PRINCIPLES OF ACCOUNTING

CHAPTER 11

CURRENT LIABILITIES AND ETHIOPIAN PAYROLL

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Chapter Introduction

Businesses regularly incur obligations that must be paid in the near future. Examples include:

- Supplier invoices
- Short-term notes
- Accrued wages
- Employment income tax
- Pension contributions
- Customer deposits
- Interest payable
- Warranty obligations

These obligations must be recognized, measured and settled accurately.

Why This Chapter Matters

Incorrect current-liability and payroll accounting may result in:

- Understated liabilities
- Overstated profit
- Incorrect employee payments
- Tax and pension noncompliance
- Penalties and interest
- Employee grievances
- Cash-flow problems
- Misleading financial statements

Opening Business Case

An organization has:

- ETB 600,000 in unpaid supplier invoices
- ETB 300,000 short-term bank loan
- ETB 750,000 monthly gross payroll
- Employment tax withheld but not remitted
- Pension contributions due
- Accrued employee overtime

DISCUSSION QUESTION

Which amounts are current liabilities, and when should each be recorded?

Chapter Scope

Part I: Accounting Concepts

- Nature of current liabilities
- Accounts payable
- Notes payable
- Accrued liabilities
- Contingent liabilities
- Employee benefits
- Liability reporting and analysis

Part II: Ethiopian Payroll

- Gross earnings
- Overtime
- Employment income tax
- Pension contributions
- Net pay
- Payroll entries
- Payroll controls

Learning Objectives

By the end of this chapter, students will be able to:

1. Define and classify current liabilities.
2. Account for accounts payable and accrued expenses.
3. Account for short-term notes and interest.
4. Identify the current portion of long-term debt.
5. Account for unearned revenue and tax collections.
6. Explain contingent liabilities.
7. Describe payroll records and controls.
8. Calculate Ethiopian gross earnings.
9. Calculate current Ethiopian employment income tax.
10. Calculate employee and employer pension contributions.
11. Prepare Ethiopian payroll journal entries.
12. Report and analyze current liabilities.

Chapter Roadmap

1. Nature of current liabilities
2. Accounts payable
3. Short-term notes
4. Accrued liabilities
5. Unearned revenue
6. Employee-related liabilities
7. Contingent liabilities
8. Payroll systems
9. Ethiopian payroll law
10. Earnings and overtime
11. Employment income tax
12. Pension contributions
13. Payroll entries and controls

Opening Reflection

A company pays employees on the fifth day of the following month. At December 31, employees have already earned ETB 280,000.

QUESTIONS

- Is there a liability at December 31?
- Should an expense be recorded?
- Does it matter that payment occurs in January?
- Which accounts are affected?

SECTION 1

Nature of Current Liabilities

What Is a Current Liability?

A current liability is an obligation expected to be settled within one year, or within the normal operating cycle.

THE LIABILITY IS GENERALLY SETTLED THROUGH

- Cash payment
- Transfer of another asset
- Provision of goods or services
- Replacement by another short-term obligation

Characteristics of Current Liabilities

Current liabilities normally:

- Arise from past transactions
- Represent present obligations
- Require future settlement
- Have relatively short payment periods
- Affect short-term liquidity
- Require reliable supporting documentation

Current versus Long-Term Liabilities

Current Liabilities	Long-Term Liabilities
Due within one year or operating cycle	Due after the current period
Affect immediate liquidity	Affect long-term solvency
Accounts payable	Long-term loan
Wages payable	Bonds payable
Short-term note	Long-term lease liability
Current loan instalment	Non-current loan balance

Examples of Current Liabilities

- Accounts Payable
- Salaries and Wages Payable
- Employment Income Tax Payable
- Pension Contributions Payable
- Interest Payable
- Short-Term Notes Payable
- Unearned Revenue
- Customer Deposits
- Current Portion of Long-Term Debt
- Warranty Liability

Recognition of a Liability

A liability is recognized when:

1. A present obligation exists.
2. The obligation results from a past event.
3. Settlement will require economic resources.
4. The amount can be measured or reasonably estimated.

Current Liabilities and the Operating Cycle

The operating cycle normally follows:

STEP 1
Purchase Goods or Services

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STEP 2
Record Liability

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STEP 3
Use Goods or Services

STEP 4
Generate Revenue

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STEP 5
Collect Cash

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STEP 6
Settle Liability

SECTION 2

Accounts Payable

Accounts Payable

Accounts Payable represents amounts owed to suppliers for goods or services acquired on credit. It normally arises from:

- Inventory purchases
- Office supplies
- Professional services
- Utilities
- Repairs
- Equipment purchases
- Other supplier invoices

Purchase on Account

Office supplies costing ETB 50,000 are purchased on credit.

Account	Debit	Credit
Office Supplies	50,000	
Accounts Payable		50,000

EFFECT

Assets increase. Liabilities increase.

Payment of Accounts Payable

The supplier is paid ETB 50,000.

Account	Debit	Credit
Accounts Payable	50,000	
Cash or Bank		50,000

Payment eliminates the obligation but does not create a new expense.

Accrued Liabilities

An accrued liability arises when

- An expense has been incurred
- The amount has not yet been paid
- The amount may not yet have been invoiced

Examples

- Accrued wages
- Accrued interest
- Accrued utilities
- Accrued professional fees

Accrued-Expense Entry

Utilities of ETB 24,000 have been consumed but not yet billed.

Account	Debit	Credit
Utilities Expense	24,000	
Utilities Payable		24,000

SECTION 3

Current Portion of Long-Term Debt

Current Portion of Long-Term Debt

A long-term loan may require payments over several years.

THE PRINCIPAL AMOUNT DUE WITHIN THE NEXT YEAR IS CLASSIFIED AS

Current Portion of Long-Term Debt

The remaining principal is reported as a long-term liability.

Classification Example

Total loan balance: ETB 2,000,000 | Principal due during next year: ETB 400,000

Balance-Sheet Classification	Amount (ETB)
Current portion of loan	400,000
Long-term loan balance	1,600,000
Total loan	**2,000,000**

SECTION 4

Short-Term Notes Payable

Short-Term Note Payable

A note payable is a formal written promise to pay:

- A specified principal
- At a specified date
- Usually with interest

A note due within one year is normally classified as current.

Common Sources of Notes Payable

A short-term note may arise when:

- Cash is borrowed
- An account payable is replaced by a note
- Equipment is purchased through financing
- A loan is renewed
- Emergency working capital is obtained

Interest Formula

Interest = Principal × Annual Interest Rate × Time

FOR A NOTE EXPRESSED IN MONTHS

Time = Number of Months ÷ 12

Maturity Value

Maturity Value = Principal + Interest

The maturity value is the total amount paid when the note becomes due.

Issuing a Note for Cash

A company borrows ETB 300,000 by issuing a 90-day, 12% note.

Account	Debit	Credit
Cash	300,000	
Notes Payable		300,000

Calculating Note Interest

INTEREST

$$300{,}000 \times 12\% \times (90 \div 360) = \text{ETB } 9{,}000$$

MATURITY VALUE

$$300{,}000 + 9{,}000 = \text{ETB } 309{,}000$$

Accruing Interest at Year-End

Assume 30 days of interest have accrued by December 31.

300,000 × 12% × (30 ÷ 360) = ETB 3,000

Account	Debit	Credit
Interest Expense	3,000	
Interest Payable		3,000

Paying the Note at Maturity

TOTAL INTEREST

ETB 9,000

PREVIOUSLY ACCRUED

ETB 3,000

REMAINING INTEREST EXPENSE

9,000 – 3,000 = ETB 6,000

Maturity Entry

Account	Debit	Credit
Notes Payable	300,000	
Interest Payable	3,000	
Interest Expense	6,000	
Cash		309,000

SECTION 5

Taxes and Unearned Revenue

Taxes Collected from Customers

A business may collect indirect taxes from customers on behalf of a government authority.

THE AMOUNT COLLECTED

- Is not business revenue
- Creates a liability
- Must be remitted to the authority

Tax-Collection Example

Goods are sold for ETB 100,000 plus ETB 15,000 tax.

Account	Debit	Credit
Cash or Accounts Receivable	115,000	
Sales		100,000
Tax Payable		15,000

Unearned Revenue

Unearned revenue arises when cash is received before goods or services are provided.

EXAMPLES

- Advance training fees
- Rent received in advance
- Customer deposits
- Subscription receipts
- Advance service payments

Receipt of Advance Payment

A company receives ETB 60,000 for services to be provided later.

Account	Debit	Credit
Cash	60,000	
Unearned Revenue		60,000

Recognizing Earned Revenue

Services worth ETB 20,000 are completed.

Account	Debit	Credit
Unearned Revenue	20,000	
Service Revenue		20,000

REMAINING LIABILITY

60,000 − 20,000 = ETB 40,000

Customer Deposits

A customer deposit remains a liability until:

- The goods are delivered
- The service is performed
- The deposit becomes refundable
- The contractual obligation is otherwise resolved

SECTION 6

Employee-Related Liabilities

Payroll Liabilities

Payroll may create liabilities for:

- Net salaries payable
- Employment income tax payable
- Employee pension payable
- Employer pension payable
- Overtime payable
- Employee deductions payable
- Accrued leave
- Bonuses payable

Accrued Wages

Employees earn ETB 280,000 by December 31 but will be paid in January.

Account	Debit	Credit
Salaries and Wages Expense	280,000	
Salaries and Wages Payable		280,000

Compensated Absences

Employee entitlements such as

- Annual leave
- Sick leave
- Other paid absences

A liability may be recognized when the benefits

- Relate to employee service already provided
- Accumulate or vest
- Are expected to be paid
- Can be reasonably estimated

Vacation-Pay Liability

Estimated employee leave earned: ETB 75,000

Account	Debit	Credit
Employee Benefits Expense	75,000	
Vacation Pay Payable		75,000

Warranty Liability

A warranty requires a seller to repair or replace defective products.

RECOGNITION PRINCIPLE

When warranty costs are probable and estimable, the expected cost is recognized in the period of sale.

Warranty Estimate

Sales of ETB 2,000,000 with an expected warranty cost of 2%.

2,000,000 × 2% = ETB 40,000

Account	Debit	Credit
Warranty Expense	40,000	
Warranty Liability		40,000

Warranty Work Performed

Warranty repairs use parts costing ETB 8,000.

Account	Debit	Credit
Warranty Liability	8,000	
Parts Inventory		8,000

The repair does not create a new warranty expense because the expense was estimated previously.

SECTION 7

Contingent Liabilities

What Is a Contingent Liability?

A contingent liability is a potential obligation whose final outcome depends on a future event.

EXAMPLES

- Lawsuits
- Loan guarantees
- Environmental claims
- Tax disputes
- Product warranties
- Contractual claims

Two Evaluation Factors

Contingent liabilities are evaluated based on:

1. Probability of loss
2. Ability to estimate the amount

Probable and Estimable

When a loss is probable and reasonably estimable, the business should generally:

- Record an expense
- Record a liability
- Provide appropriate disclosure

Probable but Not Estimable

When a loss is probable but cannot be reasonably estimated:

- No exact liability can be recorded reliably.
- The nature of the contingency should generally be disclosed.
- The reason an amount cannot be estimated should be explained.

Reasonably Possible

When the possibility of loss is reasonably possible:

- The liability is normally not recorded.
- The nature and possible amount are disclosed when practicable.

Remote Possibility

When the probability of loss is remote:

- A liability is generally not recorded.
- Disclosure is generally not required, subject to applicable reporting rules.

Contingency Decision Table

Probability	Estimable?	Treatment
Probable	Yes	Record and disclose
Probable	No	Disclose
Reasonably possible	Either	Disclose
Remote	Either	Normally no action

Lawsuit Example

Legal advisers believe the loss is probable and the estimated settlement is ETB 500,000.

Account	Debit	Credit
Litigation Loss	500,000	
Litigation Liability		500,000

SECTION 8

Reporting and Analysis

Balance-Sheet Presentation

Current Liabilities

Item	ETB
Accounts Payable	600,000
Salaries Payable	280,000
Tax Payable	120,000
Pension Payable	95,000
Interest Payable	30,000
Current Portion of Loan	400,000
Total Current Liabilities	**1,525,000**

Working Capital

Working Capital = Current Assets – Current Liabilities

EXAMPLE

2,500,000 – 1,525,000 = ETB 975,000

Positive working capital indicates that current assets exceed current liabilities.

Current Ratio

Current Ratio = Current Assets ÷ Current Liabilities

EXAMPLE

2,500,000 ÷ 1,525,000 = 1.64

Quick Ratio

Quick Ratio = (Cash + Short-Term Investments + Receivables) ÷ Current Liabilities

This ratio excludes less-liquid current assets such as inventory and prepaid expenses.

Controls over Current Liabilities

Important controls include:

- Approved purchases
- Supplier verification
- Three-way matching
- Sequential payment documents
- Independent payment authorization
- Supplier-statement reconciliation
- Liability aging reports
- Period-end search for unrecorded liabilities

Accounts-Payable Control

Before payment, compare

1. Purchase order
2. Receiving report
3. Supplier invoice

The documents should agree on

- Supplier
- Description
- Quantity
- Price
- Payment terms
- Authorization

SECTION 9

Payroll Fundamentals

What Is Payroll?

Payroll is the system used to:

- Determine employee earnings
- Calculate deductions
- Calculate net pay
- Record employer payroll costs
- Pay employees
- Remit statutory liabilities
- Maintain employee earnings records

Payroll Stakeholders

- Employees
- Human Resources
- Supervisors
- Payroll officers
- Finance staff
- Bank signatories
- Tax authorities
- Pension authorities
- Internal and external auditors

Gross Earnings

Gross earnings may include:

- Basic salary
- Hourly wages
- Overtime
- Allowances
- Bonuses
- Commissions
- Incentives
- Other employment benefits

Employee Deductions

Employee deductions may include:

- Employment income tax
- Employee pension contribution
- Staff advances
- Loan repayments
- Union dues
- Court-ordered deductions
- Other authorized deductions

Net Pay

Net Pay = Gross Earnings – Employee Deductions

Net pay is the amount ultimately transferred to the employee.

Employee Withholding Liabilities

Amounts withheld from employee earnings are not employer revenue. They create liabilities until remitted to:

- Tax authorities
- Pension administration
- Unions
- Courts
- Lenders
- Other authorized recipients

Employer Payroll Costs

Employer payroll cost may include:

- Gross salaries and wages
- Employer pension contribution
- Employer-funded benefits
- Leave cost
- Other contractual employment costs

Employee deductions do not reduce the employer's gross salary expense.

Payroll Register

A payroll register summarizes payroll information for all employees. Typical columns include:

- Employee name
- Basic salary
- Allowances
- Overtime
- Gross pay
- Employment tax
- Pension
- Other deductions
- Net pay

Employee Earnings Record

An employee earnings record provides cumulative information for one employee. It may show:

- Monthly gross earnings
- Taxable earnings
- Employment tax
- Pension contributions
- Other deductions
- Net pay
- Year-to-date totals

Payslip

A payslip should clearly communicate:

- Employee identity
- Pay period
- Earnings components
- Gross pay
- Each deduction
- Net pay
- Employer contributions where appropriate
- Bank-payment information

Payroll-System Flow

STEP 1
Employee Master Data

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STEP 2
Attendance and Approved Changes

»

STEP 3
Gross Earnings

»

STEP 4
Tax and Deductions

»

STEP 5
Payroll Review

STEP 6
Approval

»

STEP 7
Journal Entry

»

STEP 8
Bank Payment

»

STEP 9
Statutory Remittance

»

STEP 10
Reconciliation

Payroll Internal Controls

- Separate HR and payroll duties.
- Require approved salary changes.
- Verify employee existence.
- Restrict payroll-system access.
- Review unusual overtime.
- Reconcile payroll with bank payments.
- Review statutory liabilities.
- Remove terminated employees promptly.

Common Payroll-Fraud Risks

- Ghost employees
- Unauthorized salary increases
- Fictitious overtime
- Duplicate salary payments
- Altered bank accounts
- Unremitted deductions
- False allowances
- Payments to terminated staff

Employee Fringe Benefits

Fringe benefits may include:

- Housing
- Transport
- Meals
- Insurance
- Medical benefits
- Employer vehicles
- Education support
- Other non-cash benefits

Their accounting and tax treatment depends on applicable law and organizational policy.

Pension and Postretirement Benefits

Pension arrangements create obligations related to employee service. Accounting should distinguish between:

- Employee contributions withheld
- Employer pension expense
- Pension liabilities payable
- Long-term postretirement obligations

SECTION 10

Ethiopian Payroll Legal Framework

Main Ethiopian Payroll References

The localized payroll section applies the following framework:

- Income Tax Amendment Proclamation No. 1395/2025
- Income Tax Proclamation No. 979/2016, as amended
- Private Organization Employees' Pension Proclamation No. 1268/2022
- Labour Proclamation No. 1156/2019
- Implementing directives and employer policies

Source: Ministry of Finance lists Proclamation No. 1395/2025 as the amendment to the federal income-tax framework.

Current-Rate Warning

The employment-income tax brackets changed in 2025. Older payroll templates using:

- ETB 600 tax-free threshold
- 10% first taxable rate
- ETB 10,900 top-band threshold

CURRENT POSITION

Those older parameters are outdated. As of July 2026, the tax-free threshold is ETB 2,000 and the highest 35% band applies above ETB 14,000.

Source: PwC Tax Summaries — Ethiopia, taxes on personal income.

SECTION 11

Working Hours and Overtime

Normal Working Hours

Under Ethiopia's Labour Proclamation:

- Normal working time must not exceed eight hours per day.
- Normal working time must not exceed 48 hours per week.

Source: Labour Proclamation No. 1156/2019.

Overtime Authorization and Records

Overtime should:

- Be based on express employer instruction
- Be supported by qualifying operational circumstances
- Be accurately recorded for each employee
- Not normally exceed four hours per day
- Not normally exceed 12 hours per week

The employer must keep records of overtime instructions and hours worked. Source: Labour Proclamation No. 1156/2019.

Ethiopian Overtime Rates

Overtime Period	Multiplier
6:00 a.m. – 10:00 p.m.	1.50 × hourly rate
10:00 p.m. – 6:00 a.m.	1.75 × hourly rate
Weekly rest day	2.00 × hourly rate
Public holiday	2.50 × hourly rate

Overtime is paid in addition to the employee's ordinary wage. Source: Labour Proclamation No. 1156/2019.

Determining an Hourly Rate

FOR CLASSROOM CALCULATIONS, THIS CHAPTER USES

Hourly Rate = Monthly Basic Salary ÷ (30 days × 8 hours)

IMPORTANT

The 30-day divisor is a training and organizational payroll convention. The live payroll divisor should follow the employment contract, collective agreement, work rules and approved payroll policy.

Hourly-Rate Example

MONTHLY BASIC SALARY

ETB 50,000

HOURLY RATE

$$50{,}000 \div (30 \times 8) = \text{ETB } 208.33$$

Daytime Overtime Example

DAYTIME OVERTIME: 10 HOURS AT 1.50

$$10 \times 208.33 \times 1.50 = \text{ETB } 3{,}125.00$$

Night Overtime Example

NIGHT OVERTIME: 8 HOURS AT 1.75

$$8 \times 208.33 \times 1.75 = \text{ETB } 2{,}916.67$$

Weekly-Rest Overtime Example

WEEKLY-REST OVERTIME: 6 HOURS AT 2.00

$$6 \times 208.33 \times 2.00 = \text{ETB } 2{,}500.00$$

Public-Holiday Overtime Example

PUBLIC-HOLIDAY OVERTIME: 8 HOURS AT 2.50

$$8 \times 208.33 \times 2.50 = \text{ETB } 4{,}166.67$$

Total Overtime

Overtime Category	ETB
Daytime overtime	3,125.00
Night overtime	2,916.67
Weekly-rest overtime	2,500.00
Public-holiday overtime	4,166.67
Total Overtime	**12,708.34**

SECTION 12

Ethiopian Gross and Taxable Earnings

Payroll Earnings Components

A payroll may include:

- Basic salary
- Hardship allowance
- Housing allowance
- Transport allowance
- Responsibility allowance
- Overtime
- Bonus
- Commission
- Taxable non-cash benefits

Basic Salary

Fixed contractual salary before

- Overtime
- Allowances
- Bonuses
- Tax
- Pension
- Other deductions

It may be used as the base for

- Pension
- Overtime
- Leave pay
- Other employee benefits

Allowances

Allowances may compensate employees for:

- Difficult working conditions
- Housing costs
- Transport
- Responsibility
- Communication
- Representation
- Other employment circumstances

The payroll register should separately identify every allowance.

Hardship-Allowance Example

TRAINING ASSUMPTION

Hardship Allowance = 40% × Basic Salary

FOR A BASIC SALARY OF ETB 50,000

50,000 × 40% = ETB 20,000

Employment Income

DEFINITION

Employment income generally includes salary, wages, allowances, bonuses, commissions, gratuities and other cash or non-cash remuneration received in connection with employment, subject to specific statutory exemptions.

Source: PwC Tax Summaries — Ethiopia, income determination.

Taxable and Exempt Items

Before processing payroll, classify each item as:

- Taxable employment income
- Exempt employment income
- Reimbursement of an approved business expense
- Employee deduction
- Employer-only cost

CONTROL PRINCIPLE

No allowance should be treated as exempt without a documented legal basis.

SECTION 13

Ethiopian Employment Income Tax

Current Monthly Tax Brackets

Monthly Taxable Income	Rate
ETB 0 – 2,000	0%
ETB 2,001 – 4,000	15%
ETB 4,001 – 7,000	20%
ETB 7,001 – 10,000	25%
ETB 10,001 – 14,000	30%
Above ETB 14,000	35%

These bands reflect the amended employment-income tax structure currently reported under Proclamation No. 1395/2025.

Quick-Deduction Table

Taxable Income	Rate	Deduction (ETB)
ETB 0 – 2,000	0%	0
ETB 2,001 – 4,000	15%	300
ETB 4,001 – 7,000	20%	500
ETB 7,001 – 10,000	25%	850
ETB 10,001 – 14,000	30%	1,350
Above ETB 14,000	35%	2,050

FORMULA

PAYE = (Taxable Income × Rate) − Deduction

The deduction constants are mathematically derived from the marginal brackets to maintain continuity between bands.

Tax Example — ETB 2,000

TAXABLE INCOME

ETB 2,000

THE AMOUNT FALLS WITHIN THE TAX-FREE BAND

PAYE = ETB 0

Tax Example — ETB 3,500

$3{,}500 \times 15\% - 300$

$525 - 300 = $ ETB 225

Tax Example — ETB 6,000

$6{,}000 \times 20\% - 500$

$1{,}200 - 500 = \text{ETB } 700$

Tax Example — ETB 9,000

$9{,}000 \times 25\% - 850$

$$2{,}250 - 850 = \text{ETB } 1{,}400$$

Tax Example — ETB 12,000

$12{,}000 \times 30\% - 1{,}350$

$3{,}600 - 1{,}350 = \text{ETB } 2{,}250$

Tax Example — ETB 20,000

$20{,}000 \times 35\% - 2{,}050$

$7{,}000 - 2{,}050 = $ **ETB 4,950**

SECTION 14

Ethiopian Pension Contributions

Private-Organization Pension Coverage

COVERAGE

Private Organization Employees' Pension Proclamation No. 1268/2022 applies to covered Ethiopian employees of private organizations and replaced the earlier private-organization pension proclamations.

Source: Proclamation No. 1268/2022.

Pension Contribution Rates

Contributor	Rate
Employee	7%
Employer	11%
Combined Contribution	**18%**

The employer withholds the employee portion and contributes the employer portion.

Pension Contribution Base

FOR THE PRACTICAL EXAMPLES IN THIS CHAPTER

Employee Pension = 7% × Basic Salary

Employer Pension = 11% × Basic Salary

Current professional guidance identifies basic salary as the contribution base. Source: PwC Tax Summaries.

Employee Pension Example

Basic salary: ETB 50,000

- Reduces employee net pay
- Creates a Pension Payable liability
- Is not an additional employer expense

EMPLOYEE CONTRIBUTION

50,000 × 7% = ETB 3,500

Employer Pension Example

- Is an employer expense
- Does not reduce employee net pay
- Creates an employer pension liability

EMPLOYER CONTRIBUTION

50,000 × 11% = ETB 5,500

Combined Pension Liability

3,500 + 5,500 = ETB 9,000

The employer must remit both portions. Current guidance states that employers contribute 11% and employees contribute 7%; the employer is responsible for remitting both portions..

SECTION 15

Complete Ethiopian Payroll Example

Employee Payroll Information

TRAINING ASSUMPTIONS

- Basic salary: ETB 50,000
- Taxable Hardship allowance: 40%
- Total overtime: ETB 12,708.34
- All earnings in the example are taxable
- Employee pension: 7% of basic salary
- Employer pension: 11% of basic salary
- No other deductions

Calculate Gross Earnings

BASIC SALARY

ETB 50,000

HARDSHIP ALLOWANCE

50,000 × 40% = ETB 20,000

OVERTIME

ETB 12,708.34

GROSS EARNINGS

50,000 + 20,000 + 12,708.34 = ETB 82,708.34

Calculate PAYE

TAXABLE INCOME

ETB 82,708.34 | Applicable band: 35%

82,708.34 × 35% − 2,050

28,947.92 − 2,050 = ETB 26,897.92

Calculate Employee Pension

$$50{,}000 \times 7\% = \text{ETB } 3{,}500$$

Calculate Net Pay

NET PAY

Gross Earnings – PAYE – Employee Pension

82,708.34 – 26,897.92 – 3,500 = ETB 52,310.42

Employer Pension and Total Cost

EMPLOYER PENSION

$50{,}000 \times 11\% = \text{ETB } 5{,}500$

TOTAL EMPLOYER PAYROLL COST

$82{,}708.34 + 5{,}500 = \text{ETB } 88{,}208.34$

SECTION 16

Payroll Journal Entries

Record Employee Payroll

Account	Debit	Credit
Salaries and Wages Expense	82,708.34	
Employment Income Tax Payable		26,897.92
Employee Pension Payable		3,500.00
Net Salaries Payable		52,310.42

Record Employer Pension

Account	Debit	Credit
Employer Pension Expense	5,500	
Employer Pension Payable		5,500

TOTAL PENSION PAYABLE

3,500 + 5,500 = ETB 9,000

Pay Net Salaries

Account	Debit	Credit
Net Salaries Payable	52,310.42	
Bank		52,310.42

THE BANK PAYMENT SHOULD AGREE WITH

- Approved payroll register
- Employee bank details
- Bank-transfer schedule
- Payroll control total

Remit Statutory Liabilities

Account	Debit	Credit
Employment Income Tax Payable	26,897.92	
Employee Pension Payable	3,500.00	
Employer Pension Payable	5,500.00	
Bank		35,897.92

PAYE is withheld monthly and remitted by the employer, while pension contributions must be remitted for both the employee and employer portions. Source: PwC Tax Summaries.

SECTION 17

Payroll Documentation

Payroll Register Example

Item	ETB
Basic salary	50,000.00
Hardship allowance	20,000.00
Overtime	12,708.34
Gross earnings	**82,708.34**
Employment income tax	(26,897.92)
Employee pension	(3,500.00)
Net pay	**52,310.42**
Employer pension	5,500.00
Employer cost	**88,208.34**

Employee Earnings Record

The employee record should show:

- Employee identification
- Employment date
- Basic salary
- Taxable allowances
- Overtime by category
- Monthly taxable earnings
- PAYE
- Employee pension
- Employer pension
- Net pay
- Year-to-date totals

Ethiopian Payslip Structure

Earnings

- Basic salary
- Allowances
- Overtime
- Bonus
- Gross pay

Deductions

- PAYE
- Employee pension
- Advance recovery
- Other authorized deductions

Summary

- Net pay
- Employer pension contribution
- Pay period
- Bank account

SECTION 18

Payroll Controls and Compliance

Payroll-Control Checklist

Before payroll is approved, verify:

- Only active employees are included.
- Salary rates agree with contracts.
- Changes are authorized.
- Attendance is approved.
- Overtime is properly supported.
- Tax bands are current.
- Pension rates are correct.
- Bank details are independently verified.
- Net pay agrees with the payment schedule.

Ethiopian labour law requires payroll records showing gross pay, wage calculations, deductions and net pay.

Deduction Controls

A payroll deduction should be supported by:

- Law
- Collective agreement
- Work rules
- Court order
- Written employee authorization

The Labour Proclamation restricts unauthorized deductions and requires employers to maintain detailed payment records.

Monthly Payroll Reconciliation

EARNINGS

Basic Salary + Allowances + Overtime = Gross Pay

DEDUCTIONS

PAYE + Pension + Other Deductions = Total Deductions

NET PAY

Gross Pay – Total Deductions = Bank Transfer

EMPLOYER COST

Gross Pay + Employer Contributions = Total Payroll Cost

Comprehensive Exercise — Part A: Current Liabilities

At December 31, an organization has:

- Accounts payable: ETB 420,000
- Accrued wages: ETB 180,000
- Short-term note: ETB 300,000
- Accrued note interest: ETB 9,000
- Unearned revenue: ETB 75,000
- Current loan instalment: ETB 250,000
- Long-term loan balance after current instalment: ETB 1,250,000

REQUIRED

1. Calculate total current liabilities. 2. Identify the long-term liability. 3. Prepare the accrued-wages entry. 4. Prepare the accrued-interest entry.

Part A Solution — Totals

TOTAL CURRENT LIABILITIES

420,000 + 180,000 + 300,000 + 9,000 + 75,000 + 250,000 = ETB 1,234,000

LONG-TERM LIABILITY

ETB 1,250,000

Part A Solution — Journal Entries

ACCRUED-WAGES ENTRY

Account	Dr	Cr
Salaries and Wages Expense	180,000	
Salaries and Wages Payable		180,000

ACCRUED-INTEREST ENTRY

Account	Dr	Cr
Interest Expense	9,000	
Interest Payable		9,000

Comprehensive Exercise — Part B: Ethiopian Payroll

Employee information:

- Basic salary: ETB 30,000
- Hardship allowance: 40% of basic salary
- Daytime overtime: ETB 3,000
- All earnings are taxable
- Employee pension: 7% of basic salary
- Employer pension: 11% of basic salary

REQUIRED

Calculate gross earnings, PAYE, employee pension, net pay, employer pension and total employer cost, then prepare the payroll entries.

Part B Solution — Earnings and Deductions

HARDSHIP ALLOWANCE

$30{,}000 \times 40\% = \text{ETB } 12{,}000$

GROSS EARNINGS

$30{,}000 + 12{,}000 + 3{,}000 = \text{ETB } 45{,}000$

PAYE

$45{,}000 \times 35\% - 2{,}050 = 15{,}750 - 2{,}050 = \text{ETB } 13{,}700$

EMPLOYEE PENSION

$30{,}000 \times 7\% = \text{ETB } 2{,}100$

Part B Solution — Net Pay and Employer Cost

NET PAY

45,000 − 13,700 − 2,100 = ETB 29,200

EMPLOYER PENSION

30,000 × 11% = ETB 3,300

EMPLOYER COST

45,000 + 3,300 = ETB 48,300

Part B Solution — Payroll Entries

PAYROLL ENTRY

Account	Dr	Cr
Salaries and Wages Expense	45,000	
Employment Income Tax Payable		13,700
Employee Pension Payable		2,100
Net Salaries Payable		29,200

EMPLOYER PENSION ENTRY

Account	Dr	Cr
Employer Pension Expense	3,300	
Employer Pension Payable		3,300

Chapter Summary — Current Liabilities

- Current liabilities are obligations expected to be settled within one year or the operating cycle.
- Accounts payable arise from credit purchases.
- Accrued liabilities arise before payment or invoicing.
- The current portion of long-term debt is reported separately.
- Short-term notes normally require principal and interest payments.
- Unearned revenue remains a liability until the related obligation is performed.
- Contingent liabilities are evaluated according to probability and estimability.

Chapter Summary — Payroll and Ethiopian Practice

- Payroll creates expenses, deductions and several current liabilities.
- Employee deductions are liabilities until remitted.
- Employer pension is an additional employer expense.
- Ethiopian normal working time must not exceed eight hours per day or 48 hours per week.
- Ethiopian overtime rates differ by time and type of day.
- Current employment-income tax uses six progressive monthly bands.
- The current monthly tax-free threshold is ETB 2,000.
- Employee pension is 7% of basic salary; employer pension is 11%.
- Gross pay, statutory deductions, net pay and employer cost must be reconciled.
- Strong payroll control requires authorization, segregation of duties and independent review.

Payroll Accounting Flow

STEP 1
Approve Employee Data

»

STEP 2
Verify Attendance and Overtime

»

STEP 3
Calculate Gross Earnings

»

STEP 4
Calculate PAYE and Pension

»

STEP 5
Determine Net Pay

STEP 6
Review and Approve Payroll

»

STEP 7
Record Payroll Liabilities

»

STEP 8
Pay Employees

»

STEP 9
Remit Statutory Deductions

»

STEP 10
Reconcile and Archive Records

Key Message

KEY MESSAGE

Payroll deductions do not disappear when withheld. They become current liabilities that the employer must accurately record, safeguard and remit to the appropriate authority.

Reliable payroll accounting protects employees, supports legal compliance and ensures that salary expenses, deductions, employer contributions and current liabilities are completely and accurately reported.

Questions and Discussion

THANK YOU

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Reliable payroll accounting protects employees, supports legal compliance and ensures that salary expenses, deductions, employer contributions and current liabilities are completely and accurately reported.