

TONBRIDGE & MALLING BOROUGH COUNCIL

GENERAL PURPOSES COMMITTEE

28 June 2006

Joint Report of the Director of Finance and Central Services Director

Part 1- Public

Matters for Recommendation to Council

1 CALCULATION OF COSTS AND TERMS FOR EARLY RETIREMENT

Summary

A report to propose the updating of the Council's formula for calculating the costs of early retirements and a revision to the terms for early retirement set out in the Employment Stability Policy.

1.1 Background

1.1.1 Members will be aware that from time to time officers' contracts are terminated on the grounds of redundancy or in "the interests of efficiency of the service". If they are 50 or over they qualify for immediate payment of the pension benefits they have already accrued and the Authority can augment their service for pension purposes by up to six and two thirds years. There is, of course, a cost to such terminations which has, for the last decade, been taken into account when cases have been considered and put before members. This report addresses the formula for calculating the cost and also some issues around decisions on service augmentation.

1.2 Early Retirement Costs Formula

1.2.1 The formula currently in use for assessing early retirement costs was agreed by the Personnel and Performance Review Sub-Committee on 26th August 1997. It works by taking the capital cost of the employee's benefits package, as supplied to the Council by KCC, and converting that into an annual revenue cost through the application of a 6.5 per cent annuity calculation. The basis of the calculation is that the full capital cost of the termination must be restored to the Council's finances by the year of the departing employee's 65th birthday. As an example:-

1.2.2 An officer retires on his 55th birthday.

KCC informs the Council of a capital cost of £100,000

This translates into a ten year annual cost of £13910 p.a.

- 1.2.3 Therefore in calculating the net effect of the termination a cost of £13910 p.a. must be included to ensure that the Council is restored to its previous financial position, in this case within 10 years.
- 1.2.4 Whilst we do not consider this approach to be fundamentally flawed we do believe that it is now possible to establish a more accurate and realistic formula based on the assumptions within the medium term financial strategy. As before we would take as a starting point the capital cost of the termination. We would then project forward the revenue effect of that cost taking account of the net saving produced by the officer's departure, the net difference in interest receipts and salary inflation over time. By these means we could predict the point at which the Authority would have restored its financial position.
- 1.2.5 Example, using the MTFS assumptions of 4.9% interest rates and 2.5% salary inflation.

An officer retires on 31st March 2007 with a capital cost of £100,000

Revenue Implications -

| | |
|--|---------|
| Annual Saving from deleted post | £30,000 |
| Annual Cost of Establishment Adjustments | £10,000 |
| Net saving from termination | £20,000 |

| | At | At | At | At | At | At |
|---|-----------|----------|----------|----------|----------|----------|
| | 31.3.08 | 31.3.09 | 31.3.10 | 31.3.11 | 31.3.12 | 31.3.13 |
| Net Establishment Saving | (£20,000) | (£20500) | (£21013) | (£21538) | (£22076) | (£22628) |
| Capital Cost/ Balances brought Forward | £100000 | £84530 | £67771 | £49646 | £30073 | £8966 |
| Effect on Interest Receipts | £4530 | £3741 | £2888 | £1965 | £969 | (£105) |
| Balance carried Forward | £84530 | £67771 | £49646 | £30073 | £8966 | (£13767) |

- 1.2.6 It will be seen in this example that the Council's finances would be fully restored by 31st March 2013 and thereafter, other things being equal, would be enhanced. In the meantime there would be an annual revenue saving created by the establishment adjustment. The general assumption, were this formula to be adopted, would be that the full restoration point would need to be reached by the

year the officer would have reached his/her 65th birthday. Thus, in the example above the cost of the termination would not be financially justifiable if the employee were 59 or over as at 65, which is the assumed retirement age, the full saving could be achieved with no associated retirement cost and the cumulative cost of the termination would have exceeded the cumulative saving in the meantime.

- 1.2.7 This is necessarily a complex subject but its outcome is relatively straightforward. We believe that by adopting the formula and calculation method set out above the Council would have a robust means of assessing the costs of early retirements and judging whether, at least financially, they were viable. The assumptions within the formula would be adjusted in line with changes in the MTFs should these occur.
- 1.2.8 It is recommended that the new formula set out above is adopted as the Council's means of assessing the costs and viability of early retirements and that, other than in exceptional circumstances, it will be a requirement that, for a retirement to be approved, its costs will need to be fully recovered under the terms of the formula during the year in which the officer's 65th birthday falls, at the latest.

1.3 Service Augmentation

- 1.3.1 Section 6 of the Council's Employment Stability Policy, which deals with the settlement terms relating to early retirements and redundancies, reads as follows:-

6.1 Subject to:

- (i) the redundant employee agreeing that his/her termination settlement is in full and final settlement of any potential claims against the Council in respect of the termination;
- (ii) the real annual savings achieved by the termination, having taken account of the annual cost to the Council of the settlement as calculated under the Council's formula and the cost of any compensatory establishment changes, being a minimum of ten per cent of the total salary and benefits cost of the redundant post; and
- (iii) the Management Team and consultee Councillors/Committee (see paragraph 8.2) agreeing that the proposed staff structure and termination settlement are reasonable in all the circumstances of the case and particularly service provision;

the Council will pay redundancy and pension benefits to the employee at the maximum level allowed by the regulations in force at the date of the termination, subject to no more than 6 2/3 "added years" being granted to employees qualifying for this form of redundancy compensation.

- 6.2 Should any of the conditions set out above not be met a settlement will be determined by the Council, in consultation with the employee and his/her representative, according to the circumstances of the case.
- 6.3 Paragraphs 6.1 and 6.2 apply to employees whose posts are redundant. Settlements for employees who voluntarily early retire from non-redundant posts in order to provide employment opportunities for otherwise redundant employees will be set according to the circumstances of the case and will not necessarily be at the maximum permissible level.
- 1.3.2 It will be seen that in general there is an assumption of maximisation of benefits within this section. This has served the Authority well over the years as it has enabled some difficult situations to be resolved and reinforced to remaining staff the Council's aim to be a good employer. However, two new factors have emerged which we believe the Council would be well advised to incorporate into its policy.
- 1.3.3 Firstly, the revisions to the pension scheme that were implemented from 1st April 2006 had the effect of potentially making the Tonbridge and Malling policy more generous than it was before that date. The reason for this was that under the pre-revision regulations there was a cap of 40 on the maximum number of years service that could be counted for pension calculation purposes such that it was not permissible to augment service to any extent greater than the amount that would provide for 40 years service. To illustrate, although the absolute maximum permissible service enhancement is six and two thirds years, an officer with 35 years service could only be awarded five additional years to reach the maximum of 40.
- 1.3.4 That cap has been removed in the new regulations so it would be possible, under the Council's existing policy, for an officer made redundant at age 58 with 40 years service to still be awarded six and two thirds years giving him/her total pensionable service of 46 $\frac{2}{3}$ years. We do not believe that the Council would wish the change in the regulations to have this inadvertent effect and therefore will propose that the 40 year cap be specifically included in the policy.
- 1.3.5 Secondly, we are informed that it is the Audit Commission's view that, as well as the overall financial effect of any termination decision, the Authority should pay particular attention in assessing pensionable service augmentation to the loss suffered by the departing officer as a result of his/her retirement. Additional service should be primarily awarded to compensate for that loss as assessed in each case without a blanket assumption of maximisation. Given that the maximum pension any officer could enjoy is fifty percent of his/her salary it is difficult to envisage many circumstances where a loss equating to a certain amount of augmented service could not be established. However, it is feasible to imagine circumstances where the departing officer's particular talents were known to be in very high demand in the external market and therefore where a safe assumption could be made that he/she would not in fact suffer a significant

reduction of income as a result of his/her retirement. We are advised that the Authority should make an assessment of this nature rather than automatically maximising augmented service to the full extent allowed by the regulations.

- 1.3.6 We are further advised that, since early retirement should be seen very much as a last resort, it should always be made clear when proposing such terminations that the alternatives have been properly explored. To make this absolutely transparent we propose to include a condition in the Policy that explicitly addresses the issue.
- 1.3.7 A final beneficial amendment to the policy would be to make it clear that the financial tests within it, covering the authority's and the employee's position, apply to all forms of employer instigated early retirement, not only direct redundancies. Redundancies had previously been treated uniquely under the terms of Section 6 of the policy because it was only that type of retirement that attracted maximisation of retirement benefits. If it is agreed that maximisation is no longer an inbuilt assumption then we believe the alternative compensation for loss assessment should apply equally to all types of employer instigated early retirement.

1.4 Legal Implications

- 1.4.1 This report has been prepared partly to protect the Council's legal position in respect of early retirements.

1.5 Financial and Value for Money Considerations

- 1.5.1 One of the proposals in this report is designed to protect the Council's financial position. In assessing any redundancy or early retirement attention would be paid to the value for money implications and the proposals herein are intended to underpin this principle.

1.6 Risk Assessment

- 1.6.1 The proposals in the report are intended to mitigate against the risk of the Council's decisions being found to be unlawful whilst maintaining a protection against the risk of employees reducing their perception of the Council being a good employer.

1.7 Consultation

- 1.7.1 Staff representatives and the District Auditor have been consulted on the proposals in this report. Neither raised objections and the District Auditor commended our approach as adding helpful transparency to the early retirement process.

1.8 Recommendations

- 1.8.1 On the basis of the proposals in this report we recommend that Section 6 of the Employment Stability Policy be redrafted as follows:-

6.1 Subject to:

- (i) there being no redeployment opportunities which the employee could be reasonably required to take up;
- (ii) the employee agreeing that his/her termination settlement is in full and final settlement of any potential claims against the Council in respect of the termination;
- (iii) the termination rendering sufficient revenue savings that, using the Council's approved formula, its capital cost has been restored, at the latest, during the year in which the employee's sixty fifth birthday falls; and
- (iv) the Management Team and consultee members/member bodies agreeing that the proposed staff structure and termination settlement are reasonable in all the circumstances of the case and particularly service provision and the employee's individual circumstances, including loss of income, as a result of the termination;

the Council will pay redundancy and pension benefits to the employee up to the maximum level allowed by the regulations in force at the date of the termination, subject;

- (i) to no more than 6 2/3 years augmentation being awarded to employees qualifying for this form of augmentation; and
- (ii) to no augmented service being awarded that would have the effect of providing the employee with in excess of 40 years pensionable service.

6.2 Should any of the conditions set out above not be satisfied, and there being no exceptional circumstances warranting a departure from these conditions, a settlement will be determined by the Council, in consultation with the employee and his/her representative.

6.3 Paragraphs 6.1 and 6.2 apply to any employees who are dismissed/retired on the grounds of redundancy or in the interests of the efficiency of the Service.

1.8.2 It is further recommended that, in order to update the Employment Stability Policy fully, references in it to the Policy and Resources Committee and Personnel and Performance Review Sub-Committee should be replaced by the General Purposes Committee; references to the Chairmen of the Personnel and Performance Review Sub-Committee and the Finance and General Purposes Sub-Committee should be replaced by the Chairman of the General Purposes Committee and the Cabinet Member for Resources and Capital Projects; and

references to the Personnel Manager should be replaced by the Central Services Director.

Background papers:

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Nil

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