

AUDIT SCOTLAND REPORT – FINANCIAL OVERVIEW 2016-17

1. INTRODUCTION

- 1.1 Last year was the first time that Audit Scotland published a separate financial overview report. In view of the very positive feedback they have decided to continue publishing two overview reports each year: one focused on financial matters and the other on councils' performance and outcomes, due to be published in April 2018.
- 1.2 This report summarises the key points from the Financial Overview 2016-17 report and includes commentary alongside the questions for councillors to consider. The full Audit Scotland report is included as appendix 2 to this report:

2. RECOMMENDATIONS

- 2.1 Members are asked to note the key points from the Audit Scotland Financial Overview 2016-17 and to consider the comments included in Appendix 1 alongside the suggested questions for councillors.

3. DETAIL

Overview of Audit Scotland Report

- 3.1 The Audit Scotland report provides a high-level independent analysis of the financial performance of councils during, and their financial position at the end of, 2016-17. It also looks ahead and comments on the financial outlook for councils. The report is intended to inform the public and its representatives. It is particularly aimed at councillors and senior council officers and will be of significant interest to elected members who joined councils for the first time following the May 2017 elections.
- 3.2 The report is in three parts:
- Part 1 comments on councils' income and budgets for 2016-17.
 - Part 2 looks at councils' financial performance during, and position at the end of, 2016-17.
 - Part 3 looks at councils' 2017-18 finances and the challenges faced going forward.
- 3.3 This report summarises the key points from each section. The text in bold and italics is commentary that I have added relevant to Argyll and Bute.
- 3.4 Audit Scotland has identified a number of example questions that councillors may wish to consider to help them better understand their council's financial position

and to scrutinise performance. Appendix 1 notes these questions with comments included against each question.

Part 1 – Councils’ income and budgets for 2016-17

- 3.5 2016-17 was a challenging year for councils with a real-terms reduction in revenue funding, a continuation of the council tax freeze, inflationary pressures and the cost of new UK and Scottish Government (SG) policy commitments.
- 3.6 Councils depend on SG funding, the largest element relating to Grant Aided Expenditure (GAE) which has remained largely unchanged since 2008-09. The proportion of council funding directed towards national policies is increasing, a trend that will continue with SG proposals for fairer funding for equity and excellence in education. This shift increasingly restricts the flexibility councils have in managing their budgets across their full range of services. The SG and COSLA should assure themselves that the funding formula remains fit for purpose in a changing landscape for local government.
- 3.7 Councils budget setting processes for 2016-17 were complicated by later confirmation of funding from the SG and the funding arrangements for integrating health and social care. In response to funding reductions, councils approved £524m of savings and used £79m of reserves to set their budgets for 2016-17. *Argyll and Bute Council didn’t use any reserves to balance recurring expenditure, however, did use reserves for a one-off purpose in relation to the Broadband Pathfinder Project.* Councils were not always clear about the risks associated with savings and their potential impact on levels of service.
- 3.8 Despite demand pressures in social work, overall budgets reduced, but not by as much in percentage terms as other areas of service. Remaining service areas have seen larger reductions to their budgets.
- 3.9 Councils have been seeking to maximise their income through increasing charges and by introducing new charges for services. Councils have also sought to collect more of the income that is due to them. Charges for social care which are subject to regulation, represented the largest area of income from charging services in 2015-16. Although Councils generate a relatively small proportion of their overall income from fees and charges, increases can make a difference to council finances over time.

Part 2 – 2016-17 Financial Performance

- 3.10 All Councils received an unqualified audit opinion on their 2016-17 accounts but the accounts could more clearly explain their financial performance.
- 3.11 Councils are showing signs of increasing financial stress with 20 councils drawing on their usable revenue and capital reserves in 2016-17, an increase from the 8 councils that did so in 2015-16. *Argyll and Bute Council was not one of the 20.*
- 3.12 Councils’ actual use of reserves was often quite different from that originally planned, with the reasons not always being clear. In some cases, councils have

used reserves to support service delivery and also to invest in change programmes, such as meeting the additional costs of severance. It is critical that councils understand the risks of using reserves in an unplanned way in relation to future savings and long-term financial sustainability.

- 3.13 There is no prescribed minimum level of usable reserves. Typically councils' policies are to have a minimum uncommitted General Fund balance of between 2% and 4%. Councils need to be clear about the reasons for the level of reserves they hold to mitigate risks and support medium-term financial plans. ***Argyll and Bute Council level of reserves is 2% of budget and the rationale for this is outlined in the reserves report as part of the budget pack each year.***
- 3.14 Councils should consider rebasing their budgets where they consistently underspend. One such area is underspending on financing costs, where slippage on capital programmes leads to less borrowing and lower interest payments. The ongoing costs with debt reduces the amount councils have available for day to day service delivery. ***As part of the 2018-19 budget, Argyll and Bute Council are rebasing their loans charges budget in order to protect front line services.***
- 3.15 On average, councils spent almost 10% of their income on interest and debt repayment. Levels of debt and associated costs are set to rise in the future. This is because councils have invested usable reserves in their capital programmes, something referred to as internal borrowing. Internal borrowing is usual treasury management practice for councils during periods when they would make a lower return from investing their usable reserves than it would cost them to borrow money. ***Argyll and Bute Council spent around 11.5% of their income on interest and debt repayments in 2016-17. We are currently under-borrowed and are using internal borrowing, however, the proportion of internal borrowing is reasonable and does not expose the council to increased risk. This is not the same position across all Councils with some relying heavily on internal borrowing.***

Part 3 – Financial Outlook

- 3.16 The financial outlook for councils remains challenging with further real term reductions in funding and a range of cost and demand pressures on budgets.
- 3.17 Councils approved £317m of savings and the use of £105m of reserves when setting budgets for 2017-18. Some Councils plans for 2017-18 relied more heavily than others on using reserves to bridge funding gaps. A number of these councils could have relatively low levels of General Fund reserves remaining at the end of the year. ***Argyll and Bute didn't use any reserves to balance the 2017-18 budget and in comparison to other Councils is well positioned in terms of its level of reserves.***
- 3.18 Robust medium-term financial strategies and savings plans are increasingly critical to the financial sustainability of councils. ***The Policy and Resources Committee approved Argyll and Bute Council's medium to longer term financial strategy at its meeting on 19 October 2017.***

- 3.19 Uncertainty means that councils need to prepare for a range of possible scenarios both in terms of costs and funding and different savings options available to them. Regular updates on forecasts of funding gaps as savings are approved enable councillors to better understand the impact of the savings decisions they are making. However, currently only about half of councils routinely update their three-year financial forecasts as part of their annual budget-setting process. *The medium term (3 years) budget outlook report is reviewed, updated and presented to each meeting of the Policy and Resources Committee and includes estimates based on three different scenarios, best case, worst case and mid-range.*
- 3.20 It is important that savings plans are clear and that the impact on services is understood. Savings should be realistic and achievable. Where funding reductions are passed on to other bodies, such as ALEOs and IJBs, by reducing council contributions to them, it is equally important to assess the impact on service users and communities. Risks associated with income generation initiatives or arising from cuts to services should be explicit and considered by councillors as part of their scrutiny role.
- 3.21 Given the scale of the challenge facing councils, the sustainability of some services will be increasingly dependent on the ability of councils and their partners to address the underlying demand for them. With health and social care integration, for example, much depends on the extent to which resources can be switched from treatment to prevention. Council transformation programmes need to identify and deliver changes of this nature over the longer term. It is important that councils give careful consideration to their capacity to support such change when making savings as part of budget setting.

4. CONCLUSION

- 4.1 The Audit Scotland report provides a high level analysis of the financial performance of councils during, and their financial position at the end of, 2016-17 and also looks ahead at the financial outlook for councils. From the various exhibits included within the report, Argyll and Bute Council appear to be well placed to deal with the financial challenges that the council is facing now and in the future.

5. IMPLICATIONS

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| 5.1 | Policy - | None. |
| 5.2 | Financial - | None. |
| 5.3 | Legal - | None. |
| 5.4 | HR - | None. |
| 5.5 | Equalities - | None. |
| 5.6 | Risk - | None. |
| 5.7 | Customer Services - | None. |

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20 March 2018

Appendix 1 – Questions for councillors to consider
Appendix 2 - Audit Scotland Financial Overview 2016-17

Appendix 1

Questions for councillors to consider	Comment
Budget setting	
1. Does your council have a medium term financial strategy aligned with corporate objectives?	Yes, the medium to longer term financial strategy was approved by the Policy and Resources Committee on 19 October 2017.
2. How does annual budget setting link to medium term financial planning?	Although the Council have only set a one year budget over the last couple of years, the medium-term position has always been considered. When setting the budget for 2017-18, indicative budgets were set for 2018-19 and 2019-20.
3. How is your council preparing for any further real terms reduction in Scottish Government funding?	The regular budget outlook provides the latest estimates of the likely budget gap and we have a Transformation Board that are taking forward proposals to bridge the budget gap.
4. If your council plans to raise council tax do you know how much it will raise? How will you communicate and explain the reasons for the rise to constituents?	This is a matter for councillors to consider. The budget outlook includes information if the council chose to increase council tax by 3%.
5. What impact will savings have on the delivery of services? What are the potential risks?	The impact of savings along with the risks are always outlined within the budget pack in order that councillors have sufficient information to assist in their decision making.
Financial and savings plans	
6. What is your council's financial position? What particular challenges does the council face?	The financial position is outlined in the budget outlook reported that is presented to every meeting of the Policy and Resources Committee.
7. Does your council have a savings plan? What are the options to close future funding gaps?	The council does have a savings plan with options to reduce the funding gap over the next three years. The Transformation Board are actively looking at other options to close the gap.
8. What measures in the council's corporate and transformational plans are aimed at addressing the	The Transformation Board take into consideration demand for services when looking for ways to close the funding gap. They

<p>underlying demand for some services?</p>	<p>are considering how services with increasing demand can be delivered differently and more efficiently instead of being stopped or reduced. A different savings target was given to different services reflecting the demand and also the savings previously taken from the services.</p> <p>The Council will also be asked to consider reconstructing the budget from the bottom up as part of the 2019-20 budget process and this will take into consideration service demand.</p>
<p>Reserves</p>	
<p>9. What is the councils reserves policy?</p>	<p>The councils reserves policy is to hold 2% of budget as a contingency. This is reported to councillors on an annual basis as part of the budget setting process and it is explained what the contingency is there for alongside an annual risk assessment.</p>
<p>10. What have reserves been used for in recent years? Supporting services and bridging the funding gap or transforming services?</p>	<p>Over recent years our reserves have been used for transforming services, regenerating the economy and supporting large scale capital projects.</p>
<p>11. What are the different types of reserves your council holds? Do you know what these can be spent on?</p>	<p>The types of reserves are explained in the reserves and balances report that is presented to Policy and Resource committee every 2 months – this explains the usable reserves and the unusable reserves and what they can be used for.</p>
<p>12. What is the likely use of reserves for 2017/18? How does this compare to forecast funding gaps?</p>	<p>The reserves and balances report that is presented to Policy and Resources Committee every 2 months summarises the planned use of earmarked reserves and also notes whether there has been any drawdown of reserves by way of a supplementary estimate during the year.</p>
<p>13. What are the levels of reserves held by your council's IJB? Are these in line with the IJB's reserve policy?</p>	<p>The IJB reserves policy was approved by the IJB on 29 March 2017. Their reserves policy suggests a prudent level of general reserve be set at 2% of the IJB net revenue budget, this would equate to around £5m. The 2% should be viewed as an optimum level of reserves to be built up over time, recognising</p>

	the tensions between prudent financial planning and budgetary constraints.
Levels of debt and affordability	
14. What share of your council's budget is taken up with interest payments and debt repayment?	This information was included within the financial strategy document, at the time of writing around 12% of income was spent on interest and debt repayments.
15. What proportion of the council's debt is linked to inflation (ie, subject to indexation)? What does that mean for longer term affordability?	As part of the December budget outlook report, there is a note to advise councillors that the impact of a rise in interest rates, likely in the medium term, will have little impact on the Council's interest payments as the vast majority of the Council's loans are at fixed rates.
Budget outturn reports and management commentaries	
16. Do budget monitoring reports clearly explain performance against plans and any changes to plans?	The budget monitoring reports explain performance against budget for significant variances. There is generally not very many significant changes to plans and if there is it is likely to be down to additional funding received for a specific purpose which would be reported.
17. Do management commentaries clearly explain council performance and any changes to plans?	Our management commentary is detailed, at 24 pages long. There is a section dedicated to performance against our priorities which gives a balanced view on things that we have done well and things not so well. There is also a section on financial performance that explains the variance from the planned budget, in 2016-17 much of our underspend was expected and planned for.
Financial scrutiny	
18. What additional training would you like to receive to develop your knowledge and skills in financial scrutiny?	High level scrutiny training was included as part of the councillors induction programme and the Audit and Scrutiny Committee also have had a development session which discussed scrutiny. Following the Improvement Service publication on scrutiny in local government further training is planned for all councillors.

Charging for services	
19. Does your council have a charging policy? Is this in line with corporate plans and objectives? When was this last reviewed?	There is a charging policy in place for Social Care, this was created around 2011 and for all other charges there is a schedule of fees and charges. The charging policy is updated in line with benefits changes each year and all fees and charges are reviewed each year.
20. What information do you need to be able to explain increases in fees and charges to your constituents?	Over the last few years the fees and charges have either been subject to an inflationary increase or they have been part of service choices. Additional information was provided to councillors for those that were part of service choices. The information provided alongside fees and charges is an area that Strategic Finance are looking at with a view to providing further information as part of the 2019-20 budget process.
Exit packages	
21. Are staff severances in line with the council's workforce plan?	The council are finalising their workforce plan, but to date, the severances have been in line with any service redesign as a result of service choices.
22. How does the council ensure that councils have the capacity to deliver transformational change?	The council has a Transformation Board established, with representation from every service to take forward transformational change. In addition they have employed a dedicated officer to transformational change and will look at additional dedicated resource to support this and also speed up the pace of change in some services.
23. Do you know the implications of your council's pension liabilities of staff retiring early?	The unfunded pensions budget is included as part of the budget papers and the council set aside a £3.5m resource as part of the 2017-18 budget to pay for any severance costs as a result of savings.
Capital programmes	
24. How clearly does the council's capital programme link with	There is a golden thread from the LOIP through to the capital programme and this is made explicit in the budget pack

the asset management plan and corporate objectives?	documents.
25. Has non-delivery of the capital programme (ie, slippage) been significant at your council in recent years? Why?	<p>There has not been any particular significant slippage in recent years, however, some slippage is expected and is due to a number of reasons, for example:</p> <ul style="list-style-type: none">• Poor contractor performance• Weather conditions• Unforeseen works resulting in a project delay.