

Payroll Best Practices: Vacation Time & Pay



Vacation pay methods vary. Some employers provide vacation pay each period on that period's vacationable earnings. Others accrue vacation time and/or pay. There are also wide differences in how employees take annual vacations. Where vacation pay is accrued, it may be paid out as a lump-sum once a year or cashed-out without taking time particularly on termination. Other employees reduce vacation pay accruals using current hourly rates for the time taken.

Given all these differences, what best practices should employers use to simplify vacation time and pay processing and ensure compliance?

Administrative Best Practice

The first vacation best practice, which pertains to employers of any size, is implementation of employee and manager self-service supported by workflows that integrate with any scheduling, time and attendance, HR or payroll systems concerned. Specifically, there should be a single, web-based self-service window through which employees can initiate vacation-related requests and managers can approve them. Workflows should route approved requests for vacation time to the applicable scheduling or time and attendance system. By contrast approved requests to cash-out vacation pay can be routed directly to payroll.

Employment Standards Best Practices

On the employment standards side, there are 2 best practices for vacations:

- Give employees vacation time, expressed as calendar weeks away from work; and
- Provide vacation pay, usually expressed as a percentage of vacationable earnings, i.e., 4% or 6%.

It's a best practice for employers to accrue vacation time, as part of managing employee entitlements. Some employers accrue vacation time after each completed pay period, particularly where employees take vacation time in the year earned or during the first year of service stub periods. Otherwise, employers are only required to recognize vacation time as owing when a full year of service has been completed.

Best Practices for Vacation Pay

Best practices for vacation pay depend on the type of employee involved.

For hourly-paid employees, the simplest and most compliant option is to pay vacation pay each pay period on the earnings in that pay period. This eliminates any vacation pay accruals as well as any separate payment of accrued vacation pay.

Where vacation pay is not given each pay period, best practices are about how this accrual is paid out. It's common for employers to reduce accrued vacation pay using current hourly rates for the time taken. However, this practice will not be compliant in all circumstances, particularly where:

- Employees work more than regular or scheduled hours in the applicable entitlement year. Forty hours per week for 50 weeks = 2,000 hours. Paid at 4%, this equals 80 hours. As long as hourly rates haven't changed, paying employees at hourly rates for vacation time taken is compliant. However, if an employee has worked 2,100 vacationable hours, 4% = 84 hours. Paying just for the vacation time taken, i.e., 80 hours, would not meet minimum vacation pay requirements.
- Vacation pay is itself vacationable. Assume that: an employee's hourly rate is \$15; she works 2,000 hours; and no other earnings are vacationable. Accrued vacation pay owing at 4% = \$1,200 or 80 hours. If vacation pay was itself vacationable, the accrued vacation pay owing in the next vacation year would be \$1,248, i.e., the equivalent of 83.2 hours at \$15. Providing 80 paid vacation hours at \$15 would not comply with the minimum requirements.
- In the applicable vacation year, employees have exception pay earnings which are vacationable, such as overtime, non-discretionary bonuses or sales commissions. If an employee had a \$5,000 vacationable bonus, in the vacation year when vacationable earnings were otherwise 2,000 hours at \$15/hour, the vacation pay required at 4% would be \$1,400. Paying 80 hours at \$15 would only be \$1,200, so the minimum requirement would not be met.

Where employees are paid accrued vacation pay at regular hourly rates for vacation time taken, employers will have to run reports comparing vacationable earnings vs. the vacation pay given. Usually, this is the earnings in the prior vacation year against vacation pay in the current year. Where employees are allowed to take vacation time in the current year, i.e., the year the right is earned, this comparison must be based on that year (where vacation pay is a vacationable earning, include any vacation pay paid in those earnings).

Accrue Raw Vacationable Earnings Not Vacation Pay

I would argue that vacation pay best practices dictate accruing not vacation pay but raw vacationable earnings, applying the correct vacation pay percentage only when payment is made. Explanation: In jurisdictions where an additional vacation week is required after completing specific years of service, usually 5 years, the rate of vacation pay owing is contingent on completion of the fifth year. For example, in BC the earnings in an employee's fifth year of service are the basis for the vacation pay owing after the fifth year has been completed. If an employee were to quit during this fifth year, only 4% would be owing. After the fifth year is complete, vacation pay on these earnings would now be owing at 6%. This requires either adjusting the accrued vacation pay balance owing, on completion of the fifth year or accruing at the higher rate and adjusting down to 4% if the employee leaves before the fifth year is completed. These steps can be avoided if vacationable earnings, rather than vacation pay, are accrued.