FINANCIAL MANAGEMENT IN THE STATES

REVIEW

JUNE 2009

Introduction

1. This paper has been prepared to accompany and to provide a basis for a paper that is in preparation and which will review practical experience of the operation of the Public Finances (Jersey) Law 2005.

2. Whilst that paper will review the legislative framework within which the finances of the States are managed, the purpose of this paper is to set out some ideas on the States' need for financial management and ways in which current financial management practice in the States should develop. The paper proceeds in three stages:

   (1) What are the key aspects of financial management?

   (2) What should be the role of a central finance department?

   (3) What should be the role of central financial management within the States?

3. This paper sets out a series of personal views. In the end, matters of structure and allocation of responsibilities are matters for the judgement and decision of the senior management of the States subject to the oversight of the States Assembly. There is no single answer which must indubitably be correct. The approach which is adopted in any organisation will respond to senior management's assessment and balancing of the various factors and influences in play within the organisation.

4. Having said that, effective financial management is of critical importance in a period of limited resources. In such times, allocating resources efficiently to achieve the greatest benefit and managing resources to achieve the greatest value lie at the heart of political debate. Improvements in financial management thus lie at the heart of government and are not a peripheral matter.

Financial management

5. There are a number of key aspects of financial management[1]:

[1] This analysis is based on material in 'World Class Financial Management, a discussion paper published by the Audit Commission in 2005.'

(1) Financial governance and leadership;

(2) Financial planning;

(3) Finance for decision making;

(4) Financial monitoring and forecasting; and

(5) Financial reporting.

6. These individual aspects of financial management are reasonably clear and do not need further description here. The obvious point is that management goes beyond the simple keeping of records and provision of financial information as a basis for decision making. It follows that successful financial management should involve all of the senior management of an organisation and cannot be achieved by delegating all financial responsibility to a finance department or to a single officer.

7. Indeed, since some of these activities are central to political debate, most senior managers will perforce be involved in them even if they do not recognise them as being elements of financial management.

Role of central finance departments

8. There are perhaps three different types of role which can be adopted by central finance departments[2]:

(1) Managing stewardship:

which involves an emphasis on control, probity, meeting regulatory requirements and accountability.

(2) Supporting performance:

in which the finance department is responsive to customers, and committed to improving the performance of the organisation overall.

(3) Enabling transformation:

[2] This analysis is based on the Financial Management Model developed and published by CIPFA.

in which the department becomes strategic and is more orientated on the future of the overall organisation and becomes proactive in managing change and risk being outcome focused and receptive to new ideas.

9. Traditionally, finance departments have concentrated on the first of these roles but there has been a tendency to move away from this type of role for two principal reasons:

(1) Information technology

The development of modern information technology has greatly simplified the mechanical business of keeping financial records and ensuring proper accountability. In a well ordered and disciplined framework, the process can become unproblematic. Importantly, by appropriate use of available technology, it is possible to provide financial information directly to line managers in a flexible manner which enables them freedom to interrogate the data flexibly. It is however a condition of achieving this result that the organisation is disciplined so that financial information is captured and stored consistently.

(2) Limitation of resources

The growing financial pressure on all parts of the public sector because of limitation of the available resources has strengthened the need for the careful management of resources and for strategic change in public sector organisations to maximise the value achieved by use of resources.

10. In many public sector organisations, these trends have led to a reassessment of the role of the central finance department. The fact that collection of data has become less problematic coupled with the prime need to maximise the efficient use of resources and to contemplate radical cultural change has in many places led to this re-assessment.

11. In many places finance departments are subsumed within resource departments or strategic planning departments. There is no intrinsic reason why the record keeper should also be responsible for strategic financial planning or financially inspired strategic change. Equally, there is no reason why the person responsible for strategic financial planning should be an accountant.

Implications for the States

12. Within the States, the Treasury and Resources Department (the T&R Department) has for a long time been one of the pivotal departments. This is reflected in the Public Finances (Jersey) Law 2005 which gives to the Treasurer of the States a key role in supporting the Treasury and Resources Minister in financial planning but also in managing the financial control functions of the States.[3]

13. However, there are respects in which financial management in the States has been slow to develop beyond basic record keeping. Even though there has been some recent development, this does not obscure the fact that:

(1) the States have been very slow to take full advantage of the available technology to ensure that information is available flexibly and unproblematically. The means by which this could be done were acquired by the States some years ago in the form of a JD Edwards system. Only belatedly have serious attempts been made to take full advantage of its functionality.

(2) in particular, the States has not developed the extent of discipline necessary to ensure that the JD Edwards system can provide reliable information to enable States wide decisions. Put in another way, the T&R Department has not yet been effective in encouraging that discipline.

(3) the T&R Department has not sought to develop the finance function as an agent for change. This is clear from the limitations of the number and aptitudes of the staff which the T&R Department believed were necessary for the Department to function effectively.[4]

(4) As an example, for the States as a whole, the time horizon for most financial planning is the end of the next financial year which is too short in a time when many decisions affect periods many years away and when culture change programmes may take a number of years to take effect.

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[3] These issues are considered in a review of the Public Finances (Jersey) Law 2005 which is being published in company with this paper.

[4] It is clear from oral evidence given over several years by the Treasurer of the States to the Public Accounts Committee that in his view the Treasurer is responsible for making information available to the States and that others were responsible for interpreting and acting on that information. In other words, the Department's view had not progressed beyond the first level of financial management.

14. It has to be remembered that this position has reflected the preferences of many departments and politicians. For example, the lack of discipline in financial recording has assisted departments in obscuring their cost profiles and this has been regarded by some as convenient.

15. But I have long believed that improving the efficiency and effectiveness of the States requires an improvement in financial management. I have also long believed that it is inevitable that increasing public expectations of the range and quality of public services may outstrip the resources available to provide those services. When that point arrives, the under-developed state of financial management in the States will be a strategic weakness.

16. In my view, the T&R Department has been facing a choice. It either remains with a traditional stance that its role is to provide information and little else or it seeks to develop a more pro-active role encouraging longer term planning and engaging in the change process that will inevitably flow from that.

17. Each approach has implications for the longer term position of the States. The former approach will lead to a re-assessment of the formerly pivotal role of the T&R Department. The economic and financial pressure will not be denied. A decision by the T&R Department not to develop a more strategic role will leave a vacuum. This will in the end be filled by others: *because it will have to be.*

18. This is not a new point. I am here echoing the arguments that flowed from the transformation exercise some years ago. At that time, the consultants advised on the need for and the benefits of a finance function that developed from a concentration on record-keeping to the provision of more strategic support. The States generally failed to find a way of moving towards that vision.

19. It is also clear that the law's existing framework for central financial management has not led to the timely provision of the service that the States require.

20. 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".

21. If this paper's observations on the States' financial management are appropriate, then the adequacy and effectiveness of this Article must be questioned.

22. The steps which I think that central financial management in the States should consider would include improving basic financial recording and report production; and preparing to adopt a more supportive and strategic role. This would involve the central financial management team to be able to deal with subjects such as:

(1) development and monitoring of effective internal controls;

(2) management of investments;

(3) realisation of proper returns from strategic investments;

(4) financial forecasting;

(5) project evaluation and appraisal;

(6) treasury management;

(7) policy development and appraisal;

(8) risk assessment and management; and

(9) forensic accounting.

23. For example, that might involve the following:

(1) Acceptance that senior management of the States has a responsibility to lead professional financial management on a States-wide basis.

(2) Revision of the internal control framework of the States to develop the discipline necessary to ensure that the financial data provided by the JD Edwards system is reliable without interpretation. That improvement can be achieved using the JD Edwards is evident from the work that the Deputy Treasurer has done on the annual accounts and is now being extended to interim management reporting.

(3) Requiring the development of the behaviours necessary to develop discipline (such as emphasis on internal audit, insistence on implementation of recommendations,).

(4) Ensuring that central financial management is as professional as possible in all its functions. This will for example require the T&R Department to review all its functions and to plan how each should be improved. One obvious candidate for improvement include is treasury management. It is no longer acceptable for the States' liquid resources not be managed on an integrated basis.

(5) Development of medium term financial planning. At present, the Public Finances (Jersey) Law 2005 does not allocate responsibility for overall expenditure control and medium term planning. Indeed, the Treasurer has maintained that the Treasurer's responsibility is to provide financial information on the basis of which expenditure can be controlled. This does not seem sustainable in practice. Successful change will require central financial management to understand the drivers of costs for each of the States functions and to plan the trend of expenditure under various conditions. The point is to set spending levels intelligently and to enable, for example, the T&R Department's expenditure planners to challenge Chief Officers[5] effectively on the assumptions underlying their expenditure plans.

24. Some steps require changes in personnel but all are likely to require an increase in the number and aptitudes of staff. These should be permanent positions since the skills required are fundamental to sustainable and professional financial management. It may be possible to use out-sourced staff as an interim measure but this would not be a permanent solution. It would be easier to out-source the basic record-keeping than the functions that are critical to decision support.

[5] Unless the central management team is able to challenge departmental knowledge of cost drivers there is to little chance of sensible engagement over spending control. If such challenge is impossible, all that can be done is to invite departments to propose spending reductions and, if that fails, to impose reductions. Although this may be a crude means of achieving a result, it is not a way of maximising value.

25. I realise that this may not be easy to achieve in a period of financial stringency. Achievement of this may be assisted by more explicitly grouping the existing financial team in the States under the Department as was originally proposed in the transformation programme.

26. However, in addition, all of these steps require changes in behaviour as much as changes in staff. The changes in behaviour are at least as significant.

Implications for States action

27. It is not the principal purpose of this paper to make recommendations. However, a number of actions follow from the discussion in this paper:

(1) assess the state of financial management in the States;

(2) design an appropriate framework for central financial management, including the allocation of responsibilities between the T&R Department and other key officers, as financial management is a shared responsibility; and

(3) consider the implementation of this framework requires amendment to whether the Public Finances (Jersey) Law 2005.

28. This latter point will be considered in my forthcoming paper reviewing experience of that law in practice.