

Payroll Accounting 2022

Eighth Edition

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PAYROLL ACCOUNTING 2022, EIGHTH EDITION

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Landmark College

Jeanette Landin is an associate professor of business and accounting at Landmark College in Putney, Vermont, where she teaches undergraduate accounting and business courses to an at-risk student population. She is a baccalaureate student advisor and works with students to prepare them for employment.

Dr. Landin earned her BA degree from the University of California at Irvine before receiving her M.B.A and Ed.D. from the University of Phoenix, where she researched college success strategies for at-risk students. She has earned master's certificates in accounting and autism spectrum disorders.

Dr. Landin is an active member of the Institute for Management Accountants (IMA), the American Accounting Association, Teachers of Accounting Curriculum at Two-Year Colleges (TACTYC), the Association of Certified Fraud Examiners (ACFE), and Vermont Women in Higher Education (VWHE). She previously served as an active member of the California Business Educators Association and the Western Business Educators Association. Dr. Landin has served as the IMA's Committee for Academic Relations chair and as a peer reviewer for the American Accounting Association. She is a peer reviewer for the *Transnational Journal of Business* and the Associate Editor for Accounting with the Multimedia Educational Resource for Learning and Online Teaching (MERLOT).



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Dr. Schirmer was also recently an accountant with the Division of Finance for the State of Alaska. She worked as the statewide training coordinator and assisted with developing and troubleshooting the accounting program's reporting system. Dr. Schirmer was active in preparing Alaska's Comprehensive Annual Financial Report and assisted with the budgetary implementation, departmental accounting, and structure training.

Dedications

The authors dedicate this book to the following individuals:

For Chris, Kierstan, and Meaghan, who are the center of my universe, and for Dad, who believed in me until the very end.

—Jeanette Landin

For Royce and Elizabeth, who kept me grounded and reminded me to have fun. For Christina, who reminds me to stop and breathe.

—Paulette Schirmer

A Note from the Authors

We are excited to share the new edition of *Payroll Accounting 2022* with you. Payroll accounting is detailed, deadline-driven, and of utmost importance for the successful functioning of a business. The changing, detailed nature of payroll accounting involves legal challenges, economic changes, technological advances, and—above all—governmental obligations. Our text takes a modern approach to payroll accounting, incorporating coverage of real-world issues that many students will face in their careers, such as cybersecurity, payroll fraud, labor planning, and labor costs. We believe that this textbook's information and ancillary materials contribute to a comprehensive understanding of payroll accounting in the 21st century and will make accounting students more valuable to the organizations they work for in their careers.

But as educators, we understand that providing the content is not enough, so we provide multiple opportunities for students to practice in Connect. Whether you are teaching face-to-face, hybrid, or online, *Payroll Accounting 2022* is flexible enough to be used in courses as short as 3 weeks and as long as 15 weeks. We are proud of what we have accomplished with this text, and we thank the faculty and students who have provided feedback to refine the content in this edition. We strongly believe that we have taken payroll accounting education to a higher level of rigor.

Our payroll accounting approach is different from other existing texts because of our perspective about payroll's role in business. To us, payroll is more than pressing buttons, writing checks, and submitting forms—payroll is the story of **people**. These people include the ones within the business who make decisions about the company's directions and the people who work for the business and depend on their paychecks to support their livelihoods. We wrote this text because we wanted students to develop a sense of how business directly affects employees' lives and vice versa.

In light of the COVID-19 pandemic and changes to payroll practices that have emerged in 2020 and 2021, we have included information specific to employees and employers' governmental provisions. We did not wish to overload this edition with what we hope will be temporary changes to payroll practices during the pandemic. However, we wanted to make the information available for students who may encounter workplace issues related to the pandemic in the future.

To foster the connection between business and people, each chapter's introductory story contains recent events involving payroll accounting that highlight the connections among payroll, legislation, business decisions, and people affected by all the decisions made. In Chapter 1 and Chapter 2, we highlighted specific challenges stemming from the shift from employees working in a central location to working from home regarding payroll law and practice on both employees and employers. In Chapter 3, we explored the debate about increasing the minimum wage at the federal level. Chapter 4 explored the effects of the legislative guidance and temporary changes to fringe benefits to both employers and employees, such as the changes to Flexible Spending Accounts. In Chapter 5, we focused on the use of the 2021 Form W-4 and the effects of the employee Social Security tax deferral that occurred in late 2020. We removed the use of the IRS Income Tax Withholding Assistant spreadsheet because the 2021 tax tables were not updated into the tool at the time of publication. In Chapter 6, we explored the CARES Act's effects on employer tax reporting, especially as it pertains to Form 941, which was changed in June 2021 to reflect COVID-related tax reporting needed as of the second quarter of 2021. Finally, our Chapter 7 introduction considers how the shift to cloud-based accounting may affect future accounting practice despite a future return to centralized offices.

What makes this text a modern approach is that we believe that payroll is the connection between financial and managerial accounting. It has everyday connections to businesses, people, and the greater economy in a myriad of ways. Our approach is to encourage students to know the **how** of computing payroll and the **why** because we believe strongly that the future of the accounting profession involves knowledge of both the process and the purpose within the broader scheme of business. We have included materials to demonstrate the integration of payroll in other aspects of both managerial and financial accounting and business operations. Within Appendixes D and E, we have provided information that allows readers to connect their learning about payroll within the context of their own state's legal framework and links to each state's revenue department to facilitate specific learning. We are passionate about college education because we are both accounting faculty, and we bring a wealth of experience in accounting, education, industry, and governmental settings that informs our writing.

Our text features many interesting real-world connections. We've drawn examples from many different disciplines to help make payroll accounting come alive for teachers and students alike. We want to call specific attention to two discussions that are unique to our text: (1) the content in Chapter 6 that explores labor planning for employers

(Learning Objectives 6-5 and 6-6) and (2) the discussion in Chapter 7 about the function of labor costs in business and employee benefit reports as strategic tools

(Learning Objectives 7-5 and 7-6). We believe that this information contributes to a comprehensive understanding of payroll accounting in the 21st century. It will make accounting students more valuable as emerging accountants embarking upon their careers.

We strongly believe that payroll accounting needs to be applied, so we provide both a continuing problem, located at the end of each chapter, and a comprehensive problem, located in Appendix A, that may be presented in either three-month or one-month versions. Technological integration of the continuing problem and Appendix A within Connect provides an excellent tool for student learning and faculty assessment of course learning objectives. SmartBook 2.0, LearnSmart, and guided example videos of tax-form completion lead to reinforcement of both concepts and key terminology. We are excited to produce this work through McGraw-Hill because of its top-quality teaching and learning resources available through Connect. Teaching traditional payroll accounting and Internet-based financial accounting via McGraw-Hill's Connect platform for several years has been a wonderful experience for both our students and ourselves.

The AACSB guidelines encourage the achievement of the highest possible standards in business education. We believe that students should understand both how payroll should be completed and how it can be manipulated for personal gain. Payroll fraud continues to be a major source of loss for companies, and it is surprising to find how common it is. We've included examples of the frauds that employees have perpetrated in recent years. According to the Government Accounting Office, payroll fraud of all types, including misclassification of workers, costs the federal government \$16 billion annually. We hope that these stories enliven and enrich your class discussions. We've also updated the payroll processing options in Chapter 1 to reflect an accurate representation of the current state of the available technology used by businesses of any size (Learning Objective 1-5). In Chapter 2, we explored situations in which an individual may have multiple employers and changes implemented by the USCIS and the U.S. Department of Health and Human Services for Multistate employers (Learning Objective 2-2). We believe that this information about multiple employers and multistate employees is a growing issue that will challenge employers, especially as payroll employees have been working from remote locations.

Another new piece in this edition is the updated Employee Earnings Register to capture employees' data on Form W-4 and apply it to federal income tax computations. (Learning Objective 5-1). We have updated our section about cryptocurrency as a means of transmitting payroll amounts due. It is important to understand that cryptocurrency as a means of paying employees, while being considered, is a complicated issue because of its connection to the stock market, as opposed to a central bank, as a basis for its value. This topic is evolving. We are certain that we will witness the evolution of payment methods that will involve cryptocurrency in the future as far as regulating its use and protecting employee pay and employer tax remittance.

We continue to rely on our colleagues' guidance, instructor feedback, and student suggestions to keep us grounded and push us to deliver the best possible content. We hope you enjoy reading this book as much as we enjoy writing it!

Jeanette Landin
Paulette Schirmer

Changes to the Eighth Edition

Based on our reviewers' and users' feedback, we have included additional content in this eighth edition of *Payroll Accounting*. During the process of updating the eighth edition content, we clarified the payroll register as to marital status and types of dependents in both Chapter 3 and Chapter 5. We examined the CARES Act and the Payroll Protection Program in Chapter 1. We included a visual tool to assist the students with payroll register understanding in Chapter 3. We added clarification of Social Security taxes computation as the employee approaches the wage base in Chapter 5. We refined garnishment specifics and added a table regarding it to Chapter 5.

We have maintained our content about the available payroll certification exams. A correlation guide is included in Appendix F that aligns the learning objectives in the text with the topics included on payroll certification examinations offered by the National Association of Certified Professional Bookkeepers (NACPB), the American Institute of Professional Bookkeepers (AIPB), and the American Payroll Association (APA).

We appreciate all feedback and user recommendations we have received because they have helped us create a stronger, more complete text. The changes we have made have added clarity, updated information, and additional opportunities for students to demonstrate their understanding of the presented concepts.

The following are specific changes to each chapter.

Chapter 1

In Chapter 1, we updated payroll-related legislation to reflect as many changes as possible before publication. We clarified the differences between the Equal Pay Act of 1963 and the Lilly Ledbetter Act of 2009, including a current example of how the Lilly Ledbetter Act has occurred recently. We added information about the CARES Act and the Payroll Protection Program (PPP), which are still evolving issues, as well as COVID updates from OSHA, especially COBRA coverage as it relates to COVID-related job loss. We clarified the difference between Enterprise and Individual coverage under FLSA to foster student understanding of the law's fine details. We clarified the Affordable Care Act's current status since it was challenged in the courts during 2020. Finally, we extended our ethics discussion to include international laws and ethics.

Chapter 2

Chapter 2 now contains a completed example of a state's new hire reporting form. We clarified the difference between the 20-day state-based new hire reporting requirements and the three-day requirement associated with reporting information on the I-9. We updated the Independent Contractor final rule from 2020 and the working hours per month as reported by the Department of Labor. We updated data about paycard use and the rationale for the expansion of its use. We discussed the trend toward working from home as an outgrowth of COVID and the potential paradigm shift toward hybrid working arrangements.

Chapter 3

Chapter 3 contains two new visuals: One to help students understand the payroll register and the location of the required information, and one to assist with the understanding of the total, prove, and rule process. We updated the Department of Labor ruling about gig economy workers. We adjusted our payroll register format to segregate the employee's marital status and dependents for easier tax computations. We updated the 8 and 80 rule for nurses during the COVID pandemic. We have clarified pay practices for on-call and deceased workers and have added holiday and vacation pay examples using the payroll register.

Chapter 4

We continue to expand the discussion of fringe benefits in Chapter 4. We explored specific fringe benefits that employers have offered during the COVID pandemic. We clarified specific benefits that have recently been offered and may continue after the conclusion of the pandemic.

Chapter 5

Chapter 5 expanded our explanation about using pages three and four of the 2020 (and later) Form W-4 in conjunction with the Federal Income Tax Withholding Assistant spreadsheet. We added clarification to the computation of Social Security tax for employees whose wages approach the annual wage base. We discussed how employees who work from home might be subject to different state and local taxes than they would otherwise have been before

the pandemic because of the change in their primary work location. We added tables to explain garnishment maximums by category.

Chapter 6

In Chapter 6, we explained how the CARES Act provisions affect employer tax due dates in 2021 and 2022. We discussed the changes to tax forms in 2021 and the optional Social Security tax deferral that affected employees in late 2020. We explored the PPP program changes in early 2021 to provide additional relief targeted for small employers.

Chapter 7

Chapter 7 explores the effects of the COVID pandemic on payroll accounting practices. We highlighted how payroll costs could rise despite decreased employment.

Appendix A: Comprehensive Payroll Project

In Appendix A, we continued emphasizing the completion of the payroll register and the transfer of data to both employees' earnings records and accounting entries.

We included the New Hire Report form for Nevada and updated the payroll register to reflect current practices.

Appendix C: Federal Income Tax Tables

We updated both the percentage and the wage-bracket methods of determining federal income tax withholding to reflect the most current tax rates available. We have included both Publication 15 and Publication 15-T in this appendix.

Appendix D: State Income Tax Information

We updated the tax rates for each state in Appendix D.

Appendix F: Payroll Certification Information

We continued correlating the learning objectives in this text with the topics included on payroll certification examinations offered by the National Association of Certified Professional Bookkeepers (NACPB), the American Institute of Professional Bookkeepers (AIPB), and the American Payroll Association (APA). We included the certification exam requirements and contact information for each certification organization.

Text Features

Chapter Opener

Each chapter opens by focusing on a payroll accounting topic related to a real-world company to set the stage for the topic of the chapter.

1

Chapter One

Payroll Practices and System Fundamentals

Payroll systems are an essential part of job planning and strategic human resource management, cost management for products and services, and benefits analysis. A company's payroll system has historically connected human resources and accounting departments. In contemporary businesses, payroll has taken on a strategic role in company direction and plans. The continual evolution of technological tools to manage company resources, including monetary and human, provides both opportunities and challenges to employers regarding employee access and private information protection. A well-designed payroll system is a critical element in company management; for this reason, an understanding of payroll foundations is imperative. This chapter will explore the need for a payroll system, legal requirements, ethical guidelines, best practices, and variations in payroll practices among different-sized companies.

LEARNING OBJECTIVES

After studying Chapter 1, you should be able to:

LO 1-1 Identify Legislation That Pertains to Payroll and Business

LO 1-2 Discuss the Legal Framework Specific to Payroll Accounting

Stop & Check

Which Law?

1. Requires employers to verify the employee's legal right to work in the United States?
2. Protects the rights of disabled workers?
3. Governs the management of retirement plans?
4. Protects discrimination of workers older than age 40?
5. Creates safe work environments for employees?
6. Mandates equal pay for equal work?
7. Extends medical benefits for terminated employees?
8. Ensures that child support obligations will be paid?
9. Protects workers and families with preexisting medical conditions?
10. Enforces payment of monetary damages because of discrimination?
11. Requires internal controls on payroll practices of public companies?

- a. COBRA
- b. ERISA
- c. Civil Rights Act of 1991
- d. PRWOR
- e. SOX
- f. ADEA
- g. HIPAA
- h. ADA
- i. OSHA
- j. Equal Pay Act of 1963
- k. IRCA
- l. SECURE

Stop & Check

The Stop & Check feature allows students to review their understanding of the content just read. It also enables instructors to conduct formative assessments at multiple points throughout each chapter, testing the students' understanding informally as well as offering opportunities to expand on the material.

Trends to Watch

Each chapter contains a feature box that connects payroll-related recent events with industry trends that shape the future of the profession. These trends offer instructors more opportunities to expand upon chapter topics, fostering discussion and application.

Trends to Watch

LEGAL ENVIRONMENT

To say that the legal environment of payroll is continually evolving is an understatement. Since 2017, we have witnessed the following legal challenges:

- Increasing numbers of private employers and localities raise the minimum wage significantly to close the minimum wage gap and the living wage.
- Challenges to the Affordable Care Act related to the overturn of the individual mandate for health care coverage.
- Supplemental wage rate changes for payments of bonuses.
- State enforcement of predictive scheduling, fair/flexible scheduling laws on changing employee's schedules.
- Reframing the federal income tax structure, treatment for nonresident aliens, supplemental wage withholding rates, and inflation adjustments.

Some trends to watch include

- A shift to complete digitalization of payroll processes, including partial or complete remote work options.
- Increased guidance about payroll tax impacts of COVID-19 as it affects employees, both part- and full-time.
- An increase in the need for centralized and fully communicated company policies to meet remote workers' needs.
- Payroll data will increase in importance for business decisions.

End-of-Chapter Assessments

Students can demonstrate their understanding through assessments designed to complement the chapter's learning objectives. Each chapter has review questions, exercises, and problems, with the exercises and problems having two sets each chapter (Set A and Set B). Each type of assessment is designed to measure student learning as follows:

- Questions for review are designed to check for students' remembrance of concepts.
- Exercises check for understanding and application of chapter concepts.
- Problems allow students to apply and analyze payroll accounting principles.

Exercises Set A

- E1-1A.** LO 1-1, 1-2
Lupore Fabrics obtained a contract in Watts Mills, South Carolina, that involves the production of materials for military uniforms, a project contracted with the federal government for \$2,800,000. What laws govern the wages Lupore Fabrics pays to its workers for this project? (Select all that may apply.)
1. Davis-Bacon Act
 2. Sarbanes-Oxley Act
 3. Walsh-Healey Act
 4. FLSA
- E1-2A.** LO 1-1, 1-2
Martine Piccirillo works as the payroll clerk for Centinix, a security company that hires many part-time and temporary workers who are paid hourly. What law governs the hiring or documenting of these workers?
1. ADEA
 2. FLSA
 3. IRCA
 4. USERRA

Critical Thinking

- CT1-1.** You have been hired as a Dynozz Medical Software consultant, which is facing an IRS audit of its accounting records. During your review, you notice anomalies in the payroll system involving overpayments of labor and payments to terminated employees. What should you do?
- CT1-2.** Liliya Milic is the accountant for Syiva, a local nonprofit organization. She has been tasked with managing the payroll costs so that staffing levels may remain the same even if funding levels change. She considers outsourcing the payroll to a payroll processing company. What are some factors that Liliya should consider in her decision? Why are these factors important?

Critical Thinking Exercises

Want to challenge your students further? The Critical Thinking Exercises require students to consider complex real-world situations that build confidence and turn learning into mastery. These exercises offer possibilities for team presentations or class debate.

In the Real World: Scenarios for Discussion

Each chapter contains a discussion scenario that is drawn from real-world events. These scenarios encourage the expansion of chapter content and allow students to apply their learning to real situations.

In the Real World: Scenario for Discussion

Domino's Pizza franchises in New York were sued by the state of New York in 2010 for wage theft at 10 stores. Under New York law, a corporation and a franchiser are considered joint employers if they meet certain employee control criteria. The state found that Domino's met the criteria for being a joint employer because it mandates a significant number of policies with which franchisers must comply. The problem arose when Domino's mandated the use of PULSE payroll software, which the pizza company knew to be flawed and did not attempt to remedy. The flawed software led to employees being paid at rates below the legal minimum wage, failed to pay overtime, did not reimburse employees for vehicle use, and abused tip credit guidelines.

Internet Activities

The Internet Activities at the end of each chapter offer students the chance to use their web navigation skills to expand on their learning. These exercises attract tech-savvy learners, allowing them to form their own understanding of payroll concepts on their own terms.

Internet Activities

- 1-1. Using the website www.jstor.org, search for articles about payroll-related laws or relevant employment legislation. Once you find an article, summarize the article and explain how the legislation influenced contemporary payroll practices.
- 1-2. Visit the website of the American Payroll Association at www.americanpayroll.org. On the right side of the Home page, you will find articles about recent developments in payroll practices and legislation. Choose an article and create a presentation to your class about how its content affects payroll practice.
- 1-3. Want to know more about the specifics of some of the concepts in this chapter? Check out these websites:



Continuing Payroll Project: Prevosti Farms and Sugarhouse

Toni Prevosti is opening a new business, Prevosti Farms and Sugarhouse, a small company that will harvest, refine, and sell maple syrup products. In subsequent chapters, students will have the opportunity to establish payroll records and complete payroll information for Prevosti Farms and Sugarhouse.

Toni has decided that she needs to hire employees for the business to grow. Complete the application for Prevosti Farms and Sugarhouse's Employer Identification Number (Form SS-4) with the following information:

Prevosti Farms and Sugarhouse is located at 820 Westminster Road, Bridgewater, Vermont, 05520 (which is also Ms. Prevosti's home address), phone number 802-555-3456. Bridgewater is in Windsor County, Vermont. Toni, the responsible party for a Limited Liability Corporation created in the United States with one member (disregarded entity), has decided that Prevosti Farms and Sugarhouse will pay its employees on a biweekly basis. Toni's Social Security number is 055-22-0443. The beginning of the business is January 1, 2021.

Continuing Payroll Project: Prevosti Farms and Sugarhouse

Starting with Chapter 1, each chapter has an integrated, continuing payroll project—about a fictional company Prevosti Farms and Sugarhouse—that matches the chapter content and affords students a macro-level understanding of how each piece of payroll fits together.

Comprehensive Payroll Project: Wayland Custom Woodworking

The Comprehensive Payroll Project (Appendix A) allows students to track a quarter's worth of payroll transactions for a company. This Comprehensive Payroll Project offers instructors increased flexibility in teaching and assessment by offering a simulation equivalent to a full quarter of a fictitious company's payroll activities, including payroll transactions, pay processing, and tax form completion. The Comprehensive Payroll Project may be presented in different lengths—as short as one month or in its three-month entirety—to meet curricular needs. Instructors may assign this in connection with many chapters of the book or use it as a final project for their courses.



Comprehensive Payroll Project: Wayland Custom Woodworking

Wayland Custom Woodworking is a firm that manufactures custom cabinets and woodwork for business and residential customers. Students will have the opportunity to establish payroll records and to complete a month of payroll information for Wayland.

Wayland Custom Woodworking is located at 12850 Old Highway 50, Glenbrook, Nevada, 89413, phone number 775-555-9877. The owner is Mark Wayland. Wayland's EIN is 91-7444533 and the Nevada Employer Account Number is E6462582020-6. Wayland has determined it will pay its employees on a semimonthly basis. Federal income tax should be computed using the *percentage* method.

Students will complete the payroll for the final quarter of 2021 and will file the fourth quarter and annual tax reports on the appropriate dates. At the instructor's discretion, students may complete a short version, which contains the payroll transactions beginning December 6. Directions for completion of the short version follow the November 30 transactions.

Rounding can create a challenge. In these exercises, the rate for the individual's pay should be rounded to the nearest cent. Take the employee's salary and divide it by 2,080 (52 weeks at 40 hours per week). Round the result to the nearest cent.

Connect for Payroll Accounting 2022

- **SmartBook 2.0®** A personalized and adaptive learning tool used to maximize the learning experience by helping students study more efficiently and effectively. SmartBook 2.0 highlights where in the chapter to focus, asks review questions on the materials covered and tracks the most challenging content for later review. SmartBook 2.0 is available both online and offline.
- **End-of-chapter content** is a robust offering of review and question material designed to aid and assess the student's retention of chapter content. The end-of-chapter content is composed of both static and algorithmic exercises, problems, critical thinking exercises, and continuing payroll projects, which are designed to challenge students using McGraw-Hill Education's state-of-the-art online homework technology. Guided example videos are also provided with select end-of-chapter problems, which help walk students through complex payroll processes. Instructors can also assign test bank questions to students in both static and algorithmic versions.
- **Auto-graded payroll and tax forms** are integrated into Connect and are assignable. Students can complete the forms in these problems to gain a better understanding of how payroll forms are prepared in today's digital world.
- **Guided example videos** are also provided with select end-of-chapter problems, which help walk students through complex payroll processes. Instructors can also assign test bank questions to students in both static and algorithmic versions.
- **The comprehensive payroll project** from Appendix A is available on Connect in an auto-graded format. Students will apply skills, such as preparing tax forms and payroll registers, to complete the payroll process for a company from start to finish. Instructors can choose from the full three-month version or the shorter one-month version for their Connect assignment.
- **The test bank** for each chapter has been updated for the seventh edition to stay current with new and revised chapter material, with all questions available for assignment through Connect. Newly available within Connect, Test Builder is a cloud-based tool that enables instructors to format tests that can be printed or administered within a LMS. Test Builder offers a modern, streamlined interface for easy content configuration that matches course needs, without requiring a download. Test Builder provides a secure interface for better protection of content and allows for just-in-time updates to flow directly into assessments.

Auto-Graded Forms

Complete this question by entering your answers in the tabs below. There is nothing to be filled out on the "W-4 Information" tab. This is merely for reference when completing the Form W-4 tab.

Form W-4 19 Page 1 19 Page 2 W-4 Instructions

Complete the W-4 for Student Success.

W-4 Employee's Withholding Certificate

OMB No. 1545-0047

Form W-4 (Rev. December 2020)
Department of the Treasury
Internal Revenue Service

2021

▶ Complete Form W-4 so that your employer can withhold the correct federal income tax from your pay.
▶ Give Form W-4 to your employer.
▶ Your withholding is subject to review by the IRS.

Step 1: Personal Information

(a) First name and middle initial Last name Social security number

Address

City or town, state, and ZIP code

(b) ☐ Single or married filing separately
☐ Married filing jointly or Qualifying widow(er)
☐ Head of household (Check only if you are unmarried and pay more than half the costs of keeping up a home for yourself and a qualifying individual.)

Complete Steps 2-4 ONLY if they apply to you; otherwise, skip to Step 5. See page 2 for more information on each step, who can claim exemption from withholding, when to use the estimator at www.irs.gov/W4App, and privacy.

Step 2: Multiple Jobs or Spouse Works

Complete this step if you (1) hold more than one job at a time, or (2) are married filing jointly and your spouse also works. The correct amount of withholding depends on income earned from all of these jobs. Do only one of the following.

(a) Use the estimator at www.irs.gov/W4App for most accurate withholding for this step (and Steps 3-4); or

(b) Use the Multiple Jobs Worksheet on page 3 and enter the result in Step 4(c) below for roughly accurate withholding; or

(c) If there are only two jobs total, you may check this box. Do the same on Form W-4 for the other job. This option is accurate for jobs with similar pay; otherwise, more tax than necessary may be withheld. ☐

TIP: To be accurate, submit a 2021 Form W-4 for all other jobs. If you (or your spouse) have self-employment income, including as an independent contractor, use the estimator.

Comprehensive Payroll Project

Complete the Payroll Register for October 15.

PRR End Date: Company Name: Westland Custom Woodworking

Check Date:

| Name | Filing Status | Dependents | Hourly Rate or Period Wage | No. of Regular Hours | No. of Overtime Hours | No. of Holiday Hours | Commissions | Gross Earnings | Insurance | 401(k) | Taxable Wages for Federal W-4 | Taxable Wages for FICA |
|----------------|---------------|------------|----------------------------|----------------------|-----------------------|----------------------|-------------|----------------|-----------|--------|-------------------------------|------------------------|
| Audrey Chance | | | | | | | | | | | | |
| Mark Westland | | | | | | | | | | | | |
| Kevin Peterson | | | | | | | | | | | | |
| Steven Cooper | | | | | | | | | | | | |
| Lauren Brown | | | | | | | | | | | | |
| Debra Stevens | | | | | | | | | | | | |
| Total | | | | | | | | | | | | |

| Name | Gross Earnings | Taxable Wages for Federal W-4 | Taxable Wages for FICA | Federal W-4 | Social Security Tax | Medicare W-4 | Union Dues | Net Pay | Check No. |
|----------------|----------------|-------------------------------|------------------------|-------------|---------------------|--------------|------------|---------|-----------|
| Audrey Chance | | | | | | | | | 4213 |
| Mark Westland | | | | | | | | | 4216 |
| Kevin Peterson | | | | | | | | | 4217 |
| Steven Cooper | | | | | | | | | 4218 |
| Lauren Brown | | | | | | | | | 4219 |
| Debra Stevens | | | | | | | | | 4220 |
| Total | | | | | | | | | |

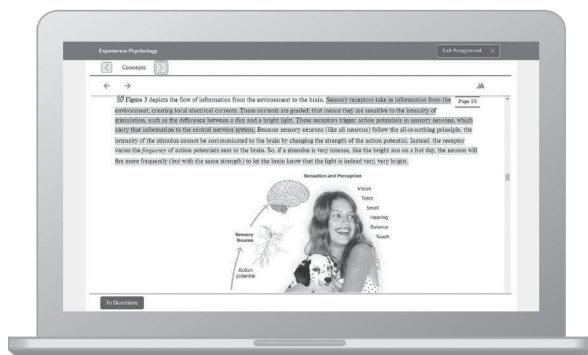


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Payroll Accounting 2022

Chapter One

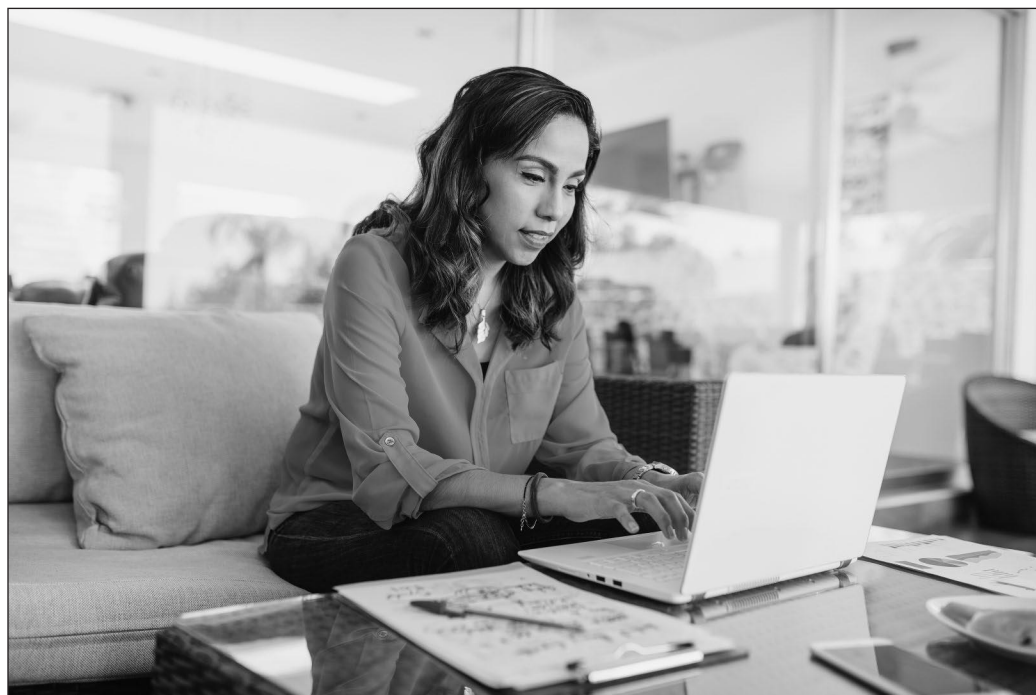
Payroll Practices and System Fundamentals

Payroll systems are an essential part of job planning and strategic human resource management, cost management for products and services, and benefits analysis. A company's payroll system has historically connected human resources and accounting departments. In contemporary businesses, payroll has taken on a strategic role in company direction and plans. The continual evolution of technological tools to manage company resources, including monetary and human, provides both opportunities and challenges to employers regarding employee access and private information protection. A well-designed payroll system is a critical element in company management; for this reason, an understanding of payroll foundations is imperative. This chapter will explore the need for a payroll system, legal requirements, ethical guidelines, best practices, and variations in payroll practices among different-sized companies.

LEARNING OBJECTIVES

After studying Chapter 1, you should be able to:

- LO 1-1** Identify Legislation That Pertains to Payroll and Business
- LO 1-2** Discuss the Legal Framework Specific to Payroll Accounting
- LO 1-3** Discuss the Ethical Guidelines for Payroll Accounting
- LO 1-4** Identify Contemporary Payroll Practices
- LO 1-5** Compare Payroll Processing Options for Different Businesses



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Payroll Accounting Goes Remote

Amid the wide variety of changes employers and employees experienced during 2020, one aspect is here to stay: Remote payroll accounting.

Although online payroll services have been evolving for several years, the practice of completing payroll-related duties became entirely remote out of necessity during 2020. The transition from in-house payroll processing to a hybrid or fully remote model was challenging yet necessary. Employers and employees adapted to a new payroll accounting model and reporting that transpired alongside the development of robust professional communication systems such as Zoom. A challenge was to ensure the security and accuracy of the payroll process, and software was developed to meet that need.

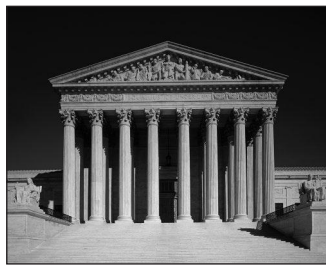
Top CPA firms such as Friedman, located in Pennsylvania, and Prager Metis, located in New Jersey, adapted to the fully remote model by ensuring that their computer-based hardware and software at the corporate offices could withstand the computerized traffic. Additionally, payroll employees ensured their home-based WiFi connections were robust and that they had the necessary forms, software, instructions, and other documentation to complete their work remotely.

The question for the future is if the remote payroll processing will continue as a fully remote, hybrid, or office-based practice. Each company will have to make the appropriate choice.

(Source: Accounting Today)

Payroll accounting is highly complex and dynamic. Large employers must abide by the law and be aware when it comes to payroll. This chapter will explore the basics of payroll systems, payroll accounting issues involved with employee pay.

LO 1-1 Identify Legislation That Pertains to Payroll and Business



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Unlike many other accounting types, payroll affects most (if not all) members of an organization. Payroll errors can lead to serious internal and external problems. Internal errors may cause a company to pay excessive wages for unneeded overtime, underpay employees, forego profits, or employ the wrong number or type of workers during seasonal or other workflow changes. Managers use internal reports about labor usage, staffing levels, and employee compensation trends to ensure operational effectiveness. Organizational decision-makers use these reports to control labor costs, hire additional employees to meet surge demands, and manage the cost of goods sold. Payroll errors can result in governmental fines, taxes, or legal charges related to labor law violations. Employers provide external reports to the Internal Revenue Service (IRS), state government tax departments, and many more agencies, depending upon the company's nature.

2020 was an extraordinary year for payroll accountants. Paychex® recommended that the following items must be clearly articulated and verified for year-end reporting:

- All in-house payroll records, including voided checks.
- All employee pension and retirement-related items.
- Any fringe benefits.
- Healthcare and dependent-related items.
- All insurance-related items.

(Source: Accounting Today)

According to the **United States Bureau of Labor Statistics**, as of 2019, employment in accounting jobs is expected to increase 4 percent through 2029, which is the average growth for business professions. Salaries average \$45,800 for payroll clerks, \$80,538 for payroll supervisors, and \$101,857 for payroll managers, according to the 2021 salary guides available via www.salary.com.

The legislative framework governing employers' payroll systems is complex. Although several fundamental laws still exist, payroll and human resource laws reflect societal evolution over time. Note how some of these laws have been challenged or changed since their inception.

The **Equal Pay Act of 1963**, which extended the provisions of the **Fair Labor Standards Act (FLSA)**, mandated that males and females be paid equally for equal work. As of 2020, 48 states have enacted legislation that clarifies and/or extends the original 1963 act. Any employees who feel they have been paid unequally based upon gender have legal options to rectify the situation:

- First, they should gather documentation regarding the differential and determine if other employees in question are willing to substantiate the difference.
- Second, they should speak with their supervisor to question the pay differential.
- Should the supervisor be unwilling to discuss or adjust the pay discrepancy, an attorney may become a necessary third step.

This act was modified by the **Lilly Ledbetter Fair Pay Act of 2009**, which removed the 180-day statute of limitations on unequal treatment claims.

In 1979, Lilly Ledbetter, an employee of Goodyear Tire and Rubber Company, started at the same pay rate as males in the same position. Over time, management declined

her raises based on negative reviews that Ms. Ledbetter later claimed were discriminatory. Under the provisions of the 1963 Equal Pay Act, the claimant had 180 days to file a complaint. Although the U.S. Supreme Court agreed with her discrimination claims, it ruled in favor of Goodyear because of the lack of timeliness of Ms. Ledbetter's filing. This ruling ultimately led to the Lilly Ledbetter Fair Pay Act of 2009.

In January 2021, the Federal Appeals Court for the 7th Circuit in Chicago upheld a case brought by Dr. Cheryl Kellogg in which she alleged wage discrimination. In *Kellogg v. Ball State University*, Dr. Kellogg's employer told her that she did not warrant a wage consistent with her education because her husband worked for the same institution, and she was not in need of the money. The appeals court overruled any concerns regarding the case's timing because of the Lilly Ledbetter Fair Pay Act.

(Source: U.S. EEOC, Education Week)

The **Civil Rights Act of 1964** prohibited discrimination based on race, creed, color, gender, and national origin. Since 1964, this act has been extended by Executive Order 11478 to protect people with AIDS, pregnant workers, people with different sexual orientations, and people with disabilities. In June 2015, the U.S. Supreme Court ruled in *Obergefell v. Hodges* (U.S. Supreme Court No. 14-556) that same-sex marriage was legal and could not be banned in any state. This extension of the 1964 Civil Rights Act represented another step toward the legal protection of worker dignity.



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The **Age Discrimination in Employment Act of 1967 (ADEA)** prevents mandatory retirement of older employees (older than age 40) and prohibits age-based discrimination in hiring.

An AARP survey conducted in Oregon found that 62 percent of workers over the age of 40 who have applied for employment have been discriminated against due to their age. Approximately 35 percent of job applicants over the age of 40 have been asked age-related questions during job interviews, which is a violation of ADEA. As of 2021, **ORS 659A.009** mandated that the individual's ability to perform a job, not the person's age, is the standard for employment.

(Source: AARP, Oregon Laws)

The **Occupational Safety and Health Act of 1970 (OSHA)** defined and enforced healthy and safe working environments for employees. Employee safety programs and personal protective equipment represent an additional cost to the employer. Still, fines for non-compliance and payments made following workplace injuries are often far more costly: fines range from \$13,494 per serious violation to \$134,937 (2021 figures) for willful or repeated violations.

The COVID-19 pandemic required additional strengthening and clarity in the OSHA standards for Personal Protective Equipment (PPE) and the General Duty of employers for employee safety.

Summary of changes

1. OSHA required employers to provide appropriate PPE for employees, including protection for eyes, hands, and the face. Special provisions of this requirement included a respiratory protection plan when respirators were required.
2. OSHA amended the general duty clause to require that employers provide a safe workplace that protected employees from physical harm to the greatest possible extent.

(Source: OSHA)

The *Employee Retirement Income Security Act of 1974 (ERISA)* regulates retirement and pension plans. ERISA has been extended by the *Consolidated Omnibus Budget Reformation Act of 1985 (COBRA)*. During 2007–2009, some employee retirement funds' value decreased, causing employees to postpone retirement. The Internal Revenue Service imposes limitations on retirement plan contributions, and those limits have shifted to reflect the need for employees to recoup losses sustained during the recession. Since that time, employee retirement benefits have shifted from being a financial burden to becoming an employee hiring and retention strategy. Retirement researchers are contemplating proposing a mandatory retirement savings law.

COBRA extended medical benefits for terminated employees at the employee's expense for up to 18 months post-employment by qualified employers. It should be noted that not all companies are subject to COBRA provisions and that states may offer "mini-COBRA" plans for employees of companies with fewer than 20 employees. The repeal of the Defense of Marriage Act (DOMA) in 2013 forced employers to offer COBRA coverage to same-sex spouses. As of 2020, terminated employees who opt not to enroll in COBRA plans may enroll in *Marketplace* plans or Medicaid for up to 60 days post-termination. If the employee chooses not to use the COBRA plan immediately, they may enroll in it at the company's next enrollment period.



Donenko Oleksii/Shutterstock

COBRA benefits currently extend to beneficiaries, including employees, dependent spouses, and children. Benefits are paid to beneficiaries in the event of reduced hours or separation of employment for any reason excluding gross misconduct and upon the death of the employee. If the company offers retiree benefits, COBRA coverage also extends to beneficiaries in Chapter 11 bankruptcy.

In 2020, the *Setting Every Community Up for Retirement Enhancement (SECURE) Act* granted small employers tax incentives to implement an automatic retirement plan enrollment for their employees. Alternatively, the act allows small employers to form a group that would allow each business's employees to have better access to retirement plans than the employer could offer by itself.

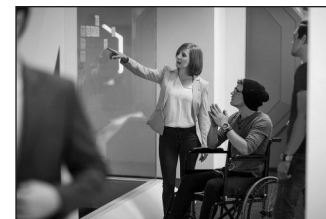
A development in 2019 involved the IRS approval of an employer connecting employee 401(k) contributions toward payment of their student loans. In one instance, the guidelines for an employer's contribution to the employee's student loan were that the employees were paying at least 2 percent of their salary toward their student loans during a given period. Other companies, such as Abbott, offer an expanded 401(k) employer match for employees who meet similar guidelines regarding their student loan repayment.

(Source: Employee Benefit News)

The *Immigration Reform and Control Act of 1986 (IRCA)* requires employers to verify that employees are legally able to work in the United States. Form I-9 is the most common payroll-related application of this law. Immigration and citizenship laws require collecting information within an I-9, and retention is three years from the date of hire or one year from the date of termination (whichever is longer).

Information collected on Form I-9 is monitored closely to ensure that the employee is legally authorized to work in the United States. Employers may also use the *E-verify* system to confirm legal employment eligibility. Note that the E-verify system does not replace the completion of the I-9 but does offer employers the opportunity to check legal employment eligibility rapidly via the Internet.

The *Americans with Disabilities Act of 1990 (ADA)* extended the provisions of the Civil Rights Act of 1964 by ensuring that people with disabilities have the same opportunities as those without mental or physical impairment. This law applies to employers with 15 or more employees on the payroll, including full-time and part-time workers. The enactment of the *Americans with Disabilities Act Amendments Act (ADAAA)* in 2008 extended the definition of disability to include many disabilities. Final Regulations on the ADAAA in 2011 clarified the definitions of disability and the required accommodations to include the following:



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- The expansion of the definition of disability includes a lower standard of the definition of impairment.
- The determination of impairments requires the employee to be assessed individually.
- Except for corrective lenses, the determination of disability does not include devices that provide relief or mitigation of the condition, such as hearing aids.
- Impairments that occur periodically or episodically or that are in remission are still considered impairments.
- Any disability determination must not require extensive analysis.

The *Civil Rights Act of 1991* granted employees who have been discriminated against the chance to be paid monetary damages through legal proceedings. This act applies to American employers and American-controlled employers with internationally based operations.

Workplace diversity and inclusion have become an increasing priority at workplaces during the last decade. As of 2020, *Forbes* posted its listing of the best workplaces for diversity and inclusion, sourced from polls of 60,000 Americans who worked for companies with a minimum of 1,000 employees. The top three employers included

1. SAP Software
2. Henry Ford Health System
3. Procter & Gamble

(Source: *Forbes*)

The *Family and Medical Leave Act of 1993 (FMLA)* granted employees the right to take medical leave under reasonable circumstances without fear of job loss. The employee may have to take unpaid leave, but medical benefits must continue under FMLA provisions. Upon returning from family leave, the employer must provide an equivalent position with equivalent pay, benefits, and employment terms. The employer has many responsibilities under the FMLA that involve employee notification of benefits and processes while on leave.



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As of 2020, several states have enacted higher-paid family leaves legislation: California, Connecticut, New Jersey, New York, Oregon, Rhode Island, Washington D.C. (July 2020), and Massachusetts (January 2021). More states consider paid family leave, which will lead to further clarification about paid family leaves, limits, and specific provisions.

In 2017, legislators passed the Tax Cuts and Jobs Act (Public Law 115-97) in Washington. This provided a tax credit to employers who offer their employees paid leave under the FMLA. Employers may be eligible for a credit of 12.5 percent up to 25 percent, whereas the employee's rate of payment is 50 percent or more of what the employee would normally

be paid during the normal course of work for the company. Eligibility limits of the type of employer and employee exist under regulations (see **Sec. §13403**).

The Tax Cuts and Jobs Act (TCJA) has led to specific areas of focus for employers. These areas of focus include

- Controversy: When the TCJA provisions expire at the end of 2025, companies may need to re-file tax returns, making record-keeping and changes made due to the TCJA enactment a critical function in payroll.
- International tax: For companies with an international presence, including employees, the TCJA may result in new tax liabilities.
- Compensation for executives: TCJA affected highly compensated employees' tax treatment and fringe benefits offered to workers. This has led to scrutiny of compensation plans and their legal compliance.
- State taxes: Because of TCJA provisions, some states have witnessed tax increases for employees. Since each state has different tax laws, and not all states have chosen to comply with TCJA provisions, state taxation has become increasingly complex.

(Source: AICPA)

The **Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA)** governs military service members' rights in terms of length of military service, return to work, and accommodations for injured veterans. USERRA was amended as to service members' rights in 2005. In 2011, USERRA was further amended by the Veterans Opportunity to Work Act, which allowed USERRA to recognize claims of a hostile work environment resulting from an individual's military status.

The U.S. Department of Labor investigates many cases involving service members' rights. Army veteran Lisa Slater returned to her job as a security officer, which she held for 13 years with her company, after deployment on active duty. However, upon her return to her employment, she found that she was classified as a new employee, which was a violation of USERRA. She received approximately \$20,000 in back wages, and her seniority was restored following arbitration.

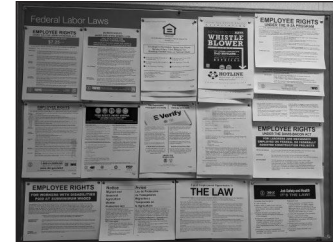
(Source: U.S. DOL)

The **Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWOR)** mandated that employers file a new hire reporting form within 20 days after an employee initially commences work. This act protects children and needy families by enforcing child support obligations. The child support provisions of PRWOR were strengthened by the passage of the **Personal Responsibility, Work and Family Promotion Act of 2002**, which reauthorized PRWOR when it expired.

According to the Office of Child Support Enforcement (OSCE), employers assisted in collecting over \$24 billion during 2018 through their timely reporting of new hires. Additionally, the Temporary Assistance for Needy Families (TANF) for child support in arrears decreased by 11 percent between 2008 and 2018.

(Source: Office of Child Support Enforcement)

The **Health Insurance Portability and Accountability Act of 1996 (HIPAA)** protects workers and their families who have preexisting medical conditions from discrimination based on those conditions. The Ebola outbreak in 2014 led to additional guidance about HIPAA rights and notifications to interested parties, including employers, during emergencies.



Jeanette Landin

HIPAA protections continue even after a business ceases operations. Filefax Inc. of Illinois was ordered to pay approximately \$100,000 in fines because of HIPAA violations, although the company is no longer in business. The issue leading to the fines involved a lack of secure storage of employee health records following an investigation by the Office of Civil Rights.

(Source: U.S. HHS)

The **Defense of Marriage Act of 1996 (DOMA)** restricted payroll-related taxes and benefits to include only traditionally married couples, denying married status to people in same-sex unions. The U.S. Supreme Court overturned DOMA in its ruling in *U.S. v. Windsor* on September 6, 2013. The Internal Revenue Service subsequently mandated that all married same-sex couples must be treated as married for all tax purposes. The repeal of DOMA had a ripple effect throughout all payroll phases because of the need to amend business and personal tax return filings back to 2011, owing to the three-year amendment rule. The effects of DOMA's repeal also have had a ripple effect on employee rights, highlighting the need for additional legislative clarification.

The repeal of DOMA provoked the need to clarify the term “family member.” Following the U.S. Supreme Court decision in *Obergefell v. Hodges* (2015), the U.S. Department of Labor updated the definition of spouse to include same-sex marriages, regardless of where they live.



Maskot/Getty Images

In *U.S. v. Windsor*, Ms. Windsor and her wife were recognized as a married couple by the state of New York, and her compensation was taxed accordingly. However, the IRS sued Windsor for unpaid taxes because her same-sex marriage violated DOMA. The U.S. Supreme Court found that DOMA violated Windsor's Fifth Amendment right to liberty and overturned DOMA. The IRS subsequently dropped its lawsuit.

(Source: U.S. Supreme Court)

The **Sarbanes–Oxley Act of 2002 (SOX)** provided criminal penalties for violations of ERISA. SOX provides protections for whistleblowers (Sec. § 806) and mandates auditors' rotation among publicly owned companies (Sec. § 203). SOX Section 302 mandates that corporate officers must attest to the accuracy and completeness of the financial statements' contents. An additional consideration for SOX public companies regarding payroll is that the internal controls of a payroll system must be reported under the law's guidelines (Sec. § 404). Costs of SOX compliance have sparked discussion about the act's effectiveness.

In 2020, SOX and the Dodd–Frank Act, which involved consumer protection and oversight of trading via the New York Stock Exchange, intersected to strengthen consumer protections (known as *qui tam* rewards). The intersection led to a bill introduced in

(continued)

(concluded)

Congress to create an independent board to oversee auditor conduct in publicly held companies, thus limiting conflicts of interest and protecting individuals who invest in companies traded on the stock market.

(Source: National Law Review)

The *American Recovery and Reinvestment Act of 2009 (ARRA)* provided tax credits for employers and employees through the Making Work Pay provisions. Although ARRA's provisions have expired, parts of it were reinstated through the *American Taxpayer Relief Act of 2012 (ATRA)*. Many of the ATRA provisions were extended through 2015 by extending the Work Opportunity Tax Credit and extended through 2021. The *Protecting Americans from Tax Hikes (PATH) Act* of 2015, which also prevented certain types of tax fraud, extended the ATRA provisions by offering employers tax credits for hiring qualified veterans and individuals who have endured long-term unemployment.

As times change, new legislation will be enacted, and existing laws are sometimes repealed and amended. An example of evolving legislation includes new local laws regarding fairness in scheduling employees' shift work schedules. Right-to-work laws are another example of employment-related legislation. As of 2020, 27 U.S. states and Guam have enacted right-to-work legislation that promotes an employee's right to opt-out of union membership. West Virginia's law has been deemed unconstitutional, and the case will likely go to the state's Supreme Court of Appeals. At the time of this writing, the notion of the right to work without forcing union participation is being considered by the U.S. Congress.

The payroll accountant's job is consistent and continual learning and research to ensure that the company is complying with all current regulations and reporting requirements. Many states, but not all, have additional payroll tax laws. Federally mandated payroll laws will be addressed in the next section.

(Source: WagePoint)

Which Law?

Stop & Check

- | | |
|--|-----------------------------|
| 1. Requires employers to verify the employee's legal right to work in the United States? | a. COBRA |
| 2. Protects the rights of disabled workers? | b. ERISA |
| 3. Governs the management of retirement plans? | c. Civil Rights Act of 1991 |
| 4. Protects discrimination of workers older than age 40? | d. PRWOR |
| 5. Creates safe work environments for employees? | e. SOX |
| 6. Mandates equal pay for equal work? | f. ADEA |
| 7. Extends medical benefits for terminated employees? | g. HIPAA |
| 8. Ensures that child support obligations will be paid? | h. ADA |
| 9. Protects workers and families with preexisting medical conditions? | i. OSHA |
| 10. Enforces payment of monetary damages because of discrimination? | j. Equal Pay Act of 1963 |
| 11. Requires internal controls on payroll practices of public companies? | k. IRCA |
| 12. Gives small employers incentives to establish retirement plans? | l. SECURE |

LO 1-2 Discuss the Legal Framework Specific to Payroll Accounting

Why did businesses start withholding taxes from employees' paychecks? Federal income tax withholding was temporarily instituted in 1861 to recover from the Civil War's high costs; however, this tax was repealed in 1872. Throughout the 19th century, cities were growing in the wake of the Industrial Revolution, as factories and companies increased automation and institutionalized mass production. People moved from rural to urban areas in unprecedented numbers, and the need for infrastructure and civil services grew. Roads needed to be built, law enforcement personnel needed to be increased, and disease outbreaks prompted sanitation systems. Therefore, the U.S. Congress formalized the permanent continuation of the federal income tax instituted during the Civil War as a means to fund the infrastructure improvements of the booming cities. After many failed attempts to reinstate a federal income tax, Congress passed the *Sixteenth Amendment to the U.S. Constitution* in 1909, ratified by states in 1913. This version incorporated a tiered income tax, including exemptions and deductions, to limit the tax imposed on wages earned; it was the harbinger of many employment-related laws (see Figure 1-1).

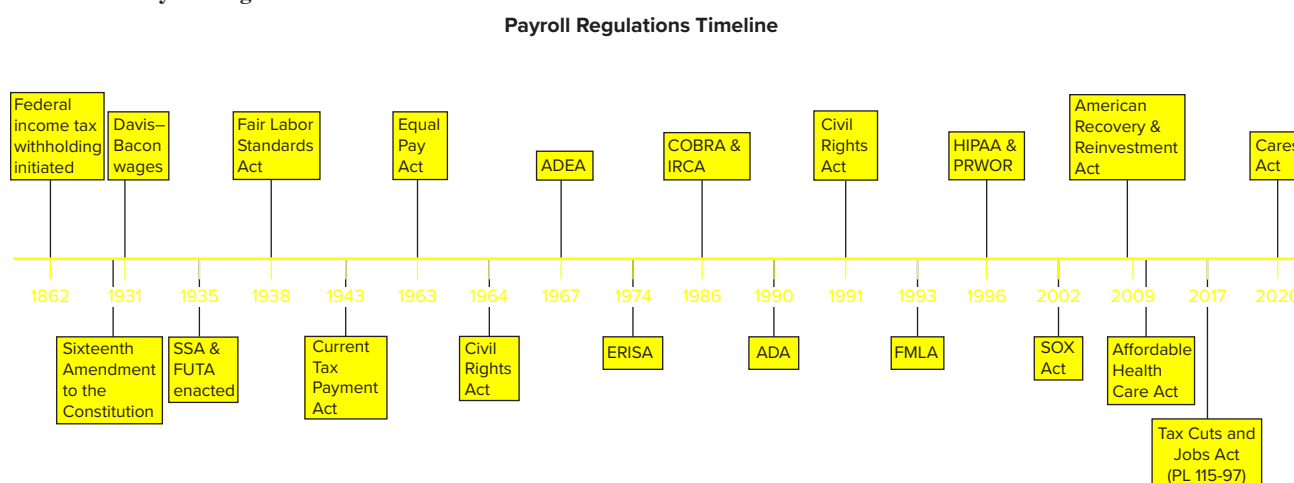


stoatphoto/Shutterstock

During the Great Depression of the 1930s, the stock market collapsed, financial institutions went bankrupt, and companies released workers or ceased business operations. The government needed money to fund programs that would stimulate economic recovery. Additionally, the need for a social welfare system emerged as the number of displaced workers increased. The 1930s became a decade of landmark employment legislation that defined the legal environment for employers and employees, most of which remains enforced in 2020.

In 1931, Congress passed the *Davis–Bacon Act*, creating a standard of wages for governmental contracts totaling more than \$2,000. The increased standard wages created under the Davis–Bacon Act brought additional revenue to small businesses and the communities where the contract workers lived, bought groceries, and purchased other services or goods. The Davis–Bacon Act comprised more than 60 different federal statutes, providing a prevailing wage and wage classification strategy to guide employers and contractors. As of 2021, the minimum wage for all employees affected by the Davis–Bacon Act is \$10.95 per hour, unless the local prevailing minimum wage rate is higher.

FIGURE 1-1
Timeline of Payroll Legislation



The determination of wages to be paid to workers affected by the Davis–Bacon Act varies by geographic area, contract, and type of work performed. To facilitate wage determination, the U.S. Department of Labor maintains a website (<https://beta.sam.gov/>). Employers may access their specific contract in question and research the contract provisions to ensure that employees are paid appropriately.

The **Walsh–Healey Public Contracts Act** of 1936 affected governmental contractors providing goods or services exceeding \$10,000. The act required companies to pay workers a minimum wage for all hours worked under 40 per week and a half (regular pay times 1.5) per hour for any hours over 40 per week. The Walsh–Healey Public Contracts Act also prohibited the employment of individuals younger than 16 years of age. Compliance with this act is enforced through the Employment Standards Administration Wage and Hour Division of the Department of Labor. These standards also apply to workers within the District of Columbia.

In 1935, the **Social Security Act (SSA)**, also known as the **Federal Insurance Contributions Act (FICA)**, established a contribution-driven fund to help the average U.S. worker respond to the social and financial distress caused by the Great Depression. Originally, the Social Security tax was designed such that younger workers supported retired, disabled workers and surviving families of deceased workers. It is important to note that the worker does not need to die or become disabled to receive Social Security benefits; the truth is that age and disability are components in the decision but are not the only factors considered when awarding Social Security benefits. A contribution-driven fund's employees and employers pay a percentage of gross earnings into the Social Security fund. Originally, the fund was designed to be earmarked for a specific individual upon retirement. Still, the fund currently assists families who experience diminished wages and working situations because of the worker's infirmity, or the illness of a family member that prevents their entry into the workforce, and monetary benefits to dependents of retired or deceased workers. Social Security is synonymous with **Old-Age, Survivors, and Disability Insurance (OASDI)**. **Medicare tax**, a government-mandated health insurance program for individuals, was also included in the SSA legislation. As of 2021, the age at which individuals may receive full retirement benefits is 67 years for people born after 1960. The full retirement age will increase from 65 years by two months each year for people born prior to 1960 until it reaches the full retirement age of 67. Individuals may begin receiving permanently reduced benefits as early as age 62, but their Social Security payments will be reduced incrementally.

(Source: Social Security Administration)

As of 2021, Social Security paid 9.7 million disabled workers a monthly benefit. This figure represented a milestone for the Social Security Administration because that number was the highest that had ever been paid. Furthermore, SSA estimated that approximately 62 percent of American retirees depended on their Social Security checks for basic food and shelter needs. The funds received from Social Security reduce the poverty rate among senior citizens. The amount of Social Security payouts varies based on age, years of work, and the highest wages earned.

(Source: Motley Fool)



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As another part of its social welfare legislation, the U.S. Congress passed the **Federal Unemployment Tax Act (FUTA)** to help displaced workers, individuals from the workforce who find themselves unemployed and meet certain state or federal qualifications. FUTA and its state counterpart, the **State Unemployment Tax Act (SUTA)**, are based upon the employees' wages. Unlike Social Security taxes, only employers pay FUTA. Some states require both employers and employees to contribute to SUTA. For example, Alaskan employees contribute up to an

annual amount of \$218 (2021 figure) to SUTA, which is collected at a rate of 0.50 percent of wages; employers contribute up to 2.57 percent of employee wages until they reach \$43,600 in annual gross earnings (2021 figure). Should an employee have more than one employer, the employee can request a return for the amounts over the annual earnings maximum in the following year. The COVID-19 pandemic strained states' unemployment funds in 2020, and increases to SUTA rates and policies may be significant in future years.

The *Fair Labor Standards Act (FLSA)* of 1938 required more detailed record keeping and worker protection. This act regulates the minimum wage, which most workers are familiar with, stated as the lowest an individual under certain classifications can be paid. Less commonly known, the minimum wage applies only to workers at businesses that meet certain conditions, which is defined by either enterprise or individual coverage. Additionally, tipped employees, such as restaurant servers, are exempt from minimum wage standards under FLSA. In the contemporary business world, a business that does not conduct interstate commerce is rare, but the provision in FLSA remains in effect.

FLSA: Enterprise vs. Individual Coverage

Under FLSA, two types of coverage prevail: Enterprise coverage and Individual coverage.

Enterprise Coverage:

- The company must have a minimum of two employees.
- The volume of sales or business performed annually must exceed \$500,000.
- Firms such as hospitals, schools, government agencies, and residential care facilities are always considered under enterprise coverage.

Individual Coverage:

- Firms that regularly conduct interstate business, such as companies that produce goods for shipment to a different state, have employees who travel to other states, or otherwise conduct business with firms or people in other states.

(Source: DOL)

An important fact about FLSA wage guidelines is that no maximum wage cap exists. Securities and Exchanges Commission (SEC) regulations stipulate that high-ranking public companies' employees' compensation packages must be published with the company's mandatory annual report.

The Department of Health and Human Services determined in 2020 that the poverty level for a family of four was \$26,200, which translates to a wage of approximately \$12.60 per hour. In other words, the minimum wage for a family to live comfortably (referred to as a *living wage*) would need to exceed \$12.60 to maintain a "normal" standard of living. As of this publication date, the federal *minimum wage* is \$7.25 per hour, although some states and locales may mandate a higher minimum wage.

(Source: The Balance)

FLSA guidelines define maximum hours, minimum age, pay rates, and mandatory break times. This part of the FLSA was an outgrowth of the early 20th century's industrial environment when no such guidelines existed. Horror stories about working conditions and children working 12- to 14-hour days abounded during the 1930s. The FLSA created the classifications of exempt and nonexempt workers. Exempt workers are salaried workers who are not subject to certain wage and overtime provisions of FLSA. Nonexempt workers are protected by the provisions of the FLSA and are therefore subject to wage and overtime provisions.

Additionally, FLSA regulation does not apply to pay periods or to the amount of paid time off given to employees. Those two items are at the discretion of the employer. Paid time off has become a topic of discussion since 2010. McDonald's began offering it to nonexempt employees in 2015 as a regular part of employee benefit packages in response to pressure from labor leaders. Eleven states and more than 30 municipalities have instituted paid sick leave for employees as of 2020. The paid sick leave laws vary widely among the states.

The third class of workers, independent contractors, is not subject to the payment provisions of the FLSA. *Independent contractors* are typically treated as vendors of a business. Independent contractors are not employees of the business and are not reflected in payroll records. The IRS uses *Form SS-8* to help determine employee or independent contractor status. The Department of Labor ruled that improper classification of workers diminished workers' legal protections under the FLSA and declared that the following items must be considered when classifying a worker as an employee or an independent contractor:

1. The extent to which a worker is an integral element of the employer's business.
2. Whether the worker's managerial skills affect his or her opportunity for profit or loss.
3. Relative investments in facilities and equipment by *both* the employee and the employer.
4. The extent to which the worker exercises independent business judgment.
5. The permanent nature of the working relationship between the employer and employee.
6. The type and extent of the control that the employer has over the employee.

(Source: U.S. Department of Labor)

Penalties for misclassification of employees as independent contractors can be high. If the misclassification is intentional on the employer's part, the monetary amount of the penalty is higher. In the case of *Fair v. Communications Unlimited Inc.*, the U.S. District in Missouri found that the employer had deliberately miscategorized workers in 10 states as independent contractors to avoid paying overtime wages required under the FLSA. The employer was ordered to provide the names and other contact information to the court to determine appropriate overtime compensation awards.

(Source: Google Scholar)

To obtain the remittance of employers' withholding taxes, the federal government needed a way to standardize the collection of taxes from employers. Before the *Current Tax Payment Act (CTPA) of 1943*, no formalized guidelines for remittance of taxes existed. Before the CTPA, employers' remittance was inconsistent and unreliable as a funding source for governmental projects. The CTPA was passed during World War II to guarantee funds to support the country's involvement in the war. The CTPA created the requirement for the submission of estimated taxes on wages earned during the year of earning instead of after the end of the year as previously required.

Another employer obligation is *workers' compensation*, commonly known as *workers' comp*. Unlike other payroll-specific laws, state laws govern workers' compensation laws. Employer requirements for providing workers' comp coverage vary from state to state. They are not required in certain states if the employer has fewer than a certain minimum number of employees. Because workers' compensation is an insurance program, it is not considered a tax; however, it is a state-mandated employer payroll expense.

Workers' compensation is an insurance policy carried by employers to provide wage continuation and pay for medical services for workers injured while doing business. The amounts assigned to the policy vary by work being performed and associated risks for various professions. For example, heavy equipment operators would have a higher workers' comp rate than office workers because their injury exposure is deemed higher by the insurance industry. The COVID-19 pandemic impact on



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certain businesses, such as meat-packing plants, may lead to changes in workers' compensation insurance procedures in future years.

Workers' compensation plans are subject to annual audits and are based upon payroll wages less any employees exempted from the coverage, typically working owners. Employers must report all employee wages; however, only one-third of overtime hours are reported to the workers' compensation auditor. Each state has different requirements for coverage and eligibility. The number of employees over which workers' compensation insurance is required varies per state, as shown in Table 1-1.

The *Affordable Care Act (ACA)* of 2010 was one of the most significant payroll accounting changes in recent years. Although the act's primary focus was to ensure health care coverage for all Americans, employers have several reporting responsibilities related to the act. One of the responsibilities included in Section 1003 is the disclosure and justification for rates of plans and any increases in premiums. Another reporting requirement is the number of full-time equivalents (FTE) employees, the cost of insurance coverage provided to employees, and the elimination of a waiting period for health insurance coverage. The Affordable Care Act legislation covers 974 pages and contains many provisions and contingencies, including a requirement for continuing premium review. In 2017, the Affordable Care Act mandated financial penalty on individuals who elected not to have medical insurance was overturned by Executive Order 13765. In 2018, a judge in Texas ruled that Executive Order 13765 caused the ACA to be unconstitutional. In 2021, the U.S. Supreme Court vacated the lower court's ruling in Texas, which means the ACA is consistent with the U.S. Constitution and remains a current law.

According to the Internal Revenue Service, employers must report whether they provide Minimum Essential Coverage part of their company-sponsored benefits, including any group health plans, COBRA plans, or preexisting insurance coverage. Health insurance coverage is reported on IRS Form 1095 A, B, or C as follows:

- Form 1095-A is for individuals who have purchased insurance from the Healthcare Marketplace, not through an employer. The Marketplace issues this form.
- Form 1095-B reports information to the IRS for individuals with minimum essential coverage through group insurance plans provided by governmental employers and qualified private-sector employers. Additionally, employers who are not applicable large employers but who sponsor self-insured group health plans must report information about employees (and their spouse and dependents) who enroll in the coverage to their employees, even though the employers are not subject to the employer shared-responsibility provisions or the information reporting requirements for applicable large employers.
- Form 1095-C is for applicable large employers who provide health insurance where the employer is responsible for the act's shared responsibility provision. This form is issued by employers who offer coverage but are not self-insured and have 50 or more full-time and/or full-time equivalent employees.

The employer must file IRS form 1095-B or 1095-C and furnish a copy to the insured if the insured received medical insurance benefits for as few as one day of one month during a calendar year. The transmittal form, which contains a summary of all Form 1095 issued, required the IRS is Form 1094-A, B, or C, depending on the type of 1095 issued.

(Source: IRS)

The 2017 *Tax Cuts and Jobs Act* and represented sweeping changes to the tax code. This law profoundly affected payroll taxes, especially employee federal income tax liability, and required a comprehensive reframing of employee income tax computation. Specific changes to payroll included a change to the Social Security wage base, adjustments to nonresident alien withholding, adjustments for inflation, and decreases in supplemental wage withholding

TABLE 1-1**Workers' Compensation Laws by State**

| STATE | MINIMUM NUMBER OF EMPLOYEES |
|----------------|---|
| Alaska | 1 (may be self-insured) |
| Alabama | 5 |
| Arizona | 1 |
| Arkansas | 3 |
| California | 1 |
| Colorado | 1 |
| Connecticut | 1 (including uninsured subcontractors) |
| Delaware | 1 |
| D.C. | 1 |
| Florida | 4 (except noted industries), 1 (construction), 6 (agricultural), 12 (seasonal) |
| Georgia | 3 |
| Hawaii | 1 |
| Idaho | 1 (including part-time workers) |
| Illinois | 1 (including part-time workers) |
| Indiana | 1 |
| Iowa | 1 (excluding very low salary employers) |
| Kansas | 1 (exempt if annual gross payroll is less than \$20,000 or agricultural employer. Sole proprietors and LLC members are exempt from coverage) |
| Kentucky | 1 |
| Louisiana | 1 (including part-time, either employees or subcontractors, exceptions for agriculture only employers) |
| Maine | 1 (subcontractors must also be covered) |
| Maryland | 1 (agricultural employers must have at least 3 employees or a payroll of less than \$15,000 annually) |
| Massachusetts | 1 (domestic workers must be covered if they work more than 16 hours per week) |
| Michigan | 1 (certain family members who are employees may be exempt, certain very small employers are exempt), 3 (private employers) |
| Minnesota | 1 |
| Mississippi | 5 (certain subcontractors' employees are covered, excludes domestic, farm, non-profit fraternal, charitable, religious, or cultural organizations) |
| Missouri | 5 (includes full and part-time, seasonal, temporary), 1 (construction), except farm laborers, domestic servants, certain real estate agents, direct sales, commercial motor-carrier owner-operators |
| Montana | 1 |
| Nebraska | 1 |
| Nevada | 1 (excluding independent enterprises) |
| New Hampshire | 1 (including part-time workers) |
| New Jersey | 1 |
| New Mexico | 3 (construction employers must cover any employees) |
| New York | 1 |
| North Carolina | 3 (only 1 employee for businesses that involve radiation exposure) |
| North Dakota | 1 (including part-time, seasonal, temporary workers) |
| Ohio | 1 |
| Oklahoma | 1 (when a business has 5 or fewer family members as employees, the family members are exempt from coverage) |
| Oregon | 1 |
| Pennsylvania | 1 |
| Rhode Island | 4 |
| South Carolina | 4 (some occupations exempt if <\$3,000 in annual payroll), (including part-time workers) |
| South Dakota | 1 |
| Tennessee | 5 (construction, subcontractors, and coal businesses must always have it) |
| Texas | No mandatory coverage except government contractors |
| Utah | 1 |
| Vermont | 1 (agricultural/farming employers with annual payroll <\$10,000 are exempt) (including part-time workers) |
| Virginia | 3 (including part-time workers) |
| Washington | 1 |
| West Virginia | 1 (independent contractors, agricultural employers with <3 employees, and casual employers are exempt) |
| Wisconsin | 3 (including part-time workers, compliance time requirement varies by industry) |
| Wyoming | 1 |

(Sources: NFIB and WCC)

rates. The Internal Revenue Service issued new mid-year tax withholding tables and forms in response to the changes mandated in this act. It introduced a new Employee's Withholding Certificate (Form W-4) and tax guide in 2020.

The *Consolidated Appropriations Act of 2018* increased the E-Verify program's funding, an Internet-based system that offers employers instant verification of an employee's eligibility to work in the United States. It is important to note that the E-Verify program does not replace the need to complete Form I-9 upon employee hire because it is a voluntary service. The following table from the USCIS compares the E-Verify program against the I-9 requirement.

| Form I-9 | E-Verify |
|--|---|
| Mandatory | Voluntary for most businesses |
| Requires a Social Security number | Requires a Social Security number |
| No photo required on identity documents | Photo is required on identity documents. |
| MUST be used to re-verify expired employment authorization | MAY NOT be used to re-verify expired employment authorization |

(Source: USCIS)

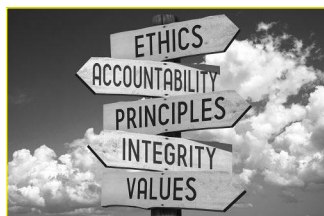
Another important part of the Consolidated Appropriations Act included monetary penalties of \$1,000 per instance (plus damages) for employers who withhold employee tip earnings inappropriately. This section of the act repealed a 2017 Department of Labor regulation that prevented employers from requiring that all tips be placed into a pool for tipped and nontipped employees. Although the act did not remove tip pools, it prevented managers and supervisors from participating in the tip pools.

Which Payroll Law?

Stop & Check

- Established requirements for employer record keeping?
- Provided government assistance for workers who are too old or infirm to work?
- Established protection for displaced workers?
- Required employers to file taxes collected promptly?
- Set aside funds for health insurance?
- Regulated wages for employees whose employer engaged in governmental contracts?
- Is governed on a state-by-state basis and protects employees injured during the course of work activities?
- Is responsible for reporting requirements of essential health coverage for full-time equivalent employees?
- Restructured payroll tax calculations, supplemental withholding allowances, and the Social Security wage base?
- Funded E-Verify programs for employee eligibility to work?
- Social Security Act
- Workers' compensation
- Current Tax Payment Act
- Fair Labor Standards Act
- Tax Act (PL 115-97)
- Federal Unemployment Tax Act
- Medicare
- Consolidated Appropriations Act
- Affordable Care Act
- Davis–Bacon Act

The *Coronavirus Aid, Relief and Economic Stimulus (CARES) Act of 2020* was enacted to provide economic relief for individuals and businesses. It included an individual economic stimulus and encouragement for businesses to keep their employees. A tax credit of 50 percent of employees' wages (up to \$10,000 in wages per employee) promoted employee retention for firms that sustained economic hardship during the pandemic and offered loans, funded by the Small Business Administration, to employers.



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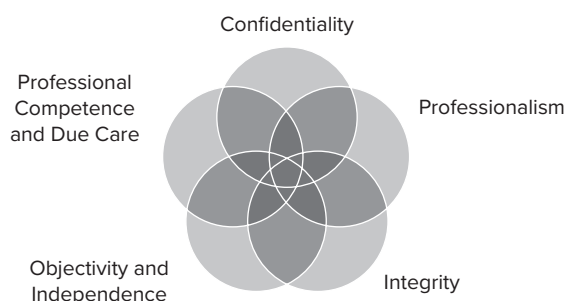
LO 1-3 Discuss the Ethical Guidelines for Payroll Accounting

Professional *ethics* is critical in any accounting context, and especially so in payroll accounting. After the Enron accounting scandal and the passage of the Sarbanes–Oxley Act of 2002 (SOX), ethics became a focus of the accounting profession as a whole. Even with the SOX framework, the payroll industry is rife with ethical violations, including fraud and theft. The payroll accountant is entrusted to handle money belonging to the firm

and rightfully owed to the government and company employees. Payment of these monies becomes a moral contract between the company and the recipients; therefore, ethics are vital in payroll accounting. Several accounting organizations, including the American Institute of Certified Public Accountants (AICPA), Institute of Management Accountants (IMA), and International Federation of Accountants (IFAC), have delineated codes of ethics that are applied in the accounting profession. The basic guidelines of an ethics code include the tenets shown in Figure 1-2.

FIGURE 1-2

Basic Guidelines for a Code of Ethics



Ethisphere maintains an annual list of the most ethical companies in the world. In 2021, the list included many companies based in the United States, such as BestBuy, Hasbro, Salesforce, TIAA, and several others. Although the companies on the list are in various industries, certain ethical principles are common to all: integrity, social responsibility, care for all stakeholders, and honesty and transparency in all business dealings.

(Source: Ethisphere)

Confidentiality

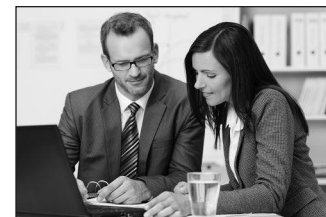
An accountant is responsible for protecting confidential information and exercising moral judgment in all actions. A payroll accountant deals with sensitive personnel information that must remain confidential. Social Security numbers, employee legal obligations, and an employer's tax liabilities are a few examples of information that a payroll accountant must protect.

New Jersey enacted the Diane B. Allen Equal Pay Act, which strengthened existing anti-discrimination laws by preventing pay differences based on traits protected under other civil rights laws. It also protected employees who discussed pay with other employees. However, it should be noted that the payroll accountant is still responsible for maintaining the confidentiality of employee records for this law to function in the way it was intended.

(Source: State of New Jersey 2018 Legislature)

Professionalism

Accountants must uphold *professionalism* by maintaining confidentiality, maintaining the public's trust, and upholding professionalism in their practice. In terms of payroll accounting, professionalism includes honoring the firm's needs, its employees, and associated governmental entities. A payroll accountant must complete all tasks and adhere to deadlines despite any personal issues. Personal honesty and transparency of transactions are the core of acting professionally.



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Bechtel, a company that focuses on sustainable energy, company planning, and other location-based issues, has a code of conduct that has evolved over 100 years and multiple countries. Their ethical code requires employees to become educated and aware of potential ethical and legal conflicts in the United States and any of the countries in which they operate.

(Source: Bechtel)

Integrity

In the workplace; integrity is the most important asset a professional can possess. *Integrity* involves doing the right thing despite any external pressure, personal temptations, or conflicts of interest. When weighing the integrity of a decision, the main question is: Am I doing what is right and just for everyone concerned? Any course of action that lacks integrity potentially restricts the rights of interested parties and compromises the company's best interests. The AICPA's code of ethics includes explicit direction about not covering up mistakes as part of an accountant's integrity.

Payroll fraud can happen anywhere that pressures, opportunities, and rationalizations exist. A payroll specialist for a District of Columbia consulting firm was indicted on embezzlement charges involving fictitious employees. The payroll specialist stole over \$250,000, including amounts deposited for payroll taxes, by changing the pay disbursement details of terminated employees. Instead of leaving the employees' files in a "terminated" status, the altered detail allowed automatic salary payments to continue but deposited to the payroll specialist's personal account. The payroll specialist, who plead guilty to wire fraud, was ordered to repay the employer \$250,000 and was sentenced to 21 months in prison.

(Source: U.S. Department of Justice)

Objectivity and Independence

Accountants must take care to be independent of any pressures that would compromise the integrity of their work. These pressures can come from business or personal relationships that may affect a payroll accountant's judgment concerning the best interests of all concerned in a given situation. *Objectivity* in accounting means that the accountant considers only facts relevant to the task at hand, independent of all other pressures. The Public Company Accounting Oversight Board (PCAOB) specifies that *independence* may be compromised if any of the following situations occur:

- Commitment to a future purchase of financial interest in a client's business.
- Personal or family ownership over 5 percent of a client's business.
- Professional engagement with a client's firm in which the payroll professional had a personal interest such as partial ownership.

Social obligations may compromise a payroll accountant's objectivity. The AICPA Code of Ethics Section 17 specifically addresses social club membership as a factor in losing an accountant's independence or objectivity. Such club membership could create a social debt that may cause an accountant to commit payroll fraud.

(Source: AICPA)



fizkes/Shutterstock

Professional Competence and Due Care

Professional competence and **due care** revolve around an accountant's competence and assume that the accounting professional is equally competent as other people in a similar role. In payroll accounting, due care is an ongoing process that involves education, training, and experience. According to the AICPA, an accountant must remain current with accounting practices and legal developments to comply with due care requirements. Payroll laws and tax guidelines change regularly. As a payroll accountant, it is essential to remain aware of annual changes that the IRS and other accounting bodies publish through participation in professional accounting organizations, subscriptions to accounting industry publications, and participation in discussions at accounting conferences.

Staying current with payroll changes is an ongoing task. Some of the sources for this information include

- IRS (www.irs.gov).
- AICPA (www.aicpa.org).
- Financial Accounting Standards Board (FASB) (www.fasb.org).
- American Payroll Association (www.americanpayroll.org).
- U.S. Department of Labor (www.dol.gov).
- Compliance Tools for HR Professionals (www.hr.blr.com).

What's Ethical?

Stop & Check

1. Giles Montragon is the payroll accountant for his company. His boss informs him that the company is considering switching payroll systems and asks for his input. What are some ethical concerns involved in changing accounting software?
2. Liza Beals, the payroll manager, is in a sorority. At a social event, she discovers that one of her sorority sisters works for the same company. Her sorority sister asks Liza for confidential information about one of her department employees, claiming that the sorority oath requires Liza's compliance. What should Liza do?



Blue Planet Studio/Shutterstock

LO 1-4 Identify Contemporary Payroll Practices

Contemporary accounting practices reflect the effects of technology and electronic communications on business. Payroll practices have adapted to include modern tools that facilitate data transmission, and new challenges such as the following have emerged:

- Direct deposit regulations for employee pay and tax remittances.
- Electronic filing requirements.
- New timekeeping methods.
- The availability of paycards as a method of wage and salary disbursement.
- Government contract influences on the payroll.
- International employees.

- Simultaneous in-house and outsourced payroll personnel.
- Integration of payroll into other company functions.
- Security of confidential, electronic personnel information.
- Cloud-based software designed for security, accessibility, and portability of data.

Payroll is not a stand-alone department. Integrated software packages offered by main-stream accounting software providers, such as QuickBooks and Sage 100, allow business owners to view data across departments and synthesize the information to make large-scale decisions. Contemporary payroll systems serve as a tool for strategic planning, performance measurement, and customer/vendor relations using mobile, cloud-based platforms that may be accessed through Internet-connected devices. Payroll accountants are a key element in the decision-making process. They must remain educated about legal and compliance issues and remain current in their understanding of software applications and relevant technological concerns.

The payroll accountant plays a vital role in a company's structure, no matter how large or small. Payroll and other employee benefits often represent the largest category of a company's expenses. Chipotle Mexican Grill Inc. (CMG) originally started as a subsidiary of McDonald's. CMG is now a separate entity and currently reported nearly \$1.5 billion in payroll expenses in its stores during the fiscal year 2019, which represented an 11 percent increase over 2018. As an innovative company in the fast-food market, CMG has integrated technology and sustainability measures to engage customers and promote locally sourced ingredients to support local farmers. Notice in the following table how, despite technology integration, CMG's labor expenses are nearly as large as its product-related expenses.

| CHIPOTLE MEXICAN GRILL INC. | | | |
|---|----------------|---------|---------|
| OPERATING COSTS AND EXPENSES (in millions, selected data) | | | |
| Company-operated restaurant expenses | 2020 | 2019 | 2018 |
| Food, beverage, and packaging | 1,932.8 | 1,847.9 | 1,600.8 |
| Labor | 1,593.0 | 1,472.1 | 1,326.1 |
| Occupancy | 387.8 | 363.1 | 347.1 |
| Other operating costs | 1,030.0 | 760.8 | 680.0 |
| General & administrative expenses | 466.3 | 451.6 | 375.5 |
| Total operating expenses | 5,694.5 | 5,142.4 | 4,606.6 |
| Operating income | 290.2 | 444.0 | 258.4 |

(Source: SEC)

Payroll Preparation Options

Several options exist for payroll preparation. The most frequently used methods for contemporary payroll preparation are electronic accounting programs. Other options available are the manual calculation of payroll using spreadsheets and charts prepared by the Internal Revenue Service and payroll preparation by outsourcing the process to a third party such as **ADP**, **Paychex**[®], and **myPay Solutions**. A hybrid solution that allows the company to outsource certain payroll functions to an external provider exists with online accounting software provided by companies such as Intuit and Sage, creators of **QuickBooks** and **Sage 100**, respectively.

Online banks are starting to enter the payroll industry as a means to facilitate payroll access via smartphones. **Chime Bank** advertises access to directly deposited funds up to two days before the employer's payment date, based on the employer's funds availability. Another option targeted for small employers includes **Amboy Bank**, which offers payroll processing, reporting, and banking services that simplify the payroll process for both employers and their employees.

Regardless of the payroll preparation method, the payroll accountant needs to understand how the process should work. In the event of hardware failure, legislative actions, or tax changes, the accountant must ensure accurate payroll preparation. Companies

can lose credibility as the result of flawed payroll and be subject to substantial fines, IRS audits, and civil litigation. Cases in which companies have paid fines for improper payroll practices abound.

Chuy's Mesquite Broiler in Arizona was fined over \$20,000 in late-payment penalties and had to pay employees nearly \$115,000 in unpaid overtime pay. The employer chose to pay its employees the first 40 hours of work via check and overtime in a separate check or cash. The problem was that the separate check for the overtime was paid at regular pay rates that did not include the overtime premium required by FLSA.

(Source: KOLD)

Some companies have seriously shortchanged employees' paychecks, paying fines in addition to the standard payroll expenditures. Other tales of employee overpayment highlight payroll systems problems, such as computer glitches that have delayed payment of the company's wages. Because the computer glitches are ultimately the responsibility of a company's president or CEO and represent a potential for ethical breaches, the volume of legislation and stories of problems involving payroll administration point to the need for a well-established payroll system. Despite the numerous federal and state legislative actions concerning payroll practices, none delineate the format and design of a payroll system.

The information contained in the personnel records is highly sensitive and must be protected against intrusion from unnecessary parties. The *Privacy Act of 1974* guarantees the safeguarding of information in private personnel records and mandates information safekeeping and due process rights to individuals. Consider the implications of the legal requirements of information safekeeping:

- Personnel records contain information about an individual's marital status, children, other dependents, and legal residence—sensitive information that must be protected under the Privacy Act of 1974.
- Payroll records generally have information about the hourly rate and salary information for each employee. Access to these records is protected by provisions of the *Equal Employment Opportunity Commission (EEOC)* and could provoke or inhibit discrimination lawsuits.
- The information contained in payroll records influences the accuracy and integrity of a company's accounting records. The recording of payroll expenses and liabilities affects a company's profitability, which influences investor and customer relations.
- Companies engaging in business with the federal government must comply with the Davis-Bacon Act (for federal contracts) and potentially the *Copeland Anti-Kickback Act* of 1934 (or construction projects, protecting taxpayers from unethical pay practices).
- The number of hours worked by an employee must comply with the Fair Labor Standards Act provisions.
- Deductions for payroll, especially for retirement plans, must be documented and verified per the Sarbanes-Oxley Act of 2002.

Employers must file tax deposits for employee withholding, Social Security, Medicare, FUTA, and SUTA taxes according to an identified timeline depending upon the size of the company's payroll. Taxes may be remitted via telephone, Internet, mail, or the company's payroll software program. Additional reports are required from the employer on either a quarterly or an annual basis. A company has many responsibilities within its payroll system:

- Tax withholding must be done consistently, reflecting the requirements of federal, state, and local authorities.
- Employers must match amounts withheld from employee paychecks for certain payroll taxes.

- Withholding of deductions that the employee voluntarily elects, such as health care, insurance, and investments, must be correctly recorded and reported.
- Timely and accurate payment must be made to the employee, government agencies, and companies for which the employee has designated the voluntary deductions.
- Tax and other liabilities must be reported to governmental agencies per established deadlines.

An accurate payroll system allows managers to focus on the firm's business, not payroll administration. As such, a well-designed system benefits the employees and governmental agencies, and thus the firm. The timely forwarding of any monies withheld from employees, either by governmental regulation or voluntary election, is critical to a firm's success.

Besides administering employee pay, a well-designed and accurately maintained payroll system is necessary during inevitable governmental audits or potential business operation interruptions, as seen during the COVID-19 pandemic during 2020. An audit is a process by which a third-party organization, either a public accounting firm or a government agency, inspects the accounting records for accuracy, integrity, and compliance with federal rules and regulations. During a payroll audit, the auditor inspects the company's records of employee pay, tax remittance, and voluntary deduction maintenance. The thought of audits instills fear into the hearts of even the most seasoned accounting professionals. Their salvation, however, is to establish and maintain an accurate payroll system.

Consider the growth of selected companies:

- Tom's of Maine started in 1968 as a local organic personal care product company and is now a nationally recognized leader in environmental stewardship and sustainability. (Source: www.toms of maine.com)
- Ben and Jerry's, which started with a \$5 correspondence course in ice-cream making and a \$12,000 investment in 1978, has become an icon of premium ice cream and environmental causes. Ben and Jerry's has since been purchased by the Unilever Corporation and maintains an independent board of directors. (Source: www.benjerry.com)
- **McDonald's Corporation** was started in 1955 by the McDonald brothers when selling their hamburger business to Ray Kroc. The brand is now an international icon for fast food, serving approximately 68 million customers in 120 countries each day.



rh2010/123RF

These companies share similar beginnings: one location, a few employees, and a relatively simple payroll. As each company has grown, so has the payroll complexity, including multiple departments and facilities in many states and countries. At the heart of each company are a well-run business model and a sound payroll system that has evolved with it.

Tracking and monitoring employee hours, locations, and applicable governmental requirements within various nations require knowledgeable payroll staff, willing to remain current with accounting trends and international regulations. Sophisticated payroll systems enable companies to create, populate, and file many documents using current software and Internet technology.

Privacy Protection

A company must make every reasonable effort to protect personnel information contained in payroll records. This is a critical part of any payroll accountant's job. Several federal privacy acts exist to protect the information contained in payroll and personnel records. Additionally, many states have enacted or expanded specific data privacy legislation. Each state's privacy law refers to "reasonable" steps that companies must take to protect customers' information.

Privacy acts include (but are certainly not limited to)

- U.S. Department of Health and Human Services **Privacy Act 09-40-0006** pertains to public employees' eligibility for pay, entitlements, raises, and benefits.



greenbutterfly/Shutterstock

- Common-Law Privacy Act, which pertains to freedom from misuse or abuse of one's private affairs.
- **Privacy Act of 1974**, about the use of information about private citizens.
- **Computer Fraud and Abuse Act (CFAA)** of 1986 addresses cybercrime, an issue that has grown in importance in recent years.

The General Accounting Office of the federal government has been working on revising guidelines about the privacy of records and releasing information as the Internet and e-business evolve. The U.S. Congress has sought ways to address contemporary computer-based cyber threats but has not passed legislation at the federal level. States have enacted privacy laws, especially as they pertain to social media, to protect employees against cyber hacks.

Online privacy is a growing concern, and it affects the security of payroll data. Employees at New-York-based Barney's went unpaid in early 2020 when a hacker group gained control of the payroll system on one of its servers. Employees were unpaid for over a week, and some employees terminated their employment in protest.

(Source: Page Six)



Tero Vesalainen/Shutterstock

The common element among these laws is protecting sensitive employee information such as addresses, dependents, compensation amounts, and payroll deductions. The payroll accountant is also responsible for discretion in discussing pay rates, bonuses, or other compensation-related topics with employees and management. Sensitive topics should never be discussed with anyone other than the employee or appropriate managers. All employment-related items may be viewed during an audit of payroll records, and auditors must treat the information with absolute confidentiality.

One way that the federal government keeps track of employers is with **Employer Identification Numbers (EINs)**. The EIN allows the IRS to know which companies may have employees, generating employment tax revenue for the government, and creating tax liabilities for employers. Form SS-4 (see Figure 1-3) is used to apply for an EIN by providing the personal Social Security number, type of business, and the existence of any prior EINs for a business owner. The EIN is required for all tax deposits, tax returns, and informational returns. It will appear on the company's Form W-2s, 940s, 941s, state tax forms, and the company's annual tax return. Form SS-4 may be completed either on paper or through an IRS online request portal that contains the same information as the paper form.

Confidential Records

Stop & Check

You are the payroll clerk of a company. A group of students approaches you to work on a class project and asks to see confidential personnel and payroll records. What would you do? What are the laws regarding the situation?

FIGURE 1-3

Example of Form SS-4

| Form SS-4 (Rev. December 2019) Department of the Treasury Internal Revenue Service | | Application for Employer Identification Number (For use by employers, corporations, partnerships, trusts, estates, churches, government agencies, Indian tribal entities, certain individuals, and others.) ▶ Go to www.irs.gov/FormSS4 for instructions and the latest information. ▶ See separate instructions for each line. ▶ Keep a copy for your records. | | OMB No. 1545-0003 |
|--|---|---|--|--|
| | | EIN | | |
| 1 Legal name of entity (or individual) for whom the EIN is being requested Thomas Braden | | | | |
| Type or print clearly. | 2 Trade name of business (if different from name on line 1) Braden Fisheries | | 3 Executor, administrator, trustee, "care of" name | |
| | 4a Mailing address (room, apt., suite no. and street, or P.O. box) 1234 Coastal Highway | | 5a Street address (if different) (Don't enter a P.O. box.) | |
| | 4b City, state, and ZIP code (if foreign, see instructions) Anchorage, AK 99509 | | 5b City, state, and ZIP code (if foreign, see instructions) | |
| | 6 County and state where principal business is located Anchorage, Alaska | | | |
| | 7a Name of responsible party Thomas Braden | | 7b SSN, ITIN, or EIN 445-54-4554 | |
| 8a Is this application for a limited liability company (LLC) (or a foreign equivalent)? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No | | 8b If 8a is "Yes," enter the number of LLC members 3 | | |
| 8c If 8a is "Yes," was the LLC organized in the United States? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No | | | | |
| 9a Type of entity (check only one box). Caution: If 8a is "Yes," see the instructions for the correct box to check. | | | | |
| <input type="checkbox"/> Sole proprietor (SSN) <input type="checkbox"/> Estate (SSN of decedent) <input type="checkbox"/> Partnership <input type="checkbox"/> Plan administrator (TIN) <input type="checkbox"/> Corporation (enter form number to be filed) ▶ <input type="checkbox"/> Trust (TIN of grantor) <input type="checkbox"/> Personal service corporation <input type="checkbox"/> Military/National Guard <input type="checkbox"/> State/local government <input type="checkbox"/> Church or church-controlled organization <input type="checkbox"/> Farmers' cooperative <input type="checkbox"/> Federal government <input type="checkbox"/> Other nonprofit organization (specify) ▶ <input type="checkbox"/> REMIC <input type="checkbox"/> Indian tribal governments/enterprises <input checked="" type="checkbox"/> Other (specify) ▶ Disregarded Entity Group Exemption Number (GEN) if any ▶ | | | | |
| 9b If a corporation, name the state or foreign country (if applicable) where incorporated | | State | Foreign country | |
| 10 Reason for applying (check only one box) | | | | |
| <input checked="" type="checkbox"/> Started new business (specify type) ▶ Commercial Fishing <input type="checkbox"/> Hired employees (Check the box and see line 13.) <input type="checkbox"/> Compliance with IRS withholding regulations <input type="checkbox"/> Other (specify) ▶ <input type="checkbox"/> Banking purpose (specify purpose) ▶ <input type="checkbox"/> Changed type of organization (specify new type) ▶ <input type="checkbox"/> Purchased going business <input type="checkbox"/> Created a trust (specify type) ▶ <input type="checkbox"/> Created a pension plan (specify type) ▶ | | | | |
| 11 Date business started or acquired (month, day, year). See instructions. 05/01/2021 | | 12 Closing month of accounting year December | | |
| 13 Highest number of employees expected in the next 12 months (enter -0- if none). If no employees expected, skip line 14. Agricultural 15 Household Other | | 14 If you expect your employment tax liability to be \$1,000 or less in a full calendar year and want to file Form 944 annually instead of Forms 941 quarterly, check here. (Your employment tax liability generally will be \$1,000 or less if you expect to pay \$5,000 or less in total wages.) If you don't check this box, you must file Form 941 for every quarter. <input type="checkbox"/> | | |
| 15 First date wages or annuities were paid (month, day, year). Note: If applicant is a withholding agent, enter date income will first be paid to nonresident alien (month, day, year) ▶ 05/15/2021 | | | | |
| 16 Check one box that best describes the principal activity of your business. | | | | |
| <input type="checkbox"/> Construction <input type="checkbox"/> Rental & leasing <input type="checkbox"/> Transportation & warehousing <input type="checkbox"/> Health care & social assistance <input type="checkbox"/> Wholesale-agent/broker <input type="checkbox"/> Real estate <input type="checkbox"/> Manufacturing <input type="checkbox"/> Finance & insurance <input type="checkbox"/> Accommodation & food service <input type="checkbox"/> Wholesale-other <input type="checkbox"/> Retail <input checked="" type="checkbox"/> Other (specify) ▶ Commercial Fishing | | | | |
| 17 Indicate principal line of merchandise sold, specific construction work done, products produced, or services provided. Fish and Seafood | | | | |
| 18 Has the applicant entity shown on line 1 ever applied for and received an EIN? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No If "Yes," write previous EIN here ▶ | | | | |
| Third Party Designee | Complete this section only if you want to authorize the named individual to receive the entity's EIN and answer questions about the completion of this form. | | | |
| | Designee's name | | Designee's telephone number (include area code) | |
| | Address and ZIP code | | Designee's fax number (include area code) | |
| Under penalties of perjury, I declare that I have examined this application, and to the best of my knowledge and belief, it is true, correct, and complete. | | Applicant's telephone number (include area code) | | |
| Name and title (type or print clearly) ▶ Thomas Braden, President | | 907-555-1346 | | |
| Signature ▶ <i>Thomas Braden</i> | | Date ▶ 05/01/2021 | | Applicant's fax number (include area code) |
| | | | | 907-555-9876 |

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 16055N

Form **SS-4** (Rev. 12-2019)

Source: Internal Revenue Service.

LO 1-5 Compare Payroll Processing Options for Different Businesses

Companies have several options for payroll processing. The option a company chooses depends on the business's size, the business's complexity in terms of geographic placement and business model, the capital available for payroll processing, and the availability of trained personnel.



Jeanette Landin

During the middle of the 20th century, employers measured workers' time using punch clocks and handwritten timesheets. Contemporary time collection devices serve as more than simple time clocks. Although the old-fashioned punch clocks still exist, companies have integrated different time-collection systems as part of their office security and computer access procedures. Time clocks are used as part of a security system to log in people as they enter a building for work, yield analysis of simple on-site versus working-hour time.

Many companies now use biometric devices such as fingerprint readers to collect time for their hourly employees. Systems such as **Kronos** offer biometric badges and time-collection devices that connect with office telephones. Using computer access as another type of collection device serves a similar function and can offer specific task tracking and precise timekeeping functionality. With mobile connectivity growth, companies now have many smartphone apps, such as **WhenIWork** and **ExakTime**, to track employee attendance and productivity. Practices relating to time collection are a vital element in payroll accuracy.

The basic elements of a payroll system are similar for all companies, but this is when size does matter. However, it is the company's size and the complexity of the laws that affect payroll procedures. Let's look at the differences between large and small company payrolls and then explore certified payroll issues.

Large Businesses

Large companies present intricate problems for payroll accountants. Companies such as Apple, Alphabet (Google), and Microsoft have multiple divisions, many of which exist in different geographical locations. General Electric (GE) has different companies that operate as separate entities within GE's framework. Payroll procedures reflect the intricacy of the company's structure and may take many forms.



Elnur Amikishiyev/123RF

One of the major challenges in larger organizations is the existence of multiple departments in which an individual employee may work on any given day. Some companies can have shared employees who will have allocable time to more than one department; for example, one employee may work for both the marketing and the production departments. When this occurs, the payroll accountant will have to record the time worked for each department, and pay rates may differ based on the tasks that the employee performs for each department.

A common payroll procedure with large companies involves employee portals on company websites. On the company's payroll website, employees may enter vacation time, overtime, and other issues that pertain to the employee's payroll data. Through the same website, employees may change withholding allowances and voluntary deductions and maintain certain aspects of their employees' files. Such web-based portals contain highly sensitive information, and the security of the information is an obvious concern for the companies who use them. Multiple identity checks and security measures are in place to ensure employee data privacy, such as SSL (secure sockets layer) encryption, *VPN* (a virtual private network), and *CAPTCHA* programs designed to differentiate between humans and other computer programs.

Providing employees with Internet-based access to their personnel files is a challenging issue. Federal laws do not grant employees the right to access their personnel

files, and companies must be aware of state laws before providing access. Questions of assigning access to other parties (such as union representatives), access to file artifacts, and the employee's right to challenge items in their file are issues that a firm should address when creating a web portal through which employees may access payroll records. Also, issues of cybersecurity and online privacy must be addressed.

(Source: SHRM)

To overcome some of the issues with payroll processing, large companies may rely heavily on payroll service vendors to assist with payroll preparation and human resources integration. Providers such as **MyPaySolutions** and **ADP** work with the company's security needs to offer websites that are secure and integrate multiple personnel functions seamlessly. Some larger firms will work with software engineers to develop independent systems, specifically meeting unique company needs.

Large companies face other issues related to accurate timekeeping, such as the volume of employee records. Companies with computerized time-measurement systems may link employees' computer logins, telephone logins, or building access with the payroll system. Companies working with radio frequency time cards and electronic payroll monitoring can properly allocate employee time to specific machines or production lines. With the currently available computer software and services, large companies have many options to maintain their payroll systems' accuracy and integrity.

Small Businesses

One apparent difference between large and small businesses is the volume and handling of payroll records. A small number of employees generally leads to fewer payroll-related transactions. Manual payroll systems may be maintained in very small businesses, including the use of handwritten time cards. Outsourcing of payroll activities may not be as prominent. With a small company, the amount of time to complete payroll-related tasks may be less than in a large company. For a small company, the task can be performed without disrupting the revenue-producing tasks of the business.



mavo/Shutterstock

Small companies have the option of processing payroll in-house with a minimum of difficulty. However, small companies may lack specifically trained payroll personnel, which may place employee pay and benefits on other personnel and increase the risk of pay or tax inaccuracies. The human resource director, office manager, and payroll professional may perform the same person's roles. Using payroll software and a properly designed payroll system, the task of payroll for a small company is generally manageable by minimal company staff. Small companies may choose to explore outsourcing as the company grows. Outsourcing payroll may be a viable option if the task becomes unwieldy or legal obligations become unmanageable.

Small companies have an option to use hosting services as a way to access cloud-storage, subscription-based services that possess security comparable to on-site accounting software. Hosted payroll accounting software can change in scale without the need for additional software licensing, update issues, or specific hardware.

For more information about hosted payroll, check out these top-rated services:

- **Paychex**
- **Intuit Payroll**
- **Gusto**
- **OnPay**
- **SurePayroll**

(Source: Business News Daily)

Depending on the size of the company, number of employees, and complexity of the payroll process, the company may choose to purchase a computer-based accounting system, it may continue to prepare worksheets and manual payroll checks, or it can decide to use an **outsourced vendor** for payroll preparation and associated tasks to an external vendor. Contemporary best practices often include cloud-based software due to the frequency and necessity of software updates and the file size. Whichever decisions the company makes as it grows, the importance of understanding the mechanics of the payroll process is paramount. Whether a company performs the payroll process in-house or outsources it, it is liable for payroll filing compliance. The next section provides an overview of the various computer-based systems available.

Common payroll mistakes made by small firms include

- Misclassifying employees as independent contractors.
- Paying payroll late.
- Omitting the value of gift cards awarded to employees as part of their taxable income.
- Failure to make timely and/or accurate payroll tax deposits.
- Improper treatment of expense reimbursements made to employees.
- Incorrect treatment of taxable fringe benefits.

(Source: *Accounting Today*)

Large vs. Small

Stop & Check

1. What are three potential payroll processing issues faced by large companies?
2. How does payroll processing differ between large and small companies?

Computer-Based Systems

Various accounting software packages exist to facilitate payroll-related accounting tasks, including QuickBooks, Sage 100, and Microsoft Dynamics GP. The use of computerized payroll systems eliminates approximately 80 percent of payroll processing time and errors. Computerized accounting systems foster the integration of payroll data with other company financial functions through Enterprise Resource Planning (ERP), allowing decision-makers to develop a comprehensive understanding of the company's operational needs. Although payroll professionals must verify employee data and update the software at regular intervals, computerized systems reduce the burdens of manual pay calculations, pay disbursement, and report compilation from the payroll accountant.

When used properly, small companies may benefit from a computerized payroll system. Although concerns about the confidentiality of personnel records exist, electronic access to records may streamline certain tasks, such as employee information updates and overtime reporting. Additionally, as the year-end approaches, companies can deliver the employees' W-2 (see Figure 1-4) tax forms electronically, ensuring employees' rapid access to their tax documents.

A trend in payroll processing involves the issuance of electronic paycards, much like preloaded credit cards, instead of paper checks. Paycards offer the employees the flexibility to wait for their paycheck to be deposited at a bank. Companies that offer direct deposit as a payment option must offer paycards to employees who do not have bank accounts. However, a paycard can be lost or stolen, and with it, the employee's paycheck. Additionally, employers may be charged fees for

FIGURE 1-4
Form W-2 Wage and Tax Statement

| | | | | | |
|---|--|--|--|---|--|
| 22222 | | a Employee's social security number 444-44-4444 | | OMB No. 1545-0008 | |
| b Employer identification number (EIN) 12-1234567 | | 1 Wages, tips, other compensation 21689.20 | | 2 Federal income tax withheld 1858.00 | |
| c Employer's name, address, and ZIP code Some Company 123 Main Street Anywhere, Anystate 00000 | | 3 Social security wages 22369.20 | | 4 Social security tax withheld 1386.89 | |
| | | 5 Medicare wages and tips 22369.20 | | 6 Medicare tax withheld 324.74 | |
| | | 7 Social security tips | | 8 Allocated tips | |
| d Control number | | 9 | | 10 Dependent care benefits | |
| e Employee's first name and initial Connie L. Baines P.O. Box 11211 Sioux City, IA 73217 | | Last name Suff. | | 11 Nonqualified plans | |
| | | | | 12a DD 707.00 | |
| | | 13 Statutory employee <input type="checkbox"/> | | 12b | |
| | | Retirement plan <input checked="" type="checkbox"/> | | 12c | |
| | | Third-party sick pay <input type="checkbox"/> | | 12d | |
| f Employee's address and ZIP code | | 14 Other | | | |
| 15 State Employer's state ID number IA 1866748 | | 16 State wages, tips, etc. 21689.20 | | 17 State income tax 976.01 | |
| | | 18 Local wages, tips, etc. | | 19 Local income tax | |
| | | | | 20 Locality name | |

Form **W-2** Wage and Tax Statement
Copy 1—For State, City, or Local Tax Department

2021

Department of the Treasury—Internal Revenue Service

Source: Internal Revenue Service.

loading a paycard. When companies consider paycards as an option, it is important to communicate to employees an understanding that there may be costs assessed by the card issuer.

Internet-Based Systems

Internet-based accounting software is an option for a company that does not need, or have the resources to purchase, a computer-based accounting system. Computer-based accounting systems such as QuickBooks, Microsoft Dynamics GP, and Sage 100 Standard offer both desktop and Internet-based services for businesses. Companies such as Xero and Wave have developed Internet-only accounting packages accessible for a monthly fee. The advantages of using Internet-based services include the ease of access for accounting personnel and managers and automatic software updates. A potential disadvantage of relying on Internet-based software for a company's accounting is information security issues.

Accounting Today conducted case studies with firms that had used Internet-based accounting software and highlighted the following:

Positive Aspects

Timely identification of financial issues because of the ease of access to company records
Low price for software access and "real-time" knowledge of business information
Increased opportunity for collaboration in the business planning and monitoring process
Continual software updates for changes in tax rates or other related practices

Challenges

Users cannot usually customize certain information layouts to suit specific company needs
Not suitable for highly complex businesses such as large manufacturing operations
Employee resistance to learning about new software and company accounting process
More options available than company personnel knew how to use

It is estimated that advances in predictive software and Artificial Intelligence-based systems will make accounting software more useful for small businesses, enabling companies to engage in real-time business analysis that had been previously out of their reach. Additionally, software advances will enable business owners to be more flexible in conducting business regarding the work location, information demands, and data transmittal.

(Source: *Accounting Today*)

Manual Systems

With manual payroll systems, the payroll employee relies on deduction percentages presented in publications from the Internal Revenue Service. **Publication 15** (also known as **Circular E**) and **Publication 15-T** are the manual payroll accountant's best friends, along with periodic updates and supplemental publications.



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The largest challenges the manual payroll preparer faces are time constraints and updated tax tables. Companies can determine the length of time between the end of the payroll period and the employee payments to a certain extent. However, employers must make every reasonable effort to pay their employees in a timely and accurate manner to avoid ethical breaches and potentially costly litigation.

Manual payroll accountants may use spreadsheet programs, such as Microsoft Excel. The accountant can create lookup formulas or other connecting formulas to facilitate the payroll process's accurate completion. Spreadsheets with formulas or macros should be used only if the accountant understands the formulas and can verify the linkage before finalizing payroll to ensure that calculations are correct.

According to the IRS, approximately 40 percent of all small businesses make payroll errors, averaging \$845 in fines per year. The most common errors include mathematical computations, missed payments, or late payments.

(Source: *Journal of Accountancy*, IRS)

Outsourced Payroll Systems

Outsourced payroll processing has become rather popular to ensure compliance with the changing legal structure and withholding requirements. When a company chooses to use an outsourcing firm to complete the payroll processes, there are several considerations: records retention, confidentiality, compliance, timeliness, and thoroughness. Managers should review the cost/benefits of outsourcing a firm's payroll processes before committing.

External payroll providers offer flexibility and advanced data analysis that might be challenging for smaller internal departments. During a survey of more than 2,000 accounting professionals, an overwhelming margin stated they would prefer to outsource payroll functions because of the process's time. External payroll management providers such as ADP and Paychex® assist company owners and managers with strategic planning and related human resources issues. However, outsourcing is not a wise decision for all companies. For a small company, outsourcing may not be cost-effective. For large or international companies, outsourcing may be the only option to manage payroll complexity.

A recent trend in payroll accounting involves cloud-based computing, meaning that the data is housed on a server external to the firm and accessible via an Internet connection. Companies such as ADP offer cloud-based payroll and human resource functions for businesses. These services reduce costs by allowing a company to avoid hardware and software costs associated with payroll. However, issues have arisen with payroll vendor stability and information security.

In late 2019, payroll provider MyPayrollHR terminated business operations abruptly, leaving hundreds of thousands of employees without the pay they were due from the thousands of employers that relied on the service. FBI investigators have warned companies to complete thorough background and reliability checks on outsourced payroll vendors before entrusting employee payroll to them.

(Source: American Payroll Association)

Certified Payroll

Companies who do business with the federal government under the Davis–Bacon Act must file a report (see Figure 1-5 for Form WH-347) delineating the payroll paid as part of the government

FIGURE 1-5
Form WH-347 Certified Payroll

U.S. Department of Labor
Wage and Hour Division

PAYROLL
(For Contractor's Optional Use; See instructions at www.dol.gov/whd/forms/wh347instr.htm)

Persons are not required to respond to the collection of information unless it displays a currently valid OMB control number.

NAME OF CONTRACTOR ☐ OR SUBCONTRACTOR ☐ ADDRESS

PAYROLL NO. FOR WEEK ENDING PROJECT AND LOCATION PROJECT OR CONTRACT NO.

OMB No. 1235-0008
Expires: 04/30/2021

| (1) | (2) | (3) | (4) DAY AND DATE | (5) | (6) | (7) | (8) DEDUCTIONS | | | | | (9) | | | | | | |
|--|---------------------------|------------------------|-----------------------|-----|-----|-----|----------------|--|--|----------------|----------------|---------------------------|------|-------------------------|-------|---------------------|----------------------------------|--|
| NAME AND INDIVIDUAL IDENTIFYING NUMBER (e.g. LAST FOUR DIGITS OF SOCIAL SECURITY NUMBER) OF WORKER | OT HOURS EXEMPTIONS | WORK CLASSIFICATION | HOURS WORKED EACH DAY | | | | | | | TOTAL HOURS | RATE OF PAY | GROSS AMOUNT EARNED | FICA | WITH- HOLDING TAX | OTHER | TOTAL DEDUCTIONS | NET WAGES PAID FOR WEEK | |
| | | | | | | | | | | | | | | | | | | |
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Source: U.S. Department of Labor.

contract with each payroll. **Certified payroll** is how the federal government keeps track of the money spent as part of government contracts. Davis–Bacon Act–related wages and the state versions of those regulations require special handling and knowledge. Certified payroll facilitates governmental internal accountability and verifies that Davis–Bacon Act requirements are met.

Information needed to complete a Certified Payroll report includes

- ✓ Company-specific identifying information.
- ✓ The job being worked on and its duration.
- ✓ Employee information that includes a social security number and address.
- ✓ Hours worked on each job and the pay rate associated with it.
- ✓ Gross pay earned for the week.
- ✓ Taxes, withholdings, and fringe benefits.
- ✓ Net pay earned per employee.

Choosing payroll technology can be a complex task for employees charged with finding appropriate technological solutions. Some of the considerations include

- Flexibility in pay options.
- Time collection procedures.
- Tax reporting.
- Geotagging of employee work locations.
- Software affordability.
- Software update schedules.

What Is the Difference?

Stop & Check

In a few words, compare the following:

- a. Manual payroll systems
- b. Computerized payroll systems
- c. Outsourced payroll systems
- d. Certified payroll

Trends to Watch

LEGAL ENVIRONMENT

To say that the legal environment of payroll is continually evolving is an understatement. Since 2017, we have witnessed the following legal challenges:

- Increasing numbers of private employers and localities raise the minimum wage significantly to close the minimum wage gap and the living wage.
- Challenges to the Affordable Care Act related to the overturn of the individual mandate for health care coverage.
- Supplemental wage rate changes for payments of bonuses.
- State enforcement of predictive scheduling, fair/flexible scheduling laws on changing employee's schedules.
- Reframing the federal income tax structure, treatment for nonresident aliens, supplemental wage withholding rates, and inflation adjustments.

Some trends to watch include

- A shift to complete digitalization of payroll processes, including partial or complete remote work options.
- Increased guidance about payroll tax impacts of COVID-19 as it affects employees, both part- and full-time.
- An increase in the need for centralized and fully communicated company policies to meet remote workers' needs.
- Payroll data will increase in importance for business decisions.

Summary of Payroll Practices and System Fundamentals

Accounting practices have existed for centuries, and a need continually exists for employers to compensate employees for the work they have performed. Once the United States began taxing personal income, payroll processing became increasingly complex. During the 20th century, payroll practices evolved to include withholding taxes from employees, remitting payroll taxes to government agencies, maintaining accurate and confidential records, and incorporating civil rights-related legislation. Payroll accounting is a field that requires precision and attention to minute details due to its changing nature. Additionally, payroll accountants must adhere to ethical guidelines, including due care, objectivity, and independence, professional competence, integrity, and confidentiality because of the nature of their work.

The establishment of a 21st-century payroll system involves careful, deliberate planning. The framework used for the payroll system must have ample room for company growth, structure to ensure system stability, and trained payroll personnel to ensure that company and government deadlines are met. Using the best practices outlined in this chapter may help a company implement a robust payroll system, whether the system is maintained by company personnel, outsourced, completed manually, or accomplished using specifically designed software. Robust payroll system design may reduce or prevent problems with employees and governmental entities.

Key Points

- Legislation that has affected employees' working conditions has mandated many aspects of the workplace, including civil rights, retirement and health benefits, and reinvestment in American workers.
- Payroll-specific legislation has influenced working hours and employee wages and was updated in 2020 to address contemporary employer concerns.
- Employer and employee tax laws have been enacted, and the remittance of tax obligations has been mandated.
- Payroll accountants must adhere to ethical guidelines because of the nature of the work performed.
- The ethical principles of confidentiality, integrity, objectivity, independence, and professional competence and due care guide the payroll accounting profession.
- Payroll practices include the electronic transmission of employee pay and tax obligations.
- The security of employee information is an ongoing concern for companies, especially with the electronic transmission of sensitive data.
- Payroll may be processed at a central corporate site or through an outsourced payroll processing company.
- Many companies use payroll accounting software, such as QuickBooks and Sage 100.
- Cloud-based payroll processing has offered many resources for companies, including partial or total payroll preparation services.
- Payroll security and privacy are critical to ensure employer legal compliance and to protect employees.

Vocabulary

| | | |
|--------------------------|------------------------------|---------------------------|
| ACA | EEOC | OSHA |
| ADA | Employer Identification | Personal Responsibility, |
| ADAAA | Number (EIN) | Work and Family |
| ADEA | Enterprise Coverage | Promotion Act of 2002 |
| ARRA | Equal Pay Act of 1963 | Privacy Act of 1974 |
| ATRA | ERISA | Protecting Americans from |
| Certified payroll | Ethics | Tax Hikes (PATH) Act |
| Circular E | FICA | Professional competence |
| Civil Rights Act of 1964 | FLSA | Professionalism |
| Civil Rights Act of 1991 | FMLA | PRWOR |
| COBRA | FUTA | Publication 15 |
| Consolidated | HIPAA | Publication 15-T |
| Appropriations Act of | Independence | SECURE |
| 2018 | Independent contractor | Sixteenth Amendment to |
| Copeland Anti-Kickback | Individual Coverage | the U.S. Constitution |
| Act | Integrity | Social Security Act (SSA) |
| Coronavirus Aid, Relief | IRCA | SOX |
| and Economic Stimulus | Lilly Ledbetter Fair Pay Act | SUTA |
| (CARES) Act of 2020 | of 2009 | Tax Cuts and Jobs Act |
| Current Tax Payment Act | Living Wage | USERRA |
| (CTPA) of 1943 | Medicare | VPN |
| Davis–Bacon Act of 1931 | Minimum Wage | Walsh–Healey Public |
| DOMA | OASDI | Contracts Act |
| Due care | Objectivity | Workers' compensation |

Review Questions

1. What is the purpose of a payroll system?
2. What are two of the differences between large- and small-company payroll practices?
3. What is certified payroll? Which companies must use it?
4. Why might it be a good idea to let employees manage their payroll records? What are some of the pitfalls?
5. What are two ways a payroll system may protect a company in the event of a visit from a government auditor?
6. What is payroll outsourcing? When might a company consider outsourcing its payroll?
7. What are three examples of federal laws that are essential to ensure legal, fair hiring practices?
8. What are the major types of payroll processing methods?
9. What are two laws governing the taxes that employers must withhold from employees?
10. What are the guidelines for FLSA in terms of overtime and pay rate?
11. Why was the Social Security Act of 1935 created? What were its provisions?
12. What are two of the advantages of a computerized payroll system over a manual system?
13. Which act created the term “Full-Time Equivalents”?
14. How has cloud-based payroll processing affected contemporary payroll practices?
15. What are two of the differences between the completion of the I-9 and the use of E-Verify systems?
16. What was the purpose of the SECURE Act?
17. What are two of the challenges that arise from the use of outsourced payroll systems?
18. What distinguishes a “living wage” from the minimum wage?
19. How does the Equal Pay Act of 1963 differ from the Lilly Ledbetter Fair Pay Act of 2009?

Exercises Set A

- E1-1A.**
LO 1-1, 1-2 Lupore Fabrics obtained a contract in Watts Mills, South Carolina, that involves the production of materials for military uniforms, a project contracted with the federal government for \$2,800,000. What laws govern the wages Lupore Fabrics pays to its workers for this project? (Select all that may apply.)
1. Davis–Bacon Act
 2. Sarbanes–Oxley Act
 3. Walsh–Healey Act
 4. FLSA
- E1-2A.**
LO 1-1, 1-2 Martine Piccirillo works as the payroll clerk for Centinix, a security company that hires many part-time and temporary workers who are paid hourly. What law governs the hiring or documenting of these workers?
1. ADEA
 2. FLSA
 3. IRCA
 4. USERRA

- E1-3A.** Jackson Wyman was dismissed from his employment at Precision Dynamics because of an incident regarding his race. Mr. Wyman sued Precision Dynamics for \$150,000 because of the discrimination. Which of the following laws provides for monetary awards during discrimination lawsuits?
LO 1-1, 1-2
1. FLSA
 2. ADEA
 3. ADA
 4. Civil Rights Act of 1991
- E1-4A.** Ovenet Inc. is a qualified private-sector company that provides health insurance to its employees. The company is self-insured. Which of the following forms should the company provide its employees to comply with the Affordable Care Act?
LO 1-1, 1-2
1. 1095-A
 2. 1095-B
 3. 1095-C
- E1-5A.** Rubin Schaub is a payroll accountant who works for a private firm. He completed his most recent professional development course in 2005. Which of the following ethical issues has he violated?
LO 1-3
1. Confidentiality
 2. Objectivity and independence
 3. Professional competence and due care
 4. Integrity
- E1-6A.** Merlin Anson owns Uninix Computers, a company with five employees. As a small business owner, he has several options for payroll processing. What factors should he consider when deciding on which payroll processing option is best for Uninix Computers? (Select all that apply.)
LO 1-4, LO 1-5
1. The number of independent contractors.
 2. The physical size of the office facility.
 3. The amount of money he has to spend on payroll processing.
 4. The computer technology used by the business.

Match the following terms with their definitions:

- | | |
|--|--|
| E1-7A. Manual payroll | a. A preloaded credit card is used to pay employees. |
| E1-8A. Timecard | b. The process of gathering information about hours worked for one or more employees. |
| E1-9A. Paycard | c. A web-based application wherein employees can modify certain payroll-related information. |
| E1-10A. Employee Internet portal | d. Governs accounting for firms with federal government contracts in excess of \$2,000. |
| E1-11A. Certified payroll | e. A record of the time worked during a period for an individual employee. |
| E1-12A. Outsourced payroll | f. Examples of companies used for outsourcing payroll processing. |
| E1-13A. Auditor | g. Provided funding for the E-Verify program. |
| E1-14A. ADP and Paychex® | h. Payroll administration using a paper payroll register. |
| E1-15A. Time collection | i. The use of an external company to track time and benefits and pay employees. |
| E1-16A. Davis–Bacon Act | j. A person or group who examines a company's accounting records for accuracy. |
| E1-17A. Consolidated Appropriations Act | k. A way for governmental agencies to track the payroll associated with a government contract. |