP) income that is not issued on the OMB-approved Income Withholding Order for Support (IWO) form as required by federal law, the employer must reject the document for withholding and return it to the sender.

The result will be that no child support is collected. The solution is to obtain and use the correct IWO form and other required documents.

Here is the flow of transactions which occur when receiving a garnishment. Every garnishment should be date stamped on the day it is received in the payroll area. This begins the audit trail and establishes the garnishment’s timeline for processing. Determine that this is a legal and valid garnishment. Once the garnishment has been determined to be valid, notify the employee of the garnishment so that this doesn’t come as a surprise to them on the next payday. Determine if the employee has other garnishments and if there is enough money in the employee’s paycheck to fulfill the garnishment, and then set up the deduction garnishment in the computerized payroll file. Normally, a file per garnishment is kept or sometimes a spreadsheet to track the details of what was deducted from the employee and when and what was remitted by the garnishee.

The maximum amount of an employee’s disposable earnings subject to child support withholding is 60 percent of his or her pay or 50 percent if the employee is already making payments to support other children or spouses. Both of these percentages increase by 5 percent if an employee is 12 or more weeks in arrears in making support payments.

To calculate disposable earnings, subtract all legally mandated deductions from an employee’s gross pay, such as federal and state income taxes, Social Security and Medicare taxes, and any locally mandated disability or unemployment taxes and state employee retirement systems. Voluntary deductions, such as dental and medical insurance deductions, are not used to calculate disposable income or disposable earnings.

Calculation - Assume a local government receives a court order to withhold child support payments from the pay of its employee J. Alexander, in the amount of $390 per weekly paycheck. The payroll manager needs to determine how much can actually be withheld from J. Alexander’s pay, who earns $850 per week and does not make support payments to another child or spouse. The employee’s typical paycheck remittance advice is

| Gross pay $850 | Disposable |
|-------------------------------------------------|
| Federal income tax $125 | $125 |
| State income tax $35 | $35 |
| Social Security tax $53 | $53 |
| Medicare tax $12 | $12 |
| Medical insurance $62 | $0 |
| 401(k) plan deduction $80 | $0 |
| Net pay $483 | $625 |
Continued calculation - Of the amounts listed on the remittance advice, the medical insurance and 401(k) deductions are voluntary and so cannot be included in the calculation of disposable earnings. This increases J. Alexander’s disposable earnings to $625. The payroll manager then multiplies this amount by 60%, which is the maximum amount of disposable earnings that can be remitted for child support. The result is $375, which is $15 less than the $390 listed on the court order. The payroll manager begins deducting and remitting $375 per week.

When a child support order is received, it takes precedence over all other types of garnishment orders, with the exception of tax levies that were received prior to the date of the receipt of the Income Withholding Order for Support (IWO). An employer must begin withholding the maximum allowable amount from an employee’s pay no later than the first pay period beginning 14 working days after the posted date of the court order, and must continue withholding funds until the order is rescinded by the court. Payment must be made within two business days after employee’s pay date.

Georgia law O.C.G.A. §19-6-33.1(c) requires that the Georgia Family Support Registry (FSR) collect and process all child support payments for:

- any case enforced by the Georgia Division of Child Support Services (DCSS), and
- all other support orders not enforced by DCSS that are subject to income deduction.

The FSR then disburses the funds to the recipient parent - payments never go straight to the parent. Instructions for remitting funds will be listed on the Income Withholding Order for Support (IWO); the employer should follow these instructions to the letter.

Governments can make child support payments online directly from a bank account, credit card or check. Payments are mailed to one of the following addresses:

- **Non-Custodial Parent** Family Support Registry
  P.O. Box 1600 Carrollton, GA 30112-1600
- **Employer or Private Attorney** Family Support Registry
  P.O. Box 1800 Carrollton, GA 30112-1800
- **Out of State Child Support Agency** Family Support Registry
  P.O. Box 1700 Carrollton, GA 30112-1700

If an employee changes employment before the obligations of the IWO are discharged, the employer is obligated to notify the issuing enforcement agency of the employee’s last known address, as well as the location of a new employer (if known). The agency needs this information to track the employee and continue to enforce the order.
If an employer chooses to ignore an IWO, it may be liable for the total amount that should have been withheld. This means that an employer must act promptly to begin withholding by the date specified in the order, and must withhold the full required amount, taking into account the rules noted earlier in this section.

Lastly, under Georgia law, O.C.G.A. §19-6-33(e)(5) an employer may charge an administrative fee up to $25 to establish the income deduction and up to $3 for each deduction thereafter.

**Garnishments for Unpaid Taxes**

If an employee does not pay his or her federal or local income taxes, the employer may receive a notification from the IRS to garnish that person’s wages in order to repay the taxes. The garnishment will cover not only the original amount of unpaid taxes, but also any penalties and interest expenses added by the government.

A garnishment for unpaid taxes takes priority over all other types of garnishments, except for child support orders that were received prior to the date of the tax garnishments. If a government receives orders from multiple taxing authorities to garnish an employee’s wages and there are not enough wages to pay everyone, then the orders are implemented in the order in which they were received.

The “Notice of Levy on Wages, Salary, and Other Income,” Form 668-W(c)(DO), is the standard form used for notifying employers to garnish an employee’s wages. This form has the following six parts:

- **Part 1.** This is for the employer. It states the employer’s obligations to withhold and remit the unpaid tax, and states the amount of unpaid tax.
- **Part 2.** This is the employee’s copy of the notification.
- **Part 3-4.** The employee must complete these pages and return them to the employer within three business days of receipt. The employer completes the back side of part 3 and returns it to the IRS with the first payment. Part 4 is kept by the employer.
- **Part 5.** The employee keeps this page, which includes tax status and exemption information.
- **Part 6.** The IRS keeps this page for its records.

If an employee fails to remit parts 3 and 4 of Form 668-W(c)(DO) to the employer, the employer is required to calculate the employee’s exempt amount of wages under the assumption that the person is married, filing separately with one exemption. The assumptions result in the smallest possible amount of exempt wages, so employees should be strongly encouraged to complete parts 3 and 4 in order to avoid having the maximum amount withheld from their pay.
When a Form 668-W(c)(DO) order is received to garnish an employee’s wages, the payroll staff must first determine if any wages are not subject to the order. Only 15 percent of the following types of wages are subject to tax payment order issued by the IRS, and they are completely exempt from an unpaid tax order issued by a state government:

- Armed forces disability benefits
- Pension and annuity payments as specified under the Railroad Retirement Act
- Unemployment compensation benefits
- Welfare and supplemental Social Security benefits
- Workers’ compensation benefits

Once these types of wages have been accounted for, the payroll staff must determine which deductions can be made from an affected employee’s pay before determining the amount of the tax levy. Generally, you can allow an employee to maintain any existing deductions when calculating the amount of pay subject to the garnishment. However, the IRS may disallow voluntary deductions from an employee’s pay in calculating the amount of the pay subject to the garnishment if these deductions are so large that they “defeat” the garnishment. Allowable deductions include:

- Federal and state income taxes
- Social Security and Medicare taxes
- Increases in deductions over which an employee has no control, such as medical insurance increase imposed by a health care provider
- Deductions required in order to be employed
- Deductions in effect prior to the tax garnishment notice, which can include deductions for medical, life and disability insurance, as well as cafeteria plan deductions

Once the applicable deductions have been used to reduce an employee’s wages to the amount that the tax levy will be applied, the payroll staff should use an IRS-supplied table to determine the amount of net wages that are exempt from the tax levy. See www.irs.gov, Forms and Publications, Publication 1494.
Example - J. Alexander has not been paying his federal income taxes, so his employer receives a notice from the IRS informing it that he owes the government $10,000 in back taxes. The employer is obligated to withhold this amount and remit it to the IRS. The payroll manager must calculate the amount of the tax levy to withhold from each paycheck. The employer obtains the following information from J. Alexander’s pay records:

<table>
<thead>
<tr>
<th>Weekly salary</th>
<th>$1,200</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal and state income taxes</td>
<td>$192</td>
</tr>
<tr>
<td>Social Security and Medicare taxes</td>
<td>$77</td>
</tr>
<tr>
<td>Medical insurance deductions</td>
<td>$40</td>
</tr>
<tr>
<td>Cafeteria plan deductions</td>
<td>$50</td>
</tr>
<tr>
<td>Net pay</td>
<td>$841</td>
</tr>
</tbody>
</table>

To calculate the amount of his net pay that is exempt from the tax levy, the payroll manager turns to the table provided in Publication 1494. A portion of the table is duplicated below.

<table>
<thead>
<tr>
<th>Filing Status: Head of Household</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pay Period</td>
</tr>
<tr>
<td>-----------</td>
</tr>
<tr>
<td>Daily</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Weekly</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Biweekly</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Semimonthly</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Monthly</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

J. Alexander is an unmarried head of household with four exemptions. For a weekly pay period, this gives him an exemption of $665.39. This means that $175.61 is subject to the tax levy, which is calculated as his net pay of $841, less the exemption of $665.39.

Once a Form 668-W(c)(DO) is received, the employer is obligated to begin withholding the mandated amount of taxes from an employee’s next paycheck, even if the applicable wages were earned prior to receipt of the form. The employer should forward the withheld amount to the IRS, with the employee’s name, Social Security number, kind of tax, tax period, and the words "LEVY PROCEEDS" noted on the check.
If the employee terminates his or her employment while the tax levy is still being deducted, the employer must notify the IRS of this event, and if possible, forward the name and address of the new employer to the IRS. If the employee continues to work for the same employer, the IRS will inform them when to stop making these deductions on a Form 668-D.

If an employer for any reason does not withhold and forward to the IRS the periodic garnishments required by Form 668-W(c)(DO), the employer will be held liable for the amounts that it should have withheld, in addition to incurring a stiff penalty.

**ADVANCES**

Employees who require more cash than they earn on their normal paychecks sometimes ask their employers for an advance on their pay. The most common type of advance is for the employee to receive funds for a business trip, for which the employee will be reimbursed once an expense report is submitted. In this case, it is most common to reimburse employees through the accounts payable system if there is a shortfall between the amount of expenses incurred and the original advance. However, if an employee neglects to turn in an expense report, then he or she is liable to the employer for the amount of the advance that was issued.

In all cases, the payroll staff must track the amount of outstanding advances and make deductions from employee paychecks to recover the amounts outstanding. Deductions frequently are made in smaller increments over multiple paychecks, so that employees have enough left for their personal needs. Managing this process properly calls for interaction with the accounts payable staff and the employees.

Standard policies should also be in place to regulate the amount of advances handed out, and the speed with which they must be paid back. Such policies serve to ensure that an employer does not become a personal bank for its employees and to minimize the risk of it losing outstanding advances if employees quit work before paying them back. The best practice to have regarding advances quite honestly is to not have them. However if you need them in your course of conducting government business, put the controls in place to oversee their repayment or “settling up” so that the employees don’t receive more than they are approved to receive.

**AUTHORIZATION**

A key item to remember for all voluntary deductions is that an employee’s written approval must be obtained for all of them to prevent employees claiming they never authorized a deduction. An employer should not automatically sign up employees for various benefits and have them only decline the benefit in writing, as then employees can state that they were never properly informed of the nature of the benefit.

Below is an example of a form that can be used to authorize deductions. This form should be kept in employee payroll files for immediate access in case an employee late
challenges the amount of a deduction. To keep these challenges from occurring, it is useful to have all deductions identified separately on the remittance advice that accompanies each paycheck.

**Deduction Authorization Form**

I hereby authorize that the following deductions be made from my pay:

<table>
<thead>
<tr>
<th>Deduction Type</th>
<th>Deduction Amount</th>
<th>Start Date</th>
<th>Stop Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cafeteria Plan - dependent</td>
<td>_____</td>
<td>_____</td>
<td>_____</td>
</tr>
<tr>
<td>Cafeteria Plan - medical</td>
<td>_____</td>
<td>_____</td>
<td>_____</td>
</tr>
<tr>
<td>Dental Insurance</td>
<td>_____</td>
<td>_____</td>
<td>_____</td>
</tr>
<tr>
<td>Dependent Life Insurance</td>
<td>_____</td>
<td>_____</td>
<td>_____</td>
</tr>
<tr>
<td>Long-Term Disability Insurance</td>
<td>_____</td>
<td>_____</td>
<td>_____</td>
</tr>
<tr>
<td>Medical Insurance</td>
<td>_____</td>
<td>_____</td>
<td>_____</td>
</tr>
<tr>
<td>Short-Term Disability Insurance</td>
<td>_____</td>
<td>_____</td>
<td>_____</td>
</tr>
<tr>
<td>Supplemental Life Insurance</td>
<td>_____</td>
<td>_____</td>
<td>_____</td>
</tr>
</tbody>
</table>

________________________ _______________________
Signature                  Date
CHAPTER 6 SUMMARY

1. There is a wide array of possible payroll deductions. A pay deduction is a subtraction from an employee’s gross or net pay. These deductions include benefits (i.e., employee-paid portion of insurance premiums), payments to third parties (i.e., charitable contributions, child support payments, garnishments), and financing situations (i.e., advances).

2. Garnishments must be handled immediately upon receipt as they are time sensitive and failure to process within the allotted time frame can lead to penalties for the government.

3. The maximum amount of an employee’s disposable earnings subject to child support withholding is 60 percent of his or her pay or 50 percent if the employee is already making payments to support other children or spouses.

4. Voluntary deductions, such as dental and medical insurance deductions, are not used to calculate disposable income or disposable earnings. However, there are some exceptions for IRS Tax Levies.

5. A child support order takes precedence over all other types of garnishment orders, with the exception of tax levies that were received prior to the date of the court order.

6. The most common type of advance is for the employee to receive funds for a business trip, for which the employee will be reimbursed once an expense report is submitted. However, if an employee neglects to turn in an expense report, the he or she is liable to the employer for the amount of the advance that was issued. Payroll staff must track the amount of outstanding advances and make deductions from employee paychecks to recover the amounts outstanding.

7. A garnishment for unpaid taxes takes priority over all other types of garnishments, except for child support orders that were received prior to the date of the tax garnishments.

8. If a government receives orders from multiple taxing authorities to garnish an employee’s wages and there are not enough wages to pay everyone, then the orders are implemented in the order in which they were received.

9. Upon receipt of a Form 668-W(c)(DO), the payroll staff must first determine if any wages are not subject to the order (i.e., armed forces disability benefits, unemployment compensation benefits, workers’ compensation benefits, etc.). Likewise, the payroll staff must determine which deductions (deductions required in order to be employed, deductions in effect prior to the tax garnishment notice, etc.) can be made from an affected employee’s pay before determining the amount of the tax levy.
10. A key item to remember for all voluntary deductions is that an employee’s written approval must be obtained to prevent employees claiming they never authorized a deduction.
CHAPTER 6 EXERCISE

Circle the correct answer.

1. A garnishment order does not relate to:
   A. Unpaid local taxes.
   B. Child support.
   C. Unpaid employer advances.
   D. Unpaid federal taxes.

2. Generally, the maximum amount of an employee’s disposable earnings subject to child support, provided the employee is not supporting a second family and is not in arrears, withholding is:
   A. 25 percent.
   B. 50 percent.
   C. 60 percent
   D. 70 percent

3. If the payroll staff receives a child support garnishment after other garnishment orders have been received:
   A. The child support garnishment is automatically considered to have the lowest priority.
   B. You should refer the order of priority to the county/city attorney.
   C. You should assign a higher priority to the child support garnishment.
   D. There is no change in the existing order of garnishment priorities.

4. Once a child support order is received, an employer must begin withholding the maximum allowable amount from an employee’s pay no later than:
   A. The first pay period beginning 14 working days after the posted date of the court order.
   B. The first pay period beginning 7 working days after the posted date of the court order.
   C. The first pay period following the end of a calendar quarter.

5. A garnishment for unpaid taxes takes priority over all other types of garnishments, except:
   A. Unpaid employer advances.
   B. Child support orders that were received prior to the notice of the tax levy.
   C. Unpaid employer advances and child support orders that were received prior to the notice of the tax levy.
6. Garnishments for unpaid taxes are reported to the employer on:

   A. Form 637.
   B. Form 668-W(c)(DO).
   C. Form 8821.
   D. Form 941.

7. Child support payments typically are remitted to:

   A. The recipient parent.
   B. The Family Support Registry (FSR).
   C. The local child support enforcement agency.
   D. The Department of Family and Children Services.

8. Disposable earnings for the purpose of child support withholding is defined as:

   A. Gross pay less involuntary and voluntary deductions.
   B. Gross pay less involuntary deductions.
   C. Gross pay less voluntary deductions.
   D. Gross pay less cafeteria plan deductions.

9. The following deductions are considered voluntary:

   C. Dental, medical insurance, 401 (k) plan, credit union and United Way.
   D. Dental, medical insurance, 401 (k) plan, credit union and unemployment taxes.

10. If an employee fails to remit parts 3 and 4 of Form 668-W(c)(DO) to the employer, the employer is required to calculate the employee’s exempt amount of wages under the:

    A. Assumption that the person is married, filing separately with one exemption.
    B. Assumption that the person is head of household with two exemptions.
    C. Assumption that the person is head of household with three exemptions.
    D. Assumption that the person is married, filing separately with two exemptions.
11. J. Alexander has not paid his federal income taxes for several years. Mr. Alexander’s employer, the City of Opportunity, receives a tax levy notice from the IRS. The city is required under the notice to garnish Mr. Alexander’s wages and forward the garnished amount to the IRS.

Mr. Alexander receives $5,000 in monthly pay. His current deductions from that pay are as follows: Federal and state income taxes - $413, Social security and Medicare withholding - $385, Medical insurance deduction - $125, and 401 (k) deduction - $100.

The city payroll coordinator refers to Publication 1494, which accompanied the tax levy notice, to determine how much of Mr. Alexander’s net pay is subject to the tax levy. Mr. Alexander claims a filing status as head of household, with three dependents. Please refer to the table on page 6-8 to determine the amount of Mr. Alexander’s net pay that is exempt to the levy:

A. $3,130.33.
B. $3,193.15.
C. $2,537.49.
D. $3,311.61.

12. Based on the information in exercise question 11 – if the City of Opportunity increases Mr. Alexander’s health insurance deduction because of a change in the premium charged by the health care provider, this is:

   A. An acceptable increase that will reduce the amount of net pay subject to the levy.
   B. An acceptable increase that has no bearing on the amount of net pay subject to the levy.

13. Based on the information in exercise question 11 – if Mr. Alexander subsequently increases the amount of his 401 (k) deduction, this is:

   A. An acceptable increase that will reduce the amount of net pay subject to the levy.
   B. An increase that will have no impact on the amount of net pay subject to the tax levy.
14. The following apply to the calculation of exempt employee income for a tax garnishment:

A. Apply garnishments to the newest tax assessment first.
B. Do not allow a deduction that is required in order to be employed.
C. Do not allow an increase in deductions over which an employee has no control.
D. Any new voluntary deductions to not reduce the amount of net pay subject to the tax levy.

15. When an employer receives a notice to garnish an employee’s wages, the payroll staff must first determine if any wages are not subject to the order. Wages such as unemployment compensation benefits, armed forces disability benefits, welfare and supplemental Social Security benefits are completely exempt from an unpaid tax order issued by a state government; however, only a percentage of these wages are subject to a tax payment order issued by the IRS. That percentage is:

A. 10 percent.
B. 12 percent.
C. 13 percent.
D. 15 percent.

16. What percentage of an employee’s disposable earnings can be deducted if the employee supports two families and is 12 or more weeks in arrears on child support?

A. 50%
B. 55%
C. 60%
D. 65%
CHAPTER 7
REPORTING AND RECORDING

OBJECTIVES


After completing this chapter, the participant should be able to:

- Recognize different components of the federal and state unemployment tax programs
- Identify the contributory and reimbursable unemployment tax options
- Recall the entry recorded when a payroll is posted to the general ledger

UNEMPLOYMENT TAX

Federal and state unemployment taxes are initiated in order to create unemployment funds which give former employees some money to tide them over until they can find work again. The laws supporting these actions are the Social Security Act and the Federal Unemployment Tax Act.

Benefits are paid by the state-sponsored programs. Georgia 2012 House Bill 347 amended Code Section 34-8-193 of Georgia Employment Security Law to create an adjustable number of maximum weeks of regular Unemployment Insurance (UI) eligibility to range from 14 to 20 weeks based upon a designated average statewide unemployment rate. The maximum number of weeks will change twice each calendar year dependent upon the average statewide unemployment rate published for April and October. The amount paid is based on the person's former pay, up to a low maximum level. The amount of benefits, their calculation, and the terms of payment vary by state programs.

This chapter reviews several components of the unemployment tax program, including the calculation of state unemployment taxes, the calculation of the contribution rate, and the reason for filing voluntary unemployment tax contributions. Federal unemployment tax is not applicable to state and local governments. See instructions for IRS Form 940 for details regarding federal unemployment.
State Unemployment Tax

State Unemployment Tax (SUTA) provides temporary income to replace a portion of wages lost by able-bodied workers who have lost their jobs. A key issue in this process is whether an employee was terminated for cause (such as theft), was laid off, or voluntarily resigned. Unemployment benefits are not paid when a person quits or is terminated for cause.

State Unemployment Tax (SUTA) in Georgia is computed on the first $9,500 of wages paid to each employee, full and part-time, and does not include elected officials. Elected officials for purposes of SUTA are defined as officials in non-tenured major policy making advisory positions which require less than eight hours of work a week; members of a legislative body or the judiciary; and, members of the state National Guard or Air National Guard except when called to federal duty.

SUTA must be computed on employee wages from the beginning of the year, even if SUTA liability is not triggered until later in the year. Governments must file Form DOL-4N quarterly to report their SUTA-taxable wages paid to each employee, and if required, to make payment of tax. Governments in Georgia have two options for payment of SUTA:

1. **Reimbursable** – the Georgia Department of Labor mails a quarterly bill for benefit payments. Governments are still required to report quarterly wages. However, payment of SUTA is made on a reimbursement basis.

2. **Contributory** – based on an experience rating system. Governments are required to report quarterly wages and make payment of SUTA.

To become eligible for the reimbursable account for the upcoming year, governments must contact the Commissioner of the Georgia Department of Labor by November 30, but regardless of the method chosen, the government must file a Form DOL-4N quarterly with the Georgia Department of Labor by the end of the month following the quarter end.

First quarter is due April 30th. Second quarter is due July 31st. Third quarter is due October 31st. Fourth quarter is due January 31st. To access Form DOL-4N, visit [www.dol.state.ga.us](http://www.dol.state.ga.us).
A government should carefully consider whether to participate as a reimbursable or contributory employer. The decision should be based on the estimated contributions as compared to the projected cost of reimbursements. If your jurisdiction rarely has an employee separate from employment, the reimbursable method may be a good option. If it is not uncommon to have separations, the contributory may be the best choice.

**RECORDING THE PAYROLL**

Usually a special journal (sometimes we call this accounting record a payroll register) for the payroll is used to record all of the payroll information for each employee. The data included on the payroll journal originates either from period employee time sheets or from the Personnel/Human Resources Department (usually at the beginning of the fiscal year) for salaried employees (i.e., an employee who receives an annual salary prorated equally over the fiscal year).

The following information is typically included in a payroll journal:

- Name of employee.
- Expenditure classifications.
- Gross payroll - The gross payroll of an employee is determined by contractual agreement (i.e., for those employees retained under contract) or by time sheets (i.e., for those employees under contract is derived by dividing the contract amount by the number of pay periods in the contract. Hourly employees’ gross payroll is computed by multiplying the hourly rate by the number of hours worked).
- Adjustments to gross payroll - There are instances when an employee’s normal gross payroll is reduced. An employee may take personal leave without pay, or an employee may use more than the allowable accumulated sick days, or may not perform the services as required by the contract. Occasionally, governments will authorize performance stipends that increase the amount of gross payroll.
- Adjusted gross payroll - This amount is the gross payroll plus or minus any adjustments to the gross payroll. This is the amount actually charged to the applicable expenditure accounts.
- Net payroll - The amount of adjusted gross payroll less total deductions—in other words, the amount the employee actually receives in his or her check.
After the payroll has been summarized, the information must be posted to the general ledger. Posting is usually done by recording the data directly from the payroll journal to the general ledger and the subsidiary expenditure ledger. The journal entry required to record the payroll follows:

<table>
<thead>
<tr>
<th>DR</th>
<th>CR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expenditure Control</td>
<td>$24,649</td>
</tr>
<tr>
<td>(Gross)</td>
<td>$1,866</td>
</tr>
<tr>
<td>FICA withheld (Deduction)</td>
<td>$4,897</td>
</tr>
<tr>
<td>Federal income tax</td>
<td>$1,275</td>
</tr>
<tr>
<td>withheld (Deduction)</td>
<td></td>
</tr>
<tr>
<td>State income tax</td>
<td>$786</td>
</tr>
<tr>
<td>withheld (Deduction)</td>
<td></td>
</tr>
<tr>
<td>Pension retirement</td>
<td>$3,500</td>
</tr>
<tr>
<td>withheld (Deduction)</td>
<td></td>
</tr>
<tr>
<td>Deferred compensation</td>
<td>$12,325</td>
</tr>
<tr>
<td>withheld (Deduction)</td>
<td></td>
</tr>
<tr>
<td>Cash in bank (Net)</td>
<td></td>
</tr>
</tbody>
</table>

Deductions are recorded as liabilities on the balance sheet until remitted to the proper agency. The amount posted to the expenditure control accounts is the adjusted gross payroll and not necessarily the taxable gross. The amount posted to cash is the amount the employee actually receives in his or her check.
CHAPTER 7 SUMMARY

1. Federal and state unemployment taxes are initiated in order to create unemployment funds which give former employees some money to tide them over until they can find work again.

2. Federal unemployment tax is not applicable to state and local governments.

3. Benefits are paid by the state-sponsored programs. The amount paid is a percentage of a person’s former pay, up to a low maximum level.

4. Unemployment benefits are not paid when a person quits or is terminated for cause.

5. State Unemployment Tax (SUTA) is computed on the first $9,500 of wages paid to each employee.

6. Governments in Georgia have two options for payment of SUTA, the reimbursement basis or contributory basis. The decision should be based on the estimated contributions as compared to the projected costs of reimbursements.

7. The payroll register, a special journal, is used to record all of the payroll information for each employee.

8. The information contained in a payroll journal includes, but is not limited to, name of employee, expenditure classifications, gross payroll, adjustments to gross payroll, adjusted gross payroll, and net payroll.

9. After the payroll has been summarized, the information must be posted to the general ledger and the subsidiary expenditure ledger.
CHAPTER 7 EXERCISE

Circle the correct answer.

1. The payroll amount that is calculated based on a contractual agreement with the employee is known as . . .
   
   A. Gross Payroll.
   B. Adjusted Gross Payroll.
   C. Net Payroll.
   D. Payroll Deductions.

2. The amount charged to the expenditure classifications is the . . .
   
   A. Gross Pay.
   B. Adjusted Gross Pay.
   C. Net Pay.
   D. Some other amount.

3. The net amount of payroll due each employee normally is the . . .
   
   A. Adjusted gross pay less payroll deductions.
   B. Gross pay less payroll deductions.
   C. The amount of the payroll deductions.
   D. Some other amount.

4. State Unemployment Tax (SUTA) in Georgia is computed on the first . . .
   
   A. $6,500 of wages paid to each employee.
   B. $7,500 of wages paid to each employee.
   C. $9,500 of wages paid to each employee.
   D. Some other amount.

5. The payroll deductions withheld from employees’ salaries are considered _________ of the state or local government until paid.
   
   A. Assets
   B. Liabilities
   C. Revenues
   D. Expenditures
6. Federal unemployment tax (FUTA) is . . .
   A. Not applicable to state and local governments.
   B. Applicable to state government only.
   C. Applicable to local government only.

7. Governments in Georgia must file Form DOL-4 to report their SUTA-taxable wages paid to each employee, and if required, to make payment of tax on a(n) . . .
   A. Monthly Basis.
   B. Semiannual basis.
   C. Quarterly basis.
   D. Annual basis.

8. This option for payment of SUTA taxes is based on an experience rating system…
   A. Contributory.
   B. Reimbursable.
   C. Percentage method.

9. Net payroll is the amount of . . .
   A. The total of all employees’ payroll checks.
   B. Gross payroll less total payroll deductions.
   C. Adjusted gross payroll less total payroll deductions.
   D. The total of all employees’ payroll checks or adjusted gross payroll less total payroll deductions.

10. The liability account used to report wages earned but not paid is . . .
    A. Accrued Salaries and Wages.
    B. Accounts Payable.
    C. Notes Payable.
    D. Withholding Taxes Payable.
CHAPTER 8
EFFECTIVE INTERNAL CONTROLS OVER PAYROLL

OBJECTIVES

Every organization, including governments, require employees to assist in meeting their goals and objectives. The cost of employing these individuals are reflected in salaries and wages and the associated benefits. The principal purpose of any payroll department is to pay the employees and remit associated deductions, taxes, and benefits. Internal controls are necessary for this department to function effectively, efficiently and within the parameters set by management.

After completing this chapter, the participant should be able to:

- Define the payroll process
- Recall the objectives for payroll
- Link the payroll objectives to the five interrelated components of an effective internal control system

DEFINING THE PAYROLL PROCESS

One of the largest expenditures for most governments is the payment of employees for providing services. The cost of paying employees includes not only the employees’ gross pay but also the employer’s share of benefits. Often benefit costs make up nearly 40% of an employee’s gross pay. The following is an example.

| The City of Vinson has an annual budget of $10,000,000. The budget can be summarized as follows – |
| Personnel  | $8,000,000 |
| Operating  | $2,000,000 |

In this example, 80% of the budget is related to the payroll process. Strong internal controls are necessary to ensure financial data is accurate.

Many governments have a division of the accounting department dedicated to paying employees, called the Payroll Department. The size of the government determines whether the department is responsible solely for payroll or if payroll is just one of many responsibilities.
The Payroll Department is charged with paying employees accurately in accordance with policies and procedures established by the jurisdiction. A sample payroll cycle is exhibited below.

1. Receipt of Time Sheets/Leave Taken
2. Entry of Time into Payroll System
3. Adjustments to Salary/Hourly Rates
4. Enter changes to deductions and withholdings
5. Balance Hours, Salaries, Deductions, Withholdings, and Benefits
6. Generate Paychecks/Direct Deposit Transmission File
7. Deliver Paychecks to Employees, Transmit Direct Deposit, Remit Payroll Withholdings, Deductions, and Benefits
8. Reconcile General Ledger Accounts
9. Reconcile Bank Statement
Governments may perform all of these steps or may contract out a portion of the process to a third party processor. Regardless of the method used, the resulting amounts will be posted to the general ledger.

**OBJECTIVES FOR PAYROLL**

Internal control review objectives are a prerequisite to the establishment of an effective internal control system. Those objectives are in three areas:

- Operations
- Financial reporting
- Compliance

Listed below are three basic objectives of an internal control system:

- Objective 1. To control operations by establishing various levels of authority, to provide approval for transactions and an adequate reporting system, and to enable those carrying out the approvals to be advised of the results from those approvals.
- Objective 2. To safeguard the organization’s assets from loss or damage as a result of waste, inefficiency, error, theft or fraud.
- Objective 3. To provide adequate information that is timely and reliable and supports the control structures so that individual management responsibilities can be identified.

To achieve these basic objectives, there are seven supplementary objectives that are also required to be met:

1. To ensure that all transactions are recorded. All valid transactions should be accurately recorded in the appropriate records, and valid transactions not recorded should be able to be detected by appropriate controls.
2. To record only valid transactions, and detect and protect against invalid transactions being entered.
3. To authorize only valid transactions and protect all records from unauthorized transactions.
4. To value transactions correctly and protect records from incorrect calculations and errors of recording.
5. To classify entries correctly in accordance with the chart of accounts or other categorizing requirements.
6. To record transactions in a timely manner so as to minimize errors caused by a delay between the transaction and its recording.
7. To include all transactions in the relevant subsidiary ledgers and correctly post them to the relevant ledger accounts.  

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Applying the above objectives of an internal control system, the objectives for payroll are as follows:

- All payroll transactions are preapproved.
- All valid payroll transactions are included in the accounting records in the proper period.
- All valid transactions are accurate, consistent with the originating transaction data, and information is recorded in a timely manner.
- All recorded payroll transactions fairly represent the economic events that actually occurred, are lawful in nature, and have been executed in accordance with management’s general authorization.
- Access to payroll records are controlled and properly restricted to authorized personnel.
- 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.

AN EFFECTIVE INTERNAL CONTROL SYSTEM FOR PAYROLL

An effective internal control structure has five interrelated components:

- Control environment
- Risk assessment
- Control procedures
- Information and communication
- Monitoring

Each of these components is important in establishing and maintaining an effective control system for payroll.

Internal Control Components (COSO)
The Control Environment and Payroll

Controls can either be an entity control or an application control. The control environment is considered to be an entity control because it addresses characteristics from management’s perspective rather than from an application such as payroll software. If the overall tone from management is not ethical and positive, then the possibility of the success of other internal control components is minimized.

The control environment is the foundation on which all other internal control components are built. Just as the foundation of a house ultimately supports the entire structure, so does the control environment support the internal control structure of an organization.

Let’s review the characteristics of the control environment. These include the following:

- Integrity and ethical values
- Commitment to competence
- Management’s philosophy and operating style
- Organizational structure
- Assignment of authority and responsibility
- Human resource policies and practices

The control environment affects payroll by establishing protocols.

- A published code of ethics needs to be communicated with employees on a consistent basis. For example, employees should be required to read the code of ethics on entering the government’s workforce and reminded of that code of ethics at set intervals during employment. Also, management needs to visibly adhere to that code. The code of ethics could also be published on the government’s website.

- Personnel should be hired that have the knowledge and skills to accomplish payroll tasks. This characteristic can be accomplished by including appropriate knowledge and skills in the job description so that only qualified employees are hired. In addition, employees should be supervised by qualified personnel.

- The organizational structure of the payroll department should be such that there are job descriptions that provide for assignment of responsibility and authority. These job descriptions should allow for proper segregation of duties.

- Written procedures should be provided in the payroll area. These procedures should cover all phases of payroll from when an employee is hired through the employee’s separation from the government. Procedures should also address when an outstanding payment becomes legally an escheat property and submitted to the appropriate state agency.
Management should exhibit a commitment to ongoing education and training process for employees in the payroll area. This is especially important due to frequent updates to deductions and withholdings from employees’ pay.

**Risk Assessment and Payroll**

COSO defines risk assessment as the **identification** and **analysis** of relevant risks to achievement of the objectives, forming a basis for determining how the risks should be managed. In addition, objectives must be established before the assessment of risk can be undertaken.

Earlier in this lesson several objectives of payroll were outlined. In the risk assessment, each of those objectives should be examined in detail to determine or identify what could cause the objectives not to be met or achieved. After identifying the risks to achievement of each of the objectives, an analysis needs to be undertaken to determine what internal control activities are already in place and what internal controls need to be established to ensure that the objectives are met.

So, let’s take a look at each of the objectives noted for payroll and identify the risks to the achievement of each.

**Objective No. 1: Authorization**

Risks associated with proper authorization include –

- Hiring an employee that was not approved and who may not be legally eligible for employment. Federal law requires that all employees hired be determined eligible to work.

- Overspending the personnel budget may result from unauthorized hiring. Positions should be budgeted for each department in the government. Salary and benefits budgeted are based on these approved positions. Hiring an unauthorized individual may result in expenditures that were not approved in the budget.

- If an unauthorized employee is hired, it may result in an ineffective employee being placed in a position. Authorization should be obtained prior to hiring an employee to ensure that the appropriate supervisors make the final decision regarding the candidate’s qualifications.

- Incorrect employee classification for benefits eligibility and Fair Labor Standards Act status (i.e. those considered exempt versus non-exempt in terms of overtime payments) may occur if hiring does not follow the eligibility process. Eligibility for benefits is often determined by number of hours worked by an employee. Unauthorized hiring of an employee may result in a higher than budgeted cost due to a requirement to pay benefits that was not originally planned. The Fair Labor Standards Act includes criteria to determine whether an employee must be paid time and a half for overtime worked. The result of this improper classification is often an overspent budget.
Objective No. 2: Safeguarding Assets

Risks associated with safeguarding of assets include –

- An unqualified employee could be hired which might result in errors in the payroll process. Payroll is a specialized area that requires attention to detail. Employees expect their salary and wages to be accurate. Federal and state governments require that tax withholding will be accurate.

- Interest and penalties might be owed due to payroll errors. Both the federal and state governments have deadlines by which tax payments must be remitted. Failure to observe these deadlines might result in assessment of penalties and interest against the government.

- Fictitious employees may be added to the payroll. This risk is especially applicable to large governments in which the payroll department does not know each employee individually. When a fictitious employee is added to a payroll system, their resulting pay is typically deposited in the account of the employee who is defrauding the government resulting in the theft of assets.

- Employees may be incorrectly classified. Fair Labor Standard Laws and the Internal Revenue Service Code require proper classification of employees. It is important that employees be classified correctly regarding exemption status related to overtime pay. In addition, the proper classification should be made regarding worker’s status as an employee or an independent contractor. Mistakes in either of these classifications may result in significant assessments against the government.

- Employees may not properly report leave taken. Typically, annual leave balances are paid to employees upon separation. If an employee does not report leave taken, the government may pay for time not worked and leave not owed.

Objective No. 3: Accurate, Reliable and Timely Information

Risks associated with providing accurate, reliable and timely information include –

- Employee’s salary or pay rate may be entered incorrectly. Incorrectly paying an employee will result in inaccurate data being included in the financial reports.

- Hours or pay period may be inaccurately entered. Payment for time not worked will result in overstatement of expenditures incurred or an unrecorded liability for time worked but not paid.

- Deduction data may be improperly entered. Deductions for health, dental, life, retirement, etc. require payment to the vendor based on a predetermined schedule in order for coverage to be effective. Mistakes related to improperly withholding amounts could result in unrecorded liabilities for the government.
• Payroll may be generated but not posted to the general ledger. Accounting software requires transactions from the payroll module be posted to the general ledger by the user. A payroll may be generated but not posted resulting in an understatement of expenditures and an overstatement of cash in the general ledger.

Control Activities for Payroll

Control activities for payroll include the following:

Hiring. There should be a written process for hiring employees.

The process should include –

• approval of the position from a budget perspective
• authorization to advertise
• receipt of appropriate application information
• participation in an established selection process
• offering of position with letter from chief executive that includes annual salary or hourly rate, benefits provided, status (full-time, part-time) and classification according to the Fair Labor Standards Act (exempt vs. non-exempt).

Documentation. Proper documentation should be completed and authorized by the employee. Deductions (other than for state and federal taxes) should not be withheld without a properly completed form from the employee.

Forms to be completed include –

• Personal data form that includes identifying information
• Form I-9, Employment Eligibility Verification, determines eligibility to work in the United States. Employers should then verify the information provided using the E-Verify system
• Form W-4, Federal Withholding
• Form G-4, State Tax Withholding
• Benefits forms including health, dental and other plans
• Retirement plan forms

With advances in information technology and payroll software, forms may often be completed and submitted online. If your system allows online submission, ensure the transmission of data is secure and employees are identified by a user name and password.

Employees paid by direct deposit typically submit a cancelled check along with a completed authorization form. Submission of a cancelled check is an excellent control to ensure accurate data is provided for the transmission of an employee’s pay.
**Authorization.** To ensure that only valid transactions are entered into the payroll system, all transactions should be properly authorized. The following is a listing of necessary authorizations.

- **Time Sheets.** Many employees complete time sheets for submission to payroll. The employee should sign the time sheet certifying that the time recorded was actually worked. The employee’s supervisor should approve the time sheet. The supervisor’s approval serves as authorization to pay the employee. The supervisor’s signature certifies the employee actually worked the time recorded. In addition, time sheets should indicate any leave taken. Again, it is the supervisor’s responsibility to determine the employee properly recorded leave taken.

- **Payroll.** Payroll checks or direct deposit transmission data should not be generated until a supervisor has authorized the payroll. The supervisor should verify all supporting documentation is present prior to approving the payroll. Depending on the payroll system, the approval may be manual (initials and date) or may be electronically approved.

**Reconciliation.** One of the most important control activities for the payroll process is reconciliation of amounts and accounts. The following is a listing of reconciliation activities –

- **Hours worked.** Hours entered into the payroll system from time sheets should be balanced to a summary report of hours worked generated from the payroll system.  

  **Example** – Mary has entered the hours from the department time sheets. When adding each of the time sheet totals, she obtained a control total of 160 hours. Mary generates a Time Worked report from the payroll system and sees that only 140 hours are shown. To identify the difference, Mary compares each time sheet to the record of time entered from the payroll report. She determines she only entered 20 hours for John Brown. Mary adjusts the time worked in the payroll system for John to 40 hours which was shown on his time sheet. She re-runs the payroll report and documents that now the report shows 160 hours worked which agrees to the total for all the time sheets entered. Mary initials and dates the report from the payroll system to reflect that she successfully balanced hours worked with the payroll system.

- **Adjusted Gross Salary.** A number of employees are typically paid the same amount each pay period because of their classification as salaried employees. Therefore, the payments to these employees should only vary if there are adjustments to their pay.

  **Example** – Vinson Government has 20 employees who are considered salaried. The payroll is generated monthly. The typical gross payroll for all 20 employees each month is $100,000. This month Jim Bulldawg’s check was reduced by $1,000 for leave taken without pay. When the payroll register is generated for the month, the gross pay for salaried employees should equal $99,000 ($100,000 normal balance less $1,000 deduction). Mary is reconciling the salaried payroll amount. The report reflects $99,000
for salaried employees. Mary initials and dates the payroll report to reflect that she successfully balanced adjusted gross salaries.

- Taxable Wages. Certain employee deductions are exempt from federal and state tax withholding. Examples of these deductions include those for retirement, contributions to deferred compensation plans, and deductions for Section 125 flexible benefits plans. Ensure that taxes are calculated on the proper gross amount by subtracting the total of pre-tax deductions from total adjusted gross wages. Payroll registers will typically reflect federal and state tax wages.

**Example** – Mary is reconciling taxable wages. She begins with Adjusted Gross Wages of $99,000. She totals the pre-tax deductions as follows –

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retirement/Deferred Compensation Contributions</td>
<td>$5,000</td>
</tr>
<tr>
<td>Section 125 Flexible Benefits</td>
<td>$1,000</td>
</tr>
<tr>
<td>Total Pre-Tax Deductions</td>
<td>$6,000</td>
</tr>
</tbody>
</table>

Next, Mary subtracts the $6,000 in pre-tax deductions from the Adjusted Gross Wages of $99,000 to get taxable wages of $93,000. Mary compares her calculation to the payroll register report of taxable wages and sees that the payroll register has total taxable wages of $94,000. Mary realizes that someone’s deductions have been set up incorrectly to withhold after tax. She reviews the changes in deductions for the current payroll. Shaun Bolt added a deferred compensation deduction of $1,000 this pay period. The deduction was NOT entered as a pre-tax item. Mary corrects the deduction and generates another payroll register. This time $93,000 is shown as the taxable amount. Mary initials and dates the total to show she has balanced the amount.

- Retirement Contributions. Often, retirement contributions are calculated as a percentage of employee gross salary. To ensure proper withholding occurs and the appropriate employer matching benefit is calculated, the payroll employee should recalculate the appropriate retirement contribution.

**Example** – Mary reviews the payroll register and determines the adjusted gross wages subject to retirement contributions is $99,000. The employees pay 5% of their adjusted gross wages for retirement. Therefore, the retirement deduction total on the payroll register should be $4,950. Mary sees that the deduction on the register is actually $4,800. Mary reviews the calculations by employee and determines 4% was added to Jamie Thompson’s employee record instead of 5%. Mary makes the change and generates a new payroll register. The total deduction is now showing as $4,950. Mary initials and dates this correct amount.

Mary reviews the employer retirement matching contribution of 5% and determines the amount is correct. Mary initials and dates the amount.

- Flexible Spending Account Deductions. Employees may annually elect to make contributions to flexible spending accounts. Unless there is a qualifying event (marriage,
divorce, adoption), the employee may not make changes to the amount withheld during the year. To ensure proper withholding, the payroll employee should determine the correct amount was withheld.

**Example** – Mary reviews the record of flexible spending account elections and determines $1,000 should have been withheld. In reviewing the payroll register, Mary sees that only $950 was withheld. Mary reviews the deductions for each employee and determines that Jennifer Adams had a qualifying event and should have had an additional $50 withheld from her pay. Mary makes the correction, generates a new payroll register, and verifies the amount. She then initials and dates the report.

Similar procedures to the ones described above should be applied to remaining deductions. Once the payroll is generated, control activities must be established to ensure direct deposit transmissions are sent, pay checks/ remittance advices are delivered, and withholdings and deductions are paid. One way to ensure these processes are completed is to generate a checklist.

The checklist should include the following tasks with a field to initial and date as the task is completed.

- Payroll balanced (this would be complete after reconciliation steps above are performed)
- Checks printed
- Payroll transmitted to bank
- Federal taxes remitted
- State taxes remitted
- Retirement contributions remitted
- Flexible spending accounts remitted
- Other withholdings and deductions remitted

Once all liabilities are paid, the final reconciliation item is to review payroll liability accounts to ensure all balances are zero. If balances remain, generate a general ledger detail to determine which amount remains unpaid or if an error occurred. This can be accomplished by comparing the amounts posted to the payroll accounts from the payroll system with amounts paid to benefit providers and state and federal governments.

**Information and Communication of Payroll**

For any organization to run and control its operations, reliable and accurate information is a must. Information must flow up and down the organization, as well as in and out of the organization. Information can be formal or informal. With these characteristics in mind, let’s consider for a moment what information would be required to be communicated about payroll.

The following are examples of what needs to be communicated about payroll, however, the list is not all inclusive. The needs of your government and the types of payables maintained may require your information and communication list to be quite different.
Enrollment periods for benefits. Information should include plan options and dates for enrollment.

1. Pay periods and dates. Information should include dates of pay period, due date for time sheets, and pay date.

2. Holidays. Scheduled paid holidays should be communicated.

3. Furlough days. If the government has scheduled furlough days, the dates should be communicated to the employees.

4. Personnel policies and procedures. Employees should have access to detailed policies and procedures related to employment with the government.

5. Salary information. Employees should receive annual notification of changes in pay rate or salary.


7. Tax withholding. Tax withholding payments and required reports must be sent to federal and state government agencies.

**Monitoring and Payroll**

Monitoring, the fifth internal control element, ensures that the internal controls operate as intended over time, and is accomplished through routine (on-going) activities, separate evaluations or a combination of both. Ongoing monitoring occurs in the course of operations. It includes regular management and supervisory activities, and other actions personnel take in performing their duties.

Ongoing monitoring in payroll takes the form of supervisory activities. Payroll reconciliations should be reviewed by an appropriate level supervisor. The supervisor should initial and date the face of the reconciliation as evidence of the review. The payroll supervisor or another member of management should review all changes to employee information. This can be easily accomplished by regularly producing an employee addition/change report.
CHAPTER 8 SUMMARY

1. Payroll can be defined as the process to pay employees for services rendered. The process includes deducting or withholding authorized amounts from employees’ pay and remitting to the appropriate vendor or governmental entity.

2. Objectives for payroll are as follows:
   
   • All payroll transactions are preapproved.
   • All valid payroll transactions are included in the accounting records in the proper period.
   • All valid transactions are accurate, consistent with the originating transaction data, and information is recorded in a timely manner.
   • All recorded payroll transactions fairly represent the economic events that actually occurred, are lawful in nature, and have been executed in accordance with management’s general authorization.
   • Access to payroll records are controlled and properly restricted to authorized personnel.
   • 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.

3. Risk assessment is the identification and analysis of relevant risks to achievement of the objectives, forming a basis for determining how the risks should be managed. The risks associated with each of the payroll objectives should be evaluated.

4. Information to be communicated about payroll can vary between governments. The following are typical items that are communicated in payroll:
   
   • Enrollment periods for benefits. Information should include plan options and dates for enrollment.
   • Pay periods and dates. Information should include dates of pay period, due date for time sheets, and pay date.
   • Holidays. Scheduled paid holidays should be communicated.
   • Furlough days. If the government has scheduled furlough days, the dates should be communicated to the employees.
   • Personnel policies and procedures. Employees should have access to detailed policies and procedures related to employment with the government.
   • Salary information. Employees should receive annual notification of changes in pay rate or salary.
   • Benefits payment. Benefit providers must receive information regarding employee enrollments.
   • Tax withholding. Tax withholding payments and required reports must be sent to federal and state government agencies.
5. Monitoring in payroll takes the form of supervisory activities. Reconciliations should be reviewed by an appropriate level supervisor. The supervisor should initial and date the face of the reconciliation as evidence of the review.

6. The payroll supervisor or another member of management should review all changes to employee information. This can be easily accomplished by regularly producing an employee addition/change report.
CHAPTER 8 EXERCISE

INSTRUCTIONS: Fill in the blanks with the correct answer.

1. _________________ is defined as a process to pay employees for services rendered.

2. Monitoring takes the form of ______________ activities.

3. List three control activities for payroll

____________________________________________________________________

____________________________________________________________________

____________________________________________________________________

4. List four examples of payroll information to be communicated.

____________________________________________________________________

____________________________________________________________________

____________________________________________________________________

____________________________________________________________________

5. ____________ _________________ is the identification and analysis of relevant risks to achievement of the objectives, forming a basis for determining how the risks should be managed.

6. What is one control activity you plan to implement as part of your government’s system of internal controls for payroll? Explain why?
CHAPTER 9
SEGREGATION OF DUTIES

OBJECTIVES

Often when reading about fraudulent acts, you will see a common theme. One employee was
given sole responsibility for a process. The employee usually is a long-time, trusted part of the
department. The fraudulent activity is discovered when the employee is unexpectedly absent
from work and cannot perpetuate established schemes. If only the responsibilities had been
divided among several people, the problem would not have occurred and the loss of public
confidence avoided. In this chapter we will discuss the importance of segregating duties.

After completing this chapter, the participant should be able to:

- Define segregation of duties
- Recall which duties should be segregated for payroll
- Complete a segregation-of-duties evaluation for a sample government

WHAT IS SEGREGATION OF DUTIES?

Segregation of duties means separating the record-keeping function from the operational
responsibility of that activity and from those who exercise physical control over the records.
Segregation of duties is one of the key concepts of internal control and is the most difficult and
sometimes the most costly objective to achieve. The term segregation of duties is common in
financial accounting systems. Companies of all sizes understand that the roles of printing payroll
checks and signing those same checks, for example, should not be combined.

Segregation of duties ensures that errors or irregularities are prevented or detected on a timely
basis by employees in the normal course of business. Segregation of duties provides two
benefits:

1) It makes deliberate fraud more difficult because people are less able to collude
   when such a system is in place.

2) Innocent errors are more likely to be detected and rectified. At the most basic
   level, it means that no single individual should have control over two or more
   phases of a transaction or operation.

Since the great recession, governments are being forced to do more with less. Often this
means that a job previously performed by two employees is now performed by one.
Typically the duties of the job are not reduced increasing the likelihood of error or fraud.
Good financial management requires the finance officer review remaining positions to identify those who can provide the appropriate segregation of duties. We will discuss how duties may be segregated below.

CATEGORIES OF DUTIES TO BE SEGREGATED

There are four general categories of duties or responsibilities that are inherent to segregation of duties:

1. Authorization
2. Custody or access to assets
3. Record keeping
4. Reconciliation or accountability

In an ideal system, different employees would perform each of these four major functions. In other words, no one person should have control of two or more of these responsibilities. The following chart reflects the common processes that fall under each of the four general categories:

- **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

The more liquid the asset, the greater the need for proper segregation of duties, especially when dealing with cash and negotiable checks. In those instances where duties cannot be fully segregated, mitigating or compensating controls must be established.
Evaluating Segregation of Duties

One of the most difficult management tasks is to evaluate segregation of duties and then make employee assignments accordingly, especially if the number of employees is limited. Here is a simple question to ask when evaluating segregation of duties:

*If I make an error in my work, will someone else in the process detect it before it becomes a major issue for management and the taxpayers to read about?*

By breaking apart tasks (approvals, access, recording, and reconciling results), governments increase the likelihood of detecting unintentional errors in results before it's too late. A person with multiple functional roles has the opportunity to abuse those powers. Adhere to the following pattern in order to minimize risk:

1. Start with a function that is indispensable but potentially subject to abuse.
2. Divide the function into separate steps, each necessary for the function to work or for the power that enables that function to be abused.
3. Assign each step to a different person or to a different department.

Ideally, different employees should perform the duties within the four categories of authorization, custody, record-keeping, and reconciliation. However, if the optimum degree of segregation cannot be achieved, a minimum degree of segregation must be maintained. At a minimum, no person should be able to perform more than two of the functions. The following matrix presents various ways to assign responsibilities that are less than optimum.

<table>
<thead>
<tr>
<th>RESPONSIBILITY/SCENARIO</th>
<th>Authorization</th>
<th>Custody</th>
<th>Recording</th>
<th>Reconciliation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Emp1</td>
<td>Emp2</td>
<td>Emp2</td>
<td>Emp1</td>
</tr>
<tr>
<td>2</td>
<td>Emp2</td>
<td>Emp1</td>
<td>Emp2</td>
<td>Emp1</td>
</tr>
<tr>
<td>3</td>
<td>Emp2</td>
<td>Emp2</td>
<td>Emp1</td>
<td>Emp1</td>
</tr>
<tr>
<td>4</td>
<td>Emp1</td>
<td>Emp1</td>
<td>Emp2</td>
<td>Emp2</td>
</tr>
</tbody>
</table>

The processes of recording (record keeping) and reconciliation should be performed by two different employees in order to maximize the opportunity to identify errors in the ordinary course of business. This best practice is illustrated in scenarios 1 and 2 in the above matrix. In scenarios 3 and 4, there must be more reliance on mitigating or compensating controls since employees are assigned incompatible functions.
Mitigating or Compensating Controls

A mitigating or compensating control reduces the risk of weakness in an existing or potential control, which could result in errors and omissions. Compensating controls are less desirable than the segregation of duties because compensating controls generally occur after the transaction is complete. Moreover, more resources are required to investigate and correct errors and to recover losses than it does to prevent the errors in the first place. However, in some instances governments do not have sufficient staff resources to establish adequate segregation of duties. In these instances, it is important for management to implement internal controls that compensate for this increased risk, such as the following.

- *Review reports of detailed transactions* – Managers review the payroll register report including reconciliations on a regular and timely basis
- *Review selected transactions* – Managers select transactions for review of supporting documents
- *Take periodic asset counts* – Managers periodically hand deliver payroll checks or direct deposit remittance advices to ensure all employees paid actually exist
- *Check reconciliations* – Managers review from time to time reconciliations of account balances such as payroll deductions payable or perform them independently

Notice that in each of these compensating controls, management performs the procedure. Compensating controls cannot be delegated; they must be performed by a supervisory or management-level employee who is knowledgeable about the process. Delegating the controls would defeat the purpose of the compensating control and render it ineffective. In addition, management should take compensating controls into consideration in the risk assessment phase of internal control evaluation.
CHAPTER 9 SUMMARY

1. Segregation of duties means separating the record-keeping function from the operational responsibility of that activity and from those who exercise physical control over the records.

2. Segregation of duties provides two benefits:
   - It makes deliberate fraud more difficult because people are less able to collude when such a system is in place.
   - Innocent errors are more likely to be detected and rectified.

3. Categories of duties that need to be segregated include the following:
   - Authorization—authorization of transactions such as new employee hires
   - Custody—access to payroll checks and EFTs
   - Record-keeping—preparing source documents, such as timesheets; maintaining journals and ledgers; preparing performance reports
   - Reconciliations—preparing bank reconciliations

4. A simple question to ask when evaluating segregation of duties is this: If I make an error in my work, will someone downstream of me detect it before it becomes a major issue for management and the taxpayers to read about?

5. The processes of record keeping and reconciliation should be performed by two different employees in order to maximize the opportunity to identify errors in the ordinary course of business.

6. If employees are assigned incompatible duties, mitigating or compensating controls must be established.

7. A mitigating or compensating control reduces the risk of weakness in an existing or potential control, which could result in errors and omissions.

8. Types of compensating controls that can be implemented include the following:
   - Review reports of detailed transactions – Managers review the payroll register report including reconciliations on a regular and timely basis.
   - Review selected transactions – Managers select transactions for review of supporting documents.
   - Take periodic asset counts – Managers periodically hand delivers payroll checks or direct deposit remittance advices to ensure all employees paid actually exist.
   - Check reconciliations – Managers review from time to time reconciliations of account balances such as payroll deductions payable or perform them independently.
EXERCISE 9-1

Below is a listing of responsibilities within the payroll function. Determine which category of duties to be segregated each would belong to. The categories of duties to be segregated include:

- Authorization
- Custody or access to asset
- Record-keeping
- Reconciliation or accountability

1. Receipt of returned paycheck
2. Approval of new hire
3. Posting of payroll
4. Signing of payroll checks
5. Bank reconciliation
6. Approval of pay changes
7. Access to bank accounts/online banking
8. Mailing of payroll checks
9. Posting of payroll adjustments
10. Sub-ledger and account reconciliation
11. Payroll register approval
EXERCISE 9-2

Complete the following segregation of duties matrix for a payroll area that has two employees, Nora and Sam, along with the payroll supervisor, Laura.

<table>
<thead>
<tr>
<th>Task</th>
<th>Authorization</th>
<th>Custody</th>
<th>Record Keeping</th>
<th>Reconciliation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Entry of time worked</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Approval of preliminary payroll register</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Printing of Payroll Checks</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Posting of payroll adjustments</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank reconciliation</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reconciliation of payroll withholding accounts</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
EXERCISE 9-3

List 4 compensating controls that may be utilized in the absence of proper segregation of duties.

1. 

2. 

3. 

4. 
CHAPTER 10
PAYROLL RESOURCES

Much of the information contained in this material is a summary of a number of Internal Revenue Service’s publications which can be downloaded from www.irs.gov. The following publications contain additional information about payroll taxes and remittances:

- Publication 509, Tax Calendars. This publication lists the dates on which a variety of taxes are due throughout the year.
- Publication 15, Employer’s Tax Guide. This manual defines employees, discusses wages, payroll period, withholding and depositing taxes and a variety of other tax-related subjects.
- Publication 15-A, Employer’s Supplemental Tax Guide. This manual discusses the legal definition of an employee, special types of wage compensation, sick pay reporting, pensions and annuities, and alternative methods for calculating withholding.
- Publication 15-B, Employer’s Tax Guide to Fringe Benefits. This publication covers a wide range of fringe benefit exclusion rules, ranging from accident and health benefits to working condition benefits. It also addresses fringe benefit valuation rules, as well as rules for withholding, depositing and reporting taxes.

Another section that is also helpful from www.irs.gov is the “Help” page.
There are also several payroll related newsletters than can be obtained at the following addresses:

**APA: Payroll Currently**
660 North Main Avenue, STE 100
San Antonio, TX 78205
http://www.americanpayroll.org/

**BNA: Payroll Administration Guide**
1801 S Bell Street
Arlington, VA 22202
www.bna.com

The remainder of this chapter is a compilation of payroll tips, best practices and general information to assist the payroll department with pay issues.

**BEST PRACTICES FOR DEALING WITH EMPLOYEES ON PAYROLL ISSUES**

1. Plan and schedule for the worst-case scenario when analyzing the potential crisis situations and their impact and probabilities.
2. Ensure that your payroll systems have a “backup” - consider using manual checks as a viable alternative during a crisis.
3. Cross-train personnel on how to use the payroll system. Do you know who else in your company has payroll experience?
4. Deal promptly and effectively with issues that adversely affect employee attitudes and morale - take care of the problem before the information surfaces through the rumor mill and employees become misinformed.
5. Notify the appropriate personnel “who need to know” the course of action and their applicable responsibilities for attaining optimum results.
6. Develop, document, and assess crisis procedures to confirm their validity and results.
7. Review and update procedures annually.

**FIVE SAFEGUARDS AGAINST OVERTIME ERRORS**

1. All records of time worked should be approved by the supervisor/department head before processing to prevent employee fraud on the time document.
2. The time records should be reviewed by the payroll areas for compliance with company policy, accuracy of mathematical calculations of hours, general reasonableness, and proper approvals.
3. Batch totals or batch processing should be used to ensure that the correct number of hours has been entered into the database.
4. Time records should be matched against the payroll register to ensure that data has been entered correctly in the database.
5. Total hours (both regular and overtime) should be checked for reasonableness:
   a. Are the regular hours/overtime hours excessive, based on historical data?
   b. Are the regular hours/overtime hours low based on historical data or the number of hours available in the time period?
FEDERAL NEW HIRE REPORTING REQUIREMENT

The employer must provide the following information to the state directory on all newly hired and rehired employees:

- Employee’s name, address, Social Security number, date of birth, start date, medical insurance availability, and state of hire.
- Employer’s name, address, and EIN

HOW LONG MUST RECORDS BE KEPT?

Three years after the last day of entry for each covered employee under FLSA, the following must be kept:

- Employee's full name and social security number
- Home address, including apartment number, if any, and ZIP code
- Date of birth, if under age 19
- Sex and occupation (for use in determining equal pay compliance)
- The beginning of the employee’s workweek (time and day)
- Regular rate of pay for overtime weeks, the basis for determining the rate, and any payments excluded from the regular rate
- Hours worked each workday and workweek
- Straight-time earnings (including straight-time pay for overtime hours)
- Overtime premium earnings
- Additions to and deductions from wages for each pay period
- Total wages paid for each pay period
- Date of payment and the pay period covered
Two years from the last date of entry under FLSA, the following must be kept:

- Basic employment and earnings records that support the data for each nonexempt employee’s hours of work, basis for determining wages, and wages paid (e.g., time or production cards)
- Records, substantiating additions to or deductions from employees’ wages, including purchase orders, operating-cost records, wage assignments and garnishments

However, the federal laws above may differ from retention schedules issued by the State of Georgia that are applicable to local governments. Below is the website for state recommended minimum retention schedules for all local government documents:

http://sos.ga.gov/cgi-bin/localretentionschedule/

SET CLEAR-CUT GUIDELINES

Segregation of job duties leads to greater internal control.
- Payroll inputs data for wages and compensation
- HR authorizes changes and reviews payroll input

New integrated systems contain “password security.”
- Payroll manager can be locked out of salary grade maintenance
- HR manager is denied access to pay data entry

Identify other systems that interface with payroll:
- Human resources
- Bank reconciliation
- Benefits
- Direct deposit
- Accounting
- Time and attendance
- General ledger
FOUR STEPS TO HANDLE AND PREVENT MISCALCULATED PAYROLL TAXES

A general knowledge of the IRS tax account system can put a payroll person on the inside track to get a payroll tax problem solved.

1. To ensure accuracy of your payroll records, it’s important to establish pay-period and quarterly balancing procedures.
2. Locate the source of any imbalances and correct employee records if necessary for adjustment in the next pay period.
3. Keep a record of the explanation for all discrepancies and all adjustments that you make as a result of your balancing procedures.
4. Be consistent in using standard operating procedures in your payroll practices.