Payroll Accounting

(Cheat Sheet)

Harold Averkamp
CPA, MBA

AccountingCoach®

Payroll Accounting

Payroll accounting involves the recording of a company's:

- Gross wages, salaries, commissions, bonuses, overtime premium, sick pay, holiday pay, and vacation pay that are earned by the employees
- Payroll taxes which include 1) the taxes that are withheld from the employees' pay, 2) payroll taxes that are paid solely by the employer, and 3) the payroll taxes that are withheld from the employees' gross pay and also paid by the employer
- Payments to employees for their net pay (the amount remaining after withholdings for taxes and other amounts are deducted from each employee's gross pay)
- Remittance of withholdings and the employer's payroll obligations to governments and others
- Costs of fringe benefits provided by the employer (medical insurance, dental insurance, life insurance, disability insurance, and retirement plans)
- Workers' compensation insurance, which covers medical claims and lost wages when an employee cannot work because of a work-related injury

Wages or Gross Wages

Wages or gross wages usually refers to the pay earned by *hourly-paid* employees. These employees are paid hourly rates of pay for the number of hours worked. If these employees have a work week that begins on Sunday and ends on Saturday, their pay date is typically the Thursday or Friday following the work week. This allows the employer a few days to prepare the hourly-paid employees' paychecks. (The term *gross wages* emphasizes that the amounts are before withholdings for taxes and other deductions.)

Salaries or Gross Salaries

Salaries or gross salaries refers to the pay earned by employees who are paid a fixed or constant amount for each pay period. For example, an office manager that is compensated with an annual salary of $52,000 will have a monthly salary of $4,333; a semi-monthly salary of $2,167; a biweekly salary of $2,000; or a weekly salary of $1,000. Since the paychecks reflect a constant amount, the paychecks of salaried employees often cover the work period up to and including the date of the paychecks. (The term *gross salaries* emphasizes that the amounts are before any withholdings for taxes and other deductions.)

Semi-monthly

Semi-monthly means two times per month. For instance, a salaried employee might be paid on the 15th day of the month and the last day of the month. An employee with an annual salary of $52,000 would have a gross salary of $2,167 for each of the *24 semi-monthly pay periods in the year*.

Bi-weekly

Bi-weekly means every two weeks (such as every other Friday). In most years, there will be 26 bi-weekly pay periods. An employee with an annual salary of $52,000 would have a gross salary of $2,000 for each of the *26 bi-weekly pay periods in a year*.

Overtime

Generally, overtime refers to an employee’s hours that exceed 40 hours in a work week. The hours in excess of 40 hours per week must be compensated for unless the employee is *exempt* from overtime pay. Merely classifying a low-paid employee as *salaried* does not eliminate the need to pay overtime pay. As a result, a salaried employee with an annual salary of $20,000 must receive additional compensation for the hours worked that are in excess of 40 hours in a work week.

Overtime Premium

Overtime premium is the *additional amount per hour* that is paid to employees for the overtime hours. To illustrate, let's assume that a company pays "time-and-a-half" for hours worked that are greater than 40 hours during the work week. If an employee earns $9 an hour (the straight-time hourly rate), the overtime premium is $4.50 per hour (half of $9.00). Therefore for every hour worked that is in excess of 40 hours in a work week, the employee will be paid $13.50 instead of the straight-time rate of $9 per hour.

Exempt Employee

An exempt employee refers to an employee who is not entitled to receive overtime pay when working more than 40 hours in a work week. For example, a company's vice president of sales earning $125,000 per year is an exempt employee because the person earns a high salary and the person can control the number of hours worked. (On the other hand, a clerk earning an annual salary of $20,000 is a nonexempt employee because the person's salary is low and the person is unlikely to be able to control the number of hours that are worked.)

Payroll Withholdings

Payroll withholdings refers to the amounts deducted from an employee's gross wages, salaries, etc. Examples of payroll withholdings include the employee's portion of the Social Security and Medicare taxes, personal income taxes, medical insurance contributions, retirement plan contributions, garnishments, etc.

Net Pay

Net pay is the employee's gross pay minus the withholdings. Net pay is also known as an employee's *take-home pay* or the amount that an employee *clears* on their paycheck.

Social Security Taxes

Social Security taxes are paid by both the employee and the employer. Usually the rate for each has been 6.2% of the employee's gross pay. In other words, if an employee earns $100,000 in a year, the employee will have $6,200 of withholding for Social Security tax, and the employer will also incur an expense of $6,200. This means the employer is required to remit $12,400 during the year. For the year 2024, there is a ceiling on the wages, salaries, etc. of $168,600 per employee that are subject to the Social Security tax. (Current rates and ceiling amounts are available at irs.gov.) The combination on the Social Security tax and the Medicare tax is known as *FICA*.

Medicare Taxes

Medicare taxes are also paid by both the employee and the employer. The basic rate for each is 1.45% of the employee's gross pay (with no annual ceiling). If an employee earns $100,000 in a year, the employee will have $1,450 of withholding for the Medicare tax, and the employer will also incur an expense of $1,450. This means the employer is required to remit $2,900 during the year. The combination of the Medicare tax and the Social Security tax is known as FICA. There is also an Additional Medicare Tax of 0.9% that applies to highly-paid employees.

FICA

FICA is the acronym for *Federal Insurance Contributions Act.* FICA refers to the combination of the *Social Security tax* and the *Medicare tax*.

Employer's Tax Guide

Employer's Tax Guide (also known as *IRS Publication 15* or *Circular E*) is a guide to U.S. payroll taxes. It is published annually by the Internal Revenue Service and it can be downloaded from irs.gov at no cost.

State Unemployment Tax

State unemployment tax is a tax paid by the employer. However, the amount of the tax is calculated by multiplying the company's state unemployment tax rate times each of its employee's annual wages, salaries, etc. up to a ceiling amount which varies from state to state. The unemployment benefit payments to employees are funded by this tax.

Federal Unemployment Tax

Federal unemployment tax is a tax paid by the employer. However, the amount of the tax is calculated by multiplying 0.6% (rate depends on credits allowed) times each employee's annual wages, salaries, etc. up to a ceiling amount of $7,000.

Worker Compensation Insurance

Depending on the number of employees, companies must provide worker compensation insurance to 1) pay the medical costs for work-related injuries or illnesses, and 2) provide compensation to the employee until the worker is able to return to work.

Compensated Absences

Compensated absences is a term used by accountants for the paid holidays, paid sick days, paid vacations, etc. provided to employees. For example, a company's vacation plan may require the company to 1) record and report the vacation expense in the accounting period when the vacation days are earned, and 2) record and report a liability for the amount of vacation days that employees have earned but have not yet taken.

Postretirement Benefits Other Than Pensions

Postretirement benefits other than pensions is a term that is used by accountants to describe the medical, dental, and vision benefits that are provided to retirees. The amounts owed for such commitments must be expensed during the years when the employee earns the benefits. The amount is also recorded as a liability (which will be reduced when the retiree receives the benefits).

Accrued Wages

Accrued wages refers to the amounts that a company owes its employees for hours worked that have not yet been recorded in the general ledger accounts. For example, hourly-paid employees often have a work week of Sunday through Saturday and are paid on the following Thursday. On any given day, the company will have a liability and an expense for hours worked that have not yet been entered in the company's general ledger accounts.