Be An Asset: Understanding Accounting for Payroll

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Payroll data is used in financial recordkeeping for:

- General Accounting – record transactions in company's books and prepare financial statements (internal & external)

- Cost Accounting – cost of labor (regional, departmental, etc)

- Budgeting – projecting costs to keep within limits

Accounting Principles

- Business entity concept
- Continuing concern concept
- ⭐ Time period concept
- Cost principle
- Objectivity principle
- ⭐ Matching principle
- Realization principle
- ⭐ Consistency principle

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Accounting Terminology & Concepts

- Accounting Flow
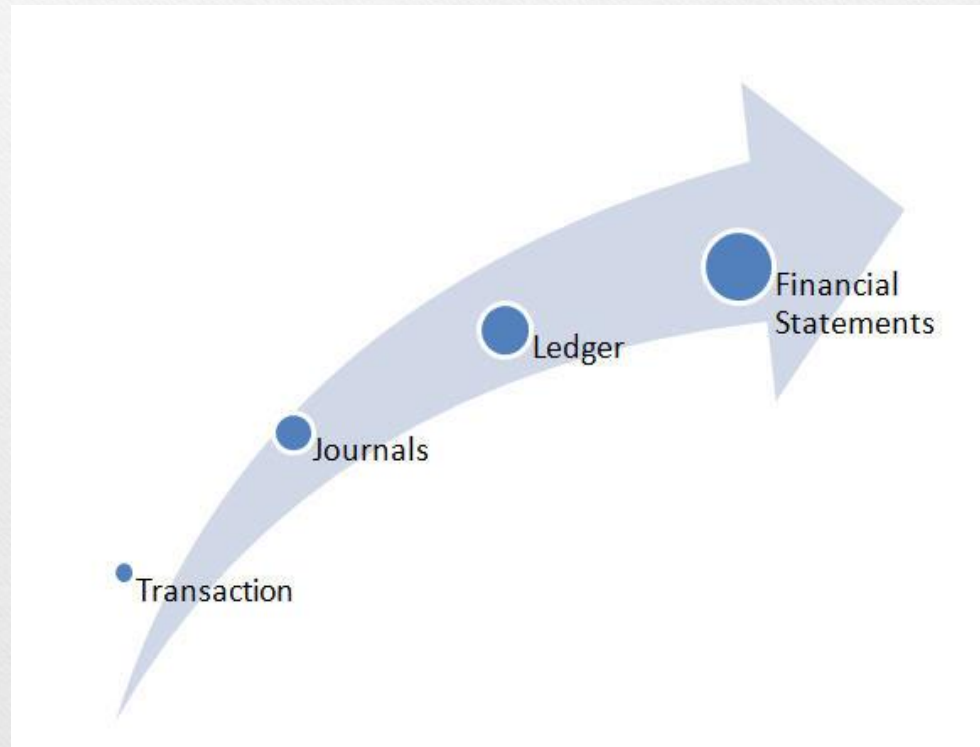
Balance Sheet formula

What you Have --   What you Owe   =   Net Worth

- Assets – Liabilities = Equity
  DR   -   CR   =   CR
  Debit   Credit   Credit

Balance sheet shows financial position at a particular point in time

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Income Statement

- Revenue – Expenses = Net Income
  CR   -   DR   =   CR

  In order for each equation to remain in balance, a "**double entry**" for each transaction is required.

  Debits always equal Credits.

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Type of General Ledger Accounts

ACCOUNT	Where Used	Examples
⭐ Asset	Balance Sheet	Cash, checking acct.
⭐ Expense	Income Statement	Salary Exp, ER Tax Exp, ER 401(k) Match
⭐ Liability	Balance Sheet	Salary Payable, Taxes Payable, Benefits Payable
• Revenue	Income Statement	Sales
• Net Worth(Equity)	Balance Sheet	Stock

⭐ accounts normally used in payroll

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Payroll Expenses

- Wages / Salaries paid to employees

- Employer Payroll Taxes

- Employer-paid Benefit Costs

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Payroll Liability Accounts

- Wages payable

- Employment taxes withheld but not yet paid

- Contributions owed to a company benefit plan

- Union dues deducted from pay but not yet paid

Normal Account Balances

Account Type	Normal Balance	Debit (What it does to the account)	Credit (What it does to the account)
Asset	Debit	Increase	Decrease
Liabilities	Credit	Decrease	Increase
Equity/Capital/Net Worth	Credit	Decrease	Increase
Income/Revenue	Credit	Decrease	Increase
Expenses	Debit	Increase	Decrease

Account Balances

- **Any <u>A</u>sset or <u>E</u>xpense Account**

Debit	Credit
increases	decreases

- Debit or Credit?
  - Vowels = <u>A</u>ssets/<u>E</u>xpense
    - Generally have a debit Balance

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Account Balances (cont'd)

- **Any <u>L</u>iability or <u>R</u>evenue Account**

Debit	Credit
decreases	increases

- Debit or Credit?

  Consonant = <u>L</u>iabilities/<u>C</u>apital(Equity) /<u>R</u>evenue

  - Generally have a credit balance

Accounting Tidbits

- Cash

  - Debits – Increase / Deposits

  - Credits – Decrease / Checks

- Traditional Balance

  - Expense – Debits

  - Liabilities – Credits

- Making a payment

  - Debit liability or Debit Expense

  - Credit Cash

Chart of Accounts

- A complete listing of account titles and account numbers in the ledger
- Example of a chart of accounts

Account Type	Account Number (Range)
Assets	100000 - 199999
Liabilities	200000 - 299999
Equity	300000 - 399999
Revenue	400000 - 499999
Expenses	500000 - 599999

Journal Entries

- A record of the transactions of a company during the accounting period

- Compound entries – more than one debit or credit

- Subsidiary Ledgers – Payroll Register - summarized and posted to the General Ledger

- General Ledger – book of Final Entry

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Recording Payroll Transactions

Payroll Expenses

- Salaries are Expenses
- Can be recorded functionally(by dept) and/or by type of pay (Reg vs OT)
- Increase the Expense and Increase a Liability (Salary Payable)
- Expense is recorded on the Pay Period End Date NOT Pay Date

Pay Period Sun – Sat	Pay Date	Date of Expense	Record Expense in Month:
06/03/16 – 06/16/16	06/22/16	06/16/16	JUNE
06/17/16 – 06/30/16	**07/06/16**	06/30/16	JUNE

Account Description /Type	Debit	Credit
Salary Expense	$6000	
Salary Payable Liability		$6000

Recording Payroll Transactions

Payroll Deductions

- Deductions are <u>L</u>iabilities -must be paid to 3rd party (IRS, state agency)
- Decreases the Salary Payable <u>L</u>iability and Increases the Tax/Other Payable <u>L</u>iability
- The <u>L</u>iability is incurred on the Pay Date

Pay Period Sun – Sat	Pay Date	Date of Liability	Record Liability in Month:
06/03/16 – 06/16/16	06/22/16	06/22/16	JUNE
06/17/16 – 06/30/16	**07/06/16**	07/06/16	JULY

Account Description/Type	Debit	Credit
Salary/Wage Payable <u>L</u>iability	$2,039	
Federal income tax withheld <u>L</u>iability		$1,200
State income tax withheld <u>L</u>iability		$ 300
Social Security/Medicare withheld <u>L</u>iability		$ 339
Health insurance premiums <u>L</u>iability		$ 200

Recording Payroll Transactions

Payroll Cash Distribution / Net Pay

- Payroll cash distribution journal:
debit - accrued salaries/wages Liability
credit – payroll checking (cash) (Asset) account

- Recorded in the accounting period in which the employees are paid. Cash is paid out and the Liability is discharged (zeroed out).

Account Description/Type	Debit	Credit
Salary/Wage Payable Liability	$3,961	
Payroll Checking Account Asset		$3,961

Recording Payroll Transactions

Employer Tax <u>L</u>iabilities and <u>E</u>xpenses

- Employer taxes (FICA, SUI) are <u>E</u>xpenses

- Increase the <u>E</u>xpense and Increase the <u>L</u>iability (Taxes Payable)

- Entries made to the employer tax <u>L</u>iabilities journal are recorded in the accounting period in which the employees are paid, since that is when the <u>L</u>iability is incurred.

<u>Account Description/Type</u>	<u>Debit</u>	<u>Credit</u>
Employer Tax <u>E</u>xpense (FICA, SUI, etc.)	$819	
Social Security/Medicare <u>L</u>iability	$459	
Federal Unemployment <u>L</u>iability	$ 36	
State Unemployment <u>L</u>iability		$324

Accounting Periods

- An accounting period is any length of time covered by an income statement, which could be a month, a quarter, a year.

- Payroll taxes are always reported on a calendar year basis.

- Accounting Period 1 year in length is known as the accounting year

- Any 12-month accounting period adopted by a business is referred to as a Fiscal Year. It may or may not coincide with the calendar year.

- Payroll Dept may have 2 year end reconciliation process, one at fiscal year-end and one at calendar year-end.
            Lucky us!!!

Accruals and Reversals

- Companies generally use Accrual method of accounting – revenue is recognized when earned and expenses are recognized when incurred. (Matching Principle)

- Only accrual accounting is acceptable under GAAP

Q: What do you do when:

Pay Period Sun - Sat	Pay Date	Date of Expense	Record Expense in Month:
06/24/16 – 07/07/16	07/13/16	07/07/16	One week June One week July

A: Accrue (estimate) a journal entry of 1 week of Expenses to June. Reverse the accrual / estimate in July (Accruals must be reversed when actual Expense or Liability is recorded.).

Accruals and Reversal Journal Entries

Use different accounts, but the same Account Type.

Account Description/Type	Debit	Credit
Accrued Salary/Wage Expense	$30,000	
Accrued Salary/Wage Payable Liability		$30,000

Account Description/Type	Debit	Credit
Accrued Employer Tax Expense	$4,095	
Accrued Social Security/Medicare Liability		$2,295
Accrued Federal Unemployment Liability		$ 180
Accrued State Unemployment Liability		$ 435

Accruals and <u>Reversal</u> Journal Entries

Reverse the entry the following month.

Account Description/Type	Debit	Credit
Accrued Salary/Wage <u>E</u>xpense		$30,000
Accrued Salary Payable <u>L</u>iability	$30,000	

Account Description/Type	Debit	Credit
Accrued Employer Tax <u>E</u>xpense		$4,095
Accrued Social Security/Medicare <u>L</u>iability	$2,295	
Accrued Federal Unemployment <u>L</u>iability	$ 180	
Accrued State Unemployment <u>L</u>iability	$ 435	

Reconciliations & Financials

- Balancing and Reconciling Payroll Accounts
  - Periodic Balancing and Reconciliation
  - Payroll Bank Account Reconciliation
- Financial Statements and Audits
  - Balance Sheet
  - Income Statement
  - Notes to Financial Statements
  - Auditing Financial Statements

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Internal Controls (think SOX)

- Segregation of job duties

- Rotation of job duties

- Payroll distribution

- Phantom employees

- Negative pay deduction

- Payroll bank account

- Blank checks

- Time reporting

- Computer system edits

- Using an internal auditor

Payroll's role in SOX Compliance

- Develop process and workflow maps that show each function

- Create written documentation for each step in the payroll process and update documentation where it already exists

- Audit recordkeeping and retention procedures to make sure that records are organized and can be easily retrieved

- Identify and communicate to management gaps and risks that can lead to a lack of control and security

- Prepare an action plan and a way to measure progress to address the gaps and risks through adequate internal controls

- Document the design, evaluation, and testing of the internal controls

Controlling Check Fraud

- Group 1 security features are manufactured into the check paper. They are difficult and expensive to reproduce.

- Group 2 security features are printed onto the paper either when the paper is converted from raw material to check stock or when the check MICR or OCR lines, payee, and amount information is completed.

Check Clearing for 21ˢᵗ Century Act "Check 21"

- October 28, 2004 law was designed to promote innovation in the U.S. payments system while updating and eliminating some of the legal barriers governing how banks process paper checks.

- Substitute checks – paper reproduction of an original check – front and back image

Accounting Tidbits

- All Little Cats Reach Exhaustion

  - **Assets**
  - **Liabilities**
  - **Capital**
  - **Revenue**
  - **Expense**

Accounting Tidbits

Certainly   Everyone   Loves   Rice   Crispies

C	E	L	R	C
R	Q	I	E	A
E	U	A	V	P
D	I	B	E	I
I	T	I	N	T
T	Y	L	U	A
		I	E	L
		T		
		Y		

Accounting Tidbits

Do   **I**   **Eat**   **Apples**   **?**

D	I	E	A
E	N	X	S
B	C	P	S
I	O	E	E
T	M	N	T
	E	S	S
		E	
		S	

Questions?

Good Luck with the CPP Exam! Be an Asset!

Thank you!

For further info, please feel free to contact us!

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