Characteristics of the Payroll System

- Similar to the purchases and cash disbursements system however
  - employees are retained long-term
  - tax withholding laws and fringe benefits require a special consideration
  - commonly a separate bank account is used
  - commonly a separate journal is used (payroll journal)
- both the purchase of labor and cash paid for it are recorded at the same time in the same journal

Accountant’s Objectives

1. Record all transactions
   - at correct values
   - to correct accounts
   - in the correct period
2. Accrued payroll and payroll taxes at the balance sheet date are correctly valued
3. Include all material disclosures affecting the accounts in the statements and related footnotes.
### Common Source Documents and Functions

#### Payroll Cycle

<table>
<thead>
<tr>
<th>Source Document</th>
<th>Function</th>
</tr>
</thead>
<tbody>
<tr>
<td>W4 forms</td>
<td>Collect employee withholding data.</td>
</tr>
<tr>
<td>Time cards</td>
<td>Record time worked by employees.</td>
</tr>
<tr>
<td>Job time tickets</td>
<td>Record time spent on specific jobs.</td>
</tr>
</tbody>
</table>

### Receipt of & Payment for Employee Services

- **Hire Employees** (Interviewed, signed an agreement for rates, fringe benefits, insurance etc.)
- **Receive Employee services** (monthly, hourly, overtime, commission, piece-rate basis)
  - Personnel record:
    - date of employment
    - rate of pay
    - authorized deductions
    - termination of emp.
  - Time card:
    - start time
    - stop time
    - hours worked
  - Deduction authorization form

### Receipt of & Payment for Employee Service

- **Pay for Employee Services** (pay employees, withholdings, payroll taxes)
- **Record in payroll journal & subsidiary ledger**
- **Summarize payroll & post to general ledger**
- **Payroll check** *(For the net pay)*
  - Checks to others
  - Withholdings, employer payroll taxes and fringe benefit exp.
  - Payroll journal
  - General ledger
  - Employee earnings subsidiary ledger

### Payroll and Payroll Tax Accruals

- **Determine payroll & payroll tax accruals**
  - hourly emp.
  - payroll tax
  - benefits
- **Record in general journal**
- **Post to general ledger**
  - Payroll accrual memo:
    - amount of payroll & payroll tax accr.
Internal Controls of a Payroll System

- Adequate documents and records
  - use of formal time cards
  - payment by check (no cash)
  - both documents should be pre-numbered
- Authorization of transactions, by initialing documents;
  - hiring of personnel,
  - wage rate,
  - regular and overtime hours approved on a weekly basis by a person familiar with the work,
  - dismissal of personnel.
- Use of time clocks and controls to insure that employees clock-in only their own cards.

Internal Controls - continued

- Segregation of duties. Signed payroll checks should not be handled or accessed by
  - personnel who hire or dismiss staff,
  - anyone who collects or approves time cards,
  - anyone who prepares payroll checks, related account records, or payroll bank reconciliation.
- Imprest payroll cash – use of a separate bank account.
  - cash receipt - weekly transfer on the payroll date, from the general cash account.
  - cash disbursement - employee checks only
  - taxes, fringe expenses etc. are paid from general cash account.

Internal Controls - continued

- Independent checks on performance
  - prepare bank reconciliation,
  - recalculate hours shown on the time cards,
  - compare wage rates,
  - compare withholdings
  - account for all payroll time cards and checks.

Inventory System

SUA Chapter 6
**Periodic vs. Perpetual Inventory**

**Periodic Inventory:**

- Beginning Inventory
- Purchases

- Ending Inventory (from periodic inventory count)
- Cost of Goods Sold

**Perpetual Inventory:**

- Beginning Inventory
- Purchases

- Cost of Goods Sold (from perpetual records)
- Ending Inventory

**Periodic Inventory**

- What is the ending value of inventory?
- Count inventory using tags or count sheets,
  - on balance sheet date,
  - record the quantity, description, and the condition of inv.
- Summarize inventory by description before costing,
- Determine correct unit cost of inventory,
  - Depend on the cost method (FIFO, LIFO, etc)
  - WIP inventory will also include overhead and labor,
  - Lower of Cost or Market adjustment.
- Extend price x quantity & add for total inventory value,
- Record in general ledger by a journal entry.

**Perpetual Inventory**

- There will be two accounting entries for each sale
  - Record the sale
  - Record the cost of goods sold
- **Benefits**
  - The quantity and dollar value on hand is known at all times
  - Provide information about theft and spoilage.
- **Source of information (subcycles that effect perpetual inventory)**
  - Sales (inventory items only)
  - Sales returns (not sales allowances)
  - Purchases (inventory items only)
  - Purchase returns (inventory returns only)
- **Periodic physical count of the actual inventory & period end adjustment.**

**Source Documents for Inventory Data**

- Bill of lading
  - units
  - date
- Receiving report
  - units
  - date
- Vendor’s Invoice
  - units
  - date
- Perpetual inventory record
  - units
  - date
Perpetual Inventory - continued

- Detailed Perpetual Inventory Records
  - units & unit costs of each type of inventory are listed.

Internal Controls

- In addition to the previously mentioned controls;
- Perpetual records are useful for
  - control of stock levels,
  - determining theft of inventory.
- Segregation of duties
  - a person should be responsible for inventory,
  - another person for maintaining perpetual records,
  - ideally another one for accounting.
- Safekeeping of inventory, in a locked location.
- Independent checks on performance.
  - independent counts of ending inventory
  - recalculation of unit and total costs of inventory