

Local government in Scotland

Financial overview 2017/18



ACCOUNTS COMMISSION 

Prepared by Audit Scotland
November 2018


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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Exhibit data

When viewing this report online, you can access background data by clicking on the graph icon. The data file will open in a new window.

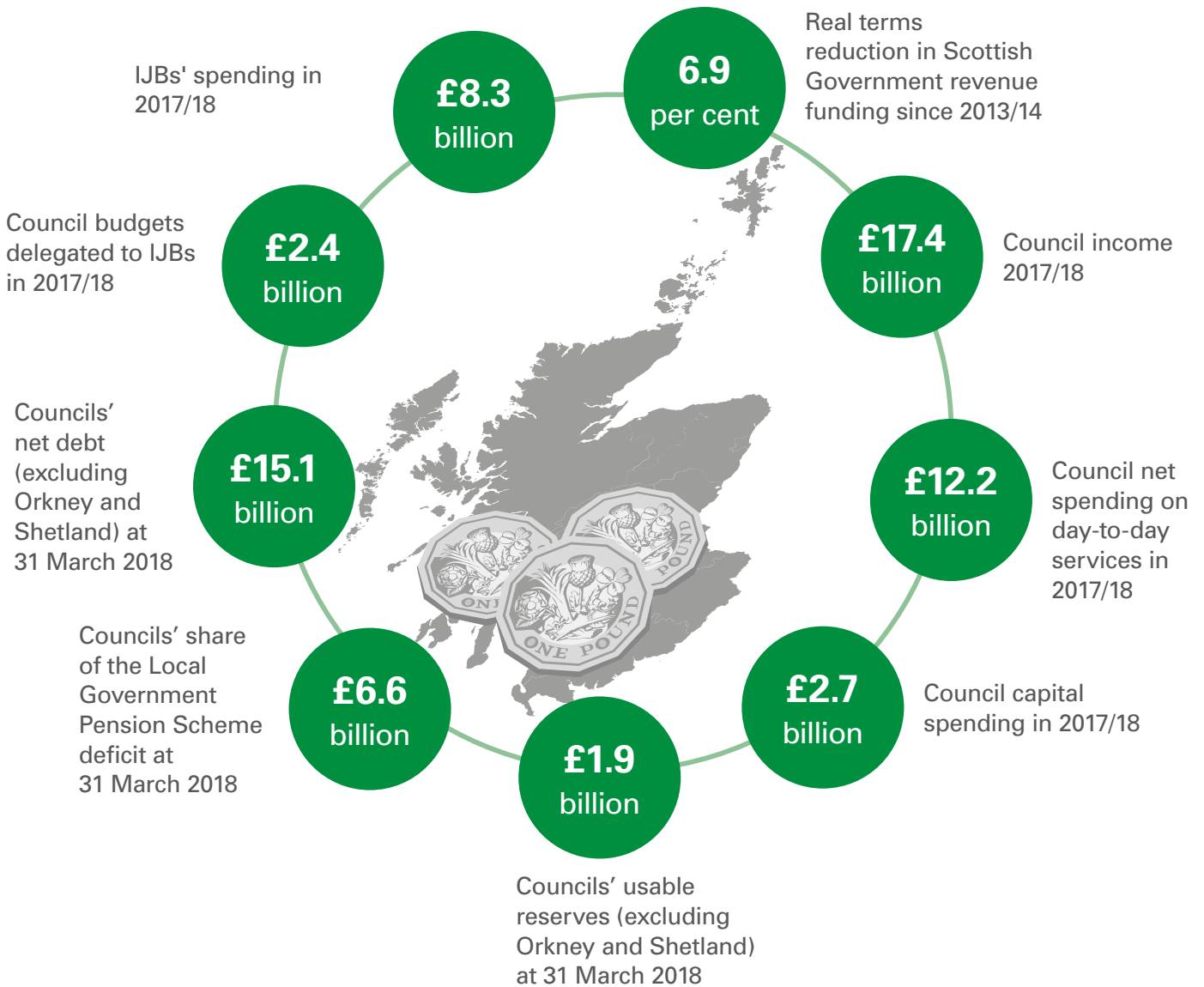
Audit team

The core team consisted of: Carol Calder, Kathrine Sibbald, Ashleigh Madjitey, Ruth Azzam and David Docherty, with support from other colleagues and under the direction of Brian Howarth.



These question mark icons appear throughout this report and represent questions for councillors.

Key facts



Chair's introduction



Welcome to the Accounts Commission's 2018 financial overview report for local government.


This report reflects a similar situation to last year as councils face an increasingly complex range of challenges and continuing pressure on finances. Challenges include increasing demand across many of the wide range of services councils deliver to local communities. Demand has to be met against tightening budgets in many service areas along with uncertainty stemming from external factors such as EU withdrawal.

One of the most significant issues for councils continues to be funding. In 2017/18, funding from the Scottish Government, councils' main source of funding, again reduced in real terms. The reduction was largely offset by increases in council tax and councils' fee income, with most councils applying the maximum three per cent increase to council tax. In total, the net effect of Scottish Government and council action was a reduction in funding of only 0.1 per cent in real terms although the impact on individual councils varied. In general, increased spending in education and social work was offset by reductions in other services. I would also note that the relationship of funding of individual councils to areas of deprivation remains unclear.

The forecast trend is for further reductions in funding from the Scottish Government in the medium term. Pressure therefore remains on councils to make further savings and find ways to meet service demand more efficiently and effectively. This will require difficult decisions and innovative thinking by councillors and senior management working together.

It is important that these decisions are taken in a planned and coordinated way. It is positive progress that almost all councils now have medium-term financial planning in place and some have made progress with long-term financial projections. I would encourage all councils to build on medium-term plans and develop suitable long-term financial planning. This supports consistency in financial decisions with corporate priorities and outcome aims, as well as supporting transformation initiatives. Councillors also need to be clear about the potential impact of planned savings or changes to fees and charges on the local community and economy as well as on achieving corporate objectives.

Last year, we highlighted the risk for some councils plans to use significant amounts of their reserves to manage funding gaps. I am pleased that this year, although overall reserves have continued to reduce, no council is using its reserves at a level that risks their financial sustainability in the next two to three years. We will continue to have an interest in how councils set their reserves policy and utilise reserves as funding pressures continue in the coming years.

The Commission recognises that one of the other most significant challenges for councils are financial issues associated with the Integration Joint Boards (IJBs). The majority of IJBs have underlying financial sustainability issues and without year-end support from the NHS and council partners, 20 out of the 30 IJBs would have reported deficits. In November 2018, we published a report on progress with [Health and social care integration](#) . This highlighted areas for improvement, including financial management and financial planning. The Commission will continue to keep a focus on IJBs and consider how best to monitor their progress in future.

Finally, we welcome that the audits of annual accounts from all 32 councils were signed off with no qualifications. This is testament to the hard work of council staff, especially those within the finance function, and of our auditors. We also note that again there has been some progress with the quality of reporting on financial matters. However, we encourage councils to continue to improve the transparency and clarity of financial information provided to councillors and the public.

I hope you find this overview useful and would welcome any feedback you may have.

Graham Sharp

Chair of Accounts Commission

Summary





Key messages

- 1** Councils depend on Scottish Government funding for a significant part of their income. Scottish Government revenue funding to councils reduced in 2017/18, in cash terms by 0.6 per cent (£0.06 billion) and in real terms, by 2.3 per cent (£0.22 billion). Council tax increases and increased fees and charges were used by councils to increase overall budgets by £0.3 billion (cash terms).
- 2** In 2017/18, councils managed funding gaps of four per cent in their net expenditure budgets of £12 billion, mainly through savings and planned use of reserves. Councils are under pressure to find different ways to fund and deliver services. In 2017/18, 24 councils increased council tax, whereas in 2018/19, all councils increased council tax.
- 3** Overall increases in spending in Education and Social Work were offset by reductions in other services.
- 4** Eighteen councils ended 2017/18 with lower levels of usable reserves than they had at the start of the year. Total usable reserves fell by £18 million, a relatively small amount.
- 5** Funding to the Integration Joint Boards (IJBs) increased in 2017/18 by three per cent in cash terms (1.4 per cent in real terms), including additional funding from the NHS. The majority of IJBs have underlying financial sustainability issues, with 20 incurring deficits or dependent on additional ('deficit') funding from their partners.
- 6** The financial outlook is for reductions in Scottish Government revenue funding to councils. This will mean continued and increasing financial pressures on council services, especially those that are not protected.
- 7** The impact of EU withdrawal is not yet clear, but councils need to identify the risks and develop contingency plans to manage these risks.

councils managed funding gaps of four per cent in their net expenditure budgets of £12 billion, mainly through savings and planned use of reserves

About this report

- 1.** This report provides a high-level independent analysis of the financial performance of councils during 2017/18 and their financial position at the end of that year. 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. The second report comments on the wider challenges and performance of councils. It will be published at the end of the financial year, in March 2019.
- 2.** Our primary sources of information for the financial overview are councils' 2017/18 audited accounts, including management commentaries and the 2017/18 external annual audit reports for each council. 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 on a different basis from the spending information that councils record in their annual accounts. We do not audit data contained in the LFRs.
- 3.** We refer to 'real-terms' changes in this report. This means we are showing financial information from past and future years at 2017/18 prices (and 2018/19 prices where 2018/19 comparisons are made), adjusted for inflation so that they are comparable. We also refer to figures in 'cash terms'. This means we are showing the actual cash or money paid or received.
- 4.** Throughout the report, we identify examples of questions that councillors may wish to consider, to help with understanding their council's financial position and to scrutinise financial performance. The Accounts Commission encourages councillors to use an appropriate level of scepticism in scrutiny and ensure they receive sufficient information to answer their questions fully. The example questions are also available on our website in [Supplement 1: Scrutiny tool for councillors](#) .
- 5.** 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 will also publish a separate supplement on the Local Government Pensions Scheme (LGPS) in December 2018.
- 6.** Orkney and Shetland have been excluded from some exhibits that show usable reserves and debt. This is because their values would make it difficult to see the relative positions of other councils. Most councils hold usable reserves of between seven and 36 per cent of their annual revenue, whereas Shetland's reserves were 260 per cent of its annual revenue and Orkney's 329 per cent of its annual revenue. These large reserves relate to oil, gas and harbour-related activities. Both Orkney and Shetland also have significant investments rather than borrowing, unlike other councils.

Part 1

Councils' budgets and spending in 2017/18



Key messages

- 1** Councils depend on Scottish Government funding for a significant part of their income. Scottish Government revenue funding to councils reduced by 2.3 per cent (£0.2 billion) in real terms in 2017/18, but council tax, grants to services and fees and charges increased, and overall budgets grew by £0.3 billion in cash terms.
- 2** Between 2013/14 and 2017/18, funding from the Scottish Government to local government decreased at a faster rate, 6.92 per cent, than the Scottish Government revenue budget at 1.65 per cent.
- 3** Distribution of funding from the Scottish Government is based mainly on population but could be more transparent to ensure clarity about how funding distribution reflects factors that drive demand and costs in councils.
- 4** In 2017/18, councils managed funding gaps of four per cent in their net expenditure budgets of £12 billion, mainly through savings and planned use of reserves. Their outturn at the year-end was better than budgeted.
- 5** Overall increases in spending in Education and Social Work were offset by reductions in other services

Scottish Government revenue funding to councils reduced by 2.3 per cent (£0.2 billion) in real terms in 2017/18

Council funding

The main source of councils' funding is the Scottish Government

7. Scottish councils get their annual funding and income from a range of sources ([Exhibit 1, page 10](#)). In 2017/18, these totalled £17.4 billion. The main source of funding is the Scottish Government, contributing 55 per cent. In 2017/18, the Scottish Government provided £9.65 billion (compared to £9.71 billion in 2016/17). Within this total, a relatively small element (two per cent, £211 million) is for specific policy areas, such as the Pupil Equity Fund, previously known as the Attainment Scotland Fund. This has increased from £91 million (one per cent) in 2016/17.

Although Scottish Government funding reduced, increases in council tax and charges increased the total amount available to councils to meet expenditure

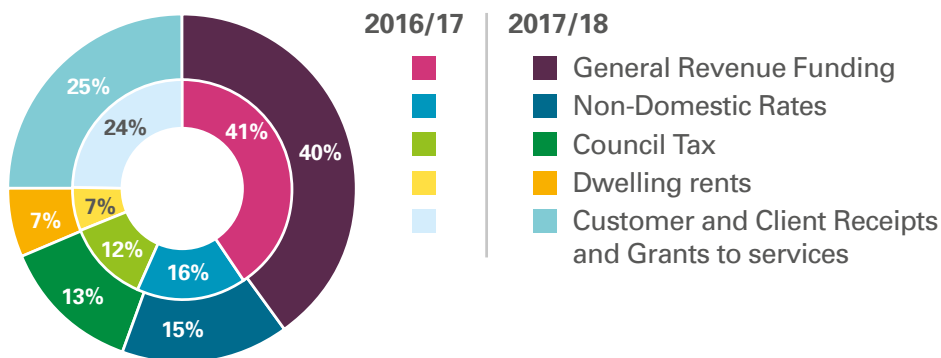
8. Total income and funding of £17.4 billion is an increase from £17.1 billion in 2016/17. Reductions in Scottish Government funding of £57 million have been

more than countered by increases in charges and grants to services, dwelling rents and council tax totalling £328 million. In total, this means that total income and funding is £271 million more in 2017/18 than 2016/17. Across Scotland in 2017/18, 13 per cent of income, £2.3 billion, was generated through council tax and 25 per cent, £4.3 billion, through fees, charges and grants credited to services.

Exhibit 1

Sources of council revenue income, 2017/18

Total funding and income to councils in 2017/18 was £17.4 billion.



Source: Finance Circulars and Audited Financial Statements



An element of Scottish Government 2017/18 funding was agreed late, limiting councils' ability to properly plan and agree their budgets

9. Provisional funding allocations for 2017/18 were issued to councils on 15 December 2016 and further increases were agreed and communicated to councils in a letter from the Finance Minister, on 2 February. The financial circular of 9 March 2017 confirmed these changes. The amount to be distributed to councils as revenue funding increased by £182 million (1.9 per cent). Councils agree their budgets at meetings during February and March. One council noted in its budget papers that 'In the last few days, (the Finance Minister) announced ...change(s) on 2nd February, the day before the administration's budget proposals were due to be signed off'. Another council noted that a 'very late and material revision was made to the revenue grant settlement... present(ing) challenges in terms of configuring a balanced budget at short notice and ensuring value for money spending proposals'. Receiving significant changes at a late stage in the budgeting process limits the time available to councils to plan, discuss and agree budgets.

Scottish Government Revenue funding fell by 2.3 per cent in real terms in 2017/18

10. Exhibit 2 (page 11) shows that in 2017/18 the **total revenue funding** ⁱ from the Scottish Government reduced by 0.6 per cent in cash and 2.3 per cent in real terms. Including additional funding of £34.5 million and health and social care funding via the NHS, Scottish Government funding was reduced by 0.8 per cent in real terms in 2017/18, compared to the previous year.



Total revenue funding:

This consists of general resource grants, specific revenue grants (together known as revenue grants), and Non-Domestic Rates income (NDR).

Total revenue funding does not include the additional £34.5 million added at Stage 1 of the Budget Bill to be paid in 2017/18 in respect of 2018/19. It also does not include health and social care funding paid to local government via the NHS.

Exhibit 2

Changes in Scottish Government funding in 2017/18

Scottish Government Revenue funding fell by 2.3 per cent in real terms in 2017/18.

	2016/17 £m	2017/18 £m	Cash %	Real %
Revenue Grant	6,939	6,985	0.7 ▲	-1.0 ▼
NDR	2,769	2,666	-3.7 ▼	-5.3 ▼
Total revenue funding	9,708	9,651	-0.6 ▼	-2.3 ▼
Further funding		35 ¹		
Health & social care funding via NHS	250	357		
	9,958	10,043	+0.9 ▲	-0.8 ▼

Note: £34.5 million was added at Stage 1 of the Budget Bill to be paid in 2017/18 and 2018/19. Accounting standards meant that this was correctly treated as 2017/18 income by councils.

Source: Finance Circulars 1/2017 and 4/2018

11. In 2017/18, the Scottish Government paid an additional £107 million to NHS boards to assist with health and social care. This was used mostly to offset new living wage and sleepover costs of care workers in local government.

Local government funding has reduced at a faster rate than other areas of the Scottish public sector

12. In May 2018, the Scottish Parliament Information Centre (SPICe) reported that between 2013/14 and 2017/18, funding from the Scottish Government to local government decreased at a faster rate than the Scottish Government revenue budget; 7.1 per cent and 1.8 per cent respectively. Using a similar approach, but with up-to-date inflators, the reductions have been 6.92 per cent and 1.65 per cent ([Exhibit 3, page 12](#)). This demonstrates a significantly higher impact on total local government funding compared to the total Scottish Government revenue budget. In cash terms, the funding from the Scottish Government to local government has fallen by 1.18 per cent while the Scottish Government revenue budget has grown by 4.41 per cent.

Distribution of funding from the Scottish Government could be clearer about how it reflects factors that drive costs in councils

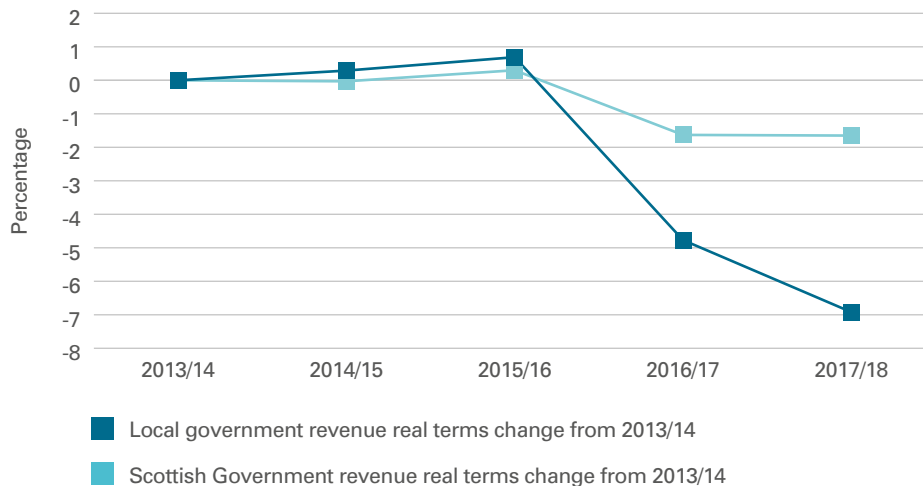
13. As we reported last year, the Scottish Government and COSLA's mechanism for distributing funding to councils is the main determinant of a councils' overall funding. Grant-aided Expenditure, or GAE, is a needs-based methodology, used to allocate the Scottish Government's pre-determined spending review totals among councils. It is made up of 89 indicators such as 'services for people with disabilities' and 'road maintenance'. These indicators are weighted to reflect factors that impact on the demand for and cost of delivering services, for example, 'the size of the 16 to 64 year-old population' and 'length of roads to maintain'.

14. The weighting factors determine the proportion of GAE funding that goes to each council. It is important to note that GAE is purely a methodology to redistribute spending review totals: councils are not obligated to spend the specific amounts on each area identified in the methodology.

Exhibit 3

Real terms change in revenue funding for Scottish Government and councils since 2013/14

Scottish Government revenue budget has fallen by 1.65 per cent between 2013/14 and 2017/18, while revenue funding to councils has fallen by 6.92 per cent over the same period.



Note: Local government funding shown is General Revenue Grant funding, other ring-fenced funding, and NDR.

Source: Audit Scotland; and SPICe



15. Since 2008/09, the total amount of GAE has remained at £7.9 billion and the weighting allocated to each GAE indicator has stayed the same. Each year the councils' relative proportion of funding has been recalculated using the 89 indicators, which means that the amount each council receives may change as its 'population', 'number of teachers', or value of other indicators change. However, the methodology used, and relative importance of each indicator used in arriving at the overall distribution of GAE has not changed in ten years.

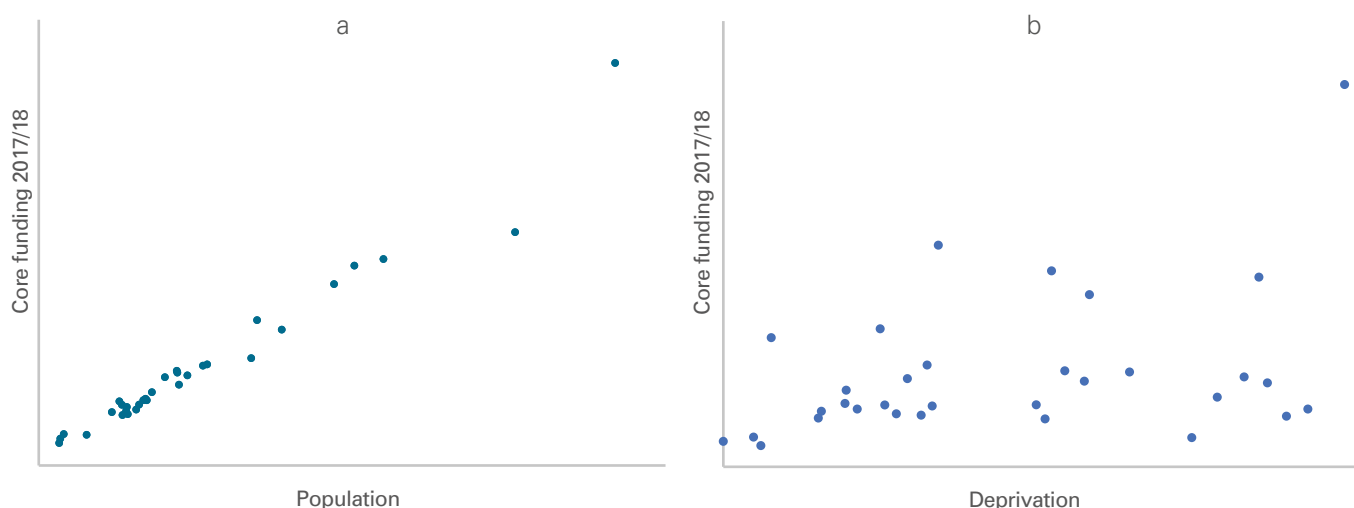
16. The majority of GAE is allocated according to population-based factors. Other factors are far less significant influences on total funding. For example, those which might be considered to link to deprivation, for example 'the number of current income deprived', are linked to a much smaller proportion of funding than population-based weighting factors.

17. This is demonstrated when we consider the relationship between how much funding a council receives and its population size and deprivation levels. The former is a very strong determinant of overall funding and the latter is only a moderate to weak factor ([Exhibit 4, page 13](#)). Given Scotland's demographic changes and the Scottish Government's commitment to tackling social and economic inequality, there is a risk that the GAE weightings no longer sufficiently represent need.

Exhibit 4

Scottish Government core funding compared to council population size and deprivation levels

The majority of core funding is allocated to councils according to population-based factors. A much smaller proportion of factors linked to deprivation influences funding levels.



Note: Deprivation has been calculated using the percentage of datazones in the council which are in the 30 per cent most deprived datazones in Scotland. Based on the Scottish index of multiple deprivation (SIMD).

Source: Scottish Government finance circulars; National Records for Scotland 2017 population estimates; and Scottish Index of Multiple Deprivation.



18. Scottish Government funding provided to councils on top of the GAE funding allocation, £3.7 billion in 2017/18, is either distributed using the same proportions as the GAE funding or through a separate methodology agreed by the Scottish Government and COSLA. The Scottish Government advises that in 2017/18, £0.2 billion was distributed using the GAE methodology and £3.5 billion through individual separate methodologies. The basis of the calculations for the separate methodologies are not publicly available and should be more transparent.

19. The £3.7 billion funding includes former ring-fenced grants, new policy commitments (since 2008/09), additional funding from the government spending reviews, special island needs allowance and loan charges. This funding, alongside the GAE, makes up the 'total estimated expenditure' which is then adjusted to take account of expected council tax and non-domestic rates income and specific ring-fenced grants such as the Pupil Equity Fund.

20. The Scottish Government and COSLA have two groups that consider the funding distribution allocations on a regular basis, the settlement and distribution group (SDG) which is supported by the data issues working group (DIWG). These groups work on understanding the strategic issues behind the distribution of funding and updating the data behind the indicators. Both groups include membership from Scottish Government, COSLA and several Directors of Finance. We recognise that a review of funding distribution is difficult in times of reducing budgets, as there will inevitably be some councils that end up with smaller allocations of funding, putting further strain on already tight budgets. But we continue to believe that it is important that the Scottish Government and COSLA assure themselves that the funding formula remains fit for purpose.

Council tax changes raised a further £189 million in 2017/18

21. Council tax is another important source of income for councils. In 2017/18, £2.3 billion, 13 per cent of council funding came from council tax, which is set by individual councils. Councils raised a further £189 million in 2017/18 through council tax, compared to 2016/17.

22. In 2017/18, the Scottish Government’s council tax freeze was lifted but with a maximum increase of three per cent. Twenty-four councils chose to increase council tax, with twenty-one increasing rates by the maximum three per cent ([Exhibit 5](#)). This raised an estimated £49 million.

23. The national changes in 2017/18, also included increases to the council tax bands E to H and removal of second-home discounts. These changes raised the remaining £140 million and benefited councils with a relatively higher proportion of higher banded properties.

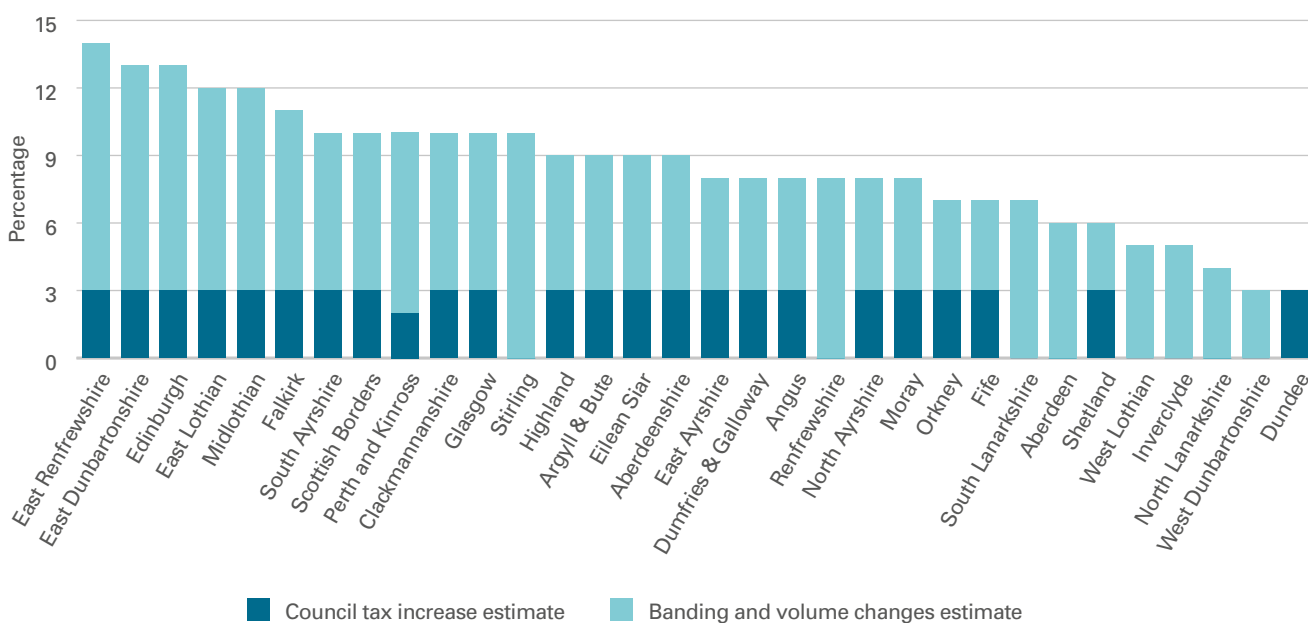
A significant element of income comes from fees, charges, house rent and grants taken directly to services

24. In 2017/18, 32 per cent (£5.4 billion) of councils’ income was generated from fees, charges, rents and grants taken to services. The majority of this sum comes from two sources including house rents and grants from government and other bodies, such as the Department of Work and Pensions, which are credited to services. A smaller proportion of this money is raised from a wide range of charges for services including parking charges, music tuition in schools and fees for road closure consent. These are not easily distinguishable in the audited financial statements.

Exhibit 5

Increase in council tax income by council, 2017/18

Council tax changes raised a further £189 million in 2017/18.



There is significant variation between councils in charges for services

25. There is wide variation in what councils charge for and the level of charge made for services. In 2017/18 and 2018/19, there is variation in how councils are making increases to their income from fees and charges. Some councils are making incremental increases across the range of charges and fees they use. Some councils are making significant increases to groups of fees and charges, such as those related to commercial waste, harbour management or to burial and cremation. Some councils are introducing new fees and charges, these include, for example, charges for garden waste collection, use of residential centres, car parking charges, public toilets, and for pest control.

26. An analysis of a sample of 16 types of charges, from data provided by local audit teams in each council, indicates that from 2016/17 to 2018/19, 11 increased by more than the rate of inflation. Inflation over the two-year period has been calculated at 4.7 per cent. The service charges which showed the highest increases were:

- purchase of grave (lair), where of the 22 councils that had provided information on fees, the average increase was 20 per cent
- adult burial (interment), where 23 councils reported an average increase of 12 per cent
- junior swimming access, where 11 councils reported an average increase of 11 per cent.

Councils' budgets 2017/18

Councils identified some consistent pressures in setting their 2017/18 budgets

27. Councils' 2017/18 budget papers identified some common themes in the pressures that councils were identifying. These include:

- Staff costs – as the single most significant expenditure for councils, changes to staff-related costs can generate significant pressure on budgets. Specific pressures included:
 - Pay inflation was a consistent pressure across councils. The Highland Council identified pay and pensions pressures of £4.2 million (0.7 per cent of its budget).
 - The introduction of the living wage and sleepover arrangements: this affected adult care services particularly. Renfrewshire Council's budget identified this pressure as £2.0 million (0.5 per cent of its budget)
- Other costs – inflationary pressures. Renfrewshire Council identified the ending of commissioned contracts and the renegotiation of new national care home contracts in adult care services as a budget pressure of £1.2 million (0.3 per cent of its budget).
- Financing costs – when a council borrows or invests in assets it can incur additional financing costs that become a new annual budget pressure. The Highland Council budgeted for additional pressures of £4.3 million (0.7 per cent of its budget) (including additional loans charges and unitary charges).



Does your council have a charging policy?

Is it in line with corporate plans and objectives?

When was this last reviewed?

Do you receive sufficient information about the potential impact on the service and wider community when making decisions about changing fees and charges?

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



How do you engage with the budget-setting process and ensure you have the opportunity to influence the development and content of a strategic budget?

- Apprenticeship levy – this is a new levy on bodies of 0.5 per cent of pay bills above £3 million. The Highland Council identified this as a pressure of £1.2 million (0.2 per cent of its budget), East Ayrshire as £0.8 million (0.2 per cent of its budget) and Dundee City Council £1.0 million (0.3 per cent of its budget). Budgets tended not to assume receipt of funding or grants from the Scottish Government or Scottish Apprenticeship Advisory Board in respect of the levy.
- Demand costs – increasing demand for services was noted as a cost pressure. This was most distinct in adult care services. Renfrewshire Council identified this as £1.2 million (0.3 per cent of its budget). East Ayrshire Council agreed to fund demand pressures in adult social care of £2.0 million (0.6 per cent of its budget).

Budgeted net expenditure of £12.4 billion included 'funding gaps' of four per cent

28. Councils' 2017/18 budgets identified total final net expenditure budgets of £12.4 billion. This is after fees, charges and grants are credited to services as budgeted income. These total net expenditure budgets were not fully met by remaining income from core Scottish Government funding, including NDR, and council tax. The shortfall or 'funding gap' was £0.5 billion (four per cent).

Funding gaps were managed by planned savings and temporary use of reserves

29. Councils identified funding gaps of up to six per cent of total revenue, but still managed to present balanced budgets through:

- planned budget savings of £0.4 billion (three per cent of revenue funding). These included management and staff reductions and restructuring, service redesign and procurement
- planned use of £0.1 billion of unearmarked reserves.

Some councils reverted to a temporary planned use of reserves due to the uncertainty presented by the local government elections in May 2017

30. The local government elections in May 2017 had a bearing on some councils' approach to budget-setting. With outgoing administrations and the possibility of changed incoming administrations, officers did not feel able to agree transformational savings plans with outgoing administrations or have confidence that these could be sustained with new incoming administrations. This meant that reserves were used as a short-term contingency to manage funding gaps in 2017/18 until wider transformational plans could be agreed with new administrations. This demonstrates why medium and long-term financial planning is important.

Councils' outturn against their 2017/18 budget was more favourable than planned

31. 2017/18 net expenditure was £12.2 billion compared to the final budget of £12.4 billion. Common themes for this improved position were savings on staff costs and loan charges.

32. As we noted above the planned use of reserves was £105 million. The actual use of revenue reserves was much lower at £38 million and those that planned to use unearmarked General Fund reserves to balance the budget did not need to use reserves in line with their plan.



How does annual budget-setting link to medium and long-term financial planning in your council?



Does your council have a savings plan?

What are the options to close future funding gaps?

How well are you kept informed about progress in delivering those savings?

Overall increases in spending in education and social work were offset by reductions in other services

33. Scottish Government provisional outturn data identified expenditure grew by 1.1 per cent in cash terms, compared to 2016/17. In real terms it fell by 0.6 per cent. There were significant differences in expenditure between services:

- Education expenditure increased by 3.2 per cent (1.5 per cent in real terms). This reflects several national priorities including raising attainment.
- Social Work expenditure increased by 2.4 per cent (0.7 per cent in real terms). This included funding the living wage and demand pressures.
- Other 'non-protected' services fell by 2.6 per cent (4.3 per cent in real terms). This includes environmental services, culture and related services, planning and development services, and roads and transport.



Which service areas are under the most pressure to make savings?

What impact will savings have on the delivery of services and outcomes for service users, the wider community and the local economy?

What are the potential risks?

Part 2

Councils' financial position



Key messages

- 1** Eighteen councils drew on their usable reserves in 2017/18, overall by a relatively small amount.
- 2** Some councils have relatively higher levels of debt for their size.
- 3** Local policies vary on whether cash and investments are held to support reserves. This could increase the need for further future borrowing.
- 4** Capital expenditure in 2017/18 decreased by five per cent in real terms. Housing and education were the main areas of investment. Despite this the number of social houses provided by councils continues to fall.
- 5** Some councils have had significant increases in their debt positions.
- 6** There were delays with the valuation of pensions liabilities in councils across Scotland in 2017/18, but the net pension liability has reduced substantially in 2017/18.
- 7** Management commentaries in councils' accounts should do more to explain financial outturn against budget.

in 2017/18, councils drew on their usable reserves by £18 million, a relatively small element of usable reserves

Councils' financial position

In 2017/18, councils drew on their usable reserves by £18 million, a relatively small element of usable reserves

34. In last year's overview report we noted that more councils were drawing on their usable reserves. This trend continued in 2017/18, with 18 councils ending 2017/18 with lower levels of usable reserves than they had at the start of the year. In 2016/17, 20 councils were in this position.

35. Some councils added to their usable reserves including South Lanarkshire (increased by £15 million, 15 per cent), Stirling (increased by £6 million, 22 per cent) and Dundee (increased by £7 million, 35 per cent), due to significant in-year surpluses relative to the usable reserve balance. One council had a significant reduction in usable reserves: Aberdeen City reduced its usable reserve by £21 million (25 per cent), through a combination of a General Fund deficit and using part of its capital reserve.



What is the council's reserve policy?

What have reserves been used for in recent years?

Supporting services and bridging the funding gap or transforming services?

36. It is important that councillors are aware how usable reserves are being used each year, especially where the cumulative scale of this is potentially significant to financial sustainability. Northamptonshire County Council, in its 2017/18 financial statements, identifies that 'financial pressureshave led to a position where the council has had to utilise almost all of its General Fund (£12 million) and earmarked reserves (£5.5 million) in order to deliver a balanced year-end outturn for 2017-18.' Our analysis based on 2018/19 budgets and levels of General Fund reserves indicates there are no short-term concerns in Scottish councils.

The overall total General Fund position is consistent with 2016/17 at £1.15 billion

37. Usable reserves held by councils totalled £2.4 billion. This includes General Fund balances and other statutory reserves. Within this total the General Fund balance remains relatively unchanged from 2016/17 at £1.15 billion. The nature and value of usable reserves are shown in [Exhibit 6](#).



What are the different types of usable reserves your council holds?

Do you know what these can be spent on?

Is it clear that the reserves are needed for the purposes they are assigned?

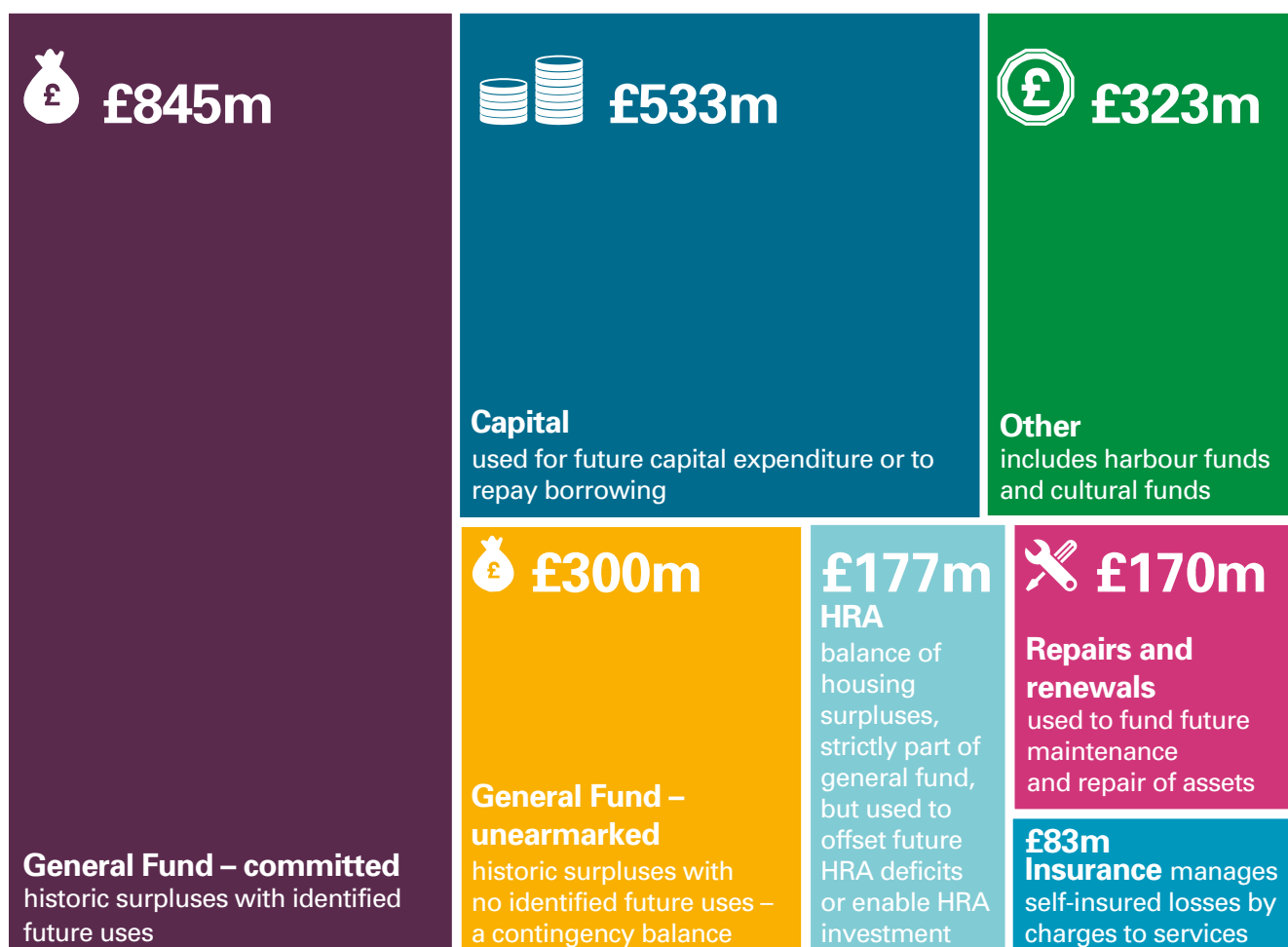
Are the reserves sufficient for those purposes?

Could the reserves be better used for something else?

Exhibit 6

The relative size and nature of council's usable reserves


In 2017/18, usable reserves held by councils totalled £2.4 billion.



There is significant variation in the relative size and the nature of reserves held

38. Councils adopt different strategies for creating and managing their reserves, with some councils operating significant capital funds with associated investment plans. This provides a significant variation in the nature and extent of funds held ([Exhibit 7](#)). Councillors should scrutinise the nature, extent and timing of plans for using specific and committed funds to ensure that these remain valid, appropriate and reasonable.

Some councils have relatively higher debt than others

39. Councils' **net debt**  varies by between 45 per cent of annual revenue in Shetland to 203 per cent in West Dunbartonshire ([Exhibit 8, page 21](#)). Higher levels of debt lead to higher annual costs of servicing this debt and councils need to ensure this is affordable. West Dunbartonshire has total debt of £535 million offset by cash assets of £22 million. This is a net external debt of £513 million compared to annual revenue of £253 million (from council tax, NDR, revenue support grant and dwelling rents).



Gross debt/net debt:

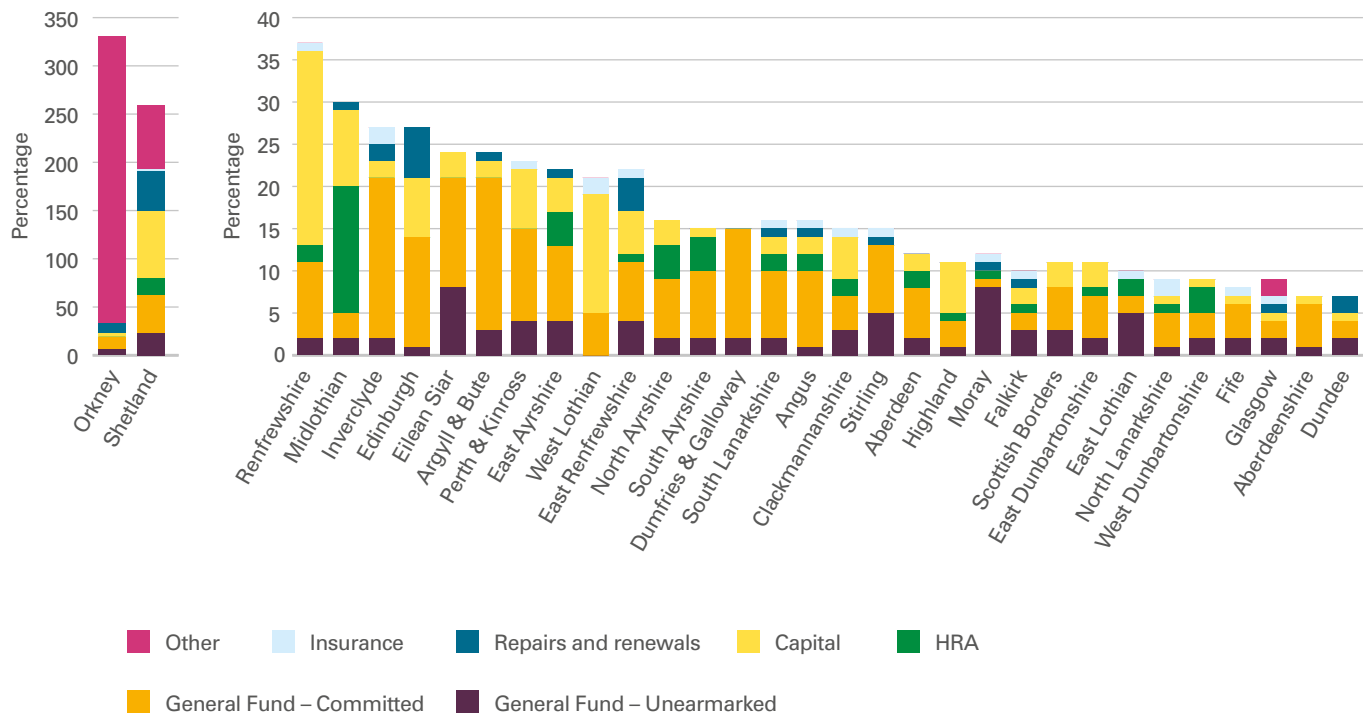
Gross debt is the total outstanding borrowing and the liabilities associated with PFI/PPP/NPDO and HuB schemes.¹ This includes both long and short-term balances.

Net debt is 'gross debt' less any cash or investments, which form part of the council's overall approach to treasury management.

Exhibit 7

Usable reserves as a percentage of council annual revenue

There is significant variation in the relative size and the nature of reserves held.



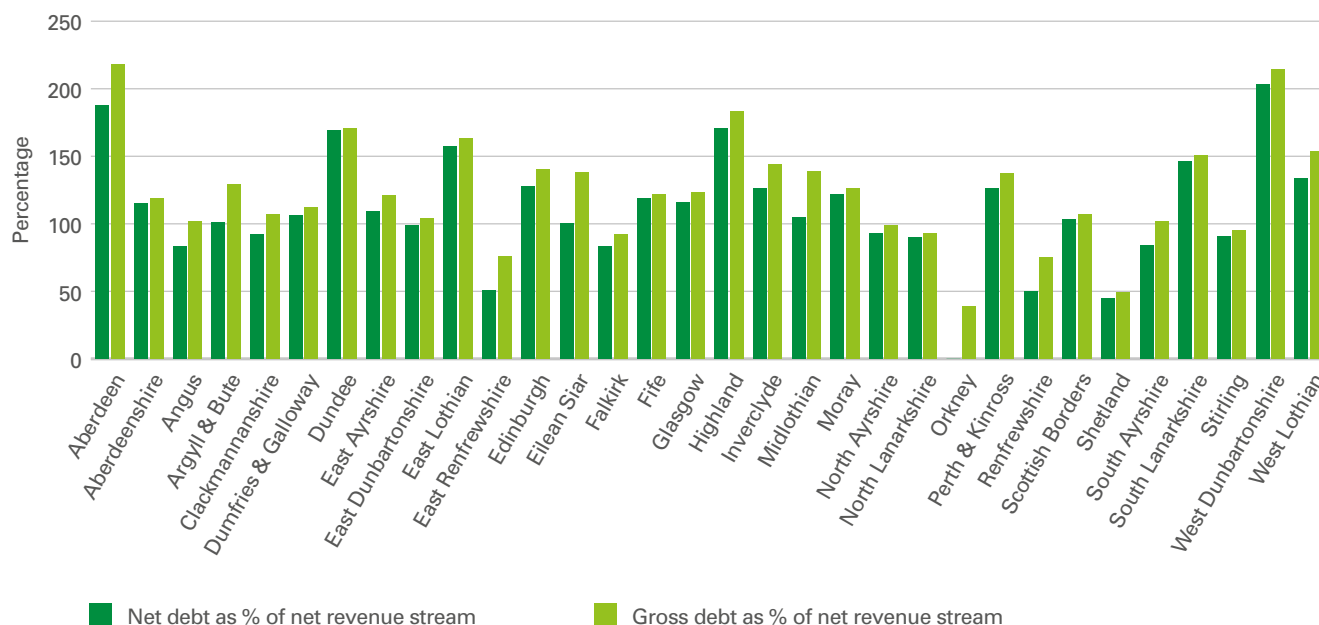
Source: Audited financial statements 2017/18 (Orkney and Shetland have reserves which are above 250 per cent of their annual revenue)



Exhibit 8

Council gross and net external debt compared to its annual revenue

Councils' net borrowing varies between 45 per cent of annual revenue in Shetland to 203 per cent in West Dunbartonshire.




Note: NRS is the net revenue stream, ie the net spending used for day-to-day delivery of council operations.

Source: Audited financial statements 2017/18 (Orkney is excluded as it has net investments)



Councils don't always have cash to support reserves and might need to borrow further

40. Thirteen councils have significant cash or investments that can be used to support the reserves position ([Exhibit 9, page 22](#)): spending reserves would reduce the cash or investments held. However, other councils have chosen in the past to use their cash or investments to fund capital spending rather than take on further borrowing. This means that some councils would need to borrow further over the longer term to provide the cash to spend on commitments identified in their reserves. This borrowing would increase their 'underlying' debt position from the position shown in [Exhibit 9](#).

41. Councillors should be aware of the current borrowing position and the potential need for future borrowing when agreeing authorised borrowing limits as part of the [prudential code](#) .

Capital spending in real terms reduced by five per cent in 2017/18

42. In real terms, capital expenditure decreased by £138 million (five per cent) between 2016/17 and 2017/18 to £2,698 million. [Exhibit 10 \(page 22\)](#), illustrates the level of capital expenditure across the main services areas. The majority of investment is in schools' estate, new social housing and major refurbishment of social housing.



What is the council's current debt position?

Do you have clear information about the potential need for future borrowing when agreeing authorised borrowing limits?

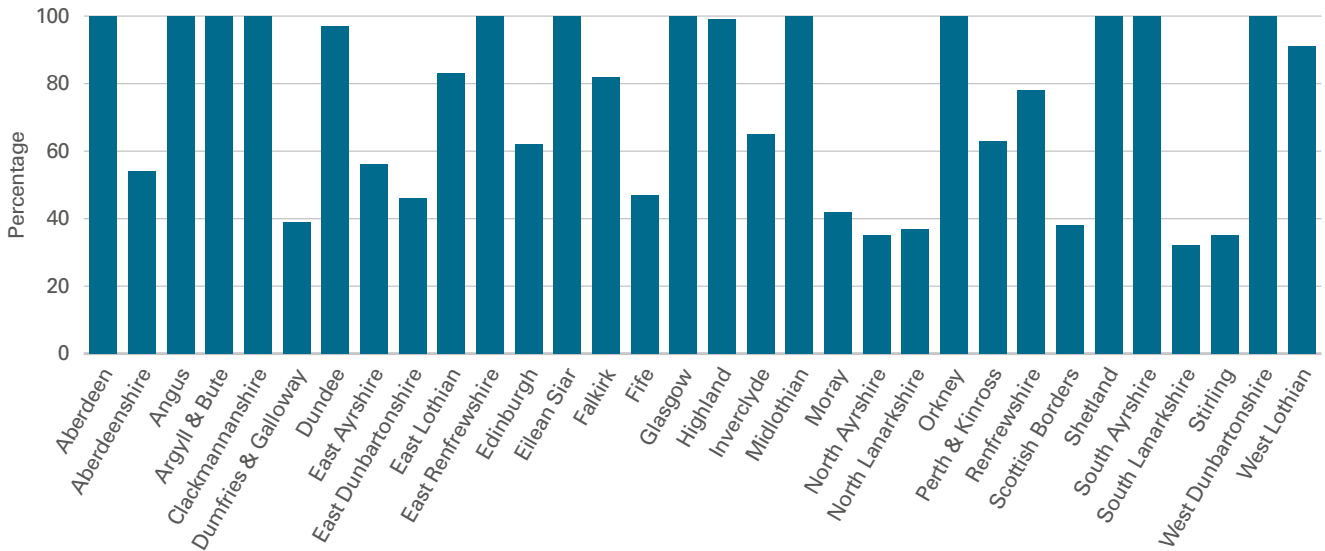
What share of the council's budget is taken up with interest payments and debt repayment?

What proportion of the council's debt is linked to inflation or at fixed rates? What does this mean for longer-term affordability?

Exhibit 9

Extent that usable reserves are represented by cash or investments

Thirteen councils have significant cash or investments that can be used to support the reserves position.



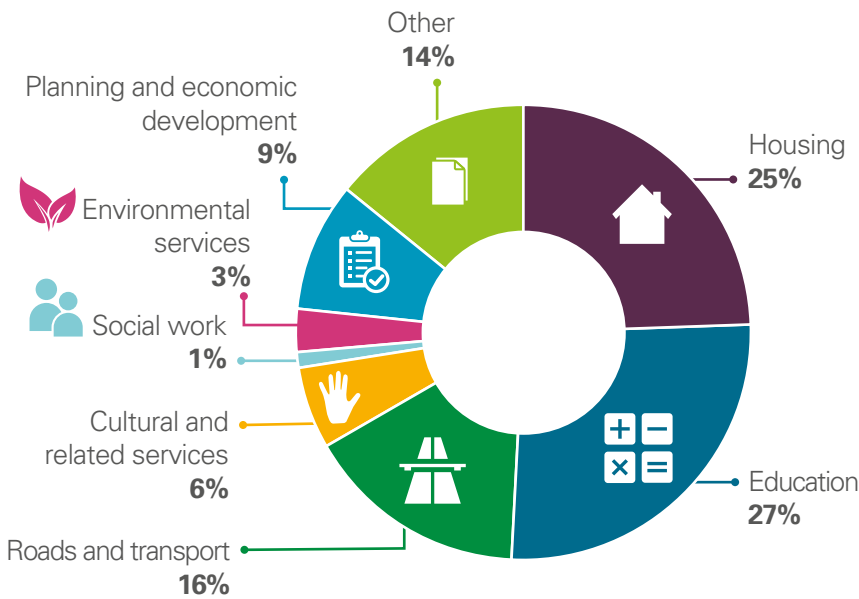
Source: Audited financial statements 2017/18 (100 per cent shown as max. amount, some councils exceed 100 per cent)



Exhibit 10

Capital expenditure by service area, 2017/18

The majority of investment is in schools' estate, new social housing and major refurbishment of social housing.



Source: Scottish Government POBE provisional outturn by service

Despite investment in social housing overall, numbers of council houses continue to fall

43. Across Scotland, social housing is provided by a mix of housing associations and by councils. In 24 areas, councils continue to be significant housing providers. The number of council houses in Scotland continued to fall slightly in 2017/18, down a further 334 houses (0.1 per cent of stock), although the rate of decrease has slowed. The right-to-buy council housing ended in Scotland on 31 July 2016, but applications submitted by that date are still being processed during 2017/18, with 1,640 sales in the first three quarters of 2017/18. Sales and other contributing factors, such as demolitions, continue to offset the number of new houses being completed by councils (with housing stock). This net movement varied between councils: 16 councils saw a decrease in house numbers and ten increased in 2017/18 (six councils no longer have housing stock following stock transfer).

Government grants and amounts from revenue continue to be the main sources of funding for capital expenditure

44. Sources of capital expenditure funding included ([Exhibit 11, page 24](#)):

- £1 billion of government grants (£138 million or 16 per cent higher than in 2016/17)
- £0.6 billion of internal charges to services (loans fund principal repayments) (£0.7 billion in 2016/17)
- £0.6 billion increase in the underlying need to borrow² (£0.7 billion in 2016/17) with £0.3 billion of this resulting in an increase in external borrowing.

Some councils had significant increases in their net debt position

45. Councils' net debt increased in 2017/18 by £0.6 billion to £15.1 billion. Twenty councils increased their net debt by a total of £0.8 billion, with another 11 councils reducing their net debt by £0.2 billion.

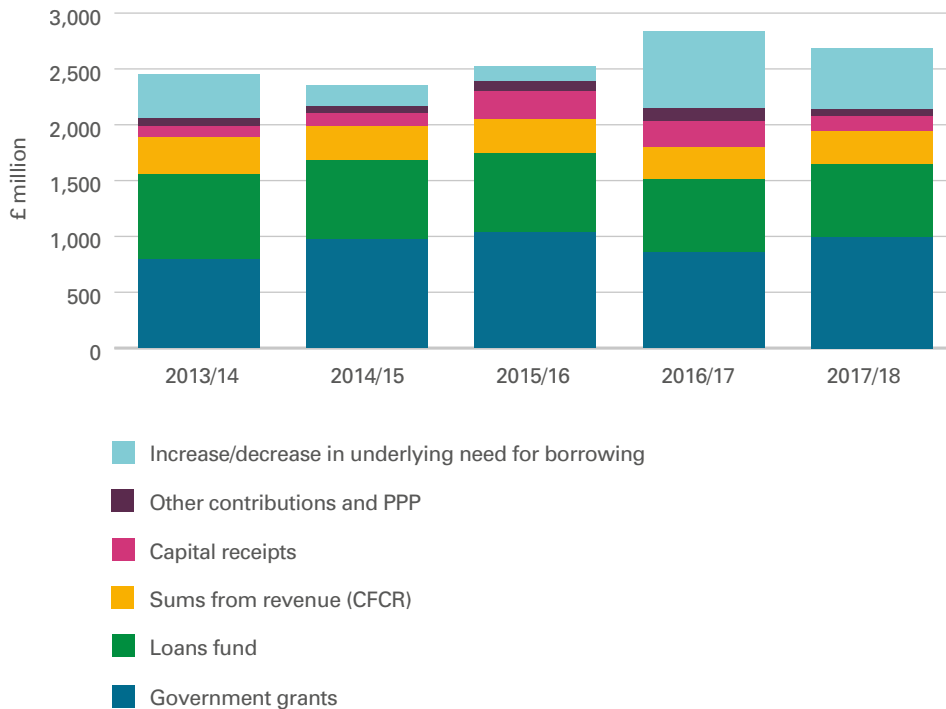
46. The councils with notable increases included:

- Argyll and Bute Council – a £58 million increase (31 per cent) due to increase in primary school finance leases and increased long-term borrowing.
- Aberdeen City Council – with the largest increase in net debt of £211 million (28 per cent) represented by a reduction in investments and an increase in finance leases, associated with Marischal Square and the ongoing capital investment and use of reserves to support delivery of the transition to its 'Target Operating Model'.
- Perth and Kinross Council – increased debt by £75 million (21 per cent) represented by an increase in long-term borrowing for capital expenditure.

Exhibit 11

Sources of funding for capital expenditure, 2013/14 to 2017/18 (real terms)

Government grants and amounts from revenue continue to be the main sources of funding for capital expenditure.



Source: Audited financial statements, sources of capital financing in real terms 2017/18 prices



Other key elements in the audited financial statements

There were delays with the valuation of pensions liabilities in councils across Scotland in 2017/18

47. Councils account for their share of the Local Government Pension Funds (LGPS) in accordance with International Accounting Standard 19 - Employee Benefits (IAS19). This relies on valuations of pension fund assets and liabilities by the scheme's actuary. Actuarial reports across Scotland used estimated data for the final part of the year. Asset returns estimated by the actuary for the final part of the year were significantly lower than actual returns, as a result of significant changes in markets. This resulted in pension fund assets reported in the council's balance sheet being understated in the unaudited accounts. This issue was corrected in the majority of audited accounts across Scotland.

48. In updating the IAS19 report, an actuary also identified an omission in the original calculation of liabilities in three councils resulting in an increase to the council's net pension liability.

49. This issue affected councils and a significant number of subsidiary bodies that are also members of the LGPS.

The net pension liability has reduced substantially in 2017/18 compared to 2016/17

50. In 2017/18, councils' total net pension liabilities in the Scottish Local Government Pension Scheme (LGPS) reduced by 43 per cent from £11.5 billion in 2016/17 to £6.6 billion in 2017/18. All councils reduced their liability, except for Aberdeen City Council. This significant improvement was due to:

- an increase in pension fund assets of £1.1 billion, an increase of four per cent
- a reduction in scheme liabilities of £3.8 billion due to reductions in life expectancy, lower than assumed salary increases and increases in the discount factor used to value future benefits, based on bond rates.

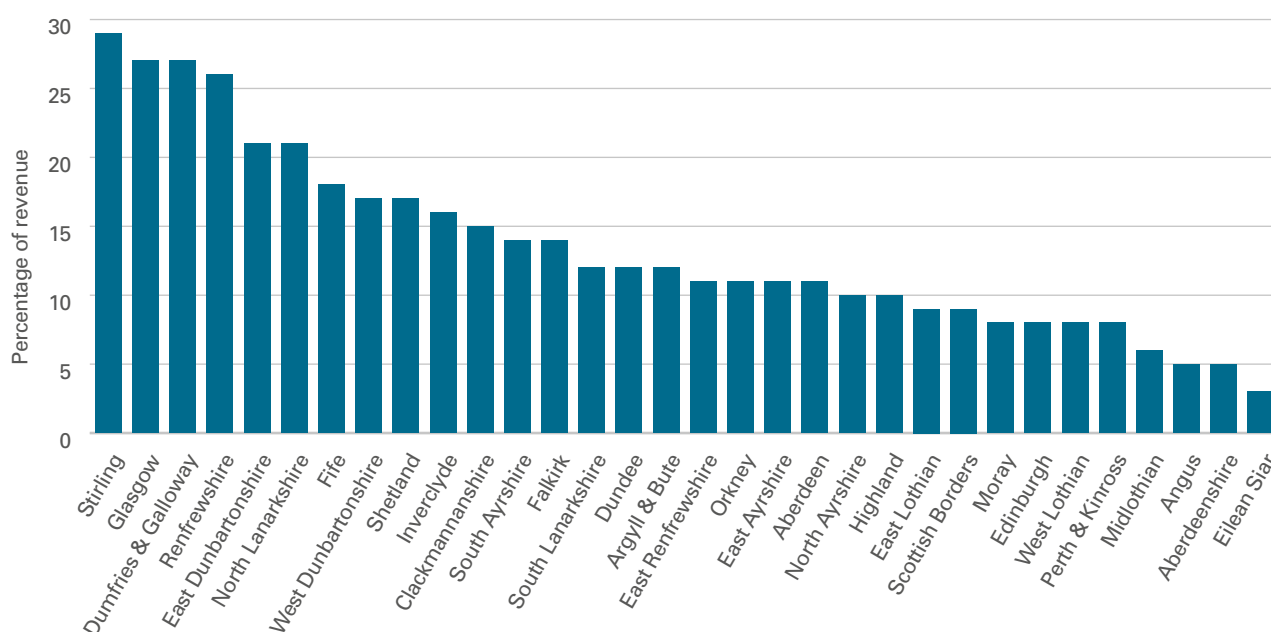
Unfunded LGPS liabilities vary significantly across councils

51. Unfunded liabilities are amounts that are not met by the Local Government Pension Schemes, but by individual employers. These can occur when an employer approves an early retirement, without actuarial reduction or with enhanced pension. [Exhibit 12](#) shows that value of these unfunded benefits as a percentage of the annual revenues of each council. These ongoing commitments can represent annual payments of one to two per cent of revenue.

Exhibit 12

The total liability for LGPS unfunded liabilities as a percentage of annual council revenue


The amounts councils are committed to pay to pension funds for historic early retirements over the medium to long-term varies significantly.



Source: Audited financial statements 2017/18 and IAS19 valuation reports by actuaries



Glasgow City Council reports additional financial pressures that may arise from further equal pay claims

52. In our *Equal Pay in Scottish councils*  report, we identified that all employers have a legal responsibility to ensure that women and men receive equal pay for equal work. In 1999, Scottish councils and trade unions reached the Single Status Agreement to harmonise local government pay and employment terms and conditions and eliminate pay inequality. Implementing the Single Status Agreement was a complex process that required all councils to undertake a large-scale job evaluation exercise. Councils underestimated the risks in this process and legal challenges continue to identify further issues.

53. Glasgow City Council has identified a new contingent liability³ disclosure in 2017/18 for equal pay claims, which it is unable to estimate. This is based on a May 2017 ruling by the Court of Session on pay protection claims, affecting around 8,000 claimants and an August 2017 ruling on the council's Job Evaluation Scheme. This will take time to resolve and the potential scale is likely to be significant and impact on the council's financial planning.

Financial management, governance and transparency

Management commentaries could do more to explain council outturns in the accounts

54. Auditors' reviews of accounts are increasingly concerned with the transparency and clarity of the narrative contained within the management commentary that accompanies the financial statements. There are a few key aspects to an assessment of whether financial reporting is transparent in the narrative:

- Is the outturn against budget position for the year clearly shown with the reasons for significant variances obvious?
- Is the outturn reported in the narrative reconciled to the movement in General Fund contained in the financial statements and major differences explained?
- Some councils do not specifically report on progress against agreed savings in their accounts. Therefore, it is difficult to demonstrate if planned savings were achieved. Councils that did report this said they achieved 105 per cent of their planned savings.

55. We identified Comhairle Nan Eilean Siar's management commentary as an example of good practice. Financial performance in 2017/18 was clearly identified in the management commentary. This included the income, expenditure and surplus/deficit positions for significant elements of the council's budget that was consistent with overall movements on the General Fund.

56. There were improvements in this area in 2017/18. However, there are still circumstances where these basic expectations of transparency are not met and the financial outturn in the management commentary does not help the reader understand clearly how the council has performed against budget and how this is reconciled to the accounts.



Do budget monitoring reports clearly explain financial performance against plans and any changes to plans, including the reasons for change?

Does the management commentary clearly explain the council's financial performance and the changes to plans and reasons for those changes?

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


Part 3

Integration Joint Boards' overview 2017/18



Key messages

- 1** Funding to the IJBs increased in 2017/18 by three per cent in cash terms. Most of this additional funding came from the NHS and includes additional Scottish Government funding to the NHS for IJBs of £107 million.
- 2** The majority of IJBs have underlying financial sustainability issues, with 11 out of 30 incurring deficits in 2017/18. A further eight would have incurred deficits without additional ('deficit') funding from their partners.
- 3** Reserve positions vary enormously between IJBs.
- 4** Medium-term financial planning is not used by most IJBs and further improvements to financial management should be introduced.

57. Funding to the IJBs increased in 2017/18 by three per cent in cash terms. Including additional Scottish Government funding to the NHS for IJBs of £107 million. IJBs were established as a result of the Public Bodies (Joint Working) (Scotland) Act 2014 (the Act). 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. We reported on progress in November 2018 in our report, [Health and social care integration – update on progress](#) .

58. In 2017/18, IJBs were responsible for directing £8.3 billion of health and social care resources, money that was previously separately managed by councils and NHS boards. In total, 29 per cent or £2.4 billion of IJB funding was allocated from councils, and £5.9 billion or 71 per cent from the NHS ([Exhibit 13, page 28](#)).

59. The total resources available to IJBs has increased by three per cent, in cash terms, from £8.1 billion in 2016/17. The majority of this £240 million was allocated from the NHS:

- £107 million was provided by Scottish Government to the NHS to direct towards social care services delivered by councils.
- In some cases, NHS boards directed additional funding to address overspends in prescribing.

the majority of IJBs have underlying financial sustainability issues



What is the IJB's financial position? Is it financially sustainable?

What are the levels of reserve held by the IJB?

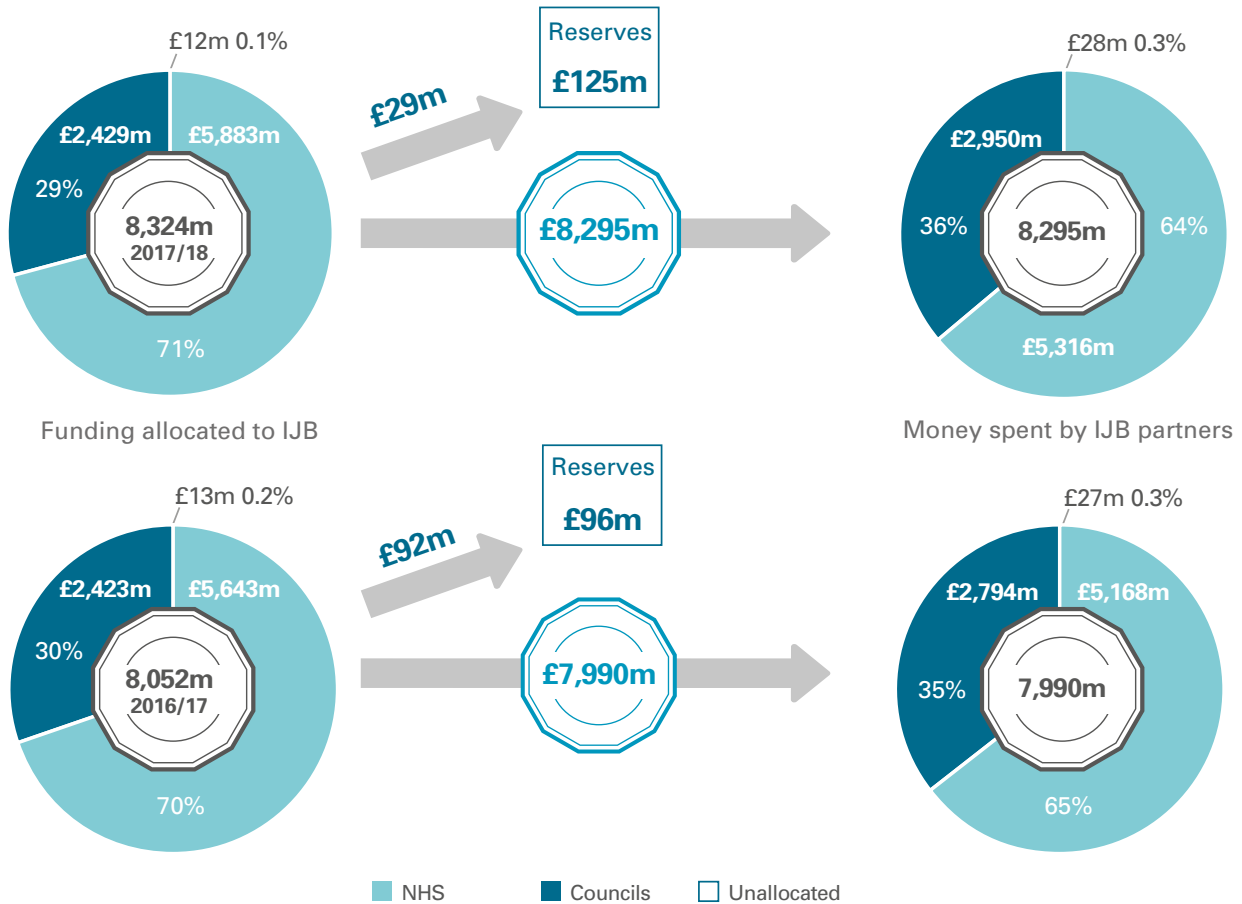
Are these in line with the IJB's reserve policy?

What does the IJB's financial position mean for the council and for the delivery of services?

Exhibit 13

Income and expenditure of Integration Joint Boards in 2016/17 and 2017/18

IJBs spent £8.3 billion on delivering health and social care services in 2017/18, 3.8 per cent (£305 million) more than in 2016/17. Of this 36 per cent was spent by councils and 64 per cent by the NHS.



Note: Some aspects of funding and expenditure is not attributed to either NHS or councils in a few audits. This represents about £15m and £12m of income in 2016/17 and 2017/18 respectively and around £28m of expenditure in both years.

Source: IJB audited accounts

60. IJBs spent £8.3 billion on delivering health and social care services in 2017/18, 3.8 per cent (£305 million) more than in 2016/17. Of this, 36 per cent was spent by councils and 64 per cent by the NHS.

61. The aim of the reform is to meet the challenges of Scotland’s ageing population by shifting resources to community-based and preventative care at home, or in a homely setting. Therefore, it would be reasonable to expect the difference between what the NHS allocates to IJBs and what it receives for acute services to increase. In 2017/18, the difference was 6.6 percentage points compared to 5.1 percentage points in 2016/17, but this does not necessarily represent any operational shift in how services are provided.

The majority of IJBs have underlying financial sustainability issues and without year-end support from partners, 20 out of 30 would have reported deficits

62. Fourteen IJBs had a surplus in 2017/18 compared to 23 in 2016/17. Those with a surplus added a further £42 million to their reserves (£95 million in 2016/17). This does not properly identify the underlying position, as 19 IJBs had additional funding from their partners, which improved their outturn position by £51 million. Without additional funding, a further eight IJBs would have reported a loss in 2017/18, rather than the 11 that did. Eight of the IJBs drew on reserves from previous years to meet in-year deficits.

63. Auditors report that prescribing costs and adult social care costs appear to be the main reasons for overspends. Auditors noted that in NHS Greater Glasgow and Clyde a 'risk-share' agreement on prescribing pressures with the health board has ended in 2017/18 and this will present IJBs in that area with greater financial risk in 2018/19.

Reserve positions vary enormously

64. The total of reserves held by IJBs has grown from £96 million in 2016/17 to £125 million over 2017/18, and now represents 1.5 per cent of total income (compared to 1.2 per cent in 2016/17).

65. IJBs hold reserves for two main purposes that assist strategic financial management and risk management:

- to earmark, or build up, funds which are to be used for specific purposes in the future
- to provide a contingency fund to cushion the impact of unexpected events or emergencies.

66. Forty per cent of the total reserves are held by two IJBs: £31 million in Glasgow and £18 million in North Lanarkshire. Comhairle nan Eilean Siar has the highest reserve relative to its income at ten per cent ([Exhibit 14, page 30](#)). North Ayrshire is unusual in having a negative reserve of £5.8 million.

67. The auditor for North Ayrshire IJB highlighted concerns that 'in the medium term, the IJB is faced with an extremely challenging financial position'. In line with many other IJBs, it has not achieved short-term financial balance, but it has not been deficit funded by its partners.

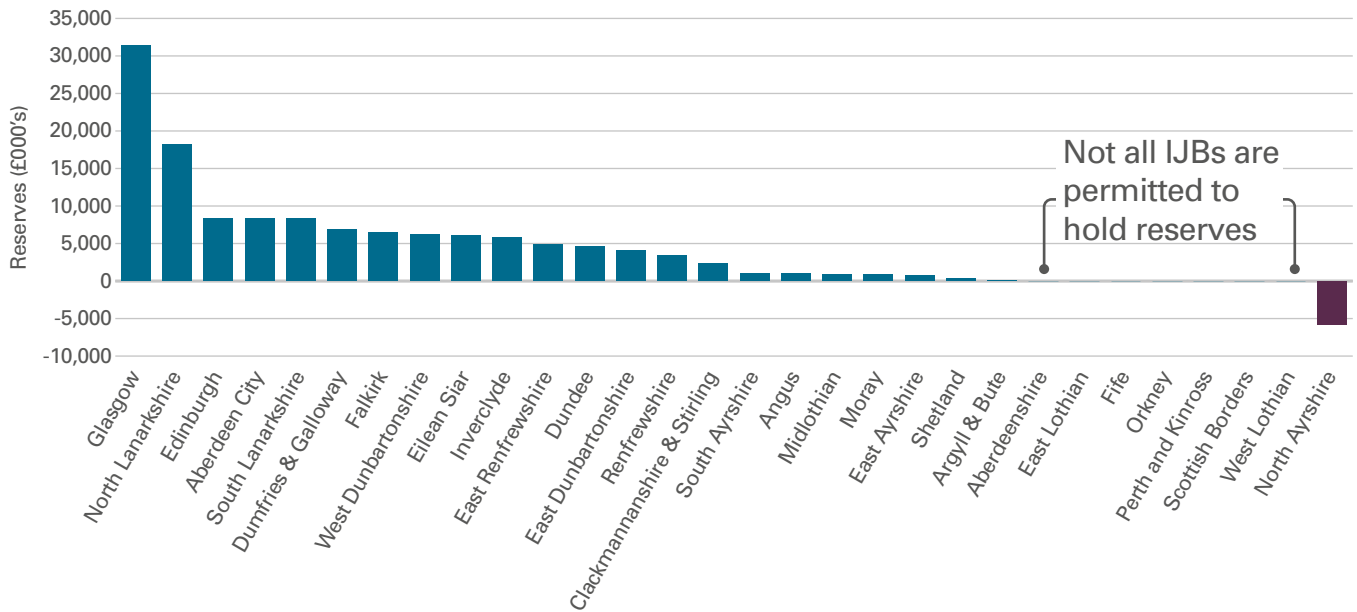
Funding gaps in 2018/19 are significant in IJBs and many do not have balanced budgets

68. Most auditors identified significant financial pressures in 2018/19 in their 2017/18 annual audit reports. The estimated funding gap for IJBs in 2018/19 was £248 million (three per cent of total income). Which is greater than identified in councils. Twelve of the IJBs still do not have balanced budgets for 2018/19 and a further four plan to incur deficits which will be met by accumulated reserves. We reported in November 2018, that these financial pressures make it difficult for IJBs to improve services.

Exhibit 14

Integration Joint Board reserves

Forty per cent of the total reserves are held by Glasgow and North Lanarkshire. North Ayrshire is unusual in having a negative reserve of £5.8 million.



Source: Audited financial statements 2017/18




IJB financial planning and financial management should be further improved

69. Only a third of IJBs have a medium-term financial plan, typically covering three years, and there is no evidence of longer term-financial planning.

70. Auditor's identified issues with financial management in the IJBs including:

- a lack of agreement or a late agreement of budgets
- poor financial monitoring due to delays and inaccuracies during the year
- instances where the projected outturns forecasts during the last quarter of 2017/18 were very different from those actually achieved.

71. As we reported in our [Health and social care report](#)  these are fundamental issue which will limit the ability of Integration Authorities to improve the health and social care system.

Part 4

Councils' financial outlook



Key messages

- 1** In 2018/19, Scottish Government revenue funding to local government increased by 0.2 per cent after two years of real-terms reductions.
- 2** The Scottish Government published a five-year financial strategy in May 2018, but multi-year budgets are not yet being developed. The financial strategy identifies greater future uncertainty and likely further reductions of nine per cent in real terms over the next five years in 'other non-protected' council funding.
- 3** Many councils are in the early stages of delivering transformational change.
- 4** Medium-term financial planning has been adopted by almost all councils, but less than half have significant long-term plans over five years.
- 5** Councils expect to manage smaller funding gaps in 2018/19 of £0.3 billion (two per cent), with all 32 councils raising council tax rates by three per cent in 2018/19. There are no councils where the budgeted use of reserves is a critical issue over the next three years.
- 6** The impact of EU withdrawal is not yet clear, but councils need to identify the risks and develop contingency plans to manage these risks, as far as possible.

councils expect to manage smaller funding gaps in 2018/19 of £0.3 billion (two per cent)

Council future funding

Scottish Government revenue funding to local government increased by 0.2 per cent

72. The Local Government Settlement in 2018/19 increased by 1.7 per cent (cash terms) from 2017/18 to £9.8 billion. This was a real-terms increase of 0.2 per cent ([Exhibit 15, page 32](#)).

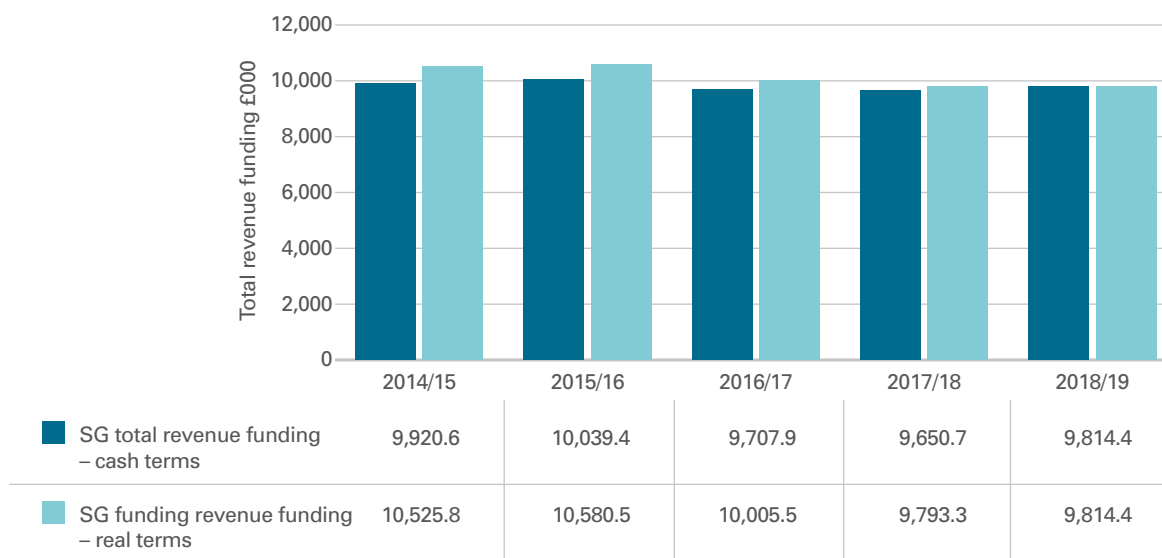
An increase in the 2018/19 settlement was late and the early payment of £35 million in 2017/18 reduced transparency in the funding available between the two years

73. On 31 January 2018, the Scottish Government announced an additional £160 million of general revenue grant funding for local authorities as part of the 2018/19 budget-setting process. Although welcomed by councils, this

Exhibit 15

Scottish Government funding to councils in real and cash terms

Scottish Government total revenue funding to councils increased in 2018/19 after two years of reduction.



Source: Audit Scotland; and Scottish Government financial circulars 2014/15 to 2018/19

announcement was late in the budget planning process (refer to [paragraph 9](#), for comments on late funding allocations). Of the additional £160 million, £35 million was reallocated from projected 2017/18 underspends within the Scottish Government and was paid to councils on 28 March 2018. For accounting purposes, following consultation with auditors, this was treated as 2017/18 income by councils. By paying 2018/19 funding allocations to local authorities in the previous financial year, this reduced transparency in the effective funding for each year to councils and increased the reserves carried by councils at 31 March 2018.

The Scottish Government published a five-year financial strategy in May 2018

74. Funding settlements to councils continue to be provided on an annual basis. This makes it challenging for councils to plan and budget effectively for the medium term, given such a significant proportion of their income comes from Scottish Government funding. On 30 June 2017, the Budget Process Review Group⁴ published its final report and this included a recommendation that the Scottish Government should develop a medium-term financial strategy. [The Scottish Government's five-year financial strategy](#)  was published in May 2018.

Multi-year budgets are not yet being developed by the Scottish Government.

75. The five-year financial strategy identifies that 'in recent years the Scottish Government has delivered a series of annual budgets, an approach which will continue for the 2019-20 budget process', but also identifies 'an expectation that the next UK Spending Review (in 2019) will ... provide the Scottish Government with the opportunity to develop a multi-year approach to the development of its budgets'.


76. The five-year financial strategy notes that 'as the Scottish Government moves away from being funded primarily through the block grant to a combination of devolved taxes and the block grant, the number of variables which will affect its longer-term funding outlook will increase'. Three key determinants are identified:

- changes in UK Government spending
- UK Government fiscal policy
- Scottish tax revenue relative to the rest of the UK.

77. The analysis suggests that, by 2022/23, the Scottish Budget could be around £37.6 billion, but scenario modelling indicates that the potential range for this could be between £35.5 billion and £39.7 billion, reflecting potential growth in the Scottish Budget between 2017/18 and 2022/23 of between £4.2 billion and £8.4 billion (in cash terms). The range of this variability amounts to around \pm six per cent of the overall budget.

78. The key resource budget commitments of the Scottish Government's social contract are Health, Police, Early Learning and Childcare, Attainment, Higher Education and Social Security. The financial strategy identifies greater future uncertainty and likely further reductions of nine per cent in real terms over the next five years in 'other non-protected' funding.

79. Two of these areas directly increase future local government funding settlements: early learning and childcare and attainment. Early learning and childcare commitments by the Scottish Government include further (recurring) uplifts in funding to councils of £210 million in 2019/20, £201 million in 2020/21 and £59 million in 2021/22. The Scottish Government has assumed a commitment to allocate additional specific revenue grants of £180 million in each of the three years 2018/19 to 2020/21 through the Pupil Equity Fund. However, other expenditure areas (non-protected areas), which are managed by councils, are not identified as a 'key resource budget commitment'.

80. The [SPICe briefing paper](#)  in June 2018, identified that 'The Scottish Government's Budget priority choices inevitably mean that other non-protected areas of spend must take up more of the slack from any future spending reductions. Under the range of scenarios provided by the Scottish Government, "other expenditure" will fall by between one and 16 per cent in real terms over the period to 2022/23, with the bulk of reductions occurring in 2019/20 and 2020/21... under the central scenario, other expenditure will fall in real terms by £1 billion (nine per cent). The largest element by far of "other expenditure" is the non-early learning and childcare part of Local Government.'

Financial pressures and planning

Councils continue to recognise significant financial challenges in the medium term

81. Most councils have identified financial challenges over the next few years including:


- decreasing revenue support grant and capital grant
- EU withdrawal and the risk of inflationary effects
- pay award pressures
- demand pressures, particularly the expected population growth in some council areas and the reduction in the relative proportion of working age to non-working age
- legislative changes which are not funded
- the economic performance of Scotland compared to the rest of the UK.

Many councils are in the early stages of delivering transformational change

82. Over half of councils began a new or refreshed transformation or change programme in the past year and one-third within the past three years. A few councils have yet to establish a programme. Because much of the transformation work is relatively recent it is too early to assess the effectiveness of the approaches taken.

83. The majority of work within transformational or change programmes is focused on service review and improvement work. Cross-organisational themes tend to focus on delivering, for example, staff and management restructures, office and property rationalisations, improvements in HR, payroll and finance systems. Some activity will have been more visible to the public such as digital approaches to customer services, increases in fees and charges, and redesign of waste management services. With funding expected to reduce further in the medium term, councils will need to consider more significant redesigns of how they operate and deliver services.

84. Transformation or change is challenging, and councils have highlighted a few common issues that have contributed to this including the effort and focus over recent years on establishing and progressing the health and social care arrangements with the NHS. Another factor is the long lead time and delays associated with ICT projects. With service and management redesign, the capacity of staff and management has been impacted. Over a third of councils have established training programmes to support transformation and change and over a third of councils have, or have recently agreed, to establish dedicated teams to support their programme.

85. The Accounts Commission recognises that with the financial pressures, councillors need to make difficult decisions. This requires effective political leadership and communications. It is essential that all councillors, not just the administration, work effectively with officers and other stakeholders to identify and deliver necessary savings. It is important that councils engage effectively with their communities about plans for savings and service redesign. We published a report [*Roles and working relationships in councils – are you still getting it right?*](#) , to support councillors in their role.



What is your council's financial position?

What particular challenges does the council face?

What new financial pressures are there for 2018/19 and 2019/20 and how much will these cost?



Does your council have a transformation plan?

Does it set out the aims and objectives and how and when these will be achieved?


Are projects within the transformation programme achieving their aims in terms of service quality, performance and cost?

How effectively are you engaged and informed about the council's transformation programme and kept informed about progress?

Are detailed options appraisals or business cases set out for changes to services planned within transformation activity?

Medium-term financial planning has been adopted by almost all councils, but less than half have significant long-term plans over five years

86. In previous reports we have emphasised the importance of medium and long-term planning to effective financial management. Councils have made good progress: 30 councils now have a medium-term financial plan. Councils' long-term financial planning is not as well developed. Sixteen councils do not yet demonstrate any long-term financial planning, some councils have elements of long-term financial plans evident such as long-term forecasting. Five councils have long-term financial plans that cover ten years or more. Only five of the plans that exceed five years appear to have considered the financial impact of population/demographic/demand changes over the longer term.

87. In the *Best Value Assurance Report on Fife Council*  this year, we identified that the ten-year long-term financial model, based on demand forecasts, is an example of good practice among Scottish councils.

88. Around a third of councils use scenario planning within their medium or long-term financial planning. It is important that councils continue to consider potential funding scenarios and the implications for and options for services in the medium and longer term. Transformational change plans are likely to cover a number of years and should be consistent with financial planning. Financial plans should also consider the impact of demand changes over the longer term.

Councils' budgets 2018/19

Councils expect to manage smaller funding gaps in 2018/19 of £0.3 billion (two per cent)

89. Councils' 2018/19 budgets identified total net expenditure budgets of £12.2 billion. These were not fully met by the remaining income from core Scottish Government and council tax. The shortfall or 'funding gap' was £0.3 billion (two per cent). The extent of funding gaps and savings plans is less in 2018/19 than 2017/18 and councils did not plan to use unearmarked reserves to support revenue budgets as they did in 2017/18.

90. All 32 councils raised council tax rates by three per cent in 2018/19, providing budgeted income of £2.5 billion.

91. In the 2018/19 budgets, all 32 councils increased council tax by the maximum three per cent, making the highest Band D rate, in Glasgow, at £1,286 and the lowest, in Eilean Siar, at £1,086.

Funding gaps are to be managed by planned savings, temporary use of reserves and additional fees and charges.

92. Councils presented balanced budgets with proposals to bridge the expected funding gap through:

- planned budget savings of £75 million (0.6 per cent of revenue funding)
- planned use of around £71 million of unearmarked reserves (0.9 per cent of net expenditure)
- increased fees and charges
- council tax increases.



Does the transformation programme of work aim to make positive change to improve outcomes for communities?

Is it about seeking opportunities to do things differently to maintain or improve performance or is the focus only on make savings?



Does your council have a long-term financial strategy (ten years or more) that reflects the anticipated changes in demographics and demands on services?

Do medium and long-term financial plans include a range of potential funding and financial scenarios?

Funding gaps vary between councils, there are no councils where the budgeted use of reserves would deplete them within three years

93. The number of councils budgeting to use unearmarked reserves in 2018/19 has reduced from 23 (in 2017/18) to 18. Last year we reported that three councils would run out of General Fund reserves within two to three years if they continued to use them at the levels planned in 2017/18. We are pleased to note that there are no councils in this position in 2018/19, with councils generally reducing their planned reliance on unearmarked General Fund reserves.

Withdrawal from the EU

94. The UK will leave the European Union (EU) on 29 March 2019. If the UK Government and EU agree the terms of the UK's withdrawal before this date, there will be a transition period to the end of 2020. Preparations for EU withdrawal across councils vary. Approaches commonly include monitoring and inclusion in risk registers as well as briefings and report to councillors. Some councils also reflect the risk in corporate and financial plans. Several councils have established working groups to focus on this issue.

95. If the UK Government and EU fail to agree arrangements for the UK's exit from the EU, there will be no transition period and organisations will need to respond immediately. There is an urgent need for all councils to identify the associated risks. It is critical they have contingency plans in place to allow them to manage these risks and respond rapidly in the event of the UK leaving the EU with no transition period.

96. The Scottish Government and COSLA are working with NHS boards, councils and other public bodies to draw together information on their workforces. This will be used to assess the potential impact of EU withdrawal on the delivery of services.

97. Audit Scotland produced a paper [*Withdrawal from the European Union, Key audit issues for the Scottish public sector*](#) , October 2018. We will consider further the implication of EU withdrawal for Scottish local government in our overview report *Local government in Scotland: Challenges and performance*, in March 2019. We have included questions from this key issues paper in [*Supplement 1: Scrutiny tool for councillors*](#)  accompanying this report.



What is the likely use of unearmarked reserves for 2018/19?

How does the remaining unearmarked reserve compare to forecast funding gaps?

What are the plans for using different reserve funds in 2019/20 and beyond?

Are these plans appropriate and reasonable?



What planning and measures has your council undertaken in preparation for EU withdrawal?

What are the risks and potential impacts of EU withdrawal for the functions of your council and for the wider communities of your council area, in terms of workforce, regulation and funding?

Endnotes



- 1 PFI/PPP/NPD/HuB - PFI is an approach financing public infrastructure where the private partner finances, designs, builds, and operates the infrastructure asset. PPPs, on the other hand, may refer to a wider range of public-private collaboration, and include several business structures and partnership arrangements such as joint ventures, concessions, outsourcing, and PFI. PFI and PPP generally involve a long-term contractual agreement between the public and private sectors with financing and risk sharing by the private partner. Scotland's Non-Profit Distributing (NPD) model is a type of PPP agreement. It differs from the PFI model in that that private sector returns are capped and any excess profit goes back to the public sector. NPDs also promote enhanced governance and transparency through the appointment of a public interest director to the project company.
- 2 An increase in the underlying need to borrow could be funded by a council over the short/medium term from working capital including reduced cash and investments. It may not result in external borrowing in year. In fact, many councils chose not to borrow as they did not consider current borrowing rates to be favourable.
- 3 Contingent Liability – a possible obligation that arises from past events and will be confirmed only by the occurrence or nonoccurrence of one-or more uncertain future events not wholly within the control of the council.
- 4 The remit of the group was 'to carry out a fundamental review of the Scottish Parliament's budget process following the devolution of further powers in the Scotland Act 2012 and Scotland Act 2016'.

Local government in Scotland Financial overview 2017/18

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN

T: 0131 625 1500 E: info@audit-scotland.gov.uk 

www.audit-scotland.gov.uk 

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