



2008

PARLIAMENT OF TASMANIA

**AUDITOR-GENERAL  
SPECIAL REPORT No. 75**

**Executive termination payments**

**September 2008**

*Presented to both Houses of Parliament in accordance with the provisions of Section 57 of the  
Financial Management and Audit Act 1990*

By Authority:

Government of the State of Tasmania

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30 September 2008

President  
Legislative Council  
HOBART

Speaker  
House of Assembly  
HOBART

Dear Mr President  
Dear Mr Speaker

**SPECIAL REPORT NO. 75**  
**Executive termination payments**

This report has been prepared consequent to examinations conducted under section 44 of the *Financial Management and Audit Act 1990*, for submission to Parliament under the provisions of section 57 of the Act.

The compliance audit examined termination payments made to senior executive staff across public sector entities.

Yours sincerely

H M Blake  
**AUDITOR-GENERAL**



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## Foreword

Senior executives in the Tasmanian public sector are usually employed on individual employment contracts which contain provisions relating to the types of payments to be made upon contract termination. It is not unusual for contracts to be terminated early. This audit focussed on 41 instances across a range of public sector entities over a four-year period where contracts were terminated before they had run full term. Compliance with terms of contracts and relevant legislation were tested relating to payments for termination, redundancy, unpaid salary, accumulated leave entitlements and payments in lieu of notice and of ex gratia amounts. These payments are referred to collectively in this Report as severance payments.

Termination payments made to outgoing senior executives in the private sector are often made public and Australian Accounting Standard AASB 124 *Related Party Disclosures* requires reporting entities, including for-profit public sector entities, to disclose in general purpose financial reports key management personnel compensation in total along with various categories of compensation including total termination benefits. However, not-for-profit entities, such as government departments and local government councils, are exempt from this accounting standard.

As a result, and while I consider the exemption unnecessary as it relates to senior public sector executive positions, in that, in my view, this lacks transparency, the findings of this compliance audit respect current accounting standards and negotiated confidentiality provisions. Therefore, this Report deliberately does not name individuals nor identify which payments were, or were not, audited.

The audit found that the majority of severance payments did not appear to be excessive compared with service, salaries or with any unfulfilled part of a contract. However, variations between the average amounts paid in State and local government entities compared with Government Business Enterprises and State-owned companies and statutory authorities were noted. It was also found that, in many instances, organisations had exercised the discretion within their powers to use ex gratia payments to exceed the written terms of employment contracts but that such payments had been made in good faith and were approved.

However, there was at times uncertainty as to which party initiated an executive termination leading to a lack of clarity in determining the basis for severance payments. In addition, a common problem identified during the audit was inadequacy of documentation and I also questioned whether standard instruments of appointment

accurately reflected intended conditions or provided for an appropriate balance of risk and reward.

This led to six recommendations aimed at clarifying employment conditions, improved transparency and enhanced governance.

HM Blake

Auditor-General

30 September 2008

## List of acronyms and abbreviations

GBE	Government Business Enterprise
HoA	Head of Agency
LSL	Long service leave
Other public sector entity	We use this term collectively for public sector entities other than government departments, that is: <ul style="list-style-type: none"><li>• Government Business Enterprises</li><li>• State-owned companies</li><li>• Statutory authorities</li><li>• Public bodies</li><li>• Local government councils</li></ul>
PILON	Payment in lieu of notice
PSMO	Public Sector Management Office
SES	Senior Executive Service
SOC	State-owned company



## **Executive summary**

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## Executive summary

Senior executives are usually employed on individual employment contracts. It is not unusual for these contracts to be terminated before they have run full term. Reasons for leaving include resignation, redundancy and changes in operational direction. Termination of an employment contract can be initiated by either the employee or the employer.

If the termination of an employment contract, without any due cause such as misconduct, is initiated by the employer then the employee may be entitled to an early termination or redundancy payment. Entitlements to these payments are specified in employment contracts or redundancy schedules.

Employers may also make ex gratia payments to departing employees. For example, an employer may offer an ex gratia payment as an incentive to an employee to accept termination of a contract or as mitigation if the position has become untenable due to factors beyond the employee's control. Ex gratia payments are negotiated in consideration of factors such as the amount an employee could reasonably have expected to earn if the contract had been allowed to run full term, legal expenses incurred defending an investigation or in recognition of significant upheaval expenses incurred in taking up or prematurely leaving a position.

The objective of this audit was to verify whether severance payments made to senior executives in the public sector were in accordance with the relevant terms and conditions of their employment. The organisations considered for the audit are listed in Appendix 2 and include:

- government departments
- local government councils
- government business enterprises
- state-owned companies
- statutory authorities
- other public bodies.

The audit was limited to severance payments made between December 2003 and December 2007.

## Audit opinion

### Severance payments

Our opinion as to whether public sector organisations use appropriate practices to determine termination payments and have made payments in accordance with terms and conditions.

The majority of severance payments did not appear to be excessive compared with service, salaries or with any unfulfilled part of a contract. However, we did note variations between the average amounts paid in State and local government compared with GBEs, SOCs and statutory authorities.

The variations mainly reflected differences in the termination provisions specified in employment contracts with organisations using different combinations of early termination, redundancy and provisions for payment in lieu of notice.

In most cases, contractual separation payments had been calculated accurately in accordance with the terms and conditions of their employment contracts.

However, in many instances, organisations had exercised the discretion within their powers to use ex gratia payments to exceed the written terms of employment contracts. Typically, the ex gratia payments were motivated by a perceived need to meet untested legal or moral obligations rather than being ‘golden handshakes’.

We found all of the ex gratia amounts had been made in good faith, and had been approved by the relevant Heads of Agencies, Chief Executive Officers or General Managers. While the ex gratia payments had all been approved we were concerned that some of the payments:

- may not have been ratified by the highest level of governance (e.g. Board of Directors, full Council or Minister)
- were often not supported by documented rationales
- were being used to offset contracts that were widely believed to offer inadequate compensation to terminated employees
- varied widely between employees in similar circumstances.

We also found that many of the severance payments did not have adequate documentation to determine which party had initiated termination of the employment contract, on what basis payments had been made or who had authorised them.

### *Leave balances*

Our opinion as to whether public sector executives had excessive leave balances and whether adequate leave management practices had been implemented.

Some leave balances were high at the time of termination and had resulted in large payments to separating employees. Nevertheless, all of the audited organisations had recently implemented policies, procedures and strategies to manage excessive leave balances.

## Recommendations and management response

## Recommendations and management response

### List of recommendations

The following table reproduces the recommendations contained in the body of this Report.

<b>Rec No</b>	<b>Report section</b>	<b>We recommend ...</b>
1	2.2.1	... documents clearly indicate which party (i.e. employer or employee) initiated an executive termination so that the basis for severance payments is transparent.
2	2.2.3	... the standard instruments of appointment for both SES employees and Heads of Agencies be reviewed to determine whether they accurately reflect the intended conditions and provide for an appropriate balance of risk and reward. Consideration should be given to: <ul style="list-style-type: none"> <li>- inclusion of both redundancy and early termination provisions</li> <li>- review of the reasonableness of the 1:6 early termination payment formula</li> <li>- retention of the early termination payment when the employee reverts to a prior position since the two rights would appear to be unrelated.</li> </ul>
3	2.2.3	... ex gratia payments should be: <ul style="list-style-type: none"> <li>- approved or ratified at the highest level of governance</li> <li>- clearly identified in supporting documentation as ex gratia payments and rationale provided.</li> </ul>
4	2.3.2	... public sector executive contracts be reviewed to determine whether they provide a fair and consistent basis for compensation for early termination of contracts, as well as redundancy provisions for loss of long-term employment.
5	2.3.3	... ex gratia payments be authorised at the highest level of governance in an entity (e.g. Remuneration Committee of Board of Directors).
6	2.4	... the basis on which all payments are made — and who authorised them — be clearly identified and recorded in the termination documentation.

## Management response

### Department of Premier and Cabinet

#### Recommendation 1: Supported in part –

In the interests of transparency it is reasonable to expect that state service agencies document termination processes involving officers.

It is not always reasonable to indicate which party initiated a termination. Terminations can be mutually agreed and not be specifically instigated by either party, but arise out of negotiations.

#### Recommendation 2: Supported in part –

The Department of Premier and Cabinet is presently scoping a project to review Practices, Procedures and Standards relating to the Senior Executive Service. A key deliverable will be contemporised termination provisions for inclusion in SES Instruments of Appointment. The Department will also take the opportunity to review Heads of Agency provisions at the same time. It is anticipated, this review will be completed by late 2008.

In relation to the recommendation to include both early termination and redundancy provisions in contracts, it is accepted that termination payments should adequately compensate for prospective employment foregone (as in the case of early termination) however, it may not always be the case that redundancy payments are also appropriate. The Australian Taxation Office requires concessionally taxed ‘eligible termination payments’ to be the result of *bone fide* redundancy. If the duties continue to be required, it may not be appropriate to provide concessionally taxed redundancy payments by way of compensation for retrospective service. My Department will consider this issue further under the aforementioned review.

#### Recommendation 3: Supported in part –

As noted in the report, the context in which the term “ex gratia” is used is important. Payments made by agencies above the contract’s termination provisions are not ‘favours’ or ‘golden handshakes’, rather the basis for these payments takes into account potentially untested legal obligations that may exist under the contract.

I note the ex gratia payments identified in the report were negotiated to take account of individual circumstances which is appropriate as they vary from case to case. Furthermore, it is important to understand that the payments have a reasonable basis in untested legal obligation (reference *Martin v Tasmania Development and Resources* (1999) 163 ALR 79 by the Federal Court of Tasmania).

Ex gratia payments need to be properly authorised, but the appropriate level of authorisation for state service appointments is as follows:

Employees and senior executive service officers – Relevant head of agency

Heads of agency – Secretary, DPAC

Secretary DPAC – Premier.

However, I would support a process that involves the authorised officer (as indicated above) having to seek ‘endorsement’ or ‘certification’ by a second party at an appropriate level (e.g. the Secretary, Department of Treasury and Finance, or Director PSMO)

**Recommendations 4, 5 and 6:** are supported.

## **Department of Treasury and Finance**

Treasury is broadly supportive of the report recommendations with the exception of recommendation number 6 and part of recommendation number 3, it is our view that Heads of Agency ought to be accountable for and able to approve ex gratia termination payments as a normal part of agency business.

## **Department of Health and Human Services**

Accepts the findings outlined in the report and is of the view that the recommendations are the appropriate response to the issues raised. DHHS is also supportive of the removal of the current ambiguity around how termination provisions are to be applied.

## **Aurora Energy**

Aurora Energy has reviewed the report and understands that the executive termination payments reviewed by the Audit in Aurora were found to be correct and in line with the terms and conditions of their individual employment contracts. We appreciate the work of the Audit office and support the recommendations made.

## **Transend**

Transend has reviewed the report and agrees with the recommendations contained within the report. Transend is in the final stages of reviewing its executive contracts of employment. In this regard, the report recommendations will be taken into account as part of the review.

## **TOTE Tasmania**

**Recommendations 1, 2 and 3:** No comment.

**Recommendation 4:** A review of the Senior Executive contract will be undertaken.

**Recommendation 5:** All changes to executive remuneration are approved by the Remuneration Committee or a subset of that Committee.

**Recommendation 6:** The payment summary sheet identifies all entitlements and payments, and is authorised by the delegated officer. This summary sheet forms an integral part of all termination documentation.

Thank you for the Department's efforts in this review.

## **RBF**

Thank you for the opportunity to review the draft Report.

Notwithstanding that RBF already complies with some of the recommendations, RBF's comments with respect to the six recommendations are as follows:

**Recommendation 1:** Agree with the recommendation.

**Recommendation 2:** Agree with the recommendation and respectfully suggest that this review be coordinated centrally by the Public Sector Management Office.

**Recommendations 3, 4, 5 and 6:** Agree with the recommendation.

## **Other organisations** (refer to Appendix 2)

All of the other organisations involved in the audit accepted the report, indicated their satisfaction with the report or had no comment to make on the recommendations.



## **Introduction**

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## Introduction

### *Background*

In the public sector, senior executives are employed on individual fixed-term contracts, usually for three to five years. The contracts, often called instruments of appointment, specify various matters including the period of employment, the rate of remuneration and employee entitlements should the employer terminate the contract.

In some cases the contracts are terminated prior to their expiry date for a range of reasons such as:

- structural changes to the organisation
- irreconcilable conflicts of interest
- poor performance or even misconduct
- executives resigning to take up alternative employment.

The term ‘senior executives’ is loosely defined for the audit because of the diversity of organisational structures and governance arrangements for the various public sector entities, but does include:

- heads of agency
- senior executive service positions
- equivalent specialists
- directors and members of boards and councils
- chief executive officers
- general managers and other executives.

### *Objective*

The objective of the audit was to verify whether severance payments made to senior executives were in accordance with the relevant terms and conditions of their employment.

### *Scope*

The audit involved investigation into the terms and conditions of employment in selected positions classified at and above Senior Executive Service (SES) Level 1 and includes Heads of Agencies and equivalent specialists. We also looked at a sample of senior executives from local government, government business enterprises (GBEs), state-owned companies (SOCs) as well as other statutory authorities and public bodies.

The time period covered by this audit was limited to those payments made between December 2003 and December 2007.

## *Audit methodology*

In line with the time scope (i.e. payments made between December 2003 and December 2007), we conducted the audit by:

- reviewing applicable legislation, policies and procedures
- collating a list of all senior executives who have vacated positions prior to the fulfilment of their terms of contract
- identifying any termination payments made to senior executives
- reviewing the terms and conditions of contracts applicable to the termination payments received by senior executives
- reviewing any additional payments awarded to terminating senior executives.

We requested each of 31 public sector organisations (refer to Appendix 2) provide a list of all the severance payments made to senior executives in the four years prior to December 2007.

Responses produced a sample of 41 severance payments that consisted of 20 cases from government departments and 21 cases from the wider public sector including GBEs, SOCs, statutory authorities and local governments.

Typical severance payments varied between these entities. Three examples, selected to demonstrate the variations, are described in Table 1.

**Table 1: Examples of severance payments**

<b>Example 1 - Severance payment calculated on time remaining on prematurely terminated contract.</b>	<b>Example 2 - Severance payment includes separate redundancy and termination payments.</b>	<b>Example 3 - Severance payment includes an ex gratia payment.</b>
<p>Anne is employed on her second five-year contract as a senior executive. After three years, Anne's employer initiates the termination of that employment contract. Management has changed its operational focus and now requires a different skill set to fill this managerial position.</p> <p>Anne's employment contract states that the employer may terminate the appointment of an officer in accordance with the provisions specified in the employment contract by providing 14 days' notice in writing.</p> <p>The provisions in Anne's employment contract entitle her to an early termination payment of one week's salary for each six weeks remaining unfulfilled on her contract. There is no provision to recognise Anne's eight years of service.</p> <p>Anne is also entitled to collect remuneration in lieu of any outstanding leave entitlements.</p>	<p>Ben has been employed in the organisation for twelve years. This is his second five-year senior executive appointment. Three years into the contract, Ben's employer initiates the termination of his contract. Operational needs have changed within the organisation and Ben's position is no longer required.</p> <p>Ben rejects an alternative lower level position, offered on the basis of his prior employment within the organisation. He is entitled to a redundancy package based on the organisation's redundancy schedule e.g. 30 weeks' salary in recognition of twelve years of service.</p> <p>Because of the premature termination, Ben is also entitled under his contract to one week's salary for each six weeks remaining unfulfilled on his contract.</p> <p>Ben will also collect any outstanding leave entitlements.</p>	<p>Kate is employed in the public sector on her second five-year contract as a senior executive. After three years, Kate and her employer agree that it is untenable for her to continue in the position due to factors beyond Kate's or her employer's control.</p> <p>If Kate had initiated the termination, she would only have been entitled to payment in lieu of outstanding leave entitlements and any unpaid salary. If the employer had initiated the termination, Kate would have been entitled to the provisions outlined in her employment contract.</p> <p>It is unclear what her entitlements are in this case of mutually agreed termination. The head of the organisation has the discretion to make an ex gratia payment to compensate for a proportion of the salary Kate will forgo.</p> <p>Kate is also entitled to collect remuneration in lieu of any outstanding leave entitlements.</p>

Typically, severance payments are based on provisions specified in employment contracts and guidelines contained in workplace agreements such as redundancy schedules. Provisions and schedules vary between organisations and between individual employment contracts.

Factors commonly considered in the settlement of an executive employment contract include years of service or any time remaining unfulfilled on the contract. Employers also have the discretion to consider various individual circumstances, such as the difficulty of obtaining equivalent alternative employment if the position has become untenable through no fault or action of the employee or the cost associated with the disruption of what may have been perceived as long-term employment.

### *Criteria*

We applied the following audit criteria:

1. Are appropriate practices followed to determine termination payments to:
  - Senior Executive Service employees
  - Heads of Agencies
  - Directors
  - Chief Executive Officers
  - General Managers?
2. Are termination payments in accordance with the relevant terms and conditions?
3. Are public sector executives' annual leave balances exceeding 40 days and what practices are applied to manage leave balances?

### *Timing*

Planning for this compliance audit began in November 2007. We undertook fieldwork between February and August 2008. The Report was finalised in September 2008.

### *Acknowledgement*

We acknowledge the assistance given by the Public Sector Management Office for their consultation throughout the audit as well as all of the government departments and other public sector entities involved in the audit.

*Resources*

The total cost of the audit excluding report publication costs was approximately \$105 000.

## 1 Overview

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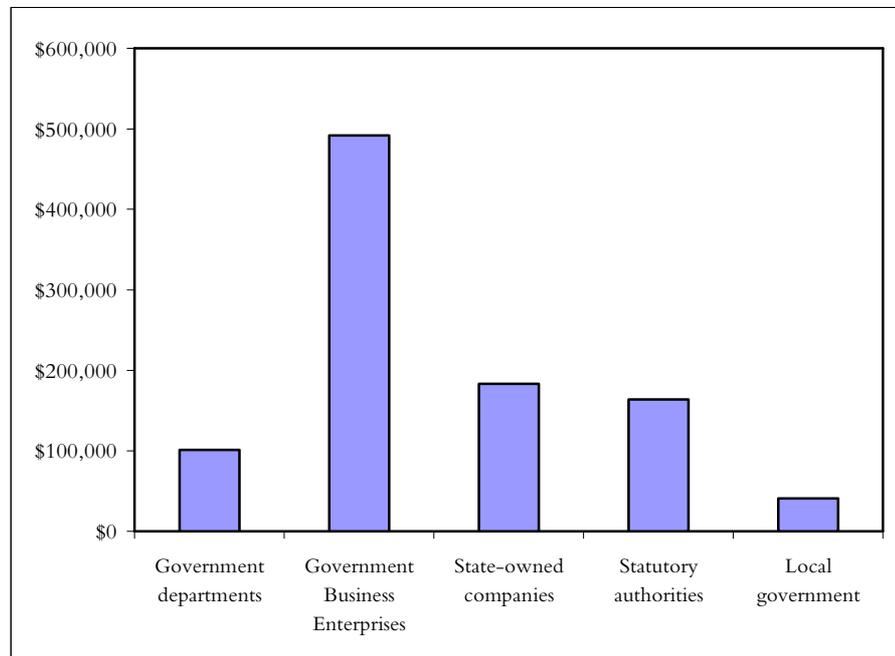
# 1 Overview

Auditees were requested to provide lists of all the senior executives who had received severance payments during the four years ended December 2007. In this Chapter, we summarise the data in a series of charts to provide a summary perspective on the amounts paid. Detailed review of the payments follows in Chapter 2.

## 1.1 *Comparison of severance payments by organisation type*

Figure 1 shows the average severance payments for the audit sample in each organisation type (e.g. government department or GBE).

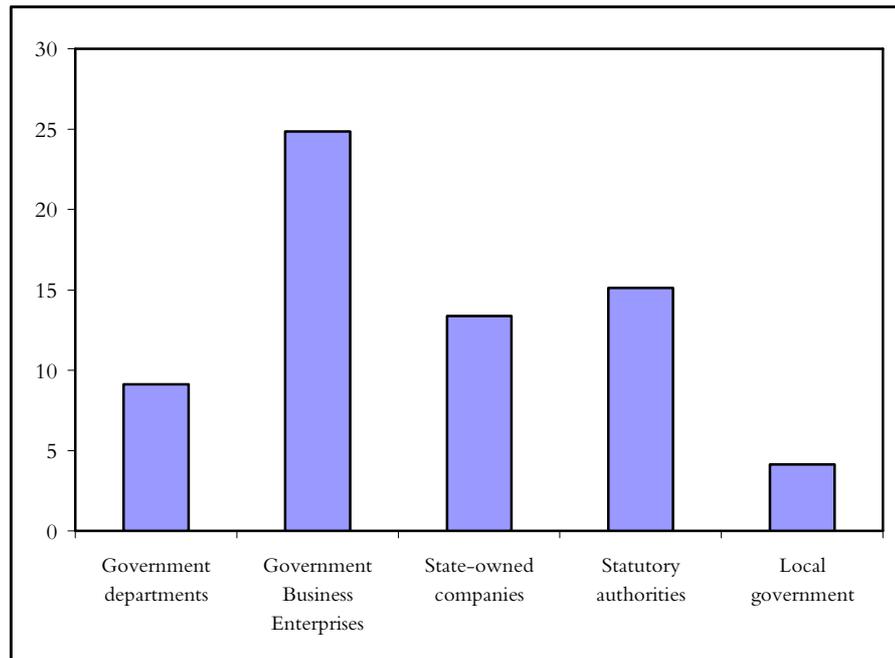
**Figure 1: Average amounts of severance payments**



There was a wide disparity between average severance payments. However, analysis indicated that direct comparison was misleading for two reasons:

- Average executive salaries captured in the sample were higher in GBEs and SOCs than in government departments, statutory authorities and local government councils.
- One large payment in the GBEs had a skewing effect on a small sample.

A more useful representation can be obtained by comparing the payments as a portion of the payees' annual salary or the number of months' salary paid as in Figure 2.

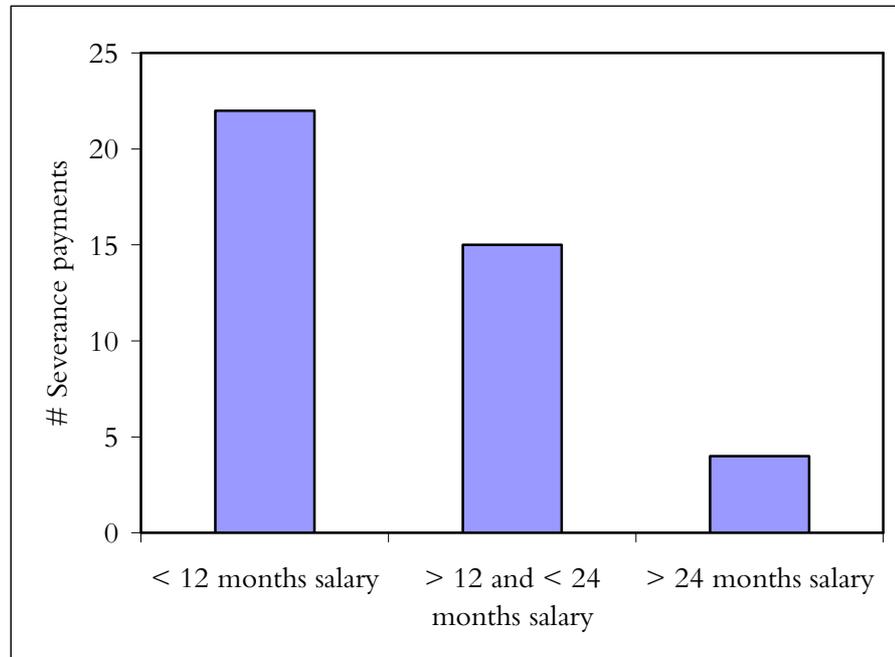
**Figure 2: Average severance payments in months of salary**

Even with the adjusted information, average severance payments were higher in SOCs and statutory authorities, and considerably higher in GBEs, than in either government departments or local government. This may partially reflect individual circumstances in what was a small sample. Some other reasons for the disparity are discussed in Chapter 2.

## 1.2 *Banding of severance payments*

Figure 3 compares the amounts received as severance payments to the payees' annual salary.

**Figure 3: Banding of severance payments in months of salary**



Twenty-two of the 41 severance payments in the sample were less than individual payee's annual salary, with only four payments exceeding two years' salary. Individual severance payments are reviewed in Chapter 2.

In Figure 4, we also compared severance payments to the amounts that would have been paid if the contracts had been completed.

**Figure 4: Banding of severance payments as a proportion of unpaid salary**

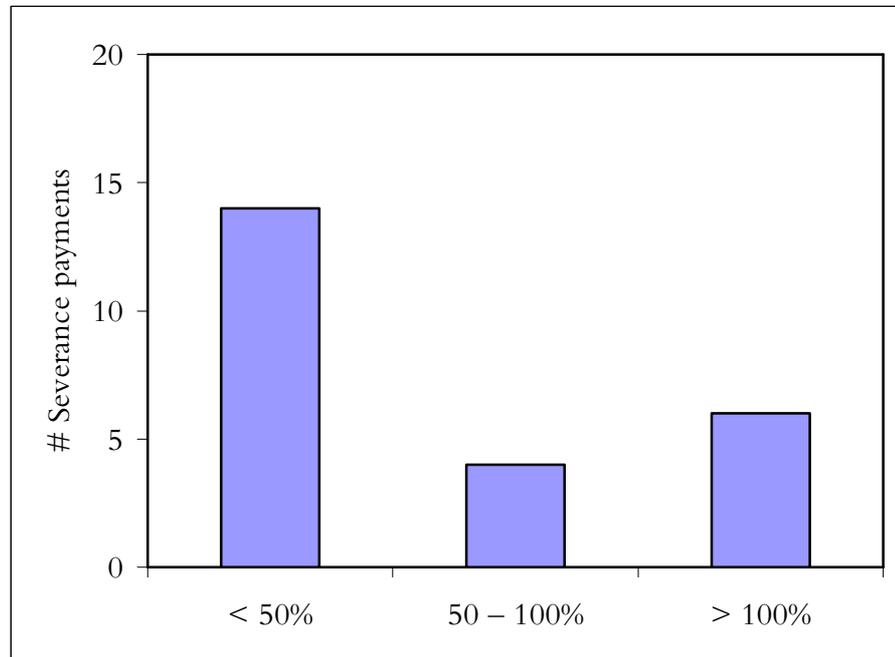


Figure 4 shows that the majority of severance payments are less than half of the salary that would have been paid if the contract had been completed.<sup>1</sup>

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<sup>1</sup> Figure 4 reflects the 24 severance payments related to unfulfilled contracts. The remainder of the 41 cases in the audit sample are not included in this comparison as they either related to on-going contracts or ran to full term.



## 2 Audit findings

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## 2 Audit findings

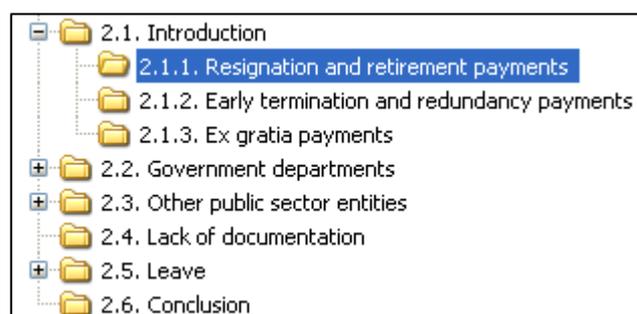
### 2.1 Introduction

Severance payments made to senior executives are calculated according to one or a combination of the following elements:

- retirement or resignation
- termination
- redundancy
- ex gratia.

Typically, severance payments also include payment in lieu of any outstanding leave entitlements and any unpaid salary.

#### 2.1.1 Resignation and retirement payments



Resignation and retirement severance payments are usually straight forward. When a senior executive chooses to resign — to take up alternative employment for example — the severance payment is made up of only unpaid salary and any outstanding leave entitlements.

Where an employee initiates termination of an employment contract there is no entitlement to

a severance payment beyond outstanding leave entitlements and any unpaid salary. However, if the employer terminates the contract — other than for misconduct — the employee may be entitled to a termination or redundancy payment or a combination of both as well as any payment in lieu of outstanding leave entitlements and any unpaid salary.

In practice, there are ‘grey areas’ in determining which party has terminated the contract and it was unusual for this matter to be explicit in the termination documentation. For example, an employee unable to perform his or her duties because of ill-health will typically discuss the matter with his or her employer and negotiate terms for release.

#### 2.1.2 Early termination and redundancy payment

We noted that executive contracts may include one or both of two payment elements in the event that the employer terminates a contract:

- Early termination payment is effectively compensation for the employment not being allowed to run for the

expected term and is typically based on the time remaining on the contract.

- Redundancy effectively treats the contract as part of long-term permanent employment and is typically paid when an employee's position is abolished. It is calculated on years of service against an entity-specific schedule.

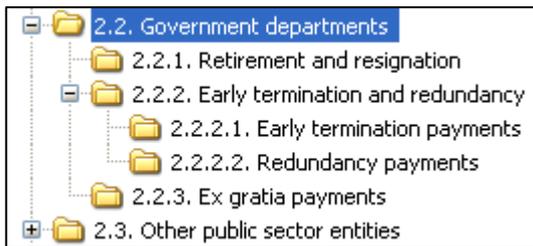
It is not uncommon for severance payments to contain both termination payments based on time unfulfilled on a contract and a redundancy payment based on years of service. In our view, the two components are for very different reasons and should be addressed separately in employee contracts. A related recommendation (i.e. No. 2) is included at the end of section 2.2.3.

### **2.1.3 Ex gratia payments**

The term *ex gratia* is used to describe any payments made beyond the entitlements explicitly defined in an instrument of appointment, an employment contract, or any other formal agreement (e.g. legislation or an enterprise bargaining agreement).

Typically, *ex gratia* payments are used to address untested legal or moral obligations rather than explicit contractual obligations. *Ex gratia* amounts can be negotiated to ensure the reasonableness of severance payments according to individual circumstances.

## 2.2 Government departments



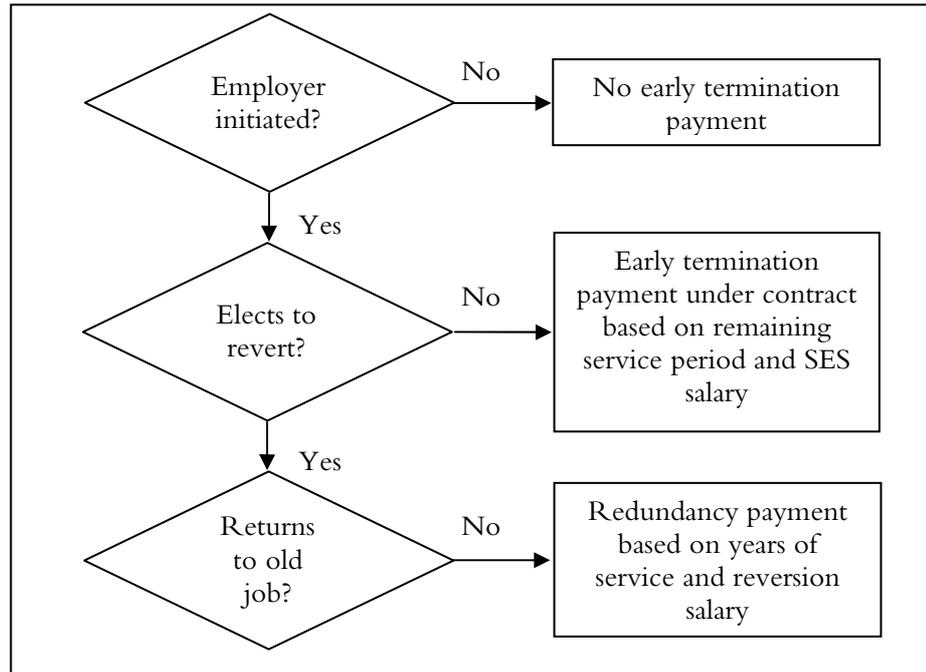
Within government departments, standard instruments of appointment are generally used to employ SES personnel and Heads of Agencies. The Public Sector Management Office (PSMO) of the Department of Premier and Cabinet must be consulted to arrange for the responsible Minister to approve any special arrangements.

When an employer terminates a contract prior to its completion, the employee is entitled to an early termination payment in accordance with the employment contract and generally this is based on the unfulfilled time remaining on the contract. The standard instrument of appointment used to employ senior executives in government departments makes no provision for a redundancy payment.

However, executives who had held a permanent position with the state service immediately before their appointment to the executive service have the option to revert to a permanent state service position. The standard instrument of appointment specifies that on reversion an officer is not entitled to an early termination payment.

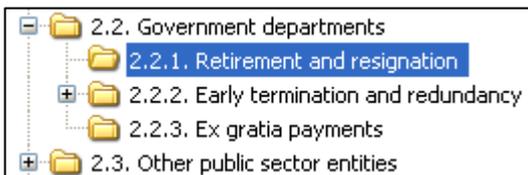
In practice, it is rare for an employee to return to the state service having worked at the executive level; more often no suitable reversion position exists. A redundancy payment is then calculated from the reversion-level position, not at the executive position, since the instrument of appointment does not include redundancy provisions.

Effectively, terminated executives have a choice between an early termination payment based on the time remaining on the executive contract and a redundancy payment based on years of service. The decision path is represented diagrammatically in Figure 5.

**Figure 5: Termination and redundancy summary**

In addition, Heads of Agencies have sometimes approved the provision of ex gratia payments, either in addition to or in place of payments that would be otherwise due. Ex gratia payments are discussed further in section 2.2.3.

### 2.2.1 *Government departments: retirement and resignation*



Severance payments made at retirement are usually limited to remuneration in lieu of leave entitlements. Of the 20 severance payments examined within government departments, four could be classified as retirement or resignation payments. Where adequate documentation enabled us to check the figures, we

found all of the retirement and resignation payments had been calculated correctly.

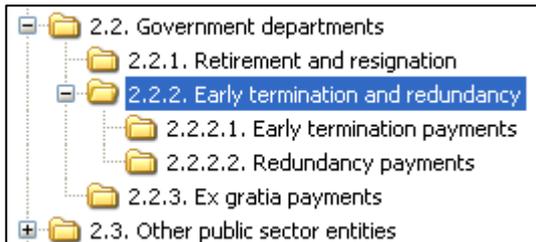
However, we also found that in most cases it was unclear which party had initiated termination of the contract, that is, whether the employee had retired, resigned or had their contract terminated. As noted in section 2.1.1, determining who had initiated the severance is an important factor in calculating entitlements under employee contracts.

Although often a sensitive matter involving issues of confidentiality, determination of which party initiated the termination of an employment contract should be unambiguous and clearly documented in the termination papers.

**Recommendation 1**

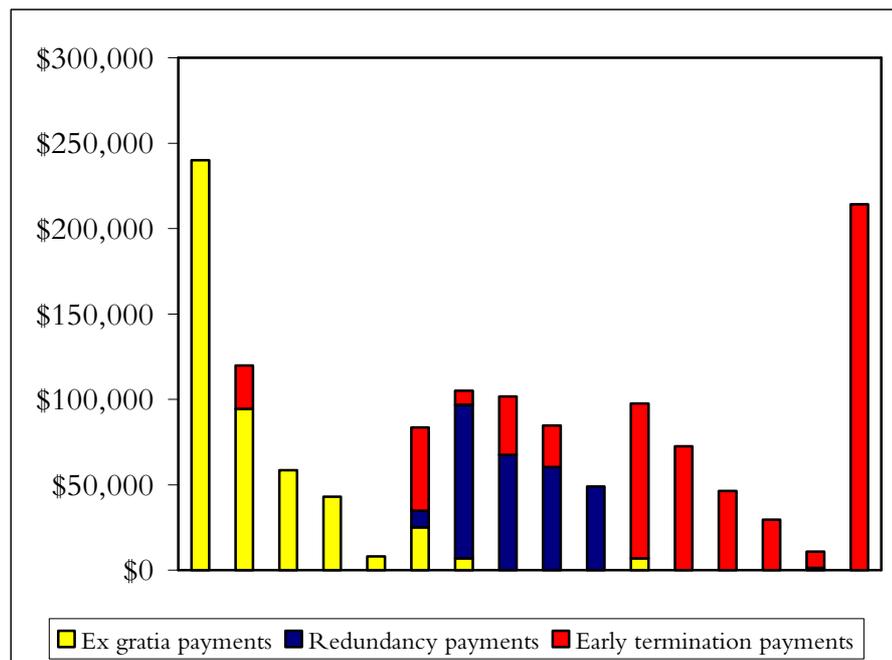
**We recommend that documents clearly indicate which party (i.e. employer or employee) initiated an executive termination so that the basis for severance payments is transparent.**

**2.2.2 Government departments: early termination and redundancy**



We reviewed 16 severance payments made in government departments that included early termination, redundancy or ex gratia components as well as leave entitlements. Figure 6 shows the early termination, redundancy and ex gratia components of each of the severance payments.

**Figure 6: Government departments: severance payment components**

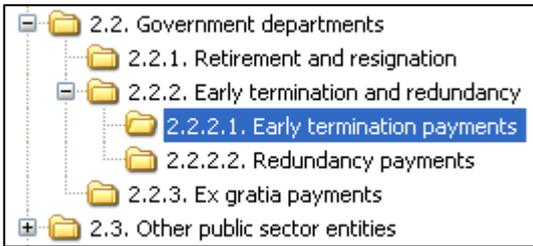


We have discussed the 16 payments under the following categories:

- early termination payments (section 2.2.2.1)
- redundancy payments (section 2.2.2.2)
- ex gratia payments (section 2.2.2.3).

However, there is some overlap and some of severance payments are discussed in more than one of the following subsections.

### 2.2.2.1 Government departments: early termination payments



Standard instruments of appointment provide a schedule for employer-initiated early termination payments based on time remaining on the contract. Typically, Head of Agency or SES employment contracts are for either a three- or five-year period. The standard schedule for a five-year contract is shown in Table 2.

**Table 2: Formulae used to calculate termination payments**

Year terminated	SES personnel	Heads of Agencies
1 <sup>st</sup> or 2 <sup>nd</sup>	1:6*	12 months' salary
3 <sup>rd</sup> or 4 <sup>th</sup>	1:6	9 months' salary
Final	1:6	6 months' salary

\*One week's salary for every six weeks of the unexpired contract period.

We found that four of the 11 early termination payments reviewed were paid strictly in accordance with the provisions of the applicable contracts. The seven non-standard early termination payments were:

- In addition to an early termination payment of \$25 319, one severance payment included an ex gratia payment of \$94 447 representing the remaining remuneration available under the unfulfilled contract. (79% of the \$119 766 severance payment).
- In addition to an early termination payment of \$24 359, one severance payment included a 'redundancy' payment of six months' salary and the right to a career transition allowance to an estimated total value of \$65 377 (77% of the \$84 736 severance payment).

There were indications that the six months of salary was a redundancy from the reversion-level position, but given that the contract precluded payment of an early termination payment on reversion, it was effectively an ex gratia payment. This payment is also discussed in section 2.2.2.2.

- In addition to payment in lieu of notice (PILON) of \$3 345 and an early termination payment of \$45 454, one severance payment included a 'redundancy' payment of \$9 737 and payment of a relocation allowance of \$25 000. Collectively, these ex gratia amounts (\$34 737) represented 42% of the total severance payment of

\$83 536. The ‘redundancy’ payment is also discussed in section 2.2.2.2.

- In addition to an early termination payment of \$34 211, one severance payment included ‘redundancy’ of \$67 546 (66% of the \$101 758 severance payment). This payment is also discussed in section 2.2.2.2.
- Three smaller gratuities represented 7% and 9% and 12% of the respective severance payments in the form of career transition allowances or extended use of motor vehicles and mobile phones.

In our view, all of the above non-standard payments represent ex gratia payments. All of the ex gratia amounts were approved by Heads of Agencies. However, it is noteworthy that there was a wide disparity in the extra payments with four of the 11 payees receiving none while others received large ex gratia amounts.

A related recommendation (i.e. No. 3) is included at the end of section 2.2.3.

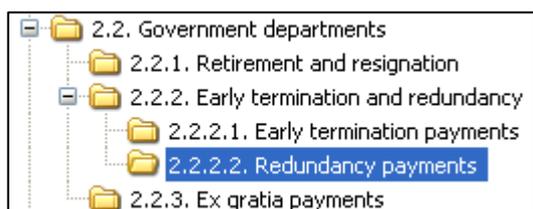
#### 2.2.2.2 *Government departments: redundancy payments*

Unlike many executive contracts used in the wider public sector (e.g. GBEs and statutory authorities), the standard instruments of appointment used in government departments do not include any redundancy provisions.

Following termination of an executive appointment, an officer may be eligible to revert to a previous permanent employee status<sup>2</sup>. However, the standard instruments of appointment specify that in the event that an officer reverts to permanent employee status he or she is not entitled to the early termination payment specified in that instrument.

Guidelines are available to support Heads of Agencies considering individual circumstances including redundancy. In our view, if a severance payment is calculated as a redundancy following the election to revert to permanent employee status, it should be based on the salary rates for the state service level to which the employee had reversion rights and not the salary payable under the SES contract. It is also our view that, in the absence of a contractual redundancy provision, any other negotiated ‘redundancy’ amount has the nature of an ex gratia payment.

However, none of the five redundancy amounts in the sample of 20 severance payments made in government departments were made in



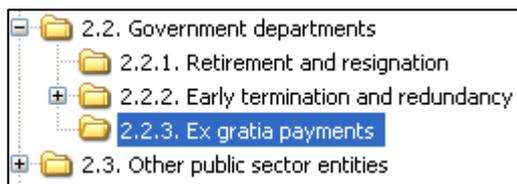
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<sup>2</sup> Section 38(4) of the *State Service Act 2000*

accordance with the above mentioned guidelines. The five non-standard redundancy payments included:

- Two redundancy payments were based on the SES salary rather than the state service reversion-level salary. It was not always clear whether the higher rate paid was the result of an error or of a deliberate decision to include an ex gratia component.
- Three severance payments (as noted in section 2.2.2) contained both an early termination component based on the executive contract and an additional redundancy component. In one case, the redundancy component was based on SES salary. In another, it was based on reversion-level salary and in the third instance we were unable to find documentation to determine the basis for payment. Our concerns with documentation are discussed in section 2.4.

### 2.2.3 *Government departments: ex gratia payments*



As previously noted in section 2.2.2.1, ex gratia payments and other items (e.g. use of motor vehicles and mobile phones) were commonly used to supplement early termination payments, although in some instances it was again not clear whether the additional payment was an error or a deliberate decision to make an additional

payment. We found all of the ex gratia amounts had been made in good faith and had been approved by the Heads of Agencies.

Discussions that we held with agencies and the PSMO indicated that there was a widespread view that existing early termination provisions were not adequate and could potentially be subject to legal challenge. Unfortunately, that concern appears to have led to an inconsistent approach to determining severance payments in government departments.

We also noted the following instances where:

- The entire severance payment of \$240 000 was of an ex gratia nature. The amount was a negotiated settlement and approximately equivalent to 12 months of the employee's SES salary.
- An ex gratia payment of \$58 471 representing six months' salary had been negotiated in place of the early termination payment of \$43 403 according to the terms of the contract. In our opinion, the difference represented an ex gratia amount of \$15 068 or 13% of the total severance payment of \$115 691.

- A redundancy payment was calculated on the SES salary instead of the state service reversion-level salary. However, from the documentation, it was clear that the payment of \$43 000 was intended as an ex gratia payment rather than an error in the salary rate.
- We were unable to locate documentation to support an apparent ex gratia payment of \$8 000.

We have no particular concerns with any of the ex gratia payments and note that all were approved at Head of Agency level or above. However, we were concerned that many of those ex gratia amounts were not identified as such nor justification provided in payment documentation. It is also our view that, because of their discretionary nature, it would be preferable that such payments be approved or ratified at the highest level of governance (e.g. Ministerial level).

#### **Recommendation 2**

**We recommend that the standard instruments of appointment for both SES employees and Heads of Agencies be reviewed to determine whether they accurately reflect the intended conditions and provide for an appropriate balance of risk and reward.**

**Consideration should be given to:**

- **inclusion of both redundancy and early termination provisions**
- **review of the reasonableness of the 1:6 early termination payment formula**
- **retention of the early termination payment when the employee reverts to a prior position since the two rights would appear to be unrelated.**

#### **Recommendation 3**

**We recommend that ex gratia payments should be:**

- **approved or ratified at the highest level of governance**
- **clearly identified in supporting documentation as ex gratia payments and rationale provided.**

## 2.3 Other public sector entities

In this section we examine termination and redundancy payments made by public sector entities other than government departments including GBEs, SOCs, statutory authorities and local government councils. Our sample consisted of 21 severance payments.

### 2.3.1 Other public sector entities: retirement and resignation



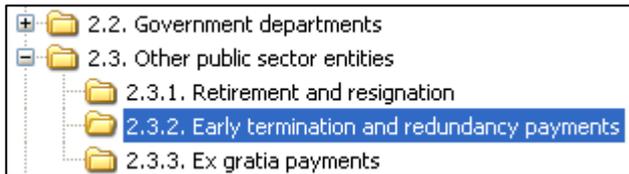
Four of the 21 severance payments were classified as resignation payments. We found that all of the resignation payments had been calculated correctly.

Three of those resignation payments contained only outstanding salary and payments in lieu of leave entitlements. The fourth example included an ex gratia payment negotiated in settlement of a superannuation claim. This payment is also discussed in section 2.3.3.

However, as with government departments, we found that in most cases it was unclear in the documentation who had initiated the termination of contract, that is, whether the employee had retired, resigned or had his or her contract terminated. As stated in Recommendation 1:

We recommend that documents clearly indicate which party (i.e. employer or employee) initiated an executive termination so that the basis for severance payments is transparent.

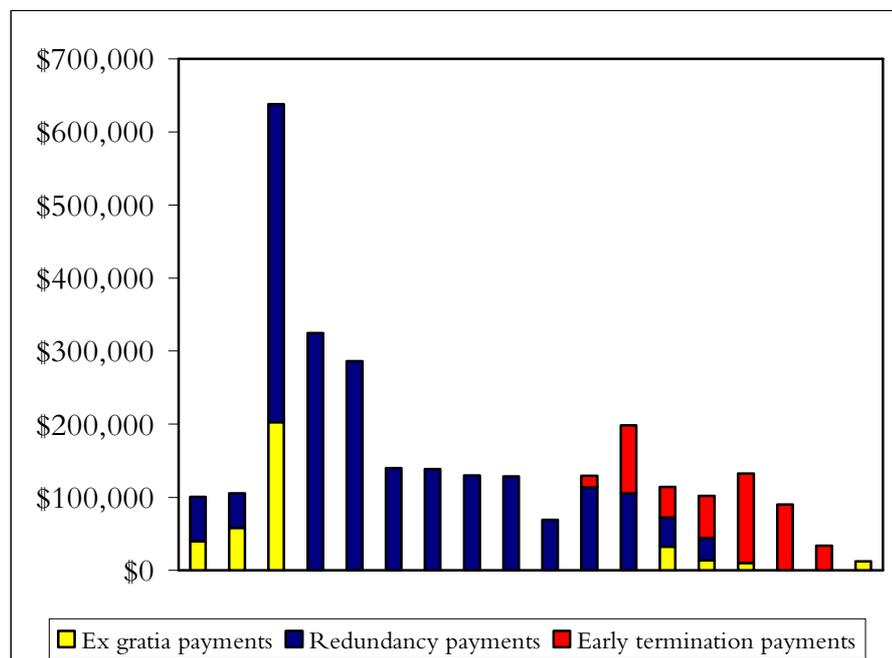
### 2.3.2 Other public sector entities: early termination and redundancy payments



Seventeen of the severance payments in the wider public sector included early termination and/or redundancy payments. Figure 7 shows the amounts of the early termination and redundancy components for each of the sampled payments, and the ex gratia amounts. It also

shows the ex gratia payment negotiated in settlement of a superannuation claim, and discussed in section 2.3.3.

**Figure 7: Breakup of severance payment components**



As discussed in section 2.1.2, we believe there is a case for inclusion of both early termination and redundancy provisions in contracts.

Generally, we found that executive employment contracts in the wider public sector made provision for redundancy payments. Commonly, the schedule for these redundancy payments provided full salary for six weeks plus two weeks for each completed year of service with the organisation.

Two of the other public sector entities also included explicit early termination provisions in their contracts. All executive employment contracts included provisions for PILON, which can have the same effect as an early termination payment. However, some contracts also provided the employer with discretion to require employees to work throughout the notice period. Accordingly, all organisations had the discretion to make a form of early termination payment, but were not necessarily obliged to do so.

**Recommendation 4**

**We recommend that public sector executive contracts be reviewed to determine whether they provide a fair and consistent basis for compensation for early termination of contracts, as well as redundancy provisions for loss of long-term employment.**

We found that eight of the 17 payments were entirely in accordance with the terms provided in the applicable contracts.

Nonetheless, we noted the following non-standard payments:

- One redundancy payment of \$68 741 was made that, according to the documentation available, could have been accompanied by 6 months' PILON (\$72 792) under the terms of the contract.
- One redundancy payment of \$138 875 was made for which we were unable to find any supporting documentation.

In addition, seven of the 17 employer-initiated termination payments in other public sector entities were supplemented with ex gratia payments and are included in the discussion in section 2.3.3 below.

### **2.3.3 Other public sector entities: ex gratia payments**



As discussed in section 2.3.1, one resignation payment included an ex gratia amount negotiated in settlement of a superannuation claim.

We also found seven further examples of ex gratia amounts amongst the early termination and

redundancy payments discussed in section 2.3.2.

The ex gratia amounts ranged from \$10 000 to \$202 808 and included:

- an employee received a negotiated settlement (\$33 745), equivalent to 12 weeks salary, in consideration of the employee's unfulfilled expectation that a six-month extension of contract could lead to a three-year contract
- payment of \$202 808
- payment of \$57 845
- payment of \$39 688
- six months of PILON and an ex gratia payment of \$32 094

- six months of PILON and an ex gratia payment of \$13 370.

In addition, we also noted two other instances of ex gratia payments:

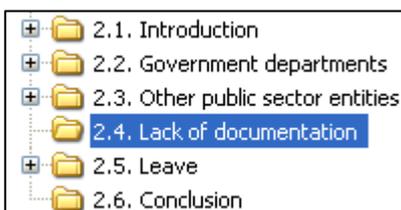
- In one case, a sum of \$12 000 was negotiated on resignation, to settle a superannuation claim.
- In addition to an early termination payment and six months of PILON, the severance payment included \$20 000 relocation allowance. As the employment contract provided for only \$10 000 relocation allowance, we considered the remaining \$10 000 an ex gratia payment.

All of the ex gratia amounts had been approved by either Chief Executive Officers or General Managers as provided under applicable legislation. As discussed in section 2.2.3, it is our view that as these payments were discretionary, they should have been approved or ratified at the highest level of governance (e.g. Remuneration Committee of Board of Directors).

#### **Recommendation 5**

**We recommend that ex gratia payments be authorised at the highest level of governance in an entity (e.g. Remuneration Committee of Board of Directors).**

## **2.4 Lack of documentation**



A common problem in both government departments and other public sector entities was inadequacy of documentation to enable us to determine:

- which party had initiated the termination
- whether or not the employee had exercised any reversionary rights (government departments)
- on what basis some of the other payments had been made or who had approved the payments.

Three payments in particular had insufficient documentation to allow us to validate their accuracy or completeness:

- As discussed in the section 2.2.2.2, we found one redundancy payment of \$138 875 without any supporting documentation.
- We found one ex gratia payment of \$8 000 without any supporting documentation.
- Another severance payment was composed entirely of leave entitlements, suggesting the executive resigned.

However, we could find no documentation to allow us to validate that assumption.

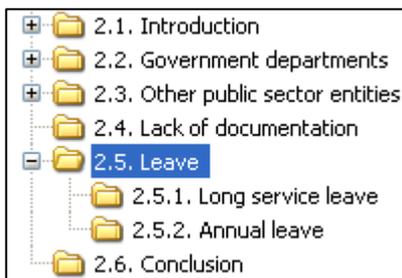
As stated in Recommendation 1:

We recommend that documents clearly indicate which party (i.e. employer or employee) initiated an executive termination so that the basis for severance payments is transparent.

### Recommendation 6

**We recommend that the basis on which all payments are made — and who authorised them — be clearly identified and recorded in termination documentation.**

## 2.5 Leave



Regardless of the circumstances under which an employee leaves an organisation, he or she may be entitled to payment in lieu of outstanding annual or recreation leave, as well as long service leave.

The accrued value of outstanding leave is a significant financial liability so public sector entities need to have procedures in place to manage employees' leave balances.

### 2.5.1 Long service leave

Long service leave (LSL) in the public sector is subject to the *Long Service Leave (State Employees) Act 1994* that includes:

... State Service officers, State Service employees or any other person who is employed in any capacity by a State authority or a prescribed employer ...

“State authority” means –

- a) any person appointed by the Governor under any Act; or
- b) any body constituted or established under any Act

to administer any department, business or undertaking on behalf of the State<sup>3</sup>

Accordingly, all entities that we audited were subject to that legislation and we found each had made reference to the Act in their terms and conditions of employment.

An employee in the public sector is entitled to receive 65 days LSL after ten years continuous service. After ten years, the LSL entitlement is augmented by 6.5 days for each successive year of full-time continuous service. An employee is entitled to a pro-rata payment if

<sup>3</sup> Section 3 of the *Long Service (State Employees) Act 1994*

he or she leaves the public sector after seven years. However, the *Long Service (State Employees) Act 1994* also specifies that an employee is not entitled to a credit in excess of 100 days unless approved by the Minister.

We found all of the entities included in the audit had policies and procedures to manage LSL balances and all complied with the requirements of the Act.

### 2.5.2 Annual leave

Unlike LSL, annual leave is not covered by a specific Act. Instead, agencies are directed under regulations attached to the *State Service Act 2000* to ensure employees take annual leave within twelve months of leave becoming due to them. Effectively, this means employees' annual leave balances should not exceed 40 days. Whilst the directive does not specifically apply to other public sector entities, all of these entities had procedures in place to manage annual leave to the same levels.

We found 13 severance payments that included payments for entitlements to more than 40 days leave. This included five instances amongst the six government departments we visited and one in each of the other entities.

In relation to large leave balances, some of the explanations that were offered were:

- excessive leave entitlements built up many years prior to the introduction of annual leave management policies
- employees brought large leave balances with them on transfer from another organisation
- in some instances, when excessive leave balances had been identified within months of the contract expiry date or the imminent termination of a contract, it was considered impractical to request the senior executive take leave prior to separation.

In many cases, it was contended that strategies to reduce some senior executives' annual leave entitlements to less than 40 days would require three to five years to be effective.

We were satisfied that all of the organisations had implemented policies, procedures and strategies to manage and reduce excessive leave balances.

## 2.6 Conclusion

The majority of severance payments do not appear to be excessive compared with service, salaries or with any unfulfilled part of the

contracts. However, we noted variations between the average amounts paid in state and local government compared with GBEs, SOCs and statutory authorities.

The variations reflected differences in severance provisions in employment contracts with organisations using different combinations of early termination, redundancy and PILON provisions. In most cases, contractual separation payments had been calculated accurately in accordance with the terms and conditions of respective employment contracts.

However, in many instances, ex gratia payments were also made some of which were large relative to the contractual separation payments. Typically, the ex gratia payments were motivated by a perceived need to meet untested legal or moral obligations rather than being ‘golden handshakes’.

We found all of these ex gratia amounts were made in good faith and had been approved by the Heads of Agencies. While the ex gratia payments were all approved, we were concerned that some payments:

- had not been ratified at the highest level of governance (e.g. Board of Directors, full Council or Minister)
- were often not supported by documented rationale
- were being used to offset contracts that were widely believed to offer inadequate compensation to terminated employees
- varied widely between employees in similar circumstances.

Many severance payments did not have adequate documentation to determine which party had initiated termination of the employment contract, on what basis payments had been made or who had authorised them.

Finally, we also found some leave balances were high at the time of termination and triggered large payments to separating employees. Nevertheless, all of the audited organisations had recently implemented policies, procedures and strategies to manage excessive leave balances.



### **3 Recent reports**

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### 3 Recent reports

<b>Year</b>	<b>Special Report No.</b>	<b>Title</b>
2004	52	Internal audit in the public sector
2005	53	Follow-up audits
2005	54	Compliance audits
2005	55	Gun control in Tasmania
2005	56	TT-Line: Governance review
2005	57	Public housing: Meeting the need?
2005	58	FBT Payment of accounts Asset management: Bridges
2006	59	Delegations in government agencies Local government delegations Overseas Travel
2006	60	Building security Contracts appointing Global Value Management
2006	61	Elective surgery in public hospitals
2006	62	Training and development
2006	63	Environmental management and pollution control act by local government
2006	64	Implementation of aspects of the <i>Building Act 2000</i>
2007	65	Management of an award breach Selected allowances and nurses' overtime
2007	66	Follow-up audits
2007	67	Corporate credit cards
2007	68	Risdon Prison: Business case
2007	69	Public building security
2007	70	Procurement in government departments Payment of accounts by government departments
2007	71	Property in police possession Control of assets: Portable and attractive items
2008	72	Public sector performance information
2008	73	Timeliness in the Magistrates Court
2008	74	Follow-up audits

## 4 **Current projects**

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## 4 Current projects

Performance and compliance audits that the Auditor-General is currently conducting:

<b>Management of threatened species</b>	Examines the measures in place to protect native species and biodiversity in Tasmania.
<b>Complaint handling by local government</b>	Examines processes used by local government in handling external complaints.
<b>Hydro hedges</b>	Examines processes for approving currency and interest hedges.
<b>Contract management</b>	Examines the effectiveness of contract management practices in a number of key government contracts.
<b>Profitability, and economic benefits to Tasmania, of Forestry Tasmania</b>	Evaluates Forestry Tasmania's financial and economic performance.
<b>Food safety — eggs</b>	Examines the effectiveness of the government's role in food safety with emphasis on egg production, retail of raw eggs and manufacture and sale of egg-related products.

## 5 Appendices

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## 5 Appendices

### *Appendix 1: Legislation*

#### *General government sector:*

SES employees, including Heads of Agencies and Prescribed Officers, are employed according to the *State Service Act 2000*. Remuneration is subject to the SES award and *Public Sector Superannuation Reform Act 1999*.

Equivalent Specialists are employed on individual contracts in highly specialised roles such as the Director of Thoracic Medicine. The substantive contract for such a position may require an SES Level 2 employee. However, the doctor required to fill the role may be accustomed to a substantially higher rate of remuneration. In order to attract suitable personnel to Equivalent Specialist positions an agency's Chief Executive Officer may approach the Premier for approval to negotiate a suitable rate of remuneration at current market rates. Following approval to extend the remuneration package the Premier delegates full power of appointment and termination to the HoA.

#### *Government Business Enterprises:*

GBE Directors and CEOs are employed according to the *Government Business Enterprise Act 1995*. Key executives are appointed under various contractual terms.

The *State Service Act 2000* does not apply in relation to GBE Directors or to employees unless the GBE is also a government agency.

#### *State-owned companies:*

Aurora Energy Pty Ltd is governed by the *Electricity Companies Act 1997*.

Transend Networks is governed by the *Electricity Supply Industry Act 1995*

Tasmanian Ports Corporation Pty Ltd was formed under *Tasmanian Ports Corporation Act 2005*. Prior to the amalgamation Tasmanian ports were governed by the *Port Companies Act 1997*.

TT-Line Company Pty Ltd was established under the *TT-Line Arrangements Act 1993*.

TOTE Tasmania is governed by the *TOTE Tasmania Act 2000*.

#### *Statutory authorities and public bodies:*

Retirement Benefits Fund Board is governed by the *Retirements Benefits Act 1993*.

TAFE Tasmania is a body corporate established by the Minister under the *TAFE Tasmania Act 1997*.

*The University of Tasmania Act 1992* governs the University of Tasmania.

#### *Local government:*

Councils are governed by *the Local Government Act 1993*.

## *Appendix 2: Entities that we approached*

We examined termination payments made to senior executives drawn from the public sector entities listed below. Not all of these entities had made severance payments within the period December 2003 to December 2007.

### *All government departments:*

Economic Development  
Education  
Health and Human Services  
Infrastructure, Energy and Resources  
Justice  
Police and Emergency Management  
Premier and Cabinet  
Primary Industries and Water  
Tourism, Arts and the Environment  
Treasury and Finance

### *Government Business Enterprises:*

Forestry Tasmania  
Hydro Tasmania  
Motor Accidents Insurance Board  
Port Arthur Historic Site Management Authority  
The Tasmanian Public Finance Corporation  
The Public Trustee

### *State-owned companies:*

Aurora Energy Pty Ltd  
Tasmanian Ports Corporation Pty Ltd (including Burnie, Hobart, Devonport and Launceston Corporations)  
Transend Networks Pty Ltd  
TT Line Company Pty Ltd  
TOTE Tasmania Pty Ltd

### *Statutory authorities and public bodies:*

Retirements Benefits Fund Board  
TAFE Tasmania  
University of Tasmania

### *Local government:*

Devonport City Council  
Launceston City Council  
Northern Midlands Council  
Latrobe Council  
Flinders Council  
Kentish Council