PUBLIC FINANCES (JERSEY) LAW 2005

A REVIEW IN THE LIGHT OF EXPERIENCE

FEBRUARY 2010

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INTRODUCTION

1. This paper is the outcome of a review of the provisions of the Public Finances (Jersey) Law 2005 (the 2005 Law) in the light of practical experience.

2. The 2005 Law represented a major revision of the legal framework for the finances of the States to take account of experience of the Public Finances (administration) (Jersey) Law 1967, (the 1967 Law) and to take account of the reforms associated with the introduction of ministerial government. The 2005 Law has now been in effect for more than four years and it is appropriate to consider the practical experience of its effect and whether its operation can be improved either by amendment or by adjustment of practice.

3. In preparing this paper, I have been mindful of the observations which I made in the Review of Financial Management in the States which I published in June 2009. In that review, I identified a number of challenges which the States must face in ensuring that financial management is of the highest quality. The framework for financial management set by the 2005 Law is one of the factors that determine the quality of that financial management.

4. This review has consisted of:

   (1) An analysis of the findings of the various reports that I have published since my appointment in 2005;

   (2) An analysis of evidence given in public hearings of the Public Accounts Committee;

   (3) Discussions with Chief Officers and others concerning the discharge of their responsibilities under the Law; and

   (4) Discussions with staff of the Treasury and Resources Department (T&R) including discussions concerning the re-structuring plan which is currently being considered.

5. However, the review has not included consideration of all those detailed changes that may prove necessary to amend the 2005 Law in consequence of the introduction of GAAP[1] based accounting principles: a change in practice which is now well advanced.

6. The outcome of this review is set out in this paper by reference to a number of key subjects. In each case, the way in which the issues are resolved may take a number of different practical forms. It is more important that the issues are deal with that any particular prescription should be followed. I have therefore couched my proposals as questions for consideration rather than as precise proposals. The principal subjects I have considered are as follows:

   (1) Framework for financial management and accountability;

   (2) The Treasurer of the States;

   (3) Financial management;

   (4) Expenditure control; and

   (5) States trading operations.

7. Each of these subjects is considered in turn in the following sections of this paper.

[1] GAAP: Generally Accepted Accounting Principles: the body of rules which governs financial reporting by private sector companies and organisations.

FRAMEWORK FOR FINANCIAL MANAGEMENT AND ACCOUNTABILITY

Introduction

8. The 2005 Law provides the framework within which the States' financial affairs are managed.

9. As such, it is important that the framework establishes appropriate principles to underlie the conduct of management as a basis for public confidence that the States' financial affairs are well managed.

2005 Law

10. In essence[2], the 2005 Law provides that:

(1) Annual estimates are approved by the States Assembly on the basis of a proposition of the Treasury Minister;

(2) Funds may then be drawn from the Consolidated Fund by individual departments in accordance with the approved estimates;

(3) The funds are entrusted to the care of each department's Accounting Officer;

(4) The Accounting Officer is personally responsible for ensuring that the funds are spent in accordance with the approved estimates and the 2005 Law;

(5) The Treasurer of the States is responsible for ensuring that the States' financial affairs are managed in a professional manner providing guidance on the way in which the States' financial affairs should be managed and thus on the way in which Accounting Officers should discharge their responsibilities;

[2] The provisions of the 2005 Law are rather more complicated than this introductory description suggests. In particular, the States Assembly's approval of annual estimates is subject to powers granted to Ministers to vary detailed estimates in the course of a year. Some of the complications are discussed later in this paper.

(6) At the end of each year, each department's Accounting Officer is required to report personally on the department's expenditure and on compliance with best financial management practice;

(7) The Treasurer of the States (who is also the Accounting Officer for T&R) is required to prepare annual accounts for the States as a whole; and

(8) The accounts for the States are audited according to arrangements made by the Comptroller & Auditor General who reports to the States.

(9) The States Assembly then reviews these accounts and reports and in this work is led by the Public Accounts Committee.

11. Article 37(1) of the 2005 Law provides that the Chief Officer of a States funded body[3] is also its Accounting Officer. Article 37(2) provides that the Minister may appoint an additional accounting officer for a States funded body. The functions of Accounting Officers are set out in detail in Article 38.

Background

12. The framework established by the 2005 Law is based on the practice of central government in London[4].

13. This practice is markedly different from the practice within local government. Whereas central government practice recognises a degree of independence between departments with consistency of purpose and administration where appropriate being achieved by other, notably political, means, local government practice treats local authorities rather more as integrated organisations.

14. Each local authority is required to make arrangements for the proper administration of their financial affairs and should appoint a single officer (the Section 151 Officer) to take

[3] A states funded body is defined by the 2005 Law as: a Ministry or department established by the States, a committee established by an Act of the States, the holder of a Crown or States appointment funded by the States together with any related establishment: article 1 of the 2005 Law.

[4] This practice is described in 'Managing Public Money' published by HM Treasury. The document can be downloaded from: www.hm-treasury.gov.uk/psr_mpm_index.htm

responsibility for the administration of those affairs[5]. The Section 151 Officer is usually the local authority's treasurer and must be a qualified accountant belonging to one of the recognised chartered accountancy bodies[6]. The Section 151 Officer is also referred to as the Chief Finance Officer[7].

15. The Section 151 Officer has a number of statutory duties including a duty to report any unlawful financial activity involving the authority, (past, present or proposed)[8] or failure to set or keep to a balanced budget[9]. The Section 151 Officer also has a number of statutory powers in order to allow this role to be carried out.[10]

Practical experience

16. Some aspects of the 2005 Law's reforms have worked well. In particular, the emphasis upon the personal responsibility of Accounting Officers for managing expenditure and money allocated to their departments has demonstrably focussed their attention.

17. Other aspects of the reforms have been less successful:

(1) There appear to be weaknesses in the arrangements for central financial management[11];

(2) There appear to be weaknesses in the mechanisms which should ensure that Accounting Officers comply with common financial management standards;

(3) There is some concern over the States' ability to control expenditure within the 2005 Law framework;

(4) The general framework for financial accountability may not have made adequate provision for quasi-commercial activities; and

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5 Section 151 of the Local Government Act 1972 (the 1972 Act).
6 Section 113 of the Local Government Finance Act 1988 (the 1988 Act).
7 Section 114(1) of the 1998 Act.
8 Section 114(2) of the 1988 Act.
9 Section 114(3) of the 1988 Act.
10 An indication of the responsibilities of Section 151 Officers is given by the extracts from the Financial Framework created by a mainland authority that are set out in Appendix One.
11 These were indicated in my review published in June 2009 and are not repeated here.

(5) There is some concern that the 2005 Law is too prescriptive in terms of the internal management of the States.

18. In addition, the framework has encountered a series of practical difficulties. For example:

(1) The amounts for which some Accounting Officers are responsible are small (e.g. the Official Analyst) so that the Accounting Officer in question does not have the resources necessary to provide internal financial support.[12]

(2) In practice, Accounting Officers do not publish complete annual reports and accounts (although they are required to prepare full Business Plans for each period).[13]

(3) Whereas in London the accounts and reports prepared by each Accounting Officer are subject to a separate report by independent auditors (the National Audit Office), in Jersey this has proved impracticable (and would probably be very expensive).

(4) There is no separate Accounting Officer for the Jersey Police whose expenditure is therefore the responsibility of the Chief Officer of the Home Affairs Department even though the Chief of Police is independent of the Department.[14]

19. Some of these problems result from the way in which the framework created by the 2005 Law has been understood and implemented in practice. Others result from the provisions of the Law.

Possible developments

20. Technically it would be possible to adopt a framework more closely allied to that applied within local government in England: centralising financial responsibility under a single official (i.e. the section 151 Officer). The States of Jersey are a large organisation within the island's

[12] In practice such support is provided by staff of T&R.

[13] Summary accounts and brief report statements for most Accounting Officers are included in the annual report and accounts published by T&R.

[14] This impasse has been partially resolved by the agreement of a Memorandum of Understanding between the Chief Officer of the Home Affairs Department and the Chief of Police. Other services for which the Department is also responsible (e.g. the Fire Service) are also operationally independent but fall within the performance management of the Department.

context but objectively are smaller than many local authorities within England. In straightforward practical terms, ignoring all other considerations, central financial responsibility would be feasible. This would offer the advantage of improving central financial disciplines and avoiding some costs associated with smaller departments having their own financial responsibilities.

21. There is a difficulty, however. Whilst such an arrangement may be practically possible, it does not match the way in which general management responsibility is discharged. Departments are accountable to their Ministers and to this extent are not subject to central management and control. Coherent and integrated policy-making depends in large part upon negotiation and agreement between Departments. A pure system of central financial management would be inconsistent with this framework.

22. In this paper, I have therefore adopted the following approach:

(1) The arrangement by which an Accounting Officer is appointed for each States funded body should continue because this both reflects the reality that Departments are to some extent accountable to their Ministers and preserves the useful emphasis on the Chief Officer's personal accountability for the financial affairs of his or her Department.

(2) Where experience shows that the responsibilities of Accounting Officers need clarification, then this should be provided.

(3) Accounting Officers should be expected and explicitly required to discharge their responsibilities within disciplines prescribed by the Treasurer and those with central responsibility for financial management. Where experience suggests that the existing law needs reinforcement to achieve this, then this also should be provided.

(4) The Treasurer should be expected and required to maintain an oversight of financial management practices to ensure that they meet the standards

prescribed and that prompt action is taken to correct any instances in which proper standards have not been observed. [15]

[15] These provisions should be supported in practice by an expectation that Departmental Finance Directors should report to the Treasurer any instances in which Financial Directions have been contravened and any instances in which the use of resources has not delivered good value for money. The Treasurer's duty to oversee the standards of financial management should then lead to an investigation of such matters with a view to resolving matters with the relevant Accounting Officer. In the event that the Treasurer could not reach such a resolution, it would be necessary to consult others including, for example, the Council of Ministers and the Comptroller & Auditor General.

THE POSITION OF THE TREASURER

Introduction

23. The position of the Treasurer is central to many aspects of the 2005 Law and to the provisions concerning financial management and expenditure control in particular. In this Section of the paper, I will review a number of aspects of the Treasurer's responsibilities

The Treasurer's responsibilities

2005 Law

24. Article 28(3) provides that it is the responsibility of the Treasurer to ensure the proper stewardship and administration of the public finances of Jersey, and, in particular:

> *"(a) to set financial standards for their administration and for monitoring compliance with those standards;*
>
> *(b) to ensure that professional practices are adhered to in their administration;*
>
> *(c) to advise on the key strategic controls that are necessary to secure their sound financial management; and*
>
> *(d) to ensure that financial information is available to enable accurate and timely monitoring of their administration,*
>
> *and to advise on the appropriation and budget process for each financial year".*

Practical experience

25. The structure of Article 28 invites the reader to infer that the detailed responsibilities which are listed indicate the most significant elements of the Treasurer's role. If this is the case, there are at least weaknesses in the list of responsibilities:

    (1) The introductory sentence of the Article requires the Treasurer to ensure the proper administration of the public finances of Jersey. It is difficult to see how this could be done unless the Treasurer is also responsible for ensuring that 'the

key strategic controls necessary to secure sound financial management are implemented. However, Article 28(3)(a) provides that the Treasurer is only responsible for advising on such controls thus implying that the Treasurer is not responsible for ensuring that they are implemented.

(2) Being responsible for the proper administration of the public finances of Jersey would normally be thought to imply ensuring that departments are managing their expenditure within the limits approved by the States Assembly (on the basis of estimates provided by the departments themselves), yet Article 28(3)(a)-(d) does not mention this at all and Article 28(3)(d) may be taken to imply that the Treasurer's responsibility is limited to the provision of information about expenditure rather than the monitoring of expenditure. While individual Accounting Officers have responsibility for managing their Departments' expenditure within levels approved by the States Assembly. It is not clear how the Treasurer can ensure proper administration of the public finances of Jersey (as required by Article 28) unless the performance of Accounting Officers in this respect is monitored.

26. This omission seems odd since the 2005 Law empowers the Treasury Minister to make decisions and make orders which have the effect of managing the overall spending totals. One would have expected that the Minister would not make such decisions without advice and that this advice would come from the most senior official of the department for which the Minister is responsible: the Treasury and Resources Department: i.e. the Treasurer.

27. If the Treasurer is not the person responsible for monitoring expenditure control, it is not clear who has the responsibility. At least, it is clear that the 2005 Law does not refer to anyone else who might be thought to have responsibility and that appears to be a significant weakness in the 2005 Law. It is unsatisfactory that the 2005 Law is precise in its description of Departmental responsibilities but silent on States-wide control and responsibilities.

28. It should also be made clear that the responsibility for monitoring overall expenditure limits extends to capital as well as revenue expenditure.

Practical experience: Setting financial management standards

29. Although Article 28 provides that the Treasurer is responsible for setting financial management standards, the Article does not specify how this should be done or how these standards and any related guidance should be promulgated within the States.

30. The only power to issue guidance is contained within Article 34 which deals with Financial Directions. The strengths and weaknesses of that power are analysed in the appropriate section of this paper.

31. In practice there is a need for standards of financial management within the States to be set and promulgated in the most effective manner possible. This should be an express responsibility of the Treasurer.

32. However, the Treasurer should be given the freedom to decide how best that guidance should be provided. One of the weaknesses of the power to issue Financial Directions is that, perhaps because they are recognised in public law, these documents have become formal documents which invite a legalistic reading. They may not therefore be the best means to encourage the highest standards of financial management.

Financial framework

33. The law which applies to local authorities in England obliges them to make provision for the proper management of their financial affairs and to appoint an officer who should be responsible for financial management,

34. Typically, local authorities would then establish a financial framework identifying all those financial management functions which must be discharged to ensure that the highest standards are achieved and identifying the officials who are to be responsible for each individual function. The Section 151 Officer would have a key responsibility for establishing the framework and maintaining it.

35. No such framework exists within the States. To ensure that all necessary functions are discharged, there may be advantage in creating a framework for the States. This is likely to demonstrate that a number of central functions have not been properly resourced or

discharged[16]. Any such framework will involve a consideration of how these functions are to be resourced and discharged. For example, it will involve consideration of whether a single person acting as Treasurer can effectively discharge all of the responsibilities of central financial management as well as all of the other responsibilities allocated to the Treasurer by the 2005 Law.

36. If such a framework were to be developed, it would best be established as a working rather than a legal document aimed at establishing appropriate conduct.

Section 151 responsibilities

37. In an earlier section of this paper, I have referred to the responsibilities of section 151 Officer within England's local government law. Two specific obligations imposed on the Section 151 Officer have no parallel within the 2005 Law:

(1) a duty to report unlawful expenditure, a loss or deficiency or an unlawful item of account as a result of the exercise of executive functions; and

(2) a duty to report a failure to set or keep a balanced budget.

38. It may be appropriate to consider adding these two duties to the responsibilities of the Treasurer. Their effect is likely to be not a plethora of reports to the States but a strengthening of the Treasurer's position in insisting upon proper financial management and prudent financial planning. In each case, it would be appropriate for such reports to be made to the States Assembly.

Issues

39. Should a comprehensive financial framework be created to augment the 2005 Law and demonstrate how the functions necessary to sustain effective financial management are to be discharged and by whom?

16 As indicated by the review of financial management which I published in June 2009.

FINANCIAL MANAGEMENT

Introduction

40. In this Section of the paper, I will review a number of aspects of the 2005 Law’s provisions concerning financial management including:

(1) Accounting Officers;

(2) Financial management standards for the States; and

(3) Compliance with financial management standards.

Accounting Officers

Provision

41. Article 37(1) provides that the Chief Officer of a States Funded Body is also its Accounting Officer.

42. Article 37 (2) provides that the Minister may appoint an additional accounting officers for a States Funded Body.

43. The functions of Accounting Officers are set out in Article 38.

Practical experience

44. The appointment of an Accounting Officer was a crucial element in the 2005 Law's reform of the States' financial management because it imposed upon Accounting Officers personal accountability for the management of the resources of their departments.

45. In practice, the focus of responsibility appears to have concentrated attention upon the importance of financial management; but, in a number of cases, it is arguable that the change has not been appropriate because it has imposed an unreasonable burden upon small departments. These include:

(1) The Office of the Dean of Jersey (2009 allocation: £22,000): included because the holders of certain offices are defined as States Funded Bodies; and

(2) The Data Protection Commission (2009 allocation: £224,000).

46. Ministerial Decision MD-TR-2007-0057[17] proposed that Non-Ministerial Departments could be merged although only for the purposes of the 2005 Law to relieve this burden. This proposal appears artificial.

47. Any proposal to ease the burden on small Departments should not attempt to create new administrative arrangements and should build upon the links that already exist.

48. One approach to this issue may be that:

(1) Where a small Department is concerned (e.g. a department with an annual allocation of less than £1 million);

(2) With the agreement of the Department's Chief Officer;

(3) The Minister shall use the power provided by Article 37(2) to appoint someone other than the Chief Officer to be Accounting Officer; and

(4) That person shall be the Treasurer.'°

Issue

49. Should a simplified structure be found for financial accountability for smaller States funded bodies?

Financial management standards for the States

2005 Law

50. The Treasurer has the responsibility to set financial management standards for the administration of the public finances of Jersey[18], and in practice this has been done by way of the issue of Financial Directions.

Background to the 2005 Law

17 A Ministerial Decision of the Treasury Minister approving suggestions for amendments to the 2005 Law.
18 Article 28(3).

51. Financial Directions were introduced by the 2005 Law[19] to replace what had been known as the Code of Directions. The predecessor legislation provided that:

> *"The Treasurer of the States shall prepare a code comprising such directions and information as appear to him to be necessary for the supervision of the administration of this Law and of the public finances of the Island and specifying any matters required by this Law to be so specified. "*[20]

52. Thus it can be seen that the measures introduced by the 2005 Law made three changes:

(1) Under the 1967 Law (as amended) financial directions were issued by the Treasurer on his own authority. Under the 2005 Law, financial directions are issued by the Treasurer with the approval of the Minister[21].

(2) Under the 1967 Law (as amended) the Treasurer was obliged to prepare a code of directions. Under the 2005 Law, the Treasurer has the power to issue financial directions but not the obligation.

(3) Under the 1967 Law (as amended) the obligation was to issue a code of directions comprising directions which seem to the Treasurer necessary for supervision of the administration of the 1967 Law. Under the 2005 Law, the directions which may be issued are those which appear necessary or expedient.

Practical experience

53. There is a practical need for guidance on the accounting and financial management procedures to be applied throughout the States. This guidance should be as simple and straightforward as possible to avoid needless bureaucracy and ensure compliance. The guidance should also be comprehensive.

54. The changes introduced by the 2005 Law do not appear to have assisted the Treasurer in providing such guidance.

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[19] Article 34.
[20] Inserted by the Public Finances (Administration)(Amendment No 5)(Jersey) Law 1991 (the 1991 Law) as Article 27 (later 37) of the 1967 Law. Before amendment by the 1991 Law, the 1967 Law provided that such a code of directions could be issued by the Finance Committee.
[21] Article 34(1).

55. Firstly, there seems little need in practice for the internal financial management guidance of the States to be approved by a Minister especially as there was no preceding requirement for approval of such guidance by a committee: such a requirement having been abolished in 1991. One consequence of such an approval process has been that directions are written in a style that is unduly formal and is not consistent with the simple practical style that is required. In turn, this contributes to the persistent failure to secure compliance with Financial Directions.

56. Secondly, the removal of an obligation to provide guidance (as under the 1967 Law) is unfortunate as the provision of guidance is a practical necessity.

57. Thirdly, the removal of the obligation to prepare a code (being replaced by a power to prepare individual directions) is unfortunate. It permits the Treasurer not to issue comprehensive guidance on financial management within the States whereas one would have expected that in practice the States require comprehensive guidance on how the States' financial affairs should be managed.

58. In practice, it is clear that the financial guidance which has been provided to the States is not comprehensive and is not in easily accessible language.

Issues

59. Should these weaknesses in the current arrangements be removed?

60. Would it be more helpful in practice if the Treasurer were to be given the responsibility to ensure that appropriate guidance is provided but the freedom to decide the precise form in which that guidance should be made available?

Compliance with financial management standards

2005 Law

61. Although the 2005 Law empowers the Treasurer to issue Financial Directions, it does not require that Accounting Officers shall comply with those Financial Directions.

Practical experience

62. Unsurprisingly, the effect of this provision is that cases of non-compliance have continued. Indeed, it can be seen from the Statement on Internal Control published with the annual accounts of the States of Jersey that the States do not consider that the States have a single system of internal control that applies to all Departments, but have parallel Departmental systems of internal control.

63. This also is unfortunate since it militates against effective overall control of the States' financial affairs and in particular of spending.

64. This lacuna should be resolved by amending Article 38 to oblige Accounting Officers to comply with Financial Directions. Alternatively, if the status of Financial Directions were to be re-considered, Accounting Officers should be obliged to follow the guidance issued by the Treasurer, whatever form that guidance may take.

65. This would have a further beneficial effect. It would ensure that individual departments have an interest in ensuring that Financial Directions (or guidance in any other form) are properly written to take account of their own individual circumstances. At present, departments are able to introduce without impunity local procedures which may involve some degree of non-compliance with Financial Directions. For example, certain aspects of the arrangements for delegated financial management within schools do not comply with the requirements of the States' Financial Directions.[22]

66. It follows that a greater expectation that all Departments should comply with the States overall requirements for financial management should lead to all Departments being more serious about ensuring that the States' rules are generally applicable so that there are few cases of non-compliance and about ensuring that guidance is made readily available in easily accessible language.

67. The effect of such a change would be to achieve the balance between central and departmental management that I explained in an earlier section of this paper. Departments should be accountable for the way in which money allocated to them has been applied, but

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[22] This is not to imply that the arrangements within schools are necessarily inappropriate. The point is that it is unsatisfactory in principle for Departments to believe that it is acceptable to devise their own practices which they know stand outside the normal requirements of the States.

Departments should authorise, control and record the use of resources according to practices specified centrally and applied throughout the States.

Issue

68. Should Accounting Officers be obliged to comply with Financial Directions (or other guidance) issued in accordance with the 2005 Law?

Disagreements

Practical experience

69. It is possible that, from time to time, an Accounting Officer may consider that a Minister wishes a course of action to be pursued that the Accounting Officer regards as unwise. Where this occurs, the Accounting Officer may also consider that it is not possible to reconcile the proposed course of action with the responsibility imposed on Accounting Officers by the 2005 Law.

70. In most cases, of course, such conflicts can be resolved by discussion, but in practice this may occasionally prove impossible. The 2005 Law does not explicitly specify how such disagreements may be resolved although it does confer on the Treasurer the responsibility for ensuring the proper stewardship of the public finances of Jersey[23]. This may be thought to imply that in cases of disagreement it may be appropriate to refer the matter to the Treasurer[24].

71. The process which should be adopted in these circumstances may be a matter best dealt with in the form of guidance issued by the Treasurer for Accounting Officers rather than in the 2005 Law. However the guidance is provided, it is important that the Treasurer should actively oversee the financial management standards of the States and ensure that advice is readily available to Accounting Officers when problems are encountered.

[23] Article 28(3).

[24] The practice that would be adopted in central government in London which would normally be used as helpful guidance within the States is as follows: "*Where an Accounting Officer of a government department considers that a Minister is contemplating a course of action that would be likely to infringe financial propriety or regularity, or the Accounting Officer's wider responsibilities for economy, efficiency and effectiveness, it is the duty of the Accounting Officer to so advise the Minister. If that advice is then overruled the Accounting Officer will be required to seek a written Direction from the Minister to enable that action to be carried out. If such a Direction is issued by the Minister, the Accounting Officer must comply with it but must also notify the Treasury and pass the relevant documents to the Comptroller and Auditor General as soon as possible.*"

Issues

72. Should the guidance issued by the Treasurer for Accounting Officers be reviewed to ensure that it is appropriate?

EXPENDITURE CONTROL

Introduction

73. In this Section, I will consider a number of issues relating to the structure of expenditure control prescribed by the 2005 Law including:

    (1) The preparation of estimates;

    (2) Amendments to expenditure approvals;

    (3) Permitted variations of expenditure approvals; and

    (4) Variations of supplementary expenditure approvals.

Preparation of estimates

2005 Law

74. Article 8 provides that the Minister shall call for estimates of States expenditure in any year and provides that when calling for estimates the minister must specify "the detail and form in which the estimates are to be provided:"

75. In practice, the Minister has consistently required that the estimates to be provided by States bodies including departments are to be extremely detailed and in the form of a budget for the year concerned.

Practical experience: detailed estimates

76. In practice, the effect of the Minister's requirement that the estimates are to be provided to him in the form of detailed budgets when coupled with the States' Assembly's timing constraints is that each Department prepares its budget for any financial year at the beginning of the previous financial year. In other words, detailed Departmental budgets are prepared almost a year before the beginning of the year to which they relate.

77. Preparation of budgets at such an early stage is unfortunate. During a year, many administrative changes in the structure of Departments may be made. The result is that

budgets which are prepared early require revision (and are revised) frequently to match these administrative changes. Each revision and transfer of budgets tends to reduce the effectiveness of the budgeting process as a control because departments take advantage of budgets transfers as opportunities to debate the true cost to be transferred.[25]

78. In practice, it is also unnecessary. The purpose of the estimates is to provide a basis on which the States Assembly can approve the allocation of funds to each States body for the ensuing year. Although the Assembly needs to be assured that in due course detailed budgets will be prepared as a matter of prudent financial management, approval of the overall allocation of funds could occur without them.

79. Estimates could be prepared and submitted to the States on the basis of:

(1) Each department's current spending;

(2) As affected by expected rates of inflation;

(3) Modified by expected changes in policy and service provision (e.g. closure or extension of services such as the extension of nursery education provision, amendment of administrative procedures such as changes to the planning appeals process, the coming into effect of new legislation and the occupation of new buildings[26]); and

(4) Reduced by targeted efficiency and other savings.

80. Such an approach would have the advantage of enabling the States Assembly to concentrate its attention on decisions about the principal changes contemplated and on overall levels of spending. Budgeting would then become the process by which Chief Officers ensure that the spending by departments does not exceed the spending allocations approved by the States.

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25 Evidence of this was provided to the Public Accounts Committee by the director responsible for Jersey Property Holdings in describing the process by which budgets allegedly related to property maintenance were or were not fully transferred to JPH on its creation. One consequence of the extent to which estimates are varied is that it is difficult to compare actual expenditure with budgets or previous years when the States' accounts are published.

26 It is a commonplace that the States' estimation process does not always provide adequately for the revenue consequences of the occupation of new buildings either through running costs or additional maintenance.

Practical experience: period covered by estimates

81. In practice, the Business Plan published each year by the States includes estimates not only for the immediately following financial year but also for three or four years following that year. The effect is to create the impression that expenditure is being forecast by the States for a four or five year period.

82. In practice this is not the case.

83. The estimates included in the Business Plan published annually are in fact projections rather than forecasts in the sense that they are calculated by the use of general percentages to reflect assumed inflation. They do not in any way take account of expected changes in policy or the planned introduction (or termination) of services. Moreover, Chief Officers do not appear to regard spending totals for periods beyond the first year covered by a Business Plan as being commitments to which they will be held.

84. This is unfortunate since many management decisions may affect many periods and may take years to implement. It is a practice that encourages short term decision making which ignores the effect of a decision upon subsequent periods and that inhibits longer term planning of services and management.

85. Change of this practice requires a change in behaviour and a change of the law. It would require the Treasury and Resources Minister to propose each year that the spending totals shown for Years 2-5 covered by a Business Plan should be regarded as the approved totals for those years subject to amendment in a subsequent Business Plan. It would also require the Council of Ministers and Chief Officers individually and as members of the Corporate Management Board to act accordingly. As resources become more limited, this change in practice and behaviour will become more important.

86. The difficulties caused by premature preparation of budgets could be avoided if the Minister were to specify that the estimates to be provided for the purpose of the business plan were not to be in such detail and that Departmental budgets should be prepared in the autumn of each year after the States have approved the Business Plan.

87. Moreover, the Business Plan spending totals for Years 2-5 should be approved formally by the States. In subsequent years, the Minister would be expected to submit estimates in accordance with the previously approved spending plans.

88. If this practice were to be effective, I understand that a change in the law may well be required.

89. Even though the States regularly approve Business Plans which include spending plans for more than one year, the 2005 Law only allows the States to agree formally the next year's spending. The effect is that any previous decisions about spending levels can be ignored. Thus, if it were to be generally accepted that public expenditure plans should be drawn up and approved on a triennial basis, it would be desirable to amend the 2005 Law to ensure that the approvals would then be regarded as binding on the States.

90. One practical consequence of such a change would be that the States would necessarily take more seriously the preparation of medium term expenditure estimates (whereas in the past these have been relatively simple projections). In particular, the medium term estimates should take account of foreseeable changes in expenditure flowing, for example, from new legislation or from the occupation of a new building.

Issues

91. Should the preparation of estimates be revised as suggested?

Amendment of expenditure approvals

2005 Law

92. Article 11(8) provides that:

> *" . . . the States may, at any time, amend an expenditure approval on a proposition lodged by the Minister on the grounds that –*
>
> *(a) there is an urgent need for expenditure; and*
>
> *(b) no expenditure approval is available".*

Practical experience

93. The practical consequence of this provision is that, having made a decision on the overall spending that should be approved for any year, the States may subsequently vary the total amount of spending approved for that year.

94. As a principle, such a provision cannot be objectionable. It must be possible that circumstances arise in which the overall spending total approved by the States requires reconsideration and the Public Finances Law should provide for such an eventuality.

95. However, this reasonable provision contains within it the risk that decisions on overall spending (as opposed to decisions about allocation of funds within approved overall spending limits) become pointless because they are subsequently varied too readily by decisions made using the procedure provided by Article 11(8).

96. This risk is heightened by the way in which the business plan is prepared. No provision is made in business plans for:

(1) Unforeseen expenditure (e.g. expenditure that becomes necessary in respect of enquiries commissioned in respect of events during a year); or for

(2) Variations in expenditure which cannot readily be controlled by a Chief Officer (e.g. variations in the States' contribution to the Social Security funds which is determined by economic factors or variations in court and case costs which are determined by legal decisions in response to events during a year).

97. Since it is likely that unforeseen expenditure will arise and it is known that certain costs cannot be managed easily within forecast totals the decision not to make provision within a business plan for such matters is problematic.

98. Consideration should therefore be given to the means by which provision for such variations in cost is made in business plans. One means by which this could be achieved would be the inclusion within each business plan of a provision for such costs. Purely for the sake of an example, this might be set at 1% or 2% of the total amount of Net Revenue Expenditure proposed for the year. This provision would then be available for allocation during a year by the Treasury & Resources Minister to meet unforeseen calls upon resources.

99. If such a provision were to be included within business plans, then it might be appropriate to consider amending Article 11(8) of the Public Finances Law so that the procedure for approval of 'urgent' expenditure may only be used in respect of expenditure which exceeds the percentage applied in creating the provision for unforeseen costs. [27]

Issue

100. Should the States' spending plans include such provisions?

Permitted variations to expenditure approvals

2005 Law

101. Article 15(1)(a) empowers the Minister to authorise variations in expenditure approvals at any time.

102. Article 15(1)(b) permits the withdrawal of funds after the end of a financial year.

Practical experience

103. There is a strong case for there being a power to vary expenditure approvals during a year. However, these powers have also been used by Ministers to vary expenditure approvals after the end of financial years so that over-spending (i.e. expenditure in excess of that approved by the States) by one Department is covered retrospectively by an excess approval (i.e. under-spending) by another Department.

104. There seems little justification for the existence of a power that permits departments to frustrate the intentions of the States. After all, Accounting Officers are not permitted by the 2005 Law to authorise spending that exceeds the approval given by the States. Thus, if, after the end of a financial year, the Minister uses the power granted by Article 15(1)(a) to cover a Department's over-spending, it must necessarily be the case that the Department's Accounting Officer has already breached the 2005 Law. It is not clear why the Law should permit a Minister to cover a breach of the Law.

[27] Currently such a provision would be in the order of £5-12 million.

105. Indeed, if a breach of the 2005 Law has occurred and a Department has over-spent its budget, it might be thought desirable that this should be evident to the States so that the Accounting Officer may be called to account for this breach.

106. In any case, the need should not normally arise. Assuming that the States has implemented proper financial accounting systems and proper expenditure control arrangements (as required by the 2005 Law) the possibility that a department may over-spend should be evident well before the end of a financial year. Once this becomes apparent, it should be possible for the Minister on the advice of the Treasurer to use his powers (during the financial year) either to use a contingency provision to cover the over-spending or to make transfer funds from another approved head of expenditure. If these approaches are not adequate, it remains possible for a request to be made to the States for a supplementary approval.

107. In other words, assuming that the States have proper management accounting systems, retrospective approvals of expenditure should not be required.

108. The power to withdraw funds after the end of a financial year is also used by the States to allow Departments to carry forward unused spending approvals to a subsequent period. This practice is justified on the basis that it tends to discourage dysfunctional behaviour. Principally, it is suggested that if carry-forwards were not permitted, Departments would be encouraged to spend the whole of any expenditure approval within a financial year and, in particular, at the end of a year to find any possible means of exhausting an approval before the end of the year.

109. This argument has obvious attractions; but its practical value is limited by the fact that a Department's 'right' to carry forward an expenditure approval is not automatic in practice. Treasury Ministers have not been prepared to agree to carry forward all unused approvals (they tend to be limited to a percentage prescribed by the Minister) and have only used their power after agreement by the Council of Ministers. Thus the perverse incentive to Departments to spend all approved funds still remains as they cannot be sure that all under-spending will be carried forward.

110. Consideration should be given again to the extent to which Departments should be able to assume that un-spent approvals will be carried forward to the following period in addition to new approvals for that period.

111. Whatever conclusion is reached, the amounts of funds approved for spending and carried forward should continue to be evident in the Treasurer's Annual Report to the States.

Issue

112. Should the Minister's power to increase a Department's approved expenditure after the end of the year to which the approval relates be abolished?

113. What constraints are appropriate on the carrying forward of expenditure approvals from one period to the next?

Variations to supplementary expenditure approvals

2005 Law

114. Article 15(4) permits a States funded body (i.e. a department, Ministry or office funded by the States) to vary its revenue expenditure as approved by the States provided that it shall not draw from the Consolidated Fund any amount in excess of the total amount approved by the States.

115. No distinction is made between expenditure approved as a part of an Annual Business Plan and expenditure subject to a subsequent supplementary approval.

Practical experience

116. There is a case for permitting such variations. Budgets are prepared long before the financial year to which they relate. They are merely estimates and circumstances will certainly change. It is not unreasonable for Departments to have some freedom to vary the precise use to which resources are put within the approved total

117. This argument does not apply to supplementary approvals. They are rare in any case and are generally submitted during a year rather long in advance. Moreover, when submitted, the

practice appears to be that applications for supplementary approval are put forward on the basis of needs described in detail.

118. There thus may be a case for amending Article 15 to provide that funds withdrawn in accordance with supplementary approvals may only be used for the purposes described in the proposition or in the report accompanying the proposition[28].

Issue

119. Should Departments have the freedom, as at present, to vary the use to which supplementary funds are applied?

Special Funds

2005 Law

120. Article 3(3) empowers the States, on the proposition of the Minister to create a Special Fund for a special purpose.

Practical experience

121. In practice, the power under Article 3(3) has been used to create a number of Special Funds. Lists of these can be found in the States' Annual Accounts.

122. Expenditure by these Funds is not included in the annual Business Plan process because one of the purposes of the Business Plan is to propose and seek approval for the application of the Consolidated Fund to meet the revenue expenditure requirements of States funded bodies: i.e. not to seek approval of expenditure that is met from Special Funds[29]. There seems no good reason for this lacuna.

Issue

123. Should the Business Plan process routinely seek the approval of the States for expenditure to be met from Special Funds as well as from the Consolidated Fund?

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[28] The States Assembly imposed similar restrictions during 2009 in approving a request for supplementary approval of expenditure in respect of swine flu.

[29] Article 12

STATES TRADING OPERATIONS

Financial control

2005 Law

124. Article 25 provides that the States may designate and disparate or distinct area of operation of the States to be a States trading operation.

125. Article 26 deals with the management of such operations.

126. Article 26 (2) provides that a States trading operation shall maintain a profit and loss account and a balance sheet.

127. Article 26 (3) provides that the Minister may by order prescribe financial controls to be observed by States trading operations.

128. Article 26 (4) provides that financial directions may be issued (by the Treasurer) in respect of the financial control and administration of States trading operations.

Practical experience: financial environment

129. Although Article 26 provides that the States trading operations are to maintain profit and loss accounts and balance sheets, it is silent as to the accounting rules that are to be applied in those accounts. Since the purpose of designating States trading operations appears to be to enable the States to manage certain commercial and quasi-commercial activities in as nearly a commercial environment as possible, it is important that the financial accounts of such activities should be maintained on commercial principles.

130. This should be achieved when the States financial accounts are prepared on a GAAP basis.

131. Until that change has been achieved, the financial performance of States trading operations cannot be assessed on normal commercial grounds nor can they be compared with normal commercial activities.

132. In the event that this change in accounting basis is not implemented for some reason, it will be necessary to ensure that the States' trading funds are not subject to non-commercial accounting practices.

Practice: governance

133. Article 26 is silent on the governance arrangements for States trading operations although it provides that financial directions may be issued (by the Treasurer) in respect of the financial control and administration of States trading operations. In practice, no financial direction has been issued which sets arrangements for the proper management and administration of trading operations.

134. In other jurisdictions, one of the benefits of recognition of trading operations as envisaged by Article 25 has been that they are established under boards which include non executive directors with commercial experience.

Practice: creation of trading funds

135. The 2005 Law's provisions concerning Trading Funds have been applied to no more than four activities: Harbours, Airport, Car Parking and States' vehicles.

136. These four funds were created when the 2005 Law came into force and no further such Trading Funds have been created. It is beyond question that there are other activities undertaken by the States which would benefit from being treated as Trading Funds.

Issues

137. Should the 2005 Law be amended to provide for trading funds to be subject to appropriate governance arrangements?

138. Should the States consider which other activities should be accorded Trading Fund status?

Returns of States trading operations

2005 Law

139. Article 27(2)(b) provides that the Minister may specify:

> *" . . . the estimated minimum contribution (if any) which may be expressed by reference to a rate of return that the trading operation will be required to make to the income of the States".*

Practical experience

140. As I have indicated above, the accounting rules that currently apply to the financial accounts of States trading operations are those which apply to the States' activities generally and not those which apply to normal commercial activities. The result is that it has not been possible to specify rates of return on a basis that is consistent with normal commercial practice. In consequence, returns are set in terms of cash that should be returned to the States' Treasury without information about the Return on Capital Employed which a fund achieves.[30]

141. The result of this is that required returns may be either unreasonably high or low.

Issue

142. Should the required returns for Trading Funds be set on a commercial basis?

[30] Although the change in the States' accounting rules is necessary to permit the change in the way in which required returns are set, the accomplishment of the change in rules would not necessarily entail a change in the way in which required returns are set.

APPENDIX ONE ≈ RESPONSIBILITIES OF A SECTION 151 OFFICER

The following extracts are taken from the Financial Framework of Bournemouth Council as an example of the way in which a substantial authority discharges its obligations under the Local Government Act to make arrangements for the proper administration of their financial affairs.

The Section 151 Officer is responsible for:

(1) Advising on corporate risk profiling and management, including the safeguarding of assets, the avoidance of risk and the provision of appropriate insurance cover;

(2) Advising on effective systems of internal control;

(3) Ensuring that there is an effective system of internal control including signing the authority's published statement on internal financial control in line;

(4) Ensuring that financial management arrangements are sound and effective;

(5) Ensuring a prudential financial framework is in place, including ensuring that budget calculations are robust and reserves adequate;

(6) Ensuring that any partnership arrangements (or other innovative structures for service delivery) are underpinned by clear and well document internal financial controls;

(7) Securing effective arrangements for prudential borrowing, treasury management, pension and trust funds, including ensuring compliance;

(8) Ensuring that there is effective internal audit function and assisting management in providing effective arrangements for financial security;

(9) Advising on anti fraud and anti corruption strategies and measures;

(10) Securing effective systems of financial administration; and

(11) Ensuring that statutory and other accounts and associated claims and returns in respect of grants are prepared including certifying that the annual statement of accounts presents fairly the financial position and transactions of the authority.

As far as financial management standards are concerned the Section 151 Officer is subject to the following provisions:

(1) Section 151 of the Local Government Act 1972 requires the Authority to appoint a suitably qualified officer responsible for the proper administration of its financial affairs.

(2) A legal duty to submit a section 114 report on unlawful expenditure, a loss or deficiency or an unlawful item of account as a result of the exercise of executive functions, to the executive, and must send copies of the report to every member of the authority, the external auditor and the mayor.

(3) Personal responsibility for the stewardship and safeguarding of public money and for demonstrating that high standards of probity exist.

(4) Duty to report inappropriate financial management as well as wrongdoing.

(5) Accountable to the Council and the appropriate Accountancy Body through the relevant disciplinary procedures for the maintenance of proper financial standards.

(6) Accountable to the Council Taxpayer and other residents for the maintenance of proper financial standards.

(7) Maintaining a continuous review of the Financial Framework and submitting any additions or changes necessary to the Cabinet for Council approval.