

**REPORT TO: SCRUTINY COMMITTEE – 18 APRIL 2018**

**REPORT ON: LOCAL GOVERNMENT IN SCOTLAND FINANCIAL OVERVIEW 2016/17**

**REPORT BY: EXECUTIVE DIRECTOR OF CORPORATE SERVICES**

**REPORT ON: 117-2018**

**1 PURPOSE OF REPORT**

To provide elected members with a summary of the above national report that has been undertaken by Audit Scotland on behalf of the Accounts Commission.

**2 RECOMMENDATIONS**

It is recommended that the Committee:-

- note the key messages arising from the Audit Scotland overview report, and
- note the action points for elected members arising from the Audit Scotland overview report.

**3 FINANCIAL IMPLICATIONS**

There are no direct financial implications arising from this report.

**4 MAIN TEXT**

4.1 Audit Scotland has developed its approach to overview reporting and will publish two overview reports per year. One on performance and outcomes is planned to be published in April 2018. The other is the attached report which provides a financial overview.

4.2 The report is split into three parts. The first part reviews the Councils income and budgets whilst the second part considers the 2016/17 financial performance. Part three considers the financial outlook for 2017/18 and going forward. Throughout the report, Audit Scotland has identified questions that councillors could ask to help them understand their council's financial position, scrutinise performance and make good decisions. These questions are also listed in separate self-assessment tool which is attached. (Supplement 1)

4.3 The key messages arising from the overview report are set out on page 7 of the report. These include messages around the following areas:-

- Council's financial challenges continue to grow. They have needed to achieve ambitious savings plans, including around £524m of savings for 2016/17.
- Councils are showing signs of increasing financial stress. 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 Council took advantage of low interest rates. Council's debt levels are not currently problematic.
- Council's budget setting process for 2016/17 were complicated by late confirmation of funding from the Scottish Government.
- All Councils received an unqualified audit opinion on their 2016/17 accounts.
- The financial outlook for Council's continues to be challenging. As such robust medium-term financial strategies and effective leadership to develop them are of increasing importance.

4.4 In addition to the main report there are separate supplements for specific areas.

Supplement 2 – Local Government Pension Scheme 2016/17  
Supplement 3 – Housing Revenues Account 2016/17

## Supplement 4 – Measures taken by Councils to close their funding gaps in 2017/18

- 4.5 It should be noted that Dundee Council's appointed local external auditor Audit Scotland submitted their detailed report on the findings of their audit 2016/17 to the Policy & Resources Committee (Article IX of the Minute of Meeting of the Policy & Resources Committee of 30 October 2017, Report No: 363-2017 refers). The matters raised in the report by Audit Scotland have already been considered by the Council and an action plan has been agreed incorporating "agreed management actions". The progress on implementing the agreed plan is ongoing and will be monitored through the Council's established procedure for dealing with external audit reports and reviewing previously agreed actions plans.

### **5 POLICY IMPLICATIONS**

This report has been screened for any policy implications in respect of Sustainability, Strategic Environmental Assessment, Anti-Poverty, Equality and Risk Management. There are no major issues.

### **6 CONSULTATION**

The Council Management Team has been consulted in the preparation of this report and agreed with it's contents.

### **7 BACKGROUND PAPERS**

None

G COLGAN  
EXECUTIVE DIRECTOR OF CORPORATE SERVICES

21 MARCH 2018

Local government in Scotland

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# Financial overview 2016/17



ACCOUNTS COMMISSION 

Prepared by Audit Scotland  
November 2017



# The Accounts Commission

The Accounts Commission is the public spending watchdog for local government. We hold councils in Scotland to account and help them improve. We operate impartially and independently of councils and of the Scottish Government, and we meet and report in public.

We expect councils to achieve the highest standards of governance and financial stewardship, and value for money in how they use their resources and provide their services.

Our work includes:

- securing and acting upon the external audit of Scotland's councils and various joint boards and committees
- assessing the performance of councils in relation to Best Value and community planning
- carrying out national performance audits to help councils improve their services
- requiring councils to publish information to help the public assess their performance.

You can find out more about the work of the Accounts Commission on our website: [www.audit-scotland.gov.uk/about-us/accounts-commission](http://www.audit-scotland.gov.uk/about-us/accounts-commission) 

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.

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## Links

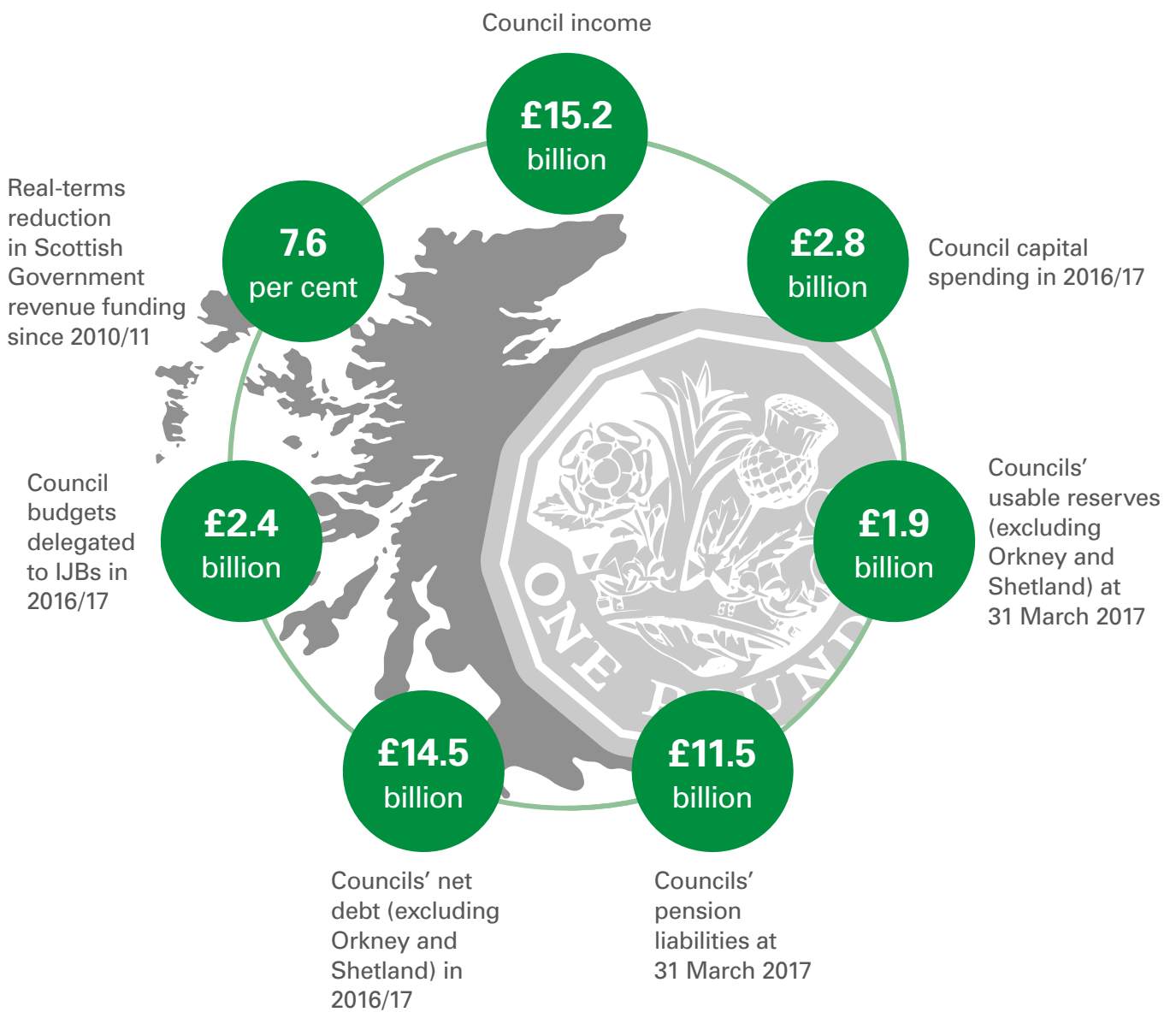
-  PDF download
-  Web link



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

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# Key facts



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# Chair's introduction



Welcome to the Accounts Commission's 2017 financial overview report for local government.

Last year was the first time that we published a separate financial overview report. In view of the very positive feedback we received from our stakeholders, we have decided to continue publishing two overview reports each year: this one focuses on financial matters, and the other on councils' performance and outcomes, which we plan to publish in April 2018.

Generally, councils face increasing challenges which require flexible responses that balance immediate needs, sound long term planning and limited financial resources. This task is a demanding one for elected members – not least for newly elected members – and I would hope that this overview report and its associated material, including the examples of questions we provide to support scrutiny by councillors, is a useful source of information and guidance.

We live in a rapidly changing public sector landscape, where external issues such as the transfer of further powers to Scotland and the decision to withdraw from the European Union add to an already complex domestic environment. Against this general backdrop the Commission is very aware of the importance of understanding the individual context faced by each council in terms of demand for services and resources available to sustain or develop them.

A major element of this operating environment for councils is the continuing pressure on finances. There was a real terms reduction in councils' main source of funding from the Scottish Government for 2016/17. This year has seen a further real terms funding reduction, with that trend forecast to continue into future years.

Councils tell us that they are finding the situation more serious than ever, with savings becoming increasingly difficult to identify and achieve. The Commission recognises this, but also recognises that some councils are in a better position to respond than others.

Effective leadership and financial management is becoming increasingly critical and medium-term financial strategies and well thought out savings plans are key to financial resilience and sustainability.

Elected members need to be clear about the potential impact of planned savings on achieving corporate objectives and the subsequent outcomes for citizens. The implications of community empowerment legislation heighten the importance of engaging effectively with communities around local priorities, and working together on options for the best future use of resources in service provision.

The Commission continues to emphasise the importance of Best Value as a comprehensive framework, based on the principle of continuous improvement that encompasses the key features of a high performing and effective council. It is especially relevant in times of tight finances, and we welcome the work being carried out by the Scottish Government, CoSLA, Solace and others, to refresh the Best Value statutory guidance so that it better reflects the current context for local government.

Finally, we welcome that once again the audits of annual accounts from all 32 councils were signed off with no qualifications. This is testament to the hard work amongst council staff, especially those within the finance function, and the good relationships developed by our auditors. There is of course, always room for improvement in financial management, such as in monitoring and reporting of financial matters to both councillors and the wider public. We will continue our interest in this.

**Graham Sharp**

Chair of Accounts Commission



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# Summary



## Key messages

- 1** Councils' financial challenges continue to grow. Funding reductions are compounded by increasing costs and demands on services. In response, councils have needed to achieve ambitious savings plans, including around £524 million of savings for 2016/17.
- 2** Councils are showing signs of increasing financial stress. They are finding it increasingly difficult to identify and deliver savings and more have drawn on reserves than in previous years to fund change programmes and routine service delivery. Some councils risk running out of General Fund reserves within two to three years if they continue to use them at levels planned for 2017/18.
- 3** Debt increased by £836 million in 2016/17 as councils took advantage of low interest rates to borrow more to invest in larger capital programmes. Councils' debt levels are not currently problematic, but some are becoming concerned about affordability of costs associated with debt within future budgets.
- 4** Councils' budget-setting processes for 2016/17 were complicated by late confirmation of funding from the Scottish Government and the funding arrangements for integrating health and social care. Councils' expenditure and use of reserves often differed noticeably from that originally planned, indicating the need for budget-setting to become more robust and reliable.
- 5** All councils received an unqualified audit opinion on their 2016/17 accounts but auditors found that in several councils financial management could be improved. Councils can use their accounts to more clearly explain their financial performance over the whole year to support better scrutiny.
- 6** The financial outlook for councils continues to be challenging, with the need to deliver savings being increasingly critical to their financial sustainability. As such, robust medium-term financial strategies and effective leadership to deliver them are of increasing importance.

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**councils are showing signs of increasing financial stress**

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## About this report

**1.** This report provides a high-level independent analysis of the financial performance of councils during, and their financial position at the end of, 2016/17. It also looks ahead and comments on the financial outlook for councils. It is one of two overview reports that the Accounts Commission publishes each year, complementing a report on councils' performance and outcomes that will be published at the start of the next financial year in April 2018.

**2.** The report is intended to inform the public and its representatives. It is particularly aimed at councillors and senior council officers, and will be of significant interest to elected members who joined councils for the first time following the May 2017 elections. While the focus of the report is on councils, we also provide some early information about Integration Joint Boards (IJBs), which are also local government bodies, following their first full year of operation in supporting health and social integration. A programme of audit work looking in more detail at health and social care integration and IJBs is under way.<sup>1</sup>


**3.** The report is in three parts:



- **Part 1 (page 10)** comments on councils' income and budgets for 2016/17.
- **Part 2 (page 20)** looks at councils' financial performance during, and position at the end of, 2016/17.
- **Part 3 (page 33)** looks at councils' 2017/18 finances and the challenges faced going forward.

**4.** Our primary sources of information are councils' 2016/17 audited accounts (including management commentaries) and their 2016/17 external annual audit reports. We have supplemented this with data submitted by councils to the Scottish Government through local finance returns (LFRs) and Provisional Outturn and Budget Estimates (POBE). LFRs present spending information for councils on a different basis from the spending information that councils record in their annual accounts. We do not audit data contained in LFRs.

**5.** UK-wide changes to the format of council financial statements in 2016/17 mean that we are no longer able to compare spending on services across councils using the annual accounts. This includes changes that make it difficult to establish the true service income and expenditure totals. We will include further analysis of these areas in our local government overview report in April 2018, using Scottish Government LFR data.

**6.** We refer to 'real-terms' changes in this report. This means we are showing financial information from past and future years at 2016/17 prices, adjusted for inflation, so that they are comparable to information from councils' 2016/17 accounts. We also refer to figures in 'cash terms'. This means we are showing the actual cash or money paid or received.

**7.** Throughout the report, we identify examples of questions that councillors may wish to consider to help them better understand their council's financial position and to scrutinise financial performance. The questions are also available on our website in [Supplement 1: Scrutiny tool for councillors](#) .

**8.** Accompanying this report, and to facilitate insight and comparisons across the sector, we have provided additional financial information on our website. The information is based on councils' audited accounts. We hope this will be useful for senior council finance officers, their staff and other interested stakeholders. We have also produced a separate supplement on councils' [Housing Revenue Account \(HRA\)](#)  and the [Local Government Pension Scheme \(LGPS\)](#) .

**9.** Throughout this report Orkney and Shetland have been excluded from exhibits that show usable reserves and debt. This is because the levels they hold mean inclusion would make it difficult to see relative positions of other councils. Most councils hold usable reserves of between five and 35 per cent of their annual income, whereas Shetland's reserves were 250 per cent of its annual income and Orkney's 300 per cent of its annual income. These large reserves relate to oil, gas and harbour related activities. As a result, both Orkney and Shetland also have more investments than borrowing unlike other councils.

# Part 1

## Councils' income and budgets for 2016/17



### Key messages

- 1** 2016/17 was a challenging year for councils with a real-terms reduction in revenue funding, a continuation of the council tax freeze, inflationary pressures and the cost of new UK and Scottish Government policy commitments.
- 2** Councils depend on Scottish Government funding for the majority of their income. The largest element of Scottish Government funding, relating to Grant Aided Expenditure, has remained largely unchanged since 2008/09, with additional funding linked to supporting national policies. The Scottish Government and COSLA should assure themselves that the funding formula remains fit for purpose in a changing landscape for local government. It is important that it is suited to improving outcomes for local communities and sensitive to priorities such as reducing inequality within and across council areas.
- 3** In response to funding reductions, councils approved about £524 million of savings and the use of £79 million of their reserves when setting budgets for 2016/17. Councils' savings plans have focused on reducing staff numbers, rationalising surplus property and improving procurement of goods and services. Councils were not always clear in their budget-setting reports about the risks associated with savings and their potential impact on levels of service.
- 4** Councils' budget-setting processes for 2016/17 were complicated by later confirmation of funding from the Scottish Government and the funding arrangements for integrating health and social care.
- 5** Councils set larger capital budgets in 2016/17 than in 2015/16. The Scottish Government capital grant fell and councils planned to fund expenditure through increased borrowing.

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**2016/17 was  
a challenging  
year for  
councils**

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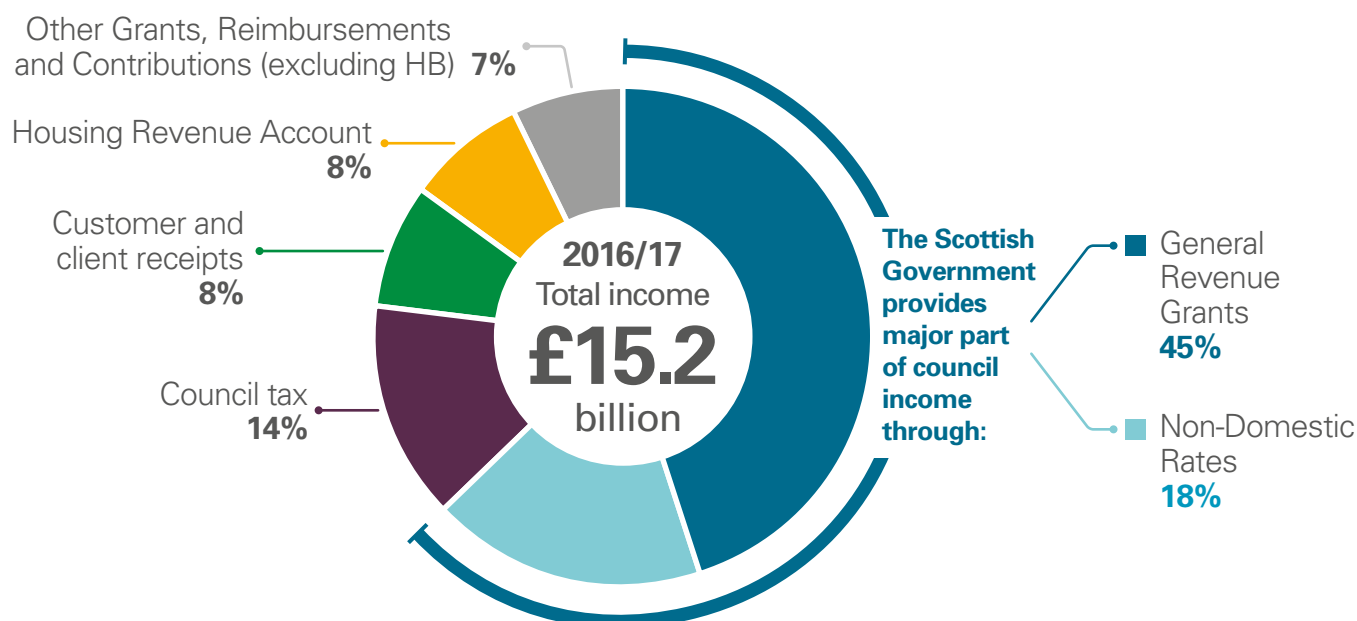
### Councils faced a major challenge from the significant fall in revenue funding for 2016/17

**10.** The Scottish Government provides almost two-thirds of councils' income through general revenue grant, non-domestic rates (NDR) and specific grants for things like community justice ([Exhibit 1, page 11](#)). In comparison, council tax accounts for 14 per cent of councils' income, and fees and charges about eight per cent of their income.<sup>2</sup>

## Exhibit 1

### Sources of council revenue income, 2016/17

Councils are dependent on the Scottish Government for the majority of their income.



#### Notes:

- Does not include all income collected for services delivered through council arm's-length external organisations (ALEOs) and Integration Joint Boards (IJBs).
- Income excludes housing benefit.
- Customer and client receipts are 2015/16 totals at 2016/17 prices.

Source: Annual accounts 2016/17 and Scottish Local Government Finance Statistics 2015-16

**11.** Scottish Government revenue funding for councils in 2016/17 fell by 5.2 per cent in real terms ([Exhibit 2](#)). Councils' revenue funding from the Scottish Government has fallen in real terms by 7.6 per cent since 2010/11. The size of the reduction in 2016/17 presented councils with a major challenge in delivering services and required most to identify significant savings.

## Exhibit 2

### Scottish Government revenue funding to councils

Revenue funding fell both in cash and real terms in 2016/17 compared to 2015/16.

	2016/17 £'000	Change on 2015/16	
		Cash %	Real %
NDR	2,769	-0.7 ▼	-2.7 ▼
Revenue Grant	6,939	-4.3 ▼	-6.2 ▼
<b>Total revenue funding</b>	<b>9,708</b>	<b>-3.3 ▼</b>	<b>-5.2 ▼</b>
Additional resource via IJBs	250		
	<b>9,958</b>	<b>-0.8 ▼</b>	<b>-2.8 ▼</b>

Source: Local Government Finance Circular 1/2017, Scottish Government

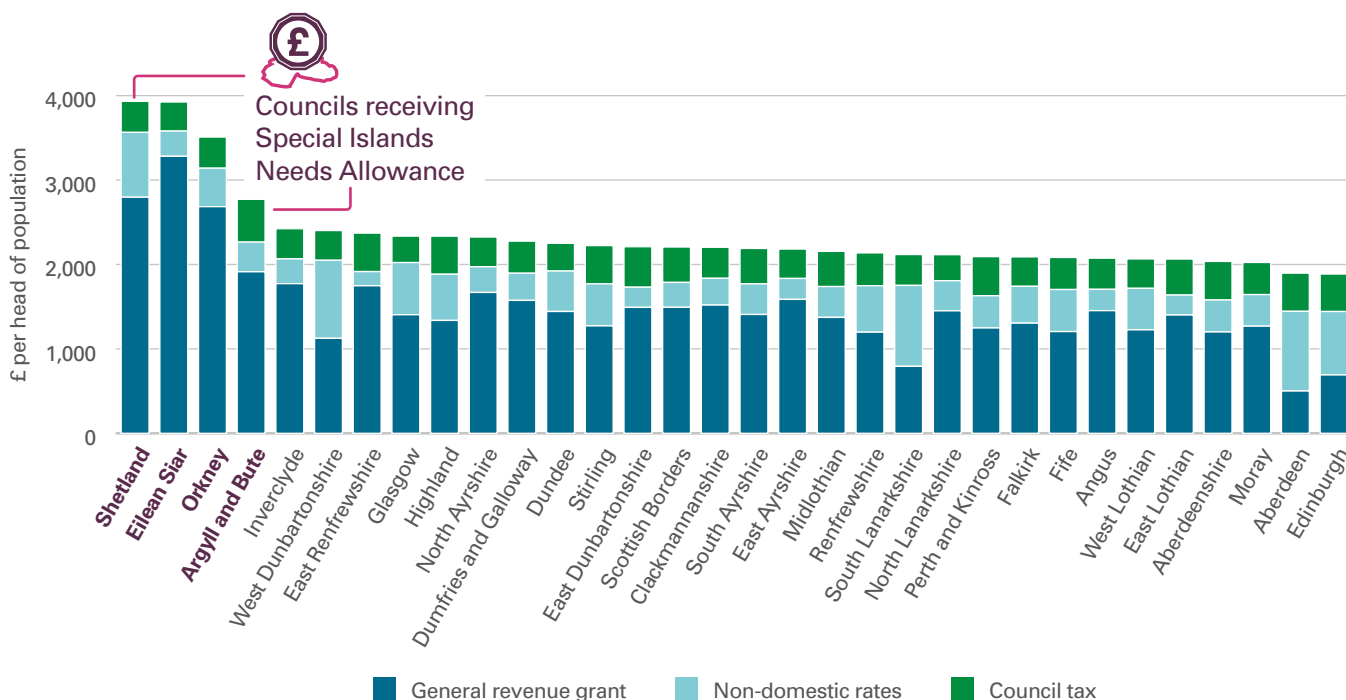
**12.** In 2016/17, the Scottish Government transferred an additional £250 million from the health budget to support health and social care integration. Even taking this into account, total revenue funding for councils fell in 2016/17.

**13.** Council tax is a key source of income for local government. Councils have typically set council tax rates to reflect local policy choices. Between 2008/09 and 2016/17, councils agreed with the Scottish Government to freeze council tax rates. To compensate them, the Scottish Government provided local government with an additional £70 million in each year of the freeze. In 2008/09, £70 million represented just over three per cent of council tax income and councils each received a share in line with their tax base. Councils that may not have increased their council tax by this amount each year will have benefited from additional funding as a result of the freeze. Councils did, however, lose the option of raising council tax to generate additional revenue. Although the council tax freeze was lifted in 2017/18, councils were constrained to increases of three per cent.

**14.** The revenue funding that councils received from the Scottish Government and council tax income varied between £2,000 and £2,400 per head of population for most councils in 2016/17 ([Exhibit 3](#)). This impacts on the income they have available and on the decisions they need to make about delivering services. The income per head of population in Argyll and Bute, Eilean Siar, Orkney and Shetland is higher than in other councils because they receive extra funding for their island populations, in recognition of the additional costs they face when providing services.

### Exhibit 3

**Income from General Revenue Grant, Non-Domestic Rates and council tax per head of population, 2016/17**  
 Most councils received between £2,000 and £2,400 per head of population.



Source: Annual accounts 2016/17; and National Records of Scotland mid-year population estimate for 2015

### Additional Scottish Government funding has been linked to supporting national policies

**15.** The Scottish Government funding mechanism is the main determinant of a council's overall funding. It is designed to reflect differences between councils in terms of population and other factors, such as geography and deprivation. The funding mechanism is based on a large number of elements as illustrated in [Exhibit 4 \(page 14\)](#). The Fraser of Allander Institute has provided a useful outline summary of how funds are allocated:

'The Scottish Government allocates grants to local authorities taking into account both the relative spending need of each authority, and the revenues raised from council tax and non-domestic rates income.

The grant allocation system first calculates the 'total estimated expenditure' (TEE) that each local authority is likely to need to meet its various commitments. The elements of TEE are:

- an assessment of spending needs, based on the Grant Aided Expenditure (GAE) assessments combined with a Special Islands Needs Allowance (SINA)
- a series of additional revenue grants – such as the funding used in the past to support the council tax freeze – the allocation of which is determined on a case-by-case basis
- a series of further non-specific changes to grant allocations, the allocation of which is based on local authorities' shares of GAE + SINA
- local authorities' commitments in respect of certain historic loan charges
- the sum of these elements is then adjusted by a 'floor' to ensure that no local authority experiences particularly large swings in support from one year to the next.

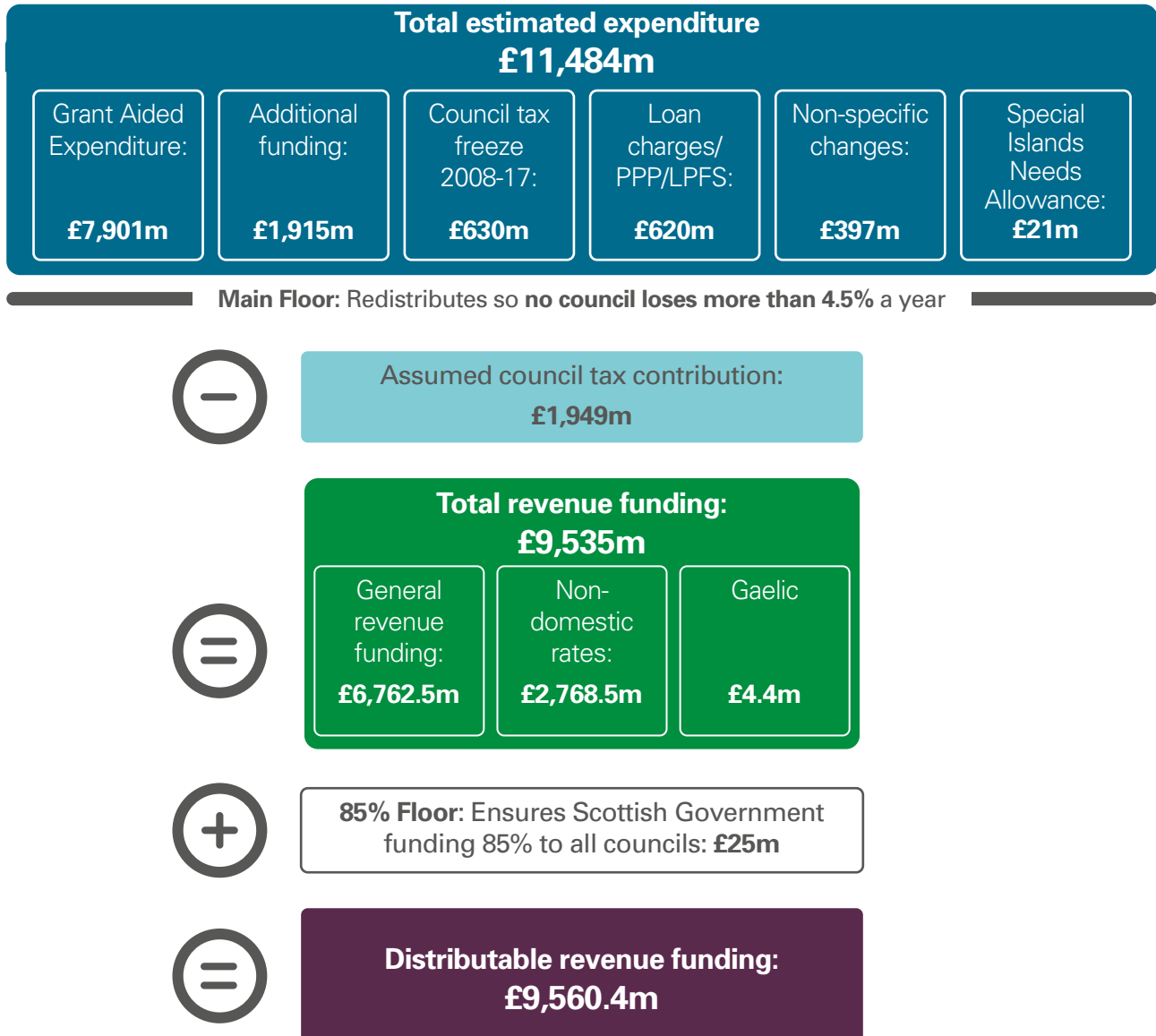
Having calculated TEE, an adjustment is then made based upon an estimate of what each local authority is expected to raise from council tax, the revenues that each local authority is forecast to raise from non-domestic rates, and their allocation of ring-fenced Gaelic funding. A further 'floor' calculation is applied to ensure that no local authority receives less than 85 per cent of the Scottish average on a per capita basis.<sup>13</sup>

**16.** Within the Scottish Government's estimate of councils' TEE in any year, the largest element is Grant Aided Expenditure (GAE). GAE totals have remained broadly the same since 2008/09, with the exception of funding for police, fire and district courts having been removed. In 2016/17, GAE was £7.9 billion of a total estimated expenditure of £11.5 billion. GAE is distributed between councils based on an estimate of their relative spending needs across 89 elements, with reference to one or more indicators. For example, the GAE for primary education is allocated with reference to its share of primary school aged pupils. A small adjustment is made based on a secondary indicator of the percentage of pupils in small schools. The variations between councils in each of the elements are mostly determined by population profiles, although other factors to reflect rurality and deprivation are also used when appropriate.

## Exhibit 4

### Local Government funding mechanism, 2016/17

The formula contains many elements.



Notes: On top of distributable revenue funding, councils also received £133 million from other grants and payments such as the Teacher Induction Scheme and Discretionary Housing Payments.

In 2016/17, the 85 per cent floor was applied to funding for Aberdeen City and City of Edinburgh Councils.

Source: Audit Scotland and Fraser of Allander Institute

**17.** New funding for councils since 2008/09, for example funding to expand early years' childcare, has come as 'additional funding' and 'non-specific changes' and is funding specifically directed at delivering particular national policies. The proportion of council funding directed towards national policies is increasing, a trend that will continue with Scottish Government proposals for fairer funding for equity and excellence in education. This shift increasingly restricts the flexibility councils have in managing their budgets across their full range of services. The Scottish Government and COSLA should assure themselves that the funding



formula remains fit for purpose in a changing landscape for local government. It is important that it is suited to improving outcomes for local communities and sensitive to priorities such as reducing inequality within and across council areas.

## Councils faced increased budgetary pressures in 2016/17

**18.** Councils faced a growing range of budgetary pressures in 2016/17 from the real-terms reduction in Scottish Government funding, the continuation of the council tax freeze and cost inflation. They also faced additional pressures in meeting new UK and Scottish Government policy commitments. Many of the budgetary pressures that councils faced were associated with staff. As councils' largest area of expenditure, additional staff-related costs have a very significant impact on their budgets ([Exhibit 5](#)).

### Exhibit 5

#### Significant budgetary pressures on councils in 2016/17

UK and Scottish Government policy commitments had sizeable cost implications for councils.



The **move to the single state pension at UK level**. This ended the employer NI rebate in relation to staff in contracted-out pension schemes (such as the LGPS and Teachers schemes).

**3.4 per cent increase in NI costs affected employees from 1 April 2016.**



The cost of introducing the **living wage for social care workers** from 1 October 2016.

**Estimated cost of £100 million.**



The undertaking to **maintain teacher numbers in Scotland** and the **Teacher Induction Scheme**.

**Councils spend around £2.4 billion on teachers. By not cutting teacher numbers they receive a share of £88 million extra funding.**



**Annual increases in staff costs.**


**Estimated cost of one per cent pay rise about £70 million. Costs also increase as staff move up pay scales.**



The **full year effect of increased pension contributions for teachers** (increased from 14.9 per cent to 17.2 per cent from September 2015).

**The estimated impact was around £20 million in 2016/17.**

**19.** In addition to the costs of meeting government policies and inflationary pressures, councils also had to deal with ongoing demand pressures. Some demand pressures such as those associated with an ageing population and placements for looked-after children, are often not easy to forecast and budget for. This highlights the need for adequate budget contingency and robust arrangements for identifying and responding to changes in demand for services.

**20.** Rent arrears can also create budgetary pressures for councils' Housing Revenue Accounts. The Department for Work and Pensions (DWP) began a roll-out of Universal Credit (UC) in Scotland in March 2016. By March 2017, UC had rolled out across five councils.<sup>4</sup> Rent arrears across these councils increased in 2016/17 by an average of 14 per cent, compared with an average of 4 per cent across the remaining councils. Our [Housing Benefit Performance Audit: Annual update 2016/17](#)  highlighted that councils are finding that the roll-out of UC is having a detrimental effect on their collection of housing rental income.

### Some service areas saw larger reductions to budgets in 2016/17

**21.** In responding to the range of pressures they face, councils approved about £524 million of savings and budgeted to use about £79 million of reserves in their budgets for 2016/17. Savings plans continued to focus on their main areas of spend, reducing staff numbers, rationalising surplus property and improving procurement of goods and services. It was not always clear from budget-setting reports how savings aligned with the council's corporate and financial plans or how they would impact on service delivery.

**22.** In 2016/17, budgets for education increased, mainly as a result of the policy commitment to maintain teacher numbers and the inflationary pressures around pay and pension costs. Despite demand pressures in social work, overall budgets reduced – but not by as much in percentage terms as in other areas of service. Remaining service areas have seen larger reductions to their budgets. In some cases, increases in fees and charges may have reduced the amount of budgeted expenditure. This pattern of larger reductions to relatively smaller service areas has been recurrent in recent years and is something that has continued into 2017/18. While it is right that resources should be aligned with policy priorities, the impact on other services and their outcomes should be carefully assessed ([Exhibit 6, page 17](#)).

### Councils have been seeking to maximise the income available to them from charging for services

**23.** Councils generate about eight per cent of their total income from charging for services (excluding housing rents). This includes income from charges to service users, rental income (excluding council houses) as well as 'other' charges. It is difficult to establish from the data available the full extent of income councils receive. Some income from services provided via arm's-length external organisations (ALEOs) and IJBs is not shown in council totals.<sup>5</sup>

**24.** Councils have been seeking to maximise their income through increasing charges and by introducing new charges for services, for example introducing charges for garden waste. Councils have also sought to collect more of the income that is due to them. Charges for social care which are subject to regulation, represented the largest area of income from charging services in 2015/16 ([Exhibit 7, page 18](#)).






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Does your council have a charging policy? Is this in line with corporate plans and objectives? When was this last reviewed?

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What information do you need to be able to explain increases in fees and charges to your constituents?

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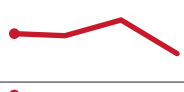






25. The Scottish Parliament's Information Centre (SPICe) has published a [detailed briefing on some fees and charges](#) . The Accounts Commission also considered fees and charges for services in its 2013 report, [Charging for services: are you getting it right?](#) 

26. Although councils generate a relatively small proportion of their overall income from fees and charges, increases can make a difference to council finances over time. However, councils face difficult decisions in balancing their need to maximise income while also ensuring their charging policy is consistent with corporate objectives, such as providing access to services and addressing inequality. Increasing prices can be unpopular with the public, but effective leadership, sensitive management, good communications and community engagement can assist with this.

## Exhibit 6

### Trend in council expenditure on main services, in real terms

There was significant variation in budget changes across council services.

	2013/14 £million	2014/15 £million	2015/16 £million	16/17 Budget £million	Change over period
 Education	4,771	4,736	4,830	4,826	1% 
 Cultural and related services	639	661	610	560	-12% 
 Social work	3,158	3,194	3,233	3,086	-2% 
 Roads and transport	454	431	427	419	-8% 
 Environmental services	686	684	698	668	-3% 
 Planning and development services	291	286	248	251	-14% 
 Other services	839	802	778	687	-18% 
 <b>Total</b> (excludes trading services and interest payments)	<b>10,840</b>	<b>10,793</b>	<b>10,823</b>	<b>10,496</b>	<b>-3%</b> 

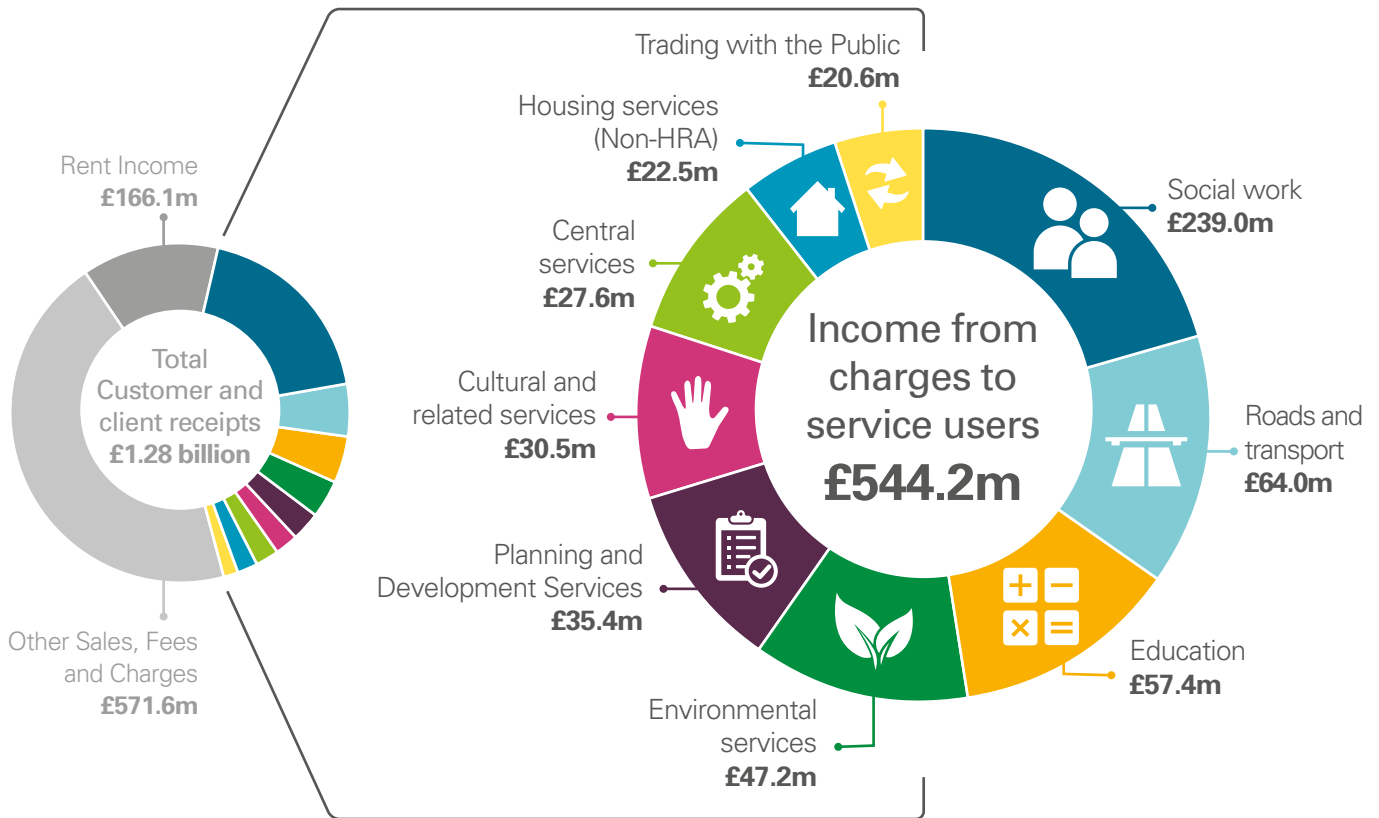
Note: 'Other services' combines Central Services and non-HRA housing.

Source: Scottish Local Government Finance Statistics 2015-16; and Scottish Government Provisional Outturn Budget Estimate returns 2016

## Exhibit 7

### Charges to service users

Charges to service users account for over £500 million of councils income.



Note: Does not include all income collected for services delivered through council ALEOs and IJBs.

Source: Scottish Local Government Finance Statistics 2015-16

## Integration Joint Boards added further complexity to budget setting

**27.** For the majority of councils, 2016/17 was the first operational year for Integration Joint Boards (IJBs). IJBs were established as a result of the Public Bodies (Joint Working) (Scotland) Act 2014. They are partnerships between NHS boards and councils and are responsible for the delivery of adult health and social care, and in some council areas, for other services, such as children’s services. The partnerships are the subject of ‘integration schemes’ which are written agreements about how they will operate, including responsibilities for any budget underspends and overspends.

**28.** Councils delegated £2.4 billion of social care expenditure to IJB budgets for 2016/17 and NHS boards contributed £5.6 billion. The introduction of IJBs has complicated budget-setting, due to differences in both the approach and timing of budget-setting between councils and NHS boards. The establishment and development of IJBs has been a complex exercise and will take time to mature. Their operation will be the focus of further performance audit work we have planned in 2018.

## Councils set larger capital programmes for 2016/17, with plans to increase borrowing

**29.** In addition to their day-to-day revenue spending on goods and services, councils also incur capital expenditure on the assets that support those services, including schools, houses and equipment such as vehicles. In 2015/16, councils spent about £2.4 billion on capital projects. Budgets for 2016/17 were much higher at over £3.3 billion.

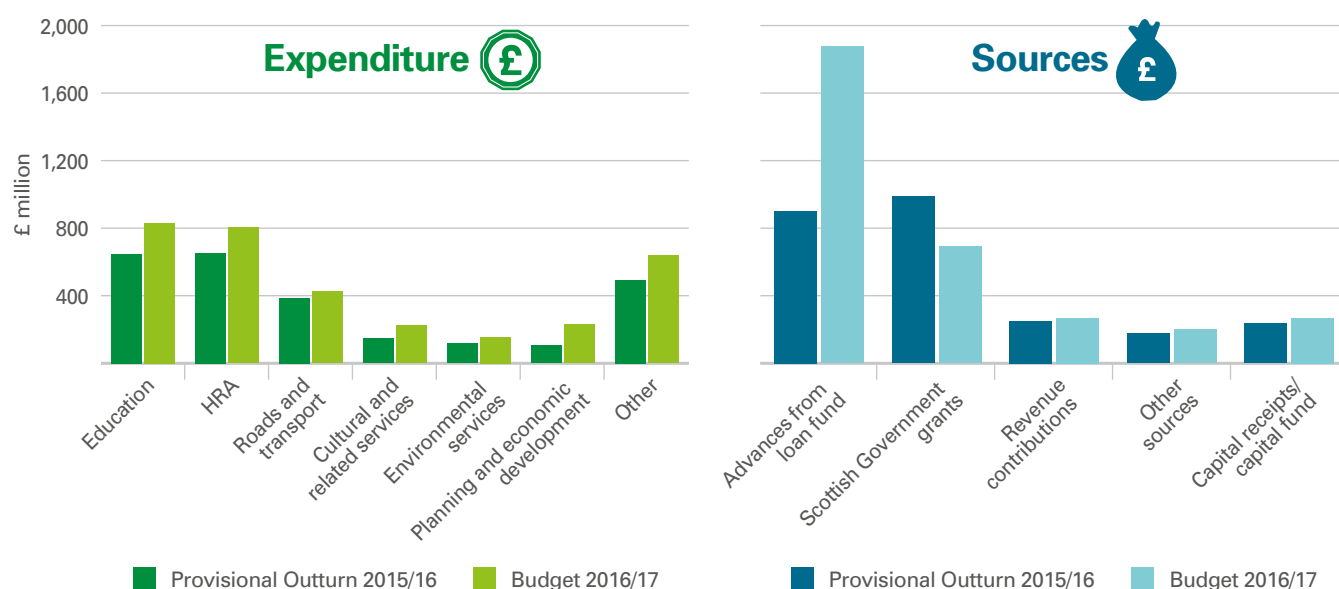
**30.** Councils finance their capital expenditure from a number of sources, including Scottish Government capital grants and borrowing. Scottish Government grants fell from £834 million in 2015/16 to £591 million in 2016/17, returning to a more usual level following re-profiling in earlier years. [Exhibit 8](#) shows where councils were planning to spend their capital and how they planned to finance it.

**31.** Councils are required to consider the affordability of their capital programmes. This includes the cost of any borrowing along with the impact on day-to-day running costs. However, they are free to determine what they consider prudent and with interest rates remaining low in 2016/17, councils assessed increased borrowing to be affordable. The delivery of capital programmes and the affordability of debt are considered further in [Part 2](#) and [Part 3](#).

### Exhibit 8

#### Capital programmes and sources of finance, 2015/16 and 2016/17

Councils planned to borrow more in 2016/17 to meet the cost of larger capital programmes.



#### Notes:

1. Excludes regional transport partnerships and Joint Valuation Boards.
2. Other budgeted use of capital includes Social Work, Central Services, Trading Services, etc.
3. Other sources of capital finance for the General Fund are grants (excluding those received from the Scottish Government).
4. For HRA this includes capital from other sources, such as developer contributions.

Source: Scottish Government Capital Provisional Outturn Budget Estimate 2015-16

# Part 2

## 2016/17 financial performance



### Key messages

- 1** All councils received an unqualified audit opinion on their 2016/17 accounts but the accounts could more clearly explain their financial performance.
- 2** Councils are showing signs of increasing financial stress with 20 councils drawing on their usable reserves in 2016/17.
- 3** Councils' actual use of reserves was often quite different from that originally planned. The reasons why are not always clear.
- 4** Auditors found that budget-setting needed to be more robust and that financial management could be improved in several councils.
- 5** Levels of net debt increased by £836 million in 2016/17. On average councils spent almost ten per cent of their revenue budgets servicing this debt. Some councils are concerned about the ongoing affordability of servicing their debt as resources decrease.
- 6** Councils that have been proactive in making difficult decisions will be better placed to deal with future financial pressures.

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**Twenty councils drew on reserves in 2016/17 – actual use of reserves was often quite different from original plans**

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### **All councils received an unqualified audit opinion on their 2016/17 accounts but the accounts could more clearly explain their financial performance to readers**

**32.** In 2016/17, for the sixth consecutive year, auditors issued a 'true and fair' unqualified audit opinion on the accounts of all 32 councils. An unqualified opinion means auditors have judged that all council's financial records and statements are fairly and appropriately presented, that the council's financial statements are sound and free from material misstatements or errors.

**33.** For the last three years, councils have had to produce a management commentary to accompany their annual accounts. These commentaries play an important role in public accountability and helping interested parties to better understand the accounts of each council and its financial performance and position. As such, they should include explanations of amounts included in the accounts as well as:

- a description of the council's strategy and business model
- a review of the council's business
- a review of principal risks and uncertainties facing the council
- an outline of the main trends and factors likely to affect the future development, financial performance and financial position of the council.

**34.** Each management commentary should concisely present the financial 'story' of a council in an understandable format for a wide audience. Auditors express an opinion on whether the management commentary is consistent with the audited financial statements and is in line with Scottish Government guidance.

**35.** Management commentaries for 2016/17 vary in how clearly councils and IJBs explain their financial and general performance. Overall there remains scope for improvement. It is the Accounts Commission's view that councillors have an important role in ensuring that the management commentary effectively tells a clear story of financial performance and can be understood and scrutinised by a wide audience. The story at the end of the year should be produced from regular reports provided to councillors throughout the year.

## Councils are showing increasing signs of financial stress

### Twenty councils drew on their usable reserves in 2016/17

**36.** In 2016/17, 20 councils drew on their usable revenue and capital reserves. Nineteen councils drew on their revenue reserves in 2016/17, an increase from the eight councils that did so in 2015/16. Council revenue reserves fell by £32 million in 2016/17. ([Exhibit 9, page 22](#)). Overall council usable reserves (capital and revenue) fell by about £33 million.

**37.** The Chartered Institute of Public Finance and Accountancy (CIPFA) has identified the rapid decline of usable reserves as one of the symptoms exhibited by councils under financial stress.<sup>6</sup> Councils with good financial management demonstrate well-planned and managed use of reserves, in accordance with carefully thought out council policies.

**38.** In some cases, councils have used reserves to support service delivery. Councils have used reserves to invest in their change programmes, such as meeting the additional costs of staff severance. In 2016/17, councils continued to focus on reducing staffing levels. They reduced their workforces by almost 2,200 staff (almost one per cent of the total workforce), at a cost of £78 million ([Exhibit 10, page 23](#)). Councils' policies around voluntary severance and redundancy typically require payback of the costs over two to three years.

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




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

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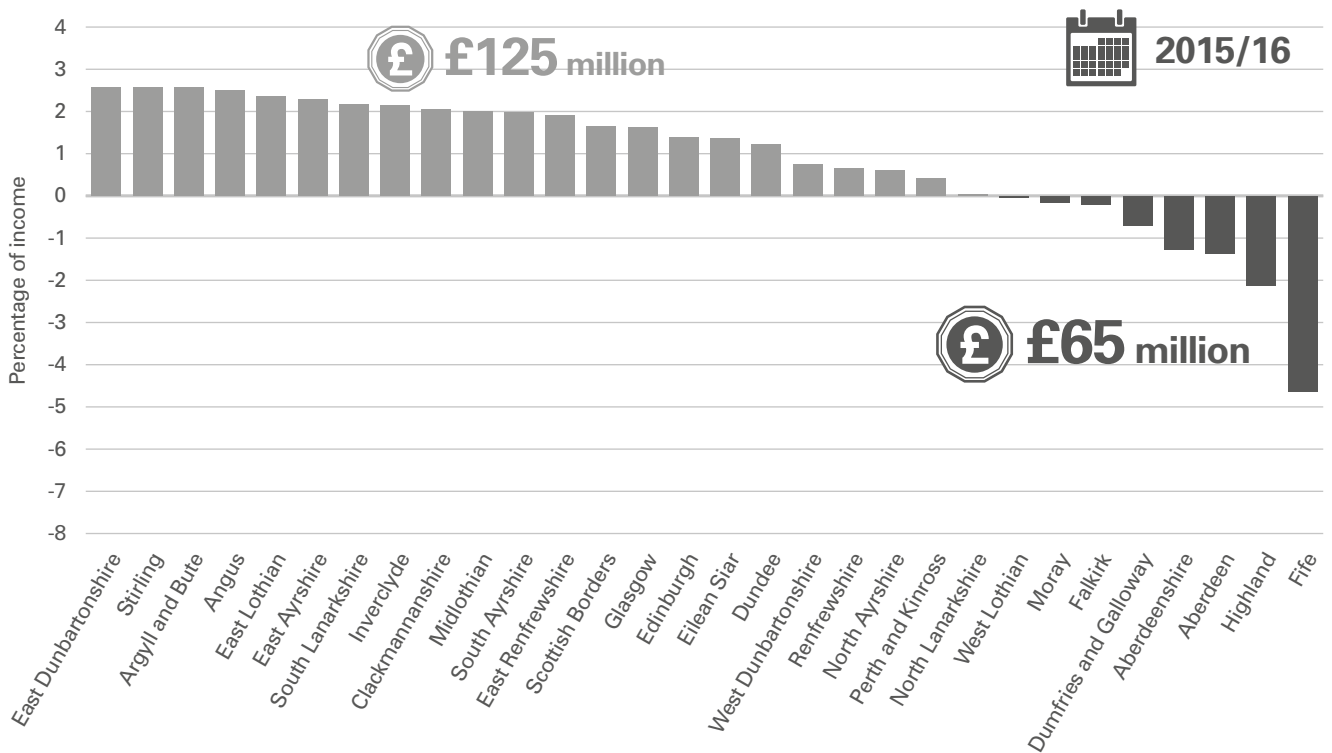
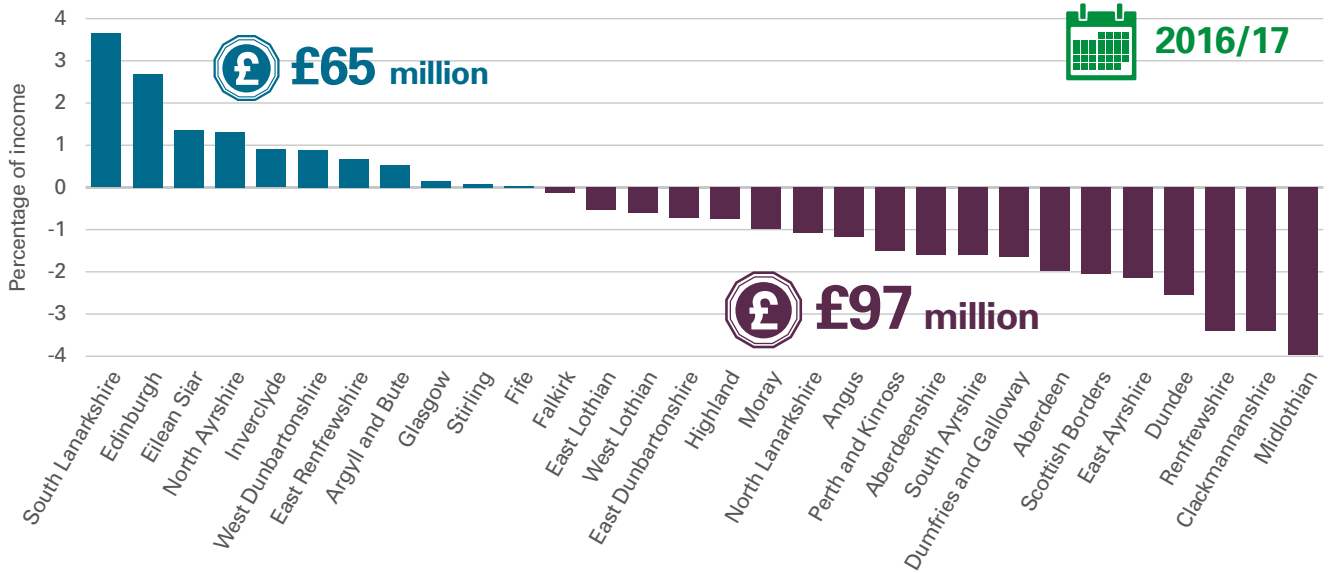
**Are staff severances in line with the council's workforce plan?**

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### Exhibit 9

#### Changes in revenue reserves (excluding HRA), 2015/16 and 2016/17

Many more councils drew on revenue reserves in 2016/17 compared with 2015/16.



Notes:

- 1. Due to issues with the scale on this exhibit Orkney and Shetland are excluded (paragraph 9).
- 2. In 2016/17, Renfrewshire moved money from revenue to capital reserves.

Source: Audited accounts 2015/16 and 2016/17



## Exhibit 10

### Exit packages, 2011/12 to 2016/17

The number and average cost of exit packages both fell in 2016/17.

	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	Total
Total number of packages	4,070	2,407	2,373	1,933	2,660	2,195	<b>15,642</b>
Total cost of packages Cash terms £000	148,750	109,068	92,640	74,935	97,231	78,125	<b>600,750</b>
Total cost of packages Real terms £000	160,868	115,528	96,535	76,955	99,172	78,125	<b>627,184</b>
Average cost per package Real terms £	39,525	47,997	40,681	39,811	37,227	35,592	<b>40,096</b>

Note: Real terms comparisons are based on 2016/17 prices.

Source: Annual accounts 2016/17

### Councils use of reserves and service expenditure was often quite different from that originally planned

**40.** In 2016/17, as many councils used more reserves than they had originally planned as used less ([Exhibit 11, page 24](#)). It is not always clear from management commentaries why the actual use of reserves differed from that planned.

**41.** There can be a range of reasons why councils need to draw more heavily on their reserves than planned. It can be the result of poor budget-setting and/or budgetary control. For example, councils may need to use reserves to balance budgets where savings have not been achieved. The failure to deliver savings might be due to councils underestimating the time required for change programmes to deliver benefits. As budgets come under greater pressure from funding reductions, cost pressures and increasing demand, it is critical that councils understand the risks of using reserves in an unplanned way in relation to future savings and long-term financial sustainability.

**42.** Auditors identified that some councils failed to deliver their savings plans in 2016/17. Auditors also highlighted that some budgets did not properly reflect patterns of previous actual expenditure and that councils should consider rebasing their budgets where they consistently underspend. One such area is underspending on financing costs, where slippage on capital programmes leads to less borrowing and lower interest payments. Built-in budget contingencies partly explain budget underspends but councils need to explain this more clearly.

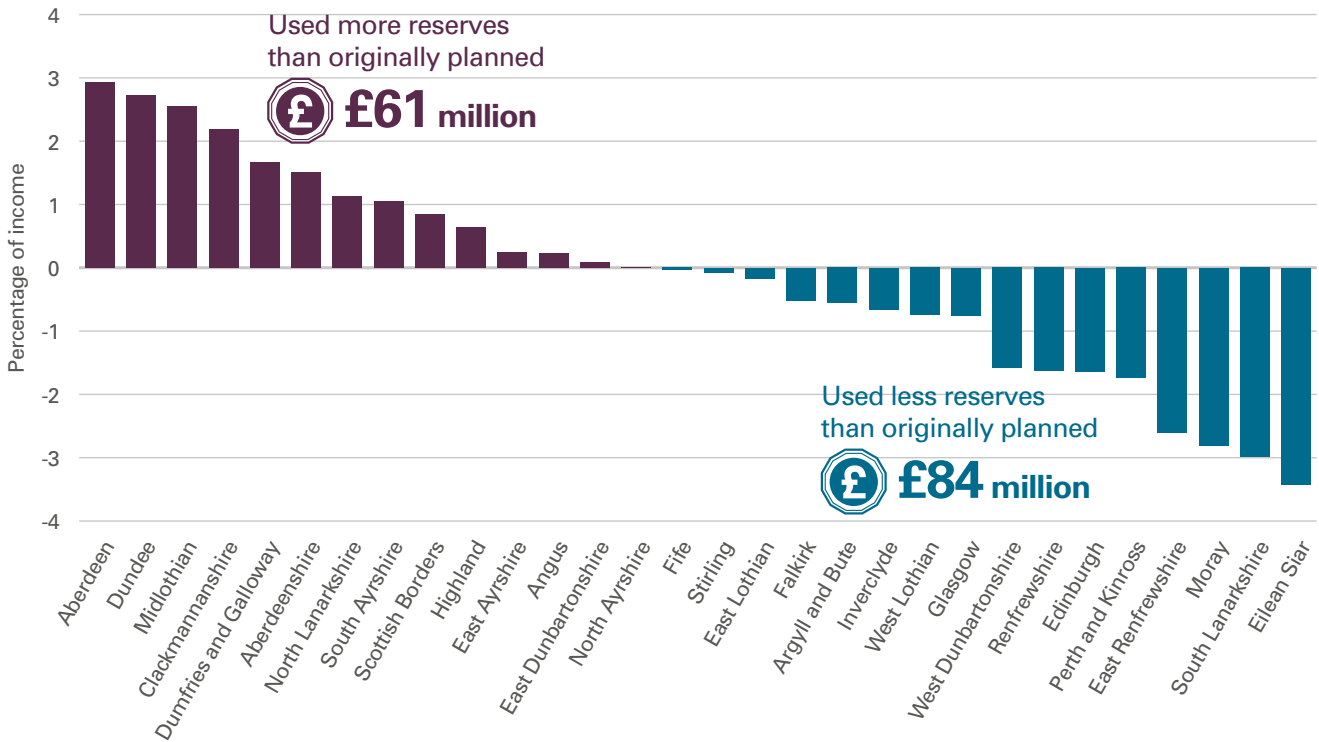


**How does the council ensure that council staff have the capacity to delivery transformational change?**

**What have reserves been used for in recent years? Supporting services and bridging the funding gap or transforming services?**

### Exhibit 11

Difference between planned and actual use of General Fund reserves as a proportion of income, 2016/17  
 The difference between planned and actual use of reserves for some councils was more than two per cent of their total income from general revenue grants and taxation.



Note: Due to issues with the scale on this exhibit Orkney and Shetland are excluded (paragraph 9).  
 Source: Audited accounts 2016/17 and auditor returns

43. Reasons often cited by councils for under and overspends against final budgets are included in [Exhibit 12 \(page 25\)](#).

44. Management commentaries in councils’ accounts tend to only identify the main reasons for over or underspends against final budgets and not why plans or budgets changed during the year. This represents an area of weakness in financial reporting that councils need to address to support more effective financial scrutiny. If significant changes are made to original budgets the reasons should be clearly reported to councillors throughout the year, as well as featuring in the management commentary accompanying the accounts at the end of the year.

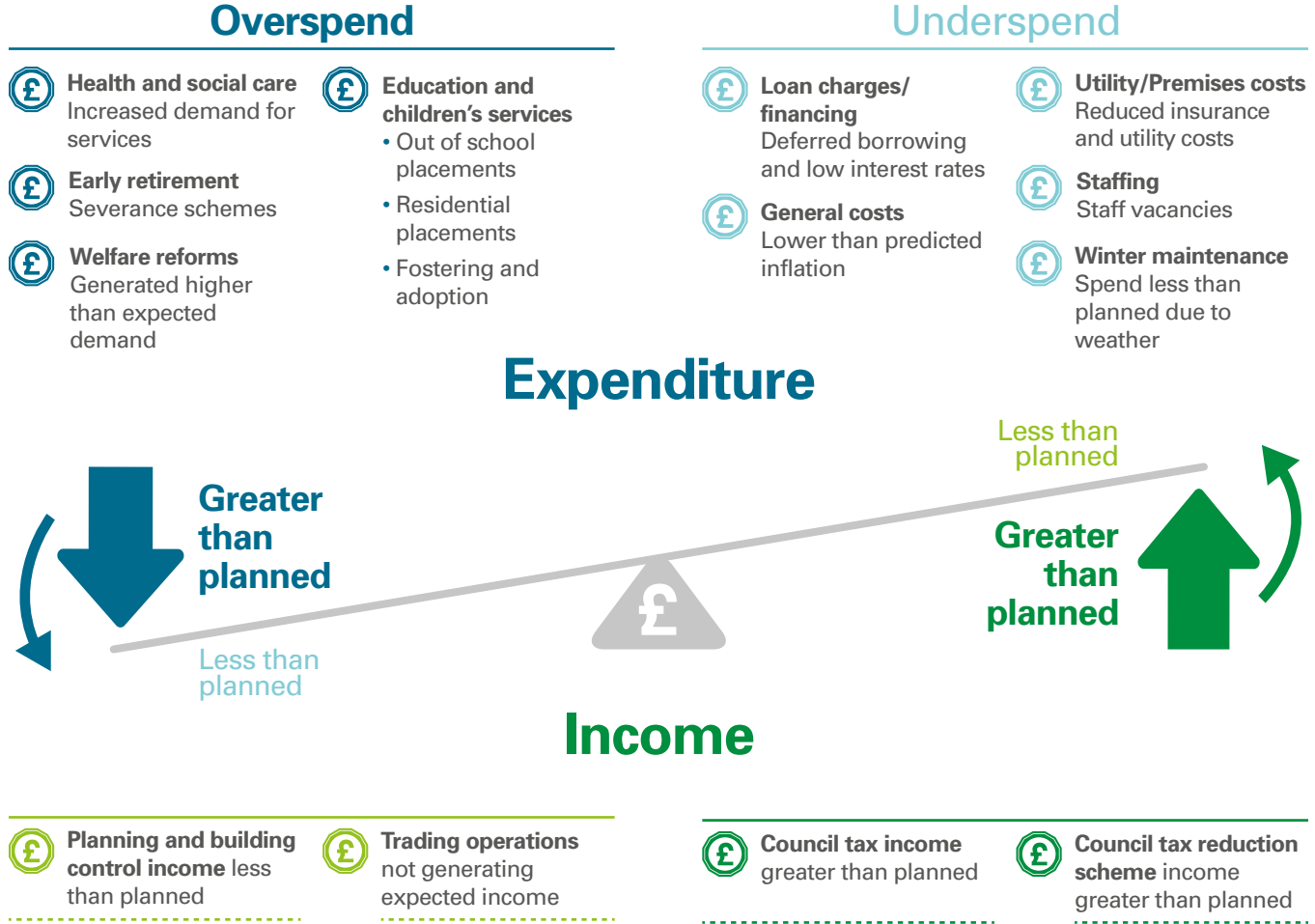


**Do budget monitoring reports clearly explain performance against plans and any changes to plans?**

**Exhibit 12**

**Commonly reported reasons for budget variances, 2016/17**

Demand pressures primarily drove overspends – with financing costs a key driver of underspends.



Source: Audit Scotland review of management commentaries

**Levels of usable reserves vary widely and it is important that councils have clear reserves policies**

**45.** The levels of usable reserves held by councils vary widely, as do policies on the minimum level of reserves they should hold. The General Fund reserve is the main revenue reserve available to support general council services. By the end of 2016/17, General Fund reserves, excluding Orkney and Shetland, totaled £1.1 billion. However, councils hold a number of other reserves and total usable reserves held amounted to £1.9 billion (excluding Orkney and Shetland, [paragraph 9](#)), ([Exhibit 13, page 26](#)).



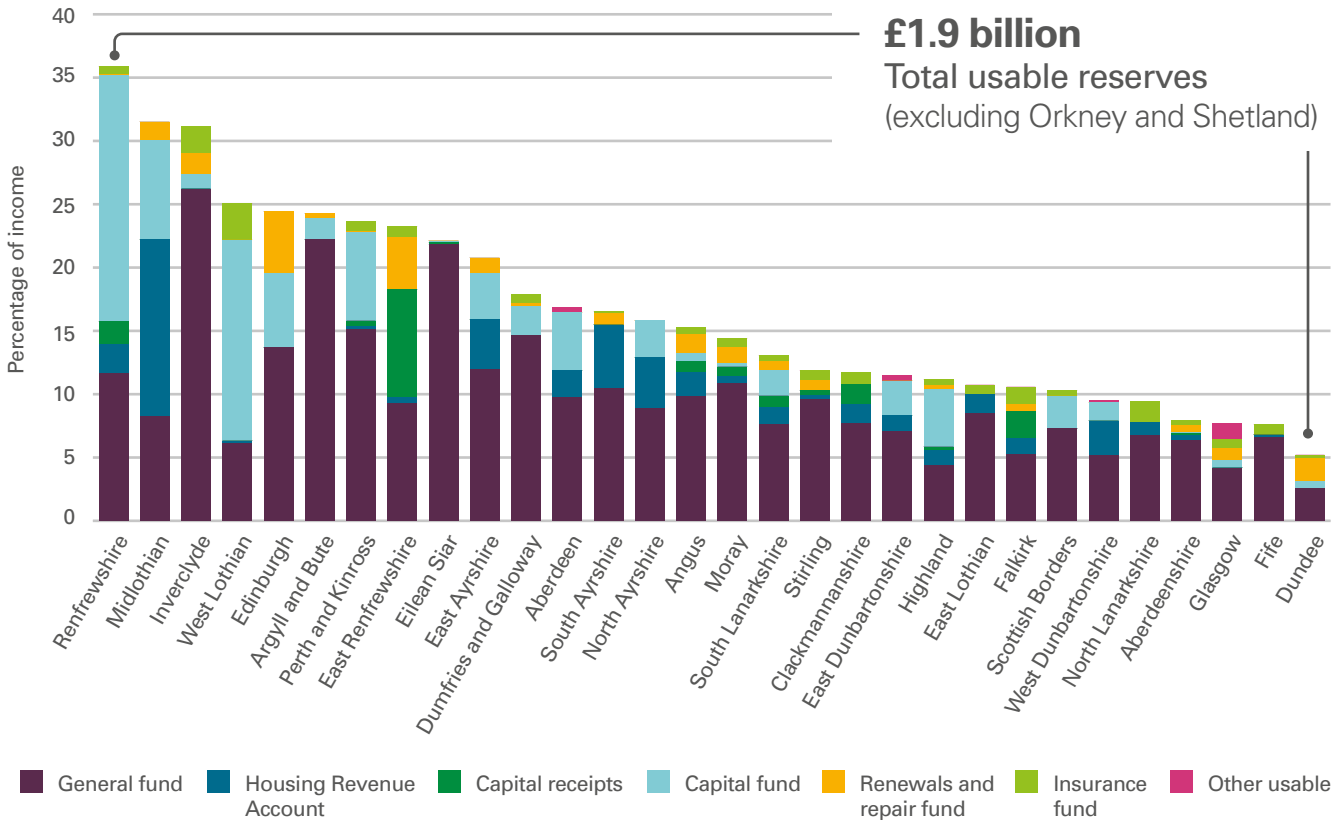
**What is your councils reserves policy?**

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

### Exhibit 13

#### Council usable reserves at 31 March 2017

There are wide variations in the level of reserves as a proportion of income from general revenue grant, taxation and housing rents.



Note: Orkney and Shetland councils have reserves far in excess of those held by other councils and are excluded. We explain why this is the case in [paragraph 9](#).

Source: Annual accounts 2016/17

**47.** At the end of their first full operational year, IJBs held usable reserves of £96 million, representing about 1.2 per cent of their total income of £8 billion in 2016/17. Reserves vary across IJBs. Not all integration schemes permit IJBs to hold reserves. Only North Ayrshire Council recorded an overspend. This was largely due to spending on social care services ([Exhibit 14, page 27](#)).

**48.** It is not clear from the accounts of IJBs to what extent reserves have been built up in a planned way, have arisen as a result of underspends on IJB activities or have been earmarked for transformation activity. There is a lot of pressure on the budgets of IJBs and reserves at the end of 2016/17 are not forecast to continue in future years. Further analysis of IJB accounts will help inform specific audit work on IJBs being carried out in 2018.

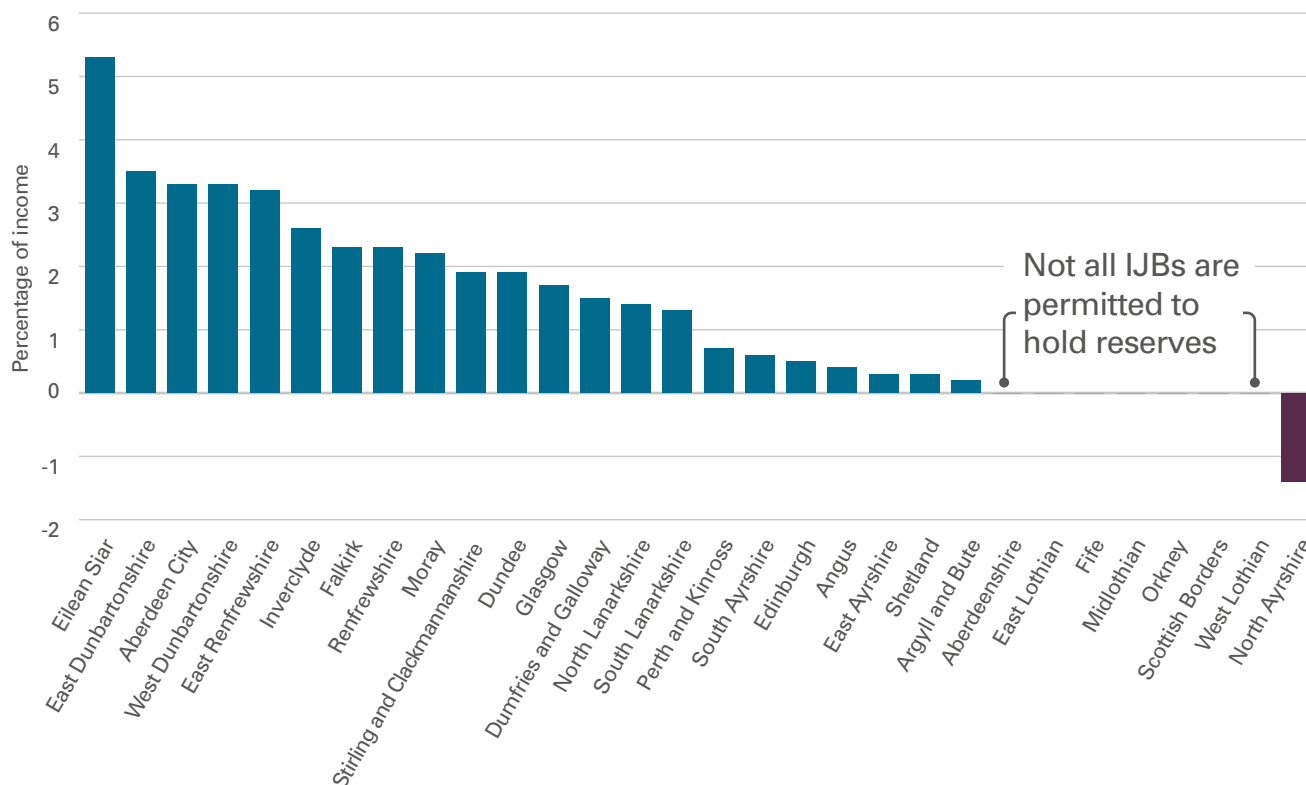


**What are the different types of reserves your council holds? Do you know what these can be spent on?**

## Exhibit 14

### IJB usable reserves as a proportion of 2016/17 income

Reserves vary across IJBs.



Note: Stirling Council and Clackmannanshire Council are members of the same IJB.

Source: Annual accounts 2016/17

## Levels of debt have increased and some councils are concerned about future affordability

**49.** Following two years of reducing debt, councils' net debt increased in 2016/17 from £13.7 billion to £14.5 billion (excluding Orkney and Shetland). The increase in borrowing was lower than that originally planned when capital programmes were approved. This was primarily due to slippage in delivering capital programmes.

**50.** As with reserves, levels of debt vary widely across councils ([Exhibit 15, page 28](#)). 2016/17 saw an increase in the HRA borrowing requirement of about £140 million, with the 26 councils who provide social housing being actively involved in new council housing development. Collectively they plan to deliver about 13,000 homes by 2020/21. The cost of servicing additional HRA debt will be met from rental income.

**51.** The ongoing costs associated with debt reduces the amount councils have available for day-to-day service expenditure. It is therefore important that assets are effectively supporting service delivery and strategic priorities. Higher levels of debt often result in higher costs for councils but actual interest and repayment costs will depend on the type of debt councils hold and the period over which it has to be repaid.

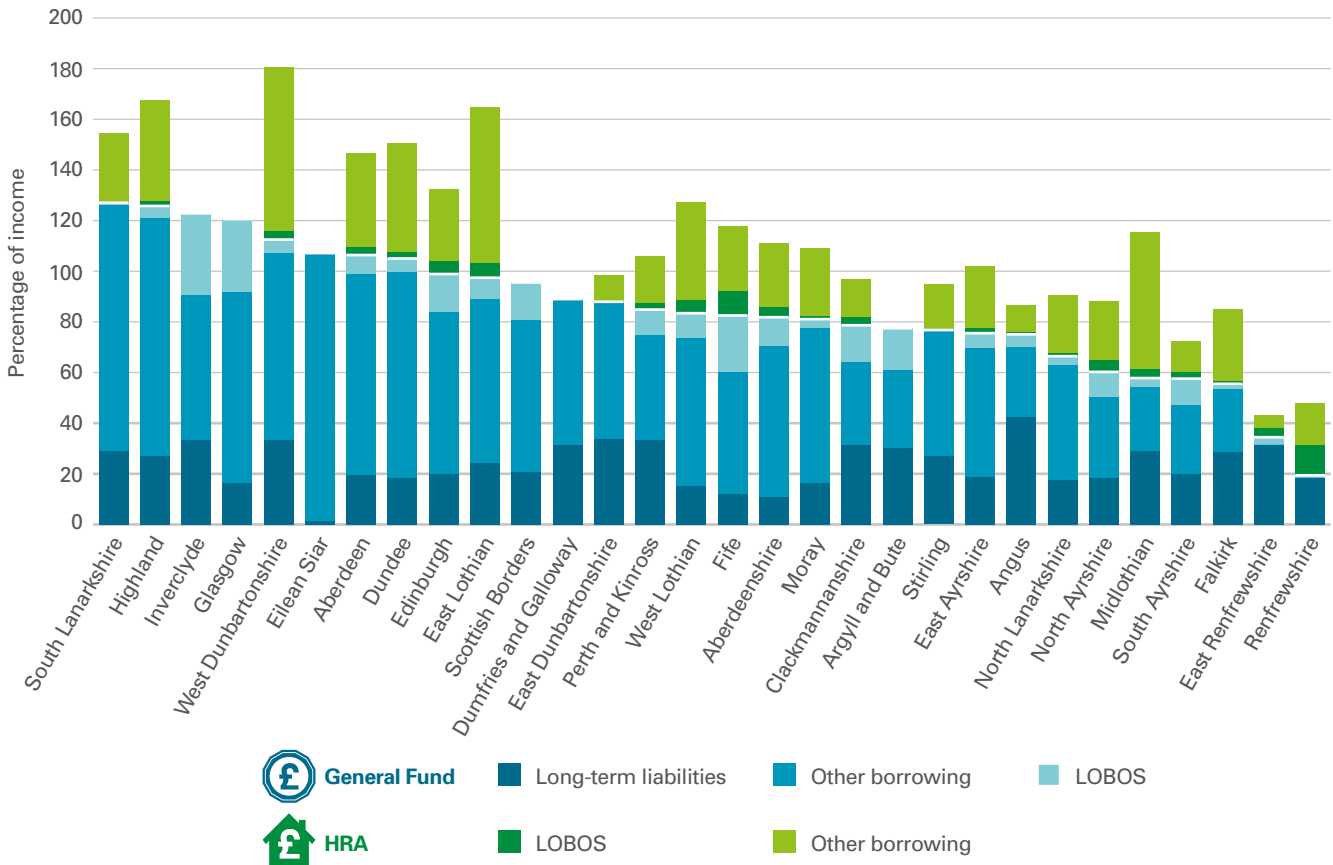


**What are the levels of reserves held by your council's IJB? Are these in line with the IJB's reserve policy?**

## Exhibit 15

### Council net external debt at 31 March 2017

Levels of debt held vary across councils as a proportion of income from general revenue grant, taxation and housing rents.



Note: Council debt has been allocated to General Fund and HRA in proportion to capital financing requirements.

Source: Annual accounts 2016/17

**52.** Despite debt increasing, the ongoing cost of servicing it, through the interest and repayment costs, reduced slightly in 2016/17. This in part reflects the lower interest rates available on new borrowing. It also reflects councils choosing to make lower voluntary debt repayments. On average, councils spent almost ten per cent of their income on interest and debt repayment ([Exhibit 16, page 29](#)).

**53.** Councils are required by regulation to consider the revenue impact of borrowing, ie its ongoing affordability. A large part of council debt has fixed interest rates which gives councils certainty about costs. However, this type of debt makes councils' assessment of longer term affordability more complex, requiring more detailed assumptions of future inflation and interest rates:



**What share of your council's budget is taken up with interest payments and debt repayment?**

- ‘Lender option borrower option’ loans (LOBOs) include options for the lender to increase interest rates. LOBOs account for about 11 per cent of council debt.
- PPP/PFI and indexed linked bonds include charges that increase with inflation. Projects financed using the Scottish Government’s Non-Profit Distributing (NPD) programme (which replaced the previous long standing PPP/PFI programmes) also include an element of indexation but typically at lower levels. The value for money of newer NPD projects will be examined in detail in a joint report by the Auditor General and the Accounts Commission in 2019/20.

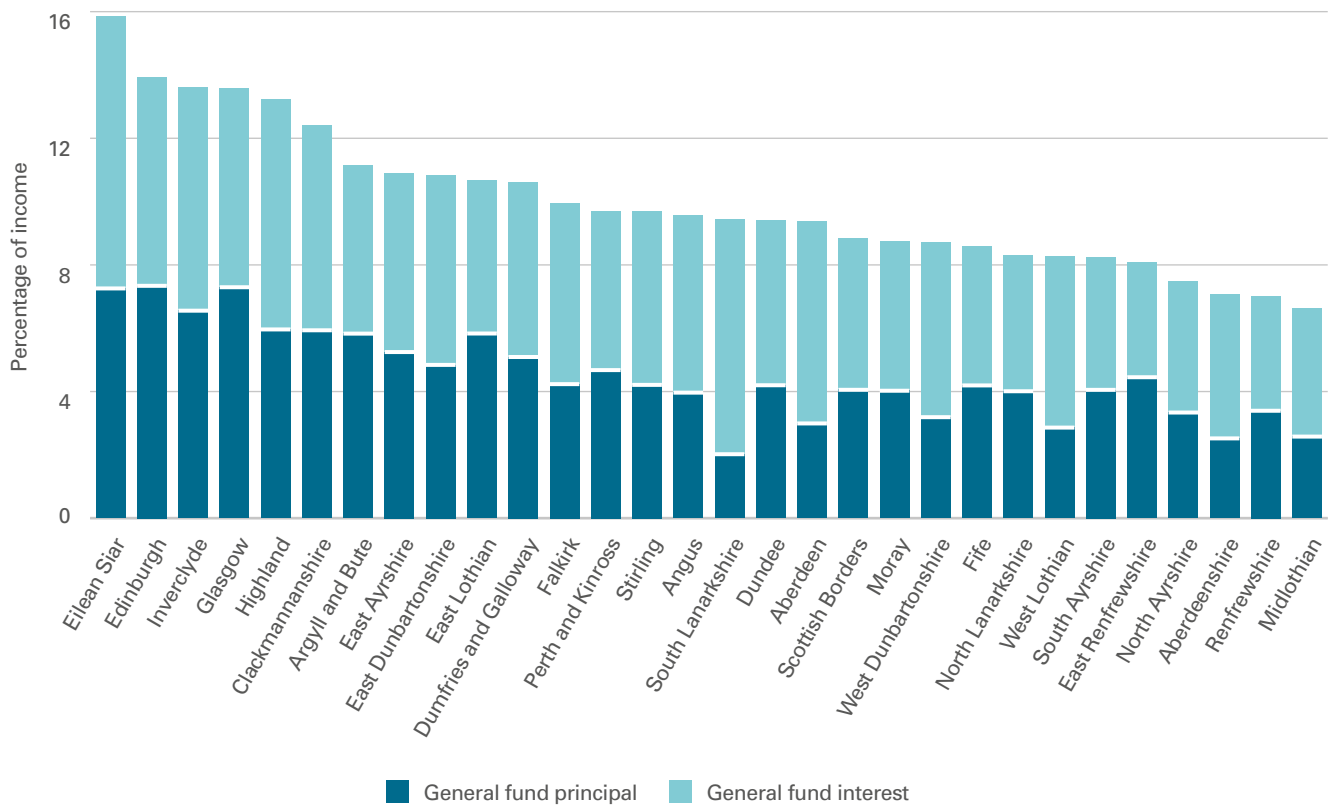


**What proportion of your council's debt is linked to inflation (ie, subject to indexation)? What does that mean for longer term affordability?**

## Exhibit 16

### Revenue cost of General Fund borrowing, 2016/17

Costs associated with debt vary across councils as a proportion of income from general revenue grants and taxation.





Source: Annual accounts 2016/17

**54.** Levels of debt and associated costs are set to rise in future. This is because councils have invested usable reserves in their capital programmes, something referred to as 'internal borrowing'. At the end of 2016/17 the amount of 'internal borrowing' was about £0.5 billion. Internal borrowing is usual treasury management practice for councils during periods when they would make a lower return from investing their usable reserves than it would cost them to borrow money. However, as councils increasingly rely on reserves to fund services they will need to replace internal borrowing with external borrowing, increasing their costs.

### Councils continue to report significant slippage in delivering capital programmes

**55.** Councils spent £2.8 billion on capital projects in 2016/17, 84 per cent of their planned expenditure of £3.3 billion. Twenty-four out of 32 councils underspent against their capital budgets in both 2015/16 and 2016/17.


**56.** The reasons for slippage in delivering capital programmes are unclear. Management commentaries for the councils recording the largest slippage give reasons such as changes to project start dates, and one council identified weaknesses in the forward planning process. However, the consistent levels of capital slippage across the country suggest that councils are setting unrealistic budgets.

**57.** In our 2013 report [Major capital investments in councils](#)  we noted 'that for most major projects completed within the previous three years, councils' early estimates of the expected costs and timetable were inaccurate, and recommended that better information was made publicly available'.<sup>7</sup> Our [follow-up report](#)  in 2016 suggested councils had made limited progress on this recommendation.<sup>8</sup> Data for 2016/17 shows that councils still need to improve in this area.

### Net pension liabilities increased for councils despite large increases in pension fund assets

**58.** Overall, net pension liabilities on council balance sheets were approximately £11.5 billion at the end of 2016/17, an increase of 51 per cent on the previous year. This increase was mainly due to a change in actuarial assumptions used to value future liabilities. It was a good year for Local Government Pension Scheme (LGPS) investments, which increased by almost 22 per cent.

**59.** Not all council pension liabilities are the responsibility of the LGPS fund. Where councils have awarded added-year pension benefits as part of severance arrangements, for both teachers and other staff, they have to meet the ongoing cost of pensions themselves. This also helps explain why the increase in council liabilities outstripped investment returns. These liabilities are not matched with any pension fund assets.

**60.** Public service pension scheme benefits have been reduced on a number of occasions to make the schemes more affordable. However, pension contributions have been a significant cost pressure for councils in recent years. The need for any increase in employer contributions will be determined through the results of the 2017 triennial funding valuation. The LGPS 2015 includes a cost-sharing mechanism that will limit any future increase for employers. A supplement on the [Local Government Pension Scheme](#)  is available on our website.




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

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

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## **Provisions and contingent liabilities can be difficult to quantify and should be kept under review**

**61.** Where councils have a known obligation and they can quantify the cost, they are required to make a provision in their accounts. Councils held provisions of £132 million at the end of 2016/17 covering areas such as equal pay compensation claims, teachers' maternity pay, holiday pay, insurance claims and landfill site reinstatement.<sup>9</sup>

**62.** Councils are also required to disclose potential liabilities that are still contingent on future events or which cannot be quantified reliably. Fourteen councils are disclosing contingent liabilities for equal pay claims that they are defending. Other contingent liabilities identified by a number of councils include those relating to holiday pay claims and potential claims arising as a result of changes to the legislation around historic child abuse.

## **Councils that have been proactive in making difficult decisions will be better placed to deal with future financial pressures**

**63.** Councils have had to make difficult decisions in recent years in the light of falling resources and increasing demand for services. Councils that have a track record of effective leadership, self-evaluation, robustly addressing the financial challenges, and are implementing effective medium to long-term strategies and plans, will be in a better place than those that have avoided difficult decisions or not applied sufficient pace to making changes. That is not to say that the challenges faced by councils have necessarily been uniform. Differences in the resources available to them, the demand for services and the costs councils face as a result of their size and remoteness can also impact on their financial position ([Exhibit 17, page 32](#)).

**64.** The effectiveness of council leadership will be tested further in the years ahead given the increasing demand for services and likely funding scenarios that the public sector faces. Decisions made as part of budget-setting for 2017/18 together with the financial outlook are considered in [Part 1 \(page 10\)](#).

**Exhibit 17****Main determinants of a council's financial position**

There are number of factors that affect a councils financial position.



# Part 3

## Financial outlook



### Key messages

- 1** The financial outlook for councils remains challenging with further real-terms reductions in funding and a range of cost and demand pressures on budgets.
- 2** In total councils approved £317 million of savings and the use of £105 million of reserves when setting budgets for 2017/18.
- 3** Some councils relying heavily on the use of reserves to fund services will need to take remedial action or they will run out of General Fund reserves within two to three years.
- 4** Robust medium-term financial strategies and savings plans are increasingly critical to the financial sustainability of councils.
- 5** Strong leadership is increasingly important and it is essential that councillors work effectively with officers, their partners and other stakeholders to identify and deliver necessary savings. It is important that councils engage with local communities when planning and delivering services and identifying savings.

the financial outlook for councils remains challenging

### Council funding continues to fall as cost pressures increase

#### Scottish Government funding fell again in real terms for 2017/18

**65.** Councils received a further real-terms reduction of 2.3 per cent in their funding from the Scottish Government for 2017/18, reflecting the overall trend and direction of travel ([Exhibit 18, page 34](#)).

**66.** Councils' funding continues to include money targeted at delivering national policy commitments that restricts the overall flexibility in their budget setting. In 2017/18, this included £120 million provided for the school attainment fund and £88 million for maintaining pupil teacher ratios and for the teachers' induction scheme.



How is your council preparing for any further real terms reduction in Scottish Government funding?

## Exhibit 18

### Scottish Government revenue funding to councils

Local government funding fell in real terms in 2017/18 compared to 2016/17.

	2017-18 £000	Change on 2016-17 %
<b>Cash terms</b>		
NDR	2,666	-3.7 ▼
Revenue Grant	6,974	0.5
<b>Total revenue funding</b>	<b>9,639</b>	<b>-0.7 ▼</b>
Additional resource via IJBs	357	
	<b>9,996</b>	<b>0.4 ▼</b>
<b>Real terms – 2016/17 prices</b>		
NDR	2,623	-5.3 ▼
Revenue Grant	6,862	-1.1 ▼
<b>Total revenue funding</b>	<b>9,485</b>	<b>-2.3 ▼</b>
Additional resource via IJBs	351	
	<b>9,836</b>	<b>-1.2 ▼</b>

Source: Scottish Government Finance Circular 1/2017

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

**67.** The council tax freeze ended in 2017/18. Twenty-four councils chose to increase council tax, with 21 approving the maximum three per cent permitted. Fourteen councils chose to remove the ten per cent discount on second homes, another option for increasing revenue. For some councils, additional income from second homes is not significant.

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

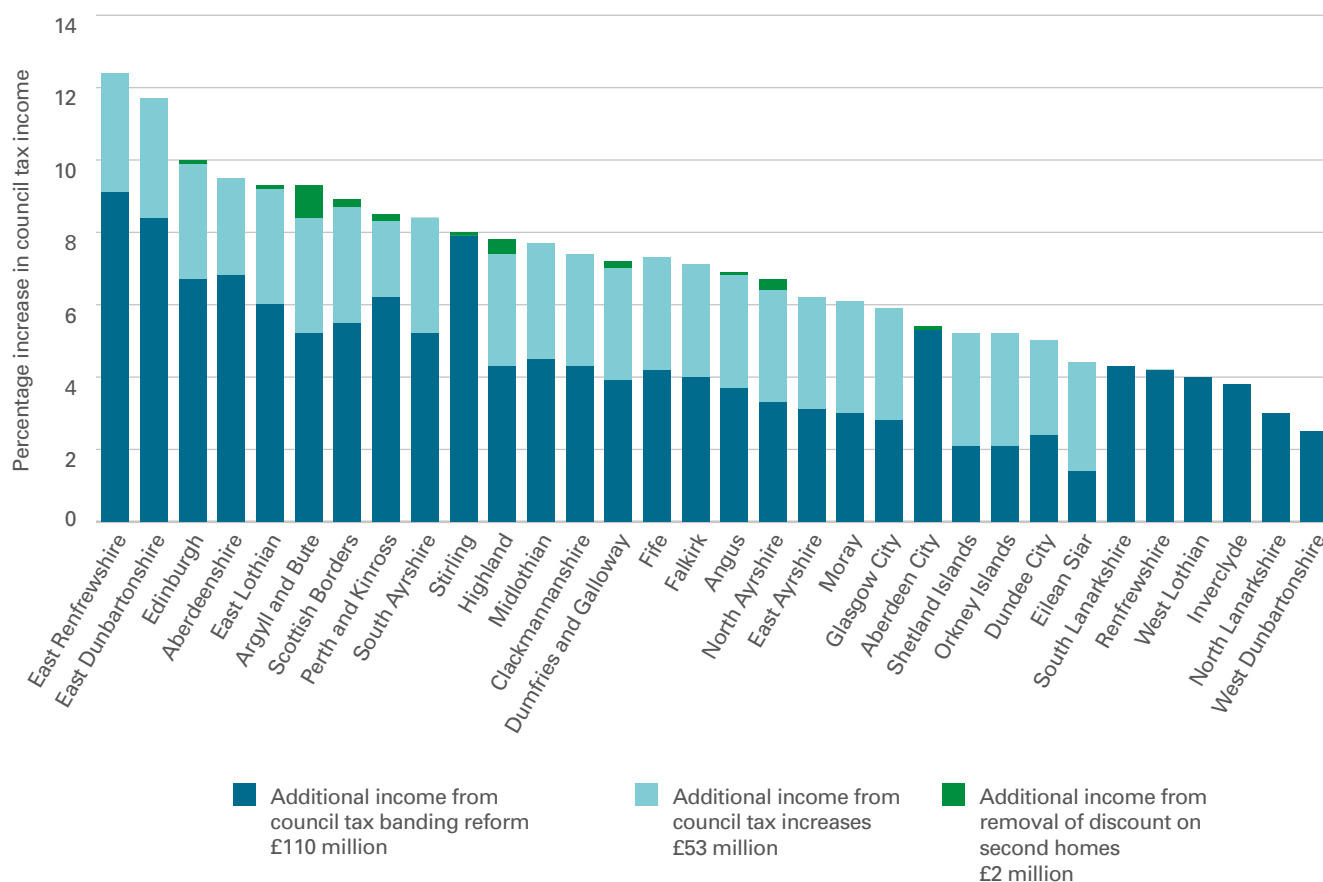


**If your council plans to raise council tax, do you know how much it will raise? How will you communicate and explain the reasons for the rise to constituents?**

## Exhibit 19

### Increase in council tax by council, 2017/18

Council tax in 2017/18 has risen as a result of reforms and the end of the council tax freeze.



Note: Council tax due before any discounts are applied.

Source: Scottish Government Finance Circular 1/2017, Council tax banding information and SPICe

## Delivering savings is critical for councils' financial sustainability

Councils approved savings of £317 million and the use of £105 million of reserves when setting budgets for 2017/18

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

- the introduction of the apprenticeship levy of 0.5 per cent of pay bills above £3 million
- the requirement to meet the first full year effect of the living wage
- meeting HMRC guidelines on paying the national minimum wage for care workers when sleeping over
- non-domestic rates (NDR) revaluation.

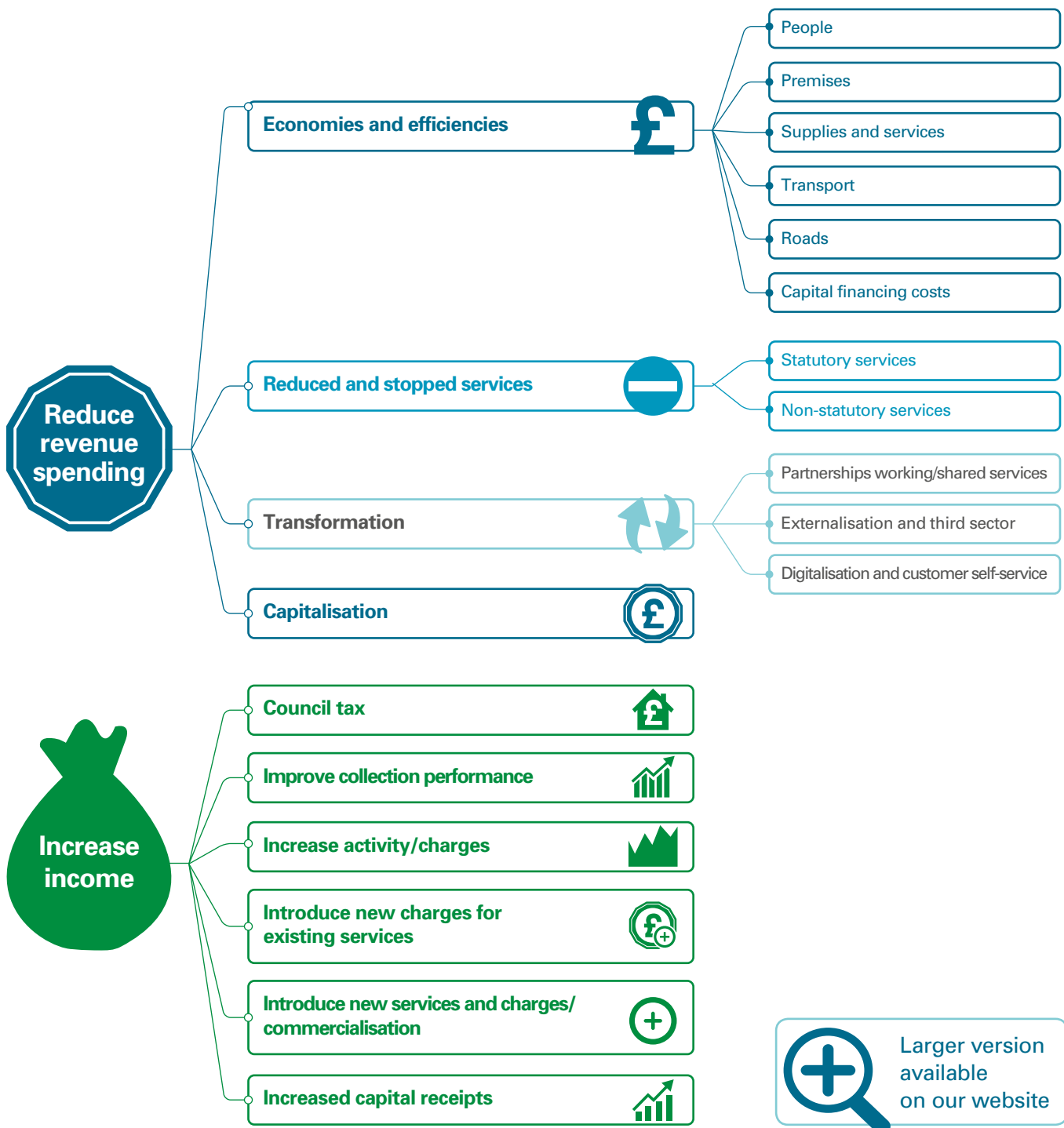


**70.** In balancing funding reductions and cost pressures, councils' 2017/18 budgets included approved savings of £317 million and the use of £105 million of General Fund reserves. Common measures taken by councils to close their funding gaps in 2017/18 are set out in [Exhibit 20](#). Not all initiatives to reduce expenditure are savings, some simply deferred expenditure by moving it from revenue to capital.

**Does your council have a savings plan? What are the options to close future funding gaps?**

## Exhibit 20

Measures taken by councils to close their funding gaps in 2017/18





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

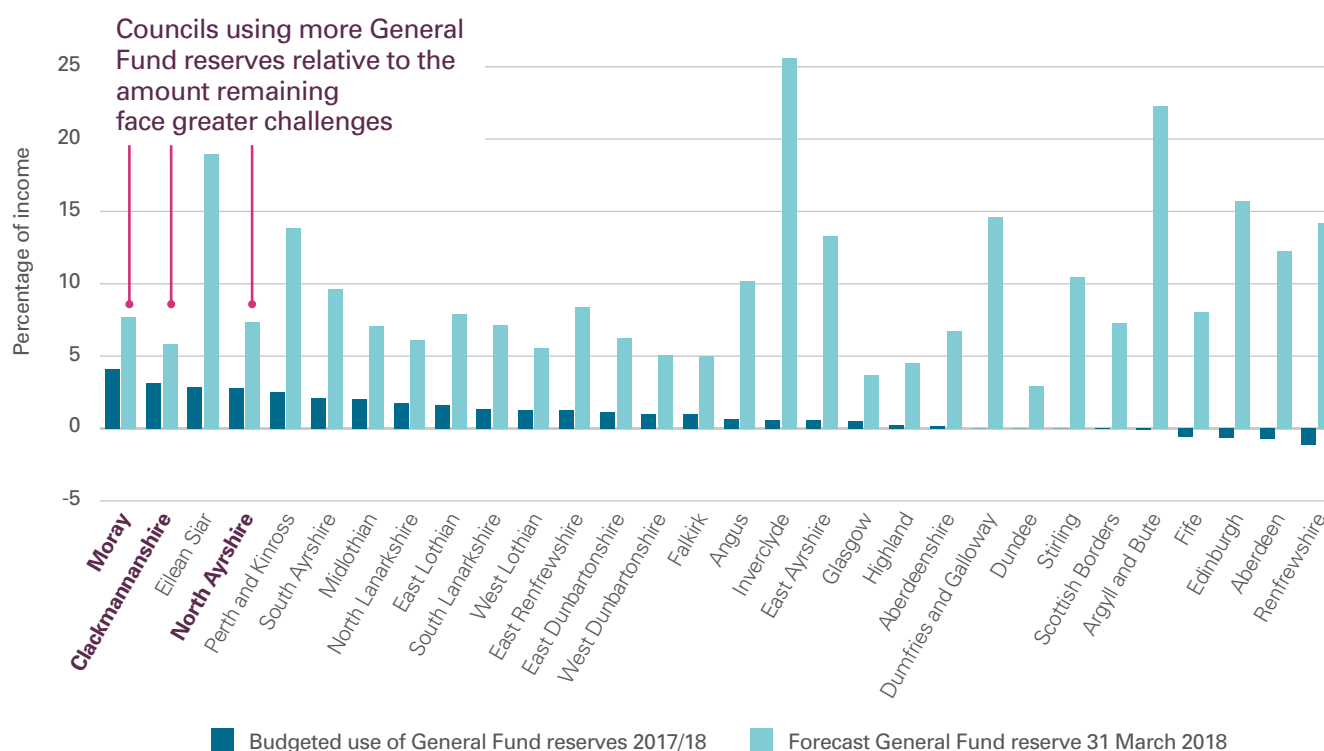
**71.** Some councils' plans for 2017/18 have relied more heavily than others on using reserves to bridge funding gaps. A number of these councils could have relatively low levels of General Fund reserves remaining at the end of the year ([Exhibit 21](#)).

**What is the likely use of reserves for 2017/18? How does this compare to forecast funding gaps?**

## Exhibit 21

### Budgeted use and remaining levels of General Fund reserves, 2017/18

Two-thirds of councils budgeted to use reserves in 2017/18.



Source: Annual accounts and auditor funding gap returns 2017

**72.** Councils using reserves to support services in 2017/18 will be faced with having to identify larger savings in 2018/19 or again using reserves. However, using General Fund reserves at the current rate is not an option for some councils – Clackmannanshire, Moray and North Ayrshire councils would run out of General Fund reserves within two to three years if they continued to use them at the level planned for 2017/18.

**73.** Forecasts made by councils when setting their budgets for 2017/18 indicated the overall local government funding gap would increase to about £350 million in 2018/19 and to about £650 million in 2019/20.<sup>10</sup>

**74.** Since setting 2017/18 budgets, councils will have changed their plans for the current year and updated their forecast funding gaps for 2018/19 and beyond. A number of factors have created further potential pressures and uncertainties, for example:

- ongoing demand pressures from people living longer and population growth
- ongoing cost pressures from general inflation



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

- increased staffing costs from staff moving up pay scales, proposals to end the public sector pay cap and potential increases in employers' pension contributions following the LGPS triennial funding valuation
- income and rent collection potentially becoming more difficult and costly as a result of increased charges and the continued roll-out of Universal Credit
- interest rate rises
- the potential impact from changes to NDR (as outlined in [Exhibit 22](#))
- potential impacts from the process of withdrawal from the European Union.

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## Exhibit 22

### Barclay review of non-domestic rates (NDR) 2017

The Barclay review recommended removing NDR relief for councils' ALEOs.

**Councils collect NDR and pay this into a central pool, which is redistributed back to councils by the Scottish Government.**

The Government established the Barclay review group in 2016 to make recommendations that would 'enhance and reform' NDR in Scotland. The review aimed to:

- better support business growth and long-term investment
- reflect changing marketplaces
- retain the same level of income (recommendations would be 'revenue neutral').

The review concluded that some form of NDR was still appropriate. The recommendations in the report focused on measures to support economic growth, improve how the system is administered and increase fairness in the system.

In seeking increased fairness, the review recommended that councils' NDR relief for ALEOs should be removed. The review recommended that legislation be changed to remove relief for ALEOs and, in the interim, that the Scottish Government should adjust its funding to recoup an estimated £45 million of ALEO funding from councils. The review recommended this is applied from April 2018.

The Scottish Government has accepted many of the points of the Barclay review, but the recommendation around ALEOs is still being considered. The Accounts Commission will examine ALEOs in more detail in a report to be published in May 2018.

Source: Report of the Barclay Review of Non-Domestic Rates, August 2017

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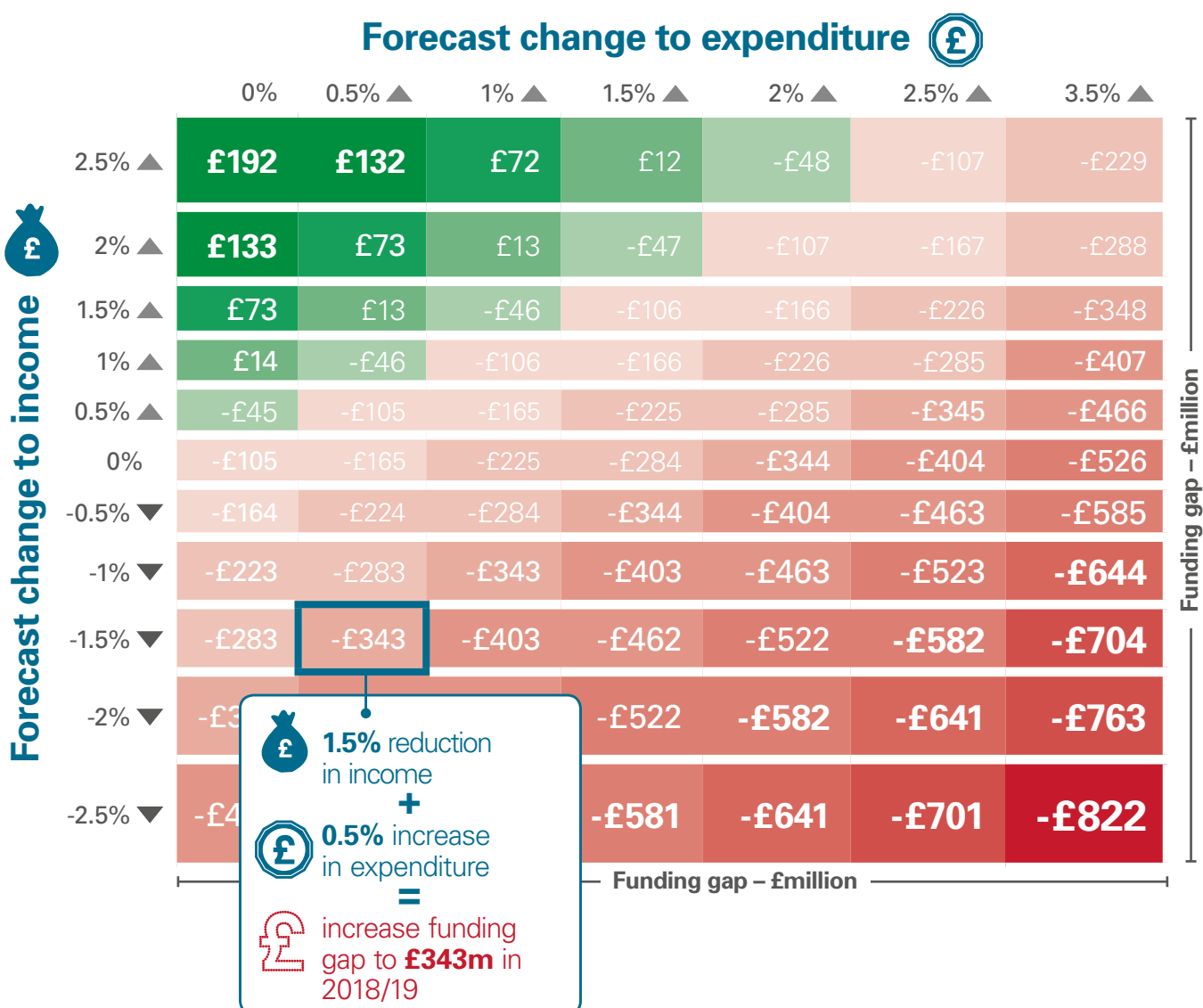


75. Uncertainty means that councils need to prepare for a range of possible scenarios both in terms of costs and funding and different savings options available to them. For example, if councils were to apply a further three per cent increase in council tax in 2018/19 this would raise about £68 million in additional income. In contrast, applying a one per cent increase to staff salaries would cost about £70 million. Even a small proportional increase above this as a result of lifting the public sector pay cap would have further significant costs. [Exhibit 23](#) shows the overall impact of various income and expenditure scenarios on the size of the total funding gap across councils for 2018/19.

### Exhibit 23

#### Council funding gaps scenarios, 2018/19

In the absence of further savings, councils would use around £343 million in 2018/19 if expenditure were to increase by 0.5 per cent and income decrease by 1.5 per cent.



Source: Audit Scotland funding gap returns

### Savings plans should be scrutinised and the impact assessed

**76.** CIPFA's report on building financial resilience and managing financial stress in local authorities highlighted the importance of planning for savings over at least a three-year period, and the need for robust challenging of plans as part of the scrutiny process.<sup>11</sup> In previous reports, the Accounts Commission has highlighted the need for councils to adopt this practice.

**77.** Regular updates on forecasts of funding gaps as savings are approved enable councillors to better understand the impact of the savings decisions they are making. However, currently only about half of councils routinely update their three-year financial forecasts as part of their annual budget-setting process.

**78.** To achieve effective financial management, long-term planning is essential. It is important that councils continue to consider likely funding scenarios and what this means for council services in the longer term as well as the medium term. For councils with lower levels of reserves, financial plans need to be increasingly detailed and robust. This will mean more work for officers and members in clearly identifying savings and assuring themselves that they have the capacity to deliver their intended plans.

**79.** It is important that savings plans are clear and that the impact on services is understood. Savings should be realistic and achievable. Where funding reductions are passed on to other bodies, such as ALEOs and IJBs, by reducing council contributions to them, it is equally important to assess the impact on service users and communities. Risks associated with income generation initiatives or arising from cuts to services should be explicit and considered by councillors as part of their scrutiny role.

**80.** Medium-term financial strategies should ensure that both revenue and capital budgets are aligned with corporate plans and that the revenue impact of capital expenditure is understood. Savings from service redesign and other initiatives need to be monitored effectively to ensure that plans and strategies continue to be relevant and accurate.

### Longer-term affordability of capital programmes should be kept under review

**81.** Council capital programmes for 2017/18 are broadly in line with those for 2016/17, with General Fund budgets at about £2.6 billion and HRA budgets at about £800 million.

**82.** Councils are required to consider the affordability of their capital programmes and any new borrowing before approving them each year. Assessments will include consideration of:

- existing debt levels and servicing costs and how these may increase
- capital reserves available
- impact on running costs, eg reduced overall running costs arising from invest to save initiatives
- additional income streams that can be used to service borrowing




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**Does your council have a medium term financial strategy aligned with corporate objectives?**

---

**How does annual budget setting link to medium term financial planning?**

---

**What impact will savings have on the delivery of services? What are the potential risks?**

---




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**How clearly does the council's capital programme link with the asset management plan and corporate objectives?**

---

- additional funding available, eg Scottish Government funding for NPD projects, additional capital grants in respect of the City Deals (a recent initiative backed by UK and Scottish governments).

**83.** As revenue resources reduce, and the cost of some debt increases, it is becoming increasingly important for councils to keep the longer-term affordability of their borrowing under review. The need for robust business cases setting out how new capital expenditure will support corporate objectives is key. Capital finance and treasury management are areas covered by regulation and where councils also take professional advice. A key treasury management issue facing councils is the risk around interest rate rises, which makes decisions about the timing of borrowing important. If councils borrow in advance of their need they will incur additional interest costs in the short term. However, if the interest rates go up before councils borrow then they will be faced with paying higher interest rates for the term of any new borrowing. Recently a number of councils have been turning to short-term borrowing to keep their interest costs down but this strategy is not without risk and it is important that councils are clear about these in their plans and reports.

### Effective leadership is increasingly important in maintaining financial sustainability

**84.** The Accounts Commission recognises that the financial challenges facing councils will inevitably mean councillors need to make difficult choices and take decisions that may not sit neatly with the manifestos they were elected on in May 2017. This requires effective political leadership and effective communications. It is essential that councillors work effectively with officers, council partners and other stakeholders to identify and deliver necessary savings. It is important that councils engage with local communities when planning and delivering services and identifying savings. We published a report [\*Roles and working relationships in councils – Are you still getting it right?\*](#)  (November 2016) to support councillors in their difficult and challenging role.

### Addressing the underlying demand for services through transformation is key to longer-term sustainability

**85.** Given the scale of the challenge facing councils, we are of the view that the sustainability of some services will be increasingly dependent on the ability of councils and their partners to address the underlying demand for them. With health and social care integration, for example, much depends on the extent to which resources can be switched from treatment to prevention. Council transformation programmes need to identify and deliver changes of this nature over the longer term. It is important that councils give careful consideration to their capacity to support such change when making savings as part of budget setting.

**86.** The extent to which council transformation plans are delivering real changes to the way services are being delivered will be explored further in the second of our local government overview reports planned for publication in April 2018.




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

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

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# Endnotes




- ◀ 1 We published the first of three planned audits on health and social care integration in 2015: [Health and social care integration](#) , December 2015. Our next national audit in this area will be carried out in 2018/19. Annual audit plans and reports for each IJB are also published on [Audit Scotland's website](#) .
- ◀ 2 This excludes income received from arm's-length external organisation (ALEOs) providing services such as leisure services on behalf of the council.
- ◀ 3 *Fiscal issues facing Local Government in Scotland*, Fraser of Allander Institute, March 2017.
- ◀ 4 East Lothian Council, Highland Council (Inverness Jobcentre only), East Dunbartonshire, Midlothian Council and Inverclyde Council (no council stock – therefore no arrears).
- ◀ 5 ALEOs are separate bodies councils create to deliver services that they previously delivered in house.
- ◀ 6 *Building financial resilience: managing financial stress in local authorities*, CIPFA, June 2017.
- ◀ 7 [Major capital investment in councils](#) , Accounts Commission, March 2013.
- ◀ 8 [Major capital investment in councils: follow-up](#) , Accounts Commission, January 2016.
- ◀ 9 For more detail on councils' implementation of equal pay, see the Accounts Commission's [Equal pay in Scottish councils](#)  report.
- ◀ 10 This forecast is based on the average of available forecasts.
- ◀ 11 *Building financial resilience: managing financial stress in local authorities*, CIPFA, June 2017.

# Local government in Scotland Financial overview 2016/17


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ISBN 978 1 911494 43 0

This publication is printed on 100% recycled, uncoated paper





# Local government financial overview 2016/17

Scrutiny tool for councillors

ACCOUNTS COMMISSION 





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?
<b>Budget setting (paragraphs 65–68 and 76–80) </b>		
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?		




Cont.

## How well informed am I?

Questions for councillors to consider	What do I know?	Do I need to ask further questions?
<b>Financial and savings plans</b> (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?		
<b>Reserves</b> (paragraphs 36-48) 		
9. What is the council's 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?		

Cont.



## How well informed am I?

Questions for councillors to consider	What do I know?	Do I need to ask further questions?
<b>Levels of debt and affordability</b> (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?		
<b>Budget outturn reports and management commentaries</b>		
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?		
<b>Financial scrutiny</b> (paragraph 84) 		
18. What additional training would you like to receive to develop your knowledge and skills in financial scrutiny?		
<b>Charging for services</b> (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?		

Cont.



## How well informed am I?

Questions for councillors to consider	What do I know?	Do I need to ask further questions?
<b>Exit packages (paragraph 40–42)</b> 		
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?		
<b>Capital programmes (paragraphs 31–33 and 65–66)</b> 		
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?		



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# Local Government Pension Scheme 2016/17



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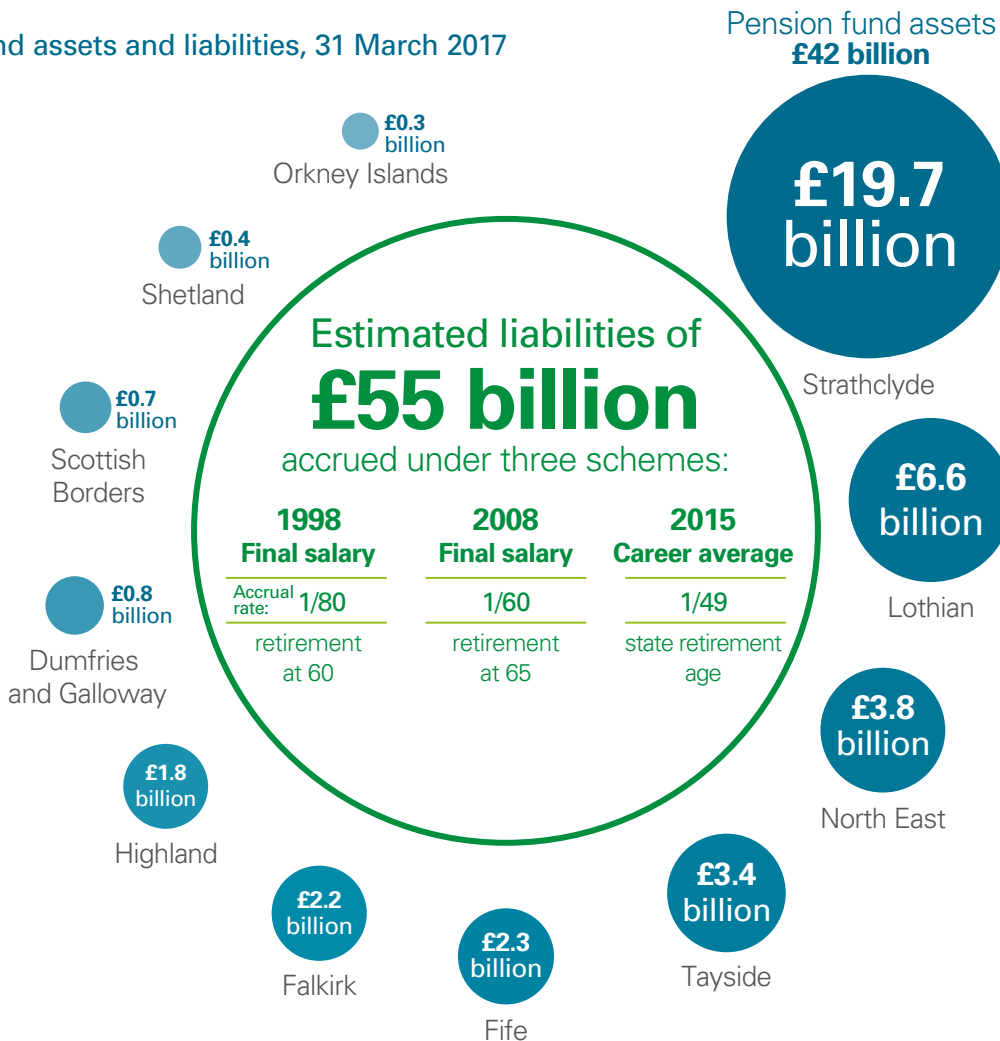
## Introduction

1. This supplement accompanies our Local Government in Scotland: Financial Overview 2016/17 and provides an overview of the LGPS in Scotland. We have drawn on the annual reports and accounts of the 11 pension funds administered by councils in Scotland and on the reports of their appointed auditors. In this, the first year of new five year auditor appointments, we are pleased that all 11 pension funds received an unqualified audit opinion on their accounts.

2. It was a good year for pension fund assets, which increased from £34.5 billion to £42 billion. However, the estimated value of liabilities also increased from £42 billion to almost £55 billion ([Exhibit 1](#)).

## Exhibit 1

LGPS Scotland assets and liabilities, 31 March 2017



Source: Pension Fund Annual Accounts 2016/17

**3.** The estimated value of LGPS liabilities is in respect of all scheduled and admitted bodies not just councils. Councils have pension liabilities associated with added years awarded on retirement that do not fall on the pension fund and are not included in [\(Exhibit 1, page 1\)](#). Council net pension fund liabilities as at 31 March 2017 were estimated to be £11.5 billion (including unfunded liabilities).

## Governance and administration

**4.** This is the second year of the LGPS 2015 scheme, which links pension benefits to career average earnings (a move away from final salaries under the previous LGPS schemes). We reported last year that pension funds had coped well with the introduction of the scheme and associated governance arrangements, but that the outlook remained challenging.

**5.** The new governance arrangements introduced under the 2015 scheme are more complex than under the previous LGPS schemes, with more stakeholders being involved. The range of stakeholders is shown in [Exhibit 2 \(page 3\)](#).

**6.** During 2016/17 the Scottish Scheme Advisory Board reported to the Scottish Minister on the future structure of the LGPS in Scotland. The report has not been made public so any proposed changes to the structure of the LGPS in Scotland are unclear. Irrespective of any proposed changes, a number of pension fund annual reports highlight plans for greater collaboration.

**7.** A survey<sup>1</sup> undertaken by the Pensions Regulator across all UK public service schemes found improvements in ensuring and demonstrating compliance with the public service code of practice on governance and administration. Auditors confirmed that LGPS pension funds in Scotland had improved arrangements and procedures in this area.

**8.** During the year the Scottish Public Pensions Agency (SPPA) commissioned KPMG to review governance across all public service pension schemes in Scotland.<sup>2</sup> One of the key issues raised by KPMG is whether there would be benefit in clarifying the role of the LGPS pension boards established under the 2015 LGPS scheme. The remit of LGPS pension boards goes beyond that for other public service schemes, requiring them to consider any pensions matters they deem relevant. The risk is that LGPS boards become overstretched and do not adequately assist scheme managers to comply with regulations and the public service code.

**9.** Councils rotated the chairs of their pension boards in 2016/17. They have also experienced wider changes in councillor membership of pension committees following the local elections in May 2017. Ensuring that elected members and appointed board members have the requisite skills and knowledge in this highly technical area is an ongoing challenge for pension funds.

## Investment performance and pension fund assets

**10.** Overall, investments performed surprisingly well in a year where several high profile political events including the Brexit referendum and U.S. presidential results, affected investor confidence. The associated fall in the pound resulted in equity prices rising and this contributed to investment returns of around 22 per cent. [Exhibit 3 \(page 4\)](#) shows investment returns for the 11 pension funds.

**11.** The average return on LGPS investments in Scotland will be strongly influenced by the returns achieved by the larger funds, in particular the Strathclyde fund which accounts for almost 47 per cent of Scotland's £42 billion of LGPS assets.

<sup>1</sup> *Public service governance and administration survey – Summary of results and commentary*, Pensions Regulator, May 2017.

<sup>2</sup> *Scottish Public Service Pensions Governance Review*, KPMG, February 2017.

## Exhibit 2

### LGPS governance arrangements

#### UK



#### The Pensions Regulator

- Issues codes of practice on governance and administration
- Provides guidance and self assessment tool kits
- Undertakes governance and administration surveys
- Significant breaches of regulation must be reported

#### Scotland



#### Scottish Ministers

- Responsible for policy and regulations
- Currently considering a report on the future structure of LGPS



#### Scottish Public Pensions Agency

- Advise Scottish Ministers on public service policy and regulation
- Commissioned a review of governance in 2016/17



#### Scottish Scheme Advisory Board

- Advise Scottish Ministers on policy and changes
- Can advise scheme managers and pension boards
- Issued report to Scottish Ministers on future structure of LGPS

### 11 administering authorities



#### Pension Committees

- Responsible for decisions on pension fund policy
- Composed of Councillors but may include representatives and advisors
- New members in May 2017



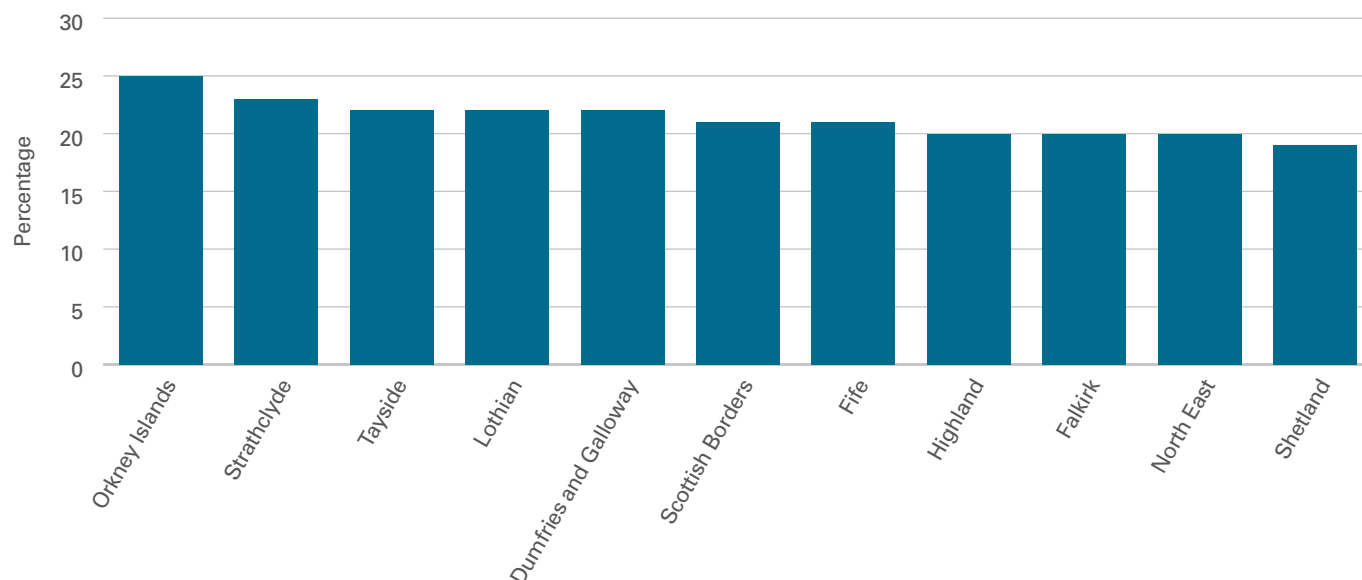
#### Pension Boards

- Supports compliance with law and regulation
- Can consider any matter deemed relevant
- Membership 50:50 employer and union representation
- May request Pension Committee to review decisions

### Exhibit 3

#### Return on investments as a percentage of opening investment assets 2016/17

Orkney had the highest investment returns in the year but is the smallest fund.



Source: Pension fund annual accounts 2016/17

**12.** There has been a continued interest across the pensions sector in the transparency of investment management costs. We welcome developments in this area, as even small reductions in cost arising from a better understanding and level of scrutiny can make a difference when compounded over time. In last year's supplement we expressed our support for full disclosure of costs in pension fund annual reports.

#### Present value of promised retirement benefits

**13.** Estimates of the present value of promised retirement benefits or 'pension liabilities' are required under both the pension regulations for funding valuations (forming the basis for employer contributions) and under accounting standards (for disclosure in the pension fund accounts). Funding valuations are carried out every three years whilst estimates of pension liabilities for accounting purposes are updated each year. Pension funds are currently awaiting their final funding valuations for 31 March 2017.

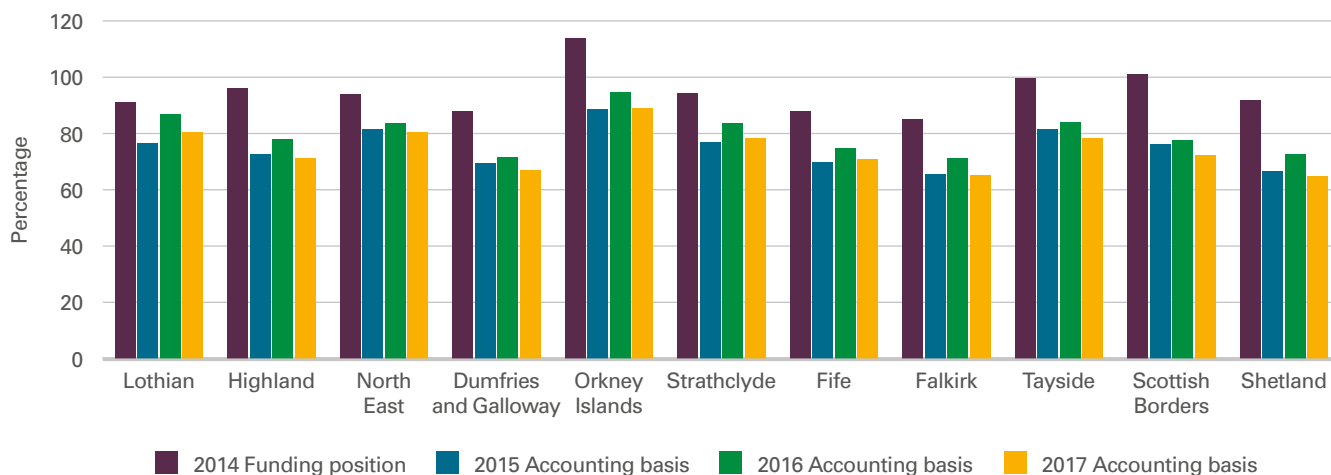
**14.** Accounting valuations produce higher estimations of liabilities and lower indicative funding levels as a result. Indicative funding levels on an accounting basis for 2017 are broadly similar to those in 2015 ([Exhibit 4, page 5](#)).

**15.** Actuaries will revisit their assumptions and use up to date data to calculate funding valuations as at 31 March 2017. It is this triennial funding valuation that will determine whether employer contributions will need to increase over the next three year period from 2018/19. Any increases for employers will be limited under the cost sharing mechanism in the LGPS 2015.

## Exhibit 4

### Pension fund assets as a percentage of estimated liabilities 2014 to 2017

Accounting valuations result in lower funding levels than those for funding purposes (2014).



Source: Pension fund annual reports and accounts

## Cost control and the employer cost cap

**16.** Under Section 13 of the Public Service Pension Act 2013 (the 2013 Act) the Government Actuaries Department (GAD) will review the 2017 triennial valuation on behalf of Scottish Ministers. This review will look at the consistency with which actuaries have undertaken valuations in Scotland and their compliance with regulations. The review will also look at the solvency and long term efficiency of the funds and may make recommendations in relation to future cost sharing between employers and active members of the scheme.

**17.** The cost sharing mechanism in the LGPS 2015 is designed to ensure that the LGPS remains affordable for employers. Under this mechanism (GAD) has established a Scotland wide LGPS employer cost cap of 15.5 per cent. If the cost of providing benefits to members increases by more than two per cent above the employer cost cap then employee contributions and/or benefits will be reviewed.

**18.** GAD recently undertook a 'dry run' review<sup>3</sup> based on the 2014 funding valuations. This raised no concerns about the solvency or longer term efficiency of the LGPS in Scotland but did raise concerns about inconsistencies in valuations by different actuaries across Scotland's 11 pension funds. We understand that actuaries are looking to address GAD's concerns before reporting in 2018.

## Outlook

**19.** Pension funds face ongoing administrative pressures including those arising from:

- councils severances
- complexities of the new career average scheme.
- guaranteed minimum pension reconciliations (with HMRC records)
- pensions auto enrolment.

**20.** To help to reduce their costs and improve services, pension funds are increasingly providing online services to employers and members through programmes of digitalisation. As services evolve pension funds will need to be alert to cyber security risks.

**21.** New regulatory arrangements for financial markets arising from Markets in Financial Instruments Directive (MIFID 2) will also impact on pension funds from 1 January 2018. MIFID 2 requires all local authorities to be treated as 'retail clients' by their asset managers which would severely limit the ability of pension funds to invest. However, the Financial Conduct Authority rules allow local authorities to opt up to 'professional investor' status allowing fund managers to continue to offer the full range of investments. MIFID 2 was designed to protect the interests of local authorities and care will be needed to ensure that opting up for pension investments does not expose the wider council to increased risks.

**22.** Delivering investment returns will no doubt remain a challenge for pension funds and pension fund managers. It is unclear to what extent further collaboration between funds will reduce costs and improve performance. It is also unclear whether the Scottish Minister will require pension funds to formally collaborate or propose any structural change following the recent report on the structure of the LGPS in Scotland.



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Supplement 3

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# Housing Revenue Account 2016/17



**Scott-Moncrieff**  
business advisers and accountants

ACCOUNTS COMMISSION

Prepared by Scott Moncrieff  
November 2017



1. This supplement accompanies the Audit Scotland [Financial Overview of Local Government in Scotland 2016/17](#). Audit Scotland commissioned Scott Moncrieff to undertake this work. The analysis is based primarily on the council's audited accounts and Scottish Government Housing Revenue Account Statistics.
2. As at March 2016,<sup>1</sup> there were an estimated 2.567 million homes across all tenures in Scotland. Socially rented properties provided by councils accounted for just over 12 per cent of that figure. Key council housing facts are set out in [Exhibit 1](#).

## Exhibit 1

### Council housing at 31 March 2017- key numbers



26 of 32 councils with stock  
162,152 people on waiting lists  
28,247 homeless applicants  
177,521 tenants receiving housing benefit



314,816 council properties  
26,245 properties let  
3,508 Right To Buy sales  
1,143 new council houses built



£11,282 million value of stock  
£1.15 billion income  
£927 million expenditure  
£66.7 million gross rent arrears

## Housing stock and demand

3. [Exhibit 2 \(page 3\)](#) shows the breakdown of homes by tenure as at March 2016. The tenure landscape in Scotland has changed over the last 5 years with the number of owner occupiers decreasing by 2.3 per cent while the number renting in the private sector has increased by 3.1 per cent. The socially rented sector has also seen a shift with the number of council homes reducing by 2,831, while those provided by housing associations has increased by 3,083.
4. As at 31 March 2017, there were 314,816 social housing properties owned and managed by 26<sup>2</sup> of the 32 local authorities in Scotland, with a value of £11,282 million. Stock held by councils varies considerably across Scotland, with North Lanarkshire Council the biggest landlord with 36,512 properties while Orkney Council is the smallest landlord with 965 properties ([Exhibit 3, page 4](#)).
5. The Housing (Scotland) 2014 Act ended the Right to Buy for all social housing tenants in Scotland on 1 August 2016. The number of council houses sold increased year on year over the last five years, with a total of 10,153 properties sold to sitting tenants. Following the announcement of the abolition in 2014, the number of applications and sales increased significantly with 8,147 applications alone in the first two quarters of 2016/17, almost double

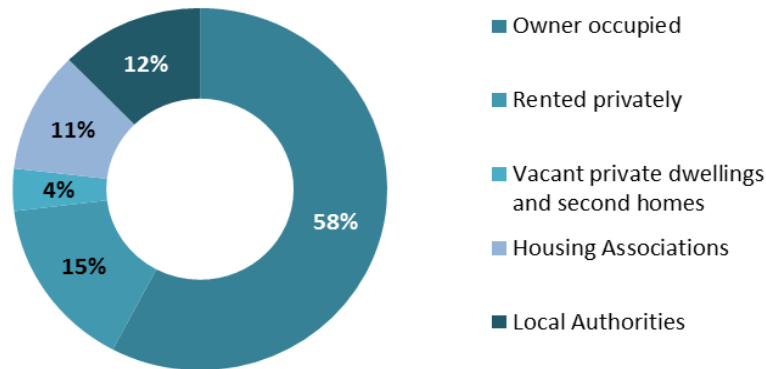
<sup>1</sup> Stock by tenure 2016 - updated after Scottish Household Survey 2016 publication October 2017

<sup>2</sup> 6 councils no longer manage housing stock due to previous stock transfers to housing associations - Dumfries & Galloway Council, Glasgow City Council and Scottish Borders Council in 2003, Eilean Siar and Argyll & Bute Council in 2006 and Inverclyde Council in 2008.

the total applications for 2015/16 (4,180). A total of 3,508 properties were sold in 2016/17, 169 per cent more than 2015/16 (1,735). Over the period 2014-2016 capital receipts increased by just over 191 per cent.

## Exhibit 2

### Total homes by tenure



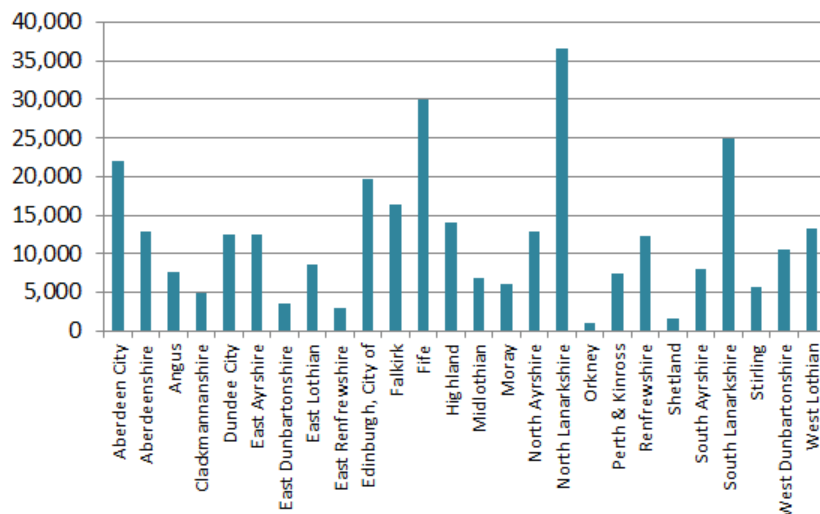
Source: Scottish Government, *Stock Estimates by Tenure March 2016*

6. As at 31 March 2017, there were approximately 162,152<sup>3</sup> applicants on waiting lists for council properties. A total of 26,245 council properties were available to let in 2016/17 with 25,788 permanent lets made.
7. In 2016/17, 28,247 applicants for housing were assessed as homeless or threatened with homelessness. 40% of all local authority lettings made in 2016-17 were to homeless households, compared to 38% in 2015/16. Homeless lets across councils vary, in 2016/17; East Ayrshire let 13 per cent of new lets to homeless applicants, whereas in City of Edinburgh Council 73 per cent of new lets were to homeless applicants. As at 31 March 2017, 10,873 applicants were living in temporary accommodation across Scotland, with the average stay being 117 days. The average figure was significantly higher in Midlothian Council (291 days) and Shetland Islands Council (371 days).
8. Changes in population and demographics have implications for housing demand. The population of Scotland is projected to rise from 5.40 million in 2016 to 5.70 million by 2039, with the number of people over 65 increasing by 53 per cent. The number of households is also increasing with a significant growth in one person households.

<sup>3</sup> Applicants may be on one or more council waiting lists; therefore the actual number of applicants is unquantifiable.

### Exhibit 3

#### Local authority housing stock March 2017



Source: Scottish Government, Annual Return of Local Authority Housing Stock March 2017

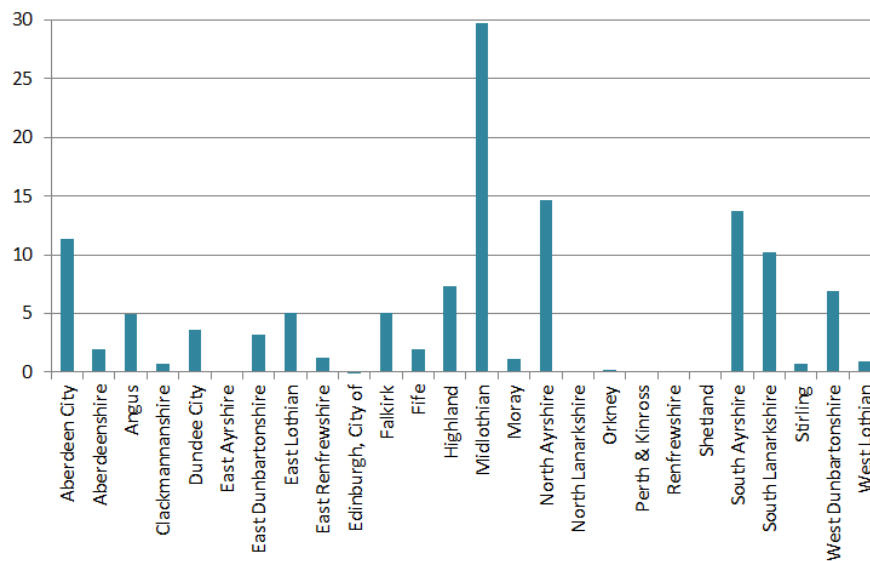
- An ageing population means there are increasing number of pensioners living alone. This places requirements for adaptations to allow people to stay independently at home. A large numbers of dwellings have already been adapted; however, there is a constant need with differing requirements. Councils completed a total of 15,316 medical adaptations in 2016/17.

#### Housing Revenue Accounts (HRA)

- Over the last 5 years there has been a general upward trend in the HRA reserves held across councils. The total level of HRA reserves in 2016/17 was £125 million. [Exhibit 4 \(page 5\)](#) shows the level of HRA reserves varies across councils, with six councils holding no reserves while Midlothian Council held reserves in excess of £29 million in 2016/17. A number of councils have used reserves to fund their capital programmes in previous years, leaving no reserves available to carry forward to 2017/18. An appropriate level of reserves is important as they allow councils to respond quickly and effectively to unforeseen events and meet future agreed commitments.
- Total HRA debt rose by £140 million (4 per cent) in 2016/17 to £3.6 billion. Councils expected total HRA debt to increase by 17 percent in 2017/18. Councils borrow money to improve existing stock and fund new build programmes.

## Exhibit 4

### HRA Reserve balances 2017/16 (£ millions)



Source: SG, HRA 2016/17 Statistics, November 2017

12. Total income across HRAs in Scotland has increased by 11 per cent across the last 5 years to just over £1.15 billion, while total expenditure has increased by 10 per cent to just over £927 million. As shown in [Exhibit 5 \(page 6\)](#), 31 per cent of expenditure in 2016/17, related to loan charges and bad debt provision, an average of £868 per house, £8 more than in 2015/16.
13. Of the remaining 69 per cent, 40 per cent of expenditure related to repairs and maintenance. Over the last five years repairs and maintenance expenditure has increased by 7.5 per cent which reflects the increasing challenges faced by social landlords in maintaining existing stock and safety and quality standards. A further 27 per cent of expenditure related to management and supervision costs. Councils spent an average of £783 per house in 2016/17, £5 more per house than in 2015/16. Councils anticipate<sup>4</sup> this to rise by a further £34 per house in 2017/18.

## Repairs and maintenance

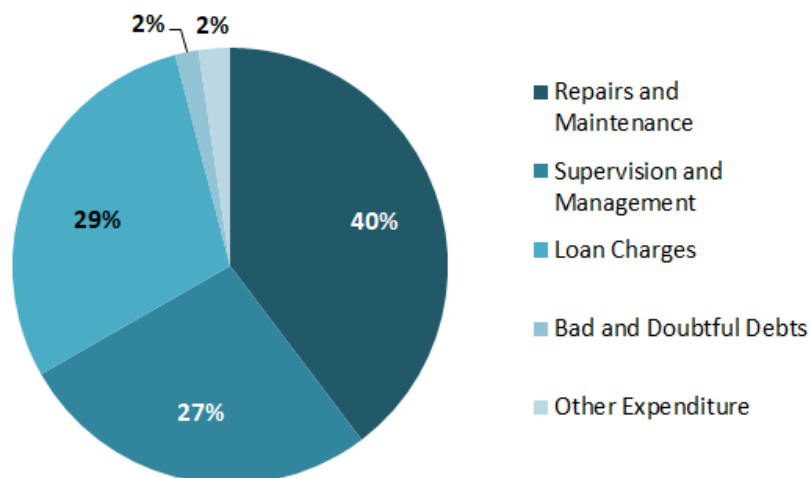
14. The 2016/17 financial statements show the total repairs and maintenance expenditure across councils was £377.50 million, averaging £1,199 per council house. Councils spent £162.24 million on enhancements to existing stock which includes major repair programmes such as roofs, kitchens and window replacements.
15. All social landlords continue to work towards meeting the Scottish Housing Quality Standards (SHQS). As at 31 March 2017, 92.5 per cent of council properties met the SHQS. Councils invested £213.7 million<sup>4</sup> in 2016/17 to bring their stock up to the SHQS and plan to invest a further £77 million<sup>5</sup> during 2017/18 bringing an estimated 5,536 properties up to the standards.

<sup>4</sup> SG, HRA 2016/17 Statistics, November 2017

<sup>5</sup> 2016/17 Annual Return of the Charter (ARC) data returns to the Scottish Housing Regulator

## Exhibit 5

### HRA Expenditure by type 2016/17



Source: SG, HRA 2016/17 Statistics, November 2017

16. Element 44 of the SHQS states that in existing properties there must be at least one smoke alarm present in the property, and this can be either battery-powered or mains-powered. However, if replacement smoke alarms are being fitted then these should be mains wired.
17. In light of the Grenfell tragedy, a Ministerial Working Group is overseeing a review of building and fire safety regulatory frameworks, and any other relevant matters. This includes a review of evidence on fire suppression systems, such as sprinklers and other preventative measures. Councils will need to consider how they will ensure they meet the cost of any recommendations for improvement as required.
18. All social rented properties are also required to meet the EESSH<sup>6</sup> by March 2020. In order to achieve compliance, properties are required to have a minimum EPC standard. As at 31 March 2017, 69.8 per cent of council properties were assessed as meeting the standard. Performance in meeting EESSH varies across local authority areas with East Ayrshire Council having the highest compliance at 94.4 per cent, while 36.9 per cent of East Lothian Council properties meet EESSH.
19. The total investment across all council properties to meet EESSH to date is £119.9 million. Councils have financed the majority (86.45 per cent) of investment themselves, with the remaining funding from subsidy and other sources. On the basis of the average investment to date, it is estimated a further investment of at least £460.5 million will be required to bring the remaining 84,254 properties up to the EESSH<sup>7</sup>. This does not take into account additional expenditure required to bring 'hard to treat' properties up to the standard. Funding these improvements presents a significant challenge for councils.

<sup>6</sup> The Energy Efficiency Standard for Social Housing (EESSH) was introduced by the Scottish Government in 2014 with the aim of increasing energy efficiency in social housing, and reducing carbon emissions as required by the Climate Change (Scotland) Act 2009.

<sup>7</sup> Figures from EESSH 2016/17 Dataset returns, Scottish Housing Regulator

## Rents

20. In 2016/17, the average rent paid across councils in Scotland was £67.83 per week. However, the average rent across councils varied with City of Edinburgh Council the highest at £94.27 per week, while Moray Council was the lowest at £55.10 per week. Again the actual rent increase applied varies across councils, with 13 councils higher than the average, 6 of which applied more than a 3.5 per cent increase. The largest increases (5 per cent) were East Lothian Council and Midlothian Council. The majority of councils set rent increases with reference to the Retail Price Index (RPI) plus 1 per cent. In the year to 31 March 2017 the average rent rose by 2.72 per cent over a period where the RPI rose by 2.1 per cent.
21. Social landlords are required<sup>8</sup> to consult tenants and take account of their views when making decisions about proposed rent increases. A review of rent consultations for 2016/17 found the majority of those councils applying above average increases did not include information on options for rent increases based on differing levels of investment or evidence they had considered affordability of rent for tenants.

## Rent arrears and voids

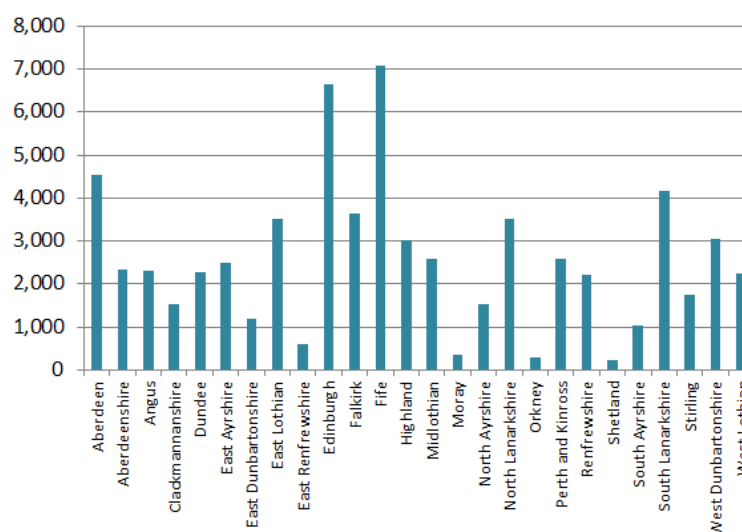
22. In 2016/17 councils, annual accounts showed gross rent arrears in monetary terms reduced slightly from £66.9 million to £66.7 million. Arrears as a proportion of total rent remained broadly constant at just under 6 per cent of total rents reported in the HRA accounts. [Exhibit 6 \(page 8\)](#) shows the level of gross arrears across councils varies significantly.
23. The level of net arrears across Scotland was just over £11 million in 2017/16, down from £12.2 million in 2015/16 partly as a result of an increase in the level of arrears which have been written off or impaired across the financial years. Over the past five years the level of impairments applied to rent arrears on the HRA have increased by 45 per cent to £55.7 million. The collection of debt is a significant operation for councils.
24. In 2016/17, the average time to re-let council houses was 39 days, resulting in an average of 1.2 per cent rent lost (£13.2 million) due to properties being empty. Again the average days to re-let vary across councils with East Ayrshire Council the highest at 75.6 days, and North Ayrshire an average of 15.4 days. The reasons for such variations could be as a result of low demand, higher letting standards and councils with Direct Labour Organisations (DLOs) having greater control over void repairs and turnaround times.

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<sup>8</sup> Under the Housing (Scotland) Act 2001

**Exhibit 6**

## Value of gross rent arrears across all councils (£000s)



Source: Local Government Annual Accounts, 2016/17

**Welfare Reform**

25. In 2016/17, 57 per cent (177,521) of council tenants in Scotland were in receipt of Housing Benefit (HB). The percentage of tenants in receipt of HB varies across councils, with 38 per cent of Shetland Council tenants in receipt of HB, while this figure was almost double in Dundee City Council at 78 per cent.
26. The Department of Work and Pensions (DWP) began a roll out of Universal Credit (UC) in Scotland in March 2016 in East Lothian. As at 31 March 2017, UC had rolled out across five council areas<sup>9</sup> in Scotland. Rent arrears across these councils increased in 2016/17 by an average of 14.1 per cent, compared with an average of 4.1 per cent across the remaining councils.
27. Our [Housing Benefit Performance Audit: Annual update 2016/17](#) reported that Councils have been reporting that the roll out of UC has had a detrimental effect on the collection of housing rental income, although it was recognised part of the increase could be an indirect impact of staff dealing with UC claimants and increased Discretionary Housing Payment (DHP) applications.
28. The full impact of Welfare Reform has not yet been seen for many councils. UC will be rolled out across a further 14 council areas, as well as the remaining job centres within the Highland Council area in 2017/18. Roll-out across the remaining 13 council areas is expected to be completed by September 2018. Councils will need to be confident that the level of HRA working balances is adequate to meet any unforeseen contingencies during the financial year particularly with regard to Welfare Reform.

<sup>9</sup> East Lothian Council, Highland Council (Inverness Job Centre only), East Dunbartonshire, Midlothian Council and Inverclyde Council (no council stock -therefore no arrears)

## New build and development

29. In 2016, the Scottish Government launched the Affordable Housing Supply Programme for 2016-21 which set out a key commitment to deliver 50,000 affordable homes, with 35,000 of these available for social rent. The programme is supported by £3 billion investment, £1.75 billion of which is available to councils to support the building of new council homes. Scottish Government statistics show that 10,276 affordable homes were approved in 2016/17 – a 29 per cent increase on the year before, 7,000 of these were for social rent. The annual number of council new build completions increased from 963 in 2012/13 to 1,143 in 2016/17<sup>10</sup>.
30. There has been some criticism that the target is not ambitious enough and does not adequately address the level of housing need in Scotland. However, stakeholders also recognise that there may be capacity issues in meeting this target. There are also issues with available land and planning issues which are being taken forward in the current review of the planning system by the Scottish Government.
31. All 26 stock holding councils are actively involved in development, and plan to deliver just over 13,000 homes over the 5 year programme<sup>11</sup>. If these projections are realised the councils will deliver just over 37 per cent of the Scottish Government's socially rented target. Resource planning assumptions for 2017/18 show councils plan to invest £422.6 million in affordable housing.

## Outlook

32. 2017/18 has seen RPI increase to 4 per cent in October (2 per cent higher than October 2016). Councils will need to ensure they carry out scenario planning on business plan assumptions to strike a balance between ensuring long term objectives such as investing in existing stock and building new houses can be met, whilst keeping rents affordable for tenants.
33. Meeting housing quality and safety standards will present a significant cost challenge for councils. In line with their HRA business plan, councils will need to consider the level of reserves that they hold, and whether they allow them to meet future demands and commitments.
34. The introduction of the Local Housing Allowance (LHA) cap may result in shortfalls between rents and housing benefit entitlement. In turn, resulting in increased rent arrears and impacting revenue streams, in addition to increasing the risk of homelessness for affected tenants.
35. The new build programme will see councils returning to build houses at a similar level to housing associations. Councils will need to balance the opportunities with associated risks which may include a shortage of skills, labour and materials which potentially will be further impacted by Brexit.

<sup>10</sup> SG, Housing Statistics for Scotland - Local authority new build, August 2017

<sup>11</sup> New Build Survey Return, Association of Local Authority Chief Housing Officers (ALACHO) July 2017



## Supplement 3

# Housing Revenue Account 2016/17

This report is available in PDF and RTF formats,  
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# Local government financial overview 2017

## Measures taken by councils to close their funding gaps in 2017/18

