Net pay smoothing

Some industries, particularly farming, often have significant fluctuations in work patterns.

Obviously, if an employee was paid a wage then their earnings would also fluctuate.

During busy periods earnings would be much higher than average, and during quieter times earnings would be much lower than average.

The common solution to this is to pay the employee a “salary” in an effort to keep payments similar each pay period, however that’s where complications start to arise.

The problem with “Salary”

Basically, a salary does not meet the requirements of employment legislation in New Zealand. It cannot be used as a catch-all for leave or hours worked.

Holidays Act: Leave must adhere to the requirements of the Holidays Act (*annual leave must be paid at the better of the employee’s contract [or 4-week average for irregular employment], an agreed weekly amount, or average earnings for the last 52 weeks*) and a salary cannot be used to cover work on public holidays (*employee must be paid penal rates*).

Minimum hourly rate: Total hours worked must be gauged against minimum pay rates and a topup paid if necessary.

It is mandatory under NZ law to record actual hours worked (*even if the employee is on a “salary”*). It is not sufficient to record “1” salary, or 40 hours (*unless they actually work 40 hours*).

These things effectively ruin the concept of a salary - it’s basically illegal to simply pay the same gross amount and standard hours each pay period (*unless it can be shown that for any pay period it both meets or exceeds the employee’s entitlements under the Holidays Act and minimum hourly rate*).

Proving compliance with the Holidays Act is next to impossible in these conditions.

Pay Smoothing

What you can do though is agree to advance or retain income as necessary to provide a stable, consistent net pay for the employee.

Normalising net pay, or Net Pay Smoothing, regards the employee’s standard contract as the basis for his net pay (*you need to set up a typical template pay along with the smoothing agency payment - this is used as the comparison when the real pay values are calculated*).

Any additional deductions (*tools, gear, fuel, fines, WINZ etc.*) still serve to reduce the net pay further, however the big advantage is that compliance with the Holidays Act is a given as long as you record the employee's hours and earnings correctly, provide topups where required and correctly apply Holidays Act entitlements and rules.

The payslip will show all the correct calculations, KiwiSaver, tax, student loan, child support and contribute correctly towards Holidays Act calculations - the only change is that an adjustment is made automatically so that the employee receives a normalised net pay.

At peak times an amount is retained, and at off-peak times the net pay is topped up.

Are there any risks to this approach?

Yes, though you're generally less exposed using net pay smoothing.

If your employee leaves at the end of an off-peak season you might not be able to recover all of their advance earnings from their final pay (*which is exactly what happens if the employee was paid a traditional fixed salary during the same period*).

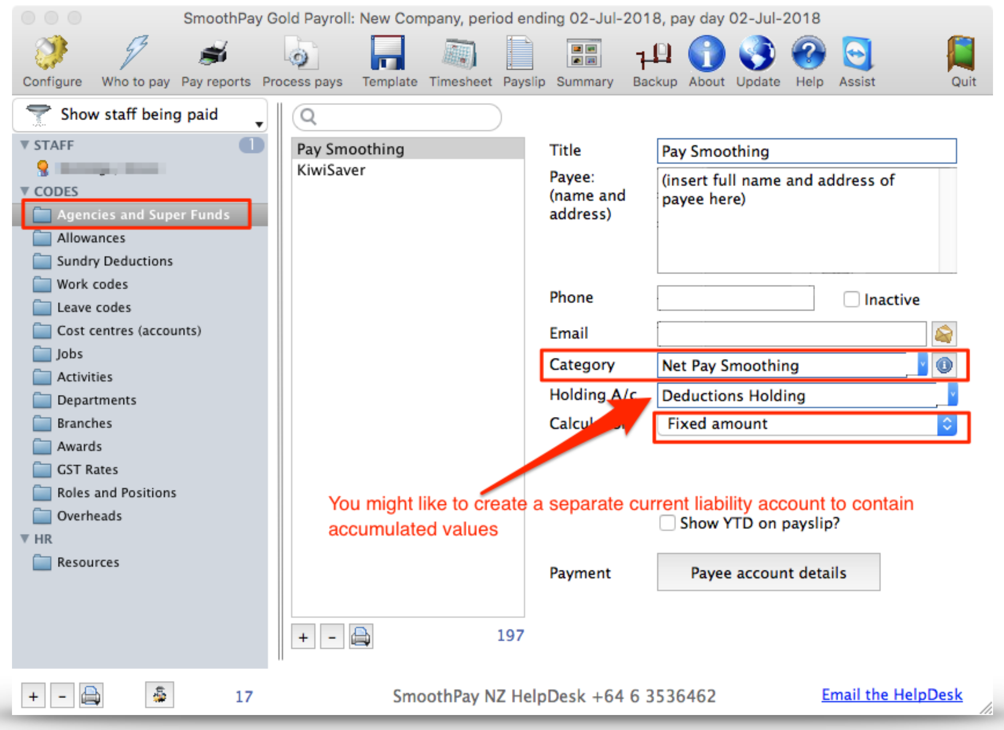
Net pay smoothing in this case gives you the opportunity to recover something from the final pay - something you can't do with a fixed salary.

If however your employee has worked only during peak time and leave before off-peak their retained earnings will need to be paid out with their final pay.

It is important that you and your employee monitor the smoothing balance - excessive amounts may mean that your initial net pay analysis needs revision.

How does SmoothPay help you do this magic?

Add an agency payment (using the Net Pay Smoothing category) to the employee's payments tab (*you can call the agency anything [e.g. Retained earnings], but it must be classified as Net Pay Smoothing to work correctly*).



Example of Pay Smoothing agency payment code setup

The employee’s pay template should be representative of a typical pay, as it’s value determines the smoothing amount (net pay) required.

The employee’s gross pay can still be calculated as usual, using an hourly rate or a “salary” (*where the hours can vary but the gross remains the same - apart from topups/ leave values that might cause a change to the gross amount*).

The difference is assigned to the Net Smoothing adjustment value. You’re effectively <u>advancing</u> wages during off-peak and <u>retaining</u> wages at peak times.

New Company

Payslip for Employee, Test to 02-Jul-2018 payday 02-Jul-2018

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Test Employee

Pay for	1 Fortnight (10 day
Period ending	02-Jul-2018
Pay day	02-Jul-2018
Pay group	Perm Orch-JEFF

Tax code: M

	Date	Units	Rate	Value
Time				
Ordinary time		80.00	20.00	1600.00
				1600.00
Deductions				
PAYE				264.54
KiwiSaver		1600.00	0.04	64.00
				328.54
Net Pay				
******5-6789123-00		1.00	1271.46	1271.46
				1271.46

Status	YTD Tax	YTD Gross
Permanent, Full time, Waged, Regular hrs	3950.90	19330.76

[Leave Balances are as at the start of this pay period]
Annual leave accrued: Nil, next accrual of 4 Weeks is due 01-Sep-2018

Example payslip showing typical pay (no smoothing of income)

Automating pay smoothing is a great time-saving feature in SmoothPay and helps you to be compliant with the Holidays Act (*a big plus*) by capturing real values instead of “standardised salary” values which is not compliant with the Act (*e.g. correct hours, days paid, leave payments etc., all without affecting the employee’s net pay amount*).

New Company

Payslip for Employee, Test to 02-Jul-2018 payday 02-Jul-2018

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Test Employee	Pay for	1 Fortnight (10 day
	Period ending	02-Jul-2018
	Pay day	02-Jul-2018
	Pay group	Perm Orch-JEFF

Tax code: M

	Date	Units	Rate	Value
Time				
Ordinary time		90.00	20.00	1800.00
				1800.00
Deductions				
PAYE				302.32
KiwiSaver		1800.00	0.04	72.00
Pay Smoothing		1.00	154.22	154.22
				528.54
Net Pay				
******5-6789123-00		1.00	1271.46	1271.46
				1271.46

Status	YTD Tax	YTD Gross
Permanent, Full time, Waged, Regular hrs	3988.68	19530.76

[Leave Balances are as at the start of this pay period]
Annual leave accrued: Nil, next accrual of 4 Weeks is due 01-Sep-2018
Net pay smoothing: $154.22 retained

Example payslip showing retention of income - payslip will always show current balance

What happens when the employee leaves?

The normal termination process (*Payrun..Leave taken..Termination*) converts any residual retained earnings into an Advance allowance or deduction.

How should I set up the employment agreement?

You need to be clear in your agreement that you will be advancing income during off-peak times, and retaining income during peak times to ensure the employee receives a stable net income.

You should also state that on termination any retained income will be paid out, and any advance income will be recovered (*the termination process will do this automatically*).

Feedback

We're always keen to do better!

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.