

**Audit Scotland Report: Local government in Scotland: Financial Overview 2017/18 (Audit Scotland, November 2018)****Report by: Gary Fairley, Head of Finance and Integrated Service Support****1 Purpose of the Report**

To provide Audit Committee with a summary of the Audit Scotland report, 'Local government in Scotland: Financial Overview 2017/18' and the Council's position in relation to the report's findings. Link to the full report here:

<http://www.audit-scotland.gov.uk/report/local-government-in-scotland-financial-overview-201718>

**2 Background**

**2.1** Each year the Accounts Commission produces an overview of issues that have arisen from their local authority audits. In line with the previous publications these will again be encompassed in two reports. The first report, which is covered in this paper, focuses on financial matters, and the other, which will be published on 14 March 2019 will focus on council's performance and outcomes.

**2.2** Local government in Scotland: Financial Overview 2017/18 was published by the Accounts Commission in November 2018 and was included on the agenda of the last Audit Committee. The report provides a high-level, independent view of Councils financial performance and position in 2017/18. It is aimed primarily at Councillors and senior council officers as a source of information and to support them in their complex and demanding roles. It is in four parts:

- Part 1 Council's budgets and spending in 2017/18.
- Part 2 Council's financial position.
- Part 3 Integration Joint Boards' overview 2017/18
- Part 4 Council's financial outlook.

**2.3** The report is the first of the Account's Commission overview outputs. It tells the strategic financial story for local government in Scotland in 2017/18, another challenging year for Councils. The report notes that there was a real term reduction in councils' main source of funding from Scottish Government for 2017/18 and advised that councils an increasingly complex range of challenges and continuing pressure on finances. With the forecast trend for further reductions in funding from

Scottish Government in the medium term the Accounts Commission noted that pressure remains on councils to make further savings and the need to find ways to meet service demand more efficiently and effectively. Further noting that this will require difficult decisions and innovative thinking by councillors and senior management working together.

- 2.4** The report further noted that most councils now have medium-term financial plans in place and therefore encouraged all councils to build on medium-term plans and develop suitable long-term financial planning. Adding that this should support consistency in financial decisions with corporate priorities' as well as supporting transformation initiatives.
- 2.5** The Accounts Commission, in referencing the previously highlighted risk of councils planning to use significant amount of reserves to manage funding gaps were pleased to note that for this year, although overall reserves continued to reduce, no council is using its reserves at the level that risks their financial sustainability in the next two to three years.
- 2.5** The Commission also recognised that one of the other most significant challenges for councils are financial issues associated with the Integrated Joint Boards (IJBs).
- 2.6** The key messages identified in the 2017/18 report include:
- Councils depend on Scottish Government funding for a significant part of their income. Scottish Government revenue funding to councils reduced in 2017/18, in cash terms by 0.6 per cent (£0.06 billion) and in real terms, by 2.3 per cent (£0.22 billion). Council tax increases and increased fees and charges were used by councils to increase overall budgets by £0.3 billion (cash terms).
  - In 2017/18, councils managed funding gaps of four per cent in their net expenditure budgets of £12 billion, mainly through savings and planned use of reserves. Councils are under pressure to find different ways to fund and deliver services. In 2017/18, 24 councils increased council tax, whereas in 2018/19, all councils increased council tax.
  - Overall increases in spending in Education and Social Work were offset by reductions in other services.
  - Eighteen councils ended 2017/18 with lower levels of usable reserves than they had at the start of the year. Total usable reserves fell by £18 million, a relatively small amount.
  - Funding to the Integration Joint Boards (IJBs) increased in 2017/18 by three per cent in cash terms (1.4 per cent in real terms), including additional funding from the NHS. The majority of IJBs have underlying financial sustainability issues, with 20 incurring deficits or dependent on additional ('deficit') funding from their partners.
  - The financial outlook is for reductions in Scottish Government revenue funding to councils. This will mean continued and increasing financial pressures on council services, especially those that are not protected.

- The impact of EU withdrawal is not yet clear, but councils need to identify the risks and develop contingency plans to manage these risks.

### **3 Financial Overview 2017/18**

#### **3.1 Part 1 – Councils’ budgets and spending in 2017/18. Key messages:**

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

These key messages reflect the challenges Midlothian Council faced when setting a budget for 2017/18. The 2017/18 budget included a package of measures to address a £12.431 million budget shortfall which included a £3.970 million utilisation of reserves. The final outturn reported to Council in June 2018 showed a net overspend for the year, met from reserves of £0.622 million.

The same challenges continue in the current financial year and are exacerbated by the cut to core grant funding in the 2019/20 grant settlement.

#### **3.2 Part 2 – Councils’ financial position. Key messages:**

1. Eighteen councils drew on their usable reserves in 2017/18, overall by a relatively small amount.
2. Some councils have relatively higher levels of debt for their size.
3. Local policies vary on whether cash and investments are held to support reserves. This could increase the need for further future borrowing.
4. Capital expenditure in 2017/18 decreased by five per cent in real terms. Housing and education were the main areas of investment.

Despite this the number of social houses provided by councils continues to fall.

5. Some councils have had significant increases in their debt positions.
6. There were delays with the valuation of pensions liabilities in councils across Scotland in 2017/18, but the net pension liability has reduced substantially in 2017/18.
7. Management commentaries in councils' accounts should do more to explain financial outturn against budget.

Again the key messages reflect the challenges the Council faces. As the resources available to the Council continue to reduce in both cash and real terms it is increasingly important that there is a robust budget setting process and that robust financial management and reporting is maintained. Council has a continued requirement to invest in assets to support the growing population. Though the level of borrowing is increasing the Treasury Management Strategy and prudential indicators provide Council with reassurance that this level of investment is financially sustainable and can be serviced from the revenue budget.

There is no doubt that difficult decisions lie ahead for all Councils and the report highlights the importance of being proactive in addressing the financial pressures.

### **3.3** Part 3 – Integration Joint Boards' overview 2017/18. Key messages:

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

The Midlothian IJB ended the financial Year with a small reserve carried forward to the current financial year, and like all IJB's continues to face significant financial challenges given the increasing demand for services.

### **3.4** Part 4 – Councils' financial outlook. Key messages:

1. In 2018/19, Scottish Government revenue funding to local government increased by 0.2 per cent after two years of real-terms reductions.
2. The Scottish Government published a five-year financial strategy in May 2018, but multi-year budgets are not yet being developed. The

financial strategy identifies greater future uncertainty and likely further reductions of nine per cent in real terms over the next five years in 'other non-protected' council funding.

3. Many councils are in the early stages of delivering transformational change.
4. Medium-term financial planning has been adopted by almost all councils, but less than half have significant long-term plans over five years.
5. Councils expect to manage smaller funding gaps in 2018/19 of £0.3 billion (two per cent), with all 32 councils raising council tax rates by three per cent in 2018/19. There are no councils where the budgeted use of reserves is a critical issue over the next three years.
6. The impact of EU withdrawal is not yet clear, but councils need to identify the risks and develop contingency plans to manage these risks, as far as possible.

The 2019/20 grant settlement published in December 2018 represents a very challenging settlement for all of Local Government with a cut to funding for core services of £237 million or 2.4%. The budget shortfall for 2019/20 reported to Council on 18 December 2018 was £9.591 million and this has been exacerbated by the settlement.

Council will be provided with the final assessment of the budget shortfall for 2019/20 when it meets on 12 February 2019 to set its budget for 2019/20. Inevitable with reducing resources and continued inflationary and demand led pressures to secure a balanced budget will require cuts across a range of services for the year ahead.

## **5 Report Implications**

### **5.1 Resource**

There are no additional resource implications.

### **5.2 Risk**

There are no additional direct risks associated with this report.

### **5.3 Single Midlothian Plan**

Themes addressed in this report:

- Community safety
- Adult health, care and housing
- Getting it right for every Midlothian child
- Improving opportunities in Midlothian
- Sustainable growth
- Business transformation and Best Value
- None of the above

#### **5.4 Key Priorities within Single Midlothian Plan**

Midlothian Council and its Community Planning Partners have made a commitment to treat the following areas as key priorities under the Single Midlothian Plan:-

- Reducing the gap in learning outcomes
- Reducing the gap in health outcomes
- Reducing the gap in economic circumstances

This report does not directly impact Midlothian Council's key priorities but a key message within the Audit Scotland Report does make reference to the need to respond to key priorities and outcomes.

#### **5.5 Impact on Performance and Outcomes**

The report does not directly impact Midlothian Council's and wider partners performance and outcomes but it does stress the need to ensure consideration is given to the wider strategic planning and objectives as part of the council's response to Audit Scotland's findings noted in their report.

#### **5.6 Adopting a Preventative Approach**

This report does not directly impact actions and plans in place to adopt a preventative approach.

#### **5.7 Involving Communities and Other Stakeholders**

This report does not directly relate to involving communities and stakeholders.

#### **5.8 Ensuring Equalities**

This report does not recommend any change to policy or practice and therefore does not require an Equalities Impact Assessment.

#### **5.9 Supporting Sustainable Development**

The recommendations in this report support Midlothian Council's position in relation to delivering sustainable services going forward.

#### **5.10 IT Issues**

There are no IT issues arising from this report at this time.

### **6 Recommendations**

The Committee is asked to note the Audit Scotland report and the position of Midlothian Council in relation to the report's key messages.

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**Report Contact: Gary Fairley**  
[gary.fariley@midlothian.gov.uk](mailto:gary.fariley@midlothian.gov.uk)

**Tel No: 0131 271 3110**

#### **Background Papers:**

Accounts Commission - Local government in Scotland: Financial Overview 2017/18 – (November 2018).