

Get Back to the Basics

A payroll accounting refresher course

By Laurie Fagundes, CPP

After you have ensured that your employees have been paid timely and accurately, the final step is to confirm that expenses and liabilities have been properly recorded in your company's financial statements.

A comprehensive payroll accounting process includes more than performing monthly payroll liability account reconciliations. It should also incorporate all of the following:

- Mapping payroll codes to the general ledger
- Balancing the payroll journal entry to the pay run activity
- Cash balancing
- Trend analysis
- Monthly general ledger account reconciliation
- Monthly research of payroll cash account reconciling items
- Quarterly tax return reconciliation

All of these steps can be facilitated by writing custom reports to extract data from your payroll system. If custom reports are not available, these processes can be completed using your standard payroll reports. Let's take a closer look at each task.

Mapping Payroll Codes

Account mapping is the process of assigning general ledger (G/L) coding to each earning, deduction, and tax code in the payroll system. This is the foundation for your payroll accounting.

Mapping could be as simple as assigning a cost center/account code combination to each payroll code, or a complicated system of assigning product or project codes in

addition to the cost center and account codes. You'll need to work with your accounting department to define the structure for your account mapping.

It is critical that all of your current codes are mapped correctly or the information in the financial statements will be misrepresented. Furthermore, you must also have a process in place to immediately assign mapping to newly created payroll codes.

Balance the Payroll Journal Entry

Balancing is a high level review of the totals booked to each G/L account to verify that all activity is booked to the proper account. In other words, balancing tells you with 100% confidence that your journal entry impacted the general ledger correctly.

You'll need the following information for each pay run:

- Earning totals by pay code
- Deduction totals by pay code
- Employee and employer tax totals by tax code
- Payroll journal entry

First, create a spreadsheet using your payroll reports to show the expected G/L activity by account. Then, add the actual G/L posting amounts by account based on your journal entry for the pay run to the spreadsheet. Finally, calculate and resolve any variance between the expected and actual G/L posting. Your balancing spreadsheet may look something like this:

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Account	EXPECTED G/L POSTING		ACTUAL G/L POSTING		Variance
	DR	CR	DR	CR	
Salary Expense	15,185,145.11		15,185,145.11		0.00
Bonus Expense	148,144.21		148,144.21		0.00
Benefits Expense		13,254.88		13,254.88	0.00
Payroll Tax Expense	363,218.97		363,218.97		0.00
Dependent Care Liability		9,884.55		9,884.55	0.00
Taxes Payable		3,274,602.96		3,274,602.96	0.00
Payroll Cash		12,398,765.90		12,398,765.90	0.00

Balance Your Cash

Because the net credit posted to payroll cash represents various bank transactions, the cash account requires additional balancing. Using your standard payroll reports, prepare a schedule for the finance department that shows the components of the net credit to payroll cash.

CASH BALANCING	
	<u>Amount</u>
Checks Issued	4,145,556.95
Out-of-Cycle Checks Issued	5,428.59
ACH Issued	8,249,556.02
Checks Voids	-1,275.66
ACH Voids	-500.00
Net CR to Payroll Cash	12,398,765.90

¹ACH (Automated Clearing House) refers to direct deposit transactions.

Verify that the total net CR to payroll cash on your cash balancing spreadsheet ties to the actual G/L activity. Your finance department needs this schedule as supporting documentation for the payroll cash reconciliation so it can match the activity in the payroll bank account to the amount posted to the general ledger.

Analyze Your Trends

Think strategically; analyze payroll trends after each pay run and look for variances. Notify finance of your findings before the department begins its monthly financial statement review. For example, you can facilitate the financial statement review process by telling finance immediately if you notice a drop in employer payroll tax expense and your research indicates it is due to employees reaching the social security wage maximum.

By reviewing trends each pay period, you can help to shorten the accounting close cycle by identifying and correcting any payroll-related issues early in the accounting period. Reviewing trends will also identify global payroll processing or system errors.

Reconcile the Monthly Account

The most common mistake when reconciling an account is to merely roll forward the account balance (i.e., the previous account balance plus the current month's activity to equal the

current account balance). A roll forward tells you how much is in the account, but doesn't tell you much more than simply looking at the balance of the account in the G/L.

A perfect account reconciliation verifies that what is in the account matches what should be in the account. A perfect payroll account reconciliation ties the G/L account balance to the payroll subsidiary ledger and/or external documentation. A perfect account reconciliation identifies variances—known as reconciling items—and provides information on how and when the reconciling items will be cleared. In fact, a perfect account reconciliation is truly an analysis of the account.

Research and Reconcile the Cash Account

For internal control reasons, the payroll department should not be responsible for reconciling the payroll cash account. However, payroll is still responsible for clearing reconciling items from the account. In most cases, only payroll has access to the information necessary to research and resolve payroll cash reconciling items. Here are a few things you should consider implementing in your reconciliation process:

- Ask the G/L department to provide you with a copy of the reconciliation each month.
- Research the reconciling items and communicate your findings to the accounting department, including how you plan to clear each item.
- If possible, make your correcting payroll entries or adjusting journal entries within one accounting period.
- Ask for a copy of the outstanding check list and research any stale-dated checks. Re-issue or void the checks as appropriate. By looking at stale-dated checks regularly, you can avoid W-2 amendments and/or escheatment.

Reconcile the Quarterly Tax Return

Many assume that quarterly tax return reconciliations are unnecessary when payroll tax filing is outsourced. However, even when payroll tax filing is outsourced, your company is still responsible for the accuracy of the returns.

Therefore, when you receive tax return copies from the vendor, you should prepare a reconciliation to tie the wages and taxes reported on the returns to your quarterly payroll report totals.

If your vendor takes an additional tax debit or credits your bank account due to underpayment/overpayment, be sure to book the corresponding journal entry. Underpayments and overpayments can result from various reasons, including rate changes to employer taxes.

Make Your Accounting Accurate

By incorporating the above steps into the payroll accounting process, you will have done your part to accurately report payroll in your company's financial statements. Since payroll is likely one of your company's largest expenses, shouldn't you take as much care to represent it accurately in the financials as you do to ensure the accuracy of your employees' paychecks?

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