

Financial Sustainability of Scotland's Local Authorities: Memorandum by Professor David Heald to the Local Government, Housing and Planning Committee of the Scottish Parliament

Introduction

I am Emeritus Professor at the Adam Smith Business School, University of Glasgow. I am a member of HM Treasury's User and Preparer Advisory Group on government financial reporting and of the Scottish Government's Tax Advisory Group. My responses are entirely my own responsibility and should not be attributed elsewhere.

In my answers below, I have retained the original numbering of the Committee's questions. I am answering only those questions on which I have knowledge and expertise relevant to the Committee's inquiry.

Question 1: What are the main challenges facing local government finance over the next five years?

The prolonged period of austerity has taken its toll, and councils are struggling to cope with increasing demands and diminishing resources. Statutory services have to be protected at the expense of non-statutory services which are often more visible and affect a larger proportion of the resident population. The physical appearance of council facilities is deteriorating. It must be extremely depressing to be an elected councillor and find that the main budget question is what to cut next.

The UK Chancellor of the Exchequer's 29 July 2024 statement on the fiscal inheritance (Reeves, 2024; Treasury, 2024) suggests that difficult times lie ahead. Scottish local government funding depends on the Barnett-formula block grant which in turn depends on the change in comparable expenditure in England.

Scottish local government would benefit from a multi-year funding settlement but the Scottish Government cannot credibly offer this to local authorities unless it receives multi-year funding from the UK Government. The 30 October 2024 Spending review will cover only one year (2025-26) with more years to be announced in Spring 2025. This should cover 2026-27, 2027-28 and 2028-29 (the full length of the present UK Parliament), but coverage may be limited to 2026-27 and 2027-28.

The proliferation of separate funding channels creates additional unproductive work and damages the capacity of local authorities to act strategically for their areas. Wherever possible, the Scottish Government should work with the Convention of Scottish Local Authorities to reduce earmarking which reduces local accountability, complicates financial management and can lead to under-spending.

There are two structural finance issues which require urgent attention, but these are “politically difficult”.

- 1) Based on 1991 property valuations, Council Tax is degraded and there have been nine freezes imposed by the Scottish Government, leading to greater grant dependence and less accountability to local electorates (Royal Society of Edinburgh, 2023). There have been major changes in property values since 1991, by both property type and geographic location. In broad terms, many properties in the west of Scotland have too high bandings and many in the east of Scotland have too low bandings. The 1986 rebellion against domestic rate revaluation (which led to the poll tax) is deep in the collective psyche. Most Scottish politicians know that that this is nonsensical but political parties are terrified of acting for fear of the electoral consequences. But the longer this goes on the inefficiencies and inequities will grow, making reform even more difficult and likely to lead to more diminution of the autonomy and accountability of Scottish local authorities. Both Wales and Northern Ireland have undertaken domestic property revaluations. It is depressing that, notwithstanding having devolved responsibility for 25 years, Scotland shares this paralysis with England.
- 2) The principles basis of the grant distribution to local authorities has been lost due to a series of short-term fixes. Resources equalisation is now far from complete, so the objective of equal access to public services across Scotland is not being realised.

As forewarned by Midwinter and McVicar (1996), devolution has led to more centralisation within Scotland, in part as a response to pressures from the devolution finance system. The above problems are more difficult to overcome when resources are scarce. What has to be resisted is the temptation to resort to further temporary fixes and to more centralisation when over-centralisation – within the UK and within Scotland – is often a major cause of difficulties.

Question 5: Is there a risk that Scottish local authorities might face similar financial difficulties to those faced by some English councils such as Nottingham, Croydon, Thurrock and Slough? If so, how can this risk best be mitigated?

The situation in Scottish local authorities is very different from that in England, though this observation does not detract from the severity of the problems summarised in my answer to Question 1 above.

The specific circumstances of England are examined in the academic paper which I co-authored with Lynn Bradley (University of Glasgow) and Ron Hodges (University of Birmingham) (Bradley et al., 2023). The local audit crisis is restricted to England, with no counterpart in Scotland, Wales or Northern Ireland.

The reasons for this difference are:

- (1) Whereas the UK Government abolished the Audit Commission and privatised District Audit (the in-house local audit facility originally established in 1844), the Scottish Government did not change the responsibilities of the Accounts Commission or Audit Scotland. Mixed local audit procurement has continued in Scotland whereas all local audits in England are contracted out to private firms which have found such business increasingly difficult due to cuts in audit fees. Cutting the cost of local audit was one of the explicit purposes of the England-only *Local Audit and Accountability Act 2014*, and this has rebounded spectacularly.
- (2) Scotland, Wales and Northern Ireland each have many fewer councils than England and there is much more knowledge at the centre of the situation on the ground than there has been in the predecessors of the now Ministry of Housing, Communities & Local Government. It is inconceivable that the devolved governments would have allowed their local authorities to borrow huge sums from the Public Works Loans Board – in essence the Treasury – for speculative investments including those outside their council area
- (3) After many local audits in England descended into chaotic lateness, the problems were compounded by events such as the Covid-19 crisis which put additional pressure on overstretched local authority finance teams. The then UK Government did not bring forward the legislation to set up the Audit, Regulation and Governance Authority, plans for which had been announced in March 2019, which would have become the system leader for local audit in England
- (4) The unexpected calling of the 4 July 2024 UK General Election resulted in the secondary legislation to authorise the English audit backstop date of 30 September 2024 not being passed in the last Parliament. The backstop date would involve all English local authority audits being published for financial years up to 2022-23, even if these were qualified or disclaimed. The new UK Government has updated the backstop date to 13 December 2024 (McMahon, 2024).

For the above reasons, and the work of the Accounts Commission and Audit Scotland, the situation in Scotland is not comparable. However, there are three points which the Committee should bear in mind:

- A. The financial resilience of Scottish local authorities has been damaged, thereby increasing vulnerability to further resource reductions
- B. When accounts are significantly delayed, complications rapidly escalate, not least because of problems with opening balances when the previous years' accounts have not been audited. Timeliness in financial reporting by Scottish local authorities is far better than in England and this must be maintained for reasons of transparency and accountability

C. One area of similarity between England and Scotland is the effect of settlements of historic Equal Pay claims. The source cited in the question (Sandford, 2024) discusses the case of Birmingham City Council, where one of the reasons for its Section 114 notice (roughly interpreted as the equivalent of bankruptcy) was its settlement of Equal Pay claims. Glasgow City Council has undertaken a sale and leaseback transaction with a council-owned legal entity, City Property Glasgow (Investments) LLP, a transaction which includes the City Chambers and Kelvingrove Art Gallery and Museum (Learmonth, 2022). Such financial engineering transactions involve transferring budgetary pain to the future.

McLean et al. (2023) of Brodies LLP noted that “While there is no direct equivalent of section 114 (of the Local Government Finance Act 1988) in Scotland, CIPFA guidance recommends that section 95 officers follow the same principles in order to discharge their overall responsibility for sound financial management.” The Local Government Information Unit report (Stride, 2023), on which their note is based, records deep anxiety about the financial condition of respondents’ local authorities and frustrations about central-local relations in Scotland.

Question 6: Do councils have enough capital funding to provide and maintain the infrastructure communities expect?

The direct answer is that existing assets are deteriorating and that there is not enough new capital. The standard response of UK Governments to fiscal pressure is to cut capital expenditure so as to protect existing services and employment. This has become particularly damaging since 2010 because the pressure on local authorities has been incessant.

A distinction should be drawn between (a) capital expenditure on new facilities, and (b) revenue expenditure on maintaining existing council assets. Inadequate spending on new facilities means that assets which should be retired are kept functioning in poor condition, damaging the environment in which public services are provided and wasting public resources on emergency repairs.

The condition of council assets is visibly deteriorating, reflecting the neglect of maintenance which is one of the first targets for budget cuts. Persisting over years, this is likely to lead to assets having a shorter economic life than would otherwise have been the case. A related matter is that, around 20 years ago under the 1997-2010 Labour Government, there was a large amount of school building and renovation, much under the now abandoned Private Finance Initiative (PFI).

It is striking that Scottish local authorities are willing to admit that PFI schools are much better maintained than their owned schools because maintenance of the former is contractually committed whereas that of the latter is often neglected unless there are security or safety issues. In terms of study

environments, some pupils are being educated in deteriorating physical environments whereas others are more fortunate. Over the next five years, the time horizon referred to in Question 1, some PFI schools will reach or approach their handback dates. Headteachers and parents will be concerned about what will then happen to the quality of maintenance of such PFI schools and whether that will fall to the level of owned schools.

Question 10: Why have reserve levels changed over recent years?

Usable Reserve	31-Mar-19	31-Mar-20	31-Mar-21	31-Mar-22	31-Mar-23
General Fund	1,143	1,315	2,274	2,687	2,870
HRA	177	188	248	215	209
Harbour Account	314	269	328	331	309
Renewal and Repairs	138	141	177	190	166
Insurance Fund	90	102	99	95	91
Other Statutory Funds	12	13	14	9	6
Total Revenue Reserves	1,874	2,027	3,141	3,527	3,650
Capital Fund / Capital Receipts	491	475	464	461	512
Capital Grants and Receipts Unapplied	180	207	227	175	370
Total Capital Reserves	671	681	691	636	882
Total Usable Reserves	2,546	2,708	3,832	4,163	4,532

Note: These figures do not necessarily match those in local authority accounts for reasons explained in the source, and data for the earlier years may have been revised from those originally published in light of later information.

Source: Scottish Government (2024, p. 64).

Local authorities are subject to a break-even requirement in each financial year. However, this is a term of art which creates misunderstanding:

- 1) This does not mean that revenues and expenditures must balance in a year because a deficit in that year can be offset by transfers from usable reserves. This constitutes a valuable buffer provided that in some years there are transfers from usable reserves and in other years transfers into usable reserves to maintain them at a prudent level. If a local authority is under constant pressure and transfers are mostly out of usable reserves, then those reserves will go down.
- 2) Local authorities across the UK prepare their accounts on the basis of the CIPFA-LASAAC (2024) Code of Practice on Local Authority Accounting which is derived from modified IFRS (ICAS, 2023). However, what really matters to Chief Financial Officers, and therefore councillors, are

the council's finances after statutory adjustments as these are the basis for Council Tax setting. The statutory adjustments have accumulated over time, often being a 'temporary but permanent' means of protecting Council Tax payers. Examples are the removal of depreciation of assets, for which loan charges are substituted, and pension adjustments which substitute employer contributions for the IFRS-based pension costs in the audited accounts (LASAAC, 2021).

It might be expected that local authority usable reserves have been going down in the recent years of financial difficulty. However, the Scottish Government's (2024) annual statistical publication shows a different picture at the aggregate level, though there might be variations across councils. The multi-year Scottish councils' data reproduced above show a large increase in 'General Fund Usable Reserves' in 2020-21 (the year of maximum Covid-19 impact when there was underspending of Covid-19 grants from the Scottish Government) which did not go into reverse in subsequent years. In 2022-23 there was a large increase in 'Capital Grants and Reserves Unapplied'.

Audit Scotland (2024, para 21) has cautioned:

The use of reserves and other non-recurring measures is unsustainable and is only a temporary plug for a budget gap in that one year. The gap will need to be met with the same level of recurring measures such as recurring savings or increases to income in future years.

The Committee might ask for clarification of such developments, for provisional data for 2023-24, and for forecasts for future years.

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Professor David Heald

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