

**INTERNAL CONTROLS FOR
PAYROLL/PERSONNEL**

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**INTERNAL CONTROLS FOR
PAYROLL/PERSONNEL**

Basic Internal Controls for Districts
Examiner's Audit Procedures
Internal Controls in NextGen Software

**INTERNAL CONTROLS FOR
PAYROLL/PERSONNEL**

Internal Controls- Systematic measures (such as reviews, checks and balances, methods and procedures) instituted by an organization to :

- (1) Conduct its business in an orderly and efficient manner,
- (2) Safeguard its assets and resources,
- (3) Deter and detect errors, fraud, and theft,
- (4) Ensure accuracy and completeness of its accounting data,
- (5) Produce reliable and timely financial and management information
- (6) Ensure adherence to its policies and plans.

<http://www.businessdictionary.com/definition/internal-control.html>

PAYROLL FRAUD

Payroll fraud is surprisingly common, affecting about 30 percent of businesses annually. Businesses lose millions of dollars thanks to unscrupulous employees who take more money than they have earned. This isn't even accounting for the costs associated with investigating potential fraud and taking action against the perpetrators. In some cases, employees are ordered to pay restitution, but often, employee fraud results in losses for the company.

However, not all payroll fraud is created equal. In general, there are three types of payroll fraud: timesheet fraud, ghost employees, and employee misclassification. Understanding the nuances between each type helps pinpoint and stop the crimes before they cost your company money.

[The Three Types of Payroll Fraud](#)
thecollegeinvestor.com/.../ Nov 17, 2015

TYPES OF PAYROLL FRAUD

- Timesheet Fraud
 - Falsified Hours and/or Salary
- Ghost Employees
- Worker Misclassification



TIMESHEET FRAUD

Timesheet fraud involves paying employees incorrectly for the hours they work.

- In some cases, companies overpay employees based on falsified timesheet submissions;
 - Unauthorized hours/Leave
- Buddy punching- Employees might even have a co-worker clock in and out for them.
- One common timesheet scheme, an employee will "forget" to clock in or out, thus requiring a manual entry, to which they then add extra hours.
- Pay rate alteration- Collusion with payroll clerk manually overriding employee timesheets to increase the number of hours worked, or even the rate of pay.

GHOST EMPLOYEES

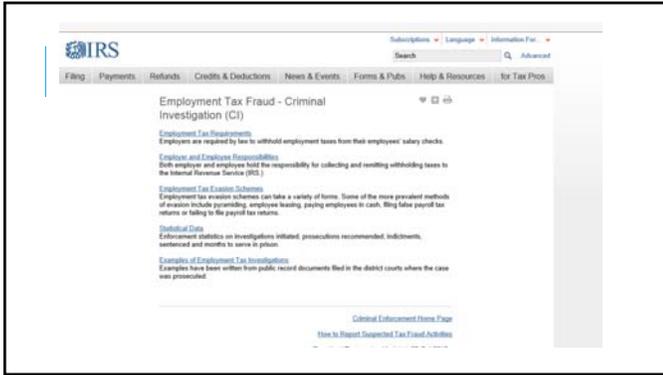
Ghost employees are the second most common type of fraud, and your payroll staff or manager often perpetrates it. In short, a ghost employee is either a fake employee who has never worked for your company — but who has been "created" by payroll to divert funds, or someone who once worked for the company and has since left, but was never officially terminated in the payroll system.

Consider this scenario: Your payroll clerk is Mary Elizabeth Smith. Mary decided that she doesn't earn enough, so she creates a "new" employee named Mary Beth Smith. Then, when she runs payroll, she cuts two checks, one legitimate to Mary Elizabeth, and then another to Mary Beth. In another scenario, assume that an employee recently left the company. Your payroll manager Mary Elizabeth decides that she'd like to earn that person's salary, so she doesn't terminate his or her pay, but instead diverts that pay with a check made out to Mary Beth Smith.

WORKER MISCLASSIFICATION

Worker misclassification is a type of payroll fraud that's perpetrated by the company itself, intentionally or due to a misunderstanding of the rules. The [IRS requires employers to classify employees](#) as either independent contractors (1099 employees) or W-2 employees, depending on the type of work they do, how they are paid, and the parameters of the job.

Some employers deliberately classify employees as 1099 workers to avoid paying payroll taxes, health insurance premiums, and other benefits, which is a clear violation of the law and constitutes fraud. Other employees misclassify employees by accident. Either way, the fine for such fraud can be as high as \$25,000 per instance — plus back payroll taxes and penalties — so it's best to work with a qualified payroll company or experienced manager to classify employees appropriately.



INTERNAL CONTROLS FOR PAYROLL/PERSONNEL

General Controls

- Audit- Internal periodic audit of the payroll function
 - Audits will reveal irregularities
 - Regular audits and review of employee schedules
- Change authorizations-
 - Require written and signed request for any changes
 - Pay and/or W4 changes
- Change tracking log-
 - Password protected interface
 - Will track all changes made to payroll
- Error checking report
 - Independent person runs and reviews reports

GENERAL CONTROLS

- Expense trend lines
 - Look for fluctuations in payroll related expenses
 - Investigate
- Issue payment report to supervisors
 - Request review for amounts and names
- Restrict access to records
 - Locked files
 - Password protected if stored in electronic format
- Separation of duties
 - Preparation/authorization
 - Personnel who create or maintain payroll data/list should not be allowed to make changes or add employees with management approval

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Payroll Calculation Controls

- Automated timekeeping system
- Built in controls
- Calculation verification
 - Second person verify calculations
 - Applies to manual calculation of payroll

PAYROLL CALCULATION CONTROLS

- Hours worked verification
- Approval by supervisor
- Prior approval of any excess hours according to the policy or
- Deviation from work schedule
- Match payroll register to supporting document- Track back to supporting documents
 - Gross wages/deductions and net wages

PAYROLL CALCULATION CONTROLS

- Match timecards/sheet to employee list
- Avoid employee not being paid
- Overtime worked verification- Supervisor Approval
 - Should have policy or procedure in place
- Pay change approval
 - Should require two signatures
- Superintendent/ Supervisor/ CSFO/ Personnel Director
 - Reduces risk of collusion

INTERNAL CONTROLS FOR PAYROLL/PERSONNEL

Check Payment Controls

- Update signature authorizations
 - Remove check signers immediately when they leave district or transfer
 - Notify bank
- Mandatory direct deposit
- Hand checks to employees
- Lock up undistributed paychecks
- Match addresses
- Payroll checking account
 - Payroll accounts should be reconciled monthly and reviewed by management

INTERNAL CONTROLS FOR PAYROLL/PERSONNEL

- When establishing internal controls to prevent fraud, first assess resources to assume you have enough employees to achieve proper separation of duties.
- Have to consider the cost vs risk.
- Objective is to deter and detect **errors, fraud, and theft**.
- Timesheet fraud can usually be caught quickly if proper controls are in place.
- Even in small districts basic controls can diminish the risk of loss.

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- ✓ Internal Controls for Districts
- Examiner's Audit Procedures
- Internal Controls in NextGen Software

SOURCES

Payroll Internal Controls: Accounting Tools <http://www.accountingtools.com/payroll-internal-controls>

The Three Types of Payroll Fraud: The College Investor, [thecollegeinvestor.com/...](http://thecollegeinvestor.com/)/ Nov 17, 2015

How Can Internal Controls Overcome Payroll Fraud? Houston Chronicle- by Chris Bradford, Demand Media

<http://smallbusiness.chron.com/can-internal-control-overcome-payroll-fraud-56266.html>
