



**Internal Audit Department**

**Payroll Audit**

**December 21, 2020  
Report Number FY 20-07**

**Distribution:**

Audit Committee, Arizona Board of Regents

Internal Audit Review Board

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This report is intended for the information and use of the Arizona Board of Regents, NAU administration, the Arizona Office of the Auditor General, and federal awarding agencies and subrecipients.

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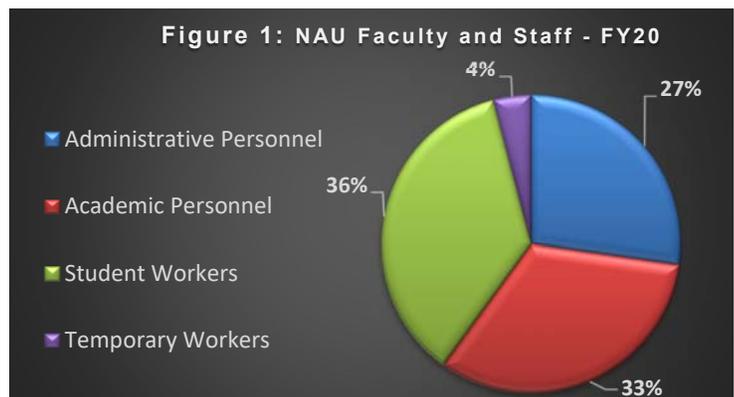
## Summary

Audit of Payroll is in the Annual Audit Plan for Fiscal Year 2020 (FY20), as approved by the Audit Committee of the Arizona Board of Regents (ABOR). This audit supports Northern Arizona University's (NAU / University) strategic goal of Stewardship by ensuring propriety of payroll processing, including compliance with applicable laws, rules and regulations, and ensuring appropriate system access for employees and system administrators.

**Background:** While a full audit of payroll processes has not been completed in more than five years, Internal Audit has since reviewed other payroll-related functions, including Vacation and Sick Leave Reporting, Student Employment, Affordable Care Act (ACA) Compliance, Employee Benefits Reporting, Departmental Audits, and I-9 Management. Payroll processing and reporting is also reviewed by the State of Arizona Office of the Auditor General during its annual financial audit of the University.

Payroll relies on people, processes, and systems for ensuring review and approvals occur at the department level. Payroll's role is to confirm that employees are paid accurately and timely and to manage deductions. Payroll also provides contracted third-party vendors the data required to manage garnishments, ACA compliance, I-9 compliance, and quarterly and annual tax reporting.

During FY20, Payroll provided support services to 4,878 full- and part-time employees, including administrative and academic personnel, and 312 temporary hires<sup>1</sup> as well as 2,736 student workers, reflected in Figure 1. For Calendar Year 2019 tax reporting purposes, Payroll processed a total of 11,488 W-2 forms.



In addition, in response to Families First Coronavirus Response Act (FFCRA) requirements, Payroll implemented the federally mandated employer-paid leave, Public Emergency Paid Sick Time (PEPST), for all University employees, including non-benefit eligible student and temporary workers, in spring 2020. Payroll also implemented a four-tiered temporary salary reduction plan impacting specific employee pay groups. See Exhibit A for additional details, including Payroll services, FY20 budgeted payroll expenditures, and an overview of pay processes reviewed for this internal audit.

**Audit Objectives:** The primary audit objectives were to ensure employee pay is appropriately authorized and computed accurately; to determine if payroll transactions are in compliance with ABOR and University policies and payroll laws and regulations; and to assess internal controls relating to payroll accounting and record keeping.

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<sup>1</sup> NAU Institutional Research Quick Facts Fall 2019. Fall 2019 Faculty and Staff by Title. In.nau.edu/wp-content/uploads/sites/129/2020/09/Fall2019QF.pdf.

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**Scope:** Because the payroll function will be audited internally on a cyclical basis in the future, a payroll risk assessment was completed to identify areas and key functions to test. The scope included working with management to identify payroll processing risks, performing tests to verify the effectiveness of internal controls, interviewing personnel, and reviewing documentation to verify compliance with federal and state regulations and University policies for the processing of payroll during Calendar Year 2019 and / or Fiscal Year 2020. We also validated the processes implemented to address requirements related to special leave requests resulting from COVID, as set forth in the Families First Coronavirus Response Act (FFCRA). We conducted such analysis, tests, and other procedures as we deemed necessary to address the audit objectives.

**Methodology:** The following procedures were performed to accomplish the audit objectives:

- Worked with NAU Payroll Management to identify Payroll processing objectives, risks and controls.
- Reviewed Arizona Revised Statutes (A.R.S.), ABOR leave policies, and NAU policies and procedures related to Payroll.
- Interviewed personnel and reviewed supporting documentation to verify compliance with federal and state regulations and University procedures for the processing of payroll.
- Reviewed the propriety of off-cycle check (OCC) payment processes, including determining if new hires and / or involuntary terminations are timely entered in the PeopleSoft system.
- Validated overtime disbursements of Fair Labor Standards Act (FLSA) non-exempt employees, including testing the conversion of reported time in the Time and Labor system to paid time processed by Payroll.
- Validated approvals for overtime and compensation (comp) time.
- Reviewed the processes and validated calculations for supplemental pay disbursements and Athletics Payment in Kind (APIK) tax reporting.
- Reviewed the processes for monitoring hours of F-1 international student employees for compliance with U.S. Customs and Immigration Services (USCIS).
- Reviewed and tested the processes Payroll developed for ensuring compliance with the FFCRA.
- Reviewed sick and vacation leaves for proper approvals and reporting.
- Reviewed FY21 base pay rates to ensure compliance with the University's Salary Reduction Plan.

The audit was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing promulgated by the Institute of Internal Auditors* and accordingly, included such tests considered necessary under the circumstances.

**Conclusion:** Overall, the University's payroll is processed timely, accurately and in compliance with applicable laws, rules and regulations. Current payroll operations adequately ensure the security, reliability and accuracy of payroll documentation and comply with the additional federal and state mandates required due to COVID, as well as ABOR and University policies and procedures. Existing and future processes could benefit by automation efforts in the following areas:

Controls Assessed		
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- Automating processes owned by Payroll could create greater efficiencies by reducing time, streamlining workflows, and reducing the risk of errors created by manual data entry.
- Human Resources and / or Payroll Management involvement in information systems governance could improve how automation projects that directly impact pay processing support workflows that enable Payroll to provide more efficient services to support the University community.
- Monitoring of employee leave could be improved to ensure only approved leave is used and that approved leave cannot be adjusted without supervisor approval.

**Observations:**

- The PeopleSoft Time and Labor system provides dashboard and other automated functionalities that could enhance the user experience; however, the ability to update system configurations and applications is limited by the following factors:
  - To save money, the PeopleSoft support vendor was replaced with a third-party enterprise software support vendor that provides tax-related updates for the Human Capital Management (HCM) module. This decision limits the extent of PeopleSoft enhancements that can be addressed going forward.
  - Improving HCM system functionality is subject to prioritization of all PeopleSoft update initiatives, supported by business analysts and PeopleSoft development teams, as directed by existing IT governance processes such as the Strategic Project Review and Resource Committee (SPRRC).
- PeopleSoft Time and Labor calculates payable time. The process of converting reported time to payable time involves the conversion of minutes to quarter hours, which can result in unexpected overtime expense. For hourly employees with positions in multiple departments, approvers are not always aware of the total hours worked by such employees and that overtime and related expenditures are actually incurred by their department as a result.
- The ITS Enterprise Information Services department added language to the OnBase Express Development Request form to ensure automation projects impacting multiple departments are identified prior to implementation. Because Payroll was previously impacted by automation projects initiated by other departments, this change will help mitigate such issues going forward.
- While less financially significant in recent years, processing of Athletics Payments in Kind (APIK) impacts how well NAU complies with both financial aid and wage reporting for the students in the program and provides the Athletics Department with a subsidized form of student employment not utilized by other departments.

We identified improvement opportunities related to automating existing manual processes, developing processes for APIK reconciliations, and creating edit controls in the PeopleSoft system to help managers and time approvers monitor hourly time and leave-related activities.

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The control standards considered, related control environment assessment and any related improvement opportunities identified are summarized in the following table.

General Control Standard (The bulleted items are internal control objectives that apply to the general control standards, and will differ for each audit.)	Control Environment/ Assessment	IO No.	Page No.
<b>Reliability and Integrity of Financial and Operational Information:</b>			
• Off-cycle check transactions are appropriate, correct, authorized, and timely posted to the University's general ledger.			
• Rates of pay are consistent with employees' annual base pay rates.			
• Overtime and comp time are converted correctly and properly calculated and paid to employees.			
• Supplemental pay rates are properly approved, calculated, and paid.			
<b>Safeguarding of Assets:</b>			
• Only approved staff have access to payroll data.			
• Overtime and comp time are approved in advance of pay.		3	9
• Time approvers have restricted access to employee data.			
<b>Effectiveness and Efficiency of Operations:</b>			
• Automated processes exist to support routine, recurring requests and provide timely workflows.		1	6
• PeopleSoft Time and Labor automation exists to monitor FLSA non-exempt time.		3	9
• PeopleSoft Time and Labor automation exists to ensure requested and deleted leaves are authorized and properly recorded.		3	9
<b>Compliance with Laws and Regulations:</b>			
• Payable time is calculated in compliance with U.S. Department of Labor recordkeeping and reporting requirements.			
• Overtime is calculated and reported accurately and in compliance with the Fair Labor Standards Act.			
• Pay disbursements are issued timely and in compliance with Arizona Revised Statutes.			
• W-2 taxable reporting of APIK tuition waivers is accurately reported and in compliance with federal tax regulations.		2	7
• Systems and procedures exist to ensure Public Emergency Paid Sick Time is adequately captured and complies with the Families First Coronavirus Response Act.			
• Policies and procedures exist to ensure Payroll processes comply with federal, state, and ABOR policies and procedures.			

Legend:	
Reasonably Strong Controls In Place	
Opportunity for Improvement	
Significant Opportunity for Improvement	

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We appreciate the assistance and cooperation provided by Payroll staff and Center for International Education (CIE) staff.



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**Audit Results: Improvement Opportunities & Solutions**

**1. Utilizing existing technologies to automate manual processes could provide processing efficiencies while reducing the risk of data input errors caused by manual data entry and workflows.**

**Solution:** Realizing that cross-divisional support is required to fully automate some projects, Payroll will develop a schedule for sponsoring and presenting automation projects impacting payroll processes to the ITS Enterprise Information Services (EIS) department and the Strategic Project Review and Resource Committee (SPRRC), if and as required. As of November 2020, a shared MS Teams group was created to manage and improve off-cycle check (OCC) communications between Payroll and the Comptroller's Office. Other process automation efforts, especially supplemental pay processing, will take more time to address given the likely need for policy updates, the number of and the role departments play as part of the process, and identifying the best solutions to achieve the necessary automation. In this regard, Human Resources will evaluate these aspects to develop an approach toward the end of the current fiscal year, with the actual automation occurring sometime later in fiscal year 2022. Internal Audit will work with Human Resources and the other departments as deemed beneficial to design and implement effective controls in the process.

**Responsible Parties:**

Pam Fleece, Director, Human Resources Information Systems  
Cheryl Brothers, Assistant Director, Human Resources

**Implementation Date:**

6/30/2021

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**DETAILS:**

**Condition:** Working with Payroll Management, we identified existing manual processes for which efficiencies could be improved with automation, providing greater assurance that data is received timely, processed correctly, and auditable. Existing NAU technologies such as OnBase could be used to automate the following manual processes:

- The Off-Cycle Check (OCC) Request Form is a hard-copy form that drives manual processing of off-cycle checks most of the time, although not all OCC payments use the form. An effective approval process and audit trail do not exist as part of the current manual process, as follows:
  - Documentation is maintained in emails to support OCC payments, which creates research time required of Payroll staff.
  - Of the 45 OCC payments tested, all were processed correctly. While the Comptroller's Office relies on PeopleSoft reports that capture the OCC payments, the spreadsheet Payroll uses to record the reasons for employees issued an OCC payment is subject to inaccuracies due to manual input as noted by the following exceptions in our audit testing:
    - OCC payment reasons are not correct, or fields are blank,
    - Payees are associated with incorrect EMPLID,
    - The FY20 DLS (Non-Contract Instruction employees) pay group that received OCC payments was incorrect, and
    - Check numbers are missing.

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**Audit Results: Improvement Opportunities & Solutions**

- The 12-Month Salary Distribution Program and Employment Agreement Form is a hard-copy form that drives manual processing of changing an employees' payment distribution plan. Certain qualifying employees / faculty may elect to receive nine-month pay over a 12-month distribution period.
- The Supplemental Pay Forms are hard-copy forms that drive manual processing of supplemental pay for faculty and / or staff. The Faculty / Academic Professional Supplemental Compensation Pre-Approval Form requires completion by faculty, including approvals and routing, prior to the start of work performance. The Faculty / Academic Professionals Supplemental Compensation – Payment Form requires completion by the funding department, including approvals and routing, prior to the payment for work performance. The Classified Staff / Service Professional Supplemental Compensation Request requires completion, approvals, and routing prior to the payment for work performance.

The Supplemental Pay process involves multiple department approvals and routing, with final approval and routing to Budget and Payroll. During FY20, Payroll received and processed a total of 427 supplemental pay requests, excluding winter break. The supplemental pay process requires that Payroll manually calculate back pay when requests are received late. We noted that 30% of the total supplemental pay requests submitted to Payroll required additional processing for prior pay periods. Of the 131 total supplemental pay requests requiring back pay calculations, 30 required back pay for four or more pay periods.

**Criteria:** Business process automation results in better use of employee time; reduction of repetitive, manual workflows; reduction of data entry errors; and improved internal controls.

**Cause:** Automating existing processes requires time and effort from departments with limited resources, especially due to additional reporting burdens created from compliance with mandated COVID-19-related laws and regulations. University resources supporting automation efforts are also subject to project prioritization processes.

**Effect / Impact:** Manual processing, including paper printing, routing, and approvals, contributes to excess burden on support staff responsible for processing, lack of audit trails, and increased risk of unidentified data entry errors.

**2. Reconciling Athletics Payment in Kind (APIK) each semester could provide assurance that payments are accurately and timely processed, posted to student accounts, and correctly reported on annual tax forms.**

**Solution:** Payroll will develop procedures to ensure APIK and tax reporting are processed correctly and provide year-end payroll data to Athletics, the Office of Scholarships and Financial Aid, and Student Departmental and Account Services. Internal Audit will issue a follow-up memorandum addressing additional observations to improve the APIK processing across the various departments involved.

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**Audit Results: Improvement Opportunities & Solutions**

**Responsible Parties:**

Cheryl Brothers, Assistant Director, Human Resources

**Implementation Date:**

3/31/2021

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**DETAILS:**

**Condition:** The purpose of APIK is to assist selected students, both undergraduate and graduate, employed through the Athletics department with in-kind payments, also known as tuition waivers, in exchange for services provided. APIK reduces the amount of scholarship funds awarded to employees and provides for the employment of students by the Athletics Department without an impact on the Department's annual budget. Awarding guidelines were established by the department previously known as Enrollment Management and Student Affairs (EMSA) and the Office of Scholarships and Financial Aid (OSFA) in a Memorandum of Understanding (MOU) dated May 2019. Students sign employment agreements and are encouraged to work up to 20 hours per week during the fall and spring semesters to receive a reduction in tuition. The work hours are processed by Payroll and reported as non-cash taxable earnings on a Form W-2. The current Memorandum of Understanding (MOU) dated May 2019 provides annual processing timelines that are no longer followed. The current "Recommended Timeline for upcoming aid year" states:

*"November*

- *By November 15<sup>th</sup> – ATHL will provide OSFA, Human Resources (HR) and Student Departmental and Account Services (SDAS) completed work hours and earnings of all APIK students for the current **calendar** year to include Spring and Fall.*
- *Information for OSFA will include a breakdown of the hours/earnings by spring and fall.*
- *OSFA will update APIK and Athletic Admin awards to reflect completed work hours and make any necessary adjustments. These awards must match what HR will report on a student's W2 and what SDAS will report on the 1098T for the calendar year."*

Note: Beginning in Spring 2019, Payroll requested the completed work hours by semester.

The hours worked for employees earning APIK are tracked on an Excel spreadsheet by Athletics and provided to Payroll, OSFA, and SDAS at the end of each semester. A reconciliation of the University's FY20 general ledger account reflected that Spring 2019 APIK awards totaling \$24,616 were not posted to 23 student accounts. Because APIK were not posted, students' scholarship funds were not adjusted, resulting in duplicate tax reporting (excess scholarship on the Form 1098-T and taxable wages on the Form W-2). Spring 2020 APIK awards totaling \$20,535 were not posted to 25 student accounts. The Spring 2020 hours contained a formula error in the Excel spreadsheet resulting in underpaid APIK of \$40 and \$420, respectively, for two employees.

**Criteria:** Federal tax laws require reporting of calendar-year wages on a Form W-2 and calendar-year scholarships and grants on a Form 1098-T, provided to taxpayers no later than January 31. For tax purposes, Athletics Payments in Kind are processed as wages reported on a Form W-2 while scholarships and grants are reported on a Form 1098-T.

**Cause:** APIK is an exception-oriented process in that processing occurs outside of the normal payroll and financial aid processing routines. While an MOU exists to attempt to address some

**Audit Results: Improvement Opportunities & Solutions**

of the resulting challenges, that process does not appear known or applied by all applicable parties and lacks a verification or reconciliation step to help ensure the processing is accurate.

**Effect / Impact:** Consistency in processes and expectations for responsibilities could be compromised resulting in incorrect tax reporting and / or incorrect financial reporting. Lack of routine review and reconciliations, especially in manual processing, contributes to inefficiencies, data processing errors, and a weak internal control environment.

**3. Creating queries or notifications in PeopleSoft Time & Labor could assist in monitoring hourly time, ensure overtime is properly authorized and approved, and ensure supervisors are informed of approved leave subsequently deleted by the employee.**

**Solution:** As of 12/10/2020, Payroll created a new query allowing time administrators and supervisors to run a Time & Labor Report of Temp & Student Reported Time in all departments and provided communications to the campus community. Payroll is developing email notifications to supervisors when approved leave, such as sick or vacation, is removed from the timesheet.

**Responsible Parties:**

Cheryl Brothers, Assistant Director, Human Resources  
Pam Fleece, Director, Human Resources Information Systems

**Implementation Date:**

Overtime: Implemented as of  
12/10/2020  
Leave Approval: 6/30/2021

**DETAILS:**

**Condition:** The WebClock timekeeping system is an automated punch in / punch out time entry required of some FLSA non-exempt employees (employees defined as non-exempt under the Fair Labor Standards Act). Alternatively, FLSA non-exempt employees may enter time manually (hard-coded) via electronic timesheets. The Time and Labor system rounds payable time up or down by quarter hours based on the exact time input and / or punches in and out, in compliance with U.S. Department of Labor requirements. Time up to seven minutes is rounded down to the quarter hour, while eight minutes or more is rounded up to the quarter hour. Departments rely on hourly employees to report and monitor their own time and adhere to the weekly allowable hours of work. While not material, we observed examples of hourly employees reporting less than 40 hours of actual time worked; however, because the system calculates by quarter hours for each separate punch in / punch out activity, payable time exceeded 40 hours, resulting in overtime expense. Time approvers can only view and approve time worked of employees within their departments. When employees hold positions in multiple departments, supervisors and / or time approvers are not aware they are incurring and / or approving overtime.

FLSA exempt employees, referred to as exception reporters, request available categories of leave through the Time and Labor system. Requests are routed to supervisors for approval and an electronic notification (e-mail) is automatically generated to update the employee of leave status as either approved or denied. Exempt employees are permitted to delete pre-approved

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leave in Time and Labor if their leave needs change after the leave was approved. However, these deletions are processed as low-level exceptions that do not notify the supervisor and no formal record of the deleted leave exists.

**Criteria:** Managers and time approvers rely on real-time information using systems with automated dashboard functionality to manage employee time and labor. University assets should be protected to the extent practical.

**Cause:** The Time and Labor system is a real-time reporting system; however, it requires time entry of data to provide useful information for managers and time approvers. Time entered using WebClock provides data immediately, while time entered using electronic timesheets provides data upon manual entry, which may be delayed depending on the timing of the manual entry in the timesheet. Because time approvers are restricted to viewing only department-level activities, managing and approving overtime and related expenses is challenging.

Deleted leave transactions were not originally configured for required approval or notification.

**Effect / Impact:** Overtime expense could be incurred unknowingly, and leaves could be deleted without detection, resulting in additional leave benefits.

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**EXHIBIT A – Background Information**

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Overall, the NAU Payroll team pays University employees and consultants timely and accurately. The Payroll unit reports through Human Resources to the Chief Human Resources Officer who also currently serves as the Interim Executive Vice President and Chief of Staff. Payroll is responsible for accurately calculating and processing wages for all pay classifications in the University system. Human Resources administers and maintains the payroll software, PeopleSoft, and provides customized reports to the Payroll unit. Departments are responsible for timekeeping, leave reporting, and budget monitoring, as well as initiating and authorizing hiring, pay adjustments, and terminations using Electronic Personnel Action Request (ePAR) forms.

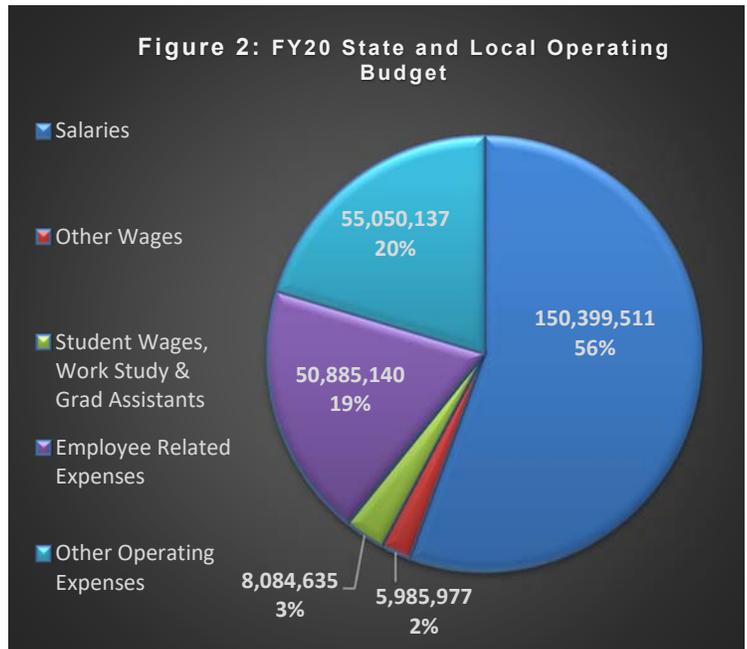
NAU Payroll supports the University in providing leadership in payroll practices, while remaining compliant with federal and state regulations and being receptive and responsive to employee and departmental needs. In addition to calculating and processing wages, NAU’s Payroll department provides the following services for the University:

- Time and Labor Supervisor Resources
- Employee Tax Information
- Hire Xpress Onboarding Software and Training
- Foreign National Hiring
- Payroll Information

- Time and Leave Reporting
- ePAR Resources
- Notice of Appointment Employment Contract Processing
- Department Location Move / Change

The University’s FY20 operating budget reflected anticipated payroll expenditures totaling \$215,355,263 comprised of salaries, other wages, student wages, and employee related expenses (ERE). Other operating expenses includes operations and utilities, travel, professional and outside services, capital, library acquisitions and student support. Salaries and ERE accounted for approximately 80% of NAU’s state operating budget, as reported in the NAU State and Local Operating Budget FY 2020, reflected in Figure 2.

On an individual program basis, 72% of salaries, other wages, student wages, and ERE were attributable to Instruction and Academic Support.



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**EXHIBIT A – Background Information**

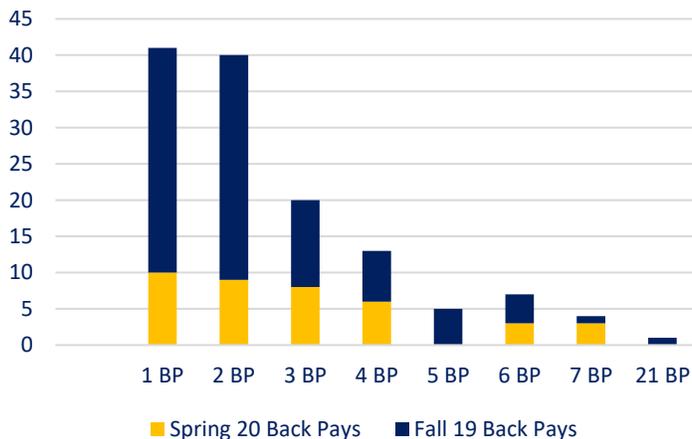
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Off-cycle checks may be requested for earnings intended to be paid on a prior scheduled payroll run but not processed due to a variety of reasons, but primarily relate to incomplete time entry and related approval, incorrect bank information, and / or untimely processing of personnel changes. On-cycle checks are processed for employees who have not established direct deposit. All off- and on-cycle requests are processed manually with payments processed in the form of a paper check. During FY20, Payroll issued 268 off-cycle checks and 285 on-cycle checks. The four most common reasons for processing off-cycle checks included:

<b>FY20 OCC Payment Reason</b>	<b>Total \$</b>	<b>Total %</b>
Lack of Employee Entry / Supervisor Approval of Online Time	34,437.69	17%
Bank Return	27,192.68	14%
Late Hiring Paperwork	19,138.73	10%
Other Reason	16,034.99	8%

Payroll is processed and disbursed bi-weekly for all employees by pay group, including appointed and classified staff, DLS (non-contract instruction), nine- and 12-month faculty, grad assistants, students, temporary staff, and those receiving work study. To consolidate and automate time and labor reporting using one University system, Payroll implemented WebClock, a timekeeping module within the PeopleSoft Time and Labor WorkCenter, in September 2017. WebClock provides an automated punch system for time reporting of FLSA non-exempt students and temporary employees, including grad assistants and those receiving work study; however, employees may also manually clock in and out using electronic timesheets. Payable time is created from reported time entries as the end product of Time and Labor. Payroll has established automated minute conversions of reported time to payable time based on time in and time out, or punches, for each instance of employee work activity.

**FY20 Supplemental Pay  
Number of Back Pay Adjustments Required**



Additional (supplemental) pay may be requested for employees requiring compensation in addition to their regular pay. Payments may be due to overloads, bonuses, awards, or temporary duties, and may be one-time payments or payments processed over several pay periods. The current supplemental pay process is manually driven with requests and approvals routing through several different departments. In FY20, Payroll received and processed a total of 427 supplemental pay requests, excluding winter break. The chart at left reflects the number of back pays required for processing supplemental pays throughout the year.

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Athletics Payment in Kind (APIK) are in-kind payments available to undergraduate and graduate students for services provided to the Athletics department. APIK are awarded to degree- or non-degree-seeking students and can count towards cost of attendance (need-based) or act as taxable income. APIK are processed by Payroll and the Office of Scholarships and Financial Aid at the end of spring and fall semesters and processed by Student and Departmental Account Services at calendar year end.

International students working under F-1 or J-1 Visa status are employed by the University in various departments and positions. As of May 2020, the University on-boarded 263 F-1 Visa holders whose countries have an existing tax treaty with the United States. International students are subject to strict work regulations of the United States Citizen and Immigration Services (USCIS), including limiting work hours to a maximum 20 hours per week during regular class sessions. NAU's Center for International Education (CIE) is responsible for monitoring hourly time and reporting international students' Visa status through the web-based federal Student and Exchange Visitor Information System (SEVIS).

Vacation, sick, and other leaves are requested by all employees through the Time and Labor system. Sick and vacation leaves are accrued at different rates, depending on employment classification, and may roll over from year-to-year. When employees request leave, notifications are routed to supervisors for review and approval. The Time and Labor system allows employees to delete leave; however, low-level notifications may or may not be reviewed by supervisors. In FY20, there were 1,536 instances of pre-approved leave, equating to 10,891.1 hours of leave, deleted with no apparent review or approval by supervisors.