Auditing Payroll & Employee Benefits

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Today's Agenda

- Planning the Audit
- Policies & Procedures
- Testing Procedures – Individual Employees
- Testing Procedures – High Level
- Testing Procedures – Additional Procedures
- Reporting Your Results
- Common Pitfalls in Auditing Payroll & Employee Benefits
- Best Practice Recommendations

Planning the Audit

- Obtain all policies and procedures related to payroll and employee benefits
  - Should include the Employee Handbook
- Tailor testing procedures based on Credit Union specific policies and procedures
- Discuss timing of your audit with appropriate individuals involved in approving/reviewing timecards, processing of payroll, payroll disbursement and recording transactions to the general ledger
- Interview appropriate individuals for any areas of concern, typically the CEO and/or CFO, along with HR
- Review the prior report for any areas of concern
- Review the most recent regulatory report for any areas of concern

Planning the Audit (continued)

- Obtain the approval hierarchy for submitting payroll
  - Select various levels of employees with various approvers
  - Select hourly and salaried employees
- Determine if timecards are submitted in paper or electronic form for approval
- Determine if payment is done via paper check or direct deposit
- Obtain the permission hierarchy in the payroll system

Planning the Audit (continued)

- Determine what employee benefits are offered
  - May vary by employee level
- Determine if non-payroll related employee benefits will be included in your testing
- Determine how employees make elections for benefits
  - Electronic or paper
- Determine how often employees can make changes to elections
  - Annually, monthly, quarterly

Policies & Procedures

- Read through all policies and procedures relating to payroll and employee benefits
- There should be BOD approved policies
- Ensure any written procedures comply with the BOD policies
- Obtain the Employee Handbook to ensure language here complies with the BOD policies
- Tailor audit procedures for any specific guidelines/requirements in the Credit Union's policies and procedures

Policies & Procedures (continued)

- Payroll Policies should contain, at a minimum:
  - Timeline for submitting and reviewing timecards
  - Timeline for reviewing, processing and submitting payroll
  - The hierarchy of approvals for each position
  - When employees can expect their payroll checks/direct deposit

- Employee Benefit Policies should contain, at a minimum:
  - Who is eligible for each benefit
  - How to make benefit elections
  - How often benefit elections can be changed

Policies & Procedures (continued)

- Additional items that can be included in a policy
  - Exhibit of timecard
  - Exhibits of various employee benefit enrollment forms
  - Descriptions/details of various employee benefits
  - Statement that timecards are subject to an audit/review by Internal Audit/Senior Management/Supervisory Committee at any time

Policies & Procedures (continued)

- Through review of policies and procedures and inquiry of management, obtain an understanding of the following controls in place:
  - Access to payroll records (physical and electronic)
  - Segregation of duties within the payroll processing cycle
    - Don’t leave out employee directed changes (demographic, benefit elections, etc.)
  - Are other “audits” being performed outside of the internal audit function
  - Be sure to encompass all electronic service providers/software programs utilized
    - Is timekeeping done with the same payroll system?
  - Process for final review of payroll prior to submission

Testing Procedures – Individual Employee

- Determine how you'll make selections
  - # of employees within one pay period
  - An entire branch/department for one pay period
  - # of employees over several pay periods

- Due to the "human element" involved, judgmentally make selections
  - Select a representation of employees (different levels, departments, branches, etc.)
  - Consider selecting any that look "odd"

Testing Procedures – Individual Employee (continued)

- Obtain employee timecards
- Verify all time worked/time off appears legitimate
- Verify proper approval per the approval hierarchy (and timely)
- Compare the employee pay rate in the payroll system to the personnel file
- Compare any and all employee benefits to the personnel file
  - Ensure the employee has actually elected these benefits
  - If no benefits in the payroll systems, ensure the employee opted out
  - Ensure the employee is eligible for the selected benefits

Testing Procedures – Individual Employee (continued)

- Recalculate employee benefits and other deductions (i.e. – payroll taxes, as deemed appropriate)
  - 401k – Regular vs. ROTH
- Obtain copy of payroll check and agree to payroll system/reports
  - Look at check stub for:
    - Payee
    - Payroll period
    - Check Date
    - All amounts - $ and Hours
- Ensure payroll was paid/direct deposited timely

Testing Procedures – Individual Employee (continued)

- Interview members of management to ensure they have knowledge of the employee
- Obtain a list from HR of all active employees to ensure the selected employees are on the list
- Ensure selected employees took their required 5 day consecutive vacation during the year
  - Will most likely not be the pay period selected for testing
  - Obtain the applicable time card and pay register

Testing Procedures – High Level

- Verify proper approvals regarding processing, reviewing, approving and submitting payroll to the processor
- Verify the payroll related journal entries were properly recorded to the general ledger accounts
- Ensure timely remittance of employee withholding and any employer related contributions to the retirement plan administrator
- Obtain a payroll system generated listing of pay codes and review for anything odd
- Consider obtaining a SOC report for the payroll processor
  - Ensure all end-user controls are in place at the Credit Union

Testing Procedures – Additional

- New Hire Testing
  - Obtain signed application
  - Obtain signed offer/offer letter
  - Ensure proper background checks were performed
  - Ensure proper initial payroll tax forms were submitted
  - Any additional steps specific to the CU's policies and procedures
    - Anything specific to the State

Testing Procedures – Additional (continued)

- Terminated Employee Testing
  - Obtain signed resignation letter/termination notice
  - Obtain a completed termination “checklist” if applicable
  - Verify the final time card was approved and all payouts were proper
  - Verify the employee was terminated timely in the payroll system
  - Verify all employee benefits were terminated timely in the payroll system
  - Verify COBRA notices are sent within 30 days of termination
  - Verify all CU property was returned prior to termination
    - Key fobs, laptops, devices, Corporate CU/Federal Reserve key, corporate credit card, etc.
  - Verify access to CU systems/programs was terminated

Testing Procedures – Additional (continued)

- Payroll System Authorized Users & Security Settings
  - Obtain the list of system users
  - Determine each user's access is necessary for their role
  - Determine who can edit time cards and payroll records
    - For anyone with edit permissions, test any edits made during the audit period, if any, for dual control/subsequent review

Testing Procedures – Additional (continued)

- Other Credit Union Specific Items
  - Unused vacation/sick time paid out at year end
  - Specific incentive pay program
  - Promotion/internal transfer testing

- Expand on Testing
  - Errors found in population
  - End-user controls are not in place
    - System access testing
    - Review other mitigating controls

Reporting Your Results

- Start by noting any findings from previous reports and whether they have been remedied/management's response
- Summarize any findings for ease of review and understanding
- Include any management responses/remedies provided prior to report issuance
- When presenting, be prepared to discuss findings in more detail, if requested
- When presenting, discuss why a finding is an issue and what risk it proposes to the CU
- Be sure to include best practice recommendations, if applicable

Common Pitfalls in Auditing Payroll & Employee Benefits

- Not having adequate professional skepticism
- Not tailoring your testing procedures to the specific policy at the CU
- On paper timecards, employee records:
  - Not footing/recalculating paper timecards
  - Not reviewing approval signatures for signs of forgery
- Not recognizing suspicious patterns
  - Salaried employee with inconsistent payrolls
  - Approval occurring but not per the approval hierarchy (timecards and/or payroll processing)
  - Employee changing tax/benefit elections more than a couple of times a year

Best Practice Recommendations

- Clearly defined BOD policies should be in place and reviewed annually for payroll and employee benefits
- Have employees sign/acknowledge all changes to their payroll/benefits
- Require employees to acknowledge their benefits annually, even if there are no changes

Thank You!

- Questions/Comments?
- For a quick guide on auditing payroll and employee benefits: