PAYROLL ACTIVITIES

A system of internal control may be implemented in many different ways. Because political subdivisions vary in purpose, size and complexity, no single method of internal control is universally applicable. However, the five internal control components should be present and functioning in all political subdivisions.

Questions have been accumulated for all five internal control components. This document includes questions pertaining to various noncompliance issues regarding payroll activities. These questions can be used to aid in designing a proper system of internal control over payroll activities that will allow deficiencies in payroll activities to be prevented or detected and corrected. It is not necessary to address all questions in this document. These are only suggestions and ultimately it is up to the unit on how they implement it. The internal control system as a whole has to be designed and implemented appropriately in order to allow errors and deficiencies in payroll activities to be prevented or detected and corrected.

Components of Internal Control:
- Control Environment
- Risk Assessment
- Control Activities
- Information and Communication
- Monitoring

Control Environment - Sets the tone of the unit and influences the effectiveness of internal controls within the unit. It comprises the integrity and ethical values of the unit and is set by the governing board and management. The standards, processes, and structures which form the control environment pervasively impact the overall system of internal control.

The questions in this section are divided by questions that pertain to the governing board, management and both the governing board and management.

Governing Board:	YES	NO
1) Does the governing board oversee the unit's internal control system over payroll activities		
2) If considered necessary, did the governing board establish an oversight committee and appoint members with high ethical values, excellent communication and problem solving skills?		
3) Does the unit have a mission statement, objective and goals?		
4) Does the governing board convey periodic messages of expectations to all employees?		
5) Are there written policies documenting internal control procedures over payroll activities? If yes, do these written policies outline the authority and responsibility for payroll activities?		
6) Did the governing board establish policies that cross over offices and departments for payroll activities?		
7) Did the governing board establish policies and procedures established to monitor employees who earn compensation or exchange time? If yes, does someone ensure that employees are following the policies?		
8) Are all compensation and benefits paid to officials and employees, including salary changes and the creation of new positions that occur during the year, included in a salary ordinance, resolution, labor contract or salary schedule adopted by the governing board, unless otherwise authorized by law? Note: Compensation for elected officials may be not changed in the year for which it is fixed. County Council approves salaries for counties.		
9) How involved is the governing board in understanding the payroll process, overseeing the effectiveness of internal controls over payroll activities, and evaluating whether the accounting records that support payroll disbursements are correct? For example, is the governing board's involvement limited to attending board meetings, or does the board oversee other things such as unit controls, accounting practices, etc.		
10) Did the governing board develop an organizational chart? If yes, is the organizational chart current and accurate?		
11) Have job descriptions been created outlining specific duties? Is yes, do these duties address responsibilities regarding payroll activities?		
12) Has fiscal authority been formally delegated to specific management personnel?		
13) Did the governing board develop a formal employee evaluation system to set the intervals in which employees will be evaluated? If yes, does the formal evaluation system include disciplinary action that will be taken if an employee does not meet the expectations noted in the evaluation system?		
14) Does management provide documented processes regarding the payroll activities to the governing board for review?		
15) How does the governing board oversee the activities of management that are related to financial reporting? What oversight does the governing board give on the accounting records?		
16) Are accounting department employees required to take vacations?		

	YES	NO
17) Has the governing board developed and implemented an ethics policy? If yes, does the policy address potential conflicts of interest? Is there a system of annual acknowledgment in place where either through e-mail submission or manual documentation, each official and employee attests that they have read the policy and will adhere to the policy?		
18) Are there regular meetings of the governing board to set policies and objectives and review the entity's performance?		
19) Are the minutes of such meetings prepared and signed on a timely basis?		
20) Are confidentiality agreements required for employees who come in contact with confidential information?		
21) Are policies regarding personal use of computer equipment and software clearly stated?		

Management:

1) Does management develop and maintain documentation of the internal control system over payroll activities?		
2) What procedures did management put in place for payroll activities?		
a. Does management assign responsibility and delegate authority to achieve a proper payroll process?		
3) Does management establish an organizational structure, assign responsibility and delegate authority in order to achieve proper payroll activities? If yes, did management establish and document the organizational structure of each office and department? Examples of items to incorporate into the structure could include: an organizational chart; outline of specific duties; designation of responsible persons for each part of the accounting process; documentation of internal control procedures over specific accounting areas; etc.		
4) Does management ensure compliance with the unit's personnel policies and procedures concerning hiring, training, promoting and compensating?		
5) Does management check credentials and references for new employees?		
6) Do employees who are involved in the payroll process receive continuous or periodic training? If yes, what kind of training do employees receive to help them maintain their accounting and financial reporting competencies?		
a. What background, education, and experience do accounting personnel have that assist them with their duties?		
7) Does management reward employees for following good internal control practices through promotions or increase in compensation?		
8) Is turnover of key fiscal personnel relatively low?		
9) Does the workload of accounting employees facilitate the preparation of reliable accounting records?		
10) Does management evaluate performance and hold individuals accountable for their responsibilities? If yes, what action is taken for employees not performing their responsibilities?		
11) Is cross training completed to ensure that more than one employee is knowledgeable about the payroll process? This cross training would allow more than one employee to be aware of potential design deficiencies in the internal controls or of noncompliance with internal controls.		
12) Do accounting supervisors frequently prepare reports or reconciliations to verify the accuracy of financial transactions?		
13) Does management take an active role in the financial reporting of the unit?		
14) Is management actually involved in supervision of the various functions?		
15) Does management ask employees for their suggestions on how to improve processes?		
16) Has management given a high priority to its internal control structure?		
17) Does management emphasize meeting the budget and/or financial and operating goals?		
18) Is management willing to adjust the financial statements for misstatements that approach a material amount?		
19) Does management discuss internal controls at management and other staff meetings?		

Governing Board and Management:

1) Does the governing board and management stress adherence to policies and procedures?		
2) Is there a clear assignment of responsibility and delegation of authority to deal with such matters as organizational goals and objective, operating functions and regulatory requirements?		

Risk Assessment - Risk is the possibility that an event will occur and adversely affect the achievement of objectives. Risk assessment is the process used to identify and assess internal and external risks to the achievement of objectives, and then establish risk tolerances. It is the basis for determining how risk will be managed.

	YES	NO
1) Does management identify, analyze and respond to risks regarding payroll activities?		
a. What areas have been identified regarding payroll activities that may be exposed to fraud risk		
i. Risk factors may include non-compliance with statutes, changes in management or employees, competence and experience of personnel assigned to payroll activities, findings reported in prior audits regarding payroll activities, new accounting system, new technology allowing alteration of documents, volume of payroll transactions, ghost employment, padding hours for time not worked, salary payment not in compliance with the salary ordinance, incorrect posting of classifications, unauthorized access to payroll applications, miscalculations, override of system controls, etc.		
b. Does management analyze the identified risks to determine the effect of the risk on on achieving correct payroll activities? For example, does management consider how likely the risk will occur, how it will impact the objective, if the risk is based on complex or unusual transactions, if the risk is based on fraud, etc.		
c. How has management addressed risks associated with using computerized accounting records, such as unauthorized access to applications or data, potential loss of data, and reliance or inadequate systems that may adversely affect internal control?		
d. How has management responded to identified risks? For example, management may accept the risk and take no action, choose to eliminate certain processes to avoid the risk and institute proper internal controls.		
e. When needed, does management go back to the governing board to enact or modify policies that will clearly define these areas?		
2) Does management clearly define proper payroll activities to enable the identification of risks and to define risk tolerances? Written procedures should be clear and address items such as who will be involved in payroll activities, how proper payroll activities will be achieved, and when will proper payroll activities be in place.		
3) How does management prevent fraud and errors in the accounting records, which are used to post payroll transactions? For example, are important internal control procedures in place such as approvals, regular preparation or review of reconciliations, review of supporting schedules or reports, etc.?		
4) Is management continually aware of changes, both external and internal, that could affect payroll activities? If yes, does management determine any modifications needed in the internal control process to adopt to these changes?		
5) Did the governing board or management incorporate external requirements, such as state statutes and Uniform Compliance Guidelines?		
6) What procedures are in place to ensure that payroll disbursements are correct and reflective of the accounting records?		
7) Are employees involved in payroll activities bonded?		

Control Activities - The actions and tools management establishes through policies and procedures that help to detect, prevent, or reduce the identified risks that interfere with the achievement of objectives and to respond to risk in the internal control system.

An integral part of the control activity component is segregation of duties. However, in very small governmental units, such segregation may not be practical. In this case, compensating activities should be implemented which may include additional levels of review for key operational processes, random and/or periodic review of selected transactions. In smaller units, these reviews and testing of processes might be performed by governing boards or other elected officials.

There is an expectation of segregation of duties. If compensating controls are necessary, documentation should exist to identify both the areas where segregation of duties are not feasible or practical and the compensating controls implemented to mitigate the risk. Clear documentation should be maintained for continuity as well as ease of communication to outside parties.

	YES	NO
1) Is there a system of checks and balances (segregation of duties) to ensure the proper reporting of payroll activities?		
a. Are salary and wage rates verified by someone outside the payroll process?		
b. Are responsibilities for preparing payroll segregated from other payroll and personnel duties? For example, approving time sheets, distribution of checks, hiring and terminating employees, approving promotions		
c. Are responsibilities for payroll accounting segregated from those involved in the general ledger function?		
d. Are payroll adjustment reports reviewed by someone outside the payroll process?		
e. Are responsibilities for signing the checks segregated from those who prepare the checks?		
f. Are unclaimed payroll checks/stubs returned to an individual other than those involved in the payroll process?		
g. Are responsibilities for posting vacation and leave records segregated from those who prepare and sign the checks?		
h. Are changes to payroll disbursements approved by an individual other than those authorized to make the changes?		

	YES	NO
i. Are responsibilities for reconciling the payroll bank account separate from those involved in the payroll process?		
j. Are responsibilities for hiring, terminating, and approving promotions segregated from those individuals involved in payroll activities and those individuals maintaining personnel files?		
k. Are responsibilities for payroll data entry segregated from those individuals who have payroll approval authority?		
l. Does an individual not involved in payroll activities periodically verify all personnel salaries and wage rates?		
2) Are payroll disbursements approved by the governing board by signing the Payroll Schedule and Voucher (form 99) or the Accounts Payable Voucher Register (form 364)? If approval is documented through the use of the Accounts Payable Voucher Register, is the Payroll Schedule and Voucher included with other claims approved by the governing board?		
3) Are employees' time and attendance records approved by their supervisors?		
4) Are time clocks and time cards properly controlled?		
5) Are corrections to recorded time and attendance records approved by the employee's supervisor and authorized by management?		
6) Are overtime payments and comp time earned monitored, properly supported, approved and reasonable?		
7) Are there adequate authorization and approval procedures regarding vacation, holiday, and sick leave compensation?		
8) Are leave accruals reviewed for reasonableness? For example employees who have taken leave, but reports don't show a decrease in the accrual balance.		
9) Are there adequate procedures in place for changes in salary and wage rates?		
a. Are these functions authorized by appropriate personnel?		
b. Are these functions reviewed and approved by someone outside the payroll process?		
c. Is information compared to documentation from human resources, departmental managers, and similar sources?		
10) Are there adequate procedures in place for the processing of new and terminated employees?		
a. Are these functions authorized by appropriate personnel?		
b. Are these functions reviewed and approved by someone outside the payroll process?		
c. Is information on new and terminated employees compared to documentation from human resources, departmental managers and similar sources?		
11) Are procedures in place to ensure that changes in employment status are promptly reported to the payroll processing department and recorded in the payroll data base?		
12) Are personnel files checked against a set checklist of required documents to determine that withholding forms and authorizations for payroll deductions exist?		
13) Is a separate payroll bank account maintained?		
14) Are payroll disbursements compared to previous payrolls and/or budgeted amounts to determine reasonableness?		
15) Are payroll reports reviewed by a department head or designated individual to ensure that payroll costs are allocated to the appropriate accounts, funds, and programs?		
16) Are payroll disbursements approved by an authorized individual prior to payment?		
17) Are investigations made of unusual journal entries?		
18) Are deposits to the payroll bank account compared with the payroll register?		
19) Are direct deposits properly reviewed, authorized, and approved?		
20) Does the appropriate level of management or another appropriate person review reconciliations between payroll registers and general ledger accounts?		
21) Are payroll checks accounted for in numerical order and reconciled to the payroll check register and general ledger?		
22) Are payroll checks accounted for in numerical order and reconciled to the disbursement ledger?		
23) Are payroll check registers and the general ledger reconciled to gross and net pay amounts noted on payroll tax returns?		
24) Is there a year-end reconciliation of total W-2 wages (including taxable fringe benefits) to the wages paid per the general ledger and payroll register?		
25) Are budget reports reviewed to ensure payroll and benefit expenditures are where they should be		
26) Do departments review payroll distribution lists for reasonableness?		
27) Are error reports created to identify employees with the same bank account number or same address?		
28) Are procedures in place to ensure that employees who leave employment are deleted from the payroll system?		

	YES	NO
29) Are there adequate procedures in place for changes in payroll deductions?		
a. Are these functions authorized by appropriate personnel?		
b. Are these functions reviewed and approved by someone outside the payroll process?		
c. Is information compared to documentation from human resources, departmental managers, and similar sources?		
30) Are there procedures in place to ensure that payroll taxes are paid in a timely manner and that payroll tax returns are filed when due?		
31) Are procedures in place to ensure that other withholdings, such as health insurance premiums, 401(k) and cafeteria plan withholdings, are remitted in a timely manner?		
32) Are benefit reports reviewed to ensure they are accurate and meet expectations? For example employee paid benefits being paid by the employer, deductions that do not make sense, etc.		
33) Did management design the entity's information system and related control activities to ensure the proper handling of payroll activities?		
a. Did management implement control activities through written policies?		
b. Is access to payroll applications appropriately controlled by user logins and passwords?		
34) Is access to signature stamps, mechanical check signers or signature plates used to sign payroll checks adequately controlled?		
35) Are payroll checks/stubs periodically distributed by someone outside the normal payroll distribution function?		
36) Is the signing of payroll checks in advance prohibited?		
37) Are voided checks and documents to support the voided checks retained?		
38) Are checks payable to "Cash" prohibited?		
39) Are blank check stock kept in a secure location?		
40) Does a responsible individual take monthly physical inventories of blank checks?		
41) Are signed checks promptly recorded?		
42) Are employee addresses and bank account numbers reviewed to determine if multiple payments are going to the same address or bank account? This is a common way organizations are defrauded when family members work for the same unit.		
43) Are employees who use post office boxes reviewed?		
44) Are personnel files reviewed to verify if they are a real person and if they are an employee?		
45) If payroll is processed by an outside service organization, are procedures in place to ensure the following?		
a. Time records submitted for processing are complete and accurate. Appropriate control totals are maintained for subsequent reconciliation to payroll registers.		
b. All other payroll information provided to the service organization (pay rates, withholdings, etc.) is authorized, and all authorized information is communicated.		
c. Payroll registers produced by the service organization are reviewed after processing, reconciled to control totals, and approved prior to distribution of paychecks.		
d. Total of paychecks and/or direct deposits agrees with payroll registers.		
46) Are individuals involved in the payroll process knowledgeable?		

Information and Communication - Relevant information from both internal and external sources is necessary to support the functioning of the other components of internal control. Communication is the continual process of providing, sharing, and obtaining necessary information.

	YES	NO
1) Are procedures established to ensure that proper communication and documentation exists for internal communications between offices, departments, management and the governing board regarding payroll activities?		
a. How does the entity internally communicate information regarding payroll activities to employees, including objectives and responsibilities for internal control? Are records maintained to document this communication?		
b. Are procedures established to ensure that the communication requirements are being followed and necessary information is being communicated properly?		
c. Are procedures established for feedback on and clarification of the information provided?		
2) What procedures are in place to collect the information needed for payroll activities?		
a. Does management use the most current information available to ensure proper payroll activities?		

Monitoring - Activities that allow management to assess the quality of internal controls over time and make adjustments as necessary. Proper monitoring ensures that controls function properly.

	YES	NO
1) Are procedures in place to ensure that appropriate personnel perform their required duties sufficiently and adequately follow the policies and procedures of the governmental unit over payroll activities?		
2) Are internal control procedures over payroll activities evaluated and adjusted on a regular basis? For example personnel changes, newly elected officials, new technology, etc.		
a. What follow-up action is taken for identified problems or weaknesses in internal controls regarding payroll activities?		
3) Are monthly reports detailing payroll disbursements and appropriations for payroll provided to the appropriate department to review for accuracy and reasonableness?		
4) Are monthly reports detailing payroll disbursements and appropriations for payroll provided to management to review for accuracy and reasonableness?		
5) Are monthly reports of payroll disbursements and appropriations for payroll provided to the governing board to review?		
6) Does a confidential reporting system exist so that individuals may report suspected fraud and abuse of the unit's policies?		
7) Are individuals knowledgeable of legal, regulatory, actuarial, and accounting requirements responsible for monitoring employee benefit matters?		
8) Is there a comparison by the appropriate level of management or another appropriate person of actual payroll disbursements to budgeted and prior payroll disbursements? If yes, are investigations performed for all variances noted?		