Vacation Pay: Navigating the Dizzying Array of Options

Employee vacation rules seem pretty simple and straightforward at first glance. However, applying the rules is far more complex than it may appear, especially when you consider all the different methods employers use to calculate and pay out vacation pay.

Paying Vacation Pay Each Period vs. Accrual

The most fundamental difference in approaches is whether vacation pay is accrued or paid out as it's earned. The latter approach offers 2 advantages:

- Paying vacation on each payment is much simpler than administering accruals; and
- In jurisdictions such as in BC, where vacation pay is itself vacationable, the employer cost are less if vacation is paid every period since the vacation pay so paid is not itself vacationable.

Paying out vacation pay every period is typically common for hourly, seasonal or casual employees who aren't likely to take time away from work as vacation. Then when employees paid on this basis do take vacation pay, vacation time is unpaid.

Accruing Vacation Pay vs. Accruing Vacation Time

Where vacation is accrued, it's accrued either as dollars or time earned. While accruing pay is the more common approach, some employers prefer to accrue time. For an employee paid semi-monthly who's entitled to 2 weeks of vacation time, the employer might accrue 4 hours each period to a maximum of 80 hours annually.

Accruing time best fits salaried employees where the employer doesn't let employees take vacation before it's been earned. In this situation, the accrual balance is the maximum vacation time available to employees.

Crediting Vacation Time at Start of the Vacation Year

Where employees are permitted to take vacation time before it's earned, it's common for employers to credit their full vacation entitlements at the start of each vacation year rather than piecemeal as it's earned. This would mean, for example, crediting employees who are entitled to 2 vacation weeks and normally work 37.50 hours per week, with 75 vacation hours at the start of each vacation year.

Letting Vacation Accruals Go Negative

Where employers let employees take vacation time before it's earned and vacation time is accrued as it's earned, the resulting vacation accrual balance will be negative. This achieves the same purpose as crediting the full vacation entitlement at the start of each vacation year. It allows employees to take vacation before it's been fully earned.

Taking Vacation during Current Vacation Year for that Vacation Year

Employment standards laws only require that employees be given vacation time and pay after completing each vacation year. Result: Vacations are normally taken in the year after they're earned. However, it's common for employers to let employees take vacation in the same year as it's earned—typically by letting vacation accruals go negative or crediting employees with their full annual vacation entitlements at the start of each vacation year.

Vacation Years Based on Anniversary of Hire vs. Common Vacation Years for All Employees

The default is that vacation years are based on the anniversary of hire. However, employment standards laws permit employers to define a common vacation year. Where such a year exists, the days between the new hire date and end of the current vacation year is termed a "stub period". After completing a stub period, employees are entitled to a prorated share of whatever vacation time and pay they'd otherwise be entitled to for a full vacation year. A common method of proration is one vacation day for each completed month of employment in the stub period, to a maximum of 10 days (assuming a 2-week vacation entitlement).

There are several reasons for adopting a common vacation year. One is that aligning vacation years with the company's fiscal year simplifies year-end accruals. Common vacation years are also used where the employer has an annual shutdown and employees are expected to take their vacation time or the employer has a fixed date for paying out accrued vacation pay. However, most good payroll or HR systems have simple methods for tracking and reporting on employee vacation accrual balances, even where these are based on the anniversary of hire.

Single vs. Multiple Vacation Pay Rates

Most employment standards laws (and most employers) base vacation entitlements on seniority. For example, Ontario now requires employers to provide annual vacations as 3 weeks and at 6%, after 5 years of service. However, the problem is that the vacation dollars paid after completing 5 years of service are based on the vacationable earnings in the prior year, i.e., during the 5th year of employment, not after it.

Employers in this situation must choose one of the following options:

- Adjust the accrued vacation pay after the 5th year is completed; or
- Switch the vacation pay accrual to 6% at the start of the 5th

The latter is less work, but creates the possibility an employee might leave without completing the 5th year and the employer might not recalculate the vacation pay owing back down to 4%.

When & How to Pay Accrued Vacation Pay

Employers who use vacation accrual methods, whether of vacation pay or time, must choose how to pay it. One common method is to pay employees who take vacation time what they'd have earned working regular hours. For hourly employees a Vacation Hours earning is used to pay employees their regular hourly rate for each vacation hour taken. This earning at the same time reduces any accrued vacation. Similarly, employees normally paid by salary would have their regular salary reduced by any vacation time taken and the equivalent dollar amount would be shown as a separate Vacation earning on the pay statement.

What's *not* good practice is just to continue the same hourly or salaried earnings as for regular pay when employees take vacation time. It's important to use a separate vacation earning on the pay statement as proof that vacation has been paid.

This method means employees are paid vacation pay on the same day as they would have otherwise been paid their regular wages. If this is not done, most employment standards laws require that any accrued vacation be paid in a lump-sum before the vacation begins.

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