Local Government and Communities Directorate
Local Government Division

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The Scottish Government

Local Government Finance Circular 4/2015

Directors of Finance of Scottish Local Authorities
Audit Scotland
COSLA

Our ref: A9339741
30 March 2015

Dear Director of Finance,

EQUAL PAY AND SEVERANCE

In response to a request from COSLA, Scottish Ministers have agreed to provide local authorities with a financial flexibility to assist with meeting the costs associated with equal pay and severance. The request made by COSLA sought a statutory intervention to delay the financial impact of equal pay and severance until a cash payment is made, and, additionally, for councils to be permitted to use capital receipts to fund equal pay back pay settlements and severance payments.

The first request is for Government intervention in local authority accounting. In accordance with The Code of Practice on Local Authority Accounting in the UK (the Code) a financial provision is required to be recognised for liabilities where future payments are probable. The provision is recognised in the financial year the liability is first identified rather than when the actual payment is made. For equal pay back pay awards authorities are likely to have identified a potential liability significantly in advance of having to make the payment. Scottish Ministers recognise that delaying the charge to revenue will create time for councils to plan for the funding of those payments and agreed the request. Whilst the period between provision and actual payment may not be so significant for severance costs Ministers agreed to extend this flexibility to cover these costs.

The second request sought Ministerial agreement for councils to use capital receipts to fund equal pay back payments and severance costs. Whilst Ministers were content to agree to the use of capital receipts to fund equal pay back payments, this was on the basis that council must act prudently. In this regard prudence requires a council to plan the funding of equal pay from revenue or revenue reserves where possible and to not rely exclusively on the use of capital receipts. A prudent approach excludes the sale of assets purely to fund equal pay costs.

Scottish Ministers had reservations on whether capital receipts should be used to fund severance costs. Whilst recognising the continuing pressure on the public sector to reduce costs, severance schemes by the nature give rise to future savings.

An Audit Scotland report in 2013[1] identified the number of years before the initial costs are met by savings i.e. the payback period, ranged from between 1 and 3 years. A further Audit Scotland report[2] identified that public bodies need to think differently to find new ways to make savings, some of which go beyond focussing on reducing workforce numbers. Public bodies need to consider more cross-organisation and cross-sector working and make more use of service redesign. The Scottish Parliament's Local Government and Regeneration Committee *Report on Draft Budget 2015-16* which issued in January 2015, also contains as a key message service redesign and effective community planning. Reflecting on these messages Scottish Ministers have agreed that capital receipts may be used to fund severance payments where these arise due to service redesign, with the redesign being properly aligned to delivering on the preventative agenda and engagement with community planning partners. There is to be no application or approval process by the Scottish Government. Rather, the alignment required is to be evidenced through a council's committee reporting structures.

Whilst Ministers agreed with the use of capital receipts to fund severance costs this flexibility is limited to the statutory element of those payments. This is consistent with the Government's previous support to local government where borrowing consents were agreed for only the statutory element of severance payments as set out in Local Government Finance Circular No. 13/2010.

In recognition of the Scottish Government's commitment to maintaining pupil teacher ratios, capital receipts may not be used to fund severance costs for teachers.

The requirements of the Code require capital receipts to be credited to the statutory Capital Fund. The Capital Fund has legislative restrictions on its use. This statutory guidance varies the accounting treatment to allow capital receipts be used to fund equal pay and severance costs.

The statutory guidance is set out in Annex A.

If you have any questions please do not hesitate to contact me.

Yours faithfully

Hazel Black

Hazel Black
Head of Local Authority Accounting

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[1] Managing early departures from the Scottish public sector
[2] Scotland's public sector workforce

ANNEX A

STATUTORY GUIDANCE – ACCOUNTING FOR EQUAL PAY AND SEVERANCE

Introduction

1. This Statutory Guidance is formally issued by Scottish Ministers under section 12(2)(b) of the Local Government in Scotland Act 2003.

2. This statutory guidance applies from 1 April 2014. It is time limited and will expire on 1 April 2018.

3. A local authority may choose to take advantage of the statutory flexibility being offered but is not required to do so, i.e. it is not mandatory.

Accounting for equal pay back payments and severance costs

4. The Code of Practice on Local Authority Accounting in the UK (the Code) sets out when a provision should be recognised. This statutory guidance applies only to a new provision, or an increase in a provision recognised for either an equal pay back payment or a severance payment. It does not cover a provision recognised in any previous financial years as these are already fully funded.

5. Where a local authority takes advantage of the statutory adjustment being offered new statutory accounts will need to be created. For equal pay an *Equal pay provision statutory adjustment account* should be created and for severance a *Severance provision statutory adjustment account* should be created.

Equal Pay

6. In the financial year 2014-15 any new accounting provision made for equal pay, or any increase in any equal pay provision, should be charged to the Comprehensive Income and Expenditure Statement (CIES) in accordance with the Code. A statutory adjustment may then be made to exclude the equal pay back payment element of any new provision, or any increase in the provision, when determining the movement on the General Fund for the financial year. The statutory adjustment should be debited to the Equal pay provision statutory adjustment account, with a corresponding credit to the General Fund in the Movement in Reserves Statement (adjustment between accounting basis and funding basis under statute).

7. The equal pay provision at 31 March 2014 may not form part of the statutory adjustment. This provision will have already been funded by the General Fund. Only new provisions, or increases in the provision from 1 April 2014 may be the subject of a statutory adjustment.

8. From 2015-16, and each subsequent financial year until the expiration of this statutory flexibility, a further statutory adjustment may be made for the back pay element of any new, or increase in, equal pay provision.

9. Where a provision is derecognised (due to payments being made or the provision being reduced), a local authority shall credit the relevant statutory

adjustment account, with a corresponding debit to the General Fund through the Movement in Reserves Statement (adjustment between accounting basis and funding basis under regulations). This requirement only applies to the extent that the provision being derecognised is the subject of a statutory adjustment.

10. By 31 March 2019 the debits to the statutory adjustment account as they relate to a provision must be matched by corresponding credits.

Severance

11. In the financial year 2014-15 an accounting provision made for severance should be charged to the Comprehensive Income and Expenditure Statement (CIES) in accordance with the Code. A statutory adjustment may then be made to exclude the value of this provision when determining the movement on the General Fund for the financial year. The statutory adjustment should be debited to the Severance provision statutory adjustment account, with a corresponding credit to the General Fund in the Movement in Reserves Statement (adjustment between accounting basis and funding basis under statute).

12. The severance provision at 31 March 2014 may not form part of the statutory adjustment. This provision will have already been funded by the General Fund. Only new provisions, or increases in the provision from 1 April 2014 may be the subject of a statutory adjustment.

13. From 2015-16, and each subsequent financial year until the expiration of this statutory flexibility, a further statutory adjustment may be made for any new, or increase in, severance provision.

14. Where a provision is derecognised (due to payments being made or the provision being reduced), a local authority shall credit the relevant statutory adjustment account, with a corresponding debit to the General Fund through the Movement in Reserves Statement (adjustment between accounting basis and funding basis under statute). This requirement only applies to the extent that the provision being derecognised is the subject of a statutory adjustment.

15. By 31 March 2019 the debits to the statutory adjustment account as they relate to a provision must be matched by corresponding credits.

Use of capital receipts to fund equal pay and severance

16. Capital receipts may only be used to fund the back pay element of equal pay payments.

17. Capital receipts may only be used to fund severance costs where those costs arise from service redesign, with the redesign being properly aligned to delivering on the preventative agenda and engagement with community planning partners. This alignment is to be evidenced through a local authority's committee reporting structure.

18. Capital receipts may not be used to fund severance costs if these costs relate to teachers.

19. For severance costs capital receipts may only be used to fund those costs which arise through the application of statute which provides an individual with a right to a payment for redundancy or to the immediate payment of a retirement pension arising from redundancy or business efficiency. Capital receipts may only be used to fund lump sums due either to the individual or a pension fund and not any future recurring payments.

20. A statutory redundancy payment is one that arises from application of Part *XI of the Employment Rights Act 1996.* A statutory retirement pension is one that arises from the application of regulation 19 of *The Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations 2008/230*, or regulation 29(7) of the *Local Government Pension Scheme (Scotland) Regulations 2014/164.*

21. Discretionary payments to enhance severance packages such as those permitted under *The Local Government (Discretionary Payments and Injury Benefits) (Scotland) Regulations 1998/192 (as amended)* or the *Local Government Pension Scheme (Scotland) Regulations 2014/164,* may not be funded from capital receipts.

22. A local authority is required to act prudently. A local authority should not rely exclusively on the use of capital receipts but should endeavour to meet this cost from revenue or revenue reserves where possible. A prudent approach excludes the sale of assets purely to fund equal pay or severance.

23. Gains on derecognition of an asset shall be charged to other operating expenditure as required by the Code. The gain is not a proper change to the General Fund or Housing Revenue Account. Where a local authority plans to use capital receipts to fund equal pay or severance the Code is varied. The requirement to credit the statutory capital fund of an amount equal to the disposal proceeds (capital receipt) is replaced with the requirement for a local authority to credit one or more of the following statutory accounts - the statutory capital fund, the Equal pay provision statutory adjustment account or the Severance provision statutory adjustment account with amounts a local authority determines should be allocated to each account but which in total is an amount equal to the disposal proceeds.

24. The value of the disposal proceeds which may be credited to either the Equal pay provision statutory adjustment account or the Severance provision statutory adjustment account may not exceed the debit value of the statutory adjustment. This means that disposal proceeds may not be credited to either statutory adjustment account in anticipation of future increases in a provision.

25. The statutory adjustment account may have a debit value or a zero balance but not a credit balance.

26. Where a provision is derecognised (due to payments being made), a local authority shall debit the relevant statutory adjustment account, with a corresponding credit to the General Fund through the Movement in Reserves Statement (adjustment between accounting basis and funding basis under statute). This requirement only applies to the extent that the provision being derecognised is the subject of a statutory adjustment.

27. The analysis of the amounts included in the Movement in Reserves Statement for the adjustments between accounting basis and funding basis under statute shall treat the provision adjustment separately from the capital receipts adjustment. This means that the analysis shall not be for the net movement in the statutory adjustment accounts.

28. As at 31 March 2019 any disposal proceeds not applied to a provision when derecognised (when a payment is made), and hence still held in a statutory adjustment account, must be credited to the statutory capital fund of the local authority.

Local Government Division
30 March 2015