Final pay (terminations)

We're often asked how best to process a final pay.

This guide is primarily for Australian employers, however the principles apply generally to all jurisdictions.

> Note that SmoothPay provides a **Final Pay calculation wizard** (use the Assistant button when you add an Annual Leave entry).
>
> The Wizard asks you the reason for the employee's termination (*for Australian users, so that it can be taxed and categorised correctly for the employee's Payment Summary*) and automatically calculates the amount payable (*based on your settings for the employee, the company and the employee's entitlements*).
>
> The employee is automatically terminated at the end of the pay process.

If you're unsure how to proceed with final payment for a specific employee then you should examine their contract and pay records, and failing that you should seek advice from your employer service, the employee's union, a workplace law specialist.

> Australian employers should join TAPS (The Association of Payroll Specialists) and they'll provide you correct advice on your obligations.
>
> In addition to paying out an employee's final annual leave entitlement you might also have to pay Long Service Leave, unused Sick Leave, redundancy or other termination payments too. These issues are outside the scope of the HelpDesk to advise - we can only provide assistance with using the software - not what you should or should not pay.

Handy links…

Australia	http://www.fairwork.gov.au/
	http://payroll.com.au/
	https://www.ato.gov.au/
New Zealand	http://www.dol.govt.nz/er

Annual leave accruals

SmoothPay is normally set to accrue a proportion of annual leave (*and other types of leave*) every pay period (Australia and most Pacific nations), or 4 weeks accruing annually for NZ. These accruals appear automatically in the employee's leave history as each pay is finalised.

Australia: National Employment Standards stipulate:

"*An employee (other than a casual employee) is entitled to four weeks of paid annual leave for each year of service with the employer. An employee's entitlement to annual leave accrues on a continuous basis according to the number of ordinary hours they worked. Annual leave continues to accrue when an employee takes a period of paid annual leave or paid personal/carer's leave.*"

SmoothPay implements this rule by using a percentage of ordinary time (or it's equivalent) to accrue annual leave each pay period at a rate (currently) of 7.692308% (4 weeks / 52 weeks = 0.07692308). Five weeks (for shift-workers etc) would be represented as 9.615385%.

New Zealand: Annual Leave should accrue annually, in weeks (regardless of how your old payroll system did it), as the law stipulates weeks, not days or hours. However, most employers still accrue annual leave in hours or days - and that's OK as long as the result produces an entitlement at least as good as that produced in weeks (it won't if your employee's work pattern changes and you'll be forever making manual adjustments, and if you're not then you should be).

There is no reason not to accumulate and consume annual leave in weeks - it's easier for you because you never need to adjust the balance or accrual, it is fairer for the employee because they get paid actual value for weeks consumed as annual leave, it is easy to validate the amount paid for the time used, and it complies with the law.

SmoothPay HelpDesk staff are not permitted (legally and ethically) to assist with leave-related questions for employers using incorrect leave accrual methods.

Pacific nations: Each country has their own interpretation and common usage for leave accruals and you should refer to the guides provided for each country and determine which rules best suit your jurisdiction. Generally, leave accrues per pay period (automatically reducing total accruals for absence), however some employers prefer to accrue annually to ensure staff receive the legislated minimum entitlement. You should seek guidance from a qualified employment specialist to determine the method that works best for you.

Payroll Guides for Leave Management, as well as individual country payroll guides are available on our website.

Determining an employee's Final Annual Leave Entitlement

SmoothPay's Annual Leave termination wizard will normally calculate this for you, however if your records are incomplete or incorrect then you can easily calculate the amount due manually:

Final annual leave entitlement - where leave accrues every pay period

Balance of accrued leave entitlements	A	
Add a further accrual if it's due (e.g. on current pay Ordinary time, or a per-period accrual of an annual entitlement)	B	
A + B = Final entitlement balance	C	

Final annual leave entitlement - where leave accrues annually

Balance remaining from accruals to last anniversary	A	
Plus proportion of annual leave accrual for each completed month of service since last anniversary	B*	
A + B = Final entitlement balance	C	

B* Calculating proportional leave accrual

The maths is easy: Take the annual accrual, divide it by 12 (months), multiply it by whole months of service since last anniversary.

Note, you could use weeks or fortnights or even days since last anniversary, instead of months, if you wanted to.

Here are some examples using 3 different methods:

Employee accrues 4 weeks on each start-date anniversary, and has been paid for 5 months since last anniversary: B = 4 (weeks) ÷ 12 (months) x 5 (months) = 1.667 weeks

Employee accrues 152 hours on each start-date anniversary, and has been paid for 15 weeks since last anniversary: B = 152 (hours) ÷ 52 (weeks) x 15 (weeks) = 43.846 hours

Employee accrues 20 days on each start-date anniversary, and has been paid for 18 fortnights since last anniversary: B = 20 (days) ÷ 26 (fortnights) x 18 (fortnights) = 13.846 days

Final annual leave entitlement - where you don't know

If you don't know, or you want to check, the employee's leave balance to date, use the following procedure:

Whole years of service	Y	
Multiply Y by annual accrual (e.g. 4 weeks)	A	
Plus proportion of annual leave accrual for each completed month of service since last anniversary	B*	
A + B = Total entitlement accrued	C	
LESS leave taken (use same measure as accrual - e.g. weeks)	D	
C - D = Balance of leave remaining	E	

This is exactly the same procedure used to establish an employee's opening leave entitlement balance (if you don't know what it is) when taking on employee data into SmoothPay (or any payroll) for the first time).

You then create an adjustment entry in Staff..Leave..History for annual leave (and other leave types too).

New Zealand: A final Pay Calculation sheet is available on our website

The employee's leave balance is NEGATIVE!

If you have allowed an employee to take more leave than they are entitled to, then you may not be able to recover the overpayment from them and should regard the employee's balance as ZERO.

In most jurisdictions it is not legal to simply deduct overpayments (or make any other type of deduction) without the written consent of the employee.
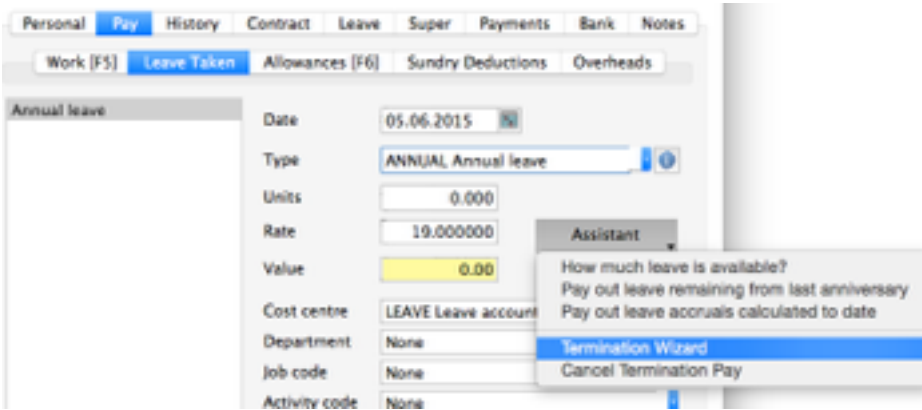
If you use our leave application forms then you are **permitted to make a deduction** for overpaid leave, as these forms have a clause permitting deduction for overpayment or error.

These are available in *HR..Resources* and from our website.

Final Payment (Australia)

ATO provides for a payment classification for annual leave payments made on termination so that the separate items payable are taxed (or not taxed) correctly and appear in the correct positions on the employee's Payment Summary (*and ETP Summary if applicable*).

The procedure to correctly terminate a permanent employee in SmoothPay:	
	Add an annual leave entry, click the Assistant button (if the Assistant doesn't appear automatically), choose Termination Wizard
	Choose the correct termination reason (THIS IS IMPORTANT so that items are taxed correctly and appear in the right place on Payment Summaries)
	In order for the amounts of unused annual leave (and possibly unused annual leave loading) to be categorised correctly the amounts payable are transferred to correctly categorised allowance codes (SmoothPay ensures these exist and are set up correctly when this occurs)

Casual employees can be terminated using the Termination Wizard (it just sets a flag to terminate the employee at the end of the pay run), or by manually terminating them (see their Contract page).

The tax treatment of unused annual leave payments is different from ordinary pay, so you must split annual leave and any other termination payments into various classifications, such as ETP's (Employment Termination Payments), Long Service Leave etc so they appear in the correct place on the employee's Payment Summary.

> SmoothPay provides for **every** ATO payment classification and all you need to do is work out the amounts to be paid, add allowance codes reflecting the appropriate ATO classifications (if you need to), then add allowance entries for each value and classification to Pay input.

Genuine Redundancy example

In this example the employee has an unpaid leave accrual and will be paid an additional 4 weeks in lieu of notice (*taken from a real-world example*).

Use the Termination Wizard as above and make sure you select "Genuine Redundancy" as the reason for termination. This causes the unused annual leave (*including any accrual for entries in the current pay*) and for tax to be calculated on the payment (*and it's loading if applicable*) using the Bonus, Backpay and Commissions tax rules (Method B).

The employee is also being paid 4 weeks in lieu of notice - DO NOT ENTER THIS AS ORDINARY TIME!

We're assuming the employee would have worked out their notice period had they simply resigned, instead of being made redundant. This is an important distinction, as this makes the payment extra to their normal earnings and eligible to be tax-free (*up to the current genuine redundancy extra payment threshold*) and shown as Lump Sum D on their Payment Summary.

> If the additional payment exceeds the threshold (or the employee would not have worked out their notice period) then the extra must be treated instead as an ETP (*and the category you choose must reflect the employee's age threshold*).

> The ATO website provides details of current termination thresholds, taxation of terminations etc. and you should consult your employment specialist, lawyer or payroll association for guidance to determine how any additional termination payments should be classified.

If the employee is paid any ETP component then an additional Termination Summary will be produced.

Feedback

Thank you to those who have contributed ideas and questions that help make this document more useful.

Any and all feedback is appreciated and if you feel we could include better examples, provide more explanation, provide references to additional information, make a process easier to use, or you spot something that isn't working the way it's supposed to - please let us know.