Briefing Paper

Financial Governance

August 2010

Introduction

This briefing paper looks at the ways in which a public organisation can organise itself to carry out Budgeting and Financial Management effectively. It includes consideration of embedding Financial Management skills in Government; the Manifesto of the Chartered Institute of Public Finance and Accountancy; Financial Governance arrangements; the roles of Members, Managers and Accountants; Devolved Financial Management; Financial Information Systems and Critical Success Factors.

Embedding Financial Management Skills in Government;

In February 2008 the Treasury's Financial Skills Advisory Panel published 'Doing the Business: Embedding Financial Management Skills in Government'. According to this report:

"Good Financial Management is like fresh air, exercise and a healthy diet. Organisations need it every day to stay fit and to live a full and active life.

"The very best organisations have understood this need and taken steps to develop financial management skills throughout their operations so that every business decision is underpinned by a proper understanding of its financial implications.

"In Government Departments… there is lots of scope for further progress and improvement in this area. Focusing on the professionalisation of the finance function has been a very logical place to begin to strengthen financial management capacity but increasingly Departments now need to promote and develop stronger skills and awareness at Board level and throughout the management structures of the organisation.

"These are significant challenges, however. Embedding really strong financial skills throughout large, complex organisations takes time and commitment. In return, the benefits are potentially huge. At the end of the journey we envisage high performing organisations which are confidently led, focused on delivering excellent results and passionate about maximising value for taxpayers' money.

"So we should not make the mistake of regarding good financial management as the province of technocrats. Rather, we should see it as the toolkit of leaders and managers who want to improve their organisations and make a real difference to the functions and services they deliver."

The Financial Skills Advisory Panel consulted widely as part of preparing their report and Adrian Waite was one of the 62 respondents.

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In central government, financial management skills has been earmarked for significant improvement under the Professional Skills for Government (PSG) agenda and the Finance Transformation programme led by the Treasury. The improvement of financial management skills has also been identified as an important priority in many local authorities, health trusts, housing associations, police authorities and other public bodies.

The Financial Skills Advisory Panel looked especially at central government identified eleven challenges and the benefits that would result from addressing them that are relevant to good financial management in all public sector organisations:

- The need to raise levels of financial awareness within Government Departments, including at Board Level – This would result in more robust business planning decision making and performance resulting in improved services and more consistent delivery.
- The need to better understand the role of, and make best use of, the Chief Financial Officer – This would result in the Permanent Secretary and the Board being better supported in developing and delivering long term strategy and better able to manage shifts in policy direction and to ensure effective delivery.
- At Board level, a reluctance to challenge in relation to high level finance matters – Addressing this would create a more robust process of constructive challenge leading to better and more informed decision making and improved governance.
- The tendency to emphasise new policy developments and service delivery at the expense of, or with little regard for, financial control – This would lead to resources being better matched to service need and efficiency gains being delivered.
- The reluctance and failure to prioritise, to stop some activities in order to create headroom and release resources for new initiatives – This would result in resources being focused on todays and tomorrow's priorities and realistic work programmes that can be delivered within budget.
- The need to strengthen fundamental disciplines such as month-end procedures and forecasting and ensure that these are sufficiently robust to cope with, for example, machinery of government changes – This would result in better management, mitigation of risk and improved value for money.
- The need to broaden the focus and understanding of the numbers which matter within the business to include, for example, fundamental cost drivers and comparative unit costs – This would result in better management and greater financial accountability at operational level.
- The need to ensure that the finance function is positioned as an accessible advisory/support service which can help the organisation conduct its business more effectively and deliver better results – This would result in reliable performance management information that would enable better operational management and early remedial action to address under performance.
- The need to identify and access best practice in other organisations and to import it effectively into Departments – This would result in the avoidance of the wasteful reinvention of solutions which are proven. There would be a growth of a culture of continuous improvement and learning.
- The need to overcome difficulties concerning the recruitment and retention of high quality finance professionals – This would result in increased capability, capacity and continuity within the organisation to manage resources, set strategy, plan and monitor performance and achieve objectives.

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- The need to develop business leadership, engagement, communications and listening skills amongst finance professionals who are technically competent in their own specialist areas but need to develop and strengthen engagement skills to be effective in the wider organisation – This would result in increased effectiveness in working corporately. Finance skills would be drawn more effectively and more routinely into decision making.

The Financial Skills Advisory Panel concluded that:

"While the finance team is an obvious starting point in any drive to improve financial management skills, it is important that the change programme also addresses the need to develop financial competence and capability in the organisation's non-financial leaders and managers. Indeed, if organisations are really serious about embedding financial management skills and disciplines it is absolutely critical to engage Board members and general / service / business managers throughout the business.

"Financial skills equip managers with the ability to evaluate the short, medium and long term resource implications of different courses of action. This in turn increases levels of ownership of spending decisions, ensures tighter control of financial resources and encourages better decision making. In Government, the best courses of action will generally be those which best demonstrate economy, efficiency and effectiveness over the long term and which therefore offer best value for money."

The Financial Skills Advisory Panel identified ten steps to success:
- Act now to kick start good financial management skills in your organisation
- Ensure finance is at the heart of developing your vision and business strategy
- Start rolling out and embedding good financial management across your business today.
- Invest in people development and training needs analysis.
- Remember the importance of communication and engagement skills.
- Keep it fresh and current.
- Reward and celebrate good financial management and tackle poor financial management.
- Start taking active steps to develop stronger leadership skills within your business's finance function
- Keep it simple.
- Temper ambition with realism. Recognise that becoming world class takes time.

The Financial Skills Advisory Panel considers that organisations should scan the business environment for early signals of forthcoming changes. They should ensure that forecasting and budgeting are robust disciplines within the business and that they are used rigorously and dispassionately to model the organisation's financial future. It is also important to ensure that these processes are efficient and effective. They must engage sufficient management time to ensure ownership but they must not take so much time that they distract management from other key responsibilities.

It is also considered that organisations should ensure that work on business planning and strategy is informed by strong financial analysis and awareness. Where possible different options should be subject to detailed financial modelling to ensure that the full implications of a preferred option are understood compared to alternative approaches.

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Organisations should also ensure that they have established clear performance indicators for each of the objectives set for the organisation, team or individual. Targets should include clear statements about expected service and financial performance. As well as delivering agreed outputs within budgeted resources, targets may often refer to the underlying cost drivers of the business, focusing on defined efficiency or productivity improvements.

The Chartered Institute of Public Finance and Accountancy Manifesto

The Chartered Institute of Public Finance and Accountancy (CIPFA) have recently published their manifesto outlining their ideas for change within our democracy ahead of the expected General Election in 2010. The CIPFA manifesto aims to give free and open ideas of what the government should do, do better and stop doing.

Within this manifesto CIPFA have outlined some of the challenges that face whichever party wins the forthcoming election. These challenges include; learning the lessons of the global financial crisis and ensuring that they are effectively addressed, managing the economy and ensuring that recovery is both swift and sustainable, implementing a medium and long term strategy to restore the public finances to good health and responding to the crisis of confidence arising from the MP's expenses scandal and regaining public trust in the country's politicians.

An important part of the CIPFA manifesto focuses on the fundamental question of how we are governed and how the public's money is managed and controlled. It seems that unless such a question is openly resolved in full view to the public then any change of government and political players will leave the accountability, trust, and confidence within our democratic system (all aspects that we want to see) remaining elusive.

CIPFA have outlined 42 recommendations that aim to explore the ways in which the United Kingdom can be under a system of better governance and financial management to support the delivery of better public services.

The belief of CIPFA is that establishing a culture of good financial management is also vital to the success of the party that wins the next General election and to the success of the country in ending the recession. Better financial information, rigorously complied and routinely published – to support the decisions taken by Ministers, Departments and all types of public service organisations seems to be the way forward for government.

CIPFA considers that all too frequently important decisions appear to be taken casually, as though they are cost-free or because costs can be accommodated within existing budgets. In no way does this demonstrate that these decisions constitute value for money or good use of taxpayers' resources. Recommendations 26-31 attempt to address this problem.

Recommendations 26-31 suggest that good financial management should start in Parliament where all legislation should be fully costed. It should also be a powerful influence on the cultures of all public bodies, it being said within the manifesto; "Good financial management should be in the bloodstream of organisations from the boardroom at the centre to the most distant front-line outpost".

Politicians and public servants alike should be driven by the aims of delivering excellent service, meeting real needs and securing the best possible value for the taxpayers' money and as CIPFA suggest they should be constantly testing performance by rigorous benchmarking, questioning and seeking ways to improve productivity and ways to save money in all aspects of the organisation's activities.

The role of the Chief Financial Officer is also considered by CIPFA suggesting that he or she must be a key member of the leadership team in all public services organisations, helping it to deliver and implement strategy and to resource and deliver the organisations objectives sustainably and in the public interest.

The manifesto goes on to say he or she must be actively involved in and able to bring influence to bear on all material business decisions to ensure that they are consistent with the organisation's financial strategy and that immediate and long term implications, opportunities and risks are fully considered. Critically, the Chief Financial Officer must lead the promotion and delivery of good financial management by the whole organisation, so that public money is safeguarded and used appropriately, economically, efficiently and effectively at all times.

Capturing real efficiency and productivity gains is another issue that CIPFA have looked at and made reference to in their manifesto of reforms. Taxpayers are naturally enthusiastic about public service efficiency but they are also sceptical of claims of huge efficiency savings, especially if their personal experiences are of rising taxation and charges.

The public need to be able to see clearly not only how much has been saved by a particular initiative but crucially, how those resources are being used. Are they being used to reduce taxes or charges for example or to create a new higher quality service.

Recommendations 32 and 33 address these questions and how CIPFA feel they should be resolved. Within the recommendations CIPFA suggest that explicit signposting in the published budgets and annual reports of public bodies would help. Further to this they say organisations should be expecting efficiency savings which are not captured and explained in the budget in terms of future use to be regarded with a high degree of scepticism.

The information that is given is also critically important for better decision making. Where initiatives have been taken, often involving upfront investment to improve productivity, organisations must be systematic and rigorous in measuring the change in performance that is actually achieved and comparing that result with the assumptions made in the business case that justified the investment.

Financial Governance

Public organisations have budget and policy framework procedure rules that will typically be part of their constitution and will cover the following aspects of financial governance:

- Framework for Executive Decisions
- Decisions outside budget or policy framework
- Urgent decisions outside the budget or policy framework
- Virement
- In-year changes to policy framework
- Call-in of decisions outside the budget or policy framework

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Financial Management, Financial Control and Audit are distinct aspects of Financial Governance:

- Financial Management concerns establishing the framework in which financial decisions are to be taken.
    - Financial Regulations provide a set of rules that govern the financial management of the organisation.
    - Standing Orders provide a set of rules that govern how contracts are to be let.
- Financial Control concerns taking decisions about the allocation of resources (budgets) and then ensuring that expenditure and income is matched to those budgets (budgetary control). Financial Information Systems are required to ensure that this happens.
- Audit is provided by an in-house team and by external auditors. The role of the auditor is principally to ensure that robust financial processes are in place. There is a section on audit in the chapter on Financial Management.

Financial Regulations will typically cover:

- Financial Management
- Financial Planning
- Risk Management and the Control of Resources
- Financial Systems and Procedures
- External arrangements

Financial Regulations will typically oblige Managers to comply with accounting guidance provided by the Chief Financial Officer and to supply the Chief Financial Officer with information when required.

Financial Regulations will typically oblige Managers to do the following in relation to Budgetary Control:

- Maintain budgetary control within their Directorates, in accordance with an appropriate framework of budgetary management and to ensure that all income and expenditure are properly recorded and accounted for.
- Ensure that an accountable budget manager is identified for each item of income and expenditure under the control of the Manager (grouped together in a series of cost centres). As a general principle, budget responsibility should be aligned as closely as possible to the decision-making that commits expenditure.
- Ensure that spending remains within the service’s overall cash limit, and that individual budget heads are not overspent, by monitoring the budget and taking appropriate corrective action where significant variations from the approved budget are forecast.

Financial Regulations provide for how virement can be carried out. In one Local Authority the rules of virement are as follows:

- Directors may exercise virement on budgets under their control for amounts up to £35,000 on any budget head during the year. Prior authorisation is required from the Director of Corporate Services together with completion of the formal virement request form.
- Amounts greater than £35,000 require the approval of the executive following a joint report by the Director of Corporate Services and the Director, which must specify the proposed expenditure and the source of funding, and must explain the implications in the current and future financial years. Amounts greater then £70,000 require the approval of Council.

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The Treatment of Year-end Balances is another matter that is covered in Financial Regulations. In one Local Authority Year-end balances are treated as follows:

- Any overspending on service estimates in total on budgets under the control of the Director must be carried forward to the following year, and will constitute the first call on service estimates in the following year, unless the Council subsequently determines otherwise by way of a supplementary estimate. The Director of Corporate Services will report the extent of overspending carried forward to the Executive and to the Council.
- Net under spending on service estimates under the control of the Director may be carried forward, subject to:
    - The authorisation of the Director of Corporate Services where the expenditure is committed and the use of the resource is restricted to the purpose the budget was originally provided for.
    - Reporting to the Executive, Corporate Resources Overview and Scrutiny Committee and Council the request for carry forward where the use of the resource is intended to be used for a purpose not as originally intended.

Roles of Members, Managers and Accountants

The roles of Members (of Councils or Boards), Managers and Accountants in the Budgetary and Financial Management process can be summarised as follows:

- Members
    - Approve budgets in line with political priorities
    - Monitor Financial Performance
- Managers
    - Manage services within approved budgets
- Accountants
    - Provide Financial Advice and Information
    - Responsible for 'Proper Financial Administration'

Managers' responsibilities with respect to budgets should include:

- Consultation on the budget format
- Ensuring that budget estimates reflect agreed service plans and are prepared in line with guidance
- Control of income and expenditure

Managers' responsibilities with respect to budgetary control should include:

- Controlling Income and Expenditure
- Monitoring performance
- Taking account of financial information provided
- Reporting to the Executive/Board on variances
- Taking action to avoid exceeding budget allocation

The Financial Skills Advisory Panel considers that the following are pre-requisites for success:

For a Board:

- Recognise Financial Management as a Strategic Enabler within the organisation
- Sponsor Transformation and Capacity Building rather than short-term fixes
- Lead by example by demonstrating good financial management at the Board

For the Business (Non-Financial Managers):

- Promote the Benefits which better Financial Management will bring to the Organisation

- Invest in Skills Development
- Reflect appropriate Financial Management Measures in Performance Targets

For the Finance Department:

- Engage and Pro-actively support the Business
- Get behind the numbers rather than simply report them.
- Aim to deliver excellence and to add real value to the organisation and its decision making.

It is considered that following the ten steps recommended by the Financial Skills Advisory Panel will lead to organisations operating and doing business in a different way:

"The Board will have a stronger grip on the business and a more confident, assertive view of how it wants the Department to develop and improve. It will be recognised to be leading and driving the change agenda.

"Management will have a clearer view of what it needs to deliver. It will have a stronger sense of being in control of the business, understanding and having its finger on the financial pulse of the organisation. It will work closely with the Chief Financial Officer and the finance team and will rely upon and derive confidence from their advice and support. It will be passionate about value for money and about continuous improvement of performance and results.

"The Finance Department will be fully engaged with the business at all levels. It will be passionate about helping the organisation to manage its affairs well and to deliver the best possible outputs and outcomes from available resources. It will be committed to meeting the needs and exceeding the expectations of customers – delivering the right information and advice at the right time to enable leaders and managers to steer the organisation effectively and to make the right decisions."

Devolved Financial Management

Devolved Financial Management is now considered to be good practice. This involves devolving responsibility for Financial Management to the lowest appropriate level in the management structure. In particular it involves:

- Aligning financial and management responsibilities so that the person who manages the resources is in control of the relevant finance and accountable for it.
- Single budget holders being responsible for each budget.
- Budget holders only being accountable for what they control. Budget holders should not be held accountable for an account in which other managers can authorise expenditure.
- Clear roles for budget holders, management team and Treasurer. These roles are usually defined in Financial Regulations or schemes of delegation.

The Audit Commission has suggested that budget holders should have the following budgetary responsibilities:

- Budget holders should be involved in the budget setting process. They should understand how each line in the budget has been calculated and should be participants in determining those budgets.
- Budgets should be subject to review by senior officers so that each level of management has an appropriate role in setting the budget.
- Each capital and revenue budget should be assigned to the individual manager best able to use and control it.

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- Relevant non-financial and financial information, in addition to the budget, should be reported to and used by senior officers. This will ensure that the budget is set in the context of all relevant information.
- There should be a line of professional accountability between those with principal functional responsibility for finance within business groups and the chief finance officer to ensure compliance with professional standards and objectivity of advice on financial matters.
- All appropriate staff should be given relevant training and guidance to enable them to take responsibility for managing risk within their own working environment. Managers should not be asked to assume responsibility for budgets or financial management unless they are empowered to do this, not only through the Financial Regulations and other procedures but also through training and guidance.

The main responsibilities of a budget holder are therefore:
- Establishing a realistic budget
- Authorising expenditure
- Monitoring expenditure and income
- Managing the service within budgets
- Reporting budget variances

To carry out these responsibilities, budget holders need:
- Business Plans
- Budgets
- Accounts
- Financial Advice
- Training
- Financial Information Systems

Budget holders need to receive regular management accounts that include the following:
- Actual Income, Expenditure and Accruals
- Annual and Profiled Budget
- Variance to date
- Projections to Year End

Management accounts are considered in more detail in the section on Budgetary Control and Monitoring

Budget Guidelines will be issued annually, usually by the Executive or Board on advice of the Chief Financial Officer. These will take account of:
- Legal requirements
- Medium-term planning prospects
- Corporate Plans
- Available resources
- Spending pressures
- Best Value and other relevant government guidelines
- Other internal policy
- Cross-cutting issues

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Financial Information Systems

The Financial Skills Advisory Panel consider that:

"Financial Information Systems will have a significant influence upon the feel of financial management services within the organisation. They will also have an important bearing upon the ease with which financial management skills can be embedded throughout the organisation.

"Managers are much more likely to develop the requisite skills if they are supported by modern, well designed systems which deliver accurate, real time financial information to their desktops at the touch of a button.

"Organisations should regularly review the effectiveness of such systems and should have a clear agreed strategy for updating or replacement whether that is likely to be required in the short, medium or long term."

Critical Success Factors

The Critical Success Factors in achieving effective Budgetary Control and Financial Management are:

- Aligning Responsibilities appropriately
- Providing Incentives for Good Financial Management
- Chief Financial Officer Controlling Totals rather than Details
- Clear and Straightforward Rules including Financial Regulations, Standing Orders and Schemes of Delegation
- Virement powers being appropriately devolved
- Clear Roles for the Board/Council, Managers and Chief Financial Officer
- Good Financial and Management Information

The intention is that Budgetary and Financial Management procedures will allow the organisation to be responsive, flexible and customer orientated. This is achieved by using budgetary and financial management procedures to:

- Identify Problems and Opportunities
- Reallocate Resources
- Reconcile aspirations of managers to be independent with responsibilities of Chief Financial Officer and role of the Council/Board
    - Schemes of delegation and Virement rules

Systems for Forecast and Review are important to:

- Use Management Accounts as basis to forecast the future
- Review service management and spending plans
- Adjust budgets to reflect changing circumstances
- Maintain link between budgets and service objectives

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Conclusions

Financial Governance is achieving an increasingly high profile in both the private and public sectors. Public bodies need good systems of financial governance. Clear accountability is of critical importance. There is a need to embed good Financial Management in public authorities at all levels. Councillors and Board Members, Managers and Accountants all have important roles to play and none can carry out their roles effectively without being empowered to do them. Devolved Financial Management is seen as good practice, good Financial Management Information Systems are required and Critical Success Factors have been identified.

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