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Balancing Local Government Budgets in Scotland

Summary

Local government across Scotland is making difficult financial decisions to balance budgets at a time of ongoing and challenging financial pressures. Against the backdrop of high inflation, wage pressures and a cost of living crisis, limited powers to raise revenue combined with increasing responsibilities and demand-side pressures, many local authorities have expressed concern about their capacity to meet statutory services and balance their budgets. This research, conducted by CIPFA and LGIU, sought to understand the views of chief finance officers (CFO) in local authorities about how they would deal with an unbalanced budget.

Conclusions

- CFOs are united in their diagnosis of the funding challenges facing local government across Scotland, pointing to funding settlements that have not increased to meet spending pressures, directed spending and limited revenue-raising options.
- CFOs were not in favour of introducing an equivalent to the 'Section 114' legislation in England that would provide a statutory process for CFOs to follow in the event that their council were not able to pass a balanced budget.
- Instead, CFOs were in favour of implementing policies to avoid the risks of unbalanced budgets happening by increasing councils' financial sustainability.

Recommendations

- Scottish Government, local authorities and other key public sector stakeholders, including COSLA and Solace, work together to progress a long-term solution to the financial sustainability of councils in an open and transparent way following a clear framework.
- The leadership of councils, including all senior officers and councillors, need to clearly understand the challenging fiscal position councils are in and make decisions accordingly, including supporting the CFO in fulfilling their statutory duty to ensure the sound financial management of their council.
- There should be a clear agreed, nationally driven convention between Scottish Government and local government to cover procedures and actions that would take place should a council be unable to agree a balanced budget.
- Specific policy decisions, for example pupil-teacher ratios and Integrated Joint Boards, should be revisited in light of the additional pressures these place on local government both in cost and the approach to grant allocation.

Introduction

In December 2023, LGIU launched its first annual state of local government finances in Scotland report. The research surveyed Scottish local government leaders, chief executives and chief finance officers, and brought to light the severe funding challenges facing local authorities. Respondents from eight different local authorities, a quarter of all councils, said their financial position meant they may not be able to fulfil their statutory duties. One written response to the

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survey went so far as to say that it was "...just a matter of time before the first Scottish council goes bankrupt".

In response to these concerns this piece of work sought to undertake an independent review into how CFOs, also known as Section 95 officers, of Scottish local authorities would respond in this instance and to comprehend how key stakeholders would support those faced with this scenario. Recommendations as a result of our findings aim to clarify sector understanding but reinforce the message that preventing this scenario is the primary objective.

Against the backdrop of a challenging national fiscal position every local authority must make difficult financial decisions surrounding the budgets that they set, and the services that these budgets pay for. CFOs must work together with elected councillors and members of their leadership team to produce a balanced budget not just because this is good financial management, but because legislation requires that an authority's yearly expenditure must not exceed the resources it has available.

To strike the right balance, the CFO must match technical expertise with an adeptness in prioritisation, communication and planning. However, this research wanted to explore with CFOs a scenario where the budget did not balance, investigate what might happen and how CFOs would feel in this position.

Our research included a round table discussion with stakeholders (including CFOs, alongside representatives from organisations with other relevant expertise, on the condition of anonymity) and a series of interviews with 11 local authority CFOs in Scotland as well as engagement with the CFO Scottish Section (the group that represents all Scottish local authority CFOs).

Our work explored three main areas:

- What are the challenges faced by CFOs to ensure good financial management?
- What action would a CFO take if faced with an unbalanced budget?
- Do CFOs feel supported to take the action required?

Our findings showed that:

Virtually all CFOs we spoke to agreed on the diagnosis of the financial challenges facing local authorities: that increased demand and costs, flat funding settlements, directed spending and limited revenue raising options were combining to make setting balanced budgets while providing statutory services more and more challenging year on year.

CFOs were clear that as opposed to introducing a legislative section 114 equivalent, the vastly preferable response would be to implement policies that reduced the chance of unbalanced budgets.

That it is essential that all the leadership of a local authority must be cognisant of the challenges faced and work together to meet the legislative requirements. While the CFO is able to advise and provide professional guidance, the financial management of an authority cannot be their responsibility alone. Councillors must be prepared to make financially prudent decisions, and senior officers need to support CFOs in fulfilling their statutory duties.

Budget context in Scotland

The report from the Scottish Fiscal Commission in March 2023 made for stark reading to all those looking at setting budgets and delivering public services. The risks identified at the time regarding fiscal sustainability are materialising and the reality of what that means to both politicians and citizens can be seen across all of Scotland's public services. The report projects that Scottish Government spending will exceed funding by an average of 1.7% each year over the next 50 years, posing a significant challenge to maintaining a balanced budget

In September the announcement by Cabinet Secretary Shona Robison confirming in-year spending cuts of up to £500 million in order to fund public sector pay deals and other inflationary pressures hitting the Scottish budget shows just how real the challenges of balancing a budget actually are. Harsh decisions have to be made, and the impact of those decisions will be felt across society.

The main risks to fiscal sustainability highlighted in the Commission's Report included:

Demographic changes:

Scotland's population is projected to decline by approximately 400,000 over the next 50 years, with an increasing proportion of older people. This will lead to higher demand for services like health and fewer working age individuals will pay tax.

Health spending:

Health spending is projected to grow significantly, from 35% of devolved spending in 2027–28 to 50% in 2072–73, driven by an aging population and additional costs from new treatments and long-term health conditions. This is far from unique within the Scottish context but, as seen elsewhere, health spending impacts how much is left for other services.

Funding challenges:

The Scottish Government's funding is closely tied to UK Government spending decisions and changes in UK Government spending and taxation can directly impact the level of funding received through the Block Grant. While this is true to some extent, it must be recognised that Scottish Government has also influenced the funding position through specific policy directions such as the freezing of council tax and decisions to support more generous social security benefits.

The challenges of balancing a Budget for local authority CFOs

As times get tougher, it may prove increasingly challenging for CFOs in Scotland to maintain a balanced Budget. In England, there have already been several cases where the CFO has deemed the situation untenable and resorted to a legislative measure known as a Section 114 (S.114) notice. This legislative measure halts all additional spending until the council agrees upon a more sustainable financial path.

In Scotland where this legislation does not exist, greater reliance is placed on a combination of other guidance, legislation and the current framework. In fact, one CFO made the comment that "a section 114 process would take away part of your local flexibility".

Research findings

The research was conducted through a roundtable attended by stakeholders and a series of interviews with local authority CFOs. The content of these discussions has been captured under three headings:

- What are the challenges faced by CFOs to ensure good financial management?
- What action would you take if faced with an unbalanced budget?
- Do you feel supported to take the action required?

What are the challenges faced by CFOs to ensure good financial management

It is perhaps unsurprising that many of the responses related to the challenges of working with elected politicians. There was consensus that councillors wanted what was best for the communities that they serve, but at times this ran contrary to the financial necessities of a balanced budget in the current fiscal circumstances.

> "Getting them to make difficult decisions is a challenge."

Approaches for improving the relationship with elected members were discussed and included ensuring they are engaged and have financial training, that there is a clear vision and strategy agreed so that everyone is aware of the direction of travel and has ample opportunity to get involved in discussions through a good governance approach. This included a focus on long-term not just short-term options with evidence backed from organisations such as Audit Scotland, COSLA, LGIU and CIPFA.

However, as we were reminded:

> "I [the CFO] am not the decision maker. I need to do as much as I can to work with the decision-makers to understand what their issues are, what information they need to try and make our arguments as persuasive as possible. But I accept that role as not the decision maker."

There was acknowledgment that there were challenges around getting a process agreed and it was important to operate in a transparent manner in order to ensure consensus around sound financial management.

> "We created a strategic budget group with representatives from each political party where we talked about the size of the saving target we had to make…They set the strategy. We then have a cross-party working group…[they] will then have presentations from each service department on what they would propose to do to fund the budget gaps… Every political group gets the same briefing, they hear each other asking questions… but it means there is a single version of the truth."

Reference was made to the importance of having a supportive chief executive taking an active role in ensuring good financial management and a culture of stewardship which enables the CFO to operate effectively. CIPFA Financial Management Code reflects this approach where the whole of the leadership team is responsible for financial management.

On a more personal level a growing number of senior finance leaders in different parts of the public sector are describing the challenge of having to juggle complex political, operational and financial trade-offs and find continual new ways to make constrained resources stretch to meet unconstrained service demands. This is demanding work, which can create both professional and emotional impacts and require difficult judgement calls.

What action would you take if faced with an unbalanced budget?

The majority of CFO's questioned talked through a scenario that included an emphasis on gaining consensus for a budget. To improve the chance of a successful outcome additional briefing papers, information and options would be made available to ensure all councillors are fully informed regarding the seriousness of the position. It was noted that while there is not the threat of a S.114, in Scotland there was the ability to produce a report which is treated with similar respect.

One respondent commented that the report should clearly let councillors know of the significant consequences of not passing a balanced budget.

This report would be the focus point of any further discussion which would include conversations around statutory and non-statutory service provision, recruitment freezes savings and the use of reserves.

Commentary around the use of reserves reflected the individual positions of the authorities but the drawing down of reserves was a common theme. While this is not a long-term option it is something that many authorities across the UK have used in the last few years. The use of windfalls, non-recurrent savings options or reserves as a means to pass balanced budgets in-year can all mask the more systemic weaknesses in the long-term financial sustainability of Scottish councils.

It was evident from the responses that the role of Scottish Government at this time was unclear. As one respondent said:

> "A lot of local government will already have had those conversations with Scottish Government about those funding challenges… we're already having those conversations to say that 'we are really struggling here'."

Do you feel supported to take the action required?

The Section 95 officers we interviewed spoke about the support provided by their CFO colleagues and that this professional support made it easier to make difficult decisions specifically as many authorities were in the same challenging circumstances.

A number of the CFOs questioned were very experienced and as such felt that although relationships with politicians could be challenging it was vital to build a strong and respectful rapport so that at difficult times they would be able to have straight conversations about the state of the budget and have their recommendations taken seriously. There was an acknowledgement that it may be more difficult for inexperienced CFOs.

It was noted that a number of respondents sought additional support externally either for specific projects or more rounded advice, to assist them in these budget discussions and that this had been useful to provide further evidence to ensure a balanced budget position could be agreed.

In addition to being supported by individuals, the research also explored the question of whether the guidance is sufficient to take the action needed. Almost without exception CFOs felt that the current guidance and legislation was sufficient and that any additional requirements would be unnecessary.

One CFO talked about the fact that in their view Section 95 has sufficient wording to make sure of stewardship of public funds. They also referenced internal policies that protect them – a budget strategy, a robust financial strategy, a treasury management strategy and a reserves strategy. In their view, this internal governance with the overarching statutory guidance was robust enough to ensure sound financial management.

Part of the support that is needed comes through the other senior leaders in the leadership team including the monitoring officer who is responsible for the legal governance of the local authority. It is essential that this group work together effectively.

Findings and recommendation for change

Virtually all CFOs we spoke to agreed on the diagnosis of the financial challenges facing local authorities. That increased demand and costs, flat funding settlements, directed spending and limited revenue raising options were combining to make setting balanced budgets while providing statutory services more and more challenging year on year.

CFOs were clear that as opposed to introducing a legislative S.114 equivalent, the vastly preferable response would be to implement policies that reduced the chance of unbalanced budgets.

The written response by the Scottish Section below provides an accurate reflection of the feedback received in the interviews.

> "There was a consensus at the meeting that any move to a more rigid or defined 'Section 114' process would not be helpful. Our view remains that focus should be on underlying financial sustainability as opposed to the development of guidance around scenarios. The role of professional judgement is important, and a more 'rules-based' or interventional approach may be detrimental to local flexibility."

Recommendations

1. That Scottish Government continues to work closely with the local government sector and other key stakeholders such as COSLA and Solace to ensure discussions around funding and policy are transparent and open and a long-term solution to financial stability is progressed. The use of a clear framework and an ability to speak 'truth to power' would increase the transparency of this approach.
2. It is essential that the responsibility for maintaining the financial sustainability in each local authority is recognised across the senior leadership teams and among local politicians. While the CFO has a specific role and leads the finance function, they must be supported by other senior colleagues to maintain the financial position of the organisation.
3. There should be a clear agreed convention between Scottish Government and local government to cover the procedure and actions that would take place should a council be unable to agree a balanced budget. This should include the roles and responsibilities of other stakeholders. This should be nationally driven rather than at an individual council level.

4. Specific policy decisions should be revisited in light of the additional pressures these place on local government both in cost and the ring-fenced approach to grant allocation. The funding of pupil-teacher ratios and partnerships with Integration Joint Boards have been identified as examples of key pressure issues.