
Since the publication of *Retiring Nature*, however, things have improved. The Commission has found that:

- the funding levels of local authority pension funds have, on average, risen – although the majority of funds still have liabilities that are greater than their assets
- central government has amended the local government pension scheme regulations in line with the Commission’s recommendations in *Retiring Nature*
- local government has endeavoured to revise its policies and practices in an effort to reduce the incidence and costs of early retirement
- annual pension costs paid by employers are, in real terms, now over £800 million higher than in 1993/94
- in the worst performing quarter of authorities, early retirement still accounts for over three-quarters of all retirements

...indicating that a number of authorities face a stiff challenge if they are to demonstrate that they are achieving best value and to meet the Government’s targets.

The improvements shown in many authorities in the Commission’s 1999 survey need to continue, and the momentum of change must be maintained. The Commission’s auditors will be conducting follow-up audits to assist local authorities with their progress.

Local government staff are an essential resource for the successful delivery of quality services to the public. At a time of change, the Commission recognises the importance of policies to manage age diversity in the local government workforce. Good management of retirement will ensure that valuable experience continues to be available to authorities delivering modernisation and best value.
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Background

1. In November 1997, the Audit Commission published its report on the operation of the Local Government Pension Scheme (LGPS), *Retiring Nature: Early Retirement in Local Government* (Ref. 1). It proved to be a timely contribution to the debate on early retirement in the public sector in England and Wales. Its focus was on the use of local authorities’ discretionary powers and practices relating to early retirement and ill-health retirement. The report showed that in some authorities, large numbers of individual decisions on early retirement had implications for the demands on resources in the future. The report highlighted that, in 1995/96:
   - three-quarters of the 42,000 retirements by members of the local government pension scheme were earlier than normal retirement age;
   - two-fifths of all retirements were on the grounds of ill-health;
   - the average additional ‘capitalised’ cost of an early or ill-health retirement was £35,000,¹ and
   - over the six years for which the Commission had detailed information from pension fund records, the total extra cost of early retirements in local government was averaging the equivalent of £1 billion a year.

2. In particular, the Commission’s report highlighted the negative impact that early retirements had on the funding levels (that is, the ratio of assets to liabilities) of local authority pension funds. This negative impact is caused when more people than were estimated receive benefits, and cease to contribute to the scheme, earlier than expected. The report also noted that employers’ contributions to the funds had increased in recent years as actuaries determined contribution rates to bring funding levels within the targets set in the individual recovery plans. It argued that the increase in employers’ pension fund contributions meant that a lower level of resources was available for the delivery of services to the public.

3. *Retiring Nature* also drew attention to the wide variations among different authorities in the number of early and ill-health retirements. Although ill-health retirements are not strictly a matter for management discretion, the report argued that the disparities in the figures suggested that levels of ill-health retirement were perhaps ‘often a matter of management policy rather than unavoidable incapacity’.

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¹ The ‘capitalised’ cost of an early retirement provides an estimate of the long-term costs to be met by the authority, as if they were to be met in the present, that is, it represents the ‘net present value’ of the total costs of additional pension fund payments up to the death of the pensioner and his/her dependants. This additional cost is the result of giving ‘added years’ of service and early payment of benefits.
4. In order to encourage changes in policy and decision-making in local government, the report made a number of recommendations [BOX A]. Underlying these recommendations was the need for local authorities to improve the quality and the amount of information available to those making decisions [BOX B].

5. The Commission’s auditors followed up the findings of the national report in their 1998 audits. Where the audit process identified them as necessary, action plans were produced, which local authorities are now implementing. Auditors will review local authorities’ progress in improving their practice in relation to these action plans next year.

6. In June 1998, the Audit Commission also produced a management handbook to promote good practice, and to assist local authorities’ pension experts in putting the Commission’s recommendations into practice (Ref. 2). The handbook set out good practice in the context of the best value framework, which comes into force in April 2000.

7. In September 1999, the Commission carried out another national survey to update its data.

BOX A

Improving the decision-making process on early retirement

The recommendations in Retiring Nature were that:

- before making a decision, the full cost commitment of an early retirement should be calculated and offset against any savings arising from a post being made redundant;
- the aggregated costs of all the decisions that resulted in an early retirement should be reported annually;
- policies be reviewed to take account of the council’s ability to pay for the costs of early retirement decisions, in relation to other calls on their resources;
- the costs of early retirements should be borne by the departments making the decisions (except, for example, where a corporate exercise triggered authority-wide redundancies);
- the local authority should ‘compensate’ the pension fund for the costs of early retirements, usually within three years and always in less than five years; and
- ill-health retirement should take place only within the guidelines of the Association of Local Authority Medical Advisers, and use should be made of qualified occupational health advisers.

Source: Audit Commission (Ref.1)
The impact of incomplete information and knowledge in the decision-making process

Costs and benefits can be pecuniary or non-pecuniary—
- A ‘pecuniary benefit’ to the employer is a reduction in the wage bill.
- A ‘non-pecuniary cost’ to the employer is the loss of ‘corporate knowledge’.

Where employers fail to consider or calculate a particular cost or a benefit, the perceived overall costs and benefits of a decision will differ from the actual costs and benefits.

Decisions taken in isolation may fail to consider ‘knock-on effects’, such as increased employer contributions to the pension fund or loss of ‘corporate knowledge’.

Where this occurs, an employer will not necessarily allocate resources economically, efficiently or effectively and, furthermore, may not achieve the expected cost savings.

Retiring Nature sought to suggest ways for local authorities to ensure that the perceived costs of a decision matched the actual costs before they acted.

Retiring Nature also suggested that early retirement packages should take account of the local authority’s ability to pay, in both the short and long-term.

Source: Audit Commission
Purpose of this update

8. This update sets out the 1999 survey’s findings; it also draws on original, but anonymised, data from the Department of the Environment, Transport and the Regions (DETR) and information from the Employers’ Organisation for Local Government. It focuses, as did the original national report, on the use by Welsh and English local authorities of their discretionary powers in relation to early retirement under the LGPS, and to practices surrounding ill-health retirement. The report, however, does not look into the management and investment strategies of pension funds.

9. In publishing this update, the Audit Commission has three objectives:

- to report on progress since the publication of Retiring Nature;
- to maintain awareness of the on going scrutiny by the Audit Commission and its auditors of local authority behaviour in this area; and
- to share good practice among practitioners.

10. Staff in the Public Services Research Directorate, Scott Dickinson and Timothy Ahlborn, produced the follow-up report, under the direction of Greg Birdseye. Advice, guidance and information were provided by Grey McIntosh, Audit Policy and Appointments, Terry Crossley and Bob Holloway (Local Government Pensions Unit of the DETR); Richard Shearer (National Assembly for Wales); Charles Nolda and Tim Rothwell (Employers’ Organisation for Local Government); John Street (Local Government Association, LGA); Paul Griffiths and Steve Dunster (Welsh LGA); and Kash Pandya (District Audit). As with the original study, several pensions and human resource management experts in local government have provided information, advice and input to the review: Keith Neale (Essex County Council); Keith Handley and Neil Fenwick (City of Bradford); Jon Redfern and Eve Martin (Manchester City Council); and Roger Blackmore (Tameside Metropolitan Borough Council). The Commission would like to thank all those who helped in the study, together with the local authorities and other bodies that provided information via fieldwork, the postal survey or telephone interview. While acknowledging these contributions, the Commission alone is responsible for the report’s findings, conclusions and recommendations.

11. This report sets out the findings in three sections:

- Chapter 1 looks at changes since the publication of Retiring Nature. It focuses, in particular, on legislative and institutional changes.
- Chapter 2 sets out the findings of the Audit Commission’s audits and the 1999 survey. The material is reviewed in relation to the findings and recommendations set out in Retiring Nature.
- Chapter 3 sets out the report’s main conclusions.

1 The LGPS, in effect, sets the regulatory framework for the management, by 88 local government pension funds in England and Wales, of their members’ savings for the future.
12. The original study focused, in particular, on the operation of the LGPS. However, many of the report’s recommendations applied equally to other parts of the public sector for which different pension arrangements exist: fire, police, teachers and the health service. The Commission may issue separate, more focused reports on these areas in the future.
Changes since the publication of *Retiring Nature*

13. This chapter looks at some of the main legislative and institutional changes that have affected local government’s approach to early and ill-health retirement over recent years. It covers, in particular:

- legislative changes, such as new political arrangements, best value and the introduction of provisions under the Disability Discrimination Act 1995, as well as changes to the LGPS regulations;
- the financial position of the pension funds and the level of employers’ contributions to them;
- the impact on the age profile and the management of the local government workforce of reducing levels of early retirement; and
- the wider picture, including developments in other parts of the public sector.

**Legislative changes**

**New political arrangements**

14. The proposed changes to political arrangements in local government, such as, the introduction of cabinets and directly elected mayors, will continue for some time to attract significant member and officer attention. In this period of change, vigilance in the management of early retirement should be maintained, in order to ensure that policies and decisions on early retirement are appropriate to the resources available. Furthermore, it is particularly important during a period of change that authorities maintain clear lines of responsibility and accountability in terms of who takes the decisions on early retirements. Thus, authorities need to ensure that the key lessons highlighted in *Retiring Nature* are applied to new local arrangements.

**Best value**

15. The Local Government Act 1999 brings the best value framework into force from 1 April 2000. It will have a fundamental impact on how local authorities plan, deliver and monitor services to the public. Best value reviews will seek to capture the impact of decisions on a range of different groups [EXHIBIT 1]. Local authorities will, as part of the best value process, need to consider the effects of early retirements on
service delivery and on the level of resources available to fund other activities. *Retiring Nature* sought to capture this process and to promote changes to the regulations and management practices [BOX C, overleaf]. The best value framework also allows local communities greater opportunity to comment on the incidence of early retirement in local government. It will also provide members and officers with some of the information that they previously lacked on local priorities for the use of resources. The challenge for local authorities and their communities is to ensure an open discussion of the issues and agreement on the appropriate response.

### EXHIBIT 1

**Early retirement and the groups involved**

Best value reviews will seek to capture the impact of decisions on a range of different groups.

Notes:

I As employers and as representatives of local inhabitants.
II As taxpayers and users of services at the local level.
III As a separate legal entity involving employers, representing members of the pension fund.
IV As taxpayers and users.
V As taxpayers to national government.
VI As negotiators and as membership-based organisations.

Source: Audit Commission
The impact of early retirement decisions on groups not directly involved in the decision-making process

- *Retiring Nature* showed that a range of individual decisions bound by the Local Government Pension Scheme regulations and local policies on early retirement, compulsory redundancies and agreements on pay and conditions were resulting in a pattern of behaviour that contributed to a situation in which many pension funds’ liabilities exceeded their assets.

- Over time, funds sought to improve their funding position.

- To ensure this occurred, the funds’ actuaries set employers’ contribution rates at higher levels.

- This impacted on taxpayers, local residents, central government, the general public and businesses.

- The allocation of resources to ‘compensate’ the pension funds for unexpectedly high levels of early retirement was felt by many members of these groups to offer a lower benefit to them than if the resources had been used to some other end, such as the protection of front line services, or a reduction in local taxes.

- The fact that decisions were often taken without knowledge of the full long-term costs meant that local authorities were not always achieving their desired goal of reducing costs.

- This situation was unacceptable to the affected groups that were not part of the decision-making process.

- Changes were introduced to the LGPS regulations and in the practices of local authorities, such as the greater involvement of members. The aim of the changes was to alter decision-making behaviour and, over time, to produce a ‘better’ allocation of resources by local authorities.

*Source: Audit Commission*
Local authorities have a responsibility to use non-discriminatory procedures to find alternative appropriate employment for staff.


16. Retiring Nature referred to the Disability Discrimination Act 1995 and its implications for early retirement. The Act states that ‘a person has a disability for the purposes of this Act if he has a physical or mental impairment which has a substantial and long-term adverse effect on his ability to carry out normal day-to-day activities’. Local authorities should be aware of the Act’s provisions and its relevance to procedures aimed at avoiding early and ill-health retirement. Local authorities have a responsibility to use non-discriminatory procedures to find appropriate alternative employment for staff, thereby avoiding the need for the early or ill-health retirement of the staff concerned.

17. Retiring Nature highlighted significantly high levels of early retirements on grounds of ill-health in some authorities. These authorities in particular should now examine their practices in light of the provisions of the Act to ensure that they are discharging their new responsibilities appropriately.

Changes to the LGPS Regulations and framework

18. Since the publication of Retiring Nature, the DETR and the United Kingdom Steering Committee on Local Authority Pensions (UKSC) have worked together to make a number of changes to the LGPS Regulations and Discretionary Payments Regulations (Appendix 1). These changes:

- require authorities to establish and review policies on discretionary payments;
- define ‘permanently unfit’ to mean at least up until 65 years of age;
- provide for the possibility of finding an employee a ‘broadly comparable job’; and
- ensure that independent and qualified occupational health practitioners certify ill-health retirements.

19. Furthermore, the Charted Institute of Public Finance and Accountancy (CIPFA) has responded to the Government’s request to produce guidance on monitoring the performance of funds between the three-year valuations (Appendix 2).

20. These responses are in line with Retiring Nature’s recommendations to update the legislation governing the LGPS to meet ‘the needs of the 1990s and beyond’ rather than the needs of the 1970s. Taken overall, the changes bring in greater consistency and clarity and set new standards for behaviour.
Pension funds

Funding levels

21. Retiring Nature noted that the average funding level, that is, the ratio of assets to liabilities, of local authority pension funds, was 90 per cent at the March 1995 actuarial valuations, compared with 97 per cent in 1992. It also noted that the funding levels varied between 70 per cent and 110 per cent. The 1998 valuations show that the average funding level had risen to 96 per cent (Ref. 3). DETR data show that most funds, while still having liabilities that exceed assets, have improved their funding positions since 1995. Ratios varied between 71 per cent and 117 per cent [EXHIBIT 2].

22. Pension fund levels have been affected by the removal of Advanced Corporation Tax (ACT) credits, in 1997. Central government’s comprehensive spending review took an additional £130 million per year into account for the three years 1999/2000 to 2001/2002 to cover the net effect of the 1998 revaluation, including the impact of ACT changes.

23. Essex County Council’s experience illustrates the impact of removing ACT credits, which, it has estimated, has reduced its funding level by 8 per cent. At the time of the 1998 valuations the council’s funding level was 91 per cent, compared with 84 per cent in 1995. It has agreed a recovery plan with its actuaries that aims to get the fund to a funding level of 100 per cent. The recovery plan means that each year for the next 13 years Essex will pay the equivalent of an extra 1.5 per cent of its payroll into the pension fund. Overall, the Local Government Association (LGA) estimates that, net of other changes, contribution rates are on average 3.7 per cent higher due to the removal of ACT credits (Ref. 4).

Employers’ contributions

24. Retiring Nature noted that contributions to the funds were increasing and that the employers’ share of the contributions was rising too (employees’ contributions are a set proportion of salary and thus the employers are required by the actuaries to find the balance). Recent data from the DETR (Ref. 5) show that this trend has continued [EXHIBIT 3]. Between 1993 and 1999, the balance of pension fund contributions between employers and employees has shifted from near parity to a ratio of almost 2:1.

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I Over the period 1990 to 1993, central government, in an effort to reduce the level of tax raised locally, permitted funding levels to drop to 75 per cent. After 1993 these measures were rescinded and those funds that had let their funding levels drop had to seek to match assets to liabilities. These events play some part in explaining the shift in funding levels and the rise in employers’ contributions at the time.

II Some funds have moved to a market valuation of assets, which means that different methodologies are being used over time.
EXHIBIT 2

The change in funding levels
(at March 1995 and at March 1998)

Most funds, while still having liabilities that exceed assets, have improved their funding positions since 1995.

Source: Audit Commission analysis of DETR data, 1995 and 1998

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EXHIBIT 3

Employers’ pension fund contributions (1993/94 to 1998/99)

The trend highlighted in *Retiring Nature* for employers’ pension fund contributions to grow as a proportion of the overall total continues...

Note: At 1999 prices; provisional results only for 1998/99.

Source: DETR, SF3 Returns
The implications of an ageing workforce

25. The UK, along with other Western European countries, has an ageing population and an ageing workforce. The UK’s local government workforce is on average older than the UK workforce as a whole (Ref. 6). All other things remaining equal, efforts to reduce early retirement in local government will further increase the average age of the local government workforce relative to the workforce as a whole. This trend poses particular challenges to local government both in tackling age discrimination in recruitment, promotion and training, etc, and in ensuring harmonious relations between employees of different ages. The Commission recognises the importance of developing policies on ‘age diversity’ in the local government workforce as part of effective workforce planning. The City of Bradford is one authority that has identified this issue and started to take steps to manage issues associated with age diversity in its workforce [CASE STUDY 1].

CASE STUDY 1

Managing early retirement and the management of an ageing workforce – City of Bradford

Background
In the wake of Retiring Nature, Bradford has sought to break the ‘early retirement culture’ among staff and management. As well as introducing new procedures for taking decisions on early retirements and enhancing the redeployment function, Bradford has attempted to deal with a workforce that is ageing relative to that of other sectors and, indeed, to that of its own past experience.

Action
Bradford has developed an age diversity policy, as a step towards effectively managing an ageing workforce, while ensuring that younger workers are also valued.

A ‘Core Group on Age’ has been established as a permanent point of reference in the authority, to provide information and guidance to members and managers on age related issues, such as the different age groups’ views of working for the Council and of working with each other.

Further steps in the process of developing an effective approach to managing age diversity include the use of focus groups and regular monitoring of data on age in relation to recruitment, training and promotion.

Outcomes
Bradford is taking steps to ensure that its staff are prepared to deal with the impact of age diversity, which is an essential step towards maintaining the efficiency of service provision with an ageing workforce.

Source: Field visit to City of Bradford, September 1999
The wider picture

... by 2008...

one-quarter of the fire services revenue budget could be consumed by employers’ pension fund contributions.

Sickness absence and ill-health retirement in the public sector

26. The recent debates over sickness absence and ill-health retirement in the public sector can be seen to be part of the wider effort to ensure continuous improvement in public services. On 5 August 1999, the then Chief Secretary to the Treasury, Alan Milburn, MP, announced ‘a wide ranging review into the level of ill-health retirement in the public sector’ (Ref. 7). The review was explained as a response to Ministers’ concerns about the wide variation in the incidence of ill-health retirement between different parts of the public sector. The Audit Commission’s work on early and ill-health retirement in local government is separate from but related to this wider debate. In particular, the experiences learned from changes in local government will inform future work across the public sector.

Pension arrangements for the police and fire services and other public services

27. In March 1998, the Home Office conducted consultations on the possible changes to police and fire service pension schemes (Ref. 8). Uniformed officers in the police and fire services are not covered by the LGPS; instead, they are covered by an ‘unfunded’ scheme, where pensions payments are funded on a ‘pay-as-you-go’ basis, that is, they are charged to revenue as they are incurred. The Commission’s response to both consultation exercises was that the most prudent long term option was to establish ‘funded’ schemes for the two services. This built on its message from, In the Line of Fire: Value for Money in the Fire Service – The National Picture (Ref. 9), which projected that by 2008 approximately one-quarter of the fire services revenue budget could be consumed by employers’ pension fund contributions. Furthermore, in 1999, the Commission reiterated its view in relation to the arrangements for the police service (Ref. 10).

28. The main obstacle to the adoption of these recommendations is their short-term costs, which arise because employers simultaneously experience a reduction in income and an increase in costs. For example, where a scheme is set up to cover new recruits, new employees’ pension fund contributions would go to the fund rather than being available to the employer as income. The employer has to contribute to the new fund, while simultaneously having to cover the costs of the on-going payments to retired officers and their dependants. Thus, short-term costs have to be ‘traded-off’ against the potential benefits in the long term.
Accounting for pensions

29. Accounting for the cost of retirement benefits in the accounts of employers is one of the most difficult areas of accounting and financial reporting. The Accounting Standards Board (ASB) recently issued Financial Reporting Exposure Draft 20 'Retirement Benefits' (FRED 20) (Ref. 11) which, if adopted, should lead to a more coherent approach to the recognition of assets and liabilities arising from retirement benefit obligations, as well as changing the basis upon which the costs of such benefits are recognised in the profit and loss/revenue accounts of reporting employers. The draft is consistent with international accounting standards in its emphasis on a market value based approach to the valuation of pension scheme assets, and this approach is also in line with the increasing use of market values by the actuarial profession in the UK. The Financial Reporting Standard (FRS) that emerges from the consultation process is unlikely to depart from the fundamental principles outlined in the draft and this could have a significant impact on local authority employers when the Standard is incorporated in the Code of Practice on Local Authority Accounting: A Statement of Recommended Practice.

30. The discretionary powers given to local authorities to grant added years to employees who are retired on the grounds of redundancy give rise to significant additional costs in the form of additional lump-sum payments and on-going pension benefits. Some elements of these costs are borne by the employing authority and are not taken into account in actuarial valuations, unless the pension fund agrees to meet on-going liabilities in return for a one-off capital payment by the employing authority. The unfunded element of ongoing pension benefits is currently met by many local authorities on a ‘pay as you go’ basis. Concern has been expressed that by failing to provide for the capital cost of these liabilities in the year in which discretionary benefits are granted, local authorities are not complying with existing accounting standards and are out of step with the practices followed by employers in other parts of the public sector.1

31. Since the publication of Retiring Nature there have been significant changes in the framework within which local government works and further changes are to be expected. Moreover, powerful social and demographic factors are generating greater public interest in early retirement in general and the costs of pensions to the economy as a whole. The recent proposals for changes to the political arrangements in local government and the introduction of the best value framework will have to capture and respond to these wider concerns within the context of the new LGPS Regulations. The next chapter provides an analysis of the pattern of retirement two years after the publication of Retiring Nature.

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1 The Commission understands that CIPFA will be working with the ASB, the Government and representative bodies to find a short-term solution acceptable to all parties. In the medium term, local authorities may have to accept that a decision to grant added-years on redundancy will have to be accompanied by the recognition in the revenue account of the full capital cost of that decision.
Findings from auditors’ reports and the Commission’s 1999 survey

32. This chapter sets out the findings of the Commission’s 1999 survey and the local audits on early retirement that were carried out following the publication of Retiring Nature. Where relevant, the chapter draws on comparative data from the private sector and other parts of the public sector. The chapter looks at:

- policy reviews, including councillor involvement in early retirement decisions, and practices relating to the granting of ‘added years’;
- the survey’s findings on levels of early and ill-health retirement overall; and
- ill-health retirement in particular.

Decision-making

33. Retiring Nature recommended that councillors should become more involved in setting and reviewing early and ill-health retirement policies and in critically assessing the performance of their authorities [EXHIBIT 4, overleaf].

34. In October 1998, the UKSC published the findings of its survey on early retirement in local government (Ref. 12). The survey, which had a response rate of 75 per cent, found that 80 per cent of authorities had reviewed their policies and procedures in the previous two years. A further 18 per cent of authorities were reviewing their procedures at the time of the survey. This data suggest that nearly all local authorities were implementing one of Retiring Nature’s key recommendations within 12 months of its publication. Auditors also found that, in most local authorities, councillors were involved in early retirement decisions. However, they found a great deal of variation in the level of councillor involvement in the decision-making process.

Added years

35. An authority has the discretion to give ‘added years’ to staff retiring before normal retirement age (Appendix 1). Retiring Nature drew attention to the wide variation in the number of added years that local authorities were offering to staff who retired early. This variation suggested that some authorities were achieving the same level of ‘benefits’ for a lower overall cost to the authority and taxpayers.
**EXHIBIT 4**

**The employer’s decision-making process**

*Retiring Nature* recommended that to improve accountability, councillors should become more involved in setting and reviewing early and ill-health retirement policies and critically assessing the performance of their authorities.

**Source:** Audit Commission

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**REDUCE NON-STAFF COSTS**

- Methods to reduce non-staff costs:
  - Travel restrictions
  - Telecommunications costs
  - Accommodation costs, etc.

**REDUCE STAFF COSTS**

**ASSESS THE RELATIVE COSTS AND BENEFITS OF EACH OF THE OPTIONS OR MIX OF OPTIONS**

*This includes the employer’s expectations about the likely behaviour of staff faced with the different options.*

**EXTERNAL AND INTERNAL PRESSURES FOR CONTINUOUS IMPROVEMENT**

**DECISION TO ‘REDUCE COSTS’**

**DECIDE ON FUTURE ACTION TO BE TAKEN**

**REVIEW PROGRESS AND ADAPT PRACTICES**

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*Source: Audit Commission*
After conducting a review... only 28 per cent offered the maximum of ten added years.

36. In 1998, auditors found that, before undertaking a review of their policy, three-quarters of a sample of nearly 100 authorities offered staff the maximum number of added years. After conducting a review, however, only 28 per cent offered the maximum of ten added years.

37. Auditors found that authorities adopted a range of different policies, including:
   • no added years;
   • maximum levels, ranging from three to five years;
   • service-related policies, ranging from one added year per three years of service to one added year per ten years of service;
   • restricting added years to those with a minimum number of years of service, for example, 15 years of service;
   • not allowing added years to employees under 55 years of age; and
   • a combination of a sliding scale and long service – for example, one added year for each five years of service, with six and two-thirds added years for those with more than 20 years of service.

Early and ill-health retirements

38. Much of the public debate over early retirement has been about the number of early and ill-health retirements relative to the number of retirements at normal retirement age. However, increasingly local authorities are also looking at early and ill-health retirements as a proportion of the workforce.

39. Moreover, in recent years, increasing use has been made of comparative data and benchmarking to assess performance and to set and monitor performance targets. One of the DETR’s targets in its Public Service Agreement with the Treasury, is to ‘require authorities to set measurable targets for reducing ill health retirements, early retirements and sickness absence over a five-year period to levels consistent with or better than those at present achieved by the best quartile of authorities’ (Ref. 13). To that end, the DETR has decided that measures of early and ill-health retirement should form part of the best value performance indicators for local government (Ref. 14).

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1 In the text, the ‘best performing quartile of authorities’ means the quarter of authorities with the lowest rates of early and ill-health retirements.
Comparative data

40. *Retiring Nature* found that, in 1995/96, three-quarters of retirements in local government were before the normal retirement age and that two-fifths of all retirements were on health grounds. A recent survey published by Income Data Services (IDS) shows that, across a range of employment sectors, two-thirds of those starting to draw their occupational pensions in the 1998 calendar year or the 1998/99 financial year were under 60 years of age [Ref. 15]. The survey also states that, in the civil service, nearly one-fifth of retirements were early and a further fifth retired on health grounds.

Early and ill-health retirements as a proportion of all retirements

41. The Commission’s 1999 survey shows that three-quarters of retirees retired before their normal retirement age in 1997/98, almost the same as the 1995/96 rate. However, this fell to two-thirds in 1998/99 [EXHIBIT 5].

42. The survey also showed that if in 1998/99, all local authorities had matched the best performing quartile’s performance, then early and ill-health retirements would have accounted for only half of all retirements rather than the two-thirds average found.

Early and ill-health retirements as a proportion of the workforce

43. The 1999 survey shows that, in 1997/98, around 1.5 per cent of the local government workforce\(^I\) retired before normal retirement age. This compares to 1.1 per cent in 1998/99. In terms of the pension scheme as a whole, which has approximately 1.26 million active members, this level of ‘loss’ would amount to around 19,000 and 14,200 employees respectively.\(^II\) However, a reduction in the scale of retirements before the normal retirement age is not to be unexpected for schemes that have experienced a large-scale ‘one-off’ outflow of active members. In the period that immediately follows a large-scale outflow of active members the flow of those eligible or willing to take early retirement tends to fall [Ref. 15].

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\(^I\) The 1999 survey covered the total workforce eligible for membership of the LGPS. This does not include teachers, but does include some non-local authority staff.

\(^II\) Given the difference between the populations of the scheme members and the total workforce, these figures are included only for the purposes of illustration. The actual figures were not available from the DETR.
Moreover, there is a wide variation in the performance of different local authorities in terms of the percentage of their workforce that retires before normal retirement age [EXHIBIT 6]. This suggests that some authorities will have to work hard if they are to demonstrate best value and meet government targets.

EXHIBIT 5
Early retirement trends in local government (1990/91 to 1998/99)
The Commission’s new survey shows that the proportion of retirees retiring earlier than their normal retirement age in 1998/99 is down to 67 per cent.

Source: Audit Commission surveys, 1996, 1997 and 1999

EXHIBIT 6
Early retirement as a percentage of the workforce (1998/99)
There is a wide variation in the performance of different local authorities in terms of the percentage of their workforce that retires before normal retirement age.

Source: Audit Commission survey, 1999
... the normal tests of the relative costs and benefits and the affordability of early retirement should be applied.

Early and ill-health retirements by chief executives and treasurers

45. In its 1999 survey, the Audit Commission sought additional details of the number of chief executives and treasurers/finance directors retiring before normal retirement age. The survey found that, between April 1995 and March 1999, in 71 per cent of authorities responding to the survey (Appendix 3) a chief executive and/or treasurer had retired early. The data [EXHIBITS 7 and 8] show that only one in seven chief executives and just one in twenty of treasurers who retired did so at normal retirement age. Thus, the survey suggests that chief executives and treasurers are much more likely to retire early than are lower-graded staff. However, they are much less likely to retire on ill-health grounds.

46. The figures for chief executives and treasurers retiring on the grounds of redundancy or efficiency between April 1995 and 1998 can, in part, be explained by local government reorganisation. Furthermore, some early retirements may follow changes of political leadership or control or on the completion of a fixed-term contract. The issue of early retirement among chief executives and treasurers may become of even greater concern with the moves to new political arrangements and the modernisation agenda. Members clearly have discretion under the LGPS regulations, but the normal tests of the relative costs and benefits and the affordability of early retirement should be applied.

47. The 1999 survey shows that the average length of service for both chief executives and treasurers was 32 years with an average of 5.5 added years, when retiring on grounds of either redundancy or efficiency. This figure is similar to the added years of other employees with comparable lengths of service.

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1 The retirement pattern of chief executives and treasurers was surveyed because they are the two most senior officer posts and, therefore, they can be said to set the level of expectation for other officers. Furthermore, the two posts are easily identifiable within the authority, whereas other chief officer posts increasingly cover a number of merged functions.
EXHIBIT 7
Treasurers’ retirement by type
(April 1995 to March 1999)
Only 5 per cent of treasurers’ retire
at the normal retirement age.

Note: the ‘outer circle’, and those figures in
yellow, relate to the workforce as a whole
over the same period.
Source: Audit Commission survey, 1999

EXHIBIT 8
Chief executives’ retirement by
type (April 1995 to March 1999)
Only 13 per cent of chief executives’
retire at the normal retirement age.

Note: the ‘outer circle’, and those figures in
yellow, relate to the workforce as a whole
over the same period.
Source: Audit Commission survey, 1999
Ill-health retirements

48. Retiring Nature highlighted the fact that two-fifths of all retirements in local government were on health grounds. It pointed out that this was a much higher proportion than in the private sector. It noted, too, that there was wide variation in ill-health retirement rates between local authorities, and argued that this suggested that management’s approach to ill-health retirements could affect the overall level of such retirements in an authority. It is worth considering this category of early retirement in more detail, as it can occur at any age, and to a certain extent falls outside the immediate control of local authorities. It is important, however, that authorities ensure that the system is not abused and that they act as good employers to support staff in their employment. Manchester City Council, for example, recognised that it had a particular problem and has subsequently sought to improve its performance [CASE STUDY 2]. It has acted to control both sickness absence and ill-health retirement by increasing the occupational health function and acting speedily to address health issues.

Ill-health retirements as a proportion of all retirements

49. The 1999 survey suggests that ill-health retirement levels in local government are falling, but they are doing so less rapidly than early retirement on the grounds of efficiency or redundancy. Nearly 37 per cent of all retirements in 1998/99 were on the grounds of ill-health, compared with 40 per cent in the Commission’s original survey. The IDS survey (Ref. 15), found that, in the 26 occupational pension schemes covered, an average of around 13 per cent of retirements were on the grounds of ill-health. The weighted-average, which takes account of workforce size, showed that 18 per cent of retirements were on ill-health grounds. In addition, it should be noted that the IDS survey found that ill-health retirements in the civil service accounted for 20 per cent of all retirements. These comparisons show that there is potential for local government to reduce ill-health retirement rates still further.

50. Furthermore, there is considerable variation between authorities in the proportion of all retirements due to ill-health, which again suggests that there is room for improvement. The 1999 survey shows that, in the financial year 1998/99, ill-health retirements accounted for just 22 per cent of all retirements in the best performing quartile of authorities, compared with the overall average of 37 per cent.

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1 The difference is accounted for mainly by the teachers’ pension scheme.
CASE STUDY 2

Sickness absence, ill-health retirements and occupational health – Manchester City Council

Background
Manchester City Council had experienced rates of ill-health retirement significantly higher than the average and has taken steps to reduce its incidence.

Action
In an effort to turn this situation around the council reviewed the way it:
- managed human resources;
- measured performance; and
- supported staff and managers to reduce sickness absence and ill-health retirement.

Each department now produces a human resource plan with two updates a year.

The occupational health unit was restructured and refocused, with the intention of providing staff with support at an earlier stage in their illness. This reorganisation was based on evidence that demonstrated that early intervention by an occupational health therapist reduced both the number of working days lost and reduced the likelihood that the staff member would be lost to the authority through ill-health retirement.

The authority also contracted out the review of ill-health retirement cases to an independent medical practitioner who was qualified in occupational health medicine.

Outcomes
Since 1998, the number of staff retiring on health grounds has fallen by one-third, with no appreciable increase in sickness absence rates.

Source: Field visit to Manchester City Council, September 1999
Ill-health retirements as a proportion of the workforce

1. The 1999 survey indicates that local government lost 0.77 per cent of its staff on health grounds in 1997/98. In 1998/99, the figure was 0.64 per cent. If the active members of the LGPS follow the same pattern, this amounts to around 9,700 people in 1997/98 and around 8,000 in 1998/99. But, again, there is significant variation in performance between authorities [EXHIBIT 9]. The rate of ill-health retirements as a proportion of the workforce was just 0.3 per cent for the best performing quartile of authorities, which is less than one-half the average for local government as a whole.

EXHIBIT 9
Ill-health retirement as a proportion of the workforce (1998/99)
The best performing quartile of local authorities had ill-health retirements as a proportion of the workforce of just 0.3 per cent, less than half the average.

Source: Audit Commission survey, 1999
Continuing the progress

52. The Commission’s 1999 survey of local authorities shows that there has been an encouraging trend towards lower rates of early and ill-health retirement in local government. However, it also reveals wide variation between local authorities, both in the share of all retirements that take place before normal retirement age and the proportion of their workforce that is retiring early. This variation suggests that a number of authorities will need to make significant improvements over the next five years if they are to match the performance of the best performing authorities, in line with government targets.

53. The Commission recognises that local authorities are in the early stages of managing and implementing reforms and changes to their practices. The introduction of new regulations governing the LGPS and discretionary payments, and the new guidance issued by CIPFA on inter-valuations and management of recovery plans, together with locally agreed changes, all demonstrate that the issues highlighted in Retiring Nature have been acted upon by key stakeholders. The challenge for local government now is to spread the successes achieved by some, and to remain vigilant in the face of significant political and organisational change.

54. Even though funding levels are improving, there should be no relaxation of sensible, informed decision-making in relation to early retirement. Local government as a whole is paying an increasing amount into pension funds, leaving fewer resources for service delivery. Prudent decisions taken now can help to reduce the future call on resources and provide better services to the public under best value.
Appendix 1

Local Government Pension Regulations 1997

Redundancy (Regulation 26)
An employee aged 50 or over with 2 years’ service is entitled to the immediate payment of a pension where the employing authority certifies that the employee has retired on grounds of redundancy. The definition of redundancy includes retirement in the interests of efficiency, or where the employee held a joint appointment which has ended because the other holder left.

Ill-health (Regulations 27-28, as amended by the LGPS (Miscellaneous Provisions) Regulations 1999)
Where an employee with 2 years’ service leaves local government employment because they are permanently incapable of discharging efficiently the duties of that employment because of ill-health or infirmity of mind, he/she is entitled to an immediate ill-health pension and grant. (An employee with one year but less than 2 years’ service is entitled to an immediate ill-health grant but no pension.)

An employee with 5 years’ service is entitled to an enhanced membership period (that is, added years) of their grant and pension. The employee’s enhanced membership period is:

- Twice the total membership, if the total membership is less than 10 years;
- If the total membership is at least 10 years but less than 13 1/3 years, 20 years; and
- The total membership plus 6 2/3 years, in other cases.

Under the 1999 regulations, from 1 July 1999, the certificate stating that the employee is permanently unfit has to be issued by an independent and qualified occupational health practitioner. A qualified occupational health practitioner is either an Associate, a Member or a Fellow of the Faculty of Occupational Health (AFOM, MFOM or FFOM), or an equivalent institution of a European Economic Area Member State.

Under the 1999 regulations, from 1 April 1999 ‘permanent’ is defined as at least up until the age of 65.

Under the 1999 regulations, from 1 April 1999, the employee also must be permanently unfit for any available broadly comparable job. ‘Broadly comparable’ relates to the duties, pay and conditions and location of the job.
**Early retirement (Regulation 31)**
From 1 April 1998, an employee aged 50 but under 60 may apply to his/her employer to retire early. The employer may agree to the early retirement, but the employee’s pension is actuarially reduced, if the total of his/her age and service comes to less than 85 (the so-called ‘85-year rule’). The employer can waive the actuarial reduction on compassionate grounds.

Where the employee is aged 60 or over, the employee has the right to retire early, although the ‘85-year rule’ may still apply. (This will be relevant in practice only where the employee has less than 25 years’ service.)

**Augmentation (Regulation 52)**
From 1 April 1998, where an employee retires early in any circumstances other than ill-health, the employer has discretion to add up to 6 2/3 years (the so-called ‘augmentation provisions’), the cost of which is met from the pension fund.

**Local government (discretionary payments) regulations 1996 (DPR) as amended by the Local government (discretionary payments) (amendment) regulations 1999**

**Redundancy payments**

**Part II**
Local authorities have the power to calculate a redundancy payment (which under the DPR includes the payment of redundancy compensation to an employee retired on grounds of efficiency of the service) on a sum up to the employee’s actual weekly pay (rather than the statutory maximum under section 227 of the Employment Rights Act 1996, currently £230 per week).

**Part III**
Local authorities have the power to add up to 10 years’ service to an employee aged 50 or over with 5 years’ service (including employees who are not members of the LGPS) who is retired on grounds of redundancy (which includes efficiency of the service). The added years will count towards the calculation of lump sum and continuing compensation.
Part IV
Under Part IV, an authority has discretion to pay compensation of up to 66 weeks’ pay (which, where applicable, must include the statutory redundancy payment) to an employee aged under 50 with at least two years’ service or an employee aged 50 and over with less than two years’ service on redundancy (which includes efficiency of the service).

From 1 April 1999, under the DPR amendment regulations the payment of up to 66 weeks’ compensation can also be made to an employee aged 50 and over, regardless of service, subject to the employee not receiving any added years under either the DPR or the LGPS.

The formula for calculating the compensation of up to 66 weeks is:

- Age 18 but under 20 – half a week’s pay for each (completed) year of service over age of 18.
- Age 20 but under 23 – half a week’s pay for each year of service over age 18 and half a week’s pay for each year over age 20.
- Age 23 but under 41 – 2 weeks’ pay for each year after the age of 18.
- Age 41 and above (up to age 65) – 2 weeks’ pay for each year of service after age 18 and 3 weeks’ pay for each year of service after the age of 41.

Policy statement on discretion
Under the DPR amendment regulations, authorities are required by 30 June 1999 to have published a statement on the policy that they intend to apply in relation to their use of the available discretions under the DPR, and keep that policy under review. Any changes to the policy must be published in a revised statement within one month of the decision to make the change, and cannot take effect until a month after the publication of the revised statement.
Appendix 2

At the request of central government, CIPFA, the public sector accountancy body, has issued *Guidance for Responsible Financial Officers Administering the LGPS on Inter-Valuation Monitoring Recovery Plans* (Ref. 17).

The guidance covers the implementation and operation of inter-valuation monitoring provisions, in line with the revised LGPS regulations, which came into force 1 April 1998. It also provides guidance on good practice in relation to recovery plans.

The guidance responds to one of *Retiring Nature’s* recommendations, that councils should introduce a system for monitoring pension funds between the triennial valuations, so that divergence from expectations can be identified and acted upon at an early stage.

The CIPFA guidance notes that Regulation 77 of the LGPS Regulations 1997 (as amended), requires administering authorities to obtain a ‘rates and adjustments certificate’ (‘the certificate’) for each of the three years following the normal valuation. ‘The certificate’ allows an authority both to monitor the overall level of employers’ contributions to the fund and to identify its own position relative to the planned level of contributions.

The guidance highlights that actuaries may, if required, vary individual employers’ contributions between valuations. By following this guidance, funds should be able to avoid the build-up of unforeseen liabilities, and authorities should be provided with information that enables them to monitor and review their performance and the full long-term impact of their policies and decisions on costs.

The recovery plans set the individual contribution rates for employing authorities with a view to achieving a balance between assets and liabilities over an agreed timescale.

The guidance also suggests that fund administering authorities should establish clear procedures with each employing authority to cover:

- advance notification of proposed early retirements by the employing authority to assist cash flow planning;
- calculation of estimated costs by the administering authority;
- notification of the employing authority’s final decision on proposals in total and/or on individual cases as they arise; and
- an annual (or more frequent) report on the actual position, plus other monitoring information, for consideration with the actuary.

The target of the recovery plans is to ensure a fund’s assets match liabilities; however, unlike legislation covering private sector schemes, the legislation covering the LGPS does not define ‘solvency’, that is, there is no legal requirement on funds to have a 100 per cent funding level.
Appendix 3

Details of the Commission’s 1999 survey

- The Audit Commission issued a questionnaire to all local authorities on 6 August 1999 with a deadline for responses of 13 September.
- The questionnaire covered the financial years 1997/98 and 1998/99 and asked for information in the following areas:
  - funding levels of pension funds;
  - the number of retirements by type;¹
  - the size of the local government workforce at the end of each financial year;
  - added years awarded; and
  - retirements of chief executives/finance directors over the period April 1995 to March 1999.
- The response rate was 66 per cent, broken down as follows:

<table>
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<th>Type of authority</th>
<th>Total</th>
<th>Responses</th>
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<td>County councils</td>
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<td>29</td>
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</tr>
<tr>
<td>Welsh authorities</td>
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<td>13</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>410</td>
<td>271</td>
</tr>
</tbody>
</table>

- Sixty-one of the 88 administering authorities replied (70 per cent).
- In the exhibits provided in the main body of the text, authorities providing void answers have been omitted.
- Field visits to City of Bradford, Essex County Council, Manchester City Council and Tameside Metropolitan Borough Council took place during September, October and November 1999.

¹ Data on retirements is essentially data on the retirement of members of the local government pension scheme, rather than of the total local government workforce.
References


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