

Governance, Risk and Best Value Committee

10.00am, Tuesday 14 March 2023

Accounts Commission: Local Government in Scotland – Financial Bulletin 2021/22 – referral from the Finance and Resources Committee

Executive/routine
Wards
Council Commitments

1. For Decision/Action

- 1.1 The Finance and Resources Committee has referred a report on Accounts Commission: Local Government in Scotland – Financial Bulletin 2021/22 to the Governance, Risk and Best Value Committee for scrutiny as part of its work programme.

Dr Deborah Smart

Executive Director of Corporate Services

Contact: Taylor Ward, Assistant Committee Officer

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Referral Report

Accounts Commission: Local Government in Scotland – Financial Bulletin 2021/22

2. Terms of Referral

- 2.1 On 7 February 2023, the Finance and Resources Committee considered a report on Accounts Commission: Local Government in Scotland – Financial Bulletin 2021/22, which provided a summary of the main issues and themes identified within the Accounts Commission’s recently published *Financial Bulletin 2021/22* and how these related to the local context within Edinburgh.
- 2.2 The Finance and Resources Committee agreed:
 - 2.2.1 To note the report.
 - 2.2.2 To refer the report to the Governance, Risk and Best Value Committee for scrutiny as part of its work programme.

3. Background Reading

- 3.1 [Finance and Resources Committee – 7 February 2023 - Webcast](#)
- 3.2 Minute of the Finance and Resources Committee – 7 February 2023

4. Appendices

- 4.1 Appendix 1 – report by the Interim Executive Director of Corporate Services

Finance and Resources Committee

10.00am, Tuesday, 7 February 2023

Accounts Commission: Local Government in Scotland – Financial Bulletin 2021/22

**Executive/routine
Wards
Council Commitments**

1. Recommendations

- 1.1 Members of the Finance and Resources Committee are asked to:
 - 1.1.1 note the contents of the report; and
 - 1.1.2 refer the report to the Governance, Risk and Best Value Committee for scrutiny as part of its work programme.

Richard Carr

Interim Executive Director of Corporate Services

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Report

Accounts Commission: Local Government in Scotland – Financial Bulletin 2021/22

2. Executive Summary

- 2.1 The report provides a summary of the main issues and themes identified within the Accounts Commission's recently published *Financial Bulletin 2021/22* and how these relate to the local context within Edinburgh.

3. Background

- 3.1 On 12 January 2023, the Accounts Commission published its annual *Financial Bulletin* report. The report is an independent high-level analysis of the financial performance of councils during the preceding year (2021/22), their financial standing entering 2022/23 and associated longer-term financial outlook.
- 3.2 As in previous years, the overview will be complemented by the publication of the *Performance Overview* report in May 2023. Both reports are, however, again specifically couched within the context of the pandemic, with the Financial Bulletin including coverage and analysis of its full-year financial impacts and the Performance Overview expected to consider councils' responses to, and recovery from, COVID-19 amidst a wider range of financial and performance challenges.
- 3.3 The report's contents and main conclusions are primarily drawn from councils' audited accounts and associated external audit reports, supplemented by a separate data request issued in October 2022 to which the Council responded.

4. Main report

Overview of report and key messages

- 4.1 The report's format largely follows that adopted in previous years, with respective sections on income, financial standing and performance and financial outlook. A series of key messages is also set out on pages 3 and 4 of the report, drawing specific attention to the following:
- (i) Despite additional COVID-19 funding, councils continued to face significant financial challenges during 2021/22, requiring significant savings to deliver balanced budgets and increasingly difficult choices to be made about spending priorities;

- (ii) in 2021/22, councils' savings performance continued to improve and total usable reserves increased, which councils have used to contribute towards meeting budget gaps arising from service demand and budget pressures;
- (iii) in 2021/22, Scottish Government revenue funding to councils increased by 5.3% in real terms¹. This represented the first real-terms increase on the 2013/14 revenue funding position since 2015/16 (excluding one-off COVID-19 money). In 2021/22, revenue funding levels for local government and other parts of the Scottish Government budget (excluding COVID funding) have converged back to a level similar to eight years ago;
- (iv) an increasing proportion of local government funding is now either formally ring-fenced or provided with the expectation it will be spent on specific services. The report calculates this to be 23% of total revenue funding in 2021/22. Ring-fenced and directed funding helps support delivery of key Scottish Government policies but removes local discretion and flexibility over how these funds can be used by councils;
- (v) councils have noted that COVID-19 and inflationary costs are having an impact on capital projects. If these issues persist, they will present risks to councils' capital programmes which form a necessary component of modernising services to deliver improved outcomes for local communities;
- (vi) Councils face the most difficult budget-setting context seen for many years with the ongoing impacts of COVID-19, inflation and the cost of living crisis. They will need to continue to make recurring savings and also make increasingly difficult choices with their spending priorities, including, in some cases, potential service reductions; and
- (vii) two-thirds of councils intend to use reserves to help bridge the 2022/23 gap between anticipated expenditure and revenue (budget gap) of £0.4 billion but this reliance on non-recurring reserves is not sustainable in the medium to long term. Delivering recurring savings and reducing reliance on using reserves to fill budget gaps will be key to ensuring longer-term financial sustainability. This makes the case for a continued focus on service reform, based on strong engagement with communities, more important now than ever.

4.2 Given the report's Scotland-wide coverage, not all of its recommendations are of direct relevance to Edinburgh but much of the content nonetheless resonates with the Council's own circumstances.

¹ This total includes sums with corresponding additional commitments, meaning that the underlying level of core revenue grant funding for Local Government increased by around 1%.

Specific references or areas of particular relevance to Edinburgh

- 4.3 **Paragraphs 7 to 10** and **Exhibit 1** indicate the broad composition of councils' funding and income over the period from 2019/20 to 2021/22. While differences across years are reflective of COVID-related disruption and/or business grant reliefs, in all cases, Edinburgh's balance of funding reflects relatively higher levels of Council Tax, Non-Domestic Rates and customer and client receipts, with a correspondingly reduced level of General Revenue Grant funding given the needs basis of the overall Local Government Finance Settlement. As with other councils across Scotland, an increasing proportion of this external grant funding is either formally ring-fenced or provided with the expectation it will be spent on specific services.
- 4.4 **Paragraph 11** details an overall improvement in in-year collection rates for Council Tax during 2021/22, such that rates broadly returned to pre-pandemic levels. This position was consistent with that in Edinburgh, where the in-year collection rate improved from 96.0% in 2020/21 to 96.8% in 2021/22, marginally below the 97.0% achieved in 2019/20. The in-year collection rate achieved continued to represent, by some margin, the highest of the four city authorities, maximising the availability of resources to support frontline service delivery.
- 4.5 **Paragraphs 17 to 20** provide a high-level overview of Scottish Government funding levels during the year, with the overall real-terms growth set out largely comprising additional sums, with related commitments, for education and health and social care. The Council's underlying like-for-like core grant funding settlement for 2021/22 showed an increase of 2% in cash terms.
- 4.6 **Exhibit 5** summarises councils' relative budget savings gaps at the time of budget-setting. Edinburgh's gap, at £31.1m, was broadly in line with the Scottish average of 3% of net expenditure. A savings programme to address this requirement on a recurring basis was developed and approved by Council in February 2022. Of these savings, 89% by value were then delivered as shown in **Exhibit 6**, continuing the improving trend of recent years and close to the Scotland-wide average of 94% noted in Paragraph 23.
- 4.7 While the position for 2022/23 will not be confirmed until May 2023, the level of savings delivery is expected to have continued the improving trend apparent in recent years, linked to the putting in place of more robust scrutiny at the savings inception, implementation and delivery stages. It should be acknowledged, however, that the majority of these approved savings in 2022/23 are of a corporate nature, meaning that sustaining these levels of delivery will become more challenging when a greater proportion requires to come from frontline services.
- 4.8 In common with the majority of other councils, as shown in **Exhibit 7** the Council's level of reserves increased in 2021/22. As of 31 March 2022, the General Fund reserves had increased to £257.205m, a movement of £36.172m from the preceding year. This sum reflected the net in-year application of COVID-related funds of £14.518m, offset by increases in sums set aside for specific investments of £31.680m and various, primarily statutory, other funds (including the Council Tax

Discount Fund, Devolved School Management Fund and the Council's General Fund) of £19.010m.

- 4.9 Of these total usable reserves, around a third were COVID-related and earmarked to support specific initiatives or offset continuing income shortfalls, or additional expenditure, assumed within the budget framework. The revenue budget update report elsewhere on today's agenda assumes full application of these COVID-related sums over the period to 2026/27.
- 4.10 **Paragraphs 28 to 32** consider the in-year impact of the pandemic and inflationary pressures on councils' capital programmes. While the actual level of capital expenditure reported was also a product of year-on-year variation in planned spend, the Council's gross capital expenditure in 2021/22 was 30% higher than in 2020/21, primarily due to a gradual resumption of relevant projects following the pandemic. Significant delays were nonetheless experienced due to the scarcity of key construction materials and staff taking time to return from furlough, as well as the new standard operating practices on-site reducing productivity leading to elongation of the capital programme. While some of this slippage is expected to have been naturally occurring, the majority was COVID related, with the lost time gradually recovered across the programme as a whole.
- 4.11 **Paragraphs 33 and 34** provide an overview of councils' debt levels during the year, noting a slight increase across Scotland as a whole. Edinburgh's own debt levels mirrored this position, with a year-on-year increase of 0.2%. Full related provision for financing charges is, however, included in the revenue budget framework and the actual level of external debt is lower than the Capital Financing Requirement (CFR) as the Council has adopted a position of under-borrowing, as set out in the Treasury Strategy.
- 4.12 **Paragraphs 35 to 39** contain an overview of in-year investment returns for Scotland's Local Government Pension Funds.
- 4.13 The remaining section of the Audit Scotland report looks at **councils' financial standing and outlooks as of the time of setting 2022/23 budgets** in February 2022. The Council undertook a comprehensive realignment of its reserves policy as part of setting the 2021/22 budget, almost doubling the size of its unallocated general reserve and reprioritising a number of other existing earmarked reserves in recognition of the on-going expenditure and income impacts of the pandemic. The 2022/23 budget was set against this backdrop.
- 4.14 A five-year timeframe was also adopted with regard to revenue budget-setting, albeit with significant gaps remaining in later years of the framework. The planning assumptions underpinning future years' funding gaps are subject to on-going review and an assessment of the implications of the Scottish Government's recently announced Budget for 2023/24 is included elsewhere on today's agenda.
- 4.15 In general terms, however, the Council continues to face significant financial pressures resulting from increased demand for services, inflation and legislative reform, as well as the on-going financial impacts of the pandemic. These factors are set against a backdrop of core grant funding (accounting for around three quarters

of the Council's overall income) that is not increasing. While opportunities for efficiencies will be examined in the first instance, members will therefore likely need to make increasingly difficult choices about the Council's priorities, including considering service reductions, across all service areas to maintain expenditure in line with available income.

- 4.16 **Paragraphs 43 to 47** summarise the main elements of the Scottish Government's Resource Spending Review announced in May 2022, with an essentially unchanged planning allocation for local government over the period from 2023/24 to 2026/27. While each year's budget is subject to separate annual Parliamentary consideration, the overall funding allocations for Local Government, when account is taken of funding for new or expanded commitments, are consistent with this baseline assumption.
- 4.17 The remaining paragraphs of the report summarise the background to councils' budget-setting processes for 2022/23. Edinburgh's budget gap was slightly lower than the Scottish average, with around a third of this requirement addressed through a 3% increase in Council Tax rates and the remainder through the identification of recurring savings, the majority of which were in corporate budgets.

5. Next Steps

- 5.1 Publication of the Financial Bulletin will be complemented by the issuing of the *Performance Overview* report in May 2023 and a subsequent report will therefore be brought forward to both the Finance and Resources and Governance, Risk and Best Value Committees.

6. Financial impact

- 6.1 There is no direct impact arising from the report's contents but the report reminds officers and members of the importance of a number of aspects of sound financial management in underpinning longer-term sustainability.

7. Stakeholder/Community Impact

- 7.1 There is no direct impact arising from the report's contents.

8. Background reading/external references

- 8.1 [Revenue Budget 2021/22: outturn report](#), Finance and Resources Committee, 8 September 2022
- 8.2 [City of Edinburgh Council – 2021/22 Annual Audit Report to the Council and the Controller of Audit](#), Finance and Resources Committee, 10 November 2022

9. Appendices

One – Local Government in Scotland – Financial Bulletin 2021/22

Local government in Scotland

Financial bulletin 2021/22



ACCOUNTS COMMISSION 

Prepared by Audit Scotland
January 2023



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Audit team

The core audit team consisted of: Blyth Deans, Adam Bullough, Chris Lewis and Martin Allan under the direction of Carol Calder.

Key messages

Local government finances for 2021/22

- 1** Despite additional Covid-19 funding, councils continued to face significant financial challenges during 2021/22, requiring significant savings to deliver balanced budgets and increasingly difficult choices to be made about spending priorities.
- 2** In 2021/22, councils' savings performance continued to improve and total usable reserves increased, which councils have used to contribute towards meeting budget gaps arising from service demand and budget pressures.
- 3** In 2021/22, Scottish Government revenue funding to councils increased by 5.3 per cent in real terms. This represented the first real-terms increase on the 2013/14 revenue funding position since 2015/16 (excluding one-off Covid-19 money). In 2021/22, revenue funding levels for local government and other parts of the Scottish Government budget (excluding Covid-19 funding) have converged back to a level similar to eight years ago.
- 4** An increasing proportion of local government funding is now either formally ring-fenced or provided with the expectation it will be spent on specific services. We calculate this to be 23 per cent of total revenue funding in 2021/22. Ring-fenced and directed funding helps support delivery of key Scottish Government policies but removes local discretion and flexibility over how these funds can be used by councils.

- 5 Councils have noted that Covid-19 and inflationary costs are having an impact on capital projects. If these issues persist, they will present risks to councils' capital programmes which form a necessary component of modernising services to deliver improved outcomes for local communities.

Outlook for local government finances

- 6 Councils face the most difficult budget-setting context seen for many years with the ongoing impacts of Covid-19, inflation and the cost of living crisis. They will need to continue to make recurring savings and also make increasingly difficult choices with their spending priorities, including, in some cases, potential service reductions.
 - 7 Two-thirds of councils intend to use reserves to help bridge the 2022/23 gap between anticipated expenditure and revenue (budget gap) of £0.4 billion but this reliance on non-recurring reserves is not sustainable in the medium to long term. Delivering recurring savings and reducing reliance on using reserves to fill budget gaps will be key to ensuring longer-term financial sustainability. This makes the case for a continued focus on service reform, based on strong engagement with communities, more important now than ever.
-

About this report

- 1.** This bulletin provides a high-level independent analysis of the financial performance of councils during 2021/22 and their financial position at the end of that year. It also sets out some of the longer-term financial challenges facing councils in the context of the Scottish Government's Resource Spending Review and the cost of living crisis.
- 2.** The Accounts Commission's wider local government overview report will be published in May 2023 and will include further analysis of the financial information presented in this bulletin along with wider commentary on the financial and performance challenges facing local government.
- 3.** Our primary sources of information for the financial bulletin are councils' 2021/22 audited accounts, including management commentaries and the 2021/22 external annual audit reports, where available. We have supplemented this with data collected as part of a data set request issued to local auditors in October 2022.
- 4.** The Covid-19 pandemic has again created challenges that have affected the preparation of this report. The rescheduling of audit timetables meant that audited accounts did not require certification until 30 November 2022. Ten sets of accounts were certified by the revised deadline, with a further 16 signed off thereafter. As at 20 December 2022, five councils' accounts are still to be certified; therefore, analysis in this report is based on 27 sets of audited accounts and five sets of unaudited accounts.
- 5.** We refer to 'real-terms' changes in this bulletin. This means that we are showing financial information from past and future years at 2021/22 prices, adjusted for inflation so that they are comparable. To make that comparison we use gross domestic product (GDP) deflators to adjust for inflation, which are published quarterly by HM Treasury. GDP deflators are the standard approach adopted by both the UK and Scottish governments when analysing public expenditure. As a result of the way that GDP is calculated, Covid-19 resulted in volatility across 2020/21 and 2021/22. To compensate for this, and to provide meaningful comparisons between years, we have used an average GDP growth rate across 2020/21 and 2021/22 in our calculations to separate inflation (changes in prices) from changes in outputs and those largely attributable to Covid-19 spending.
- 6.** We also refer to figures in 'cash terms' in this bulletin. When we use this term it means that we are showing the actual cash or money paid or received.

1. Councils' financial summary 2021/22

Total revenue funding and income

7. Total revenue funding and income to councils was £20.3 billion in 2021/22, a £0.3 billion (or one per cent) decrease on the previous year in real terms (one per cent increase in cash terms) ([Exhibit 1, page 7](#)). The majority (55 per cent) of this funding comes from the Scottish Government, with the remaining balance from other sources, see Exhibit 1 for a full breakdown.

8. Councils have received a range of new and additional funding amounting to £1.3 billion in 2020/21 and £0.5 billion in 2021/22 to support them in dealing with the financial impacts of the Covid-19 pandemic. This additional Covid-19 funding has decreased as a proportion of overall council funding as the pandemic has progressed, from six per cent of total funding received in 2020/21 to three per cent in 2021/22.

9. The Scottish Government also provided councils with £90 million to allow them to freeze council tax levels in 2021/22.

10. Excluding Covid-19 related funding, revenue funding and income saw a £0.5 billion (or three per cent) real-terms increase in 2021/22 on the previous year, from £19.3 billion to £19.8 billion.

The average Council Tax collection rate across Scotland increased during 2021/22. It is now more in line with pre pandemic levels

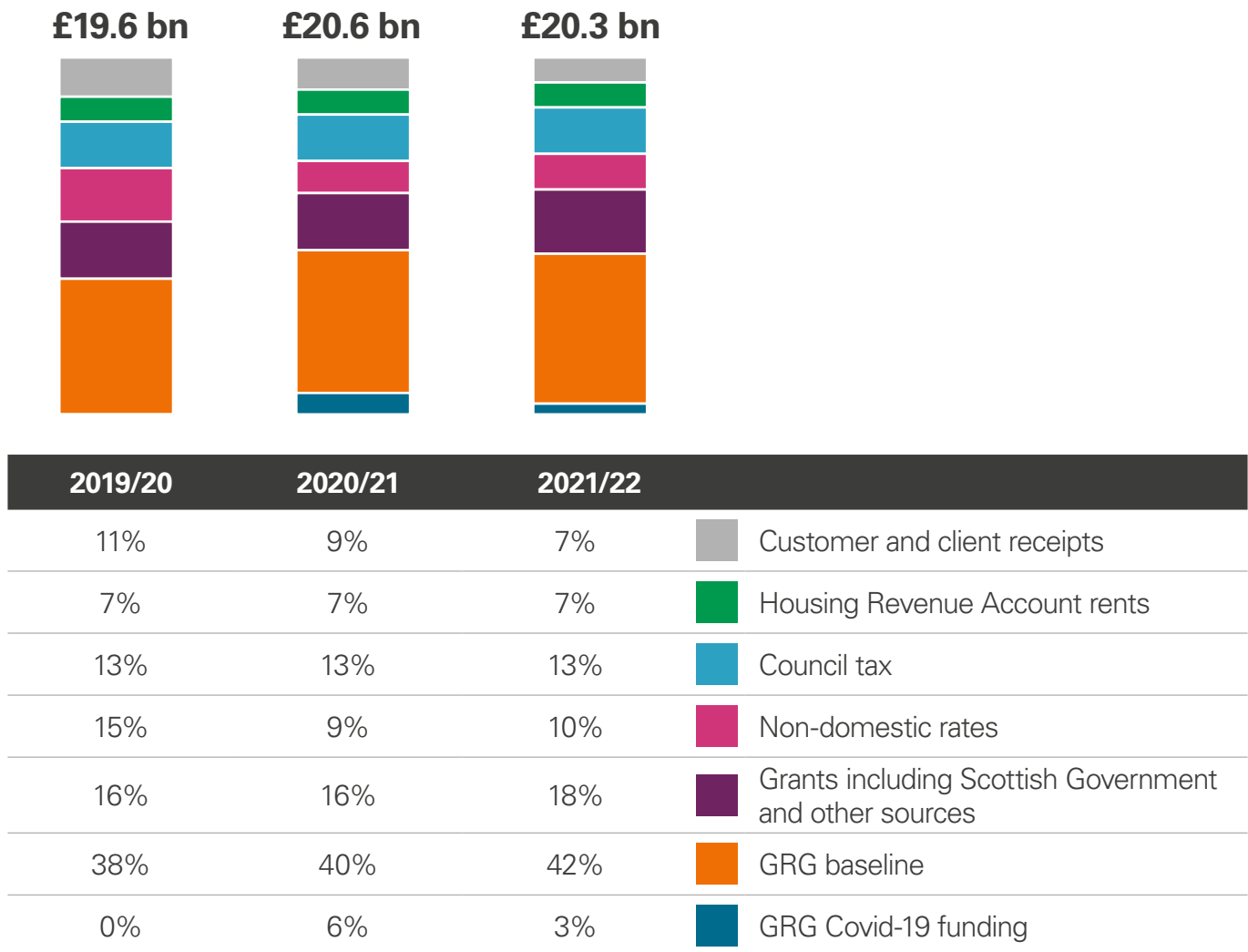
11. The in-year collection rate (for 2021/22 charges) increased from an average of 94.8 per cent in 2020/21 to 95.7 per cent, which is broadly in line with pre-pandemic collection rates (95.8 per cent in 2019/20). Collection rates rose across all councils apart from Midlothian which remained static and Orkney which fell by 2.5 per cent. The total amount of council tax billed, taking account of council tax reductions, was £2.7 billion. Of this total, £2.6 billion was collected by 31 March 2022.

Revenue funding and income saw a 3 per cent real terms increase in 2021/22, once Covid-19 related funding is excluded

Exhibit 1.

Sources of funding and income 2019/20 and 2021/22

Total revenue funding and income to councils was £20.3 billion in 2021/22, a £0.3 billion (or one per cent) decrease on the previous year in real terms (one per cent increase in cash terms).



Source: Audited financial statements 2019/20, 2020/21 and 2021/22

Scottish Government funding

12. In 2021/22 councils received total revenue funding of £12.1 billion from the Scottish Government. This consisted of General Revenue Grant funding of £8.7 billion; Non-Domestic Rates distribution (NDR) of £2.1 billion, specific grants of £0.8 billion and non-recurring Covid-19 funding of £0.5 billion. Total revenue funding to councils from the Scottish Government increased by 1.1 per cent in cash terms and decreased by 1.6 per cent in real terms in 2021/22 compared to the previous year ([Exhibit 2, page 8](#)).

Exhibit 2.

Changes in Scottish Government revenue funding in 2021/22

Scottish Government revenue funding fell by 1.6 per cent in real terms in 2021/22, although when non-recurring Covid-19 funding is taken out there is an increase of 5.3 per cent.

	2020/21 £ million	2021/22 £ million	Cash change %	Real terms change %
General revenue grant	8,099	8,682	7.2	4.4
Non-domestic rate income	1,868	2,090	11.9	8.9
Specific revenue grants	710	776	9.3	6.5
Non-recurring Covid-19 funding	1,254	515	-58.9	-60.0
Total revenue funding	11,931	12,063	1.1	-1.6
Total revenue excluding Covid-19	10,677	11,549	8.2	5.3

Source: Finance circulars and Scottish Government budget documents

13. When non-recurring Covid-19 funding is excluded, the increase in funding from the previous year is 8.2 per cent in cash terms and 5.3 per cent in real terms.

An increasing proportion of local government funding is now either formally ring-fenced or provided with the expectation it will be spent on specific services

14. Within the £12.1 billion Scottish Government revenue funding, an element is identified by the Scottish Government as specific revenue grants, set out in the annual settlement to councils. This ring-fenced funding, totalling £0.8 billion in 2021/22 (£0.7 billion in 2020/21), must be used to fund identified policies, such as:

- Early Learning and Childcare Expansion (£546 million)
- Pupil Equity Fund (£120 million)
- Criminal Justice Social Work (£86 million).

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

16. Collectively, ring-fenced and directed funding totalled £2.7 billion, representing 23 per cent of total revenue funding (18 per cent in 2020/21). £1.61 billion of this was allocated at the start of the year with a further £1.04 billion allocated throughout the year through budget revisions ([Exhibit 3, page 10](#)). A large amount of this was to support elements of education and social care service provision.

2021/22 funding levels from the Scottish Government to local government (excluding Covid-19 funding) increased in real terms for the first time since 2015/16 and converged with other Scottish Government revenue funding

17. In previous overview reports, we have commented that Scottish Government funding to local government has not kept pace with relative increases in the levels of funding allocated to other parts of the Scottish Budget. Previous overview reports have also highlighted that for many years now councils have had to make efficiency savings, redesign services, and use reserves to meet budget gaps arising from service demand and budget pressures.

18. Revenue funding from Scottish Government to local government between 2013/14 and 2021/22 increased by 6.1 per cent (in real terms) whereas Scottish Government revenue funding to other parts of the Scottish Government budget increased by a significantly higher figure of 27.2 per cent over the same period. This, and previous differences in relative funding, has largely arisen as a result of Scottish Government policy to protect funding for the NHS.

19. Over the period 2013/14 to 2021/22, after two years of relatively static funding local government saw its real-terms revenue funding fall between 2015/16 and 2020/21 (excluding Covid-19 funding) with 2021/22 being the first year of real-terms growth (excluding Covid-19 funding) since 2015/16. In 2021/22 funding levels for local government and other parts of the Scottish Government budget (excluding Covid-19 funding) have converged back to a level similar to eight years ago.

20. The large increases in the Scottish budget in 2020/21 and 2021/22 were a result of Covid-related **Barnett consequentials**. Given these were exceptional sources of funding we have analysed the underlying Scottish Government and local government revenue funding position with Covid-19 funding excluded ([Exhibit 4, page 11](#)). Under this analysis, over the same period, Scottish Government revenue funding to local government increased by 1.6 per cent and Scottish Government revenue funding to other parts of the Scottish Government budget increased by 0.8 per cent.


Barnett consequentials

The Barnett formula is the way the UK Government ensures that a share of additional funding – allocated only to England – is provided fairly to Scotland, Wales, and Northern Ireland. The formula delivers a fixed percentage of additional funding allocated in England to services which are devolved. Each devolved administration can allocate these funds as it believes appropriate.

Exhibit 3.

Ring-fenced elements of Scottish Government revenue funding

The proportion of funding which is ring-fenced and directed or provided for specific services has increased, with around £1 billion allocated during the year in 2021/22.

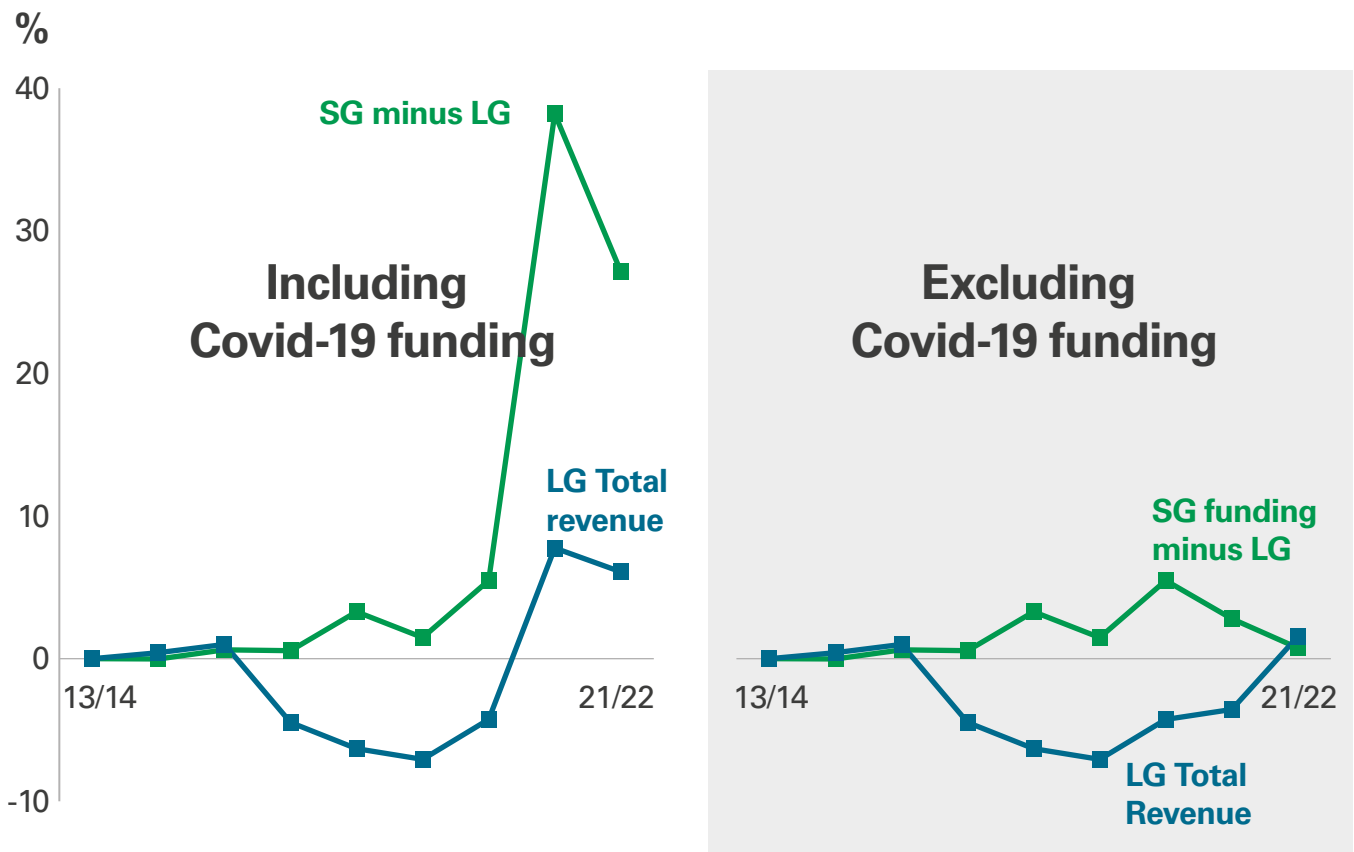
 Source	2020/21 £ million	2021/22 £ million
Specific Revenue Grant from finance circular	709.8	775.9
Measures outlined in initial circular narrative	606.3	347.4
Transfers from other portfolios in Scottish Budget	188.1	488.1
Redeterminations in further circulars	48.0	544.8
Transfers from other portfolios in Autumn budget revision	350.5	395.7
Transfers from other portfolios in Spring budget revision	42.9	104.0
Total ring-fenced/expected to be spent on specific services	1,945.5	2,655.8
Total revenue funding	10,667.8	11,549.0
Percentage ring-fenced/expected to be spent on specific services	18.2%	23.0%

Source: Scottish Local Government Finance Circulars and budget documents. Some elements of funding appear in circulars and Scottish Budget so have been removed to avoid double counting.

Exhibit 4.

A comparison of real-terms changes in revenue funding in local government and other Scottish Government areas (including and excluding Covid-19 funding)

Revenue funding from Scottish Government to local government between 2013/14 and 2021/22 increased by 6.1 per cent when Covid-19 funding is included, and by 1.6 per cent when Covid-19 funding is excluded.



Source: Finance circulars and Scottish Government budget documents

Council budgets and outturn 2021/22

In 2021/22, budget gaps were largely consistent with previous years

21. In 2021/22, Scotland's 32 councils had a budgeted net expenditure of £15.2 billion. At the time of budgeting, councils identified **budget gaps** totalling £0.4 billion (three per cent), which was broadly consistent with the gap identified in the two previous years (£0.5 billion in 2020/21 and 2019/20). The budget gap at a council level varied between one per cent and 22 per cent ([Exhibit 5, page 12](#)).

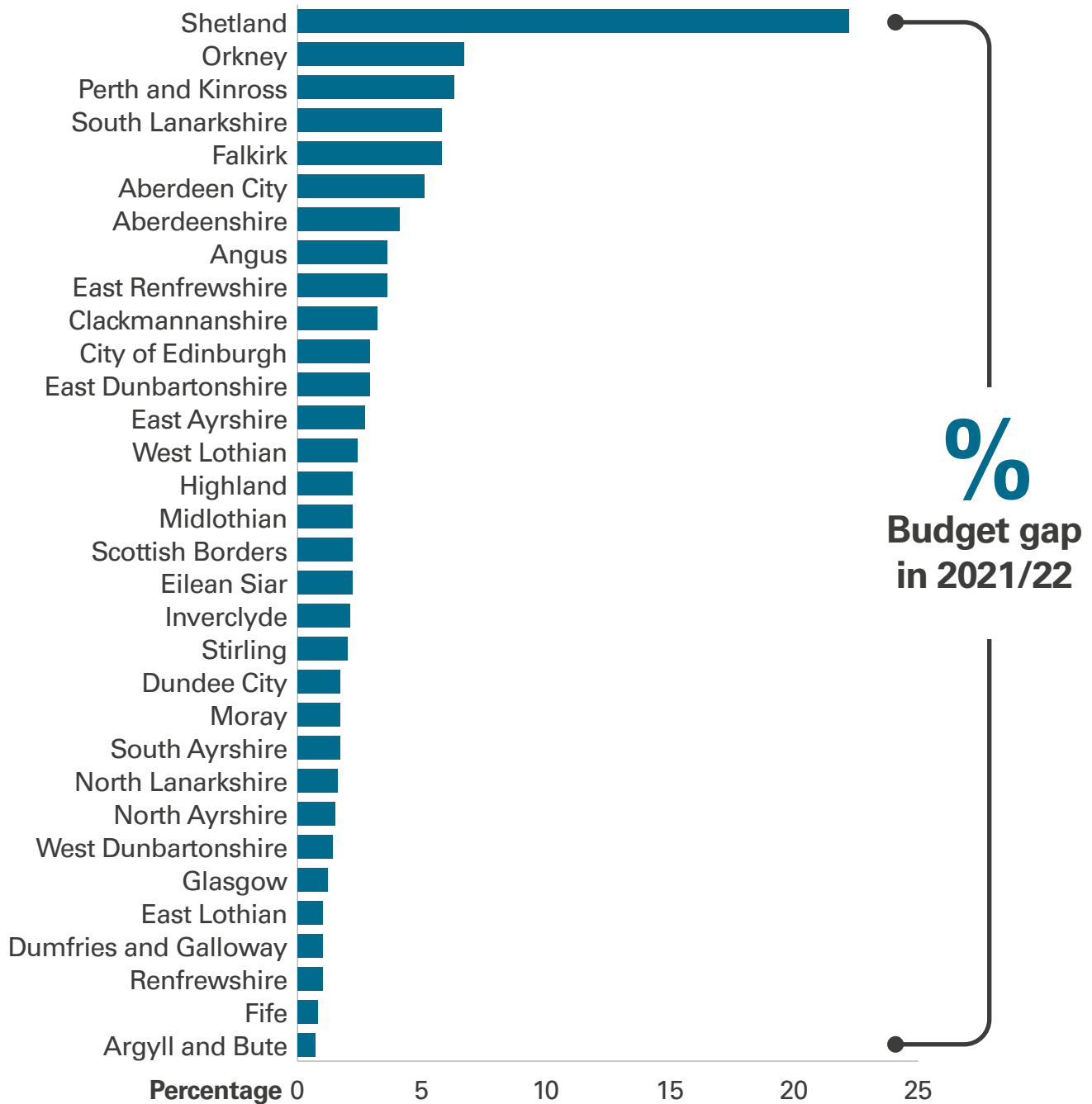
Budget gap

This describes the difference between anticipated expenditure and revenue at the time of setting the budget.

Exhibit 5.

Budget gap as a proportion of net cost of services for all 32 councils in 2021/22

The budget gap at a council level varied between one per cent and 22 per cent.



Source: Council budget papers, Auditor data return

22. Recurring savings were expected to contribute 37 per cent of the £0.4 billion budget gap in 2021/22 along with Scottish Government funding to allow councils to freeze council tax (20 per cent), use of reserves (17 per cent), non-recurring savings (eight per cent), financial flexibilities (four per cent) and a range of other specific actions (12 per cent).

Savings performance improved in comparison to previous years

23. Councils had set themselves savings targets totalling £0.2 billion in 2021/22. Ninety-four per cent of these savings were achieved (84 per cent in 2020/21), with 76 per cent on a recurring basis. Fourteen councils achieved their savings targets in full on a recurring basis, whereas five councils had over half of their savings being delivered on a non-recurring basis. Four councils had no savings targets in place for 2021/22 ([Exhibit 6, page 14](#)).

Total usable reserves increased by £0.3 billion to £4.1 billion in 2021/22

24. In 2021/22, almost three quarters of councils (23) reported an increase in usable reserves. This compares to all 32 councils reporting an increase in 2020/21, largely as a result of additional Covid-19 funding carried forward. Total usable reserves now stand at £4.1 billion, representing an increase of £0.3 billion (seven per cent) on the previous year. This compares to an increase of £1.2 billion in 2020/21 compared to 2019/20. [Exhibit 7 \(page 15\)](#) details the increase in councils' usable reserves during 2021/22.

25. General fund reserves, excluding Housing Revenue Account (HRA), have increased by £0.3 billion to £2.7 billion. The vast majority of this relates to increases in committed balances (that is reserves have been allocated for a specific purpose) which increased by £0.3 billion to £2.3 billion in 2021/22, and is more than half of the total usable reserves balance. Uncommitted reserves (money not earmarked for a specific purpose) have decreased from £0.5 billion in 2020/21 to £0.4 billion in 2021/22. These reserves are used to mitigate the financial impact of unforeseen circumstances. [Exhibit 8 \(page 16\)](#) shows the nature and value of usable reserves in 2021/22.

General fund reserves

This is the main revenue account which summarises the cost of all services provided by a council.

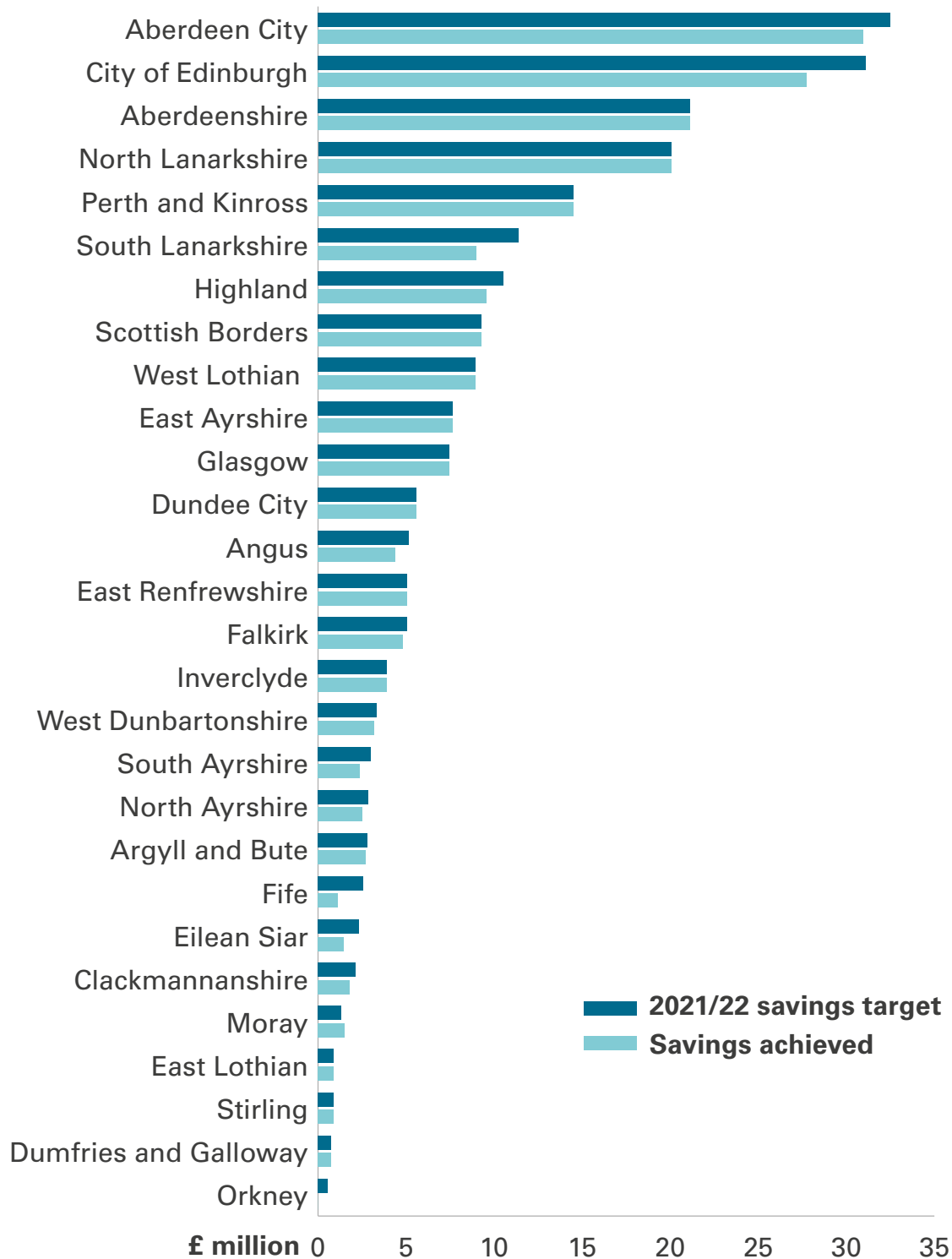
Councils have improved the way in which Covid-19 funds are disclosed in their accounts, but the level of detail varies

26. Elements of Covid-19 funding that have been carried forward in general committed and uncommitted reserves total £0.6 billion, 23 per cent of the total general fund balance. However, at a council level this varies between 49 per cent of the total general fund balance (Moray and West Lothian) to eight per cent (Dumfries and Galloway), ([Exhibit 9, page 17](#)).

Exhibit 6.

Councils' savings targets compared with savings achieved in 2021/22

Fourteen councils achieved their savings targets.



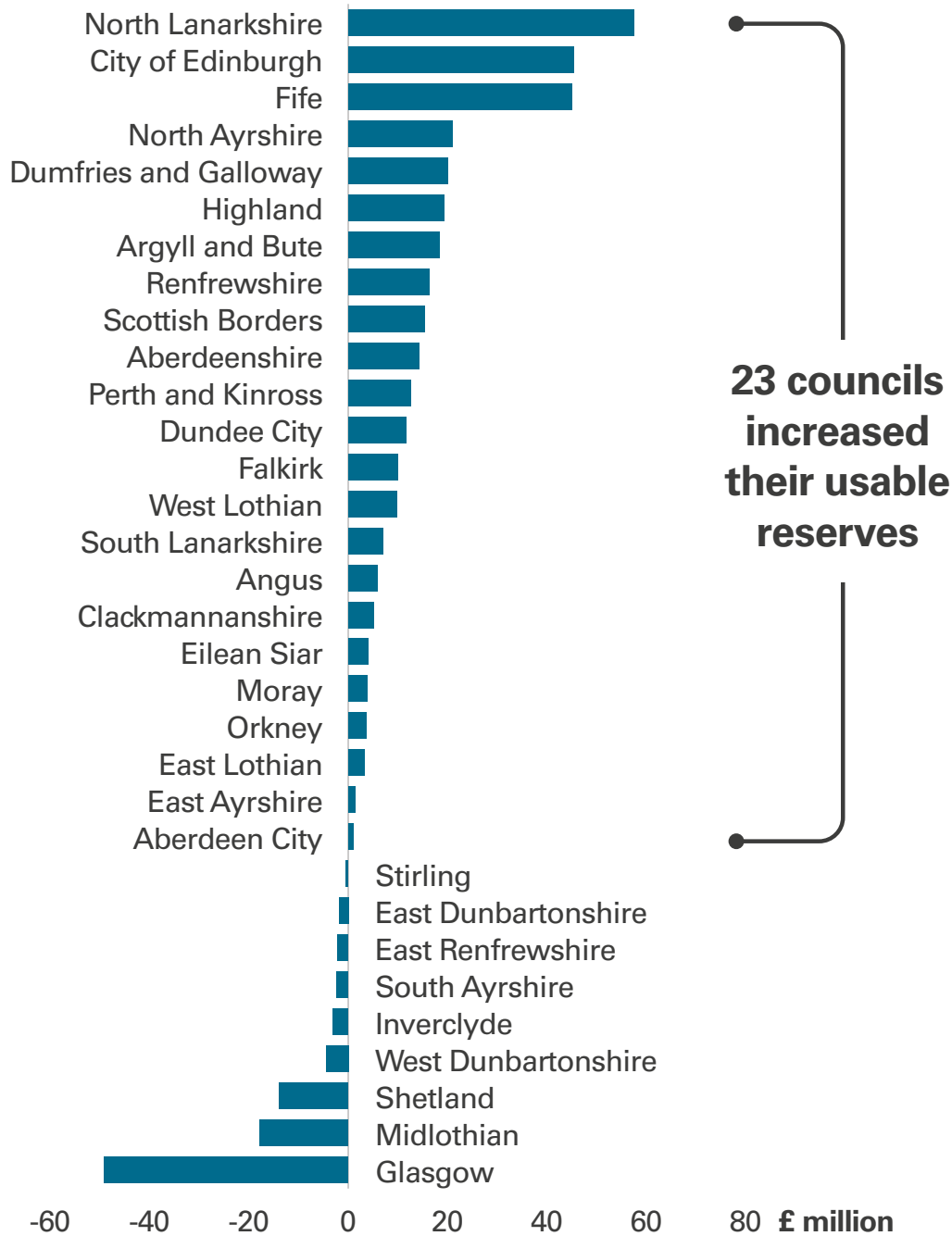
Note: Excludes East Dunbartonshire, Midlothian, Renfrewshire and Shetland due to not having savings targets in place for 2021/22.

Source: Audited financial statements 2021/22

Exhibit 7.

Changes in councils' usable reserves during 2021/22

Twenty-three councils increased their usable reserves.

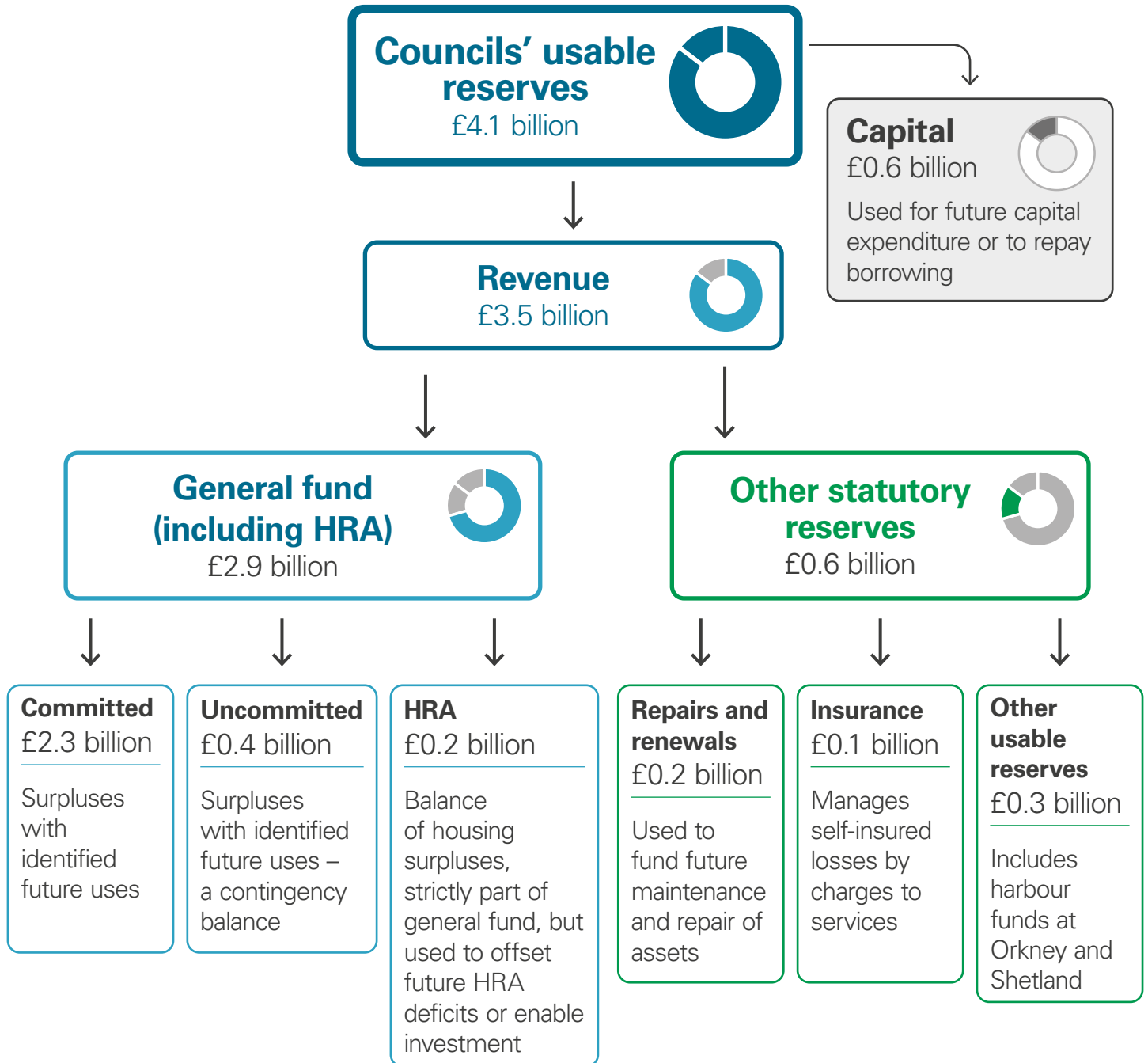


Source: Audited financial statements 2021/22

Exhibit 8.

The relative size and nature of councils' usable reserves

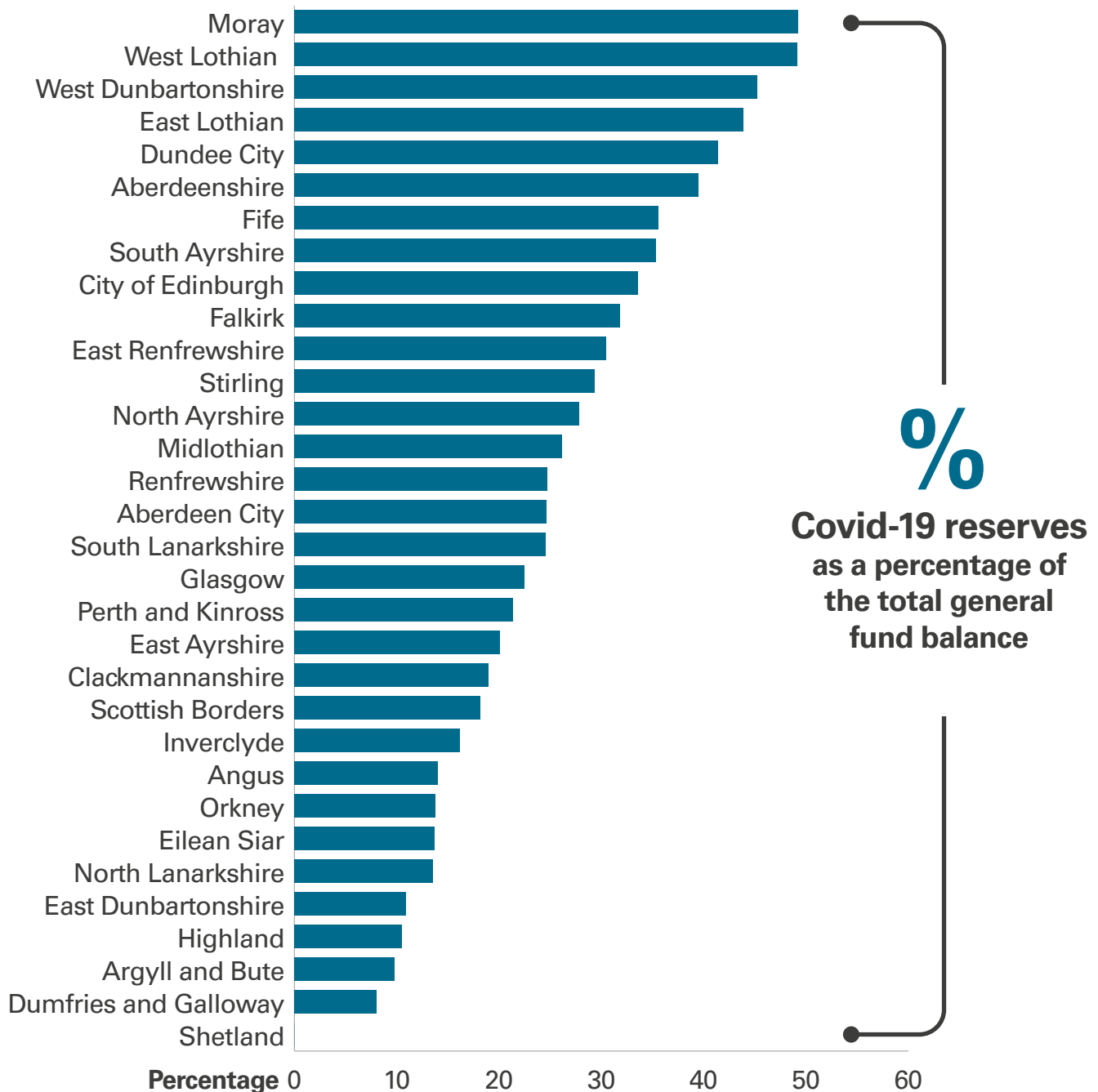
In 2021/22, usable reserves held by councils totalled £4.1 billion.



Source: Audited financial statements 2021/22

Exhibit 9.

Total Covid-19 reserves as a percentage of the total general fund balance for 2021/22



Note: Excludes Shetland as they do not have any Covid-19 related reserves carried forward.

Source: Audited financial statements 2021/22

27. In last year's [Local government in Scotland: Financial overview 2020/21](#) we noted that within the general fund, councils' accounts had not always clearly identified the element arising from Covid-19 funding and recommended that elements of Covid-19 funding that are being carried forward into general reserves should be clearly identified. Councils have improved the way in which Covid-19 reserves are disclosed in their accounts. However, this varies, with nine councils only providing a single line narrative and the remaining councils providing varying levels of detail as to how the funds have been allocated (eg, education, housing, business support, mental health and equalities). Eilean Siar and Aberdeen City had the most detailed breakdowns.

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Capital

Capital expenditure increased in 2021/22 though was still below the level in 2019/20

28. Capital spending across Scotland increased by £0.7 billion in 2021/22, from £2.4 billion in 2020/21 to £3.1 billion ([Exhibit 10, page 19](#)). Capital spending in 2019/20 was £3.6 billion.

29. Twenty-six councils (81 per cent) reported higher capital expenditure in 2021/22 than in 2020/21. Only six councils spent less on their capital programmes in 2021/22 than 2020/21.

30. The main sources of capital financing are still government grants. These were largely unchanged from 2020/21 (£1.1 billion in 2021/22 compared to £1.2 billion the previous year), however, the overall increase in capital expenditure means that an increasing amount is financed by borrowing.

Covid-19, inflationary costs and shortages in construction materials had an impact on capital projects

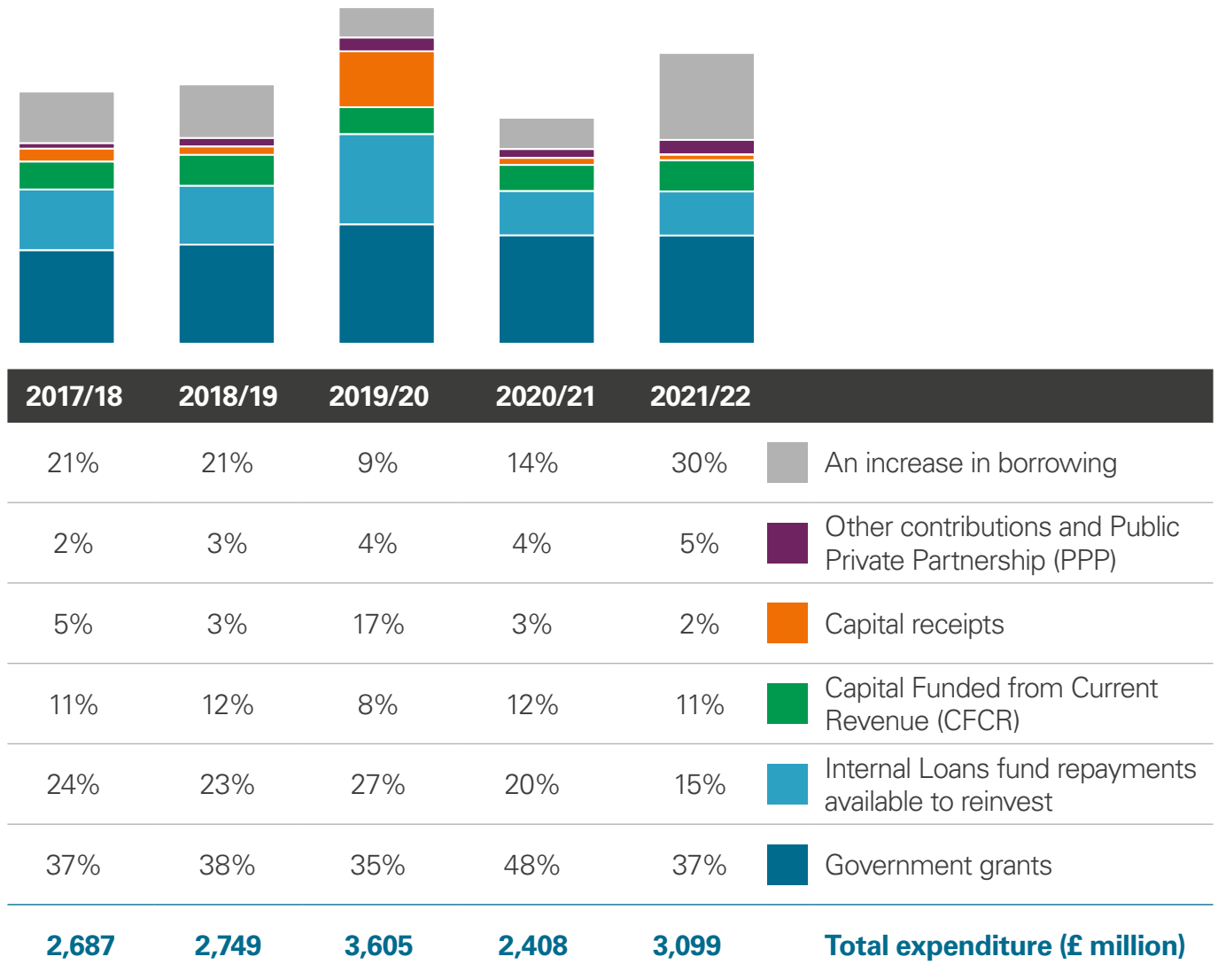
31. Auditors in councils reported slippage against capital projects and cited Covid-19, inflationary costs and shortages in construction materials as reasons for this. If these issues persist they will present risks to councils' capital programmes which are a necessary component of modernising services to deliver improved outcomes for local communities. There were some exceptions, for example in West Lothian where expenditure on capital was £141.3 million, an increase of £14.8 million against its original budget. Acceleration of £13.1 million for new developer-funded schools at Winchburgh was the most notable example.

Capital spending across Scotland increased in 2020/21 to £3.1 billion

Exhibit 10.

Capital expenditure analysed by sources of finance 2017/18 to 2021/22

Capital expenditure increased in 2021/22 although an increasing proportion was funded through an increase in borrowing.



Source: Audited financial statements 2017/18 – 2021/22

Further information about how councils may borrow money to fund capital expenditure can be found at [Local government borrowing: factsheet](#).

32. Slippage against capital projects was noted at some councils in 2021/22:

- **Dundee City Council:** Capital works costing £57 million were completed in 2021/22 against a budget of £117 million, representing slippage of 51 per cent. This was highlighted as a risk to the council delivering against strategic objectives.
- **East Dunbartonshire Council:** General services capital spending was £69 million compared with an initial budget of £96.3 million, which was subsequently revised downwards to £76.1 million for projects impacted by Covid-19. The main area of slippage was related to a new additional support needs school (£3.5 million) which has been rescheduled to 2022/23. Housing capital expenditure totalled £15.9 million against a revised budget of £17.5 million.
- **East Lothian Council:** The general services capital budget for 2021/22 was £97.7 million. A significant element of the £32.7 million underspend has been reprofiled to 2022/23. In addition to the issues and challenges arising from Covid-19, supply chain problems and the war in Ukraine were reported as having increased certain costs as well as the council's risk exposure for capital investment. The HRA capital budget for 2021/22 was £29.7 million. The overspend of £1.2 million reflects accelerated new build council housing, the costs of which have been partially offset by additional grant funding above the budgeted figure.

Net debt has increased by £0.2 billion since 2020/21

33. Total net debt (total debt less cash and investments) has increased across councils by £0.2 billion to £16.4 billion. Fifteen councils have increased their net debt in 2021/22. This compares to eight councils in 2020/21.

34. Councils' total debt has increased by £0.3 billion to £19 billion; this may be related to the increased need to borrow to fund capital expenditure, with 19 out of 32 councils having increased long-term borrowing from the previous year and 15 councils with increased short-term borrowing compared to the previous year.

Local government pension funds

2021/22 Pension Fund investment returns, although largely positive, were 62 per cent lower than in the previous year

35. Ten of the 11 main Scottish Local Government Pension Funds experienced positive investment returns in 2021/22. Orkney Islands Pension Fund recorded a loss on investment activity, representing 2.7 per cent of the net investment assets brought forward into 2021/22.

36. Although Pension Fund investment returns were largely positive, net returns on investments were 64 per cent lower than in 2020/21 (in cash terms). The net returns on investments, as a proportion of the brought forward net investment assets total, varied between a reduction of 2.7 per cent and an increase of 11 per cent in individual funds.

Scottish Pension Fund's funding positions have generally improved since the last triennial valuation

37. Scottish Pension Funds recorded a cumulative **funding level** of 104 per cent, ranging from 92 per cent to 118 per cent, per the triennial actuarial review figures as at 31 March 2020. At the time of this valuation, four of the 11 Scottish Local Government Pension Funds recorded liabilities as being greater than assets. Although four of the funds recorded liabilities in excess of assets, the 2020 position represented an improvement since the 2017 triennial valuation.

38. Auditors reported that the Covid-19 pandemic had a significant impact on Scottish Pension Fund's funding position and asset valuations, as indicated in the **triennial valuation** as at 31 March 2020. Auditors have indicated that since the valuation, asset values have largely recovered.

39. Preparation is under way for the next triennial valuation covering the period to 31 March 2023. Any changes to employer contributions as a result of the next valuation will not take effect until 2023/24.

Funding Level

This describes the pension fund assets as a proportion of the liabilities, arising from pension benefits payable.

Triennial valuation

Every three years an actuarial valuation is carried out to monitor the assets of the fund against the liabilities of the pension benefits payable.

2. Councils' financial outlook

Councils are having to deal with a number of significant financial challenges and will need to make some difficult decisions with their spending priorities

40. In last year's [Local government in Scotland: Financial overview 2020/21](#) we noted that the longer-term funding position for councils remained uncertain, with significant challenges ahead as councils continued to manage and respond to the impact of Covid-19 on their services, finances and communities.

41. At a time when councils and their communities are still feeling the impact of the Covid-19 pandemic, councils are now having to deal with the cost of living crisis and inflationary pressures. Councils consistently identified short- and long-term cost pressures in their initial 2022/23 budget papers, including:

- pay inflation and living wage costs
- costs associated with Covid-19 recovery
- energy inflation
- non-pay inflation (including cost of materials, construction costs and contract inflation)
- demand for and price sensitivity of chargeable services and the related impact on income from fees and charges.

42. Common themes across management commentaries from councils unaudited accounts for 2021/22 are that councils continue to face significant financial challenges going forward and will need to deliver consistent recurring savings and use reserves to deal with the immediate and on-going financial impacts. They also note that elected members will need to make increasingly difficult choices, which could include having to consider service reductions. Further commentary and analysis on the future funding position of councils and the associated challenges will be included in the wider local government overview being published in May 2023.

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The future funding settlements set out in the Scottish Government's Resource Spending Review reflects flat cash funding settlements for 2022/23 to 2025/26

43. In May 2022 the Scottish Government published the first multi-year Resource Spending Review (RSR) in Scotland since 2011, outlining its resource spending plans to the end of this Parliament in 2026/27. The RSR assumes an overall cash-terms increase to the Scottish Government spending envelope of £5.7 billion over the period 2022/23 to 2026/27. The estimated increase in local government funding over this period would be £0.1 billion. This reflects flat cash funding levels for 2022/23 to 2025/26, with a small uplift in 2026/27. However, the outlook of the RSR may look different after the Scottish Government's 2023/24 budget.

44. The Fraser of Allander Institute [reported](#) in May 2022 that the RSR provides welcome insight on government priorities, and highlights a scale of challenges facing public services. However, spending plans are expressed at 'level 2' for the four years of the Spending Review period. That means financial information is at a less detailed level than public bodies would ideally like for planning purposes. It also noted that at the time of their review the RSR implies that the local government budget will decline by seven per cent in real terms between 2022/23 and 2026/27. The Convention of Scottish Local Authorities (COSLA) has expressed concerns that a flat cash settlement will result in fewer jobs and cuts to services.

45. Following the RSR, in December 2022, the Scottish Government presented their [proposed spending and tax plan for 2023/24](#) to the Scottish Parliament. In this updated position, the Scottish Government sets out that there will be an increase of over £570 million in additional revenue and capital funding available to councils for 2023/24. They also confirmed that they would not seek to freeze or set a cap on council tax increases, giving council's full flexibility to vary rates locally.

46. The recent Scottish Parliament Information Centre (SPICe) [publication](#) reports that, once adjustments are made for the in-year funding councils will receive for free school meals, the additional funding for 2023/24 was just under £640 million. SPICe report that this will represent a £223 million real terms increase in funding, based on 2022/23 prices.

47. COSLA had previously estimated a [£1 billion gap](#) for councils in 2023/24 and argue that the uplift amounts to £71 million once national policy commitments are taken into account. They welcome the flexibility to set their own council tax rates but state that the scope to do this will be limited due to the cost of living crisis.

Budgets for 2022/23

Councils intend to bridge the budget gap of £0.4 billion for 2022/23 with planned savings and reserves, but the reliance on non-recurring reserves is not sustainable in the medium to long-term

48. At the time of budgeting, councils identified budget gaps totalling £0.4 billion in real terms, which represented three per cent of the 2021/22 net cost of services. This is consistent with the gap identified in the previous years. The 2022/23 estimated budget gap as a proportion of 2021/22 net cost of services varied across councils from an anticipated surplus of 0.2 per cent to a gap of 23 per cent ([Exhibit 11, page 25](#)).

49. The majority of the estimated budget gap for 2022/23 was planned to be funded through the following ([Exhibit 12, page 26](#)):

- agreed recurring savings (36 per cent)
- use of reserves (32 per cent)
- increases in Council Tax (16 per cent).

50. Sixty-six per cent of councils intended to use reserves to help bridge the 2022/23 budget gap, however, the use of reserves is not sustainable in the medium to long term. The achievement of recurring savings and a movement away from the reliance and use of non-recurring reserves will be key to ensuring longer-term financial sustainability. This makes the case for a continued focus on service reform, based on strong engagement with communities, more important now than ever.

2022/23 funding settlement

Scottish Government revenue funding in 2022/23 decreased by 0.1 per cent in real terms when non-recurring funding elements are excluded

51. In [paragraphs 43 to 47](#) we have outlined the longer-term Scottish Government spending plans which were set out in the RSR. The initial local government revenue settlement from the Scottish Government in 2022/23, before taking into account non-recurring elements, increased by 3.9 per cent (cash terms) from 2021/22 to £12.0 billion. This was a real terms decrease of 0.1 per cent ([Exhibit 13, page 27](#)).

52. Non-recurring Covid-19 funding provided to councils in 2021/22 was £0.5 billion, the last year of this funding. In 2022/23, an additional £0.25 billion has been allocated to reduce council tax bills.

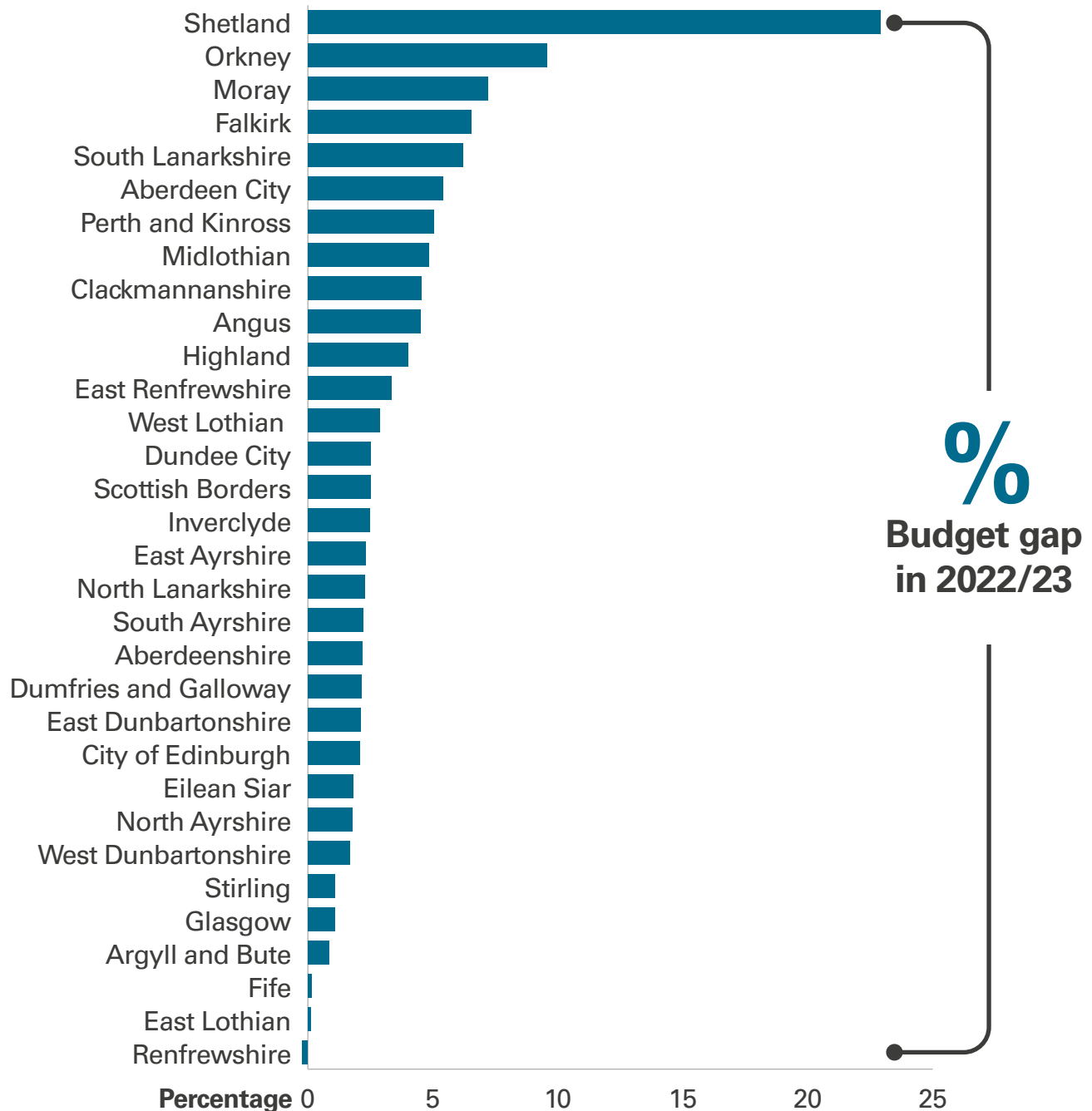
53. Total revenue funding in 2022/23 was £12.3 billion. This is a 2.4 per cent real-terms reduction on the 2021/22 position.

Councils identified budget gaps totalling £0.4 billion (3%) in real terms, of the 2021/22 net cost of services

Exhibit 11.

Budget gap as a proportion of net cost of services for all 32 councils in 2022/23

The budget gap at a council level varied between a 0.2 per cent surplus and a 22 per cent gap.

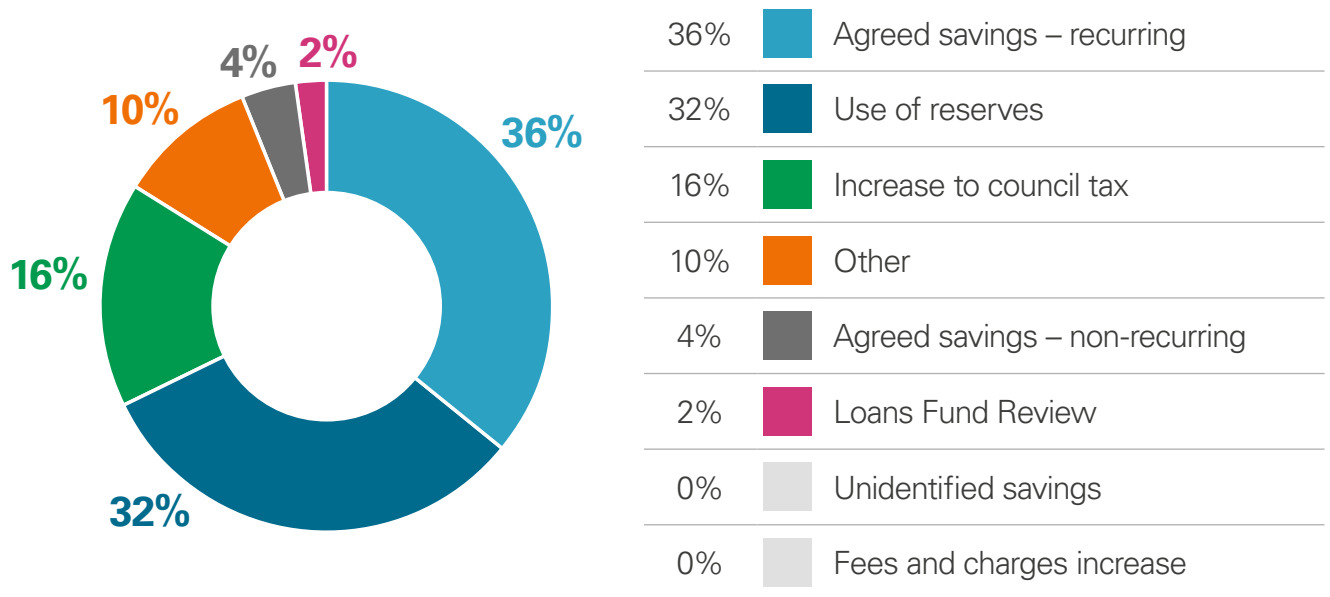


Source: Council budget papers, Auditor data returns

Exhibit 12.

Aggregate analysis of all 32 councils' proposed ways to meet the budget gap for 2022/23

The majority of the estimated budget gap for 2022/23 was planned to be funded through agreed recurring savings, use of reserves and increases in Council Tax.



Source: Auditor data returns

Exhibit 13.

Changes in Scottish Government initial revenue funding from 2021/22 to 2022/23

Total revenue funding will fall by 2.4 per cent in real terms in 2022/23.

	2021/22 £ million	2022/23 £ million	Cash change %	Real terms change %
General revenue grant	8,682	8,450	-2.7	-6.5
Non-domestic rate income	2,090	2,766	32.3	27.2
Specific revenue grants	776	785	1.1	-2.8
Non-recurring Covid-19 funding	515			
Cost of living funding		250		
Total revenue funding	12,063	12,250	1.5	-2.4
Total revenue excluding Covid-19/ cost of living	11,548	12,001	3.9	-0.1

Source: Finance circulars and Scottish Government budget documents

54. Scottish Government funding will not include Covid-specific allocations from the UK Government in 2022/23, however, there will be an increase in the overall Scottish Government budget. If we remove Covid-19 funding in 2021/22 from our analysis, the Scottish Government budget is set to increase by seven per cent in real terms, as opposed to a real-terms cut in local government funding of 0.1 per cent. However, if we include Covid-19 funding in the 2021/22 Scottish Budget, in 2022/23 it falls in real terms by ten per cent, a bigger fall than local government.

Capital funding

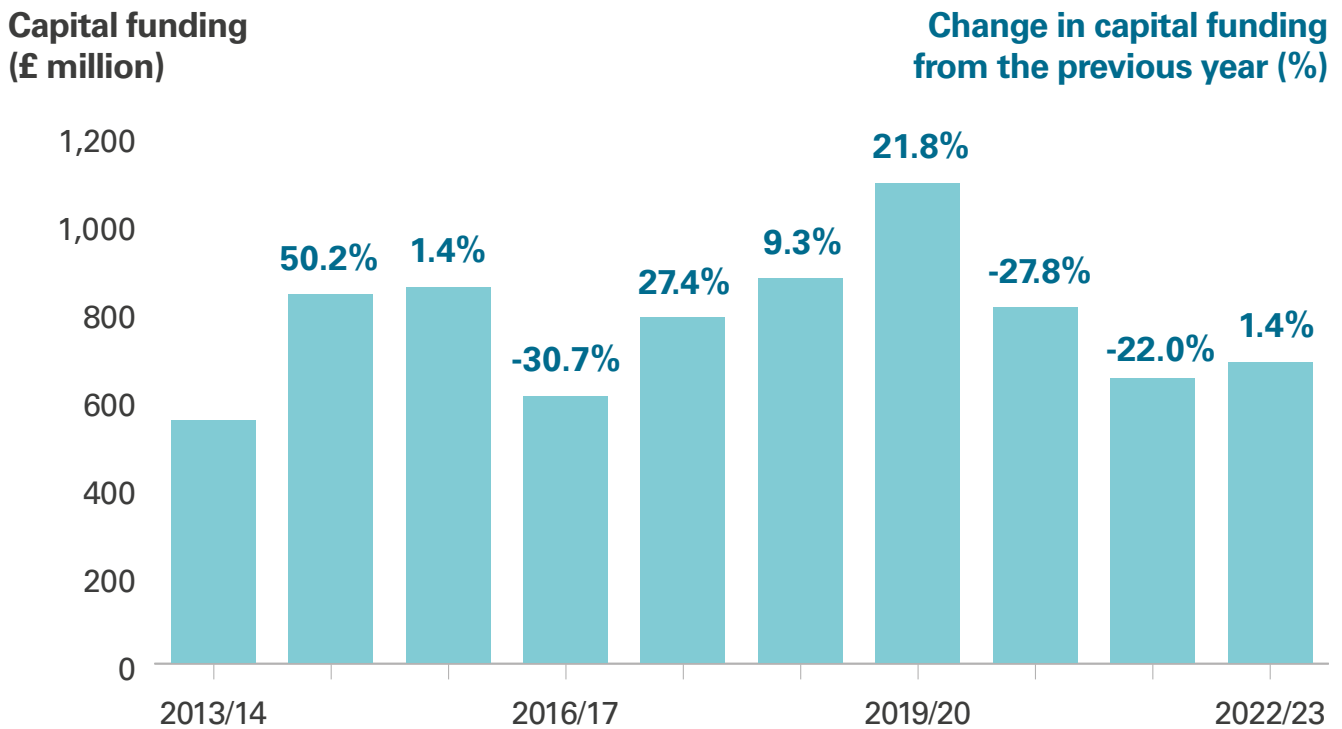
The Local Government capital settlement in 2022/23 increased from £649 million in 2021/22 to £685 million

55. Capital funding has increased by 1.4 per cent in real terms between 2021/22 and 2022/23. Capital funding had experienced significant increases up to 2019/20 before falling in 2020/21 and 2021/22. Real-terms total capital funding has now returned to levels closer to those seen in 2016/17 ([Exhibit 14, page 28](#)).

Exhibit 14.

Real-terms Scottish Government capital funding between 2013/14 and 2022/23

Scottish Government capital funding will increase slightly in 2022/23, but this follows two years of decreases over 20 per cent.



Source: Finance circulars and Scottish Government budget documents

56. Higher interest rates and inflationary costs will present risks to councils' capital programmes going forward. The affordability of capital spend will be significantly impacted by changes in interest rates. Some councils have anticipated costs will double, which has meant they will need to consider the affordability of their capital programmes going forward.

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