

The Holidays Act will proposed changes solve the headaches?

Abstract

More than 200 organisations across New Zealand have been found non-compliant with the Holidays Act since its enactment in 2003. Thousands of employees have been underpaid by a combined amount in the millions and employers have incurred significant costs to remediate and maintain compliance. This article considers the issues with the Act, the impacts, and whether the changes proposed by the Holidays Act Taskforce will address these issues. It then sets out an alternative approach.

Keywords Holidays Act, legislative reform, risk remediation, non-compliance

In 2003 a new Holidays Act came into force in New Zealand. It was intended that the new Act would remove the confusion surrounding entitlement to and payment of holidays and leave that had been laid out under the previous, 1981 Act (Muir and Sandlant, 2000). However, despite the intent of the reform, the changes increased complexity of application, employer costs and non-compliance

(Department of Labour, 2009). Numerous attempts have since been made to find a solution, including the establishment of a ministerial advisory group in 2009 resulting in recommendations and an amendment to the 2003 Act in 2010, the creation of several joint industry–government payroll sector leadership workstreams in 2016, and, most recently, the establishment of a Holidays Act Taskforce in 2018 (Minister for Workplace Relations and Safety, 2018; Employment New Zealand, 2021b). The government released the taskforce’s final report in February 2021, 16 months after it was written and 19 months after it was due (Ministry of Business, Innovation and Employment, 2018; Wood, 2021). What are the issues with the 2003 Act? Why does it matter? And will the taskforce’s recommended changes solve the current issues?

The issues

At a high level there are two key issues with the current legislation: it is ambiguous, and it is hard to apply in today’s workplace (Holidays Act Taskforce, 2018a).¹

Ambiguity

Although the 2003 Act sets out the minimum entitlements to each leave type and the payment method required, there is ambiguity in both the way entitlements should be provided and the way that leave should be paid. Specific examples include:

- whether four weeks of annual leave should be provided under section 16 or annual leave be paid out at 8% of gross earnings under section 28 because the employee works so ‘intermittently and irregularly’ that it is ‘impracticable’ to determine a week;
- defining ‘a week’ for employees whose working weeks change regularly, to enable determination of payment for, and entitlement to, annual leave;
- whether ordinary weekly pay should be calculated per section 8(1) or 8(2) – this depends on whether it is ‘possible’ to apply section 8(1);
- what is ‘regular’ for the purposes of calculating ordinary weekly pay under section 8(1);
- defining ‘a day’ for employees who do not have a fixed working day, to enable determination of payment for bereavement leave, alternative leave, public holidays, sick leave and family violence leave (collectively ‘BAPS’ leave);
- determining an employee’s relevant daily pay, being ‘the amount of pay that the employee would have received had they worked’, for BAPS leave payments per section 9;
- whether relevant daily pay or average daily pay should be used to calculate BAPS leave: average daily pay may be used, per section 9A, if it is not ‘possible or practicable’ to determine an employee’s relevant daily pay or the employee’s daily pay varies within the pay period when the holiday or leave falls;
- whether an employee is entitled to payment for a public holiday if the day was not worked or accrual of an alternative day of leave if the public holiday was worked – this depends on whether the day would ‘otherwise be a working day’ for the employee per sections 49 and 56;
- what should and should not be included in gross earnings, as is required to calculate average weekly earnings, average daily pay, ‘accrued’ annual leave on termination and pay-as-you-go holiday pay per the Act. (Holidays Act Taskforce, 2018b)

Some of these issues have been considered by the courts and the Employment Relations Authority, including most recently in October

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2021, where the Court of Appeal overturned the Employment Court decision regarding short-term incentive payments. The Court of Appeal found that where an incentive scheme explicitly gives an employer discretion as to whether an incentive payment is made, those payments are discretionary payments and therefore do not need to be included in gross earnings (*Metropolitan Glass & Glazing Limited v Labour Inspector, Minister of Business and Innovation and Employment* [2021] NZCA 560).

Application in today’s workplace

The ambiguous wording of the 2003 Act would not be a challenge were it not for the flexible working arrangements that exist in today’s workplace and the volume of employees in organisations requiring employers to adopt systemised payroll functions. The ambiguity as a result of flexible working arrangements is at odds with the way in which payroll systems operate.

A payroll system is rule-based and requires that a configuration be established to deal with each variable. The judgement

required to apply the 2003 Act to flexible workers – for example, defining ‘a day’ and a ‘relevant day of pay’ – means manual intervention and monitoring is needed to enable correct leave calculations. For organisations with thousands of employees, this is a resource- and time-intensive process that may come at the expense of performing more value-adding activities.

Contractual solutions, for example smoothed-salaries, have been implemented by some organisations to increase ease of systemisation, but this may not always be an option as agreement with employees is required (Holidays Act Taskforce, 2018b). Other employers have dealt with the inability to systemise the 2003 Act by adopting the pragmatic approach of providing over and above the legislative requirement, for example, paying for annual leave at the higher-of ordinary weekly pay per section 8(1), ordinary weekly pay per section 8(2) and average weekly earnings. This is costly but is the approach with the lowest risk of non-compliance and has the associated benefit of reduced monitoring costs.

The impact

Hundreds of New Zealand organisations have been identified as being non-compliant with the 2003 Act, resulting in thousands of employees being underpaid for annual and BAPS leave and costly remediation programmes (Employment New Zealand, 2021a).

Employee underpayments

The Ministry of Business, Innovation and Employment is responsible for regulating compliance with the 2003 Act and does so through its Labour Inspectorate. Monitoring efforts have significantly increased since instances of non-compliance were identified in 2014 within government departments, namely the New Zealand Police and the ministry itself (Edwards, 2016). Another boost to monitoring efforts came in 2017, after the Labour government increased funding for the inspectorate in response to a growing media and public outcry about the treatment of migrant workers, including non-payment of holiday pay (Donovan, 2017). By June 2020, 201 payroll audits had been completed by the Labour Inspectorate, 171 enforceable undertakings and 42 improvement notices

had been issued and five organisations had been referred to the Employment Relations Authority (Employment New Zealand, 2021a). In addition, 112 employers had paid \$237,700,000 in arrears to 227,300 employees, with an average payment amount of between \$29 and \$16,200 per employee (ibid.).

Underpayments have generally been greater and more prevalent for waged employees, who are often lower paid and thus for whom the payment is more significant. This is due to the variability of waged employees' working patterns and, thus, ambiguity with respect to the applicable calculation type and definition of some of the key terms in the 2003 Act. Additionally, employers often incorrectly exclude overtime and allowances, which make up a large proportion of some waged employees' pay, from relevant daily pay and ordinary weekly pay calculations.

The number of organisations yet to be identified as non-compliant and thus the number of employees, who have been underpaid for leave is unknown but is expected to be significant, given the number of enforceable undertakings and improvement notices issued as a percentage of audits carried out to date (Employment New Zealand, 2021a).²

Employer remediation and compliance costs

In order to rectify any previous non-compliance with the 2003 Act, organisations have been required to recalculate all employees' instances of leave for six years from initial identification of non-compliance until their systems and processes enable compliance (Employment Relations Act 2000, s131). The Labour Inspectorate has been clear that an estimation method is not acceptable and that every instance of leave must be recalculated when it is possible to do so (Labour Inspectorate, 2017).

Sequential recalculation is required due to the impact that underpayments have on calculations in periods that follow. It is noteworthy that overpayments may not be excluded from leave instances that follow unless the employer consults with the employee. Additionally, overpayments cannot be unilaterally deducted from an employee's pay (Labour Inspectorate, 2018).

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Due to the complexity of remediation programmes, most organisations have required external help with remediation. This has been expensive, with remediations costing between a few thousand and a few million dollars depending on the number of employees, years of remediation, quality of data and complexity of the working arrangements of employees. In addition, organisations have incurred significant costs to reconfigure payroll systems and implement processes and contractual solutions to enable them to be compliant going forward.

The answer

Proposed change

The taskforce's final report made 20 key recommendations for changes to the 2003 Act, all of which have been accepted by the government.

The recommendations address many of the ambiguities in the 2003 Act: for example, more guidance is given on how 'a week' and a portion of a week should be determined for annual leave payment and entitlement (Wood, 2021). Subjectivity has been removed with respect to selecting calculation types, with employers now required to pay the higher of three calculation types for annual leave and two calculation types for BAPS leave (ibid.). The definition of 'gross earnings' has been revised and is now simpler to interpret and apply; a more prescriptive and systemisable definition of an 'otherwise working day' has been added, and 'intermittent or irregular' now has a clearer definition making it easier to determine who can be paid pay-as-you-go holiday pay rather than given an annual leave entitlement (Holidays Act Taskforce, 2021). Additionally, the 'higher of' approach and the removal of the parental leave override will result in it being very unlikely for employees to receive less on a day of leave than for worked days.

However, many of the changes will not remove ambiguity and could cause further confusion and inconsistency in application: for example, the removal of ordinary weekly pay and relevant daily pay and their replacement with ordinary leave pay (ibid.). Currently, ordinary weekly pay and relevant daily pay are difficult to calculate due to the judgement or prediction required. Ordinary leave pay will require the same level of judgement and prediction, with allowances and incentive or commission payments that employees would have received if they had worked for the relevant period needing to be included in the calculation. It is likely that averaging of these payments will be required to determine the incentive or commission payments and therefore that the calculation will be very similar to the 13-week average weekly earnings calculation, rendering the ordinary leave pay calculation superfluous, especially given its complexity. Furthermore, the introduction of calculation types with units that are inconsistent will create additional confusion. Ordinary leave pay is defined in hours, whilst averaging calculations are defined in weeks for annual leave and in days for BAPS leave. This inconsistency will require organisations to define leave in

hours, days and weeks in order for the calculations to be applied and a comparison made to determine the amount owed.

An alternative approach

Commentators have suggested simplification through the adoption of one formula for all leave types, and that the new Act enable calculation and accrual of leave entitlements in the unit that best suits the workplace (Simpson Grierson, 2020). The suggested changes lack detail, but at a high level would address both the ambiguity issue by removing choice in the calculation option and the applicability issue by allowing the organisation to use the unit that works best in their workplace. However, the removal of a 'higher of' approach would result in instances where employees would receive less than they would under the existing legislation, which could result in stakeholder challenge and dissatisfaction.

Given the key issues, a new or amended Holidays Act should be simple, 'systemisable' and uniformly applicable to the variety of ways in which employees work, and it should not disadvantage employees when compared to the 2003 Act or when compared to their ordinary week or day of pay. One way this could be achieved is with an hours- and accrual-based approach, where all leave types are paid at the higher of the employee's base hourly and average hourly rate for each hour of leave taken. All employees would then accrue annual and sick leave based on hours worked and would be entitled to not less than 8% of their hours worked for annual leave and not less than 2% of their hours worked for sick leave.

An hours- and accrual-based approach would mean 'a week' and 'a day' do not need to be defined, and would remove ambiguity in determining whether annual leave entitlements should be provided or annual leave be paid out with employees' pay. It is important to note that 8% and 3% have been suggested to keep alignment with the annual entitlements of four weeks of annual leave and ten days of sick leave

A new Act that adopts the recommendations of the taskforce will not be simple, 'systemisable' or uniformly applicable to the variety of ways in which employees work, and thus unintentional non-compliance is likely to continue and compliance costs will remain high.

as is currently provided for by the 2003 Act, but alternative percentages could be adopted instead. An approach based on hours also enables easy application in today's workplace, hours being the unit usually used in a payroll system. Reducing the number of calculation types from five to two and applying the same two calculation types to all employees and leave types removes complexity and subjectivity in determining which calculation to apply. A 'higher of' approach means employees are unlikely to be disadvantaged by the change in legislation, a weakness of a one-

calculation approach. The simplicity of base hourly rate and average hourly rate means systemising the calculations would be possible with no need to, for example, determine what the 'employee would have received had they worked'.

Conclusion

There are problems with the 2003 Holidays Act that are costing New Zealanders. Employees are being underpaid when they take leave and employers are incurring significant costs to remediate and maintain compliance. Change is required.

The Holidays Act Taskforce's proposed changes will not suffice. A new Act that adopts the recommendations of the taskforce will not be simple, 'systemisable' or uniformly applicable to the variety of ways in which employees work, and thus unintentional non-compliance is likely to continue and compliance costs will remain high.

A new two-calculation, hours- and accrual-based approach provides the answer. This approach would see all leave types paid at the higher of an employee's base hourly and average hourly rate for each hour of leave taken. An employee would then accrue annual and sick leave based on hours worked and would be entitled to 8% of their hours worked for annual leave and 3% for sick leave. This approach would take away the ambiguity that has plagued the various Holidays Acts since inception, and would be easily applied to payroll systems and the various ways in which employees work. Importantly, it would also mean employees would not be disadvantaged by taking leave, with a 'higher of' approach being adopted for all leave types.

- 1 It is important to note that while the focus of this article is on unintentional non-compliance as a result of the ambiguity and difficult application of the legislation, intentional non-compliance has been reported and is often associated with the exploitation of migrant workers in conjunction with violations of the Minimum Wage Act and other employment standard legislation (Collins and Stringer, 2019).
- 2 The number of enforceable undertakings issued is greater than the number of audits undertaken due to a number of employers identifying non-compliance with the 2003 Act prior to the Labour Inspectorate making contact. These employers signed an enforceable undertaking without an audit report being produced.

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