Item 14a

Local government in Scotland

Financial bulletin 2022/23

ACCOUNTS COMMISSION

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Key messages

Funding and outturn in 2022/23

1 Despite councils receiving more funding and income in cash terms, due to high inflation in 2022/23 total revenue funding from all sources fell by £619 million (2.8 per cent) in real terms to £21.3 billion compared to 2021/22.

2 Councils received more core revenue funding from the Scottish Government than in 2021/22, rising from £12.1 billion to £12.2 billion (0.7 per cent) in real terms. However, an increasing proportion is ring-fenced or provided with the expectation it will be spent on specific services. This means that the amount of funding available for councils to spend freely on local priorities is reducing. There are commitments in the Verity House Agreement to move to a default position of removing ring-fencing or direction of funding wherever possible.

3 There is pressure on all public-sector capital budgets, and this presents risks to the viability of local government capital programmes, many of which impact on key services (eg, the construction and maintenance of schools, libraries, roads). Capital funding from the Scottish Government rose in 2022/23 but remains lower than before the pandemic and has been volatile over the past decade. Driven by increased borrowing councils' capital expenditure increased in 2022/23 by 16 per cent in cash terms to £3.6 billion. Borrowing costs have reduced in recent years as many councils have used permitted financial flexibilities to reprofile debt payments. While helping with immediate budget pressures, these decisions defer costs to later years and do not tackle the underlying challenges to financial sustainability. Additional borrowing also places further pressure on revenue budgets over the longer term.

4 At the time of setting their 2022/23 budgets, councils anticipated budget gaps of over £476 million for the year, higher than the previous year. Councils are increasingly having to rely on savings and reserves to balance budgets. Achievement of savings targets was good in 2022/23 and improved on 2021/22. Greater transparency is required in the reporting of financial outturn in council accounts, including savings performance. This transparency and timely public engagement are essential as councils make increasingly difficult decisions to reduce or stop services to help balance budgets.

Councils' financial position and outlook from 2023/24

5 Despite the financial pressures of recent years, half of councils increased their usable reserves in 2022/23, and overall usable reserves grew to £4.45 billion. This is driven by growth in committed reserves. Some of this is remaining Covid-19 funding, some is attributable to the permitted use of financial flexibilities for the repayment of longer-term debt but there are also indications councils are building up reserves to manage the known financial challenges in future years. However, the lack of transparency in some councils' annual accounts makes it difficult to draw firm conclusions on councils planned use of reserves.

6 Local appointed auditors did not identify any councils in Scotland as being financially unsustainable in the short term. However, the financial outlook is extremely challenging with Scottish councils facing unprecedented financial and service demand pressures which present real risks for the future. Although Scottish Government core funding increased in cash and real terms in 2023/24, councils reported a significant increase in the total budget gap to £725 million.

7 Councils' medium- and longer-term financial plans demonstrate a clear recognition of the difficult financial context and the need to continue to innovate at pace and make difficult decisions to become more financially sustainable. But some councils are already experiencing significant resistance when seeking to make service reductions to balance budgets. This reinforces the need for effective consultation and engagement with communities on planned local service changes.

8 The Verity House Agreement includes a commitment to offer councils longer-term funding and greater local financial flexibility. These proposed changes will be important, in providing greater financial certainty to support better long-term planning and more flexible direction of resources to meet local need. However, the recent announcement of a proposed council tax freeze significantly reduces discretion and flexibility at individual council level. The impact this will have on financial sustainability is not yet known, but councils have placed an increased reliance on raising council tax to help deliver a balanced budget over the past two years.

Recommendations

Councils should:

- Prioritise the achievement of recurring savings and avoid reliance on non-recurring savings to enhance longer-term financial sustainability (paragraph 29).
- Ensure that management commentaries are open and transparent, include a clear link between budget outturn and the financial performance in the accounts and report on the achievement of planned savings targets (paragraph 46).
- Provide clear statements about reserves policy and explicitly set out the purpose of committed reserves within their annual accounts. This will enhance the level of assurance that councils can provide regarding their ongoing financial sustainability (paragraph 55).
- Ensure effective and timely consultation and engagement with communities on the options that must be considered to achieve a balanced budget (paragraph 73).
- Strengthen their monitoring and reporting of financial resilience including clearer and more public-facing use of performance against financial resilience indicators and measures. Financial resilience indicators should be a component of councils' medium and longer-term financial plans to provide assurance that they are balancing short-term pressures with robust planning for long-term financial sustainability (paragraph 83).
- Work with the Scottish Government to build momentum and accelerate progress in the development of a fiscal framework for local government to enhance the clarity and certainty of budgets for councils in future years (paragraph 89).

About this report

1. This bulletin provides a high-level independent analysis of the financial performance of councils during 2022/23. The bulletin considers:

- councils' funding and expenditure in 2022/23
- councils' financial position at the end of 2022/23 and the financial outlook
- some of the potential impacts of the Verity House Agreement (New Deal with Local Government) made between COSLA and the Scottish Government in June 2023.

2. This bulletin is part of a series of outputs produced by the Accounts Commission which together provide an independent overview of the local government sector. In Spring 2024 we will publish a budget briefing examining the 2024/25 budgets set by councils, including analysis of anticipated budget gaps and actions to set a balanced budget.

Methodology

3. Our primary sources of information for this bulletin are councils' 2022/23 accounts, a data request issued to auditors in October 2023 and Scottish Government budget documents.

4. The analysis of accounts is based on audited accounts where available. As at our 6 November 2023 deadline, 18 councils' accounts were still to be certified; therefore, the analysis in this bulletin is based on 14 sets of audited accounts and 18 sets of unaudited accounts.

5. We received 30 data requests back from auditors. In places our analysis is therefore based on a sample rather than the full population. Returns were not received for two councils.

6. Scottish Government funding analysis uses the spring revision funding position unless otherwise stated.

7. When looking at trends, we convert some financial data to real terms using GDP deflators. This adjusts financial information from past and future years to prices for the year under review, ie 2022/23. This is to take account of inflation so that the trend information is comparable. Any financial trend data (both capital and revenue) relating to funding, income or expenditure will be shown in real terms. The exception to this is that any financial information from the councils' accounts' balance sheet remains in cash terms, even when looking at a trend. This includes reserves, debt and borrowing. These are not adjusted to real terms as they are already subject to revaluation to reflect current prices.

1. Funding and outturn

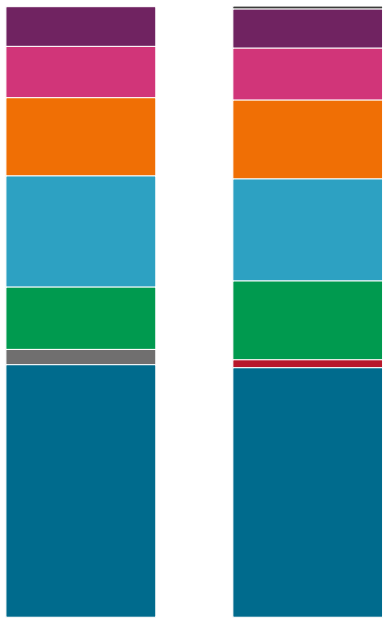
Revenue funding and income

Total funding and income fell by 2.8 per cent in real terms in 2022/23 compared to the previous year

8. In 2022/23, Scotland's 32 councils received a total of £21.3 billion in revenue funding and income (funding for day-to-day spending). In cash terms this is £757 million more than the year before but in real terms (that is adjusting for inflation) it represents a real-terms decrease of 2.8 per cent (£619 million).

9. Revenue funding and income comes from a variety of sources. Almost 60 per cent of total revenue funding comes from the Scottish Government (Exhibit 1).

Exhibit 1.
Sources of funding and income 2022/23 compared to 2021/22, real terms (£ billion)



	2021/22	**2022/23**
Interest receivable	0.03	**0.11**
Housing Revenue Account rents	1.42	**1.36**
Customer and client receipts	1.85	**1.82**
Council tax	2.82	**2.75**
Grants including Scottish Government and other sources	4.01	**3.56**
Non-domestic rates	2.23	**2.77**
Cost of living award grant	0.00	**0.28**
General revenue grant Covid-19 funding	0.55	**0.00**
General revenue grant	9.09	**8.72**
Total funding and income (£ billion)	22.00	**21.38**

Source: Councils' annual accounts 2022/23 (audited and unaudited) and 2021/22 (audited)

10. The source of the largest increase in funding was non-domestic rates, although levels are still below pre-pandemic levels (Exhibit 16, page 28).

11. The largest decreases were to grants, which fell by 11 per cent in real terms compared to 2021/22, and housing rents which, despite a cash increase of 2.3 per cent, fell by 4.1 per cent in real terms.

12. Council tax is an important source of income for councils, accounting for 13 per cent (£2.7 billion) of total funding in 2022/23. Councils received more income from council tax, due to an overall increase of 4.5 per cent in the amount of council tax billed and an increase in in-year collection rates of 0.5 per cent (from 95.7 per cent to 96.2 per cent). However, the amount received has not kept pace with inflation and in real terms this represents a fall in income of 2.5 per cent compared to 2021/22.

Core revenue funding from the Scottish Government to councils increased in cash and real terms from 2021/22 to 2022/23

13. Scottish Government core revenue funding to councils amounted to £12.2 billion in 2022/23. This is an increase to core funding in both cash and real terms from the previous year (Exhibit 2).

Exhibit 2.
Scottish Government core revenue 2021/22 and 2022/23

	Cash terms			Real terms		
Scottish Government revenue funding	**2021/22 £ million**	**2022/23 £ million**	**change %**	**2021/22 £ million**	**2022/23 £ million**	**change %**
Core revenue	**11,384**	**12,231**	**7.4%**	**12,144**	**12,231**	**0.7%**
General revenue grant	8,489	8,679	2.2%	9,056	8,679	-4.2%
Non-domestic rates	2,090	2,766	32.3%	2,230	2,766	24.1%
Specific revenue grants	805	786	-2.4%	859	786	-8.5%

Source: Scottish Government budget documents (spring revision)

14. The increase in core revenue funding was driven by a significant increase in income from non-domestic rates. The general revenue grant and specific revenue grants both fell in real terms.

15. In 2021/22, councils received an additional £0.5 billion in non-recurring revenue funding from the Scottish Government to support their Covid-19 response. When this is included, councils experienced a real terms reduction of 3.6 per cent in revenue funding from the Scottish Government in 2022/23 compared to 2021/22. In 2022/23,

a one-off grant of £278 million was received by councils, to distribute the £150 Cost of Living Award to eligible households.

An increasing proportion of Scottish Government funding is formally ring-fenced or provided with the expectation it will be spent on specific services

16. Specific revenue grants funding totalled £786 million in 2022/23 and must be used to fund specific policies or initiatives such as for early learning and childcare expansion and the pupil equity fund.

17. In addition to specific revenue grants, other funding received by councils is directed for national policy initiatives. Though not formally ring-fenced, this funding is provided with the expectation that it will be spent on specific services.

18. Examples of directed funding in 2022/23 include: £140 million for Local Government pay deals, £145 million for additional teachers and support staff and £234 million for the annual pay uplift to social care staff in commissioned services.

19. We calculate that ring-fenced and directed funding increased to 25.7 per cent in 2022/23 (Exhibit 3).

Exhibit 3.
Proportion of Scottish Government funding to local government that is ring-fenced or directed

Source	2021/22 £ million	2022/23 £ million
From initial allocation		
Specific revenue grant	805	786
Directed funding within general revenue grant	347	475
Directed funding from transfers from other portfolios	488	648
From in year allocations		
Directed funding from budget revisions and recalculations	1,061	1,236
Total ring-fenced or directed funding	**2,701**	**3,145**
Total revenue funding	**11,384**	**12,231**
Percentage ring-fenced or directed	**23.7%**	**25.7%**

Note: We have updated our methodology from last year. This changes the total ring-fenced amount for 2021/22 from 23.1% to 23.7%.

Source: Scottish Government budget documents and financial circulars

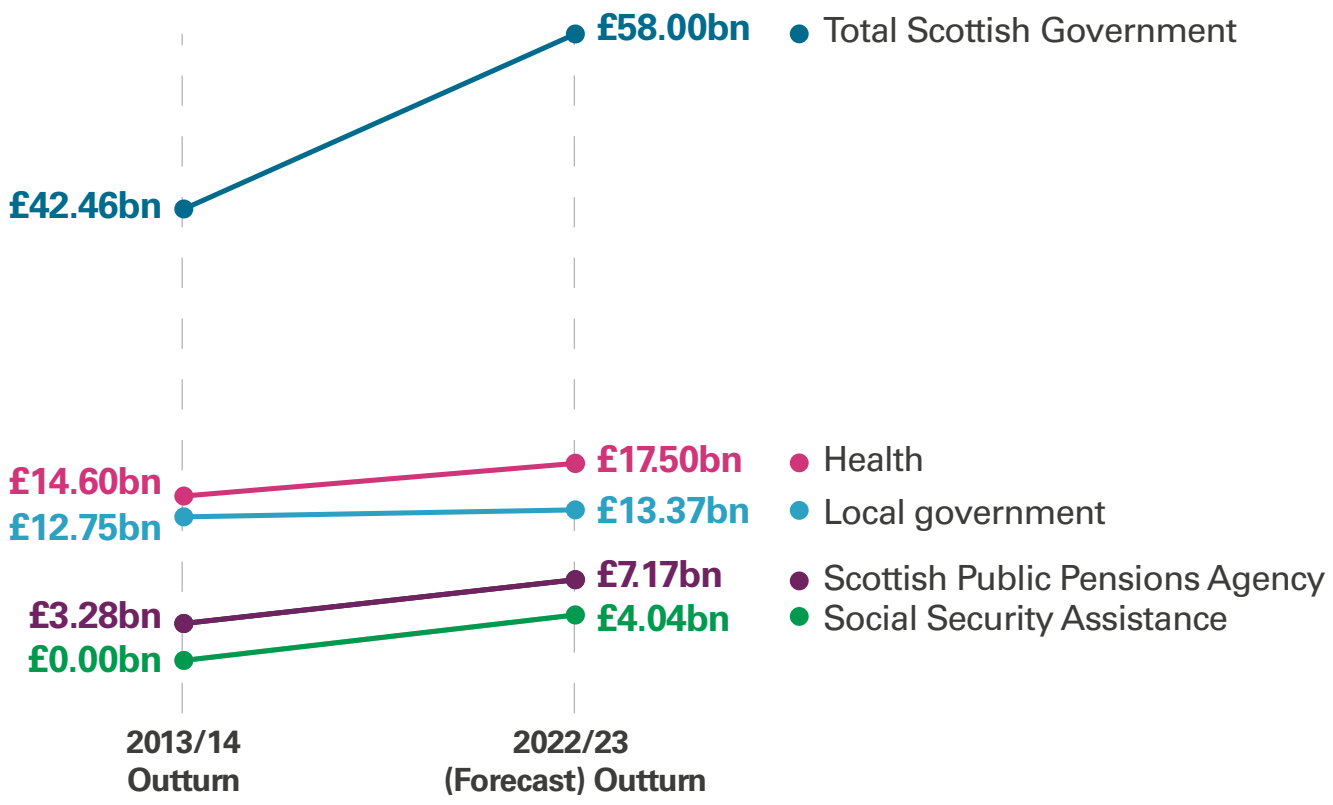
20. While directed funding is important to help deliver national priorities, it restricts councils from making decisions about how funds can be used at a local level to meet local need. The Verity House Agreement, signed in June 2023, includes a commitment to a default position of ending ring-fencing or directed funding unless there is a clear joint understanding of the rationale for such arrangements. We discuss this further in Part 2 of the report.

Over the last decade, the proportion of the Scottish Budget allocated to local government has been reduced

21. Local government is the second largest area of Scottish Government spending; however, this proportion has reduced over the last decade. In 2013/14 local government (capital and revenue) accounted for 30 per cent of the total spend. In 2022/23, it had fallen to 23 per cent. Over this period, local government spend has been relatively static in real terms while total Scottish Government spend increased by 37 percent. Areas of growth include health and social security (Exhibit 4).

Exhibit 4.

Local government spend (outturn) compared to other areas of the Scottish Budget, 2013/14 to 2022/23, real terms



Source: Scottish Budget 2023/24, Annex D: Outturn Comparison 2013/14 to 2021/22 and Scottish Budget 2024/25, Annex H: Outturn Comparison 2014/15 to 2022/23

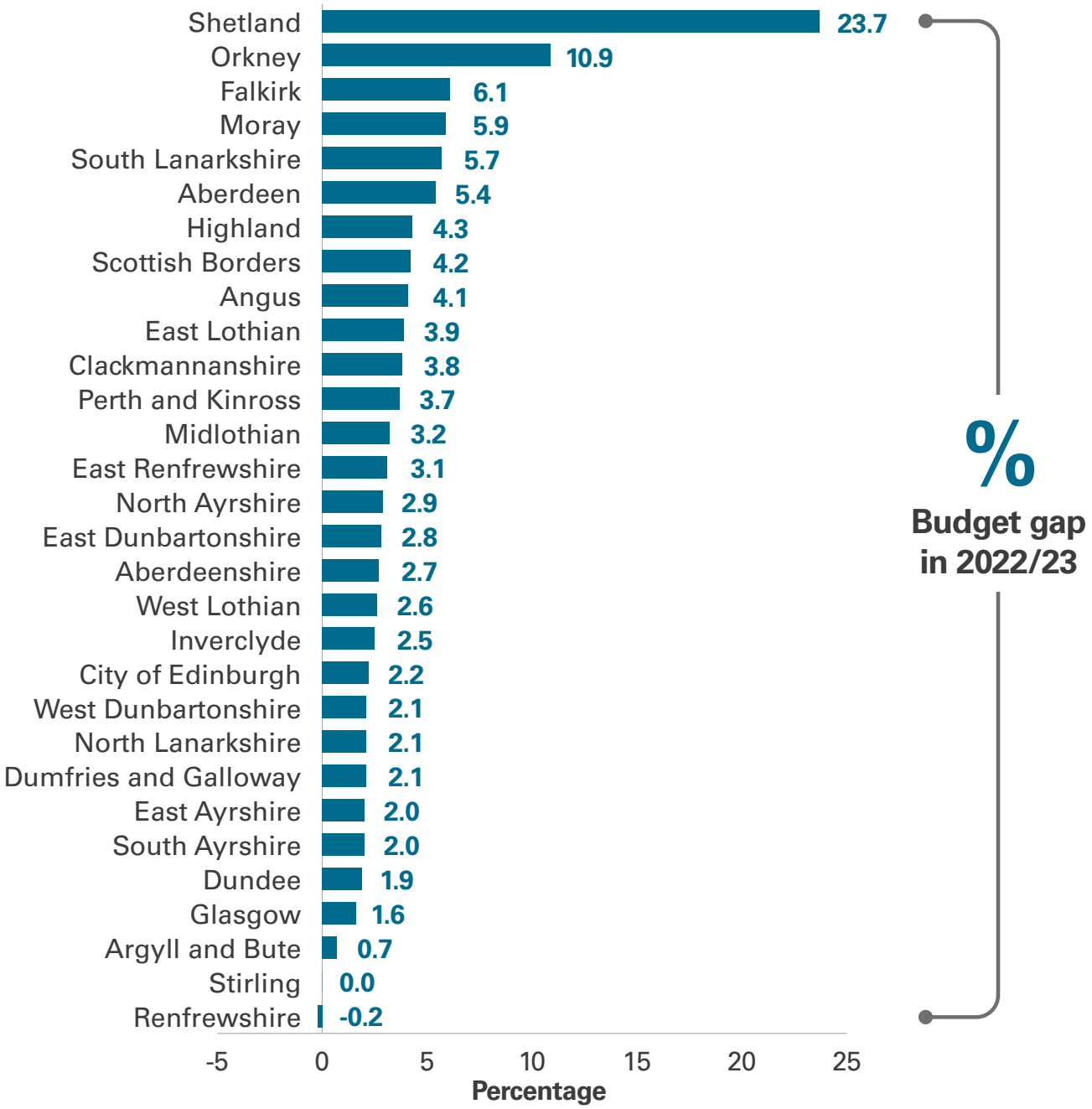
Council budget-setting

At the time of setting their 2022/23 budgets, councils in our sample identified budget gaps of over £476 million for the year

22. At the time of budgeting, the 30 councils in our sample identified **budget gaps** totalling £476 million for 2022/23, compared to £350 million for the same sample of councils for 2021/22. This represents a budget gap of 2.9 per cent of the net cost of services (Exhibit 5).

Budget gaps reflect a point in time when councils begin to set their budgets and is the difference between anticipated expenditure and funding and income.

Exhibit 5.
Budget gap as a percentage of net cost of services, 2022/23



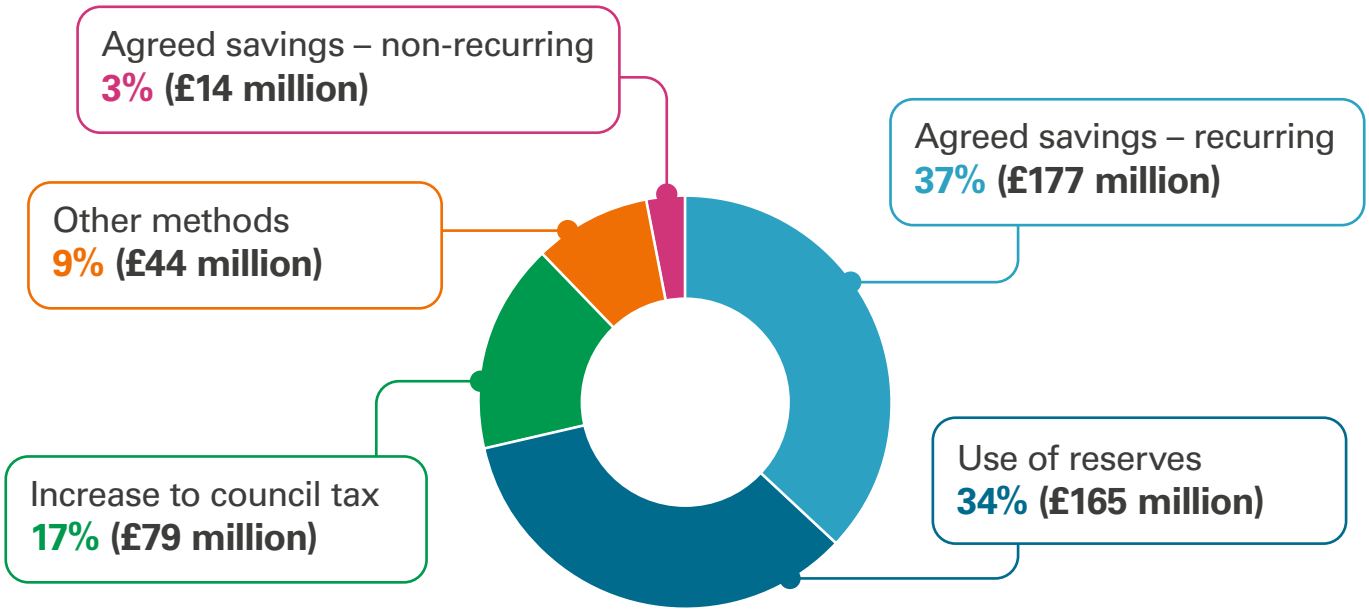
Source: Auditor data returns (30 councils in the sample)

23. Within our sample, the budget gap for 2022/23 ranged from a surplus of £1.1 million (0.2 per cent of net cost of services) in Renfrewshire to a gap of £53 million (5.7 per cent net cost of services) in South Lanarkshire. Shetland had the largest budget gap as a proportion of net cost of services, at 23.7 per cent (with a value of £34 million). One council, Stirling, reported no budget gap.

Councils largely relied on reserves and making recurring savings to deliver a balanced budget

24. From our sample of 30 councils, a range of bridging actions were used to set balanced budgets for 2022/23 (Exhibit 6).

Exhibit 6.
Councils' bridging actions to set their 2022/23 budget



Note: The chart elements add up to £479 million which is higher than the total anticipated budget gap. This is because Dundee identified bridging actions of greater value than their budget gap to allow for additional expenditure in priority areas.

Source: Auditor data returns (30 councils in the sample)

25. Use of reserves and making **recurring savings** were expected to bridge 71 per cent (£342 million) of the budget gap. The relative use of reserves to bridge the budget gap has doubled from 17 per cent in 2021/22 to 34 per cent in 2022/23.

26. Examples of other bridging actions include the use of:

- fiscal flexibilities for service concessions and capital receipts
- additional Scottish Government funding
- increased service charges
- non-recurring Covid-19 funding
- a reduction in IJB funding.

These actions are largely non-recurring and therefore not sustainable.

Recurring savings are savings, that once achieved, recur year-on-year from that date. Non-recurring savings are one-off savings that apply to one financial year and do not result in ongoing savings in future years.

Outturn

Achievement of savings targets was high, but improvements are required in the transparency of reporting

27. From our sample of 30 councils, the aggregate savings target for 2022/23 was £216 million.[1] Three councils did not have a savings target.

28. Twenty-five councils provided information about savings performance in 2022/23. Fourteen councils (56 per cent) achieved their savings target in full or more and a further eight councils (32 per cent) achieved over 80 per cent. Overall, 98 per cent of the aggregate savings target was met. This compares to 92 per cent across all councils in 2021/22 (Exhibit 7, page 14).

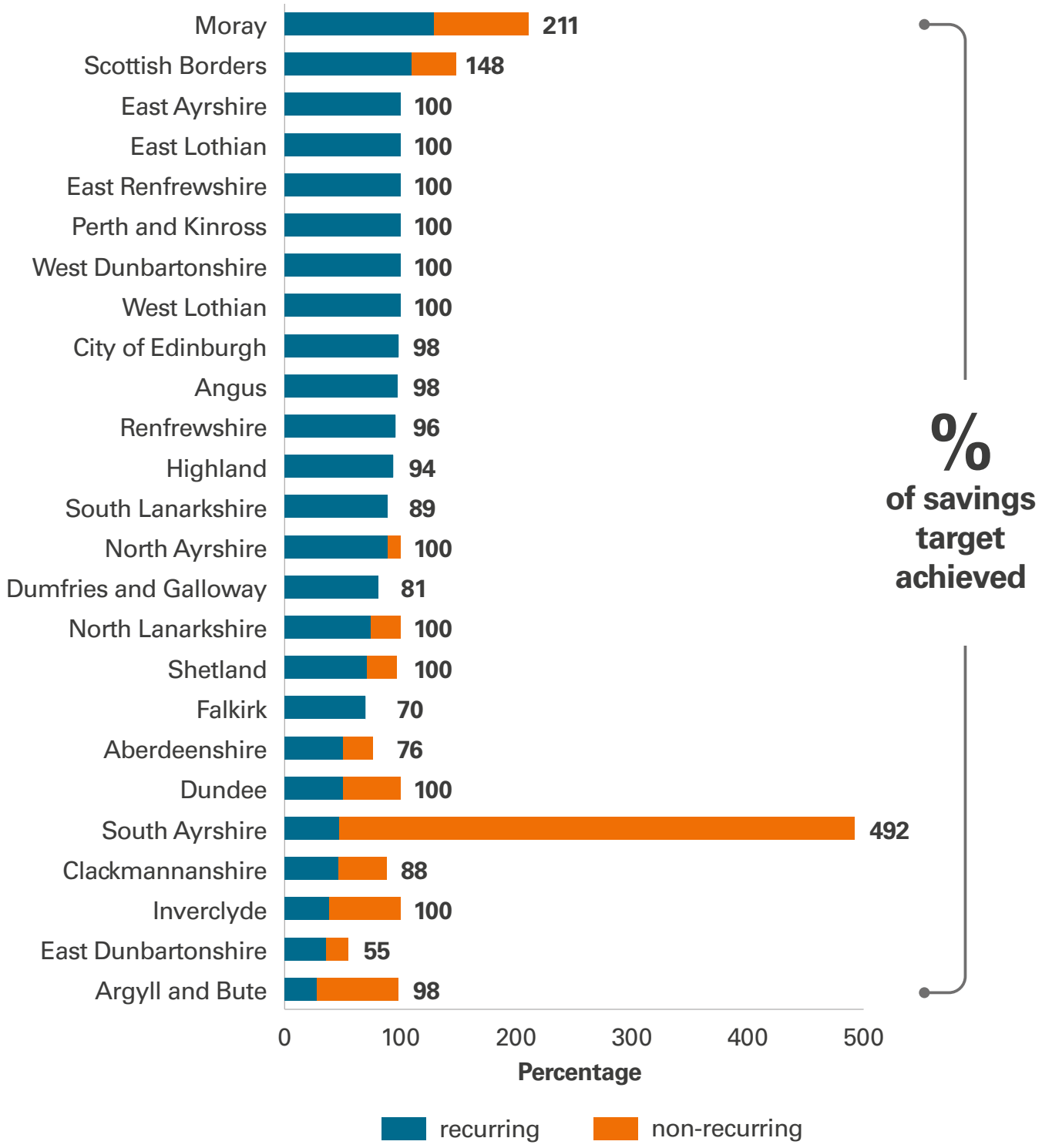
29. Where we have a breakdown of how savings were achieved, 82 per cent (£126 million), were achieved on a recurring basis, which is higher than the 76 per cent achieved across all councils in 2021/22.

Recommendation

Councils should prioritise the achievement of recurring savings and avoid reliance on non-recurring savings to enhance longer-term financial sustainability.

[1] This savings target does not match the planned savings (recurring and non-recurring combined) identified as bridging actions in Exhibit 6. Savings identified during budget setting may be further revised before a savings target is agreed.

Exhibit 7.
Percentage of savings target achieved, split by recurring and non-recurring, 2022/23



Note: Information on the split of savings achieved was not available for Dundee. South Ayrshire's savings performance was 492% due to a large (non-recurring) underspend. Five councils within the sample are not included in the chart: Midlothian, Orkney and Stirling did not have a savings target in place for 2022/23. Information on savings performance was not available for Glasgow and Aberdeen.

Source: Auditor data returns (30 councils in the sample

30. A review of councils' management commentaries identified that 66 per cent of council accounts provided no or insufficient commentary on performance against savings targets. Further detail on the transparency of management commentaries is included at paragraphs 44–46).

Over half of councils used financial flexibilities in 2022/23

31. In recent years, the Scottish Government has introduced a number of financial flexibilities to help alleviate ongoing financial and funding pressures.

32. The three main flexibilities available are:

- The use of capital receipts for revenue costs.
- The ability to apply for revised loans repayments.
- Changes to service concession arrangements which allow councils to write off the debt costs associated with these schemes over the expected lives of the respective assets rather than over the contract period of each arrangement.

33. Of our sample of 30 councils, 18 (60 per cent) reported that they used some of the financial flexibilities allowed by the Scottish Government in 2022/23.

34. Using flexibilities to meet immediate spending pressures may help councils to balance their budgets, but it defers costs to later years and does not tackle the underlying challenges to financial sustainability.

Capital funding and expenditure

Increases in capital expenditure were driven by increased borrowing

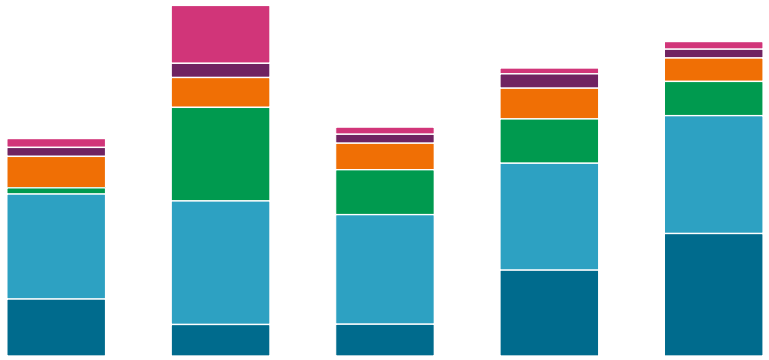
35. Councils' **capital expenditure** in 2022/23 was £3.6 billion. This is a 16 per cent (£0.5 billion) increase in cash terms compared to 2021/22.

36. The increase in capital expenditure in 2022/23 was driven by a 52 per cent increase in borrowing. At £1.41 billion, this was the largest source of capital financing, surpassing government grants which accounted for £1.35 billion of capital expenditure. The higher costs associated with borrowing place further pressure on revenue budgets over the longer term (Exhibit 8, page 16).

37. Twenty-two councils reported higher capital expenditure than in 2021/22. At a council level, year-on-year movement ranged from a £207 million increase (Glasgow) to a £54 million decrease (Angus).

Capital expenditure is the money spent by councils to maintain or improve their assets, for example school buildings and roads. It cannot be used on day-to-day running costs.

Exhibit 8.
Capital expenditure split by sources of finance in cash terms, 2018/19 to 2022/23 (£ billion)



2018/19	2019/20	2020/21	2021/22	2022/23	
0.09	0.60	0.07	0.06	0.09	Capital receipts
0.09	0.15	0.09	0.15	0.10	Other contributions and Public Private Partnership (PPP)
0.32	0.31	0.28	0.33	0.27	Capital Funded from Current Revenue (CFCR)
0.06	0.96	0.47	0.48	0.39	Internal loans fund repayments available to reinvest
1.06	1.27	1.15	1.15	1.35	Government grants
0.57	0.32	0.33	0.92	1.41	An increase in borrowing
2.18	**3.61**	**2.41**	**3.10**	**3.61**	**Total expenditure (£ billion)**

Source: Councils' annual accounts 2018/19 to 2022/23 (audited and unaudited)

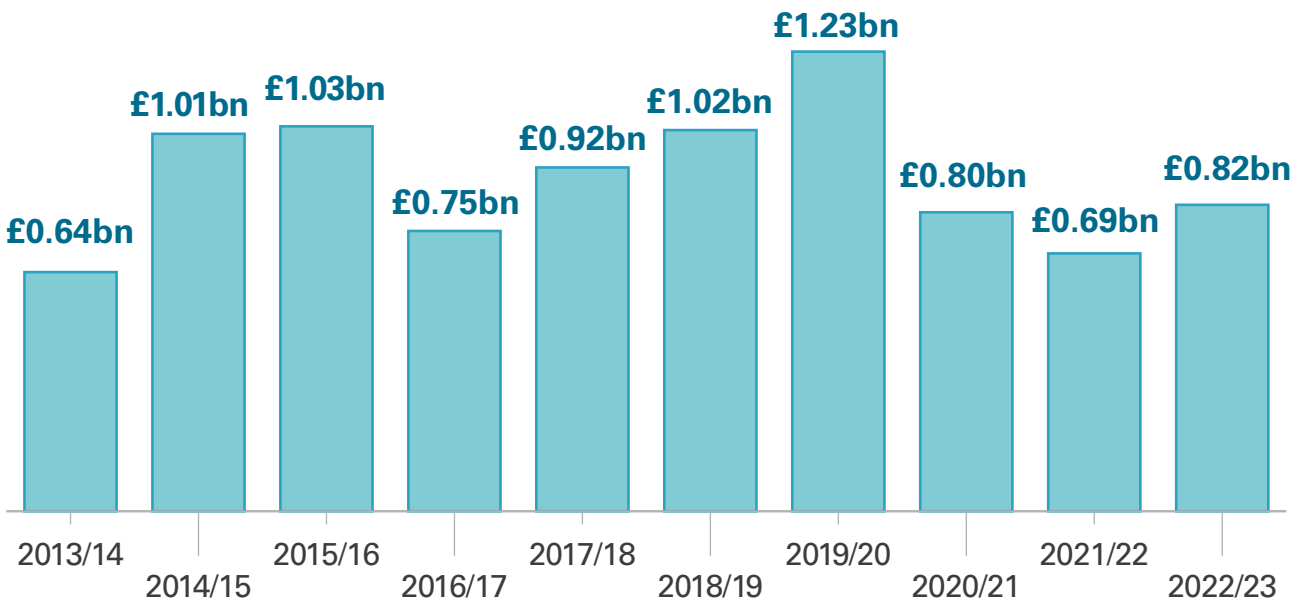
38. Slippage against capital projects was noted by auditors in some Annual Audit Reports for 2022/23. Factors included higher costs for goods and services including utilities, fuel and labour; and wider economic circumstances including inflation, war, Covid-19, interest rates and pay awards.

Capital funding from the Scottish Government rose in 2022/23 but remains lower than before the pandemic

39. Councils receive capital funding from the Scottish Government in the form of the capital grant, distributed by means of a funding formula based largely on population and road-length.

40. In 2022/23 capital funding from the Scottish Government rose by 19 per cent in real terms to £0.82 billion compared to 2021/22. However, it remains lower than many of the years leading up to the Covid-19 pandemic (Exhibit 9).

Exhibit 9.
Scottish Government capital funding to local government 2013/14 to 2022/23, real terms



Source: Scottish Government budget documents (spring revision)

41. Some capital funding is directed towards specific policies. For example, in 2022/23 around £120 million was allocated to support the local government pay deal in 2022/23 and £30 million to fund expansion of free school meals.

42. Scottish Government capital funding is volatile. Some of the more significant movements can also be attributed partly to reallocation of capital funding payments from one financial year to another, as agreed between the Scottish Government and COSLA. For example, the 2016/17 figure excludes £150 million that was reallocated and included in the 2019/20 capital settlement.

Reporting on financial outturn in management commentaries

Councils could improve the transparency of their reporting on financial outturn and progress against savings plans

43. A management commentary is a report by the council, set out within its annual accounts. It should provide information on the council's strategic priorities and key risks, as well as a balanced analysis of the financial and wider performance of the council over the year.

We undertook a review of councils' management commentaries to assess the transparency of their reporting against three elements that the Accounts Commission has previously recommended should be included:

- Is the outturn against budget position for the year clearly shown with the reasons for significant variances obvious?
- Is the outturn reported in the narrative reconciled to the movement in the general fund contained in the financial statements and major differences explained?
- Is progress against agreed savings reported?

44. Twenty councils included commentary related to outturn against budget including the main reasons for the variances. Of the remaining, nine provided insufficient detail or no commentary on variances and three lacked clarity on the outturn against budget.

45. Half of councils provided a table within the management commentary which showed the reconciliation of outturn to the movement on the general fund. Of the remaining, 12 did not provide sufficient detail within the management commentary to demonstrate a reconciliation of the general fund against reserves and four did not provide any information.

46. Eleven councils outlined progress against savings targets to some extent, with some providing a table of savings performance trends and/or links to other documents. Of the remaining, 12 provided generic statements or insufficient detail, seven provided no information and two referred only to previous or future savings plans.

Recommendation

Councils should ensure that management commentaries are open and transparent, include a clear link between budget outturn and the financial performance in the accounts and report on the achievement of planned savings targets.

2. Councils' financial position and outlook

2022/23 financial position

In 2022/23, councils increased their total usable reserves by £0.31 billion to £4.46 billion

47. Reserves play an important role in good financial management of councils. They may be used to invest in a major project, transform services or respond to unexpected events. Reserves are a one-off resource, so councils need to plan carefully for their use. In doing so, they should consider the strategic, operational, and financial risks facing the council.

48. In 2022/23, councils increase their total usable reserves by £0.31 billion, from £4.15 billion to £4.46 billion (Exhibit 10, page 20).

49. Revenue reserves increased by 2.2 per cent (£80 million) and capital reserves increased by 40 per cent (£232 million). The increase in capital reserves may be linked to slippage against capital projects (paragraph 38).

50. Half of councils increased their usable reserves in 2022/23. A review of management commentaries for those councils with the greatest increases found these were largely attributable to accounting adjustments related to the permitted use of financial flexibilities for the repayment of longer-term debt. Some councils are also committing reserves to contingency or financial sustainability funds to cushion the impact of known financial challenges in the years ahead or to help fund transformation, potential workforce reconfiguration or pay settlements.

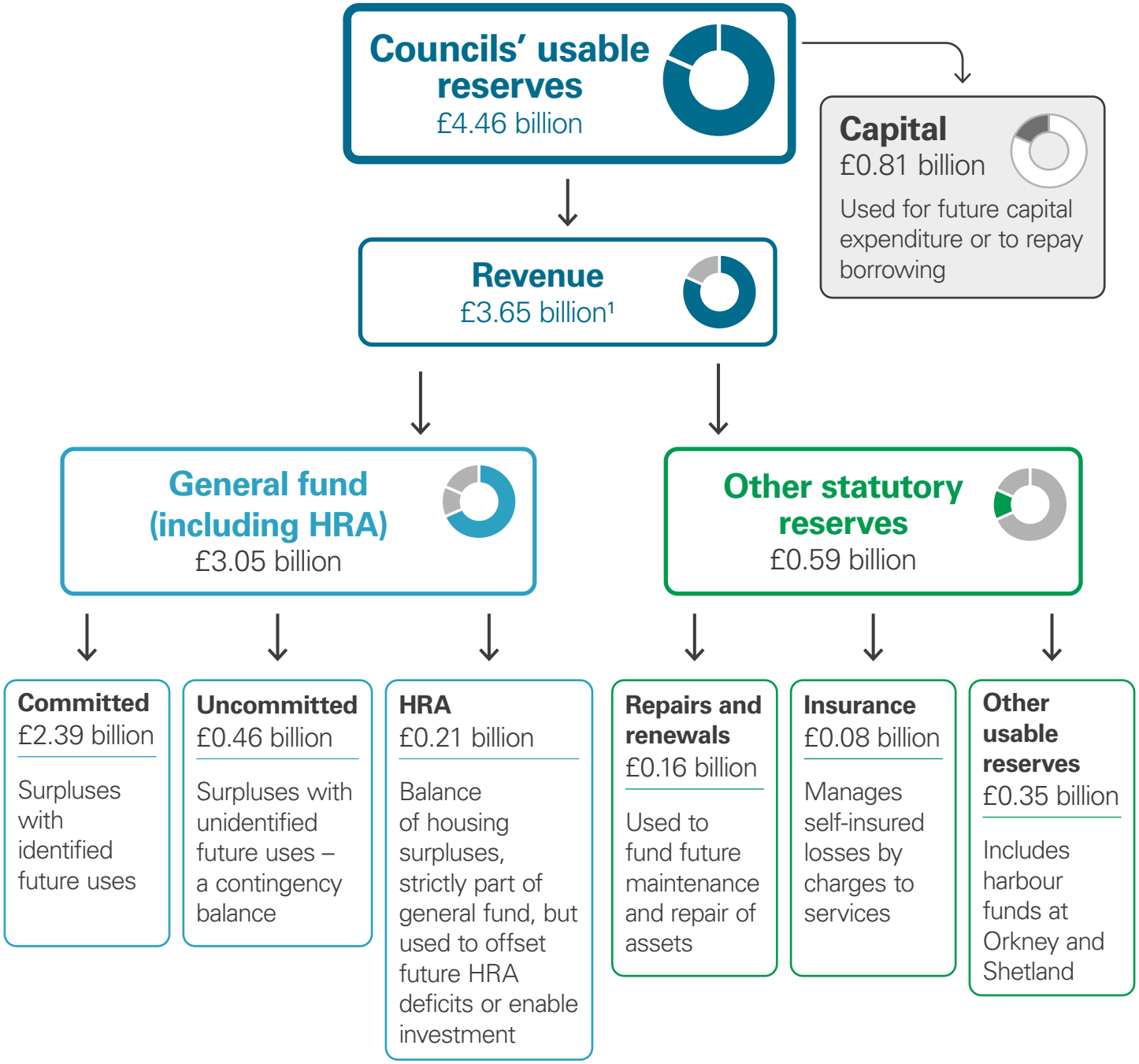
The level of reserves as a proportion of total net revenue expenditure is higher in 2022/23 than before the pandemic

51. In 2022/23, the total usable reserves across all councils as a proportion of total net revenue expenditure was 27.3 per cent compared to 20.4 per cent in 2019/20 before the pandemic (Exhibit 11, page 21).

52. In 2022/23, no council had usable reserves that were less than ten per cent of net revenue expenditure compared to four councils in 2019/20. Twenty councils had reserves that were over 20 per cent of net revenue expenditure, compared to nine in 2019/20.

Looking at the level of **reserves as a proportion of total net revenue expenditure** is one way of assessing financial sustainability. A low figure may suggest that a council will struggle financially if it experiences a financial shock or is unable to deliver a budget where income matches expenditure.

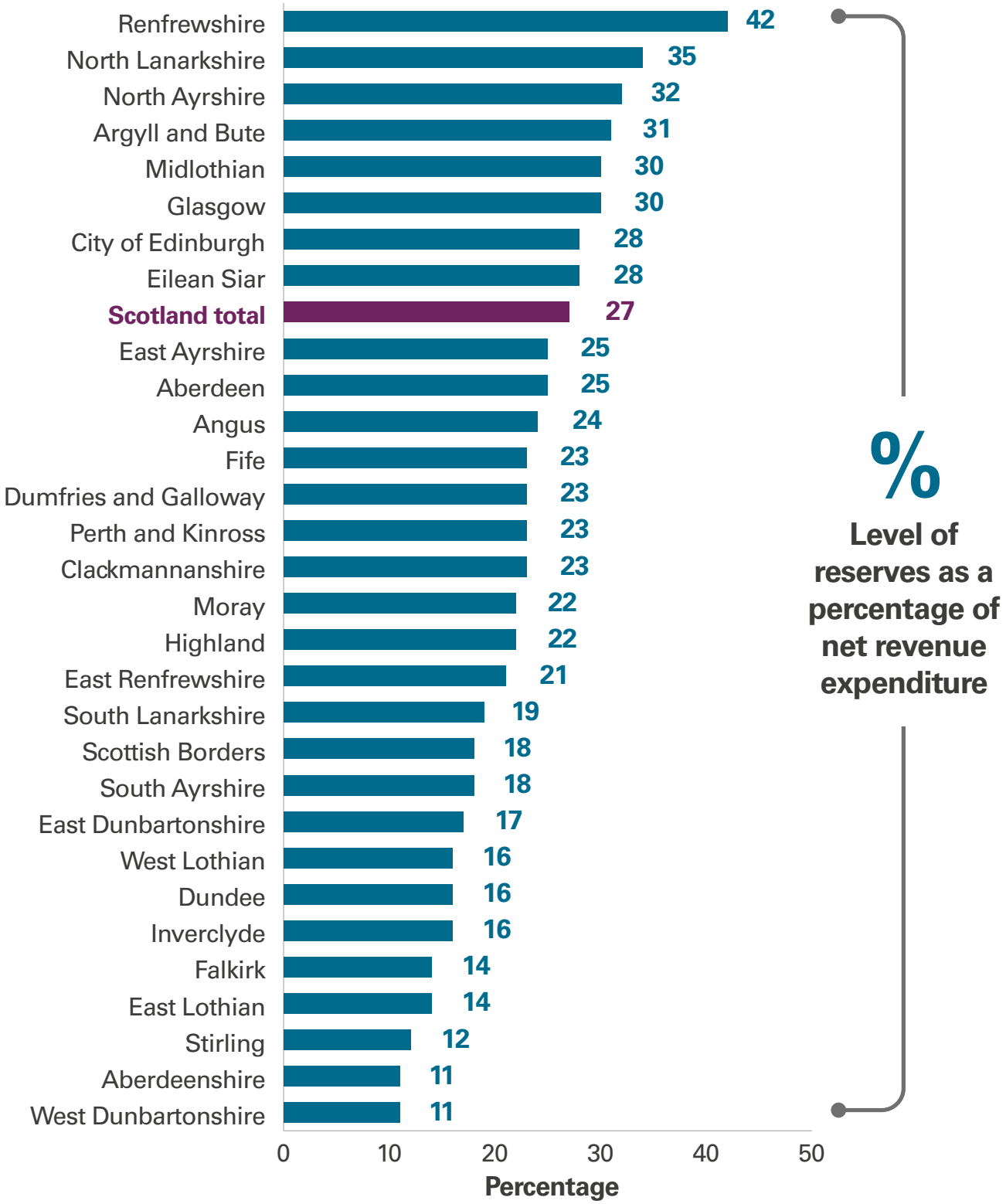
Exhibit 10.
The nature and value of councils combined usable reserves, 2022/23



Note 1. Total figure doesn't match subtotals due to rounding.

Source: Councils' annual accounts 2022/23 (audited and unaudited)

Exhibit 11.
Level of usable reserves as a proportion of net revenue expenditure, split by council, 2022/23



Note: Orkney and Shetland are excluded from this chart as both hold large reserves (over 200 per cent of net cost of services) related to oil, gas and harbour related activities.

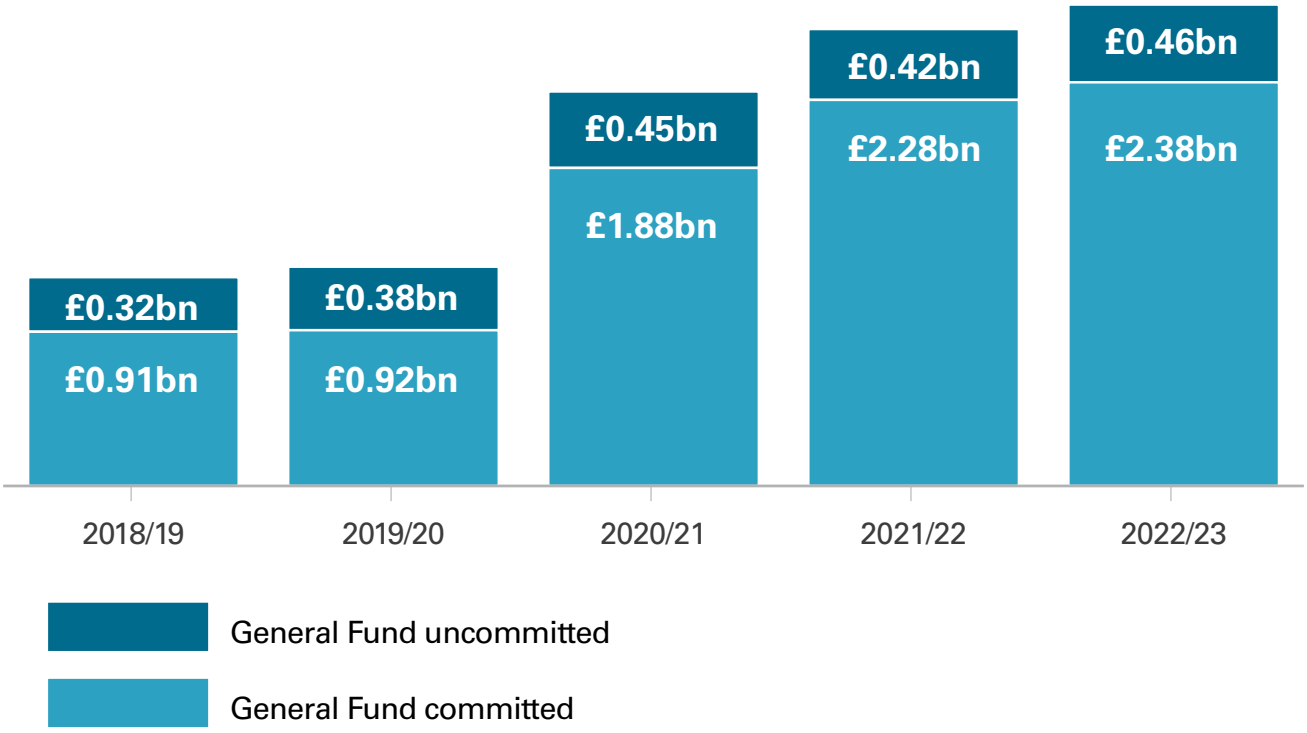
Source: Councils' annual accounts 2022/23 (audited and unaudited)

Councils increased their general fund reserves, but this is driven by growth in committed funds

53. In 2022/23, councils increased their total General Fund reserves (excluding any HRA element which not all councils have) by £0.1 billion (4.8 per cent) to £2.84 billion compared to 2021/22.

54. Committed funds have increased by £0.1 billion (4.6 per cent) since 2021/22 and by £1.47 billion (159 per cent) since 2019/20 (Exhibit 12).

Exhibit 12.
National General Fund balance, 2018/19 to 2022/23, cash terms



Note: This chart excludes HRA.

Source: Councils' annual accounts (audited and unaudited)

55. Paragraph 50 outlines some of the reasons for growth in committed funds in the past year. Based on data extracted from 2022/23 accounts, we calculate that remaining Covid-19 funding makes up around nine per cent of the total committed General Fund balance, but it is difficult to provide an exact figure for this and it may actually be higher. The continued lack of consistent transparency and detail in annual accounts around what and when reserves are committed for, and their associated spending plans, makes conclusions in this area difficult to draw.

Recommendation

Councils should provide clear statements about reserves policy and explicitly set out the purpose of committed reserves within their annual accounts. This will enhance the level of assurance that councils can provide regarding their ongoing financial sustainability.

Some councils hold very low levels of uncommitted reserves but have specific reserves earmarked for contingency instead

56. Councils have reserves policies in place that set out the rationale for the minimum reserves levels set by the council. Most councils plan to maintain uncommitted reserves at around 2 to 4 per cent of net budgeted expenditure as a contingency to respond to unforeseen events and associated cost pressures.

57. In 2022/23, five councils had an uncommitted reserve balance below two per cent of net budgeted expenditure. Low levels of uncommitted reserves present a risk as it limits a council's ability to cushion the impact of uneven cash flows, unexpected events or emergencies. However, a review of 2022/23 annual accounts for those with the lowest uncommitted balances found that these were planned decisions with specific reserve funds earmarked for contingency.

Councils' total net debt increased by £1 billion (six per cent) between 2021/22 and 2022/23

58. Total net debt (total debt less cash and investments) increased by £1 billion from £16.4 billion in 2021/22 to £17.4 billion in 2022/23 (Exhibit 13, page 24).

59. At a council level, net debt increased in 24 councils between 2021/22 and 2022/23. This compares to an increase in net debt in 15 councils in 2021/22, and eight in 2020/21.

Exhibit 13.
Councils' total net debt, 2018/19 to 2022/23

	2018/19	2019/20	2020/21	2021/22	2022/23
Net debt (£ billion)	15.7	17.1	16.2	16.4	17.4
Year-on-year % change		9.1%	-5.3%	1.4%	5.8%

Note: Orkney is excluded from the total net debt analysis as it has net investments.

Source: Councils' annual accounts (audited and unaudited)

60. There is significant variation between councils. Some councils have experienced very large increases in their net debt, with the highest increases being in South Ayrshire (29 per cent) and East Dunbartonshire (21 per cent). Both these councils were also among those with the highest increases in the previous year. West Dunbartonshire saw the largest decrease between these years, at seven per cent.

61. Glasgow City Council had the highest net debt at £2.1 billion, which represents a 10 per cent increase on the previous year. Shetland had the lowest net debt, but this had increased by 14 per cent compared to the previous year.

Councils' borrowing costs have reduced over the past nine years. However, decisions to reschedule debt repayment in recent years may create financial pressure in the longer-term

62. LGBF financial sustainability data for 2022/23 shows that the proportion of councils' general fund revenue budget being used to service debt has fallen from 8.4 per cent in 2013/14 to 5.4 per cent in 2022/23.

63. A key contributory factor to this has been the decision by councils to re-profile principal repayments over a longer period, in line with 2016 Loans Fund regulations. Some councils also used the financial flexibility afforded by the Scottish Government that permitted a reduction in the statutory repayment of debt in 2020/21, 2021/22 and 2022/23.

64. Although borrowing costs have reduced, the long-term affordability of these payments is an important element of councils' financial sustainability. There is a risk that decisions to reschedule debt repayments may add pressure on future budgets as it defers costs to later years and does not tackle the underlying challenges to financial sustainability.

Financial sustainability indicators included within the Local Government Benchmarking Framework (LGBF) consider the affordability of councils' borrowing costs. The ratio of borrowing costs to net revenue budget highlights the revenue implications of existing and proposed capital expenditure. The indicator included in the LGBF identifies the proportion of the general fund revenue budget that is required to meet the cost of borrowing.

Scottish Government funding for 2023/24

Revenue funding to local government from the Scottish Government in 2023/24 saw a cash and real-terms increase on 2022/23

65. The initial core revenue funding settlement for local government in 2023/24 was £10.9 billion. At the 2023/24 autumn revision, an additional £1.5 billion in general revenue grant funding increased total funding to £12.5 billion. This is a 13.5 per cent increase in cash terms and a 7.0 per cent increase in real terms (in 2022/23 prices) on the 2022/23 position. Almost £1 billion was transferred from health to support social care and integration, over £0.25 billion was additional funding for school staff pay and £0.2 billion was transferred from education. (Exhibit 14).

Exhibit 14.
Scottish Government revenue funding (autumn budget revision), 2023/24 compared to 2022/23, in real terms

			Cash terms			Real terms
Scottish Government revenue funding	**2022/23 £ million**	**2023/24 £ million**	**change %**	**2022/23 £ million**	**2023/24 £ million**	**change %**
Core revenue	**10,999**	**12,482**	**13.5%**	**10,999**	**11,765**	**7.0%**
General revenue grant	7,458	8,683	16.4%	7,458	8,184	9.7%
Non-domestic rates	2,766	3,047	10.2%	2,766	2,872	3.8%
Specific revenue grants	775	752	-3.0%	775	709	-8.5%

Note: Real terms calculation uses 2022/23 as base year.

Source: Scottish Government budget documents (autumn revision)

66. Over the past decade, the total value of specific revenue grants has steadily increased – see Exhibit 16 (page 28) for further details. However, at the latest 2023/24 budget revision (autumn) it decreased in both cash terms and real terms.

Councils' capital funding allocation for 2023/24 represents a real-terms decrease on 2022/23

67. The initial capital funding settlement for local government in 2023/24 was £747 million. At the autumn revision, capital funding was increased to £767 million. This represents a 2.6 per cent fall in cash terms and an 8.2 per cent fall in real terms compared to the same position in 2022/23.

68. Some capital funding is directed for specific policies. For example, £50 million capital to help with the expansion of the Free School Meals policy.

69. The capital funding outlook for the whole Scottish public sector is challenging and the Scottish Government is currently undertaking a programme of reprioritisation of capital projects. The continued pressure on capital budgets presents risks to local government capital programmes, many of which impact on key services (eg, schools, libraries, roads, etc). However, councils did increase their capital reserves by 40 per cent in 2022/23.

Councils' budget-setting for 2023/24

Councils' budget gaps increased significantly in 2023/24 compared to 2022/23

70. At the time of budgeting, from our sample of 30 councils, a total budget gap of £725 million was identified for councils' 2023/24 budgets, a significant increase on the £476 million identified in 2022/23. This represents 4.2 per cent of the net cost of services (in real terms) compared to 2.9 per cent in 2022/23.

71. All but three councils (East Lothian, Dundee and Highland) in the sample reported a higher budget gap in 2023/24 than 2022/23. The budget gaps for 2023/24 ranged from £5 million in Highland (0.6 per cent of net cost of services) to £77 million in South Lanarkshire (7.8 per cent of net cost of services). The wide range may be in part due to different approaches to budgeting rather than significant differences in cost and service pressures.

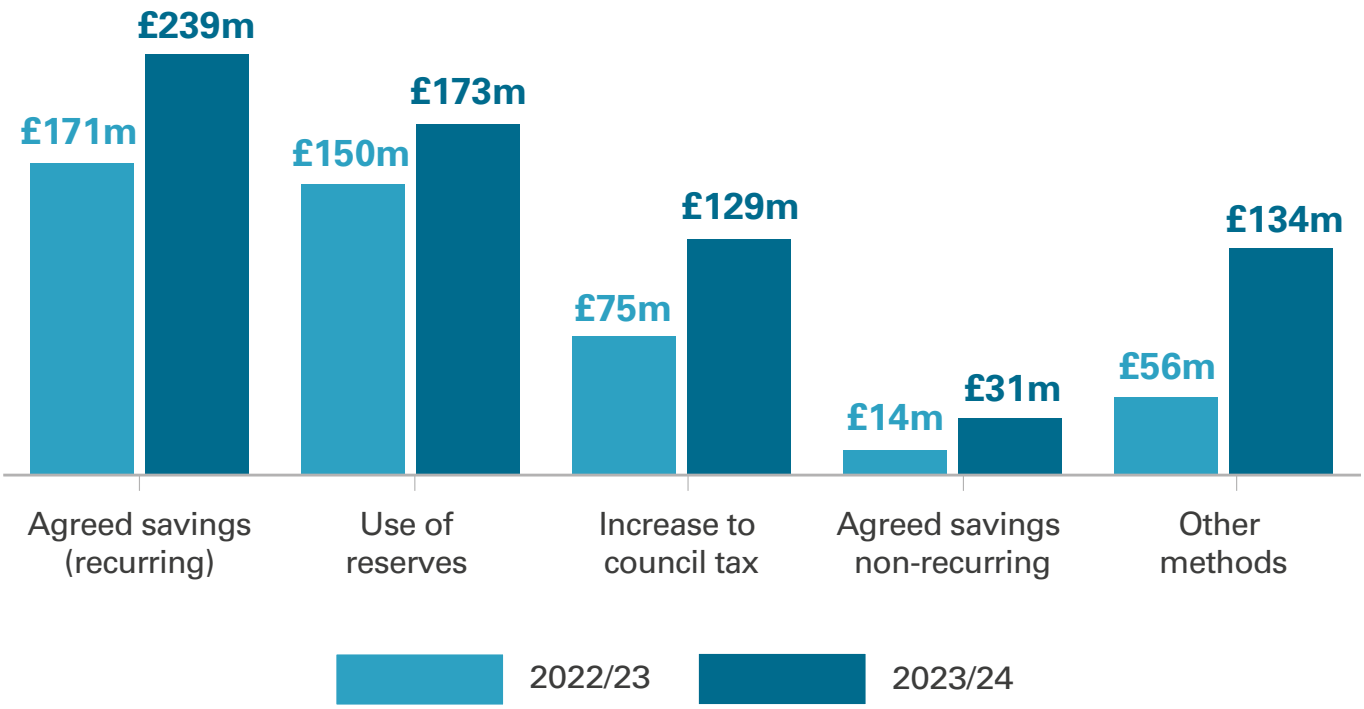
72. The most common bridging actions taken to set balanced budgets in 2023/24 were recurring savings (33 per cent), the use of reserves (27 per cent) and increases to council tax (18 per cent) (Exhibit 15, page 27).

73. Some councils have already taken difficult decisions to address budget gaps through implementation of recurring savings options. However, in the face of public opposition, some councils have reversed decisions that related to the reduction or cessation of services as part of savings put forward for 2024/25. This illustrates the increasing challenges that councils are facing in delivering balanced budgets and highlights the need for proper and timely consultation over budget proposals.

Recommendation

Councils should ensure effective and timely consultation and engagement with communities on the options that must be considered to achieve a balanced budget.

Exhibit 15.
Councils' bridging actions to set their 2023/24 budget compared to 2022/23



Note: The chart elements for 2023/24 add up to £733 million which is higher than the total anticipated budget gap for 2023/24. This is because Dundee and North Lanarkshire reported bridging actions of greater value than their budget gap.

Source: Auditor data returns (30 councils in the sample)

Financial sustainability

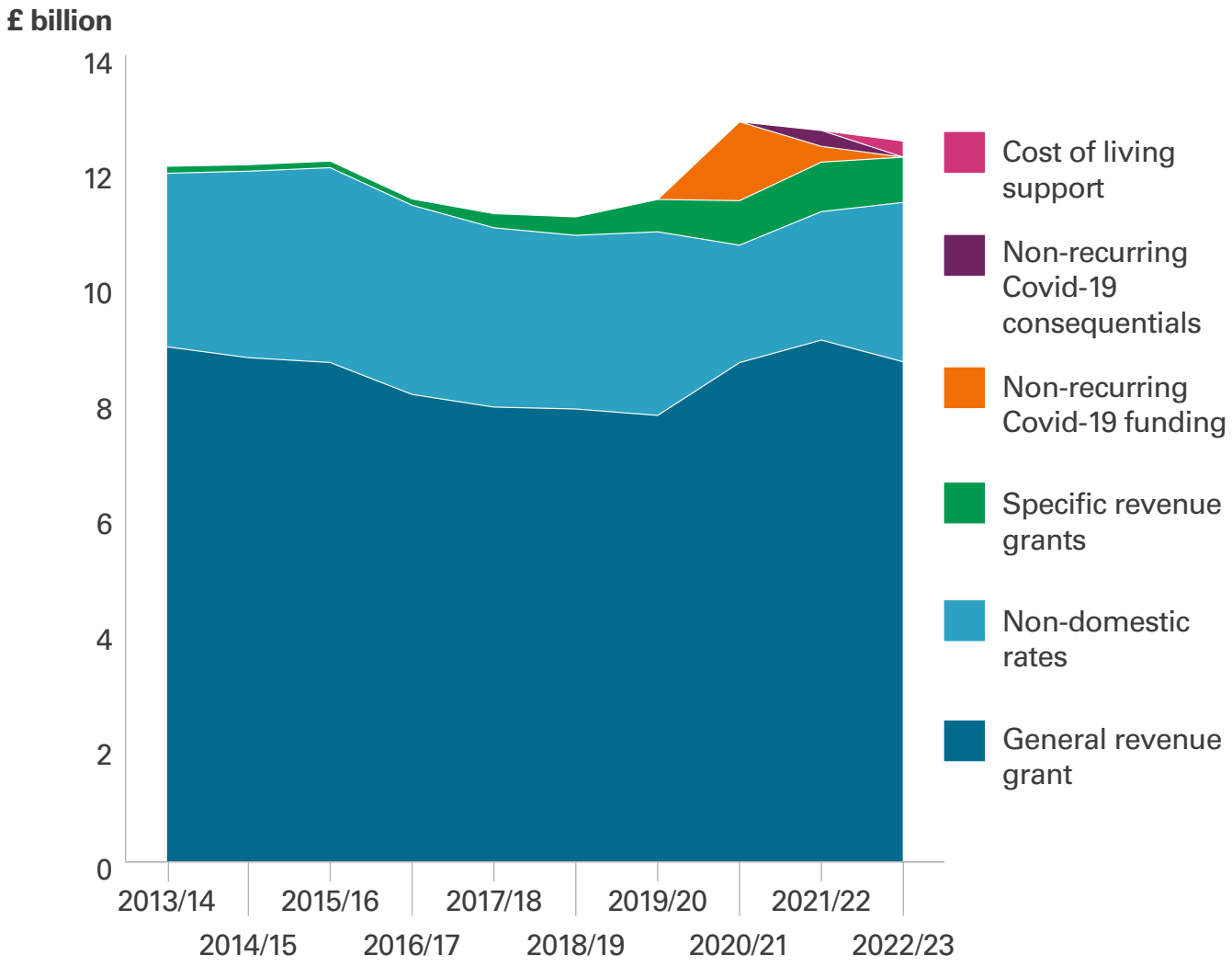
In real terms, councils' core revenue funding is similar to levels a decade ago. However, over that time, councils' have experienced periods of reduced budgets and increasingly ring-fenced funding

74. The £12.2 billion core allocation received by councils in 2022/23 compares to a real-terms value of £12.1 billion in 2013/14, a 1.3 per cent increase (Exhibit 16, page 28).

75. Over this period, in real terms the general revenue grant decreased year-on-year until 2020/21 and non-domestic rates also fell over the same period. During the pandemic, councils received additional core and specific non-recurring Covid-19 funding.

76. In real terms, the general revenue grant in 2022/23 is 2.9 per cent (£262 million) lower than in 2013/14 and income from non-domestic rates is 8.1 per cent (£244 million) lower.

Exhibit 16.
Scottish Government revenue funding to local government, real terms, 2013/14 to 2022/23



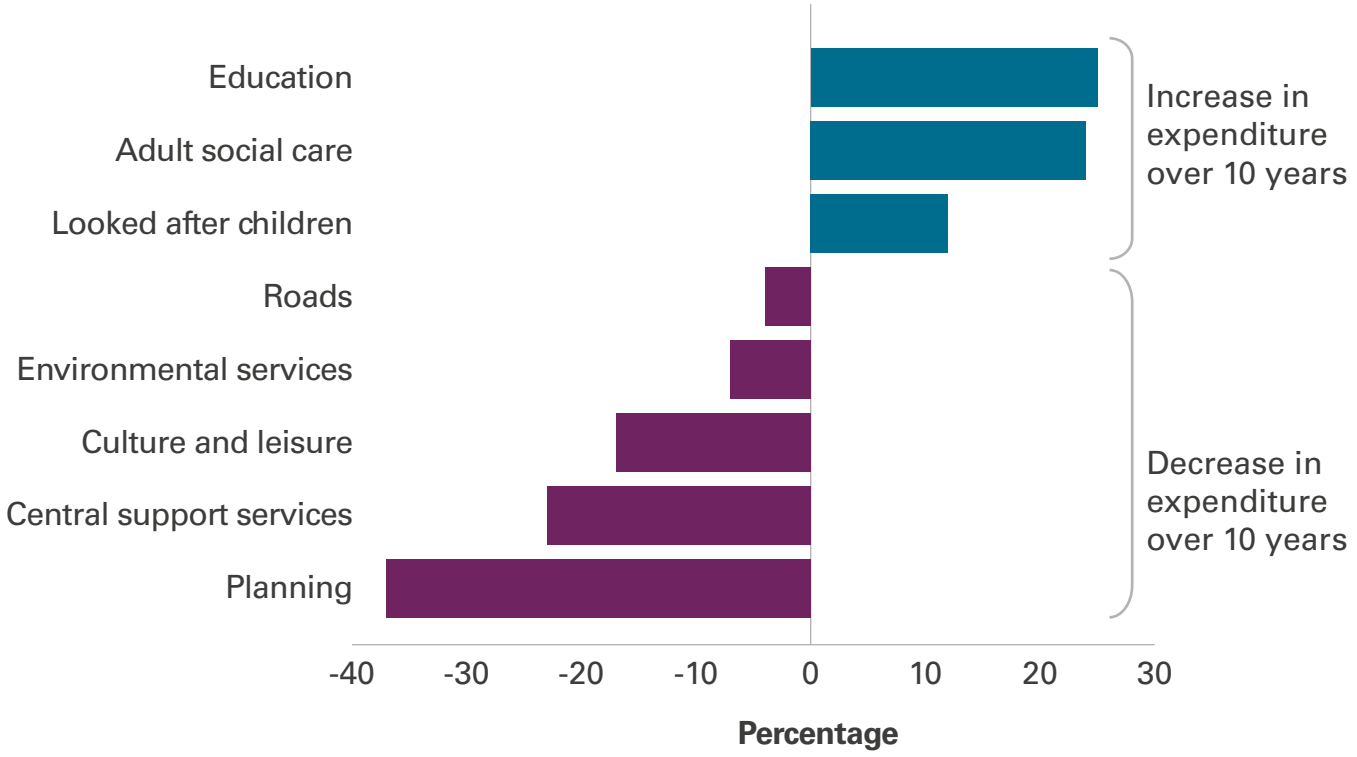
Source: Scottish Government budget documents (spring revision) for 2014/15 to 2022/23 and actual figures for 2013/14 (from 02/2014 circular) as budget documents were not available

77. Specific revenue grants have increased by over 500 per cent (£663 million) across the same period in real terms (although there was a reduction in 2022/23). This significant increase has been a key contributory factor in keeping the overall local government budget at a similar level. These grants are to support the delivery of specific national policies, for example the expansion of early learning and childcare, rather than provision of flexible funding for councils to use at their discretion.

As demand for council services continues to rise, councils have reduced spending on 'unprotected' services to balance budgets

78. As we reported in our Local government in Scotland: Overview 2023 report in May 2023, over the last decade, there is a clear divergent pattern of spending on council services. Spending on children's services (education and looked after children) and adult social care has been protected and increased because of increased demand and national policy directives. This means that the remaining 'unprotected' services have borne a disproportionate level of spending reductions (Exhibit 17).

Exhibit 17.
Percentage change in expenditure (in real terms) over ten years, 2012/13 to 2021/22



Source: Improvement Service

Councils' medium- and longer-term financial plans demonstrate a clear recognition of the significant financial challenges that lie ahead

79. Councils' medium- and longer-term financial plans provide a clear picture of the challenging and volatile financial landscape that they face. Significant pressures resulting from increased demand for services, inflation, and legislative reform, as well as the continuing financial impacts of the Covid-19 pandemic and cost of living crisis, feature strongly.

80. Generally, these plans also set out projected budget gaps over the medium and longer term, highlighting the scale of the challenge and the level of savings required to continue to deliver balanced budgets in the years ahead.

81. As the whole public sector faces the most difficult financial outlook seen for many years, councils are having to make increasingly difficult choices about their spending priorities and need to balance short-term pressures with robust planning for long-term financial sustainability.

Some councils use indicators to assess their financial resilience but the extent to which they are used and their effectiveness varies

82. From a sample of 30 councils, an assessment of financial resilience arrangements found all but five use the **financial sustainability indicators** from the local government benchmarking framework (LGBF) in local reporting. Of the same sample, only six use the CIPFA Resilience Index. The extent of this reporting also varies. Some councils provide regular reports to elected members, while others include detail on a less frequent basis in other documents, such as service plans or strategies.

83. Auditor returns indicated that in some cases, financial resilience indicators are not used to any great extent by councils on a regular basis. Financial resilience is instead built into day-to-day financial processes and strategies. In other cases, auditors highlighted the use of key financial ratios recommended by CIPFA Directors of Finance within the management commentary of the accounts or reporting upon financial resilience monitoring in their medium-term financial plans.

Financial sustainability indicators are a helpful tool for councils to measure performance and resilience on an ongoing basis. Councils have adopted different approaches to how they use indicators to monitor financial resilience.

Recommendation

Given the scale of the challenges, councils should strengthen their monitoring and reporting of financial resilience including clearer and more public-facing use of performance against financial resilience indicators and measures. Financial resilience indicators should be a component of councils' medium- and longer-term financial plans to provide assurance that they are balancing short-term pressures with robust planning for long-term financial sustainability.

The pensions' triennial funding valuation as at 31 March 2023 is not yet complete, but preliminary results suggest a potential positive impact on finances at some councils in the short term

84. The most recent triennial funding valuation took place across Local Government Pension Scheme pension funds at 31 March 2023. The main purpose of the valuation is to review the financial position of each fund and to set appropriate contribution rates for each employer for the upcoming three-year period as part of the fund's overall funding strategy.

85. Preliminary results across some pension funds show an improved funding position. An improved funding position may allow the fund to retain a surplus, change the investment strategy, take less funding risks, or reduce employer contributions.

86. Reducing employer contributions has the potential to create a 'windfall' effect for some councils, thus potentially reducing some of the cost pressures likely to be faced in 2023/24. This may allow councils some additional flexibility to manage immediate financial pressures while taking steps to enhance financial sustainability over the longer term. This will however require careful consideration at a local level. It is likely that auditors will monitor this closely as part of 2023/24 audits.

The Verity House Agreement and looking to the future

87. In June 2023, a new partnership agreement, the Verity House Agreement, was agreed between the Scottish Government and COSLA.

88. The partnership committed to:

- **From June 2023, a default position of no ring-fencing or direction of funding unless there is a mutual understanding of the reasons for a ring-fenced funding arrangement.** A reduction in the level of ring-fencing is likely to have a positive impact on the efficient and effective use of resources at a local level. Councils will experience increased local flexibility, providing greater scope to respond well to local needs in a targeted manner. However, good accountability for the use of public funds remains crucial. It is important therefore that the Scottish Government and COSLA work together to establish the right balance between direction and flexibility.
- **By the end of October 2023, undertake a joint review of specific grants and in-year transfers to local government.** The purpose of the review is to identify what funding can be baselined into the General Revenue Grant or General Capital Grant from the 2024/25 financial year to create more flexibility for councils in terms of their spending.
- **By the end of September 2023, agree a new fiscal framework which will govern the allocation of funding for local authorities and provide councils with increased control over their budget-setting processes. This includes multi-year settlements wherever possible to support strategic planning and investment.** The Accounts Commission has previously highlighted the importance of longer-term certainty in funding for councils, and the ongoing need for effective and robust financial management. This commitment in the Verity House Agreement is a welcome development.

89. Work in these areas remains ongoing, although at mid-December 2023 these milestones had not been met.

Recommendation

Councils should work with the Scottish Government to build momentum and accelerate progress in the development of a fiscal framework for local government to enhance the clarity and certainty of budgets for councils in future years.

90. In October 2023, the First Minister unexpectedly announced a council tax freeze for 2024/25 and the postponement of Scottish Government proposals to increase the council tax multipliers for properties in bands E to H, by 7.5 per cent, 12.5 per cent, 17.5 per cent and 22.5 per cent. This was done without consultation with COSLA. Following greater reliance on increasing council tax to help deliver a balanced budget over the past two years, indications were that many councils were planning to increase council tax again for 2024/25.

91. The Fraser of Allander Institute modelled that 'if councils were planning increases that mirrored last year's (5.4 per cent), fully funding the freeze and cancellation of the multipliers would cost £329 million – £148 million for the former and £182 million for the latter'.

92. In the Scottish Budget on 19 December 2023, £144 million was allocated to 'fully fund' the council tax freeze, with the Scottish Government stating this is equivalent to a five per cent increase. Details on what this means for individual councils were not available at this time.

93. The impact of the freeze on councils' financial sustainability is not yet known and we will monitor this in our future audit work. However, even when 'fully funded' a council tax freeze suppresses the growth of the council tax base over that period and the income generated when the freeze is lifted is potentially lower than if councils were able to make tax raising decisions at a local level. The latest council tax freeze follows decisions by the Scottish Government to freeze council tax between 2008/09 and 2016/17 and in 2021/22, as well as cap increases at three per cent in 2017/18 and 2018/19.

94. The Scottish Government published their single year 2024/25 budget on 19 December 2023. The 2024/25 initial core revenue and capital settlement for local government is £12.3 billion which is a 1.7 per cent cash increase on the 2023/24 initial settlement. An additional £144 million has been allocated to fund the council tax freeze. A number of elements that were previously specific grants have been baselined into the general revenue grant including early learning and childcare expansion and the Living Wage funding. We will examine the implications of the Scottish Budget for councils' own budget setting in a budget briefing in spring 2024.

Local government in Scotland

Financial bulletin 2022/23

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