Local government reform must start with financial reality

ACCOUNTS COMMISSION

Lessons from Accounts Commission audits

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Introduction

1. As the Scottish Government considers possible local government reform, it is important that these discussions are informed by the realities councils currently face. This paper draws together the findings from the Accounts Commission's recent reports - Local government in Scotland: Financial bulletin 2024/25 and Local government budgets 2026/27, and considers their relevance to the Scottish Government's Programme for Government 2026 to 2031 and proposed reform of local government.

2. As public auditors, we help ensure money is spent properly, efficiently and effectively, but we cannot comment on the merits of policy decisions. The Commission's work provides important evidence on the current condition of local government finances, the pressures facing councils and how those pressures are likely to develop over the medium term. While the reports were not prepared to assess structural reform directly, they provide important insights into the challenges that reform will need to address if it is to improve the sustainability and effectiveness of local government in Scotland.

3. A central message emerging from the evidence is that many of the most significant challenges facing local government are systemic. They arise from the interaction between increasing demand, rising costs and growing complexity in service delivery. These challenges affect councils regardless of size, geography or governance arrangements. Structural reform may therefore create opportunities for improvement, but the evidence suggests that organisational change alone is unlikely to resolve the underlying pressures facing local government.

A system under pressure

4. Despite small real terms increases in Scottish Government funding over recent years, councils still face major risks to their financial sustainability as funding fails to keep pace with rising demand and increasing costs.

5. In 2024/25, despite being largely successful in implementing the actions agreed to manage budgets, with around 90 per cent of savings targets delivered, the sector reported a collective overspend against their agreed revenue budgets for the first time in six years. Around a third of councils reported that they overspent against their agreed revenue budgets.

6. In recent years councils have continued to set balanced budgets, but they have done so against increasingly difficult circumstances. In 2025/26, councils identified a collective budget gap of £647 million when setting

their budgets. To bridge that gap, councils relied on a combination of council tax increases, recurring savings, reserve use and other measures.

7. In 2026/27, councils identified a further £529 million combined budget gap, alongside declining reserves, increasing debt levels and continued reliance on one-off measures to balance budgets. Looking ahead, councils forecast cumulative budget pressures approaching £1 billion across the next two years (2027/28 and 2028/29).

8. At the same time, councils are increasingly reliant on measures that cannot be sustained indefinitely. Usable reserves fell by seven per cent between 2023/24 and 2024/25, while 16 councils made unplanned use of reserves in 2024/25 to support spending commitments. Net debt increased from £19.3 billion in 2023/24 to almost £21.9 billion in 2024/25, reflecting growing reliance on borrowing to support investment and maintain assets.

9. The significance of these trends extends beyond immediate financial management. They suggest that councils are increasingly relying on measures that help manage short-term pressures but do not fundamentally change the trajectory of future demand and expenditure.

10. The evidence does not indicate a sector facing immediate financial failure. Councils have demonstrated considerable resilience in responding to sustained financial pressures. However, this resilience is being achieved with increasingly limited room for manoeuvre. While there is significant variation between councils, the sector's current operating model is becoming progressively less sustainable. This could mean carefully considering where services need to be reduced; how service delivery can be fundamentally reconfigured; who is eligible to receive services; and policies on fees and charges. This reinforces the need for the transformational change the Commission has consistently called for over recent years.

The current funding system limits long-term planning

11. The Commission’s reports also highlight continuing concerns regarding the ability of councils to plan strategically for the future.

12. In recent years, there has been a significant increase in the General Revenue Grant (GRG) provided to councils, reflecting the Scottish Government’s decision to baseline several, previously ring-fenced, grants. Since 2024/25, specific revenue grants, which are ring-fenced by the Scottish Government, have reduced by over 20 per cent (£56 million).

13. The Scottish Government states that increasing GRG funding supports the goals of the Verity House Agreement to lessen ring-fenced funds. However, much of what appears as an increase to GRG is in fact required to meet existing commitments, such as £244 million of the total £770 million in 2026/27, allocated for teacher pay increases. Councils must

continue using GRG funding for these obligations, limiting flexibility in spending plans.

14. At the same time, councils continue to operate within predominantly single-year funding settlements. This affects their ability to undertake long-term transformation, workforce planning and investment decisions.

15. This issue is particularly important when considering structural reform. Organisational structures can influence decision-making and governance. However, they cannot by themselves overcome uncertainty about future funding.

16. Many of the barriers to transformation and wider reform arise from the wider environment in which councils operate. If future organisations are expected to plan for the long term, there may need to be greater certainty about medium-term resource allocations and a stronger alignment between accountability and local decision-making powers.

Councils are increasingly having to reconsider the way they deliver services, but progress is slow

17. One of the most important findings emerging from both reports is the extent to which councils are increasingly focusing on transformation rather than incremental efficiency. Historically, many councils have addressed financial pressures through savings programmes and productivity improvements. The evidence now suggests that these opportunities are becoming harder to identify at the scale required.

18. In 2024/25, councils achieved significant savings, with a third meeting their full savings target; but some councils continue to rely on one-off measures to make savings. In 2024/25, savings achieved were equivalent to 2.2 per cent of total revenue budgets. There is, however, variation in both the scale and ambition of savings targets across individual councils (achieved savings ranged from 4.7 per cent of revenue budget to 0.6 per cent of revenue budget).

19. In 2026/27, to achieve a balanced budget, councils are implementing a range of local measures, including planned savings of one per cent of the combined net revenue budget across services.

20. The Scottish Spending Review projects that revenue funding for councils will decline in real terms by £528 million (four per cent) between 2026/27 and 2028/29. These projected reductions in Scottish Government funding over the medium term are expected to intensify financial pressures and increase the risk of councils becoming financially unsustainable, unless they stop, reduce or significantly redesign services.

21. The Commission's reports have highlighted that councils need to take urgent action to address the sustained and recurring cost pressures

associated with delivering services. The reports note a growing need for consideration of issues such as:

- reconfiguration of service models
- where services need to be reduced
- changing eligibility criteria
- increasing charges for some services
- rationalising assets
- digital transformation
- preventative approaches to service delivery.

22. This suggests that the challenge facing local government is increasingly one of transformation rather than efficiency.

23. The Commission's recent report Delivering for the future (May 2026) found that Scotland's councils need greater ambition to redesign services, with financial pressures growing and demand continuing to rise. Councils have been changing how they work and deliver services, but the scale and pace of change must shift to match the challenges ahead to help secure financial sustainability and meet increasing demand. As councils redesign services, it is important that they learn from and work with each other.

24. It is essential that any future structures within local government are better able to support transformation and innovation.

Social care funding, mainly through Integration Joint Boards, represents a high proportion of council spend

25. Perhaps the most significant issue identified in the reports is the growing impact of social care expenditure. Demand for adult social care continues to grow, there is an increasing complexity of need and the sector faces significant workforce pressures.

26. In 2024/25, 15 councils reported an overspend on the social care services they deliver on behalf of Integration Joint Boards (IJBs) totalling around £49 million. This was due to increased demand for care packages, both home and residential, alongside an increasing cost for these services.

27. The reports show that councils now contribute approximately £4.3 billion annually to IJBs, making community health and social care one of the largest areas of expenditure within local government.

28. The Integration Joint Boards: Financial bulletin 2024/25 highlighted that reserve levels continue to fall across IJBs, with the total level of reserves held by IJBs now lower than the budget gap forecast for the year

ahead. While several councils have sought to address community health and social care pressures through additional uplifts to the IJB, they acknowledge this only provides short-term stability. If IJBs cannot contain financial pressures, then additional funding may be sought from partners during the financial year, putting further pressure on council budgets.

29. The significance of these findings extend beyond questions of spending pressure. It demonstrates that the sustainability of local government increasingly depends upon the effectiveness of relationships between councils, IJBs, NHS bodies, the third sector and other public service partners.

30. The financial pressures experienced by councils cannot be considered in isolation from the wider public service landscape. There is a significant interdependency within current arrangements between the sustainability of local government as a whole and the sustainability of social care services.

31. A central question is 'how should health, social care, housing and community services be most efficiently and effectively organised around the people who use services?'.

Infrastructure and capital investment are emerging risks

32. Alongside revenue pressures, the Commission's reports identify increasing concerns regarding councils' capacity to sustain and develop infrastructure. Councils continue to face substantial investment requirements in relation to schools, roads, housing, digital infrastructure and climate adaptation. However, capital funding remains constrained across the public sector. Capital funding to councils decreased by 15 per cent for 2026/27.

33. Councils are increasingly reliant on borrowing for planned capital investment and annual debt servicing costs continue to increase, which heightens long-term financial risk. In 2024/25, reduced capital funding meant councils continued to rely on borrowing to finance increasingly expensive projects and, alongside changes to how they account for leases, have seen their total debt increase by over £2.5 billion in a year.

34. Councils now spend around £1.2 billion a year servicing these debts, with future borrowing requirements also increasing. Local Government Benchmarking Framework (LGBF) data for 2024/25 shows there has been an increase in the proportion of councils' revenue budgets allocated to servicing debt in the General Fund, rising from 5.4 per cent to six per cent in the last three years.

35. The evidence indicates that local government's ability to sustain infrastructure is becoming an increasingly significant challenge. Delays to investment today may create greater service and financial pressures in future years.

36. This has important implications for reform. Future organisations will inherit the same asset base, infrastructure liabilities and investment requirements that currently exist. Consequently, reform cannot be viewed solely as a question of governance arrangements. It must also consider how future structures would improve long-term planning, investment prioritisation and asset management.

Democratic accountability is important

37. These two reports also highlight the increasing importance of public engagement as councils make difficult decisions about service priorities and resource allocation. Budget consultations undertaken by councils demonstrate continuing public interest in decisions affecting education, social care, leisure services, libraries and community provision.

38. Our reports highlight the continuing importance of local accountability and transparent conversations with local communities as councils face increasingly difficult decisions about allocating scarce resources. Maintaining confidence in local decision-making is likely to become more important rather than less as financial pressures continue.

Reform must focus on outcomes

39. A key test of any reform to public services should be whether it helps improve outcomes for people and communities. It is for policy makers to define the desired outcomes of reform, and in doing so government may wish to consider whether reform proposals will support prevention and enable earlier intervention, which together can improve outcomes for citizens and reduce long-term delivery costs? Do they strengthen local democracy? Do they make services more sustainable? Do they provide greater transparency and accountability? Most importantly, will they improve the lives of those who rely on local public services?

40. The evidence from our recent reports suggests that doing more of the same will not be enough for councils to meet future challenges.

Implications for structural reform

41. The Scottish Government's reform agenda offers an opportunity to build a stronger foundation for public services.

42. The evidence from the Commission's recent reports suggests that the primary challenges facing Scottish local government are questions of sustainability, capacity, collaboration and resilience.

43. This suggests that the success of reform will depend less on the particular structure adopted and more on whether reform addresses the underlying factors driving pressure across the system. To succeed, reform must be grounded in financial realism, informed by evidence and developed in partnership with councils and communities.

44. We would suggest that the evidence from our reports provide five important lessons:

1. Reform must be driven by outcomes, not structures

Changing governance arrangements is not an end in itself. Reform should firstly focus on improving long-term outcomes, resilience and public value and then good governance to support this.

2. Financial sustainability must be at the heart of the reforms

The scale of existing financial pressures means reform must be built on realistic assumptions about future resource needs and the one-off costs associated with delivering reform. Expected efficiency savings should be independently tested.

3. There are significant interdependencies between the financial sustainability of local government and of social care

The greatest opportunities for enhanced sustainability lie at the interfaces between services rather than within organisational silos. Effective partnership working will be essential if public bodies are to meet increasing demand within constrained resources.

4. Reform costs and capacity challenges affect deliverability

Existing resource constraints have implications for the capacity to deliver reform. Assessing transition costs, available capacity and expertise and having a robust plan to secure these is important in the setting and monitoring of proposed benefits and delivery timescales.

5. Reform must not delay action to address financial sustainability

Organisational reform is unlikely to deliver benefits quickly. Councils and their partners therefore need to maintain a strong focus on the immediate actions required to improve financial sustainability, including service transformation and deeper collaboration across the public sector.

Questions for consideration

45. In considering structural reform, policy makers and decision-takers may wish to reflect on a number of questions:

Financial Sustainability

- What evidence shows that the structural reform options being proposed would strengthen long-term financial sustainability?

Purpose and outcomes

- What outcomes is reform intended to deliver, what will success look like and how long is it intended to take?

Scale and local accountability

- How can local responsiveness be maintained or strengthened?

Reform of social care

- How will reform of local government interact with reform of social care?

Transformation and capacity

- How will the needs of our most vulnerable citizens continue to be met both during the period of uncertainty before reforms are agreed; and then during the transition period to full implementation?

Infrastructure and assets

- How will reform strengthen long-term stewardship of local infrastructure?
- What mechanisms will be required to manage existing debt and capital investment requirements?

Conclusion

46. The Accounts Commission's recent work points to a local government system under sustained financial pressure, but one that continues to demonstrate resilience and adaptability. The evidence shows that reform will succeed only if it addresses the underlying drivers of financial and service delivery pressure.

47. Structural reform should be seen not as an objective in itself but as a means of creating conditions in which financially sustainable, accountable and outcome-focused services can flourish. The key challenge is therefore not simply deciding what structures should replace the current system but determining whether those structures will be better equipped to meet the current and future needs of Scotland’s communities.

48. The Accounts Commission will continue to provide independent scrutiny and evidence to support the debate.