Accounts and Budget Service

Level-IV

Learning Guide-01

Unit of Competence: Establish and Maintain a Payroll System

Module Title: Establishing and Maintaining a Payroll System

LG Code: BUF ACB4 Mo08 LO1-LG-01

TTLM Code: BUF ACB4 Mo08TTLM 0520v1

Unit of Competence: Establish and Maintain a Payroll System

Instruction Sheet	Learning Guide #1

This learning guide is developed to provide you the necessary information regarding the following **content coverage** and **topic**

1.1 Check and set up *Payroll system and employee data*

1.2 Check payroll data and clarify discrepancies with designated persons

1.3 Pay period detail and source data

1.4 Deduction and allowance

***1.5* Calculate to reflect standard pay and *variations* in accordance with employee source data**

2.1 Payroll preparation

2.2 Calculate and record *Employee entitlements* in accordance with *legislative requirements*

2.3 Payroll records

3.1 Payroll enquiries

4.1 Payroll reports

Information Sheet-1	**Record payroll data**

1.1 Check and set up *Payroll system and employee data*

The concept ***payroll*** is used to refer to the total amount paid to employees of a firm as a compensation for the service rendered to the firm in a given period of time. The payroll accounting of a firm has to be given emphasis of significance for the following reasons:

- Employees are sensitive to payroll errors and irregularities, and maintaining good employees moral requires that the payroll be paid on a timely and accurate basis.

The payroll system must be designed to process the necessary data quickly and assure payment of the correct amount to each employee.
The system must also provide adequate safeguards against unauthorized payments to employees and other misappropriations of funds. May include:

- ✓ Manual
- ✓ Computerizes

Employee data includes

- allowances
- deductions
- employee details

- leave entitlements
- pay periods
- rates of pay
- superannuation details
- tax declaration forms
- tax file number

1.2 *Check payroll data and clarify discrepancies with designated persons*

Payroll data may be useful in negotiations with labor unions, in settling employee grievances, and in determining rights to vacations, sick leaves, and retirement pensions.

Designated persons Designated persons are the persons who are check the payroll data like;

Immediate supervisor
those who have authority to approve payroll decisions

1.3 *Pay period detail and source data*

The pay period: It refers to the length of time covered by each payroll payment. Pay periods for wage workers are usually made on weekly or biweekly. On the other hand, salaried employees' ay periods are monthly or semi-monthly

Pay period is details time the payroll preparer know like;

- ✓ Salary and Wags
- ✓ Bones
- ✓ Commission
- ✓ Contract
- ✓ Piece work

Etc

1. 3.1.1 Salary and Wages: Salary and wages are usually used interchangeably. However, the term wages is more correctly used to refer to payments to unskilled-manual labor. It is usually paid based on the number

of hours worked or the number of units produced. Therefore, wages are usually paid when a particular piece of work is completed or weekly.

On the other hand, salaries refers to payments to employees who render managerial, administrative or similar services, and they are usually paid to skilled labor on a monthly or yearly basis.

Both wages and salaries related to an 'employee' is an individual who works primarily to one organization and whose activities are under the direct supervision of employer.

A self-employed person on the other hand works (gives her services) on a fee basis to various firms

1.3.1.2 Bonus

Bonus is payment to usually based on their salaries when businesses are making attractive profit as a result of better or best performance by their employees. Annual bonus is common in some organizations in our country. Commercial bank of Ethiopia, Dashen Bank Artistic Printing Enterprise and National Alcohol and Liquor Factory are only few but excellent examples in our country that confer bonus to their employees

1.3.1.3 Commission

Commission is remuneration to an employee for his/her additional activity required by the employer for instance, to promote sales an employer may give remuneration (commission) to sales personnel (employee) in p

1.3.2 Source of documents

- ✓ Employee earnings and payroll register
- ✓ Employee records
- ✓ Employee time sheet

A Payroll Register (sheet): is the list of employees of a business along with each employee's gross earnings; deductions and net pay (take home pay) for a particular pay period. The payroll register (sheet) is prepared based on attendance sheets, punched (clock) cards or time cards

Employee records

Employee
Number assigned to employees for identification purpose when a relatively large number of employees are involved

1.4 Deduction and allowance

1.4.1 Deduction: are subtractions made from the earnings of employees required by the government or permitted by the employee himself

1.4.2 Allowances- money paid monthly to an employee for special reasons, like:

- ***Position allowance-*** a monthly paid to an employee of earning a particular office responsibility.

- ***Housing allowance-*** a monthly allowance given to cover housing costs of the individual employee when the employment contract requires the employer to provide housing but the employer fails to do so.
- ***Hardship allowance***- a sum of money given to an employee to compensate for an inconvenient circumstance caused by the employer. For instance, unexpected transfer to aw different and distant work area or location.
- ***Desert allowance-*** a monthly allowance given to an employee because of assignment to a relatively hot region.
- ***Transportation (fuel) allowance-*** a monthly allowance to an employee to cover cost of transportation up to her workplace if the employer has committed itself to provide transportation service
- ***Cash indemnity allowance:*** the amount paid for cashiers to cover the risk of possible cash shortage

1.5 Calculate to reflect standard pay and *variations* in accordance with employee source data

1.5.1 Variation may include

- ✓ Holiday loading
- ✓ Over time
- ✓ Rate pay

- ✓ Taxation

1.5.1.1 Holiday loading

i. two times the ordinary hourly rate for overtime work performed on weekly rest days
ii. two and one half (2 ½) times the ordinary hourly rate for overtime work performed on a public holiday.

Overtime Earning*:* Overtime work is the work performed by an employee beyond the regular working hours.

Overtime earnings are the amount paid to an employee for overtime work performed.

Article 33 of proclamation No. 64/1975 discussed the following about how overtime work should be paid:

A worker shall be entitled to the paid at a rate of

iii. One and one-quarter (1 ¼) times his ordinary hourly rate for overtime work performed before 10:00 P.M in the evening.
iv. One and one half (1 ½) times his ordinary hourly rate for overtime work performed between 10:00 P.M and six (6:00 A.M) in the morning.

All in all, the gross earnings of an employee may include the basic salary, allowance and overtime earnings.

Tax Rate The following tax rates are applied for determination of tax payable on income from employment. The rates range from 10% to 35% and making the first Birr 600 exempted from tax payments.

Persons working in different organizations should aggregate and declare their employment income (any tax paid by the withholding agent should be considered deducted

Lo2 Payroll preparation

Information Sheet-2	***Payroll preparation***

2.1 Payroll preparation

Payroll preparation must include:

- ✓ Calculation of gross pay
- ✓ Net pay
- ✓ Preparing cheques
- ✓ Taxation and other deduction

***2.1.1 Gross Earnings*:** are taxes collected from the earnings of employees by t he employer organization as per the regulations of the government These have to be submitted (paid) to the government because3d employer organization is only acting as an agent of the government in collecting these taxes from employees

Gross Earnings = **Basic salary + Allowance + Overtime Earning**

Gross Earning = *Basic Salary + Allowance + Overtime Earning + Bonus*

Basic Salary: It is a flat monthly salary of an employee for carrying out the normal work of employment and subject to change when the employee is promoted. It is monthly salary of an employee that is paid for carrying out the normal work of employment

Ordinary Hourly Rate = *Basic Salary ÷ Normal Working Hours during the Month*

Over Time Earning *= Overtime Hours Worked X Ordinary Hourly Rate X Relevant Overtime Rate*

Net Pay Net pay represents the excess of gross earnings over total deductions of an employee.

Pay Check: A business can pay payroll by writing a check for the amount of the net pay. A check is prepared in the name of each employee and handed to employees. Alternatively a check for the total net pay can be prepared for employees to the paid by cash at the organization

Payroll Deductions: are deductions from the gross earnings of an employee such as employment income taxes (withholding taxes), labor union dues, fines, credit association pays etc.

. Other Deductions

Apart from the above two kinds of deductions, employees may individually authorize additional deductions such as deductions to pay life insurance premiums, to repay loan from the employer, to pay for donation to charitable organization, contributions to "ldir" etc.

Employment Income Tax: Every citizen is required to pay employee tax to the government in almost all countries. In Ethiopia also, income tax is charged on the gross earnings of the employee at the rates indicated under schedule A of the Proclamation N. 286/2002- Income tax proclamation.

Taxable income includes any payment or gains in cash or in kind received from employment by an individual, including income from former employment or otherwise or from prospective employment.

Employment Income (per month)		**Income Tax Payable**
Over Birr	To Birr	
0	600	No tax
601	1650	(10% X EI) – 60
1650	3200	(15% X EI) – 142.5
3201	5250	(20% X EI) – 302.5
5251	7800	(25% X EI) – 565
7801	10900	(30% X EI) – 955
Over	10901	(35% X EI) – 1500

All earnings of an employee are not subject to taxation, for instance Proclamation No. 286/2002 states that the following are not taxable income;

1. Income of casual employees who are not regularly employed, not work for more than one month for the same employer in any twelve months period.
2. Pension contribution, provident fund and all forms of retirement benefits contributed by employers in an amount that doesn't exceed 15% of the monthly salary of the employee.
3. Payments received as a compensation or gratitude in relation to personal injuries suffered by that person or the death of another person

The council of ministers regulation No. 78/2002, a regulation issued pursuant to the income tax proclamation further exempts the following from income tax;

1. Amounts paid to cover the cost of medical treatment of employees
2. Transportation allowance up to 25% of basic salary but not exceeding Br 1000.
3. Amounts paid to recover traveling expenses incurred on duty by employees

Regulations issued pursuant to the income tax proclamation further exempt the following from income tax.

1- Amounts paid by employers to cover the actual cost of medical treatment of employees.
2- Allowance in view of means of transportation granted to employees under contract of employment, i.e., transportation allowance.
3- Hardship allowance
4- Amounts paid by employee in reimbursement of traveling expenses incurred on duty

Pension Contribution

Permanent employees a governmental organization in Ethiopia is expected to pay or contribute 7% of their basic salary to the governments' pension trust fund.

This amount is withheld by the employer from each employee on every payroll and later be paid to the respective government body.

The employer is also expected to contribute towards this same fund 11% of the basic salary of every permanent government employee.

Therefore, the total contribution to the pension fund of the Ethiopian government is equal to 18% of the basic salary of all of its permanent employees.

That is, 7% comes from the employees and 11% comes from the employer.

This enables a permanent employee of a government organization to be entitled to the pension pay when retiring provided the employee satisfies the minimum requirements to enjoy the benefits.

Business and non-governmental not-for profit organization (NGO's) also have this kind of a scheme to benefit their employees with some modifications. A fund known as provident fund is established and both the employer and the employee contribute towards this fund monthly. When an employee retains or leaves employment, a lump sum amount is paid to him/her

c. Other Deductions

Apart from the above two kinds of deductions, employees may individually authorize additional deductions such as deductions to pay life insurance premiums, to repay loan from the employer, to pay for donation to charitable organization, contributions to "ldir" etc.

Net Pay

Net pay represents the excess of gross earnings over total deductions of an employee.

. Signature

The payroll sheet should have a column for signature of the employee to be taken when the employee collects the net pay.

No	Employee name	Earnings			Gross earnings	Deductions			Total deductions	Net pay	Sign
		Basic salary	Allowance	Over time		Income tax	Pension contribution	Other deduction			
01											
02											
03											

Prepared by_____ checked by_____ approved by_____

ILLUSTRATION OF A PAYROLL REGISTE

Godanaye is a government agency recently organized to rehabilitate street children. It has five employees whose salaries are paid according to the Ethiopian calendar month. The following data relates to the month of Yakutat, 2010

Serial No. Name of Employee _____ Basic Salary Transp. Allowance Overtime worked (hr) Duration of OT Work

01 Aregash Shewa Br. 730 200 4 6:00-10:00 P.M

02	Paulos Chala	1020	___	8	Sunday (8:30-5:30)
03	Mohammed Modesir	5300	___	___	___
04	Tensay Belay	1470	___	___	___
05	Haile Olango	950	___	6	Public Holiday

Additional Information

- The management of the agency usually expects a worker to work 40 hours in a week and during Yekatit there are four weeks.
- There were no absentees during the month
- All employees are permanent except Tenssay and Haile
- Paulos agreed to contribute monthly Br. 300 from his salary as a monthly saving in the credit association of the agency.

Required

1. Prepare a payroll register (sheet) for the agency for the month of Yekatit, 2010

Computation of Earnings, Deductions and Net Pay

Gross Earnings = Basic salary + Allowance + Overtime Earning

Overtime Earning

Overtime earning = OT hrs worked X (ordinary hourly rate X relevant OT rate)

1. **AREGASH:**

- OT Earning = 4 hours X (br. 730 / 160 hours X 1.25) = br. 22.81

NB Every employee is expected to work 160 hours per month

(i.e. 40 hours x 4 weeks)

- You should compute the regular hourly rate first:

Regular Hourly Rate = Monthly salary (Basic Salary)

Total Hours worked in the Month

= br. 730

160 Hours

- Therefore, the regular Hourly payment = br. 4.56

The regular hourly payment must be multiplied by the appropriate OT rate as

Follows:

br. (4.56 x 1.25) x 4 hours----------br. 22.81

2. PAULOS

- OT Earning = 8 hours X br. 1020 / 160 hours x 2 ----------br. 102.00

3. HAILE

- OT Earnings = 6 hours X br. 950 / 160 hours x 2.5 ----------br. 89.06

GROSS EARNINGS

Gross Earnings = Basic salary + Allowance + OT Earnings

1. AGEGASH
    - Gross Earnings = br. 730 + br. 200 + br. 22.81 = br. 952 .81
    - Remember taxable income in this case is br. 752.81 because the transportation allowance of br. 200 is not subject to taxation.

2. PAULOS
    - Gross Earning = br. 1020 + br. 102 = br. 1122
    - The Gross Total Earnings of Paulos consists of the br. 1020 basic salary plus the overtime earnings of br. 102, which is br. 1122.

3. MOHAMMED
    - Gross Total Earnings = br. 5300, which include the basic salary alone

4. TENSAY
    - Gross Total Earnings = br. 1470, which is the basic salary.

5. HAILE
    - Gross Total Earnings = br. 950 + 89.06 = br. 1039.06

DEDUCTIONS AND NET PAY

1. AREGASH:

- Gross Total Earnings----------br. 952.81
- Gross Taxable Income (br. 952.81 – br. 200)----------752.81

Employee Income Tax:

Earnings	*X*	*Income Tax Rate*	= *Income Tax*
0 – 600--------on 600		0	br. 00.00
601 – 752.81 on 152.81		10%	15.281

TOTAL br. 752.81----------br. 15.281

Short cut method (752.81*10%)-60----------br. 15.281

Pension contribution:

Basic salary x 7% = br. 730 x 0.07----------51.1

⇒ Total Deduction (br. 15.281 + br. 51.1) ----------br. 66.381

NB. The income tax to be deducted from the employee could have been computed by using the short-cut method as follows:

= (Taxable Income x 10%) – br. 60

= (br. 752.81 x 0.1) – br. 60 = br. 15.281

2. PAULOS:

- Gross Total Earning-----br. 1122.
- Employee Income tax

Earning *X Income Tax Rate* = *Income Tax*

0 – 600 on 600 0 br. 00.00

601 – 1650 on 522 10% 52.2

TOTAL br.1122----------br. 52.2

Short cut method (1122*10%)-60----------52.2

- Pension Contribution (br. 1020 x 0.07)---------- 71.4
- Credit Association----------300.00
- Total Deduction----------br. 423.6

3. MOHAMMED:

- Gross Total Earnings----------br. 5300.00
- *Employee Income Tax*

Earning *X Income Tax Rate* = *Income Tax*

0 – 600-------on600 0 br.

00.00

601 – 1650 on 1050 10%

105

1651 – 3200 on 1550 15%

232.5

3201 – 5250 on 2050 20% 410

5251 – 5300 on50 25%

12.5

Total br. 5300.00----------br. 760

Short form cut method (5300*25%)-565 ----------br.760

- Pension contribution (br. 5300 x 0.07)----------br. 371
- Total Deductions----------br. 1131

4. TENSAY:

- Gross Total Earnings----------br. 1470.00
- Gross Taxable Income----------1470.00

Employee Income Tax:

Earning X Income Tax Rate = Income Tax

0 –600 ----- on600 0 br.

00.00

601 – 1470 on 870 10%

87

Total br. 1470---------- br. 87

Short cut method (1470*10%)-60----------br.87

NB. No pension contributions because she is not permanent employee of the organization. Therefore, total deduction is the same as Employee Income Tax, br. 87.

5HAILE:

- Gross Total Earnings----------br. 1039.06

  Employee Income Tax: ---------- br.1039.06

  Earnings X Income Tax Rate = Income Tax

  0 – 600----on 600 0 br. 00.00

  601 – 1039.06 on 439.06 10%

  43.906

  Total br. 1039.06----------br. 43.906

- Pension contribution should not be computed for Haile because he is not permanent employee of the agency. Thus, the only deduction from Haile's earnings is the employee income tax.

NB. It is also possible to compute income tax by using the short-cut method:

Total Income Tax = (Taxable Income x 10%) – 60

= (br. 1039.06 x 0.1) – 60

= br.43.906

NET PAY:

Net pay = Gross Total Earnings – Total Deductions

1. AREGASH:

Net pay = br. 952.81 – br. (66.381)

Net pay = br. 886.429

2. PAULOS:

Net pay = br. 1122 – br. (423.6)

Net pay = br. 698.4

3. MOHAMMED:

Net pay = br. 5300 – br. (1131)

Net pay = br. 4169

4. TENSAY:

Net pay = br. 1470 – br. (87)

Net pay = br. 1383

5. HAILE:

Net pay = br. 1039.06 – br. 43.906

Net pay = br. 995.154

APROVING THE PAYROLL:

Total Earnings:

Basic salary----------br. 9470.00

Allowances----------200.00

Overtime----------213.87

Grand Total----------br. 9883.87

Deductions:

Employee Income Taxes----------br. 958.387

Pension Contributions----------493.5

Other Deductions----------300.00 =

Total Deductions----------br. 1751.887

Net Pay Total----------br. 8131.983

Total Deductions plus Net pay----------br. 9883.87

The payroll register (or sheet) for Godanaye Rehabilitation Agency prepared for the Month of Yekatit, 2010 is shown below.

Payroll Register (sheet)

For the month of Yekatit,2008

Ser. No.	Name of Employee	Earnings			Gross Earning	Deductions			Total Deduc.	Net Pay	Sign.
		Basic salary	Allowance	Over Time		Income Tax	Pension Contr.	Other Deduc.			
01	Aregash Shewa	730	200	22.81	952.81	**15.281**	51.1	___	66.381	886.419	
02	Paulos Chala	1020	___	102	1122	52.2	71.4	300	423.6	698.4	
03	Mohammed Mudesir	5300	___	___	5300	760	371	___	1131	4169	
04	Tensay Belay	1470	___	___	1470	87	___	___	87	1383	
05	Haile Olango	950	___	89.06	1039.06	43.906	___	___	43.906	995.154	
Totals		9470	200	213.87	9883.87	958.387	493.5	300	1751.887	8131.983	

Prepared by _____Checked by _____Approved by_____

2.2 Calculate and record *Employee entitlements* in accordance with *legislative requirements*

2.2.1Employee entitlements

Employee entitlements may include

- annual leave provisions
- child support
- long service leave provisions
- maternity/paternity leave provisions
- sick leave provisions
- study leave provisions
- superannuation
- workers compensation

2.2.2 legislative requirements

Legislative requirements must include:

Ethiopian Tax laws such as:

- Employment Declaration
- Code of Professional Conduct
- File number
- confidentiality and security of records
- payroll tax
- withholding tax law
- Fringe Benefits Tax law
- industry Awards
- Local, Federal and Regional States
- individual employment contracts

2.3 Payroll records

Payroll records must include:

- cash analysis sheets
- electronic funds transfer
- employee summary report
- end of month reports
- end of year reports
- pay advice slips
- payment summaries
- taxation reports

Lo3 Handle payroll enquiries

Information Sheet-3	Payroll enquiries

3.1 Payroll enquiries

Respond to payroll enquires may include

- ✓ Email
- ✓ face-to-face
- ✓ Fax
- ✓ Telephone

4.1 Payroll reports

Payroll reports may include:

- financial reports
- human resources reports
- other management reports