INSTITUTE OF DIRECTORS - LUNCH

SPEECH

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1. I was and am most grateful to the IOD for the invitation to speak at this lunch for it gives me the opportunity to share what some may perhaps regard as self-indulgent thoughts.

2. I have recently been reflecting on what has happened since I took on my role in the island and what contribution my office has made. It is just over six years since I took on the role and it is almost exactly six years since the then Public Accounts Committee spent a day reflecting on my first thoughts about the state of financial management in the States and the approach that the C&AG and the Committee should adopt to improving matters.

3. In that initial presentation, I pointed out that the most recent States accounts were not prepared according to normal accounting principles, the auditors had not reported, as would be common practice, that the accounts showed a true and fair view and had commented privately on the poor quality of financial information available within the States. As far as internal audit reports were concerned (where they existed) there were clear doubts about the reliability of financial reports and of the effectiveness of internal controls. The range of evidence of weakness suggested that the issues being identified were not isolated events but evidence of a weak or poor management culture.

4. I suggested to the Committee and we agreed that the issue of culture should be a priority. It is not obvious how an organization can devote itself to providing value for money unless it knows the true cost of what it is doing. We also agreed that certain types of value for money review would not be helpful until issues of culture had indeed been addressed. We then agreed the principles on which a programme of work should be based which have bee the foundation on which my work programmes have been planned: as far as planning is possible.

5. Those principles are:

   (1) encouragement of higher standards of financial management and financial reporting within the States sector;

   (2) encouragement of continual improvement in public services so that they meet the changing needs of diverse communities and provide fair access for all;

   (3) promotion of high standards of governance and accountability;

(4) stimulation of improvement in the quality of data and the use of information by decision makers; and finally

(5) challenging all public bodies to deliver better value for money.

6. To some extent I have been able to hold to a planned programme. However, in 2005 I did not anticipate, nor I think did anyone, the extent to which my time that would be taken up by a series of special or unforeseen reports. In 2006, I published a report on the organization of that year's Battle of Flowers. In 2008, I issued a report on various governance issues within the Waterfront Enterprise Board. In 2009, I reported on the management of foreign exchange risks arising from the Energy from Waste project. Now I am spending a great deal of time on the Lime Grove House project.

7. Since that time a great deal has changed. For example, the basis on which the States' accounts are prepared has changed: Generally Accepted Accounting Principles are now used subject to amendments based on United Kingdom practice to take account of the circumstances of the public sector. The 2010 accounts were the first to be prepared on this basis: a change which has removed some of the obscurity of past approaches.

8. There has also been a major programme of change within the Treasury and Resources Department to improve and discipline the process by which financial information is produced so that attention can be concentrated on financial planning and management. As a part of this, the operation of financial controls throughout the States is being strengthened.

9. All of these developments have resulted from the labours of people within the States. They are all welcome.

10. I have supported many of these changes in the reports that I have published since 2005 as you can just from the retrospective review of my reports that I will be publishing this week. You will be able judge with what effect. My view, expressed in the proposals in the Consultative Document that I published this summer is that my work should now be tilting more towards direct examination of value for money and towards comparison of levels of costs incurred within the Island compared with costs in comparable jurisdictions. Easier to say than to do.

11. So after five years of toil does all of this still matter?

12. In one sense, the answer is obvious and timeless: if one is going to take money from someone such as a taxpayer there is a moral obligation to ensure that it is properly used. In this sense, value for money still matters and always will.

13. There is another even more practical sense in which value for money matters to the Island enormously.

14. You can see this by looking at the States' most recently published accounts: those for 2010.

15. Firstly, the balance sheet is uncommonly strong. Most obviously there is almost no direct borrowing. The tangible and intangible assets amounting to £2.8 billion have all been acquired or developed from the States' own resources. Of course this does not take into account the investments held by the States amounting to £1.1 billion. In effect, each generation has been able to pass on the infrastructure that the next generation will need unencumbered by debt.

16. It is not quite this simple of course. There has been some proxy borrowing. For example, some social housing has been provided through housing trusts using bank loans (£.1 billion) which have been made possible by expressions of support from the States. Moreover, the balance sheet is overhung by the accumulated liabilities (stated at £.4 billion) of the States' staff pension funds.

17. However, generally the balance sheet is stronger than the balance sheet you would see if the States were simply a local authority on the mainland. This is entirely appropriate, of course, in the light of the differences between the risk profile of an quasi-independent jurisdiction such as Jersey and that of a mainland local authority.

18. Secondly, the States' Income Statement shows a deficit of £229 million on normal commercial accounting principles. This deficit includes a charge for the impairment of fixed assets of £145 million which may to some extent have reflected the exceptional economic conditions of 2010, but ignoring that factor still leaves a deficit of £84 million. For comparison, the revenue raised by the States in 2010 was £532 million.

19. Since the depreciation charge was £50 million, the deficit was larger than the depreciation charge. In other words, the revenue raised by the States was not sufficient to cover the even the accounting estimate of the cost of the fixed assets used by the States in 2010: it was not sufficient to meet the wear and tear to roads, sewers, sea defences, the hospital and so on. Of course, it is likely that a realistic capital programme to sustain the island's infrastructure would require annual expenditure higher than the accounting depreciation charge.

20. Reflecting this position, the cash flow statement shows that the cash outflow on operating activities was £36 million and that the fixed assets bought during the year which cost £76 million were financed by sales of investments.

21. In effect, these two statements are indicating a change in the historical process which led to the strength of the balance sheet. Whereas in the past, the States' resources have been sufficient to sustain the infrastructure without borrowing, in 2010 at least that was not the case. This picture is consistent with the growing awareness that the infrastructure needs significant investment in new roads, sea defences and so on.

22. Thirdly, it can be seen from the accounts that although this position has been exacerbated since the economic troubles of 2008, the trends that have produced it were evident before then.

23. The rate of growth in current spending has gone beyond the rate of growth of revenue. For some years, there has been a growing stress between the Island's reputation as a low tax jurisdiction and its understandable desire to maintain public services of a range and quality that would be expected of jurisdictions with much higher nominal rates of taxation. There was always a risk that the two policy objectives could not be sustained.

24. If these trends continue and the Island's infrastructure is to be maintained in good order then other means will have to be found to finance the infrastructure. It is perhaps not a coincidence that the IOD debate in September focused on Public Private Partnership Schemes. As an aside, whilst the debate was interesting, I regretted that the significance of a wider move towards borrowing or quasi-borrowing was neither noted nor explored. I also regretted that these was no discussion of the Island's risk profile. To what extent

would he Island's strategic risk be heightened by mortgaging some part of the Island's future income by borrowing or quasi-borrowing?

25. How the Island's financial position is resolved is a political issue. One choice might lead to the island becoming a very high tax jurisdiction. Another choice might lead to the Island maintaining its reputation for being a low tax jurisdiction by cutting the extent, quality and cost of public services to a level at which the infrastructure could be maintained within existing tax levels. Yet another choice might combine higher tax, expenditure reductions and perhaps borrowing in some form. As I say, these are essentially political choices which are for the Island to make and not for comment by me. In my view, however, these choices are critical to the Island's prospects for they have the potential to sustain or shift what have been long-standing foundations for the Island's trading position. It is good that the introduction of some medium term planning or forecasting (following one of my reports) may provide the platform for careful consideration of these issues.

26. However matters develop, it would be a surprise if expenditure constraint did not form a part of the chosen policy. In this, the outcome of the Comprehensive Spending Review is critical. Unfortunately, controlling expenditure is no easier in Jersey than it is in other democratic jurisdictions. Take a single example from the past. The Fundamental Spending Review of 2003 claimed to have made £35 cuts in recurring expenditure. My work demonstrated that of that total of £35 million, £28 million (80%) was achieved by dint of increasing charges or passing the expenditure to special funds such as the Criminal Offences Confiscation Fund. In short, the expenditure continued and falls back against the States whenever the fund is exhausted.

27. After years of penny pinching and cheese-paring it could not be expected that expenditure restraint on the scale that is required to make a serious difference would be achieved without reviewing fundamental questions about the activities in which the States should be engaged and the way in which they are organized. It was always likely that it would be necessary to test again long held assumptions: or example about how education in the Island should be organized.

28. This was never likely to be a pain free process. Life in the public sector is not as straightforward as it can sometimes be in the private sector. Public services are usually only introduced after hard fought campaigns. People depend upon them. People also depend upon services continuing to be available in their existing form (ask anyone who depends on a public bus service). Proposals to change or cut services or to change the way in which they are provided or the remuneration of the people who provide them are bound to face opposition. In a community of the size of the Island, this can be in your face opposition in a form that politicians and their families cannot escape.

29. But no matter how difficult the process may be, the Island would long regret a failure to achieve the objectives of the CSR for a failure would restrict the available policy options. Inevitably, either tax gathering or borrowing would have to be higher than they otherwise might be.

30. In all of this activity, my job is to attempt to ensure that in the public domain there is adequate and reliable information about the States' finances, the States' activities and their consequences. That is what I have tried to do since 2005. I intend to go on trying.