Note for guidance 2011/1

Severance schemes

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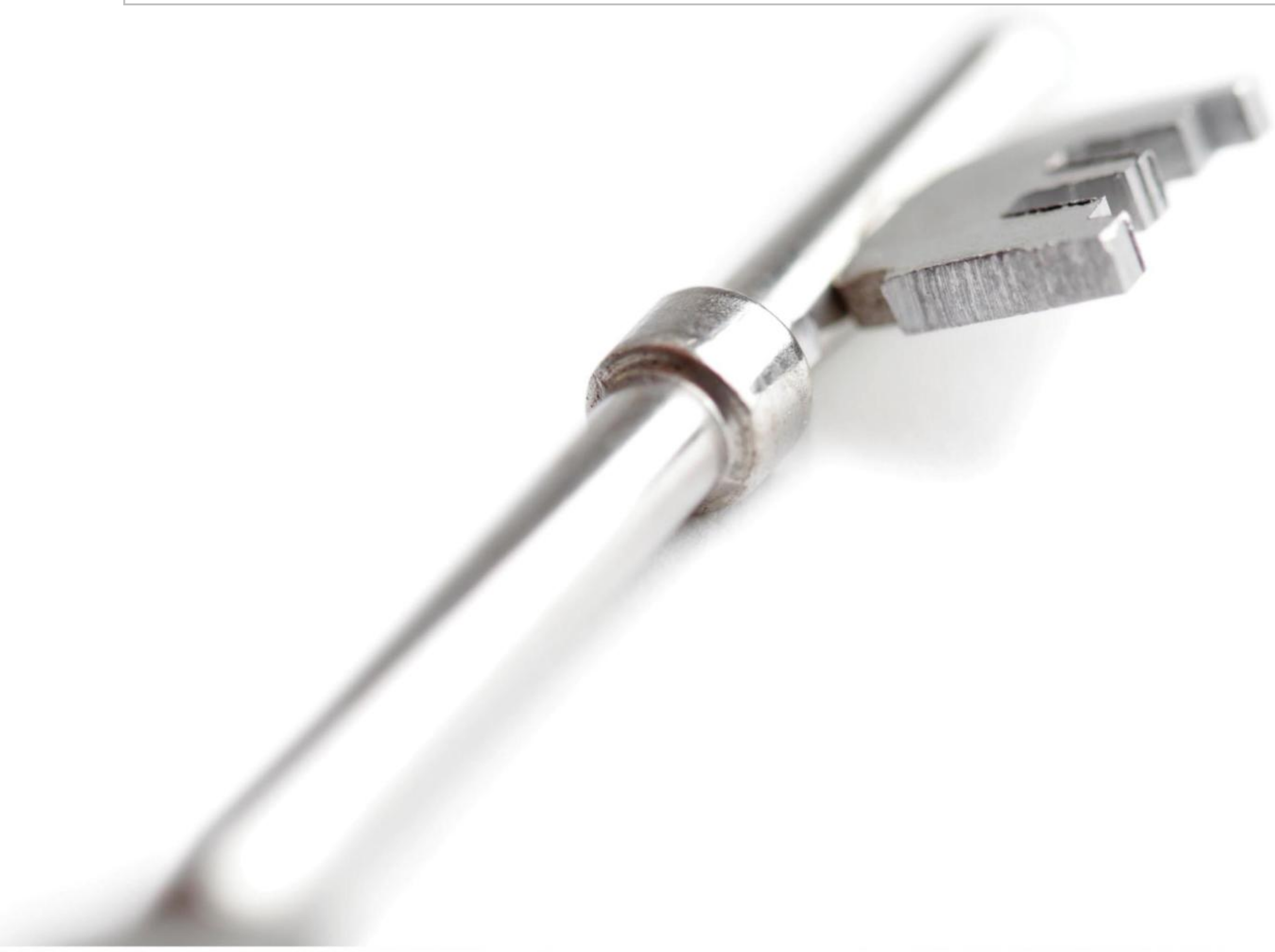

AUDIT SCOTLAND

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Foreword

Audit Scotland's Technical Services Unit (TSU) provides guidance and support to external auditors appointed by the Accounts Commission and Auditor General to assist them fulfil their responsibility under their audit appointment to give an opinion on the financial statements.

This includes the publication of notes for guidance onto the TSU intranet/extranet. The purpose of notes for guidance is to offer guidance to external auditors, and to provide information which may be of interest or assistance in the performance of their audit work.

Notes for guidance contain information which is of importance to the conduct of audits and frequently recommend that auditors take action in certain regards. It is important that a mechanism is in place for senior audit staff to review notes for guidance promptly and to ensure that steps are taken to consider such recommendations.

While auditors act independently of Audit Scotland, and are responsible for their own conclusions and opinions, consistency of opinions in similar circumstances is important and **it is expected therefore that auditors will normally follow all such guidance. Auditors should advise the TSU promptly if they disagree with, and may intend not to follow, any guidance issued on an important issue** (e.g. a matter that required consideration to be given to the qualification of the accounts of a number of audited bodies).

A note for guidance may be e-mailed to audited bodies by Audit Scotland in order that they may be aware of the guidance that has been provided to auditors.

Audit Scotland makes no representation as to the completeness or accuracy of the contents of notes for guidance or that legal or technical guidance is correct. Points of law, in particular, can ultimately be decided only by the Courts. Audit Scotland accepts no responsibility for any loss or damage caused as a result of any person relying upon anything contained in such notes.

Introduction

1. Several public bodies in Scotland have introduced severance schemes to encourage voluntary redundancy and early retirement in their workforce in response to the challenging fiscal environment, and further schemes are expected.

2. In view of the potential significance of severance schemes across Scottish public bodies and the associated public, media and political interest in their costs and impact, auditors have a role in considering the arrangements for such schemes as part of their responsibilities in respect of probity, regularity and value for money. In addition, auditors may be asked by Audit Scotland for information on these schemes, for example for overview reporting purposes. Auditors should therefore ensure they are aware of any existing or planned schemes operating in their audited bodies and be alert to the related risks. It is expected that audit work will generally include (but not necessarily restricted to) reviewing

   - the accounting treatment for significant corporate severance schemes, including the appropriateness of providing for the cost of such schemes

   - key aspects of the governance of significant corporate schemes including the nature and consideration of business cases, and associated funding plans, and the extent and nature of professional advice

   - the regularity of transactions

   - legality, propriety and governance issues relating to any departures of senior management where specific costs associated with the departure are incurred by the body.

3. This note for guidance is intended to provide auditors with guidance that may be helpful when reviewing severance schemes by

   - setting out background information on the arrangements for redundancy and early retirement in the different parts of the public sector

   - highlighting some of the key audit risks that require to be considered in reviewing severance schemes or individual cases, including voluntary early release schemes that do not necessarily offer the full benefits that would be available under redundancy and early retirement schemes.

4. Appendix 1 contains a number of prompts that auditors are recommended to consider as a result of the matters included in this note. They should not be considered exhaustive, however, nor do they all

apply to every body/sector, and auditors should tailor their work to local circumstances and their assessment of risk.

Local government

5. *The Local Government Pension Scheme (Scotland) Regulations 1998* constituted the pension scheme for local government employees in Scotland (other than teachers, police officers and firefighters) until 31 March 2009. On 1 April 2009, *The Local Government Pension Scheme (Administration)(Scotland) Regulations 2008* and *The Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations 2008* make provision for the scheme from that date.

6. The scheme has a normal retirement age of 65. The 2008 regulations introduce a minimum pension age of 55 for all new scheme members. All current scheme members also have a minimum pension age of 55 from 6 April 2010, except for any member who was in the scheme on or before 5 April 2006 whose employment is terminated on grounds of redundancy or in the interests of the efficiency of the service and is aged 50 or over at that point; such members will have a protected pension age of 50.

7. *The Local Government (Discretionary Payments and Injury Benefits) (Scotland) Regulations 1998* (as amended) provide the discretion for local authorities to pay compensation payments to employees who cease to hold employment

   - as a result of redundancy. The compensation makes up the difference between the statutory payment under the *Employment Rights Act 1996* and the amount the payment would have been if based on the full weekly pay, without applying the limits imposed by statute

   - as a result of early retirement. This is available to employees over the minimum retirement age who cease work by reason of redundancy, or in the interests of the efficiency of the service. An authority has power to credit them with an additional period of service, and benefits become payable based on that service.

8. Employers are statutorily required to have a policy on these discretionary payments.

9. *The Teachers' Superannuation (Scotland) Regulations 2005* provide for the teachers superannuation scheme. The normal retirement age is 60 for members who joined the scheme before 1 April 2007, and 65 for those joining after that date. *The Teachers (Compensation for Premature Retirement and Redundancy) (Scotland) Regulations 1996* provide for compensation for premature retirement and on redundancy of certain teachers in addition to the normal statutory compensation.

10. There are two firefighters' pension schemes. *The Firemen's Pension Scheme Order 1992* provides for members of the original scheme and *The Fire Fighters' Pension Scheme (Scotland) Order 2007* provide for the new scheme which was open to all fire fighters from 6 April 2006. The normal retirement age is 60 (55 for the original scheme) but members may retire from 55 (50 for the original scheme). Both regulations provide for compensation for premature retirement and redundancy of certain members in addition to the normal statutory compensation.

11. There are also two police pension schemes. *The Police Pension Regulations 1987* provide for the original police pension scheme and *The Police Pensions (Scotland) Regulations 2007* provides for all members who joined the police force after 6 April 2006. The normal retirement age is 60 (65 for the most senior ranks) but members may retire from 55 (50 for the original scheme). Both regulations provide for compensation for premature retirement in addition to the normal statutory compensation.

Health

12. The NHS superannuation scheme was reformed on 1 April 2008 and now has two different sections. *The National Health Service Superannuation Scheme (Scotland) Regulations 1995* provided for the scheme until 31 March 2008 (the 1995 section) while *The National Health Service Superannuation Scheme (Scotland) Amendment Regulations 2008* made significant changes to the scheme from 1 April 2008 (the 2008 section).

13. Under the 1995 section, the normal retirement age is 60, while under the 2008 section it is 65. To qualify for early retirement, the employee must have reached the minimum pension age

    - The minimum pension age of 50 is protected for members who had the right to take reduced benefits at that age on 5 April 2006. This protection may continue as long as members retiring early after 6 April 2010 take all their benefits payable under scheme rules.

    - For those without this protection, members who first joined and some who returned to the scheme after 6 April 2006, the minimum pension age changed from 50 to 55 from 6 April 2010.

14. *The National Health Service (Compensation for Premature Retirement) (Scotland) Regulations 2003* provide for the payment of compensation to an employee who has prematurely retired by reason of redundancy or in the interests of the efficiency of the service. They specify the conditions necessary to qualify for, and the method of calculation of, the compensation.

15. If the employee has not reached the minimum pension age they will not be entitled to receive pension benefits but may be entitled to a compensation payment.

Central government

16. There are a number of pension schemes used by civil servants including

- the *Classic* scheme, which closed to new entrants on 1 October 2002, and has a normal retirement age of 60 and a minimum retirement age of 50

- the *Premium* scheme which commenced on 1 October 2002 and closed to new entrants on 30 July 2007. It has a normal retirement age of 60 and an early retirement of age of 50 for members who joined before 6 April 2006 and 55 for members joining after that date

- the *Nuvos* scheme which commenced from 30 July 2007, and has a normal retirement age of 65 and a minimum retirement age of 55.

17. The *Civil service compensation scheme* is a statutory scheme made under the *Superannuation Act 1972* and is separate from the pension scheme. The scheme provides a range of terms to those who leave the service early with the employer's consent, at the employer's request, or compulsorily. In general, (subject to reckonable service) employees who are made redundant over the minimum retirement age are entitled to early retirement, while those under that age receive early severance terms. A new scheme came into effect on 22 December 2010 which gives extra protection to the lower paid and those closest to retirement, while also setting a cap on payments to higher earners.

Further education

18. Employees of further education colleges are members of either the local government scheme (see paragraph 5) or the teachers scheme (see paragraph 9).

Key risk areas

Policies

19. It is important that bodies have clear, up-to-date early retirement and voluntary redundancy policies and procedures in place. This helps to ensure that there is a consistent basis for making decisions and that all staff are aware of the information to be used when deciding on redundancy retirement cases. Delegated authority in regard to approving schemes or individual retirement packages should be clearly set out.

20. The policy statement should be approved by elected/board members and should be updated as required.

Regularity/legality and propriety

21. Corporate policies require to be in accordance with applicable regulations, and schemes and individual severance cases should be consistent with the policies. Bodies should have taken independent advice on the scheme where appropriate (e.g. where a senior post is affected). Also, where severance involves the head of paid service, other statutory officers should have been appropriately involved. There should be arrangements for communicating schemes to staff, including the right to appeal.

22. The *Scottish public finance manual* (SPFM) requires bodies covered by it to obtain prior approval from their sponsor Directorate for any severance, early retirement or redundancy scheme.

23. There is a risk that individuals benefiting, or potentially benefiting, from schemes or individual decisions have undue influence over them.

Decision-making

24. Decision-makers should have been given the full costs and benefits of the scheme along with clear identification of risks, discretionary elements and alternative options. The rationale for decisions should be clearly recorded as a basis for subsequent review. There are risks that

- decisions are not subject to or consistent with an overall policy framework/ strategy
- decisions are not considered and reviewed at an appropriate level of seniority
- decision-makers do not have access to sufficient information, including a full assessment of costs and benefits and the risks to maintaining and developing services
- decision-makers do not have access to expert and objective advice.

Affordability and value for money

25. Bodies should be aware of the likely cost of the scheme (both in terms of the accounting cost and cash-flows) and the financial periods that will be affected. There should be clear plans that show how the body is intending to fund the costs of the scheme, including any ‘strain on the fund’ costs, as there is a risk that they cannot be met from available funding. There is also a risk that decision-makers do not make an objective evaluation of all available options, incorporating consideration of all relevant public costs and benefits.

26. Bodies should rigorously appraise individual cases to ensure the expected savings outweigh the costs, and there should be a sound business case that reflects the full cost and benefits of decisions. Where discretionary payments are included, the justification should be clear. The impact of changes in the key variables in the overall business case should also be considered. The calculations for any payments should be made correctly and in accordance with the regulations and policy.

27. The SPFM contains the following specific requirements for bodies covered by it

- public funds must not be used wastefully or to underwrite inequitable or over-generous conditions of service
- notice of termination of appointments should not be delayed in order to generate compensation payments in lieu of notice
- where appropriate, ex-gratia severance or redundancy packages should be based on the arrangements set out within relevant extant terms and conditions of employment. In particular, prior consideration should be given to the availability of pension and compensation benefits within these conditions
- special payments should be transparent and negotiated avoiding conflicts of interest
- offers of subsequent employment or consultancy work should be exceptional and only made where they represent the best value for money
- any undertakings about confidentiality should leave transactions open to proper public scrutiny.

Accounting treatment

28. Bodies that prepare their accounts under international financial reporting standards are required to account for severance costs under *IAS 19 Employee benefits* which requires

- voluntary early retirement to be accounted for as a post employment benefit
- an employer's decision to terminate an employee's employment before the normal retirement date, or an employee's decision to accept voluntary redundancy or other severance in exchange for benefits to be accounted for as termination benefits.

29. Termination benefits are lump sum payments, enhancement of retirement benefits (e.g. added years), and salary for a specified notice period where employee renders no service for that period. A body is required to recognise the benefits as a liability and as an expense only when it is demonstrably committed to either

- terminate the employment of employees before the normal retirement date; or
- provide termination benefits as a result of an offer made in order to encourage voluntary redundancy or other severance

30. A body is demonstrably committed to a termination only when it has a detailed formal plan for the termination and is without realistic possibility of withdrawal (e.g. due to legal or contractual requirements, or constructive obligation). The detailed plan requires to include, as a minimum

    - the location, function, and approximate number of employees whose services are to be terminated
    - the termination benefits for each job classification or function
    - the time at which the plan will be implemented; implementation should begin as soon as possible and the period of time to complete implementation should be such that material changes to the plan are not likely.

31. In the case of an offer to encourage voluntary redundancy or other severance, the measurement of termination benefits should be based on the number of employees expected to accept the offer. Where there is uncertainty about the number of employees who will accept an offer of termination benefits, a contingent liability exists. Disclosure of the contingent liability should be made unless the possibility of an outflow in settlement is remote.

32. In respect of local authorities, pension enhancements should be treated as pension costs for the purposes of the statutory transfer between the pension reserve and the general fund.

33. There is a risk that termination benefits will either not be calculated (either by an actuary or in separate calculations) or that there may be an element of double-counting if the actuary takes them into account but the body also accounts for them separately.

Impact on service delivery

34. Where a large number of employees volunteer for redundancy/retirement, or where a key senior individual is involved, there is a risk of large gaps in the skills and knowledge within the workforce, which could potentially have a negative impact on service delivery. There should therefore be clear plans as to how the organisational impact of the departures will be handled, and information on the costs to be incurred in redesigning services.

35. There should be arrangements to minimise the impact on services e.g. senior management should not approve applications where it would lead to an unacceptable operational risk for the body, and consideration should be given to release dates being scheduled over a period of time.

Senior management

36. The departure of senior managers, including the chief executive, merits particular audit attention. Auditors should consider the adequacy of bodies' governance arrangements including

- recruitment and performance management practices
- consideration of alternative departure options e.g. disciplinary action
- the use of specialist, independent advice
- the procedures applied in negotiating a settlement e.g. compliance with legislation
- the appropriate use of compromise agreements i.e. settlements negotiated on the understanding that an employee will not pursue a compensation claim for unfair dismissal
- specific approval for named individuals from sponsor departments, where required
- reporting of options and costs to members e.g. in whose name the reports are made, and the clarity of the presentation of the information.

Contact point

37. Enquiries concerning the content of this note for guidance should be directed to

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Appendix 1

Checklist for auditors

	Yes/No/ N/A	Initials/ Date	W/P Ref
1. Does the body have clear, up-to-date early retirement and voluntary redundancy policies and procedures in place?			
2. Has the policy statement on early retirement and voluntary redundancy been approved by elected/board members?			
3. Are there arrangements for the policy statement to be updated as required?			
4. Is the policy in accordance with applicable regulations?			
5. Is the redundancy/early retirement schemes and/or individual transaction in accordance with the policy?			
6. Has the body taken independent advice on the scheme where appropriate?			
7. Have other statutory officers been appropriately involved where severance involves the head of paid service?			
8. Has the body obtained prior approval from its sponsor Directorate for any severance, early retirement or redundancy scheme (bodies covered by SPFM only)?			
9. Are decision-makers given the full costs and benefits of the scheme along with clear identification of risks, discretionary elements and alternative options?			
10 Has the rationale for decisions been clearly recorded as a basis for subsequent review?			
11. Is the body aware how much the scheme is likely to cost and what financial periods will be affected?			

	Yes/No/ N/A	Initials/ Date	W/P Ref
12. Are there clear plans that show how the body is intending to fund the scheme?			
13. Has the body rigorously appraised individual cases to ensure the expected savings outweigh the costs?			
14. Is there a sound business case that reflects the full cost and benefits of decisions?			
15. Is there clear justification for any discretionary payments?			
16. Has the body considered the impact of changes in the key variables on the overall business case?			
17. Have severance payments been calculated correctly in accordance with relevant regulations and the policy?			
18. Have the specific requirements of the SPFM been met (bodies covered by SPFM only)?			
19. Are severance costs properly accounted for?			
20. Is the measurement of termination benefits based on the number of employees expected to accept the offer?			
21. Is a contingent liability disclosed where there is uncertainty about the number of employees who will accept an offer of termination benefits?			
22. Does the body have clear plans as to how the organisational impact of the departures will be handled?			
23. Does the body have adequate arrangements to minimise the impact of departures on service delivery?			
24. Does the body have adequate governance arrangements in place for senior management departures?			