



# Payroll Guide

**Improving your processes:**

Tips for leaders, managers, supervisors  
and payroll clerks



Center for Government  
**Innovation**

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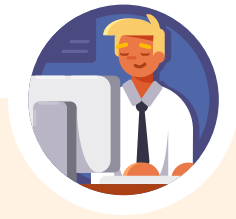
## Leadership

Leadership sets policy and direction for financial operations, such as payroll. Leadership also makes important decisions about the overall structure of control systems—how payroll functions will be organized, when to invest in technology, and when to invest in making improvements to the overall process.



## Payroll Clerks

Payroll clerks carry out the fundamental tasks of processing employee payments. They are responsible for following policy established by leadership, following the internal control system principles established by management, and safeguarding sensitive information.



## Supervisors

Supervisors of the payroll process monitor payroll activities to ensure policies are followed and internal controls operate as designed. They check payroll-related calculations and payments to ensure a high degree of accuracy. They are deeply involved in the day-to-day oversight of the payroll processes.



## Managers

Managers carry out high-level policy decisions leadership set, and they evaluate and suggest improvements to internal control systems. They support the overall payroll function and look for ways to reduce risks or improve accuracy.

# Summary

Payroll represents the largest expenditure category for most governments. It touches every employee in an organization, and every employee expects payroll processing to be highly accurate and timely. Because of this, every government needs strong controls for delivering payroll services.

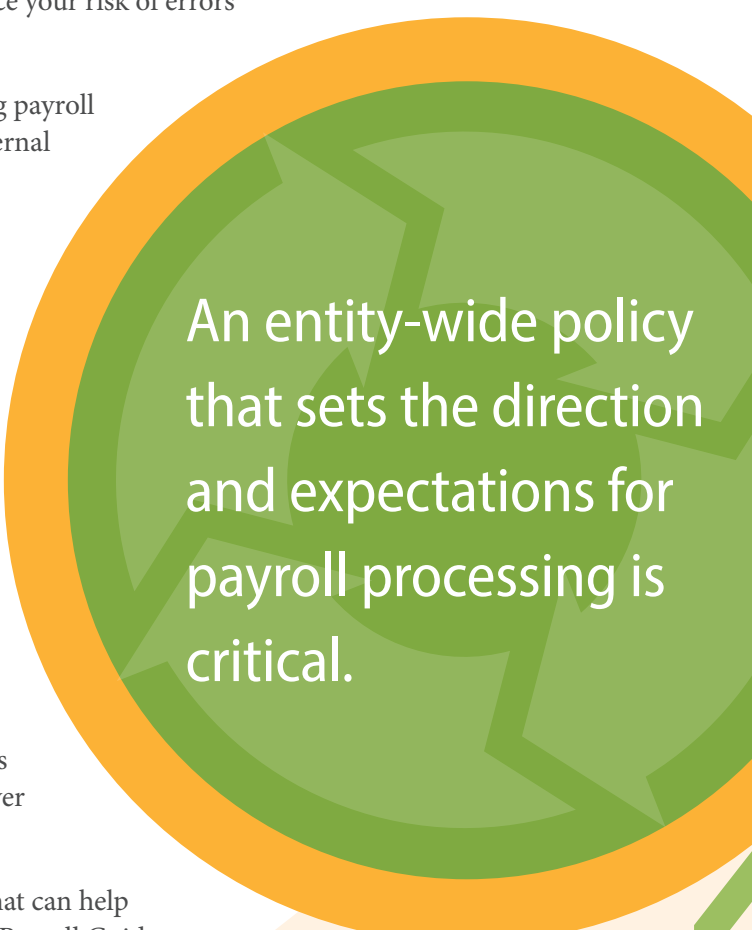
If your payroll routine is mostly manual and hasn't changed for many years, it might be time to explore updating your processes and internal controls. Take a look at new ways to automate your processes and new methods to reduce your risk of errors and fraud.

We know the challenges that governments face in managing payroll processes and in striking just the right balance between internal controls and the costs of those controls. Governments are busy managing daily operations, and sometimes they don't have the time to do the research to discover better ways of doing business.

An entity-wide policy that sets the direction and expectations for payroll processing is critical. If your government doesn't have a policy covering payroll internal controls, this guide can help get you started developing one. Although there is no one solution that fits every government and every situation, there are certainly some best practices, ideas and suggestions to consider.

We know you have limited time. That's why we have prepared guidance for you, regardless of your role. We've made it easy for you to find just what is relevant to you. This guide can be printed in sections and distributed to whomever is in charge of certain responsibilities.

This guide is intended to provide ideas and best practices that can help you build a stronger payroll process. We hope you find our Payroll Guide helpful in your work!



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# Leadership

## Improve your payroll policies today!

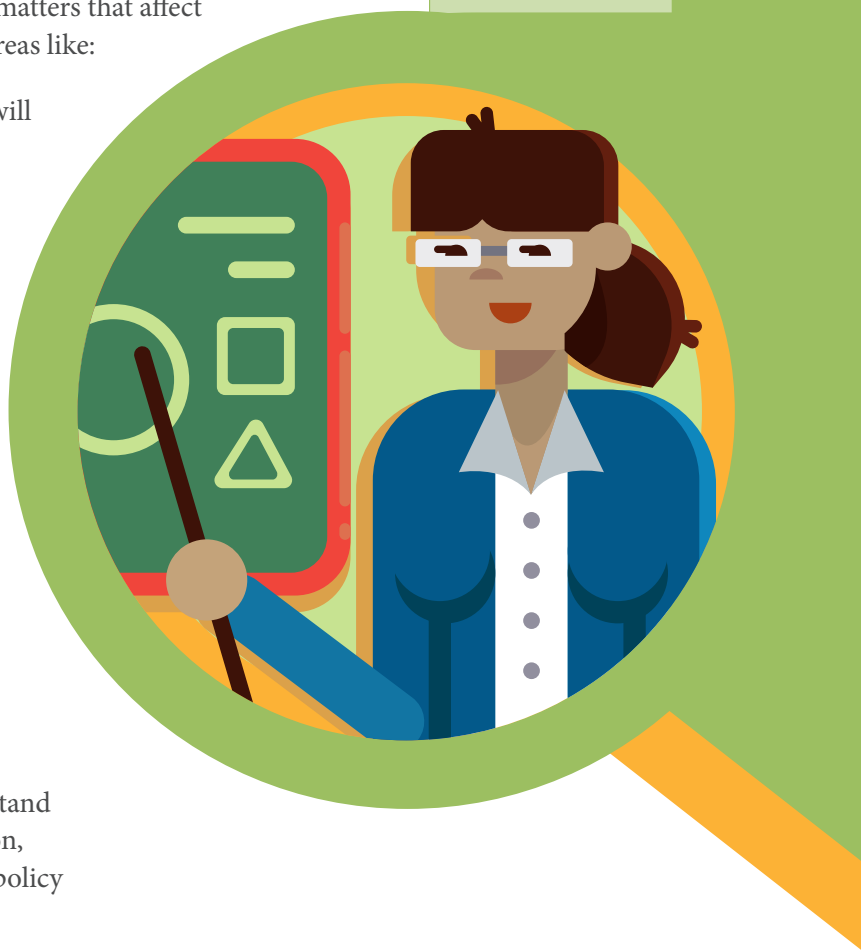
Payroll is a significant expenditure for most governments. That's why it's important to develop guidance that covers all aspects of compensating employees, as well as specific guidance for processing payroll. While it's not possible for this resource to cover every topic you should include in your personnel or payroll policies, here are some ideas to get you started.

### Establish the rules for all employees

It's important to have up-to-date personnel policies for all matters that affect compensation and benefits. Your policies should address areas like:

- **Salary or wage setting** – Describe the documents you will maintain to support salaries, wage rates and changes to them. Designate who authorizes these key documents for the organization as a whole, for each position and for each employee.
- **Non-standard compensation** – Your policy should cover all types of compensation, even those that are infrequent or only paid out in specific circumstances.
- **Timekeeping expectations** – It's important to address who is expected to record time worked, how it should be recorded, and how it will be approved. If you decide exempt employees will not submit time records, your policy should address how time off will be reported and approved for those individuals.
- **Overtime** – This is an area where entities often struggle to align actual practice with policy. Take time to understand how overtime is calculated and paid in your organization, compare actual practice to your policy, and then make policy updates if appropriate.
- **Underpayments and overpayments** – Describe your process for correcting errors.

The Municipal Research and Services Center (MRSC) has many examples of personnel policies on its website: <http://mrsc.org/Home/Explore-Topics/Personnel/Local-Rules-and-Policies/Personnel-Policy-Manuals.aspx>.



## Develop guidelines for employees who process payroll

Payroll staff members need to understand expectations and what steps they are required to take when performing their important duties. Here are a few areas to consider:

- **Payroll processing/payroll clerks** – Describe what you expect payroll staff to verify when processing payments, such as information related to timekeeping, supplemental compensation, leave balances, compensatory time, and payroll deductions.
- **Secondary reviews** – Determine when payroll calculations need a second review, such as when manual pay calculations are performed.
- **Finalization** – Describe what is required to finalize payroll, including the review and authorization needed. For example, a designated official should be charged with reviewing the detailed payroll calculations arriving at gross and net pay before and after payments are made. Another option would be to reconcile the pay run back to source records periodically.
- **Payment methods** – Determine how many payment methods will be allowed, how employees will communicate their chosen method, and how any changes in the information will be documented, verified and approved.
- **A payroll calendar** – Include all internal deadlines for the payroll process that are critical to having payroll completed on time. Also, consider addressing the process for late submittals (such as late timesheets) and other exceptions that might arise.
- **Confidentiality** – Be sure payroll staff understand what information is confidential, how to properly handle or transmit it, and when they need approval before providing it to others inside or outside the organization.
- **Reporting issues** – Determine to whom payroll employees should report concerns, including another option besides their direct supervisor or manager.

## Heed your technology

The proper use of your software application is important, and communicating expectations is critical for ensuring these tools are managed appropriately. Key areas include:

- **Payroll system configurations** – Establish the person responsible for monitoring and updating settings, configurations and tables. State how often the settings should be reviewed, what changes require a secondary review or system testing, and what supporting documentation will be kept to show this was done.
- **Payroll system security and user access** – Identify who will assign and approve user access, and specify how often user roles should be reviewed. Your policy should not allow payroll processors or payroll management to control administrative rights or user access, as these are conflicting duties.
- **Payroll applications maintenance** – Establish responsibility for updating and testing any payroll applications (patch management).



## Create a compliance plan

Payroll involves compliance with many different regulations, and it's important to stay on top of those. Your policy should consider:

- **Changes in regulations (tax, state or federal laws, union contracts)** – Assign responsibility for monitoring and implementing payroll regulations and requirements.
- **Proper employee classification** – Designate someone responsible for ensuring proper employee classification—employee vs. independent contractor, exempt vs. non-exempt, or union applicability.
- **Records retention** – Establish the length of time payroll records (hard copy and electronic) must be kept, and how the confidential information they contain should be secured. In addition, address the timing of records destruction, disposal methods and person responsible.

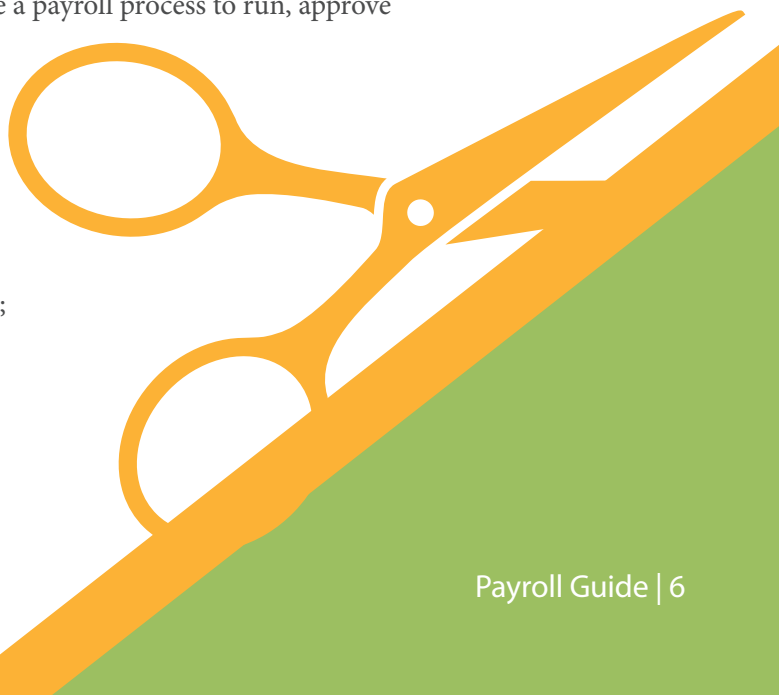
## Segregate conflicting duties

Your policy can be broad and give some general guidelines about segregating duties. Assuming you have the ability to fully implement segregation of duties, here is an example:

- Duties will be segregated between the following roles, with no single person performing more than one role in the process.
  - Authorization – those who approve wage rates, timesheets, payroll check runs and payroll checks
  - Recording – those who process payroll or record it in the general ledger
  - Custody of assets – those who print and distribute checks to employees
  - Reconciliation – those who reconcile the payroll clearing or other bank account

Alternatively, you have the option to be very specific. Again, assuming you have the ability to fully implement segregation of duties, here is an example:

- Specify any duties payroll staff should not perform. For example, payroll clerks are not allowed to reconcile the bank account, prepare the check run, authorize a payroll process to run, approve timesheets, add or remove employees, or modify wage rates.
- The payroll manager must remain independent of the payroll process and approve payroll before payments are generated. The payroll manager shall not handle checks to employees or reconcile the payroll clearing (bank) account.
- Define human resources' responsibilities. For example, human resources will add employees and set up and update wage rates; payroll should not have this ability.



If you are a smaller organization and there are conflicting duties you cannot segregate, then you can modify accordingly and instead describe compensating duties you have in place. See the payroll section of our Segregation of Duties guide for more information: <https://portal.sao.wa.gov/PerformanceCenter/#/address?mid=6&rid=18538>.

## Define roles others will play

Your policy should speak to the roles others play with respect to the payroll process. Here are some roles and functions to consider planning for:

- **Human resources** – Assign responsibilities so that it is clear what human resources is responsible for and what payroll is responsible for.
- **Manager of payroll** – Direct management to any specific review procedures you expect to be performed. Some options include data analysis of various types of compensation, review of various payroll exception reports, periodic reconciliation of payroll information to source records, and periodic in-depth internal control evaluations over the payroll process.
- **Internal audit** – Decide if you will perform self-audits of payroll disbursements or of internal controls. Determine the frequency of any self-audits, and how this information should be communicated to the governing body.
- **Cash management/treasury** – Designate the person responsible for the bank reconciliation of the payroll clearing account.



## Leadership

### Tips to save time in your payroll department

A significant amount of effort goes into accurately processing employee payments, given all the policies and regulations involved. Conserve your resources by improving these areas of your government's payroll function.

#### Use better timekeeping tools

Compared to manual methods, automated timekeeping processes can reduce errors and save time. Employees can report actual time instead of estimating time worked, because automated timesheets are processed faster and they can be completed after the pay period officially ends.

This also results in fewer corrections.

Automated timekeeping has the added benefits of improving controls and reducing fraud risk, such as those that might occur with manual timesheet manipulation.

#### Advocate for integrated systems

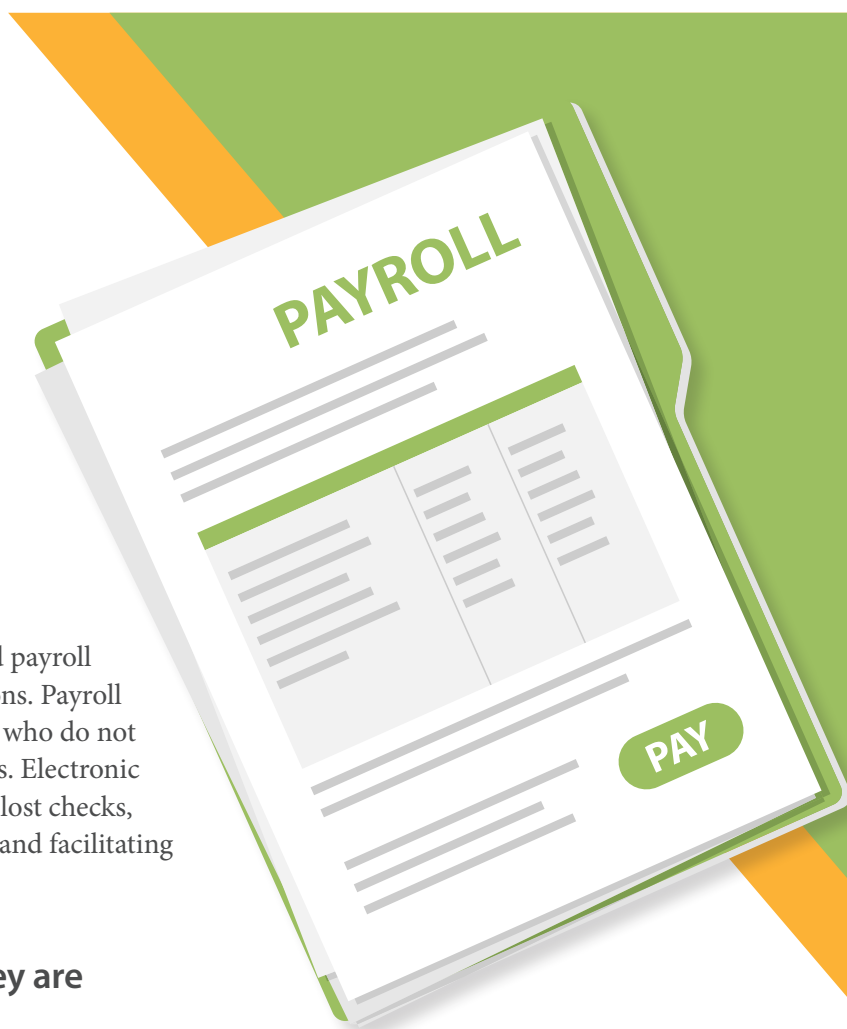
If you have multiple systems that interact with payroll, work toward electronic data transfer rather than manually keying information from one system to another. The goal here is to minimize staff time and ensure a complete and accurate data transfer.

#### Look at options other than paper checks

To reduce costly paper checks, direct deposit and payroll debit cards are possible electronic payment options. Payroll debit card programs are popular with employees who do not have bank accounts or struggle to cash paychecks. Electronic payment options can help reduce problems with lost checks, stale checks or check fraud, freeing up staff time and facilitating easier bank account reconciliation.

#### Obstacles don't block the path—they are the path

Talk to your payroll staff about barriers or obstacles that delay completion of payroll processing, such as departments that submit information late. Late reporting can cause extra work for payroll staff, increase the risk that errors will be made, and distort payroll reporting from one period to another. Work to resolve the issues to allow for more efficient payroll processes.





## What's the rush?

Off-cycle or rush payments between payroll run dates are time-intensive and costly. Analyze why they are occurring. It might be that you can take steps to reduce these, such as by requiring approval of the finance director or other high-ranking official to discourage non-critical requests.

## Reduce the burden of "leave pools"

Donated leave pools can be challenging and time consuming to administer, and employees can perceive them as inequitable. Evaluate alternatives like a catastrophic leave pool and options for short-term disability coverage. In a catastrophic leave pool, leave is donated to a central pool and is available to those who qualify.

## Quiet that ringing phone

If your payroll staff is interrupted frequently, provide information on your intranet site to address employee questions or include answers to frequently asked questions (FAQ). Another option is to consider outsourcing employee and income verification services.

## Use electronic standardized forms

There are a number of forms required as inputs for the payroll process. It can save time when those forms are standardized and electronically completed and submitted. This saves payroll from tracking and interpreting emails or handwriting.

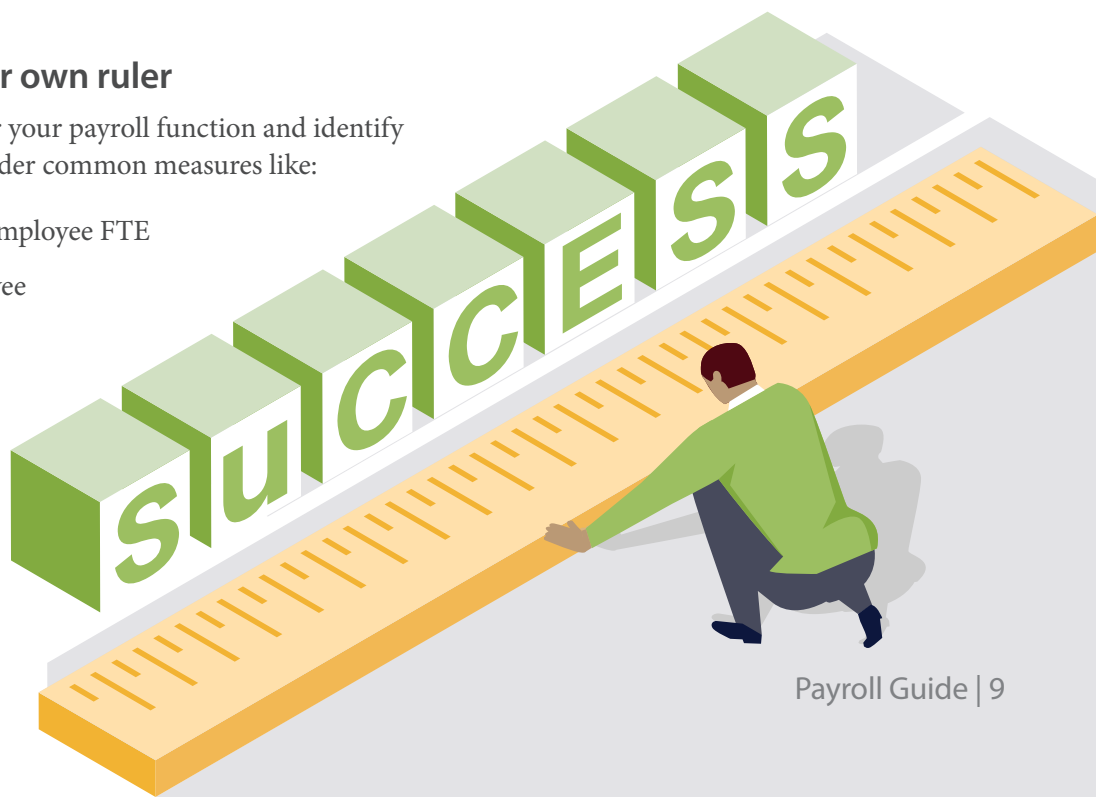
## Balance cross training with specialization

For the most technical areas within payroll, efficiencies might be gained by developing expertise in one or two people. For example, not all payroll staff need to be well-versed in the Washington Department of Retirement System rules.

## Measure progress using your own ruler

Use performance measures to monitor your payroll function and identify areas where you could improve. Consider common measures like:

- Number of paychecks per payroll employee FTE
- Overtime hours per payroll employee
- Payroll cost per paycheck
- Number of payroll runs per month
- Number of overpayments issued
- Number of off-cycle payments



# Payroll Clerks

## Remember these best practices when processing payroll

Payroll comes with many responsibilities! Employees depend on you to pay their wages and safely handle their confidential data. Your employer depends on you for accurate payments and compliance with many regulations. Follow these best practices and principles to help you along the way.

### Let policy guide you

Always follow policy and procedures, and make sure you adhere to all internal controls. If you have suggestions where policy or procedure could be improved, speak up and share with your manager.

### Make your own handbook

You know your job, but would others if they had to step in? Maintaining a desk manual of your duties adds value to the internal control system. Snapshots of the various computer screens are helpful when detailed instructions are needed on how to do something.

### Stay current on the regulations

You are responsible for following many regulations in the course of your job responsibilities. Those include local, state, and federal laws, as well as contractual requirements due to union agreements. Discuss training opportunities, such as those available through the [American Payroll Association](#), with your manager to help you stay current and maintain that high degree of accuracy. Also, network with fellow payroll professionals to engage in sharing current issues.

### Be prepared to take time off

All key payroll positions should have a well-trained backup. Discuss cross training with your manager so you can be assured the payroll process will run smoothly when you are out of the office.

### Get familiar with your payroll application

Work to understand your system's calculation process, where it obtains data from, and how it exchanges information with other systems. Your application might have pre-established settings that prevent certain types of errors, such as keeping someone from being paid for more than a set number of hours in a day. Spend some time exploring how everything works and the types of reports you can run.



## Protect privacy

You handle sensitive and confidential employee data, so make sure to protect it! First, know what information is considered sensitive (ideally, your government has a policy). Second, only send sensitive information through secure channels. Most email is not secure. Lastly, appropriately manage information kept at your desk or in unlocked drawers.

## Be on your guard for bad actors

Your position responsibilities could make you a target for fraudsters. This means that you might be sent fake or phishing emails, where bad actors try to gain access to your system or get you to change employee contact or banking information. Before you take action, be sure to verify the requester's identity by contacting them directly from the information you already have on file.

## Publish your own calendar

Mark those payroll-related important dates! Payroll is a scheduled process; keeping that calendar up-to-date and shared with others is important to staying on track.

## Some things just shouldn't be shared

Don't share your user credentials and lock your terminal when you step away from your desk.

## Plan for potential problems

People who outrank you may give you directive orders, such as to process payments that might conflict with policy or employment contracts. Have a plan for whom you will speak with, should a concern arise. Ideally, you would have several options, in case the issue involves your direct manager.

## Report red flags!

Trust yourself. If something seems unusual or just doesn't seem right, report it! Some examples of red flags in payroll include:

- An employee with the same address as a vendor
- An employee on the payroll, but not on the employee list
- Unusual payroll activity (such as an unusual rate or contract adjustment with no supporting documentation)
- Timecard alterations
- A fellow payroll/finance employee accessing payroll outside of business hours
- A fellow payroll/finance employee requesting work be held while they are gone



# Supervisors

## Remember these best practices when reviewing payroll

Supervisors play an important role in the payroll process, because they are in the best position to identify red flags and discrepancies while performing their oversight responsibilities. Here are some tips to help you make sure your oversight procedures are top notch.

### Count your chickens before—and after—they are hatched

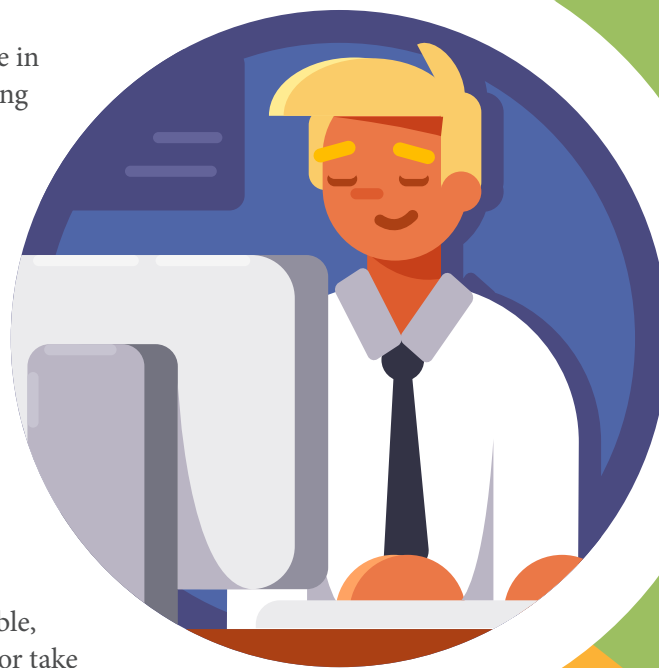
Payroll information should be reviewed and approved using a preliminary report, and again after payments are generated. It's important to verify that no unauthorized changes were made in between preliminary approval and the actual payment. You also might monitor how many errors you are detecting in the review of preliminary payroll information, as an indicator of concern should they trend upward or exceed your expectations.

### Make a game plan and stick to it

When you review payroll data or reports, it's important to have in mind the purpose of your review. This starts with understanding what could go wrong or the risks inherent in the process, so that you know what to check for every time. Be aware of the various payroll fraud risks, possible types of errors, and any risks unique to your process or system. For example, if you allow payroll advances, you might spot-check that they are properly cleared in the subsequent paycheck.

### Trust, but verify the information provided to you

It's best to generate your own report to be sure it contains all the expected information. The risk with receiving a hardcopy record from someone else is that it might have been altered to conceal something. If running your own report is not possible, reconcile the report you are relying on to something tangible, or take other steps to ensure you are provided complete and accurate information. For example, if you are reviewing the final payroll register, ensure net pay reconciles to the amount disbursed per bank records.



## Monitor staff in risky positions

Payroll clerks should not have the ability to set or change pay rates, as it is a conflicting duty. If staff are able to adjust their own pay in any way, then monitoring should be increased. Be aware of all ways payroll staff could affect their own compensation, such as by adding a negative deduction (increases net pay) or shifting employee-owned deductions to the employer.

## Work smarter, not harder

It's nearly impossible to look for and catch everything, so let the computer filter data for you and call your attention to select transactions. Explore your software to see what reports are available or if you have the option to customize. Here are just a few examples of exception reports that could help you identify unusual payroll activity:

- Changes made to payroll information, employees, or pay rates over the last month
- Employees paid 10 percent more than last pay period
- More than one employee using the same bank account
- Employees and vendors with the same bank account

## Be sure to catch this big fish

The potential error or fraud scheme: employees on the payroll that no longer work for you. If you are small, it's easy to catch during a scan of the payroll register, because the reviewer is likely familiar with all the staff. Or, it might be more effective to compare those on the payroll to active personnel files. The extent and frequency of review will be influenced by your confidence in the preventative controls you have in place.



## Make sense of overtime

Monitor that only eligible employees are paid overtime and that it is calculated correctly in accordance with your policy. Analytical review can help you identify any anomalies. Some analytical measures you could use are (1) compare overtime payments to prior periods, (2) calculate how many personnel are paid overtime by department, and (3) categorize overtime paid by what percentage over base pay. For example, if you have three employees making more than 50 percent of their base pay in overtime, that is analytically interesting and worth looking into.

## Keep tabs on compensatory-time practices

If you allow compensatory time, monitor to make sure the actual practice complies with your policy and any regulations. Compensatory time for non-exempt employees should be reported and tracked in the centralized accounting records.

## Know the value of paid time off

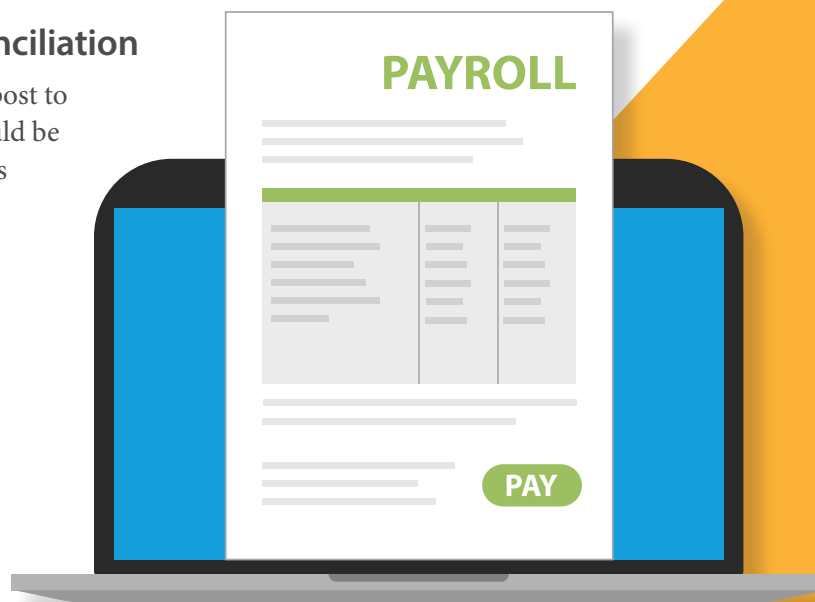
If any employees self-report paid time off on an exception basis, underreporting is a risk. If you also allow leave buyouts, there is added incentive to underreport. Consider how you might monitor for this, and specifically watch for employees recording no time off and requesting buyouts. Also, monitor leave balances for compliance with policy, such as maximum accumulation amounts. It can be helpful to report regularly any areas of concerns to management and human resources.

## Pay taxes today, save grief tomorrow

Make sure to confirm that payroll taxes are paid on time, supported, and agree to corresponding payroll records. It makes Internal Revenue Service or state tax audits go smoother, and reduces your risk of fines or penalties.

## Find comfort in a good reconciliation

Payroll withholdings and deductions post to liability accounts. These accounts should be regularly reconciled to ensure amounts withheld agree to payments made.



# Managers

## Reduce risks in your payroll process

Payroll is often a government's biggest expense. That's why it's important to ensure controls are strong and risk of loss is minimized. Here are some areas to help managers reduce their government's risk of payroll fraud or loss.

### Check backgrounds thoroughly when hiring

Performing background checks ensures you do not knowingly hire someone with a documented criminal history. It's a good starting place, even though it won't prevent you from hiring people with unreported issues, those with pending judgments, or those who just haven't committed any acts to date, but might in the future.

### Stay abreast of what's new

Make sure your payroll department has the tools and training it needs to keep up with new and changing regulations. The American Payroll Association offers training and resources to payroll professionals. There are some private companies that offer payroll information services and updates, too, for a subscription fee. Monitor key websites like the Internal Revenue Service and U.S. Department of the Treasury for updated information. Lastly, network with other governments to share information.

### Hear ye, we must have order in the payroll department

There is an ideal order for things: The pay period officially ends and then time reporting begins. This allows management to verify time worked before payroll is processed. It also guards against "estimation" practices, which can later necessitate corrections to time worked. Employees might fail to submit corrections, too, and when they do, it causes payroll staff extra work.

### One size fits all: the timesheet

Having all employees track and report time worked in the same manner, such as on timesheets, provides several benefits. First, the reporting of time off is more accurate, especially for exempt employees. Second, it creates reliable documentation if claims arise or overtime is disputed. Lastly, it helps management make informed staffing decisions, because it can see who is working more or less than their scheduled hours.



## Too small to do it all

If you lack the resources to process all aspects of payroll in-house, consider outsourcing certain tasks, such as payroll processing and tax filings, to a third-party provider. Some counties provide this service to their taxing districts for a fee. You might also outsource your legal compliance consultations, especially if you now have employees working out of multiple states. Outsourcing allows you to focus on other payroll-related tasks like monitoring timekeeping and reviewing payroll payments.

## Keep up with keeping it confidential

Educating employees on confidential information should be an ongoing process. Consider training on:

- Identification of sensitive information and how it should be handled and safeguarded
- Secure transmission of sensitive information to a third party
- Identity verification, before making changes to critical information like bank accounts
- Limit access to sensitive information in the payroll application to only specific users

## The “need-to-know basis” with software permissions

At least annually, someone should check that employees have only the system permissions needed to perform their job duties and no more. For example, if a payroll clerk doesn't generate payroll checks, then they should be restricted from this task in the software application. Also, the payroll manager should not have super user or administrative rights. All access should be need-driven, and no user (not even the manager) should have the ability to create, approve, and process a transaction from start to finish.

## Use your software tools effectively

System configurations can reduce your risk and save managers from having to perform as much review in some areas. Systems can be configured in many ways, but examples include restricting exempt employees from receiving overtime or restricting temporary employees from receiving benefits. If configurations cannot be used, develop review reports that would quickly call out exceptions.

## Checklists for important steps

Checklists are helpful for documenting the steps to carry out in a process. They also serve as a communication tool to others of what has been completed. Consider using a checklist for processing payroll to ensure tasks are not missed on a weekly, monthly, and annual basis.

## Give your controls a periodic check-up

Perform an in-depth internal control review annually or when changes are made. There are many controls to evaluate, including the very important segregation of duties. If you cannot restrict your staff from performing incompatible duties, then you should have additional monitoring in place. Check out some of our tools and resources on pages 16 and 17.





# Add this checklist to your tool belt



This self-assessment checklist will help you assess your own government's internal control environment for payroll systems.

# Be sure to check out our Cash Receipting Guide and our Segregation of Duties Guide.



## Cash Receipting

Keep your money secure:  
Tips for leaders, managers, supervisors  
and cashiers



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## Segregation of Duties

### Essential Internal Controls

Why it matters  
How to get started  
Helpful hints for small governments  
Plus, self-assessments and checklists



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“Our vision is to increase **trust** in government. We are the public’s window into how tax money is spent.”

– Pat McCarthy, State Auditor

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