

Covid-19

Balancing the budget in councils

Guide for auditors



Prepared by Audit Scotland
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Introduction

1. Covid-19 has already had a significant impact on every aspect of society in Scotland. It has affected individuals and communities, public services and the economy. Scotland's councils are at the forefront of the response, working with their partners to address the social and economic impact on communities across the country.
2. Council budgets were already under pressure from increasing costs and increasing needs from communities before the pandemic. Covid-19 brings additional financial demands which makes achieving a balanced budget even more challenging.
3. Council external auditors often raise technical questions with Audit Scotland about the legislative framework for council budgets. We have received further enquiries linked to the impact of Covid-19 on the financial position of councils. Many of these have been about the legal and policy framework around achieving a balanced budget.

This guide

4. This guide has been prepared by Audit Scotland's Professional Support in response to auditor enquiries. It is part of Audit Scotland's series of [publications](#) on Covid-19-related matters. It sets out the key features related to the requirement for councils to balance their budgets. It also sets out what steps a council may take if it cannot balance its budget.
5. It complements the more detailed operational [guidance](#) on financial sustainability that supplements the [Code of Audit of Practice](#) and applies that guidance to a council's balanced budget requirements in the context of Covid-19.
6. The guide has been prepared with auditors in the local government sector as its primary audience. Auditors are encouraged to discuss the issues in this guide with the councils that they audit. Please note that some hyperlinks link to documents in Audit Scotland's Technical Reference Library and are therefore active only for auditors.
7. Auditors have also raised questions in respect of the going concern basis of accounting. Our guide for auditors [Covid-19: Going concern in the public sector](#) deals with going concern and its inter-relationship with the concept of financial sustainability.

Contact point

8. The contact point in Professional Support for this guide for auditors is Paul O'Brien – pobrien@audit-scotland.gov.uk.

The requirements for a 'balanced budget'

9. The phrase 'balanced budget' is not explicitly used in legislation. However, [Section 95](#) of the Local Government (Scotland) Act 1973 requires every council to make arrangements for the proper administration of its financial affairs and to ensure that the proper officer for finance has responsibility for the administration of those affairs.

10. Although the term balanced budget is not used in the legislative framework, it is an implicit requirement of the proper administration of a council's finances. Total estimated expenses for a year (plus any brought-forward deficit) should equal expected funding from grants, council tax, and other income.

11. The Chartered Institute of Public Finance and Accountancy (CIPFA) defines a balanced budget as 'a financial plan based on sound assumptions which shows how income will equal spend over the short and medium term'.

Council tax's role in balancing a budget

12. Council tax is intended to be the balancing figure between expenditure and other income. The key legislative requirements are as follows:

- [Section 70](#) of the Local Government Finance Act 1992 requires councils to impose a council tax, and states that expenses not otherwise met should be met from that council tax.
- [Section 93](#) of the 1992 Act provides further details on setting the council tax. Section 93(3) requires the amount of council tax collected to be sufficient to meet the part of the total estimated expenses that falls to be met out of council tax, as well as deficits from previous periods and contingencies.
- Section 93(4) requires councils to take into account how else the total estimated expenses may be met.

Balancing the budget

13. Useful guidance is provided in CIPFA's [Balancing Local Authority Budgets](#). It explains how the financial plans should reflect deliverable cost savings as well as local income growth strategies.

14. CIPFA's recent [Financial Management Code](#), which applies in a shadow basis from April 2020, sets out standards for managing the annual budget process.

15. In practice, councils often have to use the balances on their General Fund, or other reserves to the extent permitted by the Local Government (Scotland) Act 1975, to either set a balanced budget at the start of the year or to meet a deficit arising during the year. The impact of Covid-19 may exacerbate this need. The assessment of an appropriate level of reserve balances is a matter for each council to determine.

16. Councils cannot generally borrow or use capital receipts to fund revenue expenditure, though they can do so in specific cases where permitted by statutory guidance from the Scottish Government.

17. The power to raise local taxation sets local government funding apart from other public bodies which are funded primarily from grant-in-aid from sponsor departments. However, the same principles of effective financial management apply to all bodies.

The external auditor's role

18. Public audit in Scotland has a wider scope than the private sector and reaches into judgements on audit dimensions specified in the Code of Audit Practice. One of the dimensions relates to the financial sustainability of public bodies.

19. Financial sustainability is defined in the Code as considering whether the body is planning effectively to continue to deliver its services in the medium and long term.

20. As our earlier report [Covid-19: Implications for public finances in Scotland](#) made clear, the impact of Covid-19 on public finances is unprecedented. Covid-19 is likely to have a significant impact on public finances and public services for many years.

21. The Code of Audit Practice requires auditors to conclude on the appropriateness and effectiveness of a body's arrangements for financial sustainability. The [guidance on planning 2020/21 audits](#) sets out an expectation that auditors will focus this year on the arrangements for financial planning.

22. Audit work under the Code related to whether the council has balanced its budget includes considering, concluding and reporting on areas such as whether:

- financial balance has been achieved
- any short-term financial challenges have been identified and addressed through a financial recovery plan
- a reserves strategy is in place, and the current level of reserves is in line with the strategy
- any planned deficits are able to be met from reserves
- financial planning systems are effective in identifying and addressing risks to financial sustainability
- the arrangements put in place to address any identified funding gaps are appropriate
- efficiency targets are realistic.

Options for councils in balancing budgets

23. If it becomes apparent, during the financial monitoring process, that the budget may not balance, the options available to a council include generating more income, cutting costs or implementing a voluntary spending freeze.

24. Implementing a spending freeze is a short-term measure while a long-term solution to the budget problem is worked through and agreed. More information is provided in CIPFA's [Balancing Local Authority Budgets](#). An element of a successful spending freeze is to ensure the section 95 proper officer for finance can work with budget holders to answer challenging questions such as:

- Is the expenditure absolutely necessary?

- Can it be deferred?
- Is there an alternative?
- Is the budget still needed, for example, unspent training budgets, subscriptions, etc?

25. It may be that a council has exhausted all avenues and is still unable to balance its budget. In England and Wales, the duties of the local government Chief Finance Officer include a requirement (under section 114 of the Local Government Act 1988 Act) to report to all the local authority's members if there is, or is likely to be, an unbalanced budget.

26. Although section 114 does not apply in Scotland, the [CIPFA Statement on the Role of the Chief Finance Officer](#) recommends that the principles that underlie section 114 are followed by the section 95 officer as a means of discharging their overall responsibility for sound financial management.

27. The CIPFA Statement on the Chief Finance Officer in Local Government sets out the recommended actions. In summary, should the situation emerge in Scotland, the main stages would be as follows:

- An informal indication should be given by the section 95 officer at a very early stage and an attempt made to get immediate remedial action.
- The potential of a report from the section 95 officer highlighting concerns about the council's ability to achieve a balanced budget should be made known to the Chief Executive at an early opportunity.
- The section 95 officer should consider informal consultation with the internal and external auditor.
- If the section 95 officer intends to make a report, it should be submitted to the full council for consideration within 21 days.
- The body should be prevented from entering into any agreements incurring expenditure until the full council has considered the report.
- After considering the report, the full council should prepare a report which specifies what action it proposes to take in response and the planned timescales.
- A copy of that report should be sent to the external auditor, every member of the council and the Section 95 officer.

28. In England and Wales, external auditors have a range of reporting powers and responsibilities. If the local authority acts on the Section 114 report, the external auditors do not need to take any action. However, if the authority does not take the necessary action, the external auditors can take further action by issuing an advisory notice or seeking a judicial review.

29. In Scotland, where a council does not take the appropriate action in response to a report by the section 95 officer or such a report is not prepared where auditors consider it appropriate, auditors should advise Audit Scotland so that the Controller of Audit can take the appropriate action. This may include the Controller of Audit making a report to the Accounts Commission under section 102 of the Local Government (Scotland) Act 1973.

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