Bye now, pay later?

The management of early retirement in local government

Accounts Commission for Scotland

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The Accounts Commission is a statutory, independent body which, through the audit process, assists local authorities and the health service in Scotland to achieve the highest standards of financial stewardship and the economic, efficient and effective use of their resources.

The Commission has five main responsibilities:

- securing the external audit
- following up issues of concern identified through the audit, to ensure satisfactory resolutions
- reviewing the management arrangements which audited bodies have in place to achieve value for money
- carrying out national value for money studies to improve economy, efficiency and effectiveness in local government and the NHS
- issuing an annual direction to local authorities which sets out the range of performance information which they are required to publish.

The Commission secures the audit of 32 councils, 36 joint boards (including police and fire services), 15 health boards, 47 NHS trusts and five other NHS bodies. In total, these organisations spend public funds worth around £12 billion a year.

The Commission welcomes comments and enquiries about its reports. Comments on this report should be directed to Steve Evans (Director of Value for Money Studies, Local Government) or Douglas Black (Manager, Local Government Studies), on 0131 477 1234.

Preface

Early retirement of local authority employees has become more common. This has fundamental implications for authorities' revenue budgets, pension funds and the personal circumstances of many tens of thousands of employees.

The Accounts Commission for Scotland has studied the management and control of early retirement. The study was conducted during the course of the 1997 calendar year. This report distils the study's findings and is directed principally at councillors, chief executives, heads of service, managers with responsibility for making decisions on early retirement and pension fund administrators. It will also be of interest to a broader audience interested in pensions and local government finance.

The Commission's study was informed by a questionnaire returned by all of Scotland's councils, two-thirds of joint fire brigades and two-thirds of joint police forces. In addition, information on the volume and cost of early retirements was extracted from pension fund systems for seven of the eleven administering authorities, and fieldwork was undertaken in four local authorities.[1]

The following bodies provided valuable advice and assistance:

- the Audit Commission, which has undertaken a parallel study in England and Wales
- Hymans Robertson, a firm of consulting actuaries
- COSLA Consultancy, who won the contract to provide support in the early part of the study.

We would also like to express our appreciation to the study's Advisory Group, comprising a range of experts from the field of local government finance and personnel.[2] The Group provided valuable advice and acted as a useful sounding board for the Commission's thinking.

Nevertheless, the Accounts Commission retains sole responsibility for the findings and recommendations.

The Commission will use this report, along with the forthcoming management handbook and audit guide, to plan and focus audit reviews in 1997/98.

Executive summary

The Local Government Pension Scheme (LGPS) caters for local authority employees other than teachers and fire-fighters, and also covers civilians within police forces and control room and non-uniformed employees within fire brigades. Teachers, police officers and fire-fighters have separate pension arrangements.

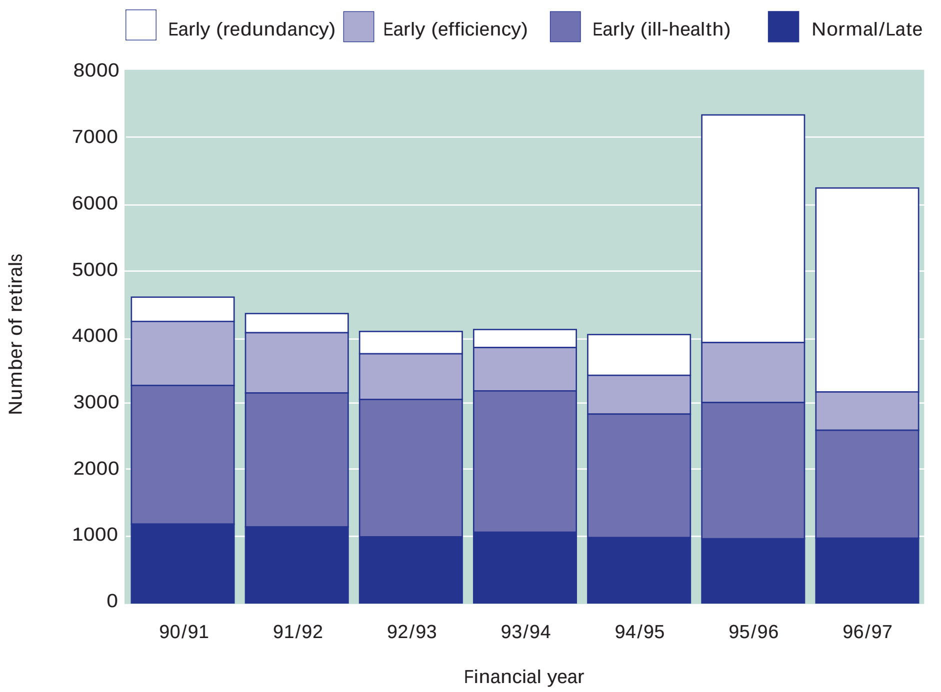
The Scheme works by each employee paying a regular contribution to a pension fund from his or her salary or wages. The employer also makes a contribution on behalf of each employee. Contributions are invested in a fund that pays for each member's retirement costs.

The LGPS was founded nearly a century ago, at a time when many local government employees spent much of their working life in stable employment before retiring at the normal age. The Scheme assumes that an employee typically retires between the ages of 60 and 65, with at least 25 years of pension contributions. It is expected that some employees will retire early. There are three types of early retirement: due to permanent ill-health, in the interests of efficiency, and due to redundancy.

However, early retirement has become the norm rather than the exception, placing strains on the way the LGPS works. Over the period from 1990/91 to 1994/95, the total number of retirals decreased but the incidence of early retirement remained at around 75% of all retirals. There was a sharp increase in retirals in 1995/96 due to large numbers of redundancies arising from local government reorganisation (exhibit 1). High levels of early retirement continued in 1996/97.

Exhibit 1: The early retirement trend in Scottish councils, 1990/91 to 1996/97

In 1995/96 there was a sharp increase in the number of early retirals.



Source: Accounts Commission surveys, 1997

For the period up to and including 1995/96, figures are grossed up to national figures from data for councils in seven out of the 11 funds, representing about 85% of council employees in the LGPS. Figures for 1996/97 are from the questionnaire survey.

Ill-health is generally the single most common route by which employees retire. In 1996/97, the level of early retirement on the grounds of ill-health was about twice that of normal retirement.

Scottish local authorities employed about 5,000 (3%) fewer full-time equivalent staff in March 1997 than in December 1994. This comparison excludes teachers, police and fire service staff and employees in functions transferred out of local authority control following local government reorganisation.[3]

There were an estimated 3,300 extra redundancy or efficiency early retirements in 1995/96 and 2,600 in 1996/97, compared with the average level over the preceding three years. The full cost of these early retirements was about £190 million, excluding redundancy payments.[4] This cost will be spread over several years to come, and there will also be savings from reductions in staff.

While there are reasons why the level of early retirement rose in 1995/96 and 1996/97, the high level over the last seven years raises questions about the management of early retirement by local authorities.

Early retirement can help in managing employee numbers and may generate savings by reducing employee costs. Where large revenue budget cuts have been needed, early retirement has helped to avoid painful compulsory redundancies.

Historically, authorities have tended to avoid compulsory redundancies by applying a policy of granting staff retiring early the maximum possible pension enhancements allowed within the statutory pension regulations, and hence promoting early retirement. However, early retirement comes at a price for both the revenue account and the pension fund - a price which is rarely fully defined or adequately compared with the corresponding savings which might accrue.

Count the cost

Costs to the employer's revenue account arise from the practice of awarding the employee added years of reckonable service to enhance pension entitlements, and possibly also redundancy payments.

Early retirement also brings additional costs to bear on the pension fund because the pension is drawn for a longer number of years than planned for in the Scheme's design and the fund loses several years of investment growth and the employee's contribution. These additional, but currently 'hidden', costs can amount to as much as the visible costs of the added years pension. In the case of ill-health retirement, where the award of added years is mandatory and not discretionary, the pension fund also bears the cost of the added years lump sum and the added years pension.

In many councils, councillors are not consulted about early retirement decisions. They should be given adequate information to enable them to take informed decisions, and to monitor the impact of decisions they have delegated to officers.

Councillors and senior managers need to be fully aware of the costs and benefits when making decisions. They should balance the interests of the individual retiring against the authority's responsibility to secure value for money.

Many authorities have inherited a tradition of no compulsory redundancies from their predecessors and, in some cases, a predisposition to award retiring employees the maximum possible benefits. Authorities should reconsider their policy on awarding added years in the light of what they can afford and what is fair to employees.

It is difficult to believe that the current level of ill-health retirements in many authorities represents the true, underlying rate of permanent ill-health among the workforce. Authorities that have not already done so should establish procedures to obtain independent medical advice from someone qualified in occupational health, and should ensure that applications for early retirement on the grounds of ill-health are scrutinised rigorously.

Reimburse the fund

It is the responsibility of an authority to be financially accountable for its decisions. The department that benefits from an efficiency or redundancy retirement should, therefore, reimburse the pension fund for the additional costs incurred. This will involve an agreement with the fund administrator on the capitalised cost of the strain on the pension fund and on the period over which repayment to the fund will be made.

Box 1 sets out recommended maximum periods over which the department that makes an efficiency or redundancy retirement should reimburse the pension fund for the strain on it. These periods take account of whether the fund is in surplus or in deficit, and of the period to the employee's normal retirement age, at the time of his or her early retiral.

Box 1: Recommended maximum repayment periods for early retirals other than ill-health retirals

		Pension fund's ratio of assets to liabilities		
		less than 90%	90% to 99%	100% or more
Period to Normal Retirement Age (NRA)[5]	less than 5 years	3 years or period to NRA, whichever is shorter	period to NRA	period to NRA*
	5 years or more	3 years	5 years	period to NRA*

* Except in specified circumstances

If the fund is in deficit, it would be prudent to provide for fast repayment. Where the funding level is below 90%, the recommended maximum period of three years is the same as the period between actuarial valuations of the fund.

However, where a fund is comfortably in surplus and an employer makes few early retirals, there will be less urgency to repay the strain on the fund. In such circumstances, the employer may prefer to allow the funding level to fall to nearer 100% than to make a payment into the pension fund. This may be acceptable to the administering authority provided there are separate contribution rates for each employer, the actuaries are content with the procedure and they have not already counted on all the surplus in setting the employer's contribution rate. Even then, the department making the early retirement should 'pay' the cost via a budget adjustment, over the period set out in box 1.

It is recommended that local authorities, key professional bodies and other relevant organisations co-operate to work out the best way of implementing this recommendation. The Chartered Institute of Public Finance and Accountancy (CIPFA) is currently considering the accounting issues on pensions and early retirements.

Ill-health retirals should be subject to rigorous scrutiny and clearly attributable to genuine ill-health. As such, they arise from circumstances outwith the immediate control of either the employer or the pension fund. The extra costs of such early retirals should have been taken into account in the valuation of the fund and the setting of the employer's contribution rate. So, provided the level of ill-health retirements is within expected bounds, there should be no need to pay additional money into the fund.

However, the level of ill-health retirements should be closely monitored by the administering authority. If it exceeds the actuary's forecast, the administering authority should consider the implications for the employer's contribution rate.

To ensure full transparency, summary financial data should be disclosed not only in the authority's accounts, but also in its annual report. The information on early retirements should set out the costs incurred within the financial year being reported and indicate the consequential costs falling in future years.

Different employer's rates of contribution will be appropriate if the level of early retirement varies significantly among the employers in the fund. Otherwise, an authority with a low incidence of early retirement will subsidise an authority that brings higher costs to bear on the fund because it has a higher incidence of early retirement.

Authorities will also wish to assimilate the advice contained in recent circulars published by the United Kingdom Steering Committee on Local Government Pensions.

Consider alternatives

After a tranche of early retirals, there are widespread human costs for the employer, the employees who leave and the employees who remain. The employer suffers a loss of skilled and experienced staff, and may have been forced to lose those who generated the best savings rather than those whose skills were least needed.

Authorities should not turn to early retirement as the first and only option when faced with budget cuts. Increased consideration should be given to exploring other options, including the redeployment of staff, recruitment restrictions and constraints on the use of overtime.

The need for early retirements could be better controlled by taking a strategic approach to planning the size and composition of the workforce, limiting the need to deal reactively with budgetary fluctuations. The Accounts Commission's recent publication *Managing people: the audit of management arrangements in local authorities* offers advice on this.

However, authorities' capacity to take a strategic approach is constrained, to some extent, by needing to work within a one-year planning and budgeting cycle. The proposed introduction of three-year planning under the Best Value regime should help.

Communicate

There should be regular communication between the administering authority's pension fund administrator and key officers and councillors within its constituent employers. This would help to raise awareness of pension issues and forewarn of potential problems.

Administering authorities should monitor a selection of key performance indicators between valuations of the fund, to allow them to judge whether the actuary's assumptions are being realised, or whether circumstances are changing so rapidly that they warrant prompt remedial action. Key indicators would include, for example, the incidence of ill-health retirals.

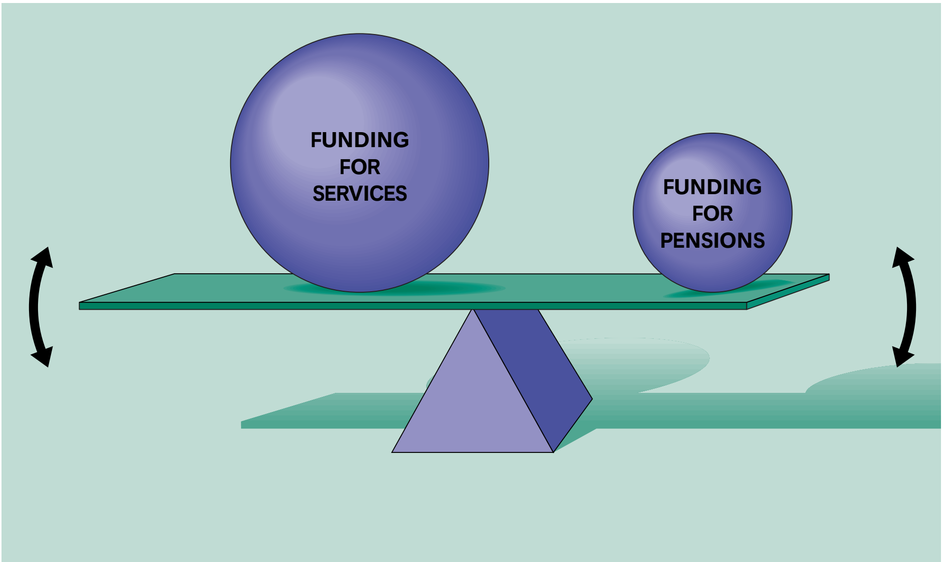
Exercise discretion

Early retirement has been, and will continue to be, an important tool which helps an authority to adjust its workforce profile to changing circumstances and to cater compassionately for genuine cases of ill-health.

It is for employers to exercise discretion in the management of early retirement and to ensure that early retirement is not only fair to the employee, but also gives value for money to the authority and secures service delivery without unduly straining the pension fund (exhibit 2).

Exhibit 2: Striking a balance

Decisions on early retirement need to balance funding for pensions against funding for services.



If early retirement continues at current levels, and if authorities do not confront the full costs, they will build up liabilities for the future that may threaten their capacity to deliver front-line services.

The Commission will be following up this report with local audits of the management of early retirement in most authorities in Scotland, and will be monitoring their responses to the report's recommendations.

1. The Scheme

There are 99 British local authority pension funds collectively referred to as the Local Government Pension Scheme (LGPS). In 1996, the 11 Scottish funds had total assets of around £8 billion.

The regulations governing the LGPS are intricate. The purpose of this report is not to provide an exhaustive description but to summarise them in a way that provides sufficient context for an understanding of early retirement issues. A glossary of terms is included at appendix 3 (page 45).

Brief history

The LGPS originated in 1922 when councils were given permissive powers to establish superannuation schemes. In 1937, this became a requirement. The Scheme was then governed by Acts of Parliament until 1974 when, under the powers in the Superannuation Act 1972, it was set out in regulations made by the Secretary of State without the need for further primary legislation. The regulations have since been amended frequently, were consolidated in 1987, and are in the process of a further consolidation and restructuring which will become effective on 1 April 1998.

Key players

Employing authority

The LGPS is a contributory scheme, with the employee and the employer both making contributions. The employee's contribution is fixed at a rate set by the pension regulations, with manual staff contributing 5% of pensionable earnings and other staff 6%. As from April 1998, all newly recruited employees will contribute at a fixed rate of 6% of their salary/wages. The employer's contribution is usually expressed as a percentage of the employee's contribution and may vary from year to year. In 1996/97, the rate varied between 75% and 165% of the employee's contribution rate, averaging 122%.[6] This means that local authorities paid superannuation contributions equating to approximately 7% of the total payroll for employees within the LGPS.

Administering authority

The employer and employee pay contributions into a fund, the assets of which are invested to yield an income stream sufficient to meet its obligations to members as they retire.

Pension funds are run by administering authorities. In Scotland, the largest local authority in each former regional council area has been designated as the administering authority on behalf of itself and other scheduled bodies.

Some administering authorities serve only one authority. Others also serve a number of scheduled local authorities, police boards and fire brigades. Most also serve a number of admitted bodies, some of which are smaller, public sector organisations or charitable bodies providing a public service. The LGPS funds represent a sharing of investment management and administration tasks, yielding economies of scale.

Some pension funds feature the same employer's contribution rate for all member bodies, while others account separately for each employer's staff.

A list of the councils served by the 11 administering authorities in Scotland is contained in appendix 4 (page 46).

The actuary

A pension fund should always be able to finance its pension obligations. Every three years, the actuary values the fund's assets and liabilities and sets the employer's future contribution rate. An administering authority may ask for a valuation sooner, if significant changes have affected the fund it manages, but this requires the approval of The Scottish Office.

The valuation process is essentially a projection of future cash flows into and out of the fund. The amount of future cash flows out of the fund, ie benefits provided to retired members, will depend on rates of future pay increases and on price inflation. The incidence of cash flows will depend on future rates of retirement and mortality.

As money is being set aside now to provide for benefits payable in the future, part of the cost of providing pension benefits can be met from investment returns achieved by the fund's assets. The higher the rate of return achieved by the assets, the lower the contribution requirement that has to be paid by employers into the fund, in future, to meet the costs of paying out benefits.

The future service contribution rate represents the cost, in excess of receipts from members' contributions, of paying benefits to existing members in each year following the valuation date.

The future service contribution rate is adjusted to take account of the past funding position so that where the fund is in deficit, an employing authority needs to pay more than the future service rate of contribution if it is to redress the imbalance.

Normal retirement

The normal retirement age falls between 60 and 65, after at least 25 years of reckonable service have been accrued, and is the same for men and women. In some situations, and if the employer approves, it is possible to work beyond the age of 65.

Benefits

Pension benefits are defined by statutory regulations. Unlike a private personal pension, an employee's benefits are not affected by variations in investment performance. They are a guaranteed proportion of the final pensionable pay and normally depend only on the final year's pay and the number of years of reckonable service.[7]

The pension has two key elements:

- an inflation-proofed pension, equating to:

  (1/80) x (years of reckonable service) x (final pensionable pay), plus

- a one-off, tax-free lump sum of three times the first year's annual pension.

The calculation for a typical normal retiral is illustrated in box 2. Other benefits are described in box 3.

Box 2: The benefits of a normal retiral: a worked example

Retirement age	60
Final salary	£20,000
Years of reckonable service	35
Multiplication factor	(35/80) = 0.4375
Annual pension	£20,000 x 0.4375 = £8,750
Lump sum	£8,750 x 3 = £26,250

Box 3: The benefits of the Local Government Pension Scheme

Benefit	**Description**
Annual pension	Based on the final year's pay and the service accrued as a member of the Scheme
Tax-free lump sum upon retirement	Equal to three times the first year's pension
Immediate payment of benefits, without penalty for early payment	If the employer requires the employee to retire on or after the age of 50, and before normal retirement age
Enhanced pension and lump sum	If required to retire early because of ill-health, and at the discretion of the employer for other early retirements
Tax-free lump sum death benefit	Payable if the employee dies before retirement
Dependants' benefit	Payable on death of employee, either before or after retirement

Early retirement

Types

The LGPS provides for three types of early retirement:

- retirement on the grounds of ill-health
- retirement due to redundancy
- retirement in the interests of efficiency.

Benefits

If an employee who is entitled to do so retires early, the pension is also paid early, in full and not abated, ie not reduced to take account of the cost of early payment. Furthermore, the pension can be enhanced by the employer awarding up to ten added years of service, subject to limits depending on age and reckonable service. Added years are awarded, at the employer's discretion, in terms of the Local Government (Compensation for Premature Retirement) (Scotland) Regulations 1979. The resulting extra pension and lump sum costs fall on the revenue account and are not borne by the pension fund. By contrast, an early pension in the private sector is typically abated. The benefits payable in a typical LGPS case are illustrated in box 4.

Box 4: An example of the benefits payable in an ill-health retiral

Factor / benefit	Aspect	Number
Key factors	Age	50
	Salary	£20,000
	Reckonable service	25 years
	Added years awarded	6.67
	Multiplication factor	(25/80) = 0.3125
Accrued benefits	Pension	£20,000 x 0.3125 = £6,250
	Lump sum = 3 x pension	£6,250 x 3 = £18,750
Added years benefits	Pension	(6.67/80) x £20,000 = £1,667
	Lump sum	£1,667 x 3 = £5,000

Ill-health

Ill-health retirement may occur at any working age and applies to employees no longer able to work effectively because they are:

"…incapable of discharging efficiently the duties of that employment by reason of permanent ill-health or infirmity of mind or body…"

As from April 1998, it is proposed that the definition of ill-health should be changed to:

"…permanently incapable of discharging efficiently the duties of that employment because of ill-health or infirmity of mind or body…"[8]

An ill-health retiral may occur at the instigation of the employee, submitting a request supported by his or her doctor. However, an authority also has the right to initiate the medical assessment of an employee it considers to be a candidate for early retirement on medical grounds.

The actual incidence of ill-health retirals is typically 50% higher than assumed by actuaries in their recent valuations, and much higher still than assumed in earlier valuations.[9]

Not all parts of an authority feature the same incidence of ill-health retirals. Direct labour organisations (DLOs) and direct service organisations (DSOs) may record an especially large proportion of ill-health retirals, laying a disproportionate burden on the pension fund.

All the early retirement costs of an ill-health retiral are met by the pension fund and none by the revenue account.

Redundancy

Early retirement by redundancy applies to an employee aged 50 or over whose post has become redundant and who is not replaced when he or she retires. It is a useful management aid where an authority is compelled to restructure or reduce its workforce and needs to make significant expenditure savings over a short period. By offering enhanced pension benefits, the authority can avoid or minimise the extent of compulsory redundancies.

The redundancy payment, enhanced lump sum and enhanced pension are paid from the employer's revenue account, while the costs of the early payment of the accrued pension and the accrued benefits lump sum fall to the pension fund.

Special lump sum payments were available from 1 April 1995 to 30 June 1997, leading up to, and in the period immediately after, local government reorganisation. Paid from the revenue account, these helped to reduce employee numbers to the levels required by the new unitary authorities and to meet their capping target for the 1996/97 financial year.

Efficiency

An efficiency retirement happens where an employee aged 50 or over retires in the interests of the efficient exercise of the authority's functions. It may be initiated, for example, when an employee is unable to adapt to new working practices or systems, such as the implementation of essential new technology, where the post itself is not being made redundant, but the demands on the postholder progress.

The costs of enhancing the lump sum and pension fall on the revenue account, but the costs of early payment of the accrued pension and lump sum fall on the pension fund.

An important distinction is that for an ill-health retiral, the pension enhancement is statutory and related to the employee's length of service, whereas in efficiency and redundancy early retirals, the pension enhancements are framed by legislation but at the employer's discretion. Before local government reorganisation, many employers awarded between six and two-thirds and ten added years, the maximum allowed. Where a sum equal to the redundancy payment plus more than six and two-thirds added years is given, a clawback is made in the additional benefits awarded.

In many respects, the implications for the employer and the pension fund of efficiency and redundancy early retirements are similar. In practice, therefore, the exit route chosen has often been that which is most beneficial to the employee.

2. Budgetary pressures

Staffing trends

The picture of early retirement needs to be set against a background of the way in which the numbers of employees in local government have changed. Authorities have witnessed a changing staffing profile since the 1980s. The numerous reasons have included the transfer of several functions out of local government control, the impact of Compulsory Competitive Tendering (CCT), flatter organisational structures and the productivity gains arising from increasing computerisation. More recently, there has been a reduction in the number of council employees, following local government reorganisation.

Transfer of functions

Some of the change in employee numbers since the early 1980s has resulted not only from early retirements, but from the transfer of functions out of direct local authority control. However, many employees in the transferred functions have remained members of the LGPS.

CCT

In some councils, Compulsory Competitive Tendering has meant that, where the bid by a DLO or DSO for a contract has been lost, the council's staff have been transferred to the successful private sector bidder. Even where contracts have been retained in-house, the drive for efficiency has seen continuing pressure to reduce the number of employees and to use new technology to become more efficient.

Flatter structures

The pursuit of flatter management structures and the introduction of new technology have had implications for the number of staff required at various levels within an authority.

Budget trends

In recent years, many local authorities have made significant budget reductions almost annually, in the face of the possibility of capping action by the Secretary of State. The cuts have fallen heavily on employee cost budgets, as the major area of expenditure.

Reorganisation

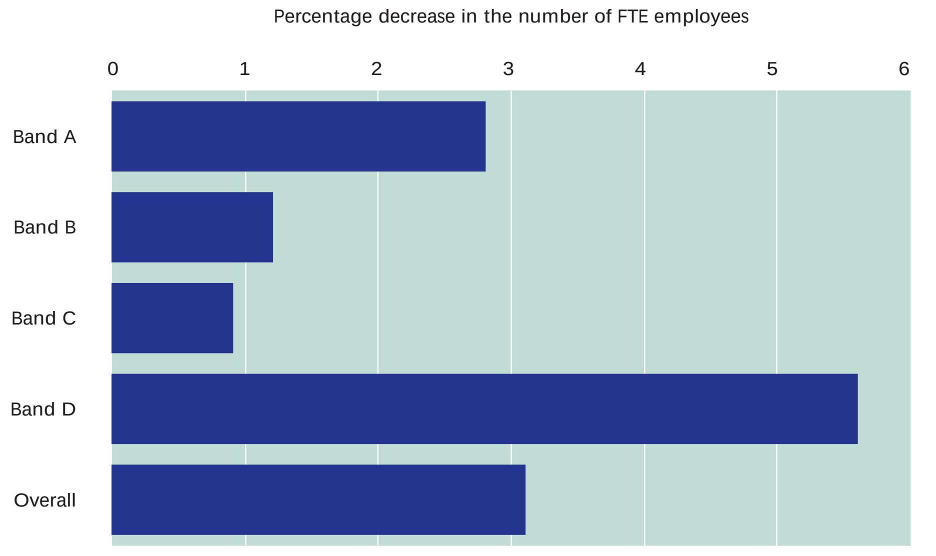
Local authorities have gone through the major change of local government reorganisation and its aftermath, with significant implications for the level of early retirements they have sought.

COSLA and the major trades unions agreed that, in effect, all employees with contracts of employment extending beyond 1 April 1996 would have the right to transfer to the new unitary authorities should they wish to do so. Staff then had to be matched to the new authorities' management structures. Early retirement has, therefore, been an important tool for tailoring the size and cost of the workforce in response to the pressures arising from local government reorganisation.

COSLA and The Scottish Office have gathered information on the number of full-time equivalent (FTE) local authority employees in December 1994 and March 1997, before and after local government reorganisation. Excluding teachers, police and fire staff, and staff in functions transferred out of local authority control, the figures show an overall reduction in staffing levels in all salary bands (exhibit 3).[10] In March 1997 there was a total of around 5,000 FTE fewer staff than in December 1994.

Exhibit 3: Percentage staffing reductions between December 1994 and March 1997

The biggest percentage reduction was in the number of staff in Band D.



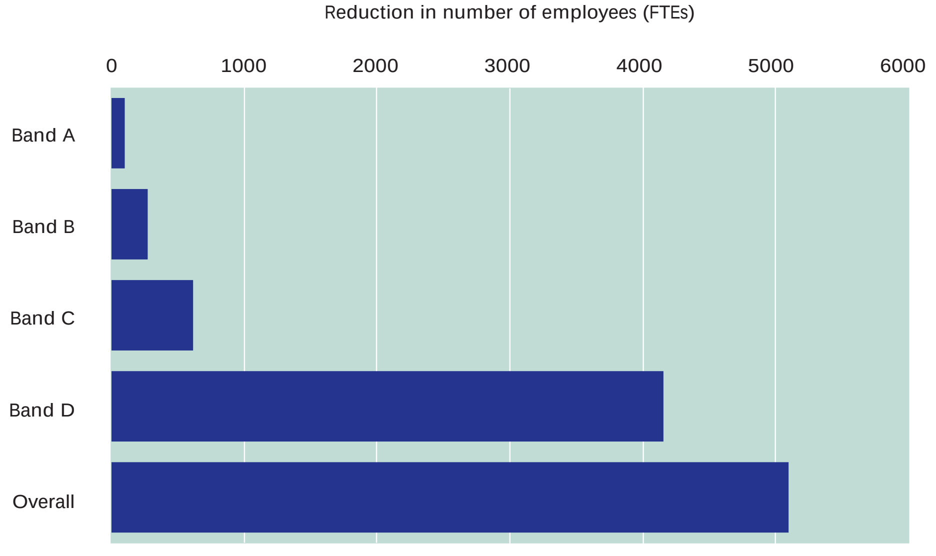
Key
Band A - more senior managers and professional staff
Band B - middle managers and main professional staff
Band C - mainly staff in clerical and equivalent grades
Band D - other staff, ie mainly manual

Source: *Quarterly Joint Staffing Watch*, COSLA, March 1997

In absolute terms, most staff were lost from Band D (mainly manual workers) and progressively fewer from the higher salary bands (exhibit 4).

Exhibit 4: Staffing reductions between December 1994 and March 1997

The biggest reduction was in the number of staff in Band D.



Source: *Quarterly Joint Staffing Watch*, COSLA, March 1997

3. Concerns

The high level of early retirements means that the way the LGPS is working is diverging from how it was designed to function. There are also concerns about whether employers are fully aware of the cost implications of their decisions. There are five key issues:

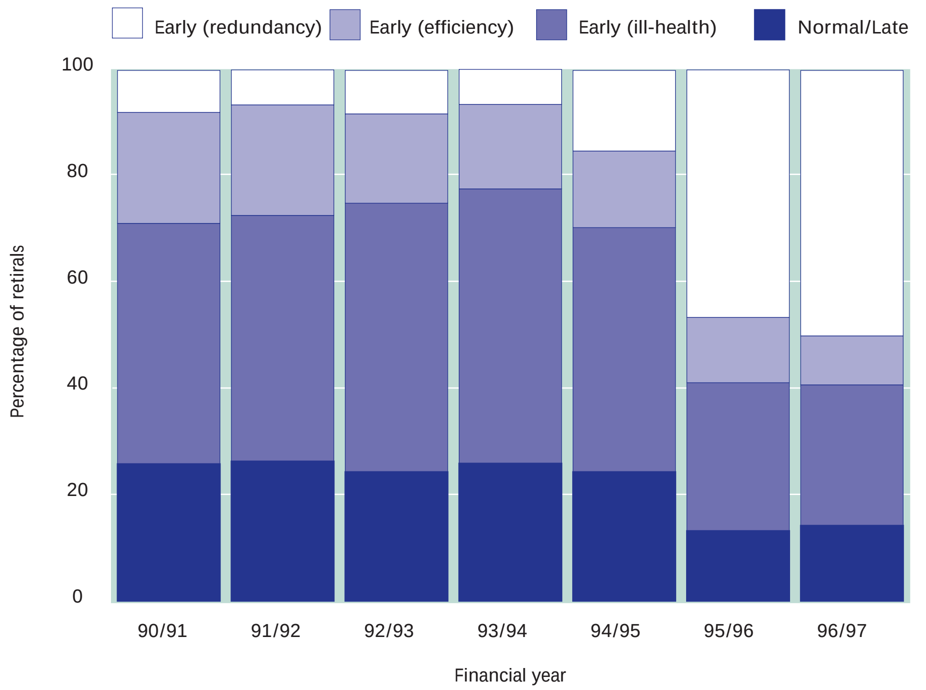
- the overall incidence of early retirement is high and has risen
- the incidence of ill-health retirements appears very high and is typically 50% higher than provided for by the actuaries
- the cost of early retirements is high
- councillors are not always consulted about early retirement decisions. Also, officers often decide to approve an early retirement without being fully aware of all the costs
- alternatives to early retirement are not always explored adequately.

Overall incidence

The proportion of employees leaving the LGPS through early retirement was at a high and sustained level throughout the early 1990s (exhibit 5). In particular, the proportion of employees leaving at or after normal retirement age was around only a quarter of the total. Except in the last two years, around half of all retirals were on the grounds of ill-health.

Exhibit 5: The early retirement trend in Scottish councils, 1990/91 to 1996/97

In 1995/96 the proportion of retirals due to redundancy increased because of local government reorganisation.



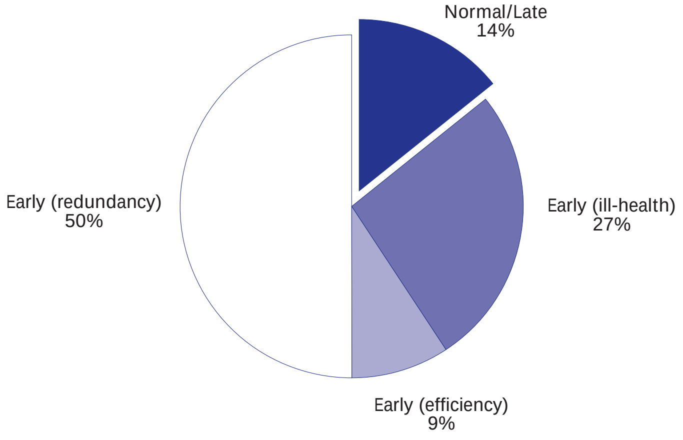
Source: Accounts Commission surveys, 1997

In 1995/96 the proportion of early retirals was still high, but a larger proportion of employees than in previous years left on the grounds of efficiency or redundancy, as a consequence of local government reorganisation.

The effects of reorganisation were still being felt in 1996/97, the first full year of operation of the new unitary councils. The proportions of retirals were largely similar to those of the previous year, with only 14% of employees retiring having worked to normal retirement age (exhibit 6). More than a quarter of all retirals were on the grounds of ill-health. However, there was also a considerable range in the incidence of early retirement among Scottish councils (exhibit 7).

Exhibit 6: Proportions of retirement, by type, in 1996/97

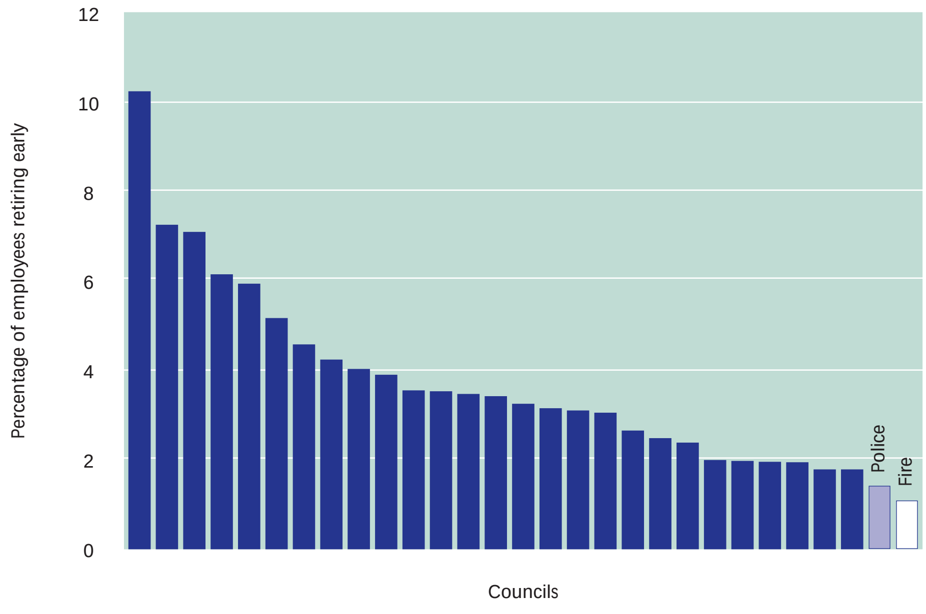
Redundancies accounted for half of all retirements.



Source: Accounts Commission survey, 1997

Exhibit 7: Variation in the incidence of early retirement in 1996/97

The incidence of early retirement among councils varied by about 5:1. Even excluding the extremes, there was still a 3:1 variation.



Note: the figure for police is an average for police force civilians. The figure for fire is for non-uniformed and control room staff.

Source: Accounts Commission survey, 1997

Exhibit 7 indicates that police force and fire brigade employees within the LGPS had a lower early retirement rate than council employees. In part, this is because they were less affected by local government reorganisation.

Sustainability

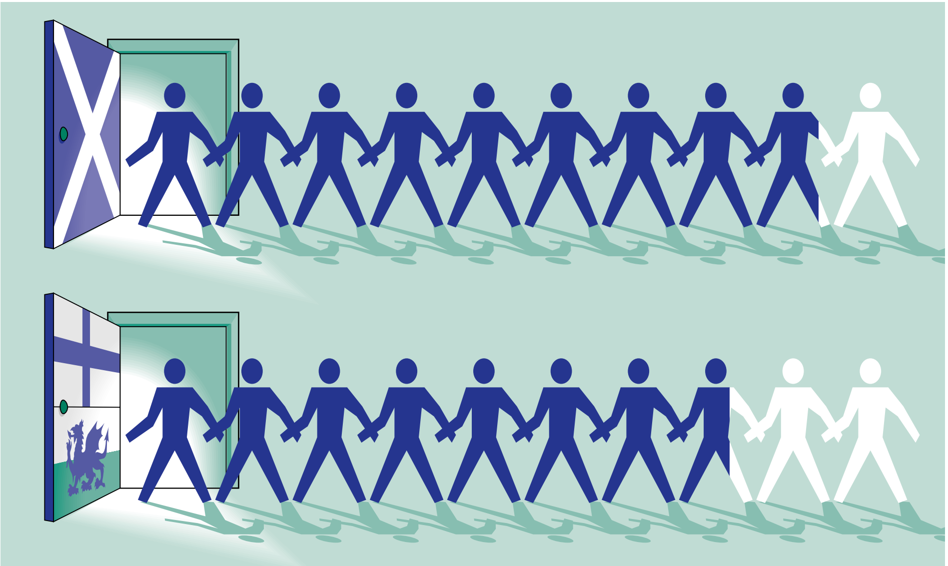
The predominance of early retirement in recent years will have changed the age profile of staff in some authorities. Some authorities may, therefore, face the prospect of 'running out' of eligible candidates for early retirement if they need to reduce staffing levels.

England and Wales

In 1995/96, there was a higher proportion of early retirement in Scotland than in England and Wales (exhibit 8), attributable largely to a higher incidence of early retirement due to redundancy, in preparation for local government reorganisation north of the border. All other things being equal, one might also expect Scotland to feature a higher proportion of ill-health retirals than authorities in England and Wales, due to the somewhat higher mortality rate in Scotland, which is likely to reflect a higher level of ill-health.[11]

Exhibit 8: Early retirement in Scotland compared with England and Wales, in 1995/96

In Scotland, 87% of employees retiring in 1995/96 took early retirement, compared with 76% in England and Wales.



Source: Accounts Commission and Audit Commission research, 1997

Ill-health retirals

Actuarial provision

As part of the triennial valuation of the pension fund, the actuary forecasts the likely numbers and costs of ill-health retirals. Hymans Robertson, the firm of consulting actuaries advising ten of Scotland's eleven administering authorities, makes an allowance equating to a percentage of the pensionable payroll. The employer's contribution rate, therefore, provides for a certain level of ill-health.

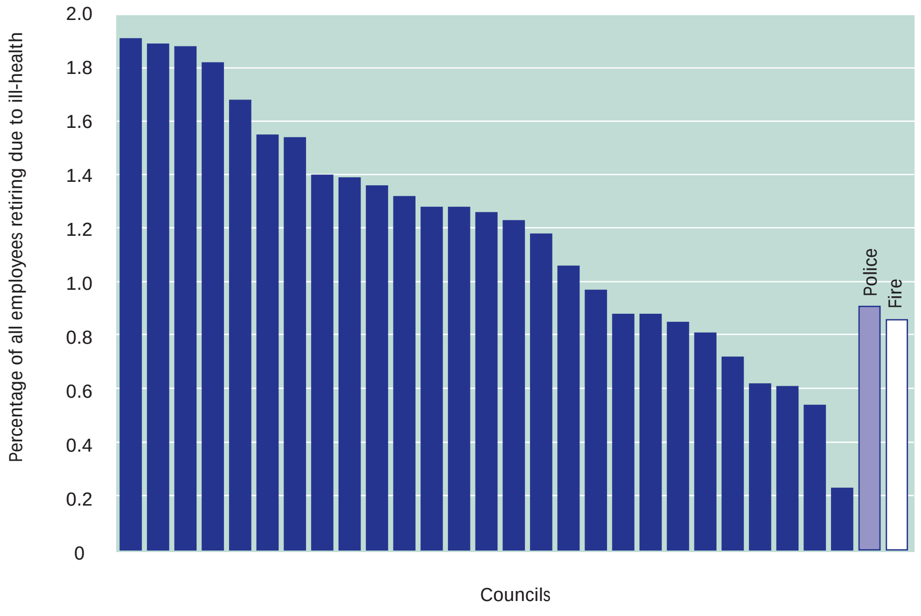
Evidence from at least two funds shows that as the level of ill-health retirals has risen, the incidence of death in service has declined, but not to a corresponding extent.

It has been argued by some authorities that a higher than normal level of ill-health retirals could be expected to have arisen in recent years because of the exposure of many employees to stress-related illnesses and the closer management of sickness absence, which has highlighted ill-health.

There is significant variability in the incidence of ill-health retirals among authorities (exhibit 9), much more than one would reasonably expect to see from the natural variation in levels of ill-health in the community at large and the differing age profiles of employees in different authorities.

Exhibit 9: Variation in the incidence of ill-health retirals in 1996/97

There is nearly a 10:1 range among councils in the incidence of ill-health retirals.



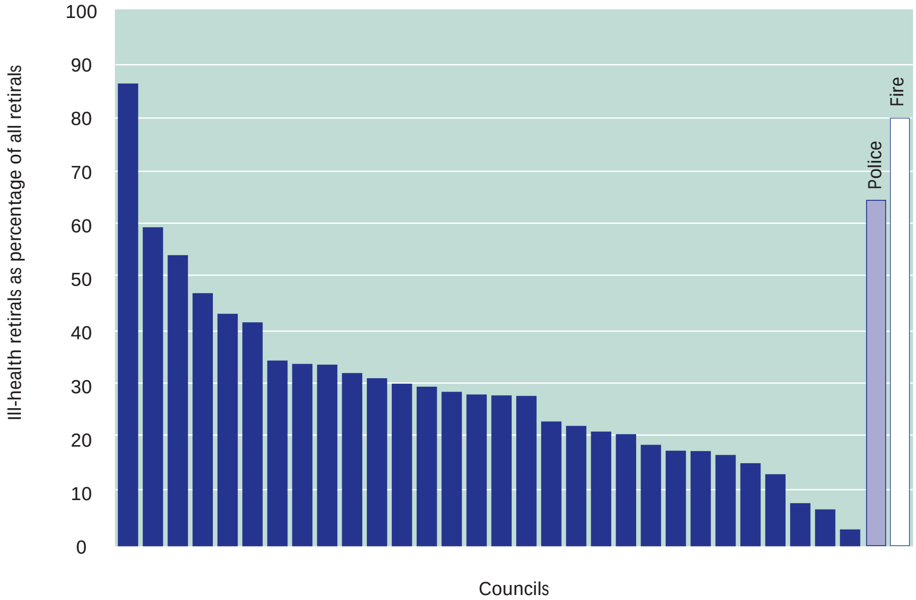
Note: the figure for police is an average for police force civilians. The figure for fire is for non-uniformed and control room staff.

Source: Accounts Commission survey, 1997

The proportion of all retirals that are due to ill-health also varies widely among authorities (exhibit 10), though this is partly due to the variation in the incidence of early retirals due to efficiency and redundancy.

Exhibit 10: Ill-health retirals as percentage of all retirals, in 1996/97

There is a wide variation in the proportion of retirals that are due to ill-health.



Note: the figure for police is an average for police force civilians. The figure for fire is for non-uniformed and control room staff.

Source: Accounts Commission survey, 1997

It is hard to accept that in many authorities over a third of all retirals are due to ill-health, while in others, the figure is less than a fifth. The United Kingdom Steering Committee on Local Government Pensions has said that:

*"While there are relatively minor regional differences in sickness absence statistics, the range (*in the incidence of ill-health retirements*) seems... more likely to reflect different management practices rather more than markedly different incidences of ill-health and stress within the workforce."*[12]

Personnel advice

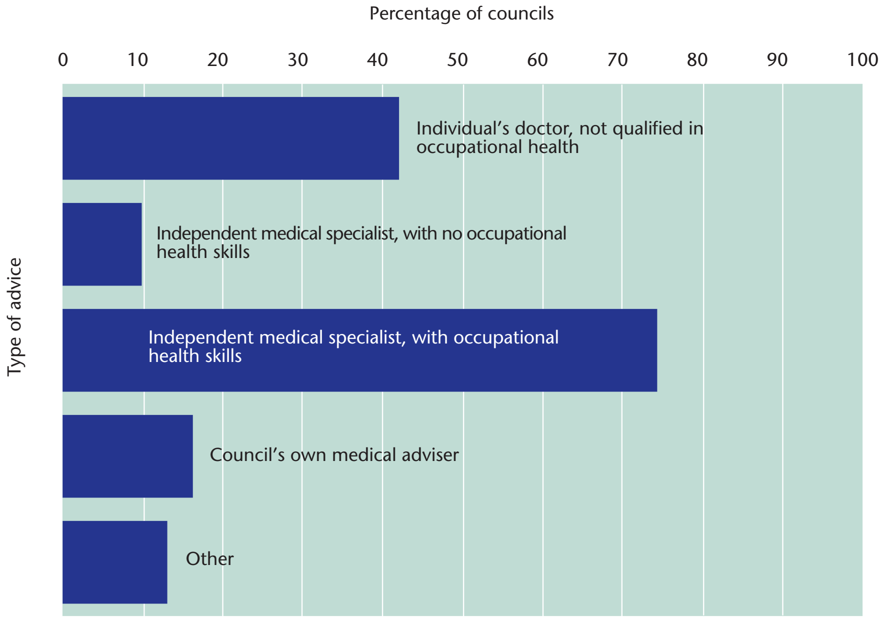
It is good practice for officers making early retirement decisions to take advice on policy and procedure from the departmental or corporate personnel function. However, five of the local authorities responding to the Accounts Commission questionnaire made decisions on ill-health retirals without reference to personnel advice.

Medical advice

Nearly all councils used several sources of information, typically an input from the GP plus the advice of an independent medical specialist qualified in occupational health (exhibit 11). However, there is some scope for a greater emphasis on the role of independent medical experts qualified in occupational health.

Exhibit 11: Medical advice taken by councils in making decisions on ill-health

The most common source of advice is an independent medical specialist with occupational health skills.



Source: Accounts Commission survey, 1997

Refusal

Twenty-one authorities - around two-thirds - had refused early retirement to some staff who had requested it on ill-health grounds. Of the councils that had not refused approval, only one had relied solely on the GP's input.

Costs

Who pays?

Box 5 summarises where the benefits are paid from in each type of early retirement, emphasising the heavier burden on the pension fund arising from an ill-health retiral compared with an efficiency or redundancy retiral.

Box 5: Where the benefits are paid from

Benefit	Element	Ill-health	Redundancy	Efficiency
Redundancy	Payment	-	Revenue account	-
Lump sum	Added years	Pension fund	Revenue account	Revenue account
	Accrued benefits	Pension fund	Pension fund	Pension fund
Pension	Added years	Pension fund	Revenue account	Revenue account
	Accrued benefits	Pension fund	Pension fund	Pension fund

As can be seen from box 5, the award of added years has a crucial bearing on the cost of early retirement to the employer. The pension regulations provide for authorities to award up to ten added years, with a clawback where more than six and two-thirds years are awarded in redundancy cases. However, as yet relatively few authorities have a clear policy on added years. Where a policy exists, it has typically been inherited from a pre-reorganisation council and may be under review.

The average number of added years awarded varies widely among councils. Based on the responses to the Commission's survey, a cluster of councils awarded around ten added years for efficiency retirals and another cluster awarded around six years. It is also interesting that some councils have awarded fewer than six and two-thirds years on average, though this may in part be a function of some retiring employees being near to their normal retirement age and hence not qualifying for as many added years to enhance their pension benefits.

The cost implications of added years for individual early retirals are typically taken into account within particular service budgets for the current and/or pending financial year. However, there is little indication that organisations take a longer-term view of the consequences of early retirement, either for their own revenue budgets or for the general welfare of the pension fund.

'Hidden' costs

It is a common misconception that the early payment of an accrued pension and an accrued lump sum does not make for any additional cost to the fund. When no extra years of service are included, it is sometimes believed that the contributions already paid are sufficient to meet the cost of providing those accrued benefits.

However, there are 'hidden' costs to the pension fund arising from:

- the outflow from the fund for the early payment of the accrued pension and lump sum
- the loss of investment income
- the loss of the employee's future contributions.

The implications are eventually taken into account when the actuary values the fund, but this happens up to three years after the commitment has been triggered and another year may have elapsed before the actuary's recommendations are implemented.

In 1998 the Commission will publish a management handbook which will give advice on how to calculate the strain on the pension fund. By way of illustration, the early retirement of a man aged 54 with 32 years of service, a final salary of £33,000 and six added years will impose a strain on the fund equivalent to a capitalised cost of £55,000. This is as significant as the capitalised cost of the added years, which amounts to £46,000.

Accrued benefits

With only one exception, authorities have taken no actuarial advice on the possibility of funding separately, and in advance, the additional costs arising from the early payment of accrued benefits for efficiency or redundancy retirements.

Added years

By contrast, authorities are taking a more rigorous approach to accounting for added years. Of the 32 councils:

- 29 had recharged service revenue accounts with the added years lump sum costs of early retirement
- 28 had recharged the accounts with the ongoing added years costs of early retirement
- 29 made some annual provision in the revenue budget for the costs arising from the award of added years.

Costs and benefits

The costs and savings of early retirement, to the employer and to the LGPS fund, are itemised in box 6. Of course, costs to the pension fund will eventually fall on the employer via higher rates of contribution than would otherwise have been the case.

Box 6: Costs and savings

	Costs	Possible savings
To the employer	· Redundancy payment · Added years lump sum · Added years pension	· Salary · On-costs · Future employer's contributions · Efficiency savings
To the pension fund	· Pension paid for longer · Loss of investment income · Loss of employer's contributions · Loss of employee's contributions	· By comparison, savings are minor

In principle, an employer can justify a redundancy early retirement on the basis that expenditure incurred now will generate savings later. In practice, few early retirement decisions appear to be made on such a rigorous basis.

Human costs

There are widespread human costs for the employer, the employees who leave and the employees who remain after a tranche of early retirals. The employer suffers a loss of skilled and experienced staff, and may have been forced to lose those who generated the best savings rather than those whose skills were least needed.

The retiring employees may wish to continue working, believe that they still have much to contribute to the organisation and actually play a valuable role, but feel coerced into early retirement through force of circumstances. Those leaving through early retirement are likely to find it increasingly difficult to secure alternative employment.

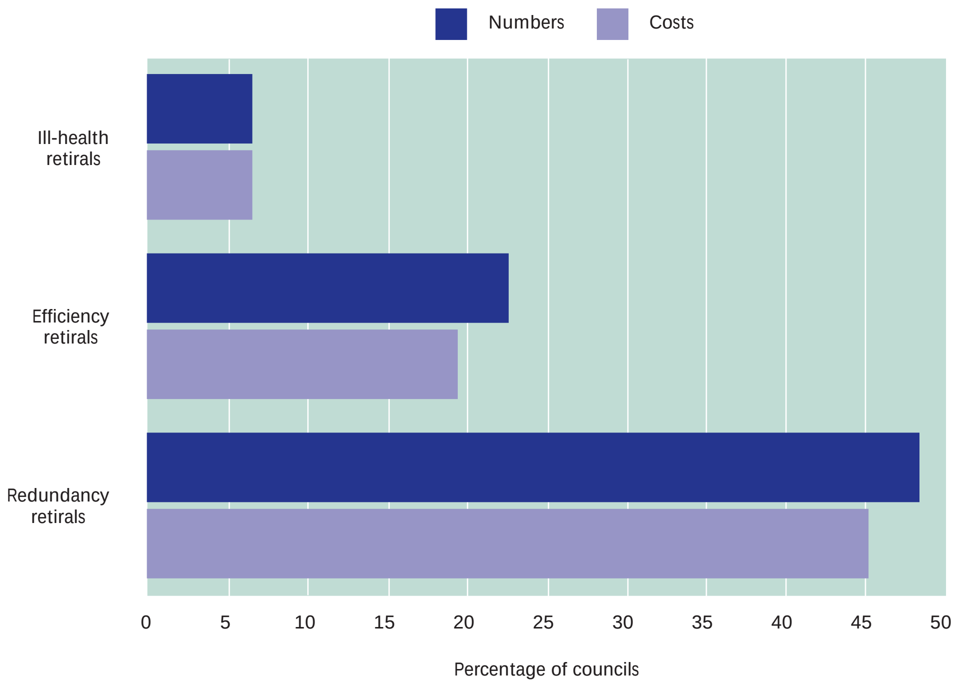
Employees who wish to continue working, but who may consider themselves as having 'survived' another round of early retirement and narrowly avoided compulsory redundancy, may suffer from impaired morale and be less productive.

Forecasts

Fewer than half of all councils made any forecast of the number or cost of early retirals due to redundancy (exhibit 12). One has to wonder, therefore, how carefully councils plan for the consequences of early retirement.

Exhibit 12: Percentage of councils making forecasts of numbers and costs

Few councils forecast the number or cost of early retirals.



Source: Accounts Commission survey, 1997

Accountability

Policy and procedure

Most authorities have a policy framework for the formal consideration of decisions on early retirement. Policies and procedures generally pertain to early retirement on the grounds of efficiency or redundancy. If an authority has framed a policy or procedure, it has usually taken account of a wide range of factors, including:

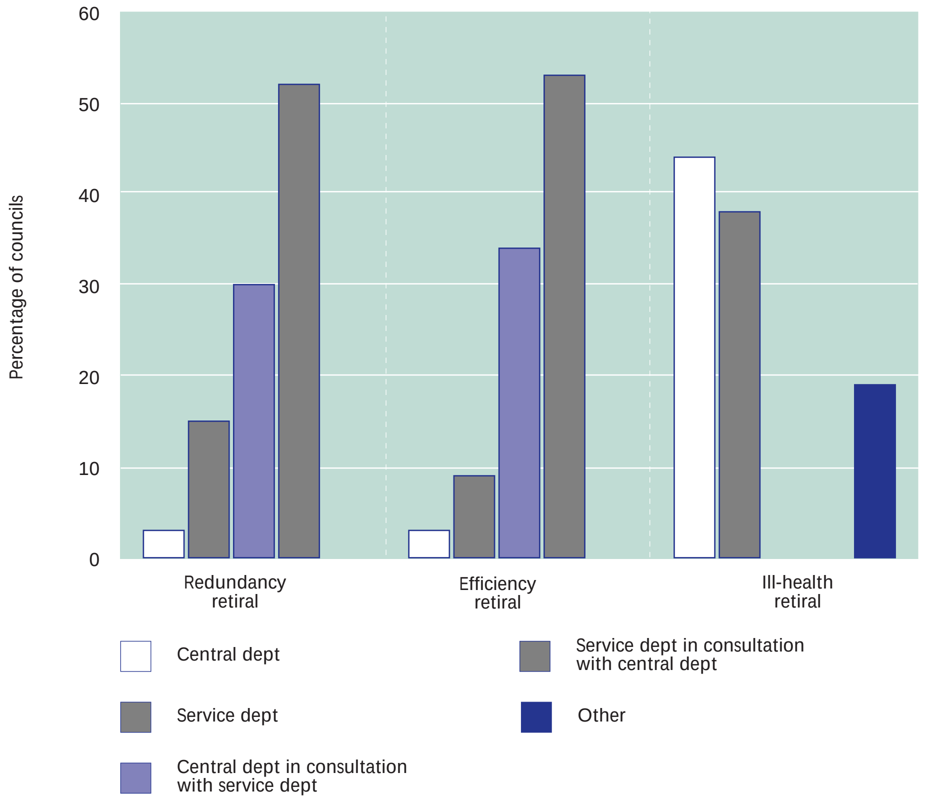
- the potential numbers and costs of early retirals
- target savings
- the age at which early retirement is taken
- pressure on the revenue budget.

Locus of decision-making

Efficiency and redundancy retirement decisions were mostly made by the department concerned, in consultation with staff in corporate personnel, or vice versa. Few decisions were made by the department alone, except in the case of ill-health retirals (exhibit 13).

Exhibit 13: Locus of decision-making on early retirals

In many councils, decisions involve consultation between the department concerned and a central department.



Source: Accounts Commission survey, 1997

Councillors

Councillors were involved in early retirement decisions in two-thirds of the 32 councils:

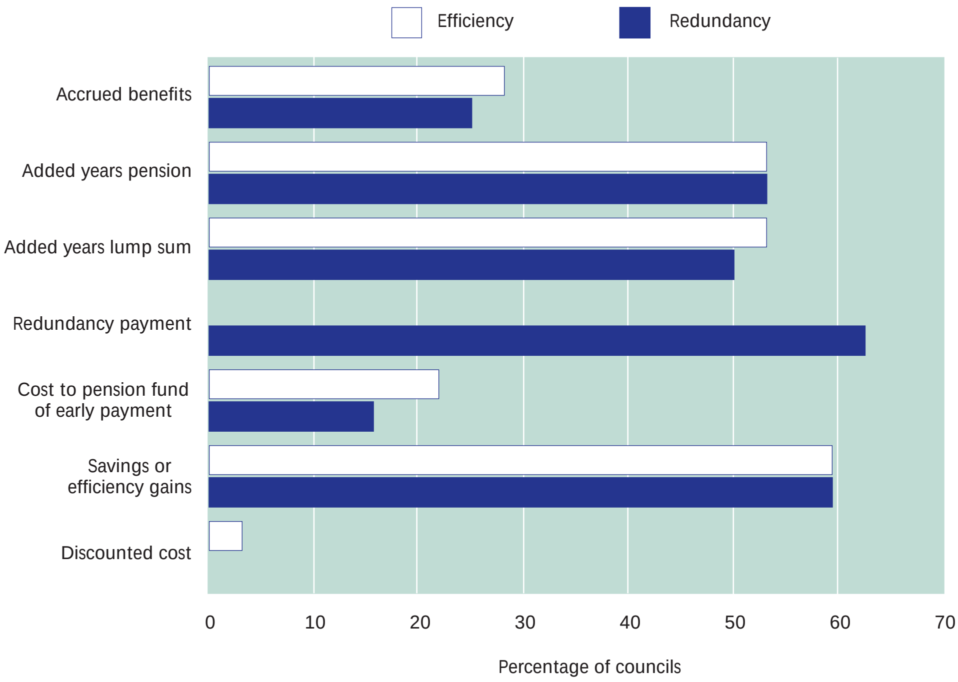
- in ten councils, councillors were not consulted at all
- in nine councils, cases were referred to the Personnel Committee for a final decision
- five councils referred decisions to the Policy and Resources Committee
- four referred decisions to the relevant service committee
- one referred decisions to the Finance Committee
- some followed other courses of action.

In some councils, more than one committee could be involved. The chief executive was involved in ten councils, though usually not without support from councillors. Decisions on ill-health cases are normally made at officer level without reference to councillors, because the decision rests on medical evidence.

Information is sometimes made available to councillors where efficiency or redundancy retirals arise. However, many councils make little if any information available to councillors (exhibit 14).

Exhibit 14: Information on efficiency/redundancy retirals made available to councillors

In some councils, information is not made available or is limited in extent.



Source: Accounts Commission survey, 1997

Alternatives

Since early retirement is expensive, authorities should ensure they first give full consideration to other options, such as:

- redeployment
- retraining
- restrictions on recruitment
- restrictions on overtime
- short-time working.

Where posts become redundant or subject to the need to make efficiency savings, efforts should be made to redeploy relevant staff to other posts for which they may be suited, either with their existing skills and experience or with supplementary training. Approximately 85% of councils have an explicit policy of allowing staff facing redundancy to be considered for retraining or redeployment, prior to a decision on redundancy.

However, under current practice there are limited opportunities for redeployment due to the short timescale in which early retirement decisions may need to be made.

In recent years the tendency has been for major decisions about the revenue budget to be left until near the end of the calendar year, leaving little time before the need to make a decision on any compulsory redundancies by 31 December. The latter date is imposed by the statutory requirement in most cases to give 90 days' notice before the redundancy takes effect by the end of the financial year. Consequently, decisions on the use of redeployment to avoid redundancy are often compressed into the space of a few weeks, leaving little time for proper planning or skills-matching. In any event, councils say that opportunities for redeployment are limited by the availability of suitable 'round holes' for 'round pegs,' even with further training.

Communications

Officers and committees

Beyond briefing information made available on individual cases, little summary information on costs is submitted to the appropriate committee on a regular basis:

- a specific report on the total first-year costs to the revenue account of the award of added years was made in only three councils
- information on the total ongoing costs arising from the award of added years was submitted in only two councils.

Administering authority and scheduled bodies

Virtually all scheduled bodies felt there was scope for involving them more in decisions affecting the pension fund. With some councils supporting more than one option:

- 15 councils thought that communications could be improved by more frequent consultation at officer level
- 13 were attracted to allowing councillors or delegated officers from scheduled bodies to act as observers on the administering authority's pension fund committee
- six presented other options for improvement.

Funding of the Scheme

Funding level

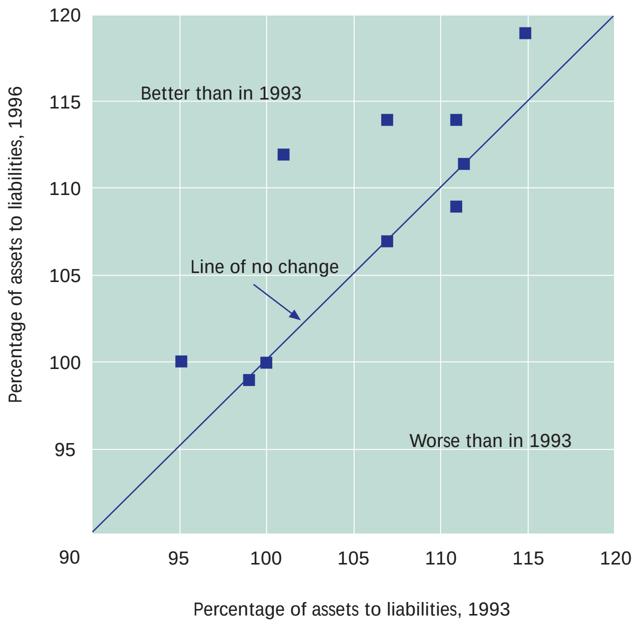
For LGPS funds in England and Wales, the Government lowered the target funding level, defined as the percentage of assets to liabilities, from 100% to 75% in 1989. This allowed authorities to reduce their contribution rate and ease pressure on the revenue budget at the time when the Community Charge was introduced. In 1992, the target funding level was reset to 100% but many funds had by then fallen well below that level. Many funds in England and Wales are now finding the climb back to 100% funding costly and slow at a time when funding for core front-line services is under strain.

In Scotland, the target funding was not lowered to 75%, so local authorities north of the border have always had the 100% target to aim for. Of the 11 Scottish funds, only two had a funding level of less than 100% at the 1993 valuation, and one of these was very close, at 99%. Information on the subsequent valuation of ten funds indicates that only one has seen a drop in funding level, and then of only one percent (exhibit 15).

By comparison, only 20 of the 87 funds in England and Wales had funding levels of 100% or more at their last valuation, in 1995, and the funding level of four out of every five funds decreased between 1992 and 1995.[13]

Exhibit 15: Pension fund valuations: changes from 1993 to 1996

Out of ten Scottish LGPS funds, only one has seen its funding level decrease since 1993.



Note: all the funds were valued at March 1993. The Fife fund was next valued at March 1995, with all the other funds next valued at March 1996.

Source: Accounts Commission survey, 1997

Actuarial valuation

The LGPS regulations specify that a pension fund must be subject to actuarial valuation at least every three years, with the opportunity for an earlier valuation if considered appropriate. All administering authorities considered this was generally frequent enough.

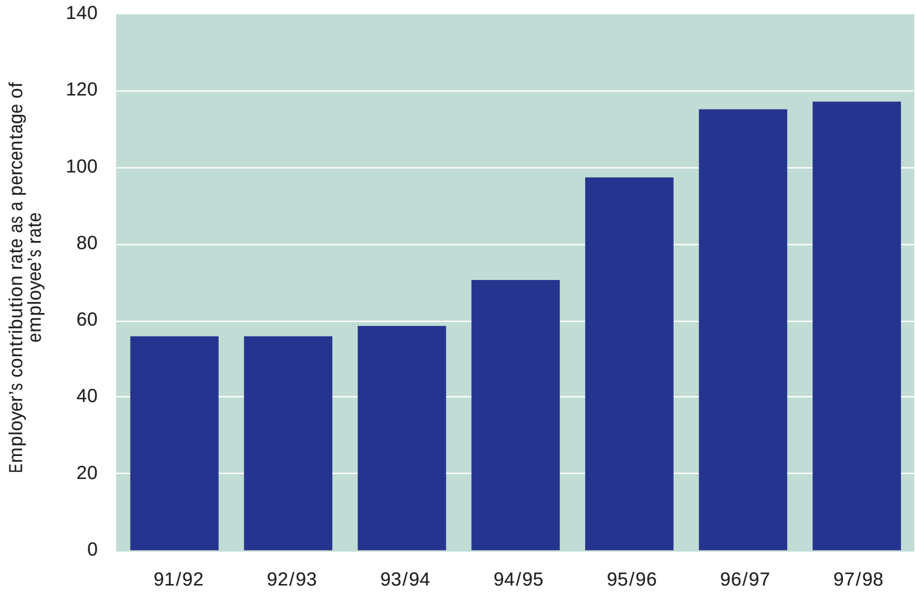
Employer contribution rates

Some pension funds have the same employer's contribution rate for all member bodies. Others have separate rates for each body.

Overall, the average contribution rate for the nine funds with a single contribution rate has nearly doubled since 1993/94, following a period of lower employer's rates in the early 1990s (exhibit 16).

Exhibit 16: Average employer's contribution rate

Contribution rates have increased.



Source: Accounts Commission survey, 1997
The chart shows the average contribution rate for the nine Scottish funds with a single employer's contribution rate for constituent scheduled bodies.

UKSC Circulars

The circulars of the United Kingdom Steering Committee (UKSC) contain advice on pensions issues, and Circular 57 contains advice on the management of early retirement. Nearly all Scottish authorities indicated they would be reviewing their early and ill-health retirement policies and practices to take account of the guidance in this circular.

4. Developments

Pension regulations

Key issues

New pension regulations are due to come into force from April 1998. Representing a complete overhaul of the many previous regulations, they are intended to make management of the Scheme more straightforward. However, they also bring new provisions and eligibility criteria, which could have a bearing on the number and cost of early retirals.

Contribution costs

Any period during which an employee is away from work because of injury or illness, with no pay, will now also count as reckonable service, increasing the cost of pensions to the employer.

The employee's contribution rate for new 'manual' workers will increase from 5% of salary to 6% of salary from 1 April 1998.

The '85 rule'

The new '85 rule' will mean that an employee whose age plus reckonable service exceeds a total of 85 will be able to leave at any age on full pension without any actuarial reduction of the pension benefits. If the employee is under 60 they will require the employer's permission. For example, a 55-year-old with 30 years' service will be able to leave on an unreduced pension five years earlier than allowed within the current regulations. In this situation, the pension fund will end up effectively bearing the cost of a normal retirement but for a longer period and with a reduced income because of the much earlier payment. However, the proposed new regulations will also extend the range of circumstances under which an abated pension may be granted. The new rules may generate more pressure from employees for early retirement and reinforce the expectation of early retirement as a right, whilst possibly reducing any implicit pressure on authorities to award added years.

Added benefits

Where a LGPS member retires after the age of 50, an employer will have the discretion to grant a pension enhancement of up to six and two-thirds added years of service. This could apply to virtually any type of departure apart from outright dismissal, not only in efficiency and redundancy cases.

Abolition of ACT credit

The Government's Budget of July 1997 withdrew the ability of tax-exempt investors such as pension funds effectively to reclaim Advance Corporation Tax (ACT) on dividend income from the Inland Revenue.

As a result of the ACT change, the value to LGPS funds of UK equities' net dividend yield has fallen. The reduction in dividend yield will effectively discount the assets of a pension fund, reducing its ability to meet its future commitments unless there is compensatory growth in the dividends paid by companies in which the fund invests. Authorities will be required to redress any shortfall in funding levels by making an increased employer's contribution.

COSLA has estimated that the withdrawal of ACT credit for pensions will cost its member authorities around £36m of dividend income a year.[14]

Actuaries to pension funds have already closed their valuations of the LGPS funds as at 31 March 1996 but have held extensive discussions with authorities to explore the implications of the ACT change. Administering authorities expect to advise member employers of the need to make significant increases in their employer's contribution rate.

Best Value

If, as has been widely mooted, a three-year planning framework were to be introduced under the Best Value regime, it would assist authorities in their budgeting, personnel planning and early retirement decisions, and reduce much of the haste with which decisions are currently made.

Incidence of early retirement

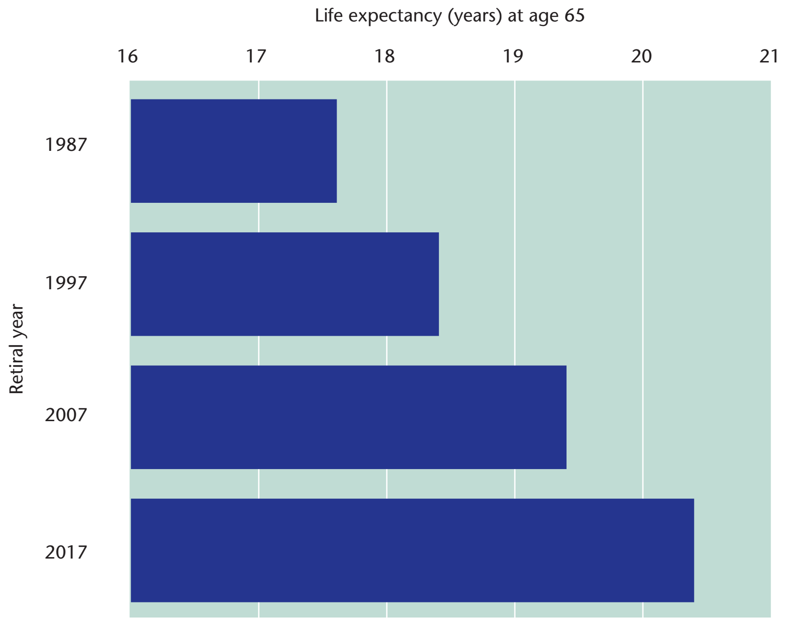
Demography

It seems likely that a proportion of the workforce will continue to retire early, before the normal retirement age. This is a trend in society which cannot be ignored.

Because the population at large is becoming healthier and people are living longer, employees should be less likely to die in service or need to retire on the grounds of ill-health. On the other hand, they are living longer after they retire, adding to the cost of pensions (exhibit 17).

Exhibit 17: Life expectancy at age 65

Life expectancy for people aged 65 is increasing.



Source: The Government Actuary, Demographics Section [15]

Note: The figures are for women; similar trends apply for men.

The over-50s

Feedback from authorities indicates that, as one might expect, the ongoing use of early retirement amongst the over-50s has depleted the number of employees in the early retirement bracket. Some councils are beginning to realise that they may not have enough people to retire early and would need to consider alternatives, such as compulsory redundancy, should they need to meet major savings targets.

Financial pressures

All the indications are that authorities are unlikely to face a significantly more comfortable financial climate in the foreseeable future. Some are expecting a need to make further budget reductions in 1998/99. Authorities will continue to wish to have recourse to early retirement as a means of adjusting the workforce to the organisation's changing circumstances, though they may not always be able to afford it or have enough over-50s, even if they can.

5. Recommendations

Early retirement is an important tool. It helps local authorities to manage overall employee numbers and costs; facilitates early retiral for employees in the interests of the efficiency of the service and allows employees to retire early if they are medically unfit to do their job.

But there is a price to pay. Many authorities are unaware of the true costs of early retirement to the revenue budget and of the strain on the pension fund, an especially worrying feature since retirement early is now more common than retirement at 'normal' age. The high level of early retirements suggests that some authorities have over-used the provisions, and the high level of ill-health retirals calls into question the health of the workforce and whether decisions are always based on objective medical evidence.

The Accounts Commission's recommendations are summarised below (box 7) and then described in more detail. The recommendations are based largely on practices already adopted by some authorities. The management handbook being developed by the Commission will give further guidance.

Box 7: Recommendations

If it has not already done so, an authority should:

1 ensure there is accountability to councillors for decisions

2 identify the full cost of early retirement to both the revenue budget and the pension fund; ensure that each department supporting an efficiency or redundancy early retiral pays for the additional costs, including the strain on the fund; reimburse the pension fund, over a reasonable period of time, for the cost of the early payment of accrued benefits

3 review procedures for approving ill-health retirals

4 disclose its pensions costs and, separately, the extra costs arising from early retirement, in its annual report as well as its accounts

5 consider alternatives to early retirement, exploring them in good time

6 monitor trends and review policies and procedures regularly.

In addition, each administering authority should:

7 consider requesting the actuary to set a different contribution rate for each employer in the same fund, reflecting the liability each imposes on the fund

8 for all employers in the same fund, regularly monitor a range of performance indicators that allow it to judge whether the actuary's forecasts are being realised

9 improve communications with the scheduled and admitted bodies.

All authorities should implement these recommendations and consider the advice in the forthcoming Accounts Commission management handbook. They should also consider the advice contained in UKSC circulars.

1. Ensure accountability

Establish a framework

Authorities need to:

- establish policies and procedures for ill-health, efficiency, and redundancy retirals
- reconsider their policy on awarding added years in the light of what they can afford and what is fair to employees
- ensure accurate management information is available, on which to base decisions and monitor trends.

Inform councillors

Authorities need to be more accountable for their early retirement decisions. Councillors should be given full details of retirements above a pre-determined salary threshold, albeit on an anonymised basis if need be, in order to ratify them. For less costly decisions (say, for retirals of staff below an annual income of £30,000) the decisions may be delegated to officers. In these cases, councillors should be given summary, anonymised information on numbers and costs.

Make informed decisions

Councillors and senior managers need to be fully aware of the costs and benefits when making decisions. They should balance the interests of the individual retiring against the authority's responsibility to secure value for money.

There may be merit in an authority exposing certain types of retirement decisions - for example, of chief executives and other heads of service - to review by an independent external body or consultant, before the final decision is made, to ensure conformity with policy and procedure and reassure the public where large sums may be involved.

2. Reimburse the fund

Establish the principle

The ongoing financial effects of retirements should be taken into account in corporate financial planning and budgeting. This means not only catering for the costs to the revenue budget of awarding added years, but also acknowledging the full size of the 'hidden' costs to the pension fund.

The employer should calculate the full costs of early retirement falling to its revenue account and the strain on the pension fund for each efficiency or redundancy early retirement, or discretionary early retirement made under forthcoming new regulations, such as the '85 rule'. This approach may require expert assistance from the authority's own finance or personnel function, and support from the pensions administration unit of the administering authority.

Agree to reimburse the fund

The department that allows an efficiency or redundancy early retirement should pay for the extra costs arising from the award of added years and the strain on the pension fund. In certain cases, such as where a council initiates a large-scale redundancy exercise, it may be appropriate for departments to obtain corporate funding for the cost of early retirements.

For efficiency and redundancy retirals, there is a range of potential methods by which the pension fund could be reimbursed from the employer's revenue budget for the strain on the fund, including:

- payment up front
- phased payment over a fixed period of years
- phased payment until normal retirement age
- phased payment over the expected life of the retiree.

The advantages and disadvantages of these methods are considered below.

Payment up front

In this approach, the strain on the fund for each retirement would be calculated. An amount corresponding to the capitalisation of the total costs would then be transferred from the department of the employing authority to the pension fund.

The advantages of this approach are that the otherwise 'hidden' costs become overt and agreed between the employer and the pension fund; and the consequences of each individual early retiral are dealt with at the time, ensuring that the fund is not strained. There is also the consideration that the decisions made by an authority today should not place an undue burden on the authority, employees or council taxpayers of the future. The discipline of an up-front payment could well slow down the rate of early retirement or encourage the authority to grant less generous terms.

The major disadvantage is that the authority may be unable to afford to pay the total costs of all early retirals up front. This could happen for a range of reasons, including overall pressure on the revenue budget, a bulge in the number of early retirals, or the distorting effect of 'spikes' in the cost due to expensive individual retirals. Any savings from the early retiral will be phased over a period of time, typically until the normal retirement age, rather than up front. Forcing the authority to pay up front might trigger the need to lose more staff just to pay for the early retiral costs of those employees already under consideration.

Phased payment over a fixed period of years

An alternative to up-front payment is to reimburse the pension fund over a fixed period of years. This could correspond to the period over which any savings might be expected to accrue, a period negotiated with the pension fund, or a fixed period such as three years, to parallel the actuarial valuation cycle.

The advantage of this approach is that accountability is still underpinned by the employer needing to confront the cost, but that the burden is spread over a number of years. The payment period could be negotiated between the pension fund and member employers to take account of factors such as:

- pressure on the employer's revenue budget
- the variability of the incidence of early retirement from year to year
- the seriousness of any pension fund deficit, reflecting the fund's capacity to withstand the strain of the early retiral.

The opportunity to smooth costs over a longer period might be particularly appropriate when a larger than average number of early retirals are allowed in any one year, eg due to a major restructuring.

Phased payment until normal retirement age

This approach to paying would see the costs annualised over the period to when the employee would otherwise have retired normally had he or she continued in the same employment. In the case of redundancy and possibly efficiency retirements, this is the period over which the savings will be achieved. The authority would, therefore, be able to finance the reimbursement from the savings, without any consequential effects on its revenue budget.

The actuarial calculations should be relatively straightforward. The advantages and disadvantages are similar to those associated with paying over a fixed period of years.

Phased payment over the expected life span

Since the pension is essentially a package of costs and benefits planned over the employee's expected life span, there is an intuitive argument that the additional costs of early retirement should be paid in much the same way that the extra costs of added years for efficiency and redundancy retirals are paid. The number of years would equate to the employee's expected longevity, which is readily forecast from his or her age at retiral, gender and other factors.

However, the strain on the fund from the early payment of the lump sum is immediate, whereas this approach might allow the pension fund to remain under strain for 25 years or more, eg from retirement at age 55 until the person's death at age 80. It is effectively no better than the current practice of allowing the strain to be identified at the next actuarial valuation, unless the authority also makes up-front revenue contributions towards the lump sum, as is required in the teachers' pension scheme.

Recommended periods

What is important is that:

- the costs of early retirement are identified
- these are agreed between the employer and the administering authority
- standard procedures are implemented for the department to pay for the early retiral
- standard procedures are implemented for the pension fund to be reimbursed by the employer.

The payment period could take account of:

- the pension fund's ratio of assets to liabilities
- the number of early retirements typically approved by the employer
- the consequent strain on the employer's revenue budget and the pension fund
- the trade-off between funding of early retirals and the maintenance of front-line services.

For these reasons, the payment period should be a matter for discussion between the administering authority and the employing authority, with the former having the final say if agreement cannot be reached. There should be no conflict of interest for the administering authority provided there are separate contribution rates for each body in the fund.

There are some parameters within which the repayment period should lie, to ensure that authorities and departments are financially accountable for their decisions and do not build up unacceptable burdens for the future.

Recommended maximum periods over which the department that makes an efficiency or redundancy retirement should reimburse the pension fund for the strain on it are set out in box 8. These periods take account of whether the fund is in surplus or in deficit and of the period to the employee's normal retirement age, at the time of their early retiral.

Box 8: Recommended maximum repayment periods for early retirals other than ill-health retirals

		Pension fund's ratio of assets to liabilities		
		less than 90%	90% to 99%	100% or more
Period to Normal Retirement Age (NRA)[16]	less than 5 years	3 years or period to NRA, whichever is shorter	period to NRA	period to NRA*
	5 years or more	3 years	5 years	period to NRA*

* Except in specified circumstances

If the fund is in deficit, it would be prudent to provide for fast repayment. Where the funding level is below 90%, the recommended maximum period of three years is the same as the period between actuarial valuations of the fund.

However, where a fund is comfortably in surplus and an employer makes few early retirals, there will be less urgency to repay the strain on the fund. In such circumstances, the employer may prefer to allow the funding level to fall to nearer 100% than to make a payment into the pension fund. This may be acceptable to the administering authority provided there are separate contribution rates for each employer, the actuaries are content with the procedure and they have not already counted on all the surplus in setting the employer's contribution rate. Even then, the department making the early retirement should 'pay' the cost via a budget adjustment, over the period set out in box 8.

The draft new regulations for the LGPS, to be implemented from April 1998, provide for the administering authority to impose an immediate adjustment to an employer's contribution rate, if required, so it would be better to agree a procedure that avoids unnecessary surprises for the employer and the administering authority.

It is recommended that local authorities, key professional bodies and other relevant organisations co-operate to work out the best way of implementing this recommendation. The Chartered Institute of Public Finance and Accountancy (CIPFA) is considering the accounting issues on pensions and early retirements.

Ill-health retirals

Ill-health retirals should be due to genuine ill-health and, therefore, arise from circumstances outwith the immediate control of either the employer or the pension fund. The extra costs of such early retirals should have been taken into account in the valuation of the fund and, provided the level of ill-health retirements is within expected bounds, there should be no need to reimburse the pension fund for the consequent strain. However, the level of ill-health retirements should be closely monitored by the administering authority. If the level is exceeding the actuary's forecast, the administering authority should consider the implications for the employer's contribution rate.

3. Review procedures for ill-health retirement

Establish corporate approach

There should be a corporate approach to ill-health retirement, informed by an awareness of the relevant professional guidelines from the Association of Local Authority Medical Advisers and from the Faculty of Occupational Medicine.

The Disability Discrimination Act 1995 places a legal compulsion on employers to make reasonable modifications to the workplace to allow a disabled person to continue working and to find reasonable alternative employment, if necessary. Employers will, therefore, need to be careful not, in effect, to dismiss people because they have become disabled and unable to do their current job without help.

Obtain independent opinion

The employee's GP should be requested to provide information but not a recommendation or a decision. The GP has a long-term commitment to his or her patient and may not have the necessary background in occupational health.

In some cases, the prognosis may be unclear. It may be better to use a panel approach, featuring doctors qualified in occupational health. The panel would be:

- independent of the employee and his or her employer
- appointed for a term of office
- required to have relevant professional qualifications
- tasked with giving an independent medical opinion.

The role of the panel would be to advise the employer on whether the employee's condition fitted the definition of ill-health as specified in the pension regulations, but the decision to grant early retirement would be made by the employer.

To encourage consistency and reduce costs, all the bodies within the one fund could use the same panel. This could be set up by the administering authority. Under the proposed new LGPS regulations, the appointment of medical advisers will require the endorsement of the administering authority.[17]

4. Ensure transparency

There should be information on early retirements in the authority's annual report as well as its accounts. It should set out the total costs falling on the revenue budget within the financial year being reported and indicate the consequential costs falling in future years, including the reimbursement to the pension fund for the strain of the early retirals. The precise disclosure arrangements need to be considered by the relevant professional bodies, in the light of the recommendation to reimburse the fund over a reasonable period of time.

5. Consider alternatives to early retirement

Plan the workforce

Early retirement should be among the last options considered when facing budget cuts, not the first and only option. This will minimise the damage to the corporate memory and the loss of expertise from the shedding of experienced staff: the price paid in terms of lost experience, service quality and future cost burdens may be high in relation to the short-term financial saving made.

The authority should minimise the risk of needing to shed staff by attempting to plan the staff resources the authority will require in future years. Authorities should refer to the advice in the Commission's recent publication, *Managing people: the audit of management arrangements in local authorities*.

The annual timescale within which budgetary decisions are currently made compromises the quality of decision-making by enforcing rapid, reactive decisions in the few months between the end of the calendar year and the beginning of the next financial year. If more time were available for such major decisions, it would allow better analysis, consultation and communication within authorities and between the employer and the pension fund.

This will require longer-term planning, plus the acceptance by councillors that painful decisions on budget cuts should not be put off until the last moment in the hope that the budgetary position will somehow improve.

Train employees

Authorities should give greater emphasis to:

- training existing staff so that they keep up with new methods
- retraining staff so that a potentially redundant person can be redeployed.

Nurture existing employees

Actively promoting health and well-being will help to reduce the risk of someone needing to retire on the grounds of ill-health, and enable employees to work to their full potential (box 9). Occupational health schemes have a role to play in helping to avert ill-health in the first place and helping to reverse it once it has been identified. Performance development and review will help staff to adapt to changing needs and identify potential problems before they become difficult to overcome.

Box 9: Looking after employees: a checklist of policy and practice

Performance development and review	Health and safety policy
Absenteeism monitoring	Hepatitis B and HIV/AIDS policy
Alcohol/drug/solvent abuse and gambling addiction policy	Maternity scheme
Disability policy	Occupational health policy
Guidance on working with computer screens	Smoking policy
Harassment	Special leave scheme
Health and safety guidance for new and expectant mothers	Violence to staff at work

Review current practice

Authorities should review their practice in the following areas:

Recruitment

- Consider the broader potential of the applicant, to help ensure that new recruits are flexible and adaptable.
- Control or restrict recruitment in areas and functions where the strategic workforce plan indicates that fewer staff will be required.

Core staff policy

- Consider the use of contractors and temporary staff to meet short-term needs.
- Explore the possibility of pooling experts among authorities.

Overtime

- Consider the viability of reductions in non-contractual overtime.

Discretion

- Move away from automatically granting the maximum added years. Some authorities grant less than the maximum allowed, and other authorities should consider whether they can also achieve the desired level of early retirement without awarding the maximum.
- There are cases where the employee may be on the cusp of ill-health, inefficiency and dismissal. Ill-health retirement is an easy and sometimes compassionate option but the employer may have a case for dismissal on the grounds of capability.

6. Monitor and review

Member bodies within a fund should not rely solely on monitoring information being supplied by the pension fund. All employers should monitor the incidence and cost of early retirement, not only at a corporate level but also at departmental or service level. The regular collection of this management information should better inform personnel policy, be useful background in framing decisions on the revenue budget and alert the employer to whether corrective adjustments to the employer's contribution rate might be required.

7. Consider separate funding levels

Some funds have the same employer's contribution rate for all constituent employers. In practice, each employer is likely to place different burdens on the pension fund. It therefore makes sense for administering authorities to request the actuary to set different rates for each body, to avoid one subsidising another. This is especially relevant where different employers within the same fund have significantly different early retirement profiles.

8. Monitor key performance indicators

Administering authorities should monitor a selection of key performance indicators between valuations to allow them to judge whether the actuary's assumptions are being realised, or whether circumstances are changing rapidly. Key performance indicators would include, for example, the level of ill-health retirals.

9. Improve communication

Regular communication between each administering authority and its scheduled bodies would help raise awareness of pension issues amongst employers and give them advance warning of potential problems.

If early retirement continues to be used at the rate seen in recent years, and if authorities do not confront the full cost, they will build up liabilities for the future that may threaten the delivery of front-line services. It would not be prudent for authorities to say goodbye to employees, and to wait until much later to pay the full costs.

The Commission will be following up this report with local audits of the management of early retirement in most authorities in Scotland, and will be monitoring authorities' responses to the report's recommendations.

Appendix 1: Study overview

Objectives

The objectives of the study were to:

- profile the levels and costs of early retirement over the financial years spanning 1990/91 to 1996/97, the first full year of operation of the unitary councils and restructured police and fire services
- ascertain authorities' policies, procedures and practices
- collect information on authorities' experiences and views
- identify issues likely to be of concern
- take account of the roles and views of relevant professional and expert bodies
- identify examples of best practice
- issue recommendations to local government and advise auditors.

Fieldwork

The Commission's fieldwork comprised four key elements:

- the extraction of data from computerised superannuation records
- fieldwork in local authorities
- a questionnaire distributed to all councils, joint police forces and joint fire brigades
- supplementary studies.

Extraction of computerised superannuation records

Hymans Robertson, a firm of consulting actuaries, were retained by the Accounts Commission to collect data from local authority superannuation records. The data covered the number and cost of early retirals for the financial years 1990/91 to 1995/96.

Fieldwork in local authorities

Preparatory fieldwork was conducted in a sample of local authorities to ensure familiarity with the issues and an initial understanding of the management of early retirement in local government. Feedback from the fieldwork informed the drafting of a questionnaire.

Questionnaire

Following a pilot among the four authorities, a questionnaire was sent to all 32 councils, six joint police forces and six joint fire brigades in Scotland (see box 10). The purpose of the questionnaire was to explore current policy, practice and procedure in relation to early retirement and to collect robust information on the levels and costs of early retirement in recent years.

Questions related only to employees or retirees within the LGPS, namely chief officers, APT&C and manual employees within councils, civilians and traffic wardens within police forces, and control room staff and non-uniformed support staff within fire brigades.

The questionnaire was sent both to administering authorities and to scheduled bodies because some issues are particular to each.

Box 10: Questionnaire responses

Local government body	Sent	Received	Response rate %
Council - administering authority	11	11	100
Council - scheduled body	21	21	100
Council - overall	32	32	100
Joint police force	6	4	67
Joint fire brigade	6	4	67
Total	44	40	91

Note: percentages are rounded.

The questionnaire was focused on people:

- aged 50 years or more, who had taken early retirement due to redundancy or in the interests of efficiency
- of any age, who had retired early on the grounds of ill-health.

The questionnaire was in three parts:

- **Part A** dealt with factual information concerning the authority's practices, policies and procedures. There was also provision to insert comments to supplement the answer to each question.
- **Part B** requested summary numbers of the pattern of early retirements during the financial year 1996/97.
- **Part C** provided an opportunity for authorities to put their recent experience of operating their early retirement scheme into context, particularly with regard to local government reorganisation and budgetary pressures. Completion was optional.

Appendix 2: Advisory Group

Members sat on the Group in a personal capacity.

Alan Cuthbertson	Director of Personnel South Lanarkshire Council
George Farquhar	Director of Human Resources Perth and Kinross Council
Peter Hay	Director of Personnel Services Aberdeenshire Council
John McAuley	Pensions Manager City of Edinburgh Council
Clive Ross	Pensions Manager Dundee City Council
David Sawers	Director of Finance Angus Council
Geoff Singleton	Depute Director of Finance Glasgow City Council
Albert Tait	Depute Chief Executive Convention of Scottish Local Authorities
Andrew Todd	Head of Service Area, Human Resources Moray Council

Appendix 3: Glossary

ACT Advance Corporation Tax.

Accrued benefits pension (Reckonable service x Final pensionable remuneration)/80.

Added years The additional reckonable service awarded by the employer towards the employee's pension.

Added years lump sum Three times the added years pension.

Administering authority Administers a superannuation scheme and pension fund on behalf of other bodies.

Admitted body An organisation, other than a local authority, whose employees' pensions are managed by an administering authority.

Early retirement See **Efficiency, Ill-health** and **Redundancy.**

Efficiency Early retirement in the interests of efficiency occurs where an employee is aged 50 or over and has ceased to be employed in the interests of the efficient discharge of the authority's functions.

Funding level A pension fund's ratio of assets to liabilities.

Future service contribution rate The rate of employer's contribution which must be paid if the fund has no surplus or deficit and is to remain 100% funded.

Ill-health Occurs where an employee is medically unfit to continue in employment. May occur at any working age.

Late retirement Retirement after the age of 65.

Normal retirement The normal retirement age (NRA) falls between 60 and 65, after at least 25 years of reckonable service have been accrued. The latest date for normal retirement is 65, even if the employee has less than 25 years of contributions. For the purposes of reimbursing the pension fund for early payment, NRA is taken to be age 60, or up to 65 if the employee does not have 25 years of contributions in the pension scheme.

Pensionable remuneration Typically, an employee's salary/wages in the best of the last three years, but may also include other benefits paid to the individual.

Reckonable service Accumulated superannuable service with the authority or its predecessors. In addition, previous service with local or public authorities may be recognised, as may service where another occupational pension scheme has operated and transfer is possible.

Redundancy Early retirement on the grounds of redundancy occurs where an employee aged 50 years or over is in a job which is redundant.

Scheduled body An authority the pensions of which are managed by an administering authority.

UKSC United Kingdom Steering Committee on Local Government Pensions.

Appendix 4: Administering authorities

Administering authority	Component councils
Aberdeen City Council	Aberdeen City Council Aberdeenshire Council Moray Council
Dundee City Council	Angus Council Dundee City Council Perth and Kinross Council
City of Glasgow Council	Argyll and Bute Council City of Glasgow Council East Ayrshire Council East Dunbartonshire Council East Renfrewshire Council Inverclyde Council North Ayrshire Council North Lanarkshire Council Renfrewshire Council South Ayrshire Council South Lanarkshire Council West Dunbartonshire Council
City of Edinburgh Council	City of Edinburgh Council East Lothian Council Midlothian Council West Lothian Council
Dumfries and Galloway Council	Dumfries and Galloway Council
Falkirk Council	Clackmannanshire Council Falkirk Council Stirling Council
Fife Council	Fife Council
Highland Council	Highland Council Western Isles Council
Orkney Islands Council	Orkney Islands Council
Scottish Borders Council	Scottish Borders Council
Shetland Islands Council	Shetland Islands Council

Appendix 5: References and notes

[1] Appendix 1

[2] Appendix 2

[3] *Quarterly Joint Staffing Watch*, COSLA, March 1997

[4] This figure is based on actuarial factors determined prior to the July 1997 change in tax credit on Advance Corporation Tax

[5] See glossary in appendix 3

[6] Accounts Commission survey, 1997
Figures are for 10 of the 11 administering authorities

[7] An employee may elect to have his or her income during any year from the previous three years taken into account instead

[8] The draft Local Government Pension Scheme Regulations (Scotland) 1997, Regulation 27 (1)

[9] Hymans Robertson, a firm of consulting actuaries

[10] *Quarterly Joint Staffing Watch*, COSLA, March 1997

[11] *The Comparative Expenditure Needs of Local Government in Scotland, England and Wales*, page 19, COSLA, 1997

[12] UKSC Circular 57

[13] *Retiring nature: early retirement in local government*, Audit Commission, 1997

[14] COSLA communication with Accounts Commission, 26 November 1997

[15] The Government Actuary, Demographics Section, communication with Accounts Commission

[16] See glossary

[17] The draft Local Government Pension Scheme Regulations (Scotland) 1997, Regulation 97(1)

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