# **ACCT 1130**

# **CHAPTER 1 – THE NEED FOR PAYROLL & PERSONNEL RECORDS**

## Introduction

Perhaps no topic in the field of business is as pervasive as payroll. Usually, it is the *largest* single expense of most businesses & a continuing management challenge in terms of cost control.

Goals of payroll accounting:

1. First we will talk about the need for payroll & personnel records, & the rules and regulations governing employment, compensation & payroll taxes.
2. To describe the payroll-record life of employees from their initial applications for employment to their applications for their first social security benefit checks.
3. To introduce the various aspects of the Fair Labor Standards Act & other laws that affect payroll operations & employment practices.
4. To describe the basic payroll accounting systems & procedures used in computing wages & salaries’ & the timekeeping methods used to record time worked.
5. To explain the various phases of the Social Security Act, the federal income tax withholding law, & other laws relating to the payment of wages & salaries.
6. To provide practice in all payroll operations, the preparation of payroll registers, the recording of accounting entries involving payrolls, & the preparation of payroll tax returns required of businesses.
7. To complete a payroll project manually or on computer.

The field of payroll management is certainly growing. Payroll managers can have a profound effect on the successful operation of a business. Even with outside payroll services & direct deposit, the payroll manager must still control the timekeeping systems used by the company, provide the necessary input to any outside service, & establish & 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.

At first glance, payroll accounting appears to be a relatively simple process. An employer pays an employee wages for work completed & 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 & payroll laws, personnel management, record keeping techniques, & accounting.

This is our task this semester. I want you to be familiar enough with these areas to be an effective payroll manager or accountant in this area.

Payroll professionals are responsible for issuing over 4 billion paychecks each year to over 100 million people in the workforce of the United States. The *processing of payrolls allows no margin for error*. Employees, employers, & government agencies monitor the work performed by payroll professionals. A payroll accounting system is the only operation in a business that is almost completely governed by various federal, state & local laws & regulations. Rules establish who is an employee, when to pay an employee, when overtime is to be paid, what deductions are made, & when taxes are paid. Lack of compliance with these laws & regulations can result in both fines & back-pay awards. Each year it is important that you keep abreast of the changes in legislation that affects payroll operations.

A 2019 survey taken showed the salary range for payroll clerks was $32,250-$60,750, while the salary range for payroll managers was $59,250-$126,250. Typically, an entry-level clerk collects, reviews, approves, & records time records. Also, the clerk updates attendance records, including vacation, sick, & personal days. Once a payroll is processed, the clerk reviews the information to ensure the accuracy of each employee’s paycheck. As the clerk progresses in the Payroll Department, job responsibilities will include entering the following information into the payroll system: time-worked data, pay rate changes, tax rate changes, employee authorized payroll deductions, new employee information, and marital & employee allowance changes.

The advanced payroll professional provides information to the Finance Department concerning the amounts to be paid for taxes, health insurance premiums, retirement plans, etc. One of the final stages involves the completion of payroll tax returns, employee information returns, federal & state census returns, & fringe benefit & welfare plan returns.

Let’s talk about some of the laws that affect payroll accounting:

## Payroll Laws

### FAIR LABOR STANDARDS ACT (FLSA)

The FLSA is a 1938 federal law that regulates wages & hours of work, sets minimum wage & overtime pay requirements, prohibits discrimination in compensation, restricts child labor, and sets out record keeping requirements. This law is commonly referred to as the Federal Wage & Hour Law.

Minimum wage. The FLSA applies minimum wage (currently $7.25; up until July 24, 2009 the minimum wage was $6.55 per hour) & maximum hour provisions to employers. Most states have established minimum wage rates for covered employees. *Where both federal & state regulations cover the same employee, the higher of the two rates prevails.*

Under the FLSA there is *no specific form* for payroll records, but records are required, and they must be kept 2-3 years. (Refer to Figure 1.2) All employers must keep records explaining the basis of wage differentials paid to employees of opposite sex for equal work performed in the same establishment. The employer must also display a poster, available from the regional office of the Wage & Hour Division, which informs employees of their minimum wage, equal pay, overtime pay, & wage-collection rights, as well as child-labor restrictions.

Tax laws are among the most complex of all federal regulations. And because of their withholding, deposit, & reporting requirements, they play a major role in payroll record keeping & operations. Today, an income tax is levied on the earnings of most employees & is deducted from their *gross* pay. All of the acts that levy income taxes provide for the collection of taxes at the source of the wage paid (payroll withholding).\

### FEDERAL INSURANCE CONTRIBUTIONS ACT (FICA) (Addressed in detail in Chapter 3)

FICA is part of the social security program planned by the federal government to provide economic security for workers & their families. The act levies a tax on employers and employees in certain industries to be paid to the federal government and credited to the Federal Old-Age & Survivor’s Trust Fund and the Federal Disability Insurance Trust Fund. We know this as OASDI.

FICA also provides a 2-part health insurance program, commonly known as Medicare, for the aged & disabled.

Social security benefits are also available to the self-employed person under the provisions of the Self-Employment Contributions Act (SECA).

Recordkeeping requirements for FICA require that employers must keep records for four years after the due date of the employee’s personal income tax return (April 15) for the year in which payment was made.

### INCOME TAX WITHHOLDING LAWS (Addressed in detail in Chapter 4)

#### Federal Income Tax

In 1913 Congress passed a constitutional amendment to levy a tax on the income of individuals & corporations. Since then, Congress has passed a variety of federal income tax laws, including the complex federal income tax regulations that make up the Internal Revenue Code (or federal tax law).

In 1943, the Current Tax Payment Act, often referred to as the Federal Income Tax Withholding Law (FITW), was passed. It is the most important law affecting payroll tax withholding. This law provides for the collection of federal income taxes at the source of wages & is enforced by the Internal Revenue Service of the Department of the Treasury. In a sense, this law turned over the responsibility for tax collection to employers, at the same time providing a steady flow of tax income to the federal government. The employer withholds from each employee’s check an amount based on the current tax formula & makes regular payments of these withholdings to the IRS or to a bank authorized by the IRS. The employer must also make quarterly reports (Form 941) to the IRS detailing amounts withheld & deposited.

Recordkeeping requirements for Federal Income Tax Withholding require that employers must keep records for four years after the due date of the employee’s personal income tax return (April 15) for the year in which payment was made.

#### State Income Tax

Most states, but not all, impose state income taxes on individuals. Employers may also be required by local income tax laws to deduct and withhold local income taxes.

### UNEMPLOYMENT TAX ACTS (FUTA & SUTA) (Addressed in detail in Chapter 5)

#### Federal Unemployment Tax Act (FUTA)

FUTA represents the other fund-raising arm of the Social Security Act. FUTA is used to pay federal & state administrative expenses of the unemployment program. If an employer employs one or more individuals in each of 20 or more weeks in occupations covered by FUTA or pays wages of $1,500 or more during any calendar quarter in the current or preceding calendar year, a federal unemployment insurance tax must be paid.

Employers subject to FUTA receive credit against most of the FUTA tax when they contribute to their state unemployment compensation funds (SUTA). FUTA taxes are paid only by the employer.

Recordkeeping requirements for FUTA require that employers must keep records for four years after the due date of the employee’s personal income tax return (April 15) for the year in which payment was made.

#### State Unemployment Tax Act (SUTA)

All states have enacted unemployment insurance laws. Each employer receives a credit against the FUTA tax because of the contribution to a state’s unemployment compensation program. The taxes paid to the individual *states* by employers are used primarily for the *payment of unemployment benefits*. SUTA taxes are paid only by the employer.

### FAIR EMPLOYMENT LAWS

Federal and state legislations have been enacted to enforce fair employment practices. Many of these laws deal with discrimination on the basis of age, race, color, religion, gender, or national origin.

#### Title VII of the Civil Rights Act of 1964

Entitled “Equal Employment Opportunity,” this law provides for several fair employment practices. The act forbids employers to discriminate in hiring, firing, promoting, compensating, or in any other condition of employment on the basis of *race, color, religion, sex, or national origin.* The EEOC (Equal Employment Opportunity Commission) was established to investigate violations of the law.

EEOC guidelines include physical characteristics (including unnecessary height or weight requirements) in the definition of national origin discrimination. The EEOC also declared that sexual harassment violates the Civil Rights Act. *The EEOC prohibits unions from including or segregating their members on these bases, and unions may not cause employers to discriminate on these bases. Employment agencies may not refer or refuse to refer applicants for employment on the basis of race, color, religion, sex, or national origin.* This act covers all employers who engage in an industry “affecting commerce” & who employs 15 or more workers for each working day in each of 20 or more weeks in the current or preceding calendar year.

Employers not subject to the Title VII coverage discussed above may come within the scope of the Civil Rights Act by reason of a contract or subcontract involving federal funds. The federal government has banned, in employment on government contracts, discrimination based on race, color, religion, gender, or national origin, in a series of executive orders.

#### The Age Discrimination in Employment Act (ADEA)

The ADEA forbids discrimination against men & women *over 40* years of age by employers, unions, & employment agencies. The act covers only *employers (who employ 20 or more workers),* employment agencies, and labor unions engaged in an industry affecting interstate commerce. This act also covers federal, state, & local government employees with a few exceptions. *The ADEA provides protection for virtually all workers over 40.*

#### The Americans with Disabilities Act of 1990 (ADA)

The ADA bans discrimination against qualified persons with disabilities because of their disability. In addition, *reasonable* *accommodations* such as wheelchair accessible restrooms & ramps for qualified disabled job applicants & workers must be provided.

#### Federal Personal Responsibility and Work Opportunity Reconciliation Act of 1996

This act mandates that all states must establish new-hire reporting programs. Every employer is required to report the name, address, and social security number on each new employee and the employer’s name, address, and federal employer identification number *within 20 days of hire* to the appropriate state agency. In many states, submission of a copy of the employee’s W-4 form (Employer’s Withholding Allowance Certificate) will satisfy the reporting requirement. The main reason for this requirement is to help in the enforcement of child support obligations. In addition, it will reduce fraud in the unemployment, workers’ compensation, and public assistance programs. Failure to report this information can result in fines of up to $25 per new hire. Even though federal law doesn’t require it, some states require the same information on independent contractors.

#### Davis Bacon Act

This act provides minimum wage coverage for laborers for contractors or subcontractors on federal government contractors.

#### Walsh-Healey Public Contracts Act

This act provides single minimum wage determined by the Secretary of Labor for laborers for contractors who furnish materials, supplies, articles, and equipment to any agency of the US.

#### Immigration Reform and Control Act of 1986 (IRCA)

IRCA forbids employers from knowingly hiring illegal aliens & provides criminal & civil penalties for violations. It requires all employers to verify employment eligibility for all individuals hired after November 6, 1986. The employer must examine the employee’s verification documents & have the employee complete Form I-9 within three (3) business days of employment. The Chapter 1 folder in Blackboard has a web link to this form.

#### Family & Medical Leave Act of 1993 (FMLA)

This act permits eligible employees as much as 12 weeks leave for family or medical reasons without fear of job layoff or dismissal. The law applied to employers with 50 or more employees within a 75-mile radius. The employer *can* *substitute* *an employee’s earned paid leave* for any part of the 12-week family leave. Employers can exempt the following:

* The highest-paid 10% of their workforce.
* Those who have not worked at least one year & at least 1,250 hours in the previous 12 months for the company.

#### Uniformed Services Employment and Reemployment Rights Act of 1994

This act gives military personnel the right to take leaves of absences from their civilian jobs for active military service and to return to their jobs with accrued seniority. The reinstatement must be to the employee’s original position or its equivalent, except for the dishonorably discharged. In addition, the return must be granted within two weeks of the job request, and health benefits must be started without any waiting period.

#### Employment Retirement Income Security Act of 1974 (ERISA)

This act covers employee pension & welfare plans established or maintained by any employer or employee organization engaged in commerce or in any industry or activity affecting commerce.

ERISA does *not* require any employer to provide a pension plan, but it *does* impose standards on both private & public employers to make sure that employees receive pension benefits they are due, commensurate with their years of employment. It also requires pension plan administrators to disclose to employees & the government financial information about plans offered.

If there is a pension plan, every employee is eligible after reaching the age of 21 or completing one year of service, whichever is later. *Vesting* conveys to employees the right to share in a retirement fund if they are terminated before the normal retirement age. Once vested, a worker has the right to receive a pension at retirement age, based on years of covered service, even though the worker may not be working for the firm at that time. Refer to 1-8e for information relating to the reporting and disclosure requirements set forth by ERISA which have tremendous implications on the recordkeeping requirements of employers.

#### Affordable Care Act of 2010 (ACA)

The ACA consists of two pieces of legislation: Patient Protection and Affordable Care Act and Health Care an Education Reconciliation Act. The act was designed to expand health insurance coverage to more Americans while increasing benefits and lowering costs for consumers.

## Other State Laws affecting the need for payroll & personnel records:

Worker’s Compensation Insurance protects employees & their dependents against losses due to injury or death incurred during employment. The employer bears the cost of the worker’s compensation insurance premiums, except in a few states. Because the *premium rates vary according to the different degrees of danger* in various classes of jobs, payroll records must indicate job classifications for rate purposes. If the employer has low accident experience, the rates may be reduced to a certain minimum.

State Disability Benefit Laws – California, Hawaii, New Jersey, New York, Rhode Island, and Puerto Rico have passed laws to provide disability benefits to employees absent from their jobs because of illness, accident, or disease *not arising out of their employment*. More discussion of state disability laws occurs in Chapter 5.

## Human Resources and Payroll Accounting Systems

Businesses must keep human resources (or personnel) and payroll records to meet the requirements of the various laws under which it operates. A business should design basic forms and records that satisfy the requirements of all the laws applicable to that organization. Some businesses consider payroll to be strictly an accounting function, but recently some businesses have placed payroll under the control of the Director of Human Resources. We will assume the two departments are separate in our book.

The *human resources system* embodies all those procedures & methods related to recruiting, selecting, orienting, training, & terminating personnel.

The requisition for personnel form notifies the Human Resources Dept. of the *need* for additional or replacement employees.

Every business should have an application form to be filled out by a person seeking employment. The application form allows the applicant to provide complete information as to personal qualifications, training, experience, & references. This form serves as a permanent record for the business & provides a means of obtaining information needed for various purposes.

Employers subject to fair employment laws must make certain that all aspects of the pre-hire inquiries are free of discrimination on the basis of race, color, religion, sex, national origin, or age. Of course, pre-hire questions pertaining to religion, sex, national origin, or age are allowed when these factors are bona fide occupational qualifications for a job. Companies may check some of the references given on the application blank. Generally, the employer must notify an employee if an investigative consumer report is being sought. In the event employment is denied because of the consumer report information, the employer must inform the individual that this was the reason or part of the reason for denying employment.

After the successful applicant is notified of employment & the starting date, time, & whom to report, a hiring notice is sent to the payroll department so that the new employee can be added properly to the payroll.

Employee History Record provides a continuous record of the relationship between the employee and the employer. Employee’s progress, attendance, promotions, performance appraisals, and salary increases are examples of data kept in this record.

Changes in Payroll Rate Form notifies the proper departments of a change in an employee’s pay rate.

A *payroll accounting system* embodies all those procedures & methods related to the disbursement of pay to employees. In most accounting systems, two basic records include: the payroll register & the employee’s earnings record.

The payroll register is a multicolumn form used to assemble & summarize the data needed at the end of each payroll period. It provides a detailed listing of a company’s complete payroll for that particular pay period. The information provided in the payroll register is used primarily to meet the requirements of the Fair Labor Standards Act, and also *provides information for recording the payroll entries in the journal* and for preparing reports required by other federal, state, and local laws. Cumulative earnings do not necessarily appear on the payroll register.

An addition to the information found in the payroll register, businesses must provide more complete information about the accumulated earnings of each employee. An employee’s earning record provides this more complete information. It is a separate payroll record for each employee. After the information is recorded in the payroll register, it can be recorded on the employee’s earning record. The information is used to prepare required periodic reports and to prepare a *W-2, Wage & Tax Statement*.

Checks are written to each employee for their *net pay* for the pay period. Most paychecks carry a stub, or voucher, that shows the earnings & deductions.