Holiday Pay – Is it really that difficult?

Commentary by Tony McKone – Director McKone Consultancy Ltd – 18 April 2016

There has been a lot of interest in the recent issues that have occurred with the correct payment of holiday pay. These issues appear to have affected both government department and large organisations payroll system.

The issue is reportedly to do with how payroll systems are calculating holiday pay.

Whilst some commentators are asking how did the employer get it wrong, the complexity of the Holidays Act 2003 appears to be at the heart of the issue. The Act has for many years now been reported, by business people and payroll practitioners alike, to be a difficult piece of legislation. Payroll systems have attempted to automate the calculation process, however it seems that some of these systems may not have been getting it right, meaning staff may have not been paid correctly.

When your staff take their holidays, you must pay them at a rate that is based on the greater of:

1. their ordinary weekly pay as at the beginning of the annual holiday; or
2. their average weekly earnings for the 12 months immediately before the end of the last pay period before the annual holiday.

If you allow an employee to take their holidays before they are due, then the calculation for their pay changes to be the greater of:

1. the employee's ordinary weekly pay as at the beginning of the annual holiday; or
2. the employee's average weekly earnings for—
    - the 12 months immediately before the end of the last pay period before the annual holiday if the employee has worked for the employer for not less than 12 months; or
    - the period of employment before the end of the last pay period before the annual holiday if the employee has worked for the employer for less than 12 months.

So now we start seeing some of the complexities of the Holidays Act coming into the equation.

Your payroll system, whether software based or manually operated, cannot rely on simply paying out holiday pay on the rate of pay that is set out in the employee's employment agreement. This would probably only work if the employee only ever worked the same hours every day and was paid the same rate of pay for those hours over the past 12-month period.

However, the variables that will impact on both ordinary and average earnings are things like regular over time, penal rates for that overtime (if they apply), any change in the employee's pay rate over the past 12-months.

There are also rules that apply for determining what happens when an employee ceases their employment before their anniversary date and they have anticipated some of their leave as well as what happens when a person ceases their employment before their anniversary date without anticipating any leave.

All these factors add up to a complicated piece of legislation that creates the opportunity for errors when calculating a person’s holiday pay.

If you operate a payroll system you should be talking to your payroll provider to ensure that the rules behind their system do comply with the Holidays Act 2003, as you will not want to find out that you have underpaid your employees due to your payroll system not correctly applying the Holidays Act rules.