



Comptroller & Auditor General

Financial Directions

21 August 2014



JERSEY AUDIT OFFICE

Financial Directions

Introduction

- 1.1 Financial Directions, issued by the Treasurer of the States are a key element of the system of internal control within the States of Jersey. In certain instances, such as borrowing and budget variations, the Public Finances (Jersey) Law 2005 requires the Treasurer of the States to issue Financial Directions. In addition Article 34 of the Public Finances (Jersey) Law empowers the Treasurer of the States, with the consent of the Minister for Treasury and Resources, to issue Financial Directions on any matter where it appears necessary or expedient for the proper administration of the public finances of Jersey.
- 1.2 The Treasurer of the States has sought to develop a comprehensive set of Financial Directions prescribing the financial procedures and controls to be followed for all financial activities of the States. As at July 2014 there were 33 Financial Directions in force made available to staff via the States' intranet. A further 20 Directions were at various stages of development.
- 1.3 To secure an effective system of internal control, Financial Directions should be:
 - appropriately designed; and
 - complied with in practice.

Objectives and scope of this review

2.1 This review considers:

- the appropriateness of design of Financial Directions; and
- the extent of compliance with those Financial Directions in practice.

2.2 It makes recommendations for improvement.

2.3 In undertaking my work I sought input from PricewaterhouseCoopers LLP (PwC) on good practice in developing financial regulations or similar documents. Research included:

- FTSE 100 global company;
- Australian state government;
- NASDAQ listed global company; and
- UK Ministerial Department.

Design of Financial Directions

3.1 Effective design of Financial Directions involves five distinct phases (see Exhibit 1).

Exhibit 1: Design of Financial Directions

Define	<ul style="list-style-type: none">• Complying with statutory requirements• Identifying other areas to cover
Develop	<ul style="list-style-type: none">• Establishing a programme for development• Establishing arrangements for approval
Implement	<ul style="list-style-type: none">• Issuing Financial Directions• Communicating contents
Embed	<ul style="list-style-type: none">• Oversight• Assurance on operation
Optimise	<ul style="list-style-type: none">• Review process• Knowledge sharing and lessons learnt

Define

3.2 Financial Directions are in place in the areas specifically required by legislation. Over the last three years substantial work has been undertaken to identify areas where Financial Directions should be issued. As a result further Financial Directions have been issued and 20 Financial Directions are at various stages of development.

3.3 Financial Directions are a cornerstone of the States' system of internal control. There is, at present, no corresponding framework for issuing equivalent Directions, to govern other elements of the system of internal control, such as information management and aspects of human resource management. However, proposed amendments to the Employment of States of Jersey Employees (Jersey) Law 2005 would require the States Employment Board to issue Codes of Practice in a number of areas relating to human resources.

3.4 Effective internal control is particularly important in a period of change. The States are committed to widespread modernisation embracing:

- Lean¹ - embedding lean thinking and continuous process improvement in States departments;

¹ <http://www.cardiff.ac.uk/lean/principles/>

- Culture - developing performance and capability management programmes to support high performance;
- Workforce modernisation - revising people management processes to reflect the contribution of individuals and not just length of service; and
- e-government - using technology to deliver customer transactions, to reduce cost and improve customer experience.

3.5 In that context, the need for clear, accessible, comprehensive but concise mandatory requirements is enhanced. Issuing such requirements can itself be an important driver of cultural change.

Recommendations

R1 Following implementation of the detailed recommendations in this report, strengthen the States' overall system of internal control by developing 'Directions' to cover other areas, such as information management and human resource management.

Develop

3.6 The Treasurer of the States has established arrangements for the management, development and updating of Financial Directions. The arrangements include consultation on draft Financial Directions. However:

- although Treasury and Resources consults with other departments prior to issuing Financial Directions, the consultation is undertaken when there is a draft Financial Direction rather than at a more formative stage and is not structured around fundamental questions. This reduces the effectiveness of consultation, a view that is reinforced by the feedback received from some departments that they do not believe that they always receive adequate feedback on why their suggestions on consultation drafts were not taken into account; and
- despite the adoption of a standard format for Financial Directions in 2011, there is substantial and unjustified variation in the level of detail, the extent of mandatory requirements and the phraseology used within Financial Directions.

Recommendations

R2 Review the mechanisms for engaging with departments to ensure that valuable insight into the practicality of existing and proposed Financial

Directions is sought, demonstrably considered and, where appropriate, acted upon.

R3 Review and amend the current standard format for Financial Directions to ensure that all Financial Directions contain:

- a clear statement of the control risks being addressed;
- a direct and accessible 'house style'; and
- a clear linkage of mandatory requirements to control risks.

Implement

3.7 There is an established procedure for approving Financial Directions, issuing them and placing them on the States intranet. However:

- there is scope to improve the drafting. For example:
 - in the Financial Direction on procurement, there are 'must dos' but in one instance there is a requirement for an alternative course of action where the 'must do' has not been complied with;
 - in the recently replaced Financial Direction on travel and accommodation there was a requirement to use standard class on trains but also a requirement for prior line manager approval for first class train travel;
- there are instances where the inter-relationships between Financial Directions are not apparent. Currently, Financial Directions are not consistently cross-referenced to one another. Many organisations use 'help authoring software' to store, manage and make guidance available. Such software facilitates updating, navigation and searching of documents; and
- whilst new Financial Directions are notified to key individuals, there is no systematic States-wide approach to promoting new Financial Directions and providing training on them to users. Although some departments have taken individual initiatives on training, the approach is inconsistent and potentially inefficient.

Recommendations

R4 Update quality assurance procedures for Financial Directions to ensure that revised corporate standards for drafting Financial Directions are complied with.

R5 Adopt an appropriate platform for Financial Directions, using readily available software, which facilitates effective updating, navigation, searching and cross referencing.

- R6** Develop a communications and training plan to ensure that all relevant staff are aware of the requirements of and changes to Financial Directions.

Embed

- 3.8 Oversight of the operation of Financial Directions takes place both within the States Treasury and within individual departments.
- 3.9 Oversight within the States Treasury comprises a combination of:
- reliance on the work of Internal Audit;
 - review of annual declarations by Accounting Officers; and
 - liaison with Accounting Officers in contentious areas.
- 3.10 The States prepare an Annual Governance Statement that is published with its annual accounts. This is supported by individual Governance Statements signed by Accounting Officers. Whilst these Governance Statements do highlight some instances of non-compliance with Financial Directions, the reporting of non-compliance is not always explicit.
- 3.11 Oversight within individual departments varies. Components include:
- assurance statements to support the Accounting Officer in signing the annual Governance Statement for their department;
 - transaction or compliance checks by finance staff; and
 - in the case of the Health and Social Services Department, oversight by a Governance Committee.
- 3.12 Departments expressed a view that more could be done to assist staff in complying with Financial Directions, for example through building in system checks to ensure compliance with Financial Directions such as ordering thresholds for purchasing. The Supply Jersey project is in the process of being rolled out and will assist in ensuring compliance with Financial Direction requirements.

Recommendations

- R7** Include an explicit statement on compliance with Financial Directions in Accounting Officers' Governance Statements, linking issues of non-compliance to individual Financial Directions.

R8 Identify and implement systems-based controls now and in the future as systems are introduced or changed. The aim should be to automate controls where possible to assist in ensuring compliance with all Financial Directions efficiently.

Optimise

3.13 There have, in some instances, been amendments to Financial Directions in light of experience. For example, a revised Financial Direction on travel and accommodation came into effect from December 2013. Although there is a detailed work plan for the development of the Financial Control Framework, including drafting of new Financial Directions and updating existing ones, there is no systematic process to review Financial Directions in the light of user experience of their design and operation or in the light of the plans to modernise the States.

Recommendations

R9 Undertake an annual review of Financial Directions following the preparation of the Annual Governance Statement to:

- consider the coverage and content of Financial Directions;
- balance the need to manage risk with the costs of compliance with Financial Directions; and
- identify areas for corrective action.

Compliance with Financial Directions

3.14 On a sample basis I reviewed compliance with the requirements of a sample of Financial Directions. In Exhibit 2 I detail how I have evaluated compliance and in Exhibit 3 I detail the results of my work.

Exhibit 2 Compliance with Financial Directions: Evaluation

Evaluation	Meaning
Green	No instances of non-compliance
Amber	Limited instances of non-compliance
Red	Significant instances of non-compliance

**Exhibit 3 Compliance with Financial Directions (FD):
Results of testing**

FD Number	Title	Compliance	Comments
3.4	Budgetary Control Procedures	Green	
3.5	Expenditure Approval	Amber	Three areas of non-compliance identified. There were reasons in each case for non compliance, such as the timing of the introduction of the Medium Term Financial Plan.
3.6	Variations to Heads of Expenditure	Green	
5.2	Travel and Accommodation (previous FD)	Red	<p>Only 4 out of 12 departments had the departmental travel policy required by the Financial Direction.</p> <p>Some instances of non-compliance with other provisions identified.</p> <p>For 11 out of 24 requirements of the Financial Direction, insufficient evidence was retained in order to quickly and routinely test compliance .</p>
5.6	Use of management consultants	Red	Evidence of non-compliance with the Financial Direction or unable to demonstrate compliance with the Financial Direction for one or more items in the sample for the majority of requirements of the Financial Direction.

3.15 In instances of more extensive non-compliance I have considered the potential reasons for non-compliance:

- the volume of mandatory requirements. In the Financial Direction on travel and accommodation there were 22 requirements and in the one on use of management consultants there were 42

requirements. The greater the volume of mandatory requirements, the greater is the risk of unintentional non-compliance;

- the inclusion in Financial Directions of guidance, as opposed to requirements, without explicitly highlighting the requirements;
- the inclusion of provisions that might be seen as onerous, for example the inclusion of a requirement for pre-authorisation of even routine travel;
- the use of inconsistent language and styles between directions; and
- the absence of corporate training on the requirements of Financial Directions.

Recommendations

- R10** Align requirements for record-keeping with mandatory requirements of Financial Directions so that it is possible to test compliance with all mandatory requirements of Financial Directions.
- R11** Minimise the volume of mandatory requirements when drafting Financial Directions.
- R12** Clearly distinguish between mandatory requirements of Financial Directions and supporting guidance on implementation.
- R13** Undertake a sense check of the practicality of all mandatory requirements of Financial Directions, including through engagement particularly of front line users, before Financial Directions are finalised.

Conclusion and way forward

- 4.1 The Financial Directions are a key component of the system of internal control of the States. There has been substantial development of the Financial Directions over the last three years to cover a wide range of areas and more Financial Directions are under development.
- 4.2 However, compliance is not consistent and it is evident that there is more to do to embed the Financial Directions within the States, securing buy-in from departments, monitoring, learning from non-compliance and embracing continuous improvement.
- 4.3 I will share some examples of best practice, drawn from both the public and private sectors, with key officers. But in my view, shorter, sharper Financial Directions, in a consistent style, accessible on an appropriate electronic platform, with roll-out supported by training would secure consistently higher compliance across the States.
- 4.4 Such a model has substantial benefits particularly as the States seeks to modernise. The extension of the model to cover other corporate activities, such as information management and human resources, would enhance both the design and operation of the States' system of internal control.
- 4.5 The goal should be Directions that are accessible, consistently complied with and not perceived as unduly onerous. That transformation requires States-wide commitment and leadership. But the benefits are substantial both in terms of governance and efficiency. In addition, the scope of Directions could usefully be extended beyond the financial to other corporate activities that form an essential part of the system of internal control.

Appendix 1 Summary of Recommendations

- R1** Following implementation of the detailed recommendations in this report, strengthen the States' overall system of internal control by developing 'Directions' to cover other areas, such as information management and human resource management.
- R2** Review the mechanisms for engaging with departments to ensure that valuable insight into the practicality of existing and proposed Financial Directions is sought, demonstrably considered and, where appropriate, acted upon.
- R3** Review and amend the current standard format for Financial Directions to ensure that all Financial Directions contain:
- a clear statement of the control risks being addressed;
 - a direct and accessible 'house style'; and
 - a clear linkage of mandatory requirements to control risks.
- R4** Update quality assurance procedures for Financial Directions to ensure that revised corporate standards for drafting Financial Directions are complied with.
- R5** Adopt an appropriate platform for Financial Directions, using readily available software, which facilitates effective updating, navigation, searching and cross referencing.
- R6** Develop a communications and training plan to ensure that all relevant staff are aware of the requirements of and changes to Financial Directions.
- R7** Include an explicit statement on compliance with Financial Directions in Accounting Officers' Governance Statements, linking issues of non-compliance to individual Financial Directions.
- R8** Identify and implement systems-based controls now and in the future as systems are introduced or changed. The aim should be to automate controls where possible to assist in ensuring compliance with all Financial Directions efficiently.
- R9** Undertake an annual review of Financial Directions following the preparation of the Annual Governance Statement to:
- consider the coverage and content of Financial Directions;
 - balance the need to manage risk with the costs of compliance with Financial Directions; and
 - identify areas for corrective action.

- R10** Align requirements for record-keeping with mandatory requirements of Financial Directions so that it is possible to test compliance with all mandatory requirements of Financial Directions.
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