CIPFA The Chartered Institute of Public Finance & Accountancy

STRATEGIC CASE STUDY

CEDAR: 8 September 2020

MARKING SCHEME

The answers detailed below show some but not all possible answers that were accepted by the marking team. Marks were awarded for other valid answers that might not be included in this document.

Key to marks:

Calculations or the manipulation of numerical data

Most calculations will be straightforward such as the creation of accounting ratios to interpret financial performance, or assessment of the sensitivity of particular estimates.

Some specific calculation marks may be allocated but candidates should not be judged solely on whether figures are 'correct', but on how they reached their figures and the reasonableness of their assumptions and approach.

Narrative

The candidate will be required to demonstrate in their narrative responses, an assessment of the impact and implications of the analysis performed and application of appropriate elements of the syllabus as part of further critical evaluation. Narrative responses should demonstrably inform decisions being faced within the case scenario.

Marks will be awarded for the evaluation of the information given in the context of the specific issues raised by the case scenario. It should demonstrate consideration of an appropriate breadth of issues, such as financial and non-financial perspectives, stakeholder considerations, ethical considerations, strategic risks and the strategic objectives and environmental context of the organisation. Candidates will be expected to demonstrate professional judgement in drawing from this evaluation appropriate conclusions, making practical and relevant recommendations and focusing their answer to suit the user(s).

The allocated marks should again be seen as a guide. Some additional credit may be awarded (within the total marks available for the section concerned and subject to the requirement for appropriate coverage of a breadth of relevant issues) for points which have been developed with particular insight or cogency.

The marking scheme will identify (in bold) points of particular significance for which marks will be ring-fenced. This will limit the marks awarded to candidates who miss the most salient issues.

Reasonable credit may also be given for any points which have not been included in the marking scheme but are clearly valid in the context of the candidate's own calculations or preceding analysis.

General comments

It is essential that candidates answer all the questions as set and meet the requirement to achieve a minimum of 25% of the marks available for each question.

Any attempt to evade the terms of the question on the grounds that the situation depicted in the examination scenario is unlikely to have arisen or occurred, or is improbable in concept, should not be awarded any credit.

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Question 1 (55 marks)

The Chief Executive has asked you to present a report to the CEDAR Board on 14 September and wants to see a draft report beforehand. The report is to include a review of the income and expenditure for the past three years (2017/18, 2018/19 and 2019/20), *You can assume that the Board will be presented with the financial statements for these years so you do **not** need to include them in the draft report.*

Q	Response points	Marks	Syllabus content	App St'd
1i	Critically analyse CEDAR's income trends in the past three years, highlighting any significant changes in the period. **Narrative content: 1 mark per developed point to a maximum of 8.** **Calculations: up to 5 marks (Appendix 1(i)):** **Analysis of restricted/unrestricted funds – 2 marks** **Comparison (% change) with key income figures from previous years' statements – 2 marks** **Adjustment for donated aid/services in kind – 1 mark** <u>Total income</u> • Income is rising year on year. Total income rose by 22% in 2018/19 and 17% in 2019/20. • Income increases are mainly in relation to restricted funds. Unrestricted funds income has fallen from being 78% of income in 2017/18 to 54% in 2019/20. (Alternatively, restricted funds income has increased as a proportion of total income from 22% in 2017/18 to 46% in 2019/20). • This increasing reliance on restricted funds may be a problem as it reduces the organisation's ability to use funds flexibly as required. • However, the 2019/20 income total includes £400 000 from donated supplies and services in kind, which represents a change in accounting policy rather than new income. Excluding this £400 000, results in an increase in income 2019/20 of 14%, and therefore a more noticeably lower growth rate in comparison with the previous year. • There is a new income source in 2019/20 from trading activities (i.e. shops), but it is too early to determine any trend in this income stream. Two of the three shops opened in 2020 have, though, only been operational for half the year, so income should be significantly higher in future years. • The main income line in the SOFA is Donations, grants and legacies, which increased by 22% in	12	PSFR D2; SPF B5	K: ARC, BI, FI, LSP, SBMG; S: BI, PSDM; B: PS

Q	Response points	Marks	Syllabus content	App St'd
	2018/19 and 14% in 2019/20 (12% excluding donated services and supplies in kind), so its rate of increase has fallen quite significantly in 2019/20. • Investments are less than 1% of total income and have fallen back to the 2017/18 level. It is not clear why CEDAR has investments, and whether they are mainly held to generate an income stream. As a very small element of total income, it is questionable whether they are worth holding. Also, the fall in income may indicate CEDAR's lack of expertise in dealing with investments. But they are relatively immaterial for the purposes of this exercise. <u>Analysis of donations, grants and legacies</u> Donations: • These are increasing slightly each year - by 8% in 2018/19 and but only by 3% last year. The proportion of donations that are restricted is increasing – 13%, 22%, 28% over the past three years. Grants: • These have shown significant increases – 83% and 31% in 2018/19 and 2019/20 respectively. It is mainly restricted income and an increasing proportion of grants is restricted – 53%, 67%, 83% in the past three years respectively. This is an increasingly significant element of CEDAR's funding. • The levels of these are likely to be volatile to some extent as a result of some large grants being received in a single year to fund temporary projects. Legacies: • This is a small element of overall income. It is clearly not within CEDAR's control, but they may be able to advertise to encourage more donors to name the charity as a beneficiary in their will – this is one of objectives of the new post. Tax reclaim: • Income level is related to donations from taxpayers. And is relatively stable at 14-15% of donations figure. • There may be scope for increasing this by ensuring that donors complete tax reclaim documentation wherever possible, but the maximum would be 20% of donations income (if all donors are taxpayers and complete relevant documentation) so the scope for increase is limited unless overall			

Q	Response points	Marks	Syllabus content	App St'd
	donations increase. Legislation changes may, though, make it easier to reclaim and increase the proportion nearer to 20%.			
1ii	*Critically analyse CEDAR's expenditure trends in the past three years, highlighting any significant changes in the period.* **Narrative content: 1 mark per developed point to a maximum of 7.** **Calculations: up to 3 marks (Appendix 1(i)):** **Analysis of restricted/unrestricted funds – 1 mark** **Analysis of expenditure on raising funds c.f. donation income – 1 mark** **Comparison with (% change) key expenditure figures from previous years' statements – 1 mark** Total expenditure: • Increases of 25% in 2018/19 and 30% in 2019/20. This is a greater increase than for total income (22% and 17% respectively). • Restricted fund expenditure increased by 58% and 68% in the past two years respectively, increasing at a greater rate than restricted income in the last year (47%). • Expenditure is split fairly evenly over the three main items in each year – raising funds (14-15%), charitable activities (84-85%), governance costs (1%). Note – £400k donated aid expenditure should be excluded from calculation, but this does not affect the percentage figures much as it is a relatively small amount. Raising funds: • Expenditure in raising funds line is aimed at encouraging donations, so should be compared with income from donations. Expenditure on raising funds is rising as a proportion of donations income - 21% in 2017/18 (2 159/10 185), 24% in 2018/19 (2 600/10 951), 30% in 2019/20 (3 433/11 285). • Effectiveness of expenditure on fundraising appears to be reducing, which may make it more difficult in future to generate additional funds from fundraising activities, or may reinforce the importance of appointing someone dedicated to fundraising with relevant prior experience as the new Head. Charitable activities:	10	PSFR D2; CGL H1; SPF B2	K: ARC, BI, FI, LSP, SBMG; S: BI, PSDM; B: PS

Q	Response points	Marks	Syllabus content	App St'd
	• These are the costs of delivering CEDAR's development projects. Expenditure would be expected to increase or decrease in line with the projects being delivered in the year, so this should really be analysed on a project by project basis rather than as a total. Governance costs: • Although this remains at around 1% of total expenditure in each year, it has increased by 17% and 48% in the period. This may be a result of greater allowances to Board members and/or through an increased cost in the charity's audit. As the activities of the charity have increased over the period (as shown by the higher levels of income and expenditure), to some extent this may be expected. However, there is a risk of these not being controlled if the elements of the expenditure line are not being monitored and the reasons for the increase should be checked. Expenditure control: • There is some indication that expenditure control may be weak, especially in relation to restricted funds. Certainly, it is clear that expenditure is increasing much more significantly than income. This may be linked to the existence of some evidence that the finance function is overstretched (e.g. the budget timetable has not been complied with, weak monitoring of project partner finances etc). • The appointment of a dedicated Head of Fundraising should help finance staff focus on key activities and provide a more effective finance service.			
1iii	*Critically evaluate CEDAR's net expenditure figures in the past three years and assess the impact on unrestricted and restricted funds.* **Narrative content: 1 mark per developed point to a maximum of 4.** <u>Net income/expenditure (before transfers)</u> 2017/18 £238k net income 2018/19 £107k net expenditure 2019/20 £2.47m net expenditure • Overall performance has deteriorated each year, and the most recent result is a significant excess of expenditure over income and a major worsening of financial performance compared to 2018/19.	4	PSFR D2; SPF B5	K: ARC, BI, FI, LSP, SBMG; S: BI, PSDM; B: PS

Q	Response points	Marks	Syllabus content	App St'd
	• There is a small impact also from other gains/losses, but it is not material. • There is net expenditure (before transfers) on restricted funds in each year, increasing to £1.49m in 2019/20. <u>Funds</u> • Net expenditure on restricted funds is covered by transfers from unrestricted funds. This is a required transfer to ensure the restricted funds balance remains positive. It has increased each year, and is estimated to be £1.5m in 2019/20. • Note that recognising donated assets and services in kind does **not** impact on the transfer required as it is also shown as expenditure for the year. • The balance on unrestricted funds has fallen from £2.89m to just £339k, limiting scope for CEDAR to bail out the restricted funds in future years by further transfers from unrestricted funds.			
1iv	*Analyse CEDAR's options regarding the use of the Millside premises, providing a recommendation on the way forward that is consistent with CEDAR's organisational objectives. Comment briefly on how your recommended action will impact on the net income/expenditure reported in the Statement of Financial Activities (SOFA).* **1 mark per developed point to a maximum of 11, including, up to 8 marks for the option appraisal (4 marks per option, with a maximum of 3 for either pros or cons for each), 2 marks for drawing conclusions and making a clear recommendation and 1 mark for the impact on the SOFA.** <u>Option 1 – develop and 10-year lease</u> Pros: • Annual income estimated at £200k, less management fee 11%, net £178k. While the income would be useful, it would represent less than 1% of CEDAR's 2019/20 total income. • Lengthy period of income generation and 10-year gap between costs of lease, refurbishment, etc. • CEDAR have option to review what to do with the asset after 10 years. • Property market may pick up over period of lease, leading to higher rents in later years or option to sell at higher price. Cons: • It seems likely that a significant cost would be incurred to make it suitable to be leased, given that £1m was planned to be spent on it when	11	CFR B1; SPD B3; SPF B1	K: ARC, BI, FI, LSP, SBMG S: BI, PSDM B: AV, PS

Q	Response points	Marks	Syllabus content	App St'd
	CEDAR originally bought it. There are also further costs of advertising and setting up the lease (though it's not clear how much this would be). • Risk of not being able to secure a lessee or premises being unoccupied for a period. • Risk of lessee not being able to keep up payments. • Cost of possible refurbishment, advertising, etc after 10 years. • Property market may fall, leading to lower rents in later years or lower selling price. • Does not address the problem of the charity's overdraft. • CEDAR have no expertise in this area and would be wholly reliant on the property consultant's advice. The fact that Millside has declined in value since its purchase may reinforce this view. • Not clear how this would contribute to CEDAR's charitable objectives. • May distract senior CEDAR staff and Board from main charitable activities. Note – There is theoretically a sub-option for CEDAR to act as its own property agent and save on the 11% consultant fee. But this would be a hugely risky course of action as CEDAR has no expertise in this area and there is no guarantee that it would save money overall as it may not be able to secure the same levels of income, periods between leases might be longer, etc. <u>Option 2 – sell Millside in its current state</u> Pros: • No significant expenditure, other than costs of generating the sale. • Generates cash receipt – estimate currently £3.6m. This would clear the charity's overdraft. • Allows CEDAR to focus on its main charitable objectives and related activities and not be distracted by an investment property. Cons: • Estimated sale price is less than the £4m paid for Millside, resulting in a probable loss from the sale. The sale price is, though, a sunk cost and should not be used as key consideration in assessing options, but the loss of £400k would impact on net income/expenditure in the year it is sold (unless an impairment is recognised in earlier year). • CEDAR would be forgoing potential rental income and sale at a potentially higher price at a later date. <u>Conclusions and recommendation</u>			

Q	Response points	Marks	Syllabus content	App St'd
	• The Millside premises were acquired for use by the charity, not as an investment property. As they are now surplus to requirements, the logical course of action would be to dispose of them, unless there are compelling reasons why another course of action would be preferable. • Although the option to rent the premises to a third party would generate annual income, there are significant risks associated with the lease option. • The most important factor to consider is how this impacts on the strategic direction of the organisation. The charitable objectives of CEDAR are clear, and as a small organisation (45 staff), they do not have resources and expertise to engage in property management on this scale. • There is a serious risk of CEDAR being distracted from its main activities if it retains Millside and seeks to use it to generate income. The most appropriate recommendation would therefore be to sell the asset, even if this results in a loss in comparison with the purchase price paid in 2019. • If the lease option is selected then this would be an income item in the SOFA. If Millside is sold, it seems likely that it will be sold for less than the purchase price and so this loss on disposal would need to be reflected in the SOFA. • Candidates may refer to the possibility of an impairment. An impairment would need to be recognised in the 2019/20 SOFA if the fall in value to £3.6m had occurred before 30 June 2020. If the fall in value occurred in 2020/21 then it would be unnecessary to recognise the impairment as it will be accounted for through recording the sale and loss on disposal (if sale is less than purchase price). This is a financial reporting issue, however, and does not impact on the decision to lease or sell the asset.			
1v	*Prepare an income budget for CEDAR for the year to 30 June 2021, with an explanation of the assumptions applied, and a brief discussion of the risks and other issues the Board should take into account in finalising CEDAR's 2020-21 budget (Note: your income budget should be consistent with your recommendation regarding the Millside premises in part (iv) of the report).* **Narrative content: 1 mark per developed point to a maximum of 9, including up to 6 for valid, well-justified budget assumptions and up to 4 for risks and other issues.** **Calculations: up to 3 marks as shown in Appendix 1(v):**	12	MA C3; SPF B4	K:ARC, BI, FI, SBMG; S: BI, PSDM; B: AV, PS

Q	Response points	Marks	Syllabus content	App St'd
	1/2 mark per budget line forecasted on a reasonable basis. Donations: • As income has increased each year over the past three years, it is reasonable to assume that it will increase in 2020/21, especially with the new Head of Fundraising in place for the second half. Assistant Head of Finance has estimated increase of £500k, split evenly across restricted and unrestricted. Grants: • Most of the grants are for more than one year, so 90% of existing grants are rolled forward to 2020/21. Plus, additional £350k restricted grant from Health Improvement Fund (half of the £700k total, which is for two years). • It may be reasonable to assume other grants will also be secured during the year, but no information is available to estimate this. • May be reasonable to look at whether CEDAR could bid for more funding through the three DDD funds (Transform Fund, Health Improvement Fund, Equality Fund). Equality Fund is most in line with CEDAR aims, so should maximise opportunities to look for access to this fund. • There is increasing reliance on restricted fund income, which must be used on specified projects, and is therefore not available for general charity activities. This reduces flexibility and CEDAR's ability to determine its own activities and priorities. Legacies: • There is no clear pattern to income from this source, as the timing and amount of legacies are by definition unpredictable. It is reasonable to assume that there will be some income, and an average of the past three years would be appropriate basis for estimate. • It could, though, be argued legacies are by definition not predictable and therefore should not be included in income projections at all. This is not a significant element of total income, so does not justify greater analysis. Tax reclaimed: • This is related to the donations figure, as tax can be reclaimed on donations by taxpayers. The maximum that can be claimed is 20% of donations, and based on claims in recent years an appropriate basis of estimate would be 15% of			

Q	Response points	Marks	Syllabus content	App St'd
	donations figures. But there may be scope for putting effort into encouraging more donors to complete tax documentation to allow CEDAR to make reclaims. • Legislation expected in 2021 that will simplify tax reclaim regulations to encourage more giving to charities, but it is not certain what the actual policy changes will be or how these might affect charities like CEDAR or how likely that the changes will be in place early enough in 2020/21 to have a material impact on CEDAR's income. Donated supplies and services in kind: • The Head of Fundraising appointment should increase income in this area. The Assistant Head of Finance and Fundraising estimates an additional £150k in donated supplies above the 2019/20 level. • This not extra cash, and does not improve the net income/expenditure result in the SOFA. But it does increase the service delivery potential of the charity through the additional services available to it and potentially through cash saved by not having to purchase these supplies. Shops: • An increase from 3 to 5 shops is planned from January 2021. As the two new shops in Baldeas were only operational from January 2020, it is assumed that the 2019/20 income is equivalent to two shops operating for a full year. The new shops in 2020/21 would mean the equivalent of 4 shops open for the full year in 2020/21. • In the absence of any other information, we can assume the additional shops will each generate similar income and developing shop income is one of the objectives for the new Head of Fundraising post, so it is reasonable to assume additional increases as a result of this appointment. • Some further work is advised though, to check their comparability with existing shops (e.g. local economic conditions) and whether the fact that the new shops will be in a much smaller city than the existing ones may limit their income potential compared to those. • It should also be noted that the shops currently opened have generated a 15% return on sales, so it would be necessary to ensure that a comparable figure is included in the expenditure budget in relation to the impact of the new shops. Rental from Millside premises:			

Q	Response points	Marks	Syllabus content	App St'd
	• The property consultants have estimated £200k. However, zero income should be assumed if it is recommended that premises are sold (see (iv) above). Investment income: • Not a material figure. Assume similar income to 2019/20. <u>General risks</u> • New post for fundraising has been approved. This is intended to focus on developing digital and related income streams, but it is not clear what is realistic in terms of income projections in this area. The person will not be in post till January 2021, a period of induction and familiarisation is likely and the lead time for fundraising campaigns could be lengthy, so the appointment is unlikely to have a significant impact on 2020/21 income. • Income projections for 2020/21 in the region of £21-22m *(depending on how the candidate has assessed each income item)*. It therefore seems likely that there will be a major difficulty in developing a realistic income budget that will match the expenditure budget proposed in May, totalling £24.3m. • The reliability and appropriateness of the expenditure budget should therefore be queried. It is £1.2m above 2019/20 expenditure, and is not prudent to budget for such an increase given recent deficits, depletion of fund balances and the evidence on forecast income. • Also, it is not clear if the draft budget takes account of the cost of interest on the loan taken out to finance the Oggs Park acquisition, so the expenditure figure may actually be understated.			
1vi	*Discuss the overall financial sustainability of CEDAR in the medium term (1-3 years) and the internal and external factors that are likely to impact on that.* **Narrative content: 1 mark per developed point to a maximum of 6.** • The draft budget is not balanced, with a shortfall of income over expenditure of approximately £1-2.5m *(depending on how the candidate has assessed each income item)*. This casts significant doubt over the financial sustainability of the organisation in the medium term given that fund balances have been so significantly depleted in recent years. • The sale of Millside would potentially reduce net income for 2020/21 by £400k through loss on the	6	PSFR D2; SPD A & B; SPF B5	K: ARC, BI, FI, LSP, SBMG; S: BI, PSDM; B: PS

Q	Response points	Marks	Syllabus content	App St'd
	sale, but it would generate a cash receipt and improve the charity's cash position. The charity has been in overdraft since July 2019, which they should look to avoid in the medium term. • Increasing income from grants provides a sound basis for financial planning in medium term, and the charity needs to ensure it gives attention towards securing this type of funding. Indications from CDP are that overall levels of government aid funding will continue and the three main DDD funds will be available for charities to bid for, but it is not clear what competition CEDAR faces when bidding for these funds. • There is a potential threat of political change (with PP replacing, or influencing, CDP given the latter's small parliamentary majority) leading to reduction in the 1% of government allocated to aid. • There are indications that expenditure may not be controlled effectively in CEDAR, especially in relation to restricted fund activities. This needs to be addressed if the organisation is to be financially viable in medium term. • The reduction in balances on unrestricted funds is a major concern. These have been reduced in recent years to cover overspends on restricted funds. The scope for further transfers from unrestricted to restricted funds is now limited. The balance on unrestricted funds is estimated at £339k at the end of 2020/21, which is less than 23% of the transfer that was required in 2020/21. • Poor budgeting practices are a concern. The timetable for preparing the budget has not been followed. The level of expenditure in the draft expenditure budget would be difficult to fund, and may omit the cost of loan interest. This suggests that budgeting is not given the level of attention and importance that it should in the organisation. • Increases in income from donations and trading activities will be important in financial planning in medium term. Projections, however, will need to be prudent and realistic – donations have been increasing, but mainly through restricted funds; and trading activities are a new area that CEDAR does not have much experience in yet. • Tax reclaim income is an important source of funds, but is dependent on government policy. There is no indication at present that the policy will not continue, but pressures on government funds could lead to the policy being reassessed. • The uncertainty relating to the charity's headquarters is an issue. It would be helpful to have this clarified so that the related expenditure can be properly budgeted for and staff can			

Q	Response points	Marks	Syllabus content	App St'd
	concentrate efforts on key activities in a more stable environment. • The new specialist post for fundraising should help to ensure that the income generation side of the charity's finances receive sufficient attention. This also frees up finance staff (who have been stretched in recent months) to deal more efficiently with expenditure monitoring, timely budgeting, preparation of financial statements, monitoring of project partner finances, etc.			

Question 2

The Chief Executive is to present an update on the partnership with Vetkaria Empowerment Project (VEP) to the Board meeting on 14 September. You are to prepare a briefing note for the Chief Executive that she can use to prepare for the meeting.

Q	Response points	Marks	Syllabus content	App St'd
2i	*A variance analysis of the financial report received from VEP, with an evaluation of any significant variances.* **Narrative content: 1 mark per developed point to a maximum of 6.** **Calculations: up to 3 marks (Appendix 2(i)):** **Adjusted donations – 1 mark** **Variance analysis – 2 marks** <u>Overall</u> • Report from VEP should have included variance figures and an explanation of significant individual variances. No variances were included in VEP's report. • VEP's project budget shows income and expenditure in balance over the 12 months to December 2020, but for the six months to the end of June the budget shows net income of £8k. • Overall, VEP is showing an adverse variance of £19.5k for the six months – i.e. actual net expenditure of £11.5k compared with budgeted net income of £8k. <u>Income</u> • The main income source for VEP is the grant from CEDAR. There is no variance shown here as the grant for the first quarter has been received and the grant for the second quarter has been accrued in full. However, it is debatable whether this should have been accrued, given the failure of VEP to comply with all reporting requirements to date. • No decision has been taken by CEDAR to withhold the second grant instalment, but as there are concerns regarding financial management at VEP, this is not guaranteed. (*If candidates adjust the actuals for this and provide a sound explanation then this should receive credit*). • If the second grant instalment were to be withheld, it would mean that a more accurate picture of the VEP net income/expenditure would be an adverse variance of £39.5k. • Revenue should be recognised when it is probable that future economic benefits (or service potential) will flow to the entity (as per the IFRS/IPSAS conceptual frameworks). The question here is	9	FA C1; MA D1	K:ARC, BI, FI, SBMG; S: BI, PSDM; B:PS

Q	Response points	Marks	Syllabus content	App St'd
	whether at the time of preparing the statement the receipt of the grant instalment for the quarter April-June could be described as 'probable'. • Donations include pledged income from a fundraising event. Only cash received as a result of this event should be recognised, as the likelihood of pledges resulting in cash to VEP cannot be described as being 'probable' and therefore should not be accrued. • Removing pledged income results in a £6k adverse variance on donations. This is approximately one third of the budget for the period. • Other income is showing actual income of nil for the period. This budget is mainly made up of sponsorship income (£4,000), which has been described by the Head of Projects as 'bold' and 'innovative'. It is dependent on VEP using local contacts to secure sponsorship funding of project events. • Although the Head of Projects has suggested that it may take time to secure sponsors, the fact that no income has been recorded against this line in the first half of the year is concerning. CEDAR would need to see some evidence of commitments for the remainder of the year from sponsors, otherwise it will need to be assumed that the income will not be forthcoming for this financial year and savings would be needed on the expenditure side of the budget to compensate for the lost income. • It is also the case that CEDAR can withhold some grant if the 50% match funding isn't obtained, which currently seems likely to be the case. • Other income also includes a small amount of investment income (budget £500). There is some doubt that this element of the income budget will be met in this year given that there is no income recorded to date. Although this is not a significant figure in the context of the project budget, it is perhaps indicative of poor budgeting on income lines and poor implementation of the budget as a whole. <u>Expenditure</u> • Staff wages and staff allowances are reasonably close to the budgeted amounts for the period. • Supplies expenditure is almost double the budget for the period. This is the most significant adverse variance in monetary terms (second largest in % terms), and accounts for 42% of the overall net income/expenditure variance. • Concerns have been raised about procurement practices in relation to supplies, and these are			

Q	Response points	Marks	Syllabus content	App St'd
	discussed further below. The large variance shown here suggests that the concerns have some basis and that supplies are not being managed effectively. • Transport costs are also showing an adverse variance: £2 400, or 40% of budget. The budget has been profiled evenly (i.e. 50% budget for six months), so this may indicate poor management of the transport expenditure or similar procurement issues to those potentially affecting supplies expenditure. <u>Exchange rate</u> • No details are available on the exchange rate between £ and $V in the period to 30 June. It should be noted, however, that it is possible that some of the variances reported may have been caused or exacerbated by movement in the exchange rate. If that were the case, CEDAR may decide to provide additional funding to offset the exchange rate loss.			
2ii	*A summary of the key aspects of CEDAR's partnership with VEP, and an assessment of VEP's compliance with the terms of the partnership agreement*. **1 mark per developed point to a maximum of 6, with up to 4 for the key aspects of the partnership and up to 4 for assessment of compliance.** • CEDAR has a reasonably long-standing relationship with VEP, and has worked alongside them in the delivery of projects since 2015. • VEP has a network of local contacts in Vetkaria, which CEDAR as a foreign organisation cannot replicate. This is of considerable benefit to CEDAR in ensuring that links are made with relevant stakeholders in the country to help deliver project activities. • CEDAR conducted a due diligence exercise on VEP in 2015. The report from this exercise gave positive results on governance and management/delivery of projects (i.e. 'low risk') • However, the due diligence report only rated VEP's financial arrangements as 'moderate risk'. It was recommended that VEP improve arrangements in relation to financial record keeping and controls over cash transactions. • Some improvements were implemented following the due diligence report so that GDB funding to VEP could be started.	6	SPD D3; SPF C4	K:ARC, BI, SBMG; S: BI; B:PS

Q	Response points	Marks	Syllabus content	App St'd
	Requirement: • Provide quarterly report (narrative and financial). Status: • No narrative report received for period to 30 June 2020 and financial report incomplete (no variance analysis) and submitted late. Requirement: • Implement safeguarding and bullying/ harassment policies. CEDAR has provided guidance and templates to assist partners in developing policy documents. Status: • VEP has stated this is not necessary as these practices are already forbidden under Vetkaria legislation. Legislation alone is not sufficient – organisations should have policies that set out how they ensure legislation is followed and staff are protected, supported, etc, so no new policies have been developed. • Confidential communication indicates possible bullying/harassment incidents have occurred recently. Individual used CEDAR helpline as VEP arrangements were not trusted. Requirement: • Employ zero tolerance approach to fraud and corruption. Status: • Indications of possible fraud relating to procurement of supplies and may also be an element of corruption in awarding of contracts to a supplier. Requirement: • Implement project budget effectively. Status: • Significant variances in first half of 2020. Requirement: • Maintain appropriate internal control systems. Status: • Evidence of breaches of controls over procurement of supplies and use of cash payments.			
2iii	*An analysis of the points made by the Head of Projects in her email of 7 September, with an explanation of the responses which would be appropriate.*	10	FA C1; MA D1; AA B3;	K:ARC, BI, LSP,

Q	Response points	Marks	Syllabus content	App St'd
	1 mark per developed point up to maximum of 10 Point raised: • Unfair to expect partners in developing context to have same standards as CEDAR Response: • VEP's policies and practices do not need to be identical to CEDAR, but they do need to be compatible and to be consistent with key principles. • This is a DDD requirement, not something imposed by CEDAR. DDD funding may be jeopardised if partner practices are not up to required levels. • CEDAR acknowledged lack of resources in partners by allowing an extra 6 months to get policies in place. • CEDAR made guidance available to partners to help them develop policies, including templates with generic text. Point raised: • Due diligence report stated that VEP scored top marks and VEP are exempt from further due diligence as a result of the high score in 2015 Response: • VEP scored well in the due diligence on project management and delivery, and on governance. • Score on finance, however, was 'moderate risk', and some deficiencies in financial record keeping and cash payment procedures were highlighted. • The due diligence was carried out in 2015. This does not necessarily reflect current practice in VEP in 2020. • Although it is true that CEDAR should accept differences in policies and practice to reflect local circumstances and the fact that VEP is a small organisation, it is not appropriate to extend this to accepting poor financial practices. • Internal controls are intended to reduce the possibility of fraud. As CEDAR requires its partners to have a zero-tolerance attitude to fraud, it is essential to have reliable internal controls in place. • VEP are not exempt from further due diligence exercises. DDD accepted for the current project that a due diligence exercise was not necessary for VEP as this was a continuation of an existing project.		CGL H1; SPD D3; SPF C4	SBMG; S: BI, BR, EI; PSDM; B: PS

Q	Response points	Marks	Syllabus content	App St'd
	• This also indicates that CEDAR should consider improving and strengthening its approach to due diligence of partner organisations. Point raised: • VEP will sort out these issues 'in their own way' Response: • CEDAR needs evidence that issues are being addressed in a satisfactory way. It is not enough to accept an assertion from the finance manager. • Head of Projects and VEP Finance Manager have known each other for 10 years, and worked together before CEDAR and VEP went into partnership. It may be that this friendship is clouding the judgement of the Head of Projects, and she is taking the Finance Manager at his word as a result of that friendship. Point raised: • CEDAR should not interfere in a local matter Response: • CEDAR, as lead partner in the project, is accountable to DDD for all activity related to the project, including activity within its partner organisations. It therefore has a right and a responsibility to ensure that it has full information on VEP's activities. Point raised: • Quarterly reports are an excessive and unnecessary burden on small partner organisations Response: • It is essential to monitor project activity on an ongoing basis to ensure that it is delivered as planned and that the budget is adhered to. • Quarterly reports are the minimum that are required to ensure that in-year budget information is timely and corrective action can be taken where required. • CEDAR is not able to issue grant funding to VEP without evidence that it is delivering the project, achieving results, and implementing the budget effectively. Narrative and financial reports are essential for providing information on these. • It is not appropriate to wait until later in the year for this information as there would be no time to take corrective action. That would also increase the risk of any fraudulent activity continuing for a longer period.			

Q	Response points	Marks	Syllabus content	App St'd
	• VEP is in need of grant funding to meet project expenses, and this may be delayed if reports are not received from VEP. Point raised: • Third quarter funding requested early Response: • The second quarter's funding has not yet been released (this was accrued in the report from VEP). It cannot be issued until full reports are received and any concerns regarding the implementation of the budget or issues of internal controls have been sorted. • It would be inappropriate to issue the next quarter's funding early in these circumstances. Point raised: • VEP should be congratulated for including sponsorship in the income budget Response: • There has been no income recorded against this line up to June and no evidence of any commitments from sponsors. • This is a further area of concern rather than something to congratulate VEP for. Point raised: • Issues should be kept quiet for now so that the field visit by the Head of Projects in October is not affected Response: • The issues raised are urgent and concerning, and therefore need to be acted on without delay. • The visit can be used to follow up on some of these issues (e.g. the Head of Projects can ask to see any evidence of sponsors being brought in, can ask to see documentation on new policies, etc), but this should be in addition to more immediate action rather than instead of it. • The friendship between the Head of Projects and the Finance Manager needs to be kept in perspective. If there is a conflict between this friendship and her responsibility as a senior member of CEDAR staff, it is essential that she prioritises her professional duty over personal issues.			
2iv	*An analysis of the issues raised in the whistleblower's email of 7 September, an assessment as to whether*	10	AA B3, F2; CGL	K:ARC, BI,

Q	Response points	Marks	Syllabus content	App St'd
	fraudulent activity has been taking place within VEP, and recommendations on any associated actions that CEDAR should take. ***1 mark per developed point to maximum of 10, with up to 5 for the analysis, up to 2 for conclusions on whether fraudulent activity has been occurring and up to 4 for the recommendations.*** <u>Allegation of bullying by Finance Manager</u> • Suggestions that the management style by the Finance Manager could be viewed as bullying, e.g.: - 'Initially cold and dismissive' and later 'threatening' attitude - Dismissing concerns raised – 'he told me I was new and didn't understand how the finances worked' - Angry reaction to being asked about missing paperwork - Pressure put on staff to act against proper procedures e.g. told whistleblower not to bother preparing quarterly reports • Individually, these are not in themselves clear evidence of bullying, and may simply be an indication that the Finance Manager and whistleblower did not get on as personalities. Collectively, they might be indicative of bullying by the Finance Manager. • In the absence of a policy on bullying and harassment there are no clear criteria within VEP to against which to gauge this behaviour, but this should be assessed against the content of CEDAR's own policy document. It highlights the importance of VEP having a clear policy document so that staff are able to refer to its content in considering whether they are being treated unfairly or inappropriately. • At the very least, they indicate a poor working environment and suggest problems in management style. They are also suggestive of behaviours that might be expected of someone who is seeking to hide fraudulent activity. • It should be noted that the whistleblower may be acting out of malice, as they are no longer working at VEP. However, it appears that they left voluntarily rather than being dismissed, so they are not seeking revenge for dismissal. Also, they claim that they have not tried to collect their final month's salary – if this is true, it suggests they do feel intimidated by the Finance Manager.		H1; SPD D3; SPF C4	LSP, SBMG; S: BI, BR, EI; PSDM; B: PS

Q	Response points	Marks	Syllabus content	App St'd

	<u>Procurement of supplies</u>
	• This appears to involve several instances of failure to follow best practice or failing to comply with VEP's own policies, albeit that the evidence relies primarily on the whistleblower's allegations.
	• Expenditure on supplies increasing for no apparent reason.
	• Dominik Supplies appears to be receiving preferential treatment. There is no evidence that the increase in use of this supplier is because of their ability to supply goods at better price or quality than other suppliers.
	• There is an inherent danger of becoming overly reliant on one supplier (it is currently alleged to be used for c.75% of supplies).
	• Processing of orders, invoices and payment for supplies appears not to be properly segregated with the Finance Manager alleged to be doing the whole process.
	• Payment for supplies should be through main payment system rather than petty cash, which should be reserved for small items, urgent payments, etc. However, the Finance Manager is alleged to be regularly using petty cash for paying for supplies.
	• Petty cash payments are alleged to regularly exceed the Finance Manual limit of $V50 and by a considerable amount (up to $V500).
	• There is alleged to be a lack of documentation, e.g. purchase orders and goods received notes - not being completed or not filed.
	• It is alleged that goods are delivered directly to field operations, so it would be difficult to verify what has been delivered. Information provided by field worker suggest supplies are not being delivered.
	
	<u>Fraudulent activity</u>
	• Although there is no definitive proof that fraudulent activity has taken place, there are a number of aspects of the procurement of supplies that suggest this might be the case:
	  • Bypassing financial procedures
	  • Failure to keep full financial records
	  • Ignoring segregation of duties
	  • Excessive use of cash payments
	  • Pressure on other staff not to ask questions or interfere
	  • Close relationship between staff member and supplier
	  • Increased use of one supplier			

Q	Response points	Marks	Syllabus content	App St'd
	• Possibility that some orders for delivery to rural locations are not being fulfilled There is enough evidence for the whistleblower's concerns to be taken seriously. These all need to be checked, however, to gather more concrete evidence, as the whistleblower may be mistaken in some instances or may be making false allegations. <u>Recommended action</u> • It is essential to notify DDD as donors for the project that there are concerns suggesting a potential fraud within the project partner. They should be kept informed at all stages in the process, and their advice should be sought on actions to be taken. These actions are required under the terms of the contract with DDD for the project. • A fraud investigation needs to be initiated, with the objective to collect sufficient evidence to confirm the suspicion or otherwise; provide evidence that is admissible for a disciplinary hearing and/or criminal proceedings if required and minimise possible losses to the organisation. • The whistleblower should be asked if they are willing to cooperate further in the investigation. • As the potential fraud has taken place in a partner organisation, CEDAR may not have direct access to information and may not have the power to take certain actions (e.g. to suspend the suspect during the investigation). • CEDAR and VEP may need to set up a joint investigation to ensure it is carried out fully and in a manner that will be satisfactory to DDD. • Contact should be made with VEP to inform them of this development, but this must be done in a way that does not alert the suspect that an investigation is to be carried out. • Internal controls at VEP need to be improved. Financial policies and procedures appear to be in place (there is a Finance Manual, limits are set for petty cash, etc.) but they are not being followed, so there is a problem of compliance. This is an important part of the relationship between CEDAR and VEP. For the partnership to work, CEDAR need to have confidence in the internal controls within the partner organisation. This will need to be discussed with VEP once the investigation has been completed.			
2v	*An assessment of the potential risks for CEDAR arising from the developments at VEP during the current project*	6	CGL H1; SPF B1	K:ARC, BI, SBMG; S: BI,

Q	Response points	Marks	Syllabus content	App St'd

	1 mark per developed point to maximum of 6
	
	<u>Financial risk</u>
	• If the alleged fraud at VEP is proven it may result in financial loss to CEDAR:
	  • through funds passed to VEP not being used as intended
	  • or withdrawal of DDD funding for current project because of misuse of funds
	  • or loss of future grants if donor regards CEDAR as a high-risk grantee as a result of the fraud
	  • or reduced donations from organisations or individuals if fraud becomes widely known.
	
	<u>Insolvency risk</u>
	• There is a risk that the alleged fraud and other financial issues evident from the variance analysis in VEP could lead to VEP becoming insolvent. This would impact on CEDAR if it resulted in VEP being unable to fulfil their obligations within the project, and could impact on the receipt of remaining project funding from DDD.
	
	<u>Reputational risk</u>
	• Although the alleged fraud has taken place within a partner organisation and not within CEDAR, there is a risk that CEDAR's reputation will be damaged. This may result in donors being less willing to be associated with CEDAR, or potential partners being less willing to enter into working arrangements with CEDAR.
	
	<u>Project delivery risk</u>
	• There is a risk that project delivery will be affected by the alleged fraud. If supplies are not being received in full, this will reduce the ability of VEP employees or volunteers to fulfil the delivery plan effectively.
	• The time spent following up on the allegations and conducting a fraud investigation may also detract CEDAR and VEP staff from carrying out planned project activities.
	
	<u>Budget risk</u>
	• If the supplies budget is being misused, there is a risk of the entire project failing to keep within budget. CEDAR may need to offset this against other project budgets (i.e. within CEDAR) or use unrestricted funds to cover any shortfall.
	
	<u>Reporting risk</u>
	• Failure to maintain proper documentation may make it impossible for VEP to provide reliable
				EI; LSP, PSDM; B: AV, PS

Q	Response points	Marks	Syllabus content	App St'd
	financial reports to CEDAR. This in turn will make accountability to DDD difficult.			
2vi	*Recommendations on actions that CEDAR should take in relation to its partnership with VEP, both in relation to the current project and potential future projects.* ***1 mark per developed point to maximum of 4*** • CEDAR has a project agreement in place with VEP at present, and this is part of an overall agreement with DDD for the project funding, and it must make sure it complies with the agreements that are in place with VEP and DDD. • As VEP has failed to comply with some aspects of the agreement (i.e. in quarterly reporting, developing new policies) CEDAR needs to consider what action would be appropriate in response to that failure. • VEP should be given reasonable time to comply with the project agreement terms, so it would be too early to conclude that the agreement between CEDAR and VEP should be terminated. • It may also be the case that the actions of one individual, the Finance Manager, are the source of the compliance failures; i.e. in perpetrating the apparent fraud and endeavouring to conceal it, the Finance Manager has deliberately prevented the submission of full reports and the development of policies. This is speculation at this stage, but it is reasonable to follow up as a line of investigation. • It will be necessary to provide DDD with a full report on the fraud investigation and action taken in order to secure the continued funding of the project. • As VEP provides access to resources and contacts that are not easily available to CEDAR, it is of strategic benefit to continue the partnership if possible. As Vetkaria is a high-priority country for DDD funding, CEDAR will want to ensure that it has access to local expertise in the future. • That should only be pursued, however, if the issue of the alleged fraud is dealt with fully by VEP, internal control procedures are tightened up, and policies on issues such as bullying and harassment are developed (together with relevant staff training). • It should be possible to obtain confirmation from DDD that they are satisfied with the action taken in response to the alleged fraud. If they confirm that the action is satisfactory, it should be acceptable for CEDAR to consider further partnerships with VEP.	4	SPD D3; SPF C4	K:ARC, BI, SBMG; S: BI, EI; PSDM; B: AV, PS

Q	Response points	Marks	Syllabus content	App St'd
	• It would be prudent to ensure CEDAR carry out a due diligence exercise on VEP before engaging them as a partner on another project, even if this is not insisted on by the donor. • There is a case for improving the monitoring arrangements for project partners beyond the review of quarterly reports.			