

# STRATEGIC PUBLIC FINANCE

**December 2019**

Duration: 3 hours

## **Marking Scheme**

There are **6** questions on this question paper.  
Questions 1 and 2 are 30 marks each.  
Questions 3 – 6 are 10 marks each.

Answer **all 6** questions

*Where a question asks for a specific format or style, such as a letter, report or layout of accounts, marks will be awarded for presentation and written communication. Marks will also be awarded for appropriate examples drawn from real life that demonstrate understanding and application of theory.*

# 1

## Public Service Funding - CIPFA Conference 2018

In a presentation to CIPFA conference delegates in 2018, former home secretary Charles Clarke stated that politicians need to grapple with questions of taxation and user charging if public services are to be funded sustainably. In his presentation to delegates, Clarke said government has three choices on public service funding in the current climate: to let services go into continued decline and allow private sector alternatives to rise; to raise general taxation; or to extend user charging such as road tolls or student fees. However, he argued the first option was undesirable as it ultimately led to divisions in society. 'The idea that efficiency savings can deal with the situation [of declining funds for public services] is untrue. Choices have to be made,' he said. 'Declining public services are very corrosive of our standard of living and socially divisive.'

Clarke acknowledged that increasing taxes and user charging was politically difficult. He noted that the Labour government in which he served was 'very nervous' when it elected to raise national insurance to fund the health service. '

User charging was also controversial, Clarke noted, saying ministers had stepped back from extended road charging as it was politically difficult. We need a better idea of what people are ready to spend money on and it needs to be transparent.'

It was reported in September 2019, that Edinburgh City Council is planning for Britain's first visitor levy in the form of a 'tourist tax' as seen in many other cities and countries across the world. Its proposal has divided local opinion and is creating tensions in the wider tourism industry.

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### ▪ Requirement for question 1

- (a) Briefly describe the two main objectives of charging by public service organisations. Discuss with use of examples, the desirable characteristics of such charges, and identify factors that should be considered when establishing a policy for setting fees and charges. (15 marks)
- (b) Describe briefly how stakeholders should be mapped and managed. Discuss, with reference to examples, why managing stakeholders is important when introducing or changing public service charges. (10 marks)
- (c) Discuss the pros and cons of introducing a 'tourist tax' such as a visitor levy for Edinburgh or another city with which you are familiar. (5 marks)

(5 marks)  
**(30 marks)**

# 2

## The Pension Agency Budget

The mishandling of a high-profile IT project has a public sector pensions body facing a budget gap of up to £23m over the next five years.

Auditors found the pensions agency had failed to provide a clear business case for its plan to integrate its pension administration and payment operations, which faltered when the IT company chosen to deliver the project, was unable to provide a working system. The pensions body was criticised in a report from the auditors for its failure to provide adequate scrutiny of the IT company's 'abnormally low' bid for the work and for the 'unrealistic' timeframe set for delivery of the project.

The agency, which runs retirement plans for over 500,000 people including health workers, teachers and police officers, spent £6.3m on the scheme to make its processes more efficient and to achieve long-term savings.

A further £2.4m had to be spent after the project was scrapped to extend the contracts of existing suppliers. Although the body had received £0.7m from the IT company last year following the conclusion of a legal process, the failure of the project meant it had been unable to progress its strategic, business and workforce plans as originally intended, the report found.

As a result, the agency requires capital allocations from alternative sources of £13.6m over the next five years to achieve its aims, as well as an additional £9.8m in its revenue budget to cover unrealised efficiency savings.

Auditors said the churn of personnel at the top of the agency, which has seen the appointment of multiple chief executives and senior responsible officers over the last four years, had undermined its ability to challenge the IT company at key stages of the project. The auditors said that more and more bodies were embarking on IT projects without the necessary staff and assurance arrangements in place to manage them properly. In this instance, they found no evidence of a clear business case for a new integrated system.

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### ▪ Requirement for question 2

- (a) Provide a simple explanation of the **purpose** of each of the 5 cases within the Treasury's Model. (5 marks)
- (b) Explain **what** should be included in the Financial Case, and **why** these considerations are important. (15 marks)
- (c) Describe five factors the CFO should consider when reviewing the development of a business case, and explain the scrutiny role of the CFO. (10 marks)
- (30 marks)**

**3**

- **Requirement for question 3**

Explain the difference between Performance Indicators (PIs) and Performance Measures (PMs). Discuss why PIs are sometimes favoured by organisations over PMs, using examples to support your argument.

**(10 marks)**

# 4

The Cross-Government Fraud Landscape Annual Report 2018 refers to an evidence base through data collection, loss measurement activity and policy research to better understand and estimate the scale of fraud and error loss in the UK public sector. As a result of this work, government estimates that fraud and error loss outside of the tax and welfare system cost central government between £2.7bn and £20.3bn in 2016-17. The huge range here is based on the 'iceberg' concept of known losses (the tip of the iceberg), estimated losses (extrapolation of known losses), and unknown losses.

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- **Requirement for question 4**

Discuss the role of the Chief Finance Officer in the prevention and detection of fraud. You should include examples of activities where frauds are common, and identify how these types of fraud might be detected or prevented.

***(10 marks)***

**5**

Simple forecasting can encourage organisations to focus on a narrow range of possibilities centred on a single view about the most likely future outcome. In contrast, scenario planning does not attempt to use a single series of static assumptions to predict the future.

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**Requirement for question 5**

(a) Appraise the theory that it is best to use a range of scenarios when undertaking effective scenario planning.

*(5 marks)*

(b) Discuss why scenario planning might be considered a more useful tool for public service organisations than just using traditional forecasting

*(5 marks)*

**(10 marks)**

# 6

The failure of the charity Kids Company in 2015 (a charity with gross income in excess of £1million) was blamed on poor governance and lack of proper scrutiny of its activities and finances, and the power of specific individuals at Board level.

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## **Requirement for question 6**

With reference to examples discuss,

- the different roles and responsibilities for internal and external auditors in ensuring accountability and transparency for charities
- the responsibilities of trustees
- the strategic role of the CFO where strong Board characters dominate how the organisation operates.

**(10 marks)**

**Question 1**

Syllabus A6

a)

Comments from Charles Clarke were: 'Any new taxation strategy has to prove money is well spent and efficient,'. We need a better idea of what people are ready to spend money on and it needs to be transparent.'

**Syllabus Ref A6 Workbook 11**

The main objectives for charging for public services are to generate income that relates to recovering the costs of providing that service. The charge may also be related to managing demand.

The desirable characteristics for public services where charging is an option include being:

- Affordable - in terms of sustainable service delivery and cost recovery, or affordability in terms of any subsidisation.
- Equitable – fair to users
- Competitive, but without unfair advantage through use of public money
- maintaining a service level that is acceptable (and does not lead to additional costs for reparation)

Above all else, any charging strategy must be legal – the organisations must not be prohibited by a specific law to charge for a particular service.

Charges should be:

- easily determined and calculated: the methodology should be relatively simple and straightforward and should not involve undue time and effort expended on the part of those responsible.
- equitable: public sector organisations have a responsibility to the users of services and to taxpayers. Charges which are made should be fair to all parties and should be seen to be fair.
- Transparent and understandable: in order to reinforce the fairness and encourage people to willingly pay the charges, the basis of charging should be clear to those paying the charges.
- Sufficient: that is, sufficient to meet whatever financial objectives have been set in relation to the service being provided. This may be:
  - full cost recovery
  - to limit the level of subsidy where the subsidy is a fixed amount
  - to limit demand by high pricing
- Compatible with other objectives: the charge should not be set in such



a way as to work against the meeting of other, service based objectives. It is important that the mission and purpose of the organisation is recognised clearly and that charges should not conflict with achieving them.

- Related to ability to pay: the local authority provides services that should be available to all, irrespective of ability to pay. In these cases charges should not act as a barrier preventing people from using the services.
- Cost-effective: the charges made should at least cover the administrative cost of recovering them unless there is some other motive behind charging such as encouraging responsible use.

When establishing policies for charging, guidance from the Treasury suggests that the standard approach is to start off by setting charges to recover full costs and then adjust in accordance with policy alignment. Full cost recovery is not always the case for public service organisations, as there may be other drivers or factors to consider. For example, a council may subsidise the cost of leisure centre use to encourage general health and well-being. Cost should be calculated on an accruals basis, including overheads, depreciation (e.g. for start up or improvement costs) and the cost of capital.

The charging organization should gather data on impact of the charge, periodically revisiting decision and ensuring charge (or change to it) still meets objectives.

The charging organization should also compare charges with other providers to ensure it is not anti- competitive by charging a price much lower than the market (for example for trade refuse collection services).

This approach is simply intended to make sure that the public body neither profits at the expense of consumers nor makes a loss for taxpayers to subsidise it. It requires honesty about the policy objectives and rigorous transparency in the public interest. Visas are an example where the cost of processing is far less than the charge to the customer. The fairness and equity of this charge seems challenging.

Especially when those in need of a visa have no alternative than to pay the fee. Although there could be an argument that the level of charge could discourage unwanted immigration.

When deciding the level of a charge, it is important to define:

- the range(s) of services for which a charge is to be made;
- how any categories of service are to be differentiated, if at all, in setting charges.

The standard approach for setting charges for services is that the same charge should apply to all users of a defined category of service, so recovering full costs for that category of service. Different charges may be set for objectively different categories of service that may cost different amounts to provide.

Different categories could be recognised by:

- distinguishing supply differences, for example in person, by post or online – such as applying a discount if a customer completes a transaction online that is cheaper and more automated to process
- priorities, for example where a quicker service costs more – such as a fast track passport application
- quality, for example charging more for a premium service with more features – such as dentistry with better cosmetic appearance
- recognising structural differences, where it costs more to supply some consumers – such as providing services to remote areas.

All these factors can feature in the structuring of charges for services. The Ministry of Justice charges for court appearances do vary depending on the type of case. It is argued by many legal professionals that the new regime of court charges are prohibitive for some, and are leading to less tribunals coming to the courtroom. In some respects, this might be considered a good thing, but only if it reduces vexatious cases, and not if it prevents some disadvantaged and poorer customers from obtaining justice. This goes against the desirable characteristic of charges being fair and equitable, and related to ability to pay. Some court charges are being levied on the poorest and least able to pay.

If the purpose of the charges is to 'nudge' behaviour into reducing use of public services, then this should only be done where services can be obtained elsewhere, or through different means. This is not the case for users of the justice system.

Some public sector services are however, discretionary - no statute underpins them. Services of this kind are often supplied into competitive markets, though sometimes the public sector supplier has a monopoly or other natural advantage. Charges for these services should be set at a commercial rate to deliver a

commercial return on the use of public resources deployed in supplying the service.

It is important for public suppliers of commercial services to respect competition law. Otherwise public services using resources acquired with public funds might disturb or distort the fair operation of the market, especially where the public sector provider might be in a dominant position.

Variation from the standard model of charge setting as described above can be used where delivery of the policy objective can be achieved. In central government consent to pursue this variation must be obtained from the Treasury, it is not clear from the case whether this has been done by the Ministry of Justice for court charges and the Home Office for visas.

Charging above cost is usually classified as a tax if not clearly related to a service to the charge payer. It can however, be used as a strategy to reduce or manage demand for some services. An example would be burial spaces. Many local authorities have limited supply of suitable land and therefore, use high pricing to discourage burial in favour of cremation; use differential pricing for non-residents, often doubling the cost of a burial plot if residency cannot be proven.

The congestion charge in London is an example of a fee that does not relate to a particular service. It is not specifically classified as a tax. It is a fee or levy charged under the Greater London Authority (GLA) Act 1999 and Road User Charging (Charges & Penalty Charges) (London) Regulations 2001. The Act gives the Mayor of London a general duty to develop and implement policies to promote and encourage safe, integrated, efficient and economic transport facilities and services to, from and within London.

Parking charges are a political topic, with pressure groups such as the RAC Foundation raising queries about the high level of charges in some areas, and the huge revenues being generated by some councils. Councils will argue, that charging for parking is used to manage behaviour and demand. The political argument regarding what the surplus income is used for has been in the news for a number of years. If councils are not actively using these surpluses to fund traffic management schemes or other transport projects, then there may be significant reserves being accumulated. We define that charges should be transparent and understandable. It is likely that pressure will continue from stakeholders to obtain information on what

services or activities any additional income has been used for.

**Up to 2 marks for describing objectives. Up to 8 marks for discussing desirable characteristics with examples and reference to the case, up to 5 marks for identifying factors when setting fees and charges**

**(Max 15 marks)**

b)

**Syllabus ref A6**

Public sector charging is a complex area that is often trying to meet multiple objectives at the same time. Organisations will have to make choices about which objectives they wish to deliver through their charging policies. They must also balance the views of various stakeholders regarding which services should be charged for (and hence the level of charge deemed acceptable), and which services should be subsidised, either fully or in part, by taxpayers.

Culturally, UK citizens are familiar with receiving many public services free at the point of use and are less used to paying for them so have minimal knowledge of the true cost of some services. When planning any introduction of charges or changes to existing services it is critical to know who will be affected and by how much. We can do this by mapping the service users and other stakeholders. This helps us manage their expectations and minimise problems and complaints later on.

Stakeholder mapping includes:

- identifying key groups of current and potential customers for the services being provided
- analysing them by gaining an understanding of their perspectives, power and interests
- mapping their relationships to your objectives and to other stakeholders
- ranking and prioritising their relative needs and issues.

Once stakeholder mapping has been undertaken, stakeholder management techniques vary by each group depending on their power and interest.

Although the main focus of the question is on those stakeholders receiving the charge, it should be recognised that stakeholders could include a wide array of internal and external interests and not just those who may be receiving the charge. Stakeholder groups could include:

- Service users (individuals and businesses etc.)
- Elected members
- Grant funding bodies
- Other public bodies (that may be directly or indirectly affected by the charges)

The most effective way to manage expectations of service users with high power and / or interest is to ensure they are engaged in any process of change and that they are properly consulted.

It is critical that those affected by changes to charges understand the reasons for charges, and are satisfied that the charges are necessary, fair and justified. The stakeholder engagement activities, including taking into account the views of stakeholders helps to deal with problems and resistance at an early stage.

It is also important to demonstrate good leadership and people management skills when undertaking stakeholder engagement activities, to ensure they are properly understood, and that the process is managed in a fair and equitable way to record all views and comments in a standard format. Those leading the stakeholder engagement must be clear and focused on key issues and themes, and not allow a particular pressure group to direct the engagement process and skew the outcomes unfairly.

Public service organisations make an important political decision when deciding how charges are used - which services should be charged for, which users should pay, and which services should be subsidised (or paid for in full) by taxpayers. Stakeholders' responses to the introduction of a new charge or the increase of an existing charge can make charging decisions politically difficult. Politicians often have conflicting views with officers and each other on introducing charging policies.

Stakeholders, such as pressure groups, can influence decisions on price setting. For example, Macmillan Cancer Support has a campaign for free parking at all English hospitals for cancer patients. Macmillan administers an online petition, and, in March 2011, wrote to the Health Secretary and all hospitals in England asking them to offer free parking to cancer patients.

Management of stakeholders is important for a range of reasons. Grant providers may also influence price setting for specific services. For example, grant monies may be provided with the stipulation that the service being funded by the grant is

provided free of charge.

It is important that a charging policy is clear, structured and consistent with the service objectives set.

There is a need to align the pricing structure to the policy and objectives of the service; for example if the policy is to encourage participation in leisure activities, then low charges might be set. To reduce traffic in a town centre, higher parking charges might be used. An annual review of charges is desirable, including a review of usage of the service.

A key factor to consider is that charges should reflect costs: therefore the costs of a service must be established before charging decisions can be made. However, it is debatable whether a charge can always represent the full cost of service provision – for example could a local authority with a brand new swimming pool really charge the £20 per swim (say) which full cost might deem necessary?

An alternative system for setting charges could be to construct a method of relating the charge to the benefit received; however, output, consumption and benefit received are often difficult to quantify.

Kirklees Council provides a good example of consultation. They posed a series of questions to their residents, asking them their thoughts on charging for services, when the alternative was not being able to supply the service. The results showed that when consultation is undertaken and explanation of why charging might be needed, the users were more open and supportive of charging than might previously been expected. This is useful and reassuring to managers and board members when considering introducing or raising charges for public services.

**1 mark per well-made point regarding stakeholder management and mapping limit to 5 marks if no examples are used to illustrate points.**

**Some candidates may do stakeholder mapping and analysis in some detail and could have inferred from the question that this was part of the answer – as asked to 'discuss with examples'. If candidates ignore the 'why is it important' then credit can be given for good relevant stakeholder analysis but limited to 3 marks. (Maximum 10 marks)**

**Note that candidates may overlap between parts a and b, marking allows some discretion across the two parts, although repetition will not gain additional**

**credit to avoid double counting of marks.**

c)

**Syllabus ref C5 Workbook 13**

There's a growing realisation that the tourism industry is not as benign as it has long been taken to be. It generates its profits from places, people and the environment – but gives very little back. It is freeloading.

The Council wants to provide sustainable investment in supporting and managing the impacts of tourism within the city. Put simply, the city wants the extra cash to clean streets, collect rubbish, improve roads, and maintain parks.

<b>Pros</b>	<b>Cons</b>
Generates local income to address direct pressures of tourism	May deter visitor numbers thus damaging the tourist industry and related jobs
Potential for investment in new attractions for tourists	May push tourists to stay in other nearby areas but they still travel to the city
Potential investment in infrastructure or conservation benefiting local people	Can be disproportionately expensive to administer (if the charge is too small and the cost of collection outweighs benefits)

**1 mark per well-made point covering positives and negatives.**

***(Max 5 marks)***

## **Question 2**

Syllabus Ref C2

a)

### **Five cases – the purpose of each case**

#### **Strategic Case**

What is the strategic fit with government/organisational policies? Is there a robust case for change?

Is it 'fit-for-purpose'?

#### **Economic Case**

Does the proposal optimise value for money? Is it appropriate? Have different options been considered during this process?

#### **Commercial Case**

Is the proposal commercially viable? How will it be procured?

Is it attractive?

#### **Financial Case**

Is the proposal financially viable? Is it affordable? Where will project match funding come from?

#### **Management Case**

Can the management structure deliver the project on time and budget? How will it be achieved?

**(Max 5 marks)**

### **Syllabus ref C2**

#### **a) Financial case**

The Financial case follows on from the Economic Case, and demonstrates that the preferred option will result in a fundable and affordable project.

This section of the business case requires the organisation to set out the capital and revenue requirement for the spending proposal over the expected life span of



the project, together with an assessment of how it will impact upon the balance sheet, income and expenditure account and pricing (if applicable) of the public sector organisation.

Any requirement for external funding must be supported by clear evidence of support for the scheme, together with any funding gaps.

The Financial case therefore will include:

- public capital and revenue requirements
- net effect on prices (if applicable)
- impact on balance sheet
- impact on income and expenditure account (if applicable)
- overall funding and affordability.

More details for each of these areas including why they should be included:

- A budget statement, which should be based on resource accounting and budgeting (RAB) principles, as this shows the resource costs over the life time of the proposal. For strategic initiatives, the budget will often comprise the forecast RAB financial statements of the whole organisation over a number of years so the full financial impact is visible to aid decision making.
- A cash flow statement, which should show the cash which will be spent on the lead option, if it goes ahead. The existing spend (if any) and the additional spend should be shown separately, so a comparison can be made.
- A funding statement, which should show which internal departments, partners and external organisations will provide the resources required. Where external funding is required, a written statement of support from the project's stakeholders or commissioners is needed. This helps decision making on what to do about sourcing additional funds.

The above should include the contingencies (in £s) necessary to ensure that there is sufficient financial cover for risks and uncertainties.

#### **b) Financial modelling**

For larger, more significant and complex schemes, a financial model of the proposed spend needs to be constructed. In its early stages this comprises of a best guess of the likely impact and outcomes of the proposed deal. However, the model should be revised as new and better information becomes available. The organisation's CFO should play a lead role in building and maintaining the model. If external management consultants are appointed to undertake this work, the structure of and inputs to the model still need to be vetted by the senior responsible owner and the director of finance.

The minimum requirements for most projects are as follows:

- recording a description of the model and the associated methodology
- agreeing and recording the underlying assumptions (for example,

interest rates, inflation, taxation, capital charges, depreciation etc.)

- detailing the proposed funding structure
- preparing the inputs schedules (financial costs, cash-releasing benefits and risk contingencies)
- preparing the projected 'profit and loss'
- preparing balance sheet projections
- undertaking cash flow projections
- preparing funding schedules
- calculating project returns for the different elements of financing
- preparing supporting schedules – i.e. for loans, fixed assets, taxation, and payments.

### **Capital and revenue requirements**

Following on from the modelling exercise, a statement showing the capital and revenue requirements for the recommended deal should be prepared.

This should set out:

- the capital and revenue consequences of the preferred option over the life span of the service and/or contract period
- how this compares with the original capital ceiling for the scheme (if any)
- any shortfall in capital and revenue requirements (the 'funding gap').
- Impact on the income and expenditure account
- The impact of the project on the organisation's income and expenditure should be assessed. Both the current position and the likely outcome should be fully recorded in the OBC by a qualified accountant who understands the project and the organisation's business.

Impact on the balance sheet

- The impact of the project on the organisation's balance sheet should also be assessed. Both the current position and the likely outcome should be fully recorded in the OBC by a qualified accountant who understands the project and the organisation's business.
- Where significant assets are an integral part of the spending, their accounting treatment will need to be examined (see commercial case).  
This will require an independent opinion from the organisation's auditors.

### **Assessing affordability**

Assessing affordability requires sound judgment of the organisation's business and requires that the:

- balance sheet has been correctly organised and properly accounts for current assets, current liabilities, long-term liabilities and capital
- balance sheet of the organisation is in a healthy state
- organisation is solvent
- organisation is not over-trading
- cash flow of the organisation is sound
- necessary allowance has been made for risks.

### **Judging affordability**

Various techniques can be used by public sector organisations to help judge affordability. These are in extensive use within the private sector but can be useful for the public sector too.

### **The balance sheet**

This involves an assessment of working capital, which is defined as follows: Working capital = current assets – current liabilities

An organisation should never run short of working capital or over-capitalise. This is a common reason for business failure. A ratio of current assets to current liabilities of 2:1 is generally agreed to be the minimum working capital ratio.

### **Solvency**

This means that the organisation can meet any debt obligation in the near future without jeopardising the liquidity of the business.

**Candidates may not cover all these areas in the time available. 1 mark per relevant point, cap at 8 marks if no reference to why some of the areas are included in the Financial Case, must include reference to impact on financial statements, and aiding decision making on affordability.**

**(15 marks)**

C)

Syllabus ref C1

The CFO has roles throughout the business case development stages. With regard to the appropriateness of the structure of the business case the factors for the CFO

to consider for a project are:

- Size – financial value in both absolute terms, and context for the organisation i.e. £10 000 project for an organisation with a revenue spending budget of £100k and assets of £200k will be significant for that organisation, for a larger organisation, this kind of project would not be material.
- Complexity – is it a straightforward project like purchase of a fixed asset in a ready-to-use state such as start-up business units? Or is it likely to require multiple experts and have numerous stages that may be difficult or unpopular, and require managing carefully, such as the construction of a waste transfer station near a town?
- Organisational impact – is the outcome and / or financial impact confined to one service area or will it affect multiple services / sites? Purchase and implementation of a new financial management system could potentially affect a whole organisation – especially if it is a fully integrated system where 'self- service' by internal users is featured for payslip printing, expense reimbursement, budget reports etc.
- External impact – is the project likely to have an impact on external organisations? Will there be additional costs? For example, building a new runway for an airport or a new hospital might require compulsory purchase of land, or compensation to local residents.
- Resources available to write an appropriate business case – does the organisation have the necessary expertise and time to write a case? What is needed in the context of the project? There is no value in a detailed business case that takes a disproportionate time (and cost) to write, compared to the value of the project.

### **CFO scrutiny role**

The CFO can have a difficult, but vital 'challenge' role in evaluating business cases. Pursuing the wrong project or activity could financially cripple an organisation. The CFO should not take a particular 'stance' but should consider the facts being presented in the business case, and challenge the integrity of potential savings, costs and benefits included in the financial and economic cases.

There should be keen focus on the objectives of the project – are they clear? Can they actually be delivered within the resources? Have the resources been defined and allocated?

The CFO should ask the hard and challenging questions like - What will happen if this project fails? How big might the impact be?

The CFO should always look for ways to enable projects that have well defined outcomes that align with the organisation's goal. This might include looking at innovative ways to obtain financing for projects. BUT, in most organisations in public services, they also have legal responsibilities for appropriate fiduciary stewardship of public funds. This may mean eventually saying 'no', when the political and cultural environment is pushing for a 'yes'. The CFO must put the overall financial health and resilience of the organisation first, and communicate clearly to the decision making body the potential impact if the project were to fail to deliver the perceived benefits. CIPFA's Code of Ethics should assist CFOs in being able to say no, when they would be in breach of their stewardship duties to allow a flawed financial case to be used to base a decision upon.

**1 mark per point. Should cover both the role in preparing parts of the business case (or their teams supporting in this) and the scrutiny and challenge role.**

***(Max 10 marks)***

### Question 3

#### **Syllabus Ref C5**

Measures of performance are specific. A measure would be the exact cost of a service or project, or the number of workshop sessions delivered. Such measures need to be 'SMART', that is:

- **S**pecific - a clear definition, including where the data comes from
- **M**easurable - data must be available to measure progress
- **A**chievable - in terms of available resource, costs and practicality
- **R**elevant - measures should relate to what is being measured
- **T**ime bound - there should be a deadline

They also need to be:

- Understandable - they must make sense to their audiences
- Defendable - the quality of data and its sources must be assured
- Traceable - you need to show where the data comes from
- Reported

Performance indicators are different from performance measures in two aspects:

- Performance indicators do not have to be **exact**.
- They look at performance in context (and often, in relation to others).
- PIs are used where there is no direct traceable relationship. They are often used to assess the performance of long term objectives or objectives that are more qualitative.
- Often a basket of proxy indicators may be needed where no one single measure is available. Take an example of expenditure on a smoking cessation programme run by a local health body. A **performance measure** would be the actual amount spent in a year (say, £350 000).

A **performance indicator** would be the spend per 1 000 population in the area served by that health body (for a population of 700 000 people the indicator would be £500 per 1 000 population). This is an indicator of the programme's performance and can be compared to performance of other health bodies. This is an average figure rather than an exact spend figure, but adds some context to the performance information.

***(Up to 5 marks for explaining PIs and PMs and the differences)***

Performance indicators tend to be favoured by public services organisations, as they can:

- be easily understood by their stakeholders (they can provide context)
- be more easily reported (there is less need for exact values and are often an average over a set time period)
- have a better 'shelf-life' - meaning they can relate to a longer timescale or trend.

All public service organisations, across all sectors from local government to Health, will have key performance indicators (KPIs) and some of these will be prescribed by government or through legislation. Key performance indicators are those which can be linked to the factors which drive a business or organisation to meet its objectives.

Until 2008, local authorities were required to produce a series of Best Value Performance Indicators across their services – which were designed to inform the public on the success and efficiency of the authorities, as well as compare their performance to others. Some authorities still produce this information, but for their own purposes.

In the Health and Education sectors, there are league tables for establishments, with the rankings based on standard KPIs for performance.

Whilst KPIs can be of use as objective measures, they do not always fully explain the context of an organisation's performance and they tend to focus on inputs and outputs, rather than outcomes.

***3 marks for discussing why PIs might be favoured, 2 marks for examples to support discussion.***

***(Max 10 marks)***

## Question 4

### Syllabus ref B1

The CFO in a public service organisation has specific responsibilities for safeguarding public money. Under that umbrella, the CIPFA statement on the role of the CFO in public service organisations states that the CFO must:

- lead the implementation and maintenance of a framework of financial controls and procedures for managing financial risks
- determine accounting processes and oversee financial management procedures that enable the organisation to budget and manage within its overall resources
- ensure robust systems of risk management and internal control
- ensure financial control is exercised consistently
- implement appropriate measures to protect its assets from fraud and loss

In practical terms the CFO must ensure the internal control framework is established to (as far as possible) prevent internal fraud through separation of duties and authorisation or access controls that will prevent or detect irregularities.

The control framework should extend to appropriate arrangements to effectively detect potential fraud, especially from external sources. As the table below shows, one of the largest areas of fraud in the public sector that is not related to tax avoidance or claiming benefits is procurement fraud. (table shows fraud areas in order of most activity)

Tax fraud
Vehicle excise fraud
Procurement fraud
Grant fraud
Television licence fee evasion
Payroll and recruitment fraud
NHS patient charges fraud
Student finance fraud
Pension fraud
National Savings and Investments fraud
Housing tenancy fraud
Procurement fraud
Payroll and recruitment fraud
Council tax fraud



Blue Badge Scheme abuse
Grant fraud
Pension fraud
Benefits fraud
Tax credits fraud

Housing tenancy fraud is a significant area – sub-letting of council housing. This can be detected by routine visits to tenants to establish who is residing in a property.

Procurement fraud is most successful where organisations fail to perform due diligence in the initial procurement process or fail to spot collusion and anti-competitive behaviour between suppliers.

Once goods or services have been procured, fraud occurs most regularly where organisations fail to manage contracts properly or where controls around authorisation of orders and payment of invoices are weak. Unscrupulous contractors submit inflated or fictitious invoices which are paid without sufficient scrutiny by contract managers or finance teams.

Bogus suppliers submit fictitious invoices and rely on weak systems of controls to obtain payment. This is often done by impersonating a real supplier to the organisation and then submitting invoices with 'new' payment details.

Financial managers must be aware of the risks of fraud and the likely areas of exposure and have plans to mitigate the financial impact if the event actually occurs. This might be through insurance or through investment in controls that minimise the risk of fraud occurrence in the first place.

Financial strategy should be developed to ensure the organisation has resilience should a fraud occur and sufficient reserves or insurance to withstand the financial impact.

***Candidate may give examples or explanations of any type of fraud. Marks for identifying different types of fraud, as well as how they might be prevented. Limit to 5 marks if only types of fraud are identified.***

***(Max 10 marks)***

## Question 5

### Syllabus ref B2

a)

#### **Scenario planning is largely focused on answering three questions:**

(1) What could happen? (2) What would be the impact on our strategies, plans and budgets? And (3) How should we respond?

For scenarios to be effective they need to be plausible but also challenging in forcing the organisation to consider possibly 'uncomfortable' situations. Scenarios invite people to explore what might happen, rather than what people want to happen.

For effective decision making, organisations should not just use the best case / worst case scenario around the status quo (as they might for sensitivity analysis) but should explore a range of scenarios.

Scenario planning is most effective when a broad coalition of stakeholders and partners is involved. Engaging diverse stakeholders in the creation of scenarios, rather than delivering forecasts to them, represents a key difference between scenario planning and traditional forecasting methods; scenario planning can generate a level of buy-in and alignment that is lacking in a traditional planning process.

***1 mark per point, to include identification of characteristics, including appraisal of why a range of scenarios should be used***

***(5 marks)***

b)

Scenario planning:

- generates a dynamic series of plausible outcomes that serve to challenge preconceptions
- uncovers blind spots
- helps align organisations around a commonly accepted sense of direction and action.

Scenario building is an alternative to conventional forecasting that is better suited to an environment with numerous uncertainties or imponderables.

Organisations must have robust medium-term financial strategies and these must

take account of different potential scenarios. Beyond two to three years, prediction does become more difficult and consideration of more radical solutions comes strongly into play.

One reason for the failure of medium to longer-term forecasting is that the futures that it maps are based on a simple trend analysis. Often this assumed that what is happening today will continue in ever- increasing severity. In doing this they fail to acknowledge that decision makers will respond to the development of these adverse trends and take action that will invalidate them. It is here that scenario planning seizes the advantage, because it forces the public service organisation to consider whether the actions of decision makers in other organisations will be benign or challenging.

Unlike forecasting, which relies on the forward projection of existing trends, scenarios can explicitly recognise the discontinuities and abrupt changes that result from political change. At a local, national and sometimes a European level, significant changes in the balance of political control often represent important points of discontinuity in financial strategies that cannot be incorporated into planning based on conventional forecasts.

Another advantage of the scenario based approach that makes it particularly relevant to the political environment is that it does not demand consensus. Scenario building can instead recognise different visions of the future and then define them more clearly in a range of internally consistent but still very different scenarios. Such an approach also allows an organisation to consider how it would respond to a wholesale revision of its previous assumptions in favour of a completely fresh set of parameters.

It is useful to understand the differences between forecasting and scenario planning. Often public service organisations make reference to the use scenario planning, but the techniques they are actually using are more closely linked with sensitivity analysis and forecasting.

In contemporary financial modelling, multiple variables are altered simultaneously to produce an assessment, often known as a scenario, which reflects the impact of these interrelated variables. Such modelling is, however, only possible when dealing with those risks for which the range of possible outcomes are known and

probabilities can be attached to each of them occurring. It cannot be extended to deal with the more fundamental longer-term uncertainty that characterises the development of a financial strategy.

So the importance of short to medium-term forecasting and sensitivity testing is not to be underestimated; these remain important and valuable management tools. However, public service organisations have sometimes neglected scenario planning's importance as a strategic tool, one that provides an alternative to forecasting. It forces decision-makers to look to the future and the inherent uncertainties that it brings. This is especially the case as the pressures on funding streams in an environment where public spending is being driven down; it is increasingly difficult for public sector organisations to forecast future levels of funding.

***1 mark per point for discussion to include comparisons between scenario planning and traditional forecasting***

***(5 marks)***

## Question 6

### Syllabus reference C4

Charities are audited under either the Companies Act 2006 or independently examined under the Charities Act 2011. The external audit requirements - as with the private sector – are based on financial thresholds for turnover and assets.

For large charities, where gross income exceeds £1million, or if total assets exceed £3.26 million and the gross income is more than £250,000, a full external audit is required. Charities, like the private sector, have freedom to choose their own auditors.

Given the financial size of turnover of Kids Company, as a charity it was subject to the same rules as companies regarding requiring external and internal auditors. Even where some charities do not meet the turnover thresholds, they elect to have internal auditors anyway. This strengthens their demonstration of transparency and accountability to stakeholders including those who may be offering funding.

One of the responsibilities of external auditors is to provide an opinion on whether the financial statements are 'true and fair'. Auditors will tell you if the accounts are 'added up correctly, but they won't necessarily tell you if the organisation is well run'. The Charities Act does impose a duty on auditors to alert the Charities Commission if they consider there is a risk of failure of a charity. The auditors of Kids Company did not alert the Commission of any such concern.

As well as the audit opinion, external auditors have a duty to report if they consider the organisation is not a going concern – financially unstable and unable to sustain its normal business and services its debts. If auditors did identify problems, the trustees should act in response. External auditors for public service organisations have a responsibility for reporting on Value for Money. As Charities are governed by the Companies Act and the Charities Act, specific reporting on VfM is not a requirement. The Charities Act does require external auditors to report activity to them that would be considered contrary to charitable activities as defined in the Charities Act.

Internal auditors are less involved in examining the overall financial position of an

organisation, but should be more focused on the governance framework and the internal controls and risk management processes. It is not clear whether Kids Company had any internal audit arrangements, nor what findings they made (if they were present) before the collapse of the organisation.

The CFO of any organisation may have to make difficult choices, or present information upon which unpopular choices must be made. They are also responsible for compliance with the laws relating to the financial operation of the organisation, and, where the CFO is professionally qualified, there are standards of ethics and behaviour that must be upheld to maintain the integrity of the professional and the individual. These standards must be maintained even if the organisational desires are in conflict with those ethical standards. It is not an absolute requirement of the Companies Act or the Charities Act, but trustees are responsible for ensuring they have appropriate skills themselves, and that appropriately skilled and qualified staff are appointed to key roles. Whether there was a qualified accountant in charge of the finance or not, one of the key problems identified by the PACAC report for Kids Company was that one dominant character (the CEO) directed the organisation, seemingly unchallenged. This is an extreme example of how a 'Command and Control' structure can cause catastrophic failure for an organisation.

A good CFO, taking their financial stewardship responsibilities seriously should demonstrate strong leadership and negotiating skills. They should be able to resist short-term pressures, especially where there are political or social agendas, as would be extremely prevalent at Kids Company due to the vulnerability of their clients. The CFO has responsibilities to ensure financial viability and stability longer term. The CFO should also demonstrate significant strength of leadership where the trustees and management team need to be persuaded to make brave or unpopular strategic decisions. The CFO must, however, demonstrate political awareness and be sensitive to what will and will not be acceptable to the decision making body that they serve.

**1 mark per point relating to responsibilities of auditors, trustees, and the CFO. Must cover all three to gain full marks, otherwise cap at 7 marks for 2 of 3, cap at 4 marks if only one is covered.**

***(Max 10 marks)***