

Agenda Item	12
Report No	HC/47/17

HIGHLAND COUNCIL

Committee: Highland Council

Date: 14th December 2017

Report Title: Budget Update

Report By: Depute Chief Executive/Director of Corporate Resources

1. Purpose/Executive Summary

- 1.1 On the 7th September Council received a report detailing the financial approach being taken to address the anticipated budget gap over the period 2018-23. This gap arises as a result of anticipated cost increases in our pay, pension and other costs at the same time as estimated annual reductions in the grant funding we receive from the Scottish Government.
- 1.2 Due to a number of uncertainties, particularly around the level of Scottish Government grant funding we will receive in future years, and the consequent assumptions we need to make we cannot say with any degree of certainty what the budget gap will be over the period. Instead, the budget gap has been estimated to be in the range of £129.7m to £186.9m.
- 1.3 The approach being taken to bridge that gap includes work in 5 key thematic areas:
- **Prioritisation**- completely stopping or reducing low priority services;
 - **Efficiency**- delivering the same outputs and outcomes, but at a reduced cost;
 - **Commercial**- Identifying new activities the Council could undertake to generate a profit that can support core Council services;
 - **Income**- increasing the overall level of income we generate from taxes, or from services we are already providing;
 - **Redesign**- fundamentally reviewing the way services are provided to increase income or reduce costs.
- 1.4 This report provides an update on the position since that report including any changes to the budget gap, other contextual information and the work underway to bridge the gap.

2. Recommendations

- 2.1 Members are asked to:
- i. Note there are no changes to the anticipated budget gap at this time
 - ii. Note the progress to date in tackling the budget gap

3. Budget gap

3.1 The September Council report proposed a flexible approach based on a number of key assumptions:

- Annual pay inflation of 1.5%. Other costs inflation at 1%
- Annual 0.5% increase in pension contribution rates
- A provision for general budget additions of £7.5m annually
- An annual increase of £2.5m in loans charges
- No change in the basic rate of Council Tax (although an increase in the tax base assumed)
- Scenarios of annual reductions of 2%, 3.5% and 5% in Scottish Government grant funding

3.2 Using those assumptions, and the scenario of a 3.5% reduction in Scottish Government funding, a budget gap of £159.2m is forecast, split as follows over the next 5 years. In the scenarios of a 2% and 5% reduction in Scottish Government funding the total estimated gap is £129.7m and £186.9m. The assumptions used are kept under regular review but at this stage there is not sufficient information available to suggest making any changes.

	2018/19	2019/20	2020/21	2021/22	2022/23	Total
Budget gap	£33.5m	£32.4m	£31.2m	£30.7m	£31.4m	£159.2m

3.3 When the findings of the Barclay Review of Business Rates were announced in August one particular item had the potential to cause a significant cost pressure for the Council. That item was the proposed end to charity relief for certain recipients, including Arms' Length External Organisations set up by Councils. This would have applied to HighLife Highland and would result in them paying an extra £1.8m in business rates annually.

3.4 Whilst the Scottish Government has committed to implementing the recommendations of the review and will confirm the full details along with their budget on the 14th December it was confirmed in late November that the recommendation in respect of charity relief for ALEOs will not be implemented. As such this specific cost pressure is not expected to arise.

3.5 It is not currently anticipated that the implementation of the review will cause any significant budget pressures to the Council as a rate-payer albeit that will need to be confirmed once the Scottish Government's budget is announced. A link to the Barclay Review report can be found in the background papers section of this report.

3.6 The Scottish Government has committed to an end to pay restraint in the public sector. Whilst the Scottish Government does not directly control salary increases payable by local government any changes made in other areas of the public sector would undoubtedly influence the local government pay settlement.

3.7 It is not expected that any Government funding be made available to fund the pay settlement and any agreement in excess of 1.5% would widen the forecast budget gap. Each additional 1% would add an estimated £3m to the Council's

total salary bill.

- 3.8 Work is currently underway to identify any budget additions required for the coming years. This will identify any:
- Undeliverable prior year savings
 - Existing cost pressures that cannot otherwise be managed
 - Additional costs as a result of legislative change
 - Contractual cost increases
 - New expenditure commitments from Council decisions
- 3.9 The Scottish Government will announce its draft budget on the 14th December. At that point we will be given an idea of the likely level of the change in our core funding albeit that may be subject to amendment up until the point at which the Government finalises its budget.
- 3.10 At present only a one year settlement is anticipated and as yet no indication has been given as to what any funding change will be. The level of reduction Highland Council is anticipating is around the average expected reduction by other local authorities.
- 3.11 As part of the agreed 2017/18 funding settlement a late amendment was made to the Scottish Government's budget, allocating £130m of revenue funds across local authorities. Highland's share of this funding was £6.173m. The Finance Secretary has refused to confirm whether this funding will be recurrent and built into the baseline funding settlement. Should it transpire that the funding is not recurrent and the reduction in our core funding is in line with expectations the forecast budget gap would increase.
- 3.12 As in previous years it is likely that the Council will be expected to deliver new policy commitments made by the Scottish Government, the most significant of which is around the delivery of increased early years provision. It is absolutely essential that any new initiatives are fully funded by new monies from Government or else the requirement on the Council to co-fund these initiatives would further widen the budget gap.

4. Current Year Position

- 4.1 The Council reported its second quarter monitoring for the current financial year, 2017/18, to Corporate Resources Committee in mid-November. At that point a year end overspend of £1.439m was forecast. Service directors have committed to take all necessary action to ensure a balanced budget is delivered by year end.
- 4.2 Within that overall reported position there are a number of over and underspends across the services, some of which are one off and some of which are recurring. In previous years relatively few changes have been made to budgets during the course of the year however this year a more proactive approach to budget management is being used.
- 4.3 As approved by Resources committee budget virements have been done to permanently move budget between certain areas of recurring over or underspend that were reported as part of the quarter 2 monitoring. Service directors have also been encouraged to action such an approach within their own service areas as a matter of course.

- 4.4 It is anticipated that this approach should help identify and reduce any areas that are sitting with more budget than is required to deliver the current level of service. Budgets will only be transferred to an area where all management actions to contain budget pressures have been exhausted but a pressure still remains.
- 4.5 For 2017/18 the Council has committed to providing NHS Highland the same level of budget as 2016/17 for the provision of adult social care services, albeit £1.174m of this sum has been funded as a one off from the Council's balances. Along with the funding received from the Council, NHS Highland also received £4.34m direct from the Scottish Government. This was funded as part of the health funding settlement, primarily to address cost pressures arising from the introduction of the living wage for adult social care.
- 4.6 NHS Highland are facing significant cost challenges in the current year with many services seeing demand growth since integration in 2012. Further growth in demand would see a significant risk in the ability to sustain services at their current levels. NHS Highland's participation is an essential part of the 2018-23 financial approach with a balanced approach required between the identification of budget savings and areas of budget pressure that may require additional funding.
- 4.7 Any areas of recurring budget pressure within the Council's overall budget that cannot be contained by management action will need to be addressed as part of the 2018-23 budget process. A potential source of funding for such items would be the annual £7.5m figure assumed for budget additions. Should budget pressures be contained by management action the funding identified for budget additions may be able to be reduced, thereby narrowing the budget gap.

5. Capital Programme Review

- 5.1 As highlighted in section 3.1 the forecast budget gap assumes an additional £2.5m being contributed into the loans charges budget every year. Work is currently underway to review the current capital programme and understand what the implications of any changes to that programme on the revenue loans charge budget would be.
- 5.2 The exact loans charge implications would depend on the nature of capital spend in any given year and the anticipated life of assets constructed, over which the principal element of the borrowing would be written off. Initial modelling has suggested that a 10 year capital programme with a total cost of £550m would mean no new funding would need to be added to the loans charges budget.
- 5.3 As part of the review of the programme a number of significant pressures requiring capital investment have been identified, from the capacity, condition and suitability of our schools, to the general fabric and condition of all our buildings, the state of our roads and bridges, and a requirement to upgrade our ICT infrastructure.
- 5.4 Whilst no decisions have yet been reached on the actual projects to be taken forward it is becoming increasingly apparent that the magnitude of those

pressures would mean that a 10 year capital programme of £550m would not address all of the most significant issues that need to be dealt with.

- 5.5 Any increase in the loans charge budget would contribute to the revenue budget gap and require savings or additional income to be generated elsewhere. Due to the intrinsic link between capital investment and the revenue budget it is intended that the 2018-19 budget decisions made in February will encompass both capital and revenue items.
- 5.6 When loans charges are expressed as a proportion of the net revenue budget the Council already has one of the very highest percentages in Scotland at just under 10%. Should the net budget decrease as is anticipated and loans charges increase that percentage would increase further. On that basis there is a strong professional view that increasing capital expenditure above a 10 year limit of £550m is not affordable or sustainable in the current financial climate.
- 5.7 The Council will continue to try to spend its capital budget in the most efficient way possible and look at how it specifies and procures projects in order to deliver best value. That said the challenge of balancing capital expenditure against making revenue savings to ensure the overall affordability of any programme will require members to make some very difficult decisions to ensure the overall financial sustainability of the Council.

6. Budget theme working groups

- 6.1 Officer working groups have been established around the budget themes with each theme being led by a service director. Each group has representation from every service and any relevant experts from elsewhere in the organisation. Each group also has a member from the administration's budget team. The Redesign Board continues to be the focus for activity on the Redesign theme.
- 6.2 All groups are now in a regular cycle of meetings and are identifying ideas for savings which can be developed into formal proposals. At this stage in the process it is not appropriate to go into the detail of the ideas under discussion but it is apparent that increases in existing charges or the introduction of new ones, or cessation or reduction of certain services will be the main areas for closing the gap in at least the first of the five years under consideration.
- 6.3 All working groups are experiencing challenges in identifying savings from a significant proportion of the Council's budget which is, for one reason or another, deemed 'protected'. This issue is also highlighted in the COSLA report summarised in section 7. Areas where there is limited or no scope to reduce budgets include:
- Teachers' salaries (budget £121m)- Scottish Government requirement to maintain pupil:teacher ratio;
 - Adult social care (budget £90.8m)- Scottish Government cap on local authorities' budget reduction in this area;
 - Key contractual commitments- PPP and NPD (budget £27m)- very limited scope to make savings on these longstanding commitments
 - Loans charges (budget £56.7m)- limited scope to make savings around the repayment of outstanding debt.
 - Direct ring-fencing of budget by Government- Attainment Fund,

Criminal Justice, Gaelic (budget £7.7m)

- Council Tax- Government cap of 3% on maximum allowable increase

There are many other areas where the requirement on the Council to meet specific legislative requirements means limited scope for savings is available.

6.4 The Council's desire to become more commercial is gathering momentum through the now established Commercial Board and the budget working group focused on that theme. It is already apparent however that the commercial opportunities that have the most potential to make a substantial impact on the budget gap will likely require start up investment, take a considerable time to deliver, or both. As such the weighting of proposals to this theme will likely come in the later years of the period under consideration.

6.5 Work will have to continue apace over the coming weeks to ensure sufficient proposals are developed to meet the budget gap. It is a legal requirement to set a balanced budget for financial year 2018/19 by the 11th March 2018 and the intention is to approve as many proposals as possible for the years beyond that.

6.6 Any proposals that are brought forward will inevitably have an impact on the Council's staff. The Council's Corporate Workforce Planning Strategy, as approved by Corporate Resources Committee in August, will be the key mechanism for considering and managing that impact.

7 Staff and Manager Engagement

7.1 Staff have been briefed about the aforementioned budget gap and the Council's financial approach. This has happened through face to face briefings for all managers (taking place in late September) and for staff working across localities (taking place in 14 locations from 30th October to 1st December). In total around 700 staff have been briefed and they have been asked for ideas for budget savings.

7.2 Nearly 200 ideas have been generated and these are being considered in the relevant theme groups. In most sessions a Trade Union representative and a member from the Redesign Board participated. Engagement with Trade Unions also continues through the Staff Partnership Forum as well as through their participation in the Redesign Board.

7.3 Wider communication on the budget position and redesign is being considered at the Redesign Board workshop on 5th December 2017. This will include communication with the general public, partners and business. The progress of the Redesign Board is reported separately to the Council.

8. 'Fair Funding for Essential Services'

8.1 On the 16th November COSLA launched a 10-page factual document entitled "Fair Funding for Essential Services" laying out the case for a fair financial settlement for local government. A copy is provided at **Appendix 1**.

8.2 This document sets out the importance of local government in the everyday lives of our citizens as well as some key contextual information about local government funding over recent years.

- 8.3 A number of the key statistics included in the document are detailed below:
- Just to stand still on current services, local government would need a revenue increase of £545m (5.7%) arising from inflation and demand;
 - Between 2010-11 and 2017-18 overall funding for local government has gone down 8% in real terms;
 - Funding for core services has further reduced as resources have been redirected towards Scottish Government led policies such as the extension of early learning and childcare, free school meals and Scottish Welfare Fund;
 - Due to recent Scottish Government budget decisions, 58% of councils' budgets cannot be reduced. That means all of the cuts have to be absorbed by the rest of the budget;

- 8.4 Page 6 of the document outlines what local government needs from the 2018-19 budget including:
- Proper investment in the local government workforce;
 - Additional investment in Health and Social Care in recognition of the rising demand;
 - Increased capital funding to invest in and attract growth;
 - Removal of the 3% cap on Council Tax;
 - Power to introduce discretionary taxation;
 - Multi-year budgets and the removal of ring-fencing and central direction through input targets;
 - Full and transparent funding for new central government initiatives.

- 8.5 Finally, the document summaries the longer term challenges facing public sector budgets:
- 'We cannot keep going on like this, storing up problems for the future. Over the long term, linking in with the overall Scottish budget process, we need a fundamental review of Scottish priorities and how services are funded, ultimately with a view of improving outcomes.'*

9. Local Government in Scotland- Financial Overview 2016/17

- 9.1 On the 28th November Audit Scotland published this financial overview report for local government. A copy of the report can be seen at **Appendix 2**. The report provides a high-level independent analysis of the financial performance of councils during, and their financial position at the end of, 2016/17. It also looks ahead and comments on the financial outlook for councils.

- 9.2 The 'key messages' can be seen on page 7 of the report and are summarised below:
- Councils' financial challenges continue to grow. Funding reductions are compounded by increasing costs and demands on services.
 - Councils are showing signs of increasing financial stress. They are finding it increasingly difficult to identify and deliver savings and more have drawn on reserves than in previous years to fund change programmes and routine service delivery.
 - Councils' debt levels are not currently problematic, but some are becoming concerned about affordability of costs associated with debt within future budgets.
 - Councils' expenditure and use of reserves often differed noticeably from that originally planned, indicating the need for budget-setting to become

more robust and reliable.

- The financial outlook for councils continues to be challenging, with the need to deliver savings being increasingly critical to their financial sustainability. As such, robust medium-term financial strategies and effective leadership to deliver them are of increasing importance.

9.3 Part 3 (pages 33 to 41) of the report comprehensively covers the financial outlook and members are encouraged to review this part of the report. The headlines from this part of the report are summarised below:

- Council funding continues to fall as cost pressures increase.
- Delivering savings is critical for councils' financial sustainability.
- Longer term affordability of capital programmes should be kept under review.
- Effective leadership is increasingly important in maintaining financial sustainability.
- Addressing the underlying demand for services through transformation is key to longer-term sustainability

9.4 Whilst the report highlights a significant number of facts and issues facing local government it does not make any specific recommendations in how councils should close their budget gap. It is apparent that Highland is not alone in the scale of the financial challenge that lies ahead with the challenge in all councils that *'...councillors need to make difficult choices and take decisions that may not sit neatly with the manifestos they were elected on in May 2017.'*

10. Next steps

10.1 The Council intends to set its budget for 2018/19 at the Council meeting on the 15th February 2018. As detailed in section 5.5 of this report that budget will include both capital and revenue items given the intrinsic links between the two. The revenue implication of any capital investment, whether increased running costs or the cost of financing any investment, will need to be factored in to any consideration of the Council's revenue budget.

10.2 In advance of that meeting members will be afforded the opportunity of briefings on the budget as the administration's firm proposals are determined. The relevant officers will be on hand to illustrate the service implications of any decisions taken.

10.3 All savings proposed will be assessed for their community and equality impacts. Given the size of the budget gap it is anticipated that a large proportion of the savings proposed will result in changes to service provision and therefore impact on service users.

10.4 As in previous years opposition political groups will be able to propose alternative budget proposals should they so wish. Any group wishing to put forward an alternative budget proposal is requested to submit these to the Director of Corporate Resources by 5pm on the 12th February to allow officers sufficient time to assess the competence and deliverability of any savings proposed.

11. Implications

- 11.1 Resource – Wider resource implications are as outlined in the report. The approach will require substantial input from officers across the organisation to identify, plan and deliver savings.
- 11.2 There are no specific Legal, Community (Equality, Poverty and Rural), Climate Change/Carbon Clever or Gaelic implications at this stage. Any proposals that are developed to address the budget gap may well have implications of this nature.
- 11.3 Risk – The budget gap figure of £159.2m is based upon a number of assumptions. Any changes in those assumptions may have a significant effect on that gap. The approach being taken is intended to be flexible to be able to absorb changes to those assumptions.

Designation: Depute Chief Executive/Director of Corporate Resources

Date: 4th December 2017

Author: Edward Foster, Head of Corporate Finance

Background Papers:

https://www.highland.gov.uk/download/meetings/id/72436/item_14_financial_approach_2018-2023

https://www.highland.gov.uk/download/meetings/id/72757/item_6_corporate_revenue_monitoring_report_to_30_september_2017

<http://www.cosla.gov.uk/sites/default/files/private/coslaspendingreviewbriefing.pdf>

[Barclay Review of business rates: http://www.gov.scot/Publications/2017/08/3435/0](http://www.gov.scot/Publications/2017/08/3435/0)

[http://www.audit-](http://www.audit-scotland.gov.uk/uploads/docs/report/2017/nr_171128_local_government_finance.pdf)

[scotland.gov.uk/uploads/docs/report/2017/nr_171128_local_government_finance.pdf](http://www.audit-scotland.gov.uk/uploads/docs/report/2017/nr_171128_local_government_finance.pdf)

Fair Funding for Essential Services

We all need local government



Local Government is Essential

Local government is democratically elected and provides a breadth of essential services to Scotland's communities which:

- support and protect all in our society;
- tackle inequalities;
- promote a fairer Scotland through inclusive growth.

Local government creates opportunities for every citizen which strengthens communities.

Local government is a key economic driver:

- Employing 10% of Scotland's workforce
- Procuring £6.3bn of goods

How is this done?



£9,640m

2017/18 Revenue
Funding from Scottish
Government



£2,075m

2017/18 Council
Tax from Citizens



£787m

2017/18 Infrastructure
(Capital) Funding



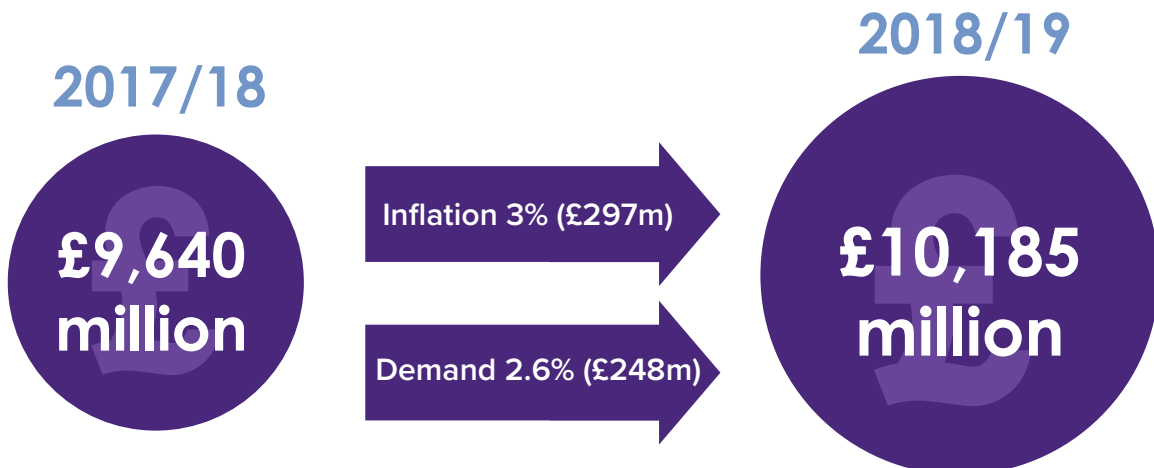
244,300

Employees

In the 2018-19 budget there must be a fair settlement for local government.

What local government needs in 2018/19

Just to stand still on current services, local government would need a **revenue increase of £545m, 5.7%** arising from inflation and demand.



Story So Far...

Recent settlements have been very challenging. The Accounts Commission said in their Local Government in Scotland Performance and Challenge 2017 report:

“Councils have faced significant challenges from a long-term decline in revenue funding and from an ageing population. The scale of these challenges continues to grow. Policy and Legislative changes are also placing additional demands on councils and changing how councils work.”

In 2012, COSLA undertook a significant piece of work recognising the demographic and inflationary pressures, and called for a review of policy. This did not happen.

Overall funding has gone down

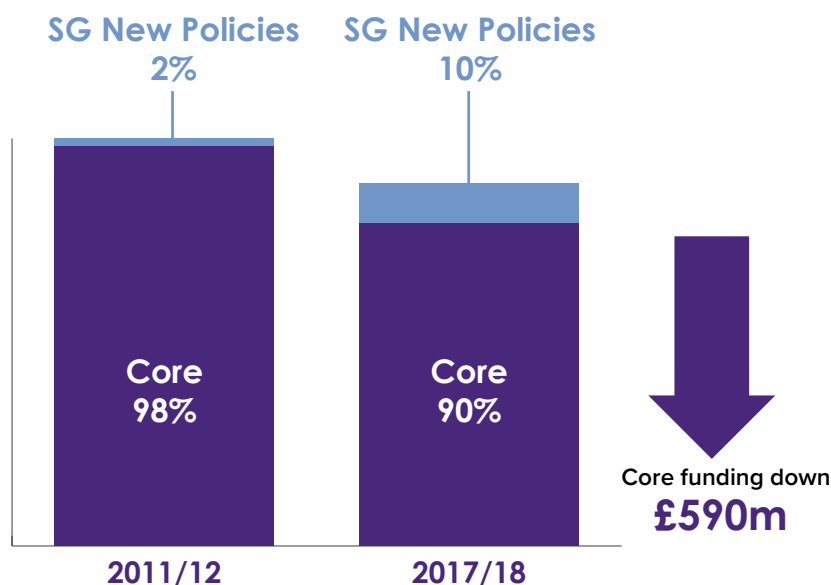
Between 2010-11 and 2017-18:



Source: SPICe Briefing = Local Government Finance: facts and figures 2010-11 to 2017-18

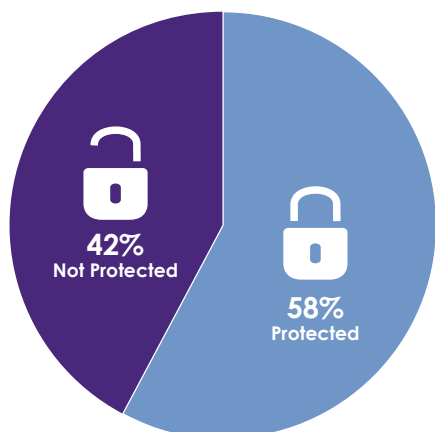
Changes to core budget

The above shows the global picture for local government, but the reality has been a significant downward shift in funding for core services, with new additional resources being directed towards Scottish Government-led policies such as the extension of early learning and childcare, free school meals and Scottish Welfare Fund. These are valuable policies but undoubtedly create challenges for the rest of the budget.



Structure of budget

Due to recent Scottish Government budget decisions, 58% of councils' budgets cannot be reduced. That means all of the cuts have to be absorbed by the rest of the budget.



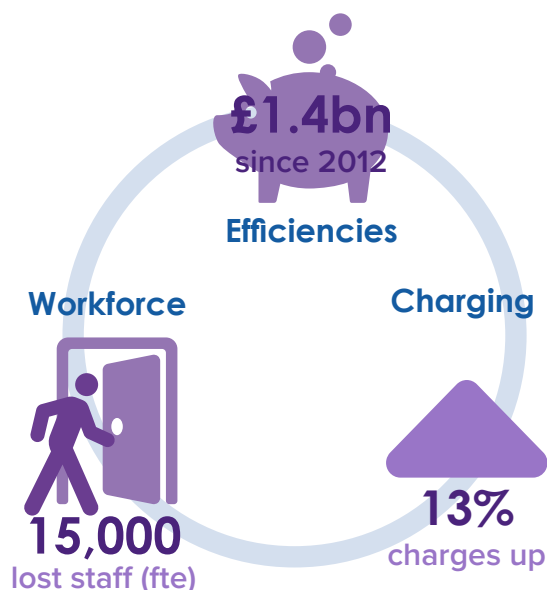
Result: 8% reduction in overall resources can only be absorbed by 42% of budget = 20% cut in those services only

However, that is only part of the story. Inflation and demand growth need to also be absorbed into the reduced part of the budget. The result is that vital services such as economic development, employability, public protection and regulatory services, and early intervention initiatives for tackling inequalities are being cut to absorb the funding shortfalls. Cuts are hitting the most vulnerable which is creating further inequalities.

Having so much of local government's budget protected through Scottish Government policy priorities prevents local government responding to local need.

Managing the cuts

Local Government has risen to the challenge but cannot continue to do so — there is no more room for manoeuvre.



Efficiencies

- £1.4bn of efficiency savings made since 2012
- Includes collaboration and streamlining of services, smarter procurement and asset management

Workforce

- 15,000 FTE staff (30,000 people) lost over the last five years
- Pay erosion

Increased Charging

- On the whole charges have increased by 13% between 2010-11 and 2015-16
- Local authorities can't price citizens out of services that deliver social inclusion, health and well-being, early intervention and prevention, when setting charges. For example, when setting charges for access to leisure and cultural facilities.

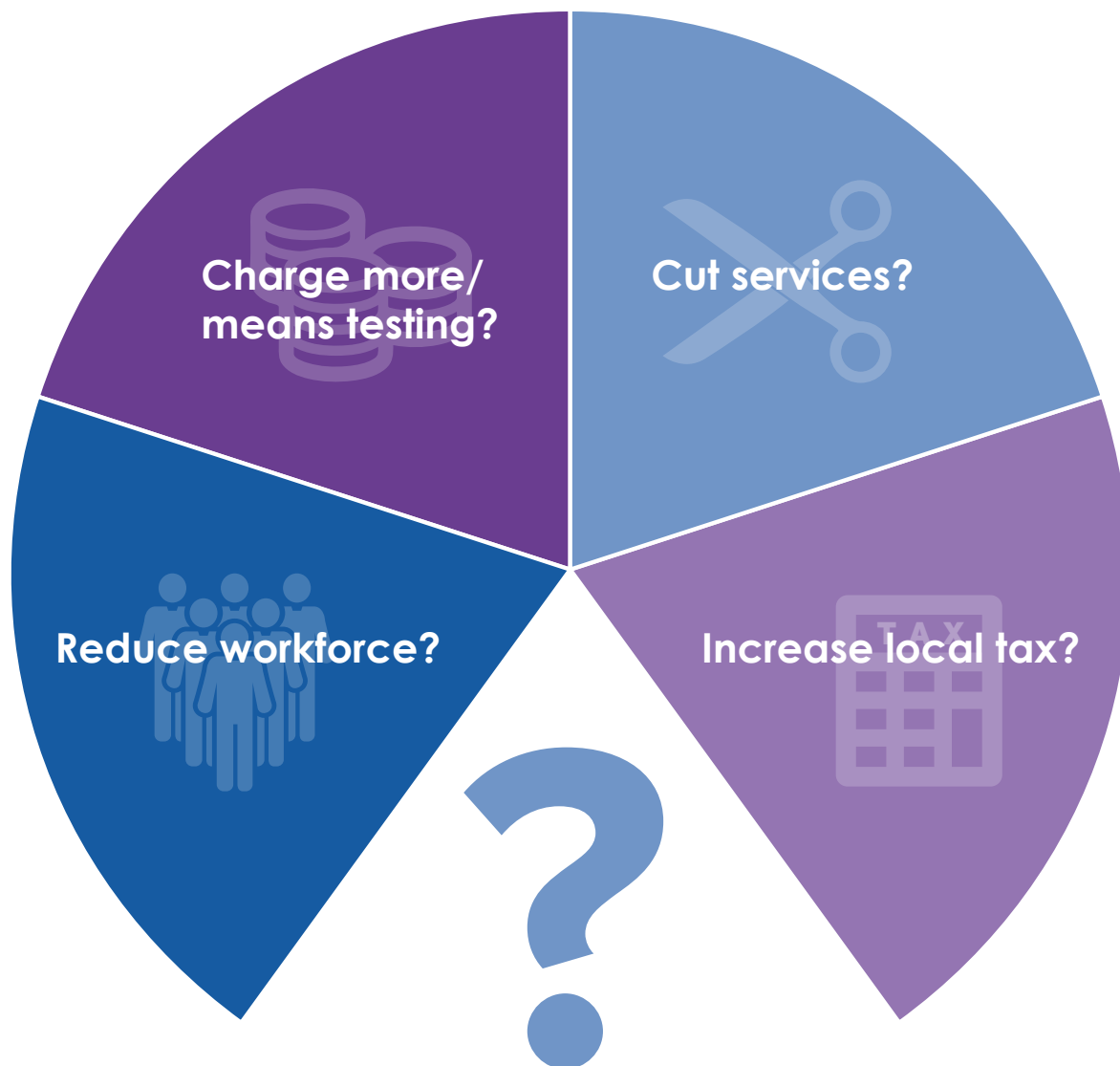
The Improvement Service, in their recent National Benchmarking Overview report, recognised this landscape.

"The absorption of major cuts while improving performance is an impressive achievement and there is a danger it is taken for granted: an assumption that, because savings have been made without a crisis of performance, savings can be continuously required and made. In reality, the trends required an overall reduction in the workforce, staff accepting year-on-year real reductions in wages, and substantial improvements in efficiency, productivity and innovation. If similar savings were necessary again across the next five years, severe issues of capacity, resilience and maintaining performance will need addressed."

So What Happens Next?

If local government continues to face the same level of grant reduction, there are extremely difficult choices ahead. The consequences and opportunity costs of this must be fully understood.

Responding to this, a number of Councils are already out to budget consultation, highlighting the magnitude and scale of the budget gaps. Councils are having to make hard choices, including:



The other question is, can we continue to do it the way we are doing now without a more fundamental review of how we deliver services? Overall, this current model is not sustainable and we cannot continue to operate from one year budgets, storing up problems for the future.

What is Needed from the 2018/19 Budget

We recognise that tough choices will need to be made across the Scottish budget but we cannot underplay the needs of local government to deliver essential services that are vital to our communities.

Local government therefore needs:

Revenue Settlement

1. **No more cuts - parity with cash increase for Scottish Government**
2. **Full baselining of £130m funding from the 2016-17 budget agreement**
3. **Allow for proper investment in the local government workforce**
 - Every 1% on local government paybill costs £70m
 - Every 10p increase in living wage for adult social care providers costs £10m.
4. **Additional investment in Health and Social Care in recognition of the rising demand.**

Structure of Settlement

1. **Multi-year budgets**
2. **Create flexibility to help deal with pressures.**

We cannot continue with 58% of the budget being nationally ring-fenced. We need true removal of ring-fencing and central direction through input targets

Capital

1. **Increased capital funding to invest in and attract growth**
2. **Return of reprofiled capital funding**

Local Taxation

1. **Removal of the 3% cap on Council Tax**
2. **Proper reform of local taxation**
3. **Power to introduce discretionary taxation**

Funding for Government Policies

1. **Full and transparent funding for new central government initiatives. Specifically:**
 - Expansion of early learning and childcare
 - Living wage for adult health and social care workers
 - Carers Act
2. **If charitable status of ALEOs is withdrawn, then the £45m shortfall in delivery of these services needs to be met.**

Longer Term

We cannot keep going on like this, storing up problems for the future. Over the long term, linking in with the overall Scottish budget process, we need a fundamental review of Scottish priorities and how services are funded, ultimately with a view of improving outcomes.

Our Essential Services

Protection Services



Children's Services

Councils protect the most vulnerable in society. In 2015-16, 15,300 children were 'looked after' or on the child protection register. This number is **reducing** and it is essential that early intervention investment continues to further drive this number down.

2017



2039

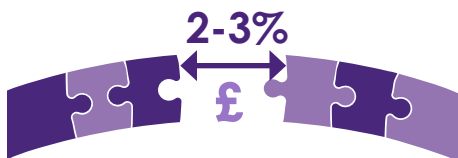


Adult Social Care

Adult social work services support and protect vulnerable adults, allowing them to live independent lives and ensuring they have access to the services they need. This area is under significant year on year budgetary pressure, as needs become more complex. The number of people 75+ is expected to double by 2039.

Spending on care for older people has grown in 6% real terms since 2010/11 but not at a pace to keep up with demographic change (another 2-3% needed).

Councils also support those with mental health issues. Healthy lives are as much about mental health as they are about physical wellbeing.



Support for Carers

Councils provide vital support to adult and young carers, helping them to manage their caring role.



-50%



-70%



-83%

Youth Justice

By intervening early, Councils have seen offending by young people halved since 2008, with a 70 per cent reduction in the number of under 18s in custody and an 83 per cent reduction in children referred to Children's Hearings System on offence grounds. This has resulted in a significant saving out with local government to the courts system.



50% funded by Councils

Providing Affordable Housing and Tackling Homelessness

Councils are playing a vital role in the delivery of 50,000 new affordable homes by contributing half the cost of meeting their commitment to this target. Alongside building new homes, Councils are ensuring their existing stock is not only maintained but also meets the highest standards for energy efficiency.

Councils have a vital role in using their duties to tackle homelessness and reducing the number of rough sleepers. Providing debt advice; intervening in cases of domestic abuse; benefit help; and help in managing rent arrears all contribute to this aim.



£241m



total debt



financial gain

Welfare Advice and Support

Helping deal with debt and the consequences of debt is an important aspect of Councils' work. The total combined debt of all clients who sought advice in 2015-16 was around £241m. The verified client financial gain accruing to users, as a result of intervention by money advice services funded by local authorities across Scotland in 2015-16, was around £55m.



Human Rights

Local authorities have been integral to the development and delivery of a distinctive Scottish approach to the integration of refugees and asylum seekers in Scotland. All councils have provided excellent leadership in the resettlement of Syrian refugees to Scotland and by the end of 2017 more than 2,000 people will have arrived.

Councils also play a key role in detecting and protecting those affected by human trafficking.

Regulatory Services

Local government provides a wide range of key regulatory services which protect the public. From ensuring food safety in restaurants and eateries, as well as trading standards enforcement to protect against illicit trade, scams and doorstep crime. Planning, building standards and environmental protection are key services which only too recently have been highlighted as vital areas for protecting the public.



Trading Standards and Environmental Health (Includes Building Control)

These services are under significant threat due to cost pressures which have seen budgets reduce significantly. For Trading Standards and Environmental Health Services there has been a sharp decline in the workforce with 20% and 23% reductions in these areas respectively. Both workforces have an ageing demographic and very few new entrants. If this trend continues across the next five years there would be only 350 Environmental health officers and 101 Trading Standards officers in the whole of Scotland. Given the potential of substantial regulatory change, post Brexit, and sharply increased demand from SME's for regulatory advice and support, there is a risk that Scotland is very poorly placed to respond.



Waste Management and Energy Efficiency

Councils are contributing significantly to protecting the environment through reducing waste, encouraging recycling, improving energy efficiency and tackling fuel poverty. The environment impacts on all parts of communities but can impact more on less advantaged parts. Initiatives to tackle issues such as fly tipping, littering and promoting greener neighbourhoods can reduce anti-social behaviour and foster greater community spirit.



Due to budget pressures, there has been a significant reduction in spend in environmental services, with a 25% reduction in street cleansing. This has been accompanied by a reduction in public satisfaction rates for refuse collection and street cleaning.

Healthy Lives and Social Inclusion



Councils play an integral role in promoting healthy lives across communities and providing access for all to services which can improve their health and well-being. This includes providing sport facilities, leisure centres, libraries, museums and parks, as well as organising or promoting cultural activities. These services form the fabric of communities and are geared to ensure that those who have least access and are least financially advantaged can use the services. The cultural and social benefits of these services also encourage people come into and participate in their communities and are very often tourist attractions in their own rights, thus helping to grow inclusive local economies.

+16.8%



+29.8%



+36.6%



There have been substantial increases in visitor numbers for sports (16.8%), libraries (29.8%), and museums (36.6%) against a backdrop of a reduction of 12% reduction in net expenditure. However, against this strain, public satisfaction rates for all culture and leisure facilities have fallen in the last 12 months.

Inclusive Growth and Economic Contribution



Education

A key contributor to economic growth is ensuring all our children are properly educated and reach their full potential and individual aspirations. Councils spend £5 billion a year on educating children (age 2 to 18), with educational services covering early years as well as school-based and community education. Educational outcomes are a strong predictor of inclusive growth and Scottish Councils are committed to improving these outcomes.



Expansion of early years is a key priority for the Scottish Government, and local government is very supportive of the expansions. However, we are clear that it must be fully resourced, and be truly additional to the current local government settlement, to ensure it is not at the expense of other vital services. We therefore welcome the Scottish Government's commitment to do this.



10%
workforce

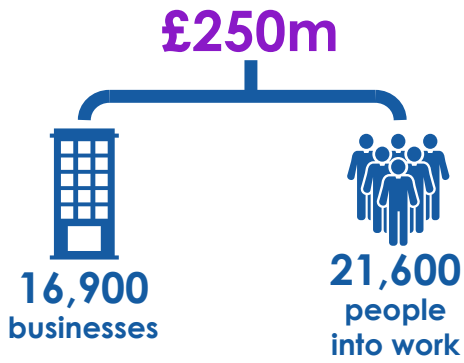


£6.3bn
procurement

Economic Growth

Councils make a significant and essential contribution towards inclusive economic growth both locally and nationally. Local authorities are major employers and combined directly employ 244,300 people or around 10% of the national workforce. Financial pressures have meant downsizing of workforces across all local authorities.

Councils also contribute to local and national businesses through procurement. Each year councils spend around £6.3 billion on procurement generating significant value and demand for the economy.



Councils invest more than a quarter of a billion pounds a year in promoting economic growth and providing direct support for business. In 2015/16 councils supported around 16,900 businesses and supported 21,600 unemployed people into jobs within their local communities. Critically in supporting economic growth, Councils are equally investing in employment and skills, through modern and craft apprenticeships and probationary teachers, to help equip young people to enter the marketplace. Council services themselves also generate economic benefit.



Roads and Infrastructure

Despite financial pressures Councils are continuing to maintain roads at a stable level and are providing a wide range of infrastructure to support and sustain communities such as schools, libraries and community centres.



Digital Connectivity is an important area in which Councils are playing their part, particularly in rural areas. Councils recognise that ensuring good digital access throughout the country will ensure communities can prosper. This includes providing greater digital access to Councils' own services.



Transport

Transport is a major driver for the economy and a lifeline for many people, including those who must travel to access work, education, health care or other amenities. Transport can help people live better, healthier and richer lives. Transport has an important part to play connecting different aspects of people's lives.

For transport policy to be nimble and responsive to the needs of communities, there must be a close and direct connection to the local democratic process. Tying transport policy to the needs of communities up and down Scotland will benefit the whole country. However, local transport services are under significant pressure and have already been reduced. A further reduction will hit communities again.

Local government in Scotland

Financial overview 2016/17



ACCOUNTS COMMISSION 

Prepared by Audit Scotland
November 2017




The Accounts Commission

The Accounts Commission is the public spending watchdog for local government. We hold councils in Scotland to account and help them improve. We operate impartially and independently of councils and of the Scottish Government, and we meet and report in public.

We expect councils to achieve the highest standards of governance and financial stewardship, and value for money in how they use their resources and provide their services.

Our work includes:

- securing and acting upon the external audit of Scotland's councils and various joint boards and committees
- assessing the performance of councils in relation to Best Value and community planning
- carrying out national performance audits to help councils improve their services
- requiring councils to publish information to help the public assess their performance.

You can find out more about the work of the Accounts Commission on our website: www.audit-scotland.gov.uk/about-us/accounts-commission 

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.

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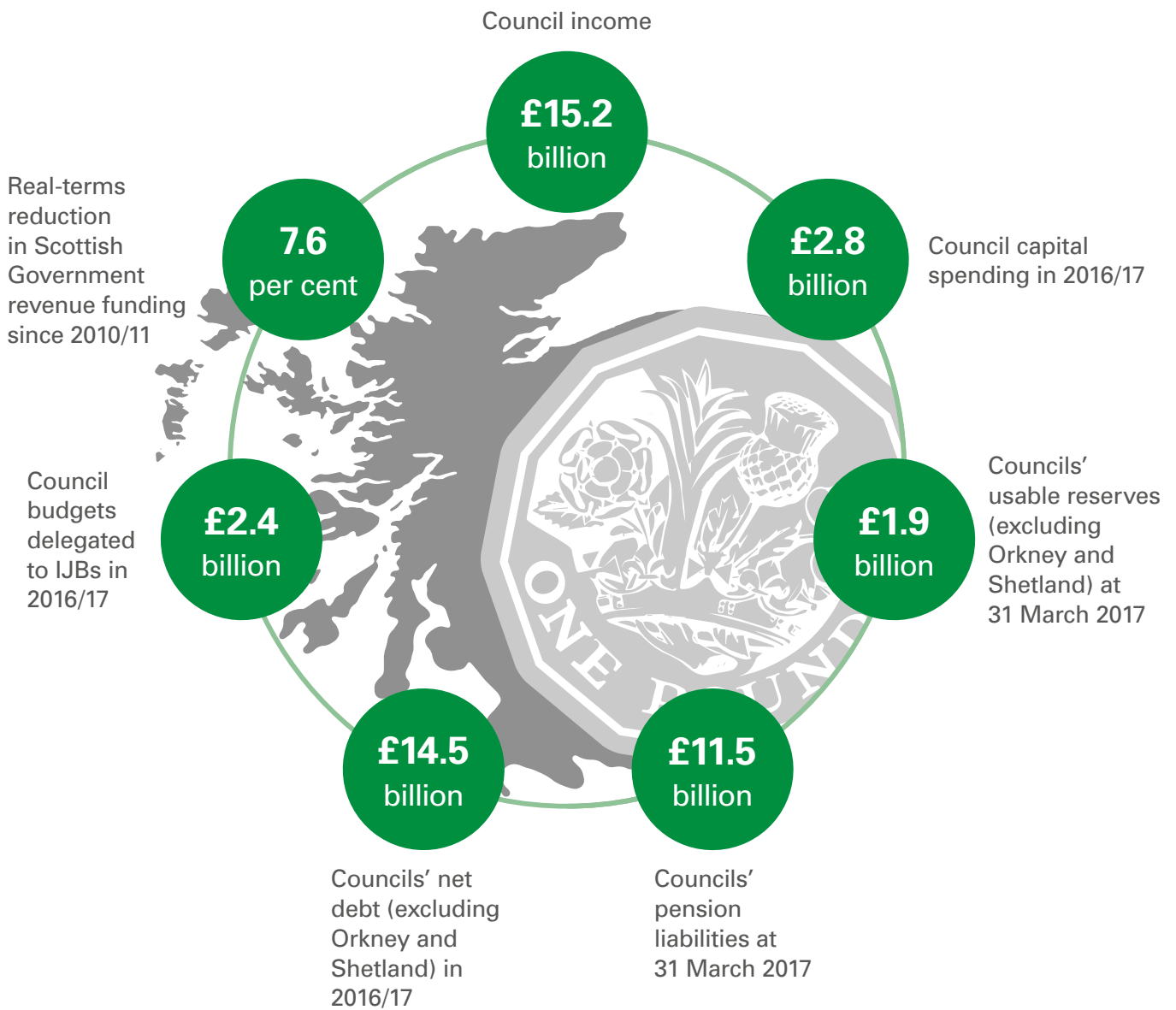
Links

-  PDF download
-  Web link



These question mark icons appear throughout this report and represent sample questions for councillors ([paragraph 7](#)).

Key facts



Chair's introduction



Welcome to the Accounts Commission's 2017 financial overview report for local government.

Last year was the first time that we published a separate financial overview report. In view of the very positive feedback we received from our stakeholders, we have decided to continue publishing two overview reports each year: this one focuses on financial matters, and the other on councils' performance and outcomes, which we plan to publish in April 2018.

Generally, councils face increasing challenges which require flexible responses that balance immediate needs, sound long term planning and limited financial resources. This task is a demanding one for elected members – not least for newly elected members – and I would hope that this overview report and its associated material, including the examples of questions we provide to support scrutiny by councillors, is a useful source of information and guidance.

We live in a rapidly changing public sector landscape, where external issues such as the transfer of further powers to Scotland and the decision to withdraw from the European Union add to an already complex domestic environment. Against this general backdrop the Commission is very aware of the importance of understanding the individual context faced by each council in terms of demand for services and resources available to sustain or develop them.

A major element of this operating environment for councils is the continuing pressure on finances. There was a real terms reduction in councils' main source of funding from the Scottish Government for 2016/17. This year has seen a further real terms funding reduction, with that trend forecast to continue into future years.

Councils tell us that they are finding the situation more serious than ever, with savings becoming increasingly difficult to identify and achieve. The Commission recognises this, but also recognises that some councils are in a better position to respond than others.

Effective leadership and financial management is becoming increasingly critical and medium-term financial strategies and well thought out savings plans are key to financial resilience and sustainability.

Elected members need to be clear about the potential impact of planned savings on achieving corporate objectives and the subsequent outcomes for citizens. The implications of community empowerment legislation heighten the importance of engaging effectively with communities around local priorities, and working together on options for the best future use of resources in service provision.

The Commission continues to emphasise the importance of Best Value as a comprehensive framework, based on the principle of continuous improvement that encompasses the key features of a high performing and effective council. It is especially relevant in times of tight finances, and we welcome the work being carried out by the Scottish Government, CoSLA, Solace and others, to refresh the Best Value statutory guidance so that it better reflects the current context for local government.

Finally, we welcome that once again the audits of annual accounts from all 32 councils were signed off with no qualifications. This is testament to the hard work amongst council staff, especially those within the finance function, and the good relationships developed by our auditors. There is of course, always room for improvement in financial management, such as in monitoring and reporting of financial matters to both councillors and the wider public. We will continue our interest in this.

Graham Sharp

Chair of Accounts Commission

Summary



Key messages

- 1** Councils' financial challenges continue to grow. Funding reductions are compounded by increasing costs and demands on services. In response, councils have needed to achieve ambitious savings plans, including around £524 million of savings for 2016/17.
 - 2** Councils are showing signs of increasing financial stress. They are finding it increasingly difficult to identify and deliver savings and more have drawn on reserves than in previous years to fund change programmes and routine service delivery. Some councils risk running out of General Fund reserves within two to three years if they continue to use them at levels planned for 2017/18.
 - 3** Debt increased by £836 million in 2016/17 as councils took advantage of low interest rates to borrow more to invest in larger capital programmes. Councils' debt levels are not currently problematic, but some are becoming concerned about affordability of costs associated with debt within future budgets.
 - 4** Councils' budget-setting processes for 2016/17 were complicated by late confirmation of funding from the Scottish Government and the funding arrangements for integrating health and social care. Councils' expenditure and use of reserves often differed noticeably from that originally planned, indicating the need for budget-setting to become more robust and reliable.
 - 5** All councils received an unqualified audit opinion on their 2016/17 accounts but auditors found that in several councils financial management could be improved. Councils can use their accounts to more clearly explain their financial performance over the whole year to support better scrutiny.
 - 6** The financial outlook for councils continues to be challenging, with the need to deliver savings being increasingly critical to their financial sustainability. As such, robust medium-term financial strategies and effective leadership to deliver them are of increasing importance.
-

councils are showing signs of increasing financial stress

About this report

1. This report provides a high-level independent analysis of the financial performance of councils during, and their financial position at the end of, 2016/17. It also looks ahead and comments on the financial outlook for councils. It is one of two overview reports that the Accounts Commission publishes each year, complementing a report on councils' performance and outcomes that will be published at the start of the next financial year in April 2018.

2. The report is intended to inform the public and its representatives. It is particularly aimed at councillors and senior council officers, and will be of significant interest to elected members who joined councils for the first time following the May 2017 elections. While the focus of the report is on councils, we also provide some early information about Integration Joint Boards (IJBs), which are also local government bodies, following their first full year of operation in supporting health and social integration. A programme of audit work looking in more detail at health and social care integration and IJBs is under way.¹


3. The report is in three parts:



- **Part 1 (page 10)** comments on councils' income and budgets for 2016/17.
- **Part 2 (page 20)** looks at councils' financial performance during, and position at the end of, 2016/17.
- **Part 3 (page 33)** looks at councils' 2017/18 finances and the challenges faced going forward.

4. Our primary sources of information are councils' 2016/17 audited accounts (including management commentaries) and their 2016/17 external annual audit reports. We have supplemented this with data submitted by councils to the Scottish Government through local finance returns (LFRs) and Provisional Outturn and Budget Estimates (POBE). LFRs present spending information for councils on a different basis from the spending information that councils record in their annual accounts. We do not audit data contained in LFRs.

5. UK-wide changes to the format of council financial statements in 2016/17 mean that we are no longer able to compare spending on services across councils using the annual accounts. This includes changes that make it difficult to establish the true service income and expenditure totals. We will include further analysis of these areas in our local government overview report in April 2018, using Scottish Government LFR data.

6. We refer to 'real-terms' changes in this report. This means we are showing financial information from past and future years at 2016/17 prices, adjusted for inflation, so that they are comparable to information from councils' 2016/17 accounts. We also refer to figures in 'cash terms'. This means we are showing the actual cash or money paid or received.

7. Throughout the report, we identify examples of questions that councillors may wish to consider to help them better understand their council's financial position and to scrutinise financial performance. The questions are also available on our website in [Supplement 1: Scrutiny tool for councillors](#) .

8. Accompanying this report, and to facilitate insight and comparisons across the sector, we have provided additional financial information on our website. The information is based on councils' audited accounts. We hope this will be useful for senior council finance officers, their staff and other interested stakeholders. We have also produced a separate supplement on councils' [Housing Revenue Account \(HRA\)](#)  and the [Local Government Pension Scheme \(LGPS\)](#) .

9. Throughout this report Orkney and Shetland have been excluded from exhibits that show usable reserves and debt. This is because the levels they hold mean inclusion would make it difficult to see relative positions of other councils. Most councils hold usable reserves of between five and 35 per cent of their annual income, whereas Shetland's reserves were 250 per cent of its annual income and Orkney's 300 per cent of its annual income. These large reserves relate to oil, gas and harbour related activities. As a result, both Orkney and Shetland also have more investments than borrowing unlike other councils.

Part 1

Councils' income and budgets for 2016/17



Key messages

- 1** 2016/17 was a challenging year for councils with a real-terms reduction in revenue funding, a continuation of the council tax freeze, inflationary pressures and the cost of new UK and Scottish Government policy commitments.
- 2** Councils depend on Scottish Government funding for the majority of their income. The largest element of Scottish Government funding, relating to Grant Aided Expenditure, has remained largely unchanged since 2008/09, with additional funding linked to supporting national policies. The Scottish Government and COSLA should assure themselves that the funding formula remains fit for purpose in a changing landscape for local government. It is important that it is suited to improving outcomes for local communities and sensitive to priorities such as reducing inequality within and across council areas.
- 3** In response to funding reductions, councils approved about £524 million of savings and the use of £79 million of their reserves when setting budgets for 2016/17. Councils' savings plans have focused on reducing staff numbers, rationalising surplus property and improving procurement of goods and services. Councils were not always clear in their budget-setting reports about the risks associated with savings and their potential impact on levels of service.
- 4** Councils' budget-setting processes for 2016/17 were complicated by later confirmation of funding from the Scottish Government and the funding arrangements for integrating health and social care.
- 5** Councils set larger capital budgets in 2016/17 than in 2015/16. The Scottish Government capital grant fell and councils planned to fund expenditure through increased borrowing.

**2016/17 was
a challenging
year for
councils**

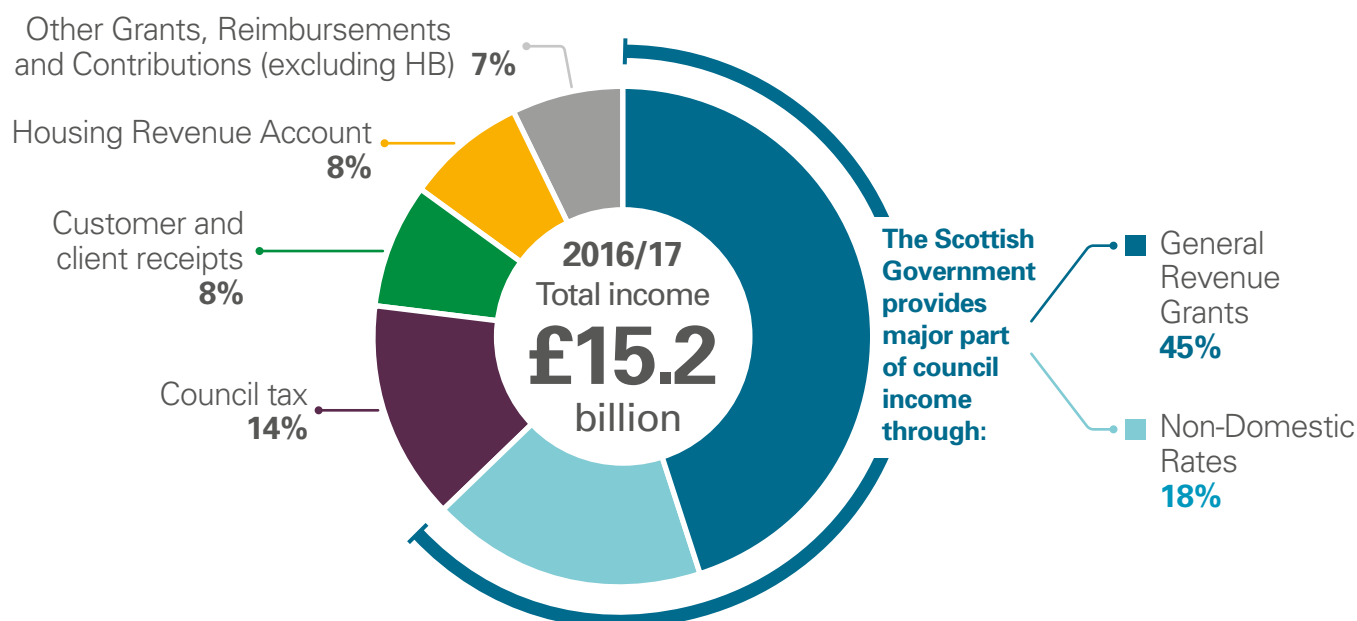
Councils faced a major challenge from the significant fall in revenue funding for 2016/17

10. The Scottish Government provides almost two-thirds of councils' income through general revenue grant, non-domestic rates (NDR) and specific grants for things like community justice ([Exhibit 1, page 11](#)). In comparison, council tax accounts for 14 per cent of councils' income, and fees and charges about eight per cent of their income.²

Exhibit 1

Sources of council revenue income, 2016/17

Councils are dependent on the Scottish Government for the majority of their income.



Notes:

- Does not include all income collected for services delivered through council arm's-length external organisations (ALEOs) and Integration Joint Boards (IJBs).
- Income excludes housing benefit.
- Customer and client receipts are 2015/16 totals at 2016/17 prices.

Source: Annual accounts 2016/17 and Scottish Local Government Finance Statistics 2015-16

11. Scottish Government revenue funding for councils in 2016/17 fell by 5.2 per cent in real terms ([Exhibit 2](#)). Councils' revenue funding from the Scottish Government has fallen in real terms by 7.6 per cent since 2010/11. The size of the reduction in 2016/17 presented councils with a major challenge in delivering services and required most to identify significant savings.

Exhibit 2

Scottish Government revenue funding to councils

Revenue funding fell both in cash and real terms in 2016/17 compared to 2015/16.

	2016/17 £'000	Change on 2015/16	
		Cash %	Real %
NDR	2,769	-0.7 ▼	-2.7 ▼
Revenue Grant	6,939	-4.3 ▼	-6.2 ▼
Total revenue funding	9,708	-3.3 ▼	-5.2 ▼
Additional resource via IJBs	250		
	9,958	-0.8 ▼	-2.8 ▼

Source: Local Government Finance Circular 1/2017, Scottish Government

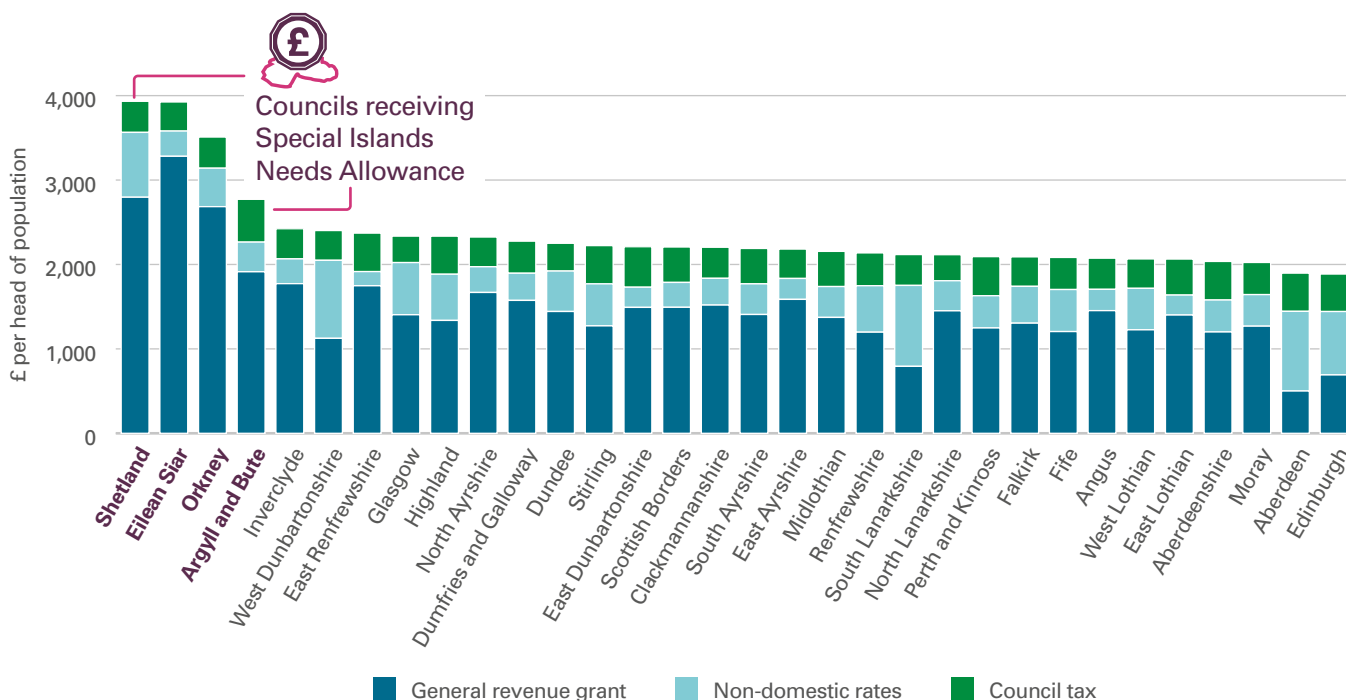
12. In 2016/17, the Scottish Government transferred an additional £250 million from the health budget to support health and social care integration. Even taking this into account, total revenue funding for councils fell in 2016/17.

13. Council tax is a key source of income for local government. Councils have typically set council tax rates to reflect local policy choices. Between 2008/09 and 2016/17, councils agreed with the Scottish Government to freeze council tax rates. To compensate them, the Scottish Government provided local government with an additional £70 million in each year of the freeze. In 2008/09, £70 million represented just over three per cent of council tax income and councils each received a share in line with their tax base. Councils that may not have increased their council tax by this amount each year will have benefited from additional funding as a result of the freeze. Councils did, however, lose the option of raising council tax to generate additional revenue. Although the council tax freeze was lifted in 2017/18, councils were constrained to increases of three per cent.

14. The revenue funding that councils received from the Scottish Government and council tax income varied between £2,000 and £2,400 per head of population for most councils in 2016/17 ([Exhibit 3](#)). This impacts on the income they have available and on the decisions they need to make about delivering services. The income per head of population in Argyll and Bute, Eilean Siar, Orkney and Shetland is higher than in other councils because they receive extra funding for their island populations, in recognition of the additional costs they face when providing services.

Exhibit 3

Income from General Revenue Grant, Non-Domestic Rates and council tax per head of population, 2016/17
 Most councils received between £2,000 and £2,400 per head of population.



Source: Annual accounts 2016/17; and National Records of Scotland mid-year population estimate for 2015

Additional Scottish Government funding has been linked to supporting national policies

15. The Scottish Government funding mechanism is the main determinant of a council's overall funding. It is designed to reflect differences between councils in terms of population and other factors, such as geography and deprivation. The funding mechanism is based on a large number of elements as illustrated in [Exhibit 4 \(page 14\)](#). The Fraser of Allander Institute has provided a useful outline summary of how funds are allocated:

'The Scottish Government allocates grants to local authorities taking into account both the relative spending need of each authority, and the revenues raised from council tax and non-domestic rates income.

The grant allocation system first calculates the 'total estimated expenditure' (TEE) that each local authority is likely to need to meet its various commitments. The elements of TEE are:

- an assessment of spending needs, based on the Grant Aided Expenditure (GAE) assessments combined with a Special Islands Needs Allowance (SINA)
- a series of additional revenue grants – such as the funding used in the past to support the council tax freeze – the allocation of which is determined on a case-by-case basis
- a series of further non-specific changes to grant allocations, the allocation of which is based on local authorities' shares of GAE + SINA
- local authorities' commitments in respect of certain historic loan charges
- the sum of these elements is then adjusted by a 'floor' to ensure that no local authority experiences particularly large swings in support from one year to the next.

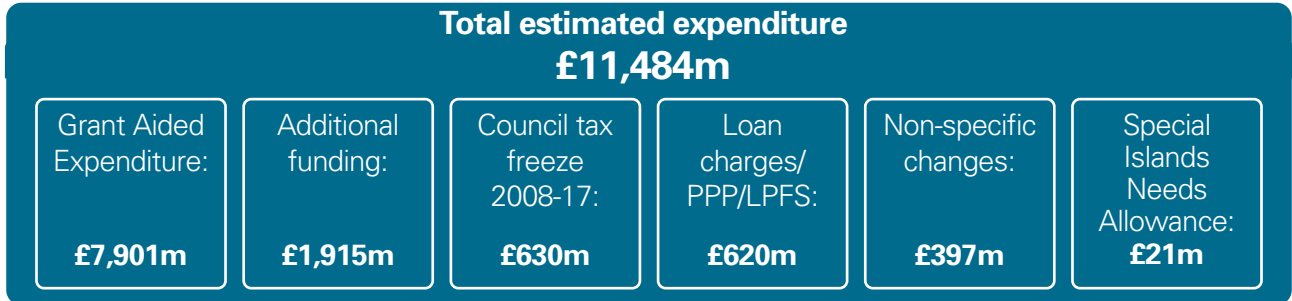
Having calculated TEE, an adjustment is then made based upon an estimate of what each local authority is expected to raise from council tax, the revenues that each local authority is forecast to raise from non-domestic rates, and their allocation of ring-fenced Gaelic funding. A further 'floor' calculation is applied to ensure that no local authority receives less than 85 per cent of the Scottish average on a per capita basis.¹³

16. Within the Scottish Government's estimate of councils' TEE in any year, the largest element is Grant Aided Expenditure (GAE). GAE totals have remained broadly the same since 2008/09, with the exception of funding for police, fire and district courts having been removed. In 2016/17, GAE was £7.9 billion of a total estimated expenditure of £11.5 billion. GAE is distributed between councils based on an estimate of their relative spending needs across 89 elements, with reference to one or more indicators. For example, the GAE for primary education is allocated with reference to its share of primary school aged pupils. A small adjustment is made based on a secondary indicator of the percentage of pupils in small schools. The variations between councils in each of the elements are mostly determined by population profiles, although other factors to reflect rurality and deprivation are also used when appropriate.

Exhibit 4

Local Government funding mechanism, 2016/17

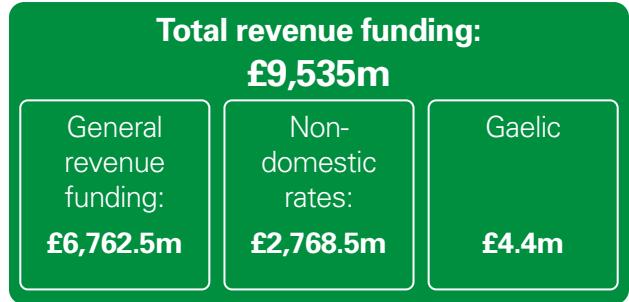
The formula contains many elements.



Main Floor: Redistributes so **no council loses more than 4.5%** a year



Assumed council tax contribution:
£1,949m



85% Floor: Ensures Scottish Government funding 85% to all councils: **£25m**



**Distributable revenue funding:
£9,560.4m**

Notes: On top of distributable revenue funding, councils also received £133 million from other grants and payments such as the Teacher Induction Scheme and Discretionary Housing Payments.

In 2016/17, the 85 per cent floor was applied to funding for Aberdeen City and City of Edinburgh Councils.

Source: Audit Scotland and Fraser of Allander Institute

17. New funding for councils since 2008/09, for example funding to expand early years' childcare, has come as 'additional funding' and 'non-specific changes' and is funding specifically directed at delivering particular national policies. The proportion of council funding directed towards national policies is increasing, a trend that will continue with Scottish Government proposals for fairer funding for equity and excellence in education. This shift increasingly restricts the flexibility councils have in managing their budgets across their full range of services. The Scottish Government and COSLA should assure themselves that the funding

formula remains fit for purpose in a changing landscape for local government. It is important that it is suited to improving outcomes for local communities and sensitive to priorities such as reducing inequality within and across council areas.

Councils faced increased budgetary pressures in 2016/17

18. Councils faced a growing range of budgetary pressures in 2016/17 from the real-terms reduction in Scottish Government funding, the continuation of the council tax freeze and cost inflation. They also faced additional pressures in meeting new UK and Scottish Government policy commitments. Many of the budgetary pressures that councils faced were associated with staff. As councils' largest area of expenditure, additional staff-related costs have a very significant impact on their budgets ([Exhibit 5](#)).

Exhibit 5

Significant budgetary pressures on councils in 2016/17

UK and Scottish Government policy commitments had sizeable cost implications for councils.



The **move to the single state pension at UK level**. This ended the employer NI rebate in relation to staff in contracted-out pension schemes (such as the LGPS and Teachers schemes).

3.4 per cent increase in NI costs affected employees from 1 April 2016.



The cost of introducing the **living wage for social care workers** from 1 October 2016.

Estimated cost of £100 million.



The undertaking to **maintain teacher numbers in Scotland** and the **Teacher Induction Scheme**.

Councils spend around £2.4 billion on teachers. By not cutting teacher numbers they receive a share of £88 million extra funding.



Annual increases in staff costs.


Estimated cost of one per cent pay rise about £70 million. Costs also increase as staff move up pay scales.



The **full year effect of increased pension contributions for teachers** (increased from 14.9 per cent to 17.2 per cent from September 2015).

The estimated impact was around £20 million in 2016/17.

19. In addition to the costs of meeting government policies and inflationary pressures, councils also had to deal with ongoing demand pressures. Some demand pressures such as those associated with an ageing population and placements for looked-after children, are often not easy to forecast and budget for. This highlights the need for adequate budget contingency and robust arrangements for identifying and responding to changes in demand for services.

20. Rent arrears can also create budgetary pressures for councils' Housing Revenue Accounts. The Department for Work and Pensions (DWP) began a roll-out of Universal Credit (UC) in Scotland in March 2016. By March 2017, UC had rolled out across five councils.⁴ Rent arrears across these councils increased in 2016/17 by an average of 14 per cent, compared with an average of 4 per cent across the remaining councils. Our [Housing Benefit Performance Audit: Annual update 2016/17](#)  highlighted that councils are finding that the roll-out of UC is having a detrimental effect on their collection of housing rental income.

Some service areas saw larger reductions to budgets in 2016/17

21. In responding to the range of pressures they face, councils approved about £524 million of savings and budgeted to use about £79 million of reserves in their budgets for 2016/17. Savings plans continued to focus on their main areas of spend, reducing staff numbers, rationalising surplus property and improving procurement of goods and services. It was not always clear from budget-setting reports how savings aligned with the council's corporate and financial plans or how they would impact on service delivery.

22. In 2016/17, budgets for education increased, mainly as a result of the policy commitment to maintain teacher numbers and the inflationary pressures around pay and pension costs. Despite demand pressures in social work, overall budgets reduced – but not by as much in percentage terms as in other areas of service. Remaining service areas have seen larger reductions to their budgets. In some cases, increases in fees and charges may have reduced the amount of budgeted expenditure. This pattern of larger reductions to relatively smaller service areas has been recurrent in recent years and is something that has continued into 2017/18. While it is right that resources should be aligned with policy priorities, the impact on other services and their outcomes should be carefully assessed ([Exhibit 6, page 17](#)).

Councils have been seeking to maximise the income available to them from charging for services



23. Councils generate about eight per cent of their total income from charging for services (excluding housing rents). This includes income from charges to service users, rental income (excluding council houses) as well as 'other' charges. It is difficult to establish from the data available the full extent of income councils receive. Some income from services provided via arm's-length external organisations (ALEOs) and IJBs is not shown in council totals.⁵

24. Councils have been seeking to maximise their income through increasing charges and by introducing new charges for services, for example introducing charges for garden waste. Councils have also sought to collect more of the income that is due to them. Charges for social care which are subject to regulation, represented the largest area of income from charging services in 2015/16 ([Exhibit 7, page 18](#)).



Does your council have a charging policy? Is this in line with corporate plans and objectives? When was this last reviewed?

What information do you need to be able to explain increases in fees and charges to your constituents?










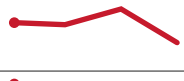






25. The Scottish Parliament's Information Centre (SPICe) has published a [detailed briefing on some fees and charges](#) . The Accounts Commission also considered fees and charges for services in its 2013 report, [Charging for services: are you getting it right?](#) 

26. Although councils generate a relatively small proportion of their overall income from fees and charges, increases can make a difference to council finances over time. However, councils face difficult decisions in balancing their need to maximise income while also ensuring their charging policy is consistent with corporate objectives, such as providing access to services and addressing inequality. Increasing prices can be unpopular with the public, but effective leadership, sensitive management, good communications and community engagement can assist with this.

Exhibit 6

Trend in council expenditure on main services, in real terms

There was significant variation in budget changes across council services.

	2013/14 £million	2014/15 £million	2015/16 £million	16/17 Budget £million	Change over period
 Education	4,771	4,736	4,830	4,826	1% 
 Cultural and related services	639	661	610	560	-12% 
 Social work	3,158	3,194	3,233	3,086	-2% 
 Roads and transport	454	431	427	419	-8% 
 Environmental services	686	684	698	668	-3% 
 Planning and development services	291	286	248	251	-14% 
 Other services	839	802	778	687	-18% 
 Total (excludes trading services and interest payments)	10,840	10,793	10,823	10,496	-3% 

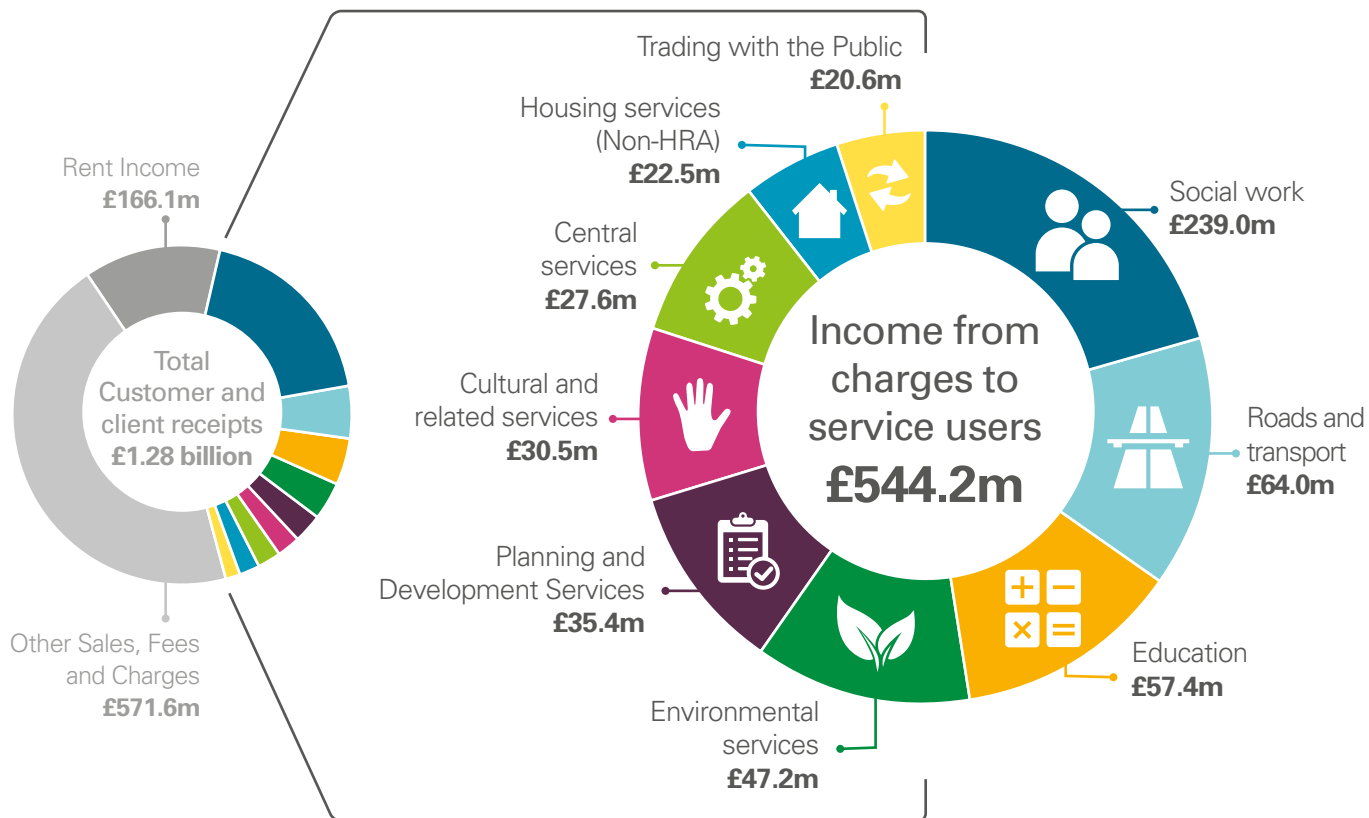
Note: 'Other services' combines Central Services and non-HRA housing.

Source: Scottish Local Government Finance Statistics 2015-16; and Scottish Government Provisional Outturn Budget Estimate returns 2016

Exhibit 7

Charges to service users

Charges to service users account for over £500 million of councils income.



Note: Does not include all income collected for services delivered through council ALEOs and IJBs.

Source: Scottish Local Government Finance Statistics 2015-16

Integration Joint Boards added further complexity to budget setting

27. For the majority of councils, 2016/17 was the first operational year for Integration Joint Boards (IJBs). IJBs were established as a result of the Public Bodies (Joint Working) (Scotland) Act 2014. They are partnerships between NHS boards and councils and are responsible for the delivery of adult health and social care, and in some council areas, for other services, such as children's services. The partnerships are the subject of 'integration schemes' which are written agreements about how they will operate, including responsibilities for any budget underspends and overspends.

28. Councils delegated £2.4 billion of social care expenditure to IJB budgets for 2016/17 and NHS boards contributed £5.6 billion. The introduction of IJBs has complicated budget-setting, due to differences in both the approach and timing of budget-setting between councils and NHS boards. The establishment and development of IJBs has been a complex exercise and will take time to mature. Their operation will be the focus of further performance audit work we have planned in 2018.

Councils set larger capital programmes for 2016/17, with plans to increase borrowing

29. In addition to their day-to-day revenue spending on goods and services, councils also incur capital expenditure on the assets that support those services, including schools, houses and equipment such as vehicles. In 2015/16, councils spent about £2.4 billion on capital projects. Budgets for 2016/17 were much higher at over £3.3 billion.

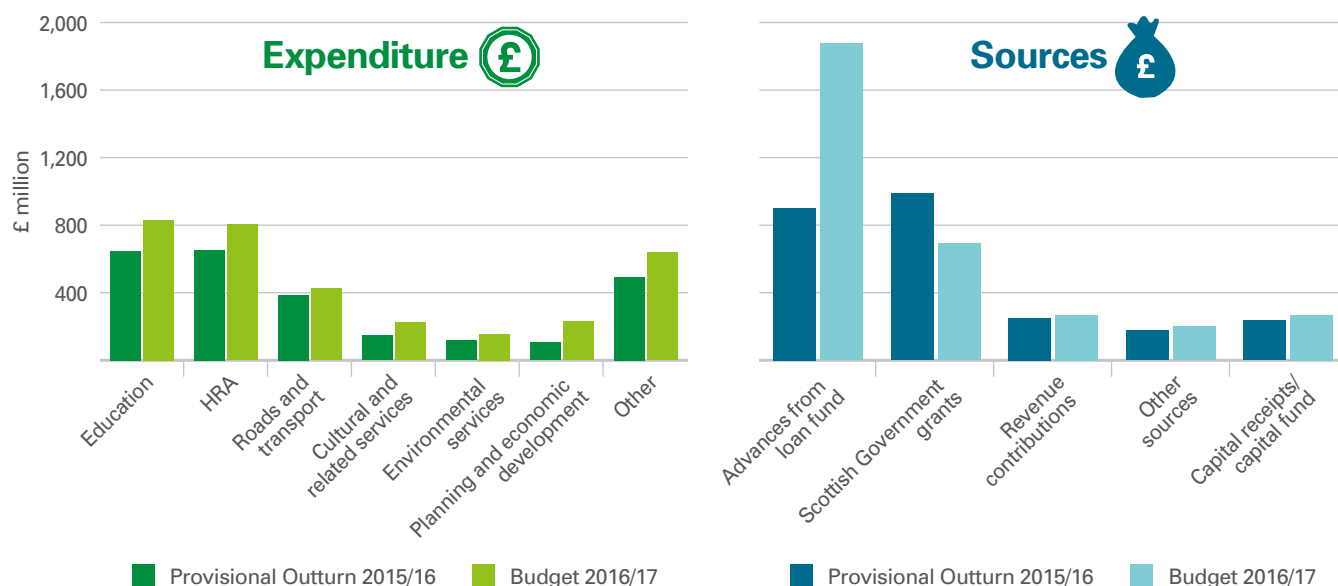
30. Councils finance their capital expenditure from a number of sources, including Scottish Government capital grants and borrowing. Scottish Government grants fell from £834 million in 2015/16 to £591 million in 2016/17, returning to a more usual level following re-profiling in earlier years. [Exhibit 8](#) shows where councils were planning to spend their capital and how they planned to finance it.

31. Councils are required to consider the affordability of their capital programmes. This includes the cost of any borrowing along with the impact on day-to-day running costs. However, they are free to determine what they consider prudent and with interest rates remaining low in 2016/17, councils assessed increased borrowing to be affordable. The delivery of capital programmes and the affordability of debt are considered further in [Part 2](#) and [Part 3](#).

Exhibit 8

Capital programmes and sources of finance, 2015/16 and 2016/17

Councils planned to borrow more in 2016/17 to meet the cost of larger capital programmes.



Notes:

1. Excludes regional transport partnerships and Joint Valuation Boards.
2. Other budgeted use of capital includes Social Work, Central Services, Trading Services, etc.
3. Other sources of capital finance for the General Fund are grants (excluding those received from the Scottish Government).
4. For HRA this includes capital from other sources, such as developer contributions.

Source: Scottish Government Capital Provisional Outturn Budget Estimate 2015-16

Part 2

2016/17 financial performance



Key messages

- 1** All councils received an unqualified audit opinion on their 2016/17 accounts but the accounts could more clearly explain their financial performance.
- 2** Councils are showing signs of increasing financial stress with 20 councils drawing on their usable reserves in 2016/17.
- 3** Councils' actual use of reserves was often quite different from that originally planned. The reasons why are not always clear.
- 4** Auditors found that budget-setting needed to be more robust and that financial management could be improved in several councils.
- 5** Levels of net debt increased by £836 million in 2016/17. On average councils spent almost ten per cent of their revenue budgets servicing this debt. Some councils are concerned about the ongoing affordability of servicing their debt as resources decrease.
- 6** Councils that have been proactive in making difficult decisions will be better placed to deal with future financial pressures.

Twenty councils drew on reserves in 2016/17 – actual use of reserves was often quite different from original plans

All councils received an unqualified audit opinion on their 2016/17 accounts but the accounts could more clearly explain their financial performance to readers

32. In 2016/17, for the sixth consecutive year, auditors issued a 'true and fair' unqualified audit opinion on the accounts of all 32 councils. An unqualified opinion means auditors have judged that all council's financial records and statements are fairly and appropriately presented, that the council's financial statements are sound and free from material misstatements or errors.

33. For the last three years, councils have had to produce a management commentary to accompany their annual accounts. These commentaries play an important role in public accountability and helping interested parties to better understand the accounts of each council and its financial performance and position. As such, they should include explanations of amounts included in the accounts as well as:

- a description of the council's strategy and business model
- a review of the council's business
- a review of principal risks and uncertainties facing the council
- an outline of the main trends and factors likely to affect the future development, financial performance and financial position of the council.

34. Each management commentary should concisely present the financial 'story' of a council in an understandable format for a wide audience. Auditors express an opinion on whether the management commentary is consistent with the audited financial statements and is in line with Scottish Government guidance.

35. Management commentaries for 2016/17 vary in how clearly councils and IJBs explain their financial and general performance. Overall there remains scope for improvement. It is the Accounts Commission's view that councillors have an important role in ensuring that the management commentary effectively tells a clear story of financial performance and can be understood and scrutinised by a wide audience. The story at the end of the year should be produced from regular reports provided to councillors throughout the year.

Councils are showing increasing signs of financial stress

Twenty councils drew on their usable reserves in 2016/17

36. In 2016/17, 20 councils drew on their usable revenue and capital reserves. Nineteen councils drew on their revenue reserves in 2016/17, an increase from the eight councils that did so in 2015/16. Council revenue reserves fell by £32 million in 2016/17. ([Exhibit 9, page 22](#)). Overall council usable reserves (capital and revenue) fell by about £33 million.

37. The Chartered Institute of Public Finance and Accountancy (CIPFA) has identified the rapid decline of usable reserves as one of the symptoms exhibited by councils under financial stress.⁶ Councils with good financial management demonstrate well-planned and managed use of reserves, in accordance with carefully thought out council policies.

38. In some cases, councils have used reserves to support service delivery. Councils have used reserves to invest in their change programmes, such as meeting the additional costs of staff severance. In 2016/17, councils continued to focus on reducing staffing levels. They reduced their workforces by almost 2,200 staff (almost one per cent of the total workforce), at a cost of £78 million ([Exhibit 10, page 23](#)). Councils' policies around voluntary severance and redundancy typically require payback of the costs over two to three years.

39. In future, severance schemes could become less attractive for staff under Scottish Government proposals to limit payments. Conversely, severance packages for staff with retirement dates after April 2020 will become more expensive for councils following changes to pension protection.



Do management commentaries clearly explain council performance and any changes to plans?

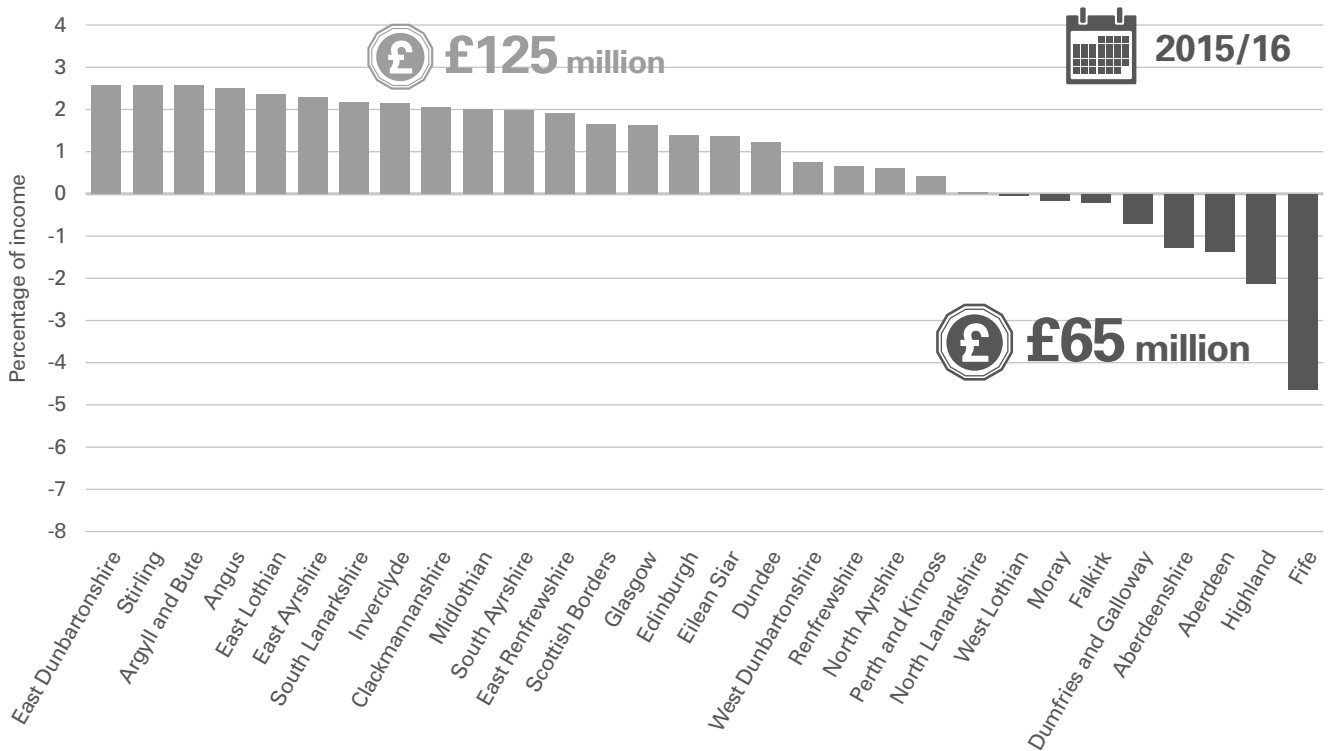
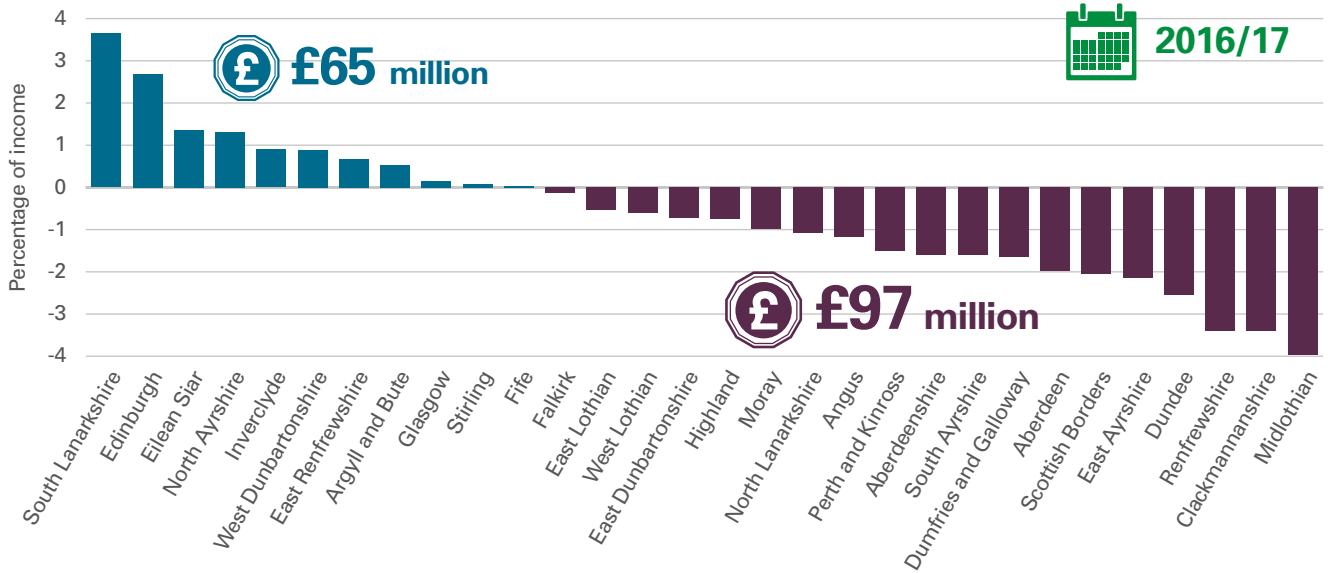


Are staff severances in line with the council's workforce plan?

Exhibit 9

Changes in revenue reserves (excluding HRA), 2015/16 and 2016/17

Many more councils drew on revenue reserves in 2016/17 compared with 2015/16.



Notes:

- 1. Due to issues with the scale on this exhibit Orkney and Shetland are excluded (paragraph 9).
- 2. In 2016/17, Renfrewshire moved money from revenue to capital reserves.

Source: Audited accounts 2015/16 and 2016/17

Exhibit 10

Exit packages, 2011/12 to 2016/17

The number and average cost of exit packages both fell in 2016/17.

	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	Total
Total number of packages	4,070	2,407	2,373	1,933	2,660	2,195	15,642
Total cost of packages Cash terms £000	148,750	109,068	92,640	74,935	97,231	78,125	600,750
Total cost of packages Real terms £000	160,868	115,528	96,535	76,955	99,172	78,125	627,184
Average cost per package Real terms £	39,525	47,997	40,681	39,811	37,227	35,592	40,096

Note: Real terms comparisons are based on 2016/17 prices.

Source: Annual accounts 2016/17

Councils use of reserves and service expenditure was often quite different from that originally planned

40. In 2016/17, as many councils used more reserves than they had originally planned as used less ([Exhibit 11, page 24](#)). It is not always clear from management commentaries why the actual use of reserves differed from that planned.

41. There can be a range of reasons why councils need to draw more heavily on their reserves than planned. It can be the result of poor budget-setting and/or budgetary control. For example, councils may need to use reserves to balance budgets where savings have not been achieved. The failure to deliver savings might be due to councils underestimating the time required for change programmes to deliver benefits. As budgets come under greater pressure from funding reductions, cost pressures and increasing demand, it is critical that councils understand the risks of using reserves in an unplanned way in relation to future savings and long-term financial sustainability.

42. Auditors identified that some councils failed to deliver their savings plans in 2016/17. Auditors also highlighted that some budgets did not properly reflect patterns of previous actual expenditure and that councils should consider rebasing their budgets where they consistently underspend. One such area is underspending on financing costs, where slippage on capital programmes leads to less borrowing and lower interest payments. Built-in budget contingencies partly explain budget underspends but councils need to explain this more clearly.

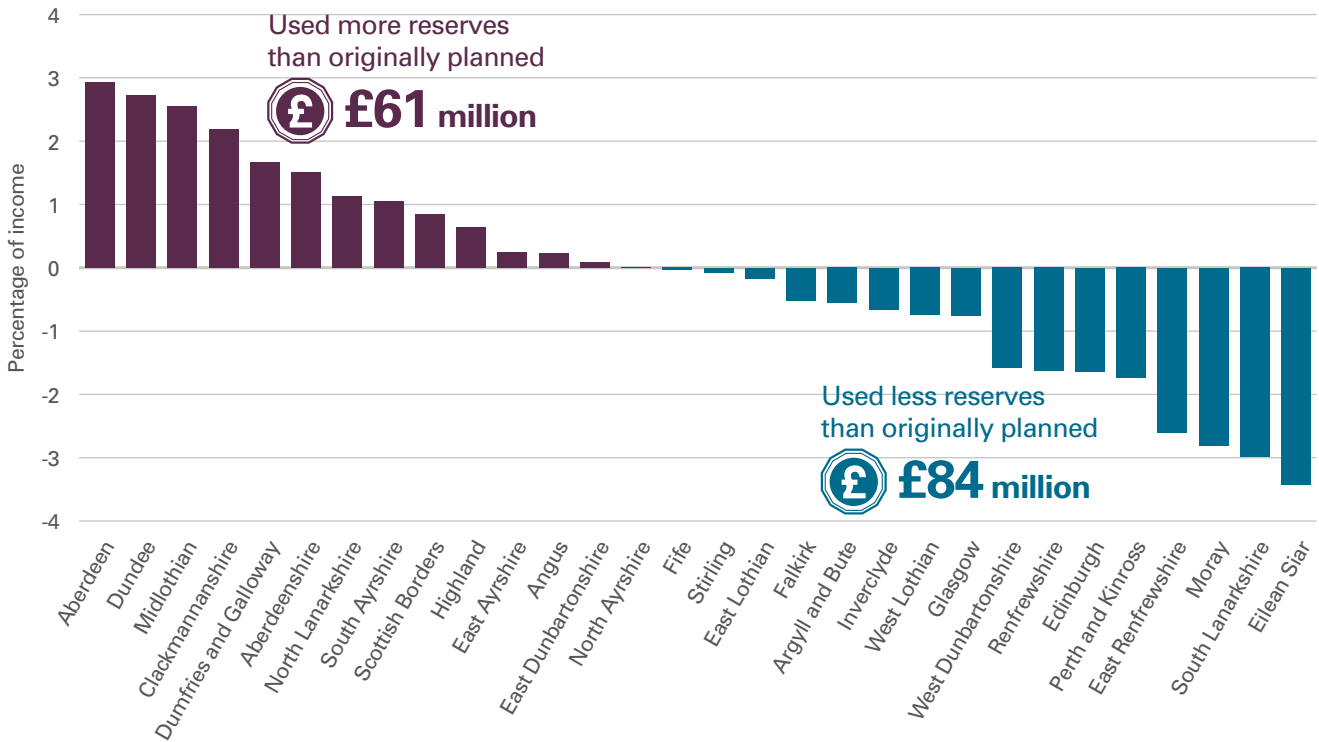


How does the council ensure that council staff have the capacity to delivery transformational change?

What have reserves been used for in recent years? Supporting services and bridging the funding gap or transforming services?

Exhibit 11

Difference between planned and actual use of General Fund reserves as a proportion of income, 2016/17
 The difference between planned and actual use of reserves for some councils was more than two per cent of their total income from general revenue grants and taxation.



Note: Due to issues with the scale on this exhibit Orkney and Shetland are excluded (paragraph 9).
 Source: Audited accounts 2016/17 and auditor returns

43. Reasons often cited by councils for under and overspends against final budgets are included in [Exhibit 12 \(page 25\)](#).

44. Management commentaries in councils’ accounts tend to only identify the main reasons for over or underspends against final budgets and not why plans or budgets changed during the year. This represents an area of weakness in financial reporting that councils need to address to support more effective financial scrutiny. If significant changes are made to original budgets the reasons should be clearly reported to councillors throughout the year, as well as featuring in the management commentary accompanying the accounts at the end of the year.

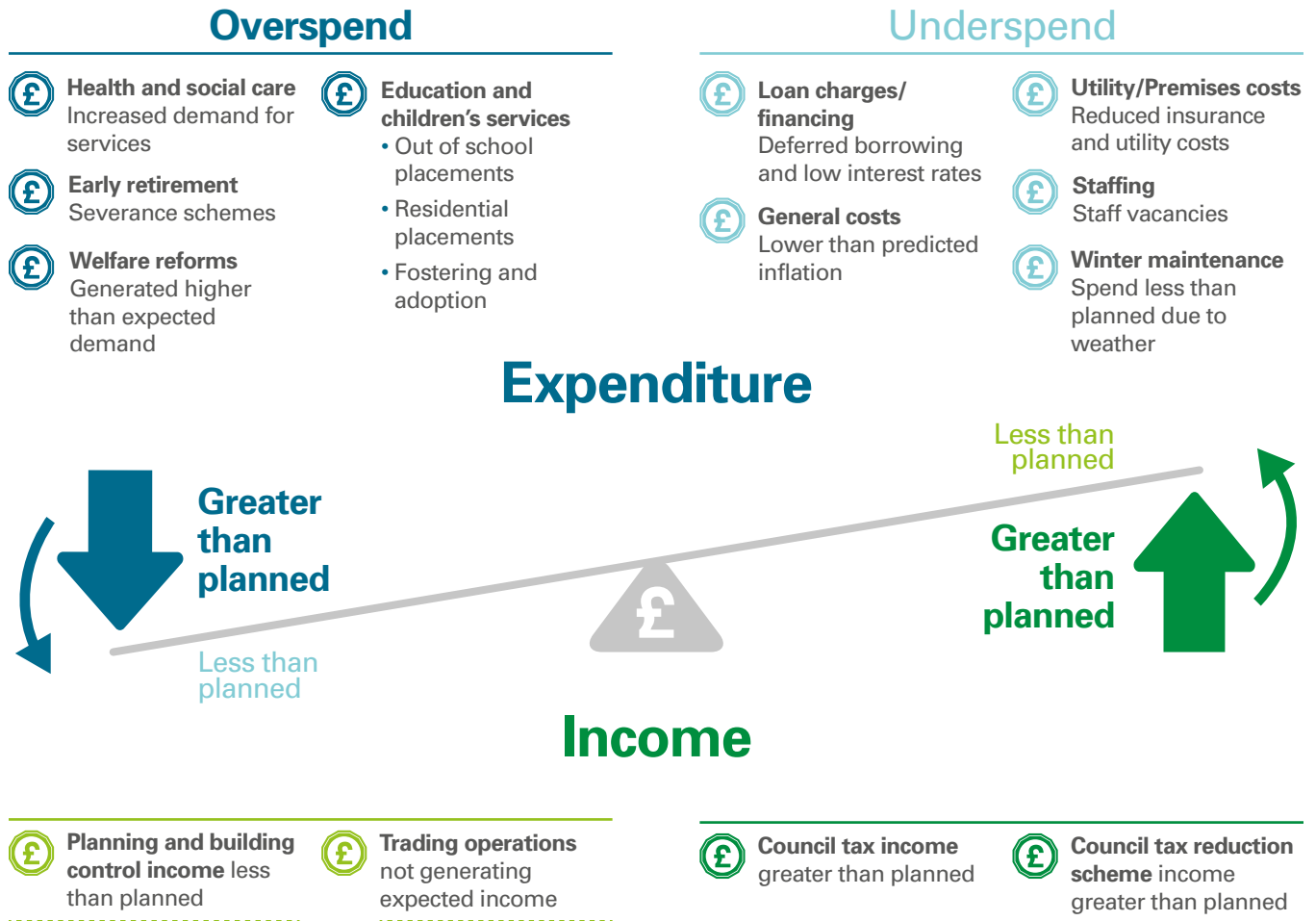


Do budget monitoring reports clearly explain performance against plans and any changes to plans?

Exhibit 12

Commonly reported reasons for budget variances, 2016/17

Demand pressures primarily drove overspends – with financing costs a key driver of underspends.



Source: Audit Scotland review of management commentaries

Levels of usable reserves vary widely and it is important that councils have clear reserves policies

45. The levels of usable reserves held by councils vary widely, as do policies on the minimum level of reserves they should hold. The General Fund reserve is the main revenue reserve available to support general council services. By the end of 2016/17, General Fund reserves, excluding Orkney and Shetland, totaled £1.1 billion. However, councils hold a number of other reserves and total usable reserves held amounted to £1.9 billion (excluding Orkney and Shetland, [paragraph 9](#)), ([Exhibit 13, page 26](#)).

46. There is no prescribed minimal level of usable reserves. Typically councils' policies are to have a minimum uncommitted General Fund balance of between two and four per cent. Councils need to be clear about the reasons for the levels of reserves they hold to mitigate risks and support medium-term financial plans.

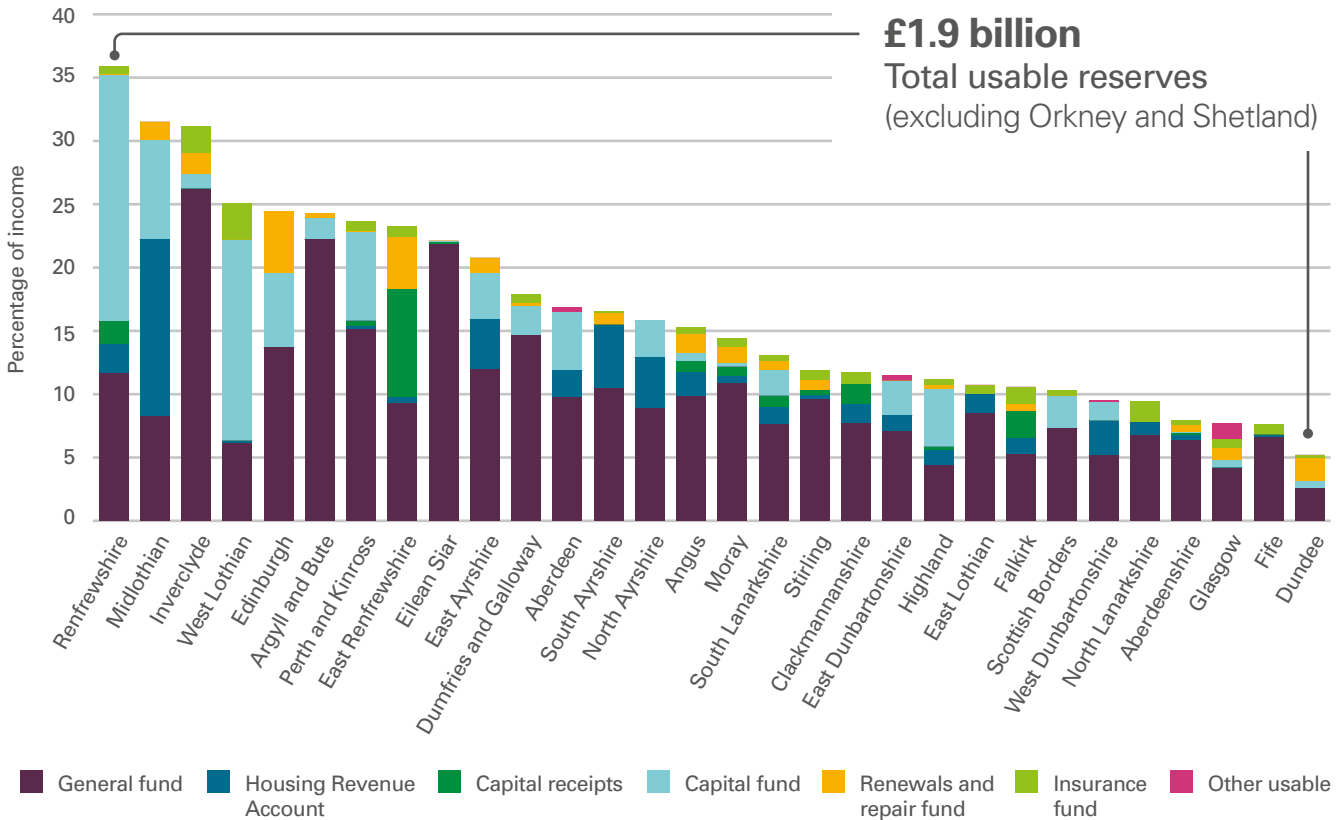


What is your councils reserves policy?

Exhibit 13

Council usable reserves at 31 March 2017

There are wide variations in the level of reserves as a proportion of income from general revenue grant, taxation and housing rents.



Note: Orkney and Shetland councils have reserves far in excess of those held by other councils and are excluded. We explain why this is the case in [paragraph 9](#).

Source: Annual accounts 2016/17

47. At the end of their first full operational year, IJBs held usable reserves of £96 million, representing about 1.2 per cent of their total income of £8 billion in 2016/17. Reserves vary across IJBs. Not all integration schemes permit IJBs to hold reserves. Only North Ayrshire Council recorded an overspend. This was largely due to spending on social care services ([Exhibit 14, page 27](#)).

48. It is not clear from the accounts of IJBs to what extent reserves have been built up in a planned way, have arisen as a result of underspends on IJB activities or have been earmarked for transformation activity. There is a lot of pressure on the budgets of IJBs and reserves at the end of 2016/17 are not forecast to continue in future years. Further analysis of IJB accounts will help inform specific audit work on IJBs being carried out in 2018.

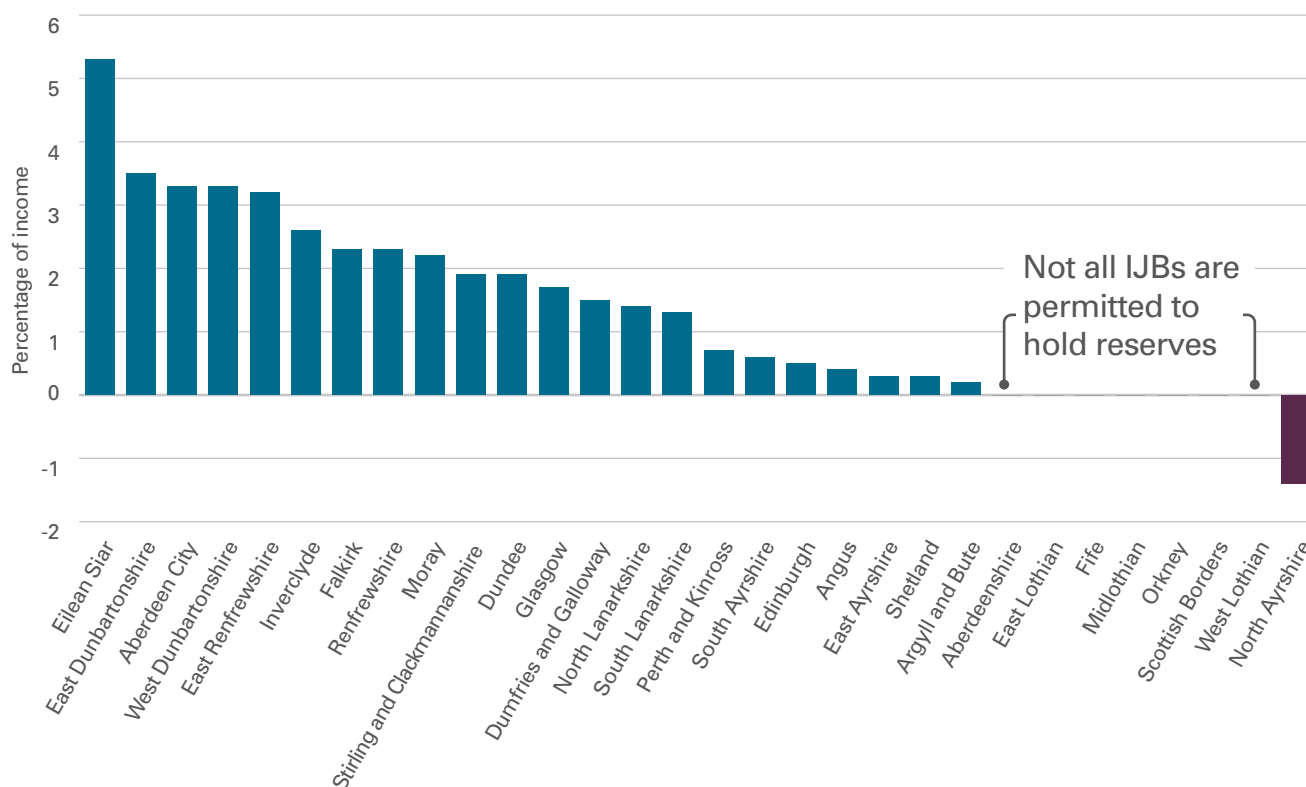


What are the different types of reserves your council holds? Do you know what these can be spent on?

Exhibit 14

IJB usable reserves as a proportion of 2016/17 income

Reserves vary across IJBs.



Note: Stirling Council and Clackmannanshire Council are members of the same IJB.

Source: Annual accounts 2016/17

Levels of debt have increased and some councils are concerned about future affordability

49. Following two years of reducing debt, councils' net debt increased in 2016/17 from £13.7 billion to £14.5 billion (excluding Orkney and Shetland). The increase in borrowing was lower than that originally planned when capital programmes were approved. This was primarily due to slippage in delivering capital programmes.

50. As with reserves, levels of debt vary widely across councils ([Exhibit 15, page 28](#)). 2016/17 saw an increase in the HRA borrowing requirement of about £140 million, with the 26 councils who provide social housing being actively involved in new council housing development. Collectively they plan to deliver about 13,000 homes by 2020/21. The cost of servicing additional HRA debt will be met from rental income.

51. The ongoing costs associated with debt reduces the amount councils have available for day-to-day service expenditure. It is therefore important that assets are effectively supporting service delivery and strategic priorities. Higher levels of debt often result in higher costs for councils but actual interest and repayment costs will depend on the type of debt councils hold and the period over which it has to be repaid.

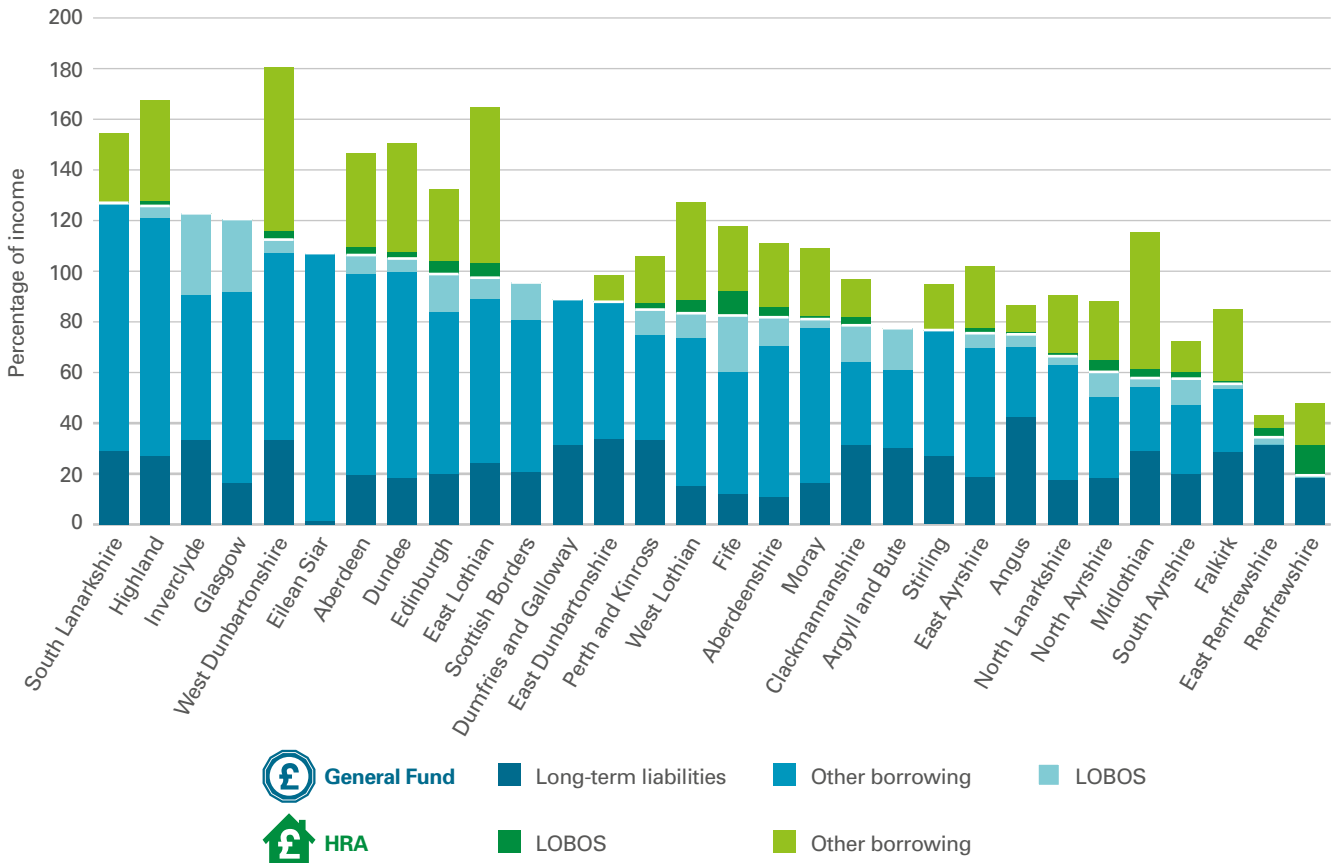


What are the levels of reserves held by your council's IJB? Are these in line with the IJB's reserve policy?

Exhibit 15

Council net external debt at 31 March 2017

Levels of debt held vary across councils as a proportion of income from general revenue grant, taxation and housing rents.



Note: Council debt has been allocated to General Fund and HRA in proportion to capital financing requirements.

Source: Annual accounts 2016/17

52. Despite debt increasing, the ongoing cost of servicing it, through the interest and repayment costs, reduced slightly in 2016/17. This in part reflects the lower interest rates available on new borrowing. It also reflects councils choosing to make lower voluntary debt repayments. On average, councils spent almost ten per cent of their income on interest and debt repayment ([Exhibit 16, page 29](#)).

53. Councils are required by regulation to consider the revenue impact of borrowing, ie its ongoing affordability. A large part of council debt has fixed interest rates which gives councils certainty about costs. However, this type of debt makes councils' assessment of longer term affordability more complex, requiring more detailed assumptions of future inflation and interest rates:



What share of your council's budget is taken up with interest payments and debt repayment?

- ‘Lender option borrower option’ loans (LOBOs) include options for the lender to increase interest rates. LOBOs account for about 11 per cent of council debt.
- PPP/PFI and indexed linked bonds include charges that increase with inflation. Projects financed using the Scottish Government’s Non-Profit Distributing (NPD) programme (which replaced the previous long standing PPP/PFI programmes) also include an element of indexation but typically at lower levels. The value for money of newer NPD projects will be examined in detail in a joint report by the Auditor General and the Accounts Commission in 2019/20.

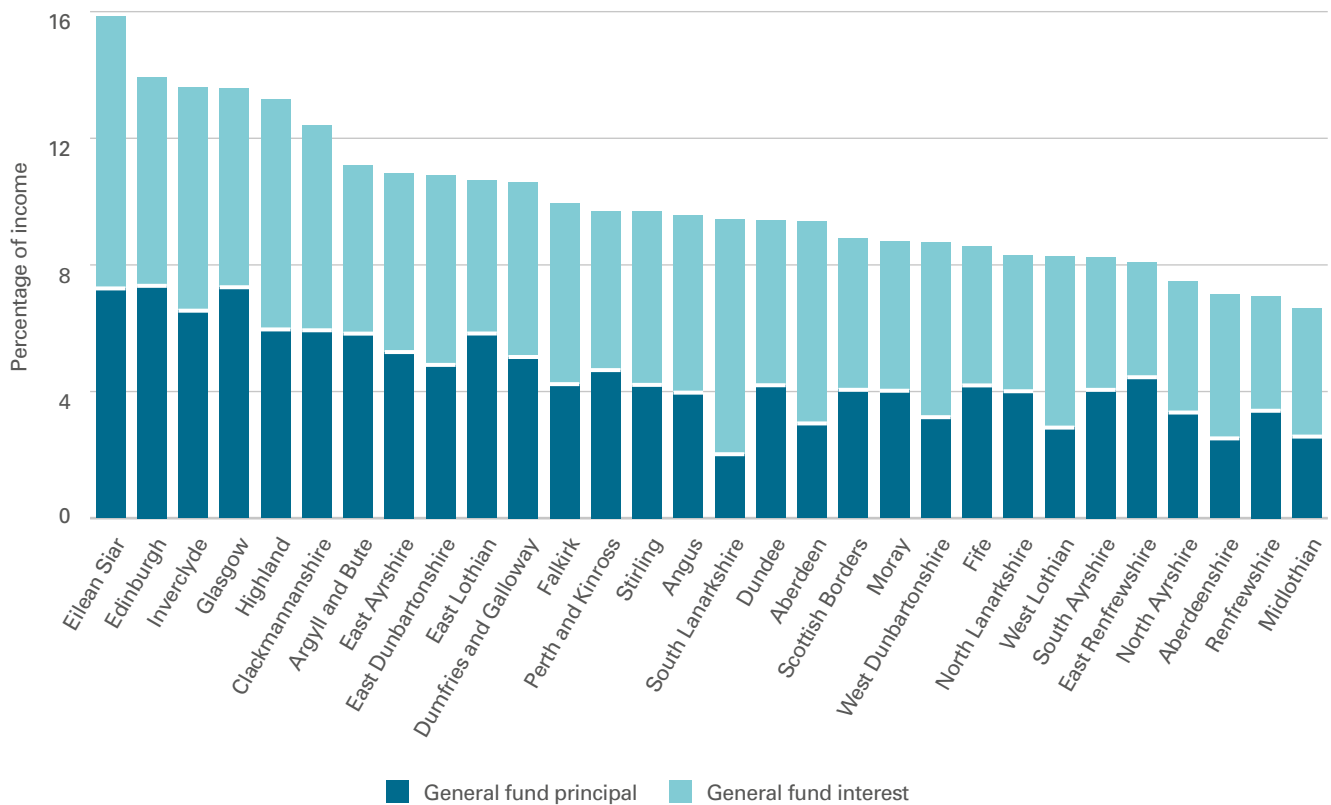


What proportion of your council's debt is linked to inflation (ie, subject to indexation)? What does that mean for longer term affordability?

Exhibit 16

Revenue cost of General Fund borrowing, 2016/17

Costs associated with debt vary across councils as a proportion of income from general revenue grants and taxation.



Source: Annual accounts 2016/17

54. Levels of debt and associated costs are set to rise in future. This is because councils have invested usable reserves in their capital programmes, something referred to as 'internal borrowing'. At the end of 2016/17 the amount of 'internal borrowing' was about £0.5 billion. Internal borrowing is usual treasury management practice for councils during periods when they would make a lower return from investing their usable reserves than it would cost them to borrow money. However, as councils increasingly rely on reserves to fund services they will need to replace internal borrowing with external borrowing, increasing their costs.

Councils continue to report significant slippage in delivering capital programmes

55. Councils spent £2.8 billion on capital projects in 2016/17, 84 per cent of their planned expenditure of £3.3 billion. Twenty-four out of 32 councils underspent against their capital budgets in both 2015/16 and 2016/17.


56. The reasons for slippage in delivering capital programmes are unclear. Management commentaries for the councils recording the largest slippage give reasons such as changes to project start dates, and one council identified weaknesses in the forward planning process. However, the consistent levels of capital slippage across the country suggest that councils are setting unrealistic budgets.

57. In our 2013 report [Major capital investments in councils](#)  we noted 'that for most major projects completed within the previous three years, councils' early estimates of the expected costs and timetable were inaccurate, and recommended that better information was made publicly available'.⁷ Our [follow-up report](#)  in 2016 suggested councils had made limited progress on this recommendation.⁸ Data for 2016/17 shows that councils still need to improve in this area.

Net pension liabilities increased for councils despite large increases in pension fund assets

58. Overall, net pension liabilities on council balance sheets were approximately £11.5 billion at the end of 2016/17, an increase of 51 per cent on the previous year. This increase was mainly due to a change in actuarial assumptions used to value future liabilities. It was a good year for Local Government Pension Scheme (LGPS) investments, which increased by almost 22 per cent.

59. Not all council pension liabilities are the responsibility of the LGPS fund. Where councils have awarded added-year pension benefits as part of severance arrangements, for both teachers and other staff, they have to meet the ongoing cost of pensions themselves. This also helps explain why the increase in council liabilities outstripped investment returns. These liabilities are not matched with any pension fund assets.

60. Public service pension scheme benefits have been reduced on a number of occasions to make the schemes more affordable. However, pension contributions have been a significant cost pressure for councils in recent years. The need for any increase in employer contributions will be determined through the results of the 2017 triennial funding valuation. The LGPS 2015 includes a cost-sharing mechanism that will limit any future increase for employers. A supplement on the [Local Government Pension Scheme](#)  is available on our website.



Has non delivery of the capital programme (ie, slippage) been significant at your council in recent years? Why?



Do you know the implications of your council's pension liabilities of staff retiring early?

Provisions and contingent liabilities can be difficult to quantify and should be kept under review

61. Where councils have a known obligation and they can quantify the cost, they are required to make a provision in their accounts. Councils held provisions of £132 million at the end of 2016/17 covering areas such as equal pay compensation claims, teachers' maternity pay, holiday pay, insurance claims and landfill site reinstatement.⁹

62. Councils are also required to disclose potential liabilities that are still contingent on future events or which cannot be quantified reliably. Fourteen councils are disclosing contingent liabilities for equal pay claims that they are defending. Other contingent liabilities identified by a number of councils include those relating to holiday pay claims and potential claims arising as a result of changes to the legislation around historic child abuse.

Councils that have been proactive in making difficult decisions will be better placed to deal with future financial pressures

63. Councils have had to make difficult decisions in recent years in the light of falling resources and increasing demand for services. Councils that have a track record of effective leadership, self-evaluation, robustly addressing the financial challenges, and are implementing effective medium to long-term strategies and plans, will be in a better place than those that have avoided difficult decisions or not applied sufficient pace to making changes. That is not to say that the challenges faced by councils have necessarily been uniform. Differences in the resources available to them, the demand for services and the costs councils face as a result of their size and remoteness can also impact on their financial position ([Exhibit 17, page 32](#)).

64. The effectiveness of council leadership will be tested further in the years ahead given the increasing demand for services and likely funding scenarios that the public sector faces. Decisions made as part of budget-setting for 2017/18 together with the financial outlook are considered in [Part 1 \(page 10\)](#).

Exhibit 17**Main determinants of a council's financial position**

There are number of factors that affect a councils financial position.



Part 3

Financial outlook



Key messages

- 1** The financial outlook for councils remains challenging with further real-terms reductions in funding and a range of cost and demand pressures on budgets.
- 2** In total councils approved £317 million of savings and the use of £105 million of reserves when setting budgets for 2017/18.
- 3** Some councils relying heavily on the use of reserves to fund services will need to take remedial action or they will run out of General Fund reserves within two to three years.
- 4** Robust medium-term financial strategies and savings plans are increasingly critical to the financial sustainability of councils.
- 5** Strong leadership is increasingly important and it is essential that councillors work effectively with officers, their partners and other stakeholders to identify and deliver necessary savings. It is important that councils engage with local communities when planning and delivering services and identifying savings.

the financial outlook for councils remains challenging

Council funding continues to fall as cost pressures increase

Scottish Government funding fell again in real terms for 2017/18

65. Councils received a further real-terms reduction of 2.3 per cent in their funding from the Scottish Government for 2017/18, reflecting the overall trend and direction of travel ([Exhibit 18, page 34](#)).

66. Councils' funding continues to include money targeted at delivering national policy commitments that restricts the overall flexibility in their budget setting. In 2017/18, this included £120 million provided for the school attainment fund and £88 million for maintaining pupil teacher ratios and for the teachers' induction scheme.



How is your council preparing for any further real terms reduction in Scottish Government funding?

Exhibit 18

Scottish Government revenue funding to councils

Local government funding fell in real terms in 2017/18 compared to 2016/17.

	2017-18 £000	Change on 2016-17 %
Cash terms		
NDR	2,666	-3.7 ▼
Revenue Grant	6,974	0.5
Total revenue funding	9,639	-0.7 ▼
Additional resource via IJBs	357	
	9,996	0.4 ▼
Real terms – 2016/17 prices		
NDR	2,623	-5.3 ▼
Revenue Grant	6,862	-1.1 ▼
Total revenue funding	9,485	-2.3 ▼
Additional resource via IJBs	351	
	9,836	-1.2 ▼

Source: Scottish Government Finance Circular 1/2017

Reductions in Scottish Government funding were only partly offset by the end of the council tax freeze

67. The council tax freeze ended in 2017/18. Twenty-four councils chose to increase council tax, with 21 approving the maximum three per cent permitted. Fourteen councils chose to remove the ten per cent discount on second homes, another option for increasing revenue. For some councils, additional income from second homes is not significant.

68. Exhibit 19 (page 35) shows the additional income councils are due from council tax in 2017/18. Additional income arising from council tax reforms to banding multipliers are also shown, but councils do not benefit from these increases as the Scottish Government funding mechanism has been adjusted accordingly.

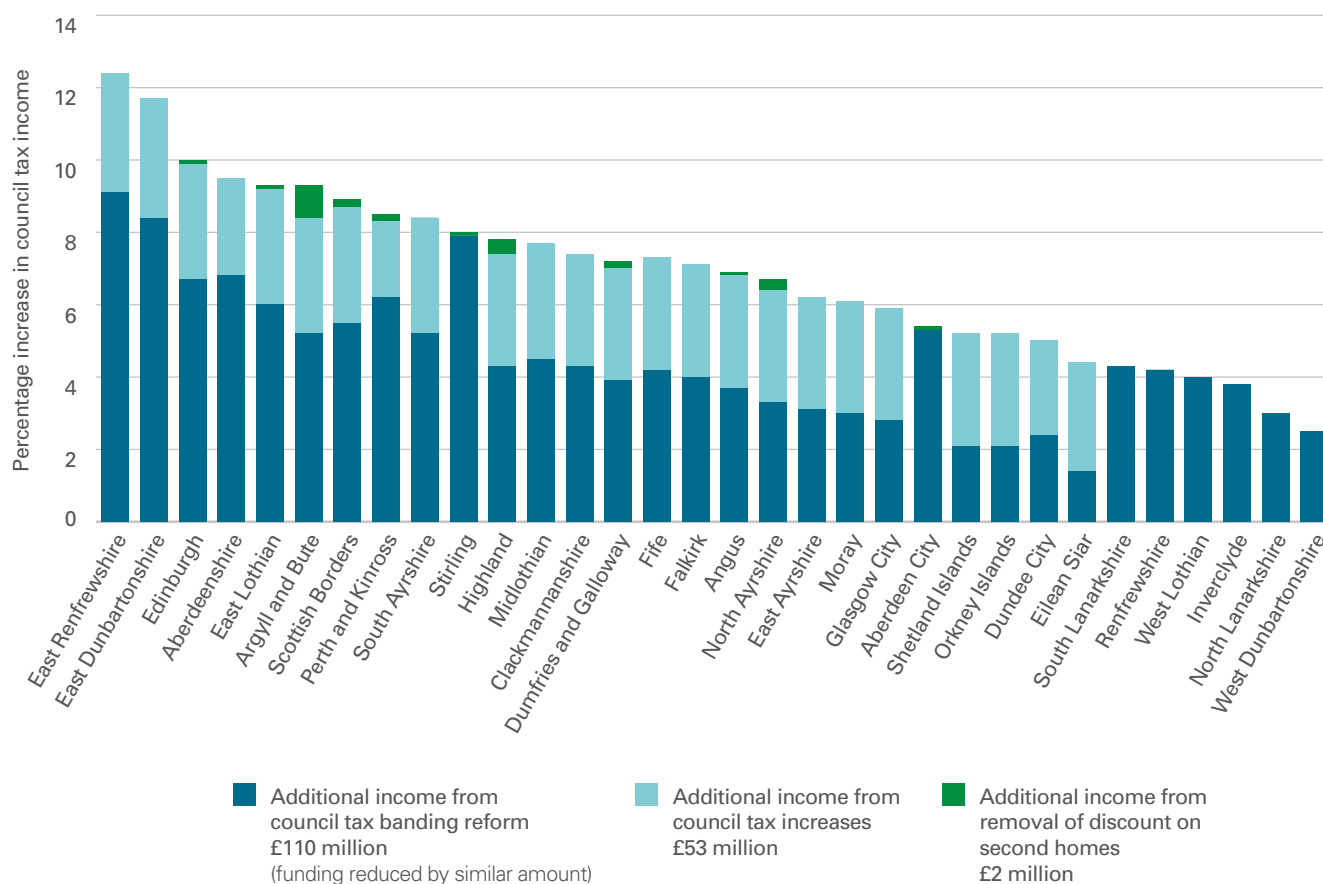


If your council plans to raise council tax, do you know how much it will raise? How will you communicate and explain the reasons for the rise to constituents?

Exhibit 19

Increase in council tax by council, 2017/18

Council tax in 2017/18 has risen as a result of reforms and the end of the council tax freeze.



Note: Council tax due before any discounts are applied.

Source: Council tax banding information and SPICe

Delivering savings is critical for councils' financial sustainability

Councils approved savings of £317 million and the use of £105 million of reserves when setting budgets for 2017/18

69. When setting budgets for 2017/18, councils had to take into account a number of new cost pressures, including:

- the introduction of the apprenticeship levy of 0.5 per cent of pay bills above £3 million
- the requirement to meet the first full year effect of the living wage
- meeting HMRC guidelines on paying the national minimum wage for care workers when sleeping over
- non-domestic rates (NDR) revaluation.

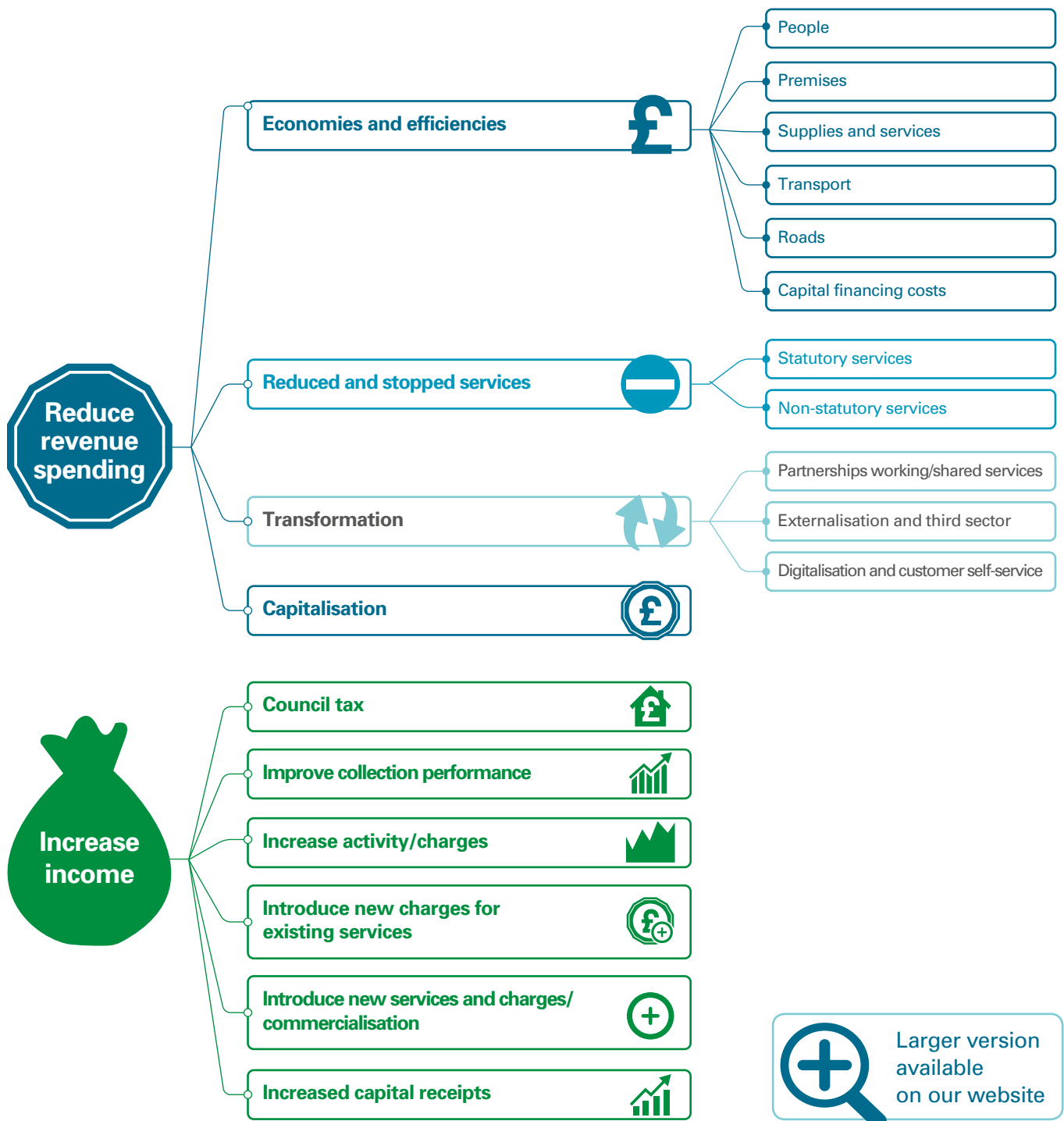


70. In balancing funding reductions and cost pressures, councils' 2017/18 budgets included approved savings of £317 million and the use of £105 million of General Fund reserves. Common measures taken by councils to close their funding gaps in 2017/18 are set out in [Exhibit 20](#). Not all initiatives to reduce expenditure are savings, some simply deferred expenditure by moving it from revenue to capital.

Does your council have a savings plan? What are the options to close future funding gaps?

Exhibit 20

Measures taken by councils to close their funding gaps in 2017/18





Some councils will need to take remedial action or they will run out of General Fund reserves within two to three years

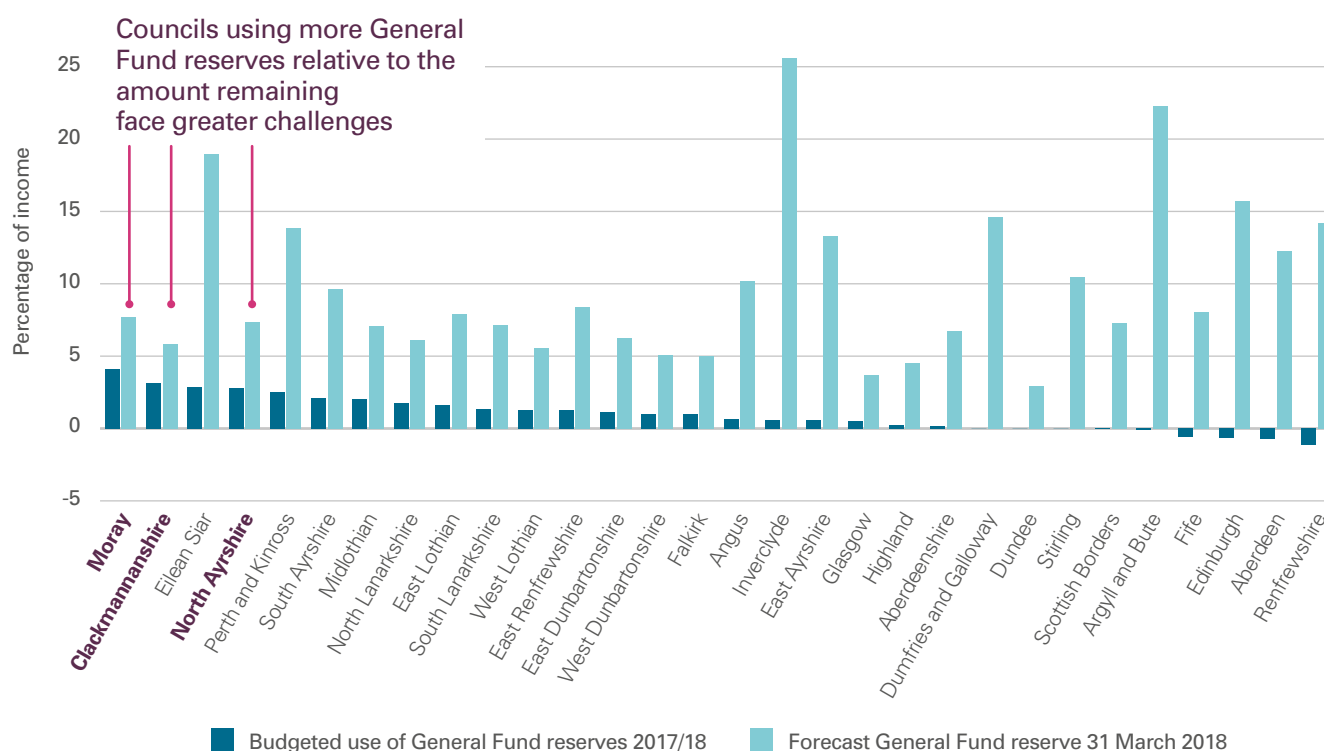
71. Some councils' plans for 2017/18 have relied more heavily than others on using reserves to bridge funding gaps. A number of these councils could have relatively low levels of General Fund reserves remaining at the end of the year ([Exhibit 21](#)).

What is the likely use of reserves for 2017/18? How does this compare to forecast funding gaps?

Exhibit 21

Budgeted use and remaining levels of General Fund reserves, 2017/18

Two-thirds of councils budgeted to use reserves in 2017/18.



Source: Annual accounts and auditor funding gap returns 2017

72. Councils using reserves to support services in 2017/18 will be faced with having to identify larger savings in 2018/19 or again using reserves. However, using General Fund reserves at the current rate is not an option for some councils – Clackmannanshire, Moray and North Ayrshire councils would run out of General Fund reserves within two to three years if they continued to use them at the level planned for 2017/18.

73. Forecasts made by councils when setting their budgets for 2017/18 indicated the overall local government funding gap would increase to about £350 million in 2018/19 and to about £650 million in 2019/20.¹⁰

74. Since setting 2017/18 budgets, councils will have changed their plans for the current year and updated their forecast funding gaps for 2018/19 and beyond. A number of factors have created further potential pressures and uncertainties, for example:

- ongoing demand pressures from people living longer and population growth
- ongoing cost pressures from general inflation



What is your council's financial position? What particular challenges does it face?

- increased staffing costs from staff moving up pay scales, proposals to end the public sector pay cap and potential increases in employers' pension contributions following the LGPS triennial funding valuation
- income and rent collection potentially becoming more difficult and costly as a result of increased charges and the continued roll-out of Universal Credit
- interest rate rises
- the potential impact from changes to NDR (as outlined in [Exhibit 22](#))
- potential impacts from the process of withdrawal from the European Union.

Exhibit 22

Barclay review of non-domestic rates (NDR) 2017

The Barclay review recommended removing NDR relief for councils' ALEOs.

Councils collect NDR and pay this into a central pool, which is redistributed back to councils by the Scottish Government.

The Government established the Barclay review group in 2016 to make recommendations that would 'enhance and reform' NDR in Scotland. The review aimed to:

- better support business growth and long-term investment
- reflect changing marketplaces
- retain the same level of income (recommendations would be 'revenue neutral').

The review concluded that some form of NDR was still appropriate. The recommendations in the report focused on measures to support economic growth, improve how the system is administered and increase fairness in the system.

In seeking increased fairness, the review recommended that councils' NDR relief for ALEOs should be removed. The review recommended that legislation be changed to remove relief for ALEOs and, in the interim, that the Scottish Government should adjust its funding to recoup an estimated £45 million of ALEO funding from councils. The review recommended this is applied from April 2018.

The Scottish Government has accepted many of the points of the Barclay review, but the recommendation around ALEOs is still being considered. The Accounts Commission will examine ALEOs in more detail in a report to be published in May 2018.

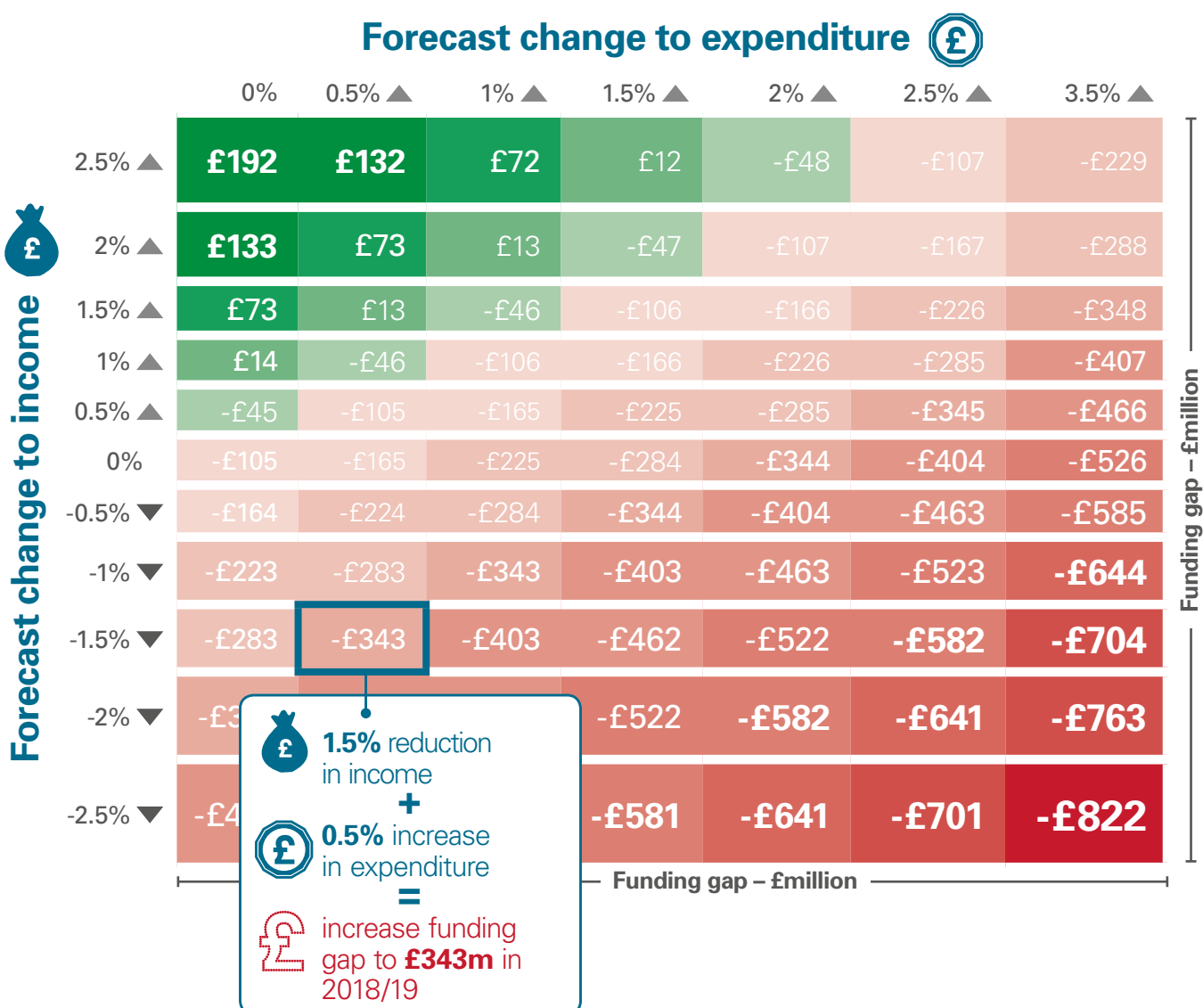
Source: Report of the Barclay Review of Non-Domestic Rates, August 2017

75. Uncertainty means that councils need to prepare for a range of possible scenarios both in terms of costs and funding and different savings options available to them. For example, if councils were to apply a further three per cent increase in council tax in 2018/19 this would raise about £68 million in additional income. In contrast, applying a one per cent increase to staff salaries would cost about £70 million. Even a small proportional increase above this as a result of lifting the public sector pay cap would have further significant costs. [Exhibit 23](#) shows the overall impact of various income and expenditure scenarios on the size of the total funding gap across councils for 2018/19.

Exhibit 23

Council funding gaps scenarios, 2018/19

In the absence of further savings, councils would use around £343 million in 2018/19 if expenditure were to increase by 0.5 per cent and income decrease by 1.5 per cent.



Source: Audit Scotland funding gap returns

Savings plans should be scrutinised and the impact assessed

76. CIPFA's report on building financial resilience and managing financial stress in local authorities highlighted the importance of planning for savings over at least a three-year period, and the need for robust challenging of plans as part of the scrutiny process.¹¹ In previous reports, the Accounts Commission has highlighted the need for councils to adopt this practice.

77. Regular updates on forecasts of funding gaps as savings are approved enable councillors to better understand the impact of the savings decisions they are making. However, currently only about half of councils routinely update their three-year financial forecasts as part of their annual budget-setting process.

78. To achieve effective financial management, long-term planning is essential. It is important that councils continue to consider likely funding scenarios and what this means for council services in the longer term as well as the medium term. For councils with lower levels of reserves, financial plans need to be increasingly detailed and robust. This will mean more work for officers and members in clearly identifying savings and assuring themselves that they have the capacity to deliver their intended plans.

79. It is important that savings plans are clear and that the impact on services is understood. Savings should be realistic and achievable. Where funding reductions are passed on to other bodies, such as ALEOs and IJBs, by reducing council contributions to them, it is equally important to assess the impact on service users and communities. Risks associated with income generation initiatives or arising from cuts to services should be explicit and considered by councillors as part of their scrutiny role.

80. Medium-term financial strategies should ensure that both revenue and capital budgets are aligned with corporate plans and that the revenue impact of capital expenditure is understood. Savings from service redesign and other initiatives need to be monitored effectively to ensure that plans and strategies continue to be relevant and accurate.

Longer-term affordability of capital programmes should be kept under review

81. Council capital programmes for 2017/18 are broadly in line with those for 2016/17, with General Fund budgets at about £2.6 billion and HRA budgets at about £800 million.

82. Councils are required to consider the affordability of their capital programmes and any new borrowing before approving them each year. Assessments will include consideration of:

- existing debt levels and servicing costs and how these may increase
- capital reserves available
- impact on running costs, eg reduced overall running costs arising from invest to save initiatives
- additional income streams that can be used to service borrowing



Does your council have a medium term financial strategy aligned with corporate objectives?

How does annual budget setting link to medium term financial planning?

What impact will savings have on the delivery of services? What are the potential risks?




How clearly does the council's capital programme link with the asset management plan and corporate objectives?

- additional funding available, eg Scottish Government funding for NPD projects, additional capital grants in respect of the City Deals (a recent initiative backed by UK and Scottish governments).

83. As revenue resources reduce, and the cost of some debt increases, it is becoming increasingly important for councils to keep the longer-term affordability of their borrowing under review. The need for robust business cases setting out how new capital expenditure will support corporate objectives is key. Capital finance and treasury management are areas covered by regulation and where councils also take professional advice. A key treasury management issue facing councils is the risk around interest rate rises, which makes decisions about the timing of borrowing important. If councils borrow in advance of their need they will incur additional interest costs in the short term. However, if the interest rates go up before councils borrow then they will be faced with paying higher interest rates for the term of any new borrowing. Recently a number of councils have been turning to short-term borrowing to keep their interest costs down but this strategy is not without risk and it is important that councils are clear about these in their plans and reports.

Effective leadership is increasingly important in maintaining financial sustainability

84. The Accounts Commission recognises that the financial challenges facing councils will inevitably mean councillors need to make difficult choices and take decisions that may not sit neatly with the manifestos they were elected on in May 2017. This requires effective political leadership and effective communications. It is essential that councillors work effectively with officers, council partners and other stakeholders to identify and deliver necessary savings. It is important that councils engage with local communities when planning and delivering services and identifying savings. We published a report [*Roles and working relationships in councils – Are you still getting it right?*](#)  (November 2016) to support councillors in their difficult and challenging role.

Addressing the underlying demand for services through transformation is key to longer-term sustainability

85. Given the scale of the challenge facing councils, we are of the view that the sustainability of some services will be increasingly dependent on the ability of councils and their partners to address the underlying demand for them. With health and social care integration, for example, much depends on the extent to which resources can be switched from treatment to prevention. Council transformation programmes need to identify and deliver changes of this nature over the longer term. It is important that councils give careful consideration to their capacity to support such change when making savings as part of budget setting.

86. The extent to which council transformation plans are delivering real changes to the way services are being delivered will be explored further in the second of our local government overview reports planned for publication in April 2018.



What additional training would you like to receive to develop your knowledge and skills in financial scrutiny?



What measures in the council's corporate and transformational plans are aimed at addressing the underlying demand for services?

Endnotes




- ◀ 1 We published the first of three planned audits on health and social care integration in 2015: [Health and social care integration](#) , December 2015. Our next national audit in this area will be carried out in 2018/19. Annual audit plans and reports for each IJB are also published on [Audit Scotland's website](#) .
- ◀ 2 This excludes income received from arm's-length external organisation (ALEOs) providing services such as leisure services on behalf of the council.
- ◀ 3 *Fiscal issues facing Local Government in Scotland*, Fraser of Allander Institute, March 2017.
- ◀ 4 East Lothian Council, Highland Council (Inverness Jobcentre only), East Dunbartonshire, Midlothian Council and Inverclyde Council (no council stock – therefore no arrears).
- ◀ 5 ALEOs are separate bodies councils create to deliver services that they previously delivered in house.
- ◀ 6 *Building financial resilience: managing financial stress in local authorities*, CIPFA, June 2017.
- ◀ 7 [Major capital investment in councils](#) , Accounts Commission, March 2013.
- ◀ 8 [Major capital investment in councils: follow-up](#) , Accounts Commission, January 2016.
- ◀ 9 For more detail on councils' implementation of equal pay, see the Accounts Commission's [Equal pay in Scottish councils](#)  report.
- ◀ 10 This forecast is based on the average of available forecasts.
- ◀ 11 *Building financial resilience: managing financial stress in local authorities*, CIPFA, June 2017.

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