


# PAYROLL ACCOUNTING



GIOVE

A Complete  
Guide to Payroll

2001 EDITION



# **PAYROLL ACCOUNTING: A COMPLETE GUIDE TO PAYROLL**

**2001 Edition**

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**FRANK C. GIOVE**

**HOUGHTON MIFFLIN COMPANY**

**BOSTON NEW YORK**

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Printed in the U.S.A.

Library of Congress Catalog Card Number: 00-133846

ISBN: 0-395-95997-7

2 3 4 5 6 7 8 9-B-04 03

# **PREFACE**

## **2001 EDITION**

Perhaps no topic in the field of business is as pervasive as payroll. Usually, it is the largest single expense of most businesses and a continuing management challenge in terms of cost control. This book provides comprehensive coverage of the payroll accounting process, including a rarely glimpsed perspective on the internal control procedures and cost-saving techniques used by management.

The text introduces the subject of payroll by first presenting the federal rules and regulations governing employment, compensation, and payroll taxes. It then takes the reader step-by-step through the entire payroll process—from timekeeping, computation of gross earnings, determining federal income tax and other payroll tax withholdings; to preparing and distributing the payroll; to the final, vital step of recording or accounting for wages, tax liabilities, and payments or deposits. The last two chapters focus on the various policies and measures companies establish to keep payroll costs under control.

The field of payroll management is certainly growing. Payroll managers, as this book shows, can have a profound effect on the successful operation of a business. Even with outside payroll services and direct deposit, the payroll manager must still control the timekeeping systems used by the company, provide the necessary input to any outside service, and establish and oversee the direct deposit system. Therefore, it is of vital importance for the payroll manager—as well as the payroll clerk—to be well versed in all aspects of payroll operations.

Readers interested in learning payroll accounting and payroll management will find this book to be a valuable training tool. Those readers who are currently employed as payroll assistants, clerks, or managers can use the book as a resource and reference manual. Other readers who will benefit from the text are those already familiar with general accounting or business management. The in-depth coverage and organizational focus will help these readers to become more knowledgeable about payroll and gain practical information about internal control and cost-saving techniques.

## Features

My goal has been to provide a comprehensive and practical book that presents payroll procedures and issues in an accessible and interesting way. The text is published as an annual edition, incorporating yearly tax revisions to keep the coverage as up-to-date and useful as possible. In addition, the entire book is structured to clarify and explain the payroll process.

*An ongoing case* begins each part and chapter, highlighting the various steps in the payroll process at Nioga Gear, Inc., a fictitious but true-to-life company.

*Learning objectives* open each chapter and provide readers with an overview of new concepts.

*Highlighted inserts*, entitled "In the News" and "Payroll in Action," illuminate current payroll issues and stimulate reader interest.

*Review questions* are straightforward, cover basic material in the book, and are designed to elicit answers that reinforce learning.

*Discussion questions* are thought-provoking, deal with current issues in payroll, and will encourage lively discussion with widely contrasting points of view.

*Exercises* are relatively short computational questions that illustrate a single procedure or principle.

*Problems* are longer computational questions involving several employees or a combination of computations.

*A continuing case problem* at the end of each chapter focuses on a service company, Frontier Landscaping, and relates directly to the chapter material it follows.

## Payroll Practice Sets

Two complete payroll practice sets are available for use with *Payroll Accounting*. *Lawson's Supply Center, Inc.* can be worked either manually or by computer (using Houghton Mifflin's General Ledger program and the data disk supplied with the practice set). Students take on the role of payroll clerk at Lawson's, a merchandising business that sells building materials and supplies; they must follow the entire payroll process for a quarterly period.

The second practice set, *Oak Creek Canyon Jewelers*, is a computerized payroll practice set designed to be used with Peachtree Accounting for Windows (Release 3.5 or Release 5.0). In this simulation, students take on the role of payroll clerk for Oak Creek Canyon Jewelers, a sole proprietorship retail operation. Students record all payroll transactions for the fourth quarter and prepare end-of-quarter and end-of-year reports.

## Instructor's Resource Manual with Solutions

For instructors using this book in an academic setting, the *Instructor's Resource Manual* is an all-inclusive aid. It contains three separate sections to enhance teaching of the material:

*Teaching Notes.* Each chapter contains a review of learning objectives and key terms. Also, a complete lecture outline provides a comprehensive review of the chapter material.

*Solutions.* Solutions are provided for all end-of-chapter reinforcement material: answers to review and discussion questions, solutions to exercises, problems, and the continuing case problem. Each solution is carefully and logically presented so that procedures and the concepts behind them can be fully understood.

*Transparency Masters.* Key figures, tables, and exhibits have been reproduced as transparency masters for classroom use.

### **Practice Set Instructor Manuals**

For each practice set, *Lawson's Supply Center, Inc.* and *Oak Creek Canyon Jewelers*, an instructor manual with solutions is available to help instructors guide students in completing the simulations.

### **Achievement Test Masters**

*Payroll Accounting* is also accompanied by a set of Achievement Tests. These ready-to-reproduce test masters cover each chapter of the text and are available to adopters upon request. The tests reflect the updated payroll requirements, forms, and tables in the 2001 Edition and have been thoroughly accuracy-tested. Solutions are also provided.

### **Acknowledgments**

Although this text was a labor of love, it would not have been possible without the conscientious and generous contributions of the fine staff at Houghton Mifflin. I owe a sincere thanks to Ray Deveau and Don Golini for encouraging me and giving me the opportunity to write this text and its annual updates. I am also indebted to an excellent group of editors at Houghton Mifflin who assisted in each of the annual updates. I am especially grateful to Ann West, Margaret Kearney, Penny Stratton, and Linda Burkell who helped me develop the first edition of the text. I would also like to thank Damaris Curran, Patricia English, and Jodi O'Rourke, who worked on this edition. In particular, I would like to thank Joanne Dauksewicz, who helped put together each edition we've published.

I would also like to thank my word processor at Niagara University, Diane Rowe. Without her dedication, this book would have been most difficult to complete. I am also grateful to the following reviewers who provided valuable comments and suggestions:

David J. Andrews  
*Robert Morris College*

Nancy Atwater  
*Brown Institute*

Courtney Baillie  
*Southeast Community College*

Thomas M. Bock  
*Berkeley College*

Michael Choma  
*New Kensington Commercial School*

Karen A. DeJulio  
*Bradford School*

Freda Dibble  
*Patricia Stevens College*

Chris Finley  
*Missouri Vocational Center*

Barbara Kramer  
*Lewis-Clark State College*

Cathy Xanthaley Larson  
*Middlesex Community College*

Linda C. Lott  
*Illinois Central College*

Shirl Mallory  
*Coosa Valley Technical Institute*

Martha McDonald  
*Metro Business College*

Jon Nitschke  
*Montana State University College  
of Technology—Great Falls*

Sandro O'Meara  
*Santa Barbara City College*

Frank A. Paliotta  
*Berkeley College*

Gail Reed  
*National College*

Debbie K. Reeder

R. Becki L. Saylor  
*Sanford Brown College*

Michael Scully  
*Catherine College*

Warren W. Smock  
*Ivy Tech State College*

Ginger Dudley Tuton  
*Coastal Carolina Community College*

Carolyn Woodbury  
*The University of Montana  
College of Technology—Missoula*

My deepest appreciation goes to my daughter, Kathryn Blackman, also a CPA, who tested and worked on the solutions to the exercises and problems and provided inspirational support in my efforts. She stood in the shoes of my late dear wife, who always encouraged me to put my thoughts and knowledge on paper.

F. C. G.



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## PART I

# PAYROLL LAWS AND RECORDKEEPING REQUIREMENTS

Julia Jones works as a telephone sales representative for Nioga Gear, Inc., an athletic shoe manufacturer. Operating out of her home, Julia makes telephone sales calls to small exercise equipment outlets and clothing stores that carry athletic clothes to ask them to consider becoming local distributors of Nioga's walking shoe. She spends ten hours a week making cold calls, for which she is paid \$2.00 per call, and the rest of her time following up on leads and servicing accounts, for which she receives an hourly wage. Her work hours range from 30 to 50 hours a week, depending on the time she spends on follow-up. She is paid once a week.

Julia, a home-based employee working alone and outside the Nioga office, is considered an employee rather than an independent contractor because her employer, Nioga, controls the details of all her work and the results to be accomplished. As an employee, Julia is protected by a variety of federal and state laws pertaining to employment and compensation. Such laws guarantee her, among other things, a minimum hourly wage; an overtime wage that is 1½ times her regular hourly rate of pay; a piece rate that equals or surpasses the minimum wage rate; and pay that is equal to the earnings of others doing the same job.

As Julia's employer, Nioga Gear is bound by some other laws; for example, it must verify that Julia is a U.S. citizen or is authorized to work in the United States. In addition, Nioga must follow the rules and regulations put forth in a variety of federal and state payroll tax laws. For instance, it must withhold a certain amount from Julia's gross pay for the payment of federal and state income and Social Security and Medicare taxes. Nioga must also set aside from its own funds an amount equal to a certain percentage

of Julia's gross pay to cover the company's contribution to Social Security, Medicare, and unemployment taxes. All of these requirements involve a substantial amount of recordkeeping and government reporting.

In the meantime, Julia has a job to do, one she does quite well. She reports to a supervisor at Nioga Gear and attends monthly sales meetings and annual sales conferences. She hopes to be promoted to a sales manager position in the spring, at which time she would move "in-house," be switched to a monthly salary and a sales commission, and receive a substantial raise.

Nioga provides Julia with a weekly paycheck and some implied assurances about the accuracy of the calculations done to prepare that check—that is, that everything from time- and record-keeping to calculating gross earnings to figuring withholding amounts and employer contributions has been done in conformity with current employment and tax laws. Abiding by these laws requires a well-organized payroll department and efficient, orderly, and effective procedures for each of the payroll functions. We'll begin our study of payroll accounting by taking a close look at the payroll laws and their effect on the payroll process.



## CHAPTER 1

# EMPLOYMENT AND PAYROLL LAWS

### LEARNING OBJECTIVES

On completing this chapter, you will be able to:

1. Distinguish between employees and independent contractors, statutory employees and statutory nonemployees, and exempt and nonexempt employees.
2. Explain the main provisions of the Fair Labor Standards Act and their effect on the computation of gross earnings.
3. Review the various laws that provide equal rights in employment and prohibit discrimination based on race, color, religion, sex, national origin, age, or disability.
4. Differentiate the employer's liability for taxes and the meaning of employer under the various tax laws.
5. Discuss the state laws on employment, those that parallel federal laws and others specifically reserved for state action.
6. Describe other laws regarding payroll recordkeeping related to retirement plans and immigration reform.

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*At first glance, payroll accounting appears to be a relatively simple process. An employer pays an employee wages for work completed and withholds portions of the employee's earnings for payroll taxes, which are then handed over to the taxing authorities. However, to carry out this operation successfully, a payroll manager needs to have a good understanding of employment and payroll laws, personnel management, recordkeeping techniques, and accounting. That is our task in this*

*text—to make the novice familiar enough with these areas to be an effective payroll manager.*

*This chapter will discuss the employment and payroll laws that pertain to payroll accounting. But before we address these laws, we need to examine the rules that dictate whether a worker is considered an employee and thus covered by these laws or an independent contractor who is not covered by them.*

## EMPLOYEE VERSUS INDEPENDENT CONTRACTOR

**Common-law test** A test that, for FICA purposes, defines an employee as one subject to the will and control of the employer in the performance of services.

**Independent contractor** An individual or company hired by the public, often by contract, with discretion on when, where, and how to accomplish a specific job and generally with an investment in equipment, tools, and facilities.

**Statutory employee** An individual who does not qualify as an employee under the common-law test but who, nevertheless, is an employee by law which designates certain full-time workers performing services with no substantial investment in the business—is subject to withholding of FICA taxes but exempt from withholding of federal income taxes.

**Statutory nonemployee** An individual who does not qualify as an employee under the common-law test but, unlike the statutory employee, has been designated as a statutory nonemployee or independent contractor—is exempt from withholding of FICA and federal income taxes.

The distinction between an employee and an independent contractor is an important one because employers must withhold federal income tax and withhold and match Social Security and Medicare taxes from employees' paychecks. Employers need not withhold taxes from payments to independent contractors, although they must furnish the Internal Revenue Service (IRS) with a record of payments made to the independent contractors.

The employer makes the decision as to whether a worker is an employee or an independent contractor, based on whether or not a common-law relationship exists between them. Under the common-law test, if the employer has the right to control both what will be done and how it will be done, then the relationship is an employer-employee one. If not, then the worker is an independent contractor.

In general, an independent contractor is one who controls a business, i.e., one who

- determines when, where, and how to work, often works under a contract, and may offer services to the general public;
- receives compensation in a lump sum or from commissions (not on an hourly, weekly, or monthly basis) and incurs expenses that may lead to a profit or loss for the business;
- has an investment in equipment, tools, and/or facilities.

Often, however, the distinction between employee and independent contractor is not clear-cut; the particular facts of each case must govern the determination. The employer who is not sure can use **Form SS-8** (Exhibit 1-1) to establish worker status for purposes of income and employment taxes. Upon review of the completed form, the Internal Revenue Service (IRS) makes a determination as to whether the individual is an employee or an independent contractor.

In general, the common-law test determines whether an individual is an employee or not. The IRS, however, has taken the initiative to define certain groups of employees without strict adherence to the test, as long as the individuals work full-time, perform services, and have no investment in the business. Two such groups, called **statutory employees**, are life insurance agents and outside salespeople. In contrast, the IRS has decided that real estate agents and direct sellers of consumer products are independent contractors or statutory nonemployees.