Chapter 1

The Fair Labor Standards Act: Introduction and Overview

Learning Outcomes

- 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
FLSA – Introduction

- Establishes minimum wage, overtime pay, record-keeping and child labor standards
- **Wage and Hour Division** responsible for administering and enforcing FLSA for government employees

FLSA Requirements for Employers

- Pay at least the Federal minimum wage to non-exempt employees
- Pay at least time and one-half for all hours worked over 40 in the workweek
- Comply with the child labor standards
- Comply with the recordkeeping requirements

Who are your Employees?

- Hired by another person or business for a wage or fixed payment in exchange for personal services and **who does not provide the services as part of an independent business**
- Any individual employed by an employer
Independent Contractor or Employee?

**Categories**
- Behavioral control
- Financial control
- Relationship of the parties

### #1 Behavioral Control
Show whether there is a right to direct or control how the worker does the work

Considered an employee when the business has the right to direct and control the worker
- Doesn’t 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

### Instruction
You receive extensive instructions on how work is to be done
- 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

- You might be an employee! Continued on next slide
**Instruction**

- Amount needed varies among different jobs
- Sufficient behavioral control may exist even if no instructions are given
  
  - **Key consideration**: whether the government has retained the right to control the details of a worker's performance or instead has given up that right

**Training**

- Government provides you with training about required procedures and methods... **you might be an employee!**

**Evaluation**

- Evaluation system measures the details of how the work is performed... **you might be an employee!**
#2 Financial Control

**Significant investment**
- Investment must have substance. However, a significant investment is not necessary to be an independent contractor.

**Expenses**
- Not being reimbursed for some or all expenses

**Opportunity for profit or loss**

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#2 Financial Control

**Services available to the relevant market**
- Free to seek out business opportunities
- Advertise, maintain a visible business location, and are available to work in the relevant market

**Paying the worker**
- Employee: regular wage amount
- Independent contractor: paid a flat fee for the job
- Keep in mind that it is common to pay some independent contractors hourly

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#3 Relationship to Parties

**Employee benefits**
- If you receive... you might be an employee
- If you do not receive... you still might be an employee

**Written contracts**

**Permanency of the relationship**
- Will the relationship continue indefinitely?

**Extent to which services performed are a key aspect**
- Indicates it is more likely that you will have the right to direct and control activities
<table>
<thead>
<tr>
<th>Independent Contractor</th>
<th>Employee</th>
</tr>
</thead>
<tbody>
<tr>
<td>An attorney or accountant who has his or her own office, advertises in the yellow pages of the phone book under “Attorneys” or “Accountants,” 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 repair, sets his or her own prices, collects from the customer, sets his or her own hours and days of work, and rents or owns the shop from a third party.</td>
<td>An auto mechanic working in someone else’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>

### Employment Relationship under the FLSA

**U.S. Supreme Court factors**

- Services rendered
- Permanency of relationships
- Contractor investment in facilities and equipment
- Control of principal
- Profit and loss opportunities
- Initiative, judgment and foresight
- Degree of independent business organization and operation

### Identifying Factors

**Review checklist on page 1-6**
**Exempt or Nonexempt**

- Nonexempt – entitled to overtime
- Most employees covered by the FLSA are nonexempt
- Some jobs are classified as exempt by definition
  - Teachers
- Most employees must meet all three “tests” to be exempt

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**Three Tests**

- **Salary Level**
  - Less than $47,476 = nonexempt
  - More than $134,004 = exempt

- **Salary Basis**
  - Minimum amount paid for “any” work performed
  - Salary is annual figure divided by the number of pay periods in a year
Three Tests

- Duties Test
  - Actual job tasks must be evaluated
  - Exempt executive job duties
  - Exempt professional job duties
  - Exempt administrative job duties

Rights of Exempt Employees

- Full amount of the base salary in any work period during which she/he performs any work
- No limits on the amount of work time required/expected by employee

"No rights at all" under the FLSA overtime rules

Exercise

Chapter 1
Chapter 2
The Payroll Process

Learning Outcomes

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

Overview

- Step #1 – Set up new employees
- Step #2 – Time card information
- Step #3 – Verify information
- Step #4 – Data input
- Step #5 – Calculate taxes
- Step #6 – Calculate wage deductions
- Step #7 – Separate manual payments
Overview

• Step #8 – Create payroll register
• Step #9 – Verification
• Step #10 – Print checks
• Step #11 – Journal entries
• Step #12 – Send out direct deposit notifications
• Step #13 – Deposit withheld taxes
• Step #14 – Issue paychecks
• Step #15 – Issue payroll reports

New Hire Packages

New hire packages should capture all information needed by the payroll office to process paychecks for new employees:

<table>
<thead>
<tr>
<th>Information Type</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal Information</td>
<td></td>
</tr>
<tr>
<td>Compensation</td>
<td></td>
</tr>
<tr>
<td>Taxes</td>
<td></td>
</tr>
<tr>
<td>Deductions</td>
<td></td>
</tr>
</tbody>
</table>

New Hire Packages

• Checklist
  – Exhibit 2-1 Morgan County New Hire Checklist.pdf
• Government go-to list’
• Government directory
New Hire Packages

- Insurance enrollment forms
- Employee manual with **signed sheet returned**
- Form W-4 for Federal Withholding
  - Exhibit 2-2 W-4.pdf

New Hire Packages

- Georgia Withholding Form G-4
  - Exhibit 2-3 G4.pdf
- Form I-9
  - Exhibit 2-4 form I9.pdf
- Georgia New Hire
  - Exhibit 2-5 GA New Hire.pdf

The Georgia Security and Immigration Compliance Act requires that public employers with the State must verify the employment eligibility status of newly hired employees using E-Verify

Creating the Personnel File

- Deduction information
- Employee correspondence
- Employee reviews
- Garnishment information
- Tax related information

Payroll Changes

- Document alterations to information used to create paychecks for audit trail
- Keep changes in personnel file
- See example of change form Page 2-8

Exercise

Chapter 2
Chapter 3
Compensation

Learning Outcomes

- **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

Hourly Rate Plan

- Most commonly used

- Multiply the wage rate times the number of hours worked during the workweek

- Sometimes complicated by shift differentials, overtime, merit increases, etc.
Partial Periods

- Usually occurs when an employee begins or stops work partway through a pay period
- Also necessary when a pay change has been made that is effective as of a date partway through the employee's pay period

Exercise Problem

- Assume J. Alexander works the second shift for the school security, where he earns a $.50 per hour as shift differential
  - His current rate of pay before the shift differential is $16.00 per hour
  - He worked 40 hours in a one-week pay period
- Calculate total wages earned

Exercise Problem

- Serenity Charter pays its employees on the 15th and last day of each month, which is 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 20th day of the month, and there are 7 business days left in the pay period.
- Calculate his gross pay for the month.
Exercise Problem

• An employee receives a monthly salary of $3,200.

• The employee is absent from work for 5 days during the month.

• The employee uses 3 days of sick leave and 2 days of unpaid leave.

• Calculate the employee’s gross wages.

Overtime

• Overtime in Georgia 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.

• Employer does not have to include vacations, holidays, sick time, etc. in the 40 hours.

Exercise Problem

• Assume J. Alexander worked 33 hours during the four-day workweek following Memorial Day.

• He will be paid for 41 hours (8 hours of holiday time plus 33 hours worked).

• Calculate the number of hours J. Alexander is eligible for overtime pay.
J. Alexander – OT Pay

- J. Alexander is not entitled to overtime compensation since eight of the hours were not actually worked during the pay period.

Other Issues

Back pay
- Back pay is usually treated as regular wages

Expense reimbursements
- Not considered as income to the employee
- Exceptions: employees living away from home for more than one year that receive living costs

Other Issues

Tuition reimbursement
- Not considered income if related to higher current job
- Considered income if the education is pursued to promote the person or shift them into an unrelated position requiring different skills

Employee awards
- Tangible property given in recognition of length of service or for safety achievement and as part of a meaningful presentation
- Up to $400 or $1,600 per year
**Life Insurance**

- First $50,000 not considered taxable income
- Amount after $50,000 is employee income subject to Social Security and Medicare taxes
- Use IRS Fair Market Value Multiplier

**Exercise Problem**

- 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
- Calculate the amount reported as part of the employee’s gross income

**Government Vehicles**

- Specialty – not taxable income to the employee
- Commute Rule - Used to commute, no personal use and not highly compensated = $1.50 of taxable income for each commute in each direction
Government Vehicles

- FMV - If trips are documented, the income charged is calculated using the IRS mileage reimbursement rate of 54.5 cents per mile less the 5.5 cents per mile if the employee purchases fuel.
  - Approach is acceptable 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.
- Exhibit 3-1 IRS Fringe Benefits Guide.pdf

Paperwork

- W-2 by the end of January
  - Exhibit 3-2 W-2.pdf
- 1099 by the end of January
  - Exhibit 3-3 1099 MISC.pdf
- Copy A of all W-2 forms to Social Security Administration by the end of January

Paperwork

- Copy of all 1099 forms to the IRS with a transmittal Form 1096 by the end of January.
- Copy of all W-2s to GA Department of Revenue by the end of January with G-1003.
- Example of Employee – Independent Contractor Worksheet
  - Exhibit 3-4 Employee-Independent Contractor Form SS-8
Exercise

Chapter 4

Benefits

Learning Outcomes

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

Allows employees to pay for some benefits with pretax dollars so that the amount of taxable income to them is reduced.

Employees choose the total amount of their annual cafeteria plan deductions at the beginning of the plan year.

- Exceptions: change in marital status, number of dependents (including adoption) 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.

Cafeteria Plan

What if an employee quits after they have made claims against the fund that exceed the amount they have thus far contributed to the plan?

Exercise Problem

- Assume J. Alexander earns $75,000 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%.

- Calculate take-home pay, net of medical costs before and after cafeteria plan enrollment deductions of $400.
Insurance Benefits

- May include medical, dental, vision and life
- Not considered income to employees
- COBRA
  - Can accept coverage for an additional 18 months
  - Extends to 36 months if an employee becomes entitled to Medicare coverage or becomes divorced
  - If a spouse or dependent child of an employee loses coverage due to death of an employee, then they can obtain coverage for up to 36 months

Insurance Benefits

- Life Insurance must be reported as employee income if the benefit exceeds $50,000

Insurance Benefits

- Leave of Absence – FMLA entitles employees to take up to 12 weeks of unpaid leave each year for a specified list of family and medical reasons
  - Continued medical coverage
  - Recommended that employer fill out a formal, detailed response to a request
  - Upon returning, an employee must be given the same or equivalent job with the same level of pay and benefits
- Exhibit 4-1 FMLA Form.pdf
Pension Plan Benefits

- **Qualified retirement plans** – deduct allowable contributions to the plan on behalf of participants. Income earned by the plan is not income until they withdraw funds.
  - Defined contribution plan – employer liable for payment but not size of the return
  - Defined benefit plan – itemizes a specific dollar amount participants will receive

Nonqualified Retirement Plans

- **Example:** 457 plan
- Allows participants to defer up to $18,500 of their wages per year and this amount changes from year to year as established by the IRS
- Restricted to the use of government and tax-exempt entities
- Distributions from the plan are usually at retirement

Sick/Disability Pay

- Employees are compensated for the normal number of working hours during his/her time off
- Additional wages may be paid
  - Short-term/long-term insurance plans
  - If employer pays the entire cost of these insurance plans, benefits received are taxable income
Workers’ Compensation Benefits

- Provides employees with wage compensation if they are injured on the job
- The calculation of cost occurs once a year for government to pay insurance premiums
- Based on workers compensation code assigned to job and calculated as a percentage of gross payroll in that job classification

Exercise

Chapter 4

Chapter 5
Payroll Taxes and Remittances
Learning Outcomes

- 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

- Required when employee is hired
- Determines tax withholding
- Update upon request of employee
- Beware of employees desiring to change exemptions to very high numbers

Federal Income Taxes

- Employer required by law to deduct income taxes from employee pay
- Based on wage bracket tables published by the IRS
- Contained within Publication 15, Circular E, in back part of publication
Sick Pay

- 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.
- Same rules apply if sick payments are made to an employee who has been absent from work for at least 6 months.

Social Security Taxes

- Employers required to withhold 6.2%.
- Employer portion is 6.2%.
- Applies to the first $128,400 of wages.

Medicare Taxes

- Employers required to withhold 1.45%.
- Employer must also match this amount at 1.45%.
- No upper limit.
- Additional Medicare Tax for wages in excess of $200,000.
  - 0.9% withholding requirement.
  - No employer share.
State Income Taxes

- Employees must complete and submit Form G-4 to have state taxes withheld from their wages.
- If no form is completed, employers must 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 the Georgia Department of Revenue for approval.

O.C.G.A § 48-2-2

GTC – Electronic Payments

Electronic submission of withholding tax of $500 or more is required.

Georgia Taxpayer Center (GTC) administers.

Remitting Federal Taxes

- Taxes withheld are the property of the federal government.
- Employer holds them in escrow until the required remittance date.
Remittances

Deposits can be made in three ways:
- **Monthly**
  - No later than the 15th day of the month following the reporting period
  - Use only if the total amount of deposits during the lookback period is less than $50,000
- **Semiweekly**
  - Mandatory if the lookback period exceeds $50,000
  - Deposits must be made if payroll falls during the week
- **100,000 Next-Day Deposit Rule**

Penalties

- ✗ Not made on time
- ✗ Insufficient deposits

Employer’s Quarterly Federal Tax Return

Form 941 must be filed by employers on a quarterly basis with the federal government

Identifies the amount of all wages on which taxes are withheld, the amount of the taxes withheld, and any adjustments to withheld taxes from previous reporting periods.
Employer’s Quarterly Federal Tax Return

- Exhibit 5-1 Form 941.pdf
- Exhibit 5-2 Form 941 Instructions.pdf

G-7 Quarterly Return

- File on Georgia Tax Center (GTC)
- Taxes withheld for each month should agree to Payroll Register
- Taxes Paid for each month should agree to
  - GTC payment confirmations
  - Vendor Activity Report

Exercise

Chapter 5
Chapter 6
Payroll Deductions

Learning Outcomes

- **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 are Garnishments?

- Means of collecting a monetary judgment against a defendant by ordering a third party to collect and pay money owed to a debtor
- Most are Court ordered
Why Garnishments Exist

- Debts are incurred
  - Borrow money and can’t pay back
  - Child support
  - Failure to file and pay state or federal income taxes
- Collection process (garnishment) is initiated
  - Employer is held liable for withholding funds from workers
  - Money deducted directly from paychecks to service debt

Wage Garnishment

- Most common type
- Types of wage garnishments
  - IRS tax levies
  - Child Support orders
  - Third Party collections

Title III, Consumer Credit Protection Act

- Administered by the US Department of Labor, Wage and Hour Division
- Protects consumer from unfair or harsh collection practices
Title III, Consumer Credit Protection Act

- Restricts employer's ability to terminate employee subject to garnishment for any **ONE** debt
  - Does not protect employee from discharge if employee's earnings have been garnished for second or subsequent debt
- Limits amount of employee's wages that may be withheld

Title III, Consumer Credit Protection Act

- Applies to all employers and individuals who receive earnings for personal services
  - Wages
  - Salaries
  - Commissions
  - Bonuses
  - Payments from pension or retirement program
- Does not ordinarily include tips
- Applies in all 50 states, District of Columbia, US territories and possessions.

Title III, Consumer Credit Protection Act

- **Disposable earnings**
  - Amount of earnings left after legally required deductions have been made
    - Federal, state and local taxes
    - Social Security
    - State employee retirement system
  - Deductions not required by law are not included in disposable earnings calculation
**Disposable Earnings**

<table>
<thead>
<tr>
<th>Gross Wages</th>
<th>Federal Tax</th>
<th>Social Security and Medicare Tax</th>
<th>State Unemployment and Disability Insurance Tax</th>
<th>State Employee's Retirement</th>
<th>Disposable Earnings</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$500</td>
<td>(120)</td>
<td>(50)</td>
<td>(20)</td>
<td>$300</td>
</tr>
</tbody>
</table>

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.

**Child Support Payments**

- Court ordered garnishments
- Maximum amount of an employee's disposable earnings subject to withholding is 60% of his/her pay or 50% if the employee is already making payments to support other children or spouses
- Percent's increase by 5% if an employee is **12 or more weeks in arrears** in making support payments

- Takes precedence over all types of garnishment order with the exception of tax levies received prior to the date of the court order
- Withholding must begin no later than the first pay period beginning 14 working days after the posted date of the court order
- Payments go to the court-designated person
Exercise Problem

- See problem on page 6-4

Advances

If for business trip, usually paid through an accounts payable system

If employee neglects to turn in an expense report, he/she is liable to the employer for the amount of the advance
- Deductions can be made from employee paychecks to recover the amounts outstanding

Unpaid Taxes

- Garnishments of original amount of unpaid taxes plus penalties and interest
- Form 668-W is the standard form used
- If an employee fails to remit part 3 and 4 of Form 668, employer is required to calculate exempt amount under the assumption of married, filing separate with one exemption

Continued on next slide
Unpaid Taxes

- Only 15% of certain types of payments are subject to the tax levy (Page 6-7)
- Certain allowable deductions (Page 6-7)
- IRS table used to determine the amount of net wages that are exempt from the tax levy
- Exhibit 6-1 IRS Pub 1494.pdf

Exercise Problem

- See Example on page 6-8

Authorization

- Voluntary deductions should be approved by the employee
- A form is a good way for an employee to authorize deductions
  - Keep in personnel file
Exercise
Chapter 6

Chapter 7
Reporting and Recording

Learning Outcomes

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
State Unemployment Tax

SUTA provides temporary income to workers who have lost their jobs.

Form DOL-4N.pdf must be filed quarterly to report SUTA taxable wages and if required, make payment of tax.

State Unemployed Tax

- **Reimbursable** - the Georgia Department of Labor mails a quarterly bill for benefit payments. Governments are still required to report quarterly wages.
- **Contributory** - paid on the first $9,500 of wages earned in a calendar year at a rate determined by Georgia Department of Labor

Recording the Payroll

- Payroll journal information
- Terminology:
  - Gross payroll
  - Adjusted gross payroll
  - Net payroll
- Payroll Deductions
- Recording the payroll
**Recording the Payroll**

The journal entry required to record the payroll follows:

<table>
<thead>
<tr>
<th>Account No.</th>
<th>DR</th>
<th>CR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expenditure control 500</td>
<td>$24,649</td>
<td></td>
</tr>
<tr>
<td>FICA payable 221</td>
<td>$1,866</td>
<td></td>
</tr>
<tr>
<td>Federal income tax 222</td>
<td>4,897</td>
<td></td>
</tr>
<tr>
<td>State income tax 223</td>
<td>1,275</td>
<td></td>
</tr>
<tr>
<td>Pension payable 224</td>
<td>786</td>
<td></td>
</tr>
<tr>
<td>Def compensation 227</td>
<td>3,500</td>
<td></td>
</tr>
<tr>
<td>Cash in bank 101</td>
<td>12,325</td>
<td></td>
</tr>
</tbody>
</table>

**Exercise**

Chapter 7

**Chapter 8**

Effective Internal Controls Over Payroll
Learning Outcomes

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 Payroll Process

- Personal Services = Big Bucks
- Expenditure includes
  - Adjusted gross pay
  - Employer's share of benefits
- Payroll department
  - Pays employees
- Strong internal controls needed

Payroll Cycle

Receipt of Time/Time/ExTax Tab

Entry of Time into Payroll System

Adjustments to Salary/Weekly Rates

Enter changes to deductions and withholdings

Balance Hours, Salaries, Deductions, Withholdings, and Benefits
Payroll Cycle

- Generate Paychecks/Deposit Report
- Transact a payroll
- Deliver Paychecks to Employees
- Transfer Direct Deposit
- Enter Payroll Withholdings, Deductions, and Benefits
- Recycle General Ledger Accounts
- Recycle Bank Statement

Control Objectives

Control operations
- Establish levels of authority
- Provide approval for transactions
- Provide feedback to approvers

Safeguard assets
- Loss or damage
- Waste, inefficiency, error, theft or fraud

Control Objectives

- Timely
- Reliable
- Supports control structure

Provide adequate information
7 Supplementary Objectives

- All transactions are recorded
- Record only valid transactions/prevent recording of invalid transactions
- Authorize only valid transactions/protect from invalid transactions
- Value transactions correctly/protect from incorrect calculations and errors in recording

Continued on next slide

7 Supplementary Objectives

- Recorded transactions are classified correcting using Chart of Accounts
- Record transaction in timely manner
- Transactions recorded to subsidiary ledgers and posted to general ledger

Continued on next slide

Control Objectives for Payroll

1. Payroll transactions are preapproved or authorized.
2. Only valid transactions are recorded and recorded in proper period.
3. Valid transactions are accurate, agree with source documents and recorded timely.

Continued on next slide
Control Objectives for Payroll

4. Recorded transactions
   - Represent economic events that actually occurred
   - Are lawful in nature
   - Are executed in accordance with management’s general authorization.

Continued on next slide

Control Objectives for Payroll

5. Access to payroll records are controlled
   - Restricted to authorized personnel

6. Proper segregation of duties

Control Environment/Payroll

- Foundation of IC system
- Elements include:
  - Integrity/ethical values
  - Commitment to competence
  - Management’s philosophy/operating style
  - Organizational structure
  - Assignment of responsibility/authority
  - Human resource policies/procedures
Control Environment/Payroll

- Control Environment = Entity Control
  - Examination of overall values, systems, policies and procedures
  - Does not relate to particular application such as capital asset system, cash receipts, cash disbursement, payroll
- Overall tone is not ethical positive, IC success is minimized

Risk Assessment/Payroll

- IDENTIFICATION and ANALYSIS of not meeting objectives

Objective No. 1: Authorization

Risks:
- Hiring an unapproved employee
- May not be legally eligible
- Overspending budget
- Hiring an unqualified employee
- Incorrect classification for benefits could result in higher costs
Objective No. 2: Safeguarding Assets

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

Objective No. 3: Accurate, reliable and timely information

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

Control Activities for Payroll

Four Categories of Control Activities
- Hiring
- Documentation
- Authorization
- Reconciliation
Control Activities for Payroll

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

Control Activities for Payroll

- Documentation — complete the forms
  - Personal data
    - Form I-9
    - Form W-4
    - Form G-4
  - Benefit forms
  - Retirement plan forms
  - Other forms

Control Activities

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

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

Control Activities for Payroll

- Checklist easy way to show completed tasks
- Also need to reconcile general ledger accounts after withholdings are paid

Information/Communication for Payroll

- Enrollment periods for benefits
- Pay periods and dates
- Holidays
- Furlough days
- Personnel policies and procedures
- Salary information
- Benefits payable
- Tax withholdings
Monitoring and Payroll

- Are controls operating as intended?
- Unmonitored controls deteriorate over time
- Ongoing monitoring
- Separate evaluations
- Combination of ongoing and separate monitoring

Monitoring and Payroll

Supervisory activities:

- Preventive control
- Detective control

Examples:
- Reconciliations of payroll amounts
- Initial and date face of reconciliation
- Review change forms for accurate and timely posting

Monitoring and Payroll

- Separate Evaluations
  - Completed by persons outside of operations after the fact
    - External auditors
    - Internal auditors
  - Objective
    - Internal controls functioning properly
    - Provide communication tools for deficiencies
Exercise
Chapter 8

Chapter 9
Segregation of Duties

Learning Outcomes

* 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 (SoD) means separating the record-keeping function from the operational responsibility of that activity and from those who exercise physical control over the records.

What is Segregation of Duties?

Deliberate fraud more difficult
Likely that innocent errors will be found

• Used to ensure that errors or irregularities are prevented or detected on a timely basis by employees in the normal course of business.

What is Segregation of Duties?

• Internal controls serve as a wellness coach for processes and structure, serving as an ever present help to keep us mindful of what is important.
Categories of Duties to be Segregated

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

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

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

Reconciliations (Accountability)
- Preparing bank reconciliations
- Preparing payroll liability reconciliations

Evaluating

Ask yourself...

- 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?

Evaluating

Function that is indispensable, potential subject to abuse

Divide function into separate steps

Assign each step to a different person or different department
Evaluating

At a minimum, no person should be able to perform more than two of the functions. The matrix illustration below presents various ways to assign responsibilities that are less than the optimum.

<table>
<thead>
<tr>
<th>RESPONSIBILITY/SCENARIO</th>
<th>Authorization</th>
<th>Control</th>
<th>Recording</th>
<th>Reconciliation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Emp1</td>
<td>Emp2</td>
<td>Emp1</td>
<td>Emp1</td>
</tr>
<tr>
<td>2</td>
<td>Emp2</td>
<td>Emp1</td>
<td>Emp2</td>
<td>Emp4</td>
</tr>
<tr>
<td>3</td>
<td>Emp1</td>
<td>Emp2</td>
<td>Emp4</td>
<td>Emp1</td>
</tr>
<tr>
<td>4</td>
<td>Emp1</td>
<td>Emp2</td>
<td>Emp2</td>
<td>Emp4</td>
</tr>
</tbody>
</table>

Mitigating or Compensating Controls

- Reduces the risk of an existing or potential control weakness resulting in errors and omissions.
- Compensating controls are less desirable than the segregation of duties.
- More resources are required to investigate and correct errors and to recover losses.

Types of compensating controls that can be implemented:
- Review reports of detail transactions
- Review selected transactions
- Take periodic asset counts
- Check reconciliations
Mitigating or Compensating Controls

- Management performs the procedure
- Compensating controls cannot be delegated

Exercise

Chapter 9

Chapter 10

Payroll Resources
IRS Publications

- **Publication 509**, Tax Calendars
- **Publication 15**, Employer’s Tax Guide
- **Publication 15-A**, Employer’s Supplemental Tax Guide
- **Publication 15-B**, Employer’s Tax Guide to Fringe Benefits

IRS Publications

- **Publication 509**, Tax Calendars –
  - Lists the dates on which a variety of taxes are due

IRS Publications

- This manual defines employees, discusses wages, payroll period, withholding and depositing taxes and a variety of other tax-related subjects.
IRS Publications

- 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.

IRS Publications

- 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.

Best Practices – Payroll Issues

- Plan and schedule for the worst-case scenario
- Ensure your payroll systems have a "backup"
- Cross-train personnel
- Deal promptly and effectively with issues
- Notify those "who need to know"
- Develop, document, and assess crisis procedures for validity and results
- Review and update procedures annually
Safeguards and Overtime

- Approval of time records by supervisor/department head to prevent employee fraud on time document
- Time records should be reviewed for compliance, mathematical calculations, general reasonableness, and proper approvals

Safeguards and Overtime

- Batch totals or processing should be used to ensure that the correct number of hours have been entered into the database
- Time records should be matched against the payroll register to ensure data has been entered correctly in the database
- Total hours should be checked for reasonableness

Record Retention

- Please refer to page 10-3 and 10-4 for a list of records that must be kept after the last day of entry for each covered employee under FLSA.
Set Clear-Cut Guidelines

- Segregation of job duties leads to greater internal control
- New integrated systems contain “password security”
- Identify other systems that interface with payroll

Preventing Miscalculated Taxes

- Establish pay-period and quarterly balancing procedures
- Locate source of any imbalances and correct employee records
- Keep a record of the explanation for all discrepancies and all adjustments that you make
- Be consistent in using standard operating procedures in your payroll practices

E-Verify Know Your Rights Quiz