

Audit Scotland Report: Local government in Scotland: Financial Overview 2016/17 (Audit Scotland, November 2017)**Report by: Kenneth Lawrie, Chief Executive****1 Purpose of the Report**

To provide Audit Committee with a summary of the Audit Scotland report, 'Local government in Scotland: Financial Overview 2016/17' and the Council's position in relation to the report's findings. Link to the full report here:

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

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 2015/16 publications for 2016/17 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 in April 2018 will focus on council's performance and outcomes.

2.2 Local government in Scotland: Financial Overview 2016/17 was published by the Accounts Commission in November 2017. The report provides a high-level, independent view of Councils financial performance and position in 2016/17. 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 three parts:

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

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 2016/17, 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 2016/17 and advised that councils were finding the situation more serious than ever, with savings becoming increasingly

difficult to identify and achieve. The Accounts Commission identified effective leadership and financial management as becoming increasingly critical and medium-term financial strategies and well thought out savings plans being key to financial resilience and sustainability.

- 2.4** The report further noted the need for elected members to be clear about the potential impact of planned savings on achieving corporate objectives and subsequent outcomes for citizens whilst identifying that the implications of community empowerment legislation heightening the importance of engaging effectively with communities around local priorities, and working together on options for the best future use of resources.
- 2.5** Audit Scotland, in their report, continue to emphasise the importance of Best Value as a comprehensive framework for continuous improvement to support high performing and effective councils.
- 2.6** The key messages identified in the 2016/17 report include:
- 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.
 - 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.
 - 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.
 - 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.
 - 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.
 - 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.

3 Financial Overview 2016/17

3.1 Part 1 – Councils’ income and budgets for 2016/17 notes the following 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.

These key messages reflect the challenges Midlothian Council faced when setting a budget for 2016/17 and subsequently the ability to delivering services within the constrained budget. The budget for 2016/17 included a package of measures to address a £7.6 million budget shortfall which included a £2.6 million utilisation of reserves. The final outturn reported to Council in June 2017 showed a net overspend for the year, met from reserves of £2.5 million.

3.2 Part 2 – Financial Performance notes the following 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.

Again the key messages reflect the challenges the Council faces. As the resources available to the Council continue to reduce in 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 – Financial Performance notes the following 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.

These Key messages reflect those encompassed in the Financial Strategy reports to Council. At £2.1 million the projected available General Fund reserve provides no scope for further utilisation of reserves to balance the 2018/19 budget. While Council only has a duty to set a

budget for the year ahead, it is critical it does so taking cognisance of the medium term financial projections.

4 Scrutiny Tool for Councillors

The Accounts Commission has produced a Scrutiny tool for Councillors which is attached at the end of this report as Appendix 1.

Throughout the report, a number of example questions are identified that councillors may wish to consider to help them better understand their council's financial position and to scrutinise financial performance. The questions are available in Appendix 1 and are also included as a link on the following Audit Scotland website:

http://www.audit-scotland.gov.uk/uploads/docs/report/2017/nr_171128_local_government_finance_supp1.pdf

5 Report Implications

5.1 Resource

There are no additional resource implications.

5.2 Risk

Whilst there are no additional direct risks associated with this report, the Audit Scotland Report – Local government in Scotland: Financial Overview 2016/17 does ask members to consider the wider scrutiny and performance management and risk elements associated with their role.

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 for clear priorities.

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 finding 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 but the Audit Scotland Report does emphasise the need to address the requirements in the Community Empowerment (Scotland) Act 2015.

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 Audit Scotland's findings for the wider overview of Local government in Scotland: Financial Overview 2016/17 and therefore support ongoing sustainable development.

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.

Appendix 1: Local government financial overview 2016/17 - Scrutiny tool for Councillors

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Background Papers:

Accounts Commission - Local government in Scotland: Financial Overview
2016/17 – (November 2017)

Scrutiny tool for Councillors

Appendix 1

Local government financial overview 2016/17

Scrutiny tool for councillors

This scrutiny tool captures a number of potential questions for councillors and relates to our report *Local government in Scotland Financial overview 2016/17*.

It is designed to provide councillors with examples of questions they may wish to consider to help them better understand their council's financial position and to scrutinise financial performance.

How well informed am I?		
Questions for councillors to consider	What do I know?	Do I need to ask further questions?
Budget setting (paragraphs 65–68 and 76–80)		
1. Does your council have a medium term financial strategy aligned with corporate objectives?		
2. How does annual budget setting link to medium term financial planning?		
3. How is your council preparing for any further real terms reduction in Scottish Government funding?		
4. 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?		
5. What impact will savings have on the delivery of services? What are the potential risks?		
Financial and savings plans (paragraph 69–80 and 86)		
6. What is your council's financial position? What particular challenges does the council face?		
7. Does your council have a savings plan? What are the		

options to close future funding gaps?		
8. What measures in the council's corporate and transformational plans are aimed at addressing the underlying demand for some services?		
Reserves (paragraphs 36-48)		
9. What is the councils reserves policy?		
10. What have reserves been used for in recent years? Supporting services and bridging the funding gap or transforming services?		
11. What are the different types of reserves your council holds? Do you know what these can be spent on?		
12. What is the likely use of reserves for 2017/18? How does this compare to forecast funding gaps?		
13. What are the levels of reserves held by your council's IJB? Are these in line with the IJB's reserve policy?		
Levels of debt and affordability (paragraphs 49-54)		
14. What share of your council's budget is taken up with interest payments and debt repayment?		
15. What proportion of the council's debt is linked to inflation (ie, subject to indexation)? What does that mean for longer term affordability?		
Budget outturn reports and management commentaries		
16. Do budget monitoring reports clearly explain performance against plans and any changes to plans?		
17. Do management commentaries clearly explain council performance and any changes to plans?		
Financial scrutiny (paragraph 84)		
18. What additional training would you like to receive to develop your knowledge and skills in financial scrutiny?		
Charging for services (paragraphs 23-26)		
19. Does your council have a charging policy? Is this in line		

with corporate plans and objectives? When was this last reviewed?		
20. What information do you need to be able to explain increases in fees and charges to your constituents?		
Exit packages (paragraph 40–42)		
21. Are staff severances in line with the council's workforce plan?		
22. How does the council ensure that councils have the capacity to delivery transformational change?		
23. Do you know the implications of your council's pension liabilities of staff retiring early?		
Capital programmes (paragraphs 31–33 and 65–66)		
24. How clearly does the council's capital programme link with the asset management plan and corporate objectives?		
25. Has non-delivery of the capital programme (ie, slippage) been significant at your council in recent years? Why?		