



Fraud Exposure and Your Non-Profit Organization – Part IV

In our first three articles, we discussed the general internal control environment, including documenting and assessing the internal controls at your organization, followed by a discussion of vendor/trade payable cash disbursements and cash receipts. This last article in our series will focus on internal controls for the payroll disbursements process.

It is important to involve more than one employee in the payroll process, even if you are using an outsourced third party processor. The key roles that must be segregated related to payroll are individuals with access to modify pay rates, access to add employees, ability to approve the payroll processing, and access to posting to the general ledger. Similar to other controls we have discussed, segregation of duties is the best preventative control that can be implemented. Key considerations are discussed below.

- *Access to modifying pay rates or adding employees* – The easiest way for an employee to commit payroll fraud is to modify their pay rate in small increments or to create a fictitious employee. Both of these fraudulent efforts may go unnoticed if review is only performed at the financial statement level, meaning that the only control is that payroll expense is compared month to month. While perhaps not material from a financial reporting standpoint, unauthorized payroll disbursements could accumulate to significant amounts over long periods of time. If there are no segregation of duties and the same employee has access to modify pay rates, add employees, and coordinate/prepare the payroll processing, there are two key controls we recommend related to this risk –
 1. If using an outside payroll processor, request the change or edit report be sent directly to HR or someone who does not input data for payroll processing. This report can be reviewed for any new employees, terminated employees who may not be terminated timely or unauthorized pay rate changes.
 2. An individual outside of payroll processing should perform a random test of employee pay rates on a periodic basis. This test is not time consuming and could involve the CFO or HR personnel choosing five employees on a quarterly basis to spot-check their pay rate per the payroll system compared to their pay rate per their personnel file. The test should also include reviewing vacation hours allowed and taken, which is often an overlooked risk.

- *Ability to approve the payroll processing* – All payroll reports should be reviewed by someone other than the preparer/person responsible for updating the data used to generate the final processed payroll disbursement. This should be done each pay run to check for anything unusual. Ideally the reports would be reviewed prior to finalizing the payroll run, as well as upon receipt of the final reports, to ensure there were no changes between the pre-payroll run report and what was actually paid. This control functions as a deterrence control as the payroll data preparer should be aware that someone will review their work and as a detection control by giving the organization a chance to detect an error or possible defalcation.
- *Access to posting to the general ledger* – Similar to the recommendation above, an employee different than the person who has access to change the payroll master data should compare the general ledger to the payroll reporting for accuracy and timely posting to the general ledger, looking at key control totals for efficiency.

Unrelated to specific segregation of duties discussed above, there are other considerations for payroll transactions. Controls worthy of consideration are as follows:

- *Recording/approving of hours worked* – Depending on the size of your non-profit organization, you may have manual individual time sheets completed, a timeclock/timepunch system, or sign-in/out sheet at the front desk. Whatever method you use for tracking time, be sure that there is at least one level of review by appropriate personnel. On a manual individual time sheet, the most logical control is to have the employee's supervisor approve the time sheet and verify the hours worked each pay period. Electronic timeclock or timepunch systems are more reliable as the employee must be there to record when arriving and leaving and these can be approved electronically by supervisors. A sign-in/out sheet at the front desk can provide a similar method of tracking for a small organization, as long as there is approval by someone with knowledge of hours worked by all employees.
- *Manual payroll checks* – This is a risk similar to any trade disbursement. Additional controls need to be implemented to monitor the check stock and monitor that authorized signatures are obtained. Careful records must be maintained to ensure that a manual check is not issued for something that will be corrected in a later payroll as well.
- *Use of direct deposit* – Requesting that employees utilize direct deposit is a mitigating control in that your organization avoids having payroll checks present in the office. This limits access to funds by your payroll clerk and limits the opportunity for enterprising thieves to gain access to the image of your paychecks, enabling them to generate a fictitious payroll run by replicating your checks thereby stealing cash, which does happen. We frequently observe organizations being apprehensive to mandating direct deposit for fear of upsetting employees for whatever reason, but we advocate that such concern is not valid. Organizations that have mandated it would all tell you that while there was some initial grumblings, it really was a non-issue and that the employees like the timing of the funds being available in their account.

- *Approval of expense reimbursements* – Approval should be done by someone with knowledge of the employee's expenses. A direct supervisor should be required to review and approve expense reimbursement requests so that the expenses can be documented as reasonable and expected based on the employee's roles and responsibilities. We advocate that employee expenses are not reimbursed unless sufficient documentation is provided.

We hope that you have found value in this series of articles on fraud exposure and internal controls and that you have an increased awareness of your organization's controls and related risks. An archive of this series, as well as other articles, can be found at www.gbq.com, and then search for the Community Action Practice or non-profit services. We also welcome any suggestions for future article topics.

If you are interested in us assisting you in assessing your internal controls, please contact Bob Stillman or Jennifer Osburn at 614.221.1120.