



# PREPARING FOR A PAYROLL AUDIT

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**A Guide to Compiling Essential Information**



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This guide will help you collect the necessary documentation and statistics required during a payroll audit. Because of the nature of the required information, it is recommended that this guide be completed by the accounting department, unless your organization has someone specifically responsible for these documents and the workers' compensation policy.

### **STEP 1: Collect Necessary Materials**

- Payroll records (employee specific)
- Unemployment tax returns
- Form 1040 Schedule C (if sole proprietor)
- Tax reports (Federal Payroll 940s or 941s)
- General ledger, subcontractor ledgers and journal (or 1099s)
- Workers' compensation (WC) insurance policy
- Employee information
- Corporate officer information
- Audit package totals
- Subcontractor information
- Certificates of insurance for each subcontractor
- Additional materials upon auditor request

### **STEP 2: Employee Information**

Record the payroll information and classification of all employees except corporate officers. Class codes generally define the business and not the employees, with the exception of standard class exceptions (e.g., clerical, outside sales, other certain sales). This is a large potential problem area—if your business has a large WC rate, but you can put some of your employees in a standard class exception (like clerical), you can drastically lower premium to pay. In bold or italics, make sure to note that these standard class exceptions vary from state to state. The manual rate can be found on your WC policy.

Note: A portion of overtime can be subtracted from the total gross payroll. For example, if your firm pays time-and-a-half, you can take the total gross overtime amount paid and subtract .33% of that number from the total amount paid over a given year. This number counts as an excluded remunerations, which is further instructions in Step 4.

### **STEP 3: Corporate Officer Information**

Owner/officers have the option to remove themselves from coverage. States also have a minimum and maximum coverage that vary by state and change over time.

## **STEP 4: Excluded Remunerations**

Excluded remunerations vary from state to state so the list below may not be accurate for your location. Determine a complete list for your state by asking your agent, ratings bureau or insurance provider.

- Tips and other gratuities received by employees
- Payments by employer to group insurance plans
- The value of special rewards for individual invention or discovery
- Severance payments, except for time worked or accrued vacation
- Payment for active military duty for reservists called to active duty
- Employee discounts on goods, property, or services purchased from the employer
- Expense reimbursements to employees for legitimate business expenses (requires some record or receipt)
- The value of an employer-provided vehicle (e.g., a car or airplane)
- The value of an incentive vacation (for example, a sales leader might win a vacation)
- The value of a ticket to an entertainment event that is provided by the employer
- Supper money for late work
- Work uniform allowances

"Time-and-a-half" overtime is included as one of the columns under Employee Information. Overtime is therefore not listed above, but you will need to add it if your company determines overtime pay using a different—or multiple—calculation. If the payroll amounts you entered under Employee Information or Corporate Officer Information include any of the following types of payments, then total such payments by employee and enter these values in the Excluded Remunerations column under Employee Information or Corporate Officer Information, as appropriate.

## **STEP 5: Audit Package Totals**

Review the information you compiled in Steps 2 through 4, checking to make sure all areas have been addressed and all figures are correct. Organize the information in a list arranged by class code. Include payroll information along with any excluded remunerations that apply.

## **STEP 6: Subcontractor**

This is only for subcontractors that do not have workers' compensation of their own. Be sure to capture only the cost of payroll for the contract—as opposed to total quarterly cost of the contract—in order to prevent overpayment.

## **STEP 7: Source Materials Checklist**

Use this sheet to ensure that you have completed and compiled all necessary materials. Clip or bind them together and have it on hand to provide to your auditor upon arrival.

## **ADDITIONAL NOTES**

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