Lesson Blueprint

Computerized Accounting with QuickBooks® 2019

# Chapter 8: Payroll Setup

## Introduction

* QuickBooks allows you to process payroll and track payroll information for your company’s employees.
* The company that hires the workers is referred to as the employer.
* The people that work for a company are called the employees.
  + The employee is the person hired by a company who will receive salary or wages on a regular basis.
* Payroll involves:
  + computing each employee’s gross earnings
  + determining each employee’s withholding and deductions
    - Withholdings generally refer to the payroll taxes the employer is required to take out of the employee’s paycheck and submit to the appropriate government agency.
    - Deductions generally refer to the amount taken out of the employee’s paycheck for various fringe benefits such as insurance and pension.
  + calculating each employee’s net pay
  + preparing employee paychecks or setting up direct deposit
  + properly recording payroll-related transactions (journal entries)
  + submitting payroll withholdings to the appropriate tax agency or other entity
  + preparing payroll compliance reports
* In order to process payroll in QuickBooks, the payroll must first be set up.
* Payroll setup involves
  + enabling the payroll feature
  + customizing and adding payroll accounts to the Chart of Accounts List
  + choosing a QuickBooks payroll service or activating the manual entries feature
  + customizing pre-established payroll items
  + establishing payroll items such as compensation and payroll taxes or payroll deductions
* These payroll items comprise the Payroll Item List.
* In this chapter, our sample company, Kristin Raina Interior Designs, will set up the payroll in anticipation of hiring two employees beginning April 1, 2021.
  + After the payroll setup is complete and the employees are hired, the payroll transactions for Kristin Raina Interior Designs will then be illustrated in Chapter 9.

## QuickBooks versus Manual Accounting: Payroll Setup

* In a manual accounting system, the process of preparing a payroll is laborious and time-consuming.
* For each employee, the company has to
  + tally the hours worked in a pay period
  + compute the gross pay for the pay period
  + determine all the withholdings and deductions from the employee’s pay
* After completing these computations, the company has to
  + prepare pay checks or direct deposit
  + prepare pay stubs showing all the earnings, withholdings, and deductions for the pay period
  + prepare all the year-to-date earnings, withholdings, and deductions
* Without the use of computers,
  + payroll withholdings are calculated manually using preprinted withholding tables
  + gross pay, withholdings, and deductions for all employees have to be totaled in order to record the payroll in a payroll journal
  + gross pay, withholdings, and deductions are then posted to the general ledger accounts
  + year-to-date earnings and withholdings need to be accumulated and used in preparing government-required quarterly and year-end reports
* In dealing with such a quantity and variety of computations, it is easy to make a mistake.
* Payroll was one of the first accounting tasks to be available on computers.
  + Payroll preparation firms were formed for this sole purpose.
  + A company simply prepares a list of each employee’s name and the hours that person worked during a pay period.
  + This information is submitted to the payroll processing firm and the payroll is usually prepared overnight.
    - The company receives its properly completed paychecks or list of direct deposits and a summary report the next morning.
    - Paychecks are distributed to the employees or direct deposits are processed.
    - A summary report is used to record the appropriate journal entries for the payroll.
    - Payroll processing firms also accumulate the necessary information for preparing government compliance reports.
* As personal computers and accounting software packages became available, companies were able to process their payroll in-house as part of their routine accounting tasks without the need to use an outside payroll preparation firm.
* QuickBooks includes a payroll feature that, once activated, allows for
  + processing a payroll with employees’ earnings, withholdings, deductions, and net pay
  + quick and easy calculations
  + simultaneous recording of the payroll transactions in the journal
  + paychecks to be immediately printed when the printer is set up to do so or the direct deposit can be set up and immediately processed
  + Simultaneously, reports are prepared that summarize all quarterly and annual information needed for required filings and for required payments of employee withholdings to the appropriate agencies.
* Part of what makes payroll processing in QuickBooks easier than that of a manual system is the use of Lists/Centers (which function as a database).
* Typical gross earnings, withholdings, and deductions, are detailed in the Payroll Item List.
* In addition, exact payroll taxes are maintained within the payroll feature and QuickBooks payroll services.
* When employees are to be paid, QuickBooks will call upon the information in the Payroll Item List along with information about the employee (discussed in Chapter 9), quickly complete all computations, and prepare all related reports.
* Because QuickBooks computes the employee’s pay by accessing information from the Payroll Item List, it is important that the Payroll Item List be accurate and complete.
* Any errors in the Payroll Item List will result in inaccurate computations in the payroll and subsequent recording of incorrect entries in the general journal.

## Payroll Definitions and Terms

* The following are the same whether payroll is processed manually or with a software package.
  + laws
  + procedures
  + filing requirements
  + definitions
  + terminology
* The following section is a brief review of the more common payroll definitions.

### Employee Payroll Information

* In order to properly determine an employee’s gross pay, tax withholdings, deductions, and net pay, and to meet federal and state record-keeping requirements, the employer needs specific information about the employee.
* This information includes, but is not limited to
  + name
  + address
  + Social Security number
  + marital status
  + gross pay amount or hourly rate
  + tax withholding allowances
  + voluntary deductions (pensions, 401(k), insurance, and so on)
* The employer uses this information along with the applicable tax rates to compute the employee’s paycheck and track the employee’s pay information.

### Gross Pay

* Gross pay is the total earnings for the employee for a specific pay period before any withholdings and deductions.
* Compensation can be in the form of
  + salary
    - If the employee is paid based upon an annual salary, the annual figure is divided over the number of pay periods in the year.
  + hourly wages
    - Gross pay for hourly workers is determined based on the number of hours worked during the pay period multiplied by the employee’s hourly pay rate.
  + tips
  + commissions
  + bonus
  + overtime earned during a pay period
* Gross pay will be subject to payroll taxes, for both the employer and employee.

### FICA Tax (Social Security) and Medicare Tax

* Federal Insurance Contribution Act (FICA) tax, also known as Social Security, is a tax imposed on both the employer and employee.
  + The rate for each is 6.2% of the first $128,400 (year 2018) of wages for each employee.
* Medicare tax is also imposed on both the employer and the employee.
  + The rate for each is 1.45%.
  + There is no wage maximum for the Medicare tax.
* Beginning 2013, there is an Additional Medicare Tax of 0.9% that has a different maximum for different taxpayers ($250,000/$200,000).
* The employer periodically remits both the employer and employee portion of the tax to the federal government.

### Federal Income Tax (FIT)

* Employers are required to withhold the appropriate amount of federal income tax (FIT) from each employee’s pay.
* The Internal Revenue Service publishes tables and instructions in order to assist employers in determining the proper withholding amount for each employee.
* The withholding amount is determined based upon the employee’s gross pay, marital status, and exemption allowances claimed.
* The employer periodically forwards the tax withheld to the federal government along with the Social Security and Medicare taxes.

### State Income Tax (SIT)

* Many states impose an income tax and require employers to withhold the tax from the employees’ pay, in a manner similar to that used for FIT.
* The employer remits this tax periodically to the appropriate state taxing authority.
* Some local governments (city, county) may also impose income taxes.
  + Rules for withholding local taxes for local governments are similar to those used by federal and state governments.

### Federal Unemployment Insurance Tax (FUTA)

* Federal Unemployment Insurance (FUTA) tax is imposed on only the employer.
* The FUTA tax is used to fund unemployment insurance programs administered by the federal government.
* The effective rate of the tax 0.6% (0.006) of the first $7,000 of each employee’s wages.

### State Unemployment Insurance (SUI)

* In addition to paying the FUTA tax, employers are required by all states to contribute to a state unemployment insurance (SUI) fund.
* Rates and regulations vary from state to state.
* However, most states impose the tax only on the employer.
* Rates can vary up to 11% based upon the employer’s location and unemployment experience, and the taxable amount varies from state to state.

### State Disability Insurance (SDI)

* Most states require employers to purchase an insurance policy that compensates employees if they are unable to work for an extended period due to illness or injury.
* sometimes called state disability insurance (SDI)
* Some states allow employers to withhold a small amount from each employee’s pay to defray the employer’s insurance premium cost.

### Company Deductions

* Many employers will sponsor various fringe benefit programs and deduct amounts from employees’ pay to fund or offset the costs of the benefits programs such as
  + 401(k) plans
  + medical and dental insurance
  + pension and profit-sharing plans
  + long-term disability
  + life insurance
* may be partially funded by a deduction made by the company from an employee’s paycheck

### Net Pay

* Net pay is the amount of the employee’s gross pay less all employee withholdings and deductions.
* As anyone who has worked knows, net pay is only a fraction of the gross pay earned.

### United States Treasury

* The United States Treasury is the tax-collecting agency of the federal government.
* The United States Treasury is responsible for collecting
  + FICA tax
  + Medicare tax
  + FIT
  + FUTA tax

## Chapter Problem

* In this chapter Kristin Raina Interior Designs will set up the payroll in anticipation of hiring two employees during the month of April 2021.
* The April 1 beginning balances for the company are contained in the company file CH8 Kristin Raina Interior Designs.
* Using steps similar to those used in Chapters 1 through 3, complete the following.
  + Open the company file CH8 Kristin Raina Interior Designs.QBW.
  + Make a backup copy of the file using the file name EX8 [*Your Name*] Kristin Raina Interior Designs.
  + Restore the backup copy.
  + Change the company name in the file to EX8 [*Your Name*] Kristin Raina Interior Designs.

## New Company Setup: Payroll Setup – Activate the Payroll Feature

* To set up payroll in QuickBooks, you must first activate (enable) the payroll feature.
* If you set up a new company file using the Detailed Start method (Chapter 6) which uses the EasyStep Interview window, you have the choice of disabling the payroll feature.
* If you set up a new company file by using the Express Start method (Chapter 7), QuickBooks automatically activates the payroll feature.
* In the company file for this chapter, the payroll feature needs to be activated in the Preferences window.
* See text for steps to activate the QuickBooks payroll feature.
* Once the Payroll feature is activated, QuickBooks automatically creates two default general ledger accounts:
  + Payroll Liabilities
  + Payroll Expenses

## Lists/Centers: Updating the Chart of Accounts List for Payroll

* When the payroll feature is activated, QuickBooks establishes
  + one default general ledger liability posting account for all payroll-related liabilities
  + one default general ledger expense posting account for all payroll-related expenses
* Open and review the Chart of Accounts List.
  + The accounts created by QuickBooks are 24000 Payroll Liabilities and 66000 Payroll Expenses.
    - When both of these accounts are created, the account type is dimmed to indicate that QuickBooks created the account and it is a system default account.
    - Recall that you must allow QuickBooks to create its own accounts in some situations, but then you can edit the account name and account number.
* QuickBooks creates one payroll liability account and one payroll expense account to be used in the payroll processing transactions (Chapter 9).
* Most companies usually create separate payroll liability accounts for
  + FIT
  + SIT
  + Social Security
  + Medicare, and so on
* Most companies usually create separate payroll expense accounts for
  + Social Security
  + Medicare
  + FUTA
  + SUI, and so on
* For our sample company, Kristin Raina Interior Designs:
  + Separate liability accounts will be created that will be subaccounts of the system default Payroll Liabilities account created by QuickBooks.
  + Separate expense accounts will be created that will be subaccounts of the system default Payroll Expenses account created by QuickBooks.
* Before creating the new accounts, customize the system default accounts to change the account numbers to follow the company’s pattern for numbering accounts on the Chart of Accounts List.

### Customize the Payroll System Default Accounts

* See text for payroll system default accounts to be customized in the Chart of Accounts List.
* Use the procedures reviewed in Chapter 4 to customize the payroll system default accounts.

### Add Payroll Accounts

* See text for payroll accounts to be added to the Chart of Accounts List.
* Use the procedures illustrated in Chapter 4 to add the payroll accounts.

## QuickBooks Payroll Services versus Calculating Payroll Manually

* Like most computerized accounting packages, QuickBooks offers several desktop payroll services:
  + QuickBooks Basic Payroll
  + QuickBooks Enhanced Payroll
  + QuickBooks Assisted Payroll
* A company would choose the service that best fits their company’s needs.
* If a company chooses to use one of the QuickBooks payroll services, they must subscribe to the service and pay a monthly fee.
* Once a company subscribes to a payroll service, the taxes imposed on employers and the employee withholdings are automatically computed based on the information in
  + Payroll Item List
  + employee’s file (Chapter 9)
  + QuickBooks’ payroll service
* If the company has not subscribed to a QuickBooks payroll service, then the firm’s payroll withholdings and payroll taxes must be entered manually.
* Part of the payroll setup is to indicate either that a payroll service will be used or that the payroll will be processed manually.
  + In business, it is advisable to subscribe to a payroll service.
  + In the classroom environment, the payroll withholdings and payroll taxes will be entered manually.
* See text for steps to set up payroll for manual processing using the Help menu.
* After indicating that you will process payroll manually, QuickBooks includes the Payroll Item List as part of the Lists menu and will allow you to process payroll manually.

## Lists/Centers: The Payroll Item List

* Once you have activated the payroll feature and the manual calculations feature, QuickBooks automatically sets up a Payroll Item List, which you may now access.
* The Payroll Item List contains a file for each type of payroll item that affects the company’s employees.
* QuickBooks automatically creates several standard payroll items, including
  + Social Security Company (FICA tax)
  + Medicare Company (Medicare tax)
  + federal withholding
* Typically, you must modify the Payroll Item List based on your company’s
  + geographic location
  + company deductions
  + pay policies
* As you know, the second level of operation in QuickBooks is to update the background information in the Lists/Centers.
  + In earlier chapters, you added, deleted, or edited vendor, customer, accounts, and inventory items files in order to keep each List/Center current for your company.
  + Now you will customize and update the Payroll Item List to match the payroll information unique to your company.
* See text for steps to review the Payroll Item List created by QuickBooks.
  + Notice that the payroll items initially created by QuickBooks are the ones generally applicable to all payroll situations.
    - Social Security tax
    - Medicare tax
    - Federal Withholding tax
    - Federal Unemployment tax, and so on
  + The tax rates (amount) and limits displayed on the Payroll Item List are those that were in effect when the text was prepared.
    - As the government revises tax rates and limits, QuickBooks should update them in the Payroll Item List accordingly.
    - Tax rates and limits in the Payroll Item List and subsequent windows illustrated in Chapter 8 may be different than what appears on the students’ computer screen; accept the tax rates and limits on the computer screen.
* See text for steps to view a specific payroll item, such as Federal Withholding.
  + The window displays the name used in paychecks and payroll reports.
  + The Edit payroll item window for each payroll item file contains pages of information that display each time you click Next.

## Lists/Centers: Customizing the Payroll Item List

* When you activated the payroll feature, QuickBooks created several payroll items required of all companies as shown in Figure 8–F.
* You will customize each of these pre-established payroll items for Kristin Raina Interior Designs to include:
  + identifying the government agency to which payment will be directed
  + appropriate liability account
  + appropriate expense account
* Kristin Raina wishes to customize the Social Security Company tax on the Payroll Item List to
  + enter the vendor
  + change the general ledger posting account for liability
    - Notice that you enter two liability accounts on this page.
  + change the general ledger posting account for expense
    - Notice that for this payroll item, the expense account is on a separate page.
* Recall that Social Security tax is withheld from the employee’s paycheck and the employer must pay an amount, which is an expense to the company.
* QuickBooks creates two payroll items:
  + Social Security Company
  + Social Security Employee
* When you edit one of these payroll items, the changes you make in one of the payroll items is carried over to the other payroll item.
* See text for steps to customize the Social Security Company and Social Security Employee payroll items.
* See text for practice exercise to customize the Medicare Company and Medicare Employee payroll items.
* See text for steps to customize the Federal Unemployment payroll item.
* See text for Practice Exercise to customize the Federal Withholding payroll item.

## Lists/Centers: Updating the Payroll Item List

* In QuickBooks there are two methods for adding a payroll item.
  + EZ Setup guides you in setting up payroll items using the QuickBooks Payroll Setup window.
  + Custom Setup allows you to directly enter information in the Payroll Item List.
* Custom Setup is used in this chapter.
* See Appendix G for the steps to set up payroll, including the Payroll Item List, using the QuickBooks Payroll Setup window.
* In Custom Setup, the steps to set up the salary and wages payroll items are slightly different from the steps to set up the payroll withholdings and employer payroll taxes payroll items.

### Adding a Salary and Wage Payroll Item

* See text for steps to add an annual salary and wage payroll item to the Payroll Item List.
* There are seven payroll item types:
  + Wage
  + Addition
  + Deduction
  + Company Contribution
  + Federal Tax
  + State Tax
  + Other Tax
* For each of these types are several subtypes listed in parentheses next to each of the payroll item types.
* When adding new payroll items, you will first select the payroll item type on this page and then on the next page, you will select the subtype.

### Adding a Payroll Withholding Payroll Item

* See text for steps to add a payroll withholding item to the Payroll Item List.
* See text for practice exercise to add a wage payroll item and a state tax payroll item.

## Reports: Payroll Reports

* Reports, the fourth level of operation in QuickBooks, allow you to display and print a number of payroll reports for
  + internal payroll management
  + government and payroll tax compliance
* Payroll management reports, most of which reflect payroll processing (Chapter 9), provide the company with valuable information.
* The *Payroll Item Listing* report reflects payroll setup and lists the following:
  + payroll item
  + type
  + rates
  + limits for some mandatory taxes
  + expense accounts
  + liability accounts
* See text for steps to view and print the *Payroll Item Listing* report.

# Chapter 8 Accounting Terms

deductions Deductions generally refer to amounts taken out of the employee’s paycheck for various fringe benefits such as insurance and pension.

employee The person hired by the company who will receive salary or wages on a regular basis.

employer The company that hires workers.

gross pay Total earnings for an employee for a specific pay period before withholdings and deductions.

net pay Total gross earnings for an employee minus all employee withholdings and deductions.

**payroll** Involves the computing of employees’ gross earnings, withholdings, deductions, and net pay; the preparation of paychecks or setting up direct deposit; the proper recording of payroll-related transactions; submission of payroll withholdings to the appropriate agency; and preparation of payroll compliance reports.

**withholdings** Withholdings generally refer to the payroll taxes the employer is required to take out of the employee’s paycheck and submit to the appropriate government agency.