CIPFA The Chartered Institute of Public Finance & Accountancy

STRATEGIC PUBLIC FINANCE

June 2017 suggested marking scheme

Duration: 3 hours

Instructions to candidates

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.

Marking Scheme for question 1

1(a) Present reasoned arguments for and against any nation going down the route of becoming a "tax haven". In your answer you should refer to publicised cases or examples from the latest thinking at a global level, or any situations from your own experience.

Syllabus Ref A3 Workbook 1.6.8

This question is meant to be challenging and topical and is designed to test whether candidates are reading around the subject and gaining knowledge in a broader context than the learning material. Tax havens are relatively breifly covered in the learning material, in relation to the global tax environment.

Considerations in relation to the UK becoming a tax haven

UK needs to pay for Brexit – on top of all the other existing commitments and debts, global constraints on governments in the area of taxation, and needs to reach trade agreements with other jurisdictions – makes a wholesale move towards tax haven status both inadvisable and unlikely. If anything, the new circumstances will make reductions in corporation tax more difficult than if the UK had remained in the EU.

Despite talk of lowering corporation tax rates, the UK has been at the forefront of international efforts to limit corporate tax reduction through base erosion and profit shifting (BEPS).

The OECD has led on this, with significant input from the UK. The OECD's agreed actions increase tax transparency and reduce opportunities to shift profits and minimise taxation. The chancellor has shown no sign of backing away from planned tax reforms in the UK to implement major aspects of the OECD action plan.

Some drawback of tax haven status:

- Erosion of national tax bases of other countries potentially leading to poorer countries becoming poorer and needing more aid
- altering the structure of taxation (by shifting part of the tax burden from mobile to relatively immobile factors and from income to consumption)
- hamper the application of progressive tax rates and the achievement of redistributive goals.

Pressure of this sort can result in changes in tax structures in which **all** countries may be forced by spill-over effects to modify their tax bases, even though a more desirable result could have been achieved through intensifying international co-operation.

More generally, tax policies in one economy are now more likely to have repercussions on other economies. These new pressures on tax systems apply to both business income in the corporate sector and to personal investment income.

Some benefits of tax haven status:

- investment by overseas businesses
- increased revenue (at a lower rate but at higher volume)

This question may be answered in relation to any country. Credit will be given for alternative but valid points in relation to other countries. 1 mark per advantage / disadvantage identified up to 6 marks, plus 6 marks for wider discussion *(maximum 12 marks)*

1(b) Discuss the potential (and actual) impacts on the way local services might be delivered when central government politics and decisions on rebalancing the finances of a country affect local budgets. Refer to relevant examples from your experience or learning (UK or other country).

Workbook 6.4

The starting point of fiscal decentralisation should be asking the question 'What public services should sub-national governments deliver'?

Sub-national governments spending assignments will vary according to size of country (population and area), geography, heritage and political situation.

When allocating services to each level of government the concept of 'subsidiarity' should be kept in mind. That is, each public service should be provided by the jurisdiction having control over the minimum geographic area that would internalise the benefits and costs of such provision.

This includes thinking about whether services may be more efficiently provided locally where: preferences can be voiced; oversight can be promoted; and benefits from taxation observed.

Candidates might identify a range of actual impacts from their own experience. Some examples might include:

- Collaboration with other similar services or neighbours
- Outsurcing of back office
- Managing dmeand through rationing or increasing charges for some services
- Service redesign or transformation
- Encouraging switch to digital services and self service online
- Investing in prevetative services
- Use of voluntary sector to fill the gap – eg libraries being run by volunteers

Politics

Political preferences also have an effect on how the cuts to spending will manifest - which adds a further level of complexity on top of the level of volatility. For example, cuts to welfare spending on tax credits and benefits, had already been announced by the UK Government in 2015 but were reversed in the Chancellor's Autumn Statement as tax receipts were forecast to be higher and a consequential relaxation of austerity measures, albeit on a temporary basis, were deemed to be affordable. Where public spending has to fall, the majority of reductions are more likely to come from public bodies either doing less, or providing services with fewer resources.

CIPFA's joint report with SOLACE, 'After the Downturn' [1]identified three strategic options, which are likely to play a part, in combination, in rebalancing the public finances. They are:

- Redefining the relationship between the State and the individual;
- significant delayering of the public sector with many more decisions taken locally with minimal oversight; and,
- a major initiative to maximise economies by much more effective collaboration between public bodies.

Financial managers when determining the funding strategies for their organisation should explore all these strategic options. They should also use sensitivity analysis and scenario planning to create information about the likely impact of economic climate changes on planned spending, and to measure the potential effect they will have on service delivery.

Between the difficult economic climate in the UK as the economy slowly recovers, and the government policy on deficit reduction, there will be a disproportionate impact on some sectors of public services as a result of Political decisions. In the UK, certain sectors or groups of stakeholders are being protected from cuts as announced in the 2015 budget. The 'triple lock' protects pensioners that guarantees annual increments on state pension payments; defence spending has been protected; and NHS spending will also increase over the 2015-2020 parliament. Taxation has been maintained at a relatively low level and as a result, the cuts to other areas of the public sector will be greater to compensate for the protected budgets.

Syllabus Ref A3 Workbook 9.2

Generally 3 marks for identifying potential impacts, 3 marks for political influence, 2 further marks for examples and discussion. Some flexibility across the question on mark allocation (maximum 8 marks)

1 c) Central government policies can have a significant effect on how local taxes are raised.

Explain the role of local taxation in the financing of *local government* in the UK, and how it combines with both other sources of income and the gearing system in the UK.

Syllabus Ref A3 workbook 6.5 and 6.6

1 (c)

Candidates should describe the elements of local tax and some examples of other sources of income. Local taxes should then be described in more detail, with knowledge of Formula Grant and Revenue Grant.

<u>Local Taxation</u>

Primary role of local taxation is for funding the delivery of local services.

[1] http://www.cipfa.org/policy-and-guidance/reports/after-the-downturn

Source of local tax income from:

- Domestic properties – through council tax
- Business premises – through retained element of Non-domestic rates (NDR), business rates supplements and business improvement districts.

Other sources of income from:

- User charges / fees such as: for using facilities like sports centres, planning application fees, collection of commercial waste
- License fees such as: taxi, gambling, sale of alcohol
- Levies such as Business Improvement District charges and business rate supplements.

NDR – been in place since 1990, Rateable value set every 5 years based on imputed rental value (what the owner might expect to get annually if the property was rented out) multiplied by the NDR multiplier set by central government. Collected by local authorities, pooled nationally and re-distributed by central government. Various discounts can be applied for different circumstances such as charities, and empty properties. High level of collection rate (over 97% in 2013/14).

From April 2013, the government introduced the business rates retention scheme, which allows the local authority to retain the local share allocation, and encourages growth of business rates as the scheme allows retention of growth (within parameters).

Council tax has been in place since 1993. Based on the value of the property, in bands A to H. Band H pays twice that of band D, and three times that of band A. Discounts are applied for homes in single occupancy, and other exemptions can apply. Council tax is raised, collected and retained locally, being collected by district or Unitary Councils on behalf of the County, Police and town / parish councils (precepting authorities), as well as for the district or unitary – who are the billing authority.

In order to increase Council tax by more than 2% per year, the council has to undertake a local referendum. There is some additional leeway – central government permits councils to raise a further 2% council tax, specifically for spending on social care commitments, without the need for a local referendum.
This central government policy has meant that local tax has been driven down (in real terms) over the past 7 or more years, as rises have been restricted, even if local demand for services has increased.

Government Grant

The actual cash grant allocated by central government to local authorities is through a mixture of methods; principally by 'formula' or a specific allocation.

Central government grant is made up of:

Formula Grant is the general term given to the main sources of general Government funding for English local authorities. Formula Grant consists of three main components:

- A share of funding from the Non-Domestic Rates (NDR) pool (the 'Distributable Amount')
- Principal Formula Police Grant (for Police and Crime Commissioners and authorities)
- A top-up grant called the Revenue Support Grant (RSG)

For all practical purposes, these three components form a single source of finance for English local government.

From 2006-07 Formula Grant has been distributed using a system referred to as the 'four-block model.' The four blocks are:

- Relative Needs Amount (intended to compensate for differences in needs of each local authority area)
- Relative Resources Amount (intend to compensate for differences in the relative strength of the Council Tax tax-base in different areas)
- Central Allocation (a common allocation per head to all authorities with the same responsibilities)

- Grant Floor Adjustment (a net nil re-allocation of grant between local authorities to ensure that every local authority receives a minimum annual increase in funding, regardless of the outcome of the preceding three blocks).

Gearing

In England the ratio of funding provided by central government to that provided from local sources is typically around 4:1

As the percentage of local authority expenditure funded by government grant is around 80% in England a 5% reduction in government grant means a 25% increase in council tax in England.

This disproportionate impact of a reduction in central government grant on local taxpayers is called the 'gearing effect'. This 80% is an average. Some local authorities are less reliant, others more so. Cut in central government grant has greater effect, the higher the proportion the grant is of their overall income.

Candidates may refer to the 'double-whammy' example from the workbook for West Midlands Police, who suffered large impact from reduction in grant because of both gearing, and the grant floor adjustment (damping).

Candidates should provide a description of how these sources of income are combined to form a balance budget for delivering services. They may present a fictitious table to represent how this might look, and may also refer to use of reserves to balance the budget. More capable candidates may refer to some local authorities being free from central government grant entirely,or aspiring to be in the near future.

1 mark per well made point. Up to 7 marks for well explained role of local taxation and 3 marks for gearing explanation. *(Maximum 10 marks)*

Marking scheme for question 2

2 (a). With reference to examples with which you are familiar, explain what 'good' governance looks like for collaborations, and in addition, the challenges that may arise in implementing sound governance arrangements.

(10 marks)

Syllabus Reference C4 Workbook 12.3

Candidates are not expected to cover all the elements listed here in the time available.

The governance arrangements for different types of collaborative working will vary. All should include:

- defined roles and responsibilities
- reporting lines
- reporting intervals
- decision making powers
- funding structure and financial record keeping responsibilities
- exit strategy - clauses should be included in the agreement about how the partnership can be terminated.

What does good governance for collaboration look like?

Here are some fundamental elements of good governance that can apply to any shared working arrangement.

Shared understanding

Partners should formally agree and record how a partnership operates, including:

- structure
- purpose and aims
- activities
- roles and responsibilities
- membership
- regulatory framework
- exit strategy.

Accountability

Partnerships should account for actions through:

- reporting, meetings
- oversight and scrutiny of performance and regulatory compliance

- openness and engagement
- complaints and redress procedures.

Decision-making

There should be clearly allocated roles, responsibilities, accountabilities and open and transparent processes, such as:

- records of delegated authority and key decisions
- effective scrutiny.

Value for money

Costs and benefits should be understood to ensure arrangement provide value for money over alternative arrangements.

Corporate governance processes

Good governance contributes to delivering high-quality, cost-effective services through effective systems and process for managing issues, such as risk (including insurable risk) performance, finance and information.

Standards of conduct and leadership

High standards should be agreed to govern the way the partnership works, to ensure the needs of all partners are met, to identify conflicts of interest and to resolve disputes.

Up to 6 marks for describing good governance framework, 4 further marks for examples and identifying challenges (max 10 marks)

Collaboration article for reference – outlines some of the challenges
So what lessons can be drawn from an alternative delivery model that is now supplying £1.5bn in contract value and employing at least 40,000 staff formerly part of the public sector?
Inevitably there's good news and bad news. On the plus side, Cabinet Office evidence suggests that public service mutuals have delivered significant savings to their parent authorities; generally improve and certainly innovate in the services they offer; and tend to achieve the 'John Lewis' effect of combining employee ownership with high levels of staff engagement. This is very much a business model that has proved its viability.
One minus, arguably, is that 100 spinouts doesn't compare well with Francis Maude's ambition for 15% of public sector staff to have transferred to employee mutual businesses by 2015.
Another concern is the relative vulnerability of many co-owned businesses to have exited the public sector. To date, spin-outs from local government or health are small to medium sized, averaging turnover of around £15m a year. Nearly all are stand-alone businesses with thin balance sheets. Many operating highly sensitive services, like social care, also choose to adopt a less ambitious, more 'socially responsible' attitude to profit distribution than conventional businesses, particularly publicly limited companies, would tolerate.
With Cabinet Office set to boost the model further via a yet to be defined right to mutualise, it's worth ministers also noting some of the significant challenges ahead.
At the heart of those challenges lie the sectors most likely to experience mutualisation. As austerity cuts even deeper into public sector budgets, authorities are now looking for drastic savings in the most sensitive of services: adult social care, youth services and children's services.
Combine that reality with the vulnerability factor described above and a number of warning signs appear.
Firstly, how many public service mutuals will be able to re-win their initial spin-out contracts when pricing is based on relatively thin profit margins, and when balance sheet weakness and big competitors may damage them for the first time?
Second, with contracts expiring, how many spin-outs can be sure of securing the investment

capital essential to diversification and growth? And third, how many of the more vulnerable mutuals could end up selling themselves to buyers their parent authority no longer has the right to vet?

None of this is a reason for government to hit the panic button. Most spin-outs are robust, performing well and popular with their customers. Among a variety of alternative delivery models in the public sector, mutuals are a minority but growing option. But there are clearly issues for Cabinet Office to address. Ministers could consider offering certain spin-outs what could be termed 'public service obligation' status. Under this option, mutuals supplying essential, complex services to the most vulnerable in society could opt for a form of ring fencing – accepting socially preferable lower profit margins, as many do now, in return for, say, tax concessions, obligatory asset locks or ceilings on external ownership.

Scale is another challenge. Without the emergence of some genuinely large public service mutuals, markets such as social care could become less diverse and more vulnerable to domination a few conventional suppliers. So one policy lever for government is to use a new round of support funding to help some of the mutuals they've fostered to become bigger and more resilient. There are encouraging signs that Cabinet Office has targets like these in its sights.

For public sector employers, with spending cuts homing in on children's, youth and disability services, employee mutuals' relatively high trust ratings among voters may make the model an increasingly attractive option. By addressing these issues, government can help ensure the viability of these innovative new providers.

PF Opinion By:
Patrick Burns 17 Jul 15

2 (b) Syllabus Ref C4 Workbook 12.5

Describe the expected characteristics of a mutual organisation and discuss the advantages and disadvantages of establishing this type of entity for delivering public services.

Characteristics of mutual and social enterprises

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 Mutuals Taskforce in 2011, and the Mutuals 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 mutuals is reflected in the numbers. By July 2014, 100 public service mutual had been created, a dramatic increase from just nine mutuals in 2010.

Some of these mutuals 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.

Mutuals 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.

Mutuals 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 mutuals 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.

www.gov.uk/government/case-studies/realise-futures-cic

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

Up to 4 marks for describing characteristics, 6 marks for the discussion around advantages and disadvantages. (Max 10 marks)

2 (c) Syllabus Ref B2 Workbook 5 and 12.2

Discuss the role of the Chief Finance Officer in the planning and execution of setting up a mutual organisation and identify what skills the CFO could bring to the process.

Where a mutual or social enterprise is being considered, CFOs or finance managers need to be engaged in the strategic thinking to ensure that all financial aspects of the project, and the financial impact for the remaining organisation have been considered.

On top of good financial analysis and appropriate financial controls, the planning should also include the following activities:

- Sound financial forecasting to establish how the business will work going forward.
- Risk identification and a control framework to mitigate the critical risks.
- Design and regularity of business reporting.
- Review of the organisation's resources (people, money, buildings, equipment and intellectual property) and decide how they can best be used to meet the objectives of the organization.
- Projection of the social impact, and how that will be delivered against target.
- Establish a governance structure that would allow a social investor to take part ownership of an organization.
- Identify opportunities to deliver services to a wider audience.
- Ensure staff are properly informed and engaged in the process.

Once the new organisation is established (be it a mutual, a CIC or other legal entity), the senior managers – including the CFO or financial managers – should consider asking the following questions to help measure progress and identify problem areas:

- Are our costs staying in line with our financial plan?
- What costs are over-running, and what can we do to haul them back?
- Where could we make savings to bring the overall budget back in line?
- Are our customers continuing to use our services?

- Are we attracting new customers?
- Are our new services covering their costs?
- Are our customers paying on time?
- Do we have enough cash to pay our staff and our suppliers on time?
- If we have borrowed money from the bank, are we delivering results in line with what we told them?
- Are our staff happy to work for us?
- Are we able to recruit good quality staff where we need them?
- Do our staff have the training and qualifications they need to do their job well?
- Are we doing the things we need to do to meet our Regulator's expectations?

Skills that the CFO should bring include:

- Negotiating and influencing
- Analysing and interpreting data
- Reporting and explaining risks to senior management
- Effective communication with colleagues and other stakeholders

1 mark per point well explained to include both role and skills (10 marks max)

Marking scheme for question 3

Syllabus Ref A6 Workbook 11.4. 11.5

(a) With reference to schools, or other examples that you are familiar with, discuss the argument for and against charging for public services. (6 marks)

Arguments for charging

- Equity - relating payment to benefit
  - Eliminate hidden subsidies for service provision
  - Non-users of the services are not required to subsidise users. This occurs when taxation is used instead of charging - for example families with children who attend state schools are subsidised by tax payers who do not have children
  - Charge can reflect the scale of usage; for example, parking charges relate to the amount of time so occasional users are not subsidising frequent users.

There is evidence that even small charges can change behaviour. Consider that in Australia, charges to visit the doctor at the local surgery were introduced in 2014, not only to generate income for Medicare, but to help reduce the number of unnecessary visits that could be self-treated.

- Economy
  - Users are more likely to value and economise their use of something they have paid for than something they receive for free at the point of use
  - Promote competition and improve value for money where services can be provided by other suppliers
- Rationing / efficient use of resources
  - Where services attract a charge, users will only buy that service when the cost to them matches the value they will receive.
  - Where services are free at the point of use there is a risk of over-supply and waste of resources
- Accountability
  - Charging for services helps develop a relationship of accountability between provider and customer. Funding via taxation can reinforce anonymous bureaucratic service delivery
  - Service quality is usually under more scrutiny if the user has paid for the service rather than receiving it free at the point of use.

Arguments against charging

- Equity – relating payment to ability to pay

  - The major barrier against charging for public services is moral. The price people are prepared to pay reflects both the value and their ability to pay for the service.
  - Discounts to certain groups (benefits claimants and those on low incomes) can create stigma and potentially the exacerbation of a dependency culture
- Costs
  - Substantial resources may be required to implement effective charging mechanism
  - Administrative costs relating to and vouchers or discount schemes need to be calculated
- Managing expectations of stakeholders
  - Culturally, UK citizens are familiar with receiving 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

3 marks for each side of the argument for and against. Limit to 4 marks if no reference is made to any examples (max 6 marks)

(b) When designing a charging structure, what steps in the cycle should be undertaken to establish fair and effective charging? (4 marks)

the basic steps that should be undertaken when designing a charging structure:

- Identify which charges should be reviewed and consider:
  - service user feedback
  - financial pressures and opportunities
  - alignment with corporate objectives.
- Assess constraints and understand the legislation considering:
  - national guidance
  - users' ability to pay
  - use of surpluses
  - target service user groups.
- Collect and analyse information and consider:
  - service uptake and user profile
  - customer satisfaction
  - other providers in the market
  - unit costs and cost recovery
  - impact of previous decisions.
- Examine options for charges and concessions by considering:

    - impact on service users including minority groups
    - forecast demand and income
    - concessions and exemptions
    - impact on other services and local businesses
    - consistency with corporate guidelines.
- Consult on proposals using:
    - workshops with service users
    - stakeholder surveys
    - sessions with decision makers
    - staff feedback.
- Revisit options as appropriate and:
    - adjust options as required
    - appraise all options
    - seek approval from decision makers.
- Implement the new charge and consider:
    - timing and phasing
    - communication of charges and the changes
    - monitoring arrangements and target setting.
- Monitor and review the impact by reviewing:
    - whether the intended aims met
    - the impact on uptake and income
    - any unintended consequences (good and bad).

½ mark per step described (max 4 marks) Candidates are not necessarily expected to describe the steps in this much detail to gain all four marks, but should describe the 8 different steps.

Marking scheme for question 4

Given that the time allocated for contact with a client can be seen as an input measure of performance, discuss the drawbacks of these kinds of measures. Make reference to social care, or other similar services with which you are familiar.

(a) As part of your answer outline other, more appropriate indicators of performance that could be used to assess effectiveness and value-for-money, including outputs and outcomes. (6 marks)

Syllabus ref C5 Workbook 13.3

Measurement of inputs - such as time spent on a task - when considering value-for-money (VfM) and effectiveness can be flawed, because no indication is given of how successful that allocation of resource and effort has been.

As an example, a 15 minute visit to a client by a carer could be spent just making a hot drink and chatting to the client, or getting that client washed and dressed, or preparing them a meal. Without assessing the outputs and outcomes of the visit - did the client's wellbeing improve, or were health issues prevented - it is difficult to assess whether or not the inputs were worthwhile.

Of the three E's (economy, efficiency and effectiveness), only 'economy' can be assessed with just inputs. Efficiency looks at outputs when compared to inputs and effectiveness focuses on the outcomes of an action or use of resources.

Looking at the three elements of inputs, outputs and outcomes:

- Inputs - Time spent with clients, costs (pay, costs of equipment and supplies)
- Outputs - Number of tasks carried out (meal prepared, client washed and dressed, etc.)
- Outcomes - Health of a client, levels of client satisfaction, measure of client's wellbeing

Suitable indicators of performance could be:

- Economy - Cost of each visit
- Efficiency - Number of tasks completed per visit
- Effectiveness - Client satisfaction, compared to cost inputs

The use of both lead and lag performance indicators should also be referred to in the answer. Lead indicators are difficult to measure, but easier to influence and can drive performance, as measured by lagging indicators - which are easier to measure, but much harder to influence and improve.

By focusing on what the inputs are and what they are doing (i.e. what effect they are having), performance and satisfaction can be improved.

1 mark per point made. Limit to 3 marks if no explanation or example is given (6 marks max)

(b) Evaluate the trade-offs between good stewardship of limited resources and public (or customer) expectations and desires. (4 marks)

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 *(4 marks maximum)*

Marking scheme for question 5

Syllabus Ref B3 Workbook 4.5, 4.2

(a) What steps can a Chief Finance Officer in any public sector organisation take to ensure that the financial consequences of any capital investment plans are fully taken into account over the medium term? (4 marks)

The Chief Finance Officr should ensure that the processes in place for determining the capital investment plans are able to match the investment cost with either service or financial benefits, maybe both. There will be supporting documentation to ensure that the business case for investing in a particular project is robust.

The revenue consequences of capital investment will be specific to the nature of the capital expenditure. The usual categories will e land and buildings, plant and equipment, IT and vehicles. It is important that the revenue consequences are matched to the timing of the investment and ideally sensitivity analysis applied to ensure that account is taken of any likely variation in scope of project, timing or cost.

There may be revenue savings arising from the new capital investment. For example, any lower cost of annual maintenance compared with existing IT systems or premises cost resulting from the closure of a building.

The forecast cost of any borrowing required is also a cost that needs to be included in medium term financial plans.

The combination of cost and savings streams together may present a net cost profile that is not affordable. If this transpires, decisions will need to be taken on the level of investment as a driver of costs and benefits. The CFO should ensure that the information is presented in an understandable manner to the decision making body so that appropriate decisions can be made regarding termination of a project, or authorising alternative funding sources.

CFO will also calculate the cost of borrowing and the specific impact on the Minimum Revenue Provision in local government accounts and the impact of the Medium Term Financial Plan.

The CFO should also identify the financial risks to the organisation and present them to the decision makers.

1 mark per step explained (max 4 marks)

(b) Describe, with examples from your experience or learning, the potential funding sources for capital spending on major infrastructure projects. (6 marks)

There are a range of sources that could attract credit in this question.

The Public Works Loans Board

This small office of government now sits within the Debt Management Office, an executive agency of HM Treasury. It effectively on-lends the proceeds of UK government bonds (Gilts) to local government.

The lending process is very simple: the DMO twice daily calculates a sophisticated yield curve based on all Gilt Market Data, adds a 1% margin and offers local authorities a menu of fixed rates for loans maturing from 1 to 50 years in 6 month increments. Interest is semi-annual and principal repayment options are

- Maturity (also sometimes called 'bullet') - all principal is repaid on the last day of the loan
- Equal Instalments of Principal (EIP) - the principal amortises on a straight-line basis with each semi annual payment, so the total payment (interest plus principal) decreases towards the end of the loan.
- Annuity - like a mortgage, the interest and principal payments combined form an equal amount at each semi annual payment date, with the ratio of interest to principal decreasing.

The PWLB also lend at variable rates.

The PWLB will lend amounts from £100 000 upwards and agree rates on the day with proceeds being delivered 2 days later. There is no documentation to process or negotiate, so administrative costs are very low.

This exceptional flexibility means local authorities can quickly take advantage of favourable rates and achieve very precise matching of their loans portfolio to their borrowing benchmark, which minimises risk and cost of carry.

Unsurprisingly, PWLB is the main lender to local government.

The PWLB is also a lender of last resort – as long as an authority believes it can afford the borrowing and intends to use it for a lawful purpose, PWLB will lend. This underpins local authorities' liquidity.

The only drawbacks are a comparatively high price (although discounts are available for authorities who share their capital spending plans and infrastructure projects of national importance); the limited range of structures and no ability to borrow on an index-linked basis. Restructuring PWLB debt is also exceptionally expensive due to the difference between the discount rates for calculating premiums or discounts and the cost of new loans.

Bank Loans

Banks and similar institutions form a significant part of the universe of lenders to local authorities. Their prices can compete well with the PWLB but the contracts are more complex and onerous, requiring external lawyers to review. More significantly, most such contracts contain embedded derivatives. The most common example is the LOBO (lenders option, borrowers option) which allows the lender to periodically propose a new

rate, which the borrower must accept or else repay the loan in full (without penalty). The option is really quite difficult to price so it can be hard to understand the likelihood of the loan being called, hence the potential exposure to interest or refinancing risk. Even if you understand these advanced instruments, constant monitoring and scenario testing is advised.

The European Investment Bank also lends to local authorities for projects it deems important. There is greater flexibility of loan structure than the PWLB and often much better prices, but at the cost of complicated contracts, slower execution and the need for the project to be large enough to warrant EIB involvement. In practice, this is only an option for very large authorities.

Inter-Authority Loans

Since the Icelandic bank crisis, many local authorities have struggled to find counterparties for their investments. For the reasons detailed above, other local authorities are an attractive safe haven with little prospect of default. With many deals now occurring bilaterally, this can be a cheap and efficient source of finance for borrowers. The only drawback is the limited scope for very long term loans, as most lending authorities will not want to tie up their reserves or other investible amounts for more than a year. This exposes the borrower to interest rate and refinancing risk.

Debt Capital Markets - Bonds

Since the PWLB increased its margins in 2010, there have been a number of authorities who have issued bonds to raise finance. Transport for London (TfL), the Greater London Authority (GLA) and Warrington Borough Council all provide examples you may wish to research.

Issuing bonds is extremely labour-intensive, involving complex documentation and legal review, close liaison with advisors and intensive marketing to investors (typically including a tour of all the major investors called a 'road show') with many follow up calls and queries. There is a strong element of negotiation of the spread over the reference instrument (usually a Gilt of similar tenor to the proposed bond). Investors also typically demand the bond have a credit rating, which means the issuer needs to be rated. The due diligence performed by the rating agencies is exhaustive and will absorb a great deal of officer time at least semi-annually in perpetuity. The total costs can be very significant (meaning hundreds of thousands).

The main types of issue are a public auction-style process, typically run by an investment bank or a private placement to a smaller group of investors.

Auctions may yield greater competition hence better pricing for a bond that is likely to have universal appeal, however, many of the participating investors will be following market indices on behalf of their clients and will only buy bonds that feature in the index. To warrant inclusion, the size of the issue needs to be quite large (£150m +) which is unrealistic for smaller authorities. The Local Government Association has set up a company, referred to as the Municipal Bond Agency, to attempt to aggregate demand and issue cross-guaranteed securities on behalf of multiple authorities in order to mitigate this.

Because the process is drawn out, there is often a delay of a few days between deciding to go for the issue and concluding the pricing. During this window, markets can move, introducing interest rate risks.

Private placements can be more flexible and quicker, but rely on identifying an investor or small group of investors whose investment needs closely match the borrower's requirements.

Despite all the complications, bonds can be very successful. The GLA and TfL have saved tens of millions of pounds net of all costs with fixed rate issues and the GLA and Warrington have issued the first ever CPI linked bonds as a hedge against the risks inherent in the business rates income. Business rates are linked to inflation, so if inflation is lower than expected, income will be lower and this could cause affordability problems if interest costs were fixed. Where borrowing is inflation linked, however, the interest costs will also fall, so that the cost relative to income is maintained. Note that if inflation exceeds expectations, the cost of the inflation linked borrowing would rise, offsetting some of the additional business rates.

International aid

Some capital project may be eligible for international aid through investment from other countries or from support from the World Bank.

European Union Grants

Some capital projects are eligible for grant fundig from the European Union.

Other potential sources that attracted credit, and full marks where explained well include:

PFI and PPP

Revenue contribution to capital

Capital receipts through disposal of assets

Community Infrastructure Levy

Use of reserves

Collaboration with partners (would still need a funding stream)

Government grants

Candidates are not expected to list all of these sources in the time available. Up to 2 marks per well explained source identified. Limit to 2 marks overall if only a list of sources is presente without any explanation or examples (max 6 marks)

Marking Scheme for question 6

Syllabus Ref B4 Workbook 8.3

(a) Discuss the advantages and disadvantages of establishing project budgets versus business as usual budgets. (4 marks)

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.

Pros	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 (max 4 marks)

(b) 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.

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. (6 marks)

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. (max 6 marks)