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Higher Education Funding  
Council for Wales

**REPORT TO THE ACCOUNTING OFFICER OF THE  
HIGHER EDUCATION FUNDING COUNCIL  
FOR WALES**

**REVIEW OF THE REMUNERATION AND SEVERANCE  
GOVERNANCE PROCESSES FOR SENIOR STAFF  
AT HIGHER EDUCATION INSTITUTIONS  
IN WALES**

**BY**

**HEFCW AUDIT SERVICE**

# REVIEW OF THE REMUNERATION AND SEVERANCE GOVERNANCE PROCESSES FOR SENIOR STAFF AT HIGHER EDUCATION INSTITUTION IN WALES

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## EXECUTIVE SUMMARY

### Background

1. The HEFCW Council decided in June 2005 to undertake a review of the processes by which all higher education institutions in Wales established the salaries of the head of institution and other senior staff, and the process for determining severance arrangements. The HEFCW Council's decision was taken in the context of the Assembly Government's commitment to, and funding for, reconfiguration and collaboration, and the changes that have happened, or might happen, in the structure of higher education in Wales. In the light of these considerations, the HEFCW Council's view was that it would be in the best interest of Welsh higher education for a review to be undertaken to demonstrate that the sector takes a robust and objective approach to the determining of salaries and severance arrangements.

### Potential risks arising from weak governance processes

2. Staff costs are the largest item of expenditure for all institutions, and institutional success is dependent on the staff they employ. With increasing competition between institutions, and the expectation of more transparency and better accountability, it is becoming more important for them to make good decisions about pay at all levels. Weak governance processes for setting senior staff remuneration and severance payments could damage institutions and result in:
  - Adverse publicity and a negative impact on the institution's reputation
  - A loss of stakeholder confidence
  - Worsened employee relations and reduced staff morale
  - Higher costs with no obvious benefit
  - The loss of key staff to other institutions or employers.

### Scope of work

3. The terms of reference of this review require a report on the extent to which present arrangements within the sector for setting remuneration and severance payments for heads of institution and other senior staff comply with the principles set out by the Committee on Standards in Public Life, namely:
  - Selflessness
  - Integrity
  - Objectivity
  - Accountability
  - Openness
  - Honesty, and
  - Leadership.
4. The terms of reference also ask that recommendations for improvements be set out, where these are appropriate. The terms of reference were communicated to the Chairmen and heads of all the Welsh higher education institutions and are reproduced in Annex A.

5. The focus of the review was on governance *processes*, not on individual *decisions* made by remuneration committees and governing bodies, though decisions may illustrate how processes operate. There will always be differences of opinion about specific decisions. This review did not attempt to determine, for example, whether remuneration committees had set the right level of remuneration, but rather whether they had acted reasonably in the circumstances of higher education in general and of the institution concerned. It is not the intention of HEFCW to specify salary levels or ranges. Nonetheless, the consequence of decisions across the sector is that pay for senior staff, particularly heads of institution, continues to rise considerably faster in aggregate than for other categories of staff. Although this issue is not explicitly included in the terms of reference of the review, it is discussed in the report.
6. The review was based primarily on institutions' papers and interviews with officers and remuneration committee members. Such evidence does not necessarily reveal in full the nature and tone of the discussion that takes place in remuneration committees and governing bodies, nor the extent of challenge of recommendations and decisions.
7. All institutions have relied, to a varying extent, on information from external sources, such as the Universities and Colleges Employers' Association (UCEA) and the Committee of University Chairmen (CUC). It was not within the scope of this review to test the quality or reliability of this information, though the report comments on its usefulness and limitations. Similarly, internally generated data were taken at face value, for to do otherwise would have required much more extensive and intrusive enquiries.
8. Given the diversity of institutions in Wales, their differing circumstances and, fundamentally, the central role of individuals in making qualitative judgements about complex issues, it is not possible to make exact comparisons between institutions. Answers to questions about processes in this area are rarely a straightforward yes or no. The report necessarily focuses on broad themes in the sector and areas for consideration and development.
9. For similar reasons it is sometimes difficult to assess whether a particular practice should be the subject of informal comment or a formal recommendation. The confidential feedback to individual institutions is therefore stated in terms of "observations and recommendations", with no clear-cut distinction between the two. Nonetheless, institutions should reflect carefully on all the points raised.
10. Institutions in Wales vary greatly in size and complexity, and these differences are reflected in governance and management practices. The report does not expect there to be a single model in the sector, and neither does it expect smaller institutions to adopt the more complex arrangements common in the largest institutions.
11. The review covered the three years 2002-03 to 2004-05. Where practice has evolved, as has been the case in many institutions, as part of broader changes in governance arrangements, the review placed most emphasis on the most recent year, and framed recommendations accordingly.
12. Since its merger with the University of Wales College of Medicine on 1 August 2004, Cardiff University has created new governance and management structures and processes. The review looked at practice in the two pre-merger institutions, but the main focus was on the merged university.

## Overall opinion

13. Governance processes across the sector are broadly sound. The review did not find any examples of clearly indefensible practice that should be of concern to institutions, HEFCW or other stakeholders. There is a low probability that institutions will be significantly damaged by the potential risks mentioned in paragraph 2. In relation to the principles outlined in paragraph 3, the broad assurances and issues are as follows:

a. Selflessness

There is no personal advantage to independent governors and remuneration committee members in setting senior staff salaries or agreeing severance payments. Heads of institution are members of remuneration committees but withdraw when their own pay is discussed. In a few instances committees have asked or permitted heads of institution and others to present cases in support of their own pay reviews, which might be considered inadvisable. However, on each occasion the individuals concerned did not take part in decision-making, and there has been no evidence of undue influence on those committees.

b. Integrity

Governors and remuneration committee members have acted conscientiously and with integrity, notwithstanding differences in practice between institutions. There is evidence of active debate about appropriate levels of remuneration, for example, and what is in the best interests of the institution.

c. Objectivity

This is one of the most challenging principles, given the lack of truly comparable, comprehensive and up-to-date information about remuneration packages in the sector. The report discusses this in some detail. Decisions inevitably involve some element of subjectivity about the relationship between pay and motivation, retention and responsibility. There is no evidence of any institution making indefensible decisions.

d. Accountability

Given the sensitive nature of staff pay and severances, most institutions have ensured proper accountability. Most remuneration committees have delegated authority for these matters. In around half of institutions there was insufficient evidence to confirm whether governing bodies received adequate and timely information about the decisions reached and the basis for them. A related issue in cases of delegated authority is whether the governing body has sufficient opportunity to review past decisions and, if necessary, challenge the process by which decisions are made. A number of recommendations have therefore been made to clarify and improve processes. Interviews with remuneration committee chairs and members revealed a widespread concern to demonstrate proper stewardship for the use of public funds.

e. Openness

Issues of sensitivity and data protection may preclude high levels of openness. What matters is whether decisions are made collectively by remuneration committees and governors rather than privately, and whether these are then adequately recorded and reported. It is clear that committees and governors fulfil this responsibility adequately.

f. Honesty

There has been no evidence of dishonest conduct in setting senior staff salaries and severances.

g. Leadership

Chairs of governing bodies appear to exercise appropriate leadership in these matters, and heads of institution likewise in relation to other senior staff. It is questionable whether institutions are taking a sufficiently strategic view of senior staff pay. This issue is addressed in the report.

14. Governance practice in general is evolving, and this is particularly true as regards senior staff pay. There has been a marked general improvement in practice during the three-year period under review, with remuneration committees meeting more regularly and frequently, and significant enhancement in the quality of papers. The announcement of this review itself seems to have provided some impetus for institutions to look again at their processes and introduce greater formality. Discussion of the findings set out in the attached report should help to continue this development.
15. All institutions have received specific feedback and there are opportunities to improve processes at each, though in most cases the observations and recommendations are of a minor nature. At no institution should there be a lack of confidence in governance arrangements.

**Follow up to the review**

16. HEFCW can derive a high level of assurance from this review. Institutions are being asked to provide a response to the individualised feedback given to them confidentially and indicate what action they will take. HEFCW will review these responses, assess whether they are adequate, and engage further with institutions as necessary. A follow-on review, either of the sector as a whole, or of any institution, need not be considered in the near future.
17. The review raises important issues about the trend in senior staff pay settlements, the information available to guide decision-making, and the use of benchmarking. These should be considered by the sector as a whole, across the UK, and in particular by representative bodies such as Universities UK and CUC. These are legitimate areas for public debate, but funding bodies and others should continue to respect institutional autonomy and recognise the competitive pressures that institutions face.

**Note**

The opinions and assurances provided in this report are given solely for the use of the HEFCW Council's Accounting Officer.

Observations are provided to the Accounting Officer in order to promote the application of best practice and ensure compliance with those requirements designed to improve accountability in the Higher Education sector.

This report is not intended for other parties and HEFCW will not accept responsibility for any reliance such parties might place on it.

## INTRODUCTION

### Structure of the Report

1. This report consists of the following sections.
2. **Background** – sets out the objectives and terms of reference of the review.
3. **General Findings** – sets out the findings from the review analysed by subject area as below:

|                                |   |
|--------------------------------|---|
| <b>Senior Staff Pay</b>        | <p>This section presents the findings from the review in respect of the following aspects of senior staff pay governance processes and procedures;</p> <ul style="list-style-type: none"><li>• General characteristics and trends</li><li>• Pay rises and pay levels</li><li>• Stewardship, affordability and benefit to the institution</li><li>• Market pressures</li><li>• Information and comparisons</li><li>• Performance related pay</li><li>• The upward pressure on pay</li><li>• Human Resources Strategy development</li></ul> |
| <b>Governance Arrangements</b> | <p>This section presents the general findings with respect to the operation of remuneration committees, their arrangements for reporting to and their relationship with the governing bodies.</p>   |
| <b>Senior Staff Severances</b> | <p>This section presents the review findings with respect to the few senior staff severance payments made in the period and describes the key elements that should be included in all the institutions' severance policies.</p>   |

4. A good practice checklist for governing bodies and remuneration committees in respect of the remuneration and severance governance processes for senior staff is set out in Annex B. This checklist presents the main issues that arose during the review, in the form of self-assessment questions for governing bodies and remuneration committees and is based on what appears to be “good practice” in the sector.

## Background

5. The HEFCW Council decided in June 2005 to undertake a review of the processes by which all higher education institutions in Wales established the salaries of the head of institution and other senior staff, and the process for determining severance arrangements. The HEFCW Council's decision was taken in the context of the Assembly Government's commitment to, and funding for, reconfiguration and collaboration, and the changes that have happened, or might happen, in the structure of higher education in Wales. In the light of these considerations, the HEFCW Council's view was that it would be in the best interest of Welsh higher education for a review to be undertaken to demonstrate that the sector takes a robust and objective approach to the determining of salaries and severance arrangements.
6. The key objective of this review was to report the extent to which arrangements within the sector for setting remuneration and severance payments for head of institution and other senior staff comply with the seven principles set out by the Committee on Standards in Public Life.
7. Terms of reference for the review were communicated to the Chairmen and heads of all the Welsh higher education institutions and are reproduced in Annex A. The review was based primarily on institutions' papers and interviews with officers and remuneration committee members at each institution.

## SENIOR STAFF PAY

### General characteristics and trends

8. Almost all institutions pay their senior staff in a relatively straightforward way, through a basic salary and some “benefits in kind”. Formal performance related pay is rare, in part because performance assessment does not appear to be highly developed, and so it is difficult to link it to financial reward. Some agreements with unions have specifically precluded this, at least for staff in general. Only one institution at the time of the review had a senior staff bonus scheme, but it intends to phase this out in the near future. There are marked differences in the extent of “benefits in kind” offered, especially for heads of institution. Since these are both taxable and disclosed in the annual accounts, the review made no distinction between these and other forms of remuneration.
9. Nonetheless, in recent years most institutions have actively reviewed senior staff pay. Whereas pay increases previously were often linked to national awards for academic staff, with or without a notional average “incremental drift”, this approach is now uncommon. The publication of salaries for heads of institution, and regular surveys by the Universities and Colleges Employers’ Association (UCEA) and the Committee of University Chairmen (CUC), have encouraged governing bodies and remuneration committees to compare and benchmark salaries much more regularly. Almost all are now doing this explicitly, and in each year.
10. As a result of this heads of institution have received larger average increases than other categories of HE staff. This is now a well established pattern across the UK as a whole and does not appear likely to change in the near future. There appears to be no abatement of the upward pressure on salaries, nor any obvious upper limit. Some heads of institution have had annual increases far greater than the sector average. These might be attempts to “catch up” with peer or comparator institutions, or climb up the published “league tables”, though they could also reflect changes in responsibility, experience or performance. A large uplift in one year may be followed by more modest increases (or no increase at all), so individual years may not indicate the trend.
11. The pattern is thus one of uneven pay increases, both between institutions and between years. It is hard to discern any strategy for determining pay over a number of years. Many awards appear to be reactive, responding to perceptions of a “market”, increases at other institutions or public criticism.
12. In general, institutions have focused most attention on the pay of vice chancellors and principals. Increasingly, institutions are also actively reviewing pay for other senior staff, particularly those at ‘level 2’ (those reporting directly to the head of institution). However, there is a growing gap between these levels. Only one institution retains a formal link between its head of institution and the next tier of senior managers. All institutions expressed concern that allowing level 2 pay increases to keep pace would prove unaffordable in the long term. This widening differential raises issues about progression, relative responsibilities and morale, although this review did not address these.
13. There have been different approaches to setting salary levels for newly appointed heads of institution and other senior staff. Some institutions have felt the need to offer a “market rate”, which may be greater than the previous post holder’s pay. Others have taken the view that pay should reflect both past experience and achievement in post, so the initial salary is set at a lower level and then reviewed after a year or so. Such a review might itself involve a large increase and make direct comparisons less useful.

14. There is no simple correlation between the size of institution (as determined by income or the number of students, for example) or mission, and the level of remuneration. There need not be such a relationship, though there is still the question as to how pay is to be determined. Institutions themselves do not have a common or clear view about this.
15. Currently, there is a mix of fixed term and permanent contracts among heads of institution. One might expect heads on fixed term contracts to have higher pay to reflect the additional risk to them, but this is not obviously the case.

### **Pay rises and pay levels**

16. One of the most difficult issues to address is the distinction and relationship between pay *increases* (and occasionally decreases, especially where there is a change in post holder) and pay *levels*. Comparisons from one year to the next, based on published data, have focused the debate mainly on average and “exceptional” increases. This is understandable, particularly from the perspective of other staff in higher education. The underlying question, however, is: what is the appropriate *level* of pay? A large increase in one year may still leave a post holder with a relatively low level of pay.
17. Whether or not a particular level of pay is considered appropriate will depend on a set of judgements: for example, the extent to which a market is thought to exist, issues of equity, institutional values and assessments of worth in comparison with other sectors. It is unlikely there will be common views across the sector. There may even be disagreements within remuneration committees and governing bodies.
18. Institutions are mostly likely to experience market pressures when they recruit staff, but they may also set pay at “market” levels to retain or motivate valued employees. Pay can reward achievement in post, and so be an incentive for good performance, though for this to be credible there need to be rigorous and objective assessment processes. Few remuneration committees have actively debated the effect of large increases on the morale and motivation of other staff, though some might argue this is not their role.
19. Some governing bodies take the view that the pay levels for senior staff, and especially the head of institution (because these salaries are published in the national press), reflect the prestige of their institution. This is a much more questionable practice, given that so much funding comes from public sources. It also threatens to create a pay spiral.
20. Some of the discussion in remuneration committees focuses on relatively small pay differentials (say, less than 5%) between institutions. Attempts to maintain fine distinctions only intensify the upward pressure on the *general* level of pay.

### **Stewardship, affordability, and benefit to the institution**

21. All HEIs in Wales receive a significant proportion of their income from public sources, although the extent of reliance varies considerably. (In 2003-04, for example, HEFCW grants comprised between 18% and 65% of income, though of course there were other public funders.) In this review, remuneration committees showed a widespread concern to demonstrate proper stewardship for the use of public funds. It is open to debate, however, as to how this should be done. There can be a tension between stewardship and paying “market levels” of remuneration, where these levels are rising faster than income from public sources. The basis for making decisions needs to be made explicit.

22. It could be argued that institutions with significant private sources of income face less pressure to demonstrate stewardship to public stakeholders: that pay increases could be shown to be funded (at least in part) from those other sources. However, this ignores the effect of an institution's actions on the wider sector; and since all institutions receive large amounts of public funding, all governing bodies should be concerned about this.
23. To the extent that institutions link senior pay to individual performance, and include measures of institutional achievement (for example, student recruitment and financial surpluses), there will be some reference to affordability. Budgetary pressures in some years have led a few institutions not to review senior pay, and this seems appropriate. Nonetheless, there are not well developed definitions of what is affordable or the relationship to financial performance.
24. Another way of addressing this issue is to ask: what benefit does the institution get in return for above-average pay increases? In other words, good performance in the role may not be a sufficient justification. Other, less senior, staff who perform well generally get modest increases. How has the institution improved as a direct result of the individual's actions? By answering this question, governing bodies will more easily show proper stewardship of public funds and justify (if appropriate) pay awards at times of financial difficulty.

### **Market pressures**

25. All governing bodies and remuneration committees are concerned about market pressures. We might usefully ask: in what areas, and in what ways, does a market operate?
26. It is worth noting that there are different markets for different roles. Directors of finance, for example, often have highly transferable skills and can move easily between sectors as well as between institutions. Academics tend to stay within the HE sector, and so the market comprises HEIs, although recruitment from overseas is common. Most heads of institution come from within the sector.
27. To what extent is the HE market segmented? All institutions pay attention to national league tables comprising all UK HEIs, but all acknowledge fundamental differences between institutions in terms of size, mission, geographical location, and so on. However, in setting senior staff pay, and especially pay for the head of institution, there is some confusion as to whether the market is the whole sector or just a segment of it. This in part reflects the fact that many institutions have difficulty defining their comparators or peers. Small, specialist institutions are generally clearer about this, as are the very largest multi-faculty universities. Middle-sized institutions may place themselves in a group of institutions with the same academic profile or aspiration (for example, research-intensive, predominantly teaching or mixed economy), similar income range, or from the same part of the UK (for example, Wales and/or neighbouring English regions).
28. It is not always obvious why particular choices are made, or whether there has been adequate discussion about them. It is understandable if institutions do not wish to define themselves narrowly, but the lack of clarity and consistency about comparators may add to the risk of pay spiralling. The choice of "peers" tends to encourage pay rises as institutions rarely compare themselves with others that pay less.
29. It is worth asking if it is always necessary to pay an incumbent a notional "market rate". Remuneration committees may too readily assume a link between pay levels and personal motivation. There are always other factors influencing a person's performance and their desire to remain in post. Market pressures are most obviously felt when institutions find it difficult to recruit staff, but is it always appropriate to raise the level of pay? Other solutions might involve job redesign.

## Information and comparisons

30. All institutions attempt some form of benchmarking, even if the choice of comparators is not always clear or defensible. The most used sources of information are the annual UCEA surveys and CUC's data on heads of institutions' remuneration (the latter not being available to the whole sector). Institutions may informally share information with others, though this practice is not well developed, and there are issues about confidentiality under the Data Protection Act. Job advertisements are not an accurate guide, since even when salary levels are stated, final remuneration packages resulting from negotiation may be considerably higher.
31. Some remuneration committees have explicitly looked beyond HE to other sectors, such as FE, maintained schools, local government and other public sector organisations. Comparisons with the private sector are rarely undertaken and the results are not helpful because of the disparity in total pay and reward structures and the degree of risk inherent in the role. Sometimes institutions have used independent experts to provide a range of data, and this may ensure a more objective and systematic approach.
32. Even within the sector it is difficult to make direct comparisons. Quite apart from the incompleteness of data, it is generally out of date by the time of publication. Institutions setting salaries for 2005-06 in, say, July 2005, will only have access to UCEA data from September 2004 and the published accounts from 2003-04, though CUC members will also have access to the CUC survey of Vice Chancellors' remuneration data as at 1 January 2005. This difficulty may be obviated by sharing current data, but institutions do not always make awards to senior staff at the same point in the year, and many are backdated. There may not be consistent treatment of non-salary benefits, and institutions may not wish to take them into account.
33. If institutions are to benchmark salaries, it is in their interest to have current and detailed information. The sector could look at ways of doing this more comprehensively across the whole of the UK.
34. The foregoing discussion assumes, of course, that all 'heads of institution' roles (for example) are similar in terms of content and responsibility. This is evidently not the case, so institutions should be wary of simply looking at the headline remuneration figure for their peers. In the absence of a proper analysis of job content, which may be impossible, comparisons will be of limited value. All this suggests that institutions should not aim at a precise figure or a particular position in a "league table". These difficulties are even greater for level 2 posts, where there is little comparability even of job titles and descriptions between institutions, and where senior teams are comprised in very different ways.
35. Remuneration committees often consider rewarding staff for taking on additional responsibilities. This may be appropriate and defensible, although it can be difficult to do this objectively. Institutional growth – for example, through merger, acquisition or major development – does not necessarily increase the burden on senior staff.

## Performance

36. Performance assessment for senior staff does not appear to be highly developed. Some institutions are being encouraged to formalise processes, such as agreeing objectives and targets for the year ahead, and allowing the remuneration committee to consider the outcomes of performance reviews.

37. As senior staff pay awards tend to be higher than those of other categories of staff, it is important to find a rational basis for setting pay. Remuneration committees should attempt to distinguish the different elements of awards, such as:
- Cost of living increase
  - Changes in responsibilities
  - Performance
  - Benchmarking (for recruitment and retention issues).
38. Only one institution has defined a clear upper limit on performance-related pay. Rewards for “exceptional” performance should not be the norm for any individual or for all senior staff and should be able to go down as well as up. Non-consolidated bonuses might allow such flexibility.

### **The upward pressure on pay**

39. There is no evidence from the review that senior pay is uncontrollable and unaffordable. Nonetheless, all stakeholders in the sector should be concerned about the long term trend and its consequences. There is a need to balance competing demands: proper reward for high levels of responsibility and commitment; equity and wider staff morale; affordability and value for money; and public accountability.
40. This is an issue for the whole of the UK and not just Wales, and therefore the discussion should also take place in the wider context. Many Welsh institutions are acutely aware of the behaviour of English neighbours and competitors, and whilst there are certain characteristics of the Welsh job market (for example, the language requirement in some cases), in general there is a high degree of staff mobility. It is therefore appropriate for discussions to take place among UK-wide bodies such as Universities UK and the Committee of University Chairmen, as well as in Higher Education Wales.

### **Human resources strategy development**

41. Many institutions have a tactical rather than strategic approach to setting senior staff pay. This is indicated, for example, in the uneven pattern of pay increases from one year to the next, the widening gap in pay between levels 1 and 2, and the relative informality of performance assessment and its link with reward. This becomes less sustainable as institutions grow in size and complexity, and compete with each other for key staff.
42. HEFCW is working with the sector on the development of human resources management practice. Its priorities (recruitment and retention; staff training and development; equal opportunities; regular review of staffing needs; annual performance review for all staff; and action to tackle poor performance) are also relevant here. Institutions should ensure that their HR strategies, as they implement them, inform the work of the remuneration committees.

## GOVERNANCE ARRANGEMENTS

### Relationship between remuneration committees and governing bodies

43. All Welsh institutions have a committee (variously named) of the governing body that fulfils the function of a “remuneration committee”. There are considerable differences in the range of work that it covers. All deal with issues relating to senior staff pay, albeit with varying definitions of “senior staff”. (In most institutions very few staff earn more than £70,000, which is the HEFCW definition.) Almost all committees review and/or approve senior staff severances. Given the marked differences in the size and nature of institutions, it is not appropriate for there to be a single model for the whole sector.
44. Some remuneration committees have full delegated authority from the governing body and report their decisions. Others make recommendations that are considered by the governing body. Where there is full delegation, the key issue is whether the governing body has the opportunity to review past decisions and, if necessary, challenge the process by which decisions are made. It needs to retain oversight because of the possible impact on employee relations, as well as on external stakeholder confidence and the public reputation. These are highly sensitive issues, and not just for the individuals personally involved.
45. Governing bodies generally receive either full or abbreviated minutes from remuneration committees, which may or may not record specific decisions. Often the chair of the committee, who is frequently also chair of the governing body, will report orally on the committee’s activity. Reporting is to the full governing body or, in some cases, is presented as “reserved business”. There does not appear to be any compelling case for one particular approach, and institutions should continue to evolve practices that reflect their own circumstances and needs. However, around a half of institutions are being asked to find ways of making it easier for governing bodies to scrutinise remuneration committee decisions or recommendations. This is all the more important given changes in the way senior staff, and especially heads of institution, are being remunerated.
46. Governing body and external confidence in the work of remuneration committees (or their equivalent) can be enhanced by regular reviews of effectiveness, as recommended by the CUC Guide, and the committee making an annual report to the governing body on its activity. Whilst reviews of general governance arrangements are now common, a number of institutions are being asked to bring the work of the remuneration committee more explicitly within their scope.

### Operation of remuneration committees

47. In general there has been a marked improvement in governance arrangements for senior staff pay and severances through the period of the review (2002-03 through to 2004-05). The announcement of this review in May 2005 provided a further incentive for change. Institutions have updated and clarified terms of reference, strengthened committee membership (both numbers and experience), and meetings are now taking place more regularly and frequently. In the most recent year, 2004-05, remuneration committees in all institutions have met at least once, and in many cases more often. The frequency of meetings must be determined by the range of business covered and the size and complexity of the institution. Where there is considerable change – for example as a result of merger, restructuring or the implementation of new pay and appraisal structures – the committee may need to meet at shorter intervals. A related issue is the timing of meetings. These should take place to allow the timely consideration of performance review outcomes and the implementation of annual pay awards.
48. It is important for remuneration committees have adequate expertise to deal effectively with the issues that arise. This usually means ensuring that at least some members either have human resources and staff management experience. In only one instance is an institution being asked to strengthen the membership.

49. Committee papers and minutes are generally of a satisfactory standard, but all institutions should continually keep their content and quality under review. Decisions, particularly about pay, need to be based on reliable and relevant evidence, and papers should distinguish between the different elements of awards, as indicated in paragraph 37 above. It is important for committees to seek independent sources of information about comparative pay levels, and not seek or accept direct representations from the staff concerned. All committees, however, maintain strict rules about staff not participating in discussions about their pay. Given the limitations of information about salaries in the sector, as discussed above, it is particularly important for committees to record adequately, in the minutes and formal reports to the governing body, why they have reached particular decisions.
50. One area of common difficulty is defining a remuneration policy, both for staff overall and for senior staff. This cannot be fully delegated to the remuneration committee but should be considered by the governing body as a whole, because staff are the main determinant of institutional success, and staff costs are the largest single item of expenditure in all institutions. In relation to senior staff, the issues to be addressed in such a policy might include:
- What the remuneration policy is trying to achieve
  - The wider implications (in terms of affordability, employee relations, and so on)
  - Use of comparative information
  - Which posts are included
  - Link with performance reviews
  - Recruitment, retention and market rates
  - Succession planning.

## SENIOR STAFF SEVERANCES

### Application of HEFCW Guidance

51. HEFCW guidance on 'Severance payments to senior staff in higher education institutions' currently applies to all staff earning more than £70,000 (as set out in the 2004-05 accounts direction). This describes broad principles as well as specific requirements. In the period under review very few such "senior staff" received severance payments, and in all cases institutions applied appropriate processes and made reasonable decisions.
52. There is inevitably a tension between differing requirements: formality and flexibility, transparency and confidentiality. Senior staff severances are included in the terms of references of remuneration committees in all except one institution, and this one case is the subject of a recommendation.
53. A key issue is the demonstration of a financial case – that is, the "value for money" test. A proposed severance or early retirement should result in financial benefit to the institution. This could be expressed in various ways, such as the "payback period": the time it takes for salary and other savings to recover the cost of severance. Where institutions are uncertain as to whether a proposal represents proper stewardship for public funds, they should refer the matter to HEFCW.
54. Management often has to make fairly rapid decisions about severance or early retirement in individual cases, notwithstanding the need for long-term planning. It may therefore not be practicable in all cases to refer proposals to the remuneration committee. In principle this is not a problem, if managers follow the approved policy and report all decisions made. This will ensure accountability.
55. With the possibility of further, and perhaps more widespread, restructuring of higher education provision in Wales, it is important for all institutions to have clear severance policies in place. Such a policy should include the following elements:
  - Formal adoption of the HEFCW guidance
  - How to apply this guidance
  - Which staff are covered
  - Where severances are reviewed and approved
  - The scope for discretion in individual cases (and who may exercise this discretion)
  - Financial and management criteria to be applied
  - The value for money test
  - Legal and contractual constraints.

## ANNEX A

### TERMS OF REFERENCE

#### Objectives

1. The review will result in a report to the Chief Executive of the HEFCW which concludes on the extent to which present arrangements within the sector for the remuneration of heads of institutions and other senior staff whose remuneration is determined by the Remuneration Committee and the arrangements through which severance payments to senior post holders are determined comply with the principles established by the Committee on Standards in Public Life namely:
  - Selflessness;
  - Integrity;
  - Objectivity;
  - Accountability;
  - Openness;
  - Honesty; and
  - Leadership.
2. The report should clearly set out the findings from the review and should make recommendations for improvements where appropriate.

#### Scope of work to be carried out

3. The reviewer will need to conduct sufficient work to provide the conclusions and recommendations set out in paragraph 2. It is anticipated that the work will include the following key elements:
  - a) A review of the systems for setting the remuneration of heads of institutions and other senior staff, including:
    - i) Institution, terms of reference and operation of the Remuneration Committee.
    - ii) Performance management and target setting and the link to remuneration policies.
    - iii) The use of benchmarks and market comparators for determining salary levels, both in principle and in practice.
  - b) A review of the arrangements for determining severance payments to senior post holders.
4. For both aspects, the reviewer should also examine:
  - i) The appropriateness of institutions' policies and procedures in relation to such payments and the extent to which these comply with the attached HEFCW guidance and the extent of compliance in practice with those policies and procedures.
  - ii) The role of the governing body in approving such payments.
5. The review will involve visits to each of the 12 Higher Education institutions in Wales.

## HEFCW GUIDANCE IN RESPECT OF SEVERANCE PAYMENTS TO SENIOR STAFF IN HIGHER EDUCATION INSTITUTIONS

### Introduction

1. The Committee of Public Accounts published its 28th Report “Severance Payments to Senior Staff in the Publicly Funded Education Sector” on 14 June 1995. In their report the Committee said that they looked to the Funding Council to disseminate guidance on severance payments.
2. The Council conducted a survey of severance payments to senior staff in higher education, the preliminary findings of which were published in the National Audit Office Report *Severance Payments to Staff in the Publicly Funded Education Sector*. The Council’s conclusion from its survey is that the great majority of institutions have behaved responsibly in dealing with severance arrangements and that there is no case, therefore, for setting up a set of complex formal controls. Nevertheless, to address public concerns over severance arrangements and to ensure accountability, the Council believes that there is merit in codifying existing and emerging good practice. This is consistent with the Council’s role in promulgating guidance to institutions on good practice, and where public funds are involved, on issues of propriety and value for money.
3. This guidance considers the Council’s role in severance arrangements, the principles and policies that should underlie them, possible terms that might be included, and the reporting and auditing of such arrangements. Within this guidance, the word “must” indicates a requirement, “should” indicates best practice and “may” indicates a suggestion.

### The Council’s Role

4. The Funding Council aims to enable institutions to manage their own financial affairs while at the same time encouraging good managerial practice and safeguarding public funds. The Council recognises that institutions are independent bodies, responsible for setting the terms and conditions of employment for their staff, including severance payments. The Council’s scope for intervening in the decisions of institutions is limited but includes considering whether the arrangements made constitute a proper use of public funds and are such that they could have been taken by a reasonable person. If the Council concludes there has been a misuse of public funds it is prepared to use all the powers at its disposal to rectify the situation.

### Responsibilities of institutions

5. As independent bodies, institutions are responsible for setting the terms and conditions of employment for their staff, including severance payments. However, in exercising their discretion in these matters, institutions must act reasonably and their actions must be for purposes pertinent to their functions.
6. Institutions have a responsibility to use both private and public funds in a prudent way that achieves value for money.

7. Severance arrangements for senior staff are sensitive and sometimes difficult matters to discuss, negotiate and agree. However, throughout any negotiation those responsible must not only act in accordance with the law but should also bear in mind the principles established by the Committee on Standards in Public Life namely:
  - Selflessness;
  - Integrity;
  - Objectivity;
  - Accountability;
  - Openness;
  - Honesty; and
  - Leadership.
8. Institutions have a responsibility to use both public and private funds in a prudent way that achieves value for money. There must be a clear allocation of responsibility to named individuals and committees, proper reporting to governing bodies and openness and transparency in dealings with all stakeholders. Therefore, there needs to be a clear statement of policy on severance.

### **Terms of Contract**

9. Institutions should consider carefully what compensation commitments staff contracts would entail in the event of early termination, particularly for unsatisfactory performance. They should give particular regard to any benefits in kind such as residences, private health care or leased cars.
10. An effective way to avoid large payments is to shorten periods of notice and contract periods. All contracts, fixed-term or otherwise, should include periods of notice of less than one year. Contracts should contain the provision that notice can be given by the institution at any time for any reason which in the opinion of the institution makes the giving of such notice desirable. Institutions should consult their own legal advisers to ensure that their position is adequately protected in this respect. Institutions may need flexibility to cope with the competitive market within which they operate, particularly when considering fixed term contracts. For this reason, fixed-term contracts for new senior staff might need to provide for an initial term of 3 - 4 years, reducing thereafter.
11. The terms of an individual's contract must be the most decisive element in determining the severance arrangements. Institutions do have an obligation to fulfil in the event of early termination. However, the employee is also under an obligation to reduce or "mitigate" the amount of compensation required by finding a new source of earnings. An assumed amount of mitigation should be built into any negotiated compensation sum. Institutions should consider phasing compensation payments over a period and reducing or stopping them when the employee takes a new job. The shorter the notice or contract period, the less significant this issue becomes.

### **Termination**

12. The reasons for early termination of employment will vary considerably. At one extreme, an individual may have let the institution down badly in some way and the institution must avoid rewarding or being perceived as rewarding poor performance. At the other end of the spectrum, there may be no question of poor performance but the institution may have different needs, for example, after a merger or restructuring. Institutions are more likely to exercise their discretion so that settlements arising from restructuring, say, are more favourable than those (if any) arising from poor performance.

13. Criteria for good or failing performance may not always be easy to establish, but all institutions should have in place appraisal procedures documenting job performance and any other matters relevant to the individual as an employee, for example, codes of conduct for staff covering general standards of behaviour. Any such criteria or guidance, supplemented by any previously documented evidence, should be taken into account in negotiating compensation in relevant cases. The actual terms negotiated will need to take into account the reasons for termination, contractual terms, discounts that account for the benefit of contractual payments being made in a lump sum, and mitigation in respect of subsequent earnings likely to be obtained in other employment.
14. Some institutions use premature retirement as a specific management tool, in which case some form of incentive may be necessary. Institutions should evaluate the costs of such incentives against the benefits derived and ensure that a suitable balance is struck. In these circumstances institutions may hold the vacancy created by the premature retirement until the cost of the severance package has been recouped. However, in other instances, say restructuring, maintaining vacancies would not be appropriate. In any event, institutions should take advice to ensure the Inland Revenue do not assess the scheme as a retirement scheme, in which case the tax relief on the first £30,000 payable to an individual is not available. Institutions should also explore the possibility of re-deployment within the institution wherever this is possible.

### **Negotiating Terms**

15. In determining individual settlements institutions should take legal advice. Employment law is complex and constantly evolving and institutions should ensure that their advice is obtained from a fully competent source.
16. As a general rule of thumb, public funds should only be used to meet contractual obligations (including formally agreed severance schemes that are part of contractual terms and conditions) and in the exercise of discretion granted by a specific scheme to institutions, for example, pension enhancement within the limits set out in the relevant pension scheme rules. Exceptions need careful justification, usually by reference to value for money considerations. For example, if advised that it is likely to lose an industrial tribunal hearing, an institution may seek to avoid such a hearing by reasonably topping-up any contractual obligation by a realistic assessment of what such a tribunal would cost. The advice available to the Council is that institutions do not have the power to use public funds to make payments on the grounds of distress or hurt suffered as a result of the severance agreement, and there is also some doubt as to whether they have the power to give gratuities to any member of senior staff in recognition of the service they have rendered to their institution.
17. In principle it is open to institutions to supplement payments with the use of private funds. However, it is rarely easy to distinguish between private and public funding sources since these funds are usually merged and managed as one. If an institution wishes to make payments which might be open to challenge were they to be made with public funds, it should do so only where it can positively demonstrate that private funds have been used, for example, by applying funds from an unencumbered endowment fund, or from the reserves of a fully ring-fenced subsidiary company. In such cases, the institution will still have to have regard to the need to behave prudently and responsibly in their use of funds that are held on trust.

18. In agreeing individual cases of premature retirement the full governing body will usually not be the right body to give approval for specific settlements. Institutions should delegate such a task to their remuneration committee (or its equivalent) or to a specific Committee set up for that purpose. Such a delegation must be conducted within a specific remit with clear boundaries determined by the governing body. Institutions should ensure that the overall financial aspects of severance packages are reported to the relevant finance or resources committee. Governing bodies must also be given the appropriate formal reports on severance payments to enable them to carry out their responsibilities.
19. Remuneration committees or their equivalent should oversee severance arrangements. They should do so in the context of a policy that covers all severance packages. This policy should set out the general principles.
20. It is unlikely that precise formulae can be devised to cover all senior staff in all circumstances. Nevertheless, the policy should clearly set out the boundaries of delegated authority for the relevant individuals. For example, an institution might have a policy that severance should normally be based on the maximum of contractual obligations plus a set amount of enhancement of pension rights, plus out-placement counselling up to a fixed sum. Any settlements in excess of this would then need to be specifically approved by the remuneration committee.
21. Institutions may find it useful, especially in negotiated severance cases without internal precedent, to seek comparative information from other institutions within the sector. However, neither schemes nor individual packages should be made up of elements picked from a range of comparator bodies if the net effect is a significantly more generous package than would be available at any of the comparator bodies.
22. Institutions should avoid negotiating a settlement and then seeking to justify it retrospectively. Instead, the contractual obligations should be established, and any discretionary elements (together with any relevant limits established) and relevant criteria should be set out, before negotiations commence. A written record should be maintained at each stage of negotiations to ensure that the ultimate settlement can be readily audited.
23. Institutions have the discretion to provide compensation for contractual holiday entitlement not taken. However, they should ensure that they have leave records to support any such payment.
24. Institutions must only give realistic references to senior staff as part of a severance arrangement. Institutions should also avoid giving open-ended commitments in severance agreements, such as undertaking to protect an individual's reputation.
25. Institutions must not agree to confidentiality clauses within severance agreements except where it is necessary to protect commercially sensitive information. Commercially sensitive information does not include information on the details of the severance package itself, nor does it justify generalised clauses whereby individuals undertake not to make statements that may damage the reputation of an institution. There may, however, be exceptional cases not covered by commercial considerations, where it is in the public interest for a confidentiality clause to be included. In these circumstances the institution should consult with the Council's Chief Executive, acting in his capacity as Accounting Officer, prior to agreeing to such a clause.
26. Institutions should seek an indemnity to protect themselves from any demand for tax which might be brought against the institution arising out of the employee's default after the severance agreement coming into force.

27. Where institutions enter into severance agreements they should consider carefully any proposal to offer further work or consultancy to the individual. There are, of course, instances where this will be desirable. For example, individuals may be needed part-time to see through a cohort of students or may be engaged in a specific project that requires completion. Any subsequent re-employment of an individual should fully take into account all severance arrangements entered into and be on the basis that the individual is not better off than he or she would have been if the severance deal had not taken place.

### **Audit**

28. Internal auditors should include within their strategic audit plan provision to review the systems for the determination and payment of severance settlements.

29. Severance settlements for senior staff must be reviewed by the institutions' external auditors. Such a review will normally take place after settlements have been agreed and will require senior audit staff because of the complexity and sensitivity of the issues involved.

30. In the event that settlements do not materially conform to the guidance set out in this document, auditors should report the facts to the institution via their management letter. If the auditor becomes aware of a proposed settlement that does not materially conform with this guidance, the auditor should, in the first case, inform the management of the institution and, if the auditor judges it desirable, members of the governing body. The auditor should also recommend to the institution that it inform the Funding Council. Only in the event of the institution refusing to inform the Funding Council should the auditor report such a proposed settlement directly to the Funding Council.

## Annex B

### **Remuneration and severances for senior staff: A good practice checklist for governing bodies and remuneration committees**

#### **Introduction**

In July and August 2005 HEFCW commissioned a review of institutions' arrangements for senior staff remuneration and severance payments. This checklist presents the main issues that arose, in the form of self-assessment questions for governing bodies and remuneration committees, based on what appears to be "good practice" in the sector. It is not intended to be a comprehensive list of all matters of interest to them.

#### **Status of this guidance**

HEFCW has issued this checklist to assist the work of governing bodies and remuneration committees. It is not mandatory and does not represent a desired single model for the whole sector. Institutions should interpret this guidance according to their own circumstances and needs. HEFCW will not seek individual responses, but the checklist may form part of future reviews of institutional governance.

#### **Senior staff pay**

1. Is up-to-date and relevant (comparative) information used to guide discussions on pay?
2. Are the different elements of pay awards (such as cost of living increases, performance and benchmarking) clearly distinguished and justified?
3. Is each element of pay awards based on appropriate evidence?
4. Can – and does – the performance-related element decrease as well as increase?
5. Has the remuneration committee considered the use of non-consolidated bonuses to reward performance?
6. Is performance-related pay based on a comprehensive system of performance assessment?
7. Are pay awards justifiable in terms of what the institution can afford?
8. Are institutional comparators made explicit, and are they relevant?
9. Is the institution attempting to target or maintain a particular position in pay league tables, and is this prudent and necessary?
10. Has the remuneration committee considered the wider perception of pay awards to senior staff, and the possible effect on the motivation and morale of other staff?
11. Is the institution clear about the benefit it will get in return for above-average pay increases?
12. Has the institution considered solutions to staff recruitment, retention and motivation other than increasing pay?
13. Does internal audit consider arrangements for setting senior staff remuneration when drawing up its risk-based plans?

### **Senior staff severances**

14. Is there an approved policy for such severances and early retirements?
15. Does this reflect the latest guidance from HEFCW?
16. Is there an agreed “value for money” test?
17. Is this applied in each case?
18. Does the remuneration committee have the opportunity to approve or review such severances?
19. Are all severances and early retirements clearly in the institution’s interests?
20. Are all severances within legal and contractual limits?

### **Remuneration committees**

21. Are the terms of reference reviewed regularly, so as to meet the changing circumstances and needs of the institution?
22. Is the extent of delegation of authority from the governing body clear to all parties?
23. Among the committee’s members, is there adequate experience of staffing or employment matters?
24. Has the committee considered the use of independent advice?
25. Is the committee meeting frequently enough to cover to discharge its responsibilities?
26. Are meetings taking place at the right times – for example, to consider performance review outcomes and implement pay awards?
27. Do the minutes adequately record the decisions made and the basis for them?
28. Does the committee avoid seeking or allowing direct representations from individual members of staff about their own pay reviews?
29. Is the head of institution able to discuss his/her remuneration and terms of employment with the Chair of the governing body, and are such discussions conveyed to the committee for it to consider privately?
30. Does the manner of reporting to the governing body ensure that governors understand the decisions or recommendations and are able to challenge them?
31. Does the committee submit an annual report to the governing body on its activity?
32. Is there a regular review of the effectiveness of the committee, which includes feedback from its members and other governors?