



# Severance payments

Severance payments can be risky for public organisations – legally, financially, and politically. The people making decisions about severance payments need to make sure that:

- any severance payments are properly authorised; and
- the amount is reasonable and a proper use of public money (that is, the payment will withstand scrutiny).

## Getting advice

Many severance payments are negotiated with the help of legal or other representatives. Using experienced advisers is wise in any sensitive or difficult situation. In the public sector, employers will often be required to justify the terms of a negotiated exit, including any severance payment. Reasoned legal advice (in writing) will be helpful or even essential if the employer is asked to explain the basis for a severance payment.

## Using a mediation service

We encourage employers and employees to attend mediation when they have a dispute. The Crown is required to be a good employer and to act in good faith, and to be an exemplary litigant. Agreeing to attend mediation promptly is consistent with those requirements. It can help to avoid legal action, and sometimes it can help to resolve disputes early and before positions become entrenched.

Whichever mediation process or forum is used, before signing any agreement the person signing on behalf of an employer should have:

- competent advice about the employer's legal position;
- a clear understanding of the risks, costs, and benefits of the proposed settlement;
- the correct level of delegated authority; and
- a written record of the basis for settlement.



## Considering the terms of settlement

In the public sector, there are often legal obligations to disclose severance payments (mentioned above). The standard wording for confidentiality clauses provides that the discussions and terms of settlement are confidential, “except as required by law”. This wording should always be inserted into settlement agreements where confidentiality has been agreed.

Severance payment agreements, like all legal contracts, must be documented correctly. The terms must be clearly spelled out, with financial and intangible components, timing, and the parties’ respective obligations carefully defined. The nature of each type of payment should be specified, and the basis for the payment should be explained so the document is self-explanatory. Any ambiguities can result in misunderstandings, interpretation arguments, or even legal proceedings.

The public organisation needs to keep a clear paper trail recording the background, risk assessment and advice obtained, basis and reason for the severance payment and terms, and evidence of the required authorisation.

## Settling on an amount

The amount of any severance payment must be reasonable in all the circumstances, although this is, by necessity, an imprecise requirement. Settlements larger than an award in comparable cases decided by the Employment Relations Authority or the courts will be given greater scrutiny, and the public organisation will need to have good reasons for the amount.

Good reasons for a comparatively higher payment might include the seniority of the employee, the effect of any publicity on all the people involved, the sensitivity of the dispute, and the value of certainty and speed of resolution. These factors can justify a higher settlement because the outcome is better than going to court.

### Common pitfalls: Keeping a severance payment confidential

An employer negotiates a severance payment with a senior employee, including strict confidentiality terms. A member of Parliament and a local newspaper make requests under the Official Information Act 1982 about the events that lead to the departure.

Information other than the settlement agreement (which is generally withheld because the prejudice to individual privacy outweighs the public interest in disclosure) must be disclosed under the Official Information Act, which in effect breaches the confidentiality of the severance arrangement.

The former employee claims there has been a deliberate breach and seeks damages. The employer must spend legal fees on exchanges between lawyers, so that the employee understands that there is a legal requirement to disclose and no basis for issuing proceedings.

The better course of action would have been to explicitly include in the settlement agreement the limits to confidentiality. In some circumstances, the parties might agree that the settlement cannot be confidential.

## Approving severance payments

Severance payments must be approved at the correct level of delegated authority. The authorisation required (that is, general manager, chief executive, board, or minister) will depend on the amount of the severance payment (that is, payments in addition to or in excess of contractual entitlements), in keeping with the rules applying

There’s more information and more good practice resources – including on this topic – on our website.



to the particular public organisation. The amount includes all financial costs, excluding Goods and Services Tax.

## Cabinet rules for severance payments

For government departments, Cabinet sets specific approval procedures and financial delegations for agreeing to any kind of settlement and payments that are not legally required. Payments above the thresholds must be approved by the responsible Minister or Cabinet. Compensation and settlement payments must also be certified by either a departmental solicitor or the Crown Law Office.

## Obligations to disclose the payments

Most public organisations will have some kind of obligation to disclose severance payments.

Accounting standards require the disclosure of some payments in the financial statements, and the governing legislation for some types of public organisations contains additional requirements for what must be disclosed in the annual report.

Whether a particular payment needs to be disclosed will depend on the specific wording of the relevant legislation and accounting standards.

For a summary of disclosure requirements, please see Part 3 of our good practice guide on severance payments.

## Additional requirement for councils

Accounting standards require some disclosing of severance payments, regardless of any confidentiality agreement. And under the Local Government Act 2002, councils have to be even more open about these sorts of payments.

A council has to disclose in its annual report the amount of a severance payment to an employee in return for the employee's agreement to end their employment. The council has to disclose the number of severance payments and the amount of each

payment, but doesn't need to identify the employees who received them.

If a severance payment is made to a council's chief executive, it must be disclosed separately in the annual report.

## What we audit

We're required to audit how councils comply with the disclosure requirements in the Local Government Act 2002 and the accounting standards.

We review the severance payment documents and processes to confirm that the council has met the disclosure requirements. We also check that the:

- decision to settle was soundly based;
- council had legal or external advice as appropriate; and
- person(s) agreeing to make the payment had appropriate financial authority.

We don't make judgements about the merits of a decision to end an employee's employment.

### Common pitfalls: A severance payment that does not properly allow for tax

An employee raises a personal grievance, challenging a restructuring process. The employer agrees to "re-package" the employee's contractual redundancy entitlements as a tax-free compensation payment. The employer pays the employee the full amount of the payment, rather than the net amount after PAYE has been deducted.

The Inland Revenue Department requests a copy of the agreement, along with any background information. The Department concludes that the payment should have been taxed. The employer is compelled to pay PAYE on the payment, but cannot recover that from the employee. The employer also has to pay a penalty and interest. The result is that the settlement costs the employer considerably more than the original redundancy entitlement.