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Copy to: The Leaders of all Scottish local authorities

31 May 2022

Dear Alison,

Earlier today, as part of a statement to Parliament, I published the Scottish Government's Resource Spending Review. The Review is ambitious but realistic. In setting high level multi-year portfolio spending envelopes it offers a strategic funding framework for the Scottish Government and our many partners to plan for the future. That of course includes local government which has such a significant role to play in so many areas of government.

Fiscal Context

Whilst the UK Government has belatedly taken action to mitigate some of the impact of rising energy prices on households, it has not responded to address the broader impact of inflation on business and public services.

The UK Spending Review in October 2021 set out a funding cash envelope for the Scottish Budget at a time when inflation was significantly lower and as a consequence the true spending power of those funding envelopes has already been significantly eroded. To date the UK Government has chosen not to adjust spending plans to reflect this and funding available for investment in public services through the rest of this parliament remains constrained. I would welcome the opportunity to discuss with you on what we might do collectively to raise this with the UK Government and the public in Scotland.

As you will be aware, the Scottish Budget for 2022-23 was already reduced in real terms by 5.2% relative to 2021-22 and growth in spending capacity over the rest of the parliament, once social security transfers are excluded, remains at only 2%. This low level of investment is deeply damaging to public services and once again highlights that Scotland does not currently hold the levers required to address our most pressing challenges.

The central funding position outlined in the spending review reflects a range of assumptions to inform the official forecasts, and are based on current tax policies as forecast by the Scottish Fiscal Commission. The funding envelopes set out here are indicative currently of

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what we can reasonably expect over the spending review years, including assumptions about additional consequential funding from UK Government beyond the spending review settlement and revenues accruing from Scotwind, but it is our annual budgets which will confirm these.

Similarly, the funding envelopes are presented at portfolio level (Level 2) and are therefore not as granular as the allocations published alongside the budget. This approach is critical so as not to constrain portfolios in the choices they make in support of our strategic priorities but does have implications for the level of detail available to make comparisons with previous years. These details, including any in-year transfers, will be confirmed as part of the annual budget process.

Vision

Despite the challenging fiscal context, the resource spending set out in this review will drive the Scottish Government's ambitious vision for Scotland's public services. We are committed to strong, responsive public services which serve individuals' needs, improve national outcomes and create the right opportunities for Scotland to be healthier, happier and more prosperous. We want public funding to build a Scotland where communities are inclusive and empowered, and people grow up loved and respected, well-educated, and healthy. I know you and other council leaders share much of this vision.

In order to achieve this, this spending review provides fresh impetus to our public services reform programme and sets out a coherent package of action that will drive progress over the life of the current Parliament, improving outcomes while driving efficiency and value for public money.

While key elements of this vision will not directly apply to local government, addressing the financial challenges facing Scotland's public services would benefit from a cross-public sector approach in order to optimise the reach of public funding to deliver the best possible services and support to our people and communities. I would therefore anticipate and welcome a complementary approach across all parts of the public sector landscape.

This package includes:

- Changes to working practices, with our Fair Work principles at their heart, to support greater flexibility and continued hybrid working across the public sector;
- A pathway to return the overall size of the public sector workforce broadly to pre-COVID-19 pandemic levels, while supporting expansion in key areas of service delivery, helping to hold total pay bill costs - as opposed to pay levels - at 2022-23 levels;
- Support through public sector pay arrangements for those on the lowest incomes faced with the hardest impacts of the cost of living crisis;
- An enhanced focus on delivering efficiency savings across the public sector, while recognising existing efficiency programmes in some sectors, which we will support through a variety of levers including;
- Fresh consideration of the public body landscape, with further engagement ahead of the next Budget about a programme of reform;

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- A multi-year estates programme to make the best use of public sector property and other assets, reflecting the impact of the COVID-19 pandemic on ways of working and the delivery of services;
- An increased focus on maximising revenue through innovation, reflecting the guidance in the Scottish Public Finance Manual;
- A programme of digital reform, focused on inclusion and connectivity, developing a strong digital economy and investment in digital transformation of public services;
- The development of a strategy for public procurement that will drive greater collaboration and value for money.

I look forward to working with the new COSLA Leadership to explore how local authorities might contribute to that approach alongside the development of a new deal for local government. I will also ensure the relevant Scottish Government officials are available to COSLA to discuss the details set out in this package. I know that some local authorities have already undertaken similar reforms already and there will be the opportunity also to learn from their experience, which I would welcome.

Local Government Settlement

Reflecting the fact that Local Authorities are key partners in the delivery of the priorities set out by the spending review, the spending review baselines the £120 million added during the 2022-23 Budget Bill process and maintains General Revenue Grant, Non-Domestic Rates Income and Specific Resource Grants between 2023-24 and 2025-26 before adding a further £100 million in 2026-27.

As the majority of in-year transfers from other portfolios apply to Level 4 budgets, the strategic approach of publishing portfolio allocations at Level 2 in the spending review precludes a direct like with like comparison with previous years' overall settlement figures. Final details of the settlement including additional transitional funding to reflect the devolution of Empty Property Relief to Councils from 1 April 2023; confirmation of the approach adopted for in-year transfers; and individual Council allocations will be confirmed alongside the annual budget process.

The spending review affirms the Scottish Government's commitment to agreeing a 'new deal' for Local Government in Scotland through the development of a Partnership Agreement and Fiscal Framework. The new deal will build on the Review of Local Democracy and seek to balance greater flexibility over financial arrangements for local government with increased accountability or the delivery of national priorities so that both partners can have certainty over inputs and outcomes alongside scope to innovate and improve the delivery of services to local people and communities.

This joint aspiration coupled with the strategic approach to portfolio allocations means that the spending review makes no assumptions about the scale and scope of any transfers to local government from other portfolios in-year. However, to offer a degree of certainty, the spending review confirms that existing in-year transfers for Health and Social Care, Early Learning and Childcare and additional Teachers worth £1 billion combined will be maintained. Final decisions on the transfers from other portfolios in future years will be confirmed following the establishment of the Fiscal Framework.

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The spending review also makes no assumptions about council tax nor about greater scope for discretionary revenue-raising, such as the Visitor Levy and the newly created Workplace Parking Levy, as decisions about further fiscal autonomy will be part of ongoing discussions to establish and agree the Fiscal Framework.

Alongside the resource spending review, we have also conducted a targeted review of our capital spending plans, to deal with much lower-than-expected funding from the UK Government, and to ensure capital investments align with government priorities, as set out in the Programme for Government and Bute House agreement. Whilst final allocations will be confirmed as part of the annual budget process, there are no changes to the Local Government capital allocations as set out in my letter to the COSLA President dated 4 February 2021.

Fiscal Flexibilities

In my letter to you on 9 December 2021 alongside the budget, I confirmed my intention to allow an extension of the flexibilities to allow capital receipts to be used to fund the financial impact of COVID and to fund transformational projects subject to confirmation from the UK Government that this will not result in an adjustment to Scotland's block grant.

Unfortunately, the UK Government recently rejected my request and confirmed that any use of this flexibility to fund the financial impact of COVID will result in an adjustment to Scotland's block grant. Given the constrained fiscal position, I am therefore no longer able to offer that specific flexibility to deal with the impact of COVID although the offer of flexibility on using receipts for transformational projects remains unchanged.

In that letter, I also outlined my commitment to continue working with Directors of Finance and CIPFA/LASAAC on a Capital Accounting Review. I have now received a copy of the conclusions of the Directors of Finance's review. I am extremely grateful to Directors of Finance for their work on that review but having considered their findings, it falls short of the comprehensive review that was anticipated at the outset of these discussions. As noted by both Audit Scotland and LASAAC, the review focuses on capital funding arrangements and on maintain existing statutory mitigation but does not deliver proposals for closer alignment with accounting standards.

The spending review therefore confirms the Scottish Government's intention to commission an independent Capital Accounting Review. The independent review will build on the review already taken forward by Directors of Finance working with key stakeholders to deliver a phased approach towards alignment with the CIPFA Code of Practice for Local Authority Accounting.

This review will help to enhance the future sustainability of local services and address the inconsistencies of current statutory arrangements with the requirements of the CIPFA Accounting Code but I acknowledge that it will not address the long-standing request from COSLA on flexibility regarding the accounting treatment of service concessions.

On 1 February 2022, I wrote to CIPFA/LASAAC inviting them to offer an independent view on COSLA's request, which had of course been substantially changed when Directors of Finance acknowledged that a key part of the original request would have been inconsistent with recognised accounting practice. I have now received their response to the amended request and whilst I am very grateful to CIPFA LASAAC for their consideration, the response

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was ultimately inconclusive on the key aspects. The fact that CIPFA/LASAAC were unable to provide a conclusive resolution to this does highlight the risks of statutory intervention and the need for a comprehensive review.

In light of the withdrawal of the request to capitalise interest payments, I am willing to accede to the request to recognise principal debt repayments over the asset life and for this approach to be applied retrospectively. I will also agree that this may apply to the grant funded element of the principal debt repayments.

This flexibility will only apply to existing service concessions and each local authority will be responsible for fully evaluating any change in method and making appropriate financial provision. The decision for making any change must be taken by the Council, that is, it may not be delegated. The Minister for Public Finance, Planning and Community Wealth will provide further details on the statutory mitigation and the remit of the independent review in due course. We will of course welcome your input to the scope and design of that review.

Conclusion

The spending review does not alter the parliamentary requirement for an annual budget process but it does provide the multi-year certainty requested by COSLA on numerous occasions. It guarantees the combination of General Revenue Grant and Non-Domestic Rates income at current levels despite a challenging UK Government Settlement and offers protection against Non-Domestic Rates revenue uncertainty post-COVID-19 and ahead of the 2023 revaluation with the addition of a further £100 million in 2026-27.

Due to the strategic nature of the portfolio allocations, it is not possible to prepare direct comparison with previous years but the spending review provides funding certainty over key transfers for Teachers and Health and Social Care. The spending review also reaffirms our commitment to working with COSLA and SOLACE to agree a new deal for Local Government in Scotland in advance of the next financial year and I look forward to commencing those discussions with the new COSLA Leadership in due course.

Yours sincerely,



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