

Payroll Procedures and Control

Essential Procedures
for Completing the
Payroll Process

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Payroll

Overview of Payroll

What Is Payroll?

The term *payroll* generally refers to the process of identifying employees, calculating the pay and payroll taxes, recording the payroll transactions, making the payments, and completing required federal and state payroll tax forms. The diagram on the next page shows you an overview of the process.

Legal Rules

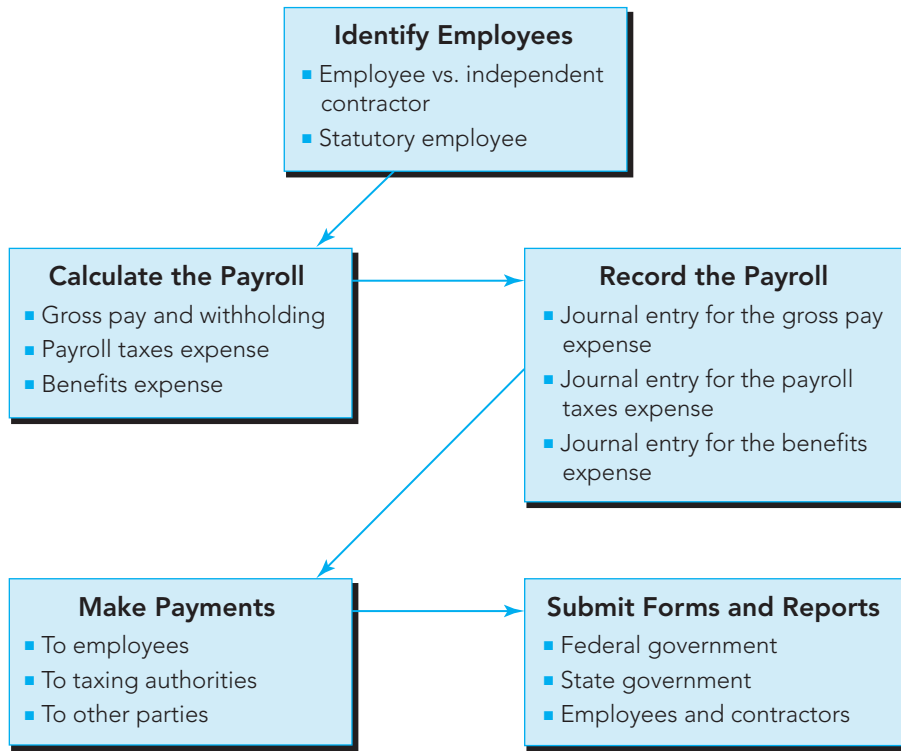
Payroll is unique from other basic accounting topics because payroll involves many federal (and state) payroll tax and income tax withholding laws, and pay rate calculation rules. Each of these legal rules imposes different requirements. So, to understand the payroll process, you will find yourself learning more than just how to properly analyze and record transactions. You will also learn about payroll laws and what is required to comply with these laws. Because each state has its own payroll laws, we focus on federal payroll requirements.

Getting Help

This material provides a general description of the payroll process. If you need to understand more about federal and state payroll laws and compliance requirements, or to calculate a payroll, you will need more help. Here are some suggestions for where to find more detailed information:

- **Circular E:** (Publication 15) This is a comprehensive employer resource for federal payroll rules. You can find it at the Internal Revenue Service website (www.irs.gov and [ftp.irs.gov](ftp://ftp.irs.gov) for ftp users) and you can also order it from the Internal Revenue Service Forms and Publications department by calling a local Internal Revenue Service office.
 - **State Information:** With access to the Internet, you can quickly find state payroll references in several ways, including: (1) You can do an Internet search for “state of (name of state) payroll tax.” (2) As of this writing, some useful websites are www.taxsites.com and the American Payroll Association site. (3) Use the reference section of a library.
 - **Professional Help:** If you are in business or going into business, you *must* obtain expert professional help, because rates change and laws change and can be complex to apply. Find a CPA or an attorney who already has clients in the same type of business that you are in and who is familiar with your type of payroll and business issues. Interview several prospects, get client references, and double-check with state licensing boards.
-

The Payroll Process



Identify Employees

Employees

Overview

Not all people who perform duties for a business are employees. It is very important to accurately identify which workers qualify as employees because the law imposes different requirements for workers who are employees and those who are not. Every business must comply with the requirements of these laws. Proper identification also reduces fraud and waste.

"Employee" Defined

The general rule (called *common law*) is that any person who performs services for a business is an **employee** if *the business controls*:

- *what* will be done, and
- *how* it will be done

This definition must be applied to each individual. It makes no difference what job title or name is used, how the individual is paid, or whether the work is full time or part time.

Note: A business can submit Form SS-8 to have the Internal Revenue Service determine employee status. Contact state employment offices for state rules.

Example of an Employee

Jane is a secretary at Smith Company and is given word-processing tasks to perform that include preparing management reports. Jane is expected to be at the business during certain hours and allow her manager to review and make changes in her work. She must use the business office and the computer equipment and word-processing software used by the business. Jane is an employee because the Smith Company supervises and controls *how the job is done*.

Not an Employee

Mary also performs the same type of services for Smith Company. Mary is given a management report to complete, and she completes the job from her own office, which is not at the Smith Company location. Mary uses her own equipment and software, and she completes the job during her own hours without review from Smith managers. Mary is not an employee because Smith Company does not supervise or control *how the job is done*.

continued ►

Employees, *continued*

Business Owners

- Proprietorships: A sole proprietor is never an employee of the business.
 - Partnership: A partner performing duties as a partner is never an employee of the partnership.
 - Corporations: Owners (shareholders) of a corporation who work in the business are employees of the corporation.
-

Independent Contractors

Overview

It is important to identify independent contractors, because *an independent contractor is not an employee*, even though the independent contractor may do the same kind of work as an employee. The documentation and compliance rules that a business must follow for independent contractors are very different than for employees, so the distinction is significant. Only employees are considered to be part of a business “payroll.”

Definition

An *independent contractor* is an individual who is in business to offer services to the public and who is in full control of the way in which the services are performed.

Examples

- People who are in business for themselves, such as doctors, lawyers, and construction contractors, are independent contractors.
 - In the example on the previous page, Mary is an independent contractor.
-

Guidelines

Determining exactly who is an independent contractor and who is an employee can sometimes be complicated, and an employer should seek professional help. The IRS, the Department of Labor, and the individual states all have their own guidelines in this matter. Here are some key (but not all) indicators of an independent contractor:

- The person doing the work determines how the job is to be done.
 - All or a significant amount of the work can be performed offsite.
 - The person doing the work also offers his/her services to others.
 - The person doing the work operates as a business making a profit or loss.
 - There is a contract for the services to be performed.
 - Payment is not by paycheck, but rather when invoices are submitted.
 - The person doing the work sets his/her own working hours or schedule.
-

Statutory Employees

Overview

A *statute* is a law that has been enacted and recorded. In some specific cases, laws have been enacted that require workers who would normally be considered independent contractors to be treated in a manner similar to employees for certain types of tax withholding. The specific occupations that qualify people as statutory employees are identified in the statutes.

Definition

A **statutory employee** is someone who is not an employee under common law but who is designated as an employee by statute for the purposes of payroll tax withholding and employer payroll taxes.

Example

By statute, a homemaker who works by following the guidelines of the person for whom the work is being done, with materials furnished by and returned to that person, is a statutory employee. Therefore, such a homemaker must be treated as an employee for the purpose of tax withholding. Other examples of independent contractors who might qualify as statutory employees include: corporate officers, certain sales people, and certain types of delivery drivers. Consult an employment attorney for guidance.

Employee Identification and Internal Control

Overview

Internal control refers to all the policies and procedures that a business uses to safeguard its assets. Employee identification must include internal control procedures that help prevent loss.

Potential Losses

- Payments to fictitious (“ghost”) employees: These payroll checks will be cashed by people who use false identification.
 - Misclassification of employees as independent contractors: An employer has liability to government taxing authorities for all amounts that should have been withheld (plus penalties) from the pay of workers who should be classified as employees. Moreover, owners, corporate officers, and even bookkeepers and accountants can be held *personally liable* for these amounts. If no form 1099 was issued to the worker, some of the amounts can be doubled.
 - Employers can be subject to lawsuits for failure to pay the gross pay, any overtime pay, and benefits that would have been payable to a person that should have been classified as an employee.
-

continued ►

Employee Identification and Internal Control, *continued*

Personnel Department (Human Resources)

The mandatory use of a separate personnel department (also called the *human resources* department) acts as an internal control device to reduce the potential frauds and errors described above. In a small business that cannot afford a separate personnel office, the owner(s) should perform most or all of these functions. An outside employee search firm or consultant can be used to assist the employer and to perform background checks of job applicants.

Employee Identification in the Personnel Department

Summary Table

The table below summarizes the functions and procedures used for employee identification that should be done *only* by the personnel department.

Function	Procedure	Purpose
Hiring	Review job description Advertise, screen, and interview	<ul style="list-style-type: none"> ■ Determine if the worker will act as employee or as independent contractor ■ Clarify job requirements and duties ■ Find qualified applicants. This also helps screen out "ghost" and unneeded employees. ■ Perform background checks
Authorizing	Complete forms that authorize employment and send forms to payroll department Issue employee badges	<ul style="list-style-type: none"> ■ Prevent "ghost" employees from being placed on the payroll list ■ Remove terminated employees from the payroll ■ Permit access and identification
Obtaining Data Required by Law	Obtain tax information form W-4 Obtain work eligibility form I-9	<ul style="list-style-type: none"> ■ Provide payroll withholding information ■ Identify undocumented immigrant workers

Check Your Understanding

Write the completed sentences on a separate piece of paper. The answers are below.

A person is an employee if the person or company they work for controls what work will be done and it will be done. Proprietors and partners performing their duties (are/are not) employees, whereas shareholders of a corporation who work for the business (are/are not) employees.

An is an individual who is in business to offer services to the public as a business. A is someone who performs a particular occupation that is legally specified as an employee occupation.

“Ghost employees” and misclassification of employees (is/is not) a potentially serious internal control problem for many businesses. A key internal control device for payroll procedures is the use of a department. In a small business, the performs these duties.

Answers

A person is an employee if the person or company they work for controls what work will be done and how it will be done. Proprietors and partners performing their duties are not (are/are not) employees, whereas shareholders of a corporation who work for the business are (are/are not) employees.

An independent contractor is an individual who is in business to offer services to the public as a business. A statutory employee is someone who performs a particular occupation that is legally specified as an employee occupation.

“Ghost employees” and misclassification of employees is (is/is not) a potentially serious internal control problem for many businesses. A key internal control device for payroll procedures is the use of a personnel department. In a small business, the owner performs these duties.

Calculate the Payroll

Overview

Introduction

To *calculate a payroll* means to make a calculation for a specific time period of total employee expense and then to determine the payments required.

Total Expense

The total employee expense includes three basic elements:

- Gross pay expense
- Payroll taxes expense
- Benefits expense

continued ►

Overview, continued**Payment Allocation**

As each expense is calculated, the allocation of the payment for that expense is determined. The most detailed part of the payment calculation is determining how much of the gross pay will be withheld from the employee and then paid to various government taxing authorities and other third parties. Additionally, the payments required for other payroll taxes and benefits are calculated.

Not Part of Payroll

Remember that independent contractors are not employees and therefore are not part of the payroll calculation. Payments to independent contractors are recorded as separate categories of operating expenses.

Gross Pay

Identifying and Calculating Gross Pay**Definition**

The term **gross pay** (sometimes called *gross earnings* or *gross wages*) means the total amount of compensation earned by an employee. This usually results in the employee receiving a paycheck. The amount earned could be for:

- **Salary:** The term *salary* generally refers to a fixed amount per period (such as annually) that is not determined by hours worked. Salaries are earned by managers, administrators, supervisors, and other professional staff.
- **Wage:** The term *wage* usually means an amount that is determined by hours worked or units of product completed (called *piecework*). Usually wages are earned by clerks and by skilled and unskilled labor.
- **Commission:** Commissions are earnings based on a percentage of sales.
- **Bonus:** Bonus earnings are extra amounts given as reward for achievement or meeting performance goals.
- **In kind:** Payment in some form of property or services (rather than money) are called *in kind* and are part of gross pay unless specifically exempted by law.

Examples of Not Gross Pay

Some examples that are *not* gross pay are:

- Amounts earned by independent contractors (because independent contractors are not employees)
- Employee business expense reimbursements under an approved plan (because approved reimbursements are exempt—they are not compensation)

Identifying and Calculating Gross Pay, *continued*

Overtime

Overtime is gross pay calculated at a higher rate per hour for those hours worked in excess of a standard daily amount of 8 hours or a weekly amount of 40 hours. Overtime is generally paid to hourly workers and workers earning less than a specified annual minimum who are not exempt from overtime. (Examples of exempt workers are top-level managers, corporate officers, and other specified jobs.) It does not matter when or how often the worker is paid. For most workers, the minimum overtime rate is 1-1/2 times the regular pay rate per hour for time exceeding 8 hours per day or 40 hours per week. Some companies add extra overtime pay rates for work such as on Sundays or holidays, or for activities designated by union contracts.

Overtime (and minimum wage) is regulated by the federal *Fair Labor Standards Act (FLSA)*, by U.S. Department of Labor regulations and by state laws that may impose additional requirements.

Overtime Example

Dave is a wage-earning employee, and his regular rate is \$18 per hour. He worked 45 hours this week, Monday through Friday. He also worked 3 hours on Saturday. His company pays twice the regular rate for weekend and holiday work. Dave's gross pay is:

$$\begin{aligned}
 40 \text{ hours} \times \$18.00 &= \$720 \text{ regular} \\
 5 \text{ hours} \times \$27.00 &= 135 \text{ overtime } (\$18 \times 1.5 = \$27) \\
 3 \text{ hours} \times \$36.00 &= \underline{108} \text{ overtime } (\$18 \times 2 = \$36) \\
 &\quad \underline{\underline{\$963}} \text{ total gross pay for the week}
 \end{aligned}$$

Withholding

Overview

Introduction

Payroll withholding means that an employer withholds (deducts) amounts from an employee's gross pay. These amounts are then paid by the employer to taxing authorities and other third parties. The amounts withheld from an employee's pay are called **payroll deductions**. The remaining amount that the employee actually receives is called **net pay**. Payroll deductions are not a tax on the employer; the employer is simply acting as a collection agent. The two categories of payroll deductions are:

- Deductions required by law
- Voluntary deductions by agreement

continued ►

Overview, *continued*

Deductions Required by Law

The following items are imposed upon individuals classified as employees and must be deducted by the employer from employee pay:

- Employee income taxes
- Employee social security (FICA) tax
- Other state employment taxes
- Other deductions imposed by law

These amounts are calculated and withheld on a *calendar year* basis, even if the business uses a different fiscal year. The process begins each new January 1 and ends on December 31.

Voluntary Deductions by Agreement

Optional deductions may consist of many different items. Some examples are:

- Savings and stock purchase plan contributions
 - Union dues
 - Charitable contributions
-

Employee Income Tax

Overview

Federal law (and many state laws and some city laws) imposes an income tax and requires that employers withhold income tax from employee pay. For every employee, the amount of the income tax deduction each period is based on a calculation that estimates the approximate amount of annual income tax for that employee. This calculation procedure has two steps.

Step 1

Form W-4 is completed by an employee when hired (and may be revised at any time). The employer uses this form to determine employee filing status and the number of withholding allowances claimed by the employee.

Filing status refers to “single,” “married,” and “other.” The percent income tax rate is different for each different filing status.

A **withholding allowance** (also called an **exemption**) exempts a fixed amount of gross pay from income tax withholding. This is because each allowance also is a deduction on the employee’s income tax return at year end. In general, each employee may claim one allowance for himself or herself, one for each spouse who does not also claim one, and one for each dependent, although more allowances are permitted if the tax return shows a material overpayment.

Employee Income Tax, *continued***Step 2**

Estimate the employee's income tax for the payroll period. The employer usually does this by referring to income tax withholding tables. This is called the *wage-bracket method*. To determine the correct income tax withholding:

Find the table:

- Refer to the filing status for the employee (single, married, etc.).
- Select the appropriate payroll period (weekly, monthly, semi-monthly, etc.).

Use the table:

- Select the wage bracket row that includes the amount of gross wages.
- Select the column for the number of allowances.
- The amount of the withholding is where the row and column intersect.

Table

A partial federal income tax withholding table is reproduced below.

MARRIED Persons— SEMIMONTHLY Payroll Period										
If the wages are . . .		And the number of withholding allowances are . . .								
At least	But less than	0	1	2	3	4	5	6	7	8
		The amount of income tax to be withheld is . . .								
\$1,380	\$1,400	\$143	\$124	\$105	\$ 86	\$ 67	\$48	\$36	\$23	\$10
1,400	1,420	146	127	108	89	70	51	38	25	12
1,420	1,440	149	130	111	92	73	53	40	27	14
1,440	1,460	152	133	114	95	76	57	42	29	16
1,460	1,480	165	136	117	98	79	60	44	31	18
1,480	1,500	158	139	120	101	82	63	46	33	20
1,500	1,520	161	142	123	104	85	66	48	35	22
1,520	1,540	164	145	126	107	88	69	50	37	24
1,540	1,560	167	148	129	110	91	72	53	39	26
1,560	1,580	170	151	132	113	94	75	56	41	28
1,580	1,600	173	154	135	116	97	78	59	43	30
1,600	1,620	176	157	138	119	100	81	62	45	32
1,620	1,640	179	160	141	122	103	84	65	47	34
1,640	1,660	182	163	144	125	106	87	68	49	36
1,660	1,680	185	166	147	128	109	90	71	52	38
1,680	1,700	188	169	150	131	112	93	74	55	40

continued ►

Employee Income Tax, *continued*

Example

Jane Smith and John Doe are paid semi-monthly. Jane claims five exemptions and has gross wages of \$1,685 for the period. The withholding for Jane is \$93. John claims one exemption and has gross wages of \$1,540. The withholding for John is \$148.

Employee Social Security (FICA)

Overview

The **social security tax** is a result of a very dramatic and difficult time in American history. This period began in 1929 with the onset of the “great depression.” (The great depression is an amazing story that you should read about.) In 1937, the United States Congress enacted the Federal Insurance Contribution Act (**FICA**). This act imposed a tax on employees (and employers) to provide workers with a guaranteed minimum amount of old age, survivor’s, and disability insurance benefits (**OASDI**). The act was expanded in 1965 to provide limited medical benefits for people without medical insurance (**Medicare**).

Wage Base and Tax Rate

A **wage base** is a maximum *calendar-year* amount of gross pay that is subject to payroll tax. Gross pay that exceeds the annual wage base is not subject to tax. **The FICA wage base usually increases every year.** The **tax rate** is the percent that must be paid as a tax. Payroll tax is calculated individually for each employee for each payroll period by multiplying the tax rate times the amount of current period’s gross pay that does not cause the cumulative gross pay to exceed the wage base.

The Social Security Tax Bases and Rates

There is a separate wage base and tax rate for each part of the social security plan. For all the FICA examples in this book, *we will assume that the OASDI wage base is \$104,000.* Here are the components of FICA:

- The wage base for the OASDI part is \$104,000. The tax rate is 6.2%. This means that during a calendar year the first \$104,000 of gross pay of each employee is subject to a 6.2% OASDI tax.
 - The wage base for Medicare is unlimited. The tax rate is 1.45%. This means that during a calendar year all gross pay is subject to a 1.45% Medicare tax.
 - For wages *not* exceeding \$104,000, the combined rate is 7.65%.
-

Employee Social Security (FICA), *continued***Procedure with Examples**

The table below illustrates the FICA tax calculation procedure. Suppose that a business has two employees, Adam and Amy. The business needs to calculate the individual and total social security tax for the monthly payroll period ending November 30. During the current year prior to this period, Adam had gross pay of \$77,500 and Amy had \$101,200. Adam's November gross pay is \$5,900, and Amy's November gross pay is \$7,500. Assume a \$104,000 wage base.

Step 1

Subtract the cumulative gross pay from the wage base.

If the result is zero or positive, cumulative pay is still below the OASDI limit, so all of the current gross pay is taxable. Go to Step 3. **If** the result is negative, cumulative pay has exceeded the limit, and this excess is not taxable for OASDI. Some or all of the current gross pay is excluded from the OASDI tax. Go to Step 2.

Examples:

Adam		Amy	
Wage base	\$104,000	Wage base	\$104,000
Cumulative gross pay	<u>83,400</u>	Cumulative gross pay	<u>108,700</u>
Go to Step 3	\$ 20,600	Go to Step 2	(\$4,700)

Step 2

Offset the negative amount (the amount excluded) against the current gross pay to find the OASDI taxable portion of the current gross pay (but not less than zero). Then go to Step 3.

Examples:

Adam		Amy	
Not applicable—all current gross pay is fully taxable for FICA		Current gross pay	\$7,500
		Excluded portion	<u>(4,700)</u>
		Taxable portion	\$2,800

Step 3

IF all the current gross pay is taxable, multiply the current gross pay by the 7.65% combined rate.

IF some of the current gross pay is excluded from OASDI:

- Multiply the taxable portion of current gross pay by 6.2% (OASDI tax).
- Multiply all the current gross pay by 1.45% (Medicare tax).
- Add the results.

Examples:

Adam		Amy	
$\$5,900 \times .0765 = \451.35		$\$2,800 \times .062 =$	\$173.60 (OASDI)
		$\$7,500 \times .0145 =$	<u>\$108.75</u> (Medicare)
		Total	\$282.35

Other Required Withholding

Other State Taxes

Some states impose additional employment-related taxes on the wages of employees. For example, many employees in California are required to have state disability insurance payments withheld. Usually other state employment taxes are calculated in the same basic manner as social security, that is, by using a wage base amount and a tax rate. See page 1 for how to get more information on wage bases, tax rates, and other state payroll information.

Note: Remember that wage bases and tax rates may change from year to year.

Other

Other required withholding is often the result of a legal action, such as court-ordered child support. Usually these payments are a fixed amount per month.

Vacation Pay

For paid absences such as vacation pay, tax and other withholding is also required. However, the withholding occurs only when the vacation paycheck is prepared for the employee and not when the vacation pay expense is accrued.

Fringe Benefits

Withholding is required for any other form of compensation, such as fringe benefits that are not otherwise exempted. (Examples of benefits exempt from withholding are qualified medical and pension plan benefits.)

Voluntary Deductions

Overview

Voluntary deductions are deductions that an employee and employer agree upon together by direct agreement or indirectly through a union contract. These amounts are usually a fixed amount per month.



For many people, the easiest and most reliable way to save money is by regular payroll withholding. If you work for a company that offers savings and investment plans or stock purchase plans, **take full advantage of these plans**. If you are not sure what these plans are or how to use them (“401k,” “cafeteria” plans, etc.) then spend the time to buy and read some basic investing books (yes, more than one!), do Internet searches, or take a basic class to find out the facts (but do *not* pay someone to invest or trade for you.) It is important to your future that you learn to invest continuously and carefully.

Check Your Understanding

Write the completed sentences on a separate piece of paper. The answers are below.

According to the Standards Act, if Judy is a wage earner and her regular rate is \$15 per hour and she worked 44 hours this week, her gross pay should be \$

To use the wage bracket method to determine income tax withholding, an employer must know the employee's status (married or single), the number of claimed on form, the gross and the appropriate payroll period.

The "social security tax" refers to the Federal Insurance Contribution Act (FICA), which provides "OASDI" benefits, which means (for retirement), (for widows and orphans) and (can't work because of illness or accident) insurance. FICA (taxes/ does not tax) the amount of current period gross pay that causes the cumulative gross pay to exceed a wage base amount.

In October, Jan earned \$1,750 plus a \$1,000 bonus and had earned \$103,150 from January through September. Dean earned \$1,500 in commissions in October and had earned \$91,000 from January through September. Using the wage base and tax rate in this section, calculate the social security tax withheld for Jan and for Dean. Jan: \$ Dean: \$

Answers

According to the Fair Labor Standards Act, if Judy is a wage earner and her regular rate is \$15 per hour and she worked 44 hours this week, her gross pay should be $\$690$. ($\15×40) + ($\$15 \times 1.5 \times 4$)

To use the wage bracket method to determine income tax withholding, an employer must know the employee's filing status (married or single), the number of exemptions (or allowances) claimed on form W-4, the gross wages (or gross pay) and the appropriate payroll period.

The "social security tax" refers to the Federal Insurance Contribution Act (FICA) which provides "OASDI" benefits, which means Old Age (for retirement), Survivors (for widows and orphans) and Disability (can't work because of illness or accident) insurance. FICA does not tax (taxes/does not tax) the amount of current period gross pay that causes the cumulative gross pay to exceed a wage base amount.

Jan's FICA:
 OASDI: $\$2,750 - \$1,900$ excluded = $\$850$ taxable $\times .062 = \$52.70$
 Medicare: $\$2,750 \times .0145 = \39.88
 Total Social Security Tax: $\$92.58$

Dean's FICA:
 $\$1,500 \times .0765 = \114.75 (Dean's cumulative gross pay is below the limit, so the combined rate can be used.)

Notice that bonuses and commissions are fully taxable compensation for FICA.

Employer Payroll Taxes

Overview

Summary of Items

In addition to the gross pay expense, employers incur a second type of payroll expense: the employer payroll tax expenses. These payroll taxes apply directly to the employer and add to the employer's total employment costs. These payroll taxes are:

- Employer Social Security (FICA)
- Federal and State Unemployment Taxes (FUTA and SUTA)
- Other state and local payroll taxes

These are taxes that the employer pays; do not confuse them with the payroll taxes that the employee pays and that are deducted from an employee's gross pay. However, just like employee deductions, employer payroll taxes are calculated on a *calendar-year* basis.

Employer Social Security (FICA)

Calculation

The social security tax also applies to the employer. In addition to being a collection agent for the employee social security, the employer also pays an equal amount of its own social security tax. Therefore, it is a "matching" system; the employer matches the amount paid by the employee.

Example

On page 13, you saw that the total employee social security tax for the employees Adam and Amy is \$733.70. Therefore, the employer must also pay an additional \$733.70 of social security tax. The total social security tax paid is: employees \$733.70 + employer \$733.70 = \$1,467.40.

Employer Social Security (FICA), *continued*

Self-Employment Tax

Even though self-employed persons (sole proprietors) are never considered to be employees of their own businesses, they are nevertheless required to pay *both* the employee *and* employer social security tax! This is called **self-employment tax** and the combined rate is $7.65\% \times 2 = 15.3\%$. It is calculated on the individual's annual income tax return and applies to the net income from the business (with some adjustments) to the limit of the social security wage base.

Unemployment Taxes

Overview

Another part of the social security laws is the Federal Unemployment Tax Act (**FUTA**). This law provides unemployment benefits to workers who lose jobs even though the workers are able and qualified. The annual FUTA wage base is the first \$7,000 of gross pay (for each employee) and the FUTA tax rate is 6.2%. However, the law allows a credit against this rate up to 5.4% for businesses in states that impose a state unemployment tax. Most states impose a 5.4% rate, so the actual FUTA rate paid is usually .8%.

All states also have state unemployment tax acts (**SUTA**). Like the federal law, these acts provide for unemployment benefits. The SUTA wage base during recent years has been the first \$7,000 of gross pay, with a basic rate of 5.4%. However, in many states the percentage rate can change *for individual employers* as it is adjusted up or down based on the stability of the employment history for a particular business.

We will use the \$7,000 wage base and the 5.4% rate in all our SUTA calculations, and \$7,000 and .8% for all our FUTA calculations.

continued ►

Unemployment Taxes, *continued***Example: FUTA and SUTA Calculation Procedure**

Assume that a business has three employees: John, Bill, and Mary. From January 1 to March 31 John had total gross pay of \$5,100, Bill had \$6,500 and Mary had \$7,200. John's April gross pay is \$1,700, Bill's is \$1,700 and Mary's April gross pay is \$3,150. The table below shows the three calculation steps to calculate FUTA and SUTA for the April payroll.

Step 1

For each employee, subtract the cumulative gross pay from the wage base.

If the result is **zero or positive**, cumulative pay is still below the limit, so all of the current gross pay is taxable. Go to Step 3. **If** the result is **negative**, cumulative pay has exceeded the limit and this excess is not taxable. Some or all of the current gross pay is excluded. Go to Step 2.

Example:

John		Bill	
Wage base	\$7,000	Wage base	\$7,000
Cumulative gross pay	<u>6,800</u>	Cumulative gross pay	<u>8,200</u>
Go to Step 3	\$200	Go to Step 2	(\$1,200)
Mary			
Wage base	\$7,000		
Cumulative gross pay	<u>10,350</u>		
Go to Step 2	(\$3,350)		

Step 2

Offset the negative amount (the amount excluded) against the current gross pay to find the taxable portion of the current gross pay (but not less than zero). Then go to Step 3.

Example:

FUTA		SUTA	
John: not applicable—all taxable		John: not applicable—all taxable	
Bill: \$1,700 – \$1,200 = \$500 taxable		Bill: \$1,700 – \$1,200 = \$500 taxable	
Mary: \$3,150 – \$3,350 = \$0 taxable		Mary: \$3,150 – \$3,350 = \$0 taxable	

Step 3

Multiply the taxable portion of the current gross pay times the tax rate, and add the results.

Example:

FUTA		SUTA	
John: \$1,700 × .008 = \$13.60		John: \$1,700 × .054 = \$91.80	
Bill: \$500 × .008 = \$ 4.00		Bill: \$500 × .054 = \$27.00	
Mary: \$0 × .008 = <u>-0-</u>		Mary: \$0 × .054 = <u>-0-</u>	
Total FUTA tax	<u>\$17.60</u>	Total SUTA tax	<u>\$118.80</u>

Employer Benefits Expense

Overview

Summary

In addition to the gross pay and the employer payroll taxes, employers may also incur a third type of payroll expense. This expense is generally called *benefits expense* or *fringe benefits*. This refers to additional compensation that is paid by the employer for the benefit of the employees. There are numerous kinds of benefits; some of the more important ones are explained here. Unless otherwise indicated, you can assume that these benefits are part of plans that qualify as tax-free and are therefore not subject to withholding.

Important Benefit Types

Insurance

- **Medical insurance:** This refers to a medical insurance plan that pays all or most of the cost of employee medical bills. Medical insurance has become the single most important benefit to employees because of the high cost of medical care.
- **Life insurance:** This insurance makes a cash payment (usually to a designated family member) in the case of the death of the insured employee. Life insurance above a certain limit is taxable to the employee and requires withholding.

The employer receives bills directly from the insurance companies and makes payments directly to the companies. The employer records these payments as operating expenses.

Pension Plan

A pension plan is an arrangement in which the employer provides for payments to employees after they retire. While an employee is still actively employed, the employer makes regular payments to a **plan administrator**. A plan administrator is a company that specializes in designing qualified pension plans and supervising the administration and investments of the plan. When an employee retires, the administrator makes payments to the employee.

The employer makes payments directly to the plan administrator, and these payments are recorded as an operating expense. However, the amount of the expense and the amount of employer liability may be subject to further calculations; this is a topic for advanced accounting courses.

continued ►

Important Benefit Types, *continued*

Vacation Pay

The expense for paid absences such as vacation pay is accrued each payroll period. This is because employees usually earn vacation pay as they work, but it is not actually paid until some later date.

Vacation Pay Liability is accrued and credited every payroll period. As each employee takes time off and is paid, Vacation Pay Liability is debited and Cash is credited. Vacation pay is subject to required withholding and employer payroll taxes at the time of payment.

Vacation Pay Example

Santa Rosa Company gives each employee two weeks of paid vacation per year. Therefore, the cost of 2 weeks of vacation is spread over the 50 weeks worked, or 4% per week. The gross wages for the current week are \$12,000. The journal entry to record the vacation pay accrual is:

Vacation Pay Expense	480	
Vacation Pay Liability		480

Suppose that during that same week, some employees took time off and collected \$650 of vacation pay. The journal entry is:

Vacation Pay Liability	650	
FICA, taxes, etc.		100
Cash		550

Workers' Compensation Insurance

Workers' compensation insurance provides a period of income replacement for a worker who is disabled or injured on the job and as a result cannot perform his or her regular duties. Most states require that an employer pay for workers' compensation insurance at a designated minimum level or have adequate funds to make benefit payments. Premium payments to an insurance company for this coverage are an employment-related expense of a business.

Internal Control for Payroll Calculation

Overview

In the previous section about employee identification, we discussed the importance of applying internal control. We continue here with internal control as it applies to the payroll calculation.

Internal Control for Payroll Calculation, *continued*

Separation of Duties

In larger companies, the responsibility of the payroll *calculation* is assigned to a separate department, called the *payroll department*. This department calculates the payroll for employees identified by the personnel department at the pay rate indicated. Only the personnel department can authorize individuals as employees, authorize or change their rate of pay, and notify them of termination. Personnel provides new or changed information to the payroll department, which returns a signed confirmation. In turn, the payroll department is the only department authorized to perform the payroll calculations.

In smaller companies, the bookkeeper can perform payroll calculations based on the employee information provided by the owner, who in effect becomes the “personnel department.”

Time Cards

Companies that have many wage employees often use time cards and a time clock. Each employee is assigned a card and must enter the card in the time clock to record his or her time of arrival and departure on the card. A security person often supervises to verify that only one card per employee is actually used. The payroll department then uses the hours on the time cards to record the hours worked and to calculate the gross pay.

Calculation Check

Payroll calculations should *always* be reviewed by a second person. In a moderate to large company, the treasurer’s office or a supervisor in the payroll office should perform the review. It is best practice to rotate the review responsibilities. In a small company, only the owner does the review.

Record the Payroll

Overview

Four Basic Parts

The process of recording the payroll involves four basic parts:

- Record the gross wages expense.
 - Record the employer payroll taxes expense.
 - Record the benefits expense.
 - Update each employee’s earnings record.
-

Summarize Information

As a preliminary step to starting the process, the employer must first summarize and organize the payroll information. This is usually accomplished by using a *payroll register* (also called a *payroll record* or *payroll journal*, although it is not a journal or a ledger). A payroll register is an informal summary tool that is used each payroll period to show the individual and total amounts of gross earnings, deductions, and net pay for that particular payroll period.

The Payroll Register Illustrated

Example

On this page and the next page is an example of a completed payroll register.

Payroll Register for the							
Employee Name	Total Hours	Earnings ¹				Current Gross Taxable for ... ³	
		Regular	Over-time	Current Gross	Year to Date Gross ²	FUTA/SUTA	FICA (OASDI)
Acevedo, Baxter	40	600.00		600.00	7,200.00	400.00	600.00
Dunwitty, Betty	40	720.00		720.00	7,920.00	—0—	720.00
Heintz, Marilyn	44	600.00	90.00	690.00	7,150.00	540.00	690.00
Onishi, James		800.00		800.00	8,800.00	—0—	800.00
Sanders, Emily	40	480.00		480.00	5,350.00	480.00	480.00
Van Arsdale, Robert	42	720.00	54.00	774.00	7,900.00	—0—	774.00
Washington, Ellie		900.00		900.00	9,900.00	—0—	900.00
Totals		4,820.00	144.00	4,964.00	54,220.00	1,420.00	4,964.00

Detailed Explanation

Each of the following items relates to highlighted items in the reference boxes shown on the illustrated payroll register.

- Earnings:** For wage employees, earnings are calculated at an hourly rate; for salaried employees (Onishi and Washington), earnings are a fixed amount. Gross earnings in the current period includes both the regular and overtime pay. For example, Marilyn Heintz earned \$600 regular pay, so her regular rate must be $\$600/40 = \15 per hour. Therefore, her overtime rate is $\$15 \times 1.5 = \22.50 per hour. Because she worked 4 hours in excess of 40, she earns overtime of $\$22.50 \times 4 = \90 .
- Year to date gross:** This is an optional column that helps identify the cumulative amount of employee gross pay that includes the current payroll. Cumulative amounts are part of each employee's individual earnings record.
- Current gross taxable for FUTA/SUTA and FICA Medicare:** This is the amount of the gross pay in the current period that is subject to these taxes. *Example:* The FUTA/SUTA limit is \$7,000. Baxter Acevedo's current period gross pay is \$600 and this amount exceeded the limit by \$200. This means that only \$400 of his current gross pay ($\$600 - \200) is subject to FUTA/SUTA taxes. The FICA limit of \$104,000 is much greater than his cumulative gross pay, so it is easy to see that all of his current gross pay is taxable for FICA.

The Payroll Register Illustrated, *continued*

Week Ended March 14, 2008									
4 Deductions						5 Payment		6 Acct. Debited	
Federal Inc. Tax	State Inc. Tax	OASDI/Medicare	Health Insurance	Union Dues	Total	Net Pay	Ck. #	Office Salaries	Wages
89.00	18.00	45.90	12.00	5.25	170.15	429.85	857		600.00
108.00	22.00	55.08	9.00	5.25	199.33	520.67	858		720.00
104.00	21.00	52.79	15.00	5.25	198.04	491.96	859		690.00
120.00	24.00	61.20	11.00	—0—	216.20	583.80	860	800.00	
48.00	10.00	36.72	18.00	5.25	117.97	362.03	861		480.00
116.00	23.00	59.21	12.00	5.25	215.46	558.54	862		774.00
180.00	30.00	68.85	10.00	—0—	288.85	611.15	863	900.00	
765.00	148.00	379.75	87.00	26.25	1,406.00	3,558.00		1,700.00	3,264.00

Detailed Explanation (continued)

- 4. Deductions:** These are the withholding deductions for each employee. For example, Baxter Acevedo has a total of \$170.15 of deductions, consisting of federal and state income taxes, FICA, health insurance contributions, and union dues.
- 5. Net Pay:** This shows the net amount of pay each employee will receive and, when paid, the check number of the payroll check written to the employee. Net pay is current gross pay minus the total deductions.
- 6. Account debited:** These columns classify the gross wage expense. In this case, gross wages are classified as either office salaries or wages. Different companies use different classifications.

Register Format

The payroll register can vary somewhat in format. Some companies use a completely separate payroll register, whereas others make it part of their cash payments journal. Also, the column titles vary somewhat. Some formats include a column on the left side for the gross amount of accrued vacation pay being used and an “other” column in the deductions section for miscellaneous deductions.

Journal Entry for the Gross Pay Expense

Overview

The first step in recording payroll is the journal entry for the gross pay expense. This journal entry consists of recording the current gross pay, the related deductions, and the net pay. *The payroll register totals are the sources of information for this journal entry.* Refer to the payroll register on the preceding pages.

Example

The example below shows a journal entry for the gross pay expense. The total debits to office salaries and wages is \$4,964, which is the total of the gross pay column, classified by type of pay. The credit to Wages Payable is the total of the net pay column, and the other payables are totals of deductions columns.

March 14	Office Salaries Expense	1,700.00	
	Wages Expense	3,264.00	
	Federal Income Tax Payable		765.00
	State Income Tax Payable		148.00
	FICA Payable		379.75
	Health Insurance Payable		87.00
	Union Dues Payable		26.25
	Salaries and Wages Payable		3,558.00

Withholding Liabilities

Notice that all the withholding deductions are recorded as credits to various liabilities. All of these are current liabilities. The employer is simply acting as a collection agent and is obligated to remit the amounts withheld to other parties in a timely manner. For example, the federal income tax and FICA withheld must be paid to the United States Treasury Department within a prescribed period of time.

Journal Entry for the Employer Payroll Tax Expense

Overview

The second step in recording payroll is the journal entry for the employer payroll tax expense. This journal entry consists of recording the employer FUTA, SUTA, and FICA payroll taxes, plus any other state payroll taxes, if applicable. The dollar amounts subject to these taxes are the totals shown in the payroll register in “current gross taxable for . . .” columns. Remember that these taxes only apply to the employer; the employees make no payments.

Journal Entry for the Employer Payroll Tax Expense, *continued*

Example

The example below shows a journal entry for the employer payroll tax expense. FUTA is $.008 \times \$1,420 = \11.36 ; SUTA is $.054 \times \$1,420 = \76.68 ; FICA/Medicare is the same as the employee withholding = \$379.75.

March 12	Payroll Tax Expense	467.79	
	FICA Payable		379.75
	FUTA Payable		11.36
	SUTA Payable		76.68

Journal Entry for the Benefits Expense

Overview

If the employer provides benefits, then the third step in recording payroll is the journal entry for the benefits expense. This journal entry consists of accruing the expense and liability for each type of benefit.

Example

The example below shows a journal entry for benefits expense consisting of vacation pay, health insurance, and pension plan expenses.

March 14	Vacation Pay Expense	225.00	
	Medical Benefits Expense	350.00	
	Pension Benefits Expense	150.00	
	Vacation Pay Payable		225.00
	Health Insurance Payable		350.00
	Pension Plan Payable		150.00

What Is Total Payroll Cost?

The total cost of a payroll is the gross pay expense, the employer payroll tax expense, and the benefits expense. For the three examples above, this is: $\$4,964.00 + \$467.79 + \$725.00 = \$6,156.79$.

Employee Earnings Records

Overview

Every employer is required by law to maintain a permanent record of the wages and withholding for each employee. The primary purpose of these earnings records is to provide the information necessary to report the annual gross pay and withholding to each employee at year end on form *W-2*. Employees use the *W-2* information for preparing their income tax returns as well as for other purposes, such as loan applications. The employer must also provide the same information to government taxing authorities.

continued ►

Employee Earnings Records, *continued*

Example

The example below is a partial employee *earnings record* that shows information for the month of March. Notice that the record is updated after each payroll period. The source of the data is the payroll register. Think of each record as a subsidiary ledger for each employee’s earnings history.

The example you see here has a cumulative gross pay column so the wage base limits can be identified. It also provides information for required quarterly payroll reports.

Tropics Travel Company Employee Earnings Record For the Year 2008													
Employee: Van Arsdale, Robert S.S.#: 123-45-6789 Employment Date: July 11, 2002 Termination Date: Address: 80 Sunshine Ct, Denver, CO 80229							Filing Status: Single Exemptions: 1 Pay Rate: \$18 hourly Job Title: Staff Assistant						
	Earnings					Deductions							
2008 Week Ended	Total Hrs.	Reg. Pay	O.T. Pay	Gross Pay	Cum. Gross Pay	Fed. Income Tax	State Income Tax	FICA/ Medcr.	Health Ins.	Union Dues	Total	Net	Check No.
3/7	40	720.00		720.00	7,126.00	108.00	22.00	55.08	12.00	5.25	202.33	517.67	755
3/14	42	720.00	54.00	774.00	7,900.00	116.00	23.00	59.21	12.00	5.25	215.46	558.54	862
3/21	44	720.00	108.00	828.00	8,728.00	133.00	26.00	63.34	12.00	5.25	239.59	588.41	912
3/28	43	720.00	81.00	801.00	9,529.00	129.00	25.00	61.28	12.00	5.25	232.53	568.47	988
March		2,880.00	243.00	3,123.00		486.00	96.00	238.91	48.00	21.00	889.91	2,233.09	
Third Quarter		8,750.00	810.00	9,560.00		1,590.00	312.00	731.34	144.00	63.00	2,840.34	6,719.66	

Note: The source of this information is the payroll register. For example, the March 14 (highlighted) entry comes from the March 14 payroll register example.

Reconciling the Payroll Register and Employee Pay Records

Each period, the payroll department must reconcile the totals on the payroll register to the total amounts on the employee earnings records. For example, if the gross pay on the March 14 payroll register is \$4,964.00, then adding up the gross pay shown on each of the employee earnings records for all the employees for March 14 should also result in a total of \$4,964.00. This reconciliation is also done for each deduction item and net pay.

Make Payments

Overview

Introduction

After the payroll is calculated and approved, payroll checks are prepared, signed, and distributed. However, payroll-related payments involve more than just payments to employees. This section explains the payment process.

Payments to Whom?

Payroll-related payments are made to the following parties:

- Employees
- Government taxing authorities
- Benefits providers
- Other designated recipients

Payments to Employees

Journal Entry

The journal entry to record payment to employees is shown below:

March 14	Salaries and Wages Payable	3,558.00	
	Cash		3,558.00

Payroll Checks

The credit to cash represents the total of all the payroll checks that employees receive. This is the total net pay. Most companies use special checks for payroll. Each check has a detachable portion called a **statement of earnings** that shows the gross pay, withholding, and net pay for the period that corresponds to the amount of the check received by an employee. The source of this information is the payroll register. Before the check is cashed, the statement of earnings should be detached and filed by the employee.

Electronic Funds Transfer

Many employees ask their employers to have the net pay automatically deposited in the employee's checking account. This results in a quicker deposit and eliminates the risk of losing the check. The employee still receives a statement of earnings with each payroll.

Payments to Taxing Authorities

Journal Entry

The journal entry to record payment to taxing authorities is shown below. This entry has two components. The example you see below consists of:

- Payment of the withholding liability for federal and state income tax and FICA/Medicare (see also page 24).
- Payment of the employer payroll tax liability (see also page 25).

Notice that the employer portion of FICA/Medicare is part of the \$759.50 debit that includes both employee and employer portions of \$379.75 each.

March 19	Federal Income Tax Payable	765.00	
	State Income Tax Payable	148.00	
	FICA Payable	759.50	
	SUTA Payable	76.68	
	FUTA Payable	11.36	
	Cash		1,760.54

Note: In practice, some of these liabilities might be paid on different dates. In that case, there would be a series of journal entries, each debiting some liabilities and crediting cash.

Payroll Deposit Deadlines

Taxing authorities have strict payment deadlines for when the employer must make payroll deposits. Depending on the size of the payroll, payment deadlines range from quarterly (less than \$500) to as often as semi-weekly (the bigger the payroll, the quicker the deadline). Internal Revenue Service Publication 15 has details.

If payment deadlines are not met, significant late payment penalties will be imposed.

Note: The government considers its receipts from the employer's payroll tax deposits as an important source of cash flow. It takes the obligation to make these deposits very seriously. When I was in school, I had a part-time bookkeeping job for a small business that was constantly late with payroll deposits and that had ignored a catch-up payment agreement with the IRS. I returned from lunch one day to find two IRS agents changing the lock on the door (after seizing the assets).

How Payments Are Made

- **Manual:** Manual federal deposits are made by using a special deposit slip (Form 8109) and making the deposit at a Federal Reserve bank or authorized commercial bank. State payment procedures vary.
- **EFT:** Some employers use an electronic funds transfer system (EFT) to automatically transfer funds to designated government accounts. Employers with prior year deposits exceeding \$200,000 must use the EFT system for federal deposits.

Payments to Other Parties

Overview

In general, payments to third parties are made according to the contractual agreement with each party. An exception is court-ordered withholding such as wage garnishments for child support, which have fixed payment dates.

Journal Entry

Journal entries to record payment to third parties are shown below:

March 25	Health Insurance Payable	350.00	
	Cash		350.00
March 31	Pension Plan Payable	150.00	
	Cash		150.00

Internal Control for Payroll Payments

Payroll Checks

Payroll checks should be prepared by one department and signed and distributed by another department, after the payroll calculation has been reviewed, with supporting documentation. For example, the payroll department prepares the payroll checks and employer deposit checks, but the treasurer or chief financial officer signs and distributes the checks. In a small business, the *owner* should:

- Review the checks for accuracy and for hours worked
- Sign and distribute the checks

In a larger business, the signed checks are sent directly to employees from the treasurer's office or employees must present identification to receive their paychecks. This helps reduce the problem of payment to fictitious employees.

continued ►

Internal Control for Payroll Payments, *continued*

Payroll Bank Accounts

For reasons of efficiency, companies with many employees keep one or even two separate payroll bank accounts. Not having a large number of payroll checks in the regular checking account makes it much easier to reconcile the account. Also, because many payroll checks may be outstanding at the end of a month, using two payroll accounts allows checks to clear from one account while the other is being used. This makes it easy to reconcile the account that is not being used during the current month.

Independent Payroll Services

Many companies use independent payroll preparation services (also called *payroll processing centers*). These services are independent businesses that specialize in payroll processing. Banks also offer these services. Such services are especially helpful for small- to moderate-sized companies. The use of an independent payroll service substantially reduces employee labor time, reduces the cost of computerized systems, and can improve internal control by reducing manual calculation errors and employee collusion.

The general procedure is for the company to provide the payroll service with basic employee payroll information and hours worked. The payroll service, using its own computer system, then performs all calculations, prepares checks, prepares required reports, and maintains payroll records. As well, it provides the information that the company uses for journal entries.

Voucher System

If a voucher system is being used (see Controlling Cash Special Report) the supervisor of the payroll department, after payroll calculations have been checked, prepares a voucher for the total amount of the net pay for the period. This voucher will be recorded in the accounting department as a debit to Salaries and Wages Payable and a credit to Vouchers Payable.

Similarly, a voucher will be prepared for each of the other liability payments, and the accounting department will debit the liability and credit Vouchers Payable.

Check Your Understanding

Write the completed sentences on a separate piece of paper. The answers are below.

In addition to gross pay, employers have at least one other type of payroll expense: employer payroll taxes. Three employer payroll taxes are , , and (use the abbreviated names).

An important internal control procedure is to (combine/separate) the payroll calculation functions and the other payroll functions. It is generally (necessary/unnecessary) to require a rotating review of all payroll calculations by different supervisors or in a small business, by the

If the wage base is \$7,000 how much of each the following employee's current period wages would be subject to tax?

1. Cornejo: Prior cumulative wages: \$3,500. Current period wages: \$1,450. Taxable:
2. Halliday: Prior cumulative wages: \$5,100. Current period wages: \$2,000. Taxable:
3. Roche: Prior cumulative wages: \$7,900. Current period wages: \$ 1,300. Taxable:

Answers

1. Cornejo: Taxable: \$1,450
2. Halliday: Taxable: \$1,900
3. Roche: Taxable: 0

In addition to gross pay, employers have at least one other type of payroll expense: employer payroll taxes. Three employer payroll taxes are FICA, FUTA, and SUTA (use the abbreviated names).

An important internal control procedure is to separate (combine/separate) the payroll calculation functions and the other payroll functions. It is generally necessary (necessary/unnecessary) to require a rotating review of all payroll calculations by different supervisors, or in a small business, by the owner.

Submit Required Forms and Reports

Key Items

Overview

Most forms and reports are prepared to comply with the requirements of government taxing authorities. Government taxing authorities want to maintain close control over cash flow from payroll deposits, and therefore require frequent reports. Substantial penalties are imposed if the reports are not submitted in a timely manner.

Other required reports are those that must be provided to employees

Government Reporting

The table below summarizes the reports that are required to be sent to government taxing agencies. State forms may vary. The frequency refers to a calendar year basis.

Form/Report	Frequency	What For
Form 941/Employer's Federal Payroll Tax Return	Quarterly	Reports the liability and withholding for federal income tax, employer/employee OASDI, and Medicare
Form XXX/Employer's State Payroll Tax Return	Quarterly	Reports the liability and withholding for state income tax, SUTA, and other state taxes
Form 940/Employer's Federal Unemployment Tax Return	Annual (year end)	Reports FUTA liability and withholding
Form W-2 (copies)/Employee Wage and Tax Statement	Annual (year end)	Reports an employee's gross pay and taxable pay and withholding for the year; sent to employees and federal, state, and local taxing authorities
Form W-3/Transmittal form	Annual (year end)	Summary federal transmittal form that must accompany the copies of the W-2 and 1099 (below) to taxing authorities
Form 1099 (copies)/Non-Employee Compensation Statement	Annual (year end)	Reports a <i>non-employee's</i> compensation and withholding; sent to federal, state, and local taxing authorities

Internet Use

The Internal Revenue Service permits Internet reporting for Forms 941 and 940 by payroll services and professional practitioners qualified under the *e-filing* system. This reporting works with most payroll software. The use of Internet reporting and paying is likely to grow in the future, involving more types of taxes.

Form **941 for 2007: Employer's QUARTERLY Federal Tax Return**
 (Rev. January 2007) Department of the Treasury — Internal Revenue Service

990107

OMB No. 1545-0029

(EIN) Employer identification number -

Name (not your trade name)

Trade name (if any)

Address

Number Street Suite or room number

City State ZIP code

Report for this Quarter of 2007
 (Check one.)

1: January, February, March

2: April, May, June

3: July, August, September

4: October, November, December

Read the separate instructions before you fill out this form. Please type or print within the boxes.

Part 1: Answer these questions for this quarter.

1 Number of employees who received wages, tips, or other compensation for the pay period including: *Mar. 12 (Quarter 1), June 12 (Quarter 2), Sept. 12 (Quarter 3), Dec. 12 (Quarter 4)* **1**

2 Wages, tips, and other compensation **2**

3 Total income tax withheld from wages, tips, and other compensation **3**

4 If no wages, tips, and other compensation are subject to social security or Medicare tax Check and go to line 6.

5 Taxable social security and Medicare wages and tips:

	Column 1		Column 2
5a Taxable social security wages	<input type="text"/>	× .124 =	<input type="text"/>
5b Taxable social security tips	<input type="text"/>	× .124 =	<input type="text"/>
5c Taxable Medicare wages & tips	<input type="text"/>	× .029 =	<input type="text"/>

5d Total social security and Medicare taxes (Column 2, lines 5a + 5b + 5c = line 5d) **5d**

6 Total taxes before adjustments (lines 3 + 5d = line 6) **6**

7 TAX ADJUSTMENTS (Read the instructions for line 7 before completing lines 7a through 7h.):

7a Current quarter's fractions of cents	<input type="text"/>
7b Current quarter's sick pay	<input type="text"/>
7c Current quarter's adjustments for tips and group-term life insurance	<input type="text"/>
7d Current year's income tax withholding (attach Form 941c)	<input type="text"/>
7e Prior quarters' social security and Medicare taxes (attach Form 941c)	<input type="text"/>
7f Special additions to federal income tax (attach Form 941c)	<input type="text"/>
7g Special additions to social security and Medicare (attach Form 941c)	<input type="text"/>
7h TOTAL ADJUSTMENTS (Combine all amounts: lines 7a through 7g.)	<input type="text"/>

8 Total taxes after adjustments (Combine lines 6 and 7h.) **8**

9 Advance earned income credit (EIC) payments made to employees **9**

10 Total taxes after adjustment for advance EIC (line 8 - line 9 = line 10) **10**

11 Total deposits for this quarter, including overpayment applied from a prior quarter **11**

12 Balance due (If line 10 is more than line 11, write the difference here.) **12**
 Follow the Instructions for Form 941-V, Payment Voucher.

13 Overpayment (If line 11 is more than line 10, write the difference here.)

Check one Apply to next return.
 Send a refund.

Name (not your trade name)

Employer identification number (EIN)

Part 2: Tell us about your deposit schedule and tax liability for this quarter.

If you are unsure about whether you are a monthly schedule depositor or a semiweekly schedule depositor, see Pub. 15 (Circular E), section 11.

14 Write the state abbreviation for the state where you made your deposits OR write "MU" if you made your deposits in multiple states.

15 Check one: Line 10 is less than \$2,500. Go to Part 3. You were a monthly schedule depositor for the entire quarter. Fill out your tax liability for each month. Then go to Part 3.

Tax liability: Month 1, Month 2, Month 3, Total liability for quarter

You were a semiweekly schedule depositor for any part of this quarter. Fill out Schedule B (Form 941): Report of Tax Liability for Semiweekly Schedule Depositors, and attach it to this form.

Part 3: Tell us about your business. If a question does NOT apply to your business, leave it blank.

16 If your business has closed or you stopped paying wages Check here, and enter the final date you paid wages / /

17 If you are a seasonal employer and you do not have to file a return for every quarter of the year Check here.

Part 4: May we speak with your third-party designee?

Do you want to allow an employee, a paid tax preparer, or another person to discuss this return with the IRS? (See the instructions for details.)

Yes. Designee's name

Select a 5-digit Personal Identification Number (PIN) to use when talking to IRS.

No.

Part 5: Sign here. You MUST fill out both pages of this form and SIGN it.

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.



Sign your name here

Signature box

Print your name here

Print your title here

Date / /

Best daytime phone () -

Part 6: For paid preparers only (optional)

Paid Preparer's Signature, Firm's name, Address, Date, Phone, EIN, ZIP code, SSN/PTIN

Check if you are self-employed.

Form 941-V, Payment Voucher

Purpose of Form

Complete Form 941-V, Payment Voucher, if you are making a payment with Form 941, Employer's QUARTERLY Federal Tax Return. We will use the completed voucher to credit your payment more promptly and accurately, and to improve our service to you.

If you have your return prepared by a third party and make a payment with that return, please provide this payment voucher to the return preparer.

Making Payments With Form 941

Make your payment with Form 941 **only if**:

- Your net taxes for the quarter (line 10 on Form 941) are less than \$2,500 and you are paying in full with a timely filed return or
- You are a monthly schedule depositor making a payment in accordance with the Accuracy of Deposits Rule. (See section 11 of Pub. 15 (Circular E), Employer's Tax Guide, for details.) In this case, the amount of your payment may be \$2,500 or more.

Otherwise, you must deposit your taxes at an authorized financial institution or by electronic funds transfer. (See section 11 of Pub. 15 (Circular E) for deposit instructions.) Do not use Form 941-V to make federal tax deposits.

Caution. If you pay amounts with Form 941 that should have been deposited, you may be subject to a penalty. See Deposit Penalties in section 11 of Pub. 15 (Circular E).

Specific Instructions

Box 1—Employer identification number (EIN). If you do not have an EIN, apply for one on Form SS-4, Application for Employer Identification Number, and write "Applied For" and the date you applied in this entry space.

Box 2—Amount paid. Enter the amount paid with Form 941.

Box 3—Tax period. Darken the capsule identifying the quarter for which the payment is made. Darken only one capsule.

Box 4—Name and address. Enter your name and address as shown on Form 941.

- Enclose your check or money order made payable to the "United States Treasury." Be sure also to enter your EIN, "Form 941," and the tax period on your check or money order. Do not send cash. Please do not staple Form 941-V or your payment to the return (or to each other).

- Detach Form 941-V and send it with your payment and Form 941 to the address provided in the Instructions for Form 941.

Note. You must also complete the entity information above Part 1 on Form 941.



▼ Detach Here and Mail With Your Payment and Tax Return. ▼



Form **941-V**

Department of the Treasury
Internal Revenue Service

Payment Voucher

OMB No. 1545-0029

2007

▶ Do not staple or attach this voucher to your payment.

1 Enter your employer identification number (EIN).		2 Enter the amount of your payment. ▶		Dollars	Cents
3 Tax period		4 Enter your business name (individual name if sole proprietor).			
<input type="radio"/> 1st Quarter	<input type="radio"/> 3rd Quarter	Enter your address.			
<input type="radio"/> 2nd Quarter	<input type="radio"/> 4th Quarter	Enter your city, state, and ZIP code.			

Form **940 for 2007:** **Employer's Annual Federal Unemployment (FUTA) Tax Return**

850107

Department of the Treasury — Internal Revenue Service

OMB No. 1545-0028

(EIN) Employer identification number -

Name (not your trade name)

Trade name (if any)

Address

Number Street Suite or room number

City State ZIP code

Type of Return
(Check all that apply.)

a. Amended

b. Successor employer

c. No payments to employees in 2007

d. Final: Business closed or stopped paying wages

Read the separate instructions before you fill out this form. Please type or print within the boxes.

Part 1: Tell us about your return. If any line does NOT apply, leave it blank.

- 1 If you were required to pay your state unemployment tax in ...
- 1a One state only, write the state abbreviation 1a
- OR -
- 1b More than one state (You are a multi-state employer) 1b Check here. Fill out Schedule A.
- Skip line 2 for 2007 and go to line 3.
- 2 If you paid wages in a state that is subject to CREDIT REDUCTION 2 Check here. Fill out Schedule A (Form 940), Part 2.

Part 2: Determine your FUTA tax before adjustments for 2007. If any line does NOT apply, leave it blank.

- 3 Total payments to all employees 3
- 4 Payments exempt from FUTA tax 4
- Check all that apply: 4a Fringe benefits 4c Retirement/Pension 4e Other
- 4b Group term life insurance 4d Dependent care
- 5 Total of payments made to each employee in excess of \$7,000 5
- 6 Subtotal (line 4 + line 5 = line 6) 6
- 7 Total taxable FUTA wages (line 3 - line 6 = line 7) 7
- 8 FUTA tax before adjustments (line 7 × .008 = line 8) 8

Part 3: Determine your adjustments. If any line does NOT apply, leave it blank.

- 9 If ALL of the taxable FUTA wages you paid were excluded from state unemployment tax, multiply line 7 by .054 (line 7 × .054 = line 9). Then go to line 12 9
- 10 If SOME of the taxable FUTA wages you paid were excluded from state unemployment tax, OR you paid ANY state unemployment tax late (after the due date for filing Form 940), fill out the worksheet in the instructions. Enter the amount from line 7 of the worksheet onto line 10 10
- Skip line 11 for 2007 and go to line 12.
- 11 If credit reduction applies, enter the amount from line 3 of Schedule A (Form 940) 11

Part 4: Determine your FUTA tax and balance due or overpayment for 2007. If any line does NOT apply, leave it blank.

- 12 Total FUTA tax after adjustments (lines 8 + 9 + 10 = line 12) 12
- 13 FUTA tax deposited for the year, including any payment applied from a prior year 13
- 14 Balance due (If line 12 is more than line 13, enter the difference on line 14.)
- If line 14 is more than \$500, you must deposit your tax.
 - If line 14 is \$500 or less and you pay by check, make your check payable to the United States Treasury and write your EIN, Form 940, and 2007 on the check 14
- 15 Overpayment (If line 13 is more than line 12, enter the difference on line 15 and check a box below.) 15

Check one Apply to next return.
 Send a refund.

▶ You **MUST** fill out both pages of this form and **SIGN** it.

Next ➔

Name (not your trade name)

Employer identification number (EIN)

Part 5: Report your FUTA tax liability by quarter only if line 12 is more than \$500. If not, go to Part 6.

16 Report the amount of your FUTA tax liability for each quarter; do NOT enter the amount you deposited. If you had no liability for a quarter, leave the line blank.

16a 1st quarter (January 1 - March 31) 16a []

16b 2nd quarter (April 1 - June 30) 16b []

16c 3rd quarter (July 1 - September 30) 16c []

16d 4th quarter (October 1 - December 31) 16d []

17 Total tax liability for the year (lines 16a + 16b + 16c + 16d = line 17) 17 [] Total must equal line 12.

Part 6: May we speak with your third-party designee?

Do you want to allow an employee, a paid tax preparer, or another person to discuss this return with the IRS? See the instructions for details.

Yes. Designee's name []

Select a 5-digit Personal Identification Number (PIN) to use when talking to IRS [] [] [] [] []

No.

Part 7: Sign here. You MUST fill out both pages of this form and SIGN it.

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete, and that no part of any payment made to a state unemployment fund claimed as a credit was, or is to be, deducted from the payments made to employees.

X Sign your name here

[]

Print your name here []

Print your title here []

Date [] / [] / []

Best daytime phone ([]) [] - []

Part 8: For PAID preparers only (optional)

If you were paid to prepare this return and are not an employee of the business that is filing this return, you may choose to fill out Part 8.

Paid Preparer's name []

Preparer's SSN/PTIN []

Paid Preparer's signature []

Date [] / [] / []

Check if you are self-employed.

Firm's name []

Firm's EIN []

Street address []

City []

State []

ZIP code []

Form 940-V, Payment Voucher

What Is Form 940-V?

Form 940-V is a transmittal form for your check or money order. Using Form 940-V allows us to process your payment more accurately and efficiently. If you have any balance due of \$500 or less on your 2007 Form 940, fill out Form 940-V and send it with your check or money order.

Note. If your balance is more than \$500, see *When Must You Deposit Your FUTA Tax?* in the Instructions for Form 940.

How Do You Fill Out Form 940-V?

Type or print clearly.

Box 1. Enter your employer identification number (EIN). Do not enter your social security number (SSN).

Box 2. Enter the amount of your payment. Be sure to put dollars and cents in the appropriate spaces.

Box 3. Enter your business name and complete address exactly as they appear on your Form 940.

How Should You Prepare Your Payment?

- Make your check or money order payable to the *United States Treasury*. Do not send cash.
- On the memo line of your check or money order, write:
 - your EIN,
 - Form 940, and
 - 2007.
- Carefully detach Form 940-V along the dotted line.
- Do not staple your payment to the voucher.
- Mail your 2007 Form 940, your payment, and Form 940-V in the envelope that came with your 2007 Form 940 instruction booklet. If you do not have that envelope, use the table in the Instructions for Form 940 to find the mailing address.



▼ Detach Here and Mail With Your Payment and Tax Return. ▼



Form **940-V**

Department of the Treasury
Internal Revenue Service

Payment Voucher

OMB No. 1545-0028

2007

▶ Do not staple or attach this voucher to your payment.

1 Enter your employer identification number (EIN).

2

Enter the amount of your payment. ▶

Dollars

Cents

3 Enter your business name (individual name if sole proprietor).

Enter your address.

Enter your city, state, and ZIP code.

Key Items, *continued*

Employee Reporting

- Each employee must receive a **Form W-2** at year end. This shows the employee's gross pay and withholding. This information is required to complete individual tax returns.
- Employers that maintain pension plans and other benefit plans should also provide a summary report to employees at year end.

Non-Employee Reporting

Each independent contractor must receive a **Form 1099-MISC** that reports total compensation and withholding. The form is required for each provider of services of \$600 or more.

The Use of Computers in Payroll

Overview

Introduction

Because of detailed calculations and potentially large amounts of data, payroll procedures are an excellent application for the use of a computer. In fact, one of the first computer applications that a small business wants to use is often the preparation of payroll (for businesses that do not use an independent payroll service).

What a Computerized Payroll System Does

A fully integrated computerized payroll system performs the following functions:

- Maintains a database of employee information and current payroll tax rates, wage bases, and other information needed for calculations
- Performs all payroll calculations
- Prints payroll checks
- Performs accounting and record-keeping functions
- Prints all payroll forms and tax returns
- Provides management with summary analysis reports

Input Is Required

Of course, the computer system cannot perform these payroll functions unless data are entered into the computer. For example, hours worked by employees must be calculated and recorded for each payroll period, and then they must be entered into the computer with employee identification codes. Additionally, the database of employee information frequently must be updated, and entering this information is not an automated procedure.

The journal entries created by the payroll software should interface with the general ledger software, so these entries are recorded with a single command.

continued ►

Overview, continued

Hidden Costs

A computerized payroll system has numerous hidden costs; therefore, the volume of calculations and reports should be large enough to create a time savings that offsets the other hidden costs. Some of these costs are:

- Substantial training and practice time is required to understand and efficiently operate a computerized accounting system.
 - Annual updates of payroll software are required.
 - Recurring updates of employee database information are required.
 - Software support services from the vendor may be an additional charge.
 - Special payroll forms are required.
 - Upgrades of computer hardware will be needed, particularly if the size of the software program increases.
-

Internal Control Issues

Computerized payroll systems create special internal control issues. (Payroll is one of the most important internal control areas in a business.) The primary concerns are about access and separation of duties.

- Because a single payroll computer module can perform virtually all the payroll functions, one person with access to the payroll program can essentially control all payroll functions.
 - Pay rates and critical data can be altered, and unauthorized program changes can be made. This means that overpayments as well as fictitious employees can easily be created.
 - Small- to moderate-sized business are particularly vulnerable because only one or two people regularly use the computer accounting system.
-

Financial Statement Presentation of Payroll Items

Key Ideas

Income Statement

Payroll-related expenses such as gross pay expense, employer payroll tax expense, and benefits expense are operating expenses on the income statement.

Key Ideas, *continued*

Balance Sheet

The balance sheet shows payroll liabilities as current liabilities. This includes:

- Salaries and Wages Payable: This is the net pay owing to employees at the end of a completed payroll period (see journal entry on page 24.) This account also shows accrued wages for a partial payroll period (see below).
- FICA/FUTA/SUTA Payable: These are the employer and/or employee withheld payroll taxes that are still undeposited, from completed payroll periods (*not* the cumulative totals for the year). These accounts are also used for the same liabilities resulting from payroll tax expense accruals for a partial payroll period (see below).
- Other: These are liabilities to pension and benefit plans and other third parties.

Period-End Accruals

- Gross pay accrual: The matching principle requires that the wages, salaries, and other compensation expense that have been incurred at the end of an accounting period, but not yet paid, must be accrued. Debit Salaries and Wages Expense, Credit Salaries and Wages Payable.
- Payroll tax expense accrual: Because payroll tax expenses are incurred at the same time as gross pay expense, employer payroll taxes should be accrued. *Example:* A fiscal year ends on June 30. The current payroll period will not end until July 5; however, as of June 30, \$4,800 of employee earnings have been earned for the time worked. The wages expense should be accrued and the employer payroll tax should be accrued on this as follows:

Payroll Tax Expense	668.60	
FICA Payable		371.00
SUTA Payable		259.20
FUTA Payable		38.40

Note: Some companies save time and do not accrue payroll tax expense because payroll taxes are not a liability until the employees are paid. This is a violation of the matching principle for an expense resulting from a probable liability.

Withholding on Accruals

It is not necessary to identify employee withholding in the situation above. This only needs to be done at the end of a completed payroll period when employees are paid. Expenses are accrued, but withholding is not recorded until the end of the payroll period.

QUICK REVIEW

- Current liabilities are obligations that require the use of company resources within a year.
- Included in current liabilities are liabilities that must be estimated, probable (contingent) liabilities, and current portion of long-term debt.
- The payroll process consists of five elements:
 1. Identify employees.
 2. Calculate the payroll.
 3. Record the payment.
 4. Make payments.
 5. Submit forms and reports.
- Identifying workers as employees or not employees is a critical first step in the payroll process; this requires internal control procedures to prevent fraud and employee/contractor misclassification errors.
- Calculating the payroll involves three basic elements:
 1. Gross pay expense and withholding
 2. Payroll taxes expense
 3. Benefits expense
- Four types of withholding deductions from gross pay are required:
 1. Income tax: Usually determined by using withholding tables.
 2. Social security tax: Calculated by using a wage base limit and a tax rate for OASDI and no wage limit and a different rate for Medicare.
 3. State unemployment tax: set by each state, generally using a wage base and tax rate method
 4. Any other deductions imposed by law
- Employer payroll tax expense always includes FICA, FUTA, and SUTA
- A payroll register is often used to organize the calculations, and employee earnings records are required by law. This is used as a source when payroll is recorded.
- Payroll tax deposit and tax return filing have deadlines specified by law, and there are significant penalties for noncompliance.
- Internal control is an essential part of the payroll calculation.
- Payroll tax liability appears as a current liability on the balance sheet.

VOCABULARY

Bonus: extra gross pay given as a reward for achievement or meeting goals

Commission: gross pay determined as a percentage of sales dollars

Contingent liability: a liability that is created only if another event happens first

Current portion of long-term debt: the amount of principal payments of a long-term loan that are payable within a year

Earnings Record: a legally required record of employee gross pay, withholding, and net pay that must be maintained by an employer for each employee

Employee: any person who performs services for a business if the business can control what work will be done and how it will be done

Exemption: another name for withholding allowance

Fair Labor Standards Act (FLSA): A federal law that governs working conditions for wage earners and sets standards for overtime pay and minimum wage

FICA: Federal Insurance Contribution Act that created social security

Filing status: marital status that determines the applicable income tax rate

VOCABULARY

Form W-2: an employee wage and tax statement that shows annual gross pay and withholding; must be provided to each employee at calendar year end

Form W-4: a federal form that indicates employee filing status and withholding allowances

Form 1099-MISC: a federal form that reports total compensation and withholding for independent contractors

FUTA: Federal Unemployment Tax Act; imposes a tax on employers that provides for payments to unemployed employees

Gross pay: the total compensation received by an employee

In kind: payment made in the form of property or services value and not cash

Independent contractor: an individual who is in business to offer services to the public and who is not an employee

Medicare: medical insurance for uninsured workers financed by social security tax

Net pay: gross pay minus deductions; the amount of cash received by an employee

Payroll: the process of (1) identifying employees, (2) calculating pay and payroll taxes, (3) recording payroll transactions, (4) making payments, and (5) completing payroll reporting forms

Payroll deduction: an amount deducted from gross pay by the employer

Payroll processing center: an independent business that specializes in payroll processing and record-keeping services

Payroll register: an accounting worksheet used to organize and summarize payroll information each payroll period

OASDI: old age, survivor's, and disability insurance financed by social security tax

Plan Administrator: a company that designs and administers pension plans

Salary: a fixed amount of gross pay per period not dependent upon hours worked

Self-employment tax: the combined employee/employer FICA amount that must be paid by a self-employed individual

Social security tax: a tax on employees and employers to provide old age, survivor's, and disability insurance benefits

Statement of earnings: a detachable portion of a payroll check that shows gross pay, deductions, and net pay

Statutory employee: a worker who is not an employee under common law but who is designated as an employee by statute

SUTA: State Unemployment Tax Act of any state; imposes a tax on employers that provides for payments to unemployed employees

Tax rate: the percent of tax

Wage: gross pay determined by hours worked or units completed

Wage base: a fixed annual calendar year amount of gross pay subject to payroll tax

Wage-bracket method: a common method of calculating income tax withholding

Withholding allowance: a fixed amount allowed for each employee, the employee's spouse, and each dependent; used to exempt that amount of wages from income tax withholding

PRACTICE

Note: For these questions and problems assume the following: OASDI, wage base of \$104,000 and a rate of 6.2%; Medicare, no limit and a rate of 1.45%; SUTA and FUTA, wage base of \$7,000 with rates of 5.4% and .8%, respectively.

Multiple Choice

Select the best answer.

1. Jeffery is paid at the rate of \$20 per hour. This week he worked 46 hours. Under the FLSA rules what is his total gross pay?
 - a. \$920
 - b. \$1,040
 - c. \$1,380
 - d. \$980
2. Employer payroll taxes do not include which of the following?
 - a. FICA
 - b. FUTA
 - c. SUTA
 - d. income tax
3. Which of the following is an essential internal control procedure for payroll?
 - a. Separate the personnel activities from payroll calculation activities.
 - b. Require the payroll department to sign all payroll checks.
 - c. Install a computerized accounting payroll system.
 - d. Use a payroll register.
4. Good internal control requires that who of the following should distribute paychecks?
 - a. payroll department
 - b. personnel department
 - c. treasurer or chief financial officer's office
 - d. the immediate supervisor
5. Which of the following is not a deduction from an employee's gross pay?
 - a. FICA
 - b. FUTA
 - c. SUTA
 - d. both b and c
6. Joe is married with three small children. If his wife does not work or works and does not claim an exemption, Joe should claim:
 - a. 6 exemptions.
 - b. 5 exemptions.
 - c. 3 exemptions.
 - d. 2 exemptions.
7. Which of the following is not a current liability?
 - a. advance payment from a customer
 - b. wages payable
 - c. possible loss in a lawsuit
 - d. any liability that must be estimated

PRACTICE

8. The amount of a payroll tax that still could be paid for the rest of the year is determined by:
 - a. calculating the amount of payroll tax that has already been paid and subtracting from a total.
 - b. comparing the cumulative gross pay to a wage base and applying a tax rate.
 - c. identifying the amount of withholding allowances claimed.
 - d. none of the above.
9. Which item is paid both by the employer and the employee?
 - a. income tax withholding
 - b. FUTA
 - c. FICA
 - d. SUTA
10. The three different journal entries required to record total payroll expenses will show:
 - a. gross pay expense, independent contractor expense, benefits expense.
 - b. gross pay expense, payroll deposits expense, payroll processing service expense.
 - c. gross pay expense, payroll tax expense, benefits expense.
 - d. net pay expense, payroll tax expense, income tax expense.
11. In regard to payroll liabilities presented on the balance sheet:
 - a. employer payroll tax deposit liability may be shown as a long-term liability.
 - b. wages payable may sometimes be a long-term liability.
 - c. employee withholding liabilities should be accrued at the end of an accounting period.
 - d. payroll liabilities are always current liabilities.
12. Which of the following should *not* be accrued at the end of an accounting period?
 - a. employer payroll tax expense
 - b. salaries and wages expense
 - c. employee withholding
 - d. employee benefits
13. Who is not an employee?
 - a. Janet in the sales department who is paid on a commission basis.
 - b. Bob in the personnel office who sometimes takes work home with him.
 - c. The owner of a corporation who performs regular duties for the company.
 - d. John, the computer consultant, who has worked every day for the last month at the same company but also works for other clients.
14. At year end:
 - a. an employee receives a W-2 form, and an independent contractor receives a 1099-MISC form.
 - b. both an employee and an independent contractor must receive a W-2.
 - c. an employee receives a W-4, and an independent contractor receives a 1099-MISC.
 - d. none of the above.
15. Which of the following does *not* determine the amount of income tax withholding?
 - a. gross pay per pay period
 - b. withholding allowances claimed
 - c. the cumulative amount of gross pay
 - d. being married or single
16. If Gloria earned \$180 of overtime pay and worked 5 hours of overtime for the week, what was her total regular pay?
 - a. \$900
 - b. \$960
 - c. \$1,440
 - d. Some other amount

PRACTICE

17. Roland earned \$105,000 for the current year. The amount of his FICA withholding should be:
 - a. \$8,032.50
 - b. \$7,191.00
 - c. \$6,510.00
 - d. some other amount
18. Which of the following is a payroll internal control weakness?
 - a. Payroll preparation is separated from employee hiring and personnel activities.
 - b. Two bank accounts are used: one for payroll and one for other operations.
 - c. The supervisor must submit time cards and hand out payroll checks.
 - d. None of the above.

Discussion Questions and Brief Exercises

1. Cupertino Enterprises purchased \$400,000 of electronics equipment and signed a 3-year note payable.
 - a. At year-end, \$85,000 of the note principal would be due within one year. Prepare the year-end journal entry and show how the liability would be reported on the balance sheet.
 - b. Identify four causes of current liabilities and give one example of each.
2. Anne-Marie is married with two dependent children, and her husband is self-employed. She is paid semi-monthly, and her gross pay this period was \$1,600. What is her income tax withholding? (Use the withholding table on page 799.)
3. What is the difference between an employee and an independent contractor?
4. What is the difference between forms W-2 and W-4? What information does each contain?
5. What is an employee earnings record? Why is it necessary and how is it used?
6. What is FICA? Who pays FICA?
7. What are FUTA and SUTA? Who pays FUTA and SUTA?
8. When an employer withholds federal income tax and state income from a paycheck, are those withholding items expenses for the employer?
9. A business allows employees to earn 1.5 days of paid vacation for each month worked. If the business has 30 employees and the average daily pay during the month is \$170, what is the vacation pay that should be accrued for the month. What would the journal entry be?
10. What is the difference between a payroll register and an employee earnings record?
11. Describe important internal control procedures designed to safeguard the payroll process.
12. In January, Dave had gross pay for the month of \$4,500. Therefore, his employer's January SUTA tax liability is: $(\$7,000 - \$4,500) = \$3,500$. So, $\$3,500 \times .054 = \189 tax liability. Correct?
13. What is the FLSA? How does it affect an employee's gross pay?

PRACTICE

14. Andy's hourly pay rate is \$20 per hour, and he receives an overtime rate of \$30 per hour. During the current pay period he worked 48 hours. His federal income tax withholding is \$220, and all his wages are subject to FICA tax. Calculate Andy's gross and net pay. Explain your calculations.
15. What are the three categories of payroll-related expense items that an employer pays?
16. Identify the five elements in the sequence of the payroll process.
17. For the current month, the gross wages expense of Potomac Company is \$30,000. Assume that all of the employee wages are taxable for FICA, SUTA, and FUTA. Calculate the employer payroll tax expense, and prepare the journal entry for the employer payroll tax.
18. Chi-Ming earned gross salary for the year of \$108,000. During the year, \$22,000 of federal income tax and \$6,500 of state income tax were withheld. \$1,800 of medical insurance premiums were withheld. The employer pays 50% of medical insurance. Prepare a single journal entry that records Chi-Ming's gross wages, withholding, and net pay for the year. Also prepare a journal entry that records the employer's payroll tax expense and benefits expense.

Reinforcement Problems

1. **Calculate missing items, prepare payroll journal entries.** The payroll records of Ogden Company show the following information for the month of January:

Instructions:

- a. Calculate the missing amounts in the table.
- b. Prepare the payroll journal entries using the completed table.

Item	Employee Earnings Items	Amount
a.	Regular pay	\$30,000
b.	Overtime pay	18,000
c.	Total gross pay	?
d.	Federal income tax withheld	6,800
e.	State income tax withheld	900
f.	FICA tax	?
g.	Charitable contribution withholding	1,000
h.	Net pay	?
Employer Payroll Tax and Benefit Items		
i.	SUTA tax	?
j.	FUTA tax	?
k.	Medical insurance	\$2,500
l.	Retirement plans	750
m.	Total employer payroll tax and benefit items	?

PRACTICE

- 2. Prepare payroll journal entries.** New Orleans Company pays employees monthly and incurred employee wages expense of \$30,000 for the month of August. Federal tax withholding is \$5,200, and state income tax withholding is \$870. Two of the employees have exceeded the FICA wage base limits, so \$4,000 of the gross pay is not subject to OASDI. Only \$15,000 of the gross pay is subject to the federal and state unemployment tax. The company also incurs a monthly expense for employee benefits as follows: health insurance, \$2,200; life insurance, \$200; pension plan benefits, 3.5% of gross pay. Union dues withheld are \$220.

Instructions: Record all necessary payroll journal entries as of August 31.

- 3. Social Security tax calculations.** In October, Evelyn earned \$4,750 and Sue earned \$2,800. From January through September, Evelyn had earned \$100,500 and Sue had earned \$94,100.

Instructions: Calculate the following:

- the October amount of FICA (social security tax) withholding for Evelyn and Sue
- the total amount of FICA tax for both employees from January through October

4. Journal entries and accruals.

- a. Kenai Company has a weekly payroll period. The current weekly payroll period has just ended on Friday, October 12. The table below shows current employee payroll information for the week ended Friday, October 12.

Employee Name	Current Hours	Rate	Federal Income Tax	Prior Cum. Earnings
Bishop	40	\$30/hr	\$255	\$56,000
Chignik	44	25/hr	190	59,200
Peters	40	40/hr	310	6,200
Sagamore	Salary	2,400/week	672	102,900

- b. Talkeetna Partnership has a weekly payroll period. The accounting year end of October 31 is on a Wednesday. The weekly payroll period will end on Friday, November 2. The table below shows you current employee payroll information for the three days ended Wednesday, October 31.

Employee Name	Current Hours	Rate	Federal Income Tax	Prior Cum. Earnings
Abrams	24	\$20/hour	\$80	\$6,000
Cantwell	24	45/hour	88	103,500
Tok	Salary	3,000/week	335	141,000
Wenham	20	35/hour	90	6,900

Instructions: Prepare the necessary journal entries for Talkeetna Partnership as of October 31.

PRACTICE

5. Identify various liabilities.

For each of the items listed below, indicate if the item should appear on the balance sheet as a liability.

- Unpaid wages at year end, but before the end of the payroll period
- Income tax withholding in item a above
- Income tax withholding at the end of a payroll period
- Warranty expense that has to be estimated
- 3 months' rent paid in advance by a tenant
- Possible loss of plant assets located in a foreign company because of foreign government expropriation
- The amount of a 10-year loan that is payable within a year
- The amount of a 10-year loan that is payable after one year
- Possible loss from a loan guarantee in which our company must pay if the borrower does not pay
- 6-month magazine subscription payments received from customers
- Employer payroll taxes at year end, but before the end of the payroll period
- Employee bonus pay for all employees entitled to receive bonuses based on various factors
- Coupons given to customers (Coupon value may be used for future purchases.)

6. Calculate the Social Security Withholding.

Use a separate piece of paper to complete the following table:

Cumulative Gross Pay Through November 30	Current Gross Pay: December	Cumulative Gross Pay Year To Date	Current Gross Pay Subject to OASDI Tax	Current Gross Pay Subject to Medicare Tax	December OASDI Withheld	December Medicare Withheld
\$ 54,300	\$3,750					
\$ 98,150	\$7,200					
\$104,275	\$3,550					
\$101,900	\$5,200					

7. Gross pay journal entry.

The following account titles and amounts are from a payroll journal entry on May 15 and are shown in no particular order. All withheld amounts are shown. Prepare a general journal entry. Recreate the complete journal entry.

Sales Salary Expense: \$5,150 FICA Payable: \$620 Federal Income Tax Payable: \$1,400
 State Income Tax Payable: \$410 Union Dues Payable: \$125 Office Wages Expense: \$3,330

PRACTICE

8. Gross and net pay calculation. Don Suzuki works as floor salesperson in a custom furniture store. Don earns a base monthly salary of \$1,000 plus a 10% sales commission. During March his total sales were \$18,400 dollars. Don's federal income tax withholding has been averaging 15% of gross pay, and state withholding has been averaging 3%. His prior gross pay for the year is \$6,100. He contributes \$50 per month to a qualified savings plan by automatic payroll withholding. Compute Don's gross and net pay for March.

9. Journal entries. Using the information in problem 8 above, prepare the general journal entries to record the employer's gross pay expense and payroll tax expense at the end of the March payroll period.

10. Payroll register, journal entries. Napa Vineyard Enterprises provides you with the payroll information for the week ended November 8, which you see presented in the table below.

Instructions:

- a. On separate piece of paper, prepare a payroll register. Use the payroll register on pages 22 and 23 as your model.
- b. Prepare the proper general journal entries.

Employee Name	Current Hours/ Ck. #	Weekly Rate	Federal Income Tax	State Income Tax	Health Insurance	Prior Cum. Earnings
Evans	41/704	\$800	\$120	\$25	\$28	\$6,600
Griffin	Salary/705	3,100	470	110	28	102,550
Klosterman	40/706	1,000	240	44	28	48,000
Theriault	40/707	760	155	38	28	6,770
Walzak	45/708	880	210	50	28	35,800

Other Information: The company contributes to the employee health insurance plan at a cost of \$100 per employee per month and pays for group term life insurance at a cost of \$10 per employee per month. Wage employees work in sales, salaried employees are office employees. Use 5.4% as the SUTA rate and .8% for the FUTA rate.

11. Record payroll entries. The accountant for Providence Enterprises assembled the following payroll information for the quarter ended March 31:

Sales wages expense	\$170,000
Administrative salary expense	325,000
Sales commissions expense	115,000
Employee withholding:	
Federal income tax	134,200
State income tax	18,300
FICA (combined OASDI/Medicare)	39,780
Medical insurance premiums	12,200
Gross wages subject to FUTA/SUTA	80,000
Employer medical insurance payable	35,800
Worker's compensation insurance	24,400

PRACTICE

11, continued

Instructions:

- Prepare a general journal entry that records the employee payroll for the quarter ended March 31.
- Prepare an adjusting journal entry to accrue Providence Enterprise's related payroll expenses as of March 31.

12. Payroll entries; various calculations. Santa Rosa Enterprises pays its employees on a biweekly basis. The table below shows payroll information for the current biweekly payroll period. The employer pays 80% of medical insurance premiums and employees pay 20%. Employees earn the required time and one-half rate for hours worked in excess of 40 hours per week. The employees also receive two weeks of paid vacation per year. One employee, Walker, not shown in the table below, received \$2,000 of vacation pay during the current period. Walker's prior cumulative earnings were \$44,000. Walker withholds \$350 of Federal income tax and \$100 of state income tax and pays \$35 of health insurance premiums per biweekly period.

Instructions: Record the payroll entries for the current biweekly payroll period. Record Walker separately.

Employee Name	Current Hours	Biweekly Rate	Federal Income Tax	State Income Tax	Health Insurance	Prior Cum. Earnings
Chen	82	\$1,200	\$220	\$ 25	\$35	\$ 5,000
Grossman	Salary	3,300	500	140	45	101,500
Moss	80	2,000	280	50	40	48,000
Siler	88	1,600	160	48	40	6,700
Zhang	80	1,200	200	22	35	29,800

13. Calculate gross and net pay; record payroll entries. Abner Watson earns regular pay of \$1,200 per week plus time and one-half (1.5) for weekly hours in excess of 40 hours per week. His federal income tax withholding is at the rate of 20%. There is no state income tax. Watson pays court-ordered child support of \$200 per week. His employer pays SUTA taxes at the rate of 5.4%, and FUTA taxes at the rate of .8%. During the week ending May 10, Watson worked 46 hours. His cumulative year-to-date pay prior to the current week is \$6,400. The employer also contributes to a medical plan at the rate of 3% of gross pay.

Instructions:

- Calculate Watson's gross pay and net pay for the week.
- Prepare a general journal entry to record each of the following for the employer:
 - Watson's wages expense, withholding, and net pay
 - The employer's payroll tax expense
 - The employer's benefits expense
 - The cash payment to Watson on May 12
 - The cash payment to pay all payroll taxes on May 15

PRACTICE

- 14. Challenging problem: complete the payroll register and review all payroll calculations.** A payroll register for the semi-monthly period ended November 12, 200X is presented below. Use 80 hours as regular hours for the period. Make copies of the page and write your answers on the copies.

Payroll Register for the Semi-Monthly							
Employee Name	Tot. Hrs.	Earnings				Current Gross Taxable for ...	
		Regular	Overtime	Current Gross	YTD Gross	FUTA/SUTA	FICA (OASDI)
Curtis, R.	80	3,200	—	3,200	44,500		
Fisher, Y.	85		120		4,100		
McLeod, S.			—		106,400		
Slocum, P.			—				1,300
Teruya, M.	84				49,600		
Total	—						

Other information:

1. Fisher is married and claims 3 exemptions. Teruya is married and claims 4 exemptions. You can use the income tax withholding table on page 11 to calculate income tax withholding.
2. The FICA tax rate is 7.65%, consisting of 6.2% for OASDI and 1.45% for Medicare. The OASDI portion wage base is \$104,000. The FUTA/SUTA wage base is \$7,000. The SUTA rate is 5.4% and the FUTA rate is .8%.
3. The state income tax rate is 4% of gross wages.
4. McLeod and Slocum are administrative employees that are paid salaries. The other employees are in sales and paid at hourly rates.
5. Overtime hours are paid at a rate of one and one-half times the regular rate for time worked in excess of 80 hours for the period.
6. Employees contribute to the health insurance plan at the rate of 1% of their regular gross pay.

PRACTICE

14, *continued*

Period Ended November 12, 200X								
Deductions					Payment			
Fed. Inc. Tax	State Inc. Tax	OASDI/Medicare	Health Insurance	Total	Net Pay	Ck. #	Admin. Salaries	Sales Wages
440.00						250		
						251		
652.50	140.00					252		
895.00		150.20	48.00			253		
			15.20			254		
						—		

15. **Identifying forms and reports.** On a separate piece of paper, complete the information in the empty spaces in the table below.

Form/Report	Frequency	What For
(Reminder: Use a separate sheet of paper to complete the table.)		Reports the liability and withholding for federal income tax, employer/employee FICA, and Medicare
		Reports the liability and withholding for state income tax, SUTA, and other state taxes
		Reports the liability and withholding for FUTA
		Reports the employee gross pay and withholding for the year; sent to federal, state, and local taxing authorities
		Summary federal transmittal form that must accompany the copies of the W-2 and 1099 (below)
		Reports a <i>non-employee's</i> compensation and withholding; sent to federal, state, and local taxing authorities



SOLUTIONS

Multiple Choice

1. d $(40 \text{ hours} \times \$20 = \$800) + (6 \text{ hours} \times \$30 = \$180)$
2. d
3. a Personnel activities include authorizing employees, terminating employees, setting pay rates, and setting withholding allowances. The departments that calculate the payroll or distribute checks should never do this.
4. c Check distribution should be separated from personnel, payroll, and direct supervisory functions.
5. d Both FUTA and SUTA are only employer expenses, and are never paid by employees.
6. b Joe claims one exemption for himself, one for his wife, and one for each child. However, he may claim more exemptions if he has other losses on his income tax return that create constant refunds.
7. c This is either “reasonably possible” or “remote,” but unlikely to be “probable.”
8. b Payroll tax is only calculated on the amount of the wage base for the year. At the point at which the next dollar of gross pay exceeds the wage base limit, no further tax is due.
9. c
10. c
11. d Regarding choice c, payroll taxes do not become a liability until the payroll is paid, so there is no withholding liability to record.
12. c Salaries and Wages expense should always be accrued. It is also technically good practice to accrue employer payroll taxes because they are expenses that are created as wage expense is created, even though the obligation for payment does not exist until the payroll is paid. Benefit expenses should also be accrued.
13. d “Consultant” refers to an independent business, not an employee.
14. a
15. c
16. b $\$180/5 = \36 overtime rate; $\$36/1.5 = \24 regular pay rate; $40 \text{ hours} \times \$24 = \$960$.
17. d The OASDI part is 6.2% on an annual maximum of \$104,000. The Medicare part is 1.45% on all gross wages. Therefore, the total for the year is $(\$104,000 \times .062) + (\$105,000 \times .0145) = \$7,970.70$.
18. c The supervisor potentially could submit time cards for fictitious employees and cash the checks.

SOLUTIONS

Discussion Questions and Brief Exercises

1.

a. Journal entry:

Long-Term Note Payable	85,000	
Current Portion of Long-Term Debt		85,000

Balance sheet:

Current liabilities	
Current portion of long-term debt	\$85,000
Long-term liabilities	
Long-term note payable less \$85,000 current portion of long-term debt	315,000

b.

1. Assets received but not yet paid for: purchase supplies on account
 2. Accrued expense: interest payable
 3. Advance payment from customer: unearned revenue
 4. Loans payable within a year: two examples—a six-month loan, or the current portion of long-term debt
2. \$100. Anne-Marie has 4 exemptions and the \$1,600 is in the bracket of *at least* \$1,600 but less than \$1,620.
 3. An employee is an individual who performs services for a business when the business controls (1) what will be done and (2) how it will be done. An independent contractor is an individual who is in business to offer services to the public and who is in full control of the way in which the services are performed.
 4. Form W-2 is an annual document from an employer that reports an employee's gross pay, taxable gross pay, and withholding items for a calendar year. (Other items may also be reported on the W-2 such as employer reimbursements and retirement plan contributions.) Form W-4 is used by the employer to determine employee filing status (married, single, etc.) and the number of withholding allowances claimed by the employee. A W-4 is submitted by an individual at the time that individual is hired as an employee.
 5. An employee earnings record is a legally required record of an employee's gross pay, withholding, and net pay that must be maintained by an employer for each employee. The earnings record is necessary because it shows for each employee the gross wages, withholding, and net pay for each pay period, as well as the year-to-date cumulative amount. The primary use of the employee earnings record is as the source of the information that is entered on form W-2. The cumulative information is also useful for indicating when wage base limits are reached.
 6. FICA is an acronym that stands for Federal Insurance Contribution Act. This is the law that created the Social Security system. FICA imposes a tax that consists of two parts. The first part is OASDI (Old Age and Survivor's Disability Insurance). The second part is Medicare, added in 1965, which provides a minimum level of medical insurance coverage. OASDI tax is calculated as a percentage of gross wages up to maximum gross wage amount, referred to as the *wage base*. The Medicare tax is a percentage of all gross wages. In this text, we use 7.65% on a wage base of \$104,000 for OASDI and 1.45% on all wages for Medicare. FICA is paid by employees, and then an equal amount is matched by the employer.

SOLUTIONS

7. FUTA is an acronym for “Federal Unemployment Tax Act,” and SUTA is an acronym for “State Unemployment Tax Act.” These are programs that provide temporary income to unemployed workers. FUTA and SUTA are taxes that are imposed only upon employers, and not on employees. The FUTA rate is 6.2%; however, a credit of up to 5.4% is allowed to states that impose state unemployment taxes.
8. Federal and state income tax withholding are not employer expenses. The employer is simply holding back some of the employee pay that the employee will need to pay income taxes. Soon after the end of the payroll period the employer transfers the withheld amounts to the federal and state taxing authorities.
9. Average daily pay $\$170 \times 30$ employees $\times 1.5$ days per employee = $\$7,650$.

Vacation Pay Expense	7,650	
Vacation Pay Liability		7,650

10. A payroll register is used to record all the wages and withholding for each payroll period. It is often the source of the journal entry for that period’s payroll. It is also the source of the information that flows into the each employee’s earnings record. An employee earnings record is a legally required permanent record maintained for each employee. (See 5 above.)
11. Internal control for payroll:
 - Separation of duties: The payroll calculations are prepared by people who do not work in the Human Resources (Personnel) Department and who do not distribute paychecks or have access to cash.
 - Time cards: Time cards are maintained to record the hours worked. Time card use is supervised and checked for accuracy.
 - Double check: Payroll calculations are independently checked for accuracy by another person in the payroll or accounting department. If a computer is used for calculations, calculations are randomly sampled and verified.
 - Paycheck distribution controls: Paychecks are not distributed by immediate supervisors, and a photo ID is required to obtain a paycheck or a paycheck is sent directly to an employee.
 - Other payment controls: Payroll bank accounts, independent payroll services, and use of voucher system.
12. Wrong. The SUTA tax (and other payroll taxes) should be calculated on the amount of *current gross pay* that does not exceed the wage base limit. Because January is the first month of the year, we can safely assume that Dave’s cumulative gross pay is the same as his January gross pay, which is $\$4,500$ and which does not exceed the SUTA limit of $\$7,000$. Therefore, the SUTA tax should be calculated on the full $\$4,500$: $\$4,500 \times .054 = \243 .
13. FLSA refers to the Fair Labor Standards Act, which is a federal law. This law affects many aspects of employment, especially working conditions and pay rates. In particular, the FLSA sets the minimum hourly wage. It also sets the number of hours an employee works to be paid overtime as well as the minimum overtime rate of pay.
14. Gross pay: $(\$20 \times 40 \text{ hours}) + (8 \text{ hours and } \$30) = \$1,040$. Net pay: $\$1,040 - \$220 \text{ income tax} - (\$1,040 \times .0765 \text{ FICA}) = \740.44 .
15. First, an employer pays gross wages to employees. Second, an employer pays payroll taxes (FICA, FUTA, SUTA, and sometimes additional state and local taxes). Third, many employers also pay employee benefits such as medical insurance and retirement plan payments.
16. Identify employees, calculate the payroll, record the payroll, make payments, submit forms and reports.

SOLUTIONS

17. FICA, $\$30,000 \times .0765 = \$2,295$; SUTA, $\$30,000 \times .054 = \$1,620$; FUTA, $\$30,000 \times .008 = \240 .

Payroll Tax Expense	4,155	
FICA Payable		2,295
SUTA Payable		1,620
FUTA Payable		240

18.

Salary Expense	108,000	
Federal Income Tax Payable		22,000
State Income Tax Payable		6,500
FICA Payable		8,014
Medical Insurance Payable		1,800
Salary Payable		69,686
Benefits Expense	1,800	
Payroll Tax Expense	8,448	
FICA Payable		8,014
SUTA Payable		378
FUTA Payable		56
Medical Insurance Payable		1,800

Calculations:

FICA: $(\$104,000 \times .0765) + (\$4,000 \times .0145) = \$8,014$

SUTA: $\$7,000 \times .054 = \378

FUTA: $\$7,000 \times .008 = \56

Medical insurance: The employer pays 50%, so that would equal the amount of medical insurance withholding from the employee.

Reinforcement Problem Solutions

1.

a.

Item c: $\$30,000 + \$18,000 = \$48,000$

Item f: $\$48,000 \times .0765 = \$3,672$ (Note: The problem does not indicate that any payroll tax wage base limits have been exceeded. This is because it is January, and it is the first payroll month.)

Item h: $\$48,000 - \$6,800 - \$900 - \$3,672 - \$1,000 = \$35,628$

Item i: $\$48,000 \times .054 = \$2,592$

Item j: $\$48,000 \times .008 = \384

Item m: $\$3,672 + \$2,592 + \$384 + \$2,500 + \$750 = \$9,898$ (Employer matches employee FICA.)

SOLUTIONS

1, continued

b.

August 31	Wages Expense	48,000	
	Federal Income Tax Payable		6,800
	State Income Tax Payable		900
	FICA Payable		3,672
	Charitable Contributions Payable		1,000
	Wages Payable		35,628
	Payroll Tax Expense	6,648	
	FICA Payable		3,672
	SUTA Payable		2,592
	FUTA Payable		384
	Employee Benefits Expense	2,500	
	Pension Plan Expense	750	
	Benefits and Pension Plan Payable		3,250

(Note: Notice that this is the first month of the year.)

2.

August 31	Wages Expense	30,000	
	Federal Income Tax Payable		5,200
	State Income Tax Payable		870
	FICA Payable		2,047
	Union Dues Payable		220
	Wages Payable		21,663
	Payroll Tax Expense	2,977	
	FICA Payable		2,047
	SUTA Payable		810
	FUTA Payable		120
	Employee Benefits Expense	2,400	
	Pension Plan Expense	1,050	
	Benefits and Pension Plan Payable		3,450

SOLUTIONS

3.

- a. For Evelyn: \$1,250 of her current gross pay exceeds the OASDI limit, so only \$3,500 of current gross pay is taxable for OASDI. Her total October FICA withholding is $(\$3,500 \times .062 = \217 for OASDI) + $(\$4,750 \times .0145 = \68.88 for Medicare). Total for Evelyn is $\$217 + \$68.88 = \$285.88$. For Sue: None of her current gross pay exceeds the \$104,000 limit, so all of her current gross pay is taxable for both OASDI and Medicare. Use the combined tax rate: $\$2,800 \times .0765 = \214.20 .
- b. The total amount of FICA January through November will be the employee withholding plus the employer FICA tax of equal amount. Evelyn's FICA withholding is: $(\$104,000 \times .062 = \$6,448) + (\$105,250 \times .0145 = \$1,526.13)$ for a total withholding of \$7,974.13. Total FICA tax for Evelyn is $\$7,974.13 \times 2 = \$15,948.26$. Sue's FICA withholding is: $\$96,900 \times .0765 = \$7,412.85$. Total FICA tax for Sue is: $\$7,412.85 \times 2 = \$14,825.70$.

4.

- a. Kenai Company

Oct. 12	Wages Expense	6,350.00	
	Federal Income Tax Payable		1,427.00
	FICA Payable		405.18
	Wages Payable		4,517.82
	Payroll Tax Expense	454.78	
	FICA Payable		405.18
	SUTA Payable		43.20
	FUTA Payable		6.40

Calculations:

- Gross wages: Chignik has earned 4 hours of overtime. Chignik's overtime rate is $\$25 \times 1.5 = \37.50 . Therefore, Chignik's gross wages are $(40 \text{ hours} \times \$25) + (4 \text{ hours} \times \$37.5) = \$1,150$. None of the other employees have overtime, so the total gross wages are $\$1,200 + \$1,150 + \$1,600 + \$2,400 = \$6,350$.
- FICA: This is 7.65% times the gross wages of all the employees except Sagamore. Only \$1,100 of Sagamore's current earnings are subject to the 6.2% OASDI tax (\$104,000 wage base – \$102,900). All of Sagamore's earnings are subject to the 1.45% Medicare tax. Therefore, $(\$1,100 \times .062) + (\$2,400 \times .0145) = \$103$ total for Sagamore. For all of the other employees, the calculation is: $\$3,950 \times .0765 = \302.18 .
- SUTA: All the employees have exceed the \$7,000 SUTA wage base except Peters. \$800 of Peters' gross wages are subject to SUTA tax: $\$800 \times .054 = \43.20 .
- FUTA: All the employees have exceed the \$7,000 FUTA wage base except Peters. \$800 of Peters' gross wages are subject to FUTA tax: $\$800 \times .008 = \6.40 .

SOLUTIONS

4, continued

b. Talkeetna Company

Oct. 31	Wages Expense	4,060.00	
	Wages Payable		4,060.00
	Payroll Tax Expense	198.99	
	FICA Payable		163.03
	SUTA Payable		31.32
	FUTA Payable		4.64

Calculations:

- Gross wages: For the hourly employees the gross wage are $(24 \text{ hours} \times \$20) + (24 \text{ hours} \times \$45) + (20 \text{ hours} \times \$35) = \$2,260$. For Tok, the weekly salary is prorated for three days: $\$3,000/5 = \600 per day. For three days: $3 \times \$600 = \$1,800$. Total for all employees: $\$2,260 + \$1,800 = \$4,060$.
- FICA: The current gross pay of Abrams and Wenham are fully taxable for FICA because the cumulative wages are less than the \$104,000 tax base. For Cantwell, \$500 of the current wages are subject to the OASDI tax base ($\$104,000 - \$103,500$), and all of the current earnings are subject to Medicare tax. Tok has exceeded the OASDI tax base, so the current gross earnings are subject only to Medicare tax.
 Abrams and Wenham: $\$1,180 \times .0765 = \90.27
 Cantwell: $(\$500 \times .062) + (\$1,080 \times .0145) = \$46.66$
 Tok: $\$1,800 \times .0145 = \26.10
- SUTA: The full \$480 of Abram's current gross wages are taxable for SUTA, and \$100 of Wenham's wages are taxable for SUTA ($\$7,000 - \$6,900$). SUTA tax is $\$580 \times .054 = \31.32 .
- FUTA: The full \$480 of Abram's current gross wages are taxable for FUTA, and \$100 of Wenham's wages are taxable for FUTA ($\$7,000 - \$6,900$). FUTA tax is $\$580 \times .008 = \4.64 .

Comment: Notice that because the accounting period has ended, the wages expense and the payroll tax expense must be accrued. However, because the payroll period will not end until Friday, it is not necessary to calculate the employee withholding until Friday, when the total wages for the payroll period will be known.

SOLUTIONS

5.

- a. Current liability (an accrued expense)
- b. Not a liability. Employee withholding is not a liability until the employees are paid (end of payroll period).
- c. Current liability
- d. Current liability and/or long-term liability depending on terms of warranty (an accrued expense that can be reasonably estimated)
- e. Current liability (unearned revenue)
- f. Not a recordable liability; possibility is remote
- g. Current liability
- h. Long-term liability
- i. Not a recordable liability; probably should be disclosed in footnotes as reasonably possible
- j. Current liability (unearned revenue)
- k. Current liability (an accrued expense)
- l. Current liability (an accrued expense that can be reasonably estimated)
- m. Current liability (an accrued expense that can be reasonably estimated)

6.

Cumulative Gross Pay Through November 30	Current Gross Pay: December	Cumulative Gross Pay Year to Date	Current Gross Pay Subject to OASDI Tax	Current Gross Pay Subject to Medicare Tax	December OASDI Withheld	December Medicare Withheld
\$54,300	\$3,750	\$58,050	\$3,750	\$3,750	\$232.50	\$54.38
\$98,150	\$7,200	\$105,350	\$5,850	\$7,200	\$362.70	\$104.40
\$104,275	\$3,550	\$107,825	–0–	\$3,550	–0–	\$51.47
\$101,900	\$5,200	\$107,100	\$2,100	\$5,200	\$130.20	\$75.40

7.

May 15	Sales Salaries Expense	5,150	
	Office Wages Expense	3,330	
	Federal Income Tax Payable		1,400
	State Income Tax Payable		410
	FICA Payable		620
	Union Dues Payable		125
	Salaries and Wages Payable		5,925

Note: The Salaries and Wages Payable is calculated as the total gross pay minus the total withholding items. There is no particular order for the withholding liabilities, but Salaries and Wages Payable is generally shown as the last credit item.

SOLUTIONS

8. Don's gross pay is $\$1,000 + (\$18,400 \times .1) = \$2,840$. Don's net pay is his gross pay minus the withholding items, which are: federal income tax, $\$2,840 \times .15 = \426 ; state income tax, $\$2,840 \times .03 = \85.20 ; FICA, $\$2,840 \times .0765 = \217.26 ; and savings plan \$50 for a total of \$778.46 withholding. Net pay is therefore $\$2,840 - \$778.46 = \$2,061.54$.

9.

March 31	Sales Salaries Expense	2,840.00	
	Federal Income Tax Payable		426.00
	State Income Tax Payable		85.20
	FICA Payable		217.26
	Savings Administrator		50.00
	Salaries and Wages Payable		2,061.54
	Payroll Tax Expense	273.06	
	FICA Payable		217.26
	SUTA Payable		48.60
	FUTA Payable		7.20

Calculations:

- FICA: $\$2,840 \times .0765 = \217.26
- SUTA: $\$900 \times .054 = \48.60 (SUTA/FUTA wage base limit is \$7,000)
- FUTA: $\$900 \times .008 = \7.20

SOLUTIONS

10.

(Note: Payroll register continues on next page.)

Payroll Register for the Week							
Employee Name	Tot. Hrs.	Earnings				Current Gross Taxable for ...	
		Regular	Overtime	Current Gross	YTD Gross	FUTA/SUTA	FICA (OASDI)
Evans	41	\$800	\$30.00	\$830.00	\$7,430.00	\$400.00	\$830.00
Griffin		\$3,100	–0–	\$3,100.00	\$105,650.00	–0–	\$1,450.00
Klosterman	40	\$1,000	–0–	\$1,000.00	\$49,000.00	–0–	\$1,000.00
Theriault	40	\$760	–0–	\$760.00	\$7,530.00	\$230.00	\$760.00
Walzak	45	\$880	\$165.00	\$1,045.00	\$36,845.00	–0–	\$1,045.00
Total		\$6,540	\$195.00	\$6,735.00	\$196,455.00	\$630.00	\$5085.00

Journal:

Nov. 8	Office Salaries Expense	3,100.00	
	Sales Wages Expense	3,635.00	
	Federal Income Tax Payable		1,195.00
	State Income Tax Payable		267.00
	FICA Payable		412.92
	Health Plan Administrator		140.00
	Salaries and Wages Payable		4,720.08
	Payroll Tax Expense	451.98	
	FICA Payable		412.92
	SUTA Payable		34.02
	FUTA Payable		5.04
	Benefits Expense	550.00	
	Benefits Plan Administrator Payable		550.00

SOLUTIONS

10, continued

Ended November 8, 200X								
Deductions					Payments			
Fed. Inc. Tax	State Inc. Tax	OASDI/Medicare	Health Insurance	Total	Net Pay	Ck #	Office Salaries	Sales Wages
\$120.00	\$25.00	\$63.49	\$28.00	\$236.49	\$593.51	704		\$830.00
\$470.00	\$110.00	\$134.85	\$28.00	\$742.85	\$2,357.15	705	\$3,100.00	
\$240.00	\$44.00	\$76.50	\$28.00	\$388.50	\$611.50	706		\$1,000.00
\$155.00	\$38.00	\$58.14	\$28.00	\$279.14	\$480.86	707		\$760.00
\$210.00	\$50.00	\$79.94	\$28.00	\$367.94	\$677.06	708		\$1,045.00
\$1195.00	\$267.00	\$412.92	\$140.00	\$2014.92	\$4720.08		\$3,100.00	\$3,635.00

Calculation Notes:

Overtime:

- Evans: $\$800/40 = \$20/\text{hr} \times 1.5 = \$30/\text{hr} \times 1 \text{ hr} = \30
- Walzak: $\$880/40 = \$22/\text{hr} \times 1.5 = \$33/\text{hr} \times 5 \text{ hrs} = \165

OASDI & Medicare withholding:

- All employees except Griffin are below \$104,000 OASDI base, so the full current gross wages are subject to the .0765 rate.
- For Griffin, $\$104,000 - \$102,550 = \$1,450$ subject to OASDI tax. The full \$3,100 is subject to Medicare. Therefore, for Griffin: $(\$1,450 \times .062) + (\$3,100 \times .0145) = \$134.85$ withholding.

Wages subject to FUTA/SUTA:

- Evans: $\$7,000 - \$6,600 = \$400$ taxable
- Theriault: $\$7,000 - \$6,770 = \$230$ taxable

SOLUTIONS

11.

a.

March 31	Sales Wages Expense	170,000	
	Administrative Salary Expense	325,000	
	Sales Commissions Expense	115,000	
	Federal Income Tax Payable		134,200
	State Income Tax Payable		18,300
	FICA Payable		39,780
	Medical Insurance Payable		12,200
	Salaries, Wages, & Commissions Payable		405,520

b.

March 31	Payroll Tax Expense	44,740	
	FICA Payable (same as employees)		39,780
	SUTA Payable (80,000 × .054)		4,320
	FUTA Payable (80,000 × .008)		640
	Medical Insurance Expense	35,800	
	Workman's Compensation Ins. Expense	24,400	
	Medical Insurance Payable		35,800
	Workman's Comp. Insurance Payable		24,400

SOLUTIONS

12, continued

- SUTA: All of Chen's earnings are within the \$7,000 SUTA wage base. \$300 of Siler's earnings are within the SUTA wage base. $\$1,545 \times .054 = \83.43 .
- FUTA: All of Chen's earnings are within the \$7,000 FUTA wage base. \$300 of Siler's earnings are within the FUTA wage base. $\$1,545 \times .008 = \12.36
- Employer medical plan expense. Employees pay 20%, so the total cost is $\$195/.2 = \975 . $\$975 \times .8 = \780
- Vacation pay expense: 2 weeks per year is 8% per biweekly payroll period for the 50 weeks worked ($2/25$ biweekly periods = 8%). Therefore, $\$9,585 \times .08 = \766.80 .

13.

- a. The regular pay rate is $\$1,200/40 = \$30/\text{hour}$. The overtime rate is therefore $\$30 \times 1.5 = \45 .
Gross pay: $\$1,200 + (\$45 \times 6) = \$1,470$.

Net pay is gross pay minus withholding. Net is calculated as:

Gross Pay		\$1,470.00
Less:		
FICA withheld ($.0765 \times \$1,470$)	\$112.46	
Federal income tax withheld ($\$1,470 \times .2$)	294.00	
Child support wage garnishment	200.00	
Total withholding		606.46
Net pay		\$863.54

- b. Watson's wages expense, withholding, and net pay:

May 10	Wages Expense		
	Federal Income Tax Payable		294.00
	FICA Payable		112.46
	Garnishment Payable		200.00
	Wages Payable		863.54

SOLUTIONS

13, continued

The employer's payroll tax expense:

May 10	Payroll Tax Expense	149.66	
	FICA Payable		112.46
	SUTA Payable (600 × .054)		32.40
	FUTA Payable (600 × .008)		4.80
	Medical Insurance Expense	44.10	
	Medical Insurance Payable		44.10

The cash payment to Watson on May 12:

May 12	Wages Payable	863.54	
	Cash		863.54

The cash payment to pay all payroll taxes on May 15:

May 12	Federal Income Tax Payable	294.00	
	FICA Payable	224.92	
	SUTA Payable	32.40	
	FUTA Payable	4.80	
	Cash		556.12

SOLUTIONS

14.

(Note: Payroll register continues on next page.)

Payroll Register for the Semi-Monthly							
Employee Name	Tot. Hrs.	Earnings				Current Gross Taxable for ...	
		Regular	Overtime	Current Gross	YTD Gross	FUTA/SUTA	FICA (OASDI)
Curtis, R.	80	3,200	–0–	3,200	44,500	–0–	3,200
Fisher, Y.	85	1,280	120	1,400	4,100	1,400	1,400
McLeod, S.		3,500	–0–	3,500	106,400	–0–	1,100
Slocum, P.		4,800	–0–	4,800	107,500	–0–	1,300
Teruya, M.	84	1,520	114	1,634	49,600	–0–	1,634
Total	–	14,300	234	14,534	292,100	1,400	8,634

*Calculations:**Curtis:*

- a. Because the YTD gross is less than \$104,000, we know that all the current wages are subject to combined OASDI/Medicare rates.
- b. The YTD gross exceeds the FUTA/SUTA limit of \$7,000 by much more than the current gross pay, so none of the current gross will be taxed for this.

Fisher:

- a. The overtime rate is $\$120/5 \text{ hrs.} = \$24/\text{hr.}$
- b. The regular rate is therefore $\$24/1.5 = \$16/\text{hr.}$
- c. Current regular pay is therefore $80 \times \$16 = \$1,280.$
- d. Because the YTD gross is less than \$104,000, we know that all the current wages are subject to combined OASDI/Medicare rates.
- e. To determine federal income tax withholding, locate \$1,400 in the “at least” column of the tax table and look for the column with 3 exemptions.
- f. The full \$1,400 is subject to FUTA/SUTA because the YTD gross does not exceed \$7,000.

McLeod:

- a. Current period regular pay is $\$140.00/.04 \text{ state tax rate} = \$3,500.$
- b. The YTD gross is \$106,400 so $(\$106,400 - \$3,500) = \$102,900,$ the YTD gross preceding the current payroll period. Therefore, $\$104,000 - \$102,900 = \$1,100,$ the portion of the current gross pay subject to both OASDI/Medicare. The excess above \$104,000 $(\$106,400 - \$104,000 = \$2,400)$ is also subject to the 1.45% Medicare rate.

SOLUTIONS

14, continued

Period Ended November 12, 200X								
Deductions					Payments			
Fed. Inc. Tax	State Inc. Tax	OASDI/Medicare	Health Insurance	Total	Net Pay	Ck #	Admin. Salaries	Sales Wages
440.00	128.00	244.80	32.00	844.80	2,355.20	250		3,200
89.00	56.00	107.10	12.80	264.90	1,135.10	251		1,400
652.50	140.00	118.95	35.00	946.45	2,553.55	252	3,500	
895.00	192.00	150.20	48.00	1,285.20	3,514.80	253	4,800	
103.00	65.36	125.00	15.20	308.56	1,325.44	254		1,634
2,179.50	581.36	746.05	143.00	3,649.91	10,884.09	...	8,300	6,234

Slocum:

- a. The part of current gross pay subject to OASDI/Medicare is \$1,300. The OASDI tax on this is $\$1,300 \times .062 = \80.60 . The total OASDI/Medicare for the current period is \$150.20. Therefore, the Medicare portion is $\$150.20 - \$80.60 = \$69.60$. We can now calculate current period gross pay because we know that the Medicare rate is 1.45% of all gross pay. So $\$69.60 / .0145 = \$4,800$ current period gross pay.
- b. We can calculate the YTD gross pay because we know that in the current period only \$1,300 of the \$4,800 was subject to the combined OASDI/Medicare tax. This limit is \$104,000. Therefore, $(\$104,000 - \$1,300) = \$102,700$ YTD gross pay preceding the current period. $\$102,700 + \$4,800 = \$107,500$ YTD gross pay.

Teruya:

- a. Health insurance is 1% of regular pay, so regular pay is $\$15.20 / .01 = \$1,520$.
- b. The regular pay rate is therefore $\$1,520 / 80 \text{ hrs.} = \$19 / \text{hr.}$ Therefore, the overtime pay rate is $\$19 \times 1.5 = \$28.50 / \text{hr.}$
- c. Overtime pay is $\$28.50 / \text{hr} \times 4 \text{ hrs.} = \114 .

SOLUTIONS

15.

Form/Report	Frequency	What For
Form 941/Employer's Federal Payroll Tax Return	Quarterly	Reports the liability and withholding for federal income tax, employer/employee FICA, and Medicare
Form XXX/Employer's State Payroll Tax Return	Quarterly	Reports the liability and withholding for state income tax, SUTA, and other state taxes
Form 940/Employer's Federal Unemployment Tax Return	Annual (year end)	Reports the liability and withholding for FUTA
Form W-2 (copies)/Employee Wage and Tax Statement	Annual (year end)	Reports the employee gross pay and withholding for the year; sent to employees and federal, state, and local taxing authorities
Form W-3/Transmittal form	Annual (year end)	Summary federal transmittal form that must accompany the copies of the W-2 and 1099 (below) to taxing authorities
Form 1099 (copies)/Non-Employee Compensation Statement	Annual (year end)	Reports a <i>non-employee's</i> compensation and withholding; sent to federal, state, and local taxing authorities