

# Accounting 101 for Payroll

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**Presented by:**

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# Brief Bio

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- ❑ Assoc. Director Finance & Accounting – Compliance, Federal Practice for KPMG LLP
- ❑ Div. Compliance Director and Controller for L-3 Communications divisions in MA and VA (2005)
- ❑ Bachelors degree Mass Communications; Emerson College, Boston MA
- ❑ Masters of Science Accountancy; Bentley University McCallum Graduate School of Business, Waltham MA

# Brief Bio – Concluded

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- ❑ CPA licensed in Virginia and Massachusetts
- ❑ Present courses in MA, MD, NJ, NY and VA
- ❑ Tenor and Actor
  - In a *movie* called “6 Hearts 1 Beat” - You can “Like” the page on Facebook!
  - Official IMDb page  
[http://www.imdb.com/title/tt2831438/?ref\\_=fn\\_al\\_tt\\_1](http://www.imdb.com/title/tt2831438/?ref_=fn_al_tt_1)
  - On stage most recently in “Calendar Girls” Alden Theatre in McLean

# Agenda

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- History of Accounting
- Basic Accounting Elements
- Basic Accounting Transactions
- Payroll Specific Elements
- Basic Accounting (Financial) Reports
- Reconciliations Demystified
- Questions

# History

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- Balance Sheet Dates to Ancient Egypt
  - They had an elaborate internal verification system
  - Irregularities meant fines, mutilation, or death
- “Double-Entry” Accounting (Debit and Credit) Since Columbus’s Voyage
  - Italian monk Luca Pacioli published description in 1494 A.D.
  - Bookkeepers were everywhere, but business and economics changed and more astute review needed\*

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\* – <http://www.enotes.com/accounting-118557-reference/accounting-174096>

# History

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- Public Accounting in US in Latter 19<sup>th</sup> Century
  - First organization established in 1887 (The AICPA today)
  - First professional exam administered in December 1896\*
- No Formal Accounting Rules Until 20<sup>th</sup> Century; No Consistency!
- First “Certified Public Accountant” in New York State

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\* – <http://www.enotes.com/accounting-118557-reference/accounting-174096>

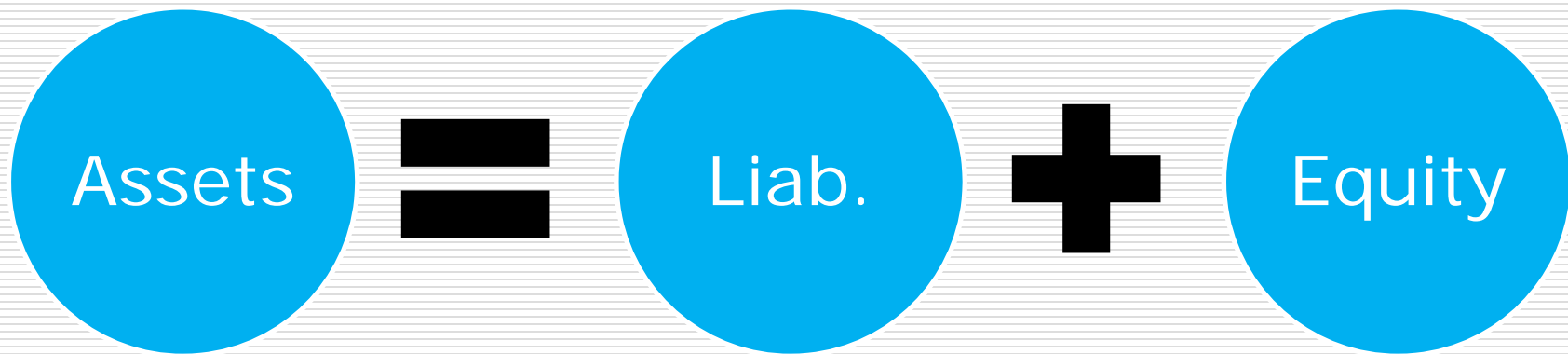
# Basic Accounting Elements

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- Accounting Equation
- Debits and Credits Defined
- Ledgers and Journals

# Accounting Equation

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# Assets

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- Benefit Company For More Than an Accounting Period
- Current Assets (Converted to Cash in Less Than 1 Year)
  - Cash
  - Accounts Receivable
  - Inventory
  - Marketable Securities
- Non-current Assets, Fixed Assets, Longer Term
- Normally a debit balance

# Liabilities

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- Obligations of the Company
  - Accounts Payable – Trade
  - Accrued Expenses (Bills we know are coming but have not received)
  - Notes Payable –
    - Short-Term – less than one year
    - Long-Term – greater than one year
- Normally a credit balance

# Equity

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- Net Residual Value of Assets – Liabilities
  - Capital / Partnership Share
  - Additional Paid-In Capital (With stock, amount paid beyond “par” value)
  - Net Income Closed at Period-End
- Normally a Credit Balance, Though Some Elements May Have a Debit Balance (*e.g.*, a Net Loss at Period-End)

# Key Definition

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- Debit and Credit
  - Abbreviated DR and CR respectively
  - Left and Right
  
- Total DR *Must Equal* Total CR

# Key Definition: DR & CR

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<b>Assets</b>	<b>Liabilities Equity</b>
Left	Right

# Ledgers and Journals

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- Journals Are Where Entries Are Made
  - Entries are how we record transactions
  - Transactions are what we “do” in business
  - Which account(s) to use based upon “Chart of Accounts”

Description	DR	CR
Cash	100.00	
Owner's Equity		100.00
To record initial investment in business		

# Ledgers and Journals

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- Ledgers Are Where We “Post” Journal Entries
  - General Ledger summarizes each and every journal entry (transaction)
  - Subsidiary Ledgers summarize certain entries
    - Examples include Cash, Accounts Receivable, Accounts Payable, Equity
    - Some subsidiary ledgers, such as Accounts Receivable, can have subsidiary ledgers, *i.e.* one for each customer!

# Basic Accounting Transactions

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- Recording Expenses and Revenue
- Closing the Period
- Basic Accounting (Financial) Reports

# Expenses

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- ❑ Expenses Permit Us to Earn Revenue! (We Match Revenue to the Expenses Incurred)

Description	DR	CR
Rent – Office Space	10.00	
Cash		10.00
To record office space rent		

# Expenses

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- Not All Expenses Are Paid Immediately
- We Want Documentation – Objective Evidence  
– That a Transaction Occurred
- Auditors Will Test Transactions Using a Sample

Description	DR	CR
Telecommunications	100.00	
Accounts Payable – Trade / Cable Co		100.00
To record office Internet connection		

# Revenue

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- ❑ Revenue Is Recorded When Earned (Realized);  
*i.e.* When We Are Entitled To It!

Description	DR	CR
Accounts Receivable – ABC Inc	500.00	
Revenue – Sales		500.00
To record sale		

# Revenue – Completing Cycle

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It's Nice To Be Paid!

Description	DR	CR
Cash	500.00	
Accounts Receivable – ABC Inc		500.00
To record cash receipt		

# Other Transaction

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But We Have To Pay Bills, Too!

Description	DR	CR
Accounts Payable – Trade / Cable Co	100.00	
Cash		100.00
To record payment to Cable Co		

# Key Definition Revisited: DR & CR

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<b>Assets</b> <b>Expenses</b>	<b>Liabilities</b> <b>Equity</b> <b>Revenue</b>
Left	Right

# Closing the Period

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- ❑ Performed at Month-End, Quarter-End and Year-End
- ❑ Balance of All Expense and Revenue Accounts Are “Closed” to Income Summary Account

Description	DR	CR
Revenue – Sales	500.00	
Income Summary		390.00
Rent		10.00
Telecommunications		100.00
To close revenue / expense accounts to I/S		

# Closing the Period

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- ❑ Income Summary Account Is Closed to Equity Section of the Balance Sheet

Description	DR	CR
Income Summary	390.00	
Accumulated Earnings & Deficit		390.00
To close income summary to equity		

# Payroll Specific Transactions

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- ❑ Record Payroll Expense (Functionally – by Job; and/or Pay Type – Regular Hrs v. OT)

Description	DR	CR
Payroll Expense	500.00	
SUTA Expense	10.00	
FUTA Expense	8.00	
Payroll Tax Withholding Payable		75.00
FUTA / SUTA Payable		18.00
Payroll Payable		425.00
To record weekly payroll		

# Payroll Specific Transactions

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## Record Payroll Payment\*

Description	DR	CR
Payroll Payable	425.00	
Cash		425.00
To record payroll disbursement		

Description	DR	CR
Payroll Tax Withholding Payable	75.00	
FUTA / SUTA Payable	18.00	
Cash		93.00
To record payroll liability payment		

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\* -- If paid by check, ensure that blank check stock is stored in locked cabinet with limited access, and separate from "signing machine" or signature plates

# Payroll Specific Transactions

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## To Accrue Payroll Expense

Description	DR	CR
Payroll Expense [(500 / 5 days) x 1 Day]	100.00	
Accrued Payroll Tax Withholding		15.00
Accrued Payroll Net		85.00
To accrue payroll for one day		

Description (Auto Reverse)	DR	CR
Payroll Expense		100.00
Accrued Payroll Tax Withholding	15.00	
Accrued Payroll Net	85.00	
Auto reverse accrual entry		

# Basic Accounting (Financial) Reports

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- Trial Balance – Listing of all accounts and balances
  - Two formats

Account Description	DR	CR	Acct. Desc.	DR(CR)
Cash	100.		Cash	100.
Accts. Rec'ble	10.		A/R	10.
Accts. Pay'ble		20.	A/P	(20)
Equity		50.	Equity	(50)
Revenue		60.	Revenue	(60)
Expense	20.		Expense	20.
<b>TOTALS</b>	<u>130.</u>	<u>130.</u>	<b>TOTAL</b>	<u>0.</u>

# Basic Accounting (Financial) Reports

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- Balance Sheet – Listing of all asset, liability and equity accounts as of a certain date

Balance Sheet As of Period-End Date			
Cash	100.		Accts. Pay'ble 20.
Accts. Rec'ble	10.		
			Equity 90.
TOTAL	<u>110.</u>		TOTAL <u>110.</u>

# Basic Accounting (Financial) Reports

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- Income Statement – Listing of all revenue and expense account balances for activity *through* a certain date

Income Statement For The Period-Ending	
Revenue	60.
Expense	(20)
Net Income*	<u>40.</u>

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\* - Dividing the Net Income into the Total Number of Issued and Outstanding Shares of Common Stock yields a figure called "Earnings Per Share"

# Why Have Financial Statements?

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- Financial Accounting Standards Board (FASB)  
*Statement of Financial Accounting Concepts*  
*No. 1* (Nov. 1978, as amended)

The purpose of financial reporting is to give interested parties insight to the nature, timing, and uncertainty of *future cash flows*.

# Who Are “Interested Parties”?

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## Owners

- Sole proprietor
- Partners or Members (LLC)
- Shareholders (“S-Corp”)
- Stockholders (Publicly Traded)
- Employees (Especially where ESOPs and Profit Sharing exist)

## Banks

## Regulatory Agencies (SEC)

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# Practice Exercises – See Handout

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It is time to record payroll for last week. All calculations for each employee's timesheet are correct. There are ten employees who are paid about the same. Assume a single income tax rate of 5%; federal unemployment is 1%; state unemployment is 2%; employee withholds 1% for retirement, which is matched by the employer; Social Security and Medicare are 2% in total and may be treated as a single item; total gross payroll for the week is \$10,000. Required: Provide the journal entry to record the weekly payroll.

# Exercise 1 – Suggested Solution

Description	DR	CR
Payroll Expense	10,000.	
Retirement Expense (10,000 x .01)	100.	
SUTA Expense (10,000 x .02)	200.	
FUTA Expense (10,000 x .01)	100.	
SS/Medicare Expense (10,000 x .02)	200.	
Tax Withholding Payable (10,000 x .05)		500.
SS/Medicare Withholding Payable		200.
Retirement Withholding Payable		100.
SS/Medicare Liability		200.
Retirement Liability		100.
SUTA Liability		200.
FUTA Liability		100.
Net Payroll Payable (10,000 – 500 – 300)		9,200.
To record weekly payroll expense	<u>10,600.</u>	<u>10,600.</u>

# Practice Exercises – See Handout

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Several days after making the above entry it is time to pay all liabilities. Required: Provide the journal entry to record payment of all the payroll related liabilities for last week's payroll.

# Exercise 2 – Suggested Solution

Description	DR	CR
Tax Withholding Payable	500.	
SS/Medicare Withholding Payable	200.	
SS/Medicare Liability	200.	
Retirement Withholding Payable	100.	
Retirement Liability	100.	
SUTA Liability	200.	
FUTA Liability	100.	
Net Payroll Payable	9,200.	
Cash		10,600.
To record weekly payroll disbursement		

# Reconciliations

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## □ Reconciliation, *noun*

- An act of reconciling [to compose or settle] or the state of being reconciled [to bring into agreement or harmony; to make consistent]
- The process of making consistent or compatible

# Reconciliations

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- For Accounting and Bookkeeping:
  - Defined: “An accounting process used to compare two sets of records to ensure the figures are in agreement and are accurate. Reconciliation is the key process used to determine whether the money leaving an account matches the amount spent, ensuring that the two values are balanced at the end of the recording period.”

# Reconciliations

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- For Accounting and Bookkeeping:
  - Explained: “At the end of every month it is a good idea to reconcile your checkbook by comparing your receipts with your bank statement. Among other advantages, this type of account reconciliation makes it possible to determine whether money is being fraudulently withdrawn from an account.”

# Reconciliations – Checking Account\*

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## Items Needed and Why

### ■ Checkbook

- All checks written, deposits made, EFTs/ACHs we know of are recorded up to the *current* date

### ■ Bank account statement

- All checks written, deposits made, EFTs/ACHs that have cleared the bank are recorded up to the *statement* date

### ■ Calculator or Excel spreadsheet

- I don't trust my "head math"

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\* - If this is the Payroll Cash Account, it is to be reconciled by someone *outside* the Payroll Department

# Practice Exercises – See Handout

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We have a new bank account that we opened last month, and we have received the first bank statement for this account, dated five days ago. Required: Reconcile the bank statement to the checkbook register.

	Checkbook	Bank Statement
Balance per:	\$ 5,250.00	\$ 6,500.00
Outstanding checks	550.00	
Checks printing fee		50.00
EFT from yesterday	750.00	

# Exercise 3 – Suggested Solution

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Recall: We simply have to take into consideration what is unknown to the other set of numbers...

	Checkbook	Bank Statement
Balance per:	\$ 5,250.00	\$ 6,500.00
Outstanding checks		(550.00)
Checks printing fee	(50.00)	
EFT from yesterday		(750.00)
TOTALS:	\$ 5,200.00	\$ 5,200.00

# Reconciliations – Payroll

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## □ Items Needed and Why

- Report of information “input” to process payroll
  - Timesheets record hours worked; those hours are matched to the employees’ pay rates; we have an expectation for gross payroll results
- Report of information “output” from processed payroll
  - Hours and rates went in, now gross pay, deductions and withholdings, employer liabilities, and net pay available; plus some reconciling items may be found

# Reconciliations – Payroll

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## Basic Procedure

- Work from two points, just like reconciling your checkbook to the bank statement
  - Total Hours and Payroll Expense per the “input” report
  - Total Hours and Payroll Expense per the “output” report

# Recall Exercise 1 – Suggested Solution

Description	DR	CR
<b>Payroll Expense (Based on 100 hrs @ \$100/hr)</b>	<b>10,000.</b>	
Retirement Expense (10,000 x .01)	100.	
SUTA Expense (10,000 x .02)	200.	
FUTA Expense (10,000 x .01)	100.	
SS/Medicare Expense (10,000 x .02)	200.	
Tax Withholding Payable (10,000 x .05)		500.
SS/Medicare Withholding Payable		200.
Retirement Withholding Payable		100.
SS/Medicare Liability		200.
Retirement Liability		100.
SUTA Liability		200.
FUTA Liability		100.
Net Payroll Payable (10,000 – 500 – 300)		9,200.
To record weekly payroll expense	<u>10,600.</u>	<u>10,600.</u>

# Suppose for Exercise 1 – “Reports”

	INPUT	OUTPUT
Labor hours	100	90
Gross Payroll Expense	\$ 10,000.00	\$ 9,000.00
Retirement Expense		\$ 90.00
SUTA Expense		\$ 180.00
FUTA Expense		\$ 90.00
SS/Medicare Expense		\$ 180.00
Income Taxes Withheld		\$ 450.00
Retirement Withheld Liability		\$ 90.00
SS/Medicare Liability		\$ 360.00
SUTA/FUTA Liabilities		\$ 270.00
Net Payroll Payable		\$ 8,280.00

It just don't add up!

# Reconciling Items

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## □ Many Possible Reconciling Items

- Outstanding checks
- Deposits in transit
- Bank fees charged or interest earned
- Rejected timesheets
- Wire transfers v. checks
- Foreign currency transactions / exchange rate variances
- Transposition

# Reconciling Items

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## □ The Magic Number 9

- A variance that evenly divides by 9, such as 27, which when divided by  $9 = 3$ , is an indication of one or more transposed figure(s)!

# Reconciling Items

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## ❑ The Magic Number 9

Outstanding Checks	
Check Amounts	Entered Amounts
\$ 500.00	\$ 500.00
658.78	658.78
37.50	37.50
1,819.43	1,891.43
<u>127.32</u>	<u>172.32</u>
\$ 3,143.03	\$ 3,260.03

# Reconciling Items

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## □ The Magic Number 9

$$\$3,260.03 - 3,143.03 = \$117.00 \text{ variance}$$

$$\$117.00 / 9 = 13.00!$$

# Reconciling Items

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## ❑ The Magic Number 9

Outstanding Checks	
Actual Amounts	Transposed Amount(s)
\$ 500.00	\$ 500.00
658.78	658.78
37.50	37.50
1,819.43	1,891.43
<u>127.32</u>	<u>172.32</u>
\$ 3,143.03	\$ 3,260.03

# Reconciling Items

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## ❑ The Magic Number 9 – Second Example

Outstanding Checks	
Check Amounts	Entered Amounts
\$ 500.00	\$ 500.00
658.78	658.78
37.50	37.50
1,819.43	1,891.43
<u>127.32</u>	<u>127.23</u>
\$ 3,143.03	\$ 3,214.94

# Reconciling Items

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## □ The Magic Number 9 – Second Example

$$\$3,214.94 - 3,143.03 = \$71.91 \text{ variance}$$

$$\$71.91 / 9 = 7.99$$

We need a two step process:

1. We know we're off in pennies – we're supposed to end with 3 cents, but we end with 94 cents; so, what do we do? There's two ways to view this variance...

# Reconciling Items

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## □ The Magic Number 9 – Second Example

Is it 91 cents – the difference of subtracting 3 from 94?

Or is it really the amount needed to go from 94 cents to, in essence, \$ 1.03; 9 cents!?

If this is the case, then a simple transposition of pennies is the likely culprit.

# Reconciling Items

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## □ The Magic Number 9 – Second Example

What happens if we add 9 cents to our variance of \$71.91? We get a round variance of \$72.00!

2. Because we get a round variance, it is likely that we have at least one transposition in the dollars, too.

# Reconciling Items

## ❑ The Magic Number 9 – Second Example

Outstanding Checks	
Actual Amounts	Transposed Amount(s)
\$ 500.00	\$ 500.00
658.78	658.78
37.50	37.50
1,819.43	1,891.43
<u>127.32</u>	<u>127.23</u>
\$ 3,143.03	\$ 3,214.94

# “Unexplained Variance” Myth

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- There Is No Such Thing as a Variance That Cannot Be Explained!
  - Double-check all formulas in the reconciliation worksheet or workbook to ensure formulas are correct and include the proper data range
  - Tick and tie *every* item on the reconciliation to its originating document or source
    - Beginning balance from general ledger or balance per bank statement; other amounts entered
    - Check error and / or exception reports

# “Unexplained Variance” Myth

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- ❑ There Is No Such Thing as a Variance That Cannot Be Explained!
  - If the reconciliation has not been performed in some time
    - ❑ Retain reconciliation after exhausting all possible sources for missed data
    - ❑ The next reconciliation ought to have the same amount of “variance”; if so, advise Accounting / Finance for adjustment
    - ❑ If the “variance” changes, there is another issue

# Thank You!

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