



Comptroller & Auditor General

Review of Financial Management

02 April 2015



JERSEY AUDIT OFFICE

Review of Financial Management

Introduction

- 1.1 Effective financial management is essential for securing value for money in the use of resources. For a self-governing jurisdiction effective financial management requires:
 - an appropriate framework for the allocation of resources by the legislature and accountability of the executive to the legislature for the use of those resources; and
 - effective systems for the planning, direction, monitoring and control of the States' finances by the executive.
- 1.2 The States face low projected growth in revenue and a substantial projected budget gap. Good financial management will allow the necessary retrenchment to be secured in a planned way, contributing to the corporate objectives of the States, facilitating reform and with the minimum impact on services.

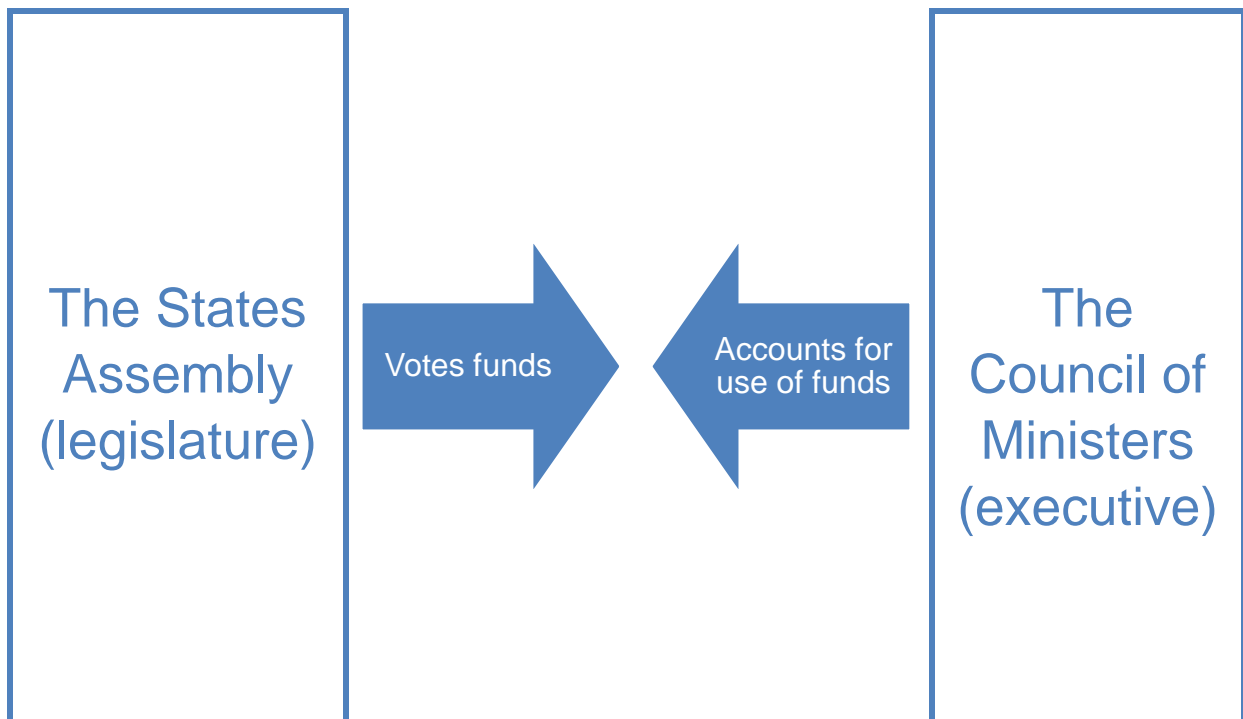
Scope and Objectives

- 2.1 This review considers the effectiveness of:
- the current framework for allocation of resources by the legislature to the executive, including through the Medium Term Financial Plan (MTFP) and annual budgetary processes;
 - the current framework of accountability by the executive to the legislature for the use of resources allocated;
 - financial governance and leadership within the States;
 - financial planning within the States, including the processes for preparation of the MTFP and annual budget.
- 2.2 In undertaking the work on the last two objectives I have taken into account the Financial Management Maturity model published by the UK National Audit Office.
- 2.3 Subsequently I intend to review and report on the effectiveness of:
- finance for decision-making within the States;
 - financial monitoring and forecasting within the States; and
 - financial and performance reporting within the States.
- 2.4 This review extends to the financial management of the States and States-funded bodies. It does not extend to the financial management of the States' pension funds or the States' strategic investments.

Allocation of resources

- 3.1 Parliamentary democracies are characterised by separation of responsibilities between the branches of government: the legislature votes funds to the executive and the executive is accountable to the legislature for the use of the funds allocated.
- 3.2 In Jersey the Council of Ministers and the States Assembly respectively perform the functions of the executive and legislature (see Exhibit 1). Detailed provisions governing the relationship are contained in the Public Finances (Jersey) Law 2005.

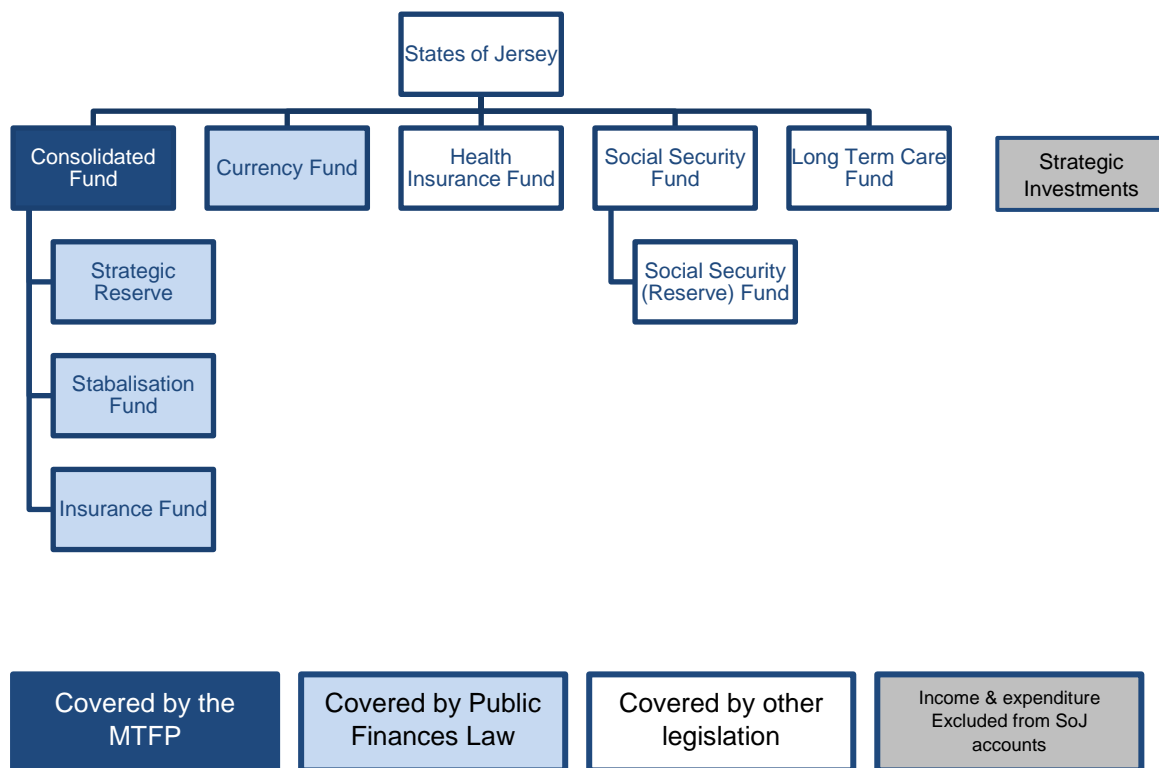
Exhibit 1: Relationship between the States Assembly and Council of Ministers



- 3.3 Accounting Officers in turn are responsible to Ministers for the use of funding allocated to their departments.
- 3.4 As a result of the legislative framework in Jersey:
- the allocation of resources by the States Assembly is predominantly through the approval of the MTFP allocating resources in advance over a three or four year period. I address the weaknesses in this framework later in this report;
 - the States Assembly approve the capital programme annually;
 - the approval of movement of funds from one year to another through the use of contingency amounts and carrying forward of unspent budgets is the responsibility of the Minister for Treasury and Resources; and
 - the costs of significant areas of public expenditure are met through ring-fenced funds. Elements of healthcare, social security provision (especially

retirement pensions) and long-term care are funded by contributions from adults of working age, their employers and the States. The expenditure of the funds is approximately a quarter of total States expenditure but the funds are excluded from the medium-term planning process meaning that only a partial picture of the States is presented. The income and expenditure of the States' strategic investments is currently excluded from both the MTFP and the States' financial statements (see Exhibit 2).

Exhibit 2: The scope of the Medium Term Financial Plan



3.5 The measure of expenditure from the Consolidated Fund included in the MTFP does not align with the concept of 'expenditure' as presented in financial statements, including those of the States. It does not include any allowance for the use of property, plant and equipment:

- 'depreciation' – a measure of the 'consumption' of the benefits of a capital asset over its normal economic life; and
- 'impairment' – an unanticipated reduction in the value of property, plant or equipment.

3.6 Instead there is a charge to the Consolidated Fund for the full cost of property, plant and equipment at the point where funds are allocated. For example, if the MTFP included an allocation for a new building at a cost of £10,000,000

with an estimated economic life of 50 years, there would be a charge to the Consolidated Fund of £10,000,000 at the point where funds were allocated but no charge for depreciation reflecting the use of the building, initially at £20,000 per year.

- 3.7 The budgets for commercial enterprises include depreciation and impairment as do the budgets for many public sector bodies, including central government in the United Kingdom (UK). Inclusion of depreciation and impairments in the budgets of these bodies means that resources are allocated to cover the full cost of assets used. As a result:
- there is an increased focus on considering alternatives to purchase of property, plant and equipment, such as leasing, as there is an on-going cost associated with the use of purchased assets;
 - property, plant and equipment is no longer regarded as a 'free good' once acquired, creating an incentive for efficiency and effectiveness in its utilisation. For example, there is a reduced incentive to managers to identify opportunities for rationalising office accommodation owned by the States;
 - there is an increased focus on maintaining property, plant and equipment as failure to do so will lead to impairments that are a charge against budget.

Recommendation

- R1** In the future extend the Medium Term Financial Plan to cover all the public finances of Jersey.
- R2** In the future include depreciation and impairment in the measure of expenditure for which funds are allocated by the States Assembly.

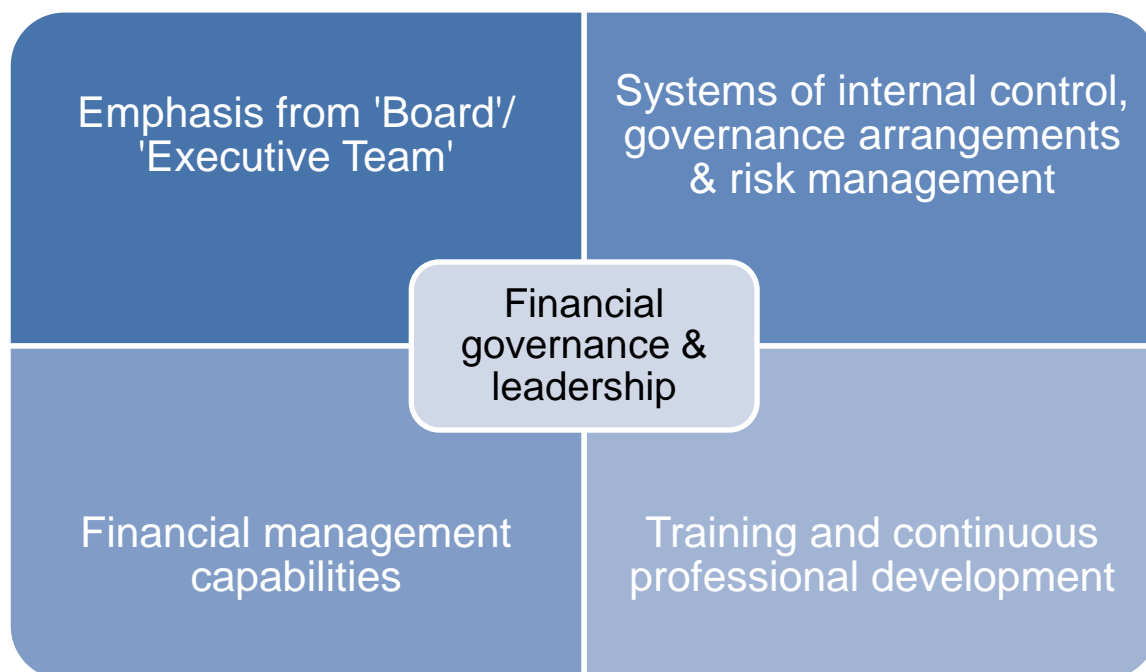
Accountability by the executive

- 4.1 The primary means by which the executive accounts for funds allocated by the legislature is through the annual financial statements laid before the States Assembly.
- 4.2 The financial statements:
- report the whole financial activities of the States (including those falling outside the Consolidated Fund) but not those of the Strategic Investments;
 - are prepared on normal accounting principles so that they include depreciation and impairment that are not a charge to the Consolidated Fund.
- 4.3 In the States' 2013 financial statements there is a single table in the introduction to the financial statements reporting performance against the funding allocated in the MTFP. This reports the carry forwards from previous years and the allocations from contingencies as single lines without further explanations. Two pages of the Annex to the financial statements provide some further information on the Consolidated Fund balance. From this information, none of which is subject to audit, it is very difficult to gain a full understanding of performance against the resources allocated by the States.
- 4.4 In the UK, central government departments prepare a 'Statement of Parliamentary Supply' explaining their expenditure against the funds voted by Parliament. This is an integral and prominent part of their financial statements on which their external auditor gives an opinion. The preparation of this statement is a key means by which those departments account to Parliament for the funds voted to them.
- 4.5 The Treasurer of the States has accepted that there is scope to enhance the accountability of the executive for the funds allocated by the States Assembly. He is therefore proposing to include enhanced reporting of performance against the funds voted by the States Assembly within the States' accounts submitted for audit for the year ended 31 December 2014 and subsequent years. I welcome this change.

Financial governance and leadership

5.1 The focus of my work has been on four key areas (see Exhibit 3).

Exhibit 3: Elements of financial governance and leadership reviewed



Leadership by the 'Board' and 'Executive Team'

5.2 Effective financial management starts from the top. In the most effective organisations finance is seen as too important to be left to the finance professionals.

5.3 The 'Board' and 'Executive Team':

- act collectively by making decisions as a team;
- challenge one another;
- review financial information with a frequency to ensure that they are continually sighted on financial matters;
- request and receive bespoke financial analysis as necessary;
- examine the link between investment, costs and service delivery;
- emphasise the importance of financial information throughout the organisation.

5.4 In Jersey the Council of Ministers and the Corporate Management Board (CMB) can be seen as the 'Board' and 'Executive Team' respectively. The challenge is financial leadership being seen as the preserve of the Minister for Treasury and Resources and the Treasurer of the States respectively rather than a collective responsibility. The Corporate Management Board considers in-year financial performance on a monthly basis from the end of the first

quarter of the financial year. However, there is no routine discussion of key strategic financial matters, such as policy on the level of reserves or the policy for funding major capital projects. The relative immaturity of the system of ministerial government and the strong departmental culture work against collective leadership on financial management.

- 5.5 But the financial challenges faced by the States make collective leadership on financial matters even more important. When ministerial government was established there was a strong linkage between individual departmental Accounting Officers and individual ministers but a relatively limited role assigned to the Chief Executive to the Council of Ministers. The Council of Ministers has recognised that the operation of the executive branch of government would be enhanced by a stronger Chief Executive function. Draft regulations would impose a leadership role on the Chief Executive and, in some circumstances, give them a power to direct Chief Officers. I welcome the proposed changes that should contribute to enhanced financial management within the States.
- 5.6 Below Chief Officer level, the Finance Advisory Board (FAB) provides a valuable forum bringing together Treasury and Resources staff and the finance heads from individual departments. Although FAB promotes consistency and a common understanding of key financial issues, there is a danger that its operation reinforces the view that finance is the responsibility of finance professionals alone.
- 5.7 How financial issues are considered within individual departments varies. Arrangements in the Health and Social Services Department are quite developed. A meeting is convened every two weeks attended by Corporate Directors (joined by senior clinicians at some meetings). The standard agenda for these meetings includes financial issues to ensure a common understanding and ownership.

Recommendations

- R3** Take steps to reinforce a culture of collective responsibility for corporate financial management issues by the Council of Ministers and Corporate Management Board.
- R4** For Corporate Management Board meetings, include standing items at least quarterly for the discussion of key strategic financial issues.
- R5** For Council of Ministers meetings, include regular discussion of strategic financial issues in the context of strategic priorities.
- R6** Routinely include strategic and operational financial issues on all departmental management team agendas.

Systems of internal control, governance arrangements and risk management

- 5.8 Effective financial management requires appropriately designed and consistently implemented systems of internal control, governance and risk management.
- 5.9 A key feature of arrangements within the States is the designation of Accounting Officers for departments and funds with personal responsibility for governance and financial matters. Each Accounting Officer receives an appointment letter setting out their responsibilities under the Public Finances (Jersey) Law 2005 and drawing their attention to Financial Directions, especially Financial Direction 2.2 relating to the role of Accounting Officers. However, the specific and rigorous provisions of Financial Direction 2.2 are not explicitly reflected in the Accounting Officer letter.
- 5.10 The concept of the Accounting Officer derives from central government in the UK. Accounting Officers in the UK also receive an Accounting Officer letter but that letter contains specific provisions that, although apparently relevant to Jersey, are not replicated in the Accounting Officers letters issued in Jersey. As a result there is no explicit:
- requirement to avoid waste and extravagance and to secure value for money;
 - duty to control assets, including stores;
 - duty to manage risk (as opposed to merely a duty to link the internal control processes to the risk management processes);
 - duty to use good quality project and programme management techniques;
 - duty to learn from experience; and
 - duty to report departures from stated practice.
- 5.11 Constitutionally there are parts of government that:
- form part of the judiciary or legislature rather than the executive branch; or
 - to preserve independence, operate at arms length from the executive branch of government.
- 5.12 In the UK it is recognised that the conventional arrangements for accountability to HM Treasury may be inappropriate and different accountability arrangements apply to such bodies, for example:
- an Accounting Officer letter issued by the Public Accounts Committee; and
 - a memorandum reflecting the respective responsibilities of the President of the Supreme Court and its Chief Executive.

Recommendations

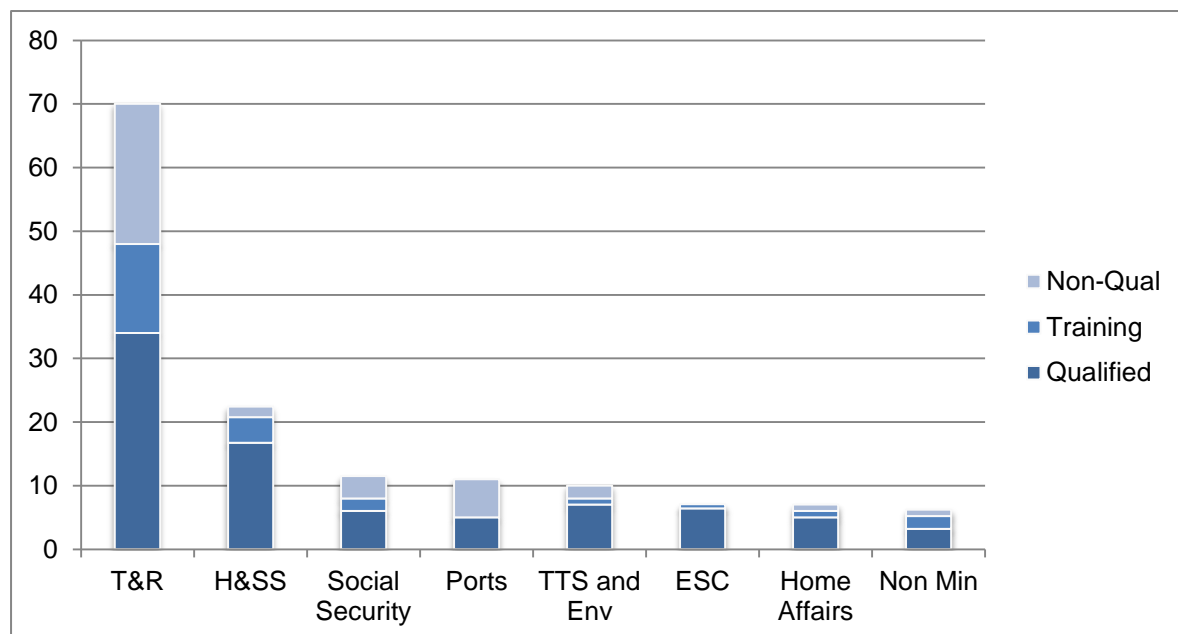
- R7** Revise the Accounting Officer letter explicitly to reflect the duties in Financial Direction 2.2.

- R8** Review the Accounting Officer letter in the context of the equivalent for Accounting Officers in UK central government and make amendments as appropriate.
- R9** Consider the amendments to accountability arrangements that are necessary in order to secure effective accountability whilst preserving constitutional independence of certain bodies.

Financial management capabilities

- 5.13 Effective financial management depends on people. It requires appropriate financial management skills at all levels of the organisation both within dedicated financial functions and more widely.
- 5.14 Corporate financial management is led by the Treasurer of the States, supported by professional finance staff in Treasury and Resources. Individual departments have their own finance functions with professionally qualified staff. The States has a significant number of professional finance staff that should place it in a strong position to enhance strategic and operational financial management. There are 145 finance staff across States departments of whom 58% are professionally qualified and a further 17% training for a professional qualification (see Exhibit 4). The majority of unqualified staff are involved in processing financial transactions.

Exhibit 4: Financial management staff across States departments



- 5.15 The States supports both initial and continuing professional training for finance staff: it meets 80% of initial professional training costs and is an accredited employer for members of the Chartered Association of Certified Accountants.

- 5.16 A key challenge for the States is using the skills of its qualified accountants to best effect. In the best performing organisations, finance departments place increasing emphasis on strategic support for the organisation (such as long-term financial planning and scenario planning) and operational support for non-financial managers (such as option appraisal and savings identification). The current organisation of finance professionals within the States, with half of them line managed in departments, and only a professional line of accountability to the Treasurer of the States, is in my view an impediment to securing the fundamental shift in focus that is required to address the significant corporate challenges that the States face. Finance is a key corporate resource and there is a compelling rationale for managing it in a similar way to other key corporate resources: human resources, information technology and estates.
- 5.17 But financial management skills should extend beyond finance staff and be reflected at all stages in the performance management process from identification of the skills and behaviours needed to the evaluation of performance. Key underpinnings of effective performance management are:
- a competency framework setting out what is expected of staff at different levels within an organisation; and
 - relevant objectives, reflecting competencies and reinforcing organisational objectives and behaviours, against which performance can be assessed.
- 5.18 The current competency framework for States staff, 'Success Through People', reflects some elements of financial management. (See Exhibit 5).

Exhibit 5: Financial management behaviours in the States' competency framework

| Grade | Behaviours-Achieves results and ensures value for money |
|-------------------------------------|--|
| Chief Executive | <ul style="list-style-type: none"> Monitors and evaluates expenditure of the States |
| Chief Officer | <ul style="list-style-type: none"> Identifies resource requirements to deliver strategy Has a commercial focus Monitors and evaluates expenditure Determines spending priorities and balances competing demands |
| Senior Manager / Head of Department | <ul style="list-style-type: none"> Evaluates return on investment of time and resources Monitors own budgets Allocates resources to deliver optimum service |
| Civil Service Grade 9 - 11 | <ul style="list-style-type: none"> Keeps within budgets Gets best out of available resources Looks for opportunities to generate income Aware of market e.g. costs, competitors, trends Ensures value for money |
| Civil Service Grade 3 - 8 | <ul style="list-style-type: none"> Uses resources efficiently to get best value for money |

5.19 The reflection of financial management behaviours in the competency frameworks is limited. Not only is financial management not separately identified but:

- there is a focus on expenditure without income for some staff;
- there is a focus on budget management without a focus on budget construction; and
- in many cases the focus is short-term rather than medium-term.

5.20 In addition there are no standard objectives reflecting financial management responsibilities for staff of different seniorities. Possible relevant objectives seen in other organisations are:

- drive and deliver a culture that emphasises continuous improvement, efficiency and value for money;
- maintain a clear focus on maximising resource efficiency, continually questioning the value of activities against strategic priorities;
- be fluent at interpreting a wide range of financial and performance information and use this to determine policy and strategy delivery;
- maintain good financial and budgetary discipline by ensuring accountability for financial controls and systems; and

- demonstrate transparency both in terms of decisions made around financial support and money spent.

5.21 Competencies and standard objectives, although necessary, are not sufficient. The States needs to know that staff are delivering the behaviours expected and, where not, corrective action is being taken. While the States has a system of performance appraisals there is widespread non-compliance with this system and inadequate monitoring of compliance.

Recommendations

- R10** Develop a plan for enhancing the contribution of financial professionals across the organisation, focussing on strategic level input and support for non-financial managers, including moving line management of all finance staff to Treasury and Resources.
- R11** Clearly reflect the full range of required financial management skills in the new competency framework and link job evaluation, recruitment, promotion, objectives, identification of training requirements and performance evaluation to those for all staff with financial management responsibilities.
- R12** Set standard objectives for financial management applicable to all staff from Chief Executive downwards with financial management responsibilities at each grade within the States.
- R13** Prioritise embedding a performance management culture across the States, including objective setting and performance appraisal, as a key component of the reform agenda.

Training and continuous professional development

- 5.22 Learning and development sits alongside performance management and the competency framework. Investing in people is an important element in developing an organisational culture to achieve excellence. Training and development on financial management skills is relevant for both finance staff and non-finance staff with financial management responsibilities.
- 5.23 For finance staff, although there are elements of training undertaken, for example of financial reporting:
- the training strategy dates from 2007 and does not appear to be used currently; and
 - the spread of finance staff across departments, although welcome, means that the approach to training and continuous professional development is fragmented.
- 5.24 For non-financial managers, training in financial skills is part of the corporate training programme. Development needs are linked to performance reviews and the widespread non-compliance with corporate policies for performance reviews reduces the value of the programme.
- 5.25 The Corporate Training Manual includes a two-day Managing Finance course (see Exhibit 6).

Exhibit 6: Managing Finance course for non-financial managers

| Objectives | Overview |
|---|---|
| <p>A two-day programme that has been designed and developed to provide First Line and Middle Managers with the skills to enable them to understand basic financial concepts and terminology. It dispels the myths around the complexities of managing finance, enabling participants to manage their budgets in an effective and efficient manner. It examines obtaining value for money through appropriate cost benefit analysis.</p> | <p>A budget holder's responsibility within the States of Jersey's Financial Planning Cycle</p> <p>Understand basic financial/accounting concepts and terminologies</p> <p>Set, monitor and explore a budget</p> <p>Apply financial controls within a budget</p> <p>Ensuring best value is achieved</p> <p>Familiarity with the States of Jersey's electronic financial system</p> <p>Partnership working with internal financial advisors</p> <p>Identify routes to network and obtain on-going support</p> <p>The role and responsibilities of managers in the procurement process</p> |

- 5.26 Similar coverage is provided in a module of the Modern Manager Programme - Understanding Financial Management and Managing Budgets. Although the courses provide a useful introduction to generic concepts:
- they are pitched at a relatively basic level and do not reflect practical situations within the States; and
 - they are not reinforced by follow-up training or e-learning.

Recommendations

- R14** Update and implement the training strategy for finance staff to provide needs-based training for finance staff across the States.
- R15** Review and update the training on financial management for non-financial staff to maximise its relevance and effectiveness.

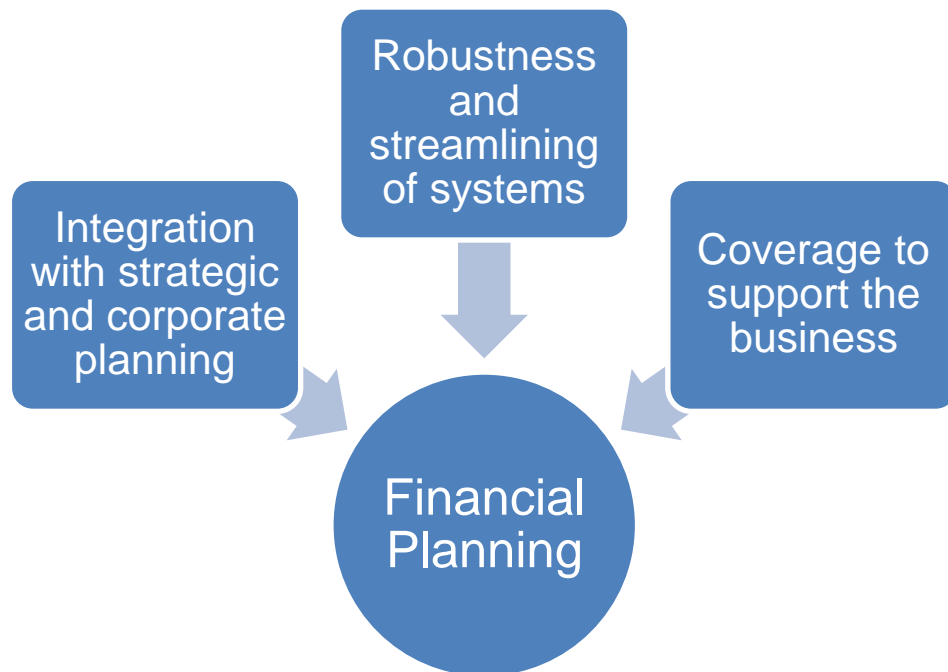
Financial planning

- 6.1 The key tools for financial planning within the States are:
- long-term capital and revenue planning;
 - the MTFP. The first MTFP was prepared in 2012 and covered the period 2013 to 2015. It serves two roles: projecting the finances of the States and allocating resources over its life. It was designed to provide a longer-term strategy for revenue and capital expenditure planning and ensure that the achievement of the goals in the States' Strategic Plan was viable. The MTFP also includes indicative capital expenditure plans for a 20-year period. The MTFP is updated annually to reflect variations in expenditure;
 - the annual budget that is focussed on taxation income; and
 - annual allocation of capital resources.
- 6.2 The first MTFP was subject to detailed scrutiny by the Corporate Services Scrutiny Panel with the benefit of expert input from the Chartered Institute of Public Finance and Accountancy and independent consultants. The Panel's report, published in October 2012, made a number of recommendations for improvement. All but one of the recommendations was accepted at the time and an implementation plan agreed. But key recommendations relating to a rolling MTFP and the policy relating to transfers to the Stabilisation Fund have not been implemented.

Recommendation

- R16** When presenting the new MTFP:
- report back to the States Assembly on progress in implementing recommendations made in the Corporate Services Scrutiny Panel 2012 report; and
 - outline proposed future action.
- 6.3 The remainder of this section focuses on three key dimensions of financial planning (see Exhibit 7).

Exhibit 7: Elements of financial planning reviewed



Integration with strategic and corporate planning

6.4 The most effective financial planning:

- is integrated with strategic and corporate planning at all levels, reflecting both plans on what is to be achieved but also plans on how it is to be achieved;
- reflects short-, medium- and long-term planning horizons; and
- produces timely information to allow budgets and forecasts to be updated.

6.5 The States has made significant progress: it has moved beyond an annual budget to a medium term financial plan. Moreover, the first MTFP was developed in light of and synchronised with the States' Strategic Plan adopted by the States Assembly in May 2012 and covering the period 2013 to 2015. The Strategic Plan identified seven priorities to achieve the overall vision (see Exhibit 8).

Exhibit 8: Strategic Plan priorities 2012 - 2015



6.6 However:

- the linkage of the current MTFP to the Strategic Plan is loose and in places artificial. Growth bids were determined and assigned to strategic priorities rather than the bids being driven by these priorities. For example, a growth bid of £600k was developed to fund a London representative office. Only subsequently was this assigned to the strategic priority of 'Get People to Work' on the basis that it might stimulate inward migration. The strained linkages may be a reflection of a lack of strategic ownership of individual strategic priorities;
- the MTFP claimed to be driven by the strategic priorities but only three of the seven strategic priorities received any growth funding in the 2012 MTFP; and
- the MTFP, reflecting the provisions of the Public Finances (Jersey) Law 2005, focuses on growth rather than on reductions in current expenditure. As a result the MTFP process does not adequately challenge existing expenditure in the context of strategic objectives.

6.7 In addition the MTFP does not fully reflect other key elements of corporate planning:

- there is some linkage to the strategic plan objectives – **what** the States is seeking to achieve – but a weaker linkage to the States' plans for **how**

they would achieve it. There is scope for a stronger reflection of the reform agenda and areas such as investment in information technology and up-skilling the workforce; and

- there is very weak linkage to other elements of corporate planning, such as workforce planning or the estates strategy.

6.8 The 2012 Strategic Plan includes a series of agreed resource principles to ensure that taxation revenues and spending are in balance and these form the basis for the MTFP. Some of those principles are incontrovertible. However:






- Principle 3 – that there should be no additional expenditure unless matched by savings or income – appears inappropriate in the context of a corporate approach to planning; and
- Principle 5 – that a balanced budget should be maintained and an appropriate balance between taxation and spending should be maintained – is vague and potentially contrary to policy objectives. The States, as recommended by the Fiscal Policy Panel, has been providing an economic stimulus to counter the economic downturn that means that, by some measures at least, it has not maintained a balanced budget in the short-term.



6.9 The very essence of corporate financial planning is to reallocate resources at a corporate level in light of strategic priorities.

6.10 In practice some of the resourcing principles are not adequately reflected in the 2012 MTFP (see Exhibit 9).

Exhibit 9: Implementation of resourcing principles in 2012 Strategic Plan

My evaluation is detailed below along with ‘traffic lights’ for the different principles; where principles are being met (green), where there are issues to be addressed (amber) and where principles are not being met and urgent action is required (red).

| Resourcing principle | Observation | Assessment |
|---|---|---|
| 1 Be prudent, taking account of the uncertain economic and financial outlook. | <p>The MTFP does not set out an overall level of prudence, linked to scenario planning.</p> <p>The MTFP did not adequately reflect the inherent uncertainty faced over the period of the MTFP, especially in the context of taxation income. This was manifested by the significant unanticipated shortfall in income tax revenue identified in 2014.</p> |  |
| 2 Identify and implement all possible savings and efficiencies. For 2013 and beyond, we will optimise methods of service delivery, to improve service delivery and value for money. | <p>The focus of the MTFP was on growth rather than on challenge of existing budgets and ways of working.</p> <p>The MTFP was not underpinned by zero-based review, including consideration of whether there was an obligation to provide a service.</p> <p>Inadequate consideration of corporate drivers of efficiencies, such as IT investment.</p> |  |
| 3 No additional spend unless matched by savings or income. | Not evident in first MTFP where growth bids significantly exceeded guidance. |  |
| 4 The Stabilisation Fund will only be used during the economic downturn, as advised by the FPP, to fund the effects of reductions in States revenues or increased demand for States services, and to provide appropriate stimulus to the economy. | <p>Stabilisation Fund set up in 2006 and £151m transferred.</p> <p>All appropriately used except £1m by 2014 to support more stable economy during economic downturn.</p> <p>Target level set at £75-£100m or 15-20% of budget.</p> <p>FPP has yet to advise that it is appropriate to direct resources into rebuilding the Stabilisation Fund.</p> |  |
| 5 Maintain balanced budgets and achieve an appropriate balance between taxation and spending. | MTFP reflects a balanced budget but what constitutes an appropriate balance between taxation and spending is difficult to assess. |  |

| Resourcing principle | Observation | Assessment |
|---|---|---|
| <p>6 Actively manage the balance sheet as well as Budget by maximising investment returns within agree levels of risk, rebuilding Stabilisation Fund and optimising use of physical assets.</p> | <p>Longer term balance sheet planning not evident but Strategic Reserve investments performance has strengthened the balance sheet.</p> <p>On advice of FPP, current plans do not include restoring Stabilisation Fund balance.</p> <p>Estates rationalisation impact not included in MTFP.</p> |  |
| <p>7 Plan our expenditure on capital and infrastructure over the long term and consider carefully the appropriate sources of funding for major projects, including borrowing.</p> | <p>Evidence of longer term capital planning.</p> <p>Alternative funding sources considered on a case-by-case basis rather than a policy decision.</p> |  |

Recommendations

- R17** In the future develop the MTFP starting from both:
- Strategic Plan priorities (**what** is to be achieved); and
 - Reform Agenda principles (**how** it is to be achieved).
- R18** In compiling future MTFPs, apply the same rigorous scrutiny to existing expenditure as to that given to planned growth.
- R19** Over the cycle of the new MTFP undertake a comprehensive programme of zero-based budget reviews.
- R20** Fully reflect key corporate planning, including workforce planning and the estates strategy in the next MTFPs.
- R21** Before compiling future MTFPs consider the appropriateness of the existing resourcing principles.
- R22** In future years establish processes to report on compliance with the resourcing principles.
- R23** Place a greater emphasis on the range of potential outcomes in compiling future MTFPs.
- R24** When advised to do so by the FPP, make provision in the MTFP for replenishment of the Stabilisation Fund.

Robustness and streamlining of systems

6.11 Effective systems for financial planning should be robust, incorporating sensitivity analysis and scenario planning involving finance and non-financial managers, but also streamlined.

6.12 In this section I consider:

- the duration of the MTFP;
- challenge of the draft MTFP;
- the usability of the MTFP.

Duration of the MTFP

6.13 The best MTFPs cover a sufficiently long period to be an effective tool for on-going financial planning.

6.14 The States' MTFP process is driven by legislation covering a specified financial period in the final year of which the next MTFP is prepared. As recognised by the Corporate Services Scrutiny Panel in 2012, this has potential adverse consequences:

- the compilation of the MTFP is not part of 'business as usual'. A more usual practice is that the MTFP is compiled, on a rolling basis, alongside an annual budget, setting out a projection (or range of projections) for future financial periods;
- there is a force for rigidity in resource allocation for the duration of the MTFP. As the MTFP establishes not only an overall resource envelope but also allocations to departments, it impedes adaptability and responsiveness, a significant disadvantage in a period of both retrenchment and reform; and
- the MTFP provides a different duration for horizon-scanning at different times within the cycle. With a year to go before the end of the MTFP cycle the MTFP can hardly be said to be a 'medium-term' plan, providing a dynamic tool for financial planning (see Exhibit 10).

Exhibit 10: Timeframe for MTFP – existing

| | | Duration of the look ahead | | | |
|--------------|--------|----------------------------|--------|--------|--------|
| | | Year 1 | Year 2 | Year 3 | Year 4 |
| Year of MTFP | Year 1 | | | | |
| | Year 2 | | | | |
| | Year 3 | | | | |
| | Year 4 | | | | |

6.15 The current MTFP period is linked to that of the States' strategic plan that is in turn linked to the term of the Council of Ministers. The MTFP is not only a planning tool but also a resource allocation tool for the term of the Council of Ministers. But it would be possible to reconcile the planning and resource allocation roles of the MTFP by:

- limiting the resource allocation role to the period of the strategic plan; but
- each year updating forecasts to cover a rolling three or four year period to provide a framework for future planning (see Exhibit 11).

Exhibit 11: Timeframe for MTFP - potential

| | | Duration of the look ahead | | | | | | |
|--------------|--------|----------------------------|--------|--------|--------|--------|--------|--------|
| | | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Year 6 | Year 7 |
| Year of MTFP | Year 1 | | | | | | | |
| | Year 2 | | | | | | | |
| | Year 3 | | | | | | | |
| | Year 4 | | | | | | | |

| | |
|---------------------|------------|
| Resource allocation | Projection |
|---------------------|------------|

Recommendation

R25 Consider amending legislation to provide for a rolling MTFP.

Challenge of the draft MTFP

6.16 Effective review and challenge of the MTFP before submission to the States Assembly is key to the robustness of the MTFP.

6.17 The first MTFP timetable included four levels of challenge to the detail of the growth bids:

- within the Department;
- with the Corporate Finance Team;
- by a Ministerial sub-group independent of the Department making the bid; and
- in bilateral meetings with each Minister attended by the Chief Minister, the Minister for Treasury and Resources and the Treasurer of the States.

6.18 This represents a high volume of challenge. However:

- the challenge related to growth bids but not to base budgets. There is scope for challenge across the base budget, for example on whether expenditure is being incurred on services where there is no statutory duty to provide them and on the range and level of fees and charges levied; and

- feedback from departments was that the process, in particular the inter-departmental reviews, was not overtly challenging.
- 6.19 Rigour of challenge could be enhanced by inclusion in the process of a structured element of external challenge to support management, perhaps drawing on the experience of senior public sector managers from the United Kingdom who have implemented significant savings.
- 6.20 The Fiscal Policy Panel (FPP), an independent panel that provides skilled input and challenge to the financial planning process encompassing both the MTFP and Budget, provides additional challenge to the MTFP and budget process. The recommendations contained in its recent report were all accepted as part of the subsequent MTFP exercise.

Recommendations

- R26** Revise arrangements for future MTFPs to provide more effective challenge of both growth bids and base budgets.
- R27** Consider including a structured element of external challenge to support managers in preparing the MTFP.

Usability of the draft MTFP

- 6.21 The best MTFPs:
- contain sufficient information in a consistent format to facilitate planning corporately in the medium-term but are sufficiently short to be accessible and usable; and
 - address issues wherever possible at a corporate level rather than a departmental level so that they are a corporate tool rather than an aggregation of departmental plans.
- 6.22 My review of the 2012 MTFP identified that:
- it was exceptionally detailed, extending to 400 pages with detailed financial plans by department contained in a separate annex of 270 pages. Although the length of the document was influenced by the fact that the exercise was new and there was a need for corporate learning, it detracts from the accessibility, usability and therefore the value of the MTFP;
 - there was an inconsistent level of detail. For example, the departmental analysis of growth bids contained in the annex to the MTFP varies significantly.

Recommendations

- R28** Adopt streamlined contents for future MTFPs informed by a review of the 2012 MTFP in practice.
- R29** Take steps to promote consistency of departmental elements of the MTFP.

Coverage to support the business

- 6.23 Effective financial planning covers all areas of the business with integration of current expenditure plans with investment programmes, treasury management, cashflow and balance sheet projections.

Long-term revenue and capital planning

- 6.24 Following the first MTFP, which was introduced to move away from annual planning to a longer-term horizon for income targets and expenditure limits, two plans have been developed which in turn inform the MTFP:
- a Long Term Revenue Plan (LTRP) covering the period up to 2020; and
 - a Long Term Capital Plan (LTCP) covering the period up to 2037 (although only covering 8 years in detail).
- 6.25 At this stage the long-term plans merely identify the issues and challenges likely to be faced with high-level policy options to be considered by the Council of Ministers. But they do highlight a gap between available resources and current demands for both revenue and capital expenditure.

Medium Term Financial Plan

- 6.26 The MTFP is detailed. But the structure and content of the MTFP does not promote dynamic corporate management of finances:
- a corporate risk assessment is not included;
 - demographic issues are addressed at departmental level although they affect the States as a whole;
 - detailed sensitivity analysis is undertaken at a departmental level and not drawn together;
 - there is no projection of the States' balance sheet – its assets and liabilities – although this is a key measure of the financial strength of an organisation.
- 6.27 The States allow for departments to bid to carry forward unspent allocations from one year to the next without authority from the States Assembly. Historically, most bids have been approved. The existence of this option means that there is not a perverse incentive to incur expenditure before the end of the financial year, even if that would be uneconomical, inefficient or ineffective. But there is a danger that excessive base budgets are not identified and challenged adequately.
- 6.28 In preparing for the 2015 MTFP, management has identified a need for expenditure reductions to balance the budget. One option being considered is uniform annual cuts in annual departmental budgets through assumed incremental efficiency savings. This is an unsophisticated and potentially counter-productive tool. For example:

- in the context of the reform agenda it does not recognise that some expenditure, such as that on information technology, is a vital driver of change and of securing greater efficiency and effectiveness in service departments; and
- it does not reflect that departments are tied into external contracts where the scope for efficiency savings arises from periodic procurement exercises rather than uniform annual improvements.

Recommendations

R30 Include in the MTFP:

- a consolidated corporate risk assessment;
- a corporate consideration of demographic issues; and
- a sensitivity analysis undertaken at corporate level.

R31 Include balance sheet forecasts in the MTFP.

R32 Review current carry-forward process to encourage and incentivise potential underspends to be identified and, where appropriate, redistributed for corporate benefit.

R33 Develop more sophisticated mechanisms for identifying efficiency savings.

Capital programme

6.29 The capital programme is incorporated into the MTFP with detailed projections for three years plus higher-level estimates over a 20-year horizon. The programme is developed from bids submitted by departments to the Corporate Finance Team in a similar way to revenue growth bids.

6.30 The relevant Financial Direction and the template provided to departments require proposed items for inclusion in the capital programme to be supported by a full business case showing how a series of criteria are met. For one business case selected at random, a number of the business case criteria had not been satisfied.

6.31 Capital expenditure is largely financed from revenue allocations and, in the current MTFP, these comprise £222m over three years. Once a project is agreed, the entire funding is allocated in the first year. The annual budget process then refines the allocation each year. At 31 December 2013, the sums allocated but unapplied totalled nearly £100m.

6.32 This approach to capital funding is very prudent meaning that no project may commence without the resources identified. But it is also unusual and potentially constraining.

Recommendations

R34 Review and reinforce compliance with corporate standards for business cases as a pre-requisite to their inclusion in the capital programme.

- R35** Consider whether a different approach to funding of the capital programme should be adopted.

Annual Budget

- 6.33 The focus of the annual budget is the raising of taxation income to fund the expenditure derived from the MTFP. The most significant component of tax revenue is personal income tax and forecasting this figure accurately is pivotal to the financial position of the States.
- 6.34 Tax income forecasts are also subject to the volatility of demographics, earnings and spending patterns and the 2015 budget showed that the income tax forecast was down by £44.5m on a total of around £500m. The scale of the variances suggests that the impact of the recession was not adequately factored into the economic assumptions at the time of the MTFP.
- 6.35 Since the first MTFP, the States has introduced more sophisticated forecasting and developed better data. This data from the Statistics Unit and the Economic Unit is provided to the Income Forecasting Group (IFG) that then makes a judgement on the projected income tax revenue. The figures considered by the IFG include income modelled at a central range plus or minus 5%, reflecting the inherent uncertainty in projecting tax revenue that could usefully be reflected in the MTFP.
- 6.36 As the annual budget is restrictive in scope it does not consider expenditure or departmental income arising from fees and charges. This weakness would be addressed if the States moved, as recommended, to a rolling MTFP.

Recommendation

- R36** Include detailed scenario modelling for a range of options in relation to tax revenues in the next MTFP.

Conclusion

- 7.1 The States has systems both for accountability for resources voted by the legislature to the executive and for financial management within the executive branch of government. But significant improvement is required.
- 7.2 I welcome the proposed changes in how the executive reports on financial performance to the legislature. However, maximum value will only be secured when the current system of allocation of resources is changed: the current system lacks transparency, is partial and provides perverse incentives.
- 7.3 Internally, the arrangements for financial management do not facilitate the reform agenda. Performance management is not embedded in the States and to embed it requires a major cultural shift. There is too much focus on departmental responsibility at the expense of collective strategic leadership.
- 7.4 The adoption of the first MTFP was a significant step forward. But the MTFP process is no longer fit for purpose and acts as a barrier to reform. It is insufficiently rooted in corporate priorities – both priorities for what the States do and priorities for how they do it. It is too inflexible and too much a drawing together of individual departmental plans. It does not adequately reflect the key drivers of change such as changes in information technology, different approaches to office accommodation and new ways of working. The States needs a flexible and dynamic MTFP that facilitates corporate planning for reform and expenditure reduction.
- 7.5 The States faces substantial budgetary pressures. It needs better financial management to be able to respond to these in a considered way. Although procedural and structural change is needed, what is needed most is cultural change. There needs to be a shift from the departmental to the corporate, from the short-term to the long-term and from a presumption of growth to the reality of retrenchment.
- 7.6 The challenge for the States and its finance function are significant. This report sets out a demanding agenda. The necessary changes will take time and will not all be secured in time for the next MTFP due to be adopted this year. Investment is needed to secure the changes. Wise investment will help to deliver an environment where financial management facilitates change and is a key part of the wider reform agenda.

APPENDIX 1: Summary of Recommendations

- R1** In the future extend the Medium Term Financial Plan to cover all the public finances of Jersey.
- R2** In the future include depreciation and impairment in the measure of expenditure for which funds are allocated by the States Assembly.
- R3** Take steps to reinforce a culture of collective responsibility for corporate financial management issues by the Council of Ministers and Corporate Management Board.
- R4** For Corporate Management Board meetings, include standing items at least quarterly for the discussion of key strategic financial issues.
- R5** For Council of Ministers meetings, include regular discussion of strategic financial issues in the context of strategic priorities.
- R6** Routinely include strategic and operational financial issues on all departmental management team agendas.
- R7** Revise the Accounting Officer letter explicitly to reflect the duties in Financial Direction 2.2.
- R8** Review the Accounting Officer letter in the context of the equivalent for Accounting Officers in UK central government and make amendments as appropriate.
- R9** Consider the amendments to accountability arrangements that are necessary in order to secure effective accountability whilst preserving constitutional independence of certain bodies.
- R10** Develop a plan for enhancing the contribution of financial professionals across the organisation, focussing on strategic level input and support for non-financial managers, including moving line management of all finance staff to Treasury and Resources.
- R11** Clearly reflect the full range of required financial management skills in the new competency framework and link job evaluation, recruitment, promotion, objectives, identification of training requirements and performance evaluation to those for all staff with financial management responsibilities.
- R12** Set standard objectives for financial management applicable to all staff from Chief Executive downwards with financial management responsibilities at each grade within the States.
- R13** Prioritise embedding a performance management culture across the States, including objective setting and performance appraisal, as a key component of the reform agenda.
- R14** Update and implement the training strategy for finance staff to provide needs-based training for finance staff across the States.
- R15** Review and update the training on financial management for non-financial staff to maximise its relevance and effectiveness.

- R16** When presenting the new MTFP:
- report back to the States Assembly on progress in implementing recommendations made in the Corporate Services Scrutiny Panel 2012 report; and
 - outline proposed future action.
- R17** In the future develop the MTFP starting from both:
- Strategic Plan priorities (**what** is to be achieved); and
 - Reform Agenda principles (**how** it is to be achieved).
- R18** In compiling future MTFPs, apply the same rigorous scrutiny to existing expenditure as to that given to planned growth.
- R19** Over the cycle of the new MTFP undertake a comprehensive programme of zero-based budget reviews.
- R20** Fully reflect key corporate planning, including workforce planning and the estates strategy in the next MTFPs.
- R21** Before compiling future MTFPs consider the appropriateness of the existing resourcing principles.
- R22** In future years establish processes to report on compliance with the resourcing principles.
- R23** Place a greater emphasis on the range of potential outcomes in compiling future MTFPs.
- R24** When advised to do so by the FPP, make provision in the MTFP for replenishment of the Stabilisation Fund.
- R25** Consider amending legislation to provide for a rolling MTFP.
- R26** Revise arrangements for future MTFPs to provide more effective challenge of both growth bids and base budgets.
- R27** Consider including a structured element of external challenge to support managers in preparing the MTFP.
- R28** Adopt streamlined contents for future MTFPs informed by a review of the 2012 MTFP in practice.
- R29** Take steps to promote consistency of departmental elements of the MTFP.
- R30** Include in the MTFP:
- a consolidated corporate risk assessment;
 - a corporate consideration of demographic issues; and
 - a sensitivity analysis undertaken at corporate level.
- R31** Include balance sheet forecasts in the MTFP.
- R32** Review current carry-forward process to encourage and incentivise potential underspends to be identified and, where appropriate, redistributed for corporate benefit.

- R33** Develop more sophisticated mechanisms for identifying efficiency savings.
- R34** Review and reinforce compliance with corporate standards for business cases as a pre-requisite to their inclusion in the capital programme.
- R35** Consider whether a different approach to funding of the capital programme should be adopted.
- R36** Include detailed scenario modelling for a range of options in relation to tax revenues in the next MTFP.



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