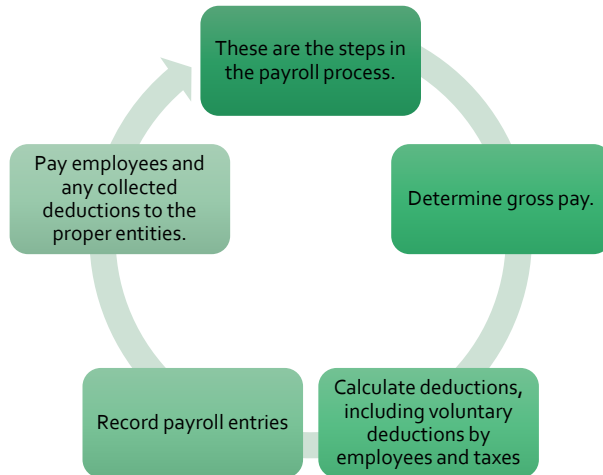


Effective Bookkeeping and Payroll

Chapter 10 - Payroll

WORKBOOK

The Payroll Process



Payroll Process – Gross Pay

Employee's can be paid a monthly or weekly salary but may also be paid hourly wages.

Hourly employees are paid for the number of hours worked during a pay period (i.e. daily, weekly or biweekly). They are paid a set hourly wage but can earn overtime if they work more than 40 hours in a week or in some cases, more than 8 hours in a day.

Salaried employees are paid a yearly salary that is divided into a monthly or weekly amount for purposes of periodic payment.

Payroll Process – Gross Pay

Hourly wages are calculated in the following way. Note that states mandate a minimum hourly wage that employees must be paid.

1) Regular Hours Worked x Regular Rate = Gross Pay (Regular)

+

2) Overtime Hours Worked x Overtime Rate = Gross Pay (Overtime)

The two summed together = Total Gross Pay

Payroll Process – Gross Pay

Let's look at an example. An employee is paid \$9/hour to be a cashier in a retail outlet. If that employee works 45 hours in a week, their pay is calculated as follows:

Regular Pay	$40 \times 9 = \$360$
	+
Overtime Pay	$5 \times (9 + 4.5) = \$67.5$
Time + 1/2	
Gross Pay	$\$360 + \$67.5 = \$427.50$

Payroll Process – Gross Pay

Salary employees are paid based on an annual salary, thus, they receive a fixed amount every payroll period. They are not typically paid for overtime although they often work more than 40 hours per week.

Example – Annual Salary / Pay Period = Gross Pay per Period

$$\$48,000 / 12 = \$4,000 \text{ Gross Pay per month}$$

Payroll Process – Gross Pay

Some salaried employees are paid a low base salary plus **commission**. These are sales positions where the owner or manager wishes to incent the employees to sell more products. The more they sell, the more their pay is.

Commissions are often calculated as a % of the employees sales for a period. In this example, the employee is paid a base salary of \$24,000/ year plus 5% of their sales. She/he is paid monthly and in January sold \$60,000 of clothing.

Base = $\$24,000 / 12 = \$2,000$

Commission for = $.05 \times \$60,000 = \$3,000$

Total Gross Pay = $\$2,000 + \$3,000 = \$5,000/\text{month}$

Payroll Process – Gross Pay

Some employees are paid according to the number of pieces or units they produce during a pay period.

There is always a requirement that the minimum wage always be paid for hours worked. Therefore, a comparison needs to be made to ensure minimum wage is met.

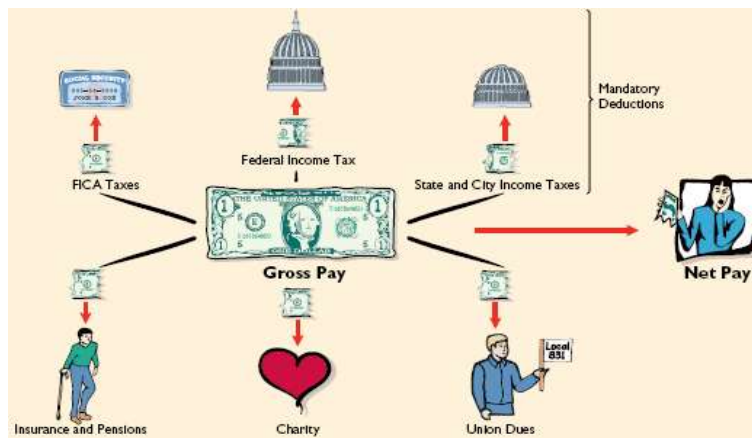
Hourly Rate: 7.50		Piece Rate: .10		
Day	Hours	Pieces	Piece Pay	Hourly Pay
1	8	700	70.00	60.00
2	8	600	60.00	60.00
3	8	550	55.00	60.00
4	8	575	57.50	60.00
5	5	370	37.00	37.50
			\$279.50	\$277.50

After totaling the pay for the period under both Piece and Hourly, we can see the Piece Pay is greater, thus, this is the Gross Pay for the period.



Payroll Process – Deductions

Now let's discuss deductions.



Some payroll deductions are mandatory for all US employees and the employer is only a collection agency. These include **Federal Income Tax, Social Security Tax and Medicare Tax.**

Some payroll deductions are mandatory for all US employees and the employer is only a collection agency. These include **Federal Income Tax, Social Security Tax and Medicare Tax.**

The rate for these taxes is set by the Federal government and does change over time. You must monitor the rate for changes as they occur.

Payroll Process – Taxes

The w-4 form determines how much Federal tax the employer withholds. It is based on the allowances that the employee claims.

Cut here and give Form W-4 to your employer. Keep the top part for your records.

Form W-4 Department of the Treasury Internal Revenue Service		Employee's Withholding Allowance Certificate <small>Whether you are entitled to claim a certain number of allowances or exemption from withholding is subject to review by the IRS. Your employer may be required to send a copy of this form to the IRS.</small>		OMB No. 1545-0047 2009
1 Type or print your first name and middle initial.		Last name		2 Your social security number
Home address (number and street or rural route)			3 <input type="checkbox"/> Single <input type="checkbox"/> Married <input type="checkbox"/> Married, but withheld at higher Single rate. <small>Write, if married, but legally separated, or spouse is a nonresident alien, check the "Single" box.</small>	
City or town, state, and ZIP code			4 If your last name differs from that shown on your social security card, check here. You must call 1-800-772-1213 for a replacement card. <input type="checkbox"/>	
5 Total number of allowances you are claiming (from line H above or from the applicable worksheet on page 2)				5
6 Additional amount, if any, you want withheld from each paycheck				6 \$
7 I claim exemption from withholding for 2009, and I certify that I meet both of the following conditions for exemption. • Last year I had a right to a refund of all federal income tax withheld because I had no tax liability and • This year I expect a refund of all federal income tax withheld because I expect to have no tax liability. If you meet both conditions, write "Exempt" here				7
Under penalties of perjury, I declare that I have examined this certificate and to the best of my knowledge and belief, it is true, correct, and complete.				
Employee's signature <small>Form is not valid unless you sign it.</small>				
8 Employer's name and address (Employer: Complete lines 8 and 10 only if sending to the IRS.)			9 Other code (optional)	10 Employee identification number (EIN)

Payroll Process – Deduction Tables

While a rate is provided for mandatory deductions, there are also tables that assist in determining the amount to withhold base on gross income.

- These tables are published by the federal government for federal income tax.
- Employees can be penalized by the federal government for not withholding enough tax during the year so it is important to use the correct table.

These forms, along with others, is found at <http://www.irs.gov>.

Payroll Process – Deductions

Social Security and Medicare Tax

Currently, the tax rate for social security is 6.2% and Medicare is 1.45% for both the employee and the employer.

- Gross Pay x 7.65% = Employee contribution
- Gross Pay x 7.65% = Employer contribution

For example, if an employee earns gross pay in one week of \$1,000, the calculation is $\$1,000 \times .0765 = 76.50$ (both the Employee and Employer pay this amount for a total of \$153)

Payroll Process – Deductions

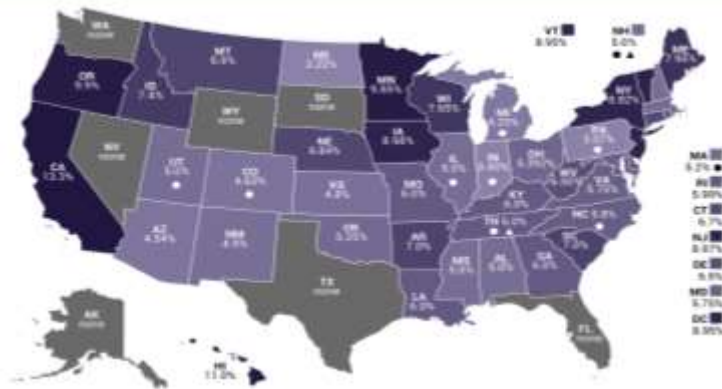
Social security is only paid on income less than \$118,500 in 2015.

Thus, once an employee earns \$118,500 in one year, they only pay 1.45% of gross pay for Medicare. No more for social security. The income cap typically increases each year with inflation.



State taxes

State Income Tax is also a mandatory deduction in those states that it is paid. State tax rates vary widely from 0 in Florida to 13% in California.



Payroll Process – Deductions

There are other mandatory deductions such as:

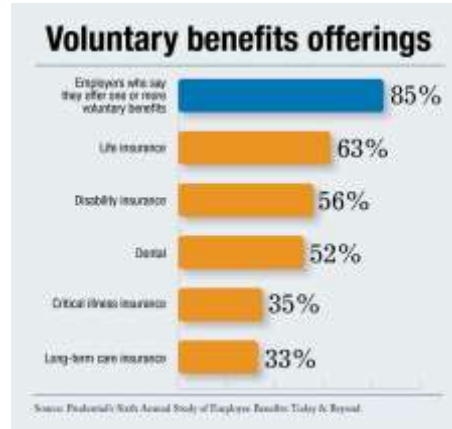
Union Dues which can be mandated if the employee belongs to a union.

Child Support which is mandated by the courts.

Payroll Process – Deductions

Employees may also request **voluntary deductions** be withheld from their pay. These deductions must be authorized in writing.

Common voluntary deductions include health insurance, 401K plans, after tax investments, charity, life insurance, vision, dental, etc....



Payroll Process – Voluntary Deductions

Deductions such as insurance are set amounts each pay period. They are agreed upon and authorized by the employee before the start of each year.

Investments before tax such as 401k plans and other after tax investment plans are often calculated like taxes as a percentage of gross pay.

There is typically no max amount that can be invested after tax, however, you cannot invest more than \$18,000 in a 401k plan each year for those under 50 years old and \$24,000 for those over 50.

[illegible]

Payroll Process – Net Pay

Net Pay is the amount that the employee receives each Pay Period after all required deductions from Gross Pay.

Net Payroll Calculation		
Gross Pay		500.00
Deductions:		
Federal Income Tax	45.26	
Social Security Tax	34.96	
Medicare	16.52	
Company Health Plan	85.00	181.74
Net Pay		\$318.26

Payroll Process – Recording

Once the payroll has been calculated, it must be entered into the accounting records.

The payroll is recorded in the:

- Employee earnings records
- Company payroll records
- Journal entries for accounting records

Payroll Process – Recording

Each employee will have an **earnings record** which is a cumulative record of all their payroll information.

The format will vary with different systems; however, the following information is normally recorded:

- Personal Information such as name, address, phone, department, emergency contact and deductions
- Employee number
- Salary rate
- Pay date, Gross Pay, List of Deductions, Net Pay for each pay period and year to date.

Payroll Process – Earnings Record

EMPLOYEE EARNINGS RECORD -- For Calendar quarter and year														4 TH 2000	
Name	BOB SMITH			S-S-N	900-50-1211			Emp.#	101						
Address	1505 CALMUT # 105			D-D-B	4361354			D-Q-H	6-3-2000						
	GLENDALE, CA 91208			Sex	MALE			D-Q-T	-						
Phone	555-1381			M-S	SINGLE			125K	\$40 EFF 12/1/00		Rate	7.95/HOUR			
Contact	NA			Allow	FEDv1 CAv1			401K	\$50 EFF 12/1/00		Other				
Prepared Ending	Total Hours	Earnings			V-T-O			Deductions							
	worked	Regular	Overtime	Total	Total Earnings	125	401	FIT	Social Security	Medicare	BIT	Health Ins	SDI	Total	
YTD	1606.50	14946.00	912.26	15858.26	15858.26			1890.00	860.21	229.94	895.75	760.00	142.73	4871.63	
14-Oct	81.32	836.00	15.74	851.74	18910.00			80.00	40.41	9.45	25.23	40.00	5.87	186.84	
28-Oct	82.52	836.00	31.05	866.55	17179.00			80.00	41.30	9.66	25.2	40.00	5.90	192.25	
31-Oct	Bonus	217.84		217.84	17495.84			16.00	19.71	4.61	6.85	0.00	2.86	50.00	
11-Nov	83.10	836.00	36.97	872.97	18166.86			80.00	41.72	9.78	26.30	40.00	6.08	192.84	
25-Nov	80.50	836.00	3.90	841.90	18808.82			80.00	39.80	9.31	25.23	40.00	5.78	186.11	
30-Nov	Bonus	326.10		326.10	19134.92			17.00	20.23	4.72	7.80	0.00	2.90	52.83	
				0.00									0.00	0.00	
	QTD	3187.84	88.72	3276.56				303.00	303.1617	47.51284	117.82	160.00	172.21	800.88	
	YTD	18133.94	1000.98	19134.92				2193.00	1186.373	277.4077	1013.57	920.00	314.94	5732.61	

Payroll Process – Payroll Record

The Company Payroll Record lists much of the same information as the Employee Payment Record; however, all the employees are listed in this record by pay period.

Payroll Process – Payroll Records

Date	Employee ID	Name	Hourly Wage	Hours	Gross Pay	Federal Allow.	State Tax	Income Tax	Security 6.2%	Medicare 1.45%	Total Tax Withheld	Insurance Deduction	Net Pay
1/2/2004	56	Kane, John	\$13.25	36.00	\$477.00	0	\$34.33	\$57.10	\$29.57	\$6.92	\$127.92	\$26.00	\$323.08
1/2/2004	57	Kane, Lori	\$25.00	40.00	\$1,000.00	2	\$74.86	\$146.54	\$62.00	\$14.50	\$297.90	\$35.00	\$667.10
1/2/2004	58	Kasher, Steven H.	\$31.00	39.00	\$1,209.00	1	\$96.49	\$213.70	\$74.96	\$17.53	\$402.68	\$35.00	\$771.32
1/2/2004	59	Katyal, Sandeep	\$13.00	20.00	\$260.00	0	\$17.73	\$24.55	\$16.12	\$3.77	\$62.17	\$26.00	\$171.83
1/2/2004	60	Kawai, Masato	\$7.50	30.00	\$225.00	1	\$13.03	\$10.36	\$13.95	\$3.26	\$40.60	\$26.00	\$158.40
1/2/2004	61	Keemey, Bonnie	\$8.22	36.00	\$295.92	0	\$20.48	\$29.94	\$18.35	\$4.29	\$73.05	\$26.00	\$196.87
1/9/2004	56	Kane, John	\$13.25	40.00	\$530.00	0	\$38.39	\$65.05	\$32.86	\$7.69	\$143.98	\$26.00	\$369.02
1/9/2004	57	Kane, Lori	\$25.00	33.00	\$825.00	2	\$59.11	\$102.79	\$51.15	\$11.96	\$225.01	\$35.00	\$564.99
1/9/2004	58	Kasher, Steven H.	\$31.00	28.00	\$868.00	1	\$65.80	\$128.45	\$53.82	\$12.59	\$260.65	\$35.00	\$572.35
1/9/2004	59	Katyal, Sandeep	\$13.00	39.00	\$507.00	0	\$36.63	\$61.60	\$31.43	\$7.35	\$137.01	\$26.00	\$343.99
1/9/2004	60	Kawai, Masato	\$7.50	30.00	\$225.00	1	\$13.03	\$10.36	\$13.95	\$3.26	\$40.60	\$26.00	\$158.40
1/9/2004	61	Keemey, Bonnie	\$8.22	36.00	\$295.92	0	\$20.48	\$29.94	\$18.35	\$4.29	\$73.05	\$26.00	\$196.87
1/16/2004	56	Kane, John	\$13.25	33.00	\$437.25	0	\$31.29	\$51.14	\$27.11	\$6.34	\$115.88	\$26.00	\$295.37
1/16/2004	57	Kane, Lori	\$25.00	40.00	\$1,000.00	2	\$74.86	\$146.54	\$62.00	\$14.50	\$297.90	\$35.00	\$667.10

Payroll Process – Recording

- Journal entries are made from the Company Payroll Record.
- The Company Payroll Record columns are totaled at the end of each pay period.
- Those totals are entered into the Journal as one compound journal entry.

Payroll Process – Recording Net Payroll

Recording Employee Pay and Deductions

ABC Legal Services General Journal				Page GJ1
Date 2015	Description	Post Ref.	Debit	Credit
Apr 18	Wage Expense		5,365.27	
	Income Tax Payable (Federal)			874.36
	Income Tax Payable (State)			612.25
	Social Security Tax Payable			346.58
	Medicare Tax Payable			265.18
	Union Dues Payable			645.00
	Health Plan Payable			746.59
	Wages Payable			1,875.31
	To record weekly payroll.			

Payroll Process – Employer Expenses

Employers must pay several additional taxes and expenses that are considered part of the employee's benefits to which the employee does not contribute.

These include:

- *Worker's compensation insurance* – Employee is paid a % of their regular pay if they are injured on the job. State mandate!
- *FUTA or Federal Unemployment Insurance* – If an employee is laid off, they can collect unemployment insurance to help cover the cost of their living expenses.
- *Health Insurance* – Often an employer will pay a significant amount of an employee's health insurance.
- Employer portion of *Social Security and Medicaid*.

Payroll Process – Recording

Recording Employer Contributions

ABC Legal Services General Journal				Page GJ1
Date 2015	Description	Post Ref.	Debit	Credit
Apr 18	FUTA Expense		162.00	
	Social Security Expense		346.58	
	Health Plan Expense		863.14	
	Worker Compensation Expense		379.00	
	FUTA Payable			162.00
	Social Security Payable			346.58
	Health Plan Payable			863.14
	Worker Compensation Payable			379.00
	Record weekly employer contributions.			

Payroll Process – Making Payments

The next step is to record payments into the **Cash Payments Journal** with each employee listed in the Memo column, the total payroll amount in the General Ledger column and the individual paycheck amounts, by employee, in the Cash column.

Remittances to the government are normally listed individually and only one check is written for the total due. The individual payment amounts are listed in the General Ledger column with the total payment in the Cash column.

Remittances for other deductions are summed and listed separately with amounts in the General Ledger column and the Cash column.

[illegible][illegible]

Payroll Process – Vacation & Sick Pay

Some companies will provide pay for other occasions that occur during the year.

Vacation Pay – The company may have a process where employee may earn vacation hours. When the employee uses these hours to take a vacation, the company will pay the employees from the earned vacation hours that have accumulated.

Sick Pay - The company may have a process where employee may earn sick hours. When the employee uses these hours due to an illness, the company will pay the employees from the earned sick hours that have accumulated.

Payroll Process – Accruals

Certain accruals are recorded each pay period for vacation pay and sick pay. For every hour or week worked, an employee will earn paid time off. The accrual is recorded each time payroll is processed with the following entry:

Dr: Vacation and Sick Pay Expense	\$xxx.xx	
Cr: Vacation Payable		\$xxx.xx
Cr: Sick Pay Payable		\$xxx.xx

When employee's use their vacation and sick pay:

Dr: Vacation Payable	\$xxx.xx	
Dr: Sick Pay Payable	\$xxx.xx	
Cr: Cash		\$xxx.xx

Payroll Process – Internal Controls

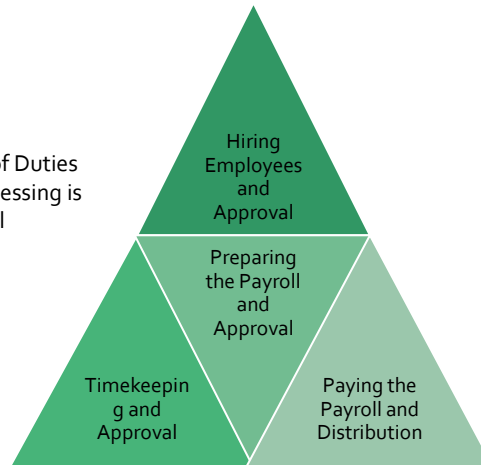
From an internal Control standpoint, payroll is a VERY HIGH RISK process.

Employees have been paid in excess of earned wages in the following ways:

- Overstating hours worked
- Unauthorized pay rates
- Adding fictitious employees
- Continuing to pay terminated employees
- Distributing duplicate payroll checks

Payroll Process – Internal Controls

Segregation of Duties
in Payroll Processing is
Critical





Questions

and

Answers

Review Questions:

1. The following is true about Social Security taxes:
 - A. Both the employee and employer pay 7.65% of employee salary
 - B. Social Security is capped at \$98,000 income
 - C. Medicare tax has a cap of \$108,500 income
 - D. All of the above
2. Payroll is recorded in the:
 - A. Employee earnings records
 - B. The company payroll records
 - C. Journal entries for accounting records
 - D. All of the above
3. True or False: Overtime pay is calculated as overtime hours worked x the overtime rate which is typically time + 1/2.
4. True or False: Commissions are calculated as a percentage of base salary.
5. True or False: Voluntary deductions include charitable donations, pretax savings and medical insurance.

Answer Key:

1. A
There is no cap on Medicare and the Social Security cap is \$108,500.
2. D
Payroll is recorded in the employee earnings records, the company payroll records, and the journal entries for accounting records.
3. A
True. Overtime pay is calculated as overtime hours worked x the overtime rate which is typically time + 1/2.
4. B
False. It is calculated as a percentage of sales.
5. A
True. Voluntary deductions include charitable donations, pretax savings and medical insurance.