



WALES **AUDIT** OFFICE
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Senior Officers' Pay and Pensions **Pembrokeshire County Council** Report in the Public Interest

Senior Officers' Pay and Pensions

This report is issued in the public interest under section 22 of the Public Audit (Wales) Act 2004. I have issued this report to draw the public's attention to a decision of Pembrokeshire County Council that, in my view, was unlawful. The Council cannot use its powers to set reasonable remuneration for the avoidance or mitigation of the effect of pensions legislation. There were also failings in governance arrangements and inadequacies in the processes to determine the pay of senior officers which also render the decision unlawful.

This report in the public interest has been prepared in accordance with section 22 of the Public Audit (Wales) Act 2004.

No responsibility is accepted in relation to any officer, member or any other person in their individual capacity or any third party.

The Wales Audit Office team that assisted me in preparing this report comprised Richard Harries and John Dwight.

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Summary

- 1** This report is issued in the public interest under section 22 of the Public Audit (Wales) Act 2004 (the 2004 Act). The Act requires me to consider whether, in the public interest, I should make a report on any matter which comes to my notice in the course of the audit, in order for it to be considered by the audited body or to be brought to the attention of the public.
- 2** I have issued this report to draw the public's attention to a decision of Pembrokeshire County Council (the Council) that, in my view, was unlawful. The Council cannot use its powers to set reasonable remuneration for the avoidance or mitigation of the effect of pensions legislation. There were also failings in governance arrangements and inadequacies in the processes to determine the pay of senior officers which also render the decision unlawful. I believe it is important that the public has a full and proper awareness of the events concerning the Council. I also consider it appropriate to give the Council an opportunity to explain the important steps it needs to take to improve arrangements and to ensure that the risk of such failures recurring is reduced to a minimum.
- 3** In September 2012, I became aware that the Council's Chief Executive had decided to take advantage of a decision made by the Council's Senior Staff Committee, which allowed certain senior officers to opt out of the Local Government Pension Scheme (LGPS) and to receive as remuneration the equivalent of the employer's (pension) contribution (which I have called a 'pay supplement' within this document) so that they make their own alternative arrangements for saving for retirement. These arrangements would apply where an individual decided (because of changes in taxation affecting pension benefits payable to higher earners) to opt out of the LGPS and no longer remain as an active contributing member. Given the unusual nature of this decision, I informed the Council that I would review this as part of my annual audit of the 2012-13 accounts.
- 4** As a result of my review, I have concluded that the decision by the Senior Staff Committee of the Council on 28 September 2011 to approve a pay supplement is unlawful. Any payment made pursuant to that decision would therefore give rise to an item of account that is 'contrary to law'.
- 5** I have concluded that the decision is unlawful for the following reasons:

 - a** the decision taken by the Senior Staff Committee was 'ultra vires' and cannot lawfully be implemented because the Council's powers to set reasonable remuneration cannot be used for the avoidance or mitigation of the effect of pensions legislation;
 - b** in making the decision, relevant considerations were not taken into account, in breach of *Wednesbury* principles;
 - c** the Council failed to have due regard to the public sector equality duty;

- d** the decision constituted indirect discrimination; and
 - e** senior officers who had a disqualifying personal and pecuniary interest in the decision, participated in the decision-making process.
- 6** In addition, I am of the view that the payments being made are not in line with the committee decision that the arrangement would be on the basis of no additional cost to the Council.
- 7** In the 2012-13 financial year, the Council paid £22,269 to the Chief Executive under the 'pay supplement' scheme. A further £28,742 will be paid to both the Chief Executive and another senior officer under the scheme in the 2013-14 financial year (up until the end of March 2014).
- 8** I have shared my legal advice with the Council. It has obtained its own legal advice in response but has declined to provide that advice to me, stating that the 'written advice is not suitable for disclosure and privilege is not waived'. The Council has provided me with a paper that sets out its position on each of the issues raised. The Council does not accept that 'the pay supplement is intrinsically unlawful'. However, in recognising some of the procedural issues and the impact of the public sector equality duty, the Council decided, in September 2013, to 'revisit its decision'. I am not aware that any action has yet been taken to address this.
- 9** I also received a number of other written submissions from members of the Senior Staff Committee on the substance of the report. Whilst such submissions sought to justify the decision taken they have not altered my view on the lawfulness of said decision.
- 10** The Council should now reconsider the disclosures made in the 2012-13 financial statements and arrange for the statements to be re-approved.
- 11** In its response the Council puts forward the view, in a number of places, that these are not matters for the auditor. As the appointed auditor it is my responsibility to decide whether it appears to me that any item of account is 'contrary to law' before exercising discretion on whether to apply to the court for a declaration to that effect; see section 32(1) of the Public Audit (Wales) Act 2004 and my functions under section 22 and 33 of the 2004 Act.
- 12** The expression 'contrary to law' may be traced back at least to section 247(7) of the Public Health Act 1875. The decided cases since that date have clearly illustrated the grounds upon which items of account may be held contrary to law. It is best summed up in *Hazell v. Hammersmith and Fulham Council London Borough [1990] 2 QB 697*. In short, an auditor is entitled to seek relief if he can show that an item of account is for any reason unlawful or improper.

Recommendations

Senior Staff Committee decision, 28 September 2011

- R1** The Council should rescind the decision and withdraw the current option for senior staff, stopping any future payments.
- R2** If the Council decides to take a new, lawful decision it must address the procedural weaknesses identified in this report and ensure that it demonstrates lawful exercise of discretion in setting reasonable remuneration and its responsibilities under the Public Sector Equality Duty.

Calculation of amounts paid

- R3** The Council should, if payments are to be lawfully made in the future, clearly demonstrate that the amount paid complies with any Senior Staff Committee decision.

Closure of the 2012-13 accounts

- R4** The Council should make an appropriate disclosure in the 2012-13 financial statements and arrange for the Corporate Governance Committee to re-approve the financial statements.

Background

- 13** Legislation was introduced in the Finance Act 2011 to restrict pensions tax relief for individuals by reducing the 'annual allowance' from £255,000 to £50,000 in 2011-12 and the lifetime allowance from £1.8 million to £1.5 million, with effect from the tax year 2012-13. The annual allowance will reduce further to £40,000, and the lifetime allowance £1.25 million with effect from 2014-15.
- 14** For employees in a 'defined benefits' scheme, such as the Local Government Pension Scheme (LGPS), a tax liability is incurred if the increase in the value of an individual's pension benefits is greater than the annual allowance. For pension savings in excess of the lifetime allowance, additional tax liabilities are also incurred, usually when an individual first receives his/her pension. A lifetime allowance of £1.5 million is estimated to be equivalent to a pension of approximately £75,000 per annum.
- 15** In light of these changes, on 28 September 2011 the Senior Staff Committee of the Council approved that 'the option of receiving the equivalent of the employer's contribution should be made available to senior staff (...who decide that staying as an active contributing member of the pension scheme would create substantial tax liabilities) so that they make their own alternative arrangements for saving for retirement'. In effect, this creates a pay supplement for any senior staff affected by the new tax provisions who opt out of the LGPS. The payment of the pay supplement representing 'the equivalent of the employer's contribution to the LGPS' was agreed on the basis of 'no additional cost accrues to the Council'.
- 16** That decision was made after receiving a report from the Director of Finance and Leisure and the Head of Human Resources (the Report). The Report was a one-page summary and recommendation that was not supported by any legal opinion or other relevant evidence.
- 17** The item of business constituted by the Report appeared on the published agenda for the meeting as 'Pensions Arrangements'. The Report presented to the committee was exempt from publication and was considered in closed session.
- 18** The Report stated that the Authority is obliged to pay employer's pension contributions for each individual senior employee. Although not mentioned in the Report, the contracts of employment for senior staff provided for them to be members of the LGPS. Those contracts also made provision for senior staff to have the right to opt out of the LGPS but no provision was made for additional remuneration to be paid to senior staff who exercised their right to opt out of the LGPS.
- 19** The Report asserted that the changes in the pension taxation provisions reduced 'incentives for recruitment' and suggested that the proposal was required 'to aid recruitment and retention'. The Report did not, however, provide any evidence to support this assertion.

- 20** The Report does not address equalities, legal or staffing implications and the specific impacts on individual members of senior staff were not examined in the Report.
- 21** As senior staff, the Director of Finance and Leisure and the Head of Human Resources had personal and pecuniary interests in the recommendation to pay a pay supplement to senior staff who opt out of the LGPS. In addition, the Senior Staff Committee met in the Chief Executive's office (as advertised on the published agenda), he was in attendance and, during the 2012-13 financial year, was the only senior staff member to take advantage of the option.

The decision taken by the Senior Staff Committee to allow senior officers to opt out of the Local Government Pension Scheme and to receive as remuneration the equivalent of the employer's pension contribution is unlawful and payments made as a result of that decision result in an item of account that is 'contrary to law'

The decision taken by the Senior Staff Committee is ultra vires and cannot be lawfully implemented because the powers bestowed on the Council to set reasonable remuneration cannot be used for the avoidance or mitigation of the effect of pensions legislation

- 22** It is commonly known and accepted (trite law) that a local authority may only do that which it is required or empowered by statute to do. Such powers as a local authority have may only be exercised reasonably and for a proper purpose. A local authority must direct itself properly in law and must act in accordance with administrative law principles.
- 23** The Council is under a duty, imposed by section 112(1)(2) of the Local Government Act 1972 (the 1972 Act) to employ officers on such reasonable terms and conditions, including as to remuneration, as the Council thinks fit.
- 24** The duty imposed by section 112 of the 1972 Act must be exercised reasonably and for the purpose for which it was given, ie to determine a reasonable level of remuneration for work to be carried out; remuneration must be the reasonable pecuniary equivalent of the service rendered.
- 25** As is the case with all statutory powers, the power to determine a reasonable level of remuneration must be exercised for the purpose for which it was given. An individual is entitled so to order his/her affairs as to avoid or minimise (but not evade) the effect on him/her of legislation. The powers of public authorities are, however, essentially different from those of a private person. Statutory power conferred for public purposes can validly be used only in the right and proper way which Parliament, when conferring it, is presumed to have intended. Avoidance/mitigation of the effect of statutory controls is not a proper purpose for which a local authority may act.
- 26** It would not be a proper exercise of the Council's power to determine a reasonable level of remuneration if the remuneration were determined for an extraneous or legally irrelevant purpose such as the avoidance or mitigation of the effect of restrictions in pensions legislation.
- 27** The decision by the Council's Senior Staff Committee to pay a pay supplement to senior staff who opt out of the LGPS scheme was made to mitigate any impact on those officers of the restrictions on pensions tax relief introduced by the Finance Act 2011.

- 28** In my view, Parliament did not intend that the impact of the restrictions on pensions tax relief should be avoided and/or mitigated by the exercise of the power, conferred on the Council by Parliament, to determine reasonable remuneration. Avoidance/mitigation of the effect of legislation is not a proper purpose for which a local authority may act. For that fundamental reason, the decision taken by the Council's Senior Staff Committee on 28 September 2011 is ultra vires the Council and cannot lawfully be implemented.
- 29** The Council's response has sought to rely on the general power of competence set out in the Localism Act 2011, section 1(1). Within this act, section 8 defines a 'local authority' as a county council in England; a district council; a London borough council; the common council of the City of London; the council of the Isles of Scilly; and an eligible parish council. As the Council acknowledges, section 1(1) of the Localism Act 2011 does not apply to Welsh authorities.
- 30** I consider that the Council's response has not addressed the fundamental issue of lawful reasonable remuneration. My view remains that the Council's powers to set reasonable remuneration cannot be used for the avoidance or mitigation of the effect of pension legislation. This is a public law concern identified by the auditor as to the improper exercise of power. This is different from the private law response set out in the Council's position paper.

In making the decision, relevant considerations were not taken into account, in breach of *Wednesbury* principles

- 31** Such powers as the Council has, must be exercised reasonably taking into account all relevant consideration: see *Associated Provincial Picture Houses v Wednesbury Corporation [1948] 1KB 223*.
- 32** The decision of the Senior Staff Committee is ultra vires the Council for the additional reason that relevant considerations were not taken into account, in breach of *Wednesbury* principles. In particular:
- a** no information was presented to the Senior Staff Committee on the impact of the provisions in the Finance Act 2011 on any member of staff for whom a pay supplement was approved;
 - b** no evidence was provided to demonstrate that a failure to approve the pay supplement would have adverse consequences for the Council in terms of the recruitment and/or retention of senior staff; and
 - c** no information was provided to the Senior Staff Committee on the equalities or legal implications of the proposal to approve a pay supplement.
- 33** In my view, the Report to the Senior Staff Committee does not provide a reasonable basis for the decision made.

34 The Council response considers that cases of breach of fiduciary duty are likely to be rarer than previously thought and that the *Wednesbury* threshold of reasonableness is more easily met than had been thought. It argues that although the Report was not detailed, it was not misleading and members were not misled.

35 In terms of the reasonableness of the decision based on the *Wednesbury* principles, I remain of the view that there was insufficient evidence within the Report to the Senior Staff Committee to support a lawful decision being made. The committee Report did not address equalities, legal or staffing implications and did not provide any evidence to support the recruitment and retention issue.

The Council failed to have due regard to the public sector equality duty

36 Section 149 of the Equality Act 2010 (the 2010 Act) places a general duty on the Council to have due regard to three aims – the need to eliminate discrimination, the need to advance equality of opportunity and the need to foster good relations.

37 Specific duties are placed on the Council by the Equality Act 2010 (Statutory Duties) (Wales) Regulations 2011 (the 2011 Regulations). Regulation 8 provides that the Council must make ‘such arrangements as it considers appropriate for – (a) assessing the likely impact of its proposed policies and practices on its ability to comply with the general duty...’.

38 As noted above, the Report to members of the Senior Staff Committee does not address whether there were any equalities issues to be considered. It does not appear that an assessment was made of the likely impact of the proposal under consideration on the three aims of the general duty to which the Council was under a statutory duty to have due regard. No such assessment was reported to the Senior Staff Committee notwithstanding that the proposal under consideration (the opportunity to opt out of the LGPS and receive additional remuneration) was intended to be available to senior staff only (potentially disproportionately benefiting male employees and/or older employees and discriminating against women and/or younger employees).

39 The Council was therefore in breach of the public sector equality duty in failing to carry out and to report to the Senior Staff Committee an assessment of the likely impact of the proposal on its ability to comply with that duty. The Council failed to have due regard to the public sector equality duty.

40 The Council response refers to the discipline of the public sector equality duty lying in the quality, not the outcome, of the decision-making process. It argues that it is not the traditional role of an auditor to enforce discrimination law.

41 I consider that the response does not address my view that the Council was in breach of the public sector equality duty. The Council failed to carry out and report an assessment of the likely impact of the proposal (before the Senior Staff Committee meeting) on the Council’s ability to comply with that duty. In my view the quality of the process adopted by the Council was poor.

The decision constituted indirect discrimination

- 42 By section 39(2) of the 2010 Act, the Council as employer must not discriminate against an employee of the Council (a) as to his/her terms of employment or (b) in the way that the Council affords an employee or employees access or by not affording him/her access to a 'benefit, facility or service'.
- 43 Pursuant to section 19 of the 2010 Act, discrimination takes place if a provision, criterion or practice puts a group who share a protected characteristic at a particular disadvantage. Age and sex are protected characteristics. Both younger employees and women employees are put at a disadvantage as they are treated less favourably than older employees and male employees in that younger employees and/or women employees are less likely to be eligible to benefit from the approved pay supplement. Avoidance/mitigation of the impact of the restrictions on pensions tax relief is not a legitimate aim on which the Council might rely in order to negate a finding of indirect discrimination.
- 44 The decision of the Senior Staff Committee constituted indirect discrimination (as defined by section 19 of the 2010 Act). Although it may be thought that employees in that group would be better off remaining in the LGPS, that does not provide an answer to an allegation of indirect discrimination.
- 45 The Council position paper points out that discrimination is a statutory tort, enforceable by an individual who may (normally within three months of the act complained of) bring a complaint that they have been discriminated against. It is the Council's view that it is not for the auditor to assert individual claims not made by any individual.

- 46 My view remains that the decision constitutes indirect discrimination and accordingly the 'pay supplement' was contrary to law.

Senior officers who have a disqualifying personal and pecuniary interest in the decision, participated in the decision-making process

- 47 A person is disqualified from participation in a local authority decision-making process if there is a real possibility that he or she would be influenced by a pecuniary or personal interest in the outcome of the decision. Disqualification from participation applies to an officer providing written or oral advice to a decision-making committee or board.
- 48 Any pecuniary or personal interest has to be declared and an individual having such an interest is not entitled to participate in the decision-making process unless that interest is too remote or insignificant to matter. In general, the participation in a decision-making process of a single individual with a disqualifying interest will vitiate the decision arrived at (see the *Kirkstall Valley* case and *R v Hendon RDC ex parte Chorley* [1933] 2 KB 696).
- 49 The decision of the Senior Staff Committee is therefore also unlawful because the Director of Finance and Leisure and the Head of Human Resources whose report was before the committee have a disqualifying personal and pecuniary interest in the decision, as senior officers who were eligible to benefit from the proposed pay supplement. In addition, the Chief Executive and Head of Human Resources were present at the meeting and did not make any declaration of interest.

- 50 The decision-making process is wider than the decision itself and includes the presence of officers at a meeting. A person is disqualified from participation in a decision-making process if there is a real possibility that he or she would be influenced by a pecuniary or personal interest in the outcome of the decision (see *R v Secretary of State for the Environment ex parte Kirkstall Valley Campaign Ltd* [1996] 3 All ER 304; *Porter v Magill* [2002] 2 AC 357).
- 51 I am satisfied that officers took part in the decision-making process whilst having a disqualifying financial interest in the outcome of the decision.

The payment made in 2012-13 did not comply with the committee decision

- 52** The Senior Staff Committee resolved to make the option available to senior staff on the basis that no additional cost accrues to the Council.
- 53** For 2012-13, payment to the Chief Executive following his opt out of the LGPS, was made based on 14.7 per cent of his annual salary, with a reduction to take account of the additional employer's national insurance contributions.
- 54** The employer's contribution rate is based on a 'common rate' of 12 per cent, with an additional percentage applied based on the triennial actuarial assessment of the additional costs required to achieve a balanced position on the pension fund. For the Council, this additional percentage is reflected in the 14.7 per cent.
- 55** In my view, payment based on 14.7 per cent would allow the additional contribution to be paid to the Chief Executive, rather than paid into the pension fund. As a result, there would be some additional cost to the Council, as a future actuarial assessment would be based on fund assets that had not received the additional contributions. In addition, the Council also needs to consider the impact on national insurance contributions, as the national insurance contribution status of the Chief Executive has changed, following his opt out of the pension scheme.
- 56** I do not therefore accept that the payment made to the Chief Executive is in line with the committee decision that 'no additional cost accrues to the Council', and have asked the Council to review its calculation.

The Council needs to make appropriate disclosures in, and re-approve, the 2012-13 financial statements

- 57** The Council's Corporate Governance Committee approved the 2012-13 financial statements at its meeting on 30 September 2013. As explained in the *Audit of Financial Statements* report, I was unable to give an audit report at that stage as I was considering the Council's response to my view that an item of account was unlawful.
- 58** As my view remains that the payment to the Chief Executive is unlawful, this should now be fully disclosed in the financial statements, which will need to be re-approved by the Corporate Governance Committee. This would then allow me to give an unqualified audit opinion, but to refer to the disclosure in an 'emphasis of matter' paragraph.
- 59** If the appropriate disclosure is not made, in my view, the financial statements would be materially misstated (given the nature of the transactions and disclosures) and I will need to issue a qualified opinion.

Next steps

- 60** The Council is now required by section 25 of the 2004 Act to consider this report at a full meeting of the Council within one month of the date of this report. At the meeting, the Council must decide:
- a** whether the report requires it to take any action;
 - b** whether the recommendations in the report are to be accepted; and
 - c** what action to take in response to the report and recommendations.

Acknowledgements

- 61** I wish to express my appreciation to officers and members of the Council for their co-operation during the audit.



Anthony Barrett
Appointed Auditor
30 January 2014