MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

Holidays Act – proactive release of documents May 2016 (part 3 of 3)

This pdf contains the following documents, which have had material redacted as follows:

a. material that is out of scope related to non-Holidays Act issues or administrative details

b. material which is free and frank advice – withheld under s9(2)(g)(i) of the OIA

c. private contact information of Ministry staff – withheld under s9(2)(a) of the OIA.

No.	Date	Title	OIA Section/s
5.	22 April 2015 (2614 14-15)	Final Cabinet Paper – Review of the Holidays Act 2003 Calculations Provisions: Terms of Reference	9(2)(a) – private contact information 9(2)(g)(i) – free and frank Out of scope
6.	23 April 2015	EGI (15) 90 Review of the Holidays Act 2003 Calculations Provisions: Terms of Reference	9(2)(a) – private contact information Out of scope
7.	29 April 2015	EGI Min (15) 8/7 Review of the Holidays Act 2003 Calculations Provisions: Terms of Reference	9(2)(a) – private contact information Out of scope
8.	1 May 2015	Additional information on the proposed Holidays Act review for Cabinet, 4 May 2015	9(2)(a) – private contact information 9(2)(g)(i) – free and frank
9.	4 May 2015	CAB Min (15) 14/9 Review of the Holidays Act 2003 Calculations Provisions: Terms of Reference	9(2)(a) – private contact information Out of scope
10.	15 September 2015	Holidays Act and payroll for meeting with Minister 15 Sept 2015	9(2)(a) – private contact information

MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

BRIEFING

Final Cabinet Paper - Review of the Holidays Act 2003 Calculations Provisions: Terms of Reference

Date:	22 April 2015	**Priority:**	**Urgent**
Security classification:	**In Confidence**	**Tracking number:**	2614 14-15

Action sought		
	Action sought	**Deadline**
Hon Michael Woodhouse Minister for Workplace Relations and Safety	**Submit** the attached final Cabinet paper 'Holidays Act 2003 Calculations Provisions: Terms of Reference' to the Cabinet Office.	**10:00am Thursday, 23 April 2015**

Contact for telephone discussion (if required)			
Name	**Position**	**Telephone**	**1st contact**
Gerard Clark	Manager, Employment Standards Policy	s 9(2)(a)	✓
s 9(2)(a)	Advisor, Employment Standards Policy		

The following departments/agencies have been consulted/informed					
☒ Treasury	☐ MoJ	☐ NZTE	☐ MSD	☐ TEC	☐ MoE
☐ MFAT	☐ MPI	☐ MfE	☐ DIA	☐ TPK	☐ MoH
		☒ Other:	State Services Commission Inland Revenue Department Department of Prime Minister and Cabinet (informed)		

Minister's office to complete:

☐ Approved ☐ Declined
☐ Noted ☐ Needs change
☐ Seen ☐ Overtaken by Events
☐ See Minister's Notes ☐ Withdrawn

Comments:

MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

BRIEFING

Final Cabinet Paper - Review of the Holidays Act 2003 Calculations Provisions: Terms of Reference

Date:	22 April 2015	Priority:	Urgent
Security classification:	In Confidence	Tracking number:	2614 14-15

Purpose

To provide you with the final Cabinet paper 'Review of the Holidays Act 2003 Calculations Provisions: Terms of Reference' for submission to the Cabinet Office by 10:00am on Thursday, 23 April 2015.

Recommended action

The Ministry of Business, Innovation and Employment recommends that you:

a **Submit** the attached final Cabinet paper to the Cabinet Office by 10:00am Thursday, 23 April 2015.

Yes / No

b **Note** the attached talking points to support you in Cabinet Economic Growth and Infrastructure Committee on Wednesday, 29 April 2015.

Noted

s 9(2)(a)

Gerard Clark
Manager, Employment Standards Policy
LACE, MBIE

22 / 4 / 15

Hon Michael Woodhouse
Minister for Workplace Relations and Safety

..... / ..... / .....

Background to the Cabinet paper

1. In our meeting with you on 2 April 2015, you directed us to draft a Cabinet paper seeking Cabinet's agreement to a targeted review of the *Holidays Act 2003*.

2. On 15 April 2015, we provided you with a draft Cabinet paper for your consideration and feedback. We have also consulted the Treasury, State Services Commission, Inland Revenue and the Department of Prime Minster and Cabinet on the draft Cabinet paper.

3. The attached final Cabinet paper (Annex one) incorporates feedback from the government agencies mentioned above, as well as changes directed by you and your office. The changes made to the draft Cabinet paper in response to government agencies' feedback are minor and aim to clarify the scope of the review.

4. We have also provided talking points for you to consider ahead of the Cabinet Economic Growth and Infrastructure Committee's consideration of this Cabinet paper (Annex two).

Next steps

5. The attached Cabinet paper needs to be signed and submitted to the Cabinet Office by 10:00am on Thursday 23 April 2015.

Annexes

Annex one: Final Cabinet paper - Review of the Holidays Act 2003 Calculations Provisions: Terms of Reference

Annex two: Talking points for Cabinet Economic Growth and Infrastructure Committee

Annex three: CAB100

Annex one: Final Cabinet paper - Review of the Holidays Act 2003 Calculations Provisions: Terms of Reference

The following ten pages are redacted under s 9(2)(g)(i)

Annex two: Talking points for Cabinet Economic Growth and Infrastructure Committee

Proposal

- I am proposing a review of the holidays and leave calculations in the Holidays Act.

Need for a review

- The current calculations for holiday and leave pay within the Holidays Act are very complex, which results in:
  - high compliance costs for businesses seeking to meet their obligations.
  - inconsistent application and/or miscalculation of entitlements and payments.
  - employers carrying liability for back-pay of up to six years, and being exposed to the substantial costs of auditing and remedying errors
  - negative impacts on employment relationships and labour productivity.

How the review will produce different outcomes to previous reviews

- The Holidays Act was last reviewed in 2009, when a Ministerial Advisory Group was unable to agree on a simplified calculation, due to a view that the calculation may reduce overall entitlements

- I consider that stakeholders' experiences with the Holidays Act calculations since the previous review – particularly the high compliance costs for businesses and the potential for underpayment for employees – provide stronger incentives to find a mutually satisfactory solution.

How the review will operate

- This first part of the review will be carried out by an expert panel made up of employer, employee and legal representatives, with additional support from a technical reference group. The technical reference group will be made up of payroll providers, and will help test the practicality of the options considered by the panel.

- MBIE will work alongside the expert panel, with the options developed by the expert panel contributing to MBIE's discussion document later in the year.

Timing of the review

- A proposed timeline of the review would see:
  - the expert panel's recommendations made by June 2015
  - public consultation in July 2015
  - Cabinet consideration of policy decisions in September 2015
  - introduction of the Bill into the house in December 2015.

Annex three: CAB100

Out of Scope

In Confidence

OFFICE OF THE MINISTER FOR WORKPLACE RELATIONS AND SAFETY

The Chair
Cabinet Economic, Growth and Infrastructure Committee

Review of the Holidays Act 2003 Calculations Provisions: Terms of Reference

Proposal

1 I seek Cabinet approval to initiate a review of the calculations provisions in the Holidays Act 2003.

Executive Summary

2 The current Holidays Act provisions have multiple calculations for holidays and leave payments. This makes the process unnecessarily complicated and leads to:

a. high compliance costs for businesses seeking to meet their obligations

b. inconsistent application and/or miscalculation of entitlements and payments

c. employers carrying liability for back-pay of up to six years, and being exposed to the substantial costs of auditing and remedying errors

d. negative impacts on employment relationships and labour productivity.

3 A review of these legislative provisions would aim to simplify the calculations, while producing as consistent and fair as possible outcomes when determining minimum entitlements for employees.

4 To carry out the review as efficiently as possible, I propose a narrowly focused review that uses the 2009 Ministerial Advisory Group's recommendations for the Holidays Act as a starting point. The review will seek to adjust the methods of calculation suggested by the Ministerial Advisory Group and deal with the reasons for the disagreement between employers and employees.

5 I consider that stakeholders' experiences with the Holidays Act calculations provisions since the previous review – particularly the high compliance costs for businesses and the potential for underpayment for employees – provide stronger incentives to find a mutually satisfactory solution.

6 The review will be carried out by an expert panel, with input from a technical reference group and support from MBIE. The expert panel will consist of employer, employee and legal representatives. The technical reference group will be comprised of a small group of payroll providers and will help test the practicality of the options considered by the expert panel.

7 I expect to seek Cabinet approval in June 2015 to release a discussion document. This discussion document will seek public input on the potential options for change. The review's final recommendations will be presented to me in September 2015. I will then report back to Cabinet with any legislative change proposals.

Background

Current legislative settings

8 The purpose of the Holidays Act is to promote balance between work and other aspects of employees' lives by providing employees with minimum entitlements to holidays and leave. Specifically, the Holidays Act provides minimum entitlements to:

a. annual holidays

b. public holidays

c. alternative holidays

d. sick leave

e. bereavement leave.

9 The Holidays Act also specifies calculation methods to determine the minimum that an employee must be paid for any of these forms of holidays and leave. These calculation provisions aim to ensure that employees are not financially disadvantaged for taking holidays and leave. For example, if an employee takes a week of annual holidays, they must be paid at least the *greater* of their ordinary weekly pay (what they would normally be paid for that week) or average weekly earnings (their average weekly pay over the last 52 weeks). The Holidays Act provides different calculations to determine the minimum payment for other forms of holidays and leave.

10 Employers and employees can agree on different amounts, types of leave and calculation methods for payment of holidays and leave, as long as the agreed arrangements provide employees with entitlements that are greater than the minimum afforded to them under the Holidays Act.

Need for a review of the Holidays Act calculations provisions

11 The current legislative provisions have multiple calculations for holidays and leave payments making the process unnecessarily complicated, particularly for employment arrangements where hours of work and/or pay rates vary or are uncertain. This complexity results in:

a. ***High compliance costs for businesses seeking to meet their obligations.*** This cost is largely due to employers being unable to systematise their payroll with the need to make judgements on individual employees' leave entitlements and payments on an ongoing basis. For example, MBIE has received a report of an employer with 5,000 employees that faces costs in excess of $400,000 per year to ensure compliance.

b. ***Inconsistent application and/or miscalculation of entitlements and payments.*** There are indications that a significant proportion of the workforce (across both private and public sectors) may be currently underpaid for leave, with most affected employees potentially owed between $250 and $500 per year.

c. ***Employers carrying liability for back-pay of up to six years, and being exposed to the substantial costs of auditing and remedying errors.*** For instance, a large private sector employer recently spent in excess of $600,000 auditing and amending their system, which led to a pay-out in wage arrears of over $1.2 million to 1400 employees.

d. ***Negative impacts on employment relationships and labour productivity.*** This is due to the employees' and employers' time and resources being diverted to trying to establish their rights and obligations. MBIE receives a large volume of requests for assistance to comply with legislation (approximately 22 per cent of the calls received by MBIE's Service Centre are primarily regarding key provisions in the Holidays Act).

Lessons from the previous legislative review

12 In 2009, the Government tasked a Ministerial Advisory Group (the Group) with (among other things) a review of the calculations of payment for holidays and leave, with a view to recommending a simpler calculation without reducing holidays and leave entitlements.

13 The Group, which represented both employers and unions, identified and explored the implications of an alternative, single and simple calculation for all holidays and leave payments.

14 The simple calculation, proposed by the employer representatives of the Group, was intended to improve the ease of automation of leave processing and reduce the need for payrolls to analyse individual employees' work patterns when determining leave payments. For example, if adopted, it would have eliminated the need to determine what constitutes a 'week' (for annual holidays) or a 'day' (for other leave) by providing for all entitlements to accrue and be deducted in "work units", which could be hours, days or weeks. However, unions have argued that this change would also have resulted in reduced entitlements for many employees who work fewer than five days a week.

15 At the time, the Government concluded that the benefits of this simple calculation were likely to be outweighed by the potential loss of entitlement by employees, and did not proceed with it. Instead, an additional averaging calculation for leave payment was provided for in legislation, as an attempt to accommodate some employers for whom the primary calculation is particularly problematic. It was recognised that, as a result, the compliance costs for some businesses were likely to increase.

Terms of Reference

16 To carry out the review as efficiently as possible, I propose that it focuses on developing the alternative calculation considered by the 2009 Ministerial Advisory Group further and works through any outstanding issues, with the goal of improving that alternative calculation and how it is applied.

17 I consider that stakeholders' experiences with the Holidays Act calculations provisions since the previous review – particularly the high compliance costs for businesses and the potential for underpayment for employees – provide stronger incentives to find a mutually satisfactory solution.

18 I recognise that any simplification of the current legislative provisions for the calculation of holidays and leave payments could result in a reduction of some employees' entitlements, and would therefore require a judgement call on its overall net national benefit. Alternatively, it may be possible to develop a provision that in general provides a slightly higher level of entitlements, while simplifying and reducing overall costs for business.

19 The terms of reference (as set out in Annex 1) outline the specific objectives, scope and indicative timing for the review. I propose to establish an expert panel to carry out the review and advise me on options and/or recommendations for change. As any potential changes will have implications for employers (both large and small), employees and the legal application of the Holidays Act, I propose to invite nominations for the expert panel from:

a. Business New Zealand,

b. Small Business Development Group,

c. New Zealand Council of Trade Unions, and

d. New Zealand Law Society.

20 I also propose to establish a technical reference group to assess the practicality of the options considered by the expert panel. This will be comprised of a small group of payroll providers that will be consulted on whether the options could be systematised in payroll systems.

21 MBIE will work alongside the expert panel and the technical reference group to facilitate the expert panel's review process and provide support.

22 The options identified, and recommendations made, by the review process will contribute to MBIE's drafting of a discussion document, which will serve as the basis for the full public consultation and submission process, prior to policy recommendations being made to Cabinet.

23 I expect to seek Cabinet approval to release a consultation document in June 2015 to seek public input on the potential options for change. I then expect the review's final recommendations to be presented to me in September 2015. I will then report back to Cabinet with any change proposals.

24 The following table provides an indicative outline of the timing of the review:

Key deliverables:	**Indicative timeline:**
Cabinet approval of the terms of reference	May 2015
Expert panel's review process and recommendations to the Minister	May-June 2015
MBIE development of the discussion document for public release	June 2015
Cabinet approval to release public discussion document	June 2015
Public consultation process	July 2015
Analysis of submissions	August 2015
Policy recommendations to the Minister	September 2015
Cabinet policy decisions	September 2015
Drafting of the Bill	October-November 2015
Cabinet approval to introduce the Bill	November 2015
Introduction of the Bill	December 2015
Legislative change process	February-October 2016

Other related work

25 It is my intention that the outcome of the review will contribute to the wider reform to strengthen the employment standards system and reduce unnecessary complexity and cost.

26 I have sought changes in the Employment Standards Bill to strengthen the enforcement of employment standards and modernise the provisions of paid parental leave. This Bill will be introduced this year.

Consultation

27 The following government agencies have been consulted on this paper, and as far as possible, the Cabinet paper reflects their comments: the Treasury, the State Services Commission, and Inland Revenue. The Department of Prime Minister and Cabinet has been informed.

28 Subsequent to Cabinet agreement, MBIE will approach the organisations for nominees for the expert panel and then refer a list of nominees to me for consideration.

Financial Implications

29 There are no fiscal implications arising from this review. The cost of engaging the expert and technical panels will be absorbed within MBIE's baseline.

Human Rights

30 The proposed review appears to be consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993. Any policy proposals as a result of this review will be assessed at the appropriate time.

Legislative Implications

31 There are no immediate legislative implications arising from this review. However, the attached terms of reference contemplate legislation being introduced to implement the policy proposals that result from this review in late 2015. The specific implications and priority of this Bill will be addressed when those policy proposals are considered by Cabinet later this year.

Regulatory impact analysis

32 Regulatory impact analysis requirements are not applicable to the proposal in this Cabinet paper.

Publicity

33 Once the expert panel and technical reference group are established, MBIE will publish the terms of reference on its website. I will also release a media statement that outlines the review and highlights indicative timing and opportunities to comment.

Recommendations

The Minister for Workplace Relations and Safety recommends that the Committee:

1 **Note** that the current complexity of the calculations provisions for holidays and leave payments in the Holidays Act 2003 results in:

- high compliance costs for businesses
- inconsistent application and/or miscalculation of entitlements and payments
- employers carrying liability for back-pay of up to six years, and being exposed to the substantial costs of auditing and remedying errors
- negative impacts on employment relationships and labour productivity

2 **Note** that a 2009 Ministerial Advisory Group, charged with a review of the Holidays Act 2003, identified simpler ways to calculate entitlements and payments, but at that time an agreement on the detail of the calculation and how it is applied could not be reached between the employer and employee representatives on the Group

3 **Agree** to initiate a review of the calculations provisions in the Holidays Act 2003

4 **Note** the attached terms of reference (see Annex one) providing an overview of the context and approach to the review.

s 9(2)(a)

Hon Michael Woodhouse
Minister for Workplace Relations and Safety
23/04/2015

Annex 1: Terms of Reference for the review of the calculations of payment for holidays and leave in the Holidays Act 2003

Objectives of the review

The objectives of this review are to identify and consider policy options that:

a) simplify calculations of minimum payment for holidays and leave by making it easier and less costly for businesses and employees to understand and apply,

while,

b) producing as consistent and fair as possible outcomes when determining minimum entitlements for employees.

Context

Current legislative settings

The purpose of the Holidays Act 2003 (Act) is to promote balance between work and other aspects of employees' lives and, to that end, to provide eligible employees with minimum entitlements to paid annual holidays, public holidays, sick and bereavement leave. These entitlements are currently set as follows:

- Four weeks' paid annual holidays a year
- 11 days of public holidays[1], 5 days for sick leave, 3 days for bereavement leave, and alternative holidays for employees who work public holidays[2].

The Act also specifies the methods for calculating the minimum payment for holidays and leave, aimed at ensuring that employees are not financially disadvantaged for taking holidays and leave. In particular:

- The calculation for annual holidays payment is set as the greater of either the "ordinary weekly pay" at the time the holiday is taken (calculated as gross earnings for last 4 weeks divided by 4) or the employee's "average weekly earnings" (calculated as gross earnings for last 52 weeks divided by 52).
- The calculation for other forms of holidays and leave payments is based on the notional concept of "relevant daily pay" which requires the employer to make an estimate of what the employee would have earned on the day had they worked (including any overtime and incentive payments that would have been received). In situations where such an estimate is not possible or practicable, the Act provides for an alternative calculation based on "average daily pay" (calculated as gross earnings for last 52 weeks divided by number of days or part days on which gross earnings were earned).

Although there is not an ability to contract out of the Act, employers and employees are free to agree on different amounts, types of leave and calculation methods for payment of leave, as long as the agreed arrangements provide employees with entitlements that are greater than the minimum afforded to them under the Act.

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[1] Entitlement to public holidays is provided if employees would have otherwise worked on those days.
[2] Only provided if the public holiday is otherwise a working day for the employee.

Concerns with the current calculations provisions

A key criticism of the current legislative provisions is that having multiple calculations for holidays and leave payments (with different units and rates used in the calculations) is unnecessarily complicated. This complexity results in high compliance costs for businesses seeking to meet their obligations and, in some situations, can contribute to an inconsistent application and miscalculation of leave payments. Any such inconsistency/miscalculation could result in:

- employees being underpaid for leave, which is contrary to the purpose of the Act[3]
- employers carrying liability for back-pay of up to six years, and being exposed to the substantial costs of auditing and remedying errors
- negative impacts on employment relationships and labour productivity due to the employees' and employers' time and resources being diverted to trying to establish their rights and obligations.

The legislative complexity arises, in part, from the Act providing for a number of different methods for employers to choose from when calculating holiday and leave payments for their employee. As a result, employers are unable to systematise their decision-making processes and have to manually determine which calculation method should be chosen in any given situation for any given employee in any given pay cycle. Although the Act provides some guidance on when a particular method should be used, such guidance is necessarily generic in nature.

It is generally accepted that exercising such judgement is relatively straightforward in situations where employees work regular hours and receive regular pay. However, issues arise when hours of work and/or pay rates vary or are uncertain, and where relevant records are not being held. This is often the case for casual and temporary workers, shift workers, employees who work overtime and employees who receive commission or bonus payments. For these complex work arrangements it is particularly difficult to establish what employees would have earned had they worked on each day of leave taken, e.g. what a day/week is worth to them (given that such employees often work in hours rather than days/weeks as the entitlements suggest) and what is to be included or excluded from the value of relevant earnings in the calculation (given the variable nature of work patterns and/or payment rates).

Due to the legislative complexity, known issues with record keeping, and the need to consider individual employee specific work and pay patterns to comply with the legislative requirements, calculating payment for holidays and leave requires significant investment of employers' time and resources and can result in inconsistent application and miscalculation.

Concerns about legislative complexity are further heightened by limited resources/attention dedicated to payroll issues by businesses, an underdeveloped payroll assurance/audit industry, and limited advice, education and information provided and sought on how compliance can be achieved in more complex situations.

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[3] Miscalculation may also produce an unintentional overpayment for leave. However, unlike underpayment, overpayment is not contrary to the objectives of the Act.

Lessons from the previous review

The 2003 Act and its 2011 Amendment sought to address criticisms of the original 1981 Act that the calculation of payment for leave was unnecessarily complicated and difficult to understand and apply.

The most recent 2011 Amendment, which introduced the "average daily pay" calculation, was made in response to the recommendations of a Ministerial Advisory Group established by the Government in 2009 to review (among other things) the calculation of payment for leave and recommend a simpler calculation without reducing holidays and leave entitlements.

The Group, which represented both employers and unions, had identified and explored the implications of an alternative, single and simple calculation for all holidays and leave payments. While the Group reached a general agreement for the alternative calculation, the employer and employee representatives did not agree on the definitions of the core components of the calculation, its application or the ways of accumulating leave.

At the time, the Government concluded that the benefits of this simple calculation were likely to be outweighed by the potential loss of entitlement by employees, and did not proceed with it. Instead, an additional "average daily pay" calculation for leave payment was provided for in legislation, as an attempt to accommodate some employers for whom the "relevant daily pay" calculation was particularly problematic. It was recognised that, as the result of adding "average daily pay" to the mix, the compliance costs for some businesses were likely to increase.

Scope of the review

To carry out the review as efficiently as possible, its main focus will be on developing the alternative calculation considered by the 2009 Ministerial Advisory Group further and working through any outstanding issues, with the goal of improving the alternative calculation and how it is applied.

It is recognised that any simplification of the current legislative provisions for the calculation of holidays and leave payments could result in some reduction of employees' entitlements, and could therefore require a judgement call on its overall net national benefit.

A trade-off between compliance costs to employers and fairness to employees may be that simpler rules could lead to increased levels of compliance, thus resulting in increased actual payments to employees even though their nominal entitlements may reduce. Alternatively, nominal entitlements may need to be adjusted upwards to safeguard against the potential downside for employees. This would result in potentially higher direct costs to employers, which would, however, be offset by lower compliance costs.

In particular, the review will examine:

a) how the alternative calculation can be further developed to achieve a better balance between the competing objectives of reducing compliance costs for employers, while minimising any potential for a reduction or inconsistency in the levels of entitlements for employees

b) the implications of expressing the units of holidays and leave entitlements in hours or days (rather than days and weeks)

c) the implications of adjusting the calculation(s) to increase the payment for holidays and leave in order to minimise any potential for a reduction or inconsistency in entitlements that may arise from changing the expression of entitlements from the current days/weeks to, for example, hours or days

d) whether paying for holidays and leave on the basis of employees' past earnings over a relevant period would result in better outcomes, when compared with the current concept of paying employees what they would have earned had they worked during the period on leave

e) what should be included/excluded in the definitions of the components of the alternative calculation

f) the implications of applying the alternative calculation to all holidays and leave payments (rather than just certain forms of leave).

Approach to the review

The review will be carried out by an expert panel, with input from a technical reference group and support from MBIE.

The expert panel will consist of nominees from:

a. Business New Zealand,

b. Small Business Development Group,

c. New Zealand Council of Trade Unions,

d. New Zealand Law Society.

The technical reference group will comprise of a small group of payroll providers, and help test the practicality of the options considered by the expert panel.

The options identified and recommendations made by the review process will contribute to MBIE's drafting of a discussion document. The discussion document will serve as the basis for public consultation and submission process, prior to policy recommendations being made to Cabinet.

The key deliverables and indicative timeline for the review are set out below:

Key deliverables:	**Indicative timeline:**
Cabinet approval of the terms of reference	May 2015
Expert panel's review process and recommendations to the Minister	May – June 2015
MBIE development of the discussion document for public release	June 2015
Cabinet approval to release public discussion document	June 2015
Public consultation process	July 2015
Analysis of submissions	August 2015
Policy recommendations to the Minister	September 2015

Out of Scope

Cabinet Economic Growth and Infrastructure Committee

EGI Min (15) 8/7

Copy No: 39

Minute of Decision

This document contains information for the New Zealand Cabinet. It must be treated in confidence and handled in accordance with any security classification, or other endorsement. The information can only be released, including under the Official Information Act 1982, by persons with the appropriate authority.

Review of the Holidays Act 2003 Calculations Provisions: Terms of Reference

Portfolio: Workplace Relations and Safety

On 29 April 2015, the Cabinet Economic Growth and Infrastructure Committee:

1 **referred** the submission under EGI (15) 90 to Cabinet on 4 May 2015, revised in the light of the discussion at the meeting;

2 **invited** the Minister for Workplace Relations and Safety to provide further information to Cabinet on the implications of any change to the calculations provisions on employees' pay.

Out of Scope

Reference: EGI (15) 90

30 [illegible]

SB 30/04/15

Out of Scope

MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

BRIEFING

Additional information on the proposed Holidays Act review for Cabinet, 4 May 2015

Date:	1 May 2015	**Priority:**	**Urgent**
Security classification:	**In Confidence**	**Tracking number:**	2724 14-15

Action sought		
	Action sought	**Deadline**
Hon Michael Woodhouse Minister for Workplace Relations and Safety	**Note** the attached information.	Prior to Cabinet on 4 May 2015

Contact for telephone discussion (if required)			
Name	**Position**	**Telephone**	**1st contact**
Gerard Clark	Manager, Employment Standards Policy	s 9(2)(a)	✓
s 9(2)(a)	Advisor, Employment Standards Policy		

The following departments/agencies have been consulted					
☐ Treasury	☐ MoJ	☐ NZTE	☐ MSD	☐ TEC	☐ MoE
☐ MFAT	☐ MPI	☐ MfE	☐ DIA	☐ TPK	☐ MoH
		☐ Other:	N/A		

Minister's office to complete:

☐ Approved ☐ Declined
☐ Noted ☐ Needs change
☐ Seen ☐ Overtaken by Events
☐ See Minister's Notes ☐ Withdrawn

Comments:

MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

BRIEFING

Additional information on the proposed Holidays Act review for Cabinet, 4 May 2015

Date:	1 May 2015	Priority:	Urgent
Security classification:	In Confidence	Tracking number:	2724 14-15

Purpose

To provide you with additional information requested by the Cabinet Economic Growth and Infrastructure Committee ahead of the Cabinet's consideration of the Holidays Act review Cabinet paper on 4 May 2015.

Recommended action

The Ministry of Business, Innovation and Employment recommends that you:

a **Note** the attached information prior to Cabinet on 4 May 2015

Noted

s 9(2)(a)

Gerard Clark
Manager, Employment Standards Policy
LACE, MBIE

..1.. / ..5... / ..15.

Hon Michael Woodhouse
Minister for Workplace Relations and Safety

..... / ..... / .....

Background

1. On 29 April 2015, Cabinet Economic Growth and Infrastructure Committee requested that additional information on the likely outcomes for employers and employees of the proposed review of the Holidays Act be provided for Cabinet's consideration. The following information is attached for your consideration.

2. **Annex One** provides an overview of this information, which you may wish to table in Cabinet on 4 May 2015. **Annex Two** sets out the previously provided talking points.

Difficulties with existing legislation leading to potential underpayment

MBIE's estimation of economy-wide underpayments

3. The current legislative provisions have multiple calculations for holidays and leave payments making the process unnecessarily complicated, particularly for employment arrangements where hours of work and/or pay rates vary or are uncertain.

4. MBIE estimates that between 194,700 and 763,350 employees are likely to be underpaid for holidays and leave.

5. The affected employees may be owed, on average, between $250 and $500 per year. This equates to between $50m and $382m per year on a nationwide scale.

6. The Limitation Act 2010 allows for any required payment of arrears to go back not less than six years. Taking into this provision, we estimate that on a nationwide scale, arrears are likely to be between $292m and $2.29b.

7. Stakeholders, such as Simpson Grierson, have also acknowledged that the complexity of the legislation is leading to disproportionate rates of unintentional breaches.

Specific cases:

8. The table below is a brief summary of some Labour Inspectorate cases regarding non-compliance with the Holidays Act.

s 9(2)(g)(i)

How the previous review attempted to deal with ongoing issues

9. Determining holidays and leave entitlements and payments for employees who work regular hours is straightforward and can be systematised (such as salaried workers or people who work the same hours each week).

10. However, MBIE estimates that approximately half of all employees have some fluctuation in their pay, whether it be due to differing hours, payments, or deductions week-to-week. The difficulty of calculating entitlements and payments for these employees varies greatly and will be largely unique each employee.

11. The previous review sought to assist employers and employees to determine entitlements and payments by simplifying the calculations, particularly for working arrangements that have fluctuating hours and/or payments.

12. Employer representatives suggested that to achieve the desired outcomes, the legislation needs to provide for the combination of:

    - **[Element 1]** A simplified formula for determining payment for holidays and leave
    - **[Element 2]** The simplified formula applying to all holidays and leave events
    - **[Element 3]** Accrual of holidays and leave in a unit best suited to the workplace (hours/days/weeks)

13. Employee representatives suggested that the combination of the above three elements would lead to many employees having their entitlements reduced, but agrees that the legislation should provide:

    - **[Element 1]** A simplified formula for determining payment for holidays and leave [same as employers]
    - **[Element 2]** The simplified formula applying to ***some*** holidays and leave events (annual holidays remained unchanged)
    - **[Element 3]** Employees continue to be provided entitlements in weeks and days.

Outstanding issues to be resolved in the proposed review

Element 1:Whether the simplified formula would be practical

14. The simplified formula has not been strenuously tested as to its practicality for businesses and payroll systems.

15. The simplified formula would require employers to continually update what hours the employee is employed for each day. Any changes would need to be by agreement with the employee.

16. MBIE has concerns about how effectively the calculation could be applied due to generally poor record-keeping practices and known significant disconnects between payroll and the 'shopfloor' of a business. However, it regards that effective deterrence and enforcement of the provisions will likely produce better business processes in the medium to longer term. The Employment Standards Bill will improve businesses' record keeping practices.

17. The calculation will also produce some 'winners' and 'losers'. We are unable to provide precise quantitative information, thus, the following is a qualitative evaluation of the proposals. These are detailed in the following table.

Implications of the employers' suggested calculation:

Negatively affected employees	**Number of employees affected**
Employees who receive significant additional work during holidays or seasons (eg Christmas) **Example:** Employee A is a chef who works 6 hours each day. During long weekends, the restaurant is in higher demand and is open 4 extra hours each day. If employee A takes sick leave on a long weekend, they will only be paid their normal rate, not the rate they would have earned had they worked the additional 4 hours.	**Confined**
Positively affected employees	**Number of employees affected**
Employees who receive commissions, regular overtime, allowances. **Example:** Employee B is a nurse who works a large number of nights and weekends, which are paid at a higher rate. Working these times increases their gross earnings for the year. If the employee takes leave on a 'normal day shift', due to the higher gross earnings, they will be paid more for being on leave rather than being at work.	**Moderate**
Likely net impact on employers	
Positive – compliance costs will be in many cases dramatically reduced, with this clarity meaning calculations can be better automated. Direct costs will also be reduced significantly through the legislation providing greater certainty.	
Areas for further development	
Determine practicality of the proposed formula [technical reference group].	

Element 2: Whether the formula should apply to all forms of holidays and leave events

18. In the previous review, employee representatives suggested that the simplified formula should apply to all forms of holidays and leave, except for annual holidays, as this would reduce payment for some employees. Employer representatives suggested it should apply to all forms of leave, which would better achieve the objective of simplifying the legislation and preserve the leave balance of employees.

19. The following table outlines how applying the simplified formula to annual holidays could produce some 'winners' and 'losers'.

Implications of the employers' suggested calculation:

Negatively affected employees	Number of employees affected
Employees who increase their hours significantly or receive a pay rise. **Example:** Employee C receives an annual pay rise. However, when the employee takes holidays or leave, this pay increase will not be represented in the employee's holiday pay until 52 weeks after they receive the increase (when they may receive another pay rise). This is due to the formula averaging the last 52 weeks gross.	**Moderate**
Positively affected employees	**Number of employees affected**
Employees who decrease their hours significantly **Example:**Employee D is a parent and decreases their hours from 40 hours to 20 hours after working for a year. The simplified formula provides that employees' entitlements are provided in hours and are not reduced if the employee reduces their hours. After one year, the employee's leave balance will remain at 160 hours, rather than being reduced to 80 hours as under current legislation. However, employee D will only be paid for the hours that they would have worked on the day for annual holidays, rather than an average that would have been higher due to working more hours.	**Moderate**
Likely net impact on employers	
Positive – compliance costs will be in many cases dramatically reduced, with this clarity meaning calculations can be better automated. Direct costs will also be reduced significantly through greater certainty.	
Areas for further development	
Examine ways to amend the formula to reduce the detrimental effects on annual holidays [expert panel and technical reference group].	

Element 3: Whether entitlements should be accrued in different work units

20. MBIE recently met with 22 payroll, who represent approximately 95 per cent of employers in New Zealand who use payroll software. It also met with 15 large employers who collectively employ approximately 10 per cent of the total workforce.

21. All of these stakeholders suggested that the working units need to be amended to better align with working arrangements. Nearly all of these stakeholders suggested that entitlements should be provided in hours, with a few stating that days would be advantageous.

22. Other stakeholders, such as Simpson Grierson, report that changing the work units to hours is their clients most desired change to employment law.

23. The desire to change work units from weeks/days to hours/days is due to employers having difficulties determining what a 'day' or 'week' means to any given employee.

24. Further to this, many employees take hours/days off rather than taking full days/weeks off. It can be difficult for employers to determine what to pay an employee for an hour's leave, when the legislation provides daily and weekly rates for holidays and leave.

25. The following table outlines how applying the simplified formula to annual holidays could produce some 'winners' and 'losers'.

Implications of the employers' suggested calculation:

Negatively affected employees	Number of employees affected
Employees who work shift patterns different from a standard week **Example:** Employee E is a security guard and works 4 days on 4 days off. Due to the accrual ra formula te taking into account hours per week, this means that the employee will only be entitled to 42 hours sick leave, rather than 60 hours in current legislation.	**Significant**
Positively affected employees	**Number of employees affected**
Employees who decrease their hours significantly (as per last example) and employees who work less than 6 months **Example:** Employee F is student who works over summer for 3 months at a fruit shop. Due to the accruing of sick leave, the employee will become entitled to a days' sick leave over summer. Under the current legislation, the employee would not meet the criteria as it requires 6 months' continuous employment.	**Moderate**
Likely net impact on employers	
Positive – compliance costs will be in many cases dramatically reduced, with this clarity meaning calculations can be better automated. Direct costs will also be reduced significantly through greater certainty.	

Areas for further development
Examine ways to amend the accrual formula to be more proportionate to employees who work less than 5 days [expert panel and technical reference group].

Annexes

Annex One: Information to table at Cabinet, 4 May 2015

Annex Two: Talking points for Cabinet, 4 May 2015

Annex One: Information to table at Cabinet, 4 April 2015

Key outstanding issues that need to be resolved in the proposed review

In the previous review, employer representatives suggested that to achieve the desired outcomes, the legislation needs to provide for:

- A simplified formula for determining payment for holidays and leave
- The simplified formula applying to all holidays and leave events
- Accrual of holidays and leave in a unit best suited to the workplace (hours/days/weeks)

The following table summarises the implications to employees' entitlements of adopting this approach without amendments.

Type of employees who may be negatively affected	Number of employees affected
Employees who receive significant additional work during holidays or seasons (eg Christmas) **Example:** Employee A is a chef who works 6 hours each day. During long weekends, the restaurant is in higher demand and is open 4 extra hours each day. If employee A takes sick leave on a long weekend, they will only be paid their normal rate, not the rate they would have earned had they worked the additional 4 hours.	**Confined**
Employees who increase their hours significantly or receive a pay rise **Example:** Employee B receives an annual pay rise. However, when the employee takes holidays or leave, this pay increase will not be represented in the employee's holiday pay until 52 weeks after they receive the increase (when they may receive another pay rise). This is due to the formula averaging the last 52 weeks gross.	**Moderate**
Employees who work shift patterns different from a standard week **Example:** Employee C is a security guard and works 4 days on 4 days off. Due to the accrual rate taking into account hours per week, this means that the employee will only be entitled to 42 hours sick leave, rather than 60 hours in current legislation.	**Significant**

Type of employees who may be positively affected	Number of employees affected
Employees who receive commissions, regular overtime, allowances **Example:** Employee D is a nurse who works a large number of nights and weekends, which are paid at a higher rate. Working these times increases their gross earnings for the year. If the employee takes leave on a 'normal day shift', due to the higher gross earnings, they will be paid more for being on leave rather than being at work.	**Moderate**
Employees who decrease their hours significantly **Example:**Employee E is a parent and decreases their hours from 40 hours to 20 hours after working for a year. The simplified formula provides that employees' entitlements are provided in hours and are not reduced if the employee reduces their hours. After one year, the employee's leave balance will remain at 160 hours, rather than being reduced to 80 hours as under current legislation. However, employee D will only be paid for the hours that they would have worked on the day for annual holidays, rather than an average that would have been higher due to working more hours.	**Moderate**
Employees who decrease their hours significantly (as per last example) and employees who work less than 6 months **Example:** Employee F is student who works over summer for 3 months at a fruit shop. Due to the accruing of sick leave, the employee will become entitled to a days' sick leave over summer. Under the current legislation, the employee would not meet the criteria as it requires 6 months' continuous employment.	**Moderate**

Likely net impact on employers
Positive – compliance costs will be in many cases dramatically reduced, with this clarity meaning calculations can be better automated. Direct costs will also be reduced significantly through greater certainty
Areas for further development
- Determine practicality of the proposed formula [technical reference group]. - Examine ways to amend the formula to reduce the detrimental effects on annual holidays [expert panel & technical reference group]. - Examine ways to amend the accrual formula to be more proportionate to employees who work less than 5 days [expert panel & technical reference group].

However, it is important to note that due to the complexity of the current legislation, it is likely many employees are not receiving their full entitlements:

MBIE's estimated economy-wide underpayments

Estimates						
	High		Mid-range		Low	
	Annually	Total (6 years)	Annually	Total	Annually	Total
Per employee	$500	$3,000	$375	$2,250	$250	$1,500
Total workers affected	763,350		479,025		194,700	
Potential total arrears	$382m	$2.290b	$180m	$1.077b	$48.7m	$292m

Examples of underpayments (cases with Labour Inspectorate involvement) – all numbers approximate.

s 9(2)(g)(i)

Annex 2: Talking points for Cabinet, 4 May 2015

Proposal

- I am proposing a review of the holidays and leave calculations in the Holidays Act.

Need for a review

- The current calculations for holiday and leave pay within the Holidays Act are very complex, which results in:
  - high compliance costs for businesses seeking to meet their obligations.
  - inconsistent application and/or miscalculation of entitlements and payments.
  - employers carrying liability for back-pay of up to six years, and being exposed to the substantial costs of auditing and remedying errors
  - negative impacts on employment relationships and labour productivity.

How the review will produce different outcomes to previous reviews

- The Holidays Act was last reviewed in 2009, when a Ministerial Advisory Group was unable to agree on a simplified calculation, due to a view that the calculation may reduce overall entitlements
- I consider that stakeholders' experiences with the Holidays Act calculations since the previous review – particularly the high compliance costs for businesses and the potential for underpayment for employees – provide stronger incentives to find a mutually satisfactory solution.

How the review will operate

- This first part of the review will be carried out by an expert panel made up of employer, employee and legal representatives, with additional support from a technical reference group. The technical reference group will be made up of payroll providers, and will help test the practicality of the options considered by the panel.
- MBIE will work alongside the expert panel, with the options developed by the expert panel contributing to MBIE's discussion document later in the year.

Timing of the review

- A proposed timeline of the review would see:
  - the expert panel's recommendations made by June 2015
  - public consultation in July 2015
  - Cabinet consideration of policy decisions in September 2015
  - introduction of the Bill into the house in December 2015.

Cabinet

CAB Min (15) 14/9

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Minute of Decision

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Review of the Holidays Act 2003 Calculations Provisions: Terms of Reference

Portfolio: Workplace Relations and Safety

On 4 May 2015, following reference from the Cabinet Economic Growth and Infrastructure Committee, Cabinet **deferred** consideration of the submission under CAB (15) 195 until 11 May 2015.

Out of Scope

Reference: CAB (15) 195

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Information provided to Hon Woodhouse 15 September 2015

Holidays Act and payroll implementation issues

Holidays Act and payroll implementation issues could be raised at the Committee of Ministers for State Sector Employment Relations meeting on 16 September.

Background:

- MBIE identified concern of widespread non-compliance with Holidays Act, associated with poor implementation of Act's requirements in payroll systems:
  - could affect between 194,700 and 763,350 employees nationwide
  - most affected employees would be underpaid between $250 and $500 per year
  - could involve $50m to $382m annually in employee underpayments
  - could be between $292m and $2.29b arrears due to employees, nationwide.
- Identification of non-compliance with Holidays Act provisions with NZ Police - $33.35m of arrears (6 years) – likely announcements and media attention on this in the next month.
- State Services Commission work with wider state sector to identify non-compliance. Initial high-level self-audits did not identify large scale issues, but this may change if and when more detailed audits are undertaken.

Labour Inspectorate Payroll Strategy 2015 -2018

Regulator approach to testing & resolving issues within the payroll system

Regulator tests /identifies issues → employers fully investigate & resolve → Regulator signs-off

Audit Programme	Forward compliance Past remediation ↑ understanding of problem	Undertake phased audits of at risk employers. 15 programmed audits in 15/16: ❑ 2 State Sector ❑ 2 Crown Agency ❑ 11 Private Sector Promote self-audits ↑ number in out-years	❑ Subject Matter Experts (Investigating Accountants, Specialist Labour Inspectors) ❑ Employer Support (external Professional Service Providers)
Education	Inform / educate employers & payroll providers	❑ Disseminate information & training to payroll providers, employers & Payroll practitioners	❑ Communications Adviser ❑ Training Manager
Engagement	Transform systems which underpin & support payroll	❑ Progressively building capability & capacity re payroll compliance (people & tools) ❑ Coherent & connected communications ❑ Programme clarification & profile of issues (Business Analyst/IT expertise)	❑ Regulator ❑ Employers ❑ Service providers Payroll Leaders Forum

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HIKINA WHAKATUTUKI

LABOUR INSPECTORATE
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Other work to address issues

- MBIE work to improve the information provided to employers and employees on these issues, and other operational changes.
- Additional funding provided in Budget 2015 allows more support for employers and employees.
- Work on proposals for a review of the way leave is calculated under the Holidays Act 2003 was undertaken in early 2015, however a review was not progressed with at this time.

- MBIE continues to be of the view that a review of the way leave is calculated under the Holidays Act 2003 could be beneficial and reduce business costs while providing greater certainty that employees receive their full entitlements.
- However any 'simplified' approach to leave pay would likely give rise to scenarios in which certain employees would be disadvantaged compared to the status quo. Any review would involve a high level of complexity both technically and in terms of stakeholder management, and would need substantial policy work and consultation.