

Audit Scotland Report: Local government in Scotland: Financial Overview 2015/16 (Audit Scotland, March 2017)**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 2015/16' 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-201516>

2 Background

2.1 Each year the Accounts Commission produces an overview of issues that have arisen from their local authority audits. For 2015/16 these will be encompassed in two reports. The first report assists Councils in identifying and planning for pressures they may face during 2017/18 and the report explores Councils financial and service performance and their journey of improving outcomes for service users and communities.

2.2 Local government in Scotland: Financial Overview 2015/16 was published by the Accounts Commission in November 2016. The report provides a high-level, independent view of Councils financial performance and position in 2015/16. 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 two parts:

- Part 1 focuses on Councils income and expenditure in 2015/16 and trends over time; and
- Part 2 comments on the financial outlook of Councils at the end of 2015/16 and outlines important factors to be considered in assessing future spending plans.

2.3 The report is the first of the Account's Commission new overview outputs. It tells the strategic financial story for local government in Scotland in 2015/16, another challenging year for Councils. Overall, Councils responded well by controlling their spending and have also increased reserves and reduced debt. Scottish Government funding has fallen in real terms in recent years and, although there was a small annual real-terms increase in 2015/16, it fell again in 2016/17. Councils also continue to face cost pressures, including increasing pension costs and wage inflation. The Accounts Commission recognise Councils have been making difficult decisions when setting their budgets and that this has

required a disciplined approach to delivering savings. This disciplined approach must continue throughout this 2017 election year, as significant challenges lie ahead and Councils need to be well placed to meet them.

2.4 In anticipation of reductions in future Scottish Government funding, most Councils have continued to increase their reserves. Councils must consider how and when reserves are used to support services, in line with their financial plans and reserves policies, as they can only be used once and relying on them is not sustainable. All Councils have identified future funding gaps that will need to be addressed through making savings or using reserves. How well placed individual Councils are to address these funding gaps is a combination of the relative size of the funding gap, the reserves they hold, and their ability to identify and make savings and to service debt.

2.5 Financial scrutiny and transparency in financial reporting are themes that recur throughout the report. Under the new [Code of Audit Practice 2016](#), auditors will comment on the financial sustainability of Councils. It is important that all Councils have long-term financial strategies in place that support their strategic priorities, underpinned by more detailed financial plans and indicative budgets that cover the next three to five years. These will help Councillors and officers assess the impact of approved spending on their current and future financial position.

2.6 New Approach to Overview Reporting

This year, the Accounts Commission have developed an approach to overview reporting for local government into a series of outputs throughout the year. The Accounts Commission will examine the performance of Council services and the challenges facing Councils in their upcoming overview report in March 2017, but hope that the links between good financial and service performance remain clear.

2.7 It is hoped that the report and the supplementary information prove to be informative and help shed light on the complex nature of local government finances. The Accounts Commission welcome feedback and will use this to inform their approach to overview reporting in future years.

2.8 The key messages identified in the 2015/16 report include:

- The overall financial health of local government was generally good in 2015/16 and there was a slight increase in overall reserves and a reduction in overall debt. Auditors did not raise concerns about the immediate financial position of Scotland's Councils and, for the fifth year in a row, issued unqualified opinions on Councils accounts.
- Significant challenges for local government finance lie ahead. Councils' budgets are under increasing pressure from a long-term decline in grant funding from the Scottish Government which is expected to continue to fall in future, rising demand for services and increasing costs, such as pensions. There is variation in how these pressures are affecting individual Councils, with some overspending their total budgets or budgets for individual services such as social

care. It is important that Councils have effective budgetary control arrangements in place to minimise unplanned budget variances that can affect their financial position.

- Councils need to change the way they work to deal with the financial challenges they face. All Councils face future funding gaps that require further savings or a greater use of their reserves. There is variation in how well placed Councils are to address these gaps.
- Councils spent £19.5 billion in 2015/16. Spending on providing services remains lower than in 2011/12, but is increasing in key services, most noticeably in social care because of rising demand from an ageing population. Many Councils overspent their social care budgets and this poses a risk to their longer-term financial position. Councils need to ensure budgets reflect true spending patterns so that the impact of current spending on their financial position is clearly understood.
- Over and above growing demands on services, Councils need to manage other financial pressures such as increasing pension costs and wage inflation. It is essential that Councils have long-term financial strategies and plans in place that align with their priorities and are supported by medium-term financial plans and budget forecasts.
- Long-term financial strategies must be in place to ensure Council spending is aligned with priorities, and supported by medium-term financial plans and budget forecasts. Even where the Scottish Government only provides Councils with one-year financial settlements, this does not diminish the importance of medium and longer-term financial planning. This is necessary to allow Councillors and officers to assess and scrutinise the impact of approved spending on future budgets and the sustainability of their Council's financial position.

3 Self-Assessment Tool

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

The self-assessment brings together a number of potential questions for Councillors related to Local government in Scotland: Financial Overview 2015/16 designed to help Councillors identify how well informed they are about each area and to highlight areas where they may wish to ask further questions and to help them better understand Council's financial position and to scrutinise financial performance. The questions are included in Appendix 1 and also included as a link on the following Audit Scotland website:

<http://www.audit-scotland.gov.uk/report/local-government-in-scotland-financial-overview-201516>

4 Report Implications

4.1 Resource

There are no additional resource implications.

4.2 Risk

Whilst there are no additional direct risks associated with this report, the Audit Scotland Report – Local government in Scotland: Financial Overview 2015/16 does ask members to consider the wider scrutiny and performance management and risk elements associated with their role.

4.3 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

4.4 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:-

- Early years and reducing child poverty
- Economic Growth and Business Support
- Positive destinations for young people

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.

4.5 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.

4.6 Adopting a Preventative Approach

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

4.7 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.

4.8 Ensuring Equalities

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

4.9 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 2015/16 and therefore support ongoing sustainable development.

4.10 IT Issues

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

5 Recommendations

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

Appendix 1: Local government financial overview 2015/16 - Self-assessment tool for Councillors

Date: 02 March 2017

Report Contact: Gary Fairley
gary.fairley@midlothian.gov.uk

Tel No: 0131 271 3110

Background Papers:

Accounts Commission - Local government in Scotland: Financial Overview 2015/16 – (November 2016)

Self-assessment tool for Councillors

Code of Audit Practice 2016

Local government financial overview 2015/16

Self-assessment tool for councillors



This self-assessment brings together a number of potential questions for councillors related to [Local government in Scotland: Financial overview 2015/16](#). It is designed to help councillors identify how well informed they are about each area and to highlight areas where they may wish to ask further questions.

We have also included a high-level guide to the main service expenditure on an accounting basis (as identified in the accounts) and on a funding basis (as used for budgeting purposes).

How well informed am I?		
Questions for councillors to consider	What do I know?	Do I need to ask further questions?
Annual accounts and financial transparency (paragraphs 10 to 12)		
<ul style="list-style-type: none"> Does the management commentary of our annual accounts provide a clear and easily understandable account of the council's finances? 		
Funding and income (paragraphs 13 to 25)		
<ul style="list-style-type: none"> How do you consider potential changes to income streams and their impact on spending and services as part of medium and long-term planning? Is income from fees and charges clearly reported? What increases in fees and charges are planned and how will these affect our citizens? Do you consider local economic impacts? 		

How well informed am I?		
Questions for councillors to consider	What do I know?	Do I need to ask further questions?
<ul style="list-style-type: none"> How do your fees and charges compare to other councils? 		
Capital investment (paragraphs 26 to 28)		
<ul style="list-style-type: none"> Is your capital investment programme appropriately funded? 		
<ul style="list-style-type: none"> Do you know what slippage there has been in capital projects and why? Are you assured that appropriate action is being taken? 		
Council budgeting (paragraphs 37 to 42)		
<ul style="list-style-type: none"> Do service budgets reflect your priorities? 		
<ul style="list-style-type: none"> Are potential overspends highlighted to you as they occur and before year-end? 		
<ul style="list-style-type: none"> Are there services where you are consistently over or under spending against your budget? Are such variances adequately explained? 		
Council workforces (paragraphs 43 to 45)		
<ul style="list-style-type: none"> Are exit packages supported by business cases setting out the total estimated costs and savings? 		
Reserves (paragraphs 46 to 49)		
<ul style="list-style-type: none"> Do you know what levels of reserves are needed, and why? 		
<ul style="list-style-type: none"> Do you think reserves are being used effectively? 		
Debt (paragraphs 50 to 62)		
<ul style="list-style-type: none"> Are there clear links between the capital programme and our treasury management strategy? 		

Questions for councillors to consider	How well informed am I?	
	What do I know?	Do I need to ask further questions?
<ul style="list-style-type: none"> Do you know what the implications that different types of borrowing options have on future revenue budgets? 		
<ul style="list-style-type: none"> Do you know the split in debt between General Fund and HRA (where applicable)? Is this reported within your management commentary? 		
<ul style="list-style-type: none"> Do you know how debt repayments affect what money is available to spend on services? 		
Financial strategies and plans (paragraphs 72 to 77)		
<ul style="list-style-type: none"> Do you have a long-term financial strategy covering five to ten years? 		
<ul style="list-style-type: none"> Are there clear links between the financial strategy and the vision for the future? 		
<ul style="list-style-type: none"> Is the long-term financial strategy supported by detailed plans covering a minimum of three years? 		
<ul style="list-style-type: none"> Do financial plans set out the implications of different levels of income, spending and activity? 		
<ul style="list-style-type: none"> Is there a clear link between the council's revenue plans and the budget information you are asked to approve? 		
Funding gaps, savings and service transformation (paragraphs 78 to 87)		
<ul style="list-style-type: none"> Do financial plans identify the differences between income and expenditure for the next three years? 		
<ul style="list-style-type: none"> Do you know the actions being taken to close the funding gap? 		
<ul style="list-style-type: none"> Do you know what plans there are to redesign services and deliver savings? 		

How well informed am I?		
Questions for councillors to consider	What do I know?	Do I need to ask further questions?
<ul style="list-style-type: none"> Are savings plans realistic within agreed timescales? 		
<ul style="list-style-type: none"> Are all savings clearly identified and categorised as recurring or non-recurring (ie, one-off) savings? 		
<ul style="list-style-type: none"> Is the council reliant on non-recurring savings? 		
<ul style="list-style-type: none"> Do you know what will happen to the reserves if savings are not made? 		
Scrutiny considerations (paragraph 88 to 89)		
<ul style="list-style-type: none"> Do you feel you have the knowledge and expertise to scrutinise your finances effectively? 		

The differences between financial information presented on a funding and an accounting basis

Council accounts show spending on services on an accounting basis which is higher than the amounts council's budget to spend

1. Councils prepare their annual accounts based on International Financial Reporting Standards. These are the same standards followed by large private sector companies and they set out the principles and rules that apply for accounting. The Code of Practice on Local Authority Accounting in the United Kingdom, published annually by CIPFA, interprets how these standards are to be applied to councils.

2. Some spending on services recorded in the accounts does not need to be funded from available resources in the year. Conversely some of the things that councils do need to fund in the year, by statute and regulation, are not required to be treated as spending by companies. Councils set their budgets on the basis of what needs to be funded in the year. This means they budget for the amounts they need to either pay or to set aside.

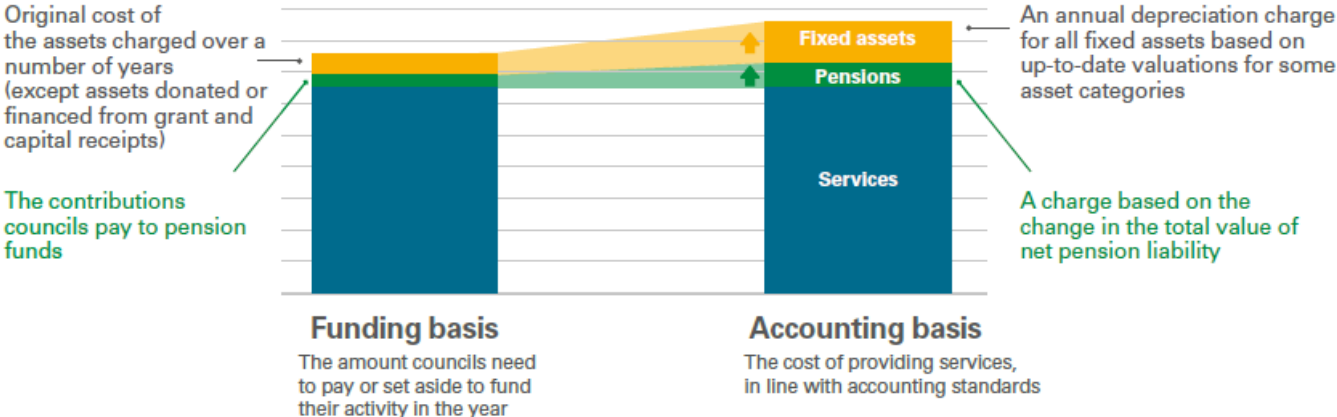
3. Councils' annual accounts include details of the adjustments necessary to get from an accounting basis to a funding basis. However, this complex area is not always well explained. Councils have found it difficult to link the figures in the annual accounts with those in budget reports. The [Exhibit 1 \(page 5\)](#) overleaf shows the main differences between service expenditure on an accounting basis (as identified in the accounts) and on a funding basis (as used for budgeting purposes).

4. From 2016/17, councils will be required to include an expenditure funding analysis showing more clearly the differences between the figures in the accounts and those that officers and members will be more familiar with from budget reports. The Commission welcomes this development as it is hoped this will present figures councillors are more familiar with and therefore make the accounts more useful at a local level and improve scrutiny of the accounts.

Exhibit 1

The main differences between a funding basis and an accounting basis

The main differences are in respect of pensions and fixed assets.



Source: Audit Scotland