



COVERSHEET

Minister	Hon Brooke van Velden	Portfolio	Workplace Relations and Safety
Title of Cabinet paper	Holidays Act Reform: Further Policy Decisions	Date to be published	19 June 2024

List of documents that have been proactively released

Date	Title	Author
May 2024	Holidays Act Reform: Further Policy Decisions	Office of Workplace Relations and Safety Minister
10 May 2024	Regulatory Impact Statement: Holidays Act reform – Further Policy Decisions	MBIE
22 May 2024	Holidays Act Reform: Further Policy Decisions – Minute of Decision ECO-24-MIN-0081 Minute	Cabinet Office
21 Dec 2023	Holidays Act Review: background, progress and next steps	MBIE
28 Mar 2024	Holidays Act Review: Policy decisions for an exposure draft of the Bill	MBIE

Information redacted

YES

Any information redacted in this document is redacted in accordance with MBIE's policy on Proactive Release and is labelled with the reason for redaction. This may include information that would be redacted if this information was requested under Official Information Act 1982. Where this is the case, the reasons for withholding information are listed below. Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Some information has been withheld for the reasons of privacy of natural persons, confidential advice to Government, free and frank opinions, and legal professional privilege.

Note: updated version published 27 February 2025



BRIEFING

Holidays Act Review: background, progress and next steps

Date:	21 December 2023	Priority:	Medium
Security classification:	In Confidence	Tracking number:	2324-0982

Action sought		
	Action sought	Deadline
Hon Brooke van Velden Minister for Workplace Relations and Safety	Agree to meet with officials to discuss options for how to proceed with the Holidays Act Review.	26 January 2024

Contact for telephone discussion (if required)				
Name	Position	Telephone		1st contact
Alison Marris	Manager, Employment Standards Policy	04 901 8564	Privacy of natural persons	✓
Anna Spencer	Principal Advisor, Employment Standards Policy	04 9013909		

The following departments/agencies have been consulted
N/A

Minister's office to complete:

Approved

Declined

Noted

Needs change

Seen

Overtaken by Events

See Minister's Notes

Withdrawn

Comments



BRIEFING

Holidays Act Review: background, progress and next steps

Date:	21 December 2023	Priority:	Medium
Security classification:	In Confidence	Tracking number:	2324-0982

Purpose

To provide you with background to the Holidays Act 2003, the work underway to improve the legislation and the basis for a discussion on how to proceed with that work.

Executive summary

The Holidays Act 2003 (the Act) is a core part of the employment relations and standards regulatory system. It sets out minimum leave entitlements and payments that employers are obliged to provide to their employees.

The Act is difficult for employers and payroll providers to apply in practice. This, combined with poor payroll and business system practices, have contributed to systemic compliance issues with the Act that have been well known since 2012. Large-scale remediation payments, running into billions of dollars, have been made across both the public and private sectors.

The Act was designed to accommodate diverse working and pay arrangements through flexible regulatory design, enabling employers to adopt a range of approaches to meeting their obligations. In practice however, this flexibility means that employers lack certainty about how to correctly calculate leave entitlements and pay. Employers must often apply their best judgment or reach agreement with employees based on the specific facts of the situation each time leave is taken, especially in situations where working arrangements and pay structures are not the same every week.

The Act's predominantly principles-based approach contrasts with a rules-based approach that would provide precise calculations and formulas, definite answers about leave entitlements and pay and be easier to implement in digital payroll systems.

In March 2020, Cabinet endorsed in full the 22 recommendations for improvements to the Act made by a tripartite Holidays Act Taskforce. The recommendations retain the underlying framework of the Act (which provides entitlement after specified periods of employment to weeks of annual leave and days of other types of leave) and include:

- i. prescriptive methodologies, calculations and definitions
- ii. improved access to some leave entitlements
- iii. some increases to minimum leave payments
- iv. improved transparency and clarity around some processes.

MBIE has completed a detailed policy design process with a stakeholder working group to design the technical details required to implement the recommendations in legislation. The previous Minister for Workplace Relations and Safety agreed to a number of adjustments to address areas where the working group identified ambiguities, gaps and opportunities for simplification. The Parliamentary Counsel Office (PCO) began drafting a Bill to implement the recommendations, but drafting work has been on hold since June 2023 to allow PCO to focus on Bills that were progressing prior to the 2023 General Election.

You have options in the following areas about how to proceed with the Holidays Act Review:

- *The priority for this work:* Progressing this work in your future work programme will require dedicated MBIE policy and legal resources and PCO drafting resource.
- *The policy direction in which to proceed:* Options include proceeding with the Taskforce's recommendations in full or considering alternative options that might go further to reduce complexity or minimise compliance costs for example (and which may or may not align with the Taskforce's recommendations).
- *The steps in the legislative process:* You could progress a Bill straight to introduction or issue an exposure draft first to test the policy direction and technical details.

We recommend:

- giving a high level of priority to completing work to reform the Holidays Act to resolve the longstanding issues and their ongoing impacts (consistent with the Coalition Government's commitment to improve the quality of regulation);
- exploring alternative options that maintain broad alignment with the Taskforce's recommendations, but go further than what has been within scope for the policy design work to date (nominated representatives of both BusinessNZ and the New Zealand Council of Trade Unions (NZCTU) have indicated a willingness to do this); and
- issuing an exposure draft of the Bill to gain wider stakeholder feedback on the policy direction and technical details before final policy decisions are made and the parliamentary part of the process commences (consistent with National and ACT's coalition agreement commitment to ensure regulatory decisions are based on the principles of good law-making).

We look forward to discussing the next steps for this work with you in more detail. We will then be able to provide more detailed advice on your chosen option.

Recommended action

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

- a **Note** that, as Minister for Workplace Relations and Safety, you are responsible for administering the Holidays Act 2003 (the Act).

Noted

- b **Note** that there has been widespread (often unintentional) non-compliance with the Act, which has resulted in significant economic impacts and that, along with problems with the implementation of the Act, the design of the legislation makes it difficult to apply in practice.

Noted

- c **Note** that:

- i. in March 2020, Cabinet agreed to endorse in full the 22 recommendations of the Holidays Act Taskforce for improvements to the Act
- ii. MBIE has completed a policy design process, and
- iii. the Parliamentary Counsel Office commenced work on drafting a Bill but this work is currently on hold.

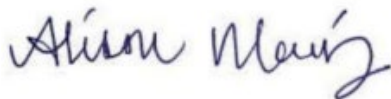
Noted

- d **Note** that you have options on how to proceed with the Holidays Act Review including what priority to give the work, the policy direction to take (proceeding with the current set of recommendations and/or considering alternative ways of addressing all or some of the difficulties with the Act) and the steps in the legislative process.

Noted

- e **Agree** to meet with officials to discuss next steps for the Holidays Act Review.

Agree/Disagree



Alison Marris
**Manager, Employment Standards
Policy**
Labour, Science and Enterprise, MBIE

21 / 12 / 2023

Hon Brooke van Velden
**Minister for Workplace Relations and
Safety**

..... / / 2023

Background to the Holidays Act 2003 and the impact of non-compliance

1. As Minister for Workplace Relations and Safety you are responsible for the Holidays Act 2003 (the Act). The purpose of the Act is to promote balance between work and other aspects of employees' lives. It sets out an employee's minimum entitlements to annual holidays (in weeks) and public holidays, sick, bereavement and family violence leave (in days), and the payments for them that employers are obliged to make. The Act also covers issues such as annual closedowns for businesses, transferring public holidays and 'cashing up' one week's annual holiday.
2. The Act is one of the core foundations of the employment relations and employment standards (ERES) regulatory system, placing rights and obligations on every employer and employee. There is significant opportunity for improvements to the Act to ensure it is, and remains, fit-for-purpose in the context of modern and constantly evolving working arrangements and is responsive to business needs. This includes resolving tensions in the current balance between the core regulatory objectives for the ERES system of flexible regulatory design, worker protection and certainty for regulated parties.
3. In our Briefing to the Incoming Minister for Workplace Relations and Safety, we recommended that work to reform the Holidays Act be accorded a high level of priority in your future policy work programme [2023 1030 refers].

The Act was intended to accommodate increasingly diverse work patterns through flexible regulatory design...

4. The Act sought to address criticisms that the Holidays Act 1981 was complicated, difficult to understand and apply and, being predicated on a 40-hour Monday-to-Friday working week, did not reflect changes in working and pay patterns that had occurred in the intervening years.
5. The Act retained the underlying leave entitlement system in the previous 1981 Act (based on weeks for annual holidays and days for other types of leave which are provided after specified periods of employment) but was designed to accommodate diverse working and pay arrangements through flexible regulatory design. There are several areas in the Act where employers can adopt a range of approaches to meet their legal obligations, and/or where employers and employees must agree how entitlements will be provided (such as determining what a week means for each individual employee).
6. The Act is based on two key principles relating to entitlements and pay.
 - i. That entitlements are determined in relation to the work pattern at the time leave is taken.
 - ii. That employees should not be financially disadvantaged by taking leave, that is, they should be paid (at least) what they would have earned had they worked.

...but does not provide the certainty and clarity that employers and employees need

7. The Act's largely principles-based approach to expressing the rules contrasts with a prescriptive, rules-based approach, which is strongly supported by many stakeholders (particularly employers and payroll providers). Rather than providing choices for calculating entitlements, a rules-based approach would provide precise calculations and formulas that would give a single 'correct' answer as to what the minimum entitlement and pay is in all situations.
8. The principles-based approach is generally straightforward to apply when work and pay arrangements are consistent and predictable. The flexible design of the Act's provisions is more difficult to apply when hours of work vary between weeks and days and when pay

structures include variable components such as commission and allowances. In these cases, employers have to use their best judgement on how to apply the principles based on the specific facts of an employee's working and remuneration arrangements, and a number of provisions require the agreement of employees each time leave is taken.

9. A number of the specific terms, calculations and processes included in the Act also lack clarity and have been a feature of a significant body of litigation related to the Act.
10. The result in practice is that:
 - employers lack certainty that the way they have calculated leave entitlements and pay meets their minimum obligations and employees have difficulty understanding whether they have received their statutory entitlements;
 - the Act is difficult to implement in payroll systems due to the number of circumstantial judgments and agreements required;
 - there are high compliance costs for employers, particularly those with large numbers of employees who have variable work and pay arrangements;
 - issues related to the implementation of the Act are a significant driver of demand for employment support services.

Systemic compliance issues with the Act have been well known since 2012

11. The challenges with applying the legislation, combined with payroll systems that are incapable of supporting compliance or not correctly configured by employers, and poor business processes (for example inaccurate record-keeping), have contributed to widespread (often unintentional) non-compliance with the Act.
12. Systemic compliance issues with the Act first came to light in 2012 in a case involving BP Oil. MBIE's engagement with key payroll providers and employers in 2014 indicated that problems with implementing the Act were likely to be widespread. A targeted review of the Act was proposed in 2015 based on attempting to resolve differences between employer and employee representatives but Cabinet decided not to proceed. The differences in opinion centred around the fact that some employees and employers were likely to be worse off if changes to the Act were implemented.
13. MBIE was asked to look for solutions within the current legislative framework and between 2015 and 2018 the Labour Inspectorate delivered a payroll strategy to address implementation issues. The programme of work focussed on remediation of historical underpayments, industry and sector engagement and better provision of information and education to employers and employees. While this has helped with implementation of the current Act and created greater awareness of what is required to comply, the extent of improvements has been constrained by the problems with the legislation and the difficulty of systematising entitlements and payments.
14. Many stakeholders remain unhappy with the current situation as the uncertainty about exactly what is required to be compliant persists. In Simpson-Grierson's 2023 pre-election survey 63 percent of employers selected Holidays Act simplification as their top priority for an incoming government to address, as was the result of the previous four pre-election surveys.

The economic impact of Holidays Act issues is significant

15. The significant and widespread underpayment of employee leave entitlements has resulted in large-scale remediation payments across both the public and private sectors, running into billions of dollars. As of June 2020 (when funding for the dedicated Labour Inspectorate

payroll audit and investigations team ceased)¹, 112 New Zealand employers (who had at least 20 employees and an electronic pay system) had made remediation payments to a total of 227,300 employees, amounting to a sum of \$237.7 million². Over 95 percent of employers assessed by the Labour Inspectorate were found to be non-compliant, and in different organisations arrears have ranged from an average of \$29 to \$8,000 per affected employee.

16. This figure does not include remediation payments due to health and school sector employees, New Zealand's two largest payrolls.
 - In April 2023 Te Whatu Ora Health New Zealand estimated 270,000 current and former employees were owed a combined total in the vicinity of \$2.235 billion. Te Whatu Ora's remediation project is expected to be completed in 2024/2025.
 - The Ministry of Education (MoE) is undertaking Holidays Act remediation on behalf of 2,500 schools and for around 200,000 current and former employees across 400,000 roles. MoE made its first remediation payment of \$38.5 million to 83,000 school employees in June 2023, focused on payments for sick leave, public holidays, bereavement leave and family violence leave. Further remediation payments are in progress and total liability is estimated at around \$500 million. This figure excludes payments for annual holidays for teachers, for which the remediation amount is yet to be determined.
17. Enquiries related to the Holidays Act drive demand for employment support and dispute resolution services in the ERES system:
 - Between July 2019 and February 2023, the proportion of monthly calls related to leave and holidays received by the MBIE Service Centre employment line each month ranged from approximately 15 percent to 37 percent. Enquiries tend to spike during public holiday periods such as Christmas/New Year and Easter.
 - Since 1 July 2018, the proportion of complaints received each year by the Labour Inspectorate involving holidays and leave issues has ranged from 36 to 59 percent. A greater proportion of investigations have involved Holidays Act issues (80 percent in 2022/2023).
 - A study of 2021 Citizens Advice Bureau enquiries found employment was the second largest area for which people sought help. About 55 percent of employment enquiries related to "employment conditions", of which half were about pay and leave issues.
 - Community Law Centres reported holiday pay enquiries comprise around four percent of their work in the 2022/2023 year.

Work commenced in 2018 to address the issues with the Act

A tripartite taskforce was established to suggest improvements to the Act

18. In May 2018, following a joint request from BusinessNZ and the NZCTU, Cabinet agreed to establish a tripartite Holidays Act Taskforce (the Taskforce) comprised of government, business, and union representatives to suggest improvements to the Act [CAB -18-MIN-0250]. The Taskforce's objectives and parameters are included in Annex Two.

¹ From June 2020, after which dedicated funding was no longer available, the Labour Inspectorate withdrew from ongoing involvement in a number of payroll cases before the employer had completed its remediation process (for example where an employer had calculated but not yet paid arrears and the Inspectorate had confidence that the employer was committed to, and capable of, completing its remediation). As a result, from 1 July 2020 the Inspectorate does not have a complete record of all of the arrears that have been paid by some of the larger employers.

19. The Taskforce was provided scope to design a system for providing and paying leave entitlements that could be fundamentally different from the current system (where weeks and days of leave entitlement arise after specified periods of employment). It was also required to preserve current levels of entitlement and the intent of the principles set out in paragraph 6 as far as possible. In addition to considering options to improve the provision of, and payment for, entitlements, the Taskforce's parameters extended to considering any other matters related to the Act that it saw fit.
20. The Taskforce undertook its review in three distinct phases:
 - i. **Understanding the issues with the Act.** This included publishing an issues paper to seek input from businesses, payroll practitioners and providers, employee representatives and individuals.
 - ii. **Developing and testing options to address the issues identified.** The testing was conducted by an external provider with expertise in payroll matters and using bona fide payroll data across a wide range of working arrangements.
 - iii. **Confirming preferred options and finalising recommendations.** This involved assessing the options developed by the Taskforce against a range of criteria, consulting with a select group of payroll providers, and confirming the final recommendations in a report provided to the Government in October 2019.

Cabinet agreed to endorse the Taskforce's 22 recommendations in full

21. The Taskforce reached agreement on an improved status quo model for calculating leave entitlements and pay, where entitlements continue to be provided after specified periods of employment and the existing units of entitlement are retained (in weeks for annual leave and days for other types of leave). The recommendations address a wide range of issues that were identified through the first phase of the review and can be grouped in four areas as follows:
 - i. Prescriptive methodologies, calculations and definitions to address the current lack of certainty about how to calculate and pay leave entitlements.
 - ii. Improved access to some leave entitlements, to address issues identified by some stakeholders related to the 12 month (annual leave) and 6 month (other forms of leave) waiting periods for employees to be able to take leave.
 - iii. Some increases to minimum leave payments for some employees, to address financial disadvantages some employees may experience when they take leave.
 - iv. Improved transparency and clarity around some processes to ensure employees are able understand their leave entitlements and pay.

The recommendations are summarised in more detail in Annex One.

22. In March 2020, Cabinet endorsed the Taskforce's 22 recommendations in full, as the basis for a substantially amended Holidays Act [CAB-20-MIN-0100]. The Government announced this decision in February 2021 (following a delay due to Covid-19).

MBIE has completed a detailed policy design process with a range of stakeholders

23. When Cabinet endorsed the Taskforce's recommendations, it noted that the complexity of the existing legislation and the proposed amendments to it meant further detailed policy design work would be required to implement them in legislation.
24. MBIE completed the detailed policy design work during 2021 – 2022. To support this process MBIE brought together a working group of stakeholders that included payroll system

providers and payroll practitioners working for public and private sector employers. The group contributed their insights into the practicalities of implementing the recommendations in payroll systems, and across a variety of complex employment environments.

25. The working group identified some areas of the Taskforce's recommendations that would benefit from greater clarity, some areas where there were gaps, and some where there were opportunities for simplification and to enhance their workability and implementation readiness for payroll systems.
26. MBIE also continued to engage with nominated representatives of the NZCTU and BusinessNZ during the policy design process on the development of solutions to the issues identified, and the tripartite consensus has been maintained.
27. The previous Minister for Workplace Relations and Safety agreed to a number of refinements, adjustments and additions to the recommendations. In accordance with the authority delegated by Cabinet, the agreed changes address technical issues identified and simplify them where possible but do not depart from the underlying intent of the Taskforce's recommendations.

The Parliamentary Counsel Office has begun drafting a Bill

28. Drafting a Bill that accurately reflects the policy intent of the changes, correctly captures the technical details of the calculations, reconciles the changes with the existing provisions of the Act, and is accessible for users is a highly technical process.
29. MBIE issued the first set of drafting instructions to the Parliamentary Counsel Office (PCO) in July 2022. Following this, PCO began drafting the "Employment (Leave Entitlements) Bill" (the Bill) which would repeal and replace the Act. Legal professional privilege
[REDACTED]
[REDACTED] As part of this process, MBIE shared the Bill with the nominated representatives of BusinessNZ and the NZCTU for targeted consultation on the technical aspects of the Bill and to ensure the details reflected the policy intent.
30. Drafting was put on hold in June 2023 to allow PCO to focus on Bills that were progressing prior to the 2023 General Election. The Bill remains incomplete and there are several drafting and technical issues yet to be resolved. Progressing a Bill to a complete and settled state will require dedicated policy, legal and PCO resources.

You have options about how to proceed with this work

31. We welcome the opportunity to discuss the Holidays Act Review with you in more detail, so that we can understand how you would like to progress this work. The section below sets out some areas for initial consideration and discussion.

The priority to be given to progressing work on reforming the Holidays Act

32. It would be useful to discuss the priority of this work with you, relative to other aspects of your policy work programme. The Coalition Government's agreements state that a priority for this term is improving the quality of regulation. Given the impact of the longstanding issues with the Act (discussed in paragraphs 11-17 above) on all employers and employees, we recommend that progressing legislative changes to improve the Holidays Act be given a high level of priority in your future work programme.
33. Progressing a Bill will require prioritisation of MBIE policy and legal resources and of PCO drafting resource. Without this, it will not be possible to produce new legislation that is fit-for-purpose and provides a certain regulatory environment while striking an appropriate balance with regulatory flexibility and worker protection.

Policy direction

34. You have options in terms of how to proceed in relation to the policy settings. There are several considerations for you in deciding on the direction in which you wish to proceed which are discussed in more detail below. In summary, the options include:
- a. *Proceed with existing Taskforce's recommendations:* This would involve completing the Bill based on the existing recommendations. While still requiring significant work before introduction, this option would deliver the fastest progress. It would not, however, provide opportunity to consider improvements that might lead to better long-term outcomes.
 - b. *Explore alternatives that align with the Taskforce's recommendations:* Under this option, we would consider alternative options for reducing complexity or minimising compliance costs (for example), while broadly aligning with the recommendations and retaining the underlying entitlements model. Examples include considering a weeks-based accrual system for annual leave; consolidating some of the payment methodologies and simplifying the new framework for using 'pay-as-you-go' for annual leave.
 - c. *Explore alternatives outside the Taskforce's recommendations:* This option would consider alternatives to the recommendations that represent a fundamentally different model for providing and paying leave entitlements (such as an hours-based entitlement accrual system for annual leave). This option would allow for new solutions to address issues. However, it is likely to be complex, would take the most time to progress, and tripartite consensus may be challenging.
35. We recommend exploring option b as a first step, while ensuring there are opportunities to test other options with stakeholders (including option c), for example through an exposure draft consultation on the Bill (discussed further below).

There are opportunities to simplify the recommendations and reduce compliance costs for employers

36. Cabinet set eight objectives for the Taskforce in its Terms of Reference (Annex Two). The Taskforce focussed particularly on providing greater clarity and certainty through the provision of detailed processes and prescriptive methodologies and on protecting employee entitlements. It focussed less on others, such as simplifying the Act and minimising compliance costs for employers.
37. The prescriptive methodologies and detailed processes the Taskforce recommended will add more certainty to the regulatory environment but also result in an inevitable amount of complexity. The policy design and drafting process has further highlighted the extent of the complexity and the challenges of implementing the recommendations in a way that provides clarity and is easy to understand and use for all stakeholders. While providing more certainty, there is a risk that the level of complexity in the draft Bill will present future implementation and compliance challenges for employers.
38. The balance struck between objectives is likely to be a contentious aspect of the Bill. During the Taskforce's consultation processes, many stakeholders (particularly employers and payroll providers) raised concerns about the level of complexity and therefore the extent to which the proposals would address the underlying issues the Act poses. This has continued to be a theme through the design process.

39. The recommendations also involve compliance costs for employers (refer to Annex Three for more detail on the financial implications). Despite refinements to simplify some key areas of concern,³ the changes required to payroll systems are still likely to be significant. The recommendations also include some increases in access to entitlements and leave payments. Compliance requirements and costs will vary depending on situation-specific factors such as employer size, the types and complexity of working arrangements and pay structures, the nature of the payroll system used and whether dedicated payroll professionals are part of staff.
40. There is potential for further modifications or alternatives to some of the Taskforce's recommendations to simplify the changes to the Act and better address the associated risks. Options b or c would both provide opportunity to consider other options for change that would achieve more balance between the Taskforce's objectives than the currently agreed package of changes.

Maintaining consensus between business and union representatives

41. Cabinet asked the Taskforce to aim to provide jointly agreed recommendations. In 2019, the Taskforce would not have reached consensus on any recommendations that moved away from the underlying framework of the Act (based on leave entitlements provided after set periods, and measured in weeks and days).
42. Employee representatives are likely to continue to oppose a fundamentally different basis for providing leave entitlements, such as an hours-based accrual model that many employers and payroll providers have suggested could provide a simpler model (option c). Their opposition is driven by the potential impacts on the principles of the current Act (set out in paragraph 6) and therefore the current level of worker entitlements the Act provides.
43. During the election period we have continued our engagement with BusinessNZ and NZCTU's nominated representatives on the Bill. BusinessNZ is supportive of an exercise to review whether the 2019 recommendations represent the best solution to the issues. Given the challenges highlighted during the policy design and drafting processes, both they and NZCTU representatives have given an initial indication that they are willing to consider alternative options that broadly align with the recommendations (option b). These options would retain the current units of entitlement and the underlying framework of the Act but better balance the changes across the objectives Cabinet set for the Taskforce (particularly by reducing the overall level of complexity).

Considering other options for change will take time to progress

44. Options b or c would require more time to progress than option a. They would involve policy development and Cabinet processes, issuing of new drafting instructions, and potentially significant redrafting work by PCO (noting however that work to complete the Bill within the current policy decisions is also significant). Option c is likely to require the most time as it requires development of a fundamentally new model for providing and paying leave entitlements and could also be complex. A robust design and testing process would be required to mitigate the risk of new, unforeseen ambiguities and challenges.
45. Taking more time on the policy process now does mean the challenges of the current Act will remain for longer. Until new legislation comes into force employers need to comply with the current Act and, like historical underpayments, will become liable to remediate employees for any underpayments during that time. However, taking longer on the development of solutions

³ For example, provision of flexibility around the 13-week reference period recommended for a number of calculations and providing ability to calculate hours to be assigned to a day of leave using an average over all days of work rather than specific calendar days. Stakeholders suggested that implementing these requirements may involve significant and costly payroll system changes, especially for small businesses.

now is more likely to achieve the desired outcomes and reduce compliance costs in the longer term.

46. As a balance between taking time to get it right and immediately progressing changes to improve the legislative framework, we recommend option b as a practical next step. Work carried out since the release of the Taskforce report, including refinements to address gaps in the Taskforce's recommendations and simplify matters where possible is not yet public. Along with any further work you would like us to progress, the resulting Bill may be more positively received than what is presented in the Taskforce report. As discussed below, there are also options for the legislative process that would allow us to continue exploring alternatives with stakeholders before a final decision is made.

Steps in the legislative process

47. Once the policy is settled and a Bill is complete, you have some choices about the steps in the legislative process. Broadly your choices are to:
- *Progress a Bill towards introduction and select committee:* this option would provide the fastest progress. Any issues that are identified by stakeholders would need to be addressed during the select committee stages, which is likely to be more difficult than addressing them earlier. Changes made at that stage also carry a higher risk of implementation issues.
- Or
- *Issue an exposure draft before introduction and the commencement of the parliamentary stages:* this option would provide an opportunity to test the policy direction and the Bill's technical details, clarity and usability with stakeholders before final decisions are made and a parliamentary process commences.
48. We recommend issuing an exposure draft as part of the legislative process. This would be consistent with the commitment in the National and ACT Parties' Coalition Agreement to ensure regulatory decisions are based on principles of good-law-making. Along with questions on the technical details of the exposure draft, the accompanying consultation document could include specific questions on alternative policy options for providing and paying leave entitlements to elicit stakeholder feedback before final decisions are made. Issuing an exposure draft would also provide the opportunity to test the implementation period required to enable robust implementation of changes to payroll and business systems.
49. While it may provide greater assurance that the Bill is free of technical issues, this option would require more time. Once a draft Bill was complete to a standard that would support consultation, MBIE would need to develop and publish a consultation document. Before introduction, submissions would need to be analysed, advice provided to you on the feedback and any issues identified, solutions developed and incorporated in an introduction version of the Bill.

Next steps

50. We look forward to discussing the next steps for this work with you in more detail. We will then be in a position to provide more detailed advice on your chosen policy direction.

Annexes

Annex One: Summary of the Holidays Act Taskforce's recommendations

Annex Two: The Taskforce's objectives and parameters

Annex Three: Financial implications and compliance costs

Annex One: Summary of the Holidays Act Taskforce recommendations

The Holidays Act Taskforce recommendations include:

- New methodologies, calculations and definitions, intended to provide prescription and clarity around how to accurately calculate entitlements and payments. These include:
 - New methods that employers must use to calculate the amount of the four week entitlement to annual holidays an employee uses when they take leave. This includes prescription around how to determine a week for the purpose of annual leave entitlement.
 - New leave payment formulas and definitions to provide greater clarity about what payments must be included in the calculations. This includes clarifications to the definition of gross earnings.
 - New eligibility tests for family violence, bereavement and sick leave and a new 'otherwise working day' test for determining days on which these entitlements apply.
 - A new test for when an employee may receive their annual holiday entitlement on a 'pay-as-you-go' basis and clear rules for reviewing whether it can continue to be used throughout the course of employment.
- Improvements in access to some leave entitlements, intended to ensure the balance of decision-making between employers and employees when it comes to requests for holidays and leave is appropriately calibrated. These include:
 - Ability for employees to take annual leave in advance of when the four week entitlement arises after each 12 months of employment on a pro-rata basis.
 - Access to sick, bereavement and family violence leave from the first day of employment for eligible employees and ability to take part days of sick and family violence leave.
 - Access to three days bereavement leave expanded to a wider number of family members, including 'cultural family groups'.
- Some increases to minimum leave payments to address disadvantages currently experienced by some employees. These include:
 - The addition of a 13-week average pay calculation for comparison to the ordinary pay and 52-week average calculations for annual leave payments so that employees (such as seasonal workers) are not disadvantaged by taking leave adjacent to a busy period.
 - Introduction of a requirement to pay the greater of ordinary and average pay for family violence, bereavement and sick leave and alternative and public holidays for all employees to resolve issues with the application of the current methodology and potential for employer gaming.
 - Removal of the 'override' to the normal rules for annual holiday payments in the Parental Leave and Employment Protection Act 1987 which disadvantages employees returning from parental leave who take annual holidays.
- Improved transparency and clarity around some processes including:
 - Clearer requirements related to the process for having a closedown period.

- What is permitted and required with regards treating employment as continuous for the purpose of leave entitlements when a business is sold or transferred.
- A requirement to provide pay statements in every pay period to provide greater transparency about leave and pay for employees.
- Additional/clarified record-keeping requirements to ensure employers have the data required to accurately complete the calculations and tests.

Annex Two: The Holidays Act Taskforce's objectives and parameters

Objectives

The Taskforce's Terms of Reference set out that Cabinet expected it to develop, test and make recommendations to the Government on policy options for the provision of, and payment for, holiday and leave entitlements that:

- a. continue to promote the existing purpose of the Holidays Act 2003
- b. provide clarity and certainty for employers and employees so that employees receive their correct entitlements
- c. be simpler than the current Act in relation to the provision of, and payment for, entitlements to holidays and leave
- d. be readily implementable in a payroll system
- e. minimise compliance costs for employers
- f. minimise perverse incentives on employers and employees
- g. ensure the balance of decision-making between employers and employees when it comes to requests for holidays and leave is appropriately calibrated
- h. be readily applicable to the full range of working and remuneration arrangements in the labour market both now and in the future
- i. aim to protect overall entitlements for employees.

Scope and parameters

The Taskforce was to consider:

- a. options to improve both the provision of, and payment for, entitlements that meet the objectives above and:
 - i. where trade-offs between competing objectives are required, it was to be explicit about how those were made
 - ii. was given scope to include consideration of the place of the standard five day, 40 hour, working week in the Act
- b. any other matters relating to the Act that it saw fit. That could include holidays and leave entitlements modified by other Acts (such as the Parental Leave and Employment Protection Act 1987).

The Taskforce was given scope to reconsider the two key principles of the Act but options were to aim to preserve the intent of those as far as possible:

- a. that entitlements are determined in relation to the work pattern at the time the leave is taken
- b. that employees should not be financially disadvantaged by taking leave, that is, they should be paid (at least) what they would have earned had they worked.

The Taskforce was not to consider the complex issue of remediation of historical underpayments of holiday and leave pay.

Annex Three: Financial implications and compliance costs

1. The recommendations have financial implications for employers. Improved clarity and certainty through greater prescription should reduce the risk of future non-compliance issues and help to reduce future remediation processes and compliance costs, offsetting some of the cost increases. This is dependent however on the extent to which the legislation is implementation ready and that it does achieve the intended clarity and certainty.

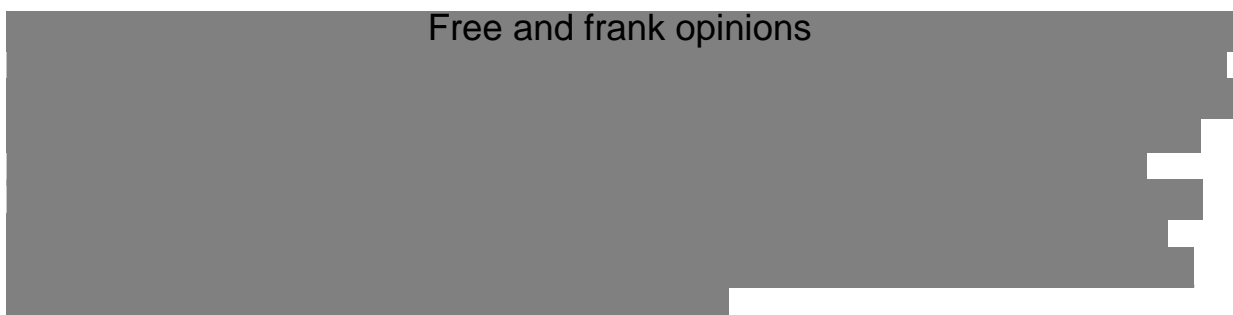
Employers will incur costs due to increased access to leave entitlements and new payment methodologies

2. The 2020 Regulatory Impact Statement estimated that the total additional cost to employers of adopting the Taskforce's recommendations, due to the increased access to leave entitlements and the use of new leave payment methodologies (refer to Annex One), could be up to \$310.3 million per year (with a corresponding benefit for employees).
3. MBIE considers that the \$310.3 million per year estimate is an overestimation. There were limitations to the estimate because it was based on a testing sample that included a large overrepresentation of employees with varied and unpredictable working arrangements, and a range of other assumptions were therefore made to 'scale-up' the costs to the entire workforce.
4. The estimate also assumes that all employers currently provide minimum leave entitlements to their employees. In practice however, many employers already provide entitlements at least equal to the increases the Bill makes to the minimum requirements and those employers will not incur additional costs related to them (for example many employers already provide sick leave from day one and do not apply the parental leave annual leave payment override).

Employers will also incur implementation costs

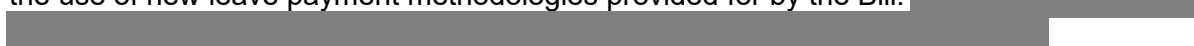
5. The implementation of the Taskforce recommendations will necessitate significant changes to every payroll system used by New Zealand employers, and there will be multiple steps in the end-to-end implementation process. These system changes will incur costs to employers and there may also be additional costs associated with accessing the specialist payroll skills and expertise that may be required.
6. The cost of implementation will vary for employers depending on a range of factors, including the type of payroll system/s they currently use to manage pay and leave. Officials estimated that approximately 20 to 30 percent of employers do not currently use payroll software, 10 to 30 percent use non-cloud-based payroll software and 50 to 60 per cent use either 'off-the-shelf' (often smaller employers) or bespoke (often larger employers including government agencies) cloud-based payroll software.

7. **Free and frank opinions**



Implications for the Government as an employer

8. As an employer, the Government will incur costs due to the increased leave entitlements and the use of new leave payment methodologies provided for by the Bill. Confidential advice to Government



9. A disproportionate number of public service employees work in two of the sectors most likely to receive an increase in leave payments due to the variable working arrangements and complex remuneration structures of employees.⁴ There are also likely to be cost pressures for Government-funded services provided through private sector employers.
10. The costs to the Government of implementing the changes in payroll systems are also expected to be substantial. As noted in the September 2022 final report back to Cabinet on the All of Government Payroll Programme to improve government payroll systems, many government agencies' payroll systems are bespoke and aging, and already struggling to adapt to ongoing changes [GOV-22-MIN-0036].

⁴ Employees that have variable working arrangements and complex remuneration structures are most likely to receive an increase in leave payments. They are most likely to work in the 'health care and social assistance', 'accommodation and food services' and 'public administration and safety' sectors. Approximately 34 percent of the 'health care and social assistance' workforce and 100 per cent of the 'public administration and safety' workforce are employed in the public service, compared to the public service's proportion of the total New Zealand workforce of 16 per cent. It is therefore likely that a greater proportion of the marginal fiscal impacts of the Taskforce's proposals will be apportioned to the Government than the sector's 16 per cent of the workforce would suggest.