

Level 3 Diploma  
In  
Payroll Management

MODULE 1: Manual Payroll

LESSON 1

**SAMPLE**

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## **INTRODUCTION**

Throughout this course you will see references to HMRC (Her Majesty's Revenue and Customs), and information which is available from them.

For any other information you wish to seek on tax and national insurance as they apply to payroll, and to other related subjects such as statutory sick pay and statutory maternity pay you should **refer to the HMRC website: <https://www.gov.uk>** where you will find a substantial range of information on how to run a payroll to meet government legislation requirements, and on topics such as tax and national insurance, benefits in kind, information for employers etc. It also contains access to a variety of employer handbooks on payroll related matters.

### **IMPORTANT**

For full access to all payroll forms and PAYE (Pay As You Earn) & NI (National Insurance) Tables, please visit the following website:

**[www.hmrc.gov.uk](http://www.hmrc.gov.uk)**

We will, of course, cover all you need to know for your exam in this course. However, the various rates and thresholds that relate to payroll and the expenses and benefits provided to employees are subject to change. It is therefore important that you familiarise yourself with HMRC's website and understand how to obtain the most up to date information once you have completed your studies. The HMRC website is also an excellent resource should you feel you wish to have a source of back-up information whilst working through the course material.

### **IMPORTANT - PLEASE NOTE**

At the end of the financial year (i.e. 5<sup>th</sup> April) there is always a cross over period whereby the course material has become historic pending updating. The tables you are using don't necessarily have to relate to the current year however you **must** use the correct tax and national insurance tables (we will cover this further in the course) for the course that you are studying. For example, if you are studying the Fifteenth Edition i.e. 2023/2024 then you must use the tables applicable for that year even if you are still studying in May 2024 (by which point it will be the financial year 2024/2025). If you commenced your studies in May 2022 for example and the material is in the process of being updated and therefore already historic you will find all the necessary tables on **our** website.

## **HMRC**

Her Majesty's Revenue & Customs (HMRC) is the main government department which administers the UK's taxation system.

It was formed in 2005 by the merging of two previous government departments: the Inland Revenue, and Customs & Excise, and it is the main source of information on the relevant facts and figures that a payroll department will need in order to run its payroll in a fashion that will satisfy all legal requirements relating to income tax, national insurance and other related matters.

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## **THE FUNCTION OF PAYROLL**

The main function of the payroll department within a business is to pay staff, or in other words to remunerate them for the work they have done on the business's behalf.

As well as remunerating staff, a payroll department also has to deal with all other statutory functions around the process of remunerating staff such as dealing with the deduction of tax under the Pay As You Earn (PAYE) system, the payment of National Insurance, the making of returns and contributions to HMRC, calculation of sick pay and maternity benefits, and paying pensions due to former staff etc. We will return to these statutory payroll requirements shortly.

**SAMPLE**

## **WHAT IS PAYROLL**

Payroll is principally a means of paying the employees of a business for their contracted work.

This involves the calculation of what each employee is due to be paid, the deduction of all amounts required by law such as income tax and national insurance, the payment of amounts due to each employee after deductions have been made, and the payment of amounts due to the appropriate government authority for the deductions made.

Payroll is an essential business function because employees expect to be paid correctly and on time; HMRC expects to receive deductions for tax and national insurance correctly and on time; and the business needs to know the total costs paid to its employees and HMRC so that it can correctly measure how profitable or otherwise its business activity has been.

**SAMPLE**

## **THE CONTRACT OF EMPLOYMENT**

The terms and conditions of service under which an employee works for a business are contained within the Contract of Employment.

Employment is a legal contract which exists from the moment that one person agrees to work for another.

As of 2020 there have been some changes as to what needs to be included within a contract of employment and when it needs to be provided. It is now a legal requirement that an employer must provide an employee with a written Statement within day 1 of an employee starting work when their employment is going to last for more than 1 month - this is not an employment contract. The statement details the main points of the contract.

As a minimum it must include:

- The name of the employer and employee
- The employee's job title and a brief description
- The date of commencement of the employment
- Details of any probationary periods i.e., duration and conditions.
- The amount of the remuneration, i.e. the salary or wages, and when these will be paid (weekly, 4 weeklies, monthly etc.) also any other remuneration/benefits such as vouchers, lunch, and health insurance.
- The normal hours of work and whether they maybe variable and if so how they vary and how that variation is determined.
- The place of work, i.e., the place where the employee will normally carry out his or her duties.
- Details of any pensions scheme taken up by the employee
- The rules applicable to periods of sickness or injury, i.e., how much the employee will receive when unfit for work, and for how long.
- Details of other paid leave e.g., maternity or paternity
- The period of notice required by either party to terminate the contract.
- Rules for disciplinary and grievance procedures
- Entitlement to paid holidays.
- If the employment is not deemed to be of a permanent nature, the period of time for which it is expected to continue or the end date of a fixed term contract.



- Entitlement to training provided by the employer or training that is required to be undertaken. Also, any training requirements whereby the employer will not bear the cost.
- Details of any Collective Agreements with trade unions that directly affect the terms and conditions of their employment. A Collective Agreement is a contract between an employer and trade union establishing conditions in the work place. This would include topics such as salary, holiday entitlement etc.

The main difference between the written statement and a contract is that the contract is signed by both parties i.e., the employee and the employer. As you will appreciate the Contract of Employment is an extremely comprehensive document setting out the full terms and conditions upon which the employment is based. It clarifies the requirements of the employer and the employee. As stated above it is normal following the job title to have a brief description of the main duties of the employee. This can help to avoid future situations where the employee feels he/she is being asked to do something unreasonable in terms of what might be expected from the Contract of Employment

It is normal for the Contract to be provided at the time when the offer of employment is made in writing i.e., in order that by signing it the employee is legally accepting the offer of employment. If the Contract is not provided at this stage the employer must then make it available within two months of the commencement of employment.

## **ENTITLEMENT TO PAY**

Most of the laws in relation to remuneration of employees and their entitlement to be paid are governed by Contract Law, and the rights of the employee are broadly determined by what he/she has agreed with the employer.

In normal terms the Contract of Employment will fully cover the circumstances in which the employee is to be remunerated by the employer for their work. In legal terms however, such a contract does not strictly need to be in writing, and an employee can have an entitlement to pay based solely on a verbal or inferred agreement.

As we have seen earlier an employer is legally required to provide an employee with a written Contract of Employment, but there can be more tenuous relationships which do not have the degree of formality normally associated with employment but which nevertheless create an entitlement to be paid. The most obvious example would be where the husband or wife of an employee helps out with some duty, or where an employee does some extra work on an informal basis e.g. taking something home to finish in his/her spare time. The legal position here depends very much on the expectations of the employer and employee to such activities, and ultimately if there was a dispute about such matters then this would be settled in a court of law.

Because such disputes can arise it is preferable to have a written Contract of Employment established and that it is sufficiently detailed to avoid future disputes.



## PROGRESS TEST 1

1. What information would be in a Contract of Employment?
2. When does a written Contract of Employment become legally binding?
3. What is the main government body that impacts on the work of the payroll department?
4. What are the main functions of a payroll department?

SAMPLE

## THE PAYROLL DEPARTMENT

In a very small business employing a relatively small number of staff, say less than 50, there will probably not be a payroll department as such, but rather the payroll will probably be administered by someone in the accounts department as part of their duties.

Where there are a larger number of employees there will probably be a separate payroll department employing a small number of dedicated payroll staff to deal with this block of work. The number required will vary depending on the size of the workforce, the complexity of the remuneration structure, and how the wages are paid. More staff will be needed if the calculation of pay rates is particularly complicated, or if the wages are paid in cash.

The main role of the Payroll Department will be to ensure the smooth processing of the weekly and monthly payrolls, **so that employees are paid on time and correctly**. This will involve the following general areas of activity:

1. Gathering the relevant information from each department in relation to hours worked, sickness, absence, bonus or commission arrangements, the return of timesheets or duty sheets or workload sheets signed by appropriate department heads for all staff in their department.
2. Calculating gross pay due to each employee, together with all deductions to be made e.g., in relation to tax, national insurance, trade union dues, voluntary deductions etc.
3. Preparation of pay slips for each employee detailing how their pay has been arrived at.
4. Arranging payment of wages and salaries to employees by whatever means used by the business to pay its workforce.
5. Reporting payroll information to the relevant business departments e.g., the accounts department.
6. Accounting for tax and national insurance deducted to HMRC.
7. Updating internal payroll records following each payroll run.

A lot of the basic information the payroll department needs will come from other departments within the business, e.g. personnel, but in general terms in order to operate the payroll the Payroll Department will need personal details for each employee:

- the employee's tax code,
- the annual salary or rate of pay,
- the hours worked,
- details of any sickness or unauthorised absences,
- any additional payments to be made (e.g., agreed overtime) or deductions to be made (contributory pension scheme etc), either of which would require to be included in the payroll run.

In medium to large organisations, it will be normal for managers to have a team of staff who report to them, and these managers will be responsible for providing the relevant information in respect of each member of their team to the Payroll Department each week or month in time to allow the Payroll Department to process the payroll for that period. This information will often be recorded on a standard form, e.g., time sheet or clock card, giving the relevant details alongside each employee's name. The manager will authorise the information by signature before passing details to the Payroll Department. There will normally be a timetable given to managers setting out when returns should be made to the Payroll Department to enable them to process the details and pay employees their correct pay on the correct date.

SAMPLE

## WAGES AND SALARIES

The terms 'wages' and 'salaries' both have their origins in distant history. 'Wages' were traditionally payments made to soldiers of fortune for fighting in wars, hence the expression 'waging war', whilst 'salaries' derives from the original salt allowance made available to soldiers in Roman times. In modern usage 'wages' has tended to be associated with manual work and has tended to refer to payments made to workers on a weekly basis, whilst 'salary' has tended to refer to office style work and has tended to be paid on a monthly basis. Generally wages have tended to be calculated on an hourly rate basis, whilst salaries have tended to be an annual figure split into monthly payments.

**In legal terms there is no distinction between the terms 'wages' and 'salary'; they both signify remuneration paid to contracted employees, and as such are liable to all legislative requirements imposed on such payments.** These include the requirements that such payments are taxed. Any arrangement entered into whereby an employee is paid without tax being deducted would be illegal and subject to penalties under current tax legislation, as well as the probability of criminal charges being raised against the employer under the common law offence of seeking to defraud Her Majesty's Government.

## **OTHER DEPARTMENTS**

The Payroll Department in most businesses will tend to have close links and routine working relations with both the Personnel Department (often now referred to as the Human Resources Department), and the Accounts or Finance Department.

The Personnel Department deals generally with all legal requirements relating to employees and will be involved in such roles as advising appointing officers at the recruitment, advertising and interview stage; dealing with Contracts of Employment; getting references before interviewed candidates are offered jobs; and notifying the Payroll Department about new staff, people leaving, maternity, remuneration details agreed, whether someone has agreed to join the pension scheme, etc. The Personnel Department would also advise staff and managers on any changes in employment legislation or terms and conditions of their employment.

The Accounts Department will need financial information from the Payroll department concerning total payments for wages and salaries. They will need information on actual payments to staff, which will usually be done by direct transfer into the employee's bank account, but may sometimes be done by cheque or cash, and payments to HMRC relating to tax and national insurance contributions.

SAMPLE



## PROGRESS TEST 2

1. What type of information on employees would you expect a Personnel Department to deal with?
2. What is another name commonly used for a Personnel Department?
3. What basic information would a Payroll Department require to enable it to run the payroll correctly and on time?
4. Would the Payroll Department required to know an employee's personal bank accounts details?

SAMPLE



## KEEPING RECORDS

Any business which employs people must legally keep records of all payments and deductions made to employees, also keep records of reports and payments you make to HMRC, employees leave and sickness absences, tax code notices, taxable expenses and benefits, payroll giving scheme documents including the agency contract and employee authorisation forms. This is required regardless of how small the payment is and how informal the employment arrangement is, and such records can be inspected as required at any subsequent date by HMRC.

Your records must show you've reported accurately, you need to keep your records for 3 years from the end of the tax year they relate to. HMRC may check your records to make sure you're paying the right amount of tax.

If you do not keep full records, HMRC may estimate what you have to pay and charge you a penalty of up to £3,000.

If your records are lost, stolen or destroyed you must tell HMRC as soon as possible if you do not have records and cannot replace them. You must also do your best to recreate them - HMRC may be able to help if you're not sure how much you paid your employees.

You must tell HMRC if your final payroll report of the tax year includes figures that are:

Estimated - that you want HMRC to accept as final.

Provisional - that you'll update later with actual figures.

## **THE NATURE OF EMPLOYMENT**

One of the first decisions an employer must make is whether someone doing work for them is actually an employee for tax purposes. In most situations it will be fairly obvious whether or not someone is an employee, however there can be situations where a person does work for a business but claims to be self-employed, i.e., he or she is responsible for making their own arrangements for paying tax and national insurance.

**If the Payroll Department is in any doubt whether to treat someone as employed or not it should treat the person as employed and account for tax and national insurance under the PAYE system until HMRC advise otherwise.** Someone who is self-employed is effectively in business himself and instead of being an employee is working for another business on the basis of one business supplying a service to another. They still pay tax and national insurance however it won't be deducted at source i.e., under the PAYE scheme. The self-employed individual will be responsible for sending payment to HMRC within the appropriate deadlines.

There are certain advantages to both being an employee and being self-employed. An employee has certain legal rights in relation to the terms of their Contract of Employment and is covered by various pieces of employment legislation that the self-employed are not entitled to. On the other hand the self-employed can, for example, claim certain business expenses against income, and can pay tax due at a later date, which may bring advantages. HMRC will tend to look at the nature of the working relationship between the two parties to determine whether or not a payment made should be taxed at source under the PAYE system or not.

It can of course be the case that someone can have two jobs: employed by day, and self-employed in the evening. In such cases you could be taxed under the PAYE scheme for employment and also have to submit a self-assessment in relation to self-employment (we will discuss self-assessment further into the course).

## TYPES OF EMPLOYEE

The main distinctions in terms of the different types of employee one may find are those deemed to be: full-time, part-time or casual.

Full-time workers are generally those who work the normal set working hours for the job; in most cases this will vary between, normally, 35-40 hours per week.

Part-time workers are generally those who work less than the normal set working hours for the job; someone may be employed to work only mornings, or only afternoons, or only a set number of days per week.

In the case of both full-time and part-time workers the hours they are required to work will be stated in their Contract of Employment.

Casual workers are, as the term implies, those employed on a casual basis, e.g., in the hotel trade staff may only be taken on over the summer months when business is at its peak. Students will often be employed on a casual basis when they are on holiday from school, college or university.

There is no legal definition of the number of hours that must be worked before an employee is defined as full-time, part-time or casual.

Traditionally it was the case that employees could, in theory, work up to 24 hours a day. Increasingly throughout the 20<sup>th</sup> and into the 21<sup>st</sup> century restrictions came in regarding the **minimum** age of an employee and the maximum number of hours an employee could work per day. With the implementation of certain European Community directives on employment legislation there has been a growing statutory limitation on the number of hours employees can be contracted to work, although Britain has retained an opt out option which allows employees the right to work more hours than the EC figure should they wish to.

## PAY SCALES

As well as an employee's starting salary it will often be the case that on employment he will be placed on a pay scale, which will allow his/her annual rate of pay to increase each year in terms of steps on an incremental scale. Normally the employee will be, on appointment, placed at the bottom point of any pay scale, but in some cases he/she may be placed at an intermediate point on the scale in recognition of some relevant qualification held, previous experience, or because it is necessary for the employer to offer a salary above the minimum of the scale to encourage the employee to accept the offer of the post.

Normally, thereafter, each year on the anniversary of the commencement of employment he/she will move up the scale by one increment, assuming his/her performance during the year is considered satisfactory. These incremental increases on the pay scale are normally in addition to any annual 'cost of living' increase that the business makes to its employees. After a period of time the employee will reach the top of his/her pay scale, at which point they will remain unless they move to another post within the company which merits a higher pay scale.

An example of pay scales can be seen in the National Health Service, where there are different scales applicable to different levels of nurses, e.g. D Grade, E Grade, F Grade etc, each of which has a series of incremental points that the nurse will move to each year until the top of the scale has been reached.

Assume for example that Jane Smith qualifies as a trained nurse and is appointed to the minimum point of E Grade, the appropriate scale being as follows:

Point 0	£30,000
Point 1	£30,500
Point 2	£31,100
Point 3	£31,800
Point 4	£32,600
Point 5	£33,300

On appointment she will be paid an annual salary of £30,000. At the end of Year 1 her salary will rise to £30,500 and so on until at the end of Year 5

she will be earning £33,300 per year. This will be independent of any 'cost of living' increases applied to these points e.g. at the end of Year 1 there may be a 2.5% increase. In this case the salary will rise to £31,262.50 rather than £30,500.

The points on the pay scale will therefore be increased by any 'cost of living' increases and Jane Smith will move onto each point at the end of every year at whatever amount that point is then set at.

At the end of the five years she will be at the top of her scale (Grade E) and will remain there unless promoted. She will thus only receive the 'cost of living' increase i.e., there will be no more incremental rises available to her.

The theory behind these pay scales is that they recognise, and reward experience gained. After a period of time, in this case five years, the employee is at the peak of the level of experience and knowledge deemed necessary for the job.

**PLEASE NOTE: These figures are for example purposes only and are not indicative of actual salaries.**

SAMPLE



**PROGRESS TEST 3**

1. Can a self-employed person be classed as an employee?
2. What are part-time workers?
3. Why would a business use a pay scale structure?

**SAMPLE**

## ANSWERS TO PROGRESS TEST 1

1.
  - The name of the employer and employee
  - The employee's job title and brief description
  - The date of commencement of the employment
  - The amount of the remuneration, i.e. the salary or wages, and when these will be paid (weekly, 4 weekly, monthly etc)
  - The normal hours of work
  - The place of work, i.e. the place where the employee will normally carry out his or her duties
  - Details of any pensions scheme taken up by the employee
  - The rules applicable to periods of sickness or injury, i.e. how much the employee will receive when unfit for work, and for how long
  - The period of notice required by either party to terminate the contract.
  - Rules for disciplinary and grievance procedures
  - Entitlement to paid holidays.
  - If the employment is not deemed to be of a permanent nature, the period of time for which it is expected to continue.
  - Details of any Collective Agreements
2. The Contract will be legally binding from the date when it is signed by the employer and the employee.
3. HMRC i.e. Her Majesty's Revenue & Customs
4. To pay staff correctly and on time in line with external HMRC requirements.

## **ANSWERS TO PROGRESS TEST 2**

1. The Personnel Department would deal with the initial advertising of vacancies; be involved in the interview process e.g. obtaining references for candidates and checking information provided; compile and issue Contracts of Employment; notify Payroll Department about new starts, staff leaving, staff wishing to join a contributory pension scheme etc; maintain and update employee records; provide advice on any changes to legislation affecting employer/employee relationship; provide advice on conditions of employment.
2. The Human Resources (HR) Department.
3. It would need the personal details relevant to each employee, i.e. name, address, NI number, tax code, annual salary or rate of pay, the hours worked, any sickness or absence, and any additional hours worked or deductions to be made.
4. It would only need to know this if the payment was to be made by BACS into the employee's bank account.



## **ANSWERS TO PROGRESS TEST 3**

1. In general terms the answer to this would be no. If someone is self-employed then they would need to be recognised as such by HMRC who would ultimately decide if this was the correct definition of the individual's working relationship with other parties. However, a self employed person may have two jobs. One of which being employed and the other self employed.
2. Those who are contracted to work less than the normal set working hours for the job.
3. To allow employee's salaries to increase year on year as they gain knowledge and experience until they reach the maximum point on the pay scale.

SAMPLE