Agenda Item 4

Scottish Government Budget and Local Government Settlement 2018/19

Falkirk Council

Title: Scottish Government Budget and Local Government Settlement 2018/19

Meeting: Falkirk Council

Date: 15th January 2018

Submitted By: Director of Corporate & Housing Services

1. Purpose of Report

1.1 This report advises Members of the key matters arising from the Scottish Government draft Budget for 2018/19 which will impact on local government, together with the Local Government Financial Settlement for 2018/19. The latter, subject to approval by the Scottish Parliament, advises the Council's 2018/19 revenue support grant and influences materially what the Council's Budget Gap is for 2018/19.

1.2 This report also presents the key messages from the Accounts Commission's publication entitled "Local Government in Scotland – Financial Overview 2016/17". The findings are intended to help Members when considering the Council's forthcoming Budget.

2. Recommendations

Council is asked to:-

(1) note the Draft Scottish Government Budget and Local Government Settlement 2018/19.

(2) determine whether a response is required to the Cabinet Secretary's appended letter in terms of para 4.2.3.

(3) agree a revised date of 28th February for the Council meeting to approve the Revenue Budget, fix the Council Tax for 2018/19 and agree the General Services Capital Programme for 2018/19-2020/21.

(4) note the Accounts Commission publication, "Local Government in Scotland – Financial Overview 2016/17".

3. Background

3.1 A report on the Revenue Budget and Medium Term Financial Picture was considered by Council at its meeting on 28th June. Council agreed the progression of a two year Revenue Budget within the context of the new Corporate Plan and Council of the Future agenda.

3.2 That meeting of Council also agreed that the Member Budget Working Group be reconvened. In the interim the Group has met regularly.

3.3 At its meeting on 20th September, Council approved the Corporate Plan 2017- 2022 and also considered a report on the Council of the Future.

3.4 The Executive, at its meeting on 17th October approved officer saving options for consultation with stakeholders. Executive also directed officers to identify further savings options for consideration.

3.5 Council at its meeting on 6th December received an update on the Budget process, provisionally agreed a Council Tax rise of 3% and considered a further tranche of officer savings options. Council also reviewed 2018/19 Business Plans from the Community Trust and the Integration Joint Board and provided feedback.

4. Considerations

4.1 Draft Scottish Government Budget 2018/19

4.1.1 The first report of the independent Scottish Fiscal Commission provided an important context for the Budget proposals in terms of official forecasts of Scottish GDP, devolved tax receipts and devolved social security expenditure. The Commission's view is that the current pattern of slower growth is likely to persist over the next five years in a range from 0.6% to 1.1%. Low growth of course implies lower earnings and thus tax revenues. Moreover, under the Fiscal Framework, the performance of the Scottish economy relative to that of the UK, has important consequences for the Budget resources available to the Scottish Government.

4.1.2 The Scottish Government is using its powers to vary income tax rates for the first time. The new five band structure will result in a more progressive approach relative to the rest of the UK and is estimated to yield a modest extra £164m in 2018/19.

4.1.3 The 1% pay cap for public sector workers under the control of the Scottish Government has been removed with a pay rise of 3% for those earning less than £30k, but with lower levels of increase for those earning more. Whilst pay for local government workers is delegated to councils with well established negotiation machinery, these terms will inevitably provide a template. The Scottish Parliament Information Centre [SPICe] note in their briefing on the Budget that, "councils may face challenges in matching this pay policy commitment".

4.2 Local Government Settlement

4.2.1 As anticipated it is a one year Settlement which is not conducive to medium term planning. The Budget should be confirmed when the Scottish Parliament debate it on 21st February. As Council will recall, the initial Settlement figures did materially change last year resulting from the minority Government's agreement with the Green Party. It is noteworthy that again this year the Green Party are arguing for additional resources for Local Government. Against that backcloth there is merit in putting back the Council's own Budget meeting from the current scheduled date of 21st February to 28th February.

4.2.2 The Settlement is set out in terms of the Cabinet Secretary's letter dated 14th December to Leaders which is at appendix 1. Members will see on the last page that, "the settlement offer must be viewed as a package" and councils "must agree to deliver all of the measures set out in the package and will not be able to select elements of the package". Whilst the Cabinet Secretary, "can confirm my intention that this will again be a sanction free settlement", the letter also makes clear that for any council not agreeing the full package, "a revised and inevitably less favourable, offer will be made".

4.2.3 The above letter requires any Council not accepting the full package to write to the Cabinet Secretary no later than 19th January, albeit following representations from COSLA this has been extended to 26th January. COSLA also sought clarification on two issues. The first related to possible scope to provide flexibility on the 3% Council Tax cap so that a 3% average increase could be achieved over the lifetime of the Parliament, but this was rejected. The second concerned treatment in practice of the sanctions, particularly relating to compliance with the 3% Council Tax cap and the maintenance of the pupil: teacher ratio of 13.7. Mr Mackay's response essentially repeated the terms in his letter of 14th December.

4.2.4 As noted in my Budget report to Council on 6th December, it is recognised that the Settlement has over recent years become particularly complex and with evident scope to interpret the numbers in different ways which leads to confusion.

4.2.5 The following paragraphs provide comment on the elements of the Settlement.

Revenue Grant Settlement

4.2.6 The Cabinet Secretary in his appended letter presents it as a flat cash Settlement compared to 2017/18 and one that is fair in the context of the Scottish Government's own fiscal block grant from the UK Government. COSLA on the other hand argue that it is not a flat cash Settlement and represents a cut of £153m.

4.2.7 The Scottish Parliament Information Centre [SPICe] in their analysis of the Settlement, state that the combination of General Reserve Grant and Non Domestic Rates falls by 0.5% [£49m] in cash terms or 2% [£184m] in real terms between 2017/18 and 2018/19. If Specific Revenue Grants are taken into account there is a small cash increase, but in real terms there remains a 1.4% reduction. SPICe notes that the £153m referenced by COSLA comprises Early Learning and Childcare expansions [£52m and £11m], Health and Social Care [£66m] and Teachers' pay [£24m] and that COSLA's argument is that these elements are specifically earmarked for national policy initiatives and are not available to support existing general local authority expenditure.

4.2.8 Falkirk's provisional revenue allocation is £266.001m, after adjusting for specific revenue grants of £3.509m, which includes the pupil equity funding. Although this is a cash reduction of £3.7m [1.40%] after excluding the new funding commitments, it is a more favourable outcome than reflected in the base scenario previously presented to Council and tilts towards the optimistic projection in the scenario range. The Revenue Grant is the key element informing the Council's Budget Gap and this is considered further in section 4.3 of this report.

Capital Grant Settlement

4.2.9 General Fund Capital Grant has been cut by £60m and this equates to £2.2m for Falkirk Council. Moreover, the repayment of the grant reprofiled in a previous Settlement will now take place in 2019/20 and not as anticipated in 2018/19. In addition, there is £150m at the national level for capital funding for the expansion of the Early Years programme.

4.2.10 The three year Programme is built on the resource base in year one and in consequence the impact ripples across years two and three, essentially aggregating to an overall projected grant loss of c£6m. Officers across Services are working to rebalance the draft General Services Capital Programme.

4.2.11 It is anticipated that there will be potential to bid into City Deal type funding.

Non-Domestic Rates

4.2.12 The 2018/19 poundage is set at 48p and has been calculated using CPI rather than RPI which aligns with the position in England. The Large Business Supplement is set at 2.6p. Transitional relief arrangements arising from the recent valuation for hospitality properties will continue in 2018/19.

4.2.13 A new Business Growth Accelerator will apply from April 2018. This will delay any increase in rates liability due to the improvement or expansion of an existing property for 12 months. In addition no rates will be due from any new build property until 12 months after it is first occupied. There is likely to be some impact on the Council's TIF scheme arising from these changes.

4.2.14 There will be a new 100% relief for properties wholly or mainly used to provide nursery care for pre-school children. Full details of qualifying criteria are still to be provided.

4.2.15 The Settlement confirms a previous announcement that following the Barclay review, charity relief will continue on current ALEO properties with a positive impact on Falkirk Community Trust.

4.3 Updated Gap Statement

4.3.1 It was noted at paragraph 4.2.8 that the provisional Settlement reflected a more favourable grant outcome than the Council's base scenario projection.

This is now reflected in the updated 2018/19 Gap Statement at appendix 2. Moreover, in the light of the emerging outcome for 2018/19 for the two key variables of grant and pay, the opportunity has been taken to also review the scenario assumptions for 2019/20 and this is reflected in a revised base scenario for that year. Further work will be undertaken on the scenarios in the Medium Term Financial Plan and this will be provided to Council as part of the Budget report in February.

4.3.2 Whilst the grant announced is more benign than our base assumption, and as noted earlier may improve further during the Scottish Parliament Budget process, there is still a Budget Gap of over £20m in 2018/19 to be bridged and tough decisions will still need to be taken by Council in February to achieve a balanced Budget.

4.4 Update on Consultation Feedback

4.4.1 The Consultation reflects 5,381 page views for Children's Services, 1,257 for Development Services and 1,210 for Corporate and Housing. Notwithstanding these page views, the actual number of comments as reflected below is relatively small. Further consideration will be given to how the Council undertakes consultation for the next Budget round and also how it is structured to facilitate easier and better analysis.

4.4.2 <u>Children's Services</u>

A total of 524 comments were received on the individual proposals by Children's Services.

The overall majority of feedback received was from people who disagreed with the proposals and most of the feedback received relates to a small number of budget proposals. The proposals which have generated the most feedback are detailed below:

- Education (Schools)
    - School mergers – 5 comments received (3 in favour, 2 against)
    - Secondary Senior Phase – 118 comments received (Nil in favour, 118 against)
- Breakfast Clubs – 87 comments received (1 in favour, 86 against)
- CLD – 73 comments received (Nil in favour, 73 against)
- Social Work – 70 comments received (8 in favour, 62 against)
- Transport to Schools – 30 comments received (15 in favour, 15 against)
- ASN /Sfla Provision – 32 comments received (Nil in favour, 32 against)
- Music Tuition – 27 Comments received (1 in favour, 26 against)
- Public Toilets – 22 Comments received (6 in favour, 16 against)
- Baby Provision/School Meals/Lets - 16 comments received (6 in favour, 10 against)
- Children's & Families General Statements - 13 comments received (Nil in favour, 13 against)
- Stop Weekend Lets – 6 comments received (1 in favour, 5 against)
- Foodbank Project – 4 comments received (1 in favour, 3 against)

4.4.3 <u>Corporate & Housing Services</u>

A total of 107 comments were received on the savings proposed by Corporate & Housing Services.

The proposals generating the most feedback were reduce/stop number of editions of Falkirk Council News, E-billing postal saving and reduce call handling in Contact Centre. Comments were generally in favour of these proposals.

- Reduce / stop number of editions of Falkirk Council News - 22 comments received, (20 in favour, 2 against)
- HR & Payroll System – removal of paper forms - 22 comments received, (20 in favour, 2 against)
- Reducing Call Handling in Contact Centre - 8 comments received, (2 in favour, 6 against)
- E-bill postal savings - 8 comments received, (7 in favour, 1 against)
- CCTV - 8 comments received, (1 in favour, 7 against)
- Remove second homes discount - 7 comments received, (7 in favour, 0 against)
- Stop retrospective Disclosure and PVG checks - 7 comments received, (5 in favour, 2 against)
- Fairer Falkirk - 6 comments received, (2 in favour, 4 against)
- Stop support for redeployment - 5 comments received, (2 in favour, 3 against)
- Restrict Cash Collection (3 hours per day 3 Offices) - 4 comments received, (0 in favour, 4 against)
- Reduce corporate training budget - 3 comments received, (2 in favour, 1 against)
- HR Operations – stop support for disability and capability cases - 3 comments received, (2 in favour, 1 against)
- Sheriff Officer income - 3 comments received, (1 in favour, 2 against)
- COSLA fee - 2 comments received, (2 in favour, 0 against)
- Elections - 2 comments received, (2 in favour, 0 against)
- Staff savings – General Fund Housing - 2 comments received, (2 in favour, 0 against)
- Promoting a Fairer Falkirk through Digital Inclusion - 2 comments received, (1 in favour, 1 against)

4.4.4 <u>Development Services</u>

A total of 275 comments were received on the savings proposals by Development Services. 45 were of a general nature & are the balancing element in the statistics set out below.

The proposals which have generated the most feedback are detailed below:

- Waste collection, charging and recycling – 111 comments received (18 in favour, 67 against)
- Charging at station car parks – 28 comments received (7 in favour, 18 against)

- Reduction or closure of the Employment and Training Unit – 30 comments received (2 in favour, 27 against)
- Removal of Christmas lights - 24 comments received (10 in favour, 11 against)
- Flower beds and hanging baskets – 13 comments received (6 in favour, 4 against)
- Reduction or removal of subsidised bus services 14 comments received (2 in favour, 8 against)
- Funding for Tourism – 14 comments received (4 in favour, 10 against)
- School crossing patrols – 8 comments received (1 in favour, 7 against)
- Roads maintenance – 8 comments received (0 in favour, 7 against)
- Street cleansing – 7 comments received (1 in favour, 4 against)
- Community Safety – 18 comments received (4 in favour, 12 against)

4.5 Accounts Commission "Local Government in Scotland – Financial Overview 2016/17"

4.5.1 The report is in three parts, providing commentary on all councils' income and budgets, financial performance during 2016/17 and the challenges going forward in the current financial year. The Financial Overview report is at appendix 3.

Income and Budgets

4.5.2 The report notes the considerable financial challenges being placed on councils to deliver services and identify savings. In comparison with 2015/16, Scottish Government revenue funding fell by 5.2% in real terms. Since 2010/11, combined revenue funding (NDR and revenue grants) has fallen in real terms by 7.6%.

4.5.3 Councils have faced expenditure pressures in meeting both UK and Scottish Government policy commitments, inflationary pressures, increasing demand for services and higher staffing costs due to increased national insurance contributions, living wage commitments, pay awards, maintaining teacher numbers and increased pension contributions.

4.5.4 In responding to these pressures, councils approved £524m of savings and utilised £79m of reserves for 2016/17. Savings plans focussed on the main areas of spend by reducing staff numbers, rationalising property and improving procurement. The report did however note that most of these reductions primarily fell on services outwith education and social work and that the impact on other services should be carefully assessed.

4.5.5 Councils have continued to maximise income through increased charges and introducing new charges for services. Income from fees and charges, however, only represents 8% of the total resources. While there will always be scope to increase income, most council services are funded by taxation and the most significant, such as education, are provided free at the point of delivery.

4.5.6 Falkirk Council recently participated in an exercise, managed by PricewaterhouseCoopers, exploring the potential for increased income generation. Officers have recently received the final report, however there is nothing in the report to suggest there are any significant or new opportunities that have not already been considered.

Financial Performance

4.5.7 An increase in the number of councils applying reserves is highlighted as a symptom of financial stress. In 2016/17, 19 councils applied their revenue reserves, an increase of 11 councils in 2015/16. The report notes that councils are finding it increasingly difficult to identify and deliver savings and are drawing on reserves to fund change programmes and routine service delivery.

4.5.8 The report also observed that the actual use of reserves and planned expenditure was sometimes quite different from originally planned and the reasons were not always clear. For Falkirk Council, it is considered that the financial position report is an appropriate mechanism for ensuring all significant variations are explained.

4.5.9 The level of council debt increased by £836m in 2016/17, with low interest rates helping councils to borrow more to invest in capital programmes. The report notes that while the level of debt is not considered problematic, some councils are concerned about the affordability within future budgets. In 2016/17 councils spent almost 10% of their income on interest and debt repayment, for Falkirk Council the figure was in line with the national average. In addition, as the report notes, councils are required through the Prudential Code to consider the ongoing affordability of debt.

Financial Outlook

4.5.10 Reductions in government funding in 2016/17 have continued in the current financial year, with a further real terms reduction of 2.3%. Funding also continues to be directed towards delivering national policy commitments, particularly within education and councils have also been faced with further cost and demand pressures in 2017/18 and beyond.

4.5.11To address these pressures, councils have approved savings of £317m and plan to use £105m of General Fund reserves for 2017/18. The report again notes that using reserves to maintain services is not sustainable and councils will be required to identify greater savings in 2018/19. Three councils, Clackmannanshire, Moray and North Ayrshire, would run out of General Fund Reserves within two to three years if they were applied at the same level as planned for 2017/18.

4.5.12 Falkirk's projected General Fund balance at 31st March 2018 is £11.420m. In 2017/18 the Council applied £3.300m to balance the budget. If reserves were applied at the same level going forward then the Council would run out of General Fund reserves within three to four years.

4.5.13 Given the continuing financial pressures the report reminds Members of the need to demonstrate effective leadership, plan for savings over at least a three year period, consider different funding scenarios and the impact on services over the medium to long term and ensure savings are realistic and achievable.

5. Consultation

5.1 Engagement has and will continue to be conducted with stakeholders as the Budget process progresses.

6. Implications

Financial

6.1 Preparation of a balanced Budget and compliance with it thereafter is a cornerstone of the Council's corporate governance obligations.

Resources

6.2 There are significant resources required to prepare the Budget and the ultimate Budget decisions taken by Members will of themselves impact on resources.

Legal

6.3 No legal implications arise from the report recommendations, other than to note that it is a legal requirement to set a balanced Budget before the statutory deadline date in March.

Risk

6.4 There are no particular risk implications arising from this report.

Equalities

6.5 Preparation of Equality & Poverty Impact Assessments (EPIAs) are an integral part of the Budget process.

Sustainability/Environmental Impact

6.6 This will be considered as part of the evaluation of savings options.

7. Conclusions

7.1 The draft Scottish Government Budget for 2018/19 reflects their block grant settlement with Westmister, including the new Fiscal Framework and application of tax raising powers, together with their policy priorities, including the protection of certain service areas, notably Health.

7.2 The Settlement is presented as a package which councils are expected to accept in its entirety. A council electing not to do this is required to write to the Cabinet Secretary by 26th January and face a reduction in revenue grant. It is disappointing that the settlement is for one year only as this is not conducive to medium term planning.

7.3 The provisional Revenue Grant figure is more favourable than the Council's base case assumption and this is to be welcomed, albeit there still remains a very challenging gap of over £20m to be bridged in 2018/19. The Capital Grant figure was lower than projected and officers will need to undertake further work to deliver a balanced draft General Services Capital Programme for Council to consider.

7.4 The report also presented key messages from the Accounts Commission Overview of 2016/17 which Council will wish to have regard to in its Budget deliberations.

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Director of Corporate & Housing Services

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Date: 4th January 2018

Appendices

1) The Cabinet Secretary's letter dated 14th December to Leaders which is at appendix 1.
2) 2018/19 Gap Statement at appendix 2.
3) The Financial Overview report at appendix 3.

List of Background Papers:

The following papers were relied on in the preparation of this report in terms of the Local Government (Scotland) Act 1973:

- Budget Working Paper files.
- Scottish Fiscal Commission - Scotland's Economic and Fiscal Forecasts, December 2017.
- SPICe Briefing – Local Government Finance: Draft Budget 2018/19 and provisional allocations to local authorities.

Cabinet Secretary for Finance and the Constitution
Derek Mackay MSP

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Copy to: The Leaders of all Scottish local authorities

14 December 2017

Dear Alison,

Today I set out the Scottish Government's draft spending and tax plans for 2018-19. Further to my announcement I write now to confirm the details of the local government finance settlement for 2018-19.

Details of the indicative allocations to individual local authorities for 2018-19 are also being published today as set out in Local Government Finance Circular No. 5/2017.

This settlement is set against the context of the continuing austerity imposed on Scotland by the UK Government, which means that by 2019-20 the Scottish Government's fiscal block grant allocation will be £2.6 billion (8.0%) lower in real terms than it was in 2010-11.

I have considered carefully the representations and evidence COSLA have presented on behalf of local government and have welcomed the constructive approach with which you have approached our negotiations.

I have noted the issues COSLA have said are important for local government and have tried where possible to address these in this settlement. I recognise the continuing financial pressures local government, along with the rest of the public sector, is facing in a very challenging fiscal environment. However, I believe that the outcome, presented in the measures set out in this letter, is the best that could be achieved in the circumstances and continues to provide a fair settlement for local government to enable them to meet our shared ambitions for the people and communities we serve.

Turning now to the detail of the package of measures, the total revenue funding to be provided through the settlement for 2018-19 will be £9630.8 million, which includes distributable non-domestic rates incomes of £2,636 million.

The core Capital funding is set at £726.4 million but with the inclusion of the expansion of Early Years provision as set out below this increases the Capital funding within the settlement to £876.4 million.

The total funding which the Scottish Government will provide to local government in 2018-19 through the settlement is therefore £10,507.1 million. This includes;

- Baselining from 2018-19 of the £130 million additional revenue investment I announced earlier this year at Stage 1 of the Budget Bill for 2017-18;
- £52.2 million revenue and £150 million capital to deliver on our joint agreed ambitious programme for the expansion of Early Years provision;
- £11 million of revenue to support the initial expansion of Early Years set out in the 2014 Act provisions;
- £24 million for the full year cost of our contribution to the Teachers' pay offer; and
- £66 million to support additional investment in social care in recognition of a range of pressures local authorities are facing.

I have also had to look very seriously at the capital allocation to Local Government, in particular the calculation of the share commitment which guarantees that Local Government will receive a fixed percentage of the overall Scottish capital budget each year until 2019-20, based on the position as at the 2015 Spending Review. However, I believe that the context has changed since this commitment was originally made, including the introduction of additional funding streams outwith the settlement which local authorities will directly benefit from.

For 2018-19 the calculation of the capital share allocation takes into account, at least in part, the additional funding streams outwith the settlement, except in the case of Early Years which is additional to the share allocation. The value of the capital funding I have made available to local government exceeds the percentage commitment made and equates to 31 per cent. Taking into account the Early Years grant, the percentage increases to 36 per cent.

The commitment to repay £150 million of re-profiled capital from an earlier settlement remains and this will be repaid in full in 2019-20.

For 2018-19 local authorities will continue to have the flexibility to increase Council Tax by up to a maximum of 3%. This local discretion will preserve the financial accountability of local government, whilst also potentially generating around £77 million to support services.

The revenue allocation delivers a flat cash settlement for local government for 2018-19 compared to 2017-18, including the additional resources to meet our commitments on the expansion of Early Years, teachers pay and support for social care. Taken together with the additional spending power that comes with the flexibility to increase Council Tax (worth around £77 million next year) the total funding (revenue and capital) delivers an increase in the overall resources to support local government services of 1.6%.

In my response on 12 September to the Barclay Review of non-domestic rates I made clear that there were certain recommendations that I wished to engage further on before coming to a conclusion, including the removal of charity relief for council arm's-length external organisations (ALEOs). In these discussions I heard a strong and consistent message from local government and other stakeholders about the importance of this benefit, to sports, leisure and culture facilities in particular, and of keeping the costs of these services affordable especially in disadvantaged and vulnerable communities.

As a result I confirmed on 28 November that charity relief will continue to be applicable to qualifying properties currently occupied by council ALEOs. However I am aware that some councils are planning to increase the numbers of ALEOs or the number of properties occupied by existing ALEOs. To mitigate against this it is my intention to offset any further charity relief benefit awarded in respect of both new council ALEOs and additional properties occupied by existing ALEOs since my announcement, by implementing an equal compensating reduction in General Revenue Grant for the councils in question.

In addition, a new relief for public sector and private sector day nurseries is proposed. This will offer 100% relief for properties wholly or mainly used to provide day nursery care for pre-school children. The relief will be applicable under EU State aid rules.

We will require local authorities to achieve a pupil:teacher ratio of 13.7, and ensure that places are provided for all probationers who require one under the Teacher Induction Scheme. This is supported by a continued funding package of £88 million, made up of £51 million to maintain teacher numbers and £37 million to support the Teacher Induction Scheme. In order to support delivery of this commitment the Scottish Government will work with COSLA to consider how the use of existing or additional data on unfilled posts and teacher vacancies could be better utilised to inform how delivery of this commitment is measured. As in previous years teachers whose posts are funded through the Attainment Scotland Fund, including Pupil Equity Funding, are additional and do not contribute towards the delivery of this commitment. An additional £24 million is also be included in the settlement to cover the additional full year cost of the teachers' pay offer for 2017-18.

We have committed to provide certainty to local authorities over the quantum of multi-year funding for the expansion of early learning and childcare to support authorities in planning for and implementing the delivery of the commitment.

I understand the Deputy First Minister has been very encouraged by the constructive discussions which are taking place through the Early Learning and Childcare Finance Working Group to reach a shared understanding of the costs arising from the expansion. It is right and proper that Scottish Government and local authority colleagues take the time to challenge and refine cost estimates for this significant investment in the education and care of our youngest children, so that we can all be assured that we make best use of public funds.

On that basis, we are content to agree to the proposal made by COSLA leaders that we should agree revenue and capital funding for 2018-19 (adds £52.2 million and £150 million respectively) in our draft spending plans announced today and to continue to work closely together to agree funding levels for 2019-20 onwards in early 2018. For 2018-19 the £52.2 million includes revenue funding for free lunches and implementation of the additional graduate commitment (from August 2018). There is also a further additional £11 million included in 2018-19 for implementation of the 2014 Act provisions.

In 2018-19 an additional £66 million is included in the settlement allocations to support additional expenditure by local government on social care in recognition of a range of pressures they and integration authorities are facing, including support for the implementation of the Carers (Scotland) Act 2016, maintaining our joint commitment to the Living Wage (including our agreement to now extend it to cover sleepovers following the further work we have undertaken) and an increase in the Free Personal and Nursing Care payments. This funding is provided directly to local authorities and is in addition to the £355 million baselined provision transferred from NHS Boards to Integration Authorities. I will look to local authorities to continue to prioritise their financial support for social care.

The Scottish Government is fully committed to further engagement with COSLA as we seek to make local taxation as a whole fair and progressive. We will work with COSLA to consider your objectives for local tax reform and our commitments for local government to retain the net incomes from the Crown Estate for the benefit of island and coastal communities.

I can also restate my commitment to our partnership working and can confirm my intention that this will again be a sanction free settlement.

The measures set out in the settlement offer must be viewed as a package to protect our shared priorities. In order to access all of the benefits involved, including those priorities supported by specific financial benefits, local authorities must agree to deliver all of the measures set out in the package and will not be able to select elements of the package.

Any individual authority not intending to agree the offer and accept the full package of measures and benefits should write to me by no later than 19 January 2018. For those authorities not agreeing the offer a revised, and inevitably less favourable, offer will be made.

I have carefully considered the representations made to me by COSLA and this is reflected in the detail of the settlement and the package of measures included. My aim throughout our discussions has been to reach an agreement with councils around the implementation of these commitments. I now invite local authorities to agree the terms of the settlement which I consider delivers the best outcome for local government that can be achieved in the circumstances.

Yours

DEREK MACKAY

Appendix 2

2018/19 & 2019/20
BUDGET GAP STATEMENT

	Latest Projection 2018/19		FTE	Latest Projection 2019/20		FTE	Comments
Budget Gap	20.500			14.000			Assumes 3% Council Tax Increase 19/20 Gap updated to reflect revised pay and RSG assumptions
Less Rebasing	3.372			0.500			
	17.128			13.500			
Service Savings Options							As per Oct Exec. Report
Childrens	6.114	*	94.50	1.882	*	-	Issue with unwinding ASN funding of £0.250m
Development	4.997		50.32	0.822		18.17	
Corporate & Housing	2.884		53.50	2.085		29.90	
	13.995		198.32	4.789		48.07	
Other Possible Options							
Building Cleaning	0.300		10.70				Initial savings figures reduced
Teachers	0.070	*	2.00	0.600	*	23.00	Reduced teaching costs
School Meals	0.162			0.106			Increasing school meal prices to £2.45
Municipal Buildings - Canteen	0.030						Close MB canteen
Smart Working/Travel	-0.200			-0.100			Reducing savings to more realistic level
	0.362		12.70	0.606		23.00	
FCT	1.828			3.500			19/20 increased by £2m (previously £1.5m)
IJB	3.000			4.000			£3m in 18/19 reflects Council decision 6/12
Terms & Conditions	-			1.500			
External Organisations	1.524			-			Includes non-recurring spend £0.024m
Apply Reserves	-			2.000			Application of £2m reserves in 19/20 - will increase 20/21 deficit
General Inflation - Rebasing	2.000			1.700			Cash reduction for services
	22.709		211.02	18.095		71.07	
Balance	-5.581			-4.595			

* Due to the terms of the settlement the savings relating to teachers are problamatic

Appendix 3

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

Contents

Links

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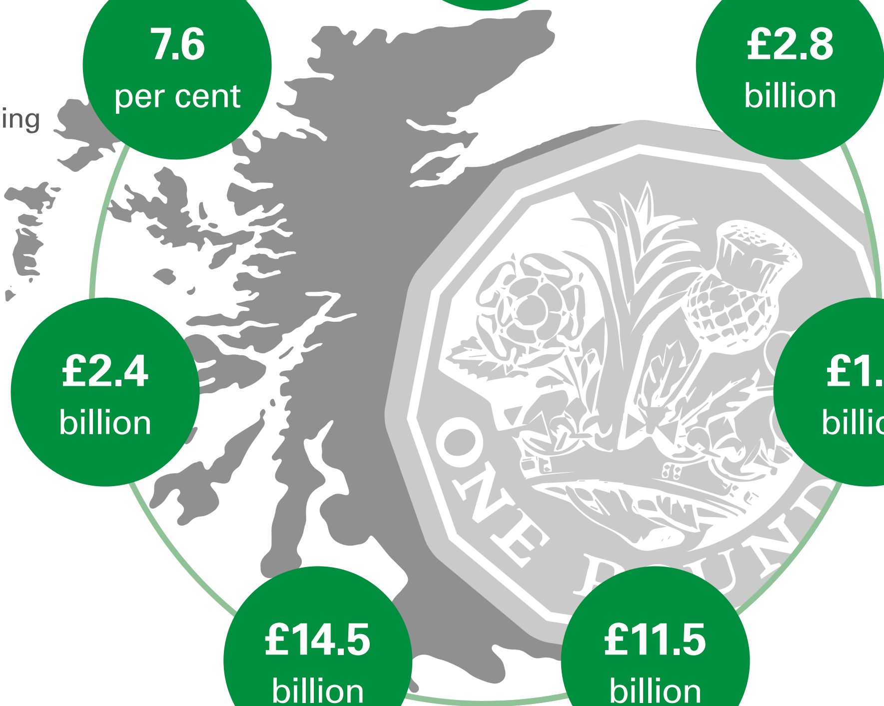
These question mark icons appear throughout this report and represent sample questions for councillors (paragraph 7).

Key facts



Council income
£15.2 billion

Council capital spending in 2016/17
£2.8 billion

Councils' usable reserves (excluding Orkney and Shetland) at 31 March 2017
£1.9 billion

Councils' pension liabilities at 31 March 2017
£11.5 billion

Councils' net debt (excluding Orkney and Shetland) in 2016/17
£14.5 billion

Council budgets delegated to IJBs in 2016/17
£2.4 billion

Real-terms reduction in Scottish Government revenue funding since 2010/11
7.6 per cent

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.

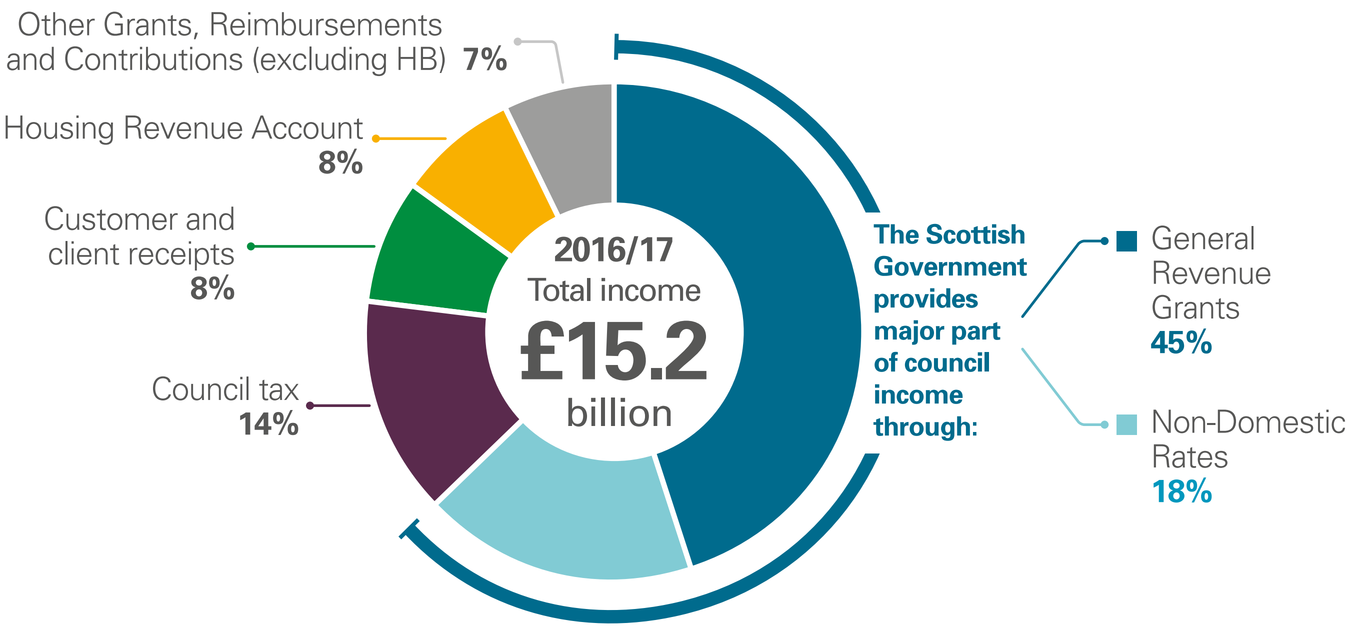
5 Councils set larger capital budgets in 2016/17 than in 2015/16. The Scottish Government capital grant fell and councils planned to fund expenditure through increased borrowing.

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:
1. Does not include all income collected for services delivered through council arm's-length external organisations (ALEOs) and Integration Joint Boards (IJBs).
2. Income excludes housing benefit.
3. 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	Change on 2015/16	
	£'000	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.

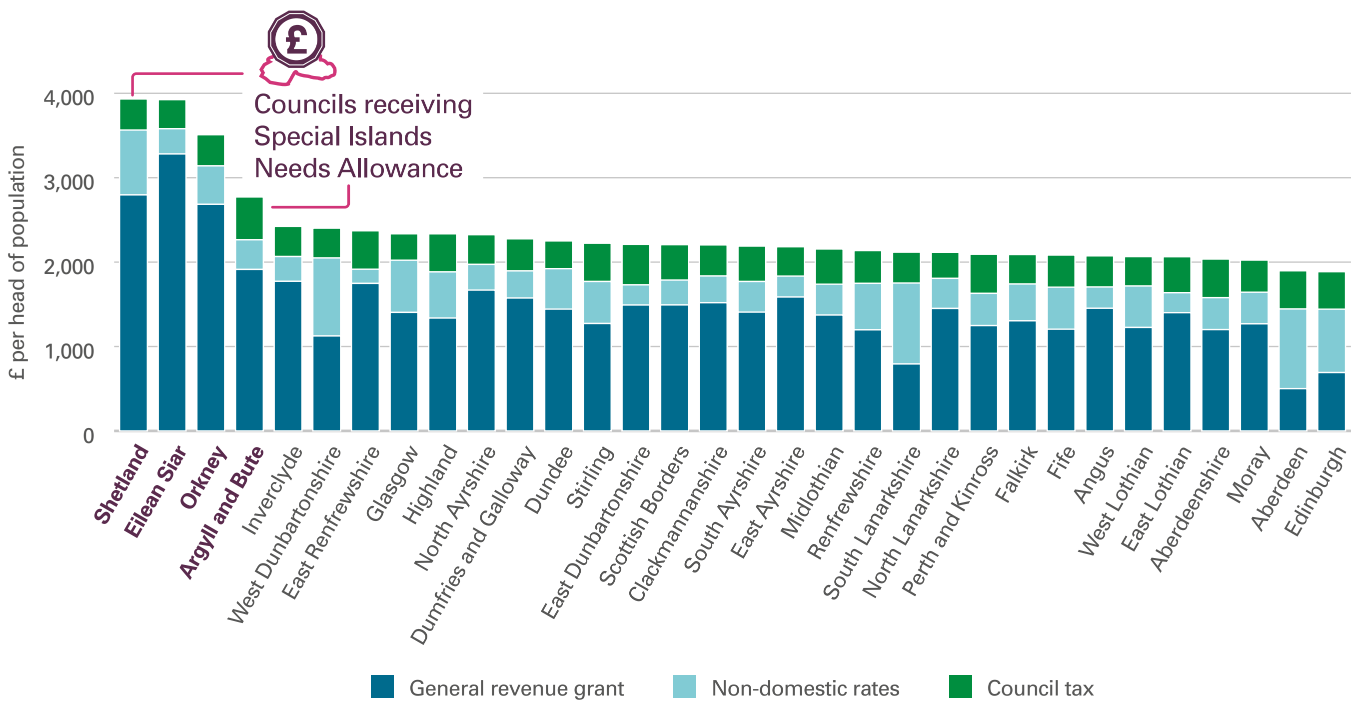
13. Council tax is a key source of income for local government. Councils have typically set council tax rates to reflect local policy choices. Between 2008/09 and 2016/17, councils agreed with the Scottish Government to freeze council tax rates. To compensate them, the Scottish Government provided local 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

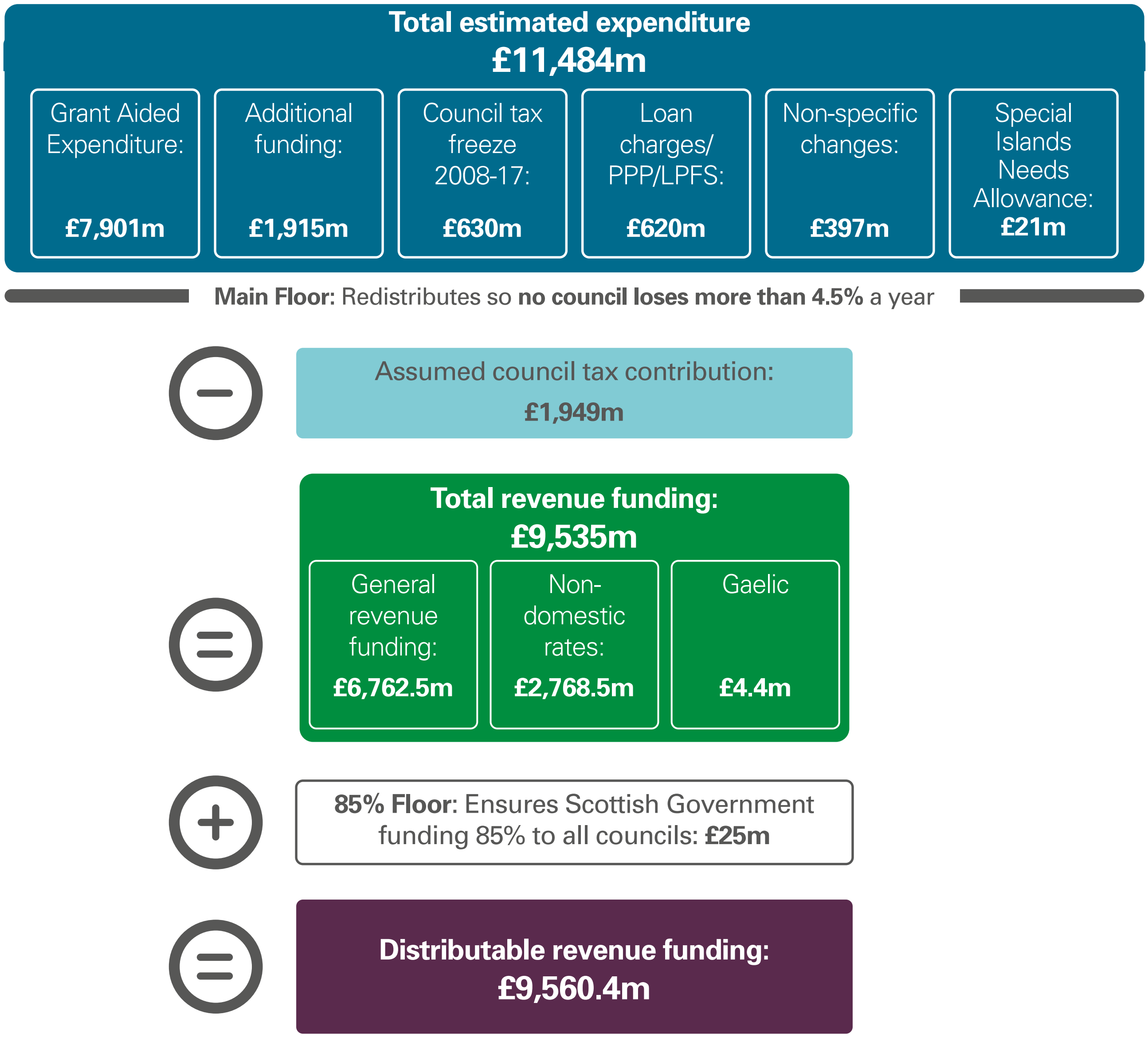
15. The Scottish Government funding mechanism is the main determinant of a council's overall funding. It is designed to reflect differences between councils in terms of population and other factors, such as geography and deprivation. The funding mechanism is based on a large number of elements as illustrated 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.'[3]

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.



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.

Source: Audit Scotland

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

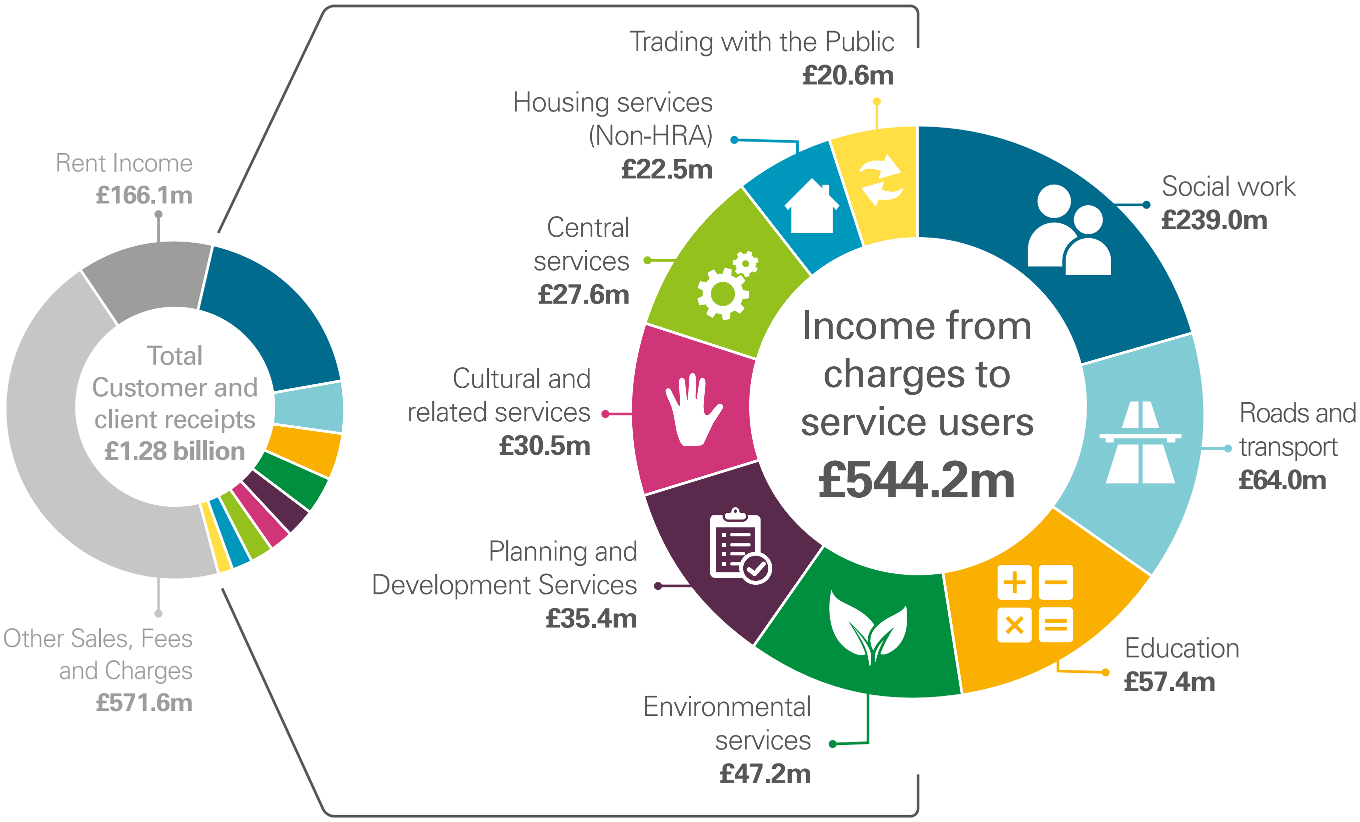
There was significant variation in budget changes across council services.

	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.

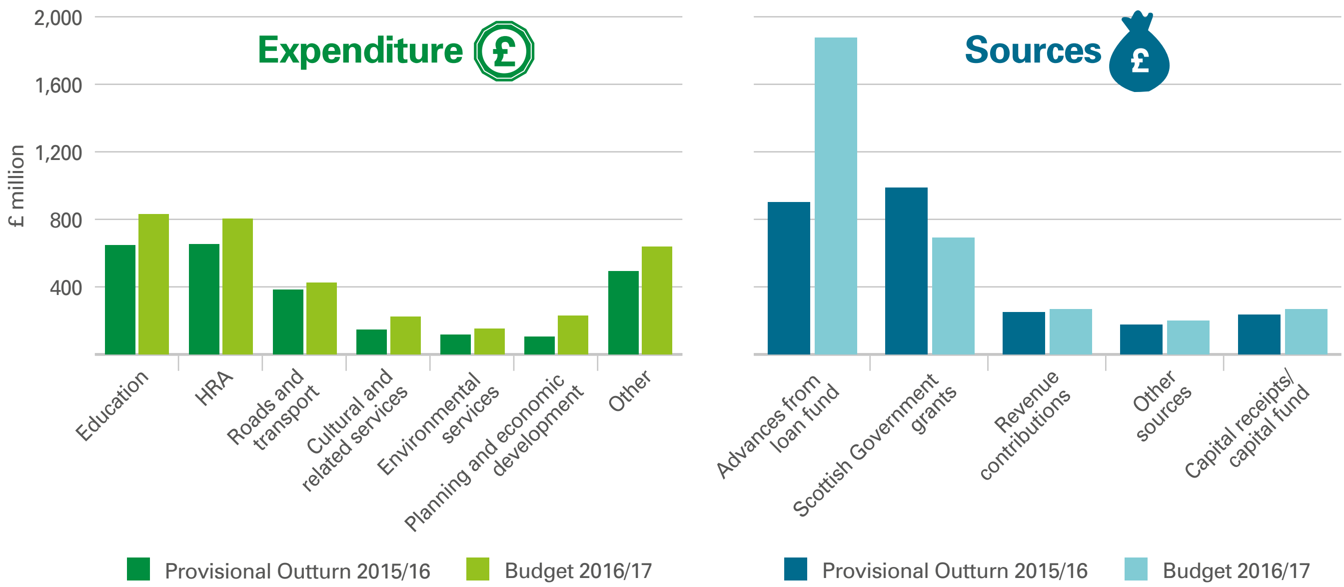
30. Councils finance their capital expenditure from a number of sources, including Scottish Government capital grants and borrowing. Scottish Government grants fell from £834 million in 2015/16 to £591 million in 2016/17, returning to a more usual level following re-profiling in earlier years. Exhibit 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 Sottish 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.

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

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.

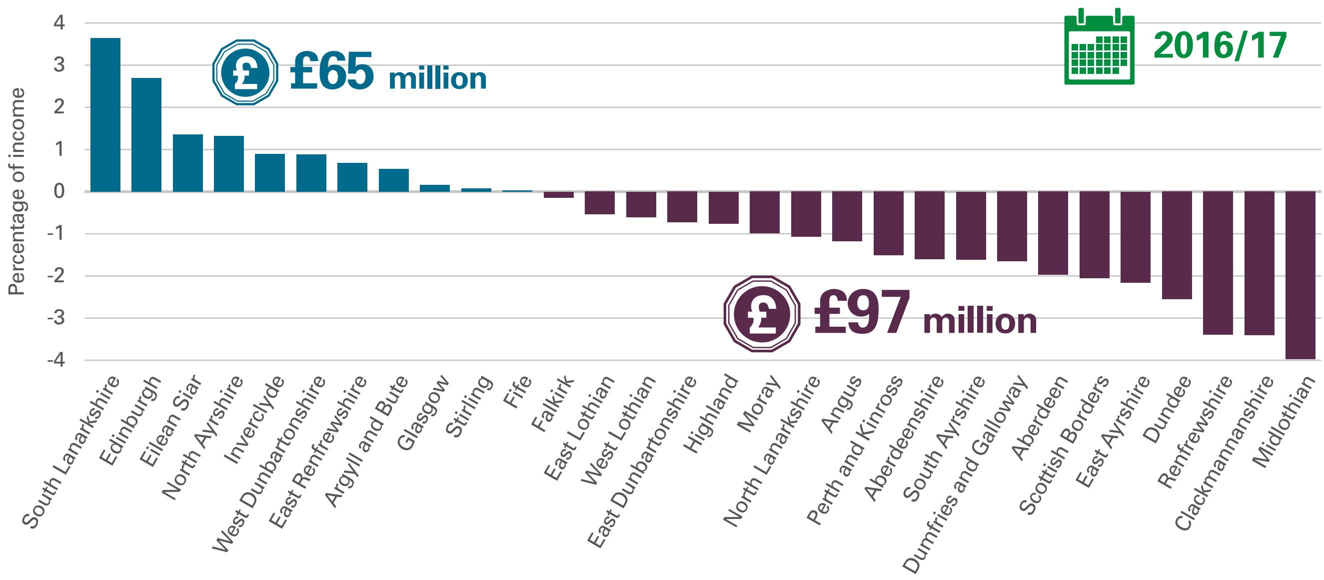
Are staff severances in line with the council's workforce plan?

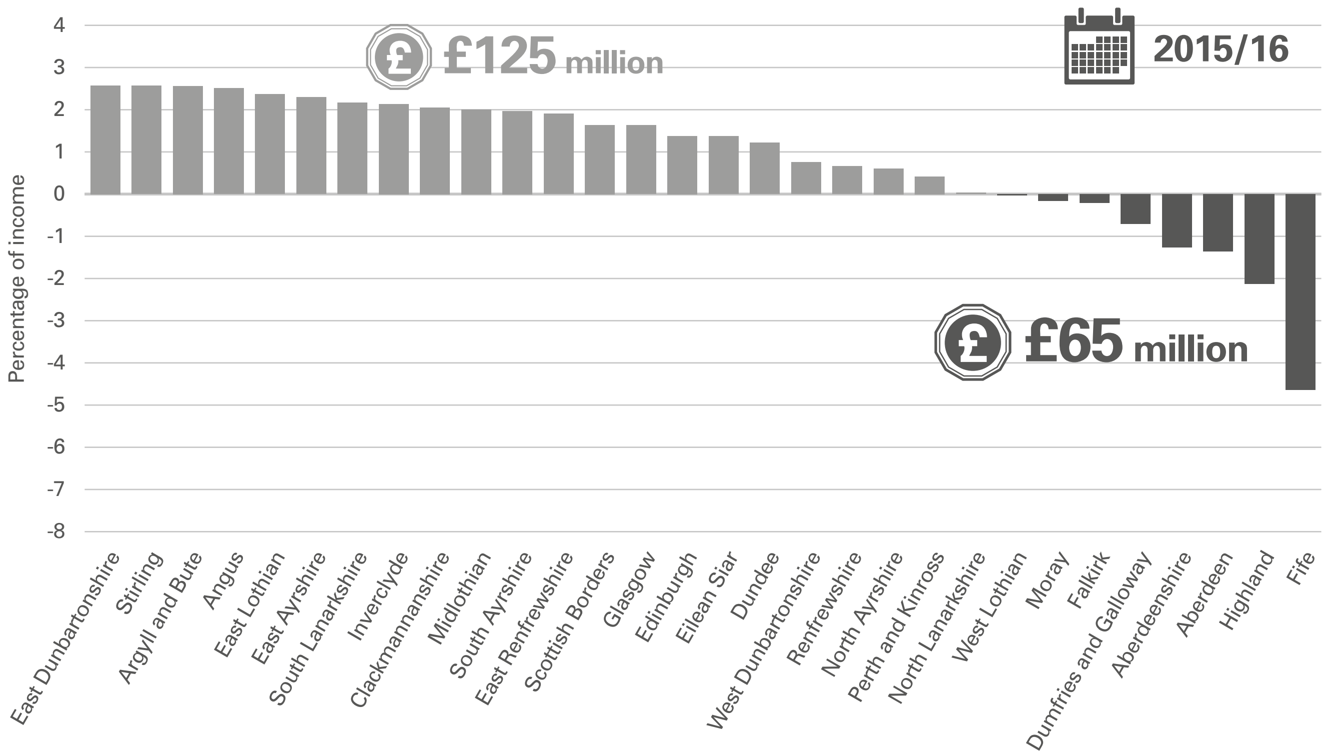
39. In future, severance schemes could become less attractive for staff under Scottish Government proposals to limit payments. Conversely, severance packages for staff with retirement dates after April 2020 will become more expensive for councils following changes to pension protection.

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.

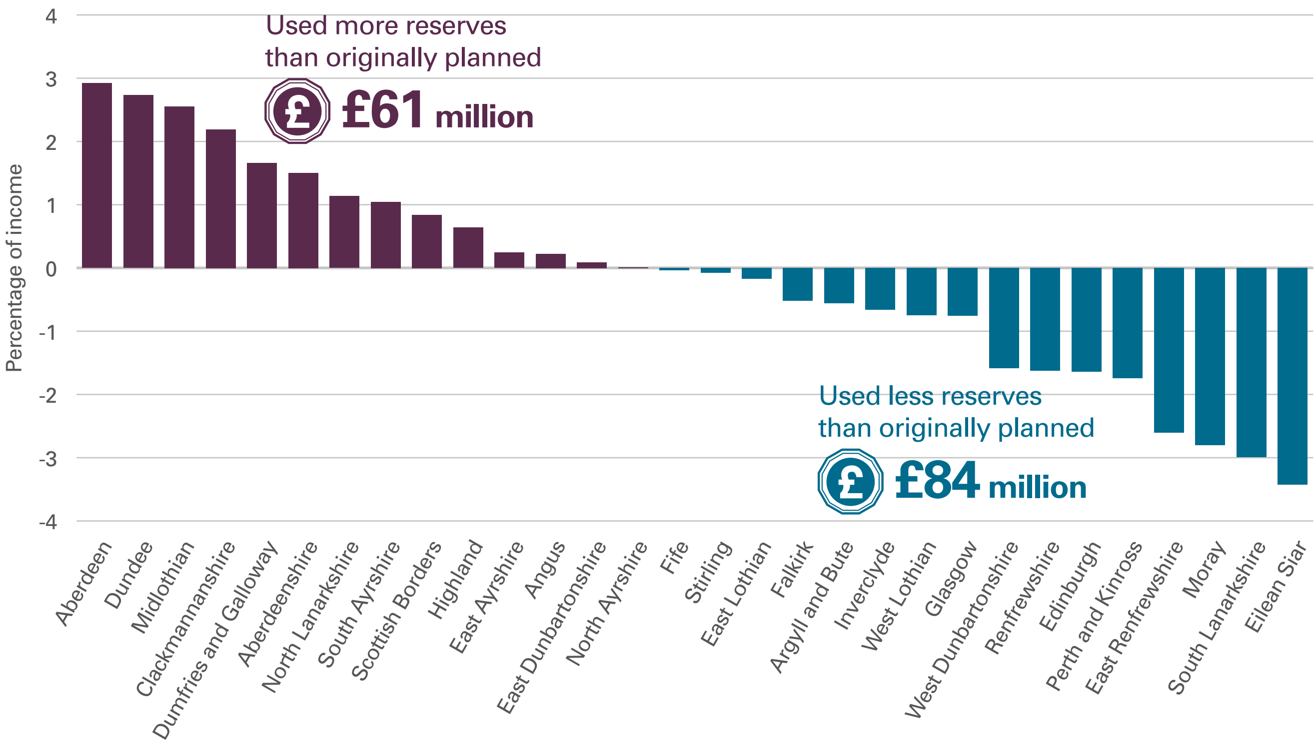
How does the council ensure that council staff have the capacity to delivery transformational change?

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.

Overspend

Health and social care
Increased demand for services

Early retirement
Severance schemes

Welfare reforms
Generated higher than expected demand

Education and children's services
- Out of school placements
- Residential placements
- Fostering and adoption

Underspend

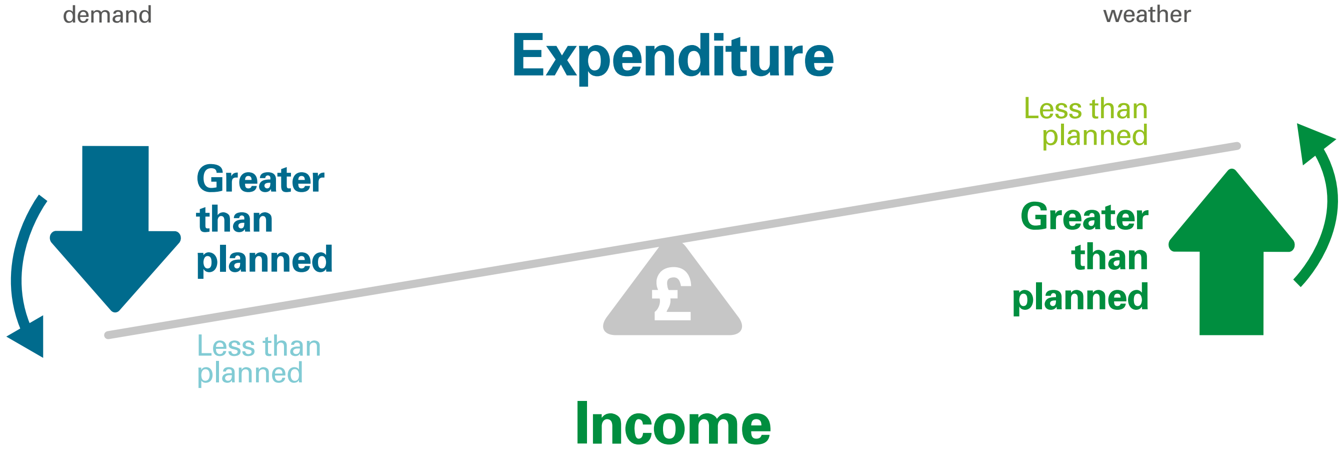
Loan charges/ financing
Deferred borrowing and low interest rates

General costs
Lower than predicted inflation

Utility/Premises costs
Reduced insurance and utility costs

Staffing
Staff vacancies

Winter maintenance
Spend less than planned due to weather



Planning and building control income less than planned

Trading operations not generating expected income

Council tax income greater than planned

Council tax reduction scheme income greater than planned

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).

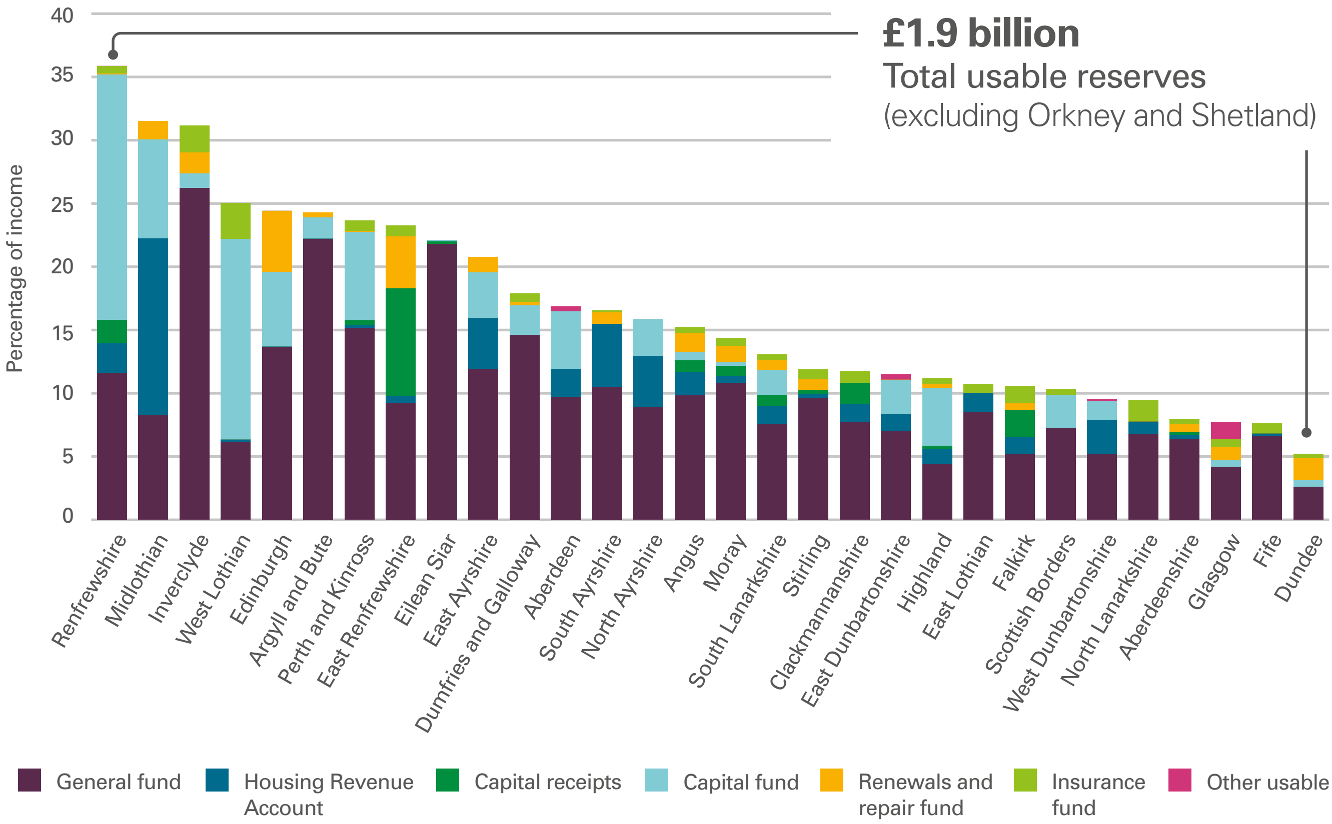
46. There is no prescribed minimal level of usable reserves. Typically councils' policies are to have a minimum uncommitted General Fund balance of between two and four per cent. Councils need to be clear about the reasons for the levels of reserves they hold to mitigate risks and support medium-term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

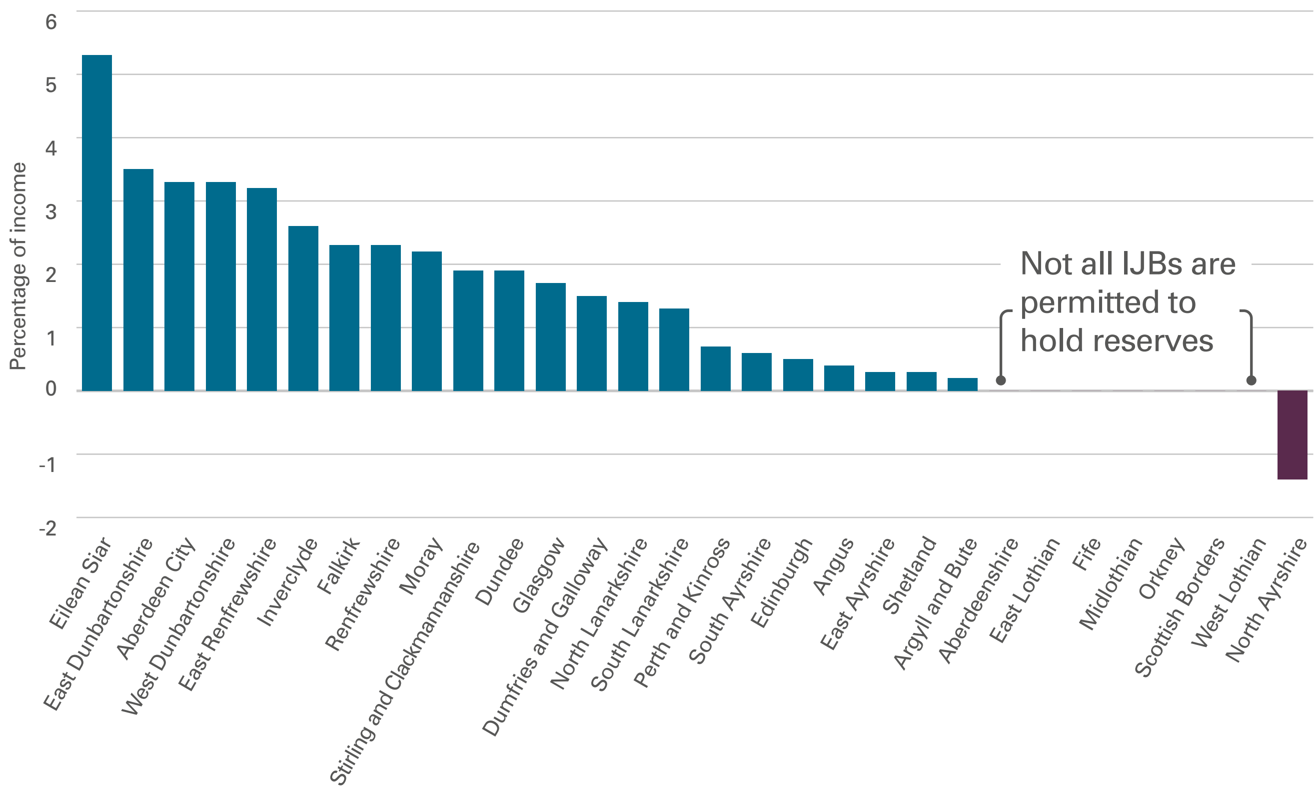
48. It is not clear from the accounts of IJBs to what extent reserves have been built up in a planned way, have arisen as a result of underspends on IJB activities or have been earmarked for transformation activity. There is a lot of pressure on the budgets of IJBs and reserves at the end of 2016/17 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.

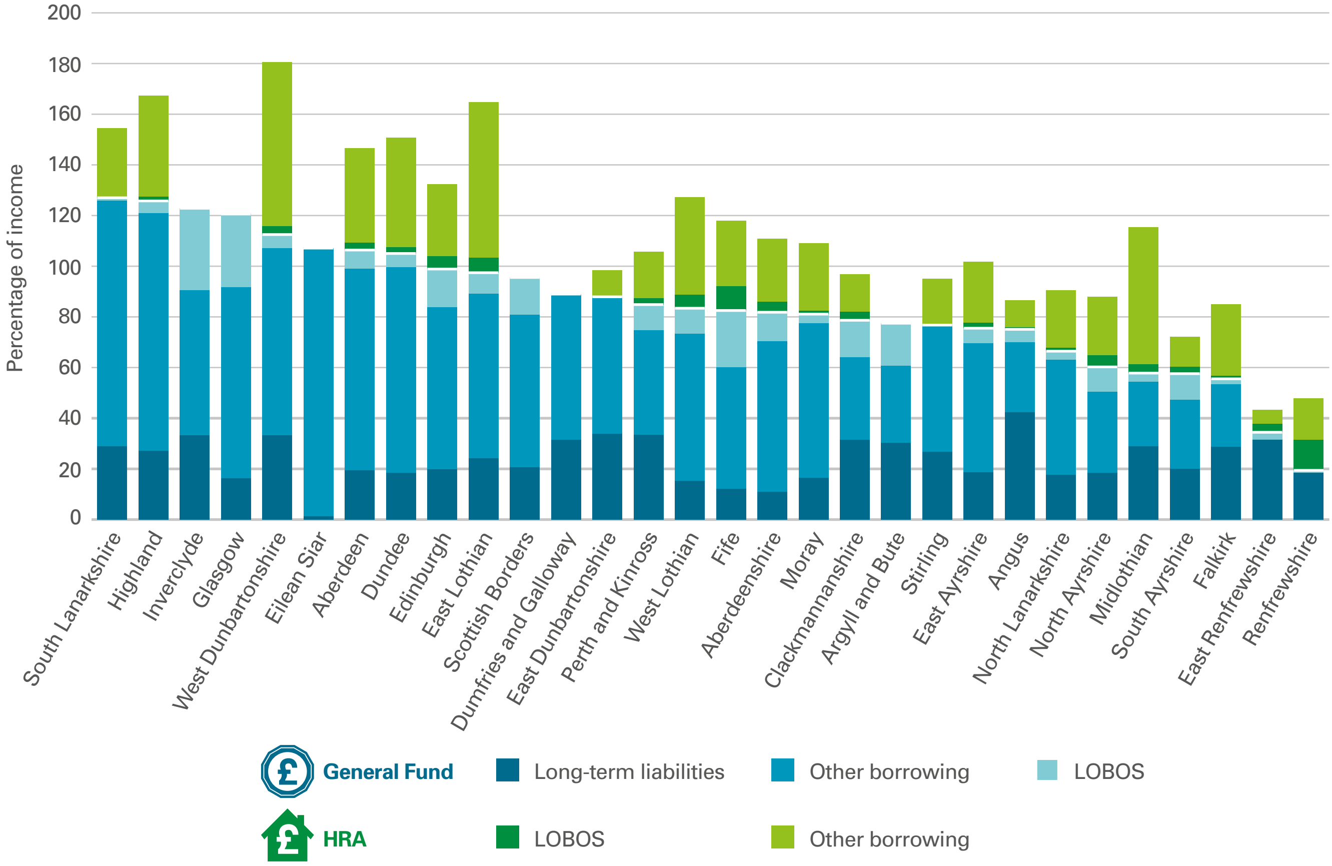
51. The ongoing costs associated with debt reduces the amount councils have available for day-to-day service expenditure. It is therefore important that assets are effectively supporting service delivery and strategic priorities. Higher levels of debt often result in higher costs for councils but actual 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?

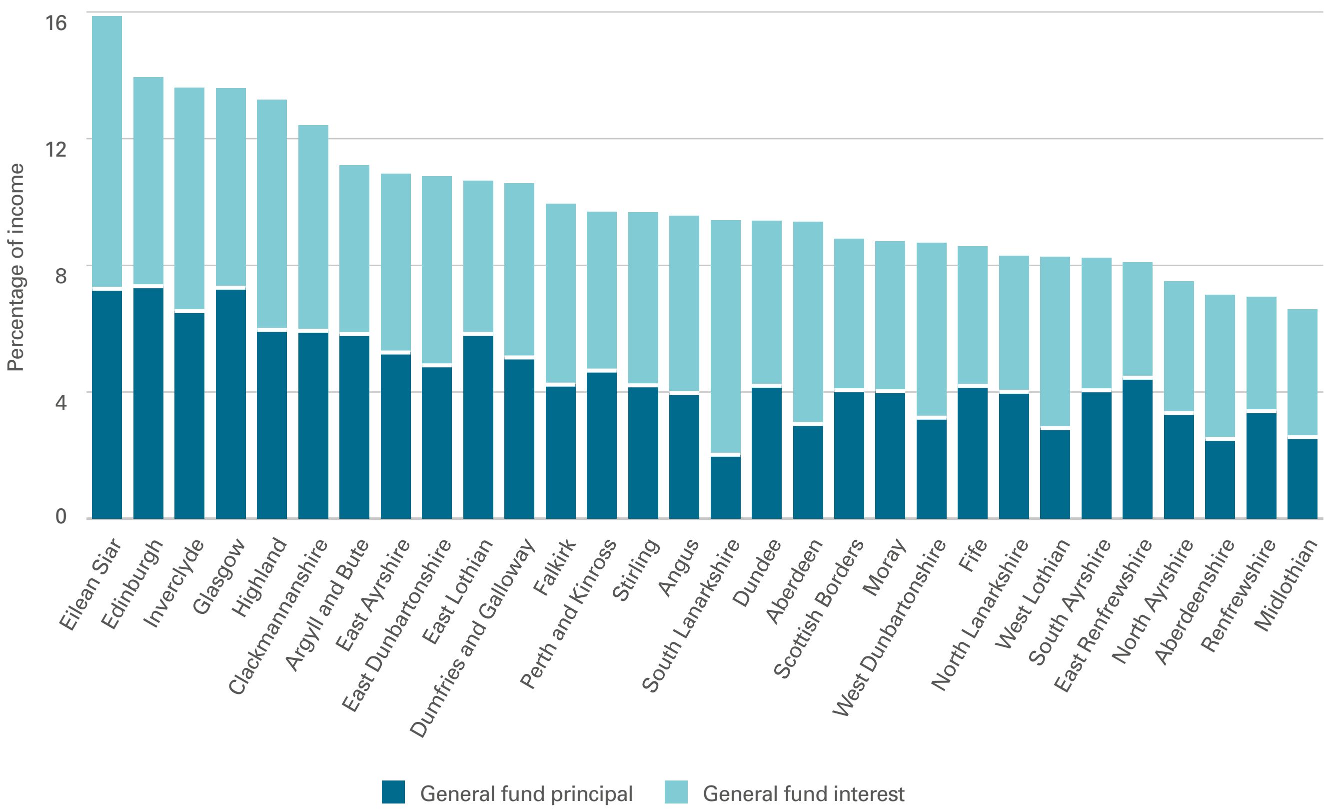
- 'Lender option borrower option' loans (LOBOs) include options for the lender to increase interest rates. LOBOs account for about 11 per cent of council debt.
- PPP/PFI and indexed linked bonds include charges that increase with inflation. Projects financed using the Scottish Government's Non-Profit 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.

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

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.

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

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.

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.

Source: Audit Scotland

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

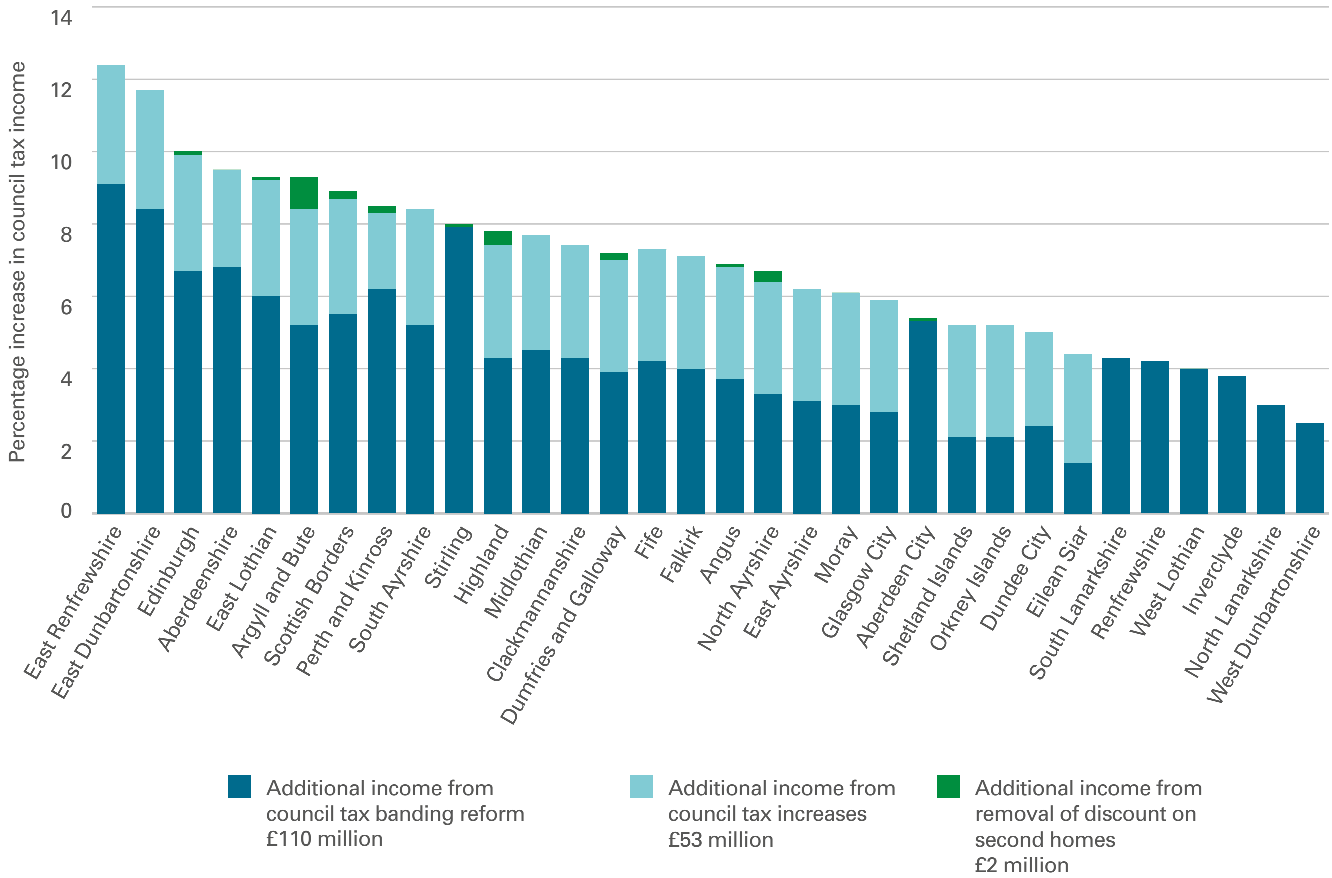
Reductions in Scottish Government funding were only partly offset by the end of the council tax freeze

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. There were reforms to council tax banding multipliers for 2017/18 that resulted in a further £110 million of council tax due across the 32 councils. This will be available in full as additional income to be spent in the local authority area it is collected. Exhibit 19 (page 35) shows the additional income councils are due from council tax in 2017/18.

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: Scottish Government Finance Circular 1/2017, 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

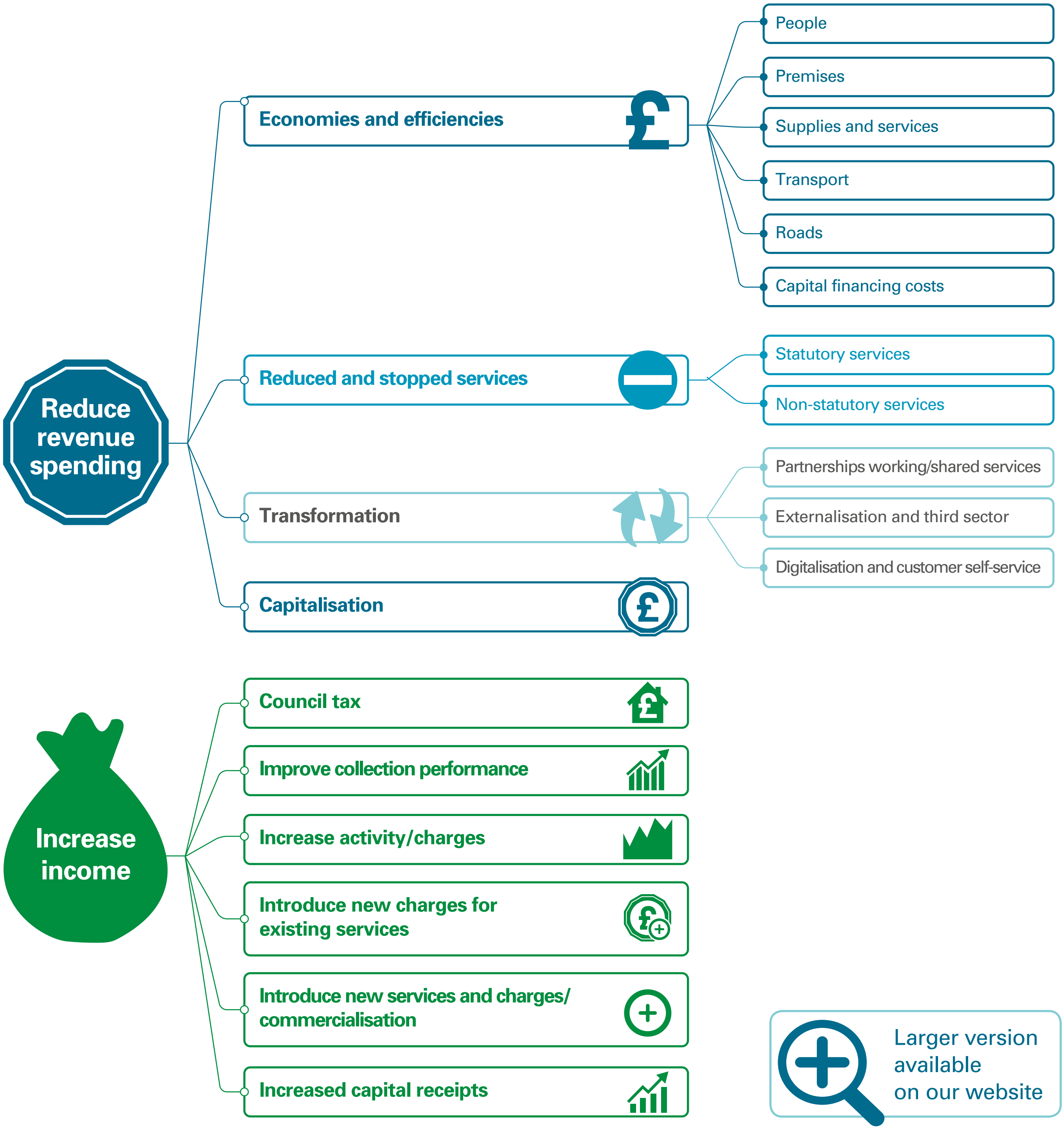
69. When setting budgets for 2017/18, councils had to take into account a number of new cost pressures, including:

- 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



Larger version available on our website

Source: Audit Scotland, analysis of budget setting reports 2017/18

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

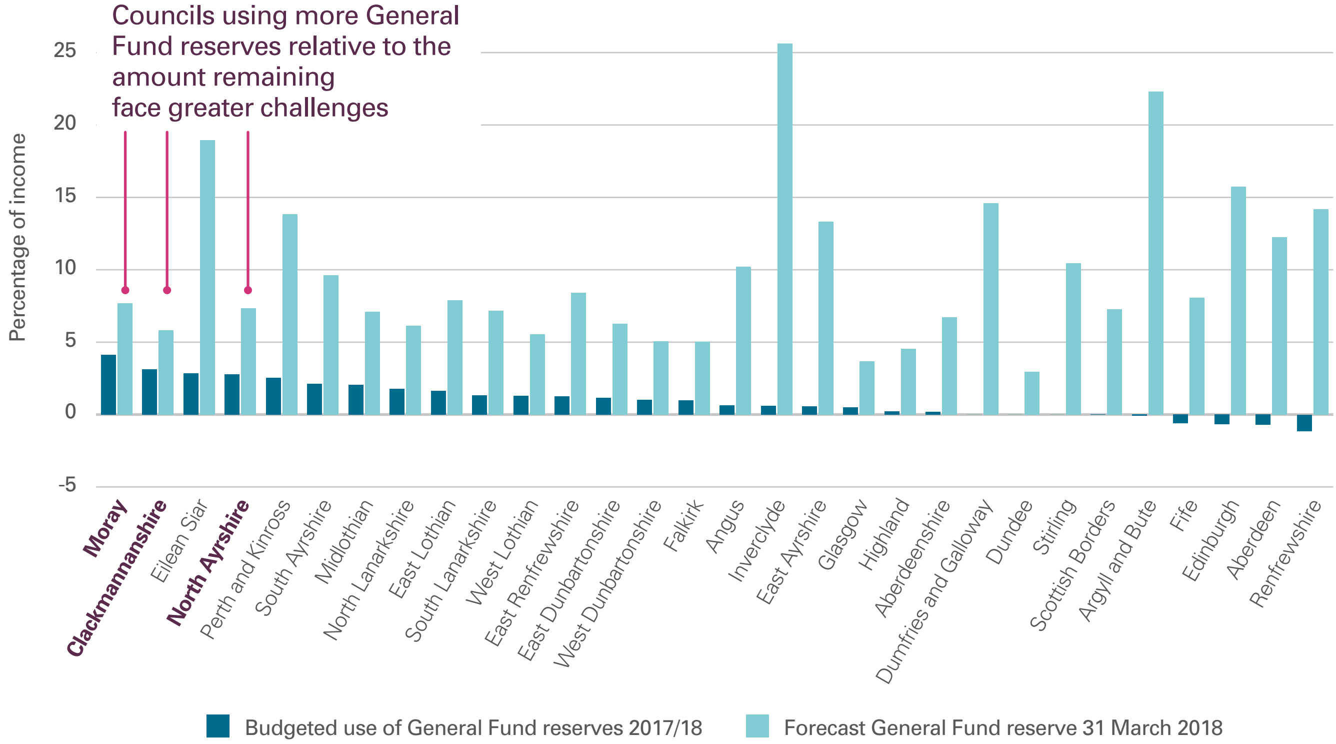
71. Some councils' plans for 2017/18 have relied more heavily than others on using reserves to bridge funding gaps. A number of these councils could have relatively low levels of General Fund reserves remaining at the end of the year (Exhibit 21).

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.

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

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

- 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.

Forecast change to expenditure

Forecast change to income	0%	0.5% ▲	1% ▲	1.5% ▲	2% ▲	2.5% ▲	3.5% ▲
2.5% ▲	£192	£132	£72	£12	-£48	-£107	-£229
2% ▲	£133	£73	£13	-£47	-£107	-£167	-£288
1.5% ▲	£73	£13	-£46	-£106	-£166	-£226	-£348
1% ▲	£14	-£46	-£106	-£166	-£226	-£285	-£407
0.5% ▲	-£45	-£105	-£165	-£225	-£285	-£345	-£466
0%	-£105	-£165	-£225	-£284	-£344	-£404	-£526
-0.5% ▼	-£164	-£224	-£284	-£344	-£404	-£463	-£585
-1% ▼	-£223	-£283	-£343	-£403	-£463	-£523	-£644
-1.5% ▼	-£283	-£343	-£403	-£462	-£522	-£582	-£704
-2% ▼	[illegible]	[illegible]	[illegible]	-£522	-£582	-£641	-£763
-2.5% ▼	[illegible]	[illegible]	[illegible]	-£581	-£641	-£701	-£822

Funding gap – £million

1.5% reduction in income
+
0.5% increase in expenditure
=
increase funding gap to **£343m** in 2018/19

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.

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?

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

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.

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

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.

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

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.

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.

Local government in Scotland

Financial overview 2016/17

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