

# PUT YOUR PROCEDURES INTO WRITING: CREATING A PAYROLL MANUAL



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#### Introduction

Payroll is one of the central aspects of any business that has employees. Employees expect to be paid and you have to submit payroll tax payments to the government. Both must be done on time and without error. To attain the level of efficiency that enables you to meet these expectations, your payroll department must be structured. This is best achieved by documenting payroll procedures, whether you have a small or large payroll.

Having a payroll procedures manual is vitally important in today's workplace environment. Detailed information on processes that includes how to calculate and track various categories associated with payroll helps to ensure continuity. Not only will you have standard operating procedures when there is a change in who handles the payroll, but you can have support if legal or regulatory issues arise.

For some HR or payroll professionals, writing a complete payroll manual from scratch can be a daunting task. All processes, policies and procedures must be documented to make it easier to refer to for any reason. This white paper is written for human resource managers, payroll specialists and benefits administrators. Putting your procedures in writing helps to ensure the same outcome occurs for each payroll processing period.

#### What Goes Into a Payroll Procedures Manual?

Each organization may have differences in their payroll processing solutions. Some companies decide that the cost benefit of outsourcing payroll functions is cheaper than having a permanent in-house staff. Other companies use a computerized software system to automate payroll. Still, others operate on a totally manual system.

Therefore, the actual process flow may vary from the following steps although each represents what should be the how-to of a thorough payroll procedures manual.

- Updates to employee master file. Person assigned to administrative tasks will update the master file with employee changes such as withholding exemptions or pay rate changes. Accuracy will impact how payroll is processed.
- Set pay period parameters. Payroll modules should be set for correct pay period. This is of special consideration for companies that may have monthly and bi-weekly pay periods.
- Enter hours worked. Instructions for entering employee hours including regular and overtime is important. This could involve manual calculations or computerized time clocks. For the latter, information is usually ported into the payroll software.
- Enter manual payment adjustments. Manual paychecks not yet recorded into the computerized payroll system apply to this procedure. Adjustments from a previous pay period, termination or initial hiring may apply.
- Termination pay calculations. Employees who leave the company should receive unused vacation and severance pay according to company policy. Generally, this applies to voluntary terminations. Involuntary terminations require near-immediate payments that often fall outside the normal payroll processing period.
- Standard deductions. Procedures for entering changes or initial entries for standard deductions such as garnishments, charitable contributions or medical insurance.
- Calculate federal and state tax withholdings. Payroll software programs will automatically calculate tax withholdings; manual processing requires using an up-to-date tax table to determine accurate amounts.

Additionally, you want to provide a description of how employees are supposed to document and submit their time for pay. The U.S. Department of Labor is flexible in allowing employers to use a timekeeping system that works best for the organization. Document how employees must submit time worked for each pay period. An example of this is if your company uses hard copy timesheets. What is the final day that employees must submit a signed timesheet to receive their paycheck on time?

Include in the procedures how employee wages are calculated. To illustrate, let's say your company uses a payroll software program. Write down steps that the employee assigned to this task must follow, i.e., how to enter payroll information for each employee into the system.

Payroll procedures should also include details for making payment adjustments. Adjustments for an employee taking an unpaid vacation day are entered differently than when the vacation day is paid.

Provide a payment schedule on how frequently payroll checks are cut. This could be weekly, bi-weekly or monthly. In addition, describe how checks are printed or how direct deposit is handled once an employee enters payroll information into the system. If your company uses an outside servicer to process actual payments, describe how records are submitted.

Before completing the final manual, have an employee follow the instructions to ensure the process is correct. Encourage feedback on processes that are unclear or seem difficult to complete.

#### **Sample Table of Contents**

The following is a sample Table of Contents is a helpful guide that you can follow to organize your payroll procedures manual. Again, actual sections may vary based on the time tracking system and types of employees within your organization.

#### **General Information**

- A. Introduction
- B. Payroll Staff and Contact Information
- C. Pay Periods
- D. Forms

#### <u>Time Clock Policy and Usage Guidelines</u>

- A. Introduction
- B. Official Time of Record
- C. Various Employee Time Reports
- D. Requirements for Daily Clock In/Out
- E. Job Classification Codes
- F. Handling Problems with Time Clock
- G. Lunch Time and Breaks
- H. Holiday Pay
- I. Overtime
- J. Unreported Hours
- K. Handling Overtime Disputes
- L. Procedure for Closing Workweek
- M. Docked Pay
- N. Sick Leave
- O. Leave of Absence Corrections
- P. Time Clock Managers
- Q. Supervisors/Approvers of Hours
- R. Tampering, Falsification and Unauthorized Viewing of Time Entries
- S. System Audits
- T. Adding and Removing Employees
- U. Definitions

#### **Deduction Procedures**

- A. Policy and Purpose
- B. Federal and State Tax Withholdings
- C. Making Changes to Employee Tax Information
- D. Processing Wage Garnishments
- E. Authorizations and Cancellations of Payroll Deductions
- F. Health Insurance
- G. Wage and Tax Statement

#### Pay Adjustments

- A. Purpose and Policy
- B. Review Process for Identifying Necessary Adjustments
- C. Correction Nonpayment, Underpayments and Overpayments
- D. Deduction Errors
- F. Cancellation/Reissue of Paycheck
- G. Undeliverable Paycheck Return
- H. Retroactive Payments
- I. Making Adjustments to Vacation/Sick Pay Balances
- J. Adjustments for Vacation/Sick Pay Over Multiple Pay Periods
- K. Audit Trail of Adjustments

#### **Disability Procedures**

- A. Purpose and Policy
- B. What to Do When a Work-Related Injury Occurs

#### **How to Document Payroll Procedures**

Procedures define explicit instructions that are necessary to perform tasks or parts of the payroll process. The best way to document payroll procedures is to write down each step as you go through the process. It is important to make sure all necessary steps are well documented. You want to document:

- Who is assigned a task
- What steps are performed to complete the task
- When the steps are required
- How each step is performed

For example, write down who is responsible for manually computing employee timesheets. Include the procedures necessary for accurate processing such as rounding hours up and down to the nearest quarter hour. For automated systems that calculate employee time, you can document procedures required for making edits to the payroll software program. An example of this is requiring that supervisors email change confirmations before a set deadline.

When you have an established policy and procedures for payroll controls, employees feel assured that wages and salaries are accurate, and will be paid on time. The writing process is the perfect time to streamline processes and clean up bad practices that some employees have developed on their own.

Typically, the payroll department works with HR regarding proper payroll and benefits processing. Multiple forms are used such as timesheets, vacation request forms, W-2s, direct deposit authorization and sick leave are a few examples. Create payroll procedure forms or have them customized by a professional printer.

#### **Drafting the Payroll Policy**

Generally, the payroll policy will describe rules and guidelines that are required to ensure consistency among employees and compliance with government wage standards. Note that a payroll policy is not part of the procedure. The procedure, however, should reflect the rules and guidelines that are contained in the policy.

Your policy should address who is responsible for executing and enforcing the policy. The policy should be uniform and support compliance with federal and state laws and regulations. There should be clear statements on the company's fiduciary principles for ensuring accuracy.

#### **Conducting an Internal Payroll Audit**

An internal payroll audit should become part of regular business operations. A good time to schedule a payroll audit is generally at the close of each quarter. The following framework will give you some guidance on what to do to determine if your payroll process is sufficient and in compliance before an external audit reveals problems.

#### **Verify All Active Employees**

Terminated employees should not remain active in the payroll system. Verify that each employee who received a paycheck during the quarter being audited was actually employed at your company. This includes each time period where a check was issued. One method of financial theft that companies are concerned with is cutting checks to terminated employees. These checks are altered for cashing and might even include the terminated employee who will cash the check and provide a kick back.

#### **Verify Employee Pay Rates**

Employee pay rates should always be in writing and approved by the manager. Verify that pay rates in the system are correct for each employee.

#### **Review Hours Paid**

This part of the auditing process involves comparing the hours employees were paid during a pay period to timesheets or other time tracking devices. Pay close attention the overtime hours paid since this is one labor expense that adds up quickly. Additionally, if your company offers paid time off for vacation, sick leave and holidays, review each entry for this category. Look for any discrepancies where an employee who received paid time off was not eligible for the pay.

#### **Compare General Ledger to Payroll Reports**

The general ledger is a recording of financial transactions within a company, which includes payroll processing. Compare the totals for taxes withheld and net check amounts, plus the gross payroll expense to the general ledger. If your company has multiple wage and salary accounts, make sure each account accurately reflects the correct expense. This may include administrative payroll, sales payroll and manager payroll. Most administrative positions are hourly, sales positions are commissions and/or bonuses, and managers are paid salaries.

#### **Review Submissions of Payroll Tax**

Payroll taxes for your company include Social Security, Medicare/Medicaid, state and federal unemployment, and federal withholdings for each employee. The frequency of remitting payroll taxes depends on the total amount of payroll that is processed. Generally, most payroll remissions to respective taxing authorities occur quarterly. The only exception is federal unemployment taxes, which may occur annually if there are low payroll amounts.

Compare the totals that are on the tax remittance reports with payroll system generated reports. This helps to ensure that all payroll amounts are reported properly. It also helps to perform manual calculations of computer-generated totals. This additional checks and balances procedure also ensure proper calculations. Electronic or check remissions should be the same amount that is recorded on tax remittance reports.

#### **Review Bank Reconciliation**

Another essential part of an internal payroll audit is reviewing the bank reconciliation for your company's payroll account. This is a way to verify that all checks have cleared for the issue amount. Make notes of any payroll checks that have not cleared the bank for further research. Get hard copies of payroll checks from the bank and review for appearances of alterations.

#### **Address Complaints about Paychecks**

Most people in business know how to handle customer complaints. Typically, these complaints are taken seriously and we are eager to find solutions to keep the customer happy. However, when an employee has a complaint, particularly about their paycheck, we feel less comfortable with resolving the issue. That is, if there are no standard procedures to follow for an easy answer.

Take one step back and think of employees as your customers – because in a very real sense, they are customers. Generally, employee complaints can fall into three separate categories. Some employees may have legitimate – or not so legitimate – complaints about other employees. They might have complaints about the quality of service of product that your company provides. There are times when they will complain about the amount of their paycheck.

For one reason or another, they believe that they were not paid correctly. Perhaps overtime hours are not included or a paid vacation day is missing. Choose your words carefully when responding to employee concerns regarding their pay. Never dismiss the issue or assume that the employee is wrong. How you handle the conversation could be the difference between resolving a human error and opening a serious issue.

If there is a legitimate reason for a reduction in pay, explain how the issue will be resolved based on the payroll policy in place. Make sure that the employee speaks to their supervisor first, if that is part of your policy. Also, make sure that there is a written explanation for why the employee believes their paycheck was incorrect.

A form should include the employee's name, job title, date of discrepancy and details regarding the issue. Not only will this help you collect pertinent details to resolve complaint, but it also provides a paper trail for auditing purposes.

#### How to Properly Deal with Department of Labor Investigations

At first, your work day started the same as any other day – then you receive a notice that the U.S. Department of Labor has begun an investigation into the wage and hour practices of your company. Before you panic, follow this sage advice: get ready to respond quickly with a payroll management system that includes solid procedures and processes. The goal of a DOL investigation is to ensure compliance with the Fair Labor Standards Act to make sure the law is followed consistently.

An investigation is not an immediate accusation of wrong doing. There are different reasons that could lead to an investigation and wondering why is neither productive nor will it change the situation. Perhaps a former or current employee filed a complaint about pay practices if they were not satisfied with a resolution to their paycheck complaint.

Another reason could be that DOL is targeting your industry for wage-and-hour problems. Hospitality and agricultural industries have experienced an increase in directed case investigations by the agency. If it is not industry-related or the result of an employee complaint, your company could simply be a random target. Whatever the reason, you must begin preparing immediately after receiving the notice.

Generally, employers have 72 hours to prepare for the investigation. While this is not much time, you have a better chance of being organized when you already have a payroll manual in place. If those in charge of payroll processing functions have been following the process, and you are conducting periodic audits, there is less cause for concern.

Organize all documents that investigators will ask to see. This may include original payroll records for the period under investigation, which will include pay adjustments. Spreadsheets and other types of electronic data compilation are not acceptable.

In addition, the investigator will not accept recreated records. Never attempt to fill recordkeeping holes with copies of allegedly old documents. Those are considered fraudulent records and could cause more problems for the company. Tell the investigator if you do not have the original document.

In addition to reviewing your payroll documentation, some DOL investigators will walk around the premises to manually count employees. They want to verify that your payroll records match the actual number of employees. Designate a company representative, usually someone from payroll or HR, to accompany the investigator for a tour of the company.

Understand that the investigator might stop and interview employees about the wage-and-hour practices of your company. Company officials are not allowed to listen when the investigator speaks with nonexempt employees because the employees might feel intimidated. However, company officials can be present when the investigator speaks with current exempt employees.

The investigator will also request a list of former exempt employees who left the company within the previous two years because of the non-willful FLSA two-year statute of limitation. Do not be surprised if the investigator also speaks with former employees who are resourceful for the investigation. The investigator might ask about former employees' job duties to determine if they were classified correctly.

The final conference is where the investigator will disclose their findings. Do not, however, expect them to reveal how much back pay you might owe, if this is the result of the investigation. Generally, you will not know how much is required until you agree to make changes towards compliance. Soon afterward, you will receive a summary notice of the investigator's findings.

If the investigation reveals that your company owes back pay, you will have approximately 90 days to compensate employees. If the back pay amount is unusually high, DOL will usually let you maker installment payments to employees.

#### Written Procedures are a Strategically Sound Practice

Payroll processes and procedures have long been viewed as another administrative task that is focused on paying employees correctly and on time. Therefore, it is rare that payroll processing is seen as having any strategic value in business. Some companies consider it a low priority unless errors result in employee pay or tax withholdings – or there is an investigation notice from DOL.

Tactically, employees must be paid accurately and on time for hours worked. When the payroll process is done correctly, it can easily become an invisible force within an organization. Diligence and professionalism of payroll managers and HR managers seldom brings the function to the attention of top executives. And yet, an enormous percentage of total company expenses is attributed to payroll. As such, having written procedures in place is vitally important for an under-appreciated function.

Many payroll professionals consider writing down procedures an arduous and time-consuming task. For this reason, some may choose to try to avoid even beginning to create a payroll manual. However, consider the benefits of having written procedures.

For starters, members of the payroll department can perform each task optimally, and with consistency. Payroll procedures will be completed accurately each time tasks are performed, even when there is employee turnover in the department.

A payroll manual is a valuable training tool for new employees or backup personnel. Payroll processes are streamlined, which can ultimately eliminate any concerns about absorbing too much time.

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