Agenda Item	**18**
Report No	**FHR/103 /13**

THE HIGHLAND COUNCIL

Finance, Housing & Resources Committee

28 August 2013

Managing Early Departures

Report by the Assistant Chief Executive

Summary

This report advises the FHR Committee of the recent Audit Scotland report (Managing Early Departures From The Scottish Public Sector) and how the Highland Council complies with the principles of best practice.

1. Background

1.1 The Audit Scotland report (attached) provides information on the current level of early departure schemes across the devolved Scottish public sector. The information is drawn largely from the annual accounts for 2011/12. Part 2 of the report and supporting appendices provides information on numbers and costs across the various sectors. Part 3 outlines Principles of Best Practice and this report outlines how the Highland Council measures up to these principles.

2. Principles of Best Practice

2.1 The Audit Scotland report details 8 principles of good practice:

- Workforce Planning
- Option Appraisal
- Policies and Procedures
- Business Cases
- Compromise Agreements
- Independent Scrutiny
- Monitoring
- Openness

2.2 The Highland Council has an Early Retirement Scheme and procedures in place. In terms of the principles of good practice, the Council's position is as follows:

- <u>Workforce Planning</u>. The Highland Council has never operated a general voluntary severance or early retirement scheme. Early retirements are based on Service needs and are targeted (when necessary) at particular parts of the organisation eg the ECS Service has used the Early Retirement Scheme to reduce the numbers of surplus teachers in particular schools.

- Option Appraisal. The Council makes every effort to avoid early retirements. It has a stringent Vacancy Management procedure in place whereby redeployment opportunities can be identified. Indeed the Council has a very good record of redeploying staff. Natural turnover is not so easy to predict now with the removal of the Default Retirement Age but is still possible with proper workforce planning.

- Policies and Procedures. The Council has an Early Retirement Scheme which sets out the criteria for early retirement (redundancy, efficiency and permanent ill health) and the compensation. It also has a section on restrictions for re-employment.

- Business Cases. Applications for early retirement are supported by the business case, the full additional costs, the relevant criterion and the anticipated savings. The financial implications are contained in 2 sections – financial implications to the Service and the “True Cost” Calculations (capitalised value to the pension fund of early payment of accrued pension rights and capitalised value to the Service account of payment of compensation).

- Compromise Agreements. The Council does not routinely use compromise agreements (now called Settlement Agreements) when employees are granted early retirement. Their use would be by exception and only after a robust risk assessment by the Service, HR and/or Legal eg where it was considered that there was a significant risk that the employee may take the Council to an Employment Tribunal. They have not been used to silence whistle blowers or to limit public accountability.

- Independent Scrutiny. Requests for early retirement are submitted to the Early Retirement Sub-Committee which is delegated authority to approve applications. The Sub-Committee is presented with the information as per Business Cases above.

- Monitoring. The Director of Finance prepares an annual report to FHR Committee on early retirements together with normal retirements.

- Openness. Details of the numbers and costs of early retirements are included in the Council’s annual accounts.

3. Implications

3.1 There are no financial, risk, equalities or climate change/carbon clever implications arising from this report.

4. <u>Recommendation</u>

4.1 Members are asked to note the Audit Scotland report and note that the Council complies with the suggested principles of best practice.

Signature:

Designation: Assistant Chief Executive

Date: 16 August 2013

Author: John Batchelor, Head of HR

Managing early departures from the Scottish public sector

ACCOUNTS COMMISSION

AUDITOR GENERAL

Prepared by Audit Scotland
May 2013

The Accounts Commission

The Accounts Commission is a statutory, independent body which, through the audit process, requests 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 four main responsibilities:

- securing the external audit, including the audit of Best Value and Community Planning
- following up issues of concern identified through the audit, to ensure satisfactory resolutions
- carrying out national performance 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 they are required to publish.

The Commission secures the audit of 32 councils and 33 joint boards and committees.

Auditor General for Scotland

The Auditor General's role is to:

- appoint auditors to Scotland's central government and NHS bodies
- examine how public bodies spend public money
- help them to manage their finances to the highest standards
- check whether they achieve value for money.

The Auditor General is independent and reports to the Scottish Parliament on the performance of:

- directorates of the Scottish Government
- government agencies, eg the Scottish Prison Service, Historic Scotland
- NHS bodies
- further education colleges
- Scottish Water
- NDPBs and others, eg Scottish Police Authority, Scottish Fire and Rescue Service.

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Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.

Contents

Exhibit data

When viewing this report online, you can access background data by clicking on the graph icon. The data file will open in a new window.

Key messages

1 In most public sector organisations, staffing costs make up a significant proportion of the budget. Early departure schemes have been used for many years by both the public and private sectors as a way of changing the size, shape and cost of the workforce. Early retirements and voluntary redundancies, for example, can be a useful way of avoiding the delays and costs of compulsory redundancies and quickly reducing staff numbers and costs. Once the initial outlay has been recouped, they can provide significant savings for organisations.

2 In recent years, many public sector organisations have turned to a range of early departure schemes. Given the significant financial challenges facing the public sector, they can be an effective way of achieving savings. Scotland's devolved public sector has been spending about £280 million a year on early departure schemes. This has helped reduce the size of its workforce, encouraging over 14,000 staff to accept early retirement in 2010/11 and 2011/12.

3 There is evidence to show that this is leading to savings. But significant amounts of public funds are also being spent on these departure schemes and, with a continuing need to reduce public spending, they are likely to remain an important management tool. Organisations therefore need to ensure that they follow the principles of good practice in how they:

- design early departure schemes
- ensure they provide value for money
- report publicly on the costs and savings.

4 The principles of effective early departure schemes have been known for many years. In 1997, for example, the Accounts Commission published *Bye Now, Pay Later*. Based on a review of local authority schemes, this set out a series of good practice standards. It encouraged councils to have clear policies on these schemes, to consider all their costs and potential savings, and to check that these savings were delivered. These principles continue to be relevant to all parts of Scotland's public sector.

5 There is evidence to show that Scotland's public sector generally follows the principles of good practice. Many have up-to-date policies on their early departure schemes. Wider workforce strategies are used by organisations to help decide where they need to reduce staff

numbers or which grades they need to reduce. Most use some form of business case to help decide if early departure will lead to savings.

6 However, there are striking differences in how organisations design and implement their early departure schemes. For example, some look to recover their costs within a year, others within three years or even longer. The quality of the business cases used to inform decisions varies and organisations also vary in the extent to which they keep councillors or board members informed on early departure schemes. This can be particularly noticeable on proposals affecting senior managers. There is also a marked inconsistency in what information is openly provided to the public on the costs of early departures and the savings which they have generated.

7 Compromise agreements can be a useful means of protecting public sector organisations from legal challenges relating to departures. They must not, however, be used to hide the full cost of early departures from the public.

8 This report provides a reminder of the principles of good practice on how organisations should design, manage and monitor their early departure schemes. The circumstances of individual organisations will vary and it is up to managers and councillors or board members to ensure that their early departure schemes are tailored to their needs. However, the underlying principles of consistent policies, independent checks, value for money, and open reporting to the public apply to everyone.

Good practice

The main principles of good practice for early departure schemes

- Early departure schemes should be driven by the needs of organisations and their workforce plans.
- Alternatives to early departures should be considered such as redeployment, natural turnover and service redesign.
- There should be clear policies and procedures which are consistently applied.
- Proposals should be supported by business cases, showing the full additional costs of early departures and their anticipated savings.
- There should be restrictions on staff who have accepted an early departure package from being re-employed.
- Councillors or board members should approve early departure schemes, ensuring that proposals represent value for money.
- Councillors or board members should approve proposals affecting senior managers to ensure each application is independently authorised.
- Compromise agreements should not be used to limit public accountability,

for example by trying to silence whistleblowers or by hiding the full cost of departures.

- Senior managers, as well as councillors or board members, should monitor progress to help ensure that planned savings are being made.
- Senior managers, as well as councillors or board members, should use lessons learned from past and existing schemes and apply these accordingly to future proposals.
- Organisations should be open in their annual reports and accounts about the costs of early departures and the savings they have generated.

See Appendix 4 for a more comprehensive list.

Source: Audit Scotland

Part 1
Introduction

1. This report aims to remind public organisations of the principles of good practice in managing early departures of staff. It is not based on any new audit work. Instead, it uses information on costs and numbers already published in annual accounts and examples of current practice drawn from auditors' reports over the past year or two.

2. Given the significant financial challenges facing the public sector, early departure schemes can be an effective way of achieving savings. They are used in both the public and private sectors. But, with higher standards of transparency, their use is more clearly visible in the public sector, where organisations are required to disclose information in their annual accounts or in response to requests made under the Freedom of Information (FOI) legislation.

3. In recent years, early departure schemes have become a particularly important issue for public sector organisations, faced with mergers and reduced budgets and a pressing need to make savings. Staffing costs form a high proportion of the costs of most public sector organisations. But, with a Scottish Government policy to avoid compulsory redundancies in the NHS and central government, organisations have needed to look for other ways to reduce the size of their workforce. In many cases, they have turned towards early retirement schemes or voluntary redundancies as a way of quickly restructuring the workforce and reducing payroll costs. With continuing financial pressures for the foreseeable future, public sector organisations will continue to use early departure schemes to deliver recurring savings by reducing the size of their workforce.

early departure schemes can be an effective way of achieving savings

4. Reaching agreement on some form of voluntary departure package can be more straightforward and cheaper than compulsory redundancy. Initial costs can be high, but these can be quickly repaid with significant savings in payroll costs. However, organisations need to be clear about how they assess the value for money of early departure schemes. They need to consider the full costs of such deals, including the impact on pension funds as well as their own revenue budgets. They also need to ensure that schemes are transparent and subject to independent scrutiny and challenge from councillors or board members, particularly where they affect senior managers.

5. There are some differences between sectors in the details of pension arrangements and how the costs of early departures are calculated. Local government pensions, for example, are 'funded'. In essence, this means that throughout their employment, each individual and their employer set aside money to fund the pension. In contrast, NHS and central government pensions are mainly 'unfunded'. Employees and employers make contributions to pensions throughout an individual's career, but no specific fund is earmarked. When pensions become due, they are simply funded from current expenditure. A more detailed explanation of pension and redundancy payments, together with a worked example, is provided at Appendix 1.

6. These differences can affect how organisations account for the costs of their early departures. However, there are underlying principles which should apply to all parts of the public sector. Any assessment of the value for money of early departures should only take into account the additional costs associated with an early retirement or redundancy. In other words, pension entitlements which have been earned over the individual's career and would be paid in due course should not be included. The assessment of value for money should focus on additional costs, such as those associated with paying pensions early or other incentives such as added years. These should include the additional costs that will be met from pension funds and recharged to employers, as well as direct costs paid from employers' budgets.

7. This report provides a reminder of the principles of good practice in managing early departures. It is based on the standards set out in the Accounts Commission's report *Bye Now, Pay Later*, published in 1997 and which was the subject of a follow-up report in 2003. These reports focused on local government, but their underlying principles are relevant to all public sector organisations, helping them achieve the highest standards of transparency and demonstrate that their early departure schemes represent value for money.

8. Early departures, as defined in this report and outlined in Exhibit 1, include voluntary early release or retirement, voluntary redundancy and compulsory redundancy. In broad terms, this is any early release for which public sector organisations fund part or all of the departure cost. Ill health and normal age retirements are excluded as pension funds cover the full cost of these departures.

9. It should be noted that not all individuals departing under early departure schemes will be entitled to a pension. Many will not yet be of retirement age, and will receive only a redundancy payment upon their exit.

Exhibit 1
Scope of this report

Included in this report	Not included in this report
✓ Voluntary early release agreements	✗ Normal age retirement
✓ Voluntary early retirement	✗ Ill-health retirement
✓ Voluntary and compulsory redundancy	

Source: Audit Scotland

10. This report also provides information on the current level of early departure schemes across the devolved Scottish public sector. This includes:

- the Scottish Government and its agencies and non-departmental public bodies (NDPBs)
- local authorities
- NHS boards
- police, and fire and rescue.

11. The information in this report is drawn largely from the annual accounts for 2011/12 which, for the first time, require most of these organisations to disclose the costs of exit packages.

12. With a planned programme of mergers, further education colleges are also making significant use of early departure schemes. However, as there is currently only a limited requirement to disclose these in their accounts, we have not been able to obtain comprehensive information on the number of staff involved or the costs of these schemes.

13. The report also provides examples of how organisations manage these schemes and assess value for money. These are drawn from reports already published by auditors and from a limited number of case studies. These examples do not seek to provide a comprehensive assessment of early departure schemes throughout Scotland's public sector. They simply aim to illustrate some of the variations in how public sector organisations currently manage early departure schemes.

14. During 2013, the Accounts Commission and the Auditor General for Scotland will also publish a joint report *Reshaping Scotland's public sector workforce*. This report will consider whether public bodies are effectively managing changes to their workforces, using cost-effective approaches and will highlight good practice. In particular, the report will consider:

- how the size and structure of the public sector workforce is changing
- what the financial costs and benefits of changes to the public sector workforce are and whether these changes are likely to provide long-term cost reductions
- whether the workforce planning approaches being used follow good practice and assess the capability of public sector organisations to meet future needs
- what are the significant opportunities and challenges which face those managing the public sector workforce in future years.

15. In addition, the Auditor General will monitor the position of the new police and fire authorities and further education colleges with regards to workforce management.

Part 2

Numbers and costs

The number of staff employed in the Scottish public sector has fallen by about 40,000 since 2009

16. Scotland's devolved public sector in recent years has been facing significant budget cuts. This has affected all areas, including Scottish Government directorates and their associated agencies and non-departmental public bodies (NDPBs), local authorities, and NHS boards. In addition, police, fire and rescue and further education colleges have been going through significant organisational mergers. As a result, after many years of growth, the number of people directly employed in the Scottish public sector has fallen by about 40,000 since 2009. About half of this reduction is due to early departures, with some also due to staff moving to other jobs, retiring normally or retiring through ill health. While there is no reliable information on the numbers involved, a significant proportion also relates to staff being transferred from local authorities to arm's-length external organisations (ALEOs).

Public sector organisations are currently spending approximately £280 million per year on early departure packages

17. Information on the scale of early departure packages is now disclosed in the annual accounts for most public sector organisations. These show that, in the two years 2010/11 and 2011/12, over 14,000 public sector staff accepted some form of early retirement or redundancy, at an initial overall cost of £561 million[1] (Exhibit 2).

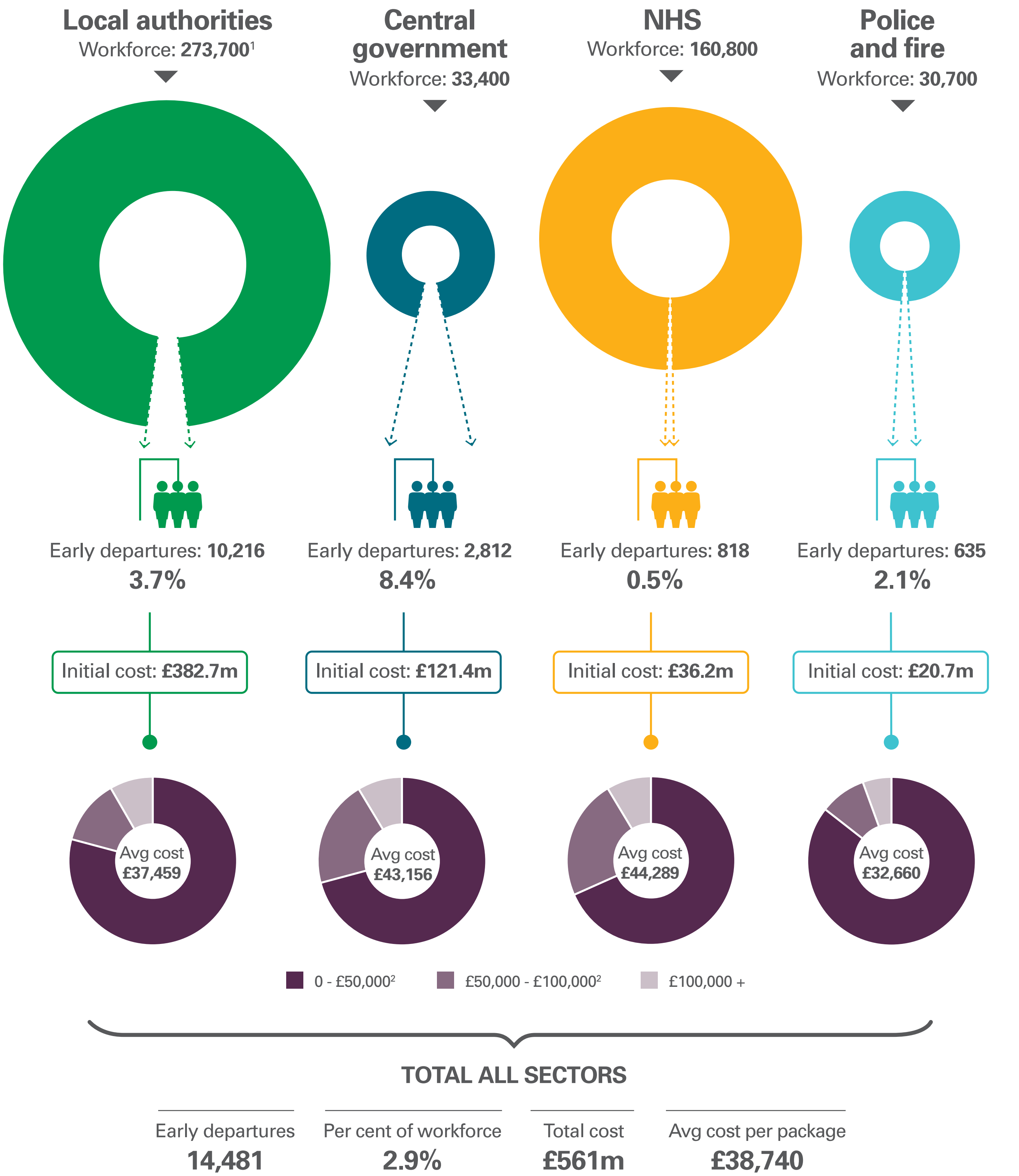
over 14,000 public sector staff accepted some form of early retirement or redundancy, at an initial overall cost of £561 million

18. Proportionately, central government organisations have made greatest use of early departures, with 8.4 per cent of staff leaving under some form of package during 2010/11 and 2011/12. This sector is very diverse, with a wide range of Scottish Government directorates, NDPBs and other agencies. As a result, it is difficult to identify any common pattern among these organisations. However, many of these organisations have undergone significant restructures or mergers, such as Education Scotland and the Care Inspectorate.

19. There has also been some variation in the cost of early departure packages. As indicated in Exhibit 2, the vast majority of individual packages have an average cost of less than £50,000. But about 8.3 per cent of packages had an average cost over £100,000, representing over 40 per cent[2] of the total expenditure on early departure packages. This can reflect a number of factors, such as the number of years service by individuals and their final salary.

20. There are also some differences between the sectors in the average cost of packages. The average cost of NHS and central government packages, at £44,289 and £43,156 respectively, is significantly higher than the costs of local government and police and fire packages. This is likely to reflect a greater focus

Exhibit 2
Early departures by sector in 2010/11 and 2011/12



Notes:
1 Workforce figures as at Q1 2010 (headcount).
2 Local authorities and police and fire figures are measured £0 - £60,000 | £60,000 - £100,000.

Source: 2011/12 audited annual accounts; Scottish Government employment statistics on reducing the number of higher-paid managers in these sectors. The NHS and Scottish Government, for example, have a target to reduce their numbers of senior managers by 25 per cent by 2015.

21. It is likely that Scotland's public sector will continue to use early departure schemes in order to help reduce workforce numbers. Further education colleges, for example, are facing a significant programme of mergers which will lead to reductions in the overall numbers employed. Similarly, the creation of national police and fire and rescue services, replacing regional organisations, will most likely lead to reductions in the number of support staff and senior officers.

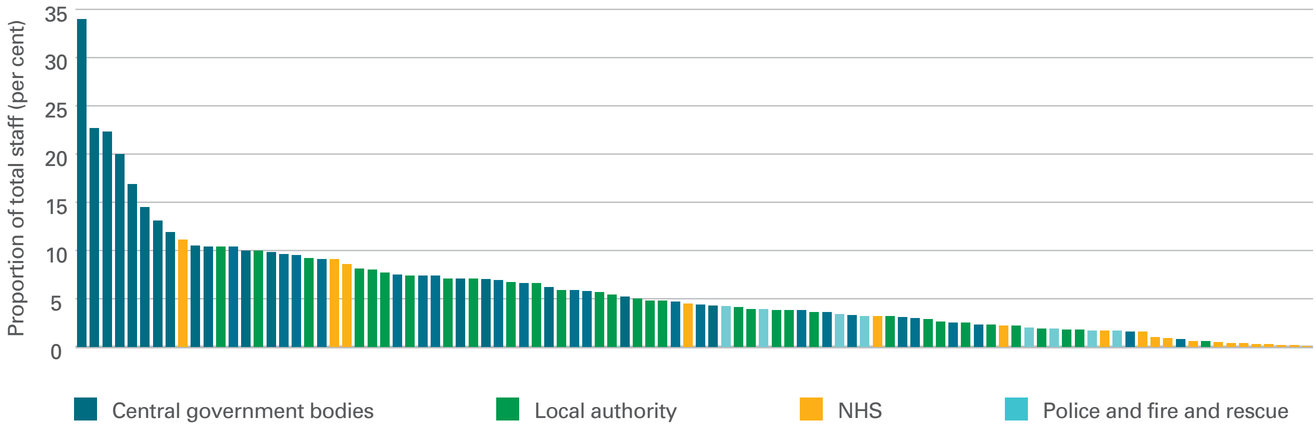
There is significant variation between individual organisations in the use of early departures and in their average costs

22. At an organisational level, there is an even greater variation in the proportion of staff taking some form of early departure (Exhibit 3). Some organisations have made little or no use of early departures over the years 2010/11 and 2011/12. In other organisations, such as Creative Scotland, Education Scotland and Skills Development Scotland, over 20 per cent of the workforce left under some form of early departure package. This reflects the differing circumstances of individual organisations and the stage they have reached in restructuring their workforce. It can also reflect the size of the workforce in these organisations: a few people leaving a small organisation can represent a significant proportion of its workforce.

Exhibit 3

Early departures by organisations in 2010/11 and 2011/12

There are significant variations in the proportion of staff leaving organisations through some form of early departure scheme (see Appendix 2 for more details).



Source: 2011/12 audited annual accounts; Scottish Government employment statistics; and NHS Scotland employment statistics

23. There are also striking variations in the average cost of departure packages of individual organisations (Exhibit 4). There can be good reasons for this. For example, over the two years 2010/11 and 2011/12, the highest average cost packages were made by the Scottish Funding Council and Scottish Enterprise. This, at least in part, reflects a planned restructuring of their management teams and a need to reduce the number of senior and relatively highly paid managers.

Exhibit 4

Average cost of early departure

The average cost of departure deals varies significantly between organisations (see Appendix 3 for more details).

Source: 2011/12 audited annual accounts

Part 3

The principles of best practice

24. Early departure schemes are an important tool for public organisations. They are not a way of rewarding staff and should not be seen as an entitlement. But they can provide a cost-effective way of managing overall employee numbers and costs. This can be particularly important in times of budget cuts or public sector mergers, where there is a need to implement relatively quick changes in the workforce.

25. But there is a price to pay. There is a risk that some organisations are unaware of the true costs of early retirements or redundancies to revenue budgets or to pension funds. Decisions made in response to short-term pressures can lead to long-term costs.

26. Public organisations face a range of different circumstances, both in terms of their financial position and the need to restructure their workforce, and in terms of the funding of their pension schemes. However, there are a number of principles of good practice which can help all public sector organisations achieve value for money. These are discussed below and listed in more detail at Appendix 4.

early departure schemes can provide a cost-effective way of managing overall employee numbers and costs

Early departure schemes should be driven by a long-term workforce strategy, rather than by short-term budget cuts

27. In the short term, organisations can turn to early departure schemes as a way to achieve budget cuts. However, early departure schemes should be driven by the strategic needs of organisations, shaped by service needs and local and national policy decisions. This more considered approach should try to ensure that schemes and decisions are based on planned restructures and skill needs.

28. There is a risk that the timescale within which budgetary decisions are currently made can compromise 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 was available for such major decisions, it would allow better analysis, consultation and communication within organisations and between the employer and the pension fund.

29. Organisations may, for example, identify the need to reduce staff numbers in a particular department or at certain grades and should tailor their early departure schemes accordingly. The audit report for Argyll & Bute Council, for example, notes that the council has a 'workforce planning framework in place which informs a five-year workforce planning strategy. All staff reductions have taken place as part of an integrated approach to transformation/modernisation. All service reviews have addressed workloads, job descriptions and have detailed implementation plans associated with them.'

30. In addition, organisations should ensure that proposals on restructuring their workforce take into account future needs and are sustainable. There is little point in spending money on departure schemes, only to spend more money on recruiting new staff to fill these vacant posts.

31. The public sector's approach to early departure schemes has steadily evolved. While there may have been an initial focus on short-term savings, there is some evidence to suggest that greater consideration is now being given to longer-term workforce planning. For example, some organisations are tailoring early departure schemes, aiming them at specific departments or jobs where they are planning to make reductions. At NHS Greater Glasgow, proposed early departures must demonstrate how they support the organisation's programme of service redesign, as well as showing why any planned payment represents value for money.

Organisations should consider alternatives to early departures

32. Early departure schemes should not be the only option considered when facing budget cuts. They can lead to savings. But they can also reduce the effectiveness of organisations, with the loss of experienced staff and specialist skills which may take years to replace. These long-term non-financial costs may outweigh any short-term savings made.

33. Organisations should, for example, consider the possibility of redesigning services and retraining staff and redeploying them in other roles. They should also take into account the impact of natural turnover, with staff reaching retirement age or moving on to other jobs.

34. Some organisations do not make widespread use of early departure schemes. Aberdeen City Council's audit report, for example, highlights that 'there is no major programme of workforce reduction required to balance the budget'. Angus Council's audit report notes that the organisation 'has not been in the position of having to offer voluntary early release schemes in order to secure significant long-term cost savings'. The report identifies that the council 'is on track to reduce the workforce…through natural wastage, vacancy management and ad hoc voluntary redundancies and early retirements'. Similarly, at NHS Tayside, the annual audit report notes that the board 'will consider savings through natural turnover and redeployment'.

35. Organisations can also make use of other ways to reduce staffing numbers. At the Crown Office and Procurator Fiscal Service, for example, the annual audit report highlighted that the organisation also had 'a significant reduction in the number of agency, temporary/contract staff and trainees employed'.

Organisations should have clear and up-to-date policies and procedures, setting out their approach to early departures

36. Organisations should have clear policies and procedures for the use of early retirements, ill-health retirements, and compulsory redundancies. These should be regularly reviewed and updated, to help ensure that they are based on accurate management information on which to base decisions and monitor trends. Organisations should also consult with trade unions or staff representatives to help ensure that they are seen as fair and reasonable. Policies and procedures should be approved by board members.

37. In general, organisations have clear and up-to-date policies and procedures for their early departure schemes. Where these are not in place, this is generally because the organisations are seeking other ways of reducing the size of their workforce through, for example, natural turnover or restrictions on overtime.

38. There are examples where organisations could have a clearer and more consistent approach when applying their early departure policies. Scottish Enterprise's annual audit report, for example, states that the organisation 'used the 2011/12 Selective Voluntary Severance (SVS) scheme in a targeted way and therefore did not formally communicate the scheme to all staff or update their policy, which dates from 2009 and is available to staff via the intranet.' The report also identifies that 'in some circumstances the compensation payable under the terms of Scottish Enterprise's contractual severance scheme were now more than available under the recently revised Civil Service Compensation Scheme. As such the scheme did not currently meet all of the guidance set out in the revised Scottish Public Finance Manual'. The scheme was approved by the Scottish Government and payments were in line with contractual obligations. The Scottish Government also noted that, for future schemes, Scottish Enterprise should make efforts, through its normal staff engagement process, to review the terms of its compensation schemes for severance, early retirement and redundancy so as to meet the guidelines in the SPFM.

39. Organisations can also vary the terms offered to different grades of staff. This may be justified by a greater need to reduce numbers at certain levels. But, without clear and transparent policies, it can leave organisations open to accusations of inconsistency, for example if an organisation implements revised schemes each year to target sections of their workforce, and offers more favourable incentives to managers than was available to other staff.

Early departure proposals should be supported by business cases, demonstrating that they represent value for money

40. Senior managers and board members need to be fully aware of the costs and benefits when making decisions. Before approving any early departures, organisations must ensure that they represent a good use of public money. Any additional costs associated with incentives such as 'added years' or lump sums, should be offset by savings in subsequent years.

41. Business cases, setting out proposals for early departures, should be based on the full additional costs. These should include the costs to pension funds which are recharged to the employer – sometimes known as the 'strain on the fund' and 'capitalised added years' costs – as well as the costs charged to their own revenue accounts. They should not, however, include costs which were due to be paid as part of a normal retirement.

42. There may be circumstances where it makes sense for the costs of individual departures to be met by the organisation's central budget, for example, where they form part of an overall corporate policy to reduce the numbers of managers at a certain grade. In general, however, costs should be charged to the budgets of the departments which expect to make savings from the early departures.

43. There should be controls over the potential re-employment of individuals who have received an early departure deal or have chosen to retire early. Strathclyde

Fire & Rescue's decision to re-employ its chief fire officer, immediately after he took early retirement, was the subject of a report by the Accounts Commission and attracted much media attention and criticism. And similar decisions have been taken in recent years by other fire and rescue and police services. Even where there are some savings, for example in superannuation contributions, organisations need to think about public perceptions. Dumfries & Galloway Council, for example, has recently announced an intention to place restrictions on the future recruitment of individuals who have accepted any form of early departure.

44. Similarly, posts which are vacated by an individual taking an early departure package should not subsequently be filled by new recruitment at the same cost. If posts are to be filled by lower graded or lower paid staff, this should be reflected in any business plans and the assessment of value for money.

45. In terms of payment in lieu of notice, organisations should plan to avoid such payments being required. It is, however, acknowledged that such arrangements may be unavoidable in exceptional circumstances, such as contractual entitlement. However, where staff start alternative employment before the notice period has expired, the payment in lieu should be reduced accordingly.

46. Scotland's public sector organisations routinely calculate payback periods, the number of years before the initial costs are met by savings, before agreeing to early departures. But the work we have carried out suggests that there is significant variation in the payback periods that are used. For schemes that we examined, the overall payback periods ranged from between one and three years.

47. There is even greater variation in the payback periods used to justify individual packages. This can be due to the incentives provided in these packages, particularly the number of 'added years' (Appendix 1). Some pension schemes allow local authorities to offer up to ten added years. In the schemes we examined, the number of added years offered ranged from zero to six and two-thirds. Organisations are not obliged to offer 'added years' and they need to have a clear rationale for their use.

48. There can, of course, be different pressures on organisations. Where there are mergers, for example, some can have a more pressing need to reduce staff numbers and therefore a greater willingness to wait longer until early departure costs are repaid. However, the longer the payback period, the greater the risk that the anticipated savings will not be realised. Organisations need to ensure that the payback periods they are using are justified and represent value for money.

49. There can also be some inconsistency in the costs which are included in these payback calculations. Central government organisations generally account for exit costs in full, in the year of agreement. Where the department has agreed early retirements, the additional costs are met by the department and not by the Civil Service Pension Scheme. Similarly, councils should include capitalised added years costs where added years have been awarded. This is the additional cost of providing added years, which the pension fund pays before recharging the former employer. However, these costs are not always fully taken into account. In Fife Council, for example, the annual audit report noted that 'capitalised costs had been excluded when calculating the future "payback periods" for individual exit packages'. This may have affected decisions on the value for money of individual packages and overstated the savings that will be made from the council's workforce reduction programme.

Councillors or board members should provide independent scrutiny of early departure schemes and formally approve packages for senior managers

50. Senior managers and board members need to be fully aware of the costs and benefits when making decisions. Councillors and non-executives do not necessarily need to be kept informed on the details affecting every individual departure deal. But they do need to approve and maintain oversight of early departure schemes and assure themselves that they are delivering the planned savings and represent value for money.

51. Councillors or board members can provide an important independent check on early departure proposals, and should formally approve the departure of senior employees. This is particularly important for senior managers, who may be responsible for designing the terms and conditions of exit schemes. It will help ensure that decisions affecting senior managers conform with the organisation's policies and procedures, and provide some additional assurance to the public where large sums may be involved.

52. In general, councillors or board members approve and are kept informed about the planned costs and benefits of proposed early departure schemes. Detailed decisions on the packages for individual members of staff are, correctly, delegated to chief executives or other senior managers. But councillors or board members generally approve policies and are kept informed about matters such as 'added years' or other incentives, the proposed number of staff involved, the planned overall costs, and the anticipated savings.

53. There can, however, be less consistency in how councillors or board members review the proposals affecting senior managers. For example, in some local authorities, approvals for early departures for senior officers are delegated to the chief executive. In others, councillors are kept fully informed about the costs and savings of the overall scheme, but not provided with separate information on the packages affecting senior managers. There is also an example of proposals affecting senior managers being discussed informally with the leader of the council, but not considered formally by a wider committee.

54. Organisations should ensure that they do not commit to generous exit packages when appointing staff, and that councillors or board members approve all exit packages for senior employees. At West Dunbartonshire Council, for example, the annual audit report includes reference to the departure package of the former chief executive. The chief executive was employed on a five-year fixed-term contract which expired during 2011/12. The contractual entitlement resulted in an 'added years' pension enhancement of eight years and 236 days. The auditors highlighted a lack of transparency in the decision-making process, as 'the council was not afforded the opportunity to review the final settlement terms which…would have been consistent with good practice'.

Compromise agreements should be clear about which employment rights are being waived and should not be used to limit public accountability

55. Employers are able to offer additional payments to encourage individuals to accept voluntary redundancy or early retirement. These are sometimes known as *ex gratia* payments. In accepting the additional payments, individuals can be asked to sign compromise agreements. These are, in effect, a way of reaching an out-of-court settlement and avoiding the costs of employment tribunals. The agreements can help manage the risk and financial implications of an early departure.

56. Compromise agreements are legally binding contracts between an employer and employee. Once signed the employee waives some employment rights in return for benefits as set out in the agreement. The agreement prevents the employee from pursuing any litigation based on claims, for example of unfair dismissal or equalities arising from their employment and its termination.

57. The use of compromise agreements has attracted significant public interest, with fears that they can be used to silence whistleblowers. The Scottish Government has recently emphasised that confidentiality clauses should only be used appropriately. It is essential that in reaching compromise agreements, public sector organisations adhere to the principles of transparency and accountability. Organisations must also understand any restrictions in terms of what employment rights have been waived by the employee.

58. Payments made under compromise agreements, or *ex gratia* payments, are not subject to the same degree of public disclosure as other early departure payments. Organisations should not use these instead of other incentives, such as 'added years', in order to avoid public accountability.

59. Organisations must also ensure that compromise agreements are administered correctly to avoid claims from employees and former employees. Aberdeenshire Council's annual audit report, for example, notes that 'significant provisions may be required to reflect the costs of compensation for equal pay claims for staff who have not yet signed compromise agreements and who have progressed a tribunal claim and costs in relation to early retirement/redundancy costs where agreements have been reached prior to the year end'.

Organisations should monitor that the planned savings in early departures have been achieved and use this to help shape future proposals

60. Having carried out a programme of early retirements and redundancies, organisations should conduct a review to check that the expected benefits were delivered. Senior managers and board members should receive information on the number of staff that have taken some form of early retirement, the initial costs of these decisions, and a comparison of the planned and actual savings. This information should be used to help shape any future programmes of early retirements or redundancies.

61. Organisations should monitor the savings generated from their early departure schemes and compare these with the planned savings. In some cases, however, this monitoring is carried out by senior managers and not reported to councillors or board members. The auditors at Falkirk Council, for example, reported that, while councillors were 'advised of the cost of compensatory payments through budget monitoring reports, they have not been informed of the most recent numbers, costs and savings attached to the voluntary departure arrangements'. Glasgow City Council reported departures for the whole workforce but did not have separate arrangements for senior employees. In January 2013, however, it was reported to the Finance & Audit

Scrutiny Committee that the chief executive had agreed to keep elected members informed of any early release or voluntary departure proposals affecting executive directors or assistant directors.

Organisations should report openly about their use of early departures and the extent to which they have delivered savings

62. Public organisations should be open about their use of public money to fund early retirements and redundancies. Since 2011/12, almost all of Scotland's public sector organisations are required to provide some information in their annual accounts on early departures. Typically, this provides details on the overall initial costs and the number of staff involved. The only exceptions are further education colleges, where there is currently only a limited requirement for any disclosure in their accounts. There is no obvious reason for this.

63. However, there is scope for organisations to go beyond their formal accounting requirements, which focus purely on the initial costs of early departures. Information can be available in committee papers or provided as a result of FOI requests. But very few organisations publish details on the actual savings that have been made from early departure schemes. This would provide a more balanced picture of early departures and allow the public to assess value for money.

64. In general, there is an expectation that organisations should be open about their use of public funds. However, they can sometimes be reluctant to publish details of individual agreements. The requirements of the Data Protection Act can be seen as preventing organisations being fully open about specific packages. However, this is not necessarily true. For example, NHS National Services Scotland agreed to the disclosure of a director's remuneration package, despite a confidentiality agreement being in place, following consultation with legal advisers.

Endnotes

1 These figures do not include further education colleges or staff retiring early due to ill health.

2 Local authorities, police joint boards and fire and rescue joint boards combined incurred 44.0 per cent of their expenditure on early departure packages in 2010/11 and 2011/12 on exits costing over £100,000.

Appendix 1

Calculating the additional costs of early departures

The main payments or charges associated with early departures

There are many variables that need to be considered when calculating the costs of offering employees early retirement or voluntary redundancy. There are, for example, differences in the details of NHS and local government pension schemes. Employee entitlements have also decreased significantly for more recent employees. In addition, employers may choose to offer additional incentives, while others may not.

However, there are four main elements common to all public sector pension or redundancy terms:

- **Pension payments:** Employees are entitled to an annual pension. The value of this will vary depending on how many years they have worked for the organisation. It may be based on their final salary or, for more recent employees, the average salary over their career. These costs are met by a pension fund, built up throughout the person's career and funded through employer and employee superannuation payments.

- **Pension lump sum:** As well as an annual pension, employees are also entitled to a lump sum. This will be based on how many years they have worked and their salary. Again, these costs are met by an individual's pension fund.

- **Added years:** An individual's annual pension and lump sum is based on how many years they have worked for the organisation and contributed towards their pension fund. As a result, they may be reluctant to accept an early retirement and reduced pension payments. Employers can choose to offer 'added years' as an incentive to individuals, adding up to ten years when calculating their annual pension and lump sum payments.

- **Redundancy lump sum:** Where they are made compulsorily redundant, employees are entitled to statutory redundancy payments. This is based on how many years they have worked for the organisation. In addition, however, employers may choose to increase these statutory payments to encourage individuals to accept redundancy or early retirement. These incentives are sometimes known as compromise agreements or *ex gratia* payments. They are, in effect, a way of reaching an out-of-court settlement and avoiding the potential costs of employment tribunals.

The additional costs of early departures

When considering offering employees early retirement or voluntary redundancy, organisations need to assess the costs and benefits. They may have an urgent need to reduce the number of employees, but organisations need to ensure that any short-term costs are outweighed by long-term savings.

In calculating these costs, there are two fundamental principles. They should:

- only focus on the **additional costs** that are incurred by an early departure package. They should not include any lump sum or annual pension payments that an employee will be entitled to if they retire normally. These have already been funded throughout the individual's career, with employer's and employee's superannuation contributions being paid into a pension fund. Additional costs such as redundancy lump sums and the impact of 'added years', however, do need to be included. The 'added years' element should be disclosed under two headings. An **additional lump sum** charge should be included to reflect the increased lump sum the individual will receive, and a **capitalised added year** charge, which is an estimate provided by the pension fund of the cost of paying an inflated pension over the employee's remaining life

- take into account the costs commonly known as the **'strain on the fund'**. In other words, the cost to the pension fund of allowing the employee to retire early without actuarial reduction. This cost is calculated by the pension fund and is based on a range of factors including the employee's age, sex and marital status. The cost is borne by the employer under early retirement and voluntary redundancy arrangements.

Illustrative example

This example is based on an employee working in local government. It shows the main costs involved when an employee retires normally and when they accept some form of early departure package. This provides a simplified picture, ignoring, for example, recent changes in pension entitlements, in order to illustrate the main principles involved. In reality such calculations are complex and take into account a number of different actuarial and other factors. While this example is based on local government, the same principle applies to all public sector organisations.

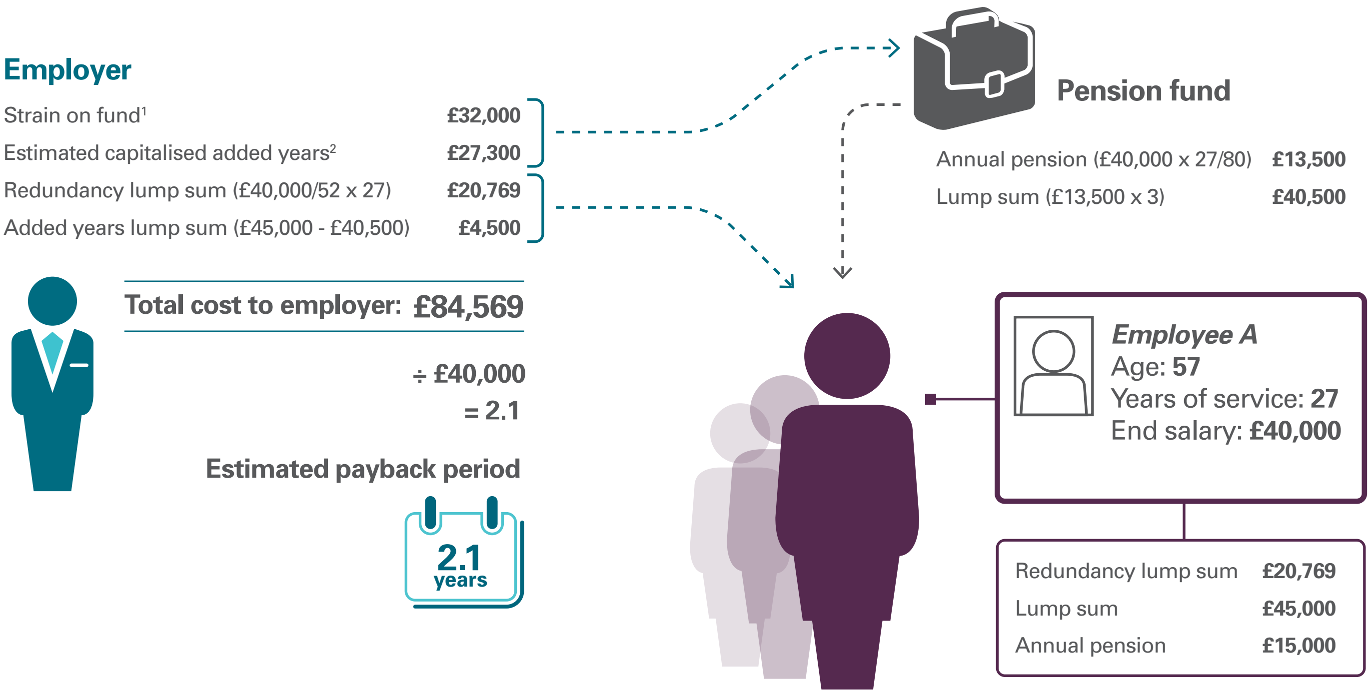
Employee A is 57 years old and currently has 27 years' service. She is due to retire at age 60 in three years' time, with a final salary of £40,000. Her pension will be based on her number of years' service, with each year contributing one-eightieth of her final salary. In addition, she will be entitled to a lump sum, calculated as three times her annual pension. In three years' time, with a total of 30 years' service, Employee A will be due to receive an annual pension of £15,000 and a lump sum of £45,000. The entire cost of this package is funded by her pension fund, built up over her career from employer and employee superannuation contributions.

In contrast, Employee A could be offered some form of early departure package. Not all public sector schemes provide additional payments. However, in this particular example, the employer has included the incentive of three 'added years' service plus a redundancy lump sum of one week's pay per year of service.

Appendix 1 illustrative example shows the payments due to Employee A and the costs met by the employer and the pension fund for this particular package. With the award of three 'additional years', she receives the same annual pension and lump sum had she worked on until she was 60. However, the cost to her

Appendix 1 illustrative example

Cost of early retirement at age 57, with 27 years' service and 3 added years



Notes:
1 Based on the cost of paying the annual pension over a longer period, and based on actuarial estimates of life expectancy.
2 The cost of adding unworked years to the length of service, and based on actuarial estimates of life expectancy.

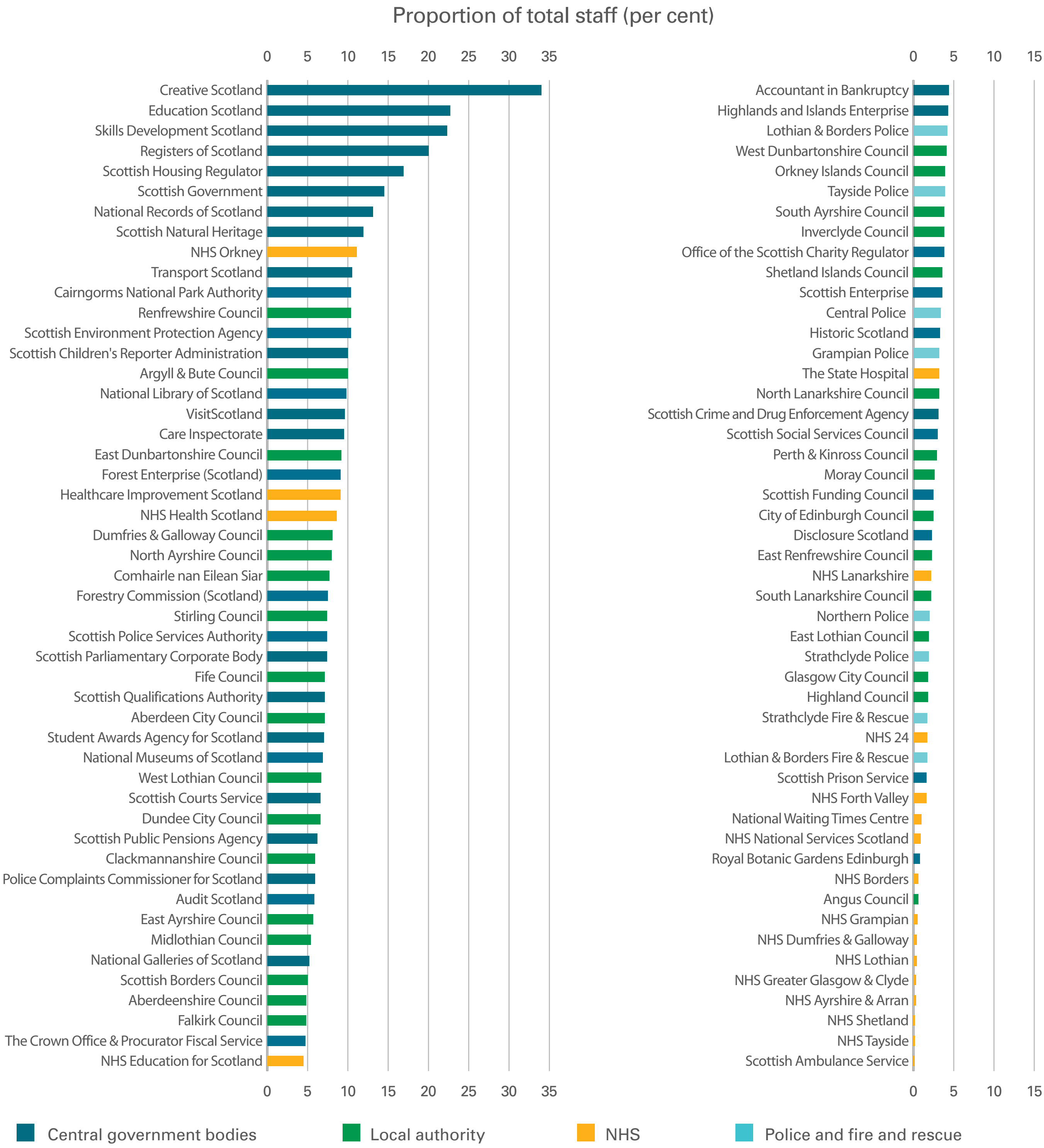
Source: Audit Scotland

pension fund is limited to the actual number of years that she has worked. The additional costs are met by the employer. The redundancy lump sum and the 'added years' lump sum are paid directly to Employee A. The costs relating to the 'strain on the fund' and the capitalised added years, which are based on actuarial estimates of life expectancy, are paid by the employer into the pension fund.

The total cost to the employer of providing this early departure package for Employee A is £84,569. Assuming that her post is not filled, the employer will now save £40,000 per year on salary costs (this is a simplification as, in reality, the employer will also save on other costs such as superannuation contributions). This would mean that, in 2.1 years, the employer will have recovered its initial outlay and will now benefit from recurring savings.

Appendix 2

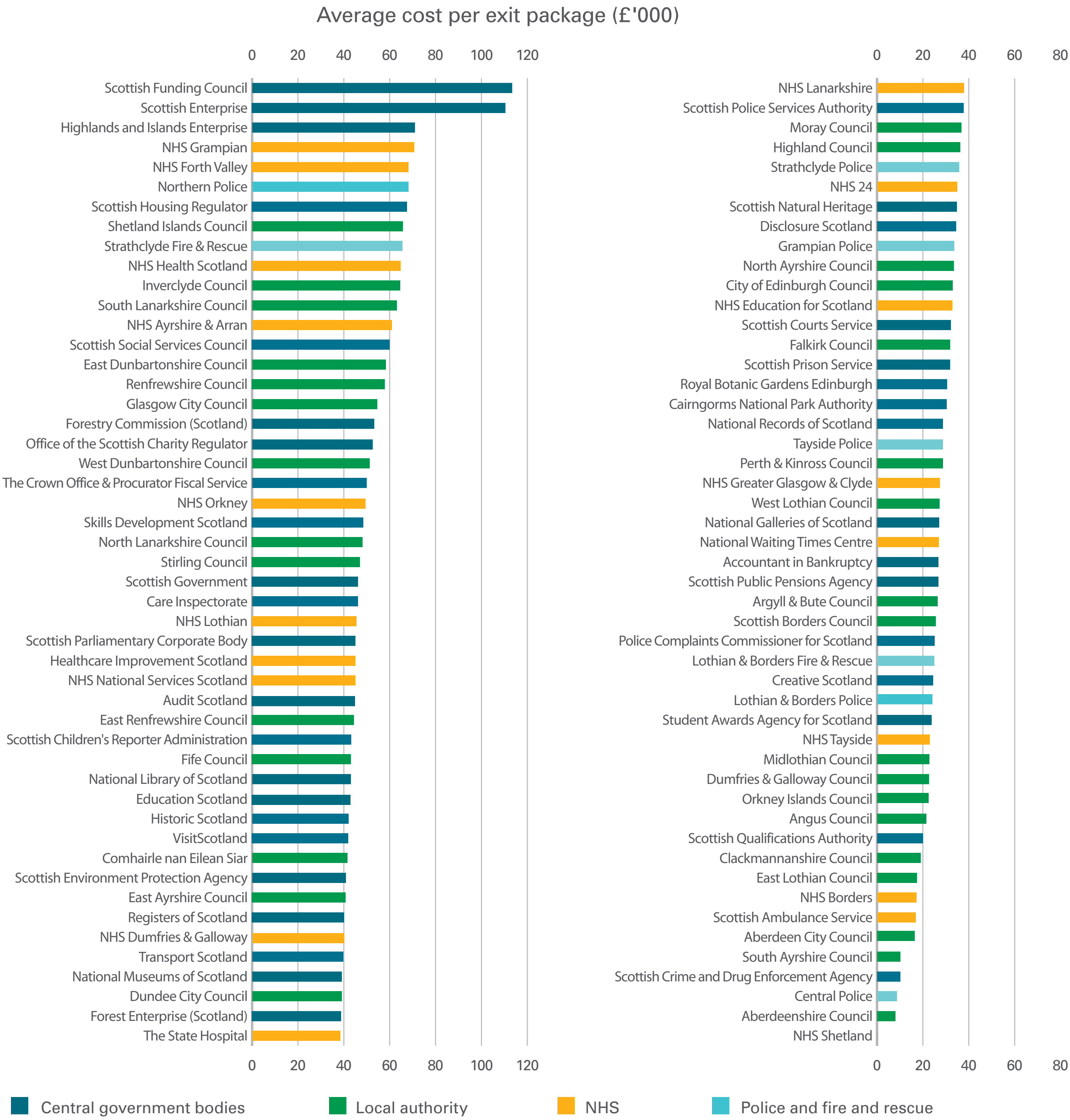
Proportion of staff taking early departure



Note: The graph does not include organisations who reported no early departures, or organisations that made no disclosure.

Appendix 3

Average cost of early departure packages



Note: The graph does not include organisations who reported no early departures, or organisations that made no disclosure.

Appendix 4

The principles of good practice

Workforce planning

Early departure schemes should be driven by the needs of organisations, not the wishes of individuals.

Workforce and service plans should be used to help shape proposals for early departure schemes, identifying parts of the organisation or particular grades where there is greatest need for reducing the number of employees.

Organisations should ensure that they retain sufficient skills and experience before authorising individual early departures.

Option appraisal

In order to avoid unnecessary costs, alternatives to early departures should be considered. These include:

- natural turnover
- vacancy management
- reducing overtime levels
- reducing the use of agency or contract staff.

Policies and procedures

Policies and procedures for early departure schemes should be regularly updated to reflect the changing needs of organisations, the results of earlier schemes and relevant guidance.

Policies and procedures should cover issues such as:

- incentives, such as ‘added years’, that might be available
- criteria for the use of ill-health retirals
- restrictions on any return to employment within the organisation or sector.

Organisations should consult with trade unions or staff representatives to help ensure that they are seen as fair and reasonable.

Policies and procedures should be clearly communicated to all staff and be transparent to the public.

Policies and procedures should be consistently applied to all staff, except where the organisation's programme is being targeted at specific grades or business areas.

Business cases

Proposals should be supported by clear business cases, showing the full additional costs of early departures and their anticipated savings.

There should be restrictions on staff who have accepted an early departure package from being re-employed by their previous employer.

Business cases should include 'strain on the fund' and 'added years' costs, borne by pension funds and recharged to employers, not just those costs directly charged to an organisation's budget.

Business cases should take into account the costs of any replacement staff employed at lower pay scales.

Organisations should ensure they are using appropriate and justifiable payback periods.

Compromise agreements

Organisations should be clear about which employment rights they expect individuals to waive in return for *ex gratia* payments.

Compromise agreements should not be used to help silence whistleblowers and limit public accountability.

Independent scrutiny

Councillors or board members should oversee early departure schemes, ensuring that proposals represent value for money.

While there may be some need for confidentiality, proposals affecting senior managers should be subject to detailed formal scrutiny by councillors or board members.

Costs presented to councillors or board members should detail separately the costs borne by the organisation as a result of offering 'added years' (the 'added years' lump sum and capitalised 'added year' costs).

Monitoring

Senior managers should monitor progress to help ensure that planned savings are realised and review future proposals accordingly.

Senior managers should report regularly to councillors or board members, detailing the cost of early departure schemes, and providing assurance that business cases are accurate and that value for money has been achieved.

Openness

Organisations should be open in their annual reports and accounts about the costs of early departures and the savings they have generated.

Managing early departures from the Scottish public sector

This report is available in PDF and RTF formats, along with a podcast summary at: **www.audit-scotland.gov.uk**

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