Governance, Risk and Best Value Committee

10.00am, Tuesday 11 October 2022

Accounts Commission: Local Government in Scotland – Financial Overview 2020/21 – 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 the Accounts Commission: Local Government in Scotland – Financial Overview 2020/21 to the Governance, Risk and Best Value Committee for scrutiny as part of its work programme.

Richard Carr
Interim Executive Director of Corporate Services

Contact: Emily Traynor, Assistant Committee Officer
Legal and Assurance Division, Corporate Services Directorate
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Referral Report

Accounts Commission: Local Government in Scotland – Financial Overview 2020/21– referral from the Finance and Resources Committee

2. Terms of Referral

2.1 On 8 September 2022, the Finance and Resources Committee considered the Accounts Commission: Local Government in Scotland – Financial Overview 2020/21 report. The report provided a summary of the main issues and themes identified within the Accounts Commission's recently published Financial Overview 2020/21 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 – 8 September 2022 - Webcast

3.2 Minute of the Finance and Resources Committee – 8 September 2022

4. Appendices

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

Finance and Resources Committee

10.00am, Thursday, 8 September 2022

Accounts Commission: Local Government in Scotland – Financial Overview 2020/21

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

Contact: Hugh Dunn, Service Director: Finance and Procurement,

Finance and Procurement Division, Corporate Services Directorate

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Report

Accounts Commission: Local Government in Scotland – Financial Overview 2020/21

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 Overview 2020/21* and how these relate to the local context within Edinburgh.

3. Background

3.1 On 10 March 2022, the Accounts Commission published its annual *Financial Overview* report. The report is an independent high-level analysis of the financial performance of councils during the preceding year (2020/21), their financial standing entering 2021/22 and associated longer-term financial outlook.

3.2 As in previous years, the overview is complemented by the publication of the *Performance Overview* report in May 2022. Both reports are, however, specifically couched within the context of the pandemic, with the Financial Overview including analysis of its full-year financial impacts and the Performance Overview considering councils' responses to, and recovery from, COVID-19. A report on the Performance Overview will be considered by the Policy and Sustainability Committee in due course.

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 April 2021 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 financial outlook. A series of key messages is also set out on pages 5 and 6 of the report, drawing specific attention to the following:

(i) The COVID-19 pandemic persisted throughout 2020/21, with the Scottish Government increasing funding to councils by £1.5 billion to support them in dealing with the impacts of the pandemic.

(ii) When COVID-19 funding is excluded, there has been a real-terms underlying reduction of 4.2% in local government funding since 2013/14.

(iii) The underlying increase in Scottish Government funding of £358 million in 2020/21 was 1.1% in real terms but over half of this increase is due to specific grants.

(iv) Councils' income from customers and clients was affected by COVID-19 restrictions and fell by £0.5 billion.

(v) In 2020/21, all councils reported surpluses and increased their usable reserves. The total increase in reserves was £1.2 billion (46%). This increase was mainly due to late COVID-19 funding, which was unspent at 31 March 2021.

(vi) Councils administered a further £1.4 billion of COVID-19 grants on behalf of the Scottish Government in 2020/21, putting additional pressure on finance staff across councils.

(vii) Capital expenditure reduced by more than 20% in 2020/21 because of COVID-19.

(viii) COVID-19 pressures contributed to greater and more frequent errors in councils' unaudited accounts.

(ix) Scottish Government capital funding to councils is expected to fall again in 2021/22.

(x) Uncertainty over the amount of funding available for COVID-19 recovery at the end of 2020/21 led to difficulties in setting budgets, and many councils established updated COVID-19 budgets in autumn 2021.

(xi) COVID-19 resulted in revised medium-term financial plans, but longer-term planning will need to be updated as COVID-19 uncertainty diminishes.

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.

Specific references or areas of particular relevance to Edinburgh

4.3 **Paragraph 9** of the report details the extent to which councils' income was affected by the pandemic during 2020/21. The majority of the Council's total net COVID-19 impact of £69m similarly represented the direct, or indirect, loss of income to the Council and/or its Arm's-Length External Organisations (ALEOs), with the largest contributors being:

(i) the loss of parking income, net of reduced enforcement costs, of £13.4m;

(ii) loss of commercial rental income of £7.1m;

(iii) loss of £6m of dividend income from Lothian Buses;

(iv) £6m of additional required financial support for Edinburgh Trams (due to drastically reduced farebox income);

(v) reduced income from the Council's cultural venues of £3.9m; and

(vi) £3m of additional financial support for Edinburgh Leisure due to reduced patronage.

4.4 **Paragraph 11 and Exhibit 2** show in-year provisional collection rates for Council Tax. While the Council's confirmed rate for 2020/21 showed a year-on-year reduction of 1%, it comfortably remained the highest rate of Scotland's four main cities.

4.5 The Council's budget for 2020/21 was underpinned by budgeted service-specific and corporate savings of £35.8m. Of these, 82% by value were delivered, close to the Scotland-wide average of 83% noted in **Paragraph 23**. Of those savings not delivered, the majority were linked directly or indirectly to the impacts of the pandemic, including loss of assumed income or necessarily-delayed organisational reviews.

4.6 While the outturn for 2021/22 remains provisional, the in-year level of savings delivery has 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.

4.7 **Paragraphs 25 to 30** and the accompanying appendices consider councils' year-end outturns and the consequent impacts on their reserve levels. In common with all other councils in Scotland, following the receipt of significant additional grant funding late in the year, the Council returned an overall surplus in 2020/21 (of some £7.9m), with this sum set aside in reserves.

4.8 The overall level of the Council's reserves as of 31 March 2021 was also influenced by the prudent prior identification, and earmarking, of savings prior to the confirmation of this external funding. As part of the year-end closedown process, the unallocated General Fund balance (funds held against the risk of unanticipated expenditure and/or reduced income arising in any particular year) was furthermore increased from £13.9m to £25.0m, in line with the Council's revised strategy and providing a further contingency against other risks to which the Council is exposed.

4.9 The approved budget for 2021/22 then assumed in-year use of £58m of COVID-related funding held in reserves, with further sums to be drawn down in 2022/23.

4.10 **Paragraphs 31 to 39** consider the in-year impact of the pandemic 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 2020/21 was 8% lower than in 2019/20.

4.11 Delays were experienced due to the scarcity of materials and contractor staff taking time to return from furlough, as well as revised on-site operating practices to comply with social distancing guidelines. The General Fund saw capital slippage of around £150m in-year and the HRA around £55m from the originally-planned programme pre-COVID. Some of this slippage was addressed in 2021/22 but an element will not be made up until the current financial year or later given subsequent disruption to supply chains linked directly or indirectly to current events in Ukraine.

4.12 **Paragraphs 40 and 41** highlight the availability of additional financial "flexibilities" made available by the Scottish Government to spread the costs of the pandemic over a longer timeframe. Prior to the announcement of significant additional grant funding, the Council's approved budget for 2021/22 had been predicated upon utilising the loans fund principal deferral flexibility but this assumption was revised by Council in May 2021, with the approved 2022/23 similarly assuming no use of available flexibilities. The Scottish Government has recently issued draft guidance in respect of the expanded basis on which the service concession flexibility will be made available for use by local authorities in 2022/23 and 2023/24.

4.13 **Paragraphs 42 to 47** consider some wider aspects of the pandemic on councils' operations during the year, including administration of business support grants and increased support for ALEOs, many of which resonate with experience in Edinburgh.

4.14 In total, some £359m of COVID-related funding was received by the Council during the year. Audit testing identified one small funding stream of £0.162m which had been accounted for as income received as principal whereas, in fact, the Council was acting as an agent (i.e. on behalf of the Scottish Government), with this change reflected in the audited accounts.

4.15 The external auditor's report intimated that no significant weaknesses were identified within the Council's systems of accounting and internal financial control and that its arrangements with regard to the detection of fraud and irregularity were considered sufficient and appropriate, complemented by active participation in the National Fraud Initiative.

4.16 **Paragraphs 48 to 52** contain an overview of in-year investment returns for Scotland's Local Government Pension Funds. While the absolute return for Lothian Pension Fund was the lowest of Scotland's eleven funds and underperformed slightly against its benchmark, the triennial valuation as of 31 March 2020 showed it to be fully funded, with employer contributions essentially unchanged for the period from 2021/22 to 2023/24.

4.17 **Paragraphs 53 to 55** highlight the Council as being amongst only seven in Scotland in addressing three key aspects of financial reporting in their annual accounts management commentaries.

4.18 The remaining section of the Audit Scotland report looks at councils' financial outlooks as of the time of setting 2021/22 budgets in February 2021. 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.

4.19 A five-year timeframe was also adopted with regard to revenue budget-setting, albeit with significant gaps remaining beyond 2021/22. The planning assumptions underpinning future years' funding gaps are subject to on-going review and an update is included in the report elsewhere on today's agenda.

4.20 The Council continues to face significant financial challenges resulting from increased demand for services, inflation, legislative reform and increased citizen expectations, as well as the continuing 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 keeping pace.

4.21 The urgent need to initiate a structured medium to longer-term savings programme was highlighted in both the Council's Best Value Assurance Report and the external auditor's report for 2020/21. Proposals to address these gaps will be subject to a process of co-design between the incoming administration and officers and form the basis of public engagement in Autumn 2022. Members will 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.

5. Next Steps

5.1 Publication of the Financial Overview has been complemented by the issuing of the *Performance Overview* report in May 2022 and a subsequent report will therefore be brought forward to both the Policy and Sustainability 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 2020/21: outturn report, Finance and Resources Committee, 12 August 2021

8.2 City of Edinburgh Council – 2020/21 Annual Audit Report to the Council and the Controller of Audit, Governance, Risk and Best Value Committee, 9 November 2021

9. Appendices

One – Local Government in Scotland – Financial Overview 2020/21

Appendix 1

Local government in Scotland

Financial overview 2020/21

ACCOUNTS COMMISSION

Prepared by Audit Scotland
March 2022

Contents

You can find more information on our website:

Exhibits data
Data files are available for Exhibit 5.

Supplement
Covid-19 funding to Local Government – 2020/21

Audit team

The core audit team consisted of: Blyth Deans, Lynne Templeton, Martin Allan, Christopher Holgate under the direction of Brian Howarth.

Chair's introduction

Our independent overview of council finances 2020/21 covers the first full year that makes clear the impacts of Covid-19. We also look ahead to the medium- to longer-term financial outlook for councils.

Dr William Moyes
Chair of the Accounts Commission

That all councils have increased their reserves, boosted by late funding from the Scottish Government to help mitigate the impacts of Covid-19, distracts from the underlying pressures and continued uncertainty on council finances.

The long-term funding position for councils remains uncertain, with significant challenges ahead. This ongoing financial uncertainty for councils is exacerbated by: Scottish Government budget settlements for councils that don't go beyond one year; impacts of an ageing population; shifting and increasing demand for many council services and, alongside this, greater uncertainty over inflationary and other price pressures.

Excluding additional Covid-19 funding, councils have seen a real terms reduction in funding from the Scottish Government of 4.2 per cent since 2013/14. This is a larger reduction than the rest of the Scottish Government budget over the same period.

With increasing amounts of money ring-fenced to meet Scottish Government priorities, it means councils must focus on specific policy areas, rather than the urgent, local priorities they have identified. And while councils have rightly shifted their focus to address the immediate impacts of Covid-19, plans to transform services have slowed.

The absence of a multi-year funding settlement, alongside the ongoing impacts of Covid-19, makes it challenging for councils to plan and budget effectively for the medium and longer term. Robust forward looking financial plans, however, will be key to maintaining financial sustainability, alongside accelerating progress with transformation programmes that have stalled, addressing issues in delivering recurring savings and bringing forward proposals to reduce costs. As Covid-19 uncertainty diminishes, councils should review longer-term planning arrangements.

The pressures on councils that existed before March 2020 continue, yet now with greater intensity. As we reported in our 2021 Local government overview inequalities have been exacerbated and deepened by Covid-19. At the same time, the financial and service demands and stresses on councils have also increased.

Councils must manage the ongoing impacts of Covid-19, while looking ahead to local service and economic recovery and transformation, as well as delivering on Scottish Government priorities. This includes ambitions for Early Learning and Childcare, climate change and plans for a National Care Service.

Simply rewinding and trying to return services to pre-March 2020 models and levels of service isn't good enough. How to restart services, deliver differently, save money and empower communities to help redesign and reshape core services, is a massive challenge for all councils. Councils need to undertake this work, involve the communities they serve and partner organisations.

This report, alongside our second overview report (due to be published in May) which will focus on the wider performance and challenges facing local government will, we hope, be a useful analysis and support for both new and returning councillors, and senior officers, as they make difficult decisions over how best to allocate money and resource.

The Accounts Commission will continue to publish outputs focusing on key issues impacting local councils and communities.

Our ambition is for our independent reporting to support challenge and change across council services.

Key messages

Local government finances 2020/21

1 The Covid-19 pandemic persisted throughout 2020/21, with the Scottish Government increasing funding to councils by £1.5 billion to support them in dealing with the impacts of the pandemic.

2 When Covid-19 funding is excluded, there has been a real terms underlying reduction of 4.2 per cent in local government funding since 2013/14.

3 The underlying increase in Scottish Government funding of £358 million in 2020/21 was 1.1 per cent in real terms. But, over half of this increase is due to specific grants. Ring-fenced funding helps support delivery of key Scottish Government policies but constrains a proportion of the total funding and resources and removes any local discretion over how councils can use these funds.

4 Councils' income from customers and clients was affected by Covid-19 restrictions and fell by £0.5 billion.

5 In 2020/21, all councils reported surpluses and increased their usable reserves. The total increase in reserves was £1.2 billion (46 per cent). This increase was mainly due to late Covid-19 funding, which was unspent at 31 March 2021.

6 Councils administered a further £1.4 billion of Covid-19 grants on behalf of the Scottish Government in 2020/21, putting additional pressure on finance staff across councils.

7 Capital expenditure reduced by more than 20 per cent in 2020/21 because of Covid-19.

8 Covid-19 pressures contributed to greater and more frequent errors in councils' unaudited accounts.

Medium- and longer-term outlook for local government finances

9 Scottish Government capital funding to councils is expected to fall again in 2021/22.

10 Uncertainty over the amount of funding available for Covid-19 recovery at the end of 2020/21 led to difficulties in setting budgets, and many councils established updated Covid-19 budgets in autumn 2021.

11 Covid-19 resulted in revised medium-term financial plans, but longer-term planning will need to be updated as Covid-19 uncertainty diminishes.

About this report

1. This report provides a high-level independent analysis of the financial performance of councils during 2020/21 and their financial position at the end of that year. It also looks ahead and comments on the financial outlook for councils in the medium and longer terms. It is one of two overview reports that the Accounts Commission publishes each year. The second report, commenting on councils' response to and recovery from the Covid-19 pandemic, will be published in May 2022.

2. Our primary sources of information for the financial overview are councils' 2020/21 audited accounts, including management commentaries and the 2020/21 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 April 2021. We received 22 returns by the deadline in late May 2021, and therefore some of the analysis included in this report is based on the available returns, which are only a sample of the total. The response rate from auditors (69 per cent) was lower than in previous years.

3. 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 2021. Twenty-three sets of accounts were certified by the revised deadline, with a further seven signed off thereafter. As at 1 February 2022, two councils' accounts are still to be certified; therefore, analysis in this report is based on 30 sets of audited accounts and two sets of unaudited accounts.

4. We refer to 'real terms' changes in this report. This means that we are showing financial information from past and future years at 2020/21 prices, adjusted for inflation so that they are comparable. Similarly, where comparisons with 2021/22 are made, we have adjusted for inflation to 2020/21 prices. 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, the increased public spending related to Covid-19 means that (in the short term) annual GDP growth rates are forecast to be volatile. To allow us to continue to provide meaningful comparisons between years, we have changed how we use GDP deflators this year. To compensate for the increased volatility, we have used an average GDP growth rate across 2020/21 and 2021/22 to separate inflation from the changes largely attributable to Covid-19 spending and changes in outputs.

5. We also refer to figures in 'cash terms'. This means that we are showing the actual cash or money paid or received.

1. Councils' income in 2020/21

Key messages

1. The Covid-19 pandemic persisted throughout 2020/21, with the Scottish Government increasing funding to councils by £1.5 billion to support them in dealing with the impacts of the pandemic.

2. The underlying increase in Scottish Government funding to councils of £358 million in 2020/21 was 1.1 per cent in real terms. But, over half of this increase is due to specific grants, which are now £710 million. Ring-fenced funding helps support delivery of key Scottish Government policies, such as expanding early learning and childcare services, but constrains a proportion of the total funding and resources and removes any local discretion over how these funds can be used by councils.

3. When Covid-19 funding is excluded, there has been a real terms underlying reduction in local government funding of 4.2 per cent since 2013/14.

Total revenue funding and income

Covid-19 had an impact on the whole of 2020/21

6. The global pandemic and consequent restrictions emerged at the end of March 2020 and persisted throughout the 2020/21 financial year. This report is the first Local Government Overview to capture the full-year impact of Covid-19 on local government finances.

Councils' total funding and income increased by £1.8 billion (10 per cent) in 2020/21, mainly as a result of additional Covid-19 funding of £1.5 billion

7. Councils' total revenue funding and income was £20.3 billion in 2020/21, an increase of £1.8 billion (or 10 per cent) on the previous year. Comparing 2020/21 with 2019/20 (Exhibit 1, page 10) shows that most funding comes from the Scottish Government in both years and illustrates the impact of Covid-19 additional funding on the overall funding of councils (7 per cent of funding received).

8. Additional Covid-19 funding included as part of the General Revenue Grant was £1.3 billion, and additional Covid-19-specific grant funding was £0.2 billion in 2020/21. When this is excluded, total revenue and income increased by £0.3 billion, or 1.6 per cent, compared with the previous year.

Councils' income from customer and client receipts reduced by an average of 25 per cent

9. Scotland wide, the reduction in income from customer and client receipts is estimated at £0.5 billion. Significant income streams were affected by Covid-19 restrictions and measures. Glasgow City and Fife Councils both suffered significant reductions in cultural and community income and car parking income. Orkney and Argyll and Bute Councils identified reductions in pier and harbour income as a direct consequence of Covid-19 travel restrictions. Councils have also experienced reductions in income from school meals, building warrants and trade waste disposal.

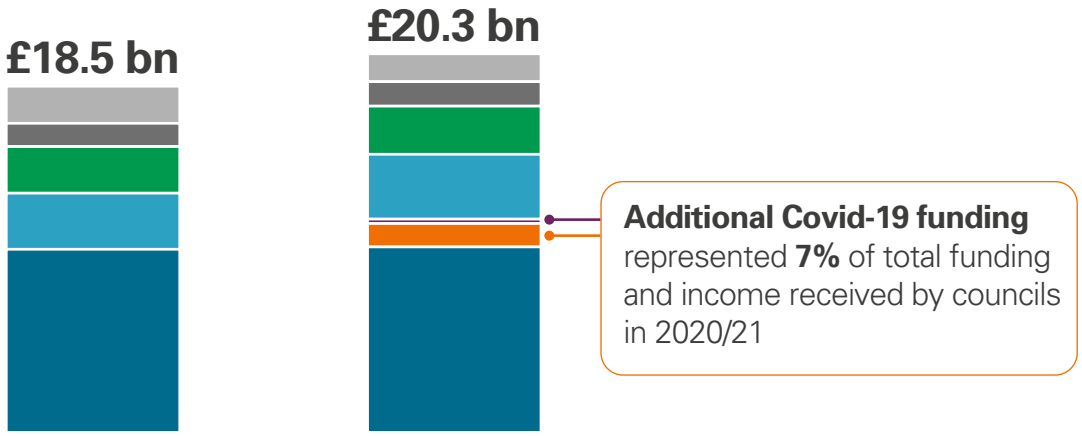
Council tax rates increased by 4.5 per cent in 2020/21

10. All councils raised council tax levels in 2020/21. The average rate increase across Scotland was 4.5 per cent. The lowest increase was 3 per cent in Clackmannanshire, Inverclyde and South Lanarkshire Councils. Twenty councils increased council tax by 4.8 per cent in line with the Scottish Government cap on council tax rate increases.

Exhibit 1.

Sources of funding and income, 2019/20 and 2020/21

Councils' total funding and income increased by £1.8 billion (10 per cent) in 2020/21, mainly as a result of additional Covid-19 funding of £1.5 billion.



2019/20	2020/21	
10.7%	7.4%	Customer and client receipts
6.7%	6.5%	Housing Revenue Account rents
13.5%	12.7%	Council tax
16.2%	17.1%	Grants including Scottish Government and other sources
0.0%	1.2%	Covid-19-specific grants
0.0%	6.2%	General revenue Covid-19 funding
52.9%	52.9%	General revenue funding and non-domestic rates

Source: Audited financial statements 2019/20 and 2020/21

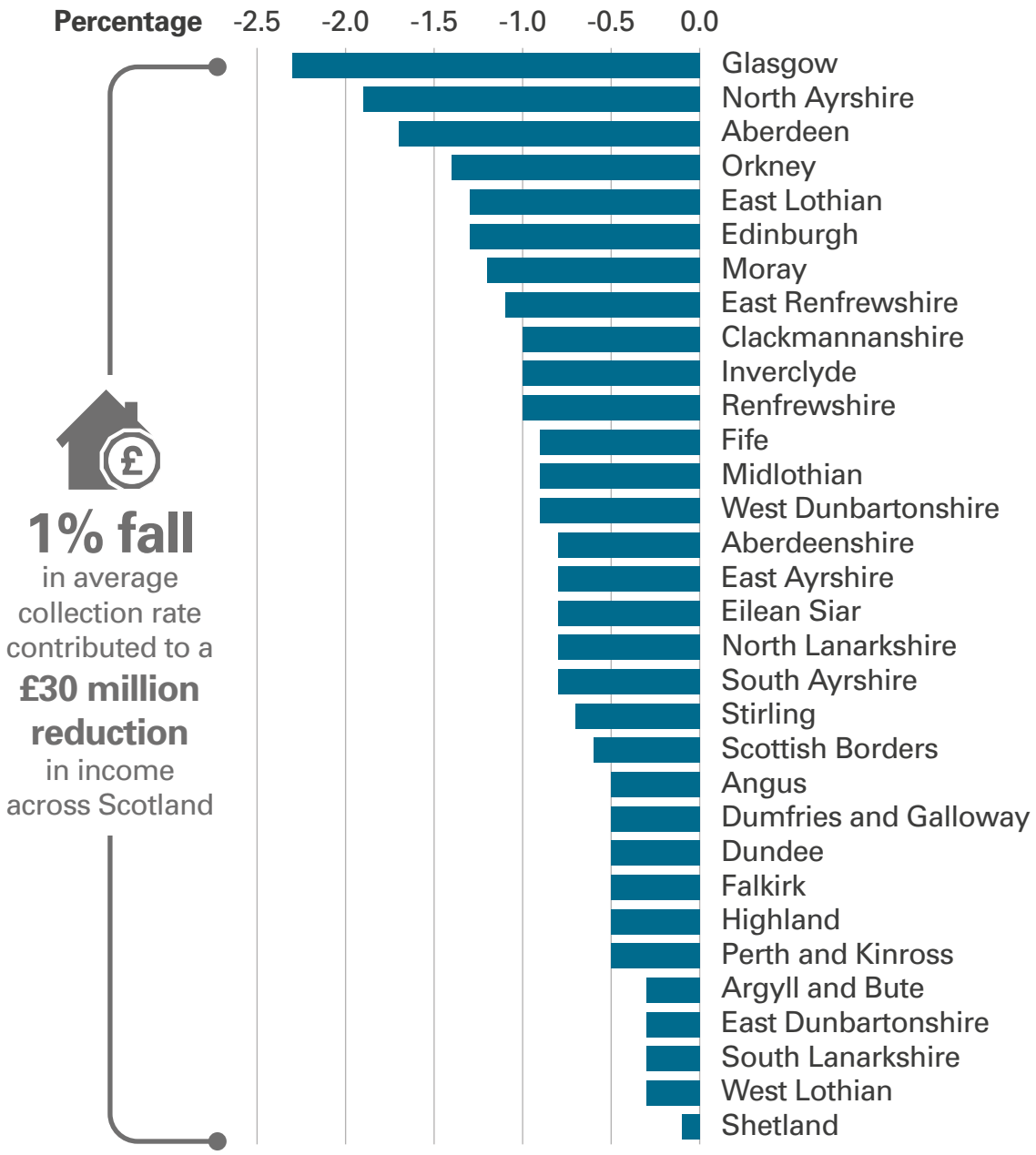
Council tax collection rates across Scotland fell by 1 per cent

11. Council tax debts accumulate over many years. The in-year collection rate (for 2020/21 charges) fell from an average of 95.8 per cent to 94.8 per cent. The 1 per cent fall in collection rate contributed to a reduction in income of £30 million. The total amount of council tax billed, taking account of council tax reductions, was £2.7 billion. Of this total, £2.5 billion was collected by 31 March 2021. Collection rates fell across all councils (Exhibit 2, page 11), with Glasgow City Council experiencing the largest reduction. Some councils chose to defer or reschedule debt recovery as part of their Covid-19 responses.

Exhibit 2.

Council Tax collection rates

The average Council Tax collection rate across Scotland fell by 1 per cent in 2020/21.



Source: Scottish Government Council Tax Collection Statistics 2020-21, Audited financial statements 2020/21

Scottish Government funding

Scottish Government revenue funding increased by 13 per cent in real terms in 2020/21. This was mainly due to Covid-19 funding of £1.5 billion

12. As noted in paragraph 7, Scottish Government funding forms a significant proportion of the total funding available to local government. The proportion increased from 55.7 per cent in 2019/20 to 58.6 per cent in 2020/21.

13. In 2020/21, total revenue funding from the Scottish Government increased by 15.6 per cent in cash terms and by 13.0 per cent in real terms (Exhibit 3). Most of this increase was due to additional Covid-19 funding of £1.5 billion, including £1.3 billion of general revenue funding and £0.2 billion of specific grants.

Exhibit 3.

Changes in Scottish Government revenue funding in 2020/21

Scottish Government revenue funding increased by 13 per cent in real terms in 2020/21, although the increase largely relates to additional specific revenue grants and non-recurring Covid-19 funding.

	2019/20 £ million	2020/21 £ million	Cash change %	Real terms change %
General revenue grant and non-domestic rate income	9,811.4	9,967.5	1.6	-0.7
Specific revenue grants[1]	507.7	709.8	39.8	36.6
Non-recurring Covid-19 funding		1,253.5		
Total revenue funding	**10,319.1**	**11,930.7**	**15.6**	**13**
GRG + NDRI + SRG	10,319.1	10,677.2	3.5	1.1

Note: 1. Includes specific revenue grants for Covid-19.

Source: Finance Circulars 2/2020 and 5/2021 and Scottish Government budget documents.

14. Total revenue funding of £11.9 billion consisted of general resource grant (GRG) funding of £8.1 billion, non-domestic rates (NDR) distribution of £1.8 billion, specific grants of £0.7 billion and non-recurring Covid-19 funding of £1.3 billion.

15. The Scottish Government NDR relief, which was announced in March 2020 to help businesses deal with the impact of Covid-19, resulted in a significant change in the expected income collected from NDR, and this was reflected in the funding given to councils. NDR funding reduced from £2.8 billion in 2019/20 to £1.8 billion in 2020/21. A compensatory increase was given to councils as GRG, as part of a guarantee by the Scottish Government to ensure total funding.

Specific Scottish Government grants contributed to over half of the underlying increase in funding of 1.1 per cent in real terms

16. When non-recurring Covid-19 funding is excluded, the increase in funding from the Scottish Government is 3.5 per cent in cash terms and 1.1 per cent in real terms. The increase in underlying revenue funding was £358 million.

17. In previous overview reports, we identified that increasing amounts of the Scottish Government's total funding to councils is for specific purposes. This trend continued in 2020/21. Over half of the increase was accounted for by specific revenue grants, including an additional £201 million to fund expanding early learning and childcare services. However, the Scottish Government gave councils flexibility in 2020/21 to use the funding for early learning and childcare to support their responses to Covid-19.

18. Specific revenue grants made up 6.7 per cent of recurring revenue funding in 2020/21, up from 4.9 per cent the previous year.

There was a 7 per cent real terms increase in funding to councils in 2020/21, due to Covid-19. However, the underlying decrease is 4.2 per cent since 2013/14

19. Funding from the Scottish Government to local government between 2013/14 and 2020/21 increased by 7.0 per cent in real terms. The Scottish Government received Scottish budget increases for Covid-19 **Barnett consequentials** of £9.5 billion and £1.3 billion was given to councils to support services and Covid-19 responses.

20. Excluding the effect of Covid-19 funding, the underlying cumulative funding position for councils has fallen by 4.2 per cent in real terms since 2013/14 (Exhibit 4, page 14). This demonstrates that local government funding has been reduced by proportionately more than the rest of the Scottish Government budget over this period. The Scottish Government is committed to protecting the Health Budget which has a direct impact on all other areas of the Scottish Budget, including local government.

Barnett consequentials

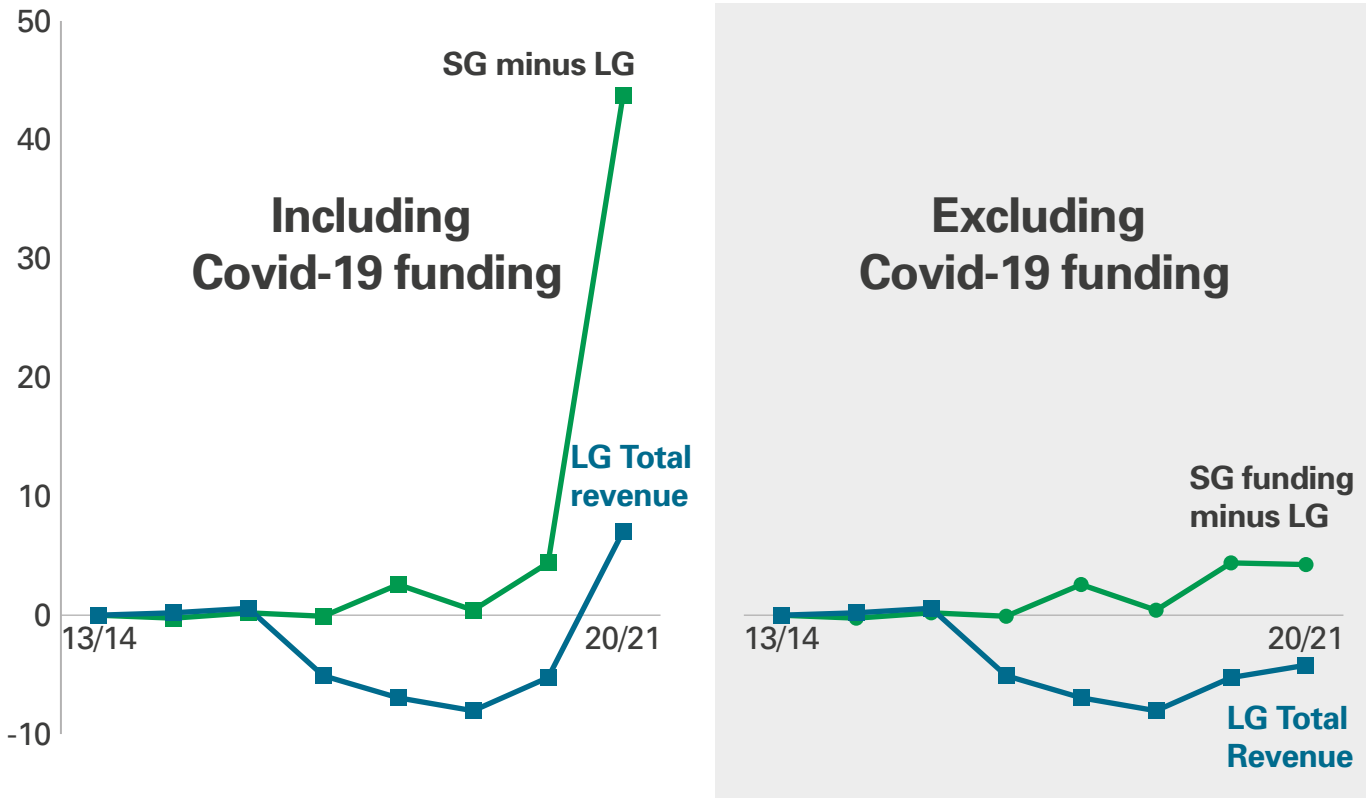
Throughout 2020/21, the UK Government introduced various spending measures to support households, businesses, and public services in recovering from the impact of Covid-19. Some of these spending measures resulted in Barnett consequentials. The Barnett formula is the way the UK Government ensures that 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, but there is no requirement for this additional funding to be spent in the devolved administrations on the services which generated the additional funding. Each devolved administration can allocate these funds as it believes appropriate.

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)

The second graph shows that, funding from the Scottish Government to local government between 2013/14 and 2020/21 decreased by 4.2 per cent in real terms once Covid-19 funding is removed.



Source: Finance Circular 5/2021 and Scottish Government budget documents

2. Councils' financial position in 2020/21

Key messages

1. Savings plans were mostly delivered across councils, but with significant variation.
2. All councils increased their usable revenue reserves, mainly due to late Covid-19 funding which was unspent at 31 March 2021. The total increase was £1.2 billion.
3. Capital expenditure reduced by more than 20 per cent in 2020/21 due to Covid-19.
4. Councils administered a further £1.4 billion of Covid-19 grants on behalf of the Scottish Government. The need to administer payment of these grants quickly to support the local economy put additional pressure on finance staff across councils.
5. Covid-19 pressures contributed to greater and more frequent errors in councils' unaudited accounts. Auditors also reported wider issues relating to Covid-19, including the slowing of progress in some councils' transformation plans, the impact of reduced income on arm's-length external organisations (ALEOs) and what that means for their financial sustainability, identified weaknesses in internal control systems, and adverse impacts on long-term planning and capacity.
6. In line with the recovery in global stock markets, pension fund investments performed well. In addition, the triennial funding position improved.

Council budgets and outturn 2020/21

In 2020/21, initial budget gaps were consistent with previous years

21. In 2020/21, councils identified net expenditure of £13.5 billion in initial budgets. These were budgets that were set before the Covid-19 lockdown in late March 2020. The budget gap at the time was £0.5 billion (1.7 per cent), which was consistent with the gap identified in the previous year.

22. Planned savings were the most common way of addressing expected budget gaps in 2020/21, although plans also included reference to income generating activities and reprofiling loan fund repayments to make savings.

Savings plans were mostly delivered across councils, but with significant variation

23. An analysis of a sample of 14 councils identified that, on average, 83 per cent of the planned savings were achieved. However, there was significant variation in how individual councils performed against their savings targets:

- East Lothian Council achieved savings of £3.1 million (99 per cent of those budgeted) in 2020/21. However, of this total, only £1 million (35 per cent) of savings were on a recurring basis. Council officers have recognised the risk of not achieving these savings annually and the council is reviewing its budgeted savings.
- Angus Council set a Change Programme saving target for 2020/21 of £9 million. The council achieved actual savings of £8.5million (95 per cent).
- Comhairle nan Eilean Siar, which planned to make £2.6 million of savings in 2020/21, achieved savings of £1.6 million or 62 per cent. The auditors note that service redesign savings of £1.0 million were not achieved, as resources were reallocated to the council's Covid-19 response.
- Fife Council planned to achieve efficiency savings of £13 million and achieved actual savings of £8 million (65 per cent). The shortfall was dealt with by in-year alternative savings, such as alternative cost reductions, unused contingency funding and a change in accounting treatment of loan charges.

24. Non-recurrent savings can include savings made as a result of delays in recruitment due to Covid-19; savings in budget provisions for energy and NDR costs; reduced operational costs arising from the Covid-19 impact on service delivery; and reductions in borrowing costs resulting from lower than anticipated capital spending.

All councils reported surpluses and increased their usable reserves in 2020/21. The total increase was £1.2 billion (46 per cent). This increase was mainly due to late Covid-19 funding, which is earmarked to be spent on Covid-19 recovery activity over the next two financial years

25. All councils increased their total usable reserves at 31 March 2021 to £3.8 billion. This represents an increase of £1.2 billion (46 per cent) on the previous year and includes revenue and capital reserves. Exhibit 5 (page 18) shows increases in councils' usable reserves during 2020/21.

26. Most of the increase in 2020/21 is in general fund reserves (including Housing Revenue Account, HRA) of £1.1 billion. This is predominantly due to a significant element of Covid-19 funding that was issued to councils very late in the financial year. This contributed to about a 70 per cent increase in reserves held by councils at the end of 2020/21. However, the view of the Convention of Scottish Local Authorities (COSLA) is that this funding is fully committed and most will be spent in 2021/22, with an element carried forward to be spent in 2022/23.

27. The timeline of funding announcements made by the Scottish Government during 2020/21 (Supplement: Covid-19 funding to Local Government – 2020/21) illustrates the challenges faced by councils in receiving and spending this additional money.

Supplement:
Covid-19 funding to Local Government – 2020/21
Accounts Commission
March 2021

Reductions in expenditure and savings achieved contributed to about 30 per cent of the increase in councils' reserves in 2020/21

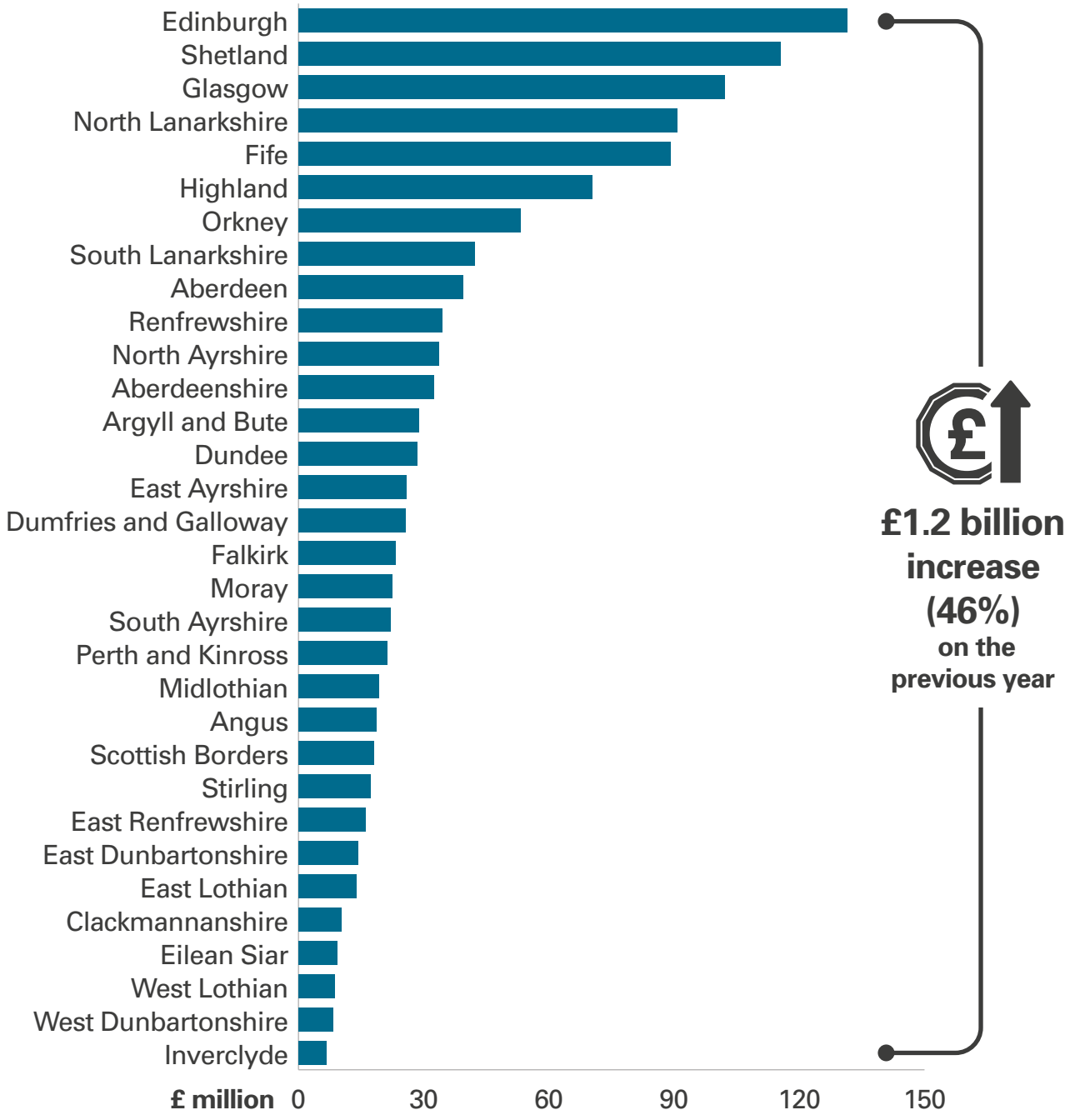
28. COSLA notes that, during 2020/21, councils faced challenges arising from a combination of loss of income and additional expenditure and had to manage financial projections without any guarantee of any additional financial support from either the UK or Scottish Governments. As a result, councils took steps to reduce expenditure and achieve budgeted savings where possible to mitigate the impact of the pandemic. As financial support was announced later in 2020/21 some of the short-term measures taken during the year by councils, to manage their budgets, resulted in increases in council reserves due to service underspends. Around 30 per cent of the increase in reserves is attributed to service underspends.

29. Over the same period, it was not possible to progress spending in some policy areas, such as expanding early years services and employability programmes, adding to a short-term increase in the level of reserves held.

Exhibit 5.

Increases in councils' usable reserves during 2020/21

All councils increased their usable reserves.



Note: Exhibit 5 data available to download on our website.

Source: Audited financial statements 2020/21

Reserves

Most of the increase in the general fund is committed to Covid-19 recovery

30. Exhibit 6 (page 20) shows the nature and value of usable reserves in 2020/21. Within the committed element of the general fund, councils' accounts have not always clearly identified the element arising from Covid-19 funding, but at least £650 million of the increased balance is identified for Covid-19 recovery, and we believe that the actual amount is much higher.

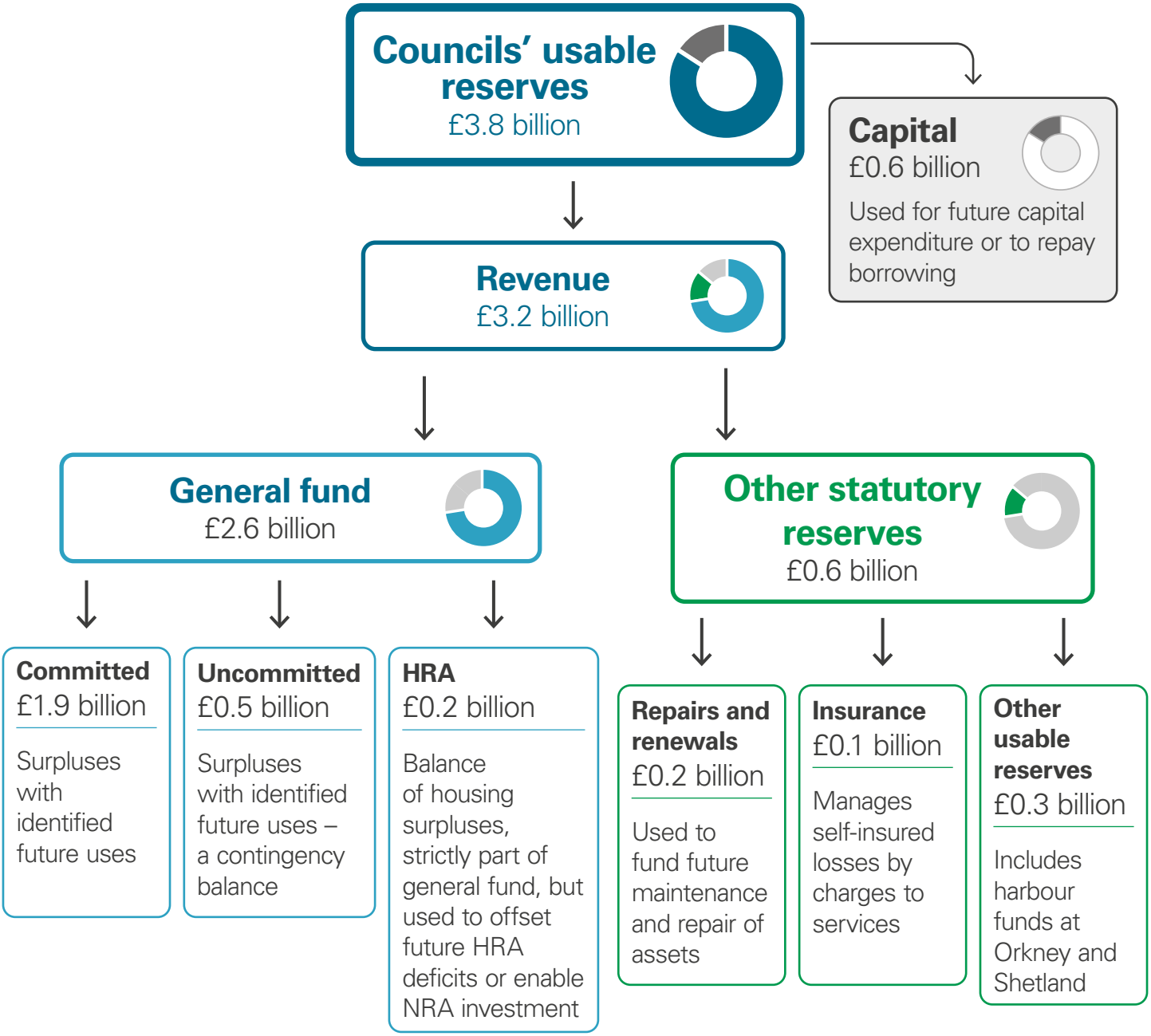
Recommendation

Elements of Covid-19 funding that are being carried forward in general earmarked and unearmarked reserves in the accounts should be clearly identified.

Exhibit 6.

The relative size and nature of councils' usable reserves

In 2020/21, usable reserves held by councils totalled £3.8 billion.



Source: Audited financial statements 2020/21

Capital

In 2020/21 underlying capital expenditure was reduced by more than 20 per cent due to Covid-19

31. Capital spending across Scotland fell by £1.2 billion in 2020/21, from £3.6 billion in 2019/20 to £2.4 billion. Glasgow City Council's **sale and leaseback transactions** in 2019/20, as part of its equal pay funding strategy, account for £0.5 billion of this reduction. The overall reduction in capital expenditure in 2020/21, net of Glasgow City Council, was still £0.7 billion (22 per cent, based on £3.1 billion underlying spending last year).

32. Auditors reported that Covid-19 restrictions had a significant adverse impact on the cost and delivery of capital projects in 2020/21. In many cases, capital plans were revised to reflect lockdown and the impact of social distancing and other suppression measures that contributed to delays in construction for a large part of 2020/21.

33. Twenty-six councils (81 per cent) reported reduced capital expenditure. Only six councils spent more on their capital programmes in 2020/21 than in 2019/20. The average decrease was 31 per cent. Significant slippage against capital programmes was also noted at some councils in 2020/21:

- Dundee City Council: Capital works of £47 million were completed during 2020/21, against an approved capital programme of £107 million (£75 million general fund projects and £32 million HRA projects). This represents slippage against the original plan of 56 per cent, but this is largely attributable to the impact of Covid-19 in the early part of the year. Multiple projects contribute to the significant slippage recorded and span all services areas, including housing, education, cultural and related services and environmental services.
- East Lothian Council: Total capital expenditure in 2020/21 was £56.9 million, relative to a budget of £98.1 million, of which £35.7 million related to general fund projects and £21.2 million to the HRA. This represents slippage against budget of 42 per cent. The underspend is almost entirely due to delays caused by Covid-19 lockdown periods and suspended construction projects.

The number of new houses completed fell by 92 per cent in the first quarter of 2020/21, because of Covid-19, but recovered over the year

34. Local authority housing completions fell by 92 per cent in the first quarter of 2020/21 to 34 from 446 in the first quarter of 2019/20. This was a direct result of the first lockdown and restrictions in response to the Covid-19 pandemic. This significant level of reduction was mirrored across all housing sectors in Scotland. Completions returned to pre-lockdown levels in the second quarter, once initial lockdown restrictions were removed, and continued to recover in the third quarter. In total, 537 completions were reported in 2020/21, an increase of 57 per cent on 2019/20 (Exhibit 7, page 22).

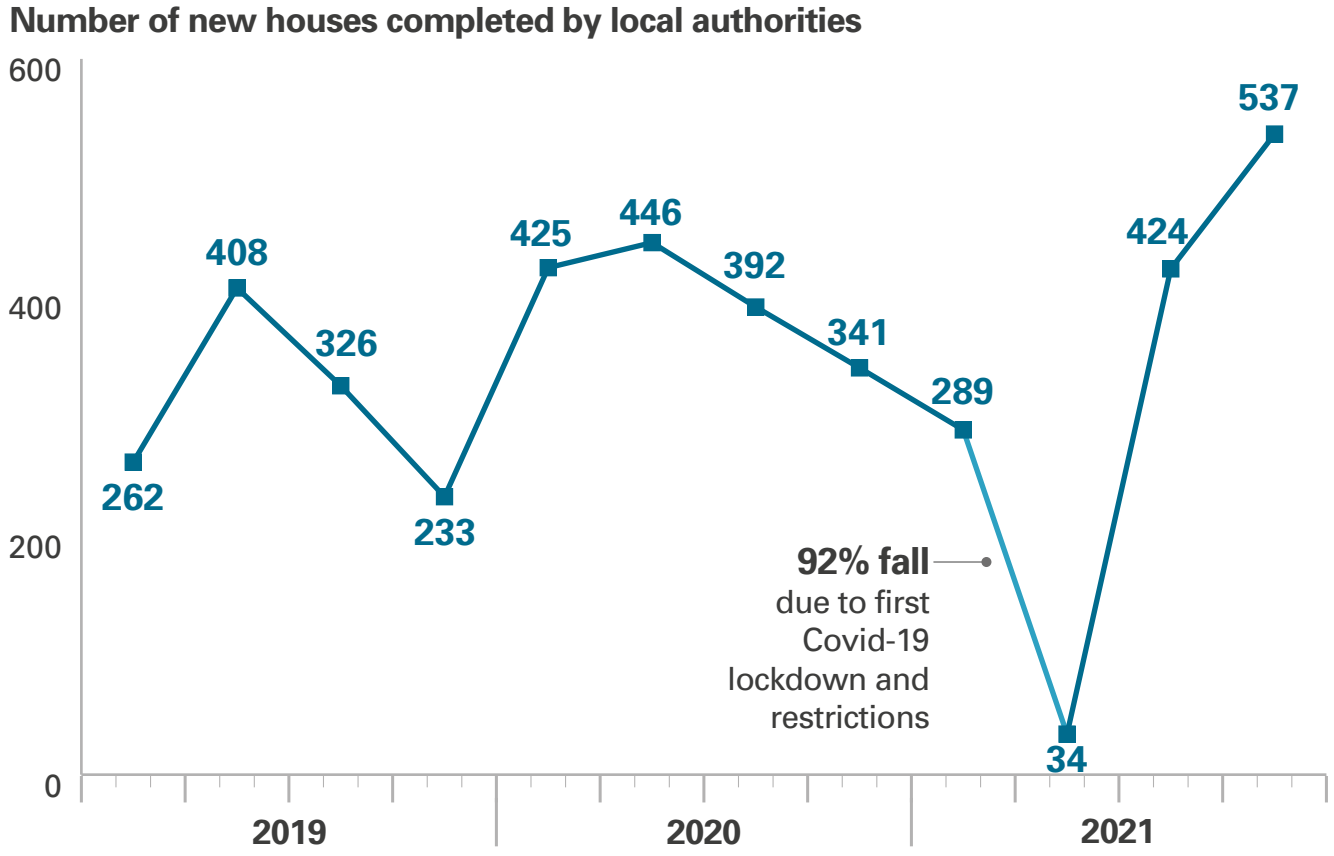
Sale and leaseback transactions

Glasgow City Council included a provision for equal pay costs in 2018/19 and during 2019/20 settled the majority of outstanding equal pay claims. The £500 million cost of settlement was met by a sale and leaseback funding strategy that raised £549 million. Our analysis in 2020/21 has been adjusted to reflect this artificial inflation of capital expenditure in 2019/20.

Exhibit 7.

Quarterly Local Authority Housing Completions

Local authority completions fell by 92 per cent in the first quarter of 2020/21.



Source: Scottish Government housing statistics quarterly update: December 2021

Capital costs increased in 2020/21, largely as a result of Covid-19

35. Fourteen of the 20 councils that we reviewed noted increased capital project costs in 2020/21, largely because of the impact of the Covid-19 pandemic. The key factors included increases in the cost of raw materials, supply chain delays and inflation associated with delayed contracts.

The main sources of capital financing are still government grants, but internal loan fund repayments from council services have reduced

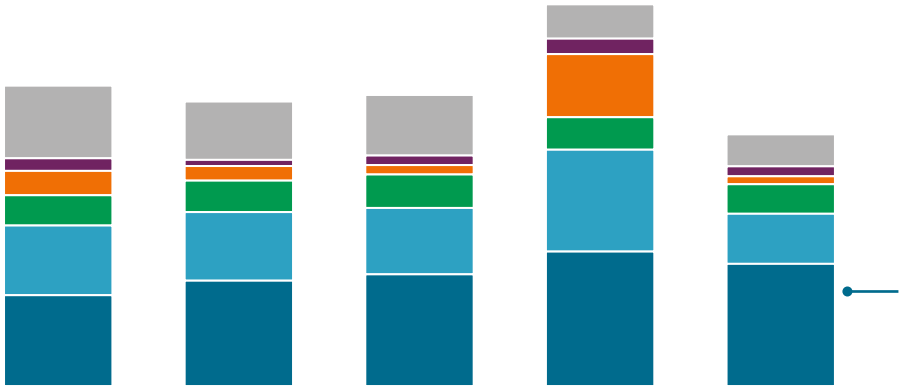
36. Government grants continued to provide the main source of capital finance (49 per cent). The amounts financed from internal loan fund repayments reduced from 27 per cent in 2019/20 to 20 per cent in 2020/21 (Exhibit 8, page 23).

37. The reduction in this internal source of capital finance might be the result of rescheduling loan fund repayments, reducing the amount available to reinvest in capital.

Exhibit 8.

Capital expenditure analysed by source of finance 2016/17 to 2020/21

Total capital expenditure fell and 49 per cent was financed by government grants.



49%
Government grants continued to provide the main source of capital finance

2016/17	2017/18	2018/19	2019/20	2020/21	
24%	21%	21%	9%	13%	Increase/decrease in underlying need for borrowing
4%	2%	3%	4%	4%	Other contributions and PPP
8%	5%	3%	17%	3%	Capital receipts
10%	11%	12%	8%	12%	Sums from revenue (CFCR)
23%	24%	23%	27%	20%	Loans fund
31%	37%	38%	35%	49%	Government grants

Source: Audited financial statements 2016/17 – 2020/21

Net debt has fallen by £1 billion

38. Total net debt (total debt less cash and investments) fell across councils by £1 billion, or 5.7 per cent, between 2019/20 and 2020/21, to £16 billion. Only seven councils' net debt increased in 2020/21.

39. The most significant element of this change is the increase in cash and investment balances: unspent Covid-19 funding received late in 2020/21 contributed £720 million to the decrease in net debt.

The wider impacts of Covid-19

Councils did not use the additional financial flexibilities granted to respond to Covid-19

40. Councils were given an additional package of spending powers and financial flexibility to respond to Covid-19 in 2020/21. However, of a sample of 22 councils, none used them in 2020/21.

41. Ten of the councils in the sample intend to use funding flexibilities in 2021/22. Some councils intend to use multiple flexibilities. Our analysis indicates that nine councils plan to defer internal loan fund repayments, five councils intend to extend debt repayment periods and two councils plan to use capital receipts to meet one-off revenue pressures arising from Covid-19.

Supporting local government recovery
Scottish Government
October 2020

Councils administered a further £1.4 billion of Covid-19 grants on behalf of the Scottish Government in 2020/21

42. Councils administered a further £1.4 billion of Covid-19 grants on behalf of the Scottish Government in 2020/21 and acted as agents in administering and disbursing these grants to businesses and individuals. The income and expenditure relating to these grants was not included as income or expenditure in the accounts reflecting the councils' position as paying agents.

43. Some council auditors reported that the additional administrative burden put additional pressure on council finance staff. The auditors of Orkney Islands Council noted that managing the volume and complexity of the various Covid-19 support schemes was challenging for finance staff. Furthermore, the auditors of North Lanarkshire Council found that the council's second officer checks of council tax and NDR discounts and reliefs were paused for a period during 2020/21, as staff were diverted to process Covid-19-related business grants.

44. Across Scotland, councils were under pressure to administer payment of these grants within a very short period of time to support the local economy. Our report Scotland's economy: Supporting businesses through the Covid-19 pandemic, due to publish in March 2022, considers the work undertaken by the Scottish Government and councils to minimise fraud risk involved in making these payments. This included placing reliance on councils' existing internal control environments to ensure eligibility of applications. Council auditors did not report any weaknesses in control in relation to these payments in 2020/21 annual audit reports.

Covid-19 contributed to greater and more frequent errors in councils' unaudited accounts

45. The Local Authority (Scotland) Accounts Advisory Committee (LASAAC) issued guidance on the accounting treatment and disclosure requirements expected for grants and for the accounting of personal protective equipment. This guidance was issued to councils in June, after unaudited accounts had already been prepared.

46. The majority of council auditors reported errors in the accounting treatment of these unusual transactions in the unaudited annual accounts, but councils made appropriate adjustments to reflect Scottish Government and LASAAC guidance.

47. Auditors also noted some wider issues including errors in asset valuations and the consolidation of group accounts. An increase in the number of errors identified may be linked to the challenges faced by council finance teams working remotely and faced with the additional responsibilities that arose during the Covid-19 pandemic.

Auditors reported issues with transformation plans, support for ALEOs, weaknesses in internal controls, and impacts on long-term planning and capacity due to Covid-19

- Progress with transformation plans: Covid-19 slowed progress in transformation and savings plans at some councils in 2020/21. For example, service redesign savings of £1 million were not achieved at Comhairle nan Eilean Siar because resources were reprioritised in response to Covid-19. Similarly, East Dunbartonshire Council's auditor noted that planned efficiency and transformation savings were not fully achieved in 2020/21, due to Covid-19, but that the shortfall was met by budget underspending. Fife Council's transformation programme has also been adversely affected by Covid-19.
- Funding of leisure ALEOs: East Dunbartonshire Council supported the East Dunbartonshire Leisure and Culture Trust (EDLCT) through its Covid-19 challenges to ensure the sustainability of its services. EDLCT experienced a significant drop in its income because its facilities were closed in response to Covid-19 and reported a loss of £4.7 million for 2020/21. The council provided additional funding to EDLCT in 2020/21 for vaccination costs (£0.3 million) and loss of income (£0.7 million), as well as letters of comfort to ensure the trust's financial sustainability. Other auditors reported similar support for leisure trusts.
- Improvements required in internal controls: The auditors of Glasgow City Council highlighted areas where improvements in internal controls are needed. These were in relation to journal authorisation, checks on discounts on council tax and NDR and on housing benefits, and key system user access. Changes in business operations and working circumstances because of Covid-19 are

likely to have contributed to the weaknesses identified. Covid-19 also had a significant impact on staff capacity and the control environment at Clackmannanshire Council. Auditors concluded that introducing remote working and additional duties and reprioritising tasks had a significant impact on staff capacity to undertake routine tasks on time. This affected the control environment, with several control weaknesses identified that needed a change in the audit approach. Substantive testing was increased to enable the auditors to obtain the required audit assurances.

- **Long-term financial planning:** Some councils have updated their long-term financial plans to reflect the ongoing impact of the Covid-19 pandemic. These plans cover a 10-year period and are in place at Argyll and Bute Council, Comhairle nan Eilean Siar, Inverclyde Council, North Ayrshire Council and West Dunbartonshire Council. The auditors of Dundee City Council note that, although a long-term financial strategy was approved in August 2019, this will now need to be revised to reflect the longer-term financial impact of Covid-19. Auditors note similar findings at Glasgow City Council, Orkney Islands Council and South Lanarkshire Council.
- **Workforce capacity challenges:** Auditors at nine councils reported issues relating to workforce capacity in 2020/21. For example, Angus Council's payroll team faced additional pressures because of staff absences; Comhairle nan Eilean Siar has faced challenges in recruiting a new director for assets, finance and resources; and Dundee City Council faced additional workload challenges caused by a number of changes in key finance staff, administrative problems presented by the Covid-19 support schemes, sickness absence and the impact of remote working.

Local government pension funds

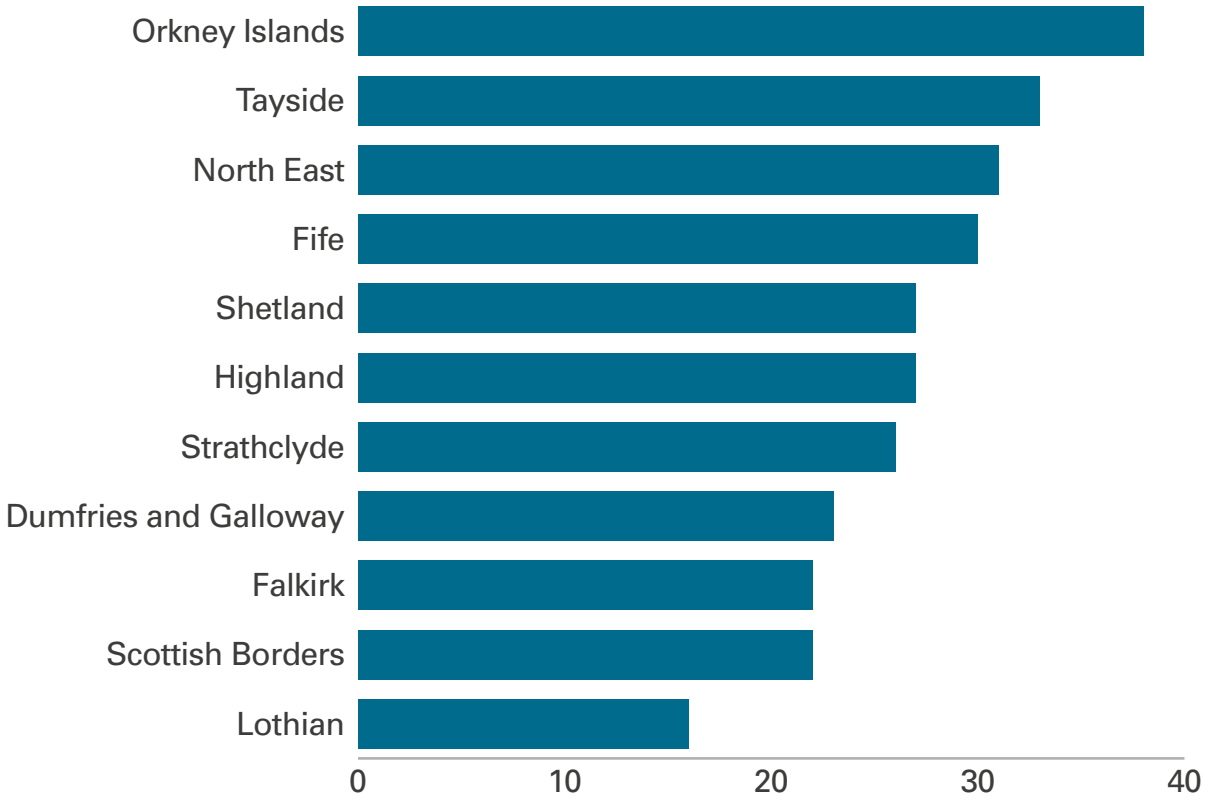
Pension fund investment returns improved in 2020/21 following initial market reactions to Covid-19 in the last quarter of 2019/20

48. The 11 main Scottish local government pension funds experienced positive investment returns in 2020/21. The annual return was between 15.6 per cent and 38.3 per cent in individual funds, based on the average assets position (Exhibit 9). The improvement in asset valuations during 2020/21 followed the global impact on investment values due to Covid-19 in the last quarter to 31 March 2020.

Exhibit 9.

Investment returns based on average assets in Scottish Pension Funds 2020/21

2020/21 investment returns were positive for all funds.



Source: Audited accounts of the Pension Funds 2020/21

Funds tended to outperform their benchmarks

49. In the majority of funds, the overall investment returns outperformed their individual annual benchmarks to 31 March 2021. Fund benchmarks and annual returns reflect the investment strategy of each fund. Funds' investment strategies and exposure to market volatility and risk will differ.

The triennial funding valuation at 31 March 2020 showed improved funding positions for most funds with a number showing funding levels of more than 100 per cent

50. The triennial funding valuation took place across Local Government Pension Scheme pension funds on 31 March 2020. The main purpose of the valuation is to review the financial position of each fund and to set appropriate contribution rates for each employer for the upcoming three-year period.

51. Overall, the funding position has improved across Scotland. Nine of the 11 pension funds showed an improved funding position compared with 2017, with the biggest increase noted at Lothian Pension Fund (98 per cent funded in 2017; 106 per cent funded in 2020).

52. Seven funds show funding levels of more than 100 per cent. These range from 118 per cent in Orkney Islands Council Pension Fund to 100 per cent at Highland Pension Fund. Not all pension funds were fully funded, however. Funding levels of 92 per cent were noted at Dumfries and Galloway Pension Fund and at Shetland Islands Council Pension Fund.

Financial management and transparency

Management commentaries in councils accounts have improved, but many are still not complying with previous recommendations on transparency

53. In previous Local government in Scotland: Financial overview reports we highlighted three key aspects in assessing whether financial reporting is transparent in the management commentaries:

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

54. Our review of 2020/21 management commentaries found that:

- Argyll and Bute Council, City of Edinburgh Council, Comhairle nan Eilean Siar, Fife Council, South Lanarkshire Council, Stirling Council and West Dunbartonshire Council included these key aspects of transparency in their management commentaries.
- Nearly all councils reported their year-end outturn, but six councils did not explain significant variances from budget.
- Only nine councils reported progress against agreed savings.

Recommendation

We recommend again that councils review and improve how they comply with these key expectations of transparency

Most councils identified the financial impact of Covid-19 in their management commentaries

55. We also considered the extent to which management commentaries for 2020/21 included detail of the impact of Covid-19 on councils' financial positions and governance arrangements. Most councils included good coverage of this in the management commentary, particularly on the total cost of Covid-19, additional funding provided and the distribution of business support grants on behalf of the Scottish Government.

3. Councils' financial outlook

Key messages

1. Uncertainty over the amount of funding available for Covid-19 recovery at the end of 2020/21 led to difficulties in setting budgets, and many councils established updated Covid-19 budgets in autumn 2021.
2. Initial Scottish Government revenue funding in 2021/22 has increased by 1.1 per cent in real terms.
3. Covid-19 resulted in revised medium-term financial plans, but longer-term planning will need to be updated as Covid-19 uncertainty diminishes.
4. Scottish Government capital funding in 2021/22 is expected to fall again. This may have a significant adverse impact on councils' investment plans.
5. The long-term funding position for councils remains uncertain, with significant challenges ahead as councils continue to manage and respond to the impact of Covid-19 on their services, finances and communities.
6. In the longer term, uncertainty creates challenges for councils as they seek to address cost and demand pressures that existed before the impact of Covid-19, as well as develop long-term plans with their partners to address complex issues such as child poverty and inequalities, to improve economic growth and to deliver Scotland's net zero ambitions.

Budgets for 2021/22

The uncertainty over the funding position for Covid-19 at the end of 2020/21 led to issues in budget setting and many councils established Covid-19 budgets in autumn 2021

56. Councils approved net expenditure budgets of £13.8 billion for 2021/22, including a budget gap of £0.2 billion (or 1.5 per cent). Many budgets were set before the full impact of Covid-19 funding was known in 2020/21, and some councils set their budget over more than one meeting due to changing financial position on funding.

57. As Covid-19 funding was not incorporated into initial council budgets for 2021/22, many councils presented additional 'Covid-19 budgets' in autumn 2021. Of a sample of 22 councils, only five (or 23 per cent) reported that they have updated their reserves policy because of changes resulting from Covid-19.

Recommendation

We expect councils to agree spending plans and timescales for Covid-19 recovery reserves with the relevant decision-making committee.

All councils froze council tax for 2021/22

58. The Scottish Government made a grant offer conditional on all councils agreeing to freeze their council tax at 2020/21 levels. All councils agreed to accept this offer and froze council tax for 2021/22.

Many councils continue to present multi-year indicative budgets

59. Sixteen councils presented multi-year indicative budgets in 2021/22. In four councils (Aberdeen City, Aberdeenshire, Scottish Borders and Stirling) budgets cover the next five years, and the others cover two or three years.

Financial pressures in 2021/22 budgets

The 2021/22 budget papers contained some common themes in the pressures that councils identified

60. Councils consistently identified short- and long-term cost pressures in their initial 2021/22 budget papers, including:

- costs associated with restarting services after restrictions have ended
- inflation
- increased pay awards
- demand pressures, particularly population and demographic changes
- pressure on capital budgets
- financial sustainability challenges for ALEOs.

61. Further commentary on the future funding position of councils and the associated challenges is included at paragraphs 70 to 73.

2021/22 funding settlement

Excluding Covid-19 funding, initial Scottish Government revenue funding in 2021/22 has increased by 1.1 per cent in real terms. However, when non-recurring Covid-19 funding is included, total revenue funding has fallen by 7.4 per cent in real terms

62. The initial local government revenue settlement from the Scottish Government in 2021/22, excluding non-recurring Covid-19 funding, increased by 3.4 per cent (cash terms) from 2020/21 to £11.0 billion. This was a real terms increase of 1.1 per cent (Exhibit 10).

63. Non-recurring funding related to Covid-19 has fallen from £1.3 billion in 2020/21 to £0.3 billion in 2021/22. As a result, total revenue funding has fallen by 7.4 per cent in real terms from £11.9 billion in 2020/21 to £11.3 billion in 2021/22.

Exhibit 10.

Changes in Scottish Government initial revenue funding in 2021/22

	2020/21 £ million	2021/22 £ million	Cash change %	Real terms change %
General revenue grant and non-domestic rate income	9,967	10,267	3.0	0.6
Specific revenue grants	710	776	9.3	6.8
Revenue funding excluding Covid-19	10,677	11,043	3.4	1.1
Non-recurring Covid-19 funding	1,254	259	-79.3	-79.8
Total revenue funding	**11,931**	**11,302**	**-5.3**	**-7.4**

Source: Finance circulars 05/2021 and Scottish Government Budget documents

Medium- and long-term financial planning

Covid-19 resulted in revised medium-term financial plans, but longer-term planning will need to be updated as Covid-19 uncertainty diminishes

64. Auditors have reported greater uncertainty in current financial planning arrangements at councils because of Covid-19. All councils will now need to revise medium-term financial plans to reflect additional financial pressures and updated funding arrangements and to account for updated savings requirements and financial assumptions.

65. Of a sample of 22 councils, all have a medium-term financial plan in place that covers a 3-5 year period. Only 19 councils review the plan annually.

66. Fifteen of the 22 councils sampled have a longer-term financial plan in place (covering a period of over five years), but many now need updated. The continuing uncertainty and related challenges created by Covid-19 mean that councils have concentrated on revising medium-term financial plans during the recovery from the pandemic. As the uncertainty created by Covid-19 diminishes, councils should update their longer-term financial plans to reflect this. It is also important that councils take account of their overarching recovery strategies in the longer term.

67. Most medium-term financial plans included in our sample contained details of savings and targets, cost pressures, updates on Scottish Government funding levels and scenario planning for the future. We noted gaps, however, in some medium-term financial plans in that key areas and risks, such as Scottish Government settlement updates, staff costs, demographics and inflation, are set out but not quantified.

Recommendation

All councils will now need to revise medium-term financial plans to reflect additional financial pressures and updated funding arrangements and to account for updated savings requirements and financial assumptions.

Councils should also review longer-term planning as Covid-19 uncertainty diminishes.

Capital funding

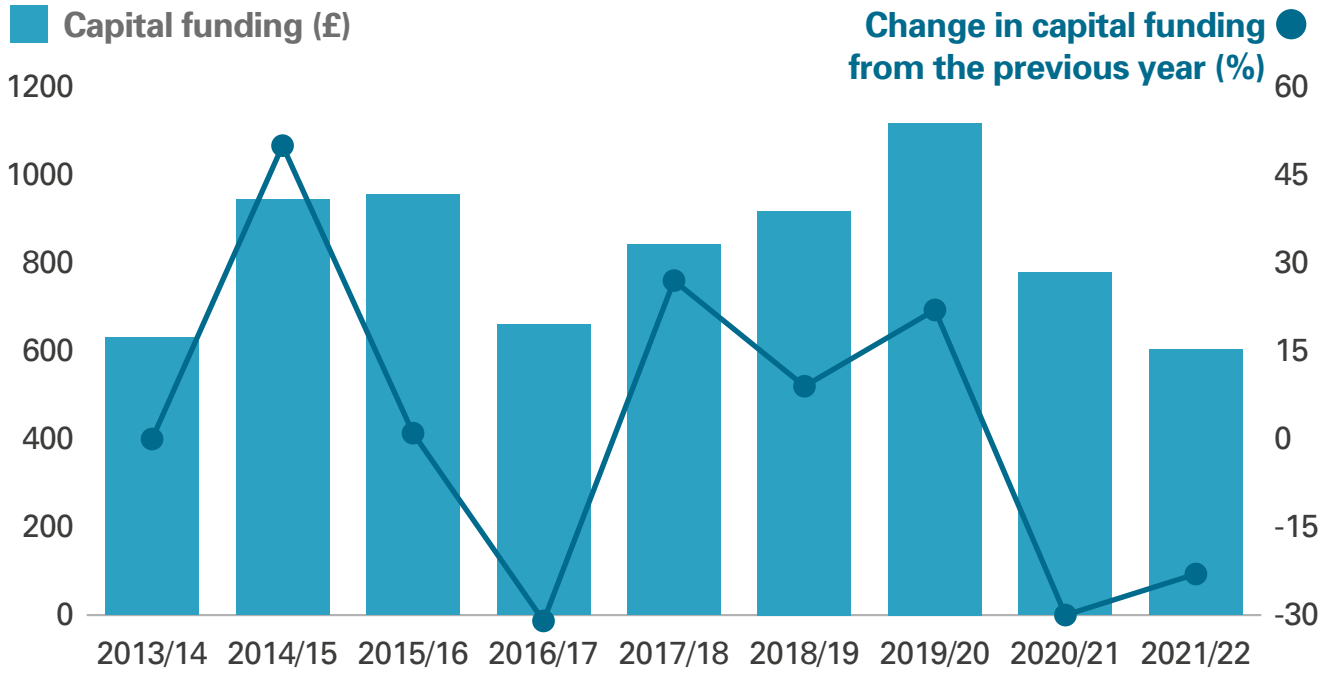
Scottish Government capital funding in 2021/22 is expected to fall again

68. The local government capital settlement in 2021/22 decreased from £0.8 billion in 2020/21 to £0.6 billion. Capital funding increased significantly up to 2019/20 before falling in 2020/21 and 2021/22 (33 per cent increase between 2017/18 and 2019/20 when capital funding was £1.1 billion). Total capital funding has fallen to a level below that in 2013/14 in real terms (Exhibit 11).

Exhibit 11.

Real terms capital funding between 2013/14 and 2021/22

Scottish Government capital funding in 2021/22 is decreasing by 23 per cent



Source: Finance circulars 05/2021 and Scottish Government budget documents

The fall in capital funding may have a significant impact on councils' investment plans

69. Reductions in capital funding may have a significant adverse impact on councils' investment plans. This may create a risk that the progress of crucial transformation activity will be restricted. This is of significant concern at a time when councils will face challenges in supporting communities and local economies to recover from the impact of Covid-19, as well as taking on other local priorities and national policy commitments.

Longer-term financial challenges

Councils' future funding position remains uncertain, with many challenges ahead

70. The funding settlement from the Scottish Government to councils continues to be provided on an annual basis. This makes it challenging for councils to plan and budget effectively for the medium and longer term and creates uncertainty over future funding. COSLA expects that the impact of the Covid-19 pandemic will last for many years and that continuing loss of income and additional expenditure will be a concern for all councils. Managing reserves and medium and longer-term financial planning will continue to be key to maintaining financial sustainability.

71. COSLA also expects that uncertainty over the continuity of Covid-19 funding in future years will bring substantial challenges to councils in developing effective medium and longer-term financial plans. As Covid-19 funding reduces, councils will need to accelerate progress with transformation programmes that have stalled, address issues in delivering recurring savings and bring forward proposals to reduce costs to maintain financial sustainability.

72. Although councils' reserves increased significantly in 2020/21, large parts have been earmarked for specific purposes, such as economic recovery, business transformation and, in some cases, balancing budgets, as part of a longer-term financial strategy. This therefore limits councils' flexibility to respond to unforeseen challenges and circumstances that may arise.

73. The requirement for councils to plan and deliver new ways of working across services, the need to meet carbon reduction targets to mitigate climate change and the potential impact of a national care service on councils' finances and service viability further exacerbate this challenge. We intend to comment further on this as part of our Local government in Scotland: Overview 2022 report, due for publication in May 2022.

The Scottish Government and COSLA are discussing the extent of ring-fencing in the local government budget

74. The provisional Scottish local government finance settlement for 2022/23 was published on 20 December 2021. This set out that a total of £12.5 billion will be distributed to local authorities in 2022/23. However, a final figure has yet to be established as the Scottish Budget process continues.

75. Almost £1.4 billion of the local government settlement is being transferred from other portfolios. As noted in our recent Scottish Budget 2022/23 briefing, the Scottish Government regards this funding as general revenue grant, available to allocate to local needs and priorities, and considers specific revenue grants the only element of the revenue

settlement that is ring-fenced. COSLA contests this view and claims that revenue funding transferred from other portfolios is ring-fenced for implementing a specific policy and comes with conditions setting out how it should be used.

76. The Scottish Parliament Information Centre notes that, if specific revenue grants are the only part of funding that is considered ring-fenced, then ring-fenced funds as a proportion of total revenue grew from 2.7 per cent in 2018/19 to 6.6 per cent in 2022/23. However, if COSLA's definition of ring-fencing is used, namely specific revenue grants plus revenue transferred from other portfolios, then ring-fenced funding as a proportion of total revenue grew from 4.0 per cent in 2018/19 to 17.9 per cent in 2022/23.

77. As we have noted earlier in the report, ring-fenced funding helps support the delivery of key Scottish Government policy initiatives but constrains a proportion of councils' total funding and removes any local discretion over how these funds can be used. The Scottish Government and COSLA continue to discuss this.

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Scottish Parliament Information Centre

January 2022

Local government in Scotland

Financial overview 2020/21

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