Bye now, pay later?

A follow-up review of the management of early retirement

Prepared for the Accounts Commission

June 2003

AUDIT SCOTLAND

The Accounts Commission

The Accounts Commission is a statutory, independent body, which through, the audit process, assists local authorities 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
- 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 and 35 joint boards (including police and fire services). Local authorities spend over £9 billion of public funds a year.

Acknowledgments

This report has been prepared by Audit Scotland on behalf of the Accounts Commission for Scotland. The study team consisted of Irene Coll, Mary Hesling and Robert Leishman.

We would like to thank the study advisory group which comprised a range of experts from councils and pension funds, for providing valuable advice and acting as a sounding-board for the project team throughout the study. Details of the members of the advisory group can be found at Appendix 4. It is noted that whilst the advisory group provided advice and guidance to the study, the Accounts Commission retains responsibility for the content of the final report.

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Accounts Commission and the Auditor General for Scotland. Together they ensure that the Scottish Executive and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

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Summary

The number of early retirements has fallen since local government reorganisation in 1996 and is now below the levels of the early 1990s.

The study

In 1997 the Accounts Commission published *Bye now, pay later?* The report examined the management of early retirement by councils, police and fire services, and made a series of recommendations for improvements.

This follow-up report examines how local authorities have responded to the recommendations. It concentrates on the management of early retirement decisions for all local authority staff other than teachers and uniformed police and fire personnel. It does not, however, seek to comment on the wider issues surrounding pension funds which the Accounts Commission is monitoring through the audit process.

Early retirement provides local authorities with a useful tool for improving efficiency through reductions in the size of the workforce. Regulations governing early retirement have changed since 1997, but local authorities still have a good deal of discretion in how they approach early retirement.

The changes in regulations mean there are now three types of early retirement. Each has different cost impacts for the authority to consider.

Findings

1. The number of early retirements has fallen.

The number of early retirements has fallen since local government reorganisation in 1996 and is now below the levels of the early 1990s (from 3,262 in 1990/91 to 1,684 in 2001/02 (Exhibit 1).

As at 31 March 2002, the number of employees within the Local Government Pension Scheme (LGPS) was 184,728.

Numbers of efficiency, redundancy and ill-health retirals have all fallen, but voluntary early retirals have increased with the introduction of the 'rule of 85'.

Ill-health retirals remain at approximately 50% of all early retirals.

2. Some councils have many more early retirals than others.

Numbers of early retirals in any single year can be influenced by a number of factors particularly any large scale restructuring within an authority. Using three-year averages to smooth out the impact of these factors, Audit Scotland found:

- efficiency, redundancy and voluntary retirals ranged from three in Stirling (0.04%) to 236 in Aberdeen City (1.25%) – a range of 30:1 (Exhibit 2)
- ill-health retirals ranged from 30 in Argyll & Bute (0.41%) to 175 in Dundee City (1.25%) – a range of 3:1.

This range is surprising given that all ill-health retirals now have to be based on independent occupational health opinions.

3. The average costs of early retirals also vary.

The strain costs of retirals depend on: age, length of service, added years awarded, time to normal retirement age and salary level. Three-year averages show:

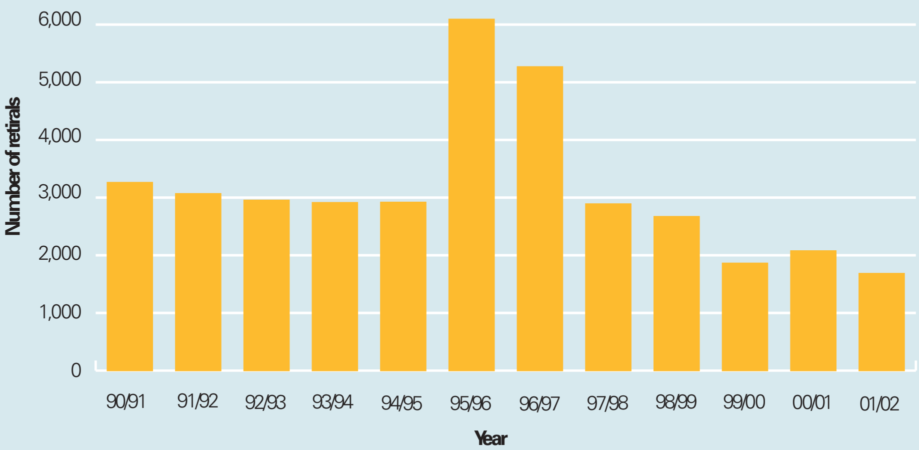
- strain on the fund costs ranged from £1,000 per retiral in Orkney to £45,000 per retiral in East Ayrshire – a range of 45:1 (Exhibit 3)
- higher strain costs tend to arise where the average age of efficiency and redundancy retirees is lower and where more added years are awarded
- employers have discretion on the number of added years – the average awarded ranged from three to seven.[1]

Type of retiral	Costs to employers
1. Due to **efficiency** or **redundancy** at the discretion of the employer.	Additional strain costs relating to the enhanced costs resulting from early retirement are borne by the authority and repaid to the pension fund over a maximum of five years.
2. Due to **ill-health** where the employee is medically unfit to work.	Ill-health retiral costs are fully borne by the pension fund.
3. Due to '**rule of 85**', where an employee aged between 50 and 60 can ask to be considered for voluntary retiral. The employer makes the final decision on these cases.	Costs to the pension fund for the early payment of benefits are borne by the employing authority.

1. Range excludes those councils with fewer than ten cases with added years.

Exhibit 1

The early retirement trend in Scottish councils 1990/91-2001/02



Source: Audit Scotland fieldwork

4. Management of early retirement has improved.

- Decisions on efficiency, redundancy and voluntary retirals are now supported by information on the full costs of the early retiral.
- Average strain costs per case have decreased from £32,000 to £20,000.
- Employers use independent, qualified occupational health specialists to inform ill-health decisions.
- All but one local authority (Inverclyde) have clear guidance on the use of retraining or redeployment as alternatives to early retirement.
- Communications between pension fund administering authorities and admitted bodies have improved.

5. But there is still more to be done.

Authorities should have clear policies on early retirement, approved by elected members, and regularly reviewed to reflect changes in regulations:

- Comhairle nan Eilean Siar does not have policies governing early retirement
- The policies of East Renfrewshire and Perth & Kinross do not cover all aspects of early retirement
- East Ayrshire, Falkirk and Inverclyde have not reviewed their policies since 1996.

Elected members (audit committee or equivalent) should receive summary information on the number and costs of decisions made, to check that policies are being implemented. In over half of authorities they do not.

Authorities should balance the potential for savings against the costs when making early retirement decisions. One authority (Fife) does not formally, for one-off cases.

Service departments should bear the costs of early retirement decisions to improve accountability and monitoring. This is not the case in three authorities (East Dunbartonshire, Inverclyde and Renfrewshire).

Recommendations

Framework for decision making

- Early retirement policies should be approved by elected members and be reviewed regularly.

Informing members

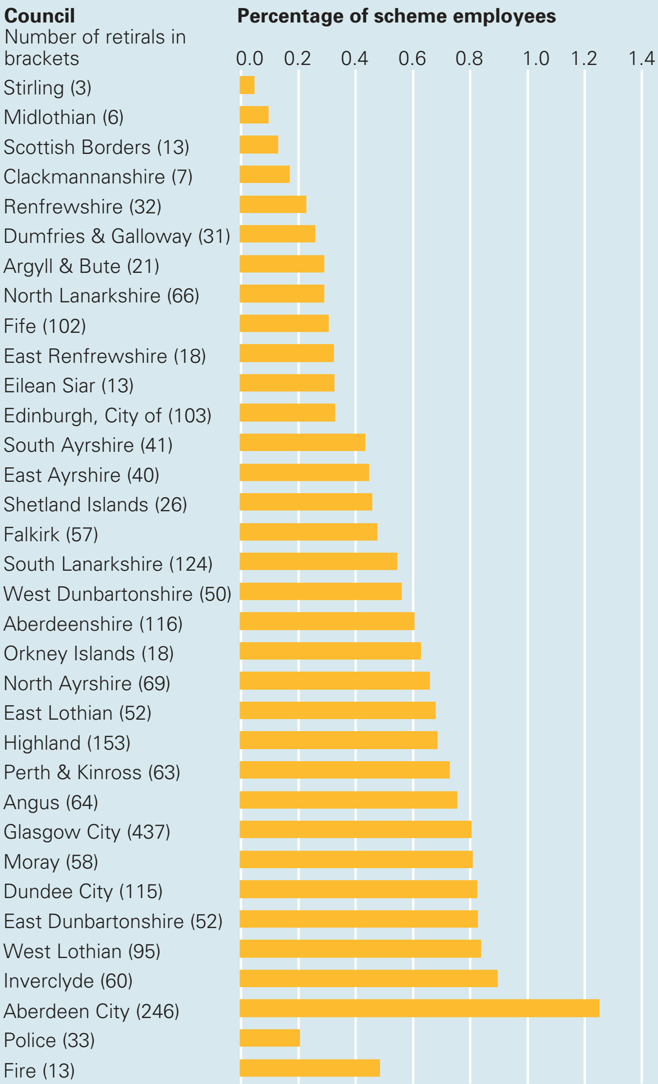
- Members should receive a report at least annually that details the number of early retiral decisions made in the year, along with the associated costs and savings attached to these decisions.

Decision making

- Local authorities should rigorously appraise individual cases to ensure the expected savings associated with a retiral outweigh the costs.
- To improve accountability and assist in monitoring, the costs of early retirement should be charged to the appropriate service budget.
- Elected members should be involved in approving early retirement decisions for senior staff.

Exhibit 2

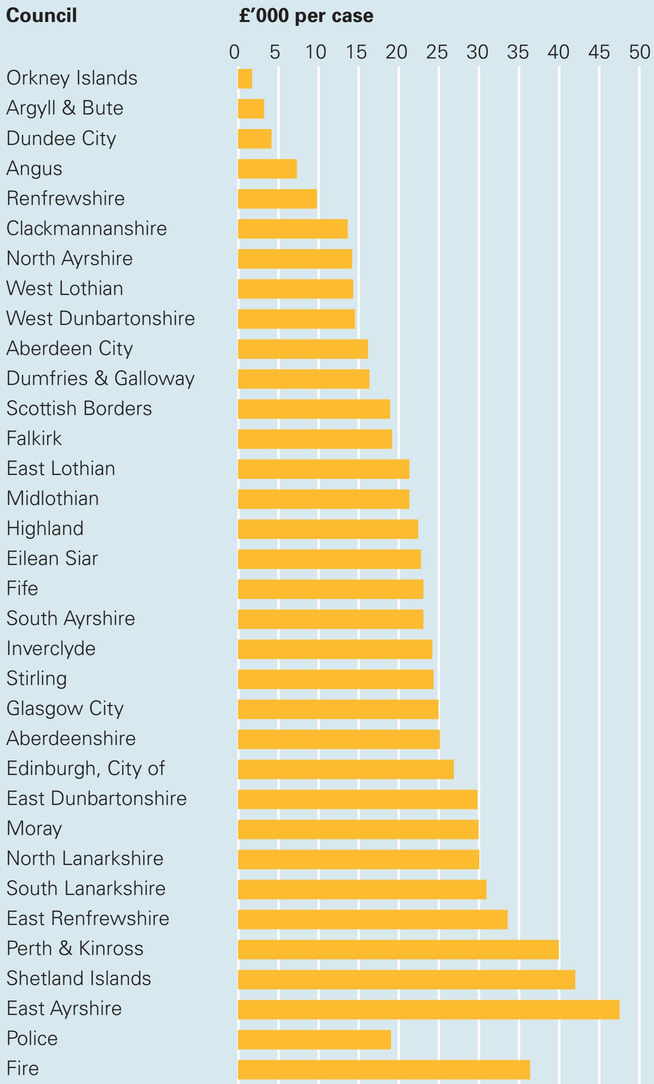
Efficiency, redundancy and voluntary 1999/2000-2001/02



Source: Audit Scotland fieldwork.

Exhibit 3

Average strain on the fund costs 1999/2000-2001/02



Source: Audit Scotland fieldwork.

Part 1: Introduction

1.1 The LGPS caters for local authority employees other than teachers, and also covers civilians within police forces and control rooms, and non-uniformed employees within fire brigades. Teachers, police officers and fire-fighters have separate pension arrangements.

1.2 The scheme works by each employee paying a regular contribution to a pension fund from his or her salary or wages. The employer (employing body) also makes a contribution on behalf of each employee. Contributions are invested in a fund that pays for each member's retirement costs. There are 11 funds in Scotland each administered by a nominated local authority within the fund. These authorities are known as the administering authorities. As at 31 March 2002, there were a total of 184,728 employees, 115,377 pensioners and 44,207 ex-employees entitled to deferred benefits within the LGPS in Scotland.

1.3 The scheme was set up with the expectation that employees would remain members until they were 65 and would contribute for at least 25 years. However, there are provisions for employees to retire from the scheme early and still be entitled to immediate payment of their retirement benefits. This is known as early retirement.

1.4 Early retirement is an important management tool. It can help in managing staff levels by facilitating the departure of employees by a number of routes:

- due to efficiency or redundancy at the discretion of the employer
- due to ill-health where the employee is medically unfit to work
- at the employee's request. This requires the approval of management, and the benefits payable may be reduced dependent on their age and length of service ('rule of 85').

1.5 Details of the LGPS rules governing each early retirement route are set out in Appendix 1. These affect local authorities in different ways as summarised in Exhibit 4.

1.6 In December 1997, the Accounts Commission for Scotland published *Bye now, pay later*. The Commission found that early retirement was widespread and costly, and made nine recommendations for employing bodies and administering authorities to improve management practices. Full details of the recommendations are set out in Appendix 2.

1.7 *Bye now, pay later* contained a commitment to monitor how the employing bodies responded to the Commission's recommendations. This report records the results of the follow-up study undertaken by Audit Scotland. The study addressed:

- how the regulations governing early retirement have changed since 1997 (Part 2)
- trends in the volume and cost of early retirement (Part 3)
- local authorities' response to the Commission's recommendations (Part 4).

Exhibit 4

Who pays for the immediate costs of early retirement?

For efficiency, redundancy and voluntary retirals, the additional costs are borne by the employing body.

Type of retiral	Costs to employers
1. Due to **efficiency** or **redundancy** at the discretion of the employer.	Additional strain costs relating to the enhanced costs resulting from early retirement are borne by the authority and repaid to the pension fund over a maximum of five years.
2. Due to **ill-health** where the employee is medically unfit to work.	Ill-health retiral costs are fully borne by the pension fund.
3. Due to '**rule of 85**', where an employee aged between 50 and 60 can ask to be considered for voluntary retiral. The employer makes the final decision on these cases.	Costs to the pension fund for the early payment of benefits are borne by the employing authority.

Source: Local Government Pension Scheme (Scotland) Regulations 1998 and Amendment Regulations 2000.

Details of Audit Scotland's methodology are set out in Appendix 3. In addition to the national report, each local authority will receive a local report detailing the position locally. Within this report the term 'local authority' is used to cover all councils, police and fire boards. The term 'council' is taken to mean all 32 councils.

1.8 This report does not consider the wider question of the performance of local government pension funds. In common with other pension funds, local government pension funds are likely to be adversely affected by recent falls in stock market values. The impact of these changes will be considered in actuarial reviews of the pension funds, and may result in changes to contribution rates paid by local authorities to fund the scheme. The Commission's report, the *Overview of the 2001/02 local authority audits*, has identified these pension issues as an important area which auditors are expected to keep under review.

Part 2: The impact of changes to pension regulations since 1997

2.1 The management of early retirement has been affected by a number of changes since 1997. This part of the report highlights significant changes which have an influence on the recommendations included in *Bye now, pay later* arising from:

- revisions to the statutory regulations governing the local government pension scheme
- changes to accounting standards
- other legislative and management arrangements.

Pension regulations

2.2 The LGPS is governed by a set of statutory regulations which have been amended twice since 1997.

2.3 The 1998[2] regulations introduced two changes:

- **the 'rule of 85'** – any employee covered by the scheme who is aged between 50 and 60 may ask for voluntary retirement. The discretion to allow early retirement under this rule rests with the employer. Where the sum of the employee's age and length of service is at least 85, the employee's benefits will be based on reckonable service to the date of retirement without reduction.
- **ill-health retirals** – from 1 April 1998, before making a decision on ill-health retirement, the employer must obtain a certificate from an independent registered medical practitioner stating that the employee is permanently incapable of discharging their current duties due to ill-health.

2.4 The 2000[3] amendments introduced two further changes:

- **ill-health** – the certificate from the independent medical advisor must state that the employee is permanently medically unfit to complete their current or any comparable employment until at least their 65th birthday. Medical practitioners used as independent advisors are also required to be qualified in occupational health medicine.
- **'strain on the fund'** – administering authorities have the right to require employing authorities to make additional payments to the pension fund to reflect the extra cost to the pension fund of immediate payment of benefits to employees who retire early on efficiency, redundancy or voluntary grounds.

Accounting standards

2.5 Changes to accounting standards governing the disclosure of information in financial accounts have introduced new requirements for disclosure of pensions information. These changes were introduced in two parts:

- Statement of Standard Accounting Practice (SSAP) 24 required that, from 1999, employing bodies disclose details of the amounts paid in pension contributions, and the capitalised costs associated with added years and other early retirement decisions as part of the notes to the accounts. It is noted that local authorities do not fully comply with SSAP 24.
- Financial Reporting Standard (FRS) 17, introduced further changes requiring the share of each authority's assets and liabilities within the pension fund to be included within its balance sheet from 2003/04. The standard is being introduced in stages and for 2001/02 limited disclosure in the notes to the accounts was required.

Changes in employment legislation

2.6 The Disability Discrimination Act (1995) requires employers to explore alternative working arrangements to keep employees in work.

2.7 Details of the recommendations made in *Bye now, pay later* and the impact of the changes are set out in Exhibit 5.

2. Local Government Pension Scheme (Scotland) Regulations 1998.
3. Local Government Pension Scheme (Scotland) Amendment Regulations 2000.

Exhibit 5

The impact of changes in regulations on the Commission's recommendations

A number of the recommendations made in *Bye now, pay later* have been overtaken or affected by changes in the pension regulations, accounting standards and employment legislation.

Original recommendation	Impact of changes
Authorities should:	
1. Ensure accountability • establish a framework of policies and procedures • policies and procedures should be regularly reviewed • elected members should be involved in decision making for senior management retirals • elected members should get a report that details the number of decisions made, with the associated costs/savings at least annually • decisions made should be based on the full costs and associated savings from the retiral.	
2. Reimburse the fund • identify the full cost of early retirement to both the revenue budget and the pension fund • reimburse the pension fund, over a reasonable period of time for the costs of the early payment of accrued benefits • ensure that each department supporting an efficiency or redundancy early retiral pays the additional costs, including the strain on the fund.	The 1998 regulations have prescribed that the strain costs are repaid to the pension fund as they arise, with the repayment period being defined in the Regulations.
3. Review procedures for ill-health retirals	Changes in ill-health regulations and decision making have ensured that all ill-health decisions are made by properly qualified, independent, occupational health specialists.
4. Ensure transparency • disclose pension costs and separately the extra costs arising from early retirement, in its' annual report as well as its' accounts	Changes in accounting standards have ensured that the costs associated with early retirals are disclosed in the annual accounts of local authorities.
5. Consider alternatives to early retirement	Changes in employment legislation now require employers to explore alternative working arrangements to keep employees in work.
6. Monitor trends	
In addition, each administering authority should:	
7. Consider separate funding levels • 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.	The introduction of the strain on the fund repayments has reduced the liability on the funds from different employers due to patterns of early retirement.
8. Monitor key performance indicators • 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.	Again, the requirement to repay strain on the fund costs has reduced the number of forecasts that actuaries have to make as the costs of early payments from funds are being repaid as they arise.
9. Improve communications • with the scheduled and admitted bodies.	

Source: Accounts Commission 1997 report *Bye now, pay later?*, The Local Government Pension Scheme (Scotland) Regulations 1998 and Amendment Regulations 2000.

Part 3: Trends and costs

3.1 *Bye now, pay later* identified a number of problems. These included:

- substantial increases in the incidence of early retirement
- a higher than anticipated incidence of ill-health retirements
- the costs of early retirements.

This part of the report reviews trends in early retirement numbers and costs since 1997.

Overall incidence

Councils

3.2 There has been a general downward trend in the number of local authority staff leaving on grounds of early retirement since 1991 (Exhibit 6). The number leaving due to early retirement in 1990/91 exceeded 3,000 but by 2001/02, the number retiring early had dropped to less than 1,500. The exception to the general trend was 1995/96 and 1996/97, when many councils used early retirement on grounds of efficiency and redundancy to help re-configure staffing structures following local government re-organisation.

3.3 *Bye now, pay later* highlighted increases in efficiency and redundancy early retirements together with higher than expected levels of ill-health retirements in 1995/96 and 1996/97. Since then there has been a significant drop in the numbers of all types of early retirement. The number of efficiency and redundancy early retirements recorded by councils has fallen by two-thirds from 1,272 (1.05% of employees in the scheme in 1997/98) to 484 (0.32%) in 2001/02, while the number of ill-health retirements has fallen by half from 1,560 (1.29% of employees in the scheme) to 942 (0.62%) (Exhibit 7).

3.4 In the same period the number of voluntary early retirements has risen from 58 (0.05%) in 1997/98 to 258 (0.17%) in 2001/02.

3.5 The profile of employees leaving on early retirement has also changed between 1998 and 2002. The average age of leavers from the LGPS has increased from 56.5 to 57.8 and the average added years awarded has decreased from 5.2 to 4.8. The average length of service of employees retiring early has fallen from 20.2 to 19.2 years. These changes will reduce the costs of retirals.

3.6 The changes in the overall number of early retirements can be attributed to a number of factors including:

- the impact of local government re-organisation in 1995/96 and 1996/97
- the introduction of a requirement for local authorities to repay additional costs of the early payment of benefits from the fund (para 2.4)
- additional disclosure of pensions information required by changes to accounting standards (para 2.5)
- changes to the ill-health retiral regulations (paras 2.3 and 2.4)
- the introduction of the 'rule of 85' (para 2.3).

Comparison with England

3.7 *Bye now, pay later* compared the incidence of early retirals in Scotland with those recorded by councils in England and Wales. This showed a marked difference in experience between the funds with around 10% more early retirals in Scotland. A similar comparison for 2001/02 found that the fall in the numbers of early retirements in Scotland has brought the level of early retirement below that of England (Exhibit 8).

Police and fire

3.8 The numbers of early retirees from civilian posts in police forces is small – averaging 55 (1.0% of scheme employment) over the last three years, of which 44 (0.8%) were for ill-health. This is a reduction on the 1.4% reported in 1996/97.

3.9 The picture is similar for non-uniform employees of fire brigades, averaging 17 (1.9%) over the last three years, of which 12 (1.4%) were for ill-health. This is an increase on the 1.1% reported in 1996/97.

3.10 Police and fire employers have higher levels of ill-health retirals than councils. This is noteworthy, but not easily explained given that all ill-health retirals must now be based on advice from an independent occupational health specialist.

3.11 Because these numbers are so small, we do not present analyses below on a force-by-force or brigade-by-brigade basis.

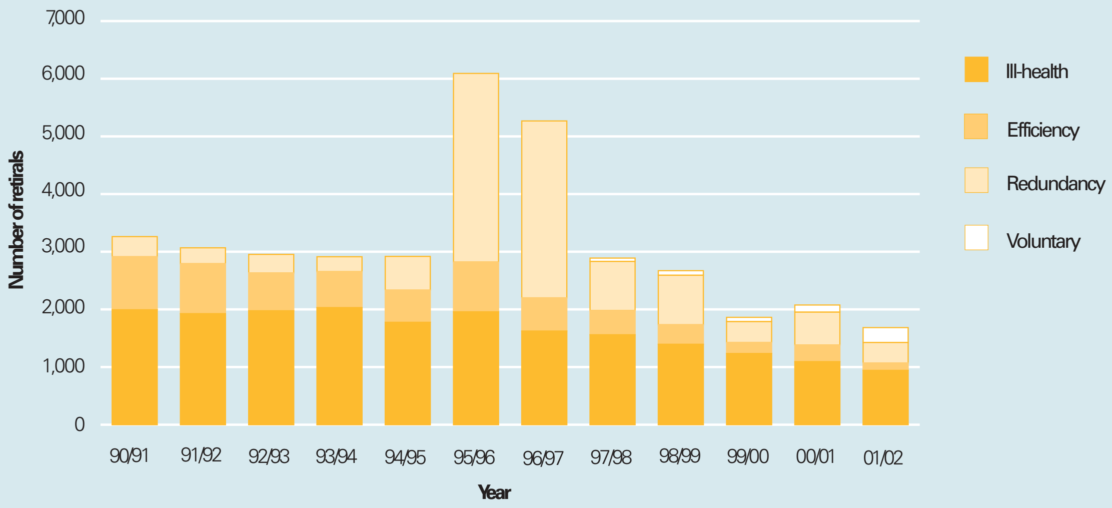
Variations in incidence of early retirement across authorities

3.12 The range of early retirements recorded by local authorities continues to vary. *Bye now, pay later* found that the incidence of early retirals varied by a ratio of 5:1 in 1996/97. In 2001/02, the range was unchanged. The level of early retirement in an authority in any one year can be influenced by a number of factors (such as major re-organisation within an authority in any year), and may mask different trends in the numbers of retirals by type over a number of years. We therefore examined the trends in more detail using three-year averages to smooth out the impact of events in a single year, and by analysing results for ill-health retirals separately from efficiency and redundancy retirals.

Exhibit 6

Number of employees retiring by category 1990/91-2001/02

The number of staff retiring early has declined steadily since 1990/91, with the exception of 1995/96-1996/97 (local government re-organisation).

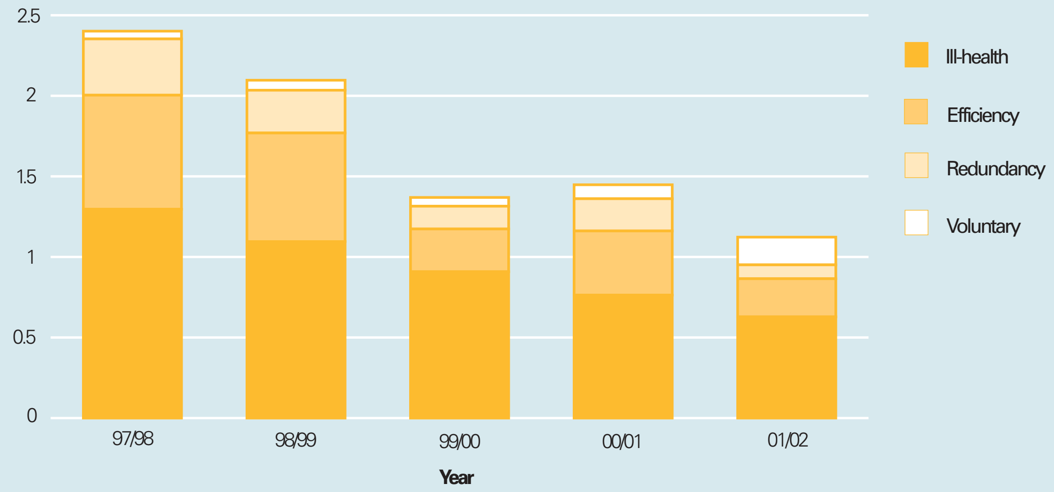


Source: 1990/91-1996/97 – fieldwork completed for the 1997 publication, 1997/98-2001/02 Audit Scotland fieldwork.

Exhibit 7

Percentage of employees retiring early by category 1997/98-2001/02

Ill-health retirals make up approximately 50% of all early retirals. Voluntary retirals are increasing.



Source: Audit Scotland fieldwork.

Exhibit 8

Comparison of retiral rates in Scotland with England 2001/02

The ill-health retiral rates from the Scottish LGPS are similar to those from the LGPS in England, whilst Scotland has a lower incidence of other early retirals.

2001/02	Ill-health – %	Others – %
England	0.66	0.54
Scotland	0.63	0.34

Source: Scotland data – Audit Scotland fieldwork, England BVPI 14 and BVPI 15 published data – www.bvpi.gov.uk

Ill-health retirals

3.13 In 1996/97, ill-health retirals in individual authorities ranged from 0.2% to 1.9% of employees. Analysis of the three-year average for ill-health retirements for 1999/2000-2001/02 (Exhibit 9) identified a narrower range, from 0.4% of total employees in Argyll & Bute Council to 1.2% of employees in Dundee City Council. Councils with high levels of ill-health early retirals in 2001/02 are not generally the ones which were high in 1996/97, with the exception of Dundee City.

3.14 All ill-health retirals are now based on certification by independent medical practitioners. It is therefore surprising that the range of early retirement on ill-health grounds remains as wide as 3:1.

Redundancy, efficiency and voluntary retirals

3.15 *Bye now, pay later* found that the level of redundancy and efficiency retirements recorded by individual councils ranged from 0.3% to 20.6% of employees. In the three-year period from 1999/2000 – 2001/02, the average annual incidence of retirement on grounds of efficiency, redundancy or voluntary retirement ranged from 0.04% of authority employees in Stirling Council to 1.25% of employees in Aberdeen City Council – a range of 30:1 (Exhibit 10). If the extremes are excluded the range drops to 4:1 which is similar to the level in 1996/97. The figures in Aberdeen City reflect the major restructuring exercise that took place within the council in 2001, that led to an increased number of redundancy and efficiency retirals.

3.16 There is some evidence of an inverse relationship between the average numbers of ill-health retirals and redundancy, efficiency and voluntary retirals. Five of the councils (Fife, Clackmannanshire, Midlothian, North Lanarkshire and Stirling), that are in the upper quartile for ill-health retirals are in the lower quartile for redundancy, efficiency and voluntary retirals.

The costs of early retirement

3.17 Local authorities bear the cost of early retirement in two ways. For early retirements on ill-health grounds, the costs are borne by the pension fund. In these cases the local authority bears additional costs, through changes to contribution levels, if early retirement patterns exceed those forecast in actuarial valuations. For other early retirements local authorities meet the cost directly through payment of 'strain on the fund' costs.

Ill-health costs

3.18 *Bye now, pay later* expressed concern over the level of ill-health early retirement. The incidence of early retirements in the early 1990s was exceeding actuarial expectations and, unless authorities took action, this could have led to increases in employers' contributions to the pension funds.

3.19 As the costs of ill-health are borne by the pension fund, the actuary makes an assumption of the number of members of the scheme that will retire in the three year period of each valuation. At each new valuation the actual retiral rates are compared to the expected level. This is then used to inform the assumptions for the following three years. Exhibit 11 sets out the difference between the expected and actual retirals as set by the actuaries for the 1999 and 2002 valuations. This shows that the fall in the number of ill-health retirements recorded since 1996/97 has brought actual numbers below actuarial expectations, so that ill-health early retirement trends offer less of a threat to actuarial valuations and, consequently, will not be a cause of increased contributions for employers.

'Strain on the fund'

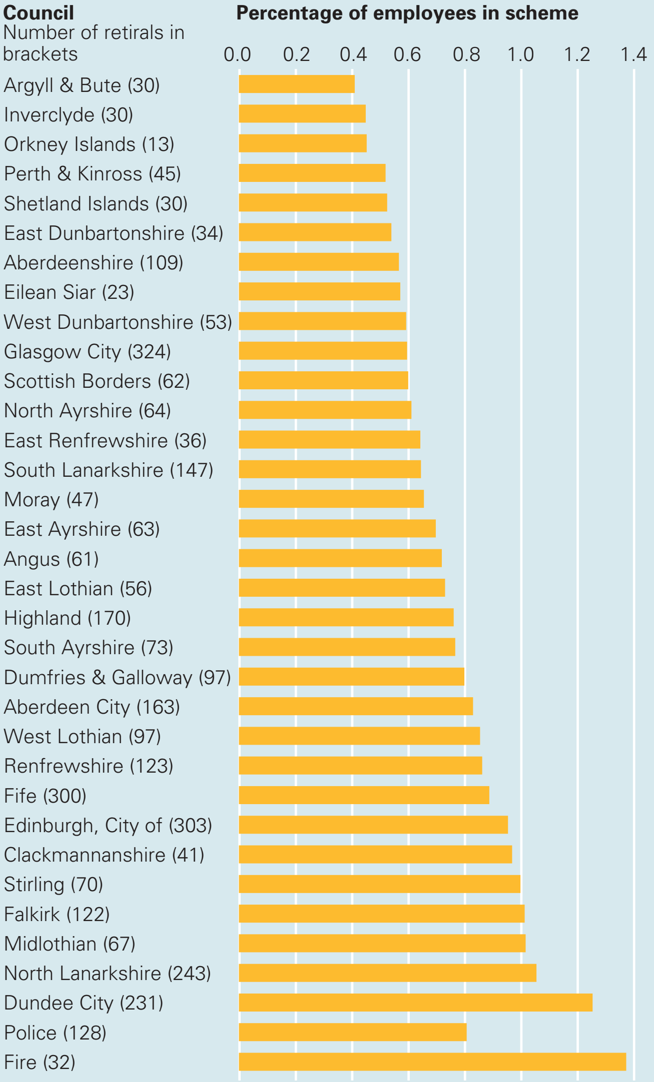
3.20 The 2000 amendments extended the administering authorities' powers to request payment from the employing authority in respect of redundancy, efficiency or voluntary retirals. The payment covers "*the extra cost of the immediate payment of the pension and retirement grant together with the cost of providing any increase under Part I of the Pensions (Increase) Act 1971*."[4] This payment has become known as the 'strain on the fund'. Since the introduction of the strain costs authorities have repaid a total of £44 million to the pension funds, at an average cost of £20,000 per retiral, down from £32,000 in 1997.

4. Local Government Pension Scheme (Scotland) Amendment Regulations 2000.

Exhibit 9

Incidence of ill-health retirals as a percentage of members of the scheme 1999/2000-2001/02

The incidence of ill-health retirals varies markedly across Scotland.

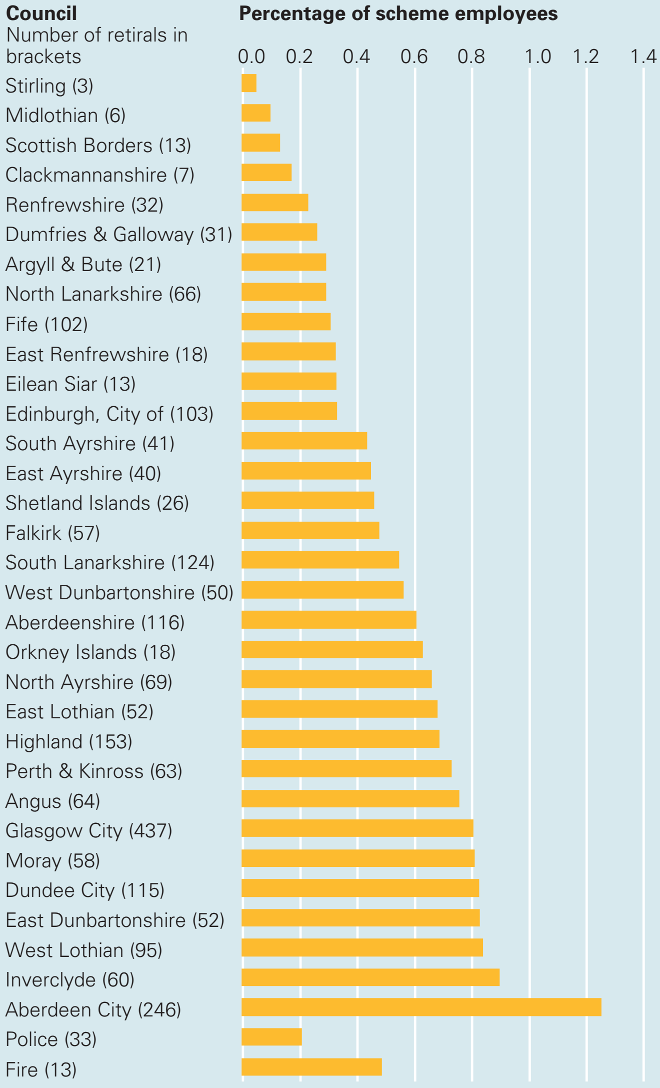


Source: Audit Scotland fieldwork.

Exhibit 10

Incidence of efficiency, redundancy and voluntary retirals 1999/2000-2001/02

The use of efficiency, redundancy and voluntary retirals varies across Scottish local authorities.



Source: Audit Scotland fieldwork.

Exhibit 11

Actual versus expected ill-health retirals from LGPS schemes at 1999 and 2002 valuations

In 1999 the number of ill-health retirals was greater than forecast. In 2002 the number of ill-health retirals was less than forecast.

	Expected	Actual
1996 – 1999	4,338	5,194
1999 – 2002	4,817	3,936

Source: 1999 and 2002 valuations. Note: 1999 figures are based on 10 funds, 2002 figures based on nine funds.

3.21 The average strain cost per employee varied significantly across authorities (Exhibit 12) from a low of around £1,000 in Orkney to over £45,000 in East Ayrshire. The variation reflects a number of factors relating to individual retirees including age, length of service, salary at retirement date and the cost of any added years awarded by the authority.

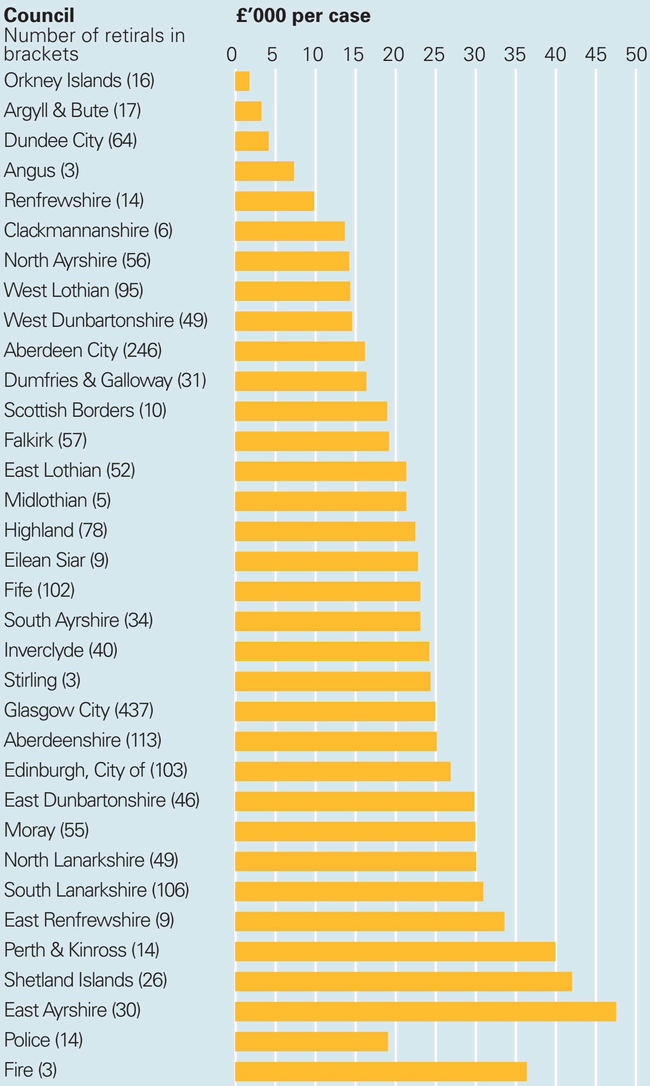
3.22 The only scope for authorities to exercise discretion (apart from the decision to approve early retirement) is in the number of added years awarded. The average of added years awarded in early retirement cases between 1999/00-2001/02 show a wide variation (Exhibit 13). Leaving aside those authorities with small numbers of cases, the average number of added years ranges from below two to over seven. Aberdeenshire, West Dunbartonshire, Perth & Kinross, Inverclyde, City of Edinburgh and Moray awarded on average around seven years, whilst Orkney, Argyll & Bute, Fife, Angus and South Ayrshire awarded fewer than four years on average.

3.23 Authorities should ensure that their early retirement policies cover added years and that they are adhered to.

Exhibit 12

Average strain on the fund costs 1999/2000-2001/02

The average strain on the fund cost varies, this is dependent on a number of factors.

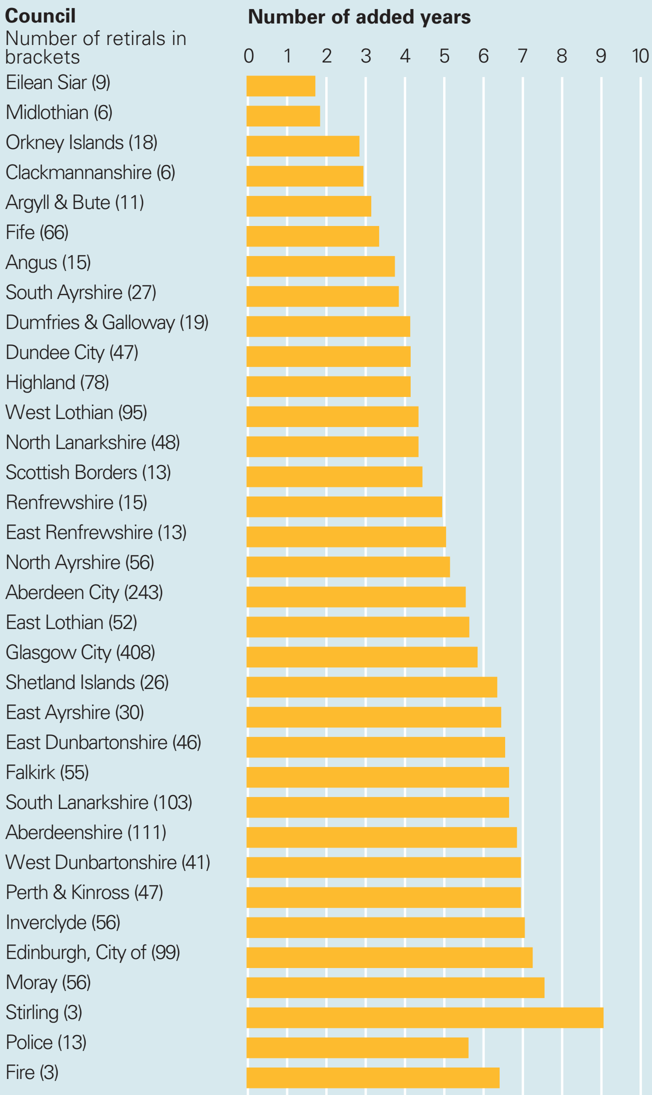


Source: Audit Scotland fieldwork.

Exhibit 13

Average added years 1999/2000-2001/02

There is a wide variation in the number of added years awarded by councils.



Source: Audit Scotland fieldwork.

Part 4: Progress on the Commission's recommendations

4.1 This part of the report examines the extent to which authorities have responded to the recommendations in *Bye now, pay later*. Generally, authorities now adopt practices similar to those recommended by the Commission, although some areas of concern have been addressed by changes to regulations.

4.2 Five of the Commission's nine recommendations cover areas which have not been affected by changes in regulations (Exhibit 5, page 9). The paragraphs below consider what authorities are currently doing in relation to these and makes further recommendations to improve the management of early retirement.

Ensure accountability

Policies and procedures

4.3 It is important that local authorities have clear, up-to-date policies and procedures. Clear policies ensure that all staff are aware of the information to be used when deciding on an early retirement case; provide a consistent base for making decisions, especially in the award of additional years; and ensure current practice reflects the requirements of existing regulations. Elected members should approve these policies and check that they are implemented – a role for the audit committee or equivalent.

4.4 Authorities have generally accepted the need for clear policies on early retirement but a number of authorities and joint boards do not have policies covering all types of retiral:

- Comhairle nan Eilean Siar does not have a formal policy on early retirements
- East Renfrewshire does not have a policy to cover redundancy and efficiency retirals
- Perth & Kinross does not have policies that cover voluntary retirals.

4.5 Changes to pension regulations since 1997 have had a significant impact on the management of early retirement, but three councils (East Ayrshire, Falkirk and Inverclyde) and Strathclyde police board have not reviewed their policies since that date.

Member involvement in decision making

4.6 Members should be involved in approving early retirement decisions for senior staff. They are in 23 authorities. In just over half of councils, members are involved in all cases. Where decisions on junior staff are delegated to officers, members should receive summary information on the numbers, costs and forecast savings.

Reporting to members

4.7 It is important that decisions made are reported to elected members so that they can review the effectiveness of their policies and monitor whether expected savings are achieved. Only 15 authorities reported the net costs of early retirement decisions made during the year.

4.8 Only three fire boards and one police board reported the costs of early retirement decisions to the joint board.

4.9 All authorities should report information on numbers, costs and associated savings expected from early retirement, to the audit committee or equivalent.

Decisions should be based on anticipated costs and savings

4.10 *Bye now pay later* found that few early retirement decisions appeared to have been made on the basis that expenditure incurred now may generate savings later.

4.11 The introduction of the requirement to repay the 'strain on the fund' costs has ensured that all authorities now calculate full cost information when making decisions. Fife was the only council not to formally balance costs against savings generated by the proposed retiral for one-off cases.

Reimburse the fund

4.12 Two of the detailed recommendations under this heading within *Bye now, pay later* have been overtaken by the requirement to repay 'strain on the fund' costs. The remaining recommendation is about allocation of costs.

Departments bearing costs of early retirements

4.13 *Bye now, pay later* recommended that the department which allows the redundancy or efficiency retiral should be charged with the costs of the retiral. This improves accountability for decisions and makes monitoring of savings easier.

4.14 By 2001/02, most (29) authorities charged the employing departments the added costs of individual early retirement cases. Of the three that did not, two (East Dunbartonshire and Inverclyde) are in the top quartile for numbers of early efficiency, redundancy and voluntary retirals.

4.15 In contrast, savings generated by early retirals almost always went to the employing department, with only East Ayrshire retaining savings corporately.

4.16 Some councils commented that where there were a number of early retirements arising from senior management re-organisation, the costs and savings of these were borne corporately.

Exhibit 14

Good Practice examples

Perth & Kinross and Renfrewshire Councils have good systems for ensuring that alternatives to early retirement are considered.

Perth & Kinross Council

The council has set up a group to review all applications for early retirement within the council. This group was set up in 1997, to help manage a large scale release of employees, and consisted of the chief executive, director of finance and the director of human resources, along with two members of the council.

The group has evolved into the Employee Resourcing Group, and currently does not have member involvement. The remit of the group is to provide appropriate controls across the council in relation to all establishment matters, including filling of posts, use of temporary contracts, payment of additional allowances as well as applications for retiral. The group also oversees redeployment within the council and ensures that all redeployees are considered for vacancies before they are advertised internally or externally.

Renfrewshire Council

In cases of long-term absence from work, managers within Renfrewshire Council are encouraged to explore alternative working arrangements with staff at an early stage to attempt to facilitate an early return to work.

Fifty-seven employees in 2001, and 24 in a six-month period in 2002, have secured returns to work by a variety of routes, including:

- additional training or retraining
- phased return to work
- allowing part time or job sharing employment
- job redesign
- redeployment to alternative work.

Source: Audit Scotland fieldwork

4.17 The accounting guidance BVACOP currently requires that the costs of early retirement are included in Unapportionable Central overheads within final accounts. This requirement holds for the 2002/03 accounts. However, consultation for the next version of BVACOP is currently underway and includes a suggestion that this should be changed to charging to services as part of the implementation of FRS 17 on retirement costs. Regardless of the outcome of this consultation, authorities should ensure that departments which allow early retirements bear the costs. They can still comply with BVACOP by making an adjustment to final accounts.

Monitor trends

4.18 Authorities should monitor the incidence, costs and savings of early retirements. This is a check on whether policies are being implemented as they should, and whether predicted savings are realised. A number of authorities do not monitor savings to ensure they are being generated as expected. Authorities should include this information in reports to members (para 4.7 above).

Alternatives to early retirement

4.19 The cost of early retirement can be significant – an average ill-health retirement case cost £50,000 in 2002. *Bye now, pay later* therefore identified a need for authorities to have procedures in place which clearly examined alternatives to early retirement – retraining and redeployment – which may be available. The Disability Discrimination Act (1995) now requires employers to seek alternative employment for staff who have become unable, through health reasons, to carry out their duties.

4.20 Alternatives to early retirement are generally covered in wider ranging authority policies on personnel issues. Policies such as retraining and redeployment can reduce early retirement. Nearly all (31) councils have clear policies on alternatives to early retirement, including retraining and redeployment, scope for recruitment bans, reduced rates of overtime and reduced use of temporary and casual staff. Inverclyde Council and Strathclyde Fire Board do not have a formal policy on retraining or redeployment. Two examples of good practice are above (Exhibit 14).

Improve communications

4.21 The administering authority is best placed to identify trends in early retirement which could affect employers. *Bye now, pay later* identified scope to improve the flow of information between councils and the pension authorities. Councils consider that communications between them and their pensions authorities have improved since 1997.

Part 5: Conclusions and recommendations

The management of early retirement has improved, but there is still more to be done.

Conclusions

The management of early retirement has improved since the publication of *Bye now, pay later.*

In particular:

- the number of early retirals has reduced
- employer bodies are using the full costs of retirals in decision making
- employers use independent, qualified occupational health specialists to inform ill-health decisions
- all authorities but one have clear guidance on the use of retraining or redeployment as alternatives to early retirement
- communications between pension fund administering authorities and admitted bodies have improved.

However there is still room for improvement:

- all authorities should have clear statements of early retirement policy which are regularly reviewed to reflect changes in regulations
- members should receive summary information on the number and costs of decisions made
- authorities should balance the potential for savings against the costs when making early retirement decisions
- service departments should bear the costs of early retirement decisions, improving accountability and monitoring.

Recommendations

Framework for decision making

- Early retirement policies should be approved by elected members and be reviewed regularly.

Informing members

- Members should receive a report at least annually that details the number of early retiral decisions made in the year, along with the associated costs and savings attached to these decisions.

Decision making

- Local authorities should rigorously appraise individual cases to ensure the expected savings associated with a retiral outweigh the costs.
- To improve accountability and assist in monitoring, the costs of early retirement should be charged to the appropriate service budget.
- Elected members should be involved in approving early retirement decisions for senior staff.

Appendix 1: Summary of retiral routes from LGPS

Route	Description	Who makes application	Who makes decision?	Enhancements to service?	Who pays for the costs of the retiral?
Redundancy	Where a post is made redundant, or an employee has asked to be considered for redundancy	Employee, usually in conjunction with employer	Employer	Enhancements of up to ten added years can be made by the employer	Employer
Efficiency	Where an employee is allowed to leave "in the interests of the efficiency of the service"	Employee, usually in conjunction with employer	Employer	Enhancements of up to ten added years can be made by the employer	Employer
Voluntary aged 60 and above	If an employee is 60 or over, and has at least 25 years service they are entitled to leave voluntarily	Employee	Employee	None	None
Voluntary 50-59	If an employee is aged 50-59, they can request to leave as a voluntary retiral	Employee	Employer	Service can be augmented by up to 6 2/3 years.	Employer
Ill-health	If an employee is permanently incapable of completing their current or any comparable job until at least their 65 birthday	Employer in conjunction with the employee	Employer on the basis of a recommendation from an independent occupational health qualified doctor	Enhancements are set out in the Local Government Pension Scheme (Scotland) Regulations 1998	Pension fund

Note: To qualify for any of the above benefits the employee has to have been a member of the Local Government Pension Scheme for at least two years.

Appendix 2: Recommendations from 1997 report

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 and then described in more detail. The recommendations are based largely on practices already adopted by some authorities.

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 frontline 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. 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.

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.

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.

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. 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.

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 3: Study methodology

Objectives

The objectives of the study were to:

- provide information on the extent to which local authorities have improved the management of early retirement
- re-assess procedures used to manage early retirement
- assess how far local authorities have responded to the Commission's recommendations in *Bye now, pay later*.

The study was undertaken at all 32 local authorities, along with the six joint police boards and six joint fire boards for their civilian employees.

Fieldwork

The fieldwork was undertaken in two parts:

- development and testing of questionnaire
- local audit work to verify the information returned in the questionnaire and review a sample of case files in each employing authority.

Questionnaire

Questionnaires were designed for use by all employing authorities as employers. The questionnaire was designed to assess how far the authorities have responded to the recommendations in *Bye now, pay later.*

A separate questionnaire was designed for the administering authorities to assess their response to *Bye now, pay later,* and also to collect information on early retirals by employing authority.

The responses included within the questionnaire were validated by the local auditors of each body.

Case file review

The local auditors at each local authority also reviewed a sample of case files to assess if the policies and procedures as laid out in the questionnaire were being followed in practice.

Appendix 4: Study advisory group

Members sat on the group in a personal capacity.

Charles Armstrong
Director of Finance –
Aberdeenshire Council

David Archibald
Head of Personnel Services –
Dumfries and Galloway Council

David Dorward
Director of Finance –
Dundee City Council

Ken Thompson
Assistant Pensions Manager –
Lothian Pension Fund

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Bye now, pay later?

A follow-up review of the management of early retirement

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