

Inquiry into payments to chief executives of dissolving local authorities in Auckland

This is an independent assurance
report about an inquiry carried out
under sections 16 and 18 of the
Public Audit Act 2001.

November 2010

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Contents

Auditor-General's overview	3
Part 1 – Introduction	5
Part 2 – The employment termination arrangements	7
Part 3 – Giving notice of termination	13
Figures	
1 – Summary of termination payments for chief executives of the eight dissolving Auckland local authorities	10

Auditor-General's overview

I have considered the employment termination arrangements for the chief executives of the eight local authorities that were dissolved on 1 November 2010 as part of the Auckland local government reforms, and the payments made under those arrangements.

The cost of the payments made under the termination arrangements is currently \$1,405,315. This is the gross cost to the local authorities, but excludes payments that would ordinarily arise at the end of employment such as accrued annual leave entitlements. This cost may rise to \$1,655,844 next year if one of the chief executives with a temporary role in the Auckland Council group does not become a permanent employee.

In deciding to inquire into the termination arrangements, I expected that:

- each local authority would have acted fairly towards its chief executive, in keeping with good employer requirements in the Local Government Act 2002;
- the Auckland Transition Agency (the ATA) would similarly have acted fairly towards the chief executives when exercising its employment-related responsibilities under the Auckland transitional legislation;
- payments would be made in keeping with contractual entitlements and with the Auckland transitional legislation, and be properly authorised;
- where possible, the local authorities and the ATA would work together to minimise the costs of termination arrangements to ratepayers; and
- chief executives and other employees would be given notice in a timely way, to avoid or limit costs of payments in lieu of notice.

My expectations were largely met. Of the total payments, almost all were made under contractual arrangements and in accordance with the Auckland transitional legislation. However, I consider that two payments with a total cost of \$42,000 were not authorised and did not need to be made.

I also consider that the total cost of payments in lieu of notice to chief executives of \$263,722 is significant and that the ATA and the local authorities could have done more to reduce or avoid these costs. The need to reduce or avoid these payments should be considered in any future restructuring of this kind.

I thank the chief executives and staff of the dissolving local authorities and of the ATA who assisted with this inquiry.



Lyn Provost
Controller and Auditor-General

3 November 2010

Part 1

Introduction

1.1 The Auditor-General carried out an inquiry into the employment termination arrangements for chief executives of the eight dissolving local authorities in Auckland¹ after receiving a request from the Minister of Local Government. The Auditor-General intended to consider these arrangements as part of the final audit of the local authorities but decided to do so sooner because of Parliamentary and public interest in the matter.

1.2 Our inquiry considered:

- the termination arrangements entered into by the local authorities for their chief executives at the end of their employment;
- the payments to the chief executives under those termination arrangements;
- the role of the Auckland Transition Agency (the ATA) in this process; and
- how the local authorities and the ATA applied the notice of termination requirements.

How we carried out our inquiry

1.3 We reviewed employment agreements and other relevant documents, including payroll information, to determine the nature and extent of termination payments to the eight local authority chief executives at the end of their employment.

1.4 We also reviewed the process the local authorities followed in determining the entitlements of their chief executives, including whether the local authorities got the ATA's approval for any variations to terms and conditions of employment made in the transition period between the enactment of the reorganisation legislation and the dissolution of the local authorities (24 May 2009 to 31 October 2010).²

1.5 We reviewed the transitional provisions relating to employment in the Local Government (Auckland Transitional Provisions) Act 2010 (the Transitional Provisions Act), and legal advice obtained by councils and the ATA on the operation of those provisions.

Structure of this report

1.6 In Part 2, we describe the employment termination arrangements for the eight chief executives, and list the payments made.

1.7 In Part 3, we set out how the notices of termination have been dealt with.

1 The eight local authorities were Auckland City Council, Waitakere City Council, Manukau City Council, North Shore City Council, Rodney District Council, Papakura District Council, Franklin District Council, and Auckland Regional Council.

2 Section 31 of the Local Government (Tamaki Makaurau Reorganisation) Act 2009 required ATA approval for certain decisions by local authorities in the period between its enactment and their dissolution.

Part 2

The employment termination arrangements

2.1 Under the Local Government Act 2002, a local authority chief executive can be appointed for a term of up to five years. The five-year term can be extended for up to two more years, subject to a satisfactory performance review within six months of the first term expiring.³ Unlike employment agreements for permanent positions, fixed-term employment agreements do not always include redundancy provisions.

The employment agreements

2.2 All but one of the eight employment agreements contained redundancy provisions and associated notice of termination requirements. Several provided that no redundancy payments would be made in the event of amalgamation or restructuring if the chief executive obtained an equivalent role with the new entity.

2.3 Six of the chief executives do not have a role in the new Auckland Council structure. The chief executives of the Auckland City Council and the North Shore City Council have accepted temporary roles.

2.4 The Transitional Provisions Act provides that employees who do not have a role with the Auckland Council are entitled to compensation for termination of their employment in accordance with their employment agreements.⁴ They are not entitled to any other payments or benefits because their position has ceased to exist.⁵

2.5 We considered the termination arrangements against these requirements.

2.6 We briefly outline the contractual arrangements for the chief executives in paragraphs 2.7-2.12.

Fixed-term employment agreements expiring after 31 October 2010

2.7 Five of the chief executives were appointed on fixed-term employment agreements that had not expired at 31 October 2010 and contained redundancy provisions. The five employment agreements provide that the respective chief executive is entitled to:

- three months' notice and six months' remuneration;
- three months' notice, and the lesser of payment to the end of the fixed term or six months' remuneration;

³ Local Government Act 2002, section 42 and clauses 34 and 35 of Schedule 7.

⁴ The Transitional Provisions Act refers to this as contractual compensation.

⁵ Sections 103 and 104.

- three months' notice, and the lesser of payment to the end of the fixed term or nine months' remuneration;
- six months' notice, and the lesser of payment to the end of the fixed term or compensation of six weeks' remuneration for the first year of service and two weeks for each subsequent year; and
- three months' notice, and the lesser of payment to the end of the fixed term or 26 weeks' remuneration for the first year of service and two weeks for each subsequent year.⁶

2.8 One of the chief executives has accepted a temporary position until 30 April 2011 as the interim chief executive of a council-controlled organisation of the Auckland Council. His redundancy entitlement is currently deferred until the end of that fixed-term role.

Fixed-term employment agreements ending on 31 October 2010

2.9 Two of the chief executives were on fixed-term employment agreements ending on 31 October 2010. Both chief executives were appointed in 2005 on five-year fixed terms that had expired. In both cases, the local authorities extended the terms of the chief executives to expire just before the dissolution date of 1 November 2010.

2.10 In one instance, the local authority resolved that the chief executive would be paid three months of his total remuneration at the completion of his extended term, subject to his meeting agreed performance expectations.

2.11 In the other instance, the chief executive agreed to extend his term to 31 October 2010 in return for retention and performance payments and a temporary role with the Auckland Council until the end of 2010.

Fixed-term employment agreement with no redundancy provision

2.12 One chief executive was employed on a fixed-term employment agreement expiring on 31 March 2011. The agreement did not provide for early termination of his employment on the grounds of redundancy. The local authority obtained legal advice on the chief executive's entitlements, given that his employment would end before the end of his agreed fixed term. The advice was that the chief executive was entitled to be paid to the end of his fixed-term employment agreement.

⁶ The redundancy provision for this chief executive was amended to this effect in May 2009 to align with entitlements applying to other senior staff of that council.

Cost to the local authorities

- 2.13 We calculate the cost to the dissolving local authorities of employment termination arrangements for the chief executives is \$1,405,315.⁷ This figure excludes payments that would ordinarily arise when employees end their employment, such as payments for annual leave entitlements. It also excludes the potential payment to the chief executive whose entitlement is currently deferred. If that payment is made, the cost will be \$1,655,844.

Disclosure requirements

- 2.14 Financial reporting standards require local authorities to disclose termination benefits paid to key management personnel.⁸ This means that compensation payments to senior staff, including chief executives, will need to be disclosed in the final annual reports of the eight local authorities.
- 2.15 In the interests of transparency, and because there has been inaccurate speculation about the size of some of the payments, we consider it appropriate to disclose the amounts paid.
- 2.16 Figure 1 shows the payments made by each local authority, the components of the payments, and the year the chief executive started in that role.⁹

⁷ This figure is the cost to the seven local authorities that made payments before dissolving.

⁸ NZ IAS 24: *Related Party Disclosures*.

⁹ Figure 1 includes the deferred redundancy entitlements of the chief executive of the North Shore City Council, as advised by that local authority before it dissolved.

Figure 1
Summary of termination payments for chief executives of the eight dissolving Auckland local authorities

Local authority	Chief executive first appointed	Description	Payment (gross)
Auckland City Council	2005	Retention payment \$50,000; pro-rated prospective performance bonus for 4-month period to 31 October 2010 \$18,666.	\$68,666
Auckland Regional Council	2005	Payment of 3 months' remuneration on completion of fixed term based on performance.	\$91,500
Franklin District Council	2007	<i>Ex gratia</i> payment \$20,000; redundancy payment 6 months' total remuneration \$135,249; payment in lieu of notice \$41,819.	\$197,068
Papakura District Council	2002	Redundancy payment 20.52 weeks' remuneration \$105,628; payment in lieu of notice \$104,102.	\$209,730
Manukau City Council	2006	Payment to end of fixed-term contract.	\$175,859
Rodney District Council	2008	Redundancy payment 9 months' remuneration \$259,200; payment in lieu of notice \$48,000; payment in lieu of untaken professional development \$35,000; payment for career transition \$7,000.	\$349,200
Waitakere City Council	2008	Redundancy payment 30 weeks' remuneration \$243,491; payment in lieu of notice \$69,801.	\$313,292
Total excluding deferred potential payment			\$1,405,315
North Shore City Council	2003	<i>[Deferred until 30 April 2011 and only if no ongoing permanent role in the Auckland Council group.]</i> Redundancy payment of 6 months' fixed annual remuneration \$187,897; payment in lieu of notice \$62,632.	\$250,529
Total			\$1,655,844

The payments

- 2.17 As noted in paragraph 2.4, where a person does not have a role in the new Auckland Council, the Transitional Provisions Act permits payments of compensation for termination in accordance with their employment agreement (contractual compensation) but not other payments in relation to the end of their employment. We consider that three payments were not contractual

entitlements. These payments were an *ex gratia* payment to the chief executive of Franklin District Council for covering the roles of senior staff who had left, and two payments to the chief executive of Rodney District Council for missed professional development opportunities and career transition.

Cashed-up payments

- 2.18 We asked Rodney District Council about the reasons for the payments to the chief executive of \$35,000 in lieu of untaken professional development and \$7,000 for not having an opportunity to receive career transition advice. We were concerned that these payments breached the Transitional Provisions Act. The effect of sections 103 and 104 of that Act is that the only compensation lawfully payable to an employee because their position with a local authority has ceased to exist is contractual compensation.
- 2.19 The Mayor and chief executive have explained the reasons for the payments. The chief executive's employment agreement provided that the Council would fund professional development opportunities at its discretion, and Council policy provided that up to 5% of an employee's total remuneration could be spent on such opportunities in any year. This is the basis for the payment of \$35,000 to the chief executive. The Mayor told us that she had instructed the chief executive that he could not take up professional development opportunities during his time at the Council because he needed to be present, initially to restructure the Council and then to prepare for the transition to Auckland Council. The chief executive has noted that this agreement predates the Transitional Provisions Act, and that the arrangements were conceived in the context of his employment agreement. He notes too that he took no part in constructing his termination entitlements.
- 2.20 The Mayor did not seek Council approval for these payments, and told us that she has responsibility for the chief executive. We accept that the agreement to defer professional development opportunities occurred before the Transitional Provisions Act, but have not seen any evidence of an agreement to compensate the chief executive at the end of his employment for the deferral.
- 2.21 The \$7,000 payment was to compensate the chief executive for not having the opportunity to receive career transition advice. The chief executive explained that other council employees were given the opportunity to obtain career transition advice at the Council's expense and that he deferred his use of this service at the request of the Mayor to ensure a smooth transition. It is not unusual for an employer to meet career transition costs incurred by employees who are being made redundant. Such assistance is usually designed to meet a need for career advice, and help in preparing a curriculum vitae and with interview techniques. However, we question whether a compensatory cash payment of \$7,000 for

missing out on career transition advice was necessary or appropriate for a chief executive, especially given the large redundancy payment (which was equivalent to nine months' remuneration).

- 2.22 In our view, the compensatory payments to the chief executive of Rodney District Council of \$35,000 for missed professional development and \$7,000 for not receiving career transition advice, although well intentioned, were not required to be made under his employment agreement. We consider that they were, therefore, in breach of sections 103 and 104 of the Transitional Provisions Act.

***Ex gratia* payment**

- 2.23 We considered whether the *ex gratia* payment to the chief executive of Franklin District Council was a breach of sections 103 and 104 of the Transitional Provisions Act for the same reasons noted in paragraph 2.18. We do not consider that the payment breached those provisions because it was to compensate the chief executive for covering the roles of senior staff who had left during the transition period.

Process followed by the local authorities

- 2.24 Five of the local authorities got legal advice about the entitlements due to their chief executives at the end of their employment. In some instances, the advice was sought for clarification, but in two instances the issues were more complex. These matters were appropriately dealt with by senior staff within the local authorities, rather than the respective chief executives. In the two more complex instances, decisions were made by relevant committees and the full councils as appropriate.

Approval for a variation

- 2.25 Franklin District Council approved a minor variation to the chief executive's employment agreement in May 2010, to clarify that redundancy entitlements are based on total remuneration, not salary. The chief executive told us that the Council did not seek the ATA's approval for that variation because it viewed the change as a point of clarification. Our view is that ATA approval should have been sought, but we acknowledge that the chief executive has not received any financial benefit from the variation.

Part 3

Giving notice of termination

- 3.1 Chief executives of local authorities are employed on fixed-term employment agreements. Under a fixed-term agreement, an employer and employee agree to the employment ending on a specified date or event. If employment ends because of the expiry of the fixed term, then neither the employer nor the employee is required to give additional notice. In effect, the parties have been on notice about when and how the employment relationship will end since they signed the agreement. Two of the chief executives were in this position, because their agreements expired the day before the eight local authorities dissolved. These two chief executives were not entitled to receive a payment for notice.
- 3.2 The remaining chief executives were on fixed-term employment agreements that expired some time during the next two years. As noted in paragraphs 2.7-2.12, in all instances but one, the fixed-term agreement allowed for early termination on the grounds of redundancy. Those employees were entitled to notice of termination and redundancy compensation, as specified in their employment agreements.
- 3.3 Each employment agreement sets out the contractual period of notice to be provided by an employer when an employee's position is disestablished and the employee is made redundant. Three months' notice is fairly standard for senior employees. An employer can require that an employee work out their notice period, or choose to pay out any unworked notice as a lump sum payment upon termination (called "payment in lieu of notice").

Which organisation provides notice of termination?

- 3.4 Usually in a redundancy situation, the responsibility for providing notice of termination rests with the employer. However, in this instance, a third party external to the employment relationship decided whether an employee's employment was terminated, and was responsible for communicating that decision to the employee. In our view, the ATA (on behalf of the interim chief executive of the new Auckland Council) was responsible for providing notice, not the individual local authorities.
- 3.5 Under the Transitional Provisions Act, the ATA¹⁰ had the:
- power to review the positions of people employed by existing local authorities;
 - power to decide in relation to each employee whether to offer the employee a position with a new employer or to terminate the employee's employment as at 31 October 2010; and

¹⁰ The responsibility rested with the chief executive of the new Auckland Council or with the ATA if the new chief executive had not yet been appointed or had not agreed to the ATA exercising those powers (section 98).

- responsibility to notify in writing each employee and the employee's existing employer of the decision made by 30 September 2010.¹¹

3.6 The Local Government (Tamaki Makaurau Reorganisation) Act 2009 was also relevant. That Act established the requirements for decision-making during the transitional period. Section 31 said that the chief executives of existing local authorities must ensure that certain decisions had been confirmed in writing by the ATA before being implemented. Decisions in this category included decisions to terminate a chief executive's employment.

When was notice of termination given?

3.7 Chief executives were given notice by the ATA on or about 23 September 2010. This meant that chief executives should have worked for five weeks of their notice period (from 24 September to 31 October), and been paid the remainder in lieu when their employment ended. If, for example, a chief executive was on three months' notice, this meant receiving payment in lieu of notice for the period 1 November to 24 December 2010.

Options for early notice of termination

3.8 Since notice was given by the ATA on or about 23 September, there was a significant amount of payments in lieu of notice for chief executives. We calculate the cost of payments in lieu of notice to be \$263,722. This cost may rise to \$326,354 if one of the chief executives does not take up a permanent role in the Auckland Council group.

3.9 The dissolving local authorities also incurred costs for payments in lieu of notice for other employees who do not have roles with Auckland Council and who did not receive the full notice required under their employment agreements.

3.10 If the notice of termination had been given earlier, chief executives and other employees would have worked the full notice period and no additional payments in lieu of notice would have been made. Clearly, this would have been preferable from a cost perspective. We do not see any fairness issues with this, given that local authority employees have been aware for months (or years) that their employment with their current councils would end on 31 October 2010.

3.11 One of the local authorities had legal advice that it could give its employees early notice with the approval of the ATA. That advice recommended that the chief executive in question be given notice three months ahead of 31 October 2010 (that is, on 31 July 2010) to avoid the costs of the notice period. The notice would have had to be confirmed by the ATA. Giving notice earlier instead of paying it out

¹¹ See section 100(1) and 100(4) of the Transitional Provisions Act.

would have reduced the final cost to ratepayers. The advice took account of the financial prudence requirement in the Local Government Act 2002.

- 3.12 The ATA received different legal advice, which was that the Transitional Provisions Act overrides any contractual notice entitlements. It is the interim chief executive of the Auckland Council (or the ATA) who decides whether to terminate an employee's employment and gives notice of that decision. The local authority would then communicate with the employee about the contractual entitlements the employee may have.
- 3.13 The ATA's legal advice also considered whether conditional notice could be given in circumstances where an employee's position had been disestablished but the ATA had not yet considered redeployment. Notice would be provided on the condition that it could be revoked if alternative roles were offered to the employee before the end of the notice period. The advantage of this approach was that notice could be given well before the statutory deadline of 30 September, which is when the ATA was to have written to employees either offering alternative employment with one of the new organisations or giving notice that their employment with their respective local authorities would be terminated. The advice on this point preferred the interpretation of section 100 of the Transitional Provisions Act as being that all employment options (including the possibility of assessing whether redeployment opportunities were available in the new organisations) should be considered before termination of employment occurred.
- 3.14 However, even operating within the parameters of the ATA's advice, there was an opportunity to identify early on those employees who did not have a substantially similar option in the new organisation and who were not seeking alternative employment. The ATA emailed all chief executives on 23 July 2010 recommending that this exercise be done by chief executives for employees in their respective local authorities. Those employees could then be given notice by the ATA early under section 100(4) of the Transitional Provisions Act.
- 3.15 There was no reason why this assessment could not have been done for chief executives as well. Certainly, the ATA knew well before the 30 September deadline that some of the chief executives were not applying for alternative roles. Had the ATA given notice for these chief executives earlier, the payment-in-lieu costs would have been reduced further. This would have been a sensible approach.

Notice to other employees

- 3.16 We are concerned that Rodney District Council did not take account of the ATA's notice of termination letters, and chose to treat notice as starting from 28 October rather than 24 September. This meant that the entire notice period for

employees who do not have a role with Auckland Council was paid out in lieu, at a cost of \$204,674. Holiday pay entitlements were also greater than they would have otherwise been for those employees. Rodney District Council agreed to treat the chief executive's notice of termination as starting on 24 September but did not do so for the other employees who were given notice.

- 3.17 In our view, these additional payments were unnecessary, as well as inconsistent with the approach taken by other local authorities. The Council told us that it decided to give its employees notice as late as possible in order to ensure that critical functions were covered up to the point of dissolution. However, this approach does not take account of the legal effect of the ATA notice.

Transition to the new Auckland Council

- 3.18 Our inquiry has considered only one of the many activities that the ATA and the eight local authorities were dealing with in the transition period. We acknowledge the size and complexity of the task they faced, including the sensitive management of employment matters during that period. We note the relatively short time in which they had to deal with those employment matters. We acknowledge the efforts and achievements of the ATA and the local authorities in managing an effective transition to the new Auckland Council.