

# PAYROLL

## THE NAVIGATOR ✓

- Understand *Concepts for Review* ☐
- Read *Feature Story* ☐
- Scan *Study Objectives* ☐
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- Read text and answer *Before You Go On*  
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- Work *Demonstration Problem* ☐
- Review *Summary of Study Objectives* ☐
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## C ONCEPTS FOR REVIEW

**Before studying this chapter, you should know or, if necessary, review:**

- a. The assumptions and principles of accounting. (Ch. 2, pp. 40–45)
- b. The difference between the accrual basis and the cash basis of accounting (Ch. 4, pp. 113–114)
- c. The accounting and financial management departments in hospitality organizations (Ch. 2, pp. 57–63)

## FEATURE STORY

### Payroll: The Important Cost in the Service Industry

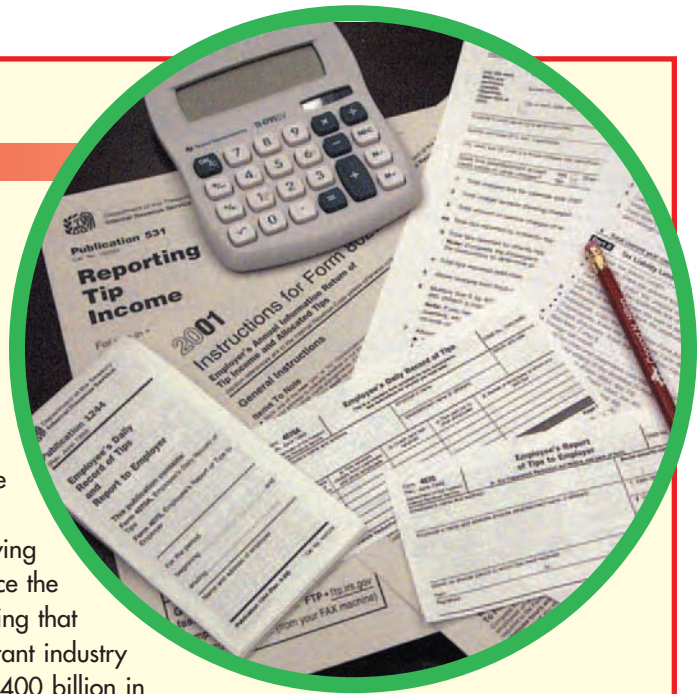
Payroll and related fringe benefits often make up a large percentage of the cost in any hospitality business. Why? The answer is quite simple: The hospitality industry is all about service. Yes, the products are always important. However, a good meal can be ruined by a bad waiter, and a rude front-desk agent can make your \$400-a-night room at a spa resort a nightmarish rather than a relaxing experience.

Service is the key to the hospitality industry. Service and product go hand in hand. Employee compensation is often the most significant expense a company incurs.

**Darden Restaurants, Inc.**, reported an approximate number of 133,220 full-time associates, and its fiscal year ending May 27, 2001, indicated restaurant labor cost of more than \$1.26 billion. This is

31.4 percent of sales. In other words, for every dollar of sales Darden brings in through its restaurants, more than 31 cents goes toward paying its labor to service the guests. Considering that the entire restaurant industry has more than \$400 billion in sales, more than 850,000 locations, and employs more than 11.6 million people, labor cost is an important line item on any income statement.

It is also important to understand that labor cost is not limited to salary and wages. Labor cost includes benefits such as vacation, holiday pay, health insurance, dental insurance, life insurance, disability insurance, and so on. Therefore, you can see why proper accounting and control of payroll are stressed in this chapter.



Companies are also required by law to maintain payroll records for each employee, file and pay payroll taxes, and comply with numerous state and federal tax laws related to employee compensation. Accounting for payroll has become much more complex due to these regulations.

Source: National Restaurant Association 2002 Restaurant Industry Pocket Fact Book.



## STUDY OBJECTIVES

After studying this chapter, you should be able to

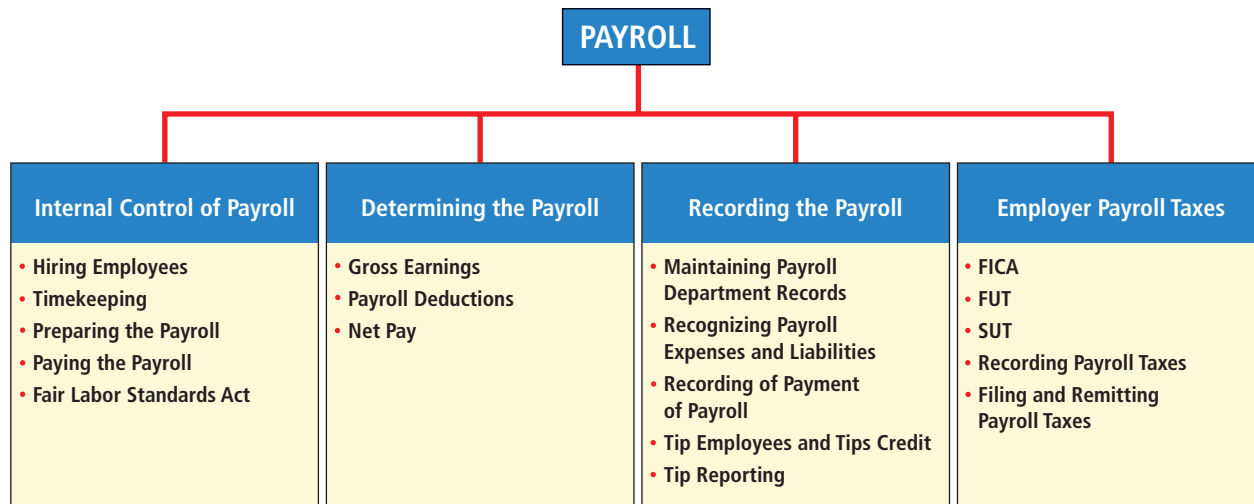
1. Discuss the objectives of internal control for payroll.
2. Compute and record the payroll for a pay period.
3. Compute and record tips under the 8 percent tip regulation.
4. Describe and record employer payroll taxes.



## PREVIEW OF CHAPTER 9

What you see from the feature story is the magnitude of the cost of labor in the restaurant business. Imagine adding the lodging business, the casino business, the club business, the tourism business, and other hospitality enterprises, and you get the picture. In this chapter, we will discuss the reasons for payroll and its internal control mechanisms, determination of payroll with all the rules and regulations, recording and payment of payroll of regular and tipped employees, and the recording and filing of payroll taxes.

The content and organization of Chapter 9 are as follows:



THE NAVIGATOR

## PAYROLL DEFINED

The term *payroll* pertains to both salaries and wages. Managerial, administrative, and sales personnel are generally paid **salaries**. Salaries are often expressed in terms of a specified amount per month or per year rather than an hourly rate. For example, the faculty and administrative personnel at the college or university you are attending are paid salaries. In contrast, wait staff, line cooks, room attendants, and bell staff are normally paid **wages**. Wages are based on a rate per hour or on a piecework basis (such as per room cleaned). Frequently, the terms *salaries* and *wages* are used interchangeably.

Payroll does not apply to payments made for services of professionals such as certified public accountants, attorneys, and architects. Such professionals are independent contractors rather than salaried employees. Payments to them are called **fees**, rather than salaries or wages. This distinction is important because government regulations relating to the payment and reporting of payroll taxes apply only to employees.

### STUDY OBJECTIVE 1

Discuss the objectives of internal control for payroll.

## INTERNAL CONTROL OF PAYROLL

Internal control will be discussed in depth in Chapter 10. As applied to payrolls, the objectives of internal control are (1) to safeguard company assets against unau-

thorized payments of payrolls, and (2) to ensure the accuracy and reliability of the accounting records pertaining to payrolls.

Irregularities often result if internal control is lax. Overstating hours, using unauthorized pay rates, adding fictitious employees to the payroll, continuing terminated employees on the payroll, and distributing duplicate payroll checks are all methods of stealing from a company. Moreover, inaccurate records will result in incorrect paychecks, financial statements, and payroll tax returns.

## TECHNOLOGY IN ACTION



No, it is not Halloween, but don't get spooked by a ghost employee! In the old days, when businesses were small and payroll was given in cash or paychecks were given to employees in person, this was not a problem. With technology and direct deposits, ghost employees seem to surface. Who are ghost employees? These are people who do not exist in your casino, cruise ships, theme parks, and hotels. They are fictitious employees that are created or are terminated or deceased employees not removed from payroll records by the perpetrator. This dishonest person continues to collect and cash paychecks for people who do not exist. What can be done? Detecting fraud takes a team. Always check bank account numbers, Social Security or identification numbers, addresses, deductions, work location and department, and the like. It may not be a bad idea to also look at sick leave and vacation. Even ghosts need a break. If someone on your payroll is not taking the normal level of sick leave and vacations, you either have a very dedicated employee or a dead one. Either way, it is good for you to find out so you can reward the former or delete the latter.



Payroll activities involve four functions: hiring employees, timekeeping, preparing the payroll, and paying the payroll. For effective internal control, these four functions should be assigned to different departments or individuals. To illustrate these functions, we will examine the case of Academy Waterparks and one of its employees, Mark Jordan.

## HIRING EMPLOYEES

The human resources (personnel) department is responsible for posting job openings, screening and interviewing applicants, and hiring employees. From a control standpoint, this department provides significant documentation and authorization. When an employee is hired, the human resources department prepares an authorization form. The one used by Academy Waterparks for Mark Jordan is shown in Illustration 9-1.

The authorization form is sent to the payroll department, where it is used to place the new employee on the payroll. A chief concern of the human resources department is ensuring the accuracy of this form. The reason is quite simple: one of the most common types of payroll frauds is adding fictitious employees to the payroll.

The human resources department is also responsible for authorizing changes in employment status. Specifically, they must authorize (1) changes in pay rates and (2) terminations of employment. Every authorization should be in writing, and a copy of the change in status should be sent to the payroll department. Notice in Illustration 9-1 on page 276 that Jordan received a pay increase of \$2 per hour.



## TIMEKEEPING

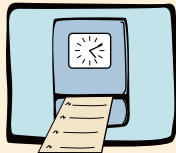
Another area in which internal control is important is timekeeping. Hourly employees are usually required to record time worked by punching a time clock. Times of arrival and departure are automatically recorded by the employee by in-

**Illustration 9-1**

Authorization form prepared by the human resources department

ACADEMY WATERPARKS			
Employee Name <u>Jordan,</u> <u>Mark</u>		Starting Date <u>9/01/01</u>	
LAST FIRST MI			
Classification <u>Skilled-Level 10</u>		Social Security No. <u>329-36-9547</u>	
Department <u>Guest Relations</u>		Division <u>Entertainment</u>	
<b>NEW HIRE</b>	Classification <u>Guest Service Agent</u> Salary Grade <u>Level 10</u> Trans. from Temp. <input type="checkbox"/>		
	Rate \$ <u>10.00</u> per hour Bonus <u>N/A</u> Non-exempt <input checked="" type="checkbox"/> Exempt <input type="checkbox"/>		
<b>RATE CHANGE</b>	New Rate \$ <u>12.00</u> Effective Date <u>9/1/03</u>		
	Present Rate \$ <u>10.00</u>		
	Merit <input checked="" type="checkbox"/> Promotion <input type="checkbox"/> Decrease <input type="checkbox"/> Other _____		
	Previous Increase Date <u>None</u> Amount \$ _____ per _____ Type _____		
<b>SEPARATION</b>	Resignation <input type="checkbox"/> Discharge <input type="checkbox"/> Retirement <input type="checkbox"/> Reason _____		
	Leave of absence <input type="checkbox"/> From _____ to _____ Type _____		
	Last Day Worked _____		
<b>APPROVALS</b>	<u>BEW</u> <u>9/1/03</u>		<u>EMW</u> <u>9-1-03</u>
	BRANCH OR DEPT. MANAGER DATE		DIVISION V.P. DATE
		<u>James E. Speer</u> PERSONNEL DEPARTMENT	

**Timekeeping**



Supervisors monitor hours worked through time cards and time reports.

serting a time card into the clock. Mark Jordan's time card is shown in Illustration 9-2 on page 277.

In large companies, time clock procedures are often monitored by a supervisor or security guard to make sure an employee punches only one card. At the end of the pay period, each employee's supervisor approves the hours shown by signing the time card. When overtime hours are involved, approval by a supervisor is usually mandatory. This guards against unauthorized overtime. The approved time cards are then sent to the payroll department. For salaried employees, a manually prepared weekly or monthly time report kept by a supervisor may be used to record time worked.

**Preparing the Payroll**



Two (or more) employees verify payroll amounts; supervisor approves.

**PREPARING THE PAYROLL**

The payroll is prepared in the payroll department on the basis of two inputs: (1) human resources department authorizations and (2) approved time cards. Numerous calculations are involved in determining gross wages and payroll deductions. Therefore, a second payroll department employee, working independently, verifies all calculated amounts, and a payroll department supervisor then approves the payroll. The payroll department is also responsible for preparing (but not signing) payroll checks, maintaining payroll records, and preparing payroll tax returns.

**Paying the Payroll**



Treasurer signs and distributes checks.

**PAYING THE PAYROLL**

The payroll is paid by the treasurer's department. **Payment by check minimizes the risk of loss from theft, and the endorsed check provides proof of payment.** For good internal control, payroll checks should be prenumbered, and all checks should be accounted for. All checks must be signed by the treasurer (or a des-

Illustration 9-2

Time card

PAY PERIOD ENDING	
No. 17	1/14/04
NAME Mark Jordan	
EXTRA TIME	REGULAR TIME
	A.M. IN OUT 8:58
	NOON IN OUT 12:00
	P.M. IN OUT 1:00
	P.M. IN OUT 5:01
	A.M. IN OUT 9:00
	NOON IN OUT 11:59
	NOON IN OUT 12:59
	P.M. IN OUT 5:00
	A.M. IN OUT 8:59
	NOON IN OUT 12:01
	P.M. IN OUT 1:01
	P.M. IN OUT 5:00
5:00	A.M. IN OUT 9:00
9:00	NOON IN OUT 12:00
	NOON IN OUT 1:00
	P.M. IN OUT 5:00
	A.M. IN OUT 8:57
	NOON IN OUT 11:58
	NOON IN OUT 1:00
	P.M. IN OUT 5:01
	A.M. IN OUT 8:00
	NOON IN OUT 1:00
	P.M. IN OUT
	A.M. IN OUT
	NOON IN OUT
	P.M. IN OUT
TOTAL 4	TOTAL 40

ignated agent). Distribution of the payroll checks to employees should be controlled by the treasurer's department. Checks may be distributed by the treasurer or paymaster.

Occasionally the payroll is paid in currency. In such cases it is customary to have a second person count the cash in each pay envelope. The paymaster should obtain a signed receipt from the employee upon payment. If alleged discrepancies arise, adequate safeguards have been established to protect each party involved.

## FAIR LABOR STANDARDS ACT

The **Fair Labor Standards Act** was instituted in 1938 and was amended with additional provisions in 1977. It is commonly known as *the Act* or **FLSA**, and it provides minimum standards for both wages and overtime entitlement. It also spells out administrative procedures by which covered work time must be compensated. Included in the Act are other provisions such as equal pay and child labor. Although you might think that an act or any law applies to everyone, the FLSA exempts specified employees or groups of employees from certain of its provisions. According to the Act, employees can be covered by the law under the *enterprise coverage* or *individual coverage*. Therefore, in the hospitality industry, if an enterprise has two or fewer employees and less than \$500,000 a year in business, those two employees will not be covered. As you can see, the Act does apply to most hospitality businesses.

The FLSA Act began applying to employees of the U.S. federal government in 1974. The U.S. Office of Personnel Management works with federal agencies to apply the Act to employees of the U.S. federal government.

As mentioned, one item the FLSA regulates is overtime. For the hospitality industry, this means all employees covered by the Act will get one and a half

times their regular pay for all hours worked over 40 hours per week. The FLSA, however, does not require extra pay for Saturdays and Sundays, and makes no special provisions for vacation pay, sick pay, holiday pay, or severances. Of course certain union contracts or states have established more advantageous overtime provisions than those stipulated by the FLSA, and these are the ones that will be in effect. This also holds true for conflicting state and federal regulations. In addition, the FLSA has certain rules such as requiring employers to maintain records of worked time of hourly employees. The form of recordkeeping used is up to the employer. In today's technologically advanced world, some businesses have replaced signing in and out on time cards with a fingerprint as a record of clocking in and out.

# DETERMINING THE PAYROLL

## STUDY OBJECTIVE 2

Compute and record the payroll for a pay period.

Determining the payroll involves computing three amounts: (1) gross earnings, (2) payroll deductions, and (3) net pay.

## GROSS EARNINGS

**Gross earnings** is the total compensation earned by an employee. It consists of wages or salaries, plus any bonuses and commissions.

Total *wages* for an employee are determined by multiplying the hours worked by the hourly rate of pay. In addition to the hourly pay rate, most companies are required by law to pay hourly workers a minimum of one and a half times the regular hourly rate for overtime work in excess of 8 hours per day or 40 hours per week. In addition, many employers pay overtime rates for work done at night, on weekends, and on holidays.

Mark Jordan's time card shows that he worked 44 hours for the weekly pay period ending January 14. The computation of his gross earnings (total wages) is shown in Illustration 9-3.

### HELPFUL HINT

The law that governs pay rates is the Federal Fair Labor Standards Act. It applies to all companies involved in interstate commerce.

### Illustration 9-3

Computation of total wages

Type of Pay	Hours	×	Rate	=	Gross Earnings
Regular	40	×	\$12.00	=	\$480.00
Overtime	4	×	18.00	=	72.00
<b>Total wages</b>					<b>\$552.00</b>

This computation assumes that Jordan receives one and a half times his regular hourly rate ( $\$12.00 \times 1.5$ ) for his overtime hours. Union contracts often require that overtime rates be as much as twice the regular rates.

The *salary* for an employee is generally based on a monthly or yearly rate. These rates are then prorated to the payroll periods used by the company. Most executive and administrative positions are salaried. Federal law does not require overtime pay for employees in such positions.

Many companies have **bonus** agreements for management personnel and other employees. Bonus arrangements may be based on such factors as increased sales or net income. Bonuses may be paid in cash and/or by granting executives and employees the opportunity to acquire shares of company stock at favorable prices (called *stock option plans*).

### ETHICS NOTE

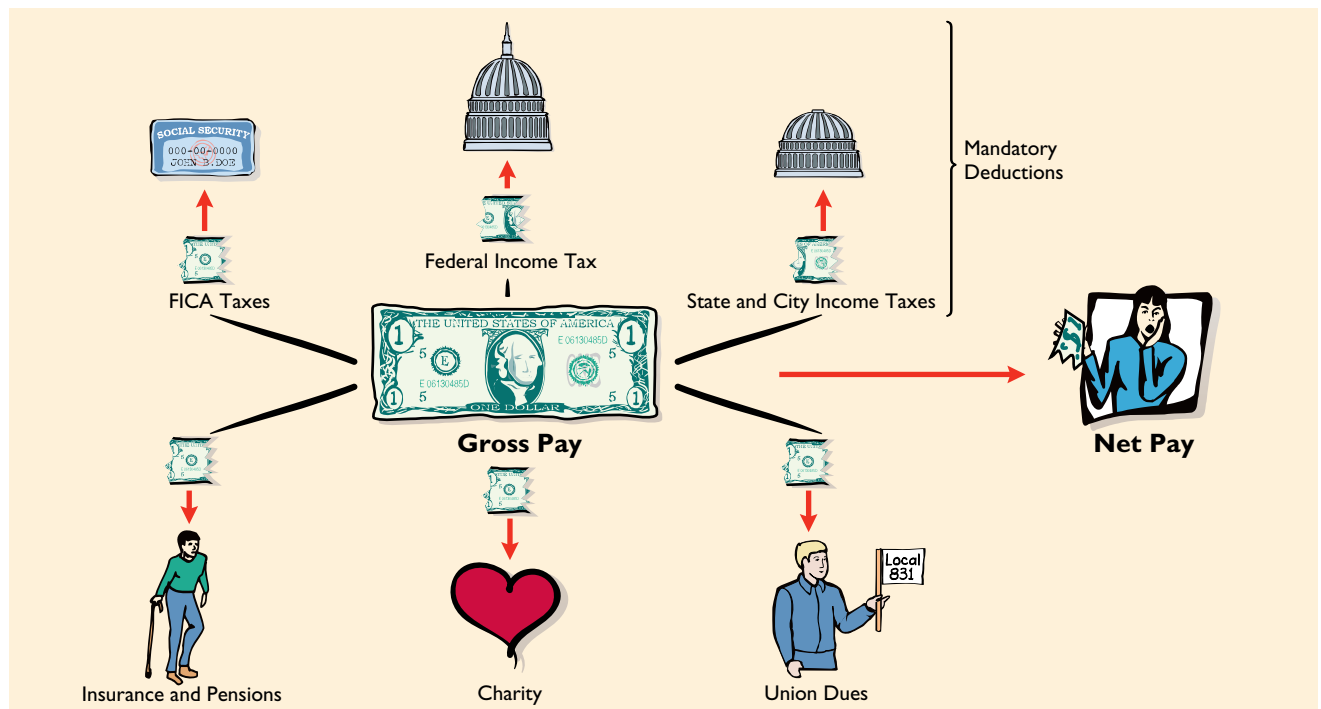
Bonuses often reward outstanding individual performance; but successful corporations also need considerable teamwork. A challenge is to motivate individuals while preventing an unethical employee from taking another's idea for his or her own advantage.

## PAYROLL DEDUCTIONS

As anyone who has received a paycheck knows, gross earnings are usually very different from the amount actually received. The difference is due to **payroll deductions**. Such deductions do not result in payroll tax expense to the employer. The employer is merely a collection agent, and it subsequently transfers the amounts deducted to the government and designated recipients. Payroll deductions may be mandatory or voluntary. Mandatory deductions are required by law and consist of FICA taxes and income taxes. Voluntary deductions are at the option of the employee. Illustration 9-4 summarizes the types of payroll deductions.

**Illustration 9-4**

Payroll deductions



### FICA Taxes

In 1937 Congress enacted the Federal Insurance Contribution Act (FICA). **FICA taxes are designed to provide workers with supplemental retirement, employment disability, and medical benefits.** In 1965, benefits were expanded to include Medicare for individuals over 65 years of age. The benefits are financed by a tax levied on employees' earnings. FICA taxes are commonly referred to as *Social Security taxes*.

The tax rate and the tax base for FICA taxes are set by Congress. When FICA taxes were first imposed, the rate was 1 percent on the first \$3,000 of gross earnings, or a maximum of \$30 per year. The rate and base have changed dramatically since that time! In 2002, the rate was 7.65 percent (6.2% Social Security plus 1.45% Medicare) on the first \$84,900 of gross earnings for each employee.<sup>1</sup> For purpose

<sup>1</sup>The Medicare provision also includes a tax of 1.45 percent on gross earnings in excess of \$84,900. In the interest of simplification, we ignore this 1.45 percent charge in our end-of-chapter assignment material. We assume zero FICA withholdings on gross earnings above \$65,000.

of illustration in this chapter, we will assume a rate of 8 percent on the first \$65,000 of gross earnings, or a maximum of \$5,200. Using the 8 percent rate, the FICA withholding for Jordan for the weekly pay period ending January 14 is \$44.16 (wages of \$552  $\times$  8%).

**Income Taxes**

Under the U.S. pay-as-you-go system of federal income taxes, employers are required to withhold income taxes from employees each pay period. The amount to be withheld is determined by three variables: (1) the employee's gross earnings; (2) the number of allowances claimed by the employee; and (3) the length of the pay period. The number of allowances claimed typically includes the employee, his or her spouse, and other dependents. To indicate to the Internal Revenue Service the number of allowances claimed, the employee must complete an **Employee's Withholding Allowance Certificate (Form W-4)**. As shown in Illustration 9-5, Mark Jordan claims two allowances on his W-4.

**Illustration 9-5**

W-4 form

Form **W-4** **Employee's Withholding Allowance Certificate** OMB No. 1545-0010  
Department of the Treasury Internal Revenue Service **2003**  
For Privacy Act and Paperwork Reduction Act Notice, see page 2.

1 Type or print your first name and middle initial **Mark** Last name **Jordan** 2 Your social security number **329-36-9547**

Home address (number and street or rural route) **2345 Mifflin Ave.** 3 ☐ Single ☒ Married ☐ Married, but withhold at higher Single rate.  
City or town, State, and ZIP code **Hampton, MI 48292** 4 If your last name differs from that on your social security card, check here and call 1-800-772-1213 for a new card ☐

5 Total number of allowances you are claiming (from line H above or from the worksheet on page 2 if they apply) **2** 6 \$ **2.00**

7 I claim exemption from withholding for 2001, and I certify that I meet BOTH of the following conditions for exemption:  
• Last year I had a right to a refund of ALL Federal income tax withheld because I had NO tax liability AND  
• This year I expect a refund of ALL Federal income tax withheld because I expect to have NO tax liability.  
If you meet both conditions, enter "Exempt" here **7**

Under penalties of perjury, I certify that I am entitled to the number of withholding allowances claimed on this certificate or entitled to claim exempt status.

Employee's signature **Mark Jordan** Date **September 1, 2003**

8 Employer's name and address (Employer: Complete 8 and 10 only if sending to the IRS) 9 Office code (optional) 10 Employer identification number

Cat. No. 102200

Withholding tables furnished by the Internal Revenue Service indicate the amount of income tax to be withheld. Withholding amounts are based on gross wages and the number of allowances claimed. Separate tables are provided for weekly, biweekly, semimonthly, and monthly pay periods. The withholding tax table for Mark Jordan (assuming he earns \$552 per week) is shown in Illustration 9-6. For a weekly salary of \$552 with two allowances, the income tax to be withheld is \$49.

Most states (and some cities) also require *employers* to withhold income taxes from employees' earnings. As a rule, the amounts withheld are a percentage (specified in the state revenue code) of the amount withheld for the federal income tax. Or they may be a specified percentage of the employee's earnings. For the sake of simplicity, we have assumed that Jordan's wages are subject to state income taxes of 2 percent, or \$11.04 (2%  $\times$  \$552) per week.

There is no limit on the amount of gross earnings subject to income tax withholdings. In fact, the higher the earnings, the higher the amount of taxes withheld.

**Other Deductions**

Employees may voluntarily authorize withholdings for charitable, retirement, and other purposes. All voluntary deductions from gross earnings should be author-

**Illustration 9-6**

Withholding tax table

**MARRIED Persons — WEEKLY Payroll Period**

(For Wages Paid in 2004)

If the wages are –		And the number of withholding allowances claimed is –										
At least	But less than	0	1	2	3	4	5	6	7	8	9	10
The amount of income tax to be withheld is –												
490	500	56	48	40	32	24	17	9	1	0	0	0
500	510	57	49	42	34	26	18	10	3	0	0	0
510	520	59	51	43	35	27	20	12	4	0	0	0
520	530	60	52	45	37	29	21	13	6	0	0	0
530	540	62	54	46	38	30	23	15	7	0	0	0
540	550	63	55	48	40	32	24	16	9	1	0	0
550	560	65	57	49	41	33	26	18	10	2	0	0
560	570	66	58	51	43	35	27	19	12	4	0	0
570	580	68	60	52	44	36	29	21	13	5	0	0
580	590	69	61	54	46	38	30	22	15	7	0	0
590	600	71	63	55	47	39	32	24	16	8	1	0
600	610	72	64	57	49	41	33	25	18	10	2	0
610	620	74	66	58	50	42	35	27	19	11	4	0
620	630	75	67	60	52	44	36	28	21	13	5	0
630	640	77	69	61	53	45	38	30	22	14	7	0
640	650	78	70	63	55	47	39	31	24	16	8	0
650	660	80	72	64	56	48	41	33	25	17	10	2
660	670	81	73	66	58	50	42	34	27	19	11	3
670	680	83	75	67	59	51	44	36	28	20	13	5
680	690	84	76	69	61	53	45	37	30	22	14	6

ized in writing by the employee. The authorization(s) may be made individually or as part of a group plan. Deductions for charitable organizations, such as the United Fund, or for financial arrangements, such as U.S. savings bonds and repayment of loans from company credit unions, are made individually. Deductions for union dues, health and life insurance, and pension plans are often made on a group basis. We will assume that Jordan has weekly voluntary deductions of \$10 for the United Fund and \$5 for union dues.

**NET PAY**

**Net pay** is determined by subtracting payroll deductions from gross earnings. For Mark Jordan, net pay for the pay period is \$432.80, computed in Illustration 9-7.

**ALTERNATIVE TERMINOLOGY**

Net pay is also called *take-home pay*.

Gross earnings		\$552.00
Payroll deductions:		
FICA taxes	\$44.16	
Federal income taxes	49.00	
State income taxes	11.04	
United Fund	10.00	
Union dues	5.00	119.20
<b>Net pay</b>		<b>\$432.80</b>

**Illustration 9-7**

Computation of net pay

Assuming that Mark Jordan's wages for each week during the year are \$552, total wages for the year are \$28,704 ( $52 \times \$552$ ). Thus, all of Jordan's wages are subject to FICA tax during the year. Let's assume that Jordan's department head earns \$1,350 per week, or \$70,200 for the year. Since only the first \$65,000 is subject to

FICA taxes, the maximum FICA withholdings on the department head's earnings would be \$5,200 ( $\$65,000 \times 8\%$ ).

# RECORDING THE PAYROLL

Recording the payroll involves maintaining payroll department records, recognizing payroll expenses and liabilities, and recording payment of the payroll.

## MAINTAINING PAYROLL DEPARTMENT RECORDS

To comply with state and federal laws, an employer must keep a cumulative record of each employee's gross earnings, deductions, and net pay during the year. The record that provides this information is the **employee earnings record**. Mark Jordan's employee earnings record is shown in Illustration 9-8.

**Illustration 9-8**  
Employee earnings record

ACADEMY WATERPARKS Employee Earnings Record For the Year 2004													
Name		Mark Jordan				Address		2345 Mifflin Ave.					
Social Security Number		329-36-9547						Hampton, Michigan 48292					
Date of Birth		December 24, 1962				Telephone		555-238-9051					
Date Employed		September 1, 2001				Date Employment Ended							
Sex		Male				Exemptions		2					
Single _____		Married <input checked="" type="checkbox"/>											
2004 Period Ending	Total Hours	Gross Earnings				Deductions						Payment	
		Regular	Overtime	Total	Cumulative	FICA	Fed. Inc. Tax	State Inc. Tax	United Fund	Union Dues	Total	Net Amount	Check No.
1/7	42	480.00	36.00	516.00	516.00	41.28	43.00	10.32	10.00	5.00	109.60	406.40	974
1/14	44	480.00	72.00	552.00	1,068.00	44.16	49.00	11.04	10.00	5.00	119.20	432.80	1028
1/21	43	480.00	54.00	534.00	1,602.00	42.72	46.00	10.68	10.00	5.00	114.40	419.60	1077
1/28	42	480.00	36.00	516.00	2,118.00	41.28	43.00	10.32	10.00	5.00	109.60	406.40	1133
Jan. Total		1,920.00	198.00	2,118.00		169.44	181.00	42.36	40.00	20.00	452.80	1,665.20	

A separate earnings record is kept for each employee. It is updated after each pay period. The cumulative payroll data on the earnings record are used by the employer to: (1) determine when an employee has earned the maximum earnings subject to FICA taxes, (2) file state and federal payroll tax returns (as explained later in the chapter), and (3) provide each employee with a statement of gross earnings and tax withholdings for the year. Illustration 9-12 on page 287 shows this statement.

In addition to employee earnings records, many companies find it useful to prepare a **payroll register**. This record accumulates the gross earnings, deductions, and net pay by employee for each pay period. It provides the documentation for preparing a paycheck for each employee. Academy's payroll register is presented in Illustration 9-9. It shows the data for Mark Jordan in the wages section. In this example, Academy Waterparks' total weekly payroll is \$17,210, as shown in the gross earnings column.

## Illustration 9-9

Payroll register

ACADEMY WATERPARKS Payroll Register For the Week Ending January 14, 2004														
Employee	Total Hours	Earnings			Deductions						Paid		Accounts Debited	
		Regular	Over-time	Gross	FICA	Federal Income Tax	State Income Tax	United Fund	Union Dues	Total	Net Pay	Check No.	Office Salaries Expense	Wages Expense
Office Salaries														
Arnold, Patricia	40	580.00		580.00	46.40	61.00	11.60	15.00		134.00	446.00	998	580.00	
Canton, Matthew	40	590.00		590.00	47.20	63.00	11.80	20.00		142.00	448.00	999	590.00	
Mueller, William	40	530.00		530.00	42.40	54.00	10.60	11.00		118.00	412.00	1000	530.00	
Subtotal		5,200.00		5,200.00	416.00	1,090.00	104.00	120.00		1,730.00	3,470.00		5,200.00	
Wages														
Bennett, Robin	42	480.00	36.00	516.00	41.28	43.00	10.32	18.00	5.00	117.60	398.40	1025		516.00
Jordan, Mark	44	480.00	72.00	552.00	44.16	49.00	11.04	10.00	5.00	119.20	432.80	1028		552.00
Milroy, Lee	43	480.00	54.00	534.00	42.72	46.00	10.68	10.00	5.00	114.40	419.60	1029		534.00
Subtotal		11,000.00	1,010.00	12,010.00	960.80	2,400.00	240.20	301.50	115.00	4,017.50	7,992.50			12,010.00
Total		16,200.00	1,010.00	17,210.00	1,376.80	3,490.00	344.20	421.50	115.00	5,747.50	11,462.50		5,200.00	12,010.00

Note that this record is a listing of each employee's payroll data for the pay period. In some companies, a payroll register is a journal or book of original entry. Postings are made from it directly to ledger accounts. In other companies, the payroll register is a memorandum record that provides the data for a general journal entry and subsequent posting to the ledger accounts. At Academy Waterparks, the latter procedure is followed.

## RECOGNIZING PAYROLL EXPENSES AND LIABILITIES

From the payroll register in Illustration 9-9, a journal entry is made to record the payroll. For the week ending January 14 the entry is:

Jan. 14	Office Salaries Expense	5,200.00	
	Wages Expense	12,010.00	
	FICA Taxes Payable		1,376.80
	Federal Income Taxes Payable		3,490.00
	State Income Taxes Payable		344.20
	United Fund Payable		421.50
	Union Dues Payable		115.00
	Salaries and Wages Payable		11,462.50
	(To record payroll for the week ending January 14)		

A	=	L	+	SE
		+1,376.80		-5,200.00
		+3,490.00		-12,010.00
		+344.20		
		+421.50		
		+115.00		
		+11,462.50		

Specific liability accounts are credited for the mandatory and voluntary deductions made during the pay period. In the example, debits to Office Salaries and Wages Expense are used for gross earnings because office workers are on a salary and other employees are paid on an hourly rate. In other companies, there may be debits to other accounts such as Store Salaries or Sales Salaries. The amount credited to Salaries and Wages Payable is the sum of the individual checks the employees will receive.



## TIPPED EMPLOYEES

Although other industries pay straight wages to their employees, the hospitality industry has regular wage employees and tipped employees. It is said that TIPS is the acronym for “To insure prompt service.” As a tipped employee, you earn your wage from two sources: a specified rate from your employer and tips from guests. All income earned by an employee, whether it is a wage from the employer or tips from guests, is taxable. Employers also need to record tip amounts carefully as such amounts affect the amount of tax the business will pay on behalf of the employee.

What is considered a tip? In a restaurant, any amount left by a guest for the wait staff or any service charge on a bill distributed to the waitstaff is defined as a tip. As for wages, as mentioned earlier, the FLSA specifies the amount of minimum wage. The Act also allows an employer to take a \$3.02 tip credit on tipped employees. In other words, if the minimum wage set by the Act is \$5.15 an hour, an employer need only pay a tipped employee \$2.13 an hour as long as the actual tips earned by the employee are not less than the FLSA maximum allowable tip credit. For example, if a tipped employee earns only \$2.00 in tips rather than the allowable credit of \$3.02, the employer has to pay the employee \$3.15 for the hour. Thus, with the tip of \$2.00 and the employer’s wage of \$3.15, the employee will still make the minimum wage of \$5.15 an hour.

As mentioned, the FLSA is strictly federal. Many states have variations of this \$3.02 credit. The Department of Labor Web site does offer a minimum wage and tip credit table that spells out the details of each state ([www.dol.gov](http://www.dol.gov)). Since this information changes according to the state and federal legislatures, please refer to the latest information on the Internet as guidelines.

## TIP REPORTING

Obviously, not all food and beverage operations are the same. You would likely tip in a full-service restaurant but would not leave a tip if you are picking up fast food at a drive-through window. To address these differences, the 1982 **Tax Equity and Fiscal Responsibility Act (TEFRA)** instituted regulations guiding food and beverage operations on tip reporting requirements. This 8 percent regulation means that if a tipped employee has gross sales of \$100, then it is expected that he or she will at least earn 8 percent of that, or \$8.00, in tips; and thus will have to report at least \$8.00 as part of his or her wages.

This 8 percent rule applies to all foodservices except cafeteria and fast-food operations. It also has other provisions to make sure that certain items not usually tipped by guests do not count as gross sales, including takeout orders, complimentary snacks at the bar area, state and local taxes, and a few others. The complimentary items, however, do apply to casinos, because it is customary that guests in casinos will tip for such service. This rule is established so that the true wage earned by a tipped employee can be calculated and the appropriate taxes are assessed to both the employee and the employer. Although it is customary for guests to tip about 15 percent of the bill, some will pay more, while others will pay less. As the TEFRA rule says, tipped employees need to report only 8 percent of the tips.

In 2002, the U.S. Supreme Court passed a ruling that holds businesses responsible for the shortfall of tip collection. The case resulted when an audit revealed employees at a Californian restaurant did not report at least 8 percent of the tips by customers left on credit cards receipts, let alone the 8 percent collected in the form of cash. If a food and beverage operation reports under the 8 percent regulation, it must file an 8027, the Employer’s Annual Information Return of Tip Income and Allocated Tips. If you are an owner or manager of a food and beverage establishment, consult the IRS. An agent will be pleased to visit your op-

eration, at no cost to you, and educate your employees on the requirements and forms they need to file.

What happens if employees did not report at least 8 percent of the legitimate gross receipts during a particular period? Do you as an employer need to do anything? Absolutely! It is the employer's responsibility to determine the amount of the shortfall that no reported and allocate such amount to the directly tipped employees. The two methods to determine this are the gross receipts method and the hours worked method.

The **gross receipts method** adds all gross receipts of each employee and multiplies the total by 8 percent. This is the amount the employer should report. The difference between this amount and the amount reported by the employee is the shortfall. Each employee's gross receipts are then divided into the total gross re-

### Illustration 9-11

#### The Gross Receipts Method

##### Step 1. Determining the amount of shortfall to be allocated

Employees	Gross Receipts	Tips Reported	
A	\$ 31,500	\$ 2,125	
B	33,450	2,000	
C	30,050	2,260	
D	24,500	1,400	
E	30,500	2,105	
	<u>\$150,000</u>	<u>\$ 9,890</u>	
Indirectly Tipped Employees		<u>\$ 750</u>	
Total actual tips reported		\$10,640	
Total tips according to 8% rule ( $\$150,000 \times 8\%$ )			\$12,000.00
Total actual tips reported			\$ 10,640
Shortfall to be allocated			<u>\$ 1,360.00</u>
Total tips according to 8% rule			\$12,000.00
Tips reported by indirectly tipped employees			<u>\$ 750.00</u>
Tips should have been reported by tipped employees			\$11,250.00

##### Step 2. Determining individual shortfall amounts

Employee	Tips that Should Have Been Reported	Gross Receipts Ratios		Employee's Share of the 8%		Actual Reported		Shortfall portion
A	$\$11,250.00 \times 31,500/150,000$	=		\$ 2,362.50	—	\$2,125	=	\$ 237.50
B	$\$11,250.00 \times 33,450/150,000$	=		\$ 2,508.75	—	\$2,000	=	\$ 508.75
C	$\$11,250.00 \times 30,050/150,000$	=		\$ 2,253.75	—	\$2,260	=	\$ —
D	$\$11,250.00 \times 24,500/150,000$	=		\$ 1,837.50	—	\$1,400	=	\$ 437.50
E	$\$11,250.00 \times 30,500/150,000$	=		\$ 2,287.50	—	\$2,105	=	\$ 182.50
	Total			<u>\$11,250.00</u>		<u>\$9,890</u>		<u>\$1,366.25</u>
								Total shortfall

##### Step 3. Allocation of shortfall

Employee	Shortfall Ratio	Shortfall to be Allocated		Tip Allocation
A	$237.5/1,366.25 \times 1,360$	=		\$ 236.41
B	$508.75/1,366.25 \times 1,360$	=		\$ 506.42
C	$0 \times 1,360$	=		\$ —
D	$437.5/1,366.25 \times 1,360$	=		\$ 435.50
E	$182.5/1,366.25 \times 1,360$	=		\$ 181.67
				<u>\$1,360.00</u>

ceipts to obtain a weighted ratio. The ratio is multiplied by the employee's 8 percent amount to determine the part of the 8 percent amount that should be reported by each employee. This is then compared to the amounts actually reported by each employee. For those employees who report at least their fair share of 8 percent, there is no allocation. For those who report less than their fair share of 8 percent, an allocation will be made to their paycheck and taxes will be assessed accordingly.

The **hours worked method** is essentially the same in terms of mathematic procedures. The difference is the use of total hours worked rather than the gross receipts as the benchmark for calculation. Illustrations 9-11 and 9-12 are examples of the gross receipts method and the hours worked method, respectively.

**Illustration 9-12**

The Hours Worked Method

**Step 1. Determining the amount of shortfall to be allocated**

Employees	Hours Worked	Tips Reported	
A	40	\$ 2,125	
B	45	2,000	
C	40	2,260	
D	30	1,400	
E	30	2,105	
	<u>185</u>	<u>\$ 9,890</u>	
Indirectly Tipped Employees		750	
Total actual tips reported		\$10,640	
Total tips according to 8% rule ( $\$150,000 \times 8\%$ )			\$12,000.00
Total actual tips reported			\$ 10,640
Shortfall to be allocated			<u>\$ 1,360.00</u>
Total tips according to 8% rule			\$12,000.00
Tips reported by indirectly tipped employees			\$ 750.00
Tips should have been reported by tipped employees			<u>\$11,250.00</u>

**Step 2. Determining individual shortfall amounts**

Employee	Tips that Should Have Been Reported	Gross Receipts Ratios		Employee's Share of the 8%		Actual Reported		Shortfall portion
A	$\$11,250.00 \times 40/185$	=		\$ 2,432.43	—	\$2,125	=	\$ 307.43
B	$\$11,250.00 \times 45/185$	=		\$ 2,736.49	—	\$2,000	=	\$ 736.49
C	$\$11,250.00 \times 40/185$	=		\$ 2,432.43	—	\$2,260	=	\$ —
D	$\$11,250.00 \times 30/185$	=		\$ 1,824.32	—	\$1,400	=	\$ 424.32
E	$\$11,250.00 \times 30/185$	=		\$ 1,824.32	—	\$2,105	=	\$ —
	Total			<u>\$11,250.00</u>		<u>\$9,890</u>		<u>\$1,468.24</u>
								Total shortfall

**Step 3. Allocation of shortfall**

Employee	Shortfall Ratio	Shortfall to be Allocated		Tip Allocation
A	$307.42/1,468.24 \times 1,360$	=		\$ 284.77
B	$736.49/1,468.24 \times 1,360$	=		\$ 682.19
C	$0 \times 1,360$	=		\$ —
D	$424.32/1,468.24 \times 1,360$	=		\$ 393.04
E	$0 \times 1,360$	=		\$ —
				<u>\$1,360.00</u>

## BEFORE YOU GO ON...

## ▶ REVIEW IT

1. Identify two internal control procedures that apply to each payroll function.
2. What are the primary sources of gross earnings?
3. What payroll deductions are (a) mandatory and (b) voluntary?
4. What account titles are used in recording a payroll, assuming only mandatory payroll deductions are involved?

## ▶ DO IT

Your cousin Stan is establishing a small catering business and will have a number of employees working for him. He is aware that documentation procedures are an important part of internal control. But he is confused about the difference between an employee earnings record and a payroll register. He asks you to explain the principal differences, because he wants to be sure that he sets up the proper payroll procedures.

## ACTION PLAN

- Determine the earnings and deductions data that must be recorded and reported for each employee.
- Design a record that will accumulate earnings and deductions data and will serve as a basis for journal entries to be prepared and posted to the general ledger accounts.
- Explain the difference between the employee earnings record and the payroll register.

**SOLUTION:** An employee earnings record is kept for *each* employee. It shows gross earnings, payroll deductions, and net pay for each pay period. It provides cumulative payroll data for that employee. In contrast, a payroll register is a listing of *all* employees' gross earnings, payroll deductions, and net pay for each pay period. It is the documentation for preparing paychecks and for recording the payroll. Of course, Stan will need to keep both documents.

*Related exercise material: 9-1 and 9-5.*

## EMPLOYER PAYROLL TAXES

### STUDY OBJECTIVE 3

Describe and record employer payroll taxes.

Payroll tax expense for businesses results from three taxes *levied on employers* by governmental agencies. These taxes are: (1) FICA, (2) federal unemployment tax, and (3) state unemployment tax. These taxes plus such items as paid vacations and pensions are collectively referred to as **fringe benefits**. As indicated earlier, the cost of fringe benefits in many companies is substantial.

### FICA TAXES

We have seen that each employee must pay FICA taxes. An employer must match each employee's FICA contribution. The matching contribution results in **payroll tax expense** to the employer. The employer's tax is subject to the same rate and maximum earnings applicable to the employee. The account, FICA Taxes Payable, is used for both the employee's and the employer's FICA contributions. For the January 14 payroll, Academy Waterparks' FICA tax contribution is \$1,376.80 ( $\$17,210.00 \times 8\%$ ).

## FEDERAL UNEMPLOYMENT TAXES

The Federal Unemployment Tax Act (FUTA) is another feature of the federal Social Security program. **Federal unemployment taxes** provide benefits for a limited period of time to employees who lose their jobs through no fault of their own. Under provisions of the Act, the employer is required to pay a tax of 6.2 percent on the first \$9,000 of gross wages paid to each employee during a calendar year. The law allows the employer a maximum credit of 5.4 percent on the federal rate for contributions to state unemployment taxes. Because of this provision, state unemployment tax laws generally provide for a 5.4 percent rate. The effective federal unemployment tax rate thus becomes 0.8 percent ( $6.2\% - 5.4\%$ ). **This tax is borne entirely by the employer.** There is no deduction or withholding from employees.

The account Federal Unemployment Taxes Payable is used to recognize this liability. The federal unemployment tax for Academy Waterparks for the January 14 payroll is \$137.68 ( $\$17,210.00 \times 0.8\%$ ).

### HELPFUL HINT

FICA taxes are paid by both the employer and employee. Federal unemployment taxes and (in most states) the state unemployment taxes are borne entirely by the employer.

## STATE UNEMPLOYMENT TAXES

All states have unemployment compensation programs under state unemployment tax acts (SUTA). Like federal unemployment taxes, **state unemployment taxes** provide benefits to employees who lose their jobs. These taxes are levied on employers.<sup>2</sup> The basic rate is usually 5.4 percent on the first \$9,000 of wages paid to an employee during the year. The basic rate is adjusted according to the employer's experience rating: Companies with a history of unstable employment may pay more than the basic rate. Companies with a history of stable employment may pay less than 5.4 percent. Regardless of the rate paid, the credit on the federal unemployment tax is still 5.4 percent.

The account State Unemployment Taxes Payable is used for this liability. The state unemployment tax for Academy Waterparks for the January 14 payroll is \$929.34 ( $\$17,210.00 \times 5.4\%$ ).

Illustration 9-13 on page 290 summarizes the types of employer payroll taxes.

## RECORDING EMPLOYER PAYROLL TAXES

Employer payroll taxes are usually recorded at the same time the payroll is journalized. The entire amount of gross pay (\$17,210.00) shown in the payroll register in Illustration 9-9 is subject to each of the three taxes mentioned above. Accordingly, the entry to record the payroll tax expense associated with the January 14 payroll is:

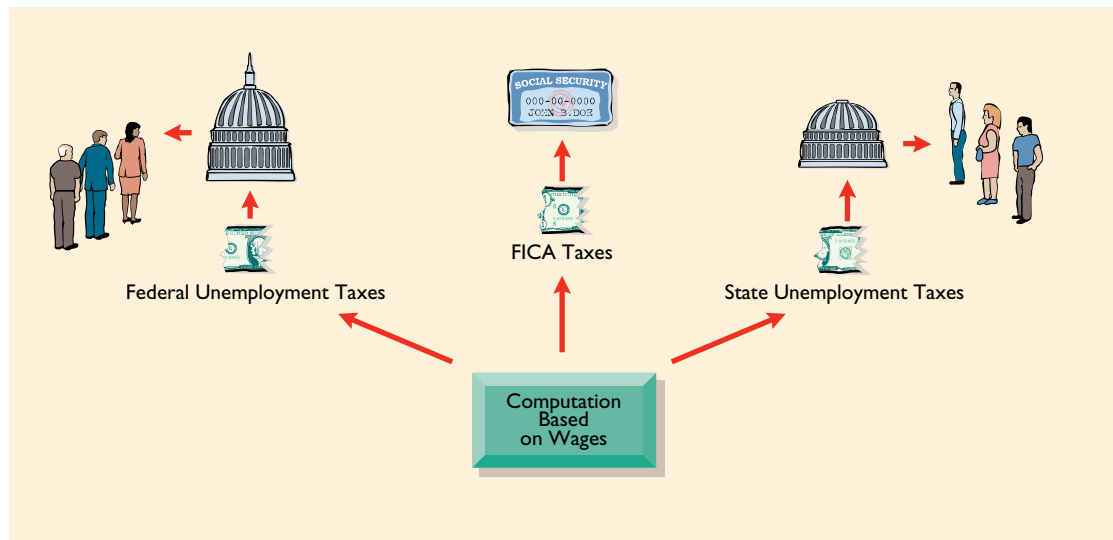
Jan. 14	Payroll Tax Expense	2,443.82	
	FICA Taxes Payable		1,376.80
	Federal Unemployment Taxes Payable		137.68
	State Unemployment Taxes Payable		929.34
	(To record employer's payroll taxes on January 14 payroll)		

A	=	L	+	SE
		+1,376.80		-2,443.82
		+137.68		
		+929.34		

Separate liability accounts are used instead of a single credit to Payroll Taxes Payable. Why? Because these liabilities are payable to different taxing authorities at different dates. The liability accounts are classified in the balance sheet as cur-

<sup>2</sup>In a few states, the employee is also required to make a contribution. In this textbook, including the homework, we will assume that the tax is only on the employer.

rent liabilities since they will be paid within the next year. Payroll Tax Expense is classified on the income statement as an operating expense.



**Illustration 9-13**

Employer payroll taxes

## FILING AND REMITTING PAYROLL TAXES

Preparation of payroll tax returns is the responsibility of the payroll department. Payment of the taxes is made by the treasurer's department. Much of the information for the returns is obtained from employee earnings records.

For purposes of reporting and remitting to the IRS, FICA taxes and federal income taxes that were withheld are combined. **The taxes must be reported quarterly, no later than one month following the close of each quarter.** The remitting requirements depend on the amount of taxes withheld and the length of the pay period. Remittances are made through deposits in either a Federal Reserve bank or an authorized commercial bank.

Federal unemployment taxes are generally filed and remitted *annually* on or before January 31 of the subsequent year. Earlier payments are required when the tax exceeds a specified amount. State unemployment taxes usually *must be filed and paid by the end of the month following each quarter*. When payroll taxes are paid, payroll liability accounts are debited, and Cash is credited.

The employer is also required to provide each employee with a **Wage and Tax Statement (Form W-2)** by January 31 following the end of a calendar year. This statement shows gross earnings, FICA taxes withheld, and income taxes withheld for the year. The required W-2 form for Mark Jordan, using assumed annual data, is shown in Illustration 9-14 on page 291.

The employer must send a copy of each employee's Wage and Tax Statement (Form W-2) to the Social Security Administration. This agency subsequently furnishes the Internal Revenue Service with the income data required.

## BEFORE YOU GO ON...

### REVIEW IT

1. What payroll taxes are levied on employers?
2. What accounts are involved in accruing employer payroll taxes?

Illustration 9-14

W-2 form

<b>a</b> Control number		OMB No. 1545-0008			
<b>b</b> Employer's identification number 36-2167882		<b>1</b> Wages, tips, other compensation \$26,300.00		<b>2</b> Federal income tax withheld \$2,248.00	
<b>c</b> Employer's name, address and ZIP code Academy Waterparks 19 Center St. Hampton, MI 48291		<b>3</b> Social security wages \$26,300.00		<b>4</b> Social security tax withheld \$2,104.00	
		<b>5</b> Medicare wages and tips		<b>6</b> Medicare tax withheld	
		<b>7</b> Social security tips		<b>8</b> Allocated tips	
<b>d</b> Employee's social security number 329-36-9547		<b>9</b> Advance EIC payment		<b>10</b> Dependent care benefits	
<b>e</b> Employee's first name and initial Last name  Mark Jordan 2345 Mifflin Ave. Hampton, MI 48292		<b>11</b> Nonqualified plans		<b>12a</b>	
		<b>13</b> Statutory employee Retirement plan Third-party sick pay <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>		<b>12b</b>	
		<b>14</b> Other		<b>12c</b>	
				<b>12d</b>	
<b>f</b> Employee's address, and ZIP code					
<b>15</b> State Employer's state ID number	<b>16</b> State wages, tips, etc.	<b>17</b> State income tax	<b>18</b> Local wages, tips, etc.	<b>19</b> Local income tax	<b>20</b> Locality name
		\$526.00			Michigan

Form **W-2** Wage and Tax Statement **2004** Department of the Treasury—Internal Revenue Service

DO IT

In January, the payroll supervisor determines that gross earnings in Halo Company are \$70,000. All earnings are subject to 8 percent FICA taxes, 5.4 percent state unemployment taxes, and 0.8 percent federal unemployment taxes. You are asked to record the employer's payroll taxes.

**ACTION PLAN**

- Compute the employer's payroll taxes on the period's gross earnings.
- Identify the expense account(s) to be debited.
- Identify the liability account(s) to be credited.

**SOLUTION:** The entry to record the employer's payroll taxes is:

Payroll Tax Expense	9,940	
FICA Taxes Payable ( $\$70,000 \times 8\%$ )		5,600
Federal Unemployment Taxes Payable ( $\$70,000 \times 0.8\%$ )		560
State Unemployment Taxes Payable ( $\$70,000 \times 5.4\%$ )		3,780
(To record employer's payroll taxes on January payroll)		

Related exercise material: 9-2, 9-3, 9-4, and 9-5.

## DEMONSTRATION PROBLEM

Indiana Jones Company had the following payroll transactions.

- Feb. 28 The payroll for the month consists of Sales Salaries \$32,000 and Office Salaries \$18,000. All wages are subject to 8 percent FICA taxes. A total of \$8,900 federal income taxes are withheld. The salaries are paid on March 1.
- 28 Employer payroll taxes include 8 percent FICA taxes, a 5.4 percent state unemployment tax, and a 0.8 percent federal unemployment tax.

**Instructions**

- (a) Journalize the February payroll transaction.  
 (b) Journalize the payroll adjusting entry at February 28.

**ACTION PLAN**

- Base employees' payroll taxes on gross earnings.
- Base employer's payroll taxes on gross earnings.

**SOLUTION TO DEMONSTRATION PROBLEM**

(a) Feb. 28	Sales Salaries Expense	32,000	
	Office Salaries Expense	18,000	
	FICA Taxes Payable ( $8\% \times \$50,000$ )		4,000
	Federal Income Taxes Payable		8,900
	Salaries Payable (To record February salaries)		37,100
(b) Feb. 28	Payroll Tax Expense	7,100	
	FICA Taxes Payable		4,000
	Federal Unemployment Taxes Payable ( $0.8\% \times \$50,000$ )		400
	State Unemployment Taxes Payable ( $5.4\% \times \$50,000$ )		2,700
	(To record employer's payroll taxes on February payroll)		

## SUMMARY OF STUDY OBJECTIVES

**1. Discuss the objectives of internal control for payroll.** The objectives of internal control for payroll are (1) to safeguard company assets against unauthorized payments of payrolls, and (2) to ensure the accuracy of the accounting records pertaining to payrolls.

**2. Compute and record the payroll for a pay period.** The computation of the payroll involves gross earnings, payroll deductions, and net pay. In recording the payroll, Salaries (or Wages) Expense is debited for gross earnings, individual tax and other liability accounts are credited for payroll deductions, and Salaries (Wages) Payable is credited for net pay. When the payroll is paid, Salaries and Wages Payable is debited, and Cash is credited.

**3. Compute and record tips under the 8 percent tip regulation.** The computation and recording of the 8 percent tip reg-

ulation is based on 8 percent of the gross receipts. The Tax Equity and Fiscal Responsibility Act (TEFRA) details the calculation of gross receipts and what types of establishments are included in this reporting. If all the employees' tips reporting do not meet at least 8 percent of the gross receipts of the business, the employer needs to perform an allocation by either the gross receipts method or hours worked method to allocate such shortfall to the appropriate employee.

**4. Describe and record employer payroll taxes.** Employer payroll taxes consist of FICA, federal unemployment taxes, and state unemployment taxes. The taxes are usually accrued at the time the payroll is recorded by debiting Payroll Tax Expense and crediting separate liability accounts for each type of tax.



## GLOSSARY

**Bonus** Compensation to management personnel and other employees, based on factors such as increased sales or the amount of net income (p. 278).

**Employee earnings record** A cumulative record of each employee's gross earnings, deductions, and net pay during the year (p. 282).

**Employee's Withholding Allowance Certificate (Form W-4)** An Internal Revenue Service form on which the employee indicates the number of allowances claimed for withholding federal income taxes (p. 280).

**The Fair Labor Standards Act (FLSA)** 1938 law, amended with additional provisions in 1977, commonly known as the Act or FLSA. It provides minimum standards for both wages and overtime entitlement, equal pay, child labor, and spells

out administrative procedures by which covered work time must be compensated (p. 277).

**Federal unemployment taxes** Taxes imposed on the employer that provide benefits for a limited time period to employees who lose their jobs through no fault of their own (p. 289).

**FICA taxes** Taxes designed to provide workers with supplemental retirement, employment disability, and medical benefits (p. 288).

**Fringe benefits** Any form of employee compensation except salary and wages. This may include insurance, retirement, bonus plans, or leaves (p. 288).

**Gross earnings** Total compensation earned by an employee (p. 278).

**Gross receipts method** A method of tip reporting which all gross receipts of employees are totaled and then multiplied by 8 percent to determine the amount of tips an employee should report (p. 286).

**Hours worked method** A method of tip reporting where the total hours worked by all employees is used as the benchmark for tip calculation (p. 287).

**Net pay** Gross earnings less payroll deductions (p. 281).

**Payroll deductions** Deductions from gross earnings to determine the amount of a paycheck (p. 281).

**Payroll register** A payroll record that accumulates the gross earnings, deductions, and net pay by employee for each pay period (p. 282).

**Salaries** Specified amount per month or per year paid to executive and administrative personnel (p. 274).

**Statement of earnings** A document attached to a paycheck that indicates the employee's gross earnings, payroll deductions, and net pay (p. 284).

**State unemployment taxes** Taxes imposed on the employer that provide benefits to employees who lose their jobs (p. 289).

**The Tax Equity and Fiscal Responsibility Act (TEFRA)** 1982 law that institutes regulations guiding food and beverage operations on tip reporting (p. 285).

**Wage and Tax Statement (Form W-2)** A form showing gross earnings, FICA taxes withheld, and income taxes withheld which is prepared annually by an employer for each employee (p. 290).

**Wages** Amounts paid to employees based on a rate per hour or on a piecework basis (p. 274).

## EXERCISES

**9-1** Gutierrez Yacht Club has the following payroll procedures.

- (a) Supervisor approves overtime work.
- (b) The human resources department prepares hiring authorization forms for new hires.
- (c) A second payroll department employee verifies payroll calculations.
- (d) The treasurer's department pays employees.

Identify payroll functions.  
(SO 1)

Identify the payroll function to which each procedure pertains.

**9-2** Becky Sherrick's regular hourly wage rate is \$14, and she receives an hourly rate of \$21 for work in excess of 40 hours. During a January pay period, Becky works 45 hours. Becky's federal income tax withholding is \$95, and she has no voluntary deductions. Compute Becky Sherrick's gross earnings and net pay for the pay period.

Compute gross earnings and net pay.  
(SO 2)

**9-3** In January, gross earnings in Bri Ski Resort totaled \$70,000. All earnings are subject to 8 percent FICA taxes, 5.4 percent state unemployment taxes, and 0.8 percent federal unemployment taxes. Prepare the entry to record January payroll tax expense.

Record employer payroll taxes.  
(SO 4)

**9-4** Employee earnings records for Borelias Restaurant reveal the following gross earnings for four employees through the pay period of December 15.

Compute maximum FICA deductions.  
(SO 2)

C. Mull	\$62,500	D. Chambers	\$64,300
L. Church	\$64,600	T. Olejnik	\$65,000

For the pay period ending December 31, each employee's gross earnings is \$2,000. The FICA tax rate is 8 percent on gross earnings of \$65,000.

### Instructions

Compute the FICA withholdings that should be made for each employee for the December 31 pay period. (Show computations.)

**9-5** Martinez Theater has the following data for the weekly payroll ending January 31.

Prepare payroll register and record payroll and payroll tax expense.  
(SO 2, 4)

Employee	Hours						Hourly Rate	Federal Income Tax Withholding	Health Insurance
	M	T	W	T	F	S			
M. Miller	8	8	9	8	10	3	\$10	\$34	\$10
E. Neupert	8	8	8	8	8	2	12	37	15
K. Mann	9	10	8	8	9	0	13	58	15

Employees are paid  $1\frac{1}{2}$  times the regular hourly rate for all hours worked in excess of 40 hours per week. FICA taxes are 8 percent on the first \$65,000 of gross earnings. Martinez is subject to 5.4 percent state unemployment taxes and 0.8 percent federal unemployment taxes on the first \$7,000 of gross earnings.

Identify internal control weaknesses and make recommendations for improvement.  
(SO 1)

**Instructions**

- (a) Prepare the payroll register for the weekly payroll.
- (b) Prepare the journal entries to record the payroll and Martinez's payroll tax expense.

**9-6** Selected payroll procedures of Palm Travel are described below.

1. Department managers interview applicants and on the basis of the interview either hire or reject the applicants. When an applicant is hired, the applicant fills out a W-4 form (Employer's Withholding Exemption Certificate). One copy of the form is sent to the human resources department, and one copy is sent to the payroll department as notice that the individual has been hired. On the copy of the W-4 sent to payroll, the managers manually indicate the hourly pay rate for the new hire.
2. The payroll checks are manually signed by the chief accountant and given to the department managers for distribution to employees in their department. The managers are responsible for seeing that any absent employees receive their checks.
3. There are two clerks in the payroll department. The payroll is divided alphabetically; one clerk has employees A to L and the other has employees M to Z. Each clerk computes the gross earnings, deductions, and net pay for employees in the section and posts the data to the employee earning records.

**Instructions**

- (a) Indicate the weaknesses in internal control.
- (b) For each weakness, describe the control procedures that will provide effective internal control. Use the following format for your answer:

**(a) Weaknesses****(b) Recommended Procedures**

Prepare payroll register and payroll entries.  
(SO 2, 3)

**9-7** Happy Vacations has four employees who are paid on an hourly basis plus time-and-a-half for all hours worked in excess of 40 a week. Payroll data for the week ended March 15, 2004, are presented below.

<u>Employee</u>	<u>Hours Worked</u>	<u>Hourly Rate</u>	<u>Federal Income Tax Withholdings</u>	<u>United Fund</u>
Joe McKane	40	\$14.00	\$ ?	\$5.00
Mary Miller	42	13.00	?	5.00
Andy Manion	44	13.00	60	8.00
Kim Cheng	46	13.00	51	5.00

McKane and Miller are married. They claim 0 and 4 withholding allowances, respectively. The following tax rates are applicable: FICA 8 percent, state income taxes 3 percent, state unemployment taxes 5.4 percent, and federal unemployment 0.8 percent. The first three employees are sales clerks for booking travel arrangements for clients (wages expense). The fourth employee performs administrative duties (office wages expense).

**Instructions**

- (a) Prepare a payroll register for the weekly payroll. (Use the wage-bracket withholding table in the text for federal income tax withholdings.)
- (b) Journalize the payroll on March 15, 2004, and the accrual of employer payroll taxes.
- (c) Journalize the payment of the payroll on March 16, 2004.
- (d) Journalize the deposit in a Federal Reserve bank on March 31, 2004, of the FICA and federal income taxes payable to the government.

Journalize payroll transactions and adjusting entries.  
(SO 2, 4)

**9-8** The following payroll liability accounts are included in the ledger of Pho Nam Noodle House on January 1, 2004.

FICA Taxes Payable	\$ 760.00
Federal Income Taxes Payable	1,004.60
State Income Taxes Payable	108.95
Federal Unemployment Taxes Payable	288.95
State Unemployment Taxes Payable	1,954.40
Union Dues Payable	870.00
U.S. Savings Bonds Payable	360.00

In January, the following transactions occurred.

- Jan. 10 Sent check for \$870.00 to union treasurer for union dues.
- 12 Deposited check for \$1,764.60 in Federal Reserve bank for FICA taxes and federal income taxes withheld.
- 15 Purchased U.S. Savings Bonds for employees by writing check for \$360.00.
- 17 Paid state income taxes withheld from employees.
- 20 Paid federal and state unemployment taxes.
- 31 Completed monthly payroll register, which shows office salaries \$14,600, store wages \$28,400, FICA taxes withheld \$3,440, federal income taxes payable \$1,684, state income taxes payable \$360, union dues payable \$400, United Fund contributions payable \$1,888, and net pay \$35,228.
- 31 Prepared payroll checks for the net pay and distributed checks to employees.

At January 31, the company also makes the following accrued adjustments pertaining to employee compensation.

1. Employer payroll taxes: FICA taxes 8 percent, federal unemployment taxes 0.8 percent, and state unemployment taxes 5.4 percent.
2. Vacation pay: 6 percent of gross earnings.

### Instructions

- (a) Journalize the January transactions.
- (b) Journalize the adjustments pertaining to employee compensation at January 31.

**9-9** The payroll procedures used by three different companies are described below.

1. In Ecom Motel each employee is required to mark on a clock card the hours worked. At the end of each pay period, the employee must have this clock card approved by the department manager. The approved card is then given to the payroll department by the employee. Subsequently, the accounting department pays the employee by check.
2. In Yerkes Casino clock cards and time clocks are used. At the end of each pay period, the department manager initials the cards, indicates the rates of pay, and sends them to payroll. A payroll register is prepared from the cards by the payroll department. Cash equal to the total net pay in each department is given to the department manager, who pays the employees in cash.
3. In Min Wu Fortune Cookies employees are required to record hours worked by “punching” clock cards in a time clock. At the end of each pay period, the clock cards are collected by the department manager. The manager prepares a payroll register in duplicate and forwards the original to payroll. In payroll, the summaries are checked for mathematical accuracy, and a payroll supervisor pays each employee by check.

*Identify internal control weaknesses and make recommendations for improvement.*

(SO 1)

### Instructions

- (a) Indicate the weakness(es) in internal control in each company.
- (b) For each weakness, describe the control procedure(s) that will provide effective internal control. Use the following format for your answer:

#### (a) Weaknesses

#### (b) Recommended Procedures

**9-10** Mama’s Barbeque employs six waitstaff. The details of their gross receipts, hours worked, and tips reported are offered below. The restaurant also had two buspersons with whom the waitstaff will share their tips. The owner, Mrs. Brown, knows the employees did not report the required 8 percent of gross receipts. Using both the gross receipts and hours worked method, please help her identify what amount of tip should be allocated to each employee, if any.

*Compute and record tips under the 8 percent tip regulation.*

(SO 3)

Employee	Gross Receipts	Hours Worked	Tips Reported
1	\$40,000	30	\$3,000
2	48,550	40	3,500
3	39,000	25	2,500
4	42,860	35	3,500
5	50,110	40	4,300
6	20,000	20	1,050

**EXPLORING THE WEB**

**9-11** The Internal Revenue Service provides considerable information over the Internet. The following demonstrates how useful one of its sites is in answering payroll tax questions faced by employers.

**Address:** [www.irs.ustreas.gov/prod/forms\\_pubs/index.html](http://www.irs.ustreas.gov/prod/forms_pubs/index.html)

**Steps**

1. Go to the site shown above.
2. Choose **Publications Online**.
3. Choose **Circular E, Employer's Tax Guide**.

**Instructions**

Answer each of the following questions.

- (a) How does the government define *employees*?
- (b) What are the special rules for Social Security and Medicare regarding children who are employed by their parents?

**GROUP DECISION CASE**

**9-12** Kishwaukee Catering Company provides catering services for banquets, events, and other catering functions within a university community. The work is fairly steady throughout the year, but peaks significantly in December and May as a result of holiday parties and graduation events.

Two years ago, the company attempted to meet the peak demand by hiring part-time help. However, this led to numerous errors and considerable customer dissatisfaction. A year ago, the company hired four experienced employees on a permanent basis instead of using part-time help. This proved to be much better in terms of productivity and customer satisfaction. But, it has caused an increase in annual payroll costs and a significant decline in annual net income.

Recently, Valarie Flynn, a sales representative of Harrington Services Inc., has made a proposal to the company. Under her plan, Harrington Services will provide up to four experienced workers at a daily rate of \$110 per person for an eight-hour workday. Harrington workers are not available on an hourly basis. Kishwaukee Catering would have to pay only the daily rate for the workers used.

The owner of Kishwaukee, Martha Bell, asks you, as the company's accountant, to prepare a report on the expenses that are pertinent to the decision. If the Harrington plan is adopted, Martha will terminate the employment of two permanent employees and will keep two permanent employees. At the moment, each employee earns an annual income of \$30,000. Kishwaukee pays 8 percent FICA taxes, 0.8 percent federal unemployment taxes, and 5.4 percent state unemployment taxes. The unemployment taxes apply to only the first \$7,000 of gross earnings. In addition, Kishwaukee Catering pays \$40 per month for each employee for medical and dental insurance.

Martha indicates that if the Harrington Services plan is accepted, Kishwaukee's needs for Harrington's workers will be as follows.

<u>Months</u>	<u>Number</u>	<u>Working Days per Month</u>
January–March	2	20
April–May	3	25
June–October	2	18
November–December	3	23

**Instructions**

With the class divided into groups, answer the following.

- (a) Prepare a report showing the comparative payroll expense of continuing to employ permanent workers compared to adopting the Harrington Services Inc. plan.
- (b) What other factors should Martha consider before finalizing her decision?

**ETHICS CASE**

**9-13** Harry Smith owns and manages Harry's Restaurant, a 24-hour restaurant near the city's medical complex. Harry employs 9 full-time employees and 16 part-time employees. He pays all of the full-time employees by check, the amounts of which are determined by Harry's public accountant, Pam Web. Harry pays all of his part-time employees in cash. He computes their wages and withdraws the cash directly from his cash register.

Pam has repeatedly urged Harry to pay all employees by check. But as Harry has told his competitor and friend, Steve Hill, who owns the Greasy Diner, "First of all, my part-time employees prefer the cash over a check, and second, I don't withhold or pay any taxes or workmen's compensation insurance on those wages because they go totally unrecorded and unnoticed."

**Instructions**

- (a) Who are the stakeholders in this situation?
- (b) What are the legal and ethical considerations regarding Harry's handling of his payroll?
- (c) Pam Web is aware of Harry's payment of the part-time payroll in cash. What are her ethical responsibilities in this case?
- (d) What internal control principle is violated in this payroll process?



*Remember to go back to the Navigator box on the chapter-opening page and check off your completed work.*