

STRATEGIC PUBLIC FINANCE

March 2020

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

UK borrowing at a five-year high - PF Magazine

UK borrowing has risen to a five-year high as political leaders have laid out large spending plans, official figures have shown.

The Office for National Statistics has said that borrowing in October 2019 was £11.2bn - £2.3bn more than in October 2018.

Borrowing in the current financial year has reached £46.3bn, £4.3bn more than in the same period last year and already exceeds the Office for Budget Responsibility's forecast of £40.6bn for the whole of 2019-20.

Economists warn that with large spending increases in areas such as education, infrastructure and health - outlined in party manifestos - the deficit could exceed £50bn by the end of 2019-20.

Andrew Wishart, at Capital Economics, said:

"The worst October for the public finances for five years won't prevent whoever wins the election embarking on a fiscal splurge. Borrowing appears to have been higher than expected due to Brexit preparations and leaves the budget deficit on track to rise this year. The investment plans laid out by the major parties suggest it will rise substantially further in 2020-21."

John Hawksworth, chief economist at PwC, said:

"Growth in central government spending (3.4%) has continued to outpace growth in receipts (2.4%) and it still looks quite likely that the budget deficit in 2019-20 as a whole could be over £50bn".

Source: Public Finance, Dominic Brady 22 November 2019

▪ **Requirement for question 1**

The broad terms of a nation's 'debt' or 'deficit' are regularly referred to by governments and media, and can sometimes cause confusion when used interchangeably.

a) Explain the following **three** terms and briefly discuss their relationships with national interest rates and economic growth.

You may include mathematical formula links to GDP and the stock of debt in your answer.

- i) National debt
- ii) Current budget deficit
- iii) Sustainable deficit

(10 marks)

b) A country's budget should accurately reflect the government's policy priorities, but should the budget be the policy driver?
Discuss how the relationship between budget setting and policy making must be balanced to enable realistic and deliverable policies.

(10 marks)

c) Compare and contrast the approaches taken by the UK and the US for the control of government borrowing in the past 10-15 years.

(10 marks)

(30 marks)

2

Community solutions for successful delivery of public services – PF Perspectives

Directors of finance and chief officers working in the public sector, along with policymakers and practitioners all over the UK, are struggling to cope with a rising tide of demand alongside reduced real-term budgets. Meanwhile, a quiet revolution is taking place.

This shift in mindset has become more urgent as councils, police, schools, the NHS and housing associations realise that they can't go on cutting without investing in real change. This means building strong, happy, healthy and socially connected communities, and believing in their ability to take decisions that improve their own lives and those of their neighbours.

A Chair of a NHS Foundation Trust in the UK stated:

"We need to trust public servants to work with people, not just to do things to them. Local leaders need to make it all right to test new approaches in integrated place-based teams, and invest more in local community grassroots organisations. This, and not cutting community and voluntary groups, is what will really help people and reduce public demand for expensive, ineffective and clunky state solutions."

Requirement for question 2

a) In 2014 the RSA published its report 'Managing Demand: Building Future Public Services'. This examined the financial case for demand management. It concluded that the financial case is strong enough for local authorities to prioritise strategic - rather than piecemeal - demand management. It identified the following elements as being part of the demand management framework:

- Community leadership
- Building insight
- Changing behaviour
- Changing the system
- Creating shared values
- Building community resilience

Evaluate each of these elements, and refer to examples to demonstrate your understanding.

(18 marks)

b) Discuss the expected characteristics of a mutual organisation and evaluate the advantages and disadvantages of establishing this type of entity for delivering public services. Provide examples from your learning or experience to illustrate your understanding.

(12 marks)

(30 marks)

3

The Chief Finance Officer (CFO) of a public services organisation has a pivotal role on the senior management team, including good stewardship of public funds.

Requirement

a) Explain the role of the CFO and the key personal qualities you would expect an effective CFO to display.

(5 marks)

b) Evaluate the trade-offs between good stewardship of limited resources and the management of stakeholder expectations and desires.

(5 marks)

(10 marks)

4

The legacy of austerity measures in the UK for local government has resulted in a need for councils to consider both how they maintain their financial resilience and to review their traditional attitudes to risk appetite.

Requirement

a) With reference to CIPFA's Financial Resilience Index, outline the purpose of the Index, and identify some of the indicators of financial stress used to calculate it.

(4 marks)

b) Define the term risk appetite, and with reference to a public sector organisation with which you are familiar, explain how risk appetite can vary for different activities across an organisation.

(6 marks)

(10 marks)

5

Finance managers should be aware of **project** risks so they can help manage the financial impact of those risks on the delivery of the project, and their organisation as a whole.

Requirement

a) Identify the common risks to project delivery, and include actions that a finance manager might take to manage the risks. Refer to relevant examples from your experience or learning, do not limit your answer to financial risk.

(5 marks)

b) Discuss the advantages and disadvantages of establishing project budgets versus business as usual budgets.

(5 marks)

(10 marks)

6

A senior elected Member of a Council in the UK has made the following statement:

"the cuts to budgets for public services over the past 10 years in the UK have been unprecedented. I believe we should do everything in our power to generate income, including from investments. What can we do to get the best return on our money? Interest rates are so low for borrowing, why are we not borrowing money to invest in successful companies?"

You are the Finance Manager with responsibility for treasury management at the council. Prepare a short report to Members as outlined in the requirements below.

Requirement

Prepare a report to Members of the council that discusses the issues regarding the above statement, giving examples of powers, recommended practice and legislation where relevant. Include an assessment of any similar restrictions that would apply to borrowing, as well investment, and any other factors you consider relevant.

Comparison to constraints for other public sector organisations will also gain credit.

(10 marks)

Question 1

Syllabus ref

Workbook 1 Syllabus ref A1

a)

The national debt refers to the amount of money owed by the government. This is the debt that has been built up over many years by many governments and is the accumulation of the annual budget deficits, plus any years where there were budget surpluses.

(2 marks)

The current budget deficit, or surplus, is the difference between the government's everyday expenses and its revenues; in other words, between what it spends and what it receives in taxes and any other income in a given year.

(2 marks – must refer to 'in year')

Sustainable deficit is where the deficit (or surplus) does not increase the stock of debt as a percentage of Gross Domestic Product (GDP).

This can be represented by:

$$\text{Sustainable deficit} = g - r \text{ (d/gdp)}$$

(2 marks)

where:

g is the rate of growth in the economy

r is the interest rate the government

pays on its debt **d** is the stock of debt

gdp is the gross domestic product.

The important factor to consider here is that it is the relationship between these variables and that has been crucial in the debate during a period when deficits are not sustainable.

The policy options in this situation are:

- to increase growth
- to reduce debt or
- to reduce interest rates.

There is therefore an argument to increase debt to stimulate growth, which in turn generates additional tax revenue and reduces welfare payments. The counter argument is that when debt is too high it creates higher interest rates and crowds out the private sector.

(1 mark per point describing the inter-relationships up to 4 marks)

(Max 10 marks)

(Syllabus Ref A1 b)

The budget preparation process is a powerful tool for achieving policy coherence. The budget is both an instrument of economic and financial management and an implicit policy statement, as it sets relative levels of spending for different programmes and activities. Policy decision-making is complex and involves different factors inside and outside the government. It is a mistake to attempt to combine all the procedures of policy formulation and the budget process itself.

However, a coherent relationship needs to be established between the policy-making agenda, which should take into account economic and fiscal realities and the budget, which should accurately reflect the government's policy priorities.

The budget process should both take into account policies already formulated and be the main instrument to make them explicit and 'operational'. However, policy proposals should be developed and reviewed outside of the pressured environment of the budget process itself. Making policy through the annual budget would give undue prominence to short-term issues, rather than longer-term, strategic issues, since the policy debate would be invariably dominated by immediate financial considerations.

An overall strategic framework should underpin the formulation of sectoral policies, provided that it is a genuine and concrete strategy, based on a thorough analysis. Within this framework, line ministries and agencies should prepare their own strategic plans that include:

- their mandate, consistent with statutory requirements
- a set of desired policy goals (outcomes and objectives)
- the broad approaches to achieving these policy goals
- a description of the concrete policy measures that will be used to achieve these goals
- a broad cost estimate.

Expenditure programmes and performance plans can be derived for these strategic plans, once the allocation of resources between different sectors has been determined.

This strategic planning is not a static or occasional event, but a dynamic and inclusive process. If done well it is continuous and provides the basis for the day-to-day operations of the organisations that manage the different expenditure programmes.

Unfortunately, in many cases, this exercise degenerates into bureaucracy, where a long-term perspective, unrealistic assumptions and logical frameworks are used as a substitute for clear thinking about realistic policy options and instruments. A good practical rule for preparing and evaluating a strategic framework is to keep it simple.

To ensure that policy-making is not just creating a 'wish-list', the link between

policy and the budget process is essential and at least two clear rules should be established:

- The resource implications of a policy change should be identified, before a policy decision is taken. Any entity proposing new policies should quantify their effects on public expenditure including both the impact on its own spending and on the spending of other government departments.

- The ministry of finance (such as the Treasury in the UK) should be consulted in good time about all proposals involving expenditure before they are reviewed by ministers (or a ministerial committee) and certainly before any public announcements are made.

I mark per well made point up to 10 marks

(Max 10 marks)

Syllabus

ref A1 c)

In the UK, after 16 years of taking a 'golden rule' approach with a balanced budget and prudent borrowing levels (no more than 40% of GDP), the fiscal crises of 2008 required a different perspective for the control of borrowing.

In 2010, the coalition government introduced legislation that moves away from a requirement for a balanced budget and focuses on the economic theory relating to sustainable fiscal position instead.

Since interest rates on government bonds have tended to be higher than growth rates, a balanced budget will not be sustainable.

Since 2015, the medium term plans (Comprehensive Spending Review) from the Chancellor of the Exchequer are for surpluses in 'normal' times (originally projected as being 2020).

Political parties in the UK have to ensure that markets have confidence in the UK public finances, and this drive to achieve fiscal stability and budget surpluses, coupled with reduced public debt have led to a lengthy period of austerity with cuts to funding of public services.

Whether this strategy will be successful in promoting economic growth and achieving fiscal stability remains to be seen as the period has extended well beyond the 5 years talked about in 2015. The UK government (via the Chancellor of the Exchequer) announced in 2018 that austerity had ended. It remains to be seen whether this is actually true. Trying to measure the longer-term impact of austerity was the subject of much research and published articles in 2019 such as <https://neweconomics.org/2019/02/austerity-is-subduing-uk-economy-by-more-than-3-600-per-household-this-year>

Compare this with the approach taken by the United States, where there is legislation to cap the amount of borrowing by central government. This gives a

much harder borrowing constraint, which can lead to political, rather than economic use of borrowing limits.

As a consequence, debt limits have often been raised by government - sometimes to avoid default. It has also led to some re-thinking on spending priorities.

Congress has always acted when called upon to raise the debt limit. Since 1960, Congress has acted 78 separate times to permanently raise, temporarily extend, or revise the definition of the debt limit – 49 times under Republican presidents and 29 times under Democratic presidents. During the Obama administration in the USA (2007-2015) there were several political battles to raise the debt limit and it was used as a political weapon between the executive (President) and legislature (Senate and Congress) to extract concessions on spending priorities.

The national debt for the US nearly doubled under Obama: It was \$10.6 trillion when he took office and was nearly \$20 trillion when he left. The rise has been blamed on factors from the Great Recession to wars in Iraq and Afghanistan and rising costs of Social Security and Medicare. Many of those pressures still exist in 2019. The CBO predicts federal spending will rise from 20.8 percent of GDP in 2019 to 23 percent in 2029, with programs such as Social Security and Medicare expected to spend more to cope with an aging population and rising health care costs.

An economic commentator reported in 2019: 'The deficit typically grows during recessions — when tax receipts shrink and demand for food stamps and other government assistance rises — then falls during good times. The current spike in the deficit at a time of strong economic growth and low unemployment represents a break with that historical pattern.'

1 mark per well-made point covering both UK and US approaches.

(Max 10 marks)

(Total marks 30 marks)

Marking Instruction

a)

Answer to national debt - **(2 marks)**

comparison on surplus or deficit - **(2 marks – must refer to 'in year')**

g-r (d/gdp) **(2 marks)**

(1 mark per point describing the inter-

relationships up to 4 marks) (Max 10 marks)

b)

1 mark per well made point up to 10 marks **(Max 10 marks)**

c)

1 mark per well-made point covering both UK and US approaches. **(Max 10 marks)**

Sub Marking Instruction 1

Answer to national debt - **(2 marks)**

comparison on surplus or deficit - **(2 marks – must**

refer to 'in year') g-r

(d/gdp)**(2 marks)**

10 Marks

(1 mark per point describing the inter-relationships up to 4 marks)

Sub Marking Instruction 2

1 mark per well-made point up to 10 marks

10 Marks

Sub Marking Instruction 3

1 mark per well-made point covering both UK and US approaches.

Question 2

Syllabus Ref C1

While resources are not expanding, demand for services tends to increase. This is through demographic change, economic conditions, consumer expectation and policies promoting choice, technological advance (especially in the health service) or better and more accessible information. Sometimes demand out-strips resource growth especially where demand is aligned with demographic change, and there is a time lag in information about those changes.

At the same time policy may deliberately restrict management's coping tactics, for example through limits on clients' maximum waiting times. Techniques of demand management, from productivity improvement to triage, are widely used across the public sector.

Community leadership

Recognise that demand is political

– transformative change requires political buy-in, and it is vital that local politicians lead a new conversation with citizens that is more collaborative. Where communities are taking more responsibility, then their representatives must lead the way.

Find the right local narrative

– use language that the organisation understands rather than academic and generic terms that may be meaningless to stakeholders.

Building insight

Create the methods to get closer to communities

– demand cannot be understood purely through the lens of services currently provided. Public sector bodies need to look outwards, creating the methods to generate deeper insight into the needs, wants and aspirations of citizens.

Get beyond the services and build new partnerships

– once better insight has been obtained, the responsibility is to use it effectively. Addressing the real drivers of demand will require public managers to broker new cross-sector relationships and build new partnerships.

Changing behaviour

Leverage emerging data on outcomes and behaviour

– many local authorities (some UK examples being Kirklees and Calderdale) are already building on nudge and network techniques to change the way they interact with the community and address failure demand.

Build trust to change behaviour

– long term behaviour change requires a two-way relationship, with responsibility on both citizens and state, and high levels of trust between them. This is a challenge for all public agencies, but Ipsos MORI find that 79% of citizens trust their local council to make 'difficult decisions', as opposed to 11% for central government. However, the LGA suggests that local authorities will need to engage in new, more collaborative ways with communities as cuts bite harder.

Changing the system

Think whole system, whole place

– managing future demand will be about scaling up isolated, service-based practice and embedding a culture shift across public organisations.

Work collaboratively across agencies and sectors

– the default assumption for local public services should be for outcome-focused collaboration around the holistic needs of citizens (and thus the root causes of demand).

Commissioning and procurement practice makes this difficult, examples such as the MEAM (Making Every Adult Matter) approach, and Worcestershire County Council's 'Early Help Hub' show that it is possible.

Creating shared value

Manage demand and growth strategies interdependently

– demand management and inclusive growth should be two sides of the same coin, as Greater Manchester's proposed switch from reactive to proactive investment spending demonstrates. AGMA data suggests that 35% of public spending in the area is 'reactive' and therefore potentially addressable through early intervention.

Use market shaping and procurement to support communities

– the Public Services (Social Value) Act and EU procurement changes from 2015 offer an opportunity to manage demand through more targeted and collaborative commissioning, focused on community benefit and value as well as price.

Building community resilience

Engage the community in co-designing and commissioning services

– transformative demand management – and long term transformative change in public services – cannot happen without truly engaging and enrolling the community in the design and delivery of services. Examples of this include Turning Point's Connected Care model to Lambeth's Outcomes Framework for Children and Young People.

Build coalitions between business, public services and society

– the role of the private and social sector in managing demand is key. Being in work is the single best tool of demand management, and responsible employment practice, living wage and skills development are all advocated as ways for the private sector to support this agenda. Public sector organisations need to think about ways to convene a broader dialogue about social responsibility, shared values and inclusive growth.

3 marks per area – 1.5 - 2 marks for well explained area, up to 1.5 marks for examples. Cap at 2 marks per area if no examples are included. (Total 18 marks)

b) Syllabus Ref C4

The Cabinet Office has defined mutuals as organisations that have 'left the public sector to provide public services (under contract) and in which employee control plays a significant role in its operation'.

Mutuals may be suitable models for delivering community-led services in areas where potential for profit is limited, or where existing arrangements had proven ineffective.

Alongside the creation of the Mutuels Taskforce in 2011, and the Mutuels Support Programme in 2012, Parliament passed laws to facilitate the process by which employees can take over the services they deliver.

As part of the Localism Act 2011, the 'right to provide' powers afforded council staff rights to provide services as staff-led enterprises and bid to take over the services they deliver from March 2011. The 'community right to challenge' provided community interest groups to challenge council ownership and bid for the right to run council services and assets. In particular, the powers require organisations to consider suitable proposals from front line staff who want to take over and run their services as mutual organisations.

The success of mutuels is reflected in the numbers. By July 2014, 100 public service mutual had been created, a dramatic increase from just nine mutuels in 2010.

Some of these mutuels have become quite large. For example, the 'Leading Lives' mutual in Suffolk, dedicated to providing council care and support services, now employs 500 staff of whom 70% are members of the mutual.

Mutuels are important for commercially minded councils because they offer a potential way around prescriptions of what local authorities may charge for, or trade for profit in. Setting up a staff-owned mutual in an area that would fall under a council's statutory service provisions is a way for them to generate a new income stream – particularly rent and business rates.

Mutuels are characterised by a shared community purpose and collective ownership. Mutual is a term that refers to the ownership of an organisation. The phrase 'public service mutual' has become shorthand for an organisation that has left the public sector but continues to deliver public services. Strictly, a mutual is an organisation in which employees hold majority ownership. In practice, the extent to which employees control and influence how the business is managed plays an equally significant role in determining whether an organisation could be called a mutual.

Advantages	Disadvantages
Freedom and opportunity to innovate outside of constraints of the public sector	Loss of control by public sector body might lead to unexpected changes in service level
Access to funding not available in the public sector	Business expertise may be lacking if staff have previously only been in the public sector
Employee ownership leads to higher levels of productivity	Unfamiliar regulations (company or charity accounts requirements)

Examples

Greenwich Leisure Limited, spun out of Greenwich Council's leisure department in 1993 and now managing a turnover of £80m, is one example of how successful mutuels from local authorities can be.

www.gll.org/b2b/pages/being-a-charitable-social-enterprise

Realise Futures was previously part of the Suffolk County Council's Adult and Community Services. Cabinet approval for the externalisation of Realise Futures under the Right to Provide Initiative was given in March 2012 and became wholly independent as a Community Interest Company (CIC) and public service mutual in November 2012.

Be Independent is an adult social care mutual, spun out of the City of York Council in April 2014. It is a Community Interest Company (limited by guarantee) with a Board of 6 Director - owners of which 3 are employed by the business – thereby giving a business with 50% staff ownership.

www.gov.uk/government/case-studies/be-independent-cic

Provide is a public service mutual delivering community health services across Essex, Cambridgeshire and Peterborough, as well as the London boroughs of Waltham Forest and Redbridge. Launched in April 2011 as part of an initiative to separate the commissioning and provider roles of the local NHS, Provide's 1,100 staff have taken the organisation from strength to strength over the past three years, winning Social Enterprise of the Year at the 2013 National Business Awards UK.

www.gov.uk/government/case-studies/provide

(3 marks for clear definition of mutuals, 1 mark per advantage or disadvantage up to a total of 6 marks, 3 marks for examples 12 marks)

Marking Instruction

a) 3 marks per area – 1.5 - 2 marks for well explained area, up to 1.5 marks for examples. Cap at 2 marks per area if no examples are included.

(Total 18 marks)

b) (3 marks for clear definition of mutuals, 1 mark per advantage or disadvantage up to a total of 6 marks, 3 marks for examples 12 marks)

Sub Marking Instruction 1

3 marks per area – 1.5 - 2 marks for well explained area, up to 1.5 marks for examples. Cap at 2 marks per area if no examples are included.

(18 marks)

Sub Marking Instruction 2

(3 marks for clear definition of mutuals, 1 mark per advantage or disadvantage up to a total of 6 marks, 3 marks for examples 12 marks)

Question 3

Syllabus ref - B2

a)

The CFO, as the organisation's most senior executive role charged with leading and directing financial strategy and operations, occupies a pivotal role, both for external stakeholders and within the Leadership Team. In the public service context, CFOs must also meet the demands of openness and accountability in decision making, balance competition for limited resources across a range of worthwhile objectives, deliver value for money and safeguard taxpayers' money. Delivering these requires a range of personal qualities, as well as support from both the finance function and the organisation as a whole.

The CIPFA Statement lists the desirable qualities of a CFO under each of the five principles. As part of your studies you should read the generic CIPFA Statement or some of the sector specific statements. The main personal qualities can be summarised as:

- Robust and resilient leadership.
- Flexible leadership style, able to move through visioning to implementation and collaboration/consultation to challenge as appropriate.
- Able to network and build robust relationships both internally and externally.
- Working effectively with other Leadership Team members with political awareness and sensitivity.
- Address and deal effectively with difficult situations and challenge effectively, to give and receive constructive feedback.
- Implement best practice in change management and leadership.
- Balance conflicting pressures and needs, including short and longer term trade-offs.
- Innovative to add value and a good communicator.
- Maintain an appropriate balance between the deeper financial aspects of the CFO role and the need to develop and retain a broader focus on the environment and stakeholder expectations and needs.
- Act with integrity, objectivity, professional competence and due care, confidentiality, and professional behaviour.
- Develop and sustain partnerships, and engage effectively in collaboration.
- Establish an open culture, built on effective coaching and a "no blame" approach.
- Understand personal and professional strengths.

½ mark per point made up to maximum of 5 marks - not expected to

cover all points in the model answer.

(5 marks maximum)

b)

Students should demonstrate an awareness of the dichotomy between customer expectations - people wanting increasingly more and more from their public services - and limited budgets and resources, in a time of financial austerity.

Emphasis should be around the limited resources and sharing this with stakeholders. The use of the 'budget choices' slide calculator by some councils has helped put the message across about the real costs of services and the choices that need to be made.

Many public service commentators are calling for a clear debate on developing a realistic consensus on what people can expect to receive in terms of services and what they can expect to pay, in terms of taxation and charges for services.

Being clear and honest with stakeholders about what services cost to deliver, as well as how they are delivered is essential in managing people's expectations. Getting stakeholders to understand how funding is used, and how priorities are determined. PSOs must be aware of how expectations might change and anticipate trends so that service delivery stays relevant.

Mapping stakeholders before consultation can help focus on their needs and manage their expectations. 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 and interests
- mapping their relationships to your objectives and to other stakeholders
- ranking and prioritising their relative needs and issues.

1 mark per point

(5 marks maximum)

(Max 10 marks)

Marking Instruction

a)

½ mark per point made up to maximum of 5 marks - not expected to cover all points in the model answer.

(5 marks)

b)

1 mark per point

(5 marks)

(10 marks)

Sub Marking Instruction

1 a)

½ mark per point made up to maximum of 5 marks - not expected to cover all points in the model answer.

(5 Marks)

Sub Marking Instruction 2

b) 1 mark per point

(5 marks)

Question 4

Syllabus ref C4

a)

CIPFA's Financial Resilience Index is a comparative analytical tool that may be used by chief financial officers to support good financial management, providing a common understanding within a council of their financial position.

The index is made up of a set of indicators. These indicators take publicly available data and compare similar authorities across a range of factors. There is no single overall indicator of financial risk, so the index instead highlights areas where additional scrutiny should take place in order to provide additional assurance. This additional scrutiny should be accompanied by a narrative to place the indicator into context.

Indicators of financial stress:

- Level of Reserves
- Change in reserves
- Interest payable / Net revenue expenditure
- Gross external debt
- Social care ratio
- Fees & Charges to service expenditure ratio
- Council tax requirement / net revenue expenditure
- Growth above baseline

1 – 2 marks for explaining the Index. ½ a mark per indicator identified up to 2-3 marks. Flexible marking as this is not detailed in the learning material, testing reading around subject.

(4 marks)

Syllabus ref B1

b)

Risk appetite is the term commonly used to describe where an organisation considers itself to be on the spectrum ranging from willingness to take or accept risk through to an unwillingness or aversion to taking some risks.

Risk appetite in public service organisations has been historically low compared to the private sector. This is understandable, as most organisations delivering public services rely on public money and have responsibilities for appropriate stewardship, and not being reckless with funds.

Risk appetite is based on the level of unmitigated or residual risk that an organisation is prepared to tolerate or, in other words, the level at which no further action will be taken to reduce the risk.

Risk appetite will vary according to the nature of the business and the type of

service provided. Investment, trading or physical delivery of services will focus more on opportunities and their consequent risk than services whose prime purpose is stewardship of public funds or protecting the public; for example, a local authority supply trading organisation is likely to have a different risk appetite to child protection services.

Risk appetite may also vary within the organisation if it has a number of discrete functions; for example, risk appetite around a major construction project in a local authority may differ from risk appetite in relation to treasury management or archiving services.

As public service organisations face reducing financial resources at a time when the demand for public services is increasing, governing bodies need to ensure that their risk appetite is still appropriate to make the most of opportunities as well as to guard against threats.

The austerity measures in the UK over the past five years, and the projection that this will continue over the next five years at least, has driven public service organisations to examine their risk appetite. For example, the Chief Executive of the London Borough of Barking & Dagenham stated that: 'Risk needs to be managed rather than avoided, and consideration of risk should not stifle innovation. The Council delivers services in an increasingly litigious and risk averse society and believes that risk management is a tool for exploiting opportunities as well as safeguarding against potential threats. LBBB uses the discipline of risk management to promote innovation in support of the council's strategic objectives as detailed in the Corporate Plan.'

2 marks for definition of risk appetite, 1 mark per relevant point about different risk appetites for different activities, must include reference to examples for explanation (up to total of 6 marks)

(6 marks)

(Max 10 marks)

Marking Instruction

a)

1 – 2 marks for explaining the Index. ½ a mark per indicator identified up to 2-3 marks. Flexible marking as this is not detailed in the learning material, testing reading around subject. (total 4 marks)

b)

2 marks for definition of risk appetite, 1 mark per relevant point about different risk appetites for different activities, must include reference to examples for explanation (up to total of 6 marks)

(Max 10 marks)

Sub Marking Instruction 1

1 – 2marks for explaining the Index. ½ a mark per indicator identified up to 2-3 marks. Flexible marking as this is not detailed in the learning material, testing reading around subject.

(Max 4 marks)

Sub Marking Instruction 2

2 marks for definition of risk appetite, 1 mark per relevant point about different risk appetites for different activities, must include reference to examples for explanation (up to total of 6 marks)

Question 5

Syllabus Ref B1

a)

Note that this should not just be financial risks, as most risks, if they materialise, will have an impact on delivery and / or cost.

- Commercial Risk – Contractual issues, failure of suppliers to timescales/quality etc, collapse of contractors etc.
- Financial Risk – Inflation, failure to meet targets, financial developments affecting plans etc.
- Legal Risk – New legislation, failure to obtain appropriate approval, unexpected licensing requirements etc.
- Management Risk – Lack of clarity regarding roles and responsibilities, poor leadership, inappropriate decision making etc.
- Resource Risk – Skill set, limited resource availability, training requirements etc.
- Schedule Risk – Delays in supplies, dependencies on other projects, poor estimations of time etc.
- Technical Risk – Inadequate design, infrastructure failure, breaches in information security etc
- Candidates may come up with other ways of managing risks, but as examples:
 - identify all likely costs at the outset of the project to secure appropriate funding
 - Identify key milestones of the project and assign deadlines and responsibility for their completion. Ensure this is clearly communicated to and understood by relevant individuals
 - Regularly monitor and report the costs at intervals to suit the project needs, rather than routine monthly / quarterly budget reporting
 - Account for project cost separately to business as usual so any over-runs can be specifically identified and reported more easily

Regular project meetings to assess whether milestones have been achieved on time, and actions to address slippage established and assigned to individuals as responsible

½ mark per risk. Candidates should offer actions or mitigations for the risks they identify, otherwise total marks should be limited to 3 marks maximum.

(5 marks)

b)

Projects can be funded and managed through the normal business as usual budget processes of an organisation, but this is rare, especially where an activity is outside of the day-to-day activities of the organisation.

There are pros and cons to having a separate budget for each project.

Pro	Cons
Incentive to identify all likely costs at the outset of the project to secure appropriate funding	Spending progress on projects may not get reported to management in the same routine way as regular budget monitoring
Monitoring can be done by the project team at intervals regular enough to suit the project needs, rather than routine monthly / quarterly budget reporting	Temptation to spend all allocated project budget, even if not all is eventually required as it is seen as 'belonging' to the project
Easier for project team to monitor and demonstrate the compliance with any conditions attached to funding as money is separately accounted for	Additional report writing, and time consuming management meetings may be needed to receive just the project budget reports
Senior managers can identify where individual projects within a team or department are performing (or not), as over or underspends are not hidden in net budget figures for the department	Reluctance of project managers to report underspends may result in unnecessary service cuts elsewhere in the organisation

1 mark per well explained advantage or disadvantage

(5 marks)

(Max 10 marks)

Marking Instruction

½ mark per risk. Candidates should offer actions or mitigations for the risks they identify, otherwise total marks should be limited to 3 marks maximum.

(5 marks)

1 mark per well explained advantage or disadvantage

(5 marks)

Sub Marking Instruction 1

½ mark per risk. Candidates should offer actions or mitigations for the risks they identify, otherwise total marks should be limited to 3 marks maximum.

(5 marks)

Sub Marking Instruction 2

1 mark per well explained advantage or disadvantage (max 5 marks)

(5 marks)

Question 6

Syllabus reference B3

Candidates will be expected not just to write off the statement in the question as incorrect or foolish, but to provide some reason and challenge to both sides of the argument.

The report should identify that alongside the legal framework that must be observed for investments, there are other risks to be managed.

They may also make reference to the examples for local authorities, health bodies and charities given in the learning material, as well as any they may be able to draw on from their careers or the countries they work in, for comparisons in this case.

The following style is not prescriptive, but candidates should present something like the following:

Purpose:

Report to Cabinet regarding approaches to maximising income for the Council from managing its investment portfolio.

Date: March 2020

Presented to: Cabinet

Introduction

In response to the recent comments to Cabinet about how we should consider investing our portfolio to maximise income to the council, this report aims to address the constraints under which we must operate to remain within the law. It also seeks to clarify what our legal powers are regarding investment and borrowing, and what the recommended practices are.

This should assist Cabinet in making appropriate choices regarding the wise management of its investments, appropriate regard to the risks, and take account of other factors that Members might wish to consider when dealing with public funds.

There are challenges in balancing financial return with risk. In the banking collapse of 2008, many councils lost significant sums, and as a consequence, guidance such as CIPFA's Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes ('the Code of Practice') advocates a risk averse approach to treasury management to ensure that 'priority is given to security and liquidity when investing funds'.

Legal powers and restrictions

Essentially, a local authority in England, Wales or Northern Local authorities in England and Wales are statutorily required to comply with the Local

Government Act 2003, which sets out capital finance and borrowing regulations in local government. Ireland may borrow or invest for any purpose relevant to its functions, under any enactment, or *'for the purpose of the prudent management of its financial affairs'*. The latter is intended to cover those investments made in the course of treasury management and also covers the temporary investment of monies borrowed to finance expenditure in the near future. It should be noted, however, that borrowing purely to invest remains unlawful.

The council operates in a less constrained environment than NHS Trusts where they only have the power to invest any surplus funds with the National Loans Fund Temporary Deposit Facility operated by HM Treasury or Government Banking Services accounts. NHS Foundation Trusts have more freedom, but are still subject to guidance and a list of criteria to meet when making investments.

The restrictions around borrowing are outlined in a section below.

Recommended practice

The Prudential Code is a guidance document that draws from the requirements of the LG Act 2003. As part of the council's compliance, we must annually determine an affordable borrowing limit at an amount to ensure it does not borrow more than it has the revenue capacity to service and repay.

CIPFA publishes Code of Practice for Treasury Management in the Public Services, which the council is obliged to have regard to. Together with the Prudential Code, this encourages authorities to have an integrated strategy for borrowing and investment.

Within the Code of Practice, there are Treasury Management Practices that cover 12 different areas ranging from risk management to corporate governance. As a council, we include these in our Treasury Management Strategy that we review each year. This includes how we manage our risks, where we will invest our money and how we do that in a transparent way.

If we, as a council, wanted to alter our arrangements to give us greater freedoms about who we would prefer to invest with, the council would need to amend, and agree a new strategy. This can be done, but we would still need to comply with the legal framework.

Other factors

When considering how we invest the council's money there are ethical issues and management of risks that need to be understood. We can use investment to promote causes the council wishes to support such as infrastructure, social housing, renewable energy, or advocate boycotts of causes the council does not approve of such as tobacco, fossil fuels, pornography, weaponry.

Often, ethical concerns coincide with sound investment practice, for example companies engaging in unsustainable environmental practices may well be poor investments due to the risk of fines, future regulations restricting their activity or simply exhaustion of natural resources. Similarly, corrupt practices, complicity with or direct perpetration of human rights abuses or exploitation are likely to have negative financial consequences in the medium and long term, as the business model is unlikely to be sustainable as societal conditions inevitably improve. Moreover, poor behaviour of the kinds described may be correlated with general poor governance; for instance a company, which sanctions covert bribes may itself be at increased risk of major fraud. When considering taking a different approach to investment strategy to maximise income, Cabinet members must understand the potential risks – both in financial terms, and in reputational terms if the electorate should feel strongly for or against investment in particular companies based on the social responsibilities and ethics of these companies that might, or might not give a higher financial reward.

Borrowing regulations

Local authorities in England and Wales are statutorily required to comply with the Local Government Act 2003, which sets out capital finance and borrowing regulations in local government. Specifically, the Act states that local authorities:

- may borrow for capital expenditure without government approval, for any purpose relevant to their functions or for the prudent management of its financial affairs
- must be able to demonstrate that any borrowing is sustainable
- may only borrow in sterling; HM Treasury consent is required to borrow in any other currency
- must determine and review how much money they can afford to borrow
- Essentially, the Council may borrow or invest for any purpose relevant to its functions, under any enactment, or '*for the purpose of the prudent management of its financial affairs*'. The latter is intended to cover those investments made in the course of treasury management and also covers the temporary investment of monies borrowed to finance expenditure in the near future. It should be noted, however, that borrowing purely to invest remains unlawful.

Conclusion

As Finance Manager to the Council, there are specific duties around stewardship that must be upheld, including ensuring that the council complies with the relevant legislation. Cabinet members must have regard to prudence and to the careful stewardship of resources and investments.

Whilst the Leader's statement is a valid point that should be discussed, there are existing constraints that may prevent the council from 'investing in anything'. Indeed it could be dangerous, reckless and potentially unlawful to do

so.

This does not mean that we cannot change our treasury management strategy, but that we must:

be aware of the risks – financial and reputational;

- determine the risk appetite – how much are we willing to lose if we fail to achieve a higher return from a riskier investment;
- comply with the relevant legislation;
- comply with recommended guidance, or be prepared to explain why we are taking a different path.
- comply with recommended guidance, or be prepared to explain why we are taking a different path.

1 mark for using a report style, but must include both plain English (not overly technical) and tactful style to gain a full mark for this. This is a comprehensive model answer and candidates may not cover all points in the time available so 1 further mark per well explained point up to 7 marks across the areas of law, recommended practice, borrowing and other factors such as risk appetite. Maximum of 5 marks if only one or two areas are covered. 2 further marks for including discussion and a concluding response to statement.

(Max 10 marks)

Marking Instruction

1 mark for using a report style, but must include both plain English (not overly technical) and tactful style to gain a full mark for this. This is a comprehensive model answer and candidates may not cover all points in the time available so 1 further mark per well explained point up to 7 marks across the areas of law, recommended practice, borrowing and other factors such as risk appetite. Maximum of 5 marks if only one or two areas are covered. 2 further marks for including discussion and a concluding response to statement. (maximum 10 marks overall)

(Max 10 marks)

Sub Marking Instruction 1

1 mark for using a report style, but must include both plain English (not overly technical) and tactful style to gain a full mark for this. This is a comprehensive model answer and candidates may not cover all points in the time available so 1 further mark per well explained point up to 7 marks across the areas of law, recommended practice, borrowing and other factors such as risk appetite. Maximum of 5 marks if only one or two areas are covered. 2 further marks for including discussion and a concluding response to statement.

(Max 10 marks)