Comptroller and Auditor General

Review of Financial Management – Part 2

25 February 2016

JERSEY AUDIT OFFICE

R.19/2016

Review of Financial Management – Part 2

Introduction

1.1 Effective financial management is essential for securing value for money in the use of resources. It requires effective systems for the planning, direction, monitoring and control of the States' finances.

1.2 In 2015 I issued a report focussing on:

- the effectiveness of the current framework for allocation of resources by the legislature to the executive and the accountability of the executive to the legislature for the resources allocated;
- the effectiveness of financial governance and leadership within the States; and
- the effectiveness of financial planning within the States, including the processes for preparation of the Medium Term Financial Plan (MTFP) and annual budget.

1.3 In this second report I consider:

- financial monitoring and forecasting; and
- financial and performance reporting.

1.4 Having concluded two major reviews of financial management and a review of the States' Financial Directions, I also consider the way forward.

Scope and Objectives

1.5 This review considers the effectiveness of:

- financial management and forecasting both at departmental level and States-wide; and
- internal financial and performance reporting both at departmental level and States-wide.

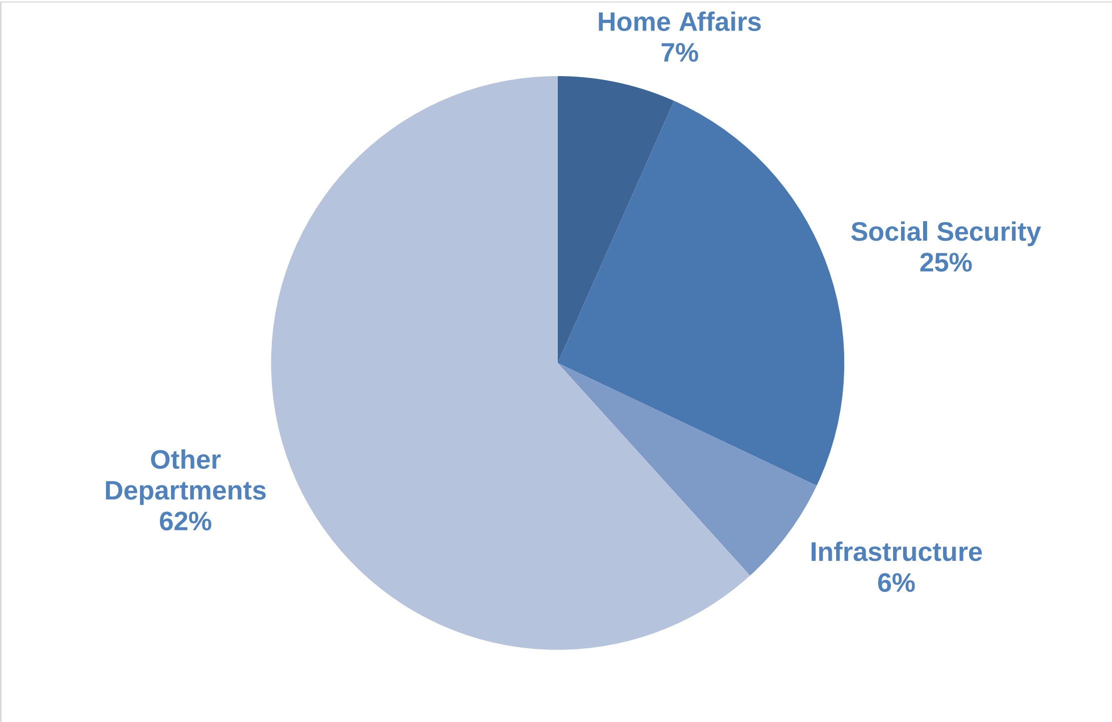
1.6 This review extends to the financial management of the States and States-funded bodies. It does not extend to:

- the States' capital programme;
- budgeting for and monitoring of the States' general revenues;
- the States' pension funds; or
- the States' strategic investments.

1.7 In undertaking the work, I have taken into account the Financial Management Maturity model published by the UK National Audit Office.

1.8 In order to reflect practical experiences and compare arrangements within the States, my review includes more detailed reviews of financial forecasting and reporting in three departments that between them account for over a third of Consolidated Fund expenditure (see Exhibit 1).

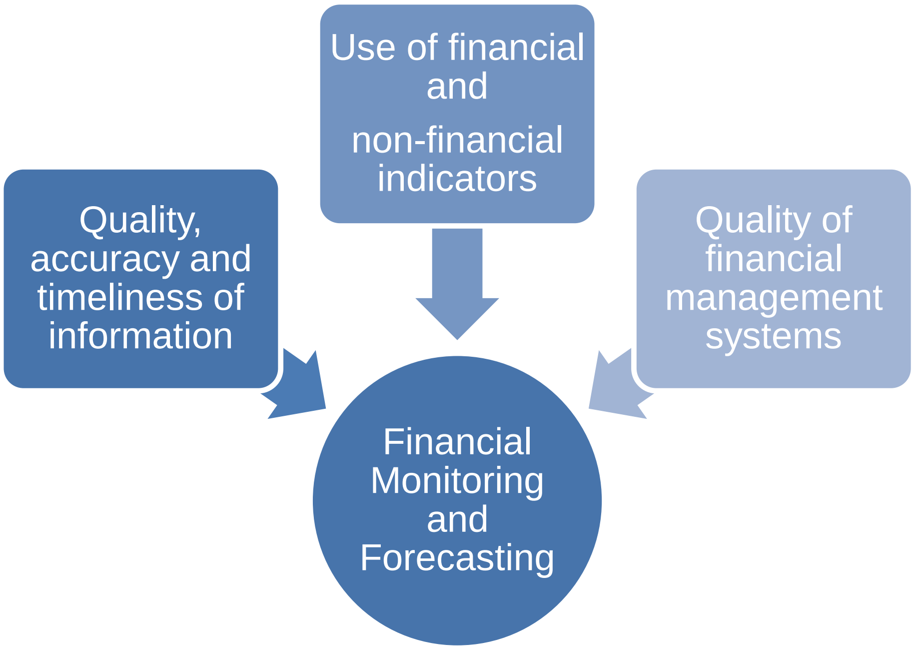
Exhibit 1: Consolidated Fund expenditure reviewed in more detail as part of this review



Financial monitoring and forecasting

2.1 The focus of this work has been on three areas that typically contribute to effective financial monitoring and forecasting in an organisation (see Exhibit 2).

Exhibit 2: Elements of financial monitoring and forecasting



Quality, accuracy and timeliness of forecasting and monitoring information

2.2 Effective financial management involves:

- clear processes for preparation of annual budgets building on medium term financial plans;
- preparation of detailed annual budgets on a timely basis before the start of the financial year; and
- provision of accurate and timely information to facilitate monitoring of performance and expected out-turn against budget on a regular and timely basis.

2.3 The budget setting process within the States includes key steps:

- documentation and communication of the overall budget setting process in a Financial Direction that is currently being updated;
- budget preparation starting from the totals in the Medium Term Financial Plan (MTFP) with adjustments for allocation of contingency, additional funding, transfers between capital and revenue and transfers between departments;
- loading of base budgets onto the JD Edwards main accounting system before the start of the financial year;

- profiling of budgets to reflect the anticipated timing of expenditure, either on the basis of model profiles or on the basis of user supplied profiles;
- scrutiny of requests for carry-forwards of unused budgets by Treasury and Resources prior to consideration by the Council of Ministers. The process adopted for the 2015 budget was more robust than in the previous year with scrutiny of the justification for underspends and half the underspends being surrendered to the Consolidated Fund in April 2015. Although there were specific reasons for the delay, the timing of the decision, more than a quarter of the way into the financial year, created uncertainty for departmental managers. I understand that the timetable for the decision has been advanced for 2016. I will continue to monitor progress in this area;
- the ability to vary budgets and profiles to the end of March, including to reflect approved carry-forwards from the previous year;
- the ability to vary budgets subsequently with the approval of the Minister for Treasury and Resources, relevant Minister or Accounting Officer as appropriate; and
- maintenance of a 'budget virement ledger' to ensure that budget transfers have a neutral effect overall.

2.4 The budget monitoring process within the States involves:

- user access to financial information on a real-time basis through the JD Edwards Console module. However, some subsidiary systems, such as the Gatehouse system used within the Department for Infrastructure (formerly Transport and Technical Services) for weighbridge income, only interface with the main accounting system on a monthly basis. In such cases access to real-time information is less valuable;
- raising of accruals to reflect expenditure incurred but not yet invoiced;
- provision of month-end monitoring reports to budget holders; and
- monthly discussions between budget holders and departmental finance managers. For the departments considered in detail there is evidence that the discussions were reasonably thorough and that both budget holders and finance managers had a good grasp of the budgets in question.

Use of financial and non-financial performance indicators

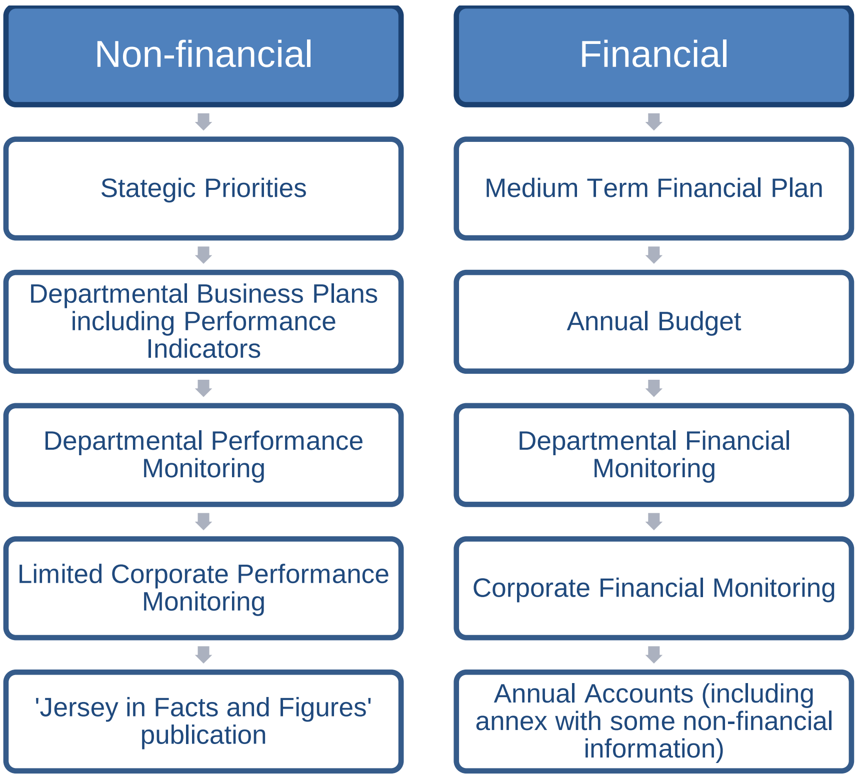
2.5 Management of finances is about more than managing budgets: it is about managing what is achieved with the money spent. The best performing organisations set budgets for financial performance and targets for non-financial performance alongside each other. They also monitor financial and non-financial performance in tandem. In that way they can drive efficiency and effectiveness.

2.6 High performing organisations also:

- prepare a corporate plan linking strategic objectives to financial and other plans, reflecting 'business as usual' activities as well as changes to activities and focussing on both what is to be achieved and how it will be achieved;
- align performance indicators to strategic objectives; and
- identify a subset of key performance indicators for monitoring at corporate level.

2.7 The key components of the States' system for financial and non-financial performance information are set out in Exhibit 3.

Exhibit 3: The States' arrangements for financial and non-financial performance information



2.8 What is striking is that there is limited integration of forecasting and reporting of financial and non-financial information, meaning that it is difficult to assess an activity from both a financial and non-financial perspective. This is crucial both to achieve value for money and to manage change effectively.

2.9 There is no States-wide Corporate Plan. This means that there is no explicit drawing together of financial and other key plans, such as those covering property, information technology and human resources. But it also means that the linkage of departmental business plans, performance indicators and targets must be directly to the Strategic Plan. Review of the only four departmental business plans published by October 2015 identified significant differences in the content (see Exhibit 4).

Exhibit 4: Key elements from published departmental business plans 2015

Department	No. of Key Performance Indicators	No. of Targets	Link to Strategic Plan	Financial details
Environment	106	161	Reference in introduction but no link to detailed objectives	Budget only
Education	42 ('key actions')	'Signs of success' but no targets	✗	✗
Home Affairs	47	44	✓	✗
Social Security	34 ('initiatives')	34	✓	Budget only

2.10 From the review of the four plans it is evident that:

- the linkage to the financial resources available is weak with two departments providing budget details only and two not even providing those;
- the indicators and targets included are numerous and not prioritised, making it difficult for management to focus their efforts. Best performing organisations have a limited number of key performance indicators linked to strategic priorities routinely received and reviewed by the Board or equivalent; and
- the linkage to the States' Strategic Plan is weak – even where departmental aims and objectives are linked to the Strategic Plan this feels like an artificial exercise with departmental objectives shoe-horned into the Strategic Plan rather than flowing from it. This is evident, for example, in the Home Affairs Business Plan (see Exhibit 5).

Exhibit 5: Linkage of Home Affairs objectives to Strategic Plan priorities

Strategic Priorities
1. Get people into work; 2. House our community; 3. Promote family and community values; 4. Reform government and the public sector; 5. Manage population growth and immigration; 6. Reform Health and social services; 7. Sustainable long term planning.

Home Affairs Priorities from 2015 Business Plan	Link to Strategic Plan priorities
1. Secure the capacity and capability required to deliver and sustain effective services for the purpose of protecting the public and providing a safe and caring community;	3,4,5
2. Underpin the vision of a safe and caring community;	3,4,5
3. To ensure effective development and delivery of partnership arrangements;	3,4,5
4. To maintain defence contribution to UK;	3
5. To maintain and preserve a register of all births, marriages, civil partnerships, adoptions and deaths;	3
6. To ensure that staff and resources are managed so as to deliver high standards of performance and provide value for money.	3,4,7

Source: Home Affairs Business Plan 2015

2.11 Good targets meet 'SMART' criteria (see Exhibit 6).

Exhibit 6: SMART targets

Specific	• Setting out exactly what you wish to achieve
Measureable	• Being able to measure unambiguously whether a target has been met
Achievable	• Reasonably attainable given the resources allocated
Relevant	• Relevant to objectives e.g. those in the Strategic Plan
Time-bound	• Setting a specific timeframe for attainment

2.12 Many of the targets in the departmental business plans fail to meet one or more of the SMART criteria. For example, the Education Business Plan stated that there will be an increase in the number of States nursery places available without specifying by how much they will increase and by when.

Recommendations

R1 Develop a States-wide Corporate Plan as a bridge between Strategic Priorities, the Medium Term Financial Plan and departmental business plans.

R2 Develop a consistent framework for departmental business plans that:

- links departmental objectives to Strategic Priorities;
- supports the Corporate Plan;
- improves integration of financial and non-financial objectives; and
- ensures that targets are SMART.

R3 Over time develop integrated corporate financial and non-financial forecasting and reporting across the States, starting with a small number of key indicators for which relevant and appropriate information is available.

Quality of financial management systems

2.13 High quality and accessible financial information systems contribute to effective financial management. There is an increasing trend in high performing organisations for enhancing the financial skills of non-financial managers and providing them with the tools to allow them to interrogate, manipulate and use financial information themselves to promote ownership, accountability and efficiency.

2.14 The majority of the States' financial systems are part of the JD Edwards suite that is relatively old and not as user-friendly as more modern systems. Operating it is labour intensive and support is becoming more challenging. There is some provision for the replacement of JD Edwards in the capital programme.

2.15 The key financial system that does not form part of this suite – Navison, operated by Social Security – interfaces daily with the JD Edwards main accounting system.

2.16 The main accounting system includes two levels of access for monitoring and reporting:

- Console is available as a read only option for all budget holders and offers an option for transaction and report interrogation using date parameters only. But the focus of reports is narrowly on budget monitoring and budget holders do not have the flexibility to interrogate data to prepare reports that meet their specific needs; and
- Insight is licenced only to finance managers in all departments allowing them to interrogate and manipulate data within the system to provide reports on a range of parameters. However further processing is necessary using spreadsheets to prepare reports for senior management and Ministers.

2.17 The restricted access to Insight, coupled with the limited training on finance for non-financial managers and cultural issues create inefficiencies. Many budget holders routinely rely on finance managers to support the monthly analysis of the data and updates to the forecast and are reliant on them for any other form of financial analysis. The degree of support varies depending on the individual budget manager and their understanding and acceptance of responsibility.

2.18 In each of the departments reviewed, the monthly process includes a stage where each finance manager meets each budget holder to go through the latest figures, discuss performance and prepare the forecast. In Home Affairs, in the interests of efficiency, this is done on a group basis. In other departments it can take a number of days to meet all budget holders. This process is labour intensive and the cost of this intervention may be disproportionate to the benefits arising.

2.19 Budget holders are provided with reports monthly containing key financial information to facilitate financial management:

- budget;
- year to date budget;
- year to date spend;
- year to date variance;
- monthly budget;

- monthly spend;
- monthly variance;
- full year forecast; and
- full year forecast variance to final approved budget.

However, the presentation is not intuitive.

2.20 Good financial monitoring requires not only information on performance against budget ('the figures') but also an understanding of the reasons for variances ('the words'). The facility within JD Edwards to add commentary on budget variances is little used. Departments mainly rely on manual intervention through export to spreadsheets which have been developed within each department over time. On the basis of the sample reviewed, the approach varies from a simple download of data from the system into spreadsheets to allow commentary to be added (the approach used in Social Security and Home Affairs) to the development of a system which allows direct production of a monitoring report for senior managers and the Minister (in the Department for Infrastructure - formerly Transport and Technical Services). There are no formal standards for testing and validating spreadsheets used for summary reporting, increasing the risk of error.

2.21 While there are similarities in approach between departments there are also differences arising from custom and practice rather than from business need. In addition, there is limited sharing of current practices or improvements made in forecasting and monitoring of budgets between departments.

Recommendations

R4 Review the timetable and resources for the proposed replacement of the JD Edwards main accounting system.

R5 Shift the balance of responsibility for budget monitoring and forecasting to budget holders and provide them with the tools necessary to perform the role.

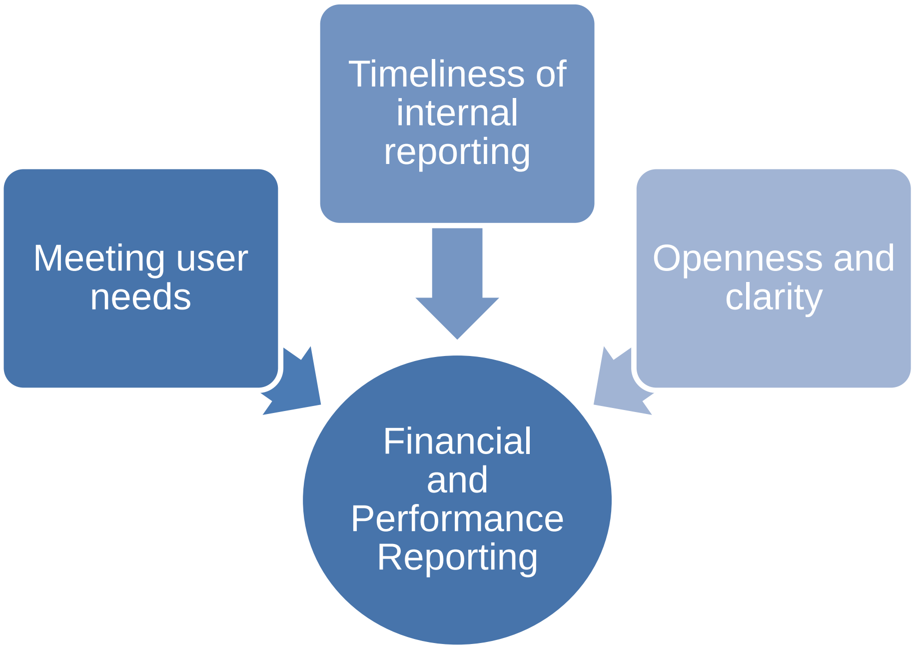
R6 Adopt States-wide standards for obtaining assurance on the integrity of key spreadsheets used for accountability and decision making.

R7 Across the States, review the tools used for budget monitoring and reporting, with the aim of consistent adoption of best practice.

Financial and performance reporting

3.1 Effective management requires timely and accurate reporting of financial and non-financial performance to senior management and politicians. I have focussed on three dimensions of such reporting (see Exhibit 7).

Exhibit 7: Elements of financial and performance reporting



Meeting user needs

3.2 Good quality financial and performance reporting systems reflect different user needs. Information should be tailored to ensure that reports are relevant and useful.

3.3 The key corporate requirements set out in Financial Directions require departments to:

- undertake monthly variance analysis and forecast updates;
- identify and report reasons for major variances; and
- submit reports on performance and variances to Chief Officers and Ministers.

3.4 The arrangements are departmentally focussed, with corporate reporting focussing predominantly on income and aggregation of expenditure information provided by departments.

3.5 The key stages in the reporting process are:

- **preparation of reports for senior management and Ministers.** The three departments reviewed all produce such reports within 10 working days of the month end. Social Security prepares for senior management an additional 'Flash' report directly from the system showing figures only, on the first day possible after the ledger closes (normally therefore 4 working days after the month end);

- **submissions to Treasury and Resources.** The departments send Treasury and Resources a monthly analysis of key variances in template form to enable reports to the Corporate Management Board (CMB) and the Council of Ministers to be prepared;
- **reporting to CMB.** CMB receives a monthly report including:
    - a forecast of total income and expenditure;
    - a summary of headline messages, including on corporate income issues that are not considered at departmental level;
    - clear explanations of the reasons for variances; and
    - an indication of likely variances that will impact on the year end forecast.

  However, the report does not include an effective summary of key risks which have been escalated by departments for CMB to consider, or monitoring of savings plans at corporate level. I plan to undertake a separate review of risk management; and
- **reporting to the Council of Ministers.** The Council of Ministers receives a quarterly report in a similar format to that received by CMB but with the addition of some information on manpower, overtime, debtor and creditor days and investment performance.

3.6 The content and format of monthly monitoring reports varies substantially (see Exhibit 8).

Exhibit 8: Monthly Monitoring Reports – comparison

Contents	CMB	Home Affairs	Infrastructure	Social Security
Overview of current position	✓	✓	✓	✓
Detailed Income and Expenditure	✓	✓	✓	✓
Commentary on variances	✓	Limited	High level	High level
Reconciliation to MTFP	✓	×	✓	✓
Year-end forecast	✓	High level	✓	✓
Balance Sheet	×	×	✓	✓
Non-financial performance information	×	Manpower information only	Manpower information only	Claimant numbers
Manpower issues	×	Staff numbers and overtime	Overtime and call out	Staff costs
Savings requirement	×	✓	✓	×
Capital programme	Separate	✓	✓	× (less relevant)
Compliance and audit issues	×	✓	✓ (out of date)	×
Risks	×	✓	×	×
Action focus/decisions required	×	×	×	×

3.7 Whilst the specific user needs are different – and reporting needs to reflect that – there are some elements that could usefully be included in all monitoring reports to aid effective scrutiny and action by senior management. Key areas not consistently covered are:

- integration of financial and non-financial information. Without such integration it is difficult to assess the impact of spending decisions on service delivery;
- expenditure on core strategic initiatives e.g. reform; and
- risks and mitigation of those risks.

3.8 Much non-financial information is monitored at departmental level separately from financial information. In the case of Home Affairs, performance is monitored for the individual services in meetings between the Chief Officer and Minister but no sub-set of indicators and targets is considered by the departmental management team.

3.9 Proactive canvassing of user needs is an important means of ensuring that information is relevant and useful. There is no structured States-wide approach to identifying user needs and no evidence of looking externally to drive improved reporting to stakeholders. The Finance Advisory Board and the Financial Managers Reporting Group that reports to it have a potentially key role to play in driving change. However, the focus of those groups has not been to seek out and share good practice from within the States or beyond. There is limited evidence of user views being sought at departmental level in the departments we reviewed:

- new Ministers are given the opportunity to comment on the information provided to them. This process is potentially ineffective without knowledge of the alternatives to focus their consideration. Unsurprisingly there is little evidence of changes as a result; and
- Social Security undertook a survey of budget holders to assess views on the support received, including questions on the usefulness of current reports with a view to removing redundant or unused information.

Recommendations

R8 Develop a common core of monitoring information to be used across the States, including integration of financial and non-financial information, risks and risk mitigation.

R9 Adopt a structured approach to consulting users on the information needed to monitor performance against corporate and departmental priorities and revise reporting in light of consultation responses.

R10 Refocus the work of the Finance Advisory Board and Finance Managers Reporting Group to include driving good practice and change across the States.

Timeliness of internal reporting

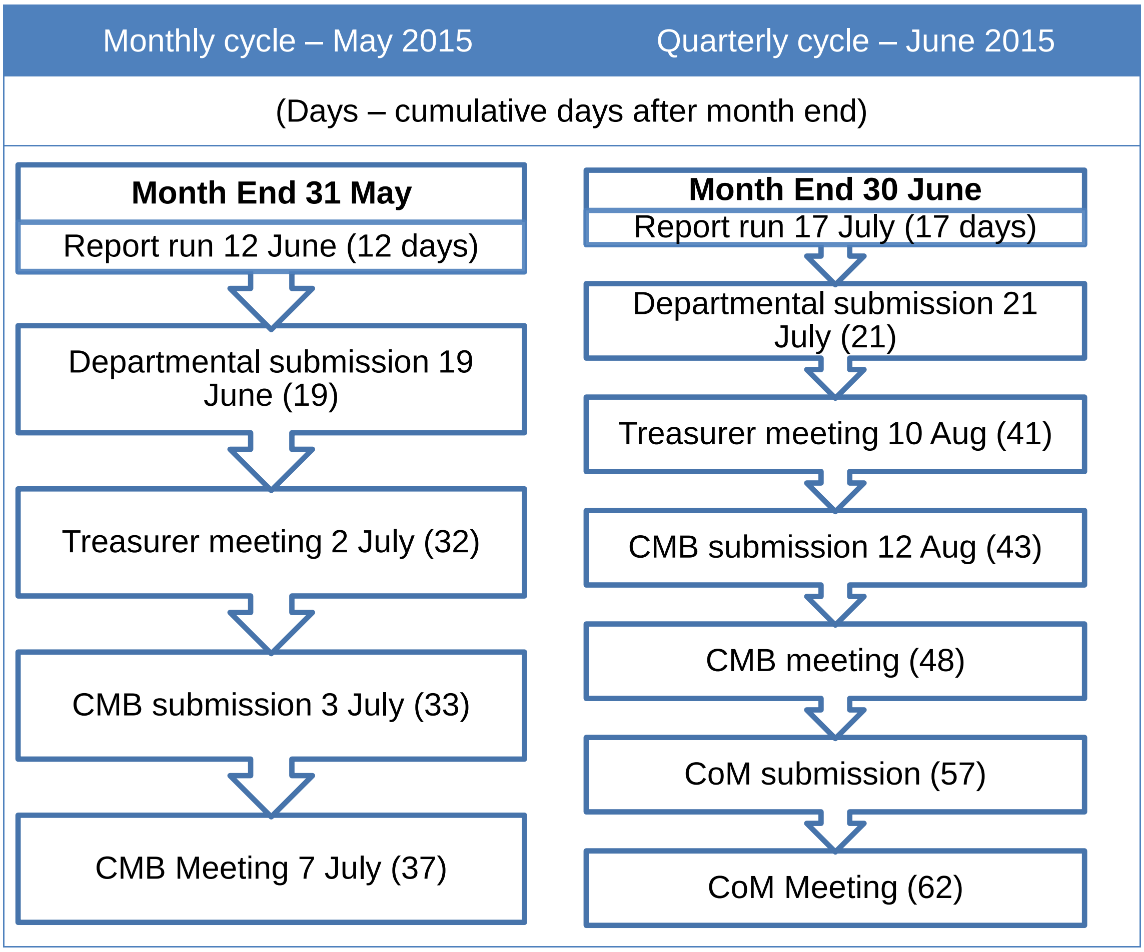
3.10 Effective financial reporting in an organisation will include preparation of timely information for budget holders, managers and other decision makers.

3.11 Budget monitoring is undertaken on two bases:

- departmental, where reporting to Ministers is required within four weeks of period end. My review did not identify any non-compliance with this requirement; and

- corporate, with departmental returns collated and reported to the CMB monthly and the Council of Ministers quarterly. The precise timetable for reporting is dictated by the timing of meetings but in Exhibit 9 I include a representative example of timetables for both monthly and quarterly reporting.

Exhibit 9: Timeline for corporate revenue reporting in May and June 2015



3.12 Timely reporting allows prompt consideration and corrective action by management. Timely corporate reporting allows consideration of performance and corrective action across an organisation. The current reporting cycle is too slow particularly at corporate level, potentially delaying corrective action.

Recommendation

R11 Reduce the time period for reporting performance against budget at both departmental and corporate level.

Openness and clarity

3.13 Reports produced for managers and budget holders should provide the relevant information necessary to monitor expenditure and income and facilitate decision making on the basis of appropriate data. Ideally, reports should provide incisive commentary on variances and integrate performance reporting to allow an operational and financial perspective.

3.14 As noted above:

- the volume of commentary in departmental reporting varies;
- at both departmental and corporate level, there is very limited integration of financial and non-financial information; and
- there is no effective integration of reporting on risk and risk mitigation through the escalation of key risks into corporate financial monitoring.

The way forward

4.1 The basic components of financial forecasting and reporting are in place and operated across the States. However, the highest performing organisations do much more to promote the best use of resources and facilitate change. To improve performance, the States should:

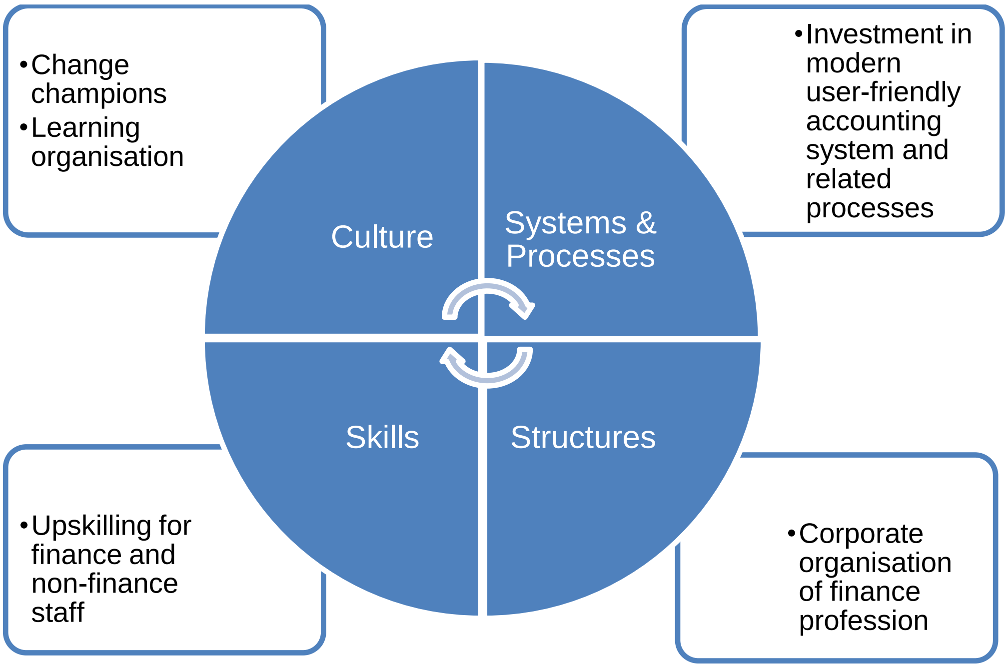
- develop the approach to corporate planning through adoption of a States-wide Corporate Plan which reflects both the States' strategic objectives (the 'whats') and the reform agenda (the 'hows');
- integrate forecasting and reporting of financial and non-financial information;
- provide the skills and tools for non-financial managers to assume greater responsibility for financial management; and
- adopt considerably more ambitious timetables for departmental and corporate reporting.

4.2 Having now undertaken two reviews of financial management – and a review of Financial Directions – I have identified substantial changes that I believe are necessary in the financial management of the States and made recommendations accordingly.

4.3 But implementing those recommendations in isolation is not sufficient. The imperative for these is strengthened by the States' projected revenue shortfall and its commitment to reform. Good financial management is pivotal to securing sustainable savings with the minimum impact on the public.

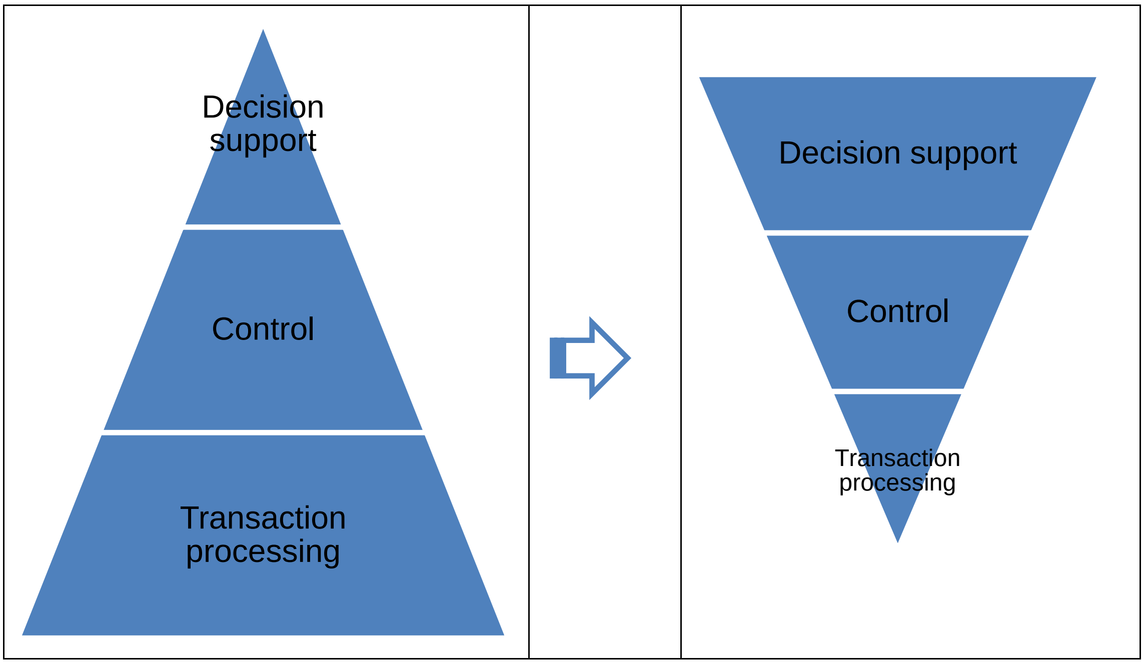
4.4 My work has identified key levers for securing the necessary change. Action is needed across the board to secure the necessary change – in systems (both the technology and the processes), structures, skills and culture. And addressing other elements, such as systems, without tackling culture, would not secure the changes required (see Exhibit 10).

Exhibit 10: Securing change in financial management



4.5 The best performing finance functions have shifted their focus. They spend less time on transaction processing and on the routine control activities. This is achieved through investment in systems, changes to organisation and processes and strengthening the financial management skills of non-financial managers. They shift their focus to spending more time on supporting managers in making decisions – through, for example, option appraisals and cost benefit analysis – making a vital contribution to driving efficiency and effectiveness (see Exhibit 11).

Exhibit 11: Shifting the balance of the finance function



4.6 Fundamental action and change is required on a broad front to secure the improvements in financial management that are needed to support change within the States. There are recognised models that the States could adopt to assist it in doing so such as:

- the financial management model prepared by the Chartered Institute of Public Finance and Accountancy; or
- the financial maturity model prepared by the UK National Audit Office.

Recommendation

R12 Carry out a fundamental review of the finance function across the States and, based on its results, adopt and implement a change programme.

Appendix 1: Summary of recommendations

Financial monitoring and forecasting

R1 Develop a States-wide Corporate Plan as a bridge between Strategic Priorities, the Medium Term Financial Plan and departmental business plans.

R2 Develop a consistent framework for departmental business plans that:

- links departmental objectives to Strategic Priorities;
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Financial and performance reporting

R8 Develop a common core of monitoring information to be used across the States, including integration of financial and non-financial information, risks and risk mitigation.

R9 Adopt a structured approach to consulting users on the information needed to monitor performance against corporate and departmental priorities and revise reporting in light of consultation responses.

R10 Refocus the work of the Finance Advisory Board and Finance Managers Reporting Group to include driving good practice and change across the States.

R11 Reduce the time period for reporting performance against budget at both departmental and corporate level.

The way forward

R12 Carry out a fundamental review of the finance function across the States and, based on its results, adopt and implement a change programme.

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