Custom Payroll Services

Report on policies and procedures
Placed in operation for the company's
Payroll system as of October 27, 2008

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INDEPENDENT ACCOUNTANTS' REPORT

To the Custom Payroll Services, Inc.
Board of Directors

We have examined the accompanying description of the controls of Custom Payroll Services, Inc. applicable to the processing of payroll for users. Our examination included procedures to obtain reasonable assurance about whether (1) the accompanying description presents fairly, in all material respects, the aspects of Custom Payroll Services, Inc.'s controls that may be relevant to a user organization's internal control as it relates to an audit of the financial statements, (2) the controls included in the description were suitably designed to achieve the control objectives specified in the description, if those controls were complied with satisfactorily, and (3) such controls had been placed in operation as of October 27, 2008. The control objectives were specified by Custom Payroll Services, Inc. Our examination was performed in accordance with standards established by the American Institute of Certified Public Accountants and included those procedures we considered necessary in the circumstances to obtain a reasonable basis for rendering our opinion.

We did not perform procedures to determine the operating effectiveness of the controls for any period. Accordingly, we express no opinion on the operating effectiveness of any aspects of Custom Payroll Services, Inc.'s controls individually or in the aggregate.

In our opinion, the accompanying description of the aforementioned processing of payroll application presents fairly, in all material respects, the relevant aspects of Custom Payroll Services, Inc.'s controls that had been placed in operation as of October 27, 2008. Also, in our opinion, the controls, as described, are suitably designed to provide reasonable assurance that the specified control objectives would be achieved if the described controls were complied with satisfactorily.

The description of the controls at Custom Payroll Services, Inc. is as of October 27, 2008 and any projection of such information to the future is subject to the risk that, because of change, the description may no longer portray the controls in existence. The potential effectiveness of specific controls at Custom Payroll Services, Inc. is subject to inherent limitations and, accordingly, errors or fraud may occur and not be detected. Furthermore, the projection of any conclusions, based on our findings, to future periods is subject to the risk that changes may alter the validity of such conclusions.

This report is intended solely for use by the management of Custom Payroll Services, Inc., its clients and independent auditors of its clients.

Katz, Abosch, Windesheim, Gershman & Freedman, P.A.

November 20, 2008
Timonium, Maryland

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GENERAL DESCRIPTION OF OPERATIONS

Custom Payroll Services, Inc. ("CPS") began operations in 1995 in Baltimore, Maryland. CPS services clients of all sizes and focuses on the mid-market. We provide a full spectrum of services through our Millennium software and the PayEntry web products. Our payroll services include payroll processing, payroll checks, direct deposits, agency checks, multi-state and local tax service, time clock imports, time and attendance systems, software imports, general ledger imports, journal entries, human resource systems and financial and management reports.

The payroll software is licensed by Millennium Software created by MPAY, which is SAS-70 Type I compliant. The software development team at Millennium Software is responsible for the development and enhancements of the payroll software, including the maintaining of current tax tables, used in the payroll processing.

Organization Structure

President

The founder and president of the company, Martha Burman was a CPA for 20 years in public accounting and private industry prior to starting the company. Her leadership and the senior management team develop creative solutions to complex business challenges. The senior management team has been with the company a combined total of 51 years and had a combined total of 53 years of accounting experience, 14 years of information technology (IT) experience, 25 years of payroll tax experience and 42 years of payroll experience before joining the company.

Operations

Departments are designed around function:

- The payroll department includes the payroll specialists (CSR's) who process payrolls, answer client inquiries and process payroll ACH files.

- The conversion department, in addition to the conversion of new accounts, also has the responsibility for product quality and compliance.

- The information technology department manages the computer system, develops other technology as needed by clients and the company, and provides ongoing technical assistance to clients and other internal departments.

- The mailroom packages and ships all printed reports and checks to clients as well as maintains all supply inventories.

- The tax department is responsible for tax payments by ACH or check and the filing of tax returns to the federal, state and local jurisdictions.

- The sales department manages the sales and marketing functions of the company by networking in the community, meeting in local groups and individually with CPAs, and working with other potential referral sources. They also work with new clients to obtain information for conversion of payroll to CPS.

- The accounting department reconciles all banking activity daily by working with all current banking transactions downloaded from the internet compared to all transactions initiated within the payroll system, analyzing and resolving all exceptions.

Information Flow

Internally, on a daily basis, there is a constant flow of questions and information between employees and departments as clients call with questions. Client telephone calls and emails go directly to the payroll specialist every business day. Our clients have access to the telephone extensions of all managers in the company and are free to call us at any time.

All day, information is exchanged internally through emails, impromptu and regular managers' meetings and on a one-to-one basis between staff. The flow is a primary strength of CPS and supports our strong CSR function; it also enhances the training of our staff and of our clients. This communication system is one of the reasons that CPS is so successful.

CONTROL ENVIRONMENT ELEMENTS

Code of Ethics

As an organization, CPS is committed to acting ethically, responsibly and in compliance with the law. This commitment extends to all areas of the organization including service standards, confidentiality of client information and conflict of interest. The company depends not only on the skills, abilities and commitment of all its employees but also on their integrity and collective common sense. CPS is a long-standing member of the American Payroll Association and the Independent Payroll Providers Association.

Service Standards

We continually strive to increase client satisfaction by providing customers with quality products and services that are innovative and responsive to their requirements. CPS' clients must always be treated with courtesy and dignity. They must also be treated in a manner that is designed to ensure appropriate confidentiality, privacy, security of all client company and employee information, and to provide opportunity for resolution of complaints.

Confidentiality

During the course of business, CPS gains information about our clients. Neither CPS nor its staff will share the information it possesses about those clients with any person or organization outside of CPS without prior permission of the parties involved. All employees are required to sign a confidentiality statement annually.

Monitoring

CPS' management and supervisory staff monitor the quality of internal control performance as part of their daily job function. To assist them, a system of procedures, policies, checklists, logs and processes have been developed and implemented. Reconciliations are done throughout the payroll process and reviews are done at various levels to ensure accuracy.

Operating Procedures Manuals

Millennium user manuals are provided to each staff member and are updated regularly via the Internet.

Procedures manuals are maintained for each function and are also used for training purposes. Technical manuals are also maintained on a variety of subjects.

User manuals are provided to clients using the Millennium PC input system or the Payentry.com system.

Internal Training

MPAY, Swipeclock, the Independent Payroll Providers Association and the American Payroll Association offer courses that are relevant to our work here. Every manager is well trained with many years of professional experience in their respective fields. Training is an ongoing process; managers regularly and often schedule classes, demos and discussions for their employees. In addition, managers provide extensive training for their employees so that we all have a common understanding of the basic principles and guidelines that CPS has established to ensure quality customer service.

Fraud prevention controls

CPS has implemented a variety of fraud prevention controls to ensure the protection of its client's information and cash. These controls are discussed throughout this report. The principal fraud prevention controls are:

- Restrictions are placed on user access to the payroll system, through user ID and password controls and system permissions, which restrict only authorized users to client information and permit processing of data directly related to the employee job function.

- The use of pressure sealed check stock, which is kept under physical security at all times and access restricted to authorized personnel.
- Secure HTTP connection and the use of a firewall prevents unauthorized access to the file servers from outside the organization.
- Client information is shredded after use and reports are stored off site at a secure location to prevent unauthorized access to sensitive payroll information.

Administration

Employee manual

The Employee manual is published containing the principles guiding conduct of employees and personnel policies and benefits. It is kept up to date on a regular basis. The most recent update was February 2008.

Job descriptions

Written job descriptions are maintained for each position. These are approved by management and provided to new employees upon hiring.

Hiring practices and employee evaluations

CPS's objective is to hire the most qualified personnel for each position. Performance evaluations are conducted annually for each employee and copies are maintained in employee personnel file. Copies of the employee's signed confidentiality statement and receipt of the manual is maintained in each employee's personnel file.

GENERAL DESCRIPTION OF APPLICATION PROCESSING

Description of Processing Environment

CPS provides payroll services through its Hunt Valley, Maryland site. The facility maintains back-up batteries on all systems to allow for an orderly shutdown of all systems if power is interrupted. All employee workstations are protected by network and payroll system passwords.

Payroll Processing

Payroll information is received from the client by one of five methods: fax, email, call-in, PC input or on-line pay entry. PC input clients have the Millennium software installed on their PC. During the day on-line pay entry and PC input payrolls ready for processing are submitted via a secure HTTP connection. Clients utilizing the fax method send data and totals to our office on an Input Worksheet Report and a Payroll Specialist enters the payroll data. If the Payroll Specialist has any questions or the totals do not balance with the input worksheet, they will contact the client prior to processing the payroll.

Fax, email and call-in clients are due in our office before 12:00 noon. PC input and on-line pay entry clients are due in our office before 3:00 p.m. An email is sent to all clients who have not submitted payroll by 3:00 p.m. two business days before their payroll check date. A final follow-up call is made by 4:00 p.m. for late or missing scheduled payrolls.

During the payroll process, gross pay, taxes and deductions are calculated. The calculations update the client's database records. Payroll reports and checks are printed, sorted and made ready for delivery to the client.

Payroll Output Process

Payroll processing creates various output based on the client's preferences. CPS provides all clients with checks and/or direct deposit vouchers, reports detailing the processed payroll and reports designed specifically to meet the needs of the client.

Checks

Checks printed as part of the output of a processed payroll vary in quantity based on the company processed. Most clients that utilize a stored digital signature receive checks printed on a pressure-seal style check stock. Once the checks are printed in the mailroom they are passed through a pressure-seal machine. The check stock used by CPS is a fraud resistant stock that prevents viewing employee information until the employee peels off the perforations to break the seal. Clients that do not utilize a digital signature receive checks printed on 2-up legal check stock with a supply of envelopes. Direct deposit payments generate vouchers with a complete check stub for both pressure-seal and 2-up legal checks.

ACH

All direct deposit transactions from payrolls processed are sent to Commerce Bank via ACH files. These ACH files are created twice daily at mid-day and end-of-day (if necessary). These files are sent to Commerce Bank who in turn sends them to the Federal Reserve Transfer agent. A Level II Payroll Specialist, prior to submitting the file to the bank reviews ACH transactions for exceptions. A fax is sent to the bank confirming the totals for the file, and the bank emails CPS a confirmation that they have received a file with the same totals. At the close of business a final fax is sent to the bank listing all of the files sent for the day with instructions not to accept any additional files. The bank signs and returns a fax confirmation. At the end of the business day the Payroll Manager or another manager reviews the ACH verification reports to ensure all companies processed that day were successfully sent on an ACH file.

New Accounts

The conversion department receives new account information from the sales executive. New accounts are converted continuously throughout the year. New accounts are assigned to a conversion specialist who reviews the startup information for completeness and accuracy, including all required tax filing documentation. Clients are given a setup schedule to keep them aware of installation, training and first payroll transmission dates. This department informs all other departments of the impending start date. Year-to-date payroll history is entered and balanced prior to the first payroll processing. The conversion department does the first payroll processing and reviews the output prior to packaging.

Tax

The tax department performs functions daily to ensure that tax liabilities calculated during the payroll processing are paid timely and accurately. CPS guarantees to our client's accurate and timely payment of taxes provided the taxes are funded and the payroll is processed timely.

The Deposit by Due Date Report is compared to the ACH warehouse in the payroll software and checks created for the client tax liabilities due on a given date. Other reports are reviewed to verify that the bank paid all deposits submitted the prior day.

Request for new tax code setups are communicated to the tax department by email and fax. The CSR receives the request from the client and notifies the tax department. The New Tax Jurisdiction Form is completed by the tax department. The tax department will follow-up with the client for the new account numbers and tax rates.

Separation of Duties

Network passwords only allow authorized personnel to perform certain functions. No payroll employee has permission to key in a payroll, process a payroll and then retrieve that payroll's output from the mailroom. Employees whose job functions include packaging payrolls in the mailroom are not permitted to process payrolls or key in payroll data.

Information Systems

Complete Database Backup

The architecture of the database stored on CPS' SQL Server matches the database schema from the latest release from MPAY. CPS does a complete backup nightly of all database changes that occurred that day. Additionally hourly transaction logs are copied onto a backup server throughout the day. Our off-site backup system contains all mission critical information and the data is synced on a nightly basis.

Millennium Updates

MPAY releases new tax tables updates and software updates as needed. Tax updates are pulled into our SQL server via syncing the Millennium software with MPAY's servers. Clients then receive the tax update by initiating sync from their location to CPS'. Application updates are released by MPAY and prior to installation the necessary department managers review the release notes. Once everyone understands what is on the update, the Systems Administrator installs this release on every workstation in CPS. CPS immediately begins processing payrolls with the new updates. Periodically software updates are available to clients via CPS' website and memos sent out. CD's with the software installation are available upon request. The IT department is available to walk clients through this process if necessary.

Web Training

Clients receive initial training on the Millennium software using web conferencing software. This software allows real time interaction between a CPS trainer and the client. Clients have the opportunity to receive additional training as necessary.

CONTROL OBJECTIVES AND PROCEDURES

As a company CPS' primary purpose is to process our clients' payrolls, and handle all customer service issues in an efficient and effective manner. Every policy, procedure and control disclosed herein is an integral part of the daily operations.

In the following sections there is a clearly stated objective, followed by the manner in which CPS meets that objective. This system of internal controls is intended to provide reasonable assurances that our stated objectives are met. CPS strives to meet these pre-defined objectives as they relate to each client's payroll. These objectives have been separated into the following areas:

- General Computer Controls
- Access Security Controls
- New Account Setup Controls
- New Client Information Setup Controls
- Processing Controls
- Output Controls
- Tax Compliance Controls
- Automatic Clearing House (ACH) Processing Controls

GENERAL COMPUTER CONTROLS

General Computing Equipment Identification

Objective: Ensure that the correct computers are performing the tasks that are best suited for the hardware and software makeup of the specific machine.

Workstations

Every employee of CPS has a computer at his or her desk. These machines are the sole property of Custom Payroll Services and are treated, maintained and configured for such purposes. Workstations are used to log on to the CPS domain to access the servers, execute and use Millennium, and other office related tasks.

Laptops

Executives use laptop computers for the purposes of software demonstrations. These laptops are the property of CPS and virus definitions are updated automatically every time the laptop connects to the internet. These laptops are not connected to the network without permission from a manager and direct intervention from the Systems Administrator.

File Server

The file server is used to store all client data, and operations data. Workstations throughout the office utilize mapped network drives to store data in its appropriate location on this server. The section titled Internet Security details the manner in which these folders are protected. Each employee at CPS has specific permissions on the domain, which limits access to files stored on the file server. These permissions are assigned and controlled by Active Directory and applied by the Systems Administrator.

Exchange Server

The Exchange server provides CPS with email services onsite and is accessible through a secure HTTPS connection. This server contains a large RAID array on which the email data resides. RAID technology allows us to access the data at a faster rate then a standard hard drive controller. This machine also handles Microsoft updates because every computer connects to it for email and the capacity of the RAID array allows for the necessary space required for the process.

SQL Server

The production SQL Server leverages 64bit technology so that the system can process large amounts of data in an efficient manner. The database itself is stored on a RAID 1+0 (10) array consisting of six hard drives for faster record access. Since this server has 64bit architecture it can address a larger amount of memory.

Print Server

The print server handles all print jobs from any computer in the office. This server is configured for fast throughput and printer management through the configuration of the server operating system. This allows us at different times throughout the year, as our needs change, to map different jobs to different printers of varying speed and performance.

Process Servers

The process servers handle specific jobs assigned by the Millennium payroll software. Every workstation uses these servers to manipulate data stored on the SQL Server. One of these servers handles communication to our clients and vendor through MPAY's proprietary software.

Backup Server

The backup server is a large NAS device that stores all of CPS' data throughout the day via a continuous protection module and nightly on scheduled backup times. All critical information is then sent offsite and accessible via software provided by the vendor.

Data Center

CPS employs an off-site data center to host our Millennium Hosted Solution. The data center provides power, bandwidth, and rack space for the three servers running at their location. One of these machines is a 64-bit SQL server that also runs the Citrix software. Another server acts as the processing machine for this environment, and the last server acts as the domain controller for all of the off-site servers. In order to maximize the available resources in these machines, there is a minimal amount of software outside of those components necessary for the Millennium Payroll software to function properly. The tasks performed by the SQL and Processing servers mimic those performed by the similar servers found in CPS' office.

Alternate Power Sources

Workstation UPS

All user workstations are protected against power surges and power loss by UPS units. These units allow users time to close all work and shut down. They recharge themselves as needed when power is provided from the wall outlets.

Server UPS

The servers benefit from server quality UPS units. These high power UPS units are capable of powering the servers and processing machines for 25 minutes if power is interrupted, allowing sufficient time to shut them down.

Backup

All new files are immediately copied to the backup server and changes to those files are copied immediately upon modification. The data stored on all other servers is transferred to the backup server at predefined intervals. Only the files altered during that business day are updated on the backup server. Every evening the backup server probes these machines to find the files with a "last modified date" that corresponds to that business day.

Off-site Storage

CPS utilizes USDataTrust and its facilities at two redundant Iron Mountain data centers nationwide, to backup all files nightly. At the end of each workday USDataTrust's software establishes a connection between our office and their facility to upload all daily changes. This ensures that CPS has a complete backup of all databases and files at a secure off-site location daily. If any of our servers malfunctions, USDataTrust has provided us with a server which has replicated data of what is stored offsite. This server will provide us with a fast means of restoring data if the need were to arise. CPS has other servers that once loaded with the aforementioned data, can take the place of the existing server with minimum downtime. USDataTrust's storage facility inside Iron Mountain is classified as "the most secure non-military facility in the country."

Network Security

Hardware

A SonicWall hardware firewall protects the CPS network. This appliance ensures that only responses to communications initiated by CPS are allowed access to the network. Additionally content filtering is performed and inappropriate content is denied access onto CPS' network. Updates to this firewall are automatically obtained through SonicWall upon release.

AV Maintenance

All computers have Symantec Anti-virus installed. CPS uses Symantec Corporate as our anti-virus software of choice. This allows the IT department to update every computer by automatically updating the predefined Symantec Corporate Server. The virus definitions update is performed daily or more often if necessary. CPS uses the 'Full System Scan' option within Symantec Corporate Anti-virus, weekly, to ensure all computers are protected and clean.

Processing Machines

There are two processing servers at CPS. These are the only computers in the office that process payrolls in conjunction with the SQL Server. These machines have the bare minimum of software installed on them so that the resources can be used solely for payroll processing. Every payroll is processed on one of these two servers and the process is initiated by a client syncing their database. To insure that no payrolls are processed outside of normal business hours a custom application is executed by the I.T. department that puts all companies' payrolls on hold at the close of business, and reverses this process at the start of business daily.

ACCESS SECURITY CONTROLS

Objective: Protect all sensitive data stored on the CPS network (including confidential client data), by only allowing access to those users with appropriate permissions.

Domain Authentication

The CPS domain and subsequent data stored on its network is accessible through strict password authentication. Passwords allow users, based on their department and their position within that department, access to the folders and files protected on the domain. No CPS workstation will leave the premises at any time. Authenticating workstations on the domain requires the employee to login with their unique username and password. Permission from both the Systems Administrator and CPS President must be received prior to any laptop authenticating itself on the domain. User names are developed using current naming conventions and passwords are changed periodically by the Systems Administrator.

Data Center

The data center employs a high-level of physical security to the building itself. Internally all access to our servers is limited by those employees who have permission to access those machines. Access to the Millennium Hosted Solution employs several levels of security. To access any software running in that environment users must enter a strong password prior to launching any application. In order to run the Millennium Payroll Software another strong password is required and maintained by the Director of Operations at CPS. All of these servers are behind a Juniper firewall that is updated and maintained jointly by the data center and CPS.

Workstation Policies

Millennium

The Millennium Systems Administrator is outside of the IT department. This is done to separate responsibilities, which limits liability, and encourages segregation of duties. Millennium is regulated by its own internal password verification. These assigned passwords are different from network passwords. Employee permissions are determined and created for departmental requirements. Changes in an employee's department or position will affect the user's Millennium permission accordingly.

CPS Usage Policy

CPS has a policy on workstation usage. Every employee must sign this when hired or when the documentation is updated. This document states that neither any software will be installed nor any workstation reconfigured without direct IT department approval. Weekly, the IT department accesses every workstation for virus definition updates and computer usage compliance. No access to the network is permitted from outside the office without permission.

Physical Controls

Under Lock and Key

All servers reside in a locked room within the CPS facility which is a single-story building. The server room is locked nightly and only accessible by the IT department and facility manager. Access to the building is controlled by security fobs, which are programmed to allow access during specific time periods. Only the owner and two of the managers have keys to the building. In addition couriers (or any visitor) have access to the building by buzzing the mailroom and having the doors opened for them.

Alarm System

CPS employs an alarm system that monitors and logs approved and unsolicited access to the office. Upon termination of an employee, or if a password's confidentiality becomes compromised alarm codes are changed or de-activated accordingly. All entry and exiting of CPS is monitored and suspicious activity is brought to the attention of CPS' President, and the authorities if necessary.

NEW CLIENT SETUP CONTROLS

Objective: To setup a client in the payroll system with accurate employee information for the current quarter and year's wage and tax liability.

Description of Policies and Procedures

The conversion department works closely with sales executives to ensure all information is obtained to complete a new account setup successfully and within the established deadlines. A standard "Template Company" is used to create the new company. Check-off forms are used to ensure all steps of the process have been completed and other departments are informed of the impending start. Year-to-date payroll history is entered and balanced. A review of company settings is done to ensure all settings are ready for the first payroll processing. The first payroll is reviewed for accuracy before packaging.

Templates

A standard "Template Company" is used to begin every conversion. Each new company begins with standardized parameters and information unique to the new account is entered based on data obtained in the conversion package, tax package and documented telephone conversations with the client. Conversion of data is done both electronically and manually.

Import Utilities

Conversion data received in spreadsheet format can be imported directly into our software. The utilities can import: employee demographics, direct deposit setup, time off accrual balances, payroll history.

Check-off Form

A check-off list is utilized to ensure that all departments are informed of the impending start and their roles in the conversion and payroll process. A complete outline of the company module, in Millennium, is used to make sure someone has looked at every tab or flag that must be setup. A review process is done before the first payroll processing to ensure all manual steps have been returned to normal processing. A checklist is used for the first payroll processing to ensure that all reports and checks meet the client's requirements. These forms are reevaluated and updated continuously. A Permanent Payroll Instruction Form (PPI) is kept on the network and a hardcopy is kept in the client's payroll folder that gives the payroll department information about non-routine procedures specific to the client.

Tax Documentation

The conversion specialist receives a legal document with the pre-printed legal name and taxpayer identification number for each tax jurisdiction. These documents are forwarded to the tax department to obtain EFTPS PIN numbers for electronic tax payments if required. A signed Form 8821 and Form 8655 is obtained from the client allowing the tax department to act as their representative on specific tax matters. The client signs a tax filing agreement.

Client Signature Scan

Clients may elect to have CPS print a signature on the check. The conversion department would receive a signature using a signature form and create the signature file in a printer specific format. Samples are printed and checked for accuracy. The signature is applied electronically as the check is printed.

New Client Transition, Installation and Training

Installation and training is coordinated between the IT, payroll and conversion departments. Once the conversion is near completion, the IT department is notified. They will contact the client and schedule the date of installation. This date is then listed on the conversion calendar in Outlook, by IT, and an email notification is also sent to the conversion department. A training schedule is established with the client. Training is assigned to a qualified representative in the conversion or payroll department. This training is done using web conferencing software. Instructions regarding basic information about the client are reviewed with the instructor at this time.

First Payroll

The initial payroll is transmitted to CPS in a request status. The conversion department is informed that the payroll is in. They will review the company setup to ensure everything is ready for a live payroll. Employee level calculations are tested to ensure accuracy with taxes, deductions, 401k, etc. The payroll is then processed. The mailroom will bring the payroll to the conversion department for review. Post payroll processes will be checked then the payroll will be returned to the mailroom for delivery.

NEW CLIENT INFORMATION SETUP CONTROLS

Objective: All necessary new client information is obtained and setup to insure accurate payroll information.

New Accounts

The conversion department receives new account information from the sales executive. New accounts are assigned to a conversion specialist who reviews the startup information for completeness and accuracy, including all required tax filing documentation. Clients are given a setup schedule to keep them aware of installation, training and first payroll transmission dates. Year-to-date payroll history is entered and balanced prior to the first payroll processing.

Description of Policies and Procedures

The conversion specialist works with the sales executive and new client to ensure that all information is received to complete a timely and accurate conversion. A conversion specialist has considerable experience in the conversion process, payroll system and customer service. Procedures are followed by the department in the processing of a new account. The following procedures are used by the conversion specialist for loading a new client:

Company Setup

A standard conversion package and tax conversion package is used to gather information necessary to load a new client onto the payroll system. Additional notes exclusive to the new client are also taken at the time of the initial process at the client's office. The conversion specialist utilizes a template company to create the new account. This template includes all of the standard parameters for setting up and processing payroll. Company specific information is incorporated into this process.

Prior History Entry and Balancing

A new client may have previous payroll and tax information for the year. Reports are obtained from the new client for balancing purposes.

Once the conversion specialist has reviewed and confirmed that all of the necessary source data has been keyed into the system, the payroll history is entered. Depending on the size of the company and how the data was given to CPS, this process may be done manually (data entry) or electronically (Excel spreadsheet). Validation checks are done to ensure that employee year-to-date amounts are balanced prior to the first payroll processing. In a separate process, client tax liability and deposits are reviewed and balanced both quarter-to-date and year-to-date. Prior to the first payroll run, the tax liability and other tax related company setup are audited by the tax department for accuracy.

Millennium Installation and Training

The payroll software is installed by a member of the IT department staff using web conferencing software. Transmission and printing are tested and passwords are assigned.

The client is trained by a qualified conversion specialist or payroll department representative using web conferencing software. The representative explains the use of the input worksheet, which organizes the payroll information efficiently and emphasizes the importance of comparing control totals against the system totals after payroll entry. The client is shown how to run the register prior to processing, which provides them with a copy of their final payroll register to ensure that employees were paid accurately. On-going training is available via regularly scheduled web training.

PROCESSING CONTROLS

Objective: To ensure that all client payroll transactions are processed and that client checks and reports are complete.

Payroll Processing Controls

When a payroll is forwarded for processing via PC input or online pay entry, it is processed automatically unless put on hold. Payrolls can be put on hold for any number of reasons, such as the need to change the check stock format, to enter taxable wage corrections, checking internal payroll calculations, or verification of data submitted by the client. Any payroll that is set to come in on hold is added to the Payroll Hold Log spreadsheet. The Payroll Specialist will check the Payroll Hold Log and the client's payroll folder ("blue folder") for changes or special instructions. If the payroll comes in on hold, the Payroll Specialist will investigate why.

When a fax payroll or call-in is submitted for processing, it is put in that client's blue folder, which contains any changes or special instructions. The Payroll Specialist verifies the identity of the client personnel to ensure that it is an authorized person. The payroll data is entered by a Payroll Specialist and reviewed. If there are variances between client provided totals, and the totals provided by Millennium, the Payroll Specialist contacts the client. Once the totals are balanced, the payroll is processed. At this time the reports and checks will produce in our mailroom. Mailroom specialists review client payroll output for clarity of print and obvious formatting errors before packing and delivery to the client.

Deleted Payroll Runs

CPS does not delete a payroll that has already been processed if requested by a client. We will offer to do an adjustment payroll to fix an error. Payrolls with errors during processing are deleted and rerun. The payroll department coordinates with the ACH processor and the mailroom, to make sure that the ACH file has not yet been sent and that all paperwork from the deleted run was put in the shredder in the mailroom. After these steps are confirmed the payroll is re-processed.

Adjustment Runs

An adjustment payroll run is needed to make corrections to a payroll that has already been processed. An adjustment form is completed for each adjustment processing to document what caused the adjustment, if is to be billed to the client, if time off accruals need to be blocked, if it is a negative or backdated payroll, and if deleting prior tax deposits is necessary. These adjustment runs must be handled appropriately to collect or credit tax liabilities to the client and to make correct tax payments. The tax manager signs the adjustment run form before the Payroll Specialist can enter the adjustment payroll. The tax manager approves the deletion of the initial payroll tax deposits. After entering and verifying the accuracy of the adjustment payroll, the Payroll Specialist gives the paperwork to a manager. The manager blocks accruals if necessary, modifies or blocks billing, deletes previous tax deposits if needed, determines if tax liability is negative, or if the adjustment involved moving taxes for a prior period that have already been paid, and if so determines if ACH transfer should be placed on hold or if an ACH fix is needed. After the payroll is processed an employee of the tax department verifies that the taxes will be paid correctly or if an ACH fix is necessary.

FICA Variances

We monitor potential taxation issues that can be caused by a client's accidental removal of an employee's tax codes or manual check calculation errors. This can cause the amount collected for mandatory taxes like FICA (Social Security and Medicare) to be incorrect. This variance must be corrected on the individual employee in order for their W-2 to be correct, and for the quarterly and annual tax returns to be accurate. A Payroll Specialist runs a report to check for any FICA variances for the payrolls processed on the previous day. Those that are identified are researched and reported to the payroll manager. If corrections are necessary they are done immediately. FICA variances that occur prior to the end of the quarter are fixed on the next payroll.

Client Communications

Throughout the day CPS receives and makes calls to clients in regards to payroll. The CSR verifies that the person at the client's office is authorized to speak with CPS prior to assisting with software or payroll related issues. If the person requesting information is not the client contact, that person must have permission given to us by our known contact.

The CPS shared email account is monitored constantly by the CSR's for client communication. Based on the nature of the email, the CSR will contact the client if the issue raised is payroll related or forward the email to the appropriate department. The CSR is notified of the resolution or the expected resolution date, and the CSR then notifies the client. Because the CSR is responsible for most client communications, it is crucial that the entire department is kept abreast of any outstanding issues.

OUTPUT CONTROLS

Objective: To package all payrolls in an accurate and efficient manner and to ensure that the pre-defined courier for that client receives the sealed payroll package. In addition, appropriate security measures are in place for clients that pick up their payroll from CPS.

Description of Policies and Procedures

Payroll checks are generated by the Millennium software and printed using laser printers with MICR toners located in the mailroom. Checks produced for direct deposit payments are automatically coded as non-negotiable by the system.

Millennium is designed to reprint a check if the document is damaged as a result of a paper jam or sealing error. In these instances the mailroom employee returns the damaged check to the payroll department with "VOID" written across the check. Once the check is reprinted the voided check is returned to the mailroom for shredding.

Late payroll transmissions are discussed to determine if the processing and delivery of the payroll can be accomplished within the processing deadline. Payrolls that have been printed and not packaged and payrolls that have been packaged but not picked up by close of business are locked up overnight.

Nobody other than specific mailroom personnel is allowed entry into the mailroom, unless escorted by a mailroom employee or supervisor. A mailroom employee delivers new account first payrolls that need to be reviewed prior to packaging to the conversion specialist. Prior to leaving the mailroom, the number of checks and reports are verified. When the package is returned to the mailroom, checks and reports are verified again to ensure that everything was returned.

Payroll Packaging

Once the client transmits their payroll the processing machine sends the print job(s) to the appropriate printer. Each processed payroll prints with a Packout Report that lists all of the client specific directions for packaging the payroll. This includes notes for the courier, new hire reporting requirements, if the checks are to be sealed and the total check count. Checks are sealed based on instructions. The checks and reports are sealed in an envelope and sorted by delivery type. The client receives payroll checks and reports from either a delivery service, the U.S. Postal Service or by client pick up at the CPS office. Courier service packages are sent by Maryland Messenger and Next Day Express ("NDX") for clients in the Maryland, Washington, DC and Northern Virginia areas using packaging envelopes preprinted with the CPS return address and confidential in red at the top. All other deliveries are sent by Federal Express.

Payrolls Picked Up

Occasionally clients choose to pick up their payroll from the CPS office. This directive is setup in advance. When a client representative arrives, a mailroom employee locates the package and verifies the identity of the person receiving the package. The payroll is logged with the company's identification number, date, time, signature of the person receiving the package and the initials of the mailroom employee. Picture identification is required for client personnel picking up payroll.

TAX COMPLIANCE CONTROLS

Objective: To ensure that tax deposits are made in accordance with each tax jurisdiction's regulations.

Payroll Tax Compliance

CPS recognizes the importance of keeping abreast of ever changing payroll regulations. CPS subscribes to the APA (American Payroll Association) BNA (Bureau of National Affairs) Payroll Library online. The BNA library provides us the ability to access "new" payroll law releases, payroll forms and a complete database for research of payroll laws. Weekly Email Alerts highlighting any proposed bills and legislation on payroll are received.

CPS encourages all employees to research payroll and payroll tax issues as they arise through "The Payroll Source" published by the APA Administration. Seminars and payroll training classes sponsored by APA or Millennium Software are attended by tax and payroll staff.

Tax Deposits

Daily

CPS guarantees the accuracy and timely submission of all tax payments for clients on our full-tax service as long as the client's account is funded accordingly. Tax payments are made by ACH and check. The Deposit by Due Date Report and 100K Liability Report are printed daily to aid the tax department in making these payments.

Tax Checks are printed and mailed daily from Millennium for state and local taxes that are not authorized to be paid by ACH. The Deposit by Due Date is compared against the ACH warehouse and tax checks before submitting the ACH or the mailing of tax checks. An ACH credit file is created through the Millennium ACH Warehouse in CCD format and is transmitted to Commerce Bank. Commerce disburses the tax money to the appropriate agencies. All ACH files and tax checks are sent one day prior to due date. ACH files are acknowledged by Commerce bank via email and filed in date order in the tax department. Copies of tax checks and coupons are stored in client's current year tax file.

CPS provides three levels of tax service:

Full tax service – makes tax payments electronically or by check to taxing agencies for the client. The client funds the tax payments by making an ACH transfer to the CPS tax escrow account each pay period.

Mini-tax service - The mini-tax service provides clients a payroll summary with detailed tax payment requirements. Tax checks printed with the client's bank account are included in the regularly scheduled payroll delivery.

No tax service - The non-tax clients will be provided a payroll summary with detailed tax payment requirements. Tax checks are printed by the client.

Quarterly

Quarterly tax returns are processed and verified for accuracy by the tax department. All full tax service clients are balanced to ensure all tax liabilities that have been collected during the quarter have been paid. Any funds that have been under or over collected are satisfied by ACH at that time. Tax checks for quarterly unemployment are printed each quarter for tax jurisdictions that do not support an ACH method of payment. Quarterly unemployment tax checks are stored in a locked file drawer until they are mailed.

Annually

Employees' year-to-date amounts are balanced to the Form 941 tax returns after the processing of each quarter and at year-end. The W-2's are printed after the last quarter of the year. The employees W-2's are printed on pressure seal style stock for all clients. Employer W-2's are printed on blank paper. Non-tax and mini-tax clients receive copies of their W-2's on diskette. The Social Security copies of W-2's for full tax clients are submitted by CPS electronically using a website upload. State and local W-2's are filed electronically or on diskette where permitted. W-2's filed on paper are accompanied by an annual reconciliation form for the appropriate tax agency.

Tax Notices

Tax notices received by our full tax clients are forwarded to the tax department for handling. Upon receipt of a notice it is logged in a tax notice log and assigned a number. The client is notified via fax to acknowledge receipt of the notice. The tax department contacts the taxing authority to determine the issue. Once the issue has been identified, correspondence is forwarded to the agency with copies to the client. Tax notices are followed up on until the issue gets resolved. Once resolved it is logged and filed in the client's penalty file. If non full tax service clients receive a tax notice, the tax department will provide assistance on how to resolve the notice with the tax agency.

New Account Tax Audit

The conversion department advises the tax department of all new accounts via email. Permanent tax files are created and depending on the level of tax service, the audit process proceeds. During the tax/audit process, pertinent information supplied by the client is verified - unemployment rates, tax identification numbers, etc. Missing tax information is verified with the taxing agencies. Tax data supplied by the client is compared to data keyed in by the conversion department. Corrections to the taxes tab are made if there are changes and the conversion department is informed. EFTPS enrollments to various agencies are completed and Power of Attorney forms are submitted to the IRS for full tax service clients. Notes pertaining to special handling instructions or requests by clients are logged. Permanent tax files are stored in the tax department for quick reference if necessary.

Client Termination

The tax department receives an email and the Client Termination Form from the payroll department. After receipt of this documentation the tax department completes the termination process as stated on the form. If the client is full tax service, all PIN numbers issued by the IRS are terminated once the final tax payment has been made. Quarter-end and year-end special handling issues are followed based on the instructions provided on the Client Termination Form. Copies of all termination information are stored in the permanent tax folder in the tax department. Escrow balancing is completed for all full-tax service clients and if necessary given to accounting before a refund is generated.

AUTOMATIC CLEARING HOUSE (ACH) PROCESSING

There are two types of ACH files created through the software system. These files are sent throughout the day to CPS' financial institution, Commerce Bank.

ACH Credit files – These files include tax payments to federal and state tax agencies in CCD format.

Standard payroll files – These files include payroll transfers for direct deposit, billing and tax in CCD and PPD format.

Tax ACH Process

The accounting manager monitors the Commerce Bank accounts daily. Deposits generated by the payroll software and banking activity are downloaded into a company software program for verification of tax deposits daily. Discrepancies are researched and resolved by the tax department. All tax outstanding checks are reconciled with the monthly tax reconciliation process. Tax checks that have been outstanding over ninety days are voided and re-issued. The accounting manager may submit a stop payment on outstanding checks.

Tax ACH files are created through Millennium and stored on the network. One file is sent daily. Multiple files are sent on an as needed basis. Tax files are scanned for any formatting errors before transmission. Tax files are processed by the Commerce Bank program and uploaded to the bank's website. A Fax Transmittal Sheet is sent to the bank's ACH department to advise them of a file being transmitted. Any discrepancies in file totals are rejected and the bank advises the tax department. Email confirmation of a successful file is received from the bank. The bank distributes them to the appropriate taxing agency.

Payroll ACH Process

ACH

Prior to creating an ACH file, a Level II Payroll Specialist runs a report to show which payrolls will be included on the file. This report compares previous payroll transfer amounts with current transfer amounts. Any variance over 50 percent is investigated and verified prior to file creation. After verification, the file for those clients is created and transmitted to our bank.

All payroll liability transfers are sent through Commerce Bank via ACH files. Payroll trust checks are issued on CPS' bank account at Wachovia Bank. These ACH files are created twice daily at mid-day and end-of-day (if necessary). These files are sent to Commerce Bank who in turn sends them to the Federal Reserve Transfer agent. A fax is sent to the bank confirming the file totals for the file and the bank emails CPS a confirmation that they have received a file with the same totals included. At the close of business a final fax is sent to the bank listing all of the files sent for the day with instructions not to accept any additional files. The bank signs and returns a fax confirmation.

ACH Returns

Commerce Bank will notify CPS of any ACH returns and indicate the reason for the return. All returns are logged. The return notifications are provided by email three times a day at 10:00 a.m., 1:00 p.m. and 5:00 p.m. A Payroll Specialist and the accounting manager review each return. Items are returned for the following reasons.

Direct deposit pre-note rejection – These are the result of inaccurate bank account information submitted to the bank. These do not involve the movement of funds. A fax is sent to the client so they may obtain additional information from the employee or make corrections provided by the bank as noted on the return.

Direct deposit returns - These are the result of inaccurate bank account information submitted to the bank. These do involve the movement of money. A fax to the client notifies them of the returned money so that they may reimburse the employee by other means. The money is either collected or returned to the client at the end of the week via an ACH FIX done by the payroll manager.

Insufficient funds for client impounds – These are the result of insufficient funds in the client's bank account. The payroll manager immediately forwards a fax to the client with a follow up telephone call. The payroll manager in coordination with the accounting manager works to resolve the problem. The payroll manager discusses with the client why the bounce occurred, and if the funds are now available. Once the funding is verified, the funds are recollected via the client initiating a wire, ACH, or certified check. If necessary, tax deposits are put on hold until we are sure that the funds are received. The client is then reviewed for past history of NSF to determine if either direct deposit or tax service should be discontinued.

Tax ACH Returns – In the event that Commerce Bank was not able to successfully forward a tax payment to the taxing agency, CPS is notified by email. The email is given to the tax department for research. After researching, the appropriate action is taken to fix the error and the tax payment is resent.

Trust Voided Checks

Every morning a Payroll Specialist runs a report to look for trust checks voided from the Custom Payroll Services payroll bank account. Research is done to determine if the funds have been returned to the client and stop payments are applied if necessary to ensure that the funds are secured. If we do not have the check or voucher, we contact the client and ask them to send that document back to us. After 5 days, a stop payment is placed on all checks that have not been returned by the client.

Positive Pay

To protect the company from fraud resulting from forged checks on the CPS trust account, at the end of each business day, the payroll department sends a positive pay file to Wachovia Bank, which includes all the trust paychecks processed that day. Prior to submitting the file to the bank, we balance the total amount of the trust checks processed during the day to the total amount in the file. The file includes the check number, the amount and the payee. The positive pay file is checked against the items presented at the bank. Any exceptions are sent to CPS for review. The exceptions are reviewed during the daily monitoring of the bank accounts performed by the accounting manager. After notification from Wachovia Bank, the accounting manager and payroll manager work together to resolve any exceptions.

CLIENT CONTROL CONSIDERATIONS

Processing of transactions for client organizations by CPS covers only a portion of the overall internal structure of each client organization. It is not feasible for all the control objectives relating to the processing of transactions to be completely achieved by CPS. Therefore, each client organization's internal structure must be evaluated in conjunction with the internal control structure described in this report.

This section highlights client organization internal control structure responsibilities that CPS has considered in developing its control policies and procedures describe in this report. Each client organization must evaluate its own system of internal control to determine if the following items are in place:

Payroll Input Controls

Clients should have policies and procedures in place to insure that:

- New clients should perform a detailed review of their first payroll checks and reports for accuracy and completeness.

- Clients are provided a timesheet to assist them in reporting payroll to the department each pay period. The timesheet helps clients to organize and calculate rates of pay, regular and overtime hours worked, and other earnings for each employee, and provides the scheduled day of payroll input. Clients should have control, policies and procedures in place to prepare and review payroll information on the time sheet for completeness and accuracy before input to CPS.

- Clients should have control policies and procedures in place to ensure that they calculate payroll totals on the client timesheet prior to input at the department. These totals can then be compared to the accumulated totals that are calculated and displayed on the department payroll system as payroll is being taken to ensure accuracy of input.

- Clients utilizing the Millennium service to input data on their own PC should have policies and procedures in place to:

    1) Control user and password ID codes that allow access to payroll information and data transmission to CPS.
    2) Insure that only authorized and properly trained personnel are allowed access.
    3) Ensure use of Millennium's control total facility. This feature will detail variances between client's anticipated payroll totals and accumulated totals calculated for each employee.

4) Ensure review of the two audit reports, which are designed to check the accuracy and completeness of data input prior to the transmission of payroll data to CPS.

    - Payroll Register Prior to Process
    - Employee Change Listing Report

Payroll Output Process Controls

Clients who pick up payroll at CPS's premises should have control policies and procedures in place to ensure that access to their client number, used as identification at CPS, is limited to the designated employee.

Clients should have control policies and procedures in place to ensure that payroll output, including downloaded Millennium payroll data, is restricted to authorized client personnel and that it is reviewed for completeness and accuracy.

Other Client Control Considerations

Clients should have policies and procedures in place to ensure that:

- Bank accounts used for payroll disbursements are reconciled on a timely basis each month.

- Payroll output will be retained for the appropriate length of time to satisfy all federal, state and local payroll compliance agencies.

- Passwords are changed on a periodic basis, especially if a payroll person leaves their company.

- Backup of all client-maintained data is consistently performed.

- Employee dishonesty coverage is maintained for all personnel responsible for processing payroll.