CIPFA The Chartered Institute of Public Finance & Accountancy

Strategic stage

SCS Marking Scheme M22 paper

08 March 2022

Question 1 (55 marks)

Q1	Response points	Marks	Syllabus Content	App'p Std.
a)	*Assess why the project of establishing an IT department was unsuccessful the first time it was attempted by the College, and discuss how a more formal approach could have helped overcome the problems identified.* **1 mark per developed point to a maximum of 15. A maximum of 9 marks for the reasons why the first attempt to create an IT department failed and a maximum of 9 marks for impact of using a more formal approach.** General points • No project sponsor appears to have been identified, meaning that there was no project ambassador reporting to the board of governors, and a lack of regular communication between those working on the project and governors as decision-makers. • Though it is important for governors to monitor the progress of the project and be responsible for key decisions, it is highly doubtful that a governor (Eric Epworth) should have been so closely involved in such day-to-day project activities. To allow more objective scrutiny and decision-making by governors, detailed project management work should be undertaken by College staff. No project manager and clearly defined project team was formally appointed, which had the following consequences: • The CEO seemed to be assumed to be the project manager, but there is evidence that he lacked consistent commitment to the project, perhaps due to insufficient time to allocate to the project, meaning that project meetings were cancelled, or went ahead in his absence. • There was a lack of clarity about where responsibility for decisions rested, so when disagreement arose, it was allowed to escalate into conflict (e.g., between marketing director, Dave Duggan and HR director, Tony Tape). • There appeared to be nobody responsible for ensuring that all the members of the project team were present at meetings, meaning	15	BCM: A1 SCS:A1-A4, A6; B1-B4; C1-C2; D1-D3	K:ARC, BA, LSP, SBMG; S:BI, C, L, PSDM; B:AV, F, PS

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	that only some views were taken into account when decisions were to be made. • Nobody appeared to be responsible for monitoring progress of the project and alerting senior leaders, including the board of governors, when problems arose. • There was confusion about who had the authority to change aspects of the project. • There is no evidence that the scope and objectives of the project were clearly identified, which meant that there was confusion about key parameters such as the intended number of students on the course and the language to be taught. • There is no evidence that there was formal market research conducted to lead into a feasibility study ahead of decisions being made to instigate the project and the parameters to build into it. • There is no evidence of involvement in the project team of key users from the faculty where the new department would be based. There was no budget set out and approved at the outset, with the following implications: • The overall cost of the new IT department was not estimated in advance so no feasibility study could be carried out to see if it was actually affordable. • Since there were no estimates for costs such as salaries, people involved in the process had no guidance as to how much things should cost. • It was not possible to compare actual costs to a budget, meaning that overspends could go undetected for a considerable time. • There is no evidence that the Finance directorate was formally involved in project management activities, suggesting that insufficient attention was given to project financial planning and control. The apparent lack of a formal detailed project plan meant that: • The board of governors did not have the chance to review and challenge the assumptions underpinning the proposal. This meant for instance that there was great surprise at the salary offers made to candidates. • Interdependencies between activities did not appear to be properly considered. For instance, the equipment was bought before			

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	the language to be taught was decided. This resulted in significant sums of money being wasted. Also, lecturers were recruited before the new department was formally approved. • There appeared to be no specific milestone points created, meaning that when things went wrong, or activities were delayed it did not become immediately apparent, and time was wasted. This meant for instance that the uncertainty around the language to be taught was allowed to go on to long, and the prospectus was incorrect when it was published, meaning an errata sheet had to be distributed. A more formal approach would involve: • The production and approval of a Project Initiation Document (PID) • A formal project governance structure A PID should have improved matters as follows: • Planned outcomes from the project would have been considered and approved in advance, and formally recorded so that anyone in any doubt would have been able to refer to the official record when making decisions about the project. • Detailed budgets and timetables would have been prepared so that an assessment of its feasibility could have been undertaken before the project was begun. • Any assumptions about the project could have been identified and challenged so that a realistic plan, including budget, could have been created. • Milestones throughout the project would have been identified at which specific deliverables would need to occur, such as the details of the language to be taught and recruitment of staff. • A detailed plan of works would have been established to ensure that no work would be carried out until the preceding activity had been signed off by an authorised individual, such as the project sponsor. • Reporting procedures would have been decided upon, so that it would have been clear what was to be reported, and to whom (e.g., amount spent versus budget, deliverables achieved etc.) • Responsibilities and authority would have been assigned so that it was clear who had			

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	the power to change key project assumptions. • A record would be made of any changes made to budget, scope or timeframe of the project, and who authorised them, to allow a thorough post-project review. The establishment of a formal project governance structure would involve the identification of the project sponsor, project team, project manager and project administration arrangements, including accounting and support for project meetings. This should have generated the following benefits: • At an early stage of the process the board should have agreed to a formal project governance structure, whereby a project sponsor or board was charged with ensuring that the project was successful and adequate funding for it was secured. • A clearly identified project sponsor would have ensured that the proposal would have obtained consistently effective support and scrutiny across the organisation, in particular at senior management and board level. • The sponsor should also have ensured that communication between stakeholders, such as the directors of HR and Marketing and the science and engineering faculty were managed much more effectively. • An effective project manager would have co-ordinated activities so that, for example, the HR Director would not have recruited staff to teach Latic at the same time that the Marketing Director was finding out that no employers in the area needed Latic coding. • An effective project manager would have ensured more effective engagement with stakeholders such as the science and engineering faculty, and the end users, in effect the local businesses and individuals that would be intended to be the beneficiaries of the College's offer. • An effective project manager would have ensured the delivery of the project, in line with deadlines, budgets and specifications such that intended outcomes were realised. • An effective project manager should have ensured the establishment of an appropriate project team, setting out how it fitted with and reported to the College's existing governance structures. • The project manager should have established administrative support			

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	arrangements that ensured the effective ongoing involvement of all project team members. • A project accountant would have ensured the management and monitoring of the budget and pointed out the need for the budget to be agreed much earlier in the project.			
b)	*Using Porter's Five Forces model, evaluate and provide conclusions on the competitive environment facing Ellasam College if it wishes to enter the computer coding educational sector.* **1 mark per developed point to a maximum of 15, with a minimum of 1 mark reserved for each of the 5 Forces. Credit is given for valid points wrongly categorised. 1-2 marks are reserved for overall conclusions as to the nature of the competitive environment.** **Threat of new entrants** General (classroom or online) The key issue here is to identify and assess the effectiveness of the barriers to entry for potential new entrants: • A new college would require accreditation which could be difficult to acquire. Without that, many potential students would find it impossible to get state funding, meaning that many students would be put off from attending. This barrier to entry is likely to be so significant that it means this threat is very low. Classroom courses • A traditional physical college would require significant investment to develop. Towns of the size of Jeanville typically do not have multiple colleges, which is likely to be because there is unlikely to be a large enough population in its catchment area for multiple colleges to be viable. No organisation is probably likely to set up another physical college in the town of Jeanville, so this is unlikely to be a significant issue. • Over a long period, colleges like Ellasam will have developed strong relationships with distribution channels, in particular local	15	SPD: A3, C1 SCS: A1-A4, A6; B1-B3; C1-C2; D1-D3	K:ARC, BA, LSP, SBMG; S:BI, C, L, PSDM; B:AV, F, PS

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	businesses, by providing courses on knowledge and skills relevant to those businesses. It can be difficult for new entrants to break into such relationships with an offer that is more attractive than that provided by an established player such as Ellasam College. Online courses • An online college is likely to be much cheaper and quicker to create, and could therefore be much more of a threat. • Online courses based in foreign countries will be difficult for students in Jeanania to access unless they are translated into Jeananian, since language skills are poor in Jeanania. There is no evidence of overseas training companies having had much incentive in creating courses in the Jeananian language in the past, and this may continue. • However, the government's recent piloting of a revised accreditation process is said to be extended to other industries with skills shortages, which could mean that it will soon be applicable to this sector. This may mean that the threat of entry from this source is considerably increased, especially as there is recent evidence of Jeananian citizens being increasingly open to online learning. **Power of buyers/customers** General (classroom or online) • Once students have started the course, switching costs would probably be high – it might mean having to start a particular course from scratch again. In particular, students on two-year courses would find it very difficult to switch to another course part way through. • However, collectively, enrolled students can have power to influence course delivery. That was evidenced during the previous attempt to establish the IT department when those students that enrolled complained to the JME about their experience, triggering a formal investigation into the College. • The national government can also be viewed as a buyer. It is keen to see a diversification of the economy and wants to see projects like this taking off. While they have the			

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	power to withdraw funding, it is unlikely they would do that and still achieve their strategic goals, but with their powers of accreditation and as funders of many of the students, they have power to influence, particularly if there are concerns about a college's performance. • Particularly due to the financial support on offer to them from the government, there is a risk that organisations requiring the kind of IT skills concerned may develop the capability themselves by directly employing people with relevant capabilities and upskilling their staff directly – in effect a form of backward vertical integration by entities currently viewed as buyers. This is probably only a meaningful threat if the value of a qualification from an accredited college is seen as less important than the acquisition of the associated skills and capabilities to businesses and the individuals concerned. Classroom courses • Students aged 16-18 are likely to have low bargaining power. It would probably be difficult for them to go to another physical college – this is the only local classroom-based college. Given their age, it's unlikely that they will be in a position to move and live away from home during term time. • Local employers sending their employees on vocational courses may be in a stronger position. If they send large numbers of students, they may be able to demand discounts on the standard fees charged and/or to influence course delivery. • This threat can be intensified when a local employer is also a donor and attaches conditions to their support. Online courses • Currently there are few online programming courses in Jeanania, so it would be difficult for customers to switch. • The lack of language skills of Jeananians and lack of accreditation of foreign-based deliverers of online courses is also likely to mean that people are not likely to be tempted to enrol on online courses delivered by foreign organisations in other languages. • If online courses were to be developed as hoped by JME, more would be available and the cost of switching would be much less,			

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	thus increasing the bargaining power of customers. The fact that there is evidence of citizens being increasingly prepared to learn online adds further to this threat. **Power of suppliers** General (classroom or online) • Hardware suppliers would have low power, since there are many suppliers that a college such as Ellasam could buy from. • However, if the industry grows quickly, it is possible that supply is unable to match demand and the power of individual suppliers could grow. • It is possible, though, that there could be significant switching costs once a college has committed to working with a particular supplier and delivering courses based on a particular coding language. This could provide significant power to the supplier(s) concerned. • Staff would be a very important supplier. Lecturers with the required knowledge and skills are in short supply. Those with these attributes and the desire to go into teaching may be even harder to find. This means they are likely to be in a position to demand high salaries and once employed they may be hard to retain without significant changes to the way the College operates and unusually high salary increases. • Other staff providing the support to the new IT courses are less likely to have such scarcely available skills. However, they and staff elsewhere in the college may become disgruntled by the focus on the IT department and, in particular, the higher salaries paid to the lecturers. The previous attempt to establish an IT department nearly led to industrial action and that is a likely to be a threat again and may lead to higher salaries generally in the college. Online courses • Live classes online would still be dependent on having qualified staff available to provide some of the teaching when required. However, since much of the material is recorded, once it has been produced, the reliance on the availability of staff is somewhat reduced.			

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	• A foreign online course provider would have a range of recorded courses in other languages, which could be translated into Jeananian: translators could therefore be an important supplier. Given the weak foreign language skills of Jeananians, it may be hard to source suitably skilled translators and so those that exist may possess significant power in this circumstance. • The online course would need the support of an internet provider to support web operations, but they are becoming increasingly common in Jeanania, so it would be relatively easy to switch to another provider should the need arise. **Rivalry with existing competitors** General (classroom or online) • Given the regulatory role of JME regarding fees, there is limited scope for price competition and so any competitive threat is likely to be best dealt with by applying strategies built on other potential sources of competitive advantage. • The College has a strong focus on cost control, with associated incentives, so it may be feasible to adopt a cost leadership strategy in relation to competitive threats, while still setting prices in line with existing approaches. Classroom courses • With there only be one college in towns such as Jeanville, and particularly 16–18-year-old students unlikely to travel significant distances for their course, this threat is likely to be low. • However, the episode a few years ago when the college in Leviford responded quicker than Ellasam to an approach to the engineering design department does illustrate that for some activities, there is rivalry with other colleges that provides some threat. Online courses • There is little evidence of many online delivery competitors as yet in Jeanania, so there is little concern in respect of this, but this may not be the case for long.			

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	• As the industry is expected to grow in the next few years, it is conceivable that organisations such as Ellasam College can grow with it, which may also minimise the extent of competitive rivalry. • But as technology is inherently fast moving, colleges will need to ensure that they are agile enough to adapt to the sector's evolving needs. Given Ellasam's bureaucratic set-up, there is concern that it may not be sufficiently flexible in this respect. **Threat of substitutes** • Online courses are potentially a substitute for classroom courses and vice versa. Currently there is little evidence of the development of online courses in Jeanania, but as Ellasam is developing them, other colleges could be too. • The proposal may also to some extent cannibalise its own market – in other words attract students who would have already been attracted to Ellasam for face-to-face courses. • JME appears keen to encourage foreign online providers to apply for accreditation, so the threat is increasing. • For students in full time employment supported for vocational training, employers may decide to run their own courses in house. However, once Ellasam has its courses established and has developed the online option, the costs associated with this mean that it may be much cheaper to send their students to Ellasam rather than run their own in-house courses. **Conclusions** • Overall, the competitive environment is broadly supportive of this proposed development. The proposal to develop the online courses in tandem with the face-to-face courses should be an effective way of dealing with the threats to the classroom courses. • It would be helpful to obtain more information about how much of a threat may be posed by domestic (or foreign) providers of online courses, in particular whether any are sufficiently further advanced in their development plans to provide them with the			

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	scope to secure sustainable first mover advantage ahead of Ellasam. • As long as the staff can be recruited and retained without undue impact on the College's finances and other activities, there is no compelling reason to cancel the development of the IT department arising from these environmental factors.			
c)	*Taking into account the specific requirements detailed in the CEO's email of 7 March, critically evaluate the financial implications of the proposed new IT department.* **1 mark per developed point to a maximum of 19, including a minimum of 3 marks reserved for consideration of the discount rate assumption plus up to 6 marks for calculations (see Excel document).** • After re-evaluation to allow for the revised assumptions put forward by the CEO, the NPV is still showing as negative so on this analysis on pure financial grounds the proposal should not go ahead. • The NPV is now, though, much more marginal and so the decision whether to proceed from a financial perspective is much more finely balanced based on these figures. However, there are also a number of assumptions built into the appraisal which are questionable and should be revisited before a decision is taken. • The upfront set-up cost is a particularly material factor in the results. While the redundancy costs will be unavoidable if the other departments are closed to accommodate the new department, the soundness of the estimate of the rest of this cost should be reviewed, which appears to be mostly or wholly focused on refurbishing a new lecture theatre – is it, for example, strictly necessary? Without any adjustments to other figures, a reduction of this assumed cost by around £70 000 would create a positive NPV. • The number of face-to-face students appears to have been capped at 100 in the analysis because that is the size of the largest classroom, when, for example, it may be unnecessary to assume all the students would need to be in the same classroom at the same time. • It is also apparent that there are rooms already at the College that can	25	FM: C1-C5; MA: B1, B3, D4; SPD: A4; SPF: C3 SCS: A1-A4, A6; B1-B3; C1-C2; D1-D3	K:ARC, BA, FI, LSP, SBMG; S:BI, C, L, PSDM; B:AV, F, PS

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	accommodate 150. It may therefore be practical to accommodate more face-to-face students than assumed and/or to spend less on refurbishment. • Also, the assumed number of students should take account of market research, rather than be driven primarily by an internal constraint on class size that may be able to be flexed if there is sufficient demand. It is not clear that such analysis has taken place. • College room capacity and staff numbers will place some limit on student numbers and it would be worth clarifying those constraints before finalising the appraisal. • It is unclear why online course student numbers were originally assumed to stop growing at 90 per year in year 3. Initial market indications suggest that online demand is likely to grow and if the College can secure a competitive advantage in the sector, it may be reasonable to assume that growth in numbers will continue beyond year 3, as the CEO proposes. • With much of the material for online courses to be provided via recorded lectures there should also be little by way of internal constraints on the ability to cope with increased numbers of online students. • The lifetime of the new department is assumed to be five years. This seems unrealistic; there is no reason why it should not continue for longer, with the appraisal therefore taking place over a longer period. • Some consideration of the market life cycle would be worthwhile as it is not likely to continue indefinitely, especially due to the technological focus of its work, though if the department can adapt with new technological developments, it ought to have a life longer than 5 years. • Even with the original assumptions the IT department generates a net surplus each year and this grows to a surplus in excess of £600k in year 3 and over £500k in year 5. So, even on the original assumptions it is likely that a positive NPV would be generated by around year 8, and sooner still if the appraisal applies the CEOs assumptions. • With the suggestion by the CEO that the projections may be unduly cautious, and, for example, that it is reasonable to assume that student numbers would continue to grow from year 3, it seems too cautious to assume a five-year life and it is likely that an			

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	appraisal over a longer period would improve the NPV considerably. • Given the uncertainty over the life cycle that should be assumed, it may be useful to supplement the NPV analysis with analysis of the payback period to enable College decision-makers to determine whether the forecast payback is sufficiently swift. • The payback method has the weakness of ignoring the time value of money but if the cash flows are discounted before the payback period is calculated this would arguably provide decision-makers with useful information alongside the NPV. It also provides a useful measure of time-related risk for potential investment projects. • With the numbers of students assumed to be increasing over time, it needs to be assessed whether staff levels should also be assumed to be increased at some point. If 6 staff (4 lecturers and 2 administrators) are needed for 30 students in year 1, it seems quite likely that more staff will be needed for the 190 students assumed from year 3, a point that has even more weight if the numbers of students are higher still as per the CEOs suggestion. • Generally, given the expectation that student numbers will grow considerably over time, some assessment of cost behaviour would be appropriate, in particular whether any cost items should prudently be assumed to be variable with student numbers (or some other cost driver), or have a semi-fixed (stepped) relationship with a cost driver such as student numbers. • The number of students lost because of the closure of the carpentry and joinery department has been assumed to grow at 10% pa, when in fact the department earmarked for closure has seen falling numbers over the last three years. This is likely therefore to be overstating the foregone income (i.e., cost) of closing this department and worsening the NPV shown. • The cost of administrative staff should not be included in the NPV calculation, since they are not an incremental cost; if the IT school does not open, they will remain in the carpentry and joinery department, while if it closes, they will transfer to the IT department, so there is not expected to be a relevant cost implication for this item. Its inclusion is therefore wrongly worsening the NPV shown.			

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	• The savings on staff made redundant has not been adjusted by inflation, even though it is currently 2% per annum, and is expected to rise in the future. Given the use of a nominal discount rate, it is appropriate to inflate each item and so this should be increased by the expected rate of salary increase. The analysis therefore understates the saving made from this source.
	• While it is likely to be true that there will be market pressure to increase the pay of IT lecturers at a higher rate than inflation and that of other Ellasam staff, a 10% growth rate, when inflation is 2% may be overly cautious and it may be reasonable to assume a lower growth rate even though inflation is expected to increase.
	• Similarly administrative staff salaries have been inflated at 5% per annum, when at the moment inflation is only rising at 2% per annum. While inflation is expected to increase, and there may be greater pressure to pay staff more due to the likelihood of paying the IT lecturers higher salaries, the validity of this assumption should be questioned.
	• Also, administrative staff working in support of the IT department would, under the current structure, be part of the HR team and would be likely to receive the same pay rise as other HR staff; it is unlikely that they would receive the higher increase that some are arguing to be necessary for the IT department lecturers.
	• Costs for running the IT department other than staff have not been included. A case may be made for many other costs to be taken into account, including:
	  ○ It isn't clear that an allowance has been made for any investment cost associated with the creation of the courses to be offered by the new department. The set-up costs are stated as including the refurbishment of the new lecture theatre and the redundancy cost of the staff in the department to be closed but there will be other costs associated in bringing the courses into operation, such as equipment, creation of course materials etc.
	  ○ There may need to be upfront extra recruitment costs for lecturers given that the College is likely to need to run a bespoke campaign to attract the kind			

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	of people that it is assuming will be needed. There may be associated incremental costs. ○ Marketing costs for the new courses may be absorbable within the cost of existing staff and materials and not therefore a relevant cost, but as it is very much a new venture for the College, it may be prudent to allow for some increased cash flow in this area. ○ There are likely to be other departmental running costs, such as course materials, IT licences, maintenance of equipment etc. These may differ from the running costs of the department earmarked for closure and, if so, there is a relevant cost implication. ○ The nature of the IT industry is that there is likely to be a need for regular update of materials and upgrade of equipment, so that the College's course offer keeps pace with the expectations of employers and students. Some cost allowance should be built into the projections in later years for this. • The student fees calculation seems to be based on the assumption that all students are going to be paying the annual fees, whereas some of them may be on one semester courses. • The face-to-face course fee is assumed to be the same as current average fees at the College. At the very least, some allowance should be made for inflation during the period before the IT department would be in operation given that the appraisal uses a nominal discount rate. • Further, the approach to setting fees should be based on the costing guidance provided by JME, and so should be built up on a bottom-up cost basis rather than taking the current average. As staff costs are likely to be higher for the IT department than the rest of the College, it is likely that the fees will be higher than the current average. • If the IT department does pay staff higher salaries, this may mean that the initial fee for the department's courses can be justifiably higher than that for other courses. If higher pay increases are also awarded to the department's staff over time, then, with reference to the JME's costing guidance, that may also mean there is justification for the			

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	department's fees to be increased by a larger amount than other College courses. However, compliance with the JME's fees guidance may limit the scope for the kind of fee increases put forward by the CEO. • Student fees are shown as starting in year 1; however, as they are paid at the start of the year, they should be shown as starting in year 0. This applies to both the fees generated by the IT department and the fees lost from the departments being closed. • Once agreement is reached on the assumptions to make regarding parameters such as the appraisal period, discount rate, fees, student numbers etc, it would be wise to subject the revised appraisal to sensitivity analysis for the most uncertain and material assumptions, such as the impact on the NPV of changes to student numbers or fees. • As there are a number of key assumptions, it may be useful to conduct a simulation whereby a number of variables are changed at the same time in order to gauge the overall impact on the NPV. • Some of the calculations built into the original appraisal do appear to be incorrect (such as the inclusion of administrative staff as an incremental cost), and should be corrected before the board report is finalised. But, also, further work is needed to test whether the assumptions (such as on student numbers) are unduly pessimistic. At the same time, though, it is important to be wary of optimism bias. There is unlikely to be past experience to assess in order to gauge the likelihood of such bias being built into the assumptions, but an objective assessment of all assumptions by SMT, with as much evidence from market research as possible, is advised before presenting the final board report. • There may also be wider strategic benefits from setting up the department that may have a financial impact in future years. For example, the development of online IT courses may act as a catalyst for the College to develop its online delivery capability and support profitable growth in other departments and faculties. • Decision-makers should also take into account non-financial factors, especially as the financial analysis may well end up quite marginal. For example, opening the IT department may generally enhance the reputation of the College. Given the			

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	government's technology agenda, this may increase the College's standing politically, and could have financial benefits by leading to an increase in demand for other courses. Such an important strategic decision should not rest solely on a financial analysis or be analysed in isolation from its potential impact on the whole of the College's business. Discount rate assumption • The discount rate recommended to be used by colleges is 8%, rather than the 10% that has been used, as this is the government's assessment of the appropriate rate having taken account of interest rates, inflation and general economic activity. It is probably based on a government assessment of the social time preference rate, together with an allowance for inflation. • With inflation expected to rise, and the discount rate a nominal rate, it is possible that the discount rate set by the government will be increased soon too, but this risk should be evaluated as part of sensitivity analysis – the appraisal should use the government rate unless there is a rational case for not doing so. • As currently, the College is funded primarily by government, it seems reasonable to follow their guidance on this issue and so the assumption to use a 10% discount rate on the face of it seems wrong. • A lower discount rate such as 8% would improve the NPV and it is likely to make it a positive result when also taking into account the CEOs revised assumptions (*Excel sheet shows it would do but candidates aren't expected to quantify this*). • However, if the college takes advantage of the opportunity to borrow money from the private sector, then it may need to adjust its discount rate and take the cost of borrowing into account. • The government funding received could be considered to be a form of debt, but at the very lowest rates possible. Governments have the capacity to raise finance from their citizens by increasing taxation, and they are unlikely to find themselves in a situation where they are unable to pay their debts; this means that generally governments are seen as very safe by lenders, and can borrow at very low rates. At any given time, the			

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	government of Jeanania could change its policy on funding students, but it is unlikely to do so at short notice, and hence they are seen by public sector organisations as a low-risk source of funds. • By contrast, with borrowing from the private sector there is always a degree of risk; if the college is unable to pay the interest on a loan, or is unable to repay capital when it falls due, there is the risk that the lender will take action to get their money back. Any loans from the bank may be secured against an asset, for example the land at Seaby's Green, and so there is a risk that the college will lose that land if it defaults on any part of its loan. • Lenders may judge that there is a material systematic risk associated with this investment and therefore require a higher return. They may assess that the College would be moving away from relatively stable markets into a sector that is more dynamic due to the impact on it of technological change (be it the course content itself or the online delivery angle or both). They may also feel the previous failed attempt at a similar investment supports the view that there is higher inherent risk involved. • If the College judges that there is a material increase in systematic risk as a result of this investment, then there is an argument for adding a risk factor to the discount rate, as the Finance Director appears to have done. • It is unlikely that this risk factor can be determined in any systematic way, but it would require judgement and should be a decision reached by the board given that they should be accountable for the College's risk appetite and how that appetite should be applied to individual strategic decisions of this kind.			

Question 2 (45 marks)

Q2	Response points	Marks	Syllabus Content	App'p Std.
a(i)	*Discuss and evaluate the alternative methods available to the College to finance the establishment of the new IT department as identified in the CEO's email of 7 March.* **1 mark per developed point to a maximum of 15 marks, with a maximum of 7 for borrowing, 6 for sale of Seaby's Green and 5 for the Dippernib donation.** <u>Borrowing</u> • With the fees revenue of the college at £33m, and it being allowed to borrow up to 10% of that amount, it would be feasible to finance the investment by borrowing with the expected investment cost being £2.2m. • The college may consider taking out a larger loan if the financial projections for the new department continue to show a negative cash flow in its early years. A further £1.1m could be borrowed and the College would still comply with the JME's rules. • Theoretically, at least, there are different borrowing options available: issuing bonds and taking out a loan from a financial institution. Bonds • In theory, issuing bonds would be possible, but the amount is very small for a bond issue, and the costs would be relatively high. • Also, the financial markets in Jeanania are not particularly well developed, so it could be a particularly complex process to undertake. • Bonds would provide the advantage that the coupon payable would be known in advance, making financial planning easier than for a variable rate bank loan, though equivalent in that regard to a fixed rate loan. Interest rates are forecast to rise, so the issue of borrowing costs, their certainty and their impact on cashflows could become significant. Bank loan • There would be a number of considerations: - Fixed or variable rate - Duration of the loan - Secured or unsecured - Repayment pattern	15	FM:A3, B2; SPF:A1, B3; SPD:A4, C1 SCS: A1-A4, A6; B1-B3; C1-C2; D1-D3	K:ARC, BA, FI, LSP, SBMG; S:BI, C, L, PSDM; B:AV, F, PS

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	• With the expectation of inflation increasing in the short term, interest rates may be expected to rise, meaning that on the face of it, a fixed rate loan may be more attractive. • However, fixed rate loans would probably involve higher interest rates, because the banks would be factoring in an expectation of higher rates in the future. • It may seem more sensible to opt for as long a loan as possible, however, a longer term loan is likely to be considered to be riskier by the lender and be associated with a higher interest rate. • The College could also obtain a lower cost loan if the loan is secured against identified tangible non-current assets with land and buildings tending to be the best quality assets. • One option may be using Seaby's Green as security against the loan given that it is a discrete part of the campus and is clearly being considered for disposal anyway. It would need to be formally valued, but based on the recent sale of nearby land it could be worth at least the value of the loan that would be required and therefore be suitable. • Subject to finalising the above details, a bank loan should be fairly quick and simple to set up. • There is also potential scope for a variety of repayment options depending on the College's preferences, so it is a flexible option for the College. • Given the new government policy flexibility on college borrowing this could be something that the College will be expecting to do anyway at some point to fund investment. It may be with its new policy that JME is wanting to reduce the use of accumulated net income to fund investment by colleges. Since the College is limited to borrowing 10% of student fees in any one year, it arguably makes sense to start getting loans in place now before interest rates go up. • This option would increase the College's costs for many years to come, more so than the other options and there is some risk of not being able to repay the loan which should be considered before any decision is made. • It will also reduce its flexibility to use Seaby's Green if it is used as security on a loan. Any development there would need to be approved by the bank as they would be concerned about the impact it may have on			

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	the value of the land, and hence it's quality as security on the loan. <u>Selling Seaby's Green</u> Advantages • A clear advantage over the borrowing option is that there would be no interest repayments to make and therefore no ongoing financial impact in this regard. • There would also be savings on the costs of maintenance and upkeep of the land and its facilities. This is unlikely to be significant based on the extent to which the facility appears to be maintained currently, but the maintenance of the sports facilities and activities such as mowing will still have cost implications. • The facility is relatively underused by the college and there is no evidence that the College has a plan for its use, so it no longer being available would arguably have relatively limited impact on students. Disadvantages • As a college we have a responsibility to the welfare of our students, and the sale of the land removes an opportunity for our students to enjoy exercise and access to green spaces. • The parkland is also enjoyed by the local community; if that is taken away from them, there could be lots of complaints, as happened previously when the College considered selling the land to a housing developer. • Action by either students or local community groups could ultimately trigger a JME investigation. • Though not currently exploited by the College, there may be income generating possibilities from the asset – for example, hiring out the sports facilities; once sold these potential opportunities are gone for good. • It could take some time to actually sell the land and be a complex process. It requires valuation, marketing etc, and it may be that potential buyers will want to obtain planning approval before committing to buying the land. Certainly, it is likely to be much quicker to borrow the money required. • If the funding needs to be available quickly, as seems likely, this might not be the best option; it may be necessary to obtain potentially expensive bridging finance if there			

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	was a business need to set up the department before it was possible to sell the land. • Compared to the other options there is great uncertainty about the amount of financing that will be available. While the recent sale value of a nearby piece of land was sold for £800 000 (meaning it sold for £53k per hectare) suggests that selling the 50-hectare Seaby's Green, may generate more than enough to finance the investment, it should be recognised that land sales are inherently unpredictable and that may be even more so as a result of the impact of the pandemic. • Work would have to be undertaken to assess the comparability of that piece of land to Seaby's Green and a formal valuation obtained. But even after that, the actual sale value is inherently unpredictable and there can be no certainty it will generate the amount needed. • If sold, there is likely to be considerable disruption for students, staff and the local community whatever use Seaby's Green is put to by its buyers. This could also be ongoing disruption if the new use has an ongoing impact on the use of local infrastructure, pollution etc. This may well lead to complaints from local residents and students to such an extent that it damages the College's business and leads to a JME investigation. • The fact that the land was gifted to the college may pose some limitations on its use. This may have been checked when the College came close to selling the land before, but it may not have been given that the sale did not ultimately proceed and so this should be verified before any further consideration of this option. • Even if there are no formal constraints posed by it being a gift, it may prove bad publicity for the college to be seen to be 'profiteering' from such a gift, given that it was probably gifted to be for the benefit of the stakeholders of the college and that would not be possible if it is sold except via the one-off financial benefit. <u>Accepting the donation from Dippernib</u> Advantages • It would provide the students with an opportunity to get some work experience with one of the leading internet-based companies in the country.			

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	• The online marketplace is set to grow and the College is likely to face increasing competition; having the opportunity to get work experience at a firm like Dippernib could be a significant differentiator and hence enhance the College's competitive advantage. • Having Dippernib's involvement in the design of courses, in effect a form of co-production, provides access to experts in the field and will allow the College to create courses that are more attractive to potential students. Disadvantages • It would only cover part of the amount needed, meaning that we would also have to use other sources to finance the establishment of the IT department, such as seeking other donations, a loan, or from reserves. So, the pros and cons of those other sources that may realistically be used as well, also need to be considered. • It is possible that this arrangement would be a source of competitive disadvantage. Some students may feel the association with Dippernib is inappropriate given the focus of their business and not apply to Ellasam as a result. • Some may be deterred from applying due to a perception that the course design will be so tied up with meeting Dippernib's needs and not provide suitably transferrable skills and so as to limit their own career flexibilities later on. • It is not clear how other (potential) employers, many presumably competitors of Dippernib, would react to such a close relationship between the College and Dippernib. Such organisations may perceive that a course designed in alliance with Dippernib will be too skewed towards meeting their needs rather than their own. • The involvement of Dippernib's management in the design of courses needs to be more precisely determined; this could result in courses being run that are purely for the benefit of Dippernib, not the students or the college. The limits of their authority over the design of courses needs to be established. Key questions include: – do they want the final say on what courses will be run? How long will they want to be involved? To what extent are Ellasam's staff prepared to relinquish some academic freedoms to design and develop their courses?			

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	Other considerations • It may be possible to push back on some of the conditions attached to the donation if they are felt to be undesirable, especially as the loan covers less than half of the upfront cost. • It would also be important to establish for how long the donor's proposed conditions would apply given that the donation is a one-off amount.			
a(ii)	*Evaluate the appropriateness of the College's structure and control systems in respect of the new IT department, identifying and discussing changes to them which may help to facilitate the success of the IT department.* **1 mark per developed point to a maximum of 12. A maximum of 8 marks is available for each of the evaluation of the current set-up and discussing potential improvements.** <u>Issues with the current set-up</u> • The college is highly centralised and decision making is slow. It is likely that the IT department would operate in a highly dynamic sector and so, to succeed, it is likely to need to be agile, capable of making decisions and implementing changes to its course offer quickly and generally being responsive to the market – this will be hard to achieve within the context of current bureaucratic decision-making processes. • The upshot of the existing processes is that the only way that the development of new courses or other changes is likely to happen swiftly enough is if the CEO proposes them, rather than them being initiated by lecturers or department head. But the CEO is not an academic, and is unlikely to know which courses could easily be developed or be most suitable for the marketplace. • The structuring of administrative services as a service centre in the HR directorate may also hinder the chances of the IT department being successful. There is already some evidence that the faculty staff having no authority over administrative staff working in their faculty is leading to staff performance issues not being effectively addressed. This is	12	BCM:C3; MA:C1, C2; SPD:B3, D1, D2; SPF:B4 SCS: A1-A4, A6; B1-B3; C1-C2; D1-D3	K:ARC, BA, FI, LSP, SBMG; S:BI, C, L, PSDM; B:AV, F, PS

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	likely to be demotivational to the staff reliant on such support. • Further analysis of the rights and wrongs of this administrative services set-up would be necessary before firm conclusions could be drawn, but if the concerns are proven this could make it a lot more difficult for the new department to be as flexible to customer needs as is likely to be necessary, not least because the staff concerned provide services such as student liaison and maintenance and so the impact of their poor performance would be directly felt by students. • While it is good practice to set a medium term budget (as the College does with its three-year budget), it does not seem as if the College re-assesses it in enough detail during the annual budget reviews. Their approach may have sufficed in the past, when the external environment was more stable, but it is likely that the College is going to be operating in an increasingly dynamic and uncertain environment and a more flexible approach to budgeting is likely to be necessary. • Individual faculties seem, in effect, to be treated as cost centres, meaning that their principal focus is on keeping costs down rather than on developing new courses. There is therefore little incentive for management to innovate by developing new courses or encouraging more students to attend courses. • Any new courses will increase the number of staff, and hence salary costs, meaning they may not be able to meet their target of costs coming in under budget, and so will probably reduce the scope for faculty management to benefit from the bonus. • The new IT department is going to need to develop new and update existing courses over time and generally be innovative given the nature of the sector, but the control system is likely to discourage the faculty from wanting to do so. • Generally, it seems inappropriate for the only performance measure to be the achievement of budgeted cost targets. By focusing performance measures solely on cost minimisation, managers are not incentivised to make decisions that would improve College performance in a broader sense. <u>Suggestions for improvements</u>			

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	Responsibility centres • It may be appropriate for the faculties to be set up as profit centres, with targets set for the level of surplus that is created in any given year in order to try to incentivise faculty managers to take decisions that enhance profitability. • With regard to profit centres a key issue would be the controllability of costs by faculty managers. It is not clear at present whether the cost measure that is used to judge whether the bonus is payable is focused solely on costs that are controllable by the faculty. But to be a profit centre it is likely that the measure would include costs that are not easily controllable by faculty management. • In addition, as a profit centre, it would be necessary for faculty managers to have at least have some responsibility for decisions that influence revenues, such as fees. Bonus system • Linked to this, it would be worth considering amending the bonus system. If profit centres were implemented then the bonus could be linked to faculty surplus which would reduce the current disincentive to innovate and grow the department. • But given there may be practical difficulties associated with implementing profit centres, and such an approach may be perceived as unfair and divisive, a better approach may be a bonus system based on a measure of the College's performance overall, such as its surplus. Performance management • It would also be useful for the college's performance management system to be more multi-dimensional. Other financial measures would be worth measuring, such as revenue and surplus. There is also a case for formally building in non-financial performance measures too, such as student numbers, student feedback, customer retention etc. So, a model like the balanced scorecard may be worth introducing. Organisational design			

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	• Faculty heads could generally be given more autonomy to develop their courses as they think fit. This could be empowering and have advantages such as increased speed of decision-making, greater creativity and innovation, be motivational for the staff concerned and provide greater job satisfaction. • With regard to the administrative services department, it would first be worth assessing whether within the current set-up, performance management issues could be handled more effectively. It may be that a more formal service level agreement system is needed with the HR department, with recharges tied to service delivery standards. • If that is not likely to deal effectively with the problems being identified with the current set-up, the College should consider the option of faculty administrative staff instead being part of the faculty management structure rather than reporting to senior HR staff. • If it is considered likely that the current structure and associated decision-making processes will hinder the IT department's development and a restructure of the whole college and of the fundamental changes to performance management and control, processes is not desirable, as the CEO indicates, one option worth considering is for the IT department to be established as a separate business unit outside of the framework of the rest of the college. It could perhaps report directly to the Faculties Director. This would allow it greater freedom to develop its courses as it saw fit, and maintain its commercial focus. • If the IT department was to be set up as a separate business unit with greater freedoms, then it would still be essential that appropriate control mechanisms were established to ensure goal congruence. Specific control mechanisms may still include monthly management accounts highlighting actual spend against budget, but its performance management should also focus more on output measures such as student feedback and retention and post-course employment success for course participants. • However, it could also be argued that the College as a whole is facing an increasingly volatile environment and its bureaucratic set-up may not be fit for such an environment. It may therefore be the right time for the			

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	College to consider a flatter structure, with more decentralised decision-making and empowerment of faculty staff across all of the College's operations.			
a(iii)	*Assess the potential implications of the College's plans for staffing the new IT department.* **1 mark per developed point to a maximum of 6.** • Even with salaries offered being above College norms, it might prove very challenging to recruit the staff needed. The College has had a stable staff base for a long period and so may not have significant recent experience of recruitment. • In addition, the College will be looking to recruit very different types of people than the kind of lecturers generally recruited previously, in a sector where their experience may be limited at best. This could also make recruitment especially challenging. • The new lecturers, coming from an IT background, will be used to a much more flexible environment than the bureaucratic structures that exist at the College – many of them are likely to have been used to working as freelancers and changing jobs much more often than lecturers who have been working at the College for many years. • If the College seek to apply the existing decision-making structures to the new IT department it is likely that the new recruits will find it very demotivational. The staff are likely to expect greater role flexibility, to be more to empowered to make decisions on how to develop the course offer and generally greater speed of decision-making when higher level authorisation is necessary. • Over time, as demands continue to grow for the skills of such individuals, it is likely that the staff in the IT department will expect regular pay rises to keep pace with their sector. This is also likely to trigger similar demands from other College staff. • The systems for determining pay rises (in particular the appeals process) at the College are such that this could also greatly increase workload for the HR department and lead to increasing frustration among staff as their requests take time to be considered and may be denied. Staff retention and recruitment of replacements for those who leave may become an increasing issue.	6	BCM: C1, C3 SCS: A1-A4, A6; B1-B3; C1-C2; D1-D3	K:ARC, BA, LSP, SBMG; S:BI, C, EI, L, PSDM; B:AV, F, PS

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	• If these demands are met, other courses could soon become financially unviable given the restrictions over fees for courses attended by young students and the likelihood of the College facing more competition generally. • If these demands are not met, and other College staff see IT staff securing higher pay rises, and perhaps much quicker response from HR to their appeals, perceiving that the pay system is unfair, then it could seriously damage morale across the College and quite possibly trigger industrial action and legal challenge depending on equalities law in Jeanania. • HR sets remuneration packages based on a predetermined level set by JME. Other members of staff would be demotivated by the fact that the IT department staff would not have to be limited to this structure. It may also add to the chances of an adverse JME investigation if the cumulative effect of the issues stimulates a JME investigation as JME may not think that the College has a sound basis for departing from its guidelines. • Staff absenteeism and turnover may also increase and there could be a significant adverse impact on the quality of course delivery, which may also ultimately result in a potentially damaging JME inspection. • This could also add significantly to HR workload, in terms of recruiting new staff, both initially to establish the IT department, and on an ongoing basis if these pay issues do cause a sustained increase in staff turnover. Given the longstanding staff stability at the College, it is unlikely that the HR department will have the capacity for a significant increase in ongoing recruitment activity, especially if, too, there are more staff pay appeals to handle.			
b)	*Recently there have been concerns in the media about the performance of the College from a corporate social responsibility (CSR) standpoint. The CEO intends to meet with the Chair of the board separately ahead of the next board meeting to discuss these issues and, as detailed in his email of 7 March, requires a briefing note for the meeting with the Chair. The note should provide an analysis of the issues that may lead to concerns about the application of the College's CSR statement and the ethical issues that should be considered by governors, in respect of potential decisions regarding:*		SPD:B1, B2; CGL:H1-H4; SPF:B2, C1 SCS: A1-A6; B1-B3; C1-C2; D1-D3	K:ARC, BA, LSP, SBMG; S:BI, C, EI, L, PSDM; B:AV, F, PS

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	- *the development of the new IT department* - *the sale of Seaby's Green* - *accepting the donation from Dippernib.* **1 mark per developed point to a maximum of 12, with a maximum of 4 marks available for each of the 3 decision areas. 1-3 marks are reserved for general governance points of concern.** Development of the IT department • As part of its Corporate Social Responsibility (CSR) statement, the College have an obligation to help meet the training needs of the region's employers – providing well trained computer programmers contributes to the achievement of that goal. • The college is also committed in its CSR statement to a fair pay policy; the plan to offer the IT department staff higher pay, and the risks that this gap may widen in future, seems to go against that commitment. • Opening the IT department is likely to need another department to be closed. Though the College is looking at closing a department where student numbers have been falling this still means that it could be argued that employers' needs in these areas will not be being met if it is closed. • Falling demand for that department's courses may be an indicator of reducing needs, but there may be other causes of falling demand (e.g., a perception about the poor quality of the course) and it would be ideal to assess why demand has been falling and to properly assess its future viability before deciding to close any other department. • Given the specialist nature of the courses provided by the other departments, staff redeployment opportunities are unlikely, so this is expected to cause redundancies which will need to be managed sensitively and fairly. • It is important that governors declare potential conflicts of interest and the board handles these appropriately. With regard to the new IT department, it is likely that the associated closure of the carpentry and joinery department will result in the redundancy of the husband of one of the governors (Delia Davenport) – on the grounds of familiarity and self-interest, her objectivity is likely to be compromised (or	12		

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	perceived to be). This would therefore be a clear conflict of interest that should be declared by the governor and handled appropriately by the board. • Other governors have been lecturers at the College and may also not be impartial when faced with a decision on whether to close the carpentry and joinery department. Sale of Seaby's Green • The board of governors have a responsibility to a range of stakeholders as outlined in their CSR statement and so due consideration should be paid to the impact on these stakeholders before reaching any decision to sell Seaby's Green. • This includes a responsibility to ensure that the College's students are healthy - providing the opportunity to exercise is an important aspect of that. Losing the land would reduce the ability to achieve that, though it seems as if there is little exploitation of this potential at present. • With regard to the wider community, the College has a duty to support its social and economic welfare. This means that the College has to consider the impact that the loss of Seaby's Green could have upon those members of the public who currently enjoy the use of it. • Supporting society by allowing the land to be used to provide housing, especially bearing in mind the affordable housing rules which any housebuilder would have to comply with, could, though, be seen as a positive contribution to the College's CSR stance, but there is no guarantee that the land sale will result in this use. • The governors need to consider whether the development of the land contributes to the wellbeing of the planet. Currently, it is an open space, that is relatively untended and not heavily used, which may be seen currently as a positive contribution to environmental sustainability. • It could be argued that this issue is one for the planning authorities to grapple with. However, there is the risk that stakeholders will perceive that by selling the land to, say, a housing developer, the College has facilitated development that has adverse environmental consequences, with associated reputational damage for the College.			

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	• One of the governors (Anne Ashworth) is on the board of a local housebuilder; her objectivity could be questioned on the grounds of self-interest. If the land was sold to a company for which she is a board member she would be in a position to benefit. She may be inclined to favour rejecting Dippernib's offer to make it likelier that the land would be sold. It would be important to ensure that the governors have robust procedures in place for declaring and managing potential conflicts of interest. Acceptance of Donation from Dippernib • From a CSR perspective, it could be seen as a positive for the College to encourage organisations such as Dippernib who provide employment to local people and thereby support local economic development; forming the kind of partnership being proposed could therefore be viewed positively in this regard. • The CSR position states that the College supports Jeananian values; being associated with an organisation that promotes and make money from gambling may, though, seem to go against that. • Giving a senior manager from Dippernib a seat on the board may lead to accusations that it is possible to "buy" a seat on the board of governors, and open the College up to allegations of corruption. • However, it could be questioned whether this would be any different from the fact that people who have previously donated to the College are already governors, namely Colin Crabtree and Eric Epworth, though we do not know to what extent their appointment as governors was tied to their donations. It would be necessary to ensure that the College has robust arrangements for assessing the suitability of donations and dealing with potential conflicts of interest amongst governors. • Even if the situation with how CC and EE became governors is similar, it doesn't mean that would justify agreeing to the terms put forward by from Dippernib. It may point to concerns with the procedures used by the College to recruit governors and the code of conduct they are required to abide by. • There needs to be further clarity regarding the situation in respect of the students who will be working as interns at Dippernib; is it			

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	intended that it will be compulsory? Will it be guaranteed? The College will want to consider including the details of this in the prospectus, so it is important to be clear on this so it is not accused of misleading students. • If the internships are to be a compulsory part of the course, then the College needs to consider how the experience is going to be monitored by college staff to ensure it is the right type of employment – i.e., something that is relevant to the students' course or are they, perhaps, just being used as a source of free labour by Dippernib? The College will need to determine if internships per se are consistent with their CSR stance. Other governance issues • There are some other indications that governance best practice is not followed. For example, in addition to the appointment as governors people who have donated to the college, the appointment of a number of former employees as governors further casts doubt on how independent the board really is. • In addition, EE being on the board for 15 years is another indicator that governance good practice is not followed. • The response to the concerns raised about their decision-making and how far the CSR stance is really applied, according to the CEO, may also suggest that the board does not have a positive approach to self-evaluation. • These concerns serve to cast doubt on how likely it is that governors will handle the CSR and ethical issues associated with decisions on the new IT department and its financing.			