Payroll Service Tip

10 Biggest Payroll Mistakes And How To Avoid Them

A Report Focusing on Comprehensive Payroll Information

Managing your company's payroll is an enormous job. Mistakes can be costly in more ways than just money - things like low employee morale, an unmotivated staff and high employee turnover can negatively affect your business.

We selected some of the most common mistakes companies make with payroll. Here are the 10 biggest (and the most frequent) mistakes people make when processing payroll.

Mistake #1. Misclassifying A Worker's Employee Type

Exempt employees are not required to receive overtime. Non-exempt employees are required to receive overtime. The act of placing an employee on salary (rather than hourly pay) does not make the employee exempt from overtime. To determine an employee's status, one must look at both federal and state laws.

The three most common exempt categories are Executive, Administrative and Professional. Their definitions are very specific and not necessarily what you would expect, and there are exceptions for certain industries and jobs. For example, Federal and some state laws agree that an exempt employee can not work on non-exempt duties more than 20% of the time (twice that for retail and service businesses). Federal rules requires exempt employees must be paid at least $455 per week. Federal rules also state a non-exempt employee can be paid a salary, but must still be paid overtime after working more than 40 hours in a week.

Employers must be diligent on this subject, for it is possible that a disgruntled worker will see the overtime standards on your required Wage Poster along with clear information about how to contact the Wage and Hours Board should they want to lodge a complaint against you.

Mistake #2. Miscalculating State Unemployment Tax

Miscalculating or not paying your State Unemployment Tax on time may result in losing your federal unemployment tax credit of 5.4%.

Three questions you need to ask yourself:

- Are we paying the correct rate for our company?
- Are we using the correct maximum amount of wages?
- If a claim is filed, who will supply the required information - you, your accountant or your payroll provider - and who will contest the claim?

In addition, you are also required to post state-supplied information about unemployment benefits or notify terminated employees that they could be eligible for them. An employer who fails to provide notice can be sued if an eligible employee fails to file a timely claim.

Mistake #3. Improper Overtime Payments

States can vary on the laws that govern overtime payments, so it is important to understand your state's rules.

A common practice in some small businesses is granting compensatory overtime or "comp time" (time off) instead of paying overtime as legally required. This is illegal in many situations. Usually only state or government agencies may legally offer comp time, and it is subject to a certain exclusions. Some states do not allow it at all.

In addition, overtime is not always 1.5 times the employee's hourly rate. In fact, you must add in other payments, such as production bonuses and shift differentials in calculating an employee's overtime rate.

Also you must follow any state's Wage and Hour regulations if they are more generous than the federal rules.

Mistake #4. Mishandling Garnishments, Levies or Child Support

The courts allow plaintiffs to collect certain court-determined debts by going straight to the employer to collect the money directly from the employee's wages.

It is your responsibility to withhold it, write a check, and send it to the third-party. Similar rules apply to workers with court orders to pay child support through payroll deductions. Certain tax levies can also be applied against wages.

There are rules for withholding, for how much an employee must be allowed to retain and, if multiple claims, which ones get paid first. Naturally, the state gets involved, typically requiring child support be paid first. But, if a federal tax levy arrives in your office first, it gets deducted beforehand.

Mistake #5. Poor Record-Keeping and Data-Gathering

Errors in data entry, misapplying pay rules and similar clerical mistakes average nearly 1.2 percent of total payroll costs, according to the Nucleus Research report issued on 12/23/02. The sheer volume of paper required to do your payroll makes it easy to understand why.

How long do you have to keep payroll records? Which agencies decide? About 10 different agencies and laws have requirements. The IRS has a general requirement that payroll records should be retained for four years. This includes time sheets, journals and cancelled checks.

(Note: These time frames can differ from state to state and some states require an employer to be able to provide records within a certain period of time, or incur fines.)

Mistake #6. Paycheck Security Issues

Many businesses do not think about check security until they become a victim. There are dozens of ways for thieves to change the dollar amount on a regular business check.

Today's sophisticated color scanners, copiers and printers make reproducing checks easy.

Perhaps no one working for you would ever commit check fraud, but they might endorse your check over to someone who would.

Have you ever noticed how many different security features payroll companies have on their check paper? Since they write more checks than any other business in the country, they have already discovered the dangers. Review and consider upgrading your check security.

Mistake #7. Missing Tax Deposit and Filing Deadlines

Anyone who processes payroll knows of the confusing array of deadlines for federal, state, county and municipal tax deposits and tax filing deadlines for the entire year. You must also report the earnings and withholdings of each employee, payments to contract workers, total withholdings amounts and other information.

Also, the government requires use of the EFTPS (Electronic Federal Tax Payment System) for your payments if your yearly obligation to the federal government totals $200,000 or more. Even a small company can reach this threshold easily, especially since it includes all corporate taxes, payroll taxes (quarterly Form 940 and yearly Form 941) and withholdings from pension distributions.

Mistake #8. Ignoring Taxable Items

Gifts, prizes, bonuses and awards employees receive are taxable, including the personal use of a company car.

Unlike wages, there are several ways to withhold taxes from these items. If you pay the amount on a regular paycheck, it is taxed at the normal rate. However, if you pay it separately, you must withhold at the supplemental tax rate. Or "gross it up," paying the tax due on the gift yourself, which means that part of that becomes income.

Mistake #9. Wrong Information on Form W-2

You must get a W-2 to every employee by January 31 that lists their wages and taxes for the prior year. You also need to file this form with various government agencies by a deadline which is determined by your filing method (electronic or paper).

A common mistake is mismatching names and Social Security numbers. This results in earnings not being properly credited to employees and problems with Social Security payments. Leaving out other taxable items also happens frequently.

Mismatching is so common that the Social Security Administration runs a toll-free Employee Verification Service at 1-800-772-6270.

Other problems are easier to avoid. Do not write dollar signs in the boxes. Government optical scanners often read them as eights. Using a computer (or typewriter) font that is too large or too light is a common mistake. Stick with 12-point Courier. One IRS Section Chief suggests placing the numbers in the middle of the boxes.

Mistake #10. 1099-MISC Forms With Incorrect Information

Form 1099-misc should be sent to unincorporated businesses to which you have made payments of more than $600 in the previous calendar year. Payments to corporations and payments for the sale of goods do not require 1099 reporting.

All 1099 forms are due to recipients every year by January 31 and to the IRS by February 28.

The simplest way to get the information needed to prepare the form is to send your vendors a Form W-9 before paying their invoice. The W-9 asks for information such as name, address, and Tax ID Number (either Social Security or Employer ID Number). Be sure to transfer the information carefully. The IRS says mismatching names to taxpayer identification numbers is the most significant mistake occurring on Form 1099.

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