The Chartered Institute of Public Finance & Accountancy

STRATEGIC PUBLIC FINANCE

December 2020

Duration: 3 hours

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

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

Risks to financial stability for councils when commercial activities fail.

1

External auditor Grant Thornton has raised concerns over the governance of Nottingham City Council's wholly-owned energy company Robin Hood Energy.

In a report presented to the council's audit committee on Friday, the firm noted an additional £13.3m of financing expenditure relating to the company compared with its draft accounts.

The expenditure was made up of an increase in the loss allowance for loans and guarantees to the company of £5.8m and the impairment of the council's £7.5m equity holding in the company to zero.

John Gregory, key audit partner at Grant Thornton, told the committee: "We have been very concerned for some time about the situation with Robin Hood Energy.

We had identified company governance as one of our three significant value-for-money risks for the year, the others being the council's financial sustainability and the management of major projects."

Robin Hood Energy was set up in 2015 by the council, as the first local authority-owned energy supplier.

Grant Thornton noted the reported losses of Robin Hood Energy had doubled from £11.4m to £23.1m and that a prior-year adjustment was also made, reversing a £200,000 profit to a £1.6m loss.

The council's 2018-19 accounts have not been signed off by auditors due to the concerns over the energy firm and a delay to the completion of its own audit.

The report said the delay to the audit of Robin Hood Energy stemmed from difficulties in resolving a range of audit queries and accounting firm BDO's concerns about the financial position of the company. [BDO were the auditors for RHE]

Source: Public Finance 3 August 2020 Oliver Rudgewick

Requirement for question 1

a) Explain the role of auditors in organisations such as Nottingham City Council and the company, Robin Hood Energy. You should include reference to their influence on the financial strategy, and the types of reports the public sector auditors might issue, and the potential impact of such reports.

(8 marks)

b) When Nottingham City Council took the decision to establish an energy company, they should have considered the risks and returns relating to such and investment and business decision.
Explain the responsibility of the CFO in relation to considering risks and returns before such a decision is made, and how the risk appetite statement (both for the organisation, and within the Council's Treasury Management Strategy) should help the decision making.

(12 marks)

c) The auditors Grant Thornton raised concerns over the Council's financial sustainability. The following activities can help financial managers develop solutions to being more financially sustainable:

- Long term agreements
- Diverse sources of income
- Seeking opportunities
- Managing reserves

For each heading, discuss with examples why these activities could help to ensure appropriate levels of service are maintained.

(10 marks)

(30 marks)

2

The importance of business cases and controlling optimism bias through ethical financial leadership.

The upcoming review of the UK Treasury's Green Book should limit private sector involvement in business cases to reduce complexity and increase transparency, according to think tank Centre for Cities.

The Centre for Cities criticised the use of proprietary economic models that companies do not make open to public scrutiny on the grounds of commercial sensitivity.
It said: "While academic research standards require that benefit-cost models be published, public money is being spent on models that are produced by the private sector to shape public decision-making, yet cannot be investigated or critiqued."

The report said that both local authorities and private companies have an incentive to 'sweat' the benefit cost ratios (BCR) and make it look as high as possible so that their project looks more appealing compared to those prepared by other places.

The think-tank argued this has made the models too complex, and the increasingly complicated cost-benefit analyses are becoming less accurate.

The report found that there is a belief that projects with higher BCRs are, or should be more likely to win funding from central government.
It added, this creates an 'arms race' in BCR modelling whereby increasingly complex and flattering economic cases are created to win funding from The Treasury.

Centre for Cities said that local government needs to have capacity to perform Green Book processes in-house and take on more of the political risk that development and good urban policy can involve.

Source: Public Finance – Oliver Rudgewick 28 Sep 20

Requirement for question 2

a) Provide a simple explanation of the purpose of each of the following four cases within the Treasury's Five Case Model for business cases.

- Strategic Case
- Financial Case
- Commercial Case
- Management Case

(8 marks)

b) Robust business cases should be produced for major projects following the Treasury's Five Case Model.
Explain what should be included in the Economic Case, and why these considerations are important. Provide a short explanation about how optimism bias can be addressed.

(12 marks)

c) In the context of acting within ethical responsibilities, accountants need to be involved in developing solutions that are both 'attractive and right'.
Explain the role of the CFO in relation to the Economic Case, and the ethical leadership that is required when fulfilling that role.

(10 marks)

(30 marks)

3

Even before Covid-19, changes in local authority funding were forcing councils to look at different ways of generating revenue using their property assets. The pandemic may increase the trend towards using commercial structures to generate revenue (and capital) from land assets - as well as meeting social objectives.
The joint venture model is an established way of achieving this. At the end of July, Basingstoke and Deane Borough Council and Hampshire County Council became the latest authorities to sign such a contract with a developer – to deliver the £1.2bn Manydown housing project.

Requirement for question 3

a) Describe the characteristics of joint ventures as a type of collaboration.

(4 marks)

b) Discuss the advantages and disadvantages of joint ventures. Refer to examples where appropriate.

(6 marks)

(10 marks)

4

Requirement for Question 4

Identify **five** different charging / pricing methods. For each method identified, provide an example of a chargeable public service, and evaluate why that method of pricing might be most appropriate for that particular service.

(10 marks)

5

Public/Private Partnerships (PPPs) are an established method for financing major projects, and even though the use of new PFI/PF2 arrangements have been sidelined in the UK, there is still significant use of PPP's in other countries, and a legacy of projects in the UK where the concepts must still be understood.

Requirement for question 5

a) For a capital project of your choice (real or fictitious), give a brief description of your project stating any relevant assumptions

(2 marks)

b) For your project, identify the risks and, giving reasons, who should bear that risk for any **three** of the following categories.

- Design
- Construction & development
- Performance
- Operating cost
- Variability of revenue
- Termination
- Technology & obsolescence
- Residual value

(6 marks)

c) Briefly discuss why PPPs are still considered a useful way of delivering major capital projects.

(2 marks)

(10 marks)

6

Corruption remains a risk for any aid donor or recipient country.

Requirement for question 6

A.

i) Explain, with examples to illustrate your understanding, the term ‘fungibility of aid’.

(2 marks)

ii) Using examples from your experience or learning, explain how corruption risks around aid distribution might be mitigated.

(5 marks)

(7 marks)

B.

PEFA uses a range of indicators to measure whether aid is being delivered effectively.

Outline the **disadvantages** of relying on a standard set of performance indicators to measure aid effectiveness.

(3 marks)

(10 marks)

Marking Scheme

Question 1

Syllabus ref B1 WB 7

a)
Auditors and financial strategy
Auditors in the public sector and private sector both perform a regulatory role in accordance with relevant laws. In the UK, the **Companies Act** regulates the private sector (and is applicable to charities and other organisations that operate as companies), and guidance is provided by the UK governance Code. Candidates may refer to the two different auditors and their roles in this case, BDO for RHE and GT for the City Council. The Local Audit & **Accountability Act 2014** outlines the audit requirements for the UK public sector.

External auditors have an increasing influence on the development of financial strategy. Their influence is not only restricted to their opinion on the **truth and fairness** of the financial statements and the reporting of any material misstatements in the accounts but also on their assessment of **value for money**. This assessment may influence the organisations ability to **obtain funding** or their financial standing with banks and other lending institutions. This may have an effect on the organisation's ability to obtain **credit** for projects and investment.

The National Audit Office (NAO) have provided external auditors with guidance on assessing the **financial resilience** of a local authority and the strength of its arrangements in place to ensure good value for money is achieved. The approach will focus on matters that will highlight **risks** associated with significant projects or programmes, the strength of **governance** arrangements and the degree to which required savings have **robust** plans.

There may be further influence where the external auditors have undertaken **value for money** audits or **reports in the public interest**. These reports are in the public domain and can cause adverse publicity that leads to stakeholder action and changes to policy or even legislation.

In relation to Nottingham City Council, the auditors, Grant Thornton added a public interest report, which auditors are required to issue if they find significant issues with a council's accounts.

Candidates may gain credit for reference to other regulators or inspectors:
As a financial manager, it is important to be aware of the range of regulators that exist for your type organisation as part of the finance manager's role is to understand the rules (financial and otherwise) within which the organisation must operate.

Financial strategy and service alignment to resources must be developed within the constraints of the regulators and inspectors and appropriate business and financial records must be maintained to demonstrate compliance to the inspectors.

The cost of compliance must also be taken into consideration when developing financial strategy, especially where the penalties for non- compliance could cause unnecessary financial pressures.
The public sector is subject to more regulation and inspection than the private sector

because of the need to openly and independently demonstrates how public money has been spent.

Financial managers of public service organisations need to appreciate the interdependencies across organisations of budget planning when there is a wholly owned commercial company, where failure could have a significant impact on the public sector owner.

1 mark per relevant point, should cover across all three sections of the question – influence on financial strategy, types of reports and potential impact to gain full marks. (8 marks)

b) **Syllabus Ref B3 WB3**

CFO responsibility

It is entirely the responsibility of the individual local council to interpret the legislation and determine the boundary of their activities, which would be deemed intra or ultra vires (within or outside of the law).

They have a responsibility to ensure the decision makers understand the financial implications of their choices, through clear reporting that shows this – positive or negative so that informed choices can be made.

The CFO should be the voice of reason, or realism, when investment plans could present significant risk to the Council, or are not aligned to the corporate objectives, and /or to the capability to deliver or afford the plans.

Balancing risk and return in PS when investing or borrowing

There is always a high level of subjectivity when assessing risk for doing something new as we are essentially looking into the future: asset prices cannot be reliably forecast, nor can business decisions be predicted with certainty.

In the treasury management context, for both borrowing and investment, it is usual to work within a system of risk constraints and attempt to obtain best value within those constraints. The same applies with the investment in a company like RHE.

For investments in particular, CIPFA's Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes ('the Code of Practice') notes that the Parliamentary conclusion: 'in balancing risk against return, local authorities should be more concerned to avoid risks than to maximise returns' is relevant to all public service organisations and such organisations 'should ensure that priority is given to security and liquidity when investing funds'.

In other contexts, it may be necessary to obtain a certain level of return from investment balances and so the financial challenge is to achieve this with minimum risk. However, even in these circumstances, it would be unusual, and poor governance, for there to be no overarching framework of controls to mitigate the risks.

Risk Appetite Statements

A clear statement, which is explicit about the level of risk an organisation is prepared to tolerate, is essential to begin framing a sensible treasury strategy and indeed is referred to in Key Principle 2 of the Code of Practice.
CIPFA's Treasury Management Risk Toolkit for Local Authorities contains the following guidance for preparing such a statement, applicable to any sector:

1. The risk appetite statement should be compatible with any general statement of financial risk appetite in the authority's overall risk policy or risk register.
2. Preparation of the statement should take account of the materiality of treasury risks for the authority. An authority that is more or less debt free with a low level of investments may have a different attitude to treasury risk to an authority that has a relatively high level of debt or investments proportionate to its population or income.
3. The statement should flow naturally from the statement of the objectives of treasury management (and could therefore logically follow it in the authority's treasury management policy statement).
4. The authority's risk appetite may change over time. In times of greater financial difficulty, the authority may want a lower level of risk or revenue account volatility from its treasury operations. Or it might be more inclined to take risks on something like an energy company.
5. Statements are likely to be subjective, but one way to sharpen the focus might be to position the authority relative to other local authorities, e.g. 'the authority is not highly exposed to treasury risks and can therefore accept a higher risk portfolio than most other authorities' or 'the authority wishes to take a relatively low exposure to risk compared with most authorities'.
6. The statement should be consistent with the level of treasury skills and experience available to the authority. For example, if officers do not have time to manage credit ratings and credit analysis, the authority may decide to place its deposits with the government.
7. The statement should identify the main areas where the authority gives itself the freedom to take a position which is not the lowest risk, e.g. by investing in financial institutions or major projects not only in the government.

Any such statement will be driven by subjective influences, but good examples will enable qualitative and quantitative parameters to be considered when evaluating the risks around any investment decision.

All these elements should assist decision makers to be aware of the level of risk of their decision, and map it to the risk appetite statement for that type of activity to see if it is within the current appetite. Decisions that give rise to risks outside of the appetite of the organization should not be undertaken. If the risks associated with running an energy company had been properly explored and then compared to the risk appetite for a new activity like this, the decision whether to go ahead may have been different.

2-3 marks for CFO part, 9-10 marks for risk appetite references and TM Strategy references. Up to a total of 12 marks

c) **Syllabus ref B5 WB 10**

Long-term agreements

Using long term agreements can help reduce the risk of volatile funding by building in some certainty to long term financial agreements such as minimum guaranteed funding, and time bound release of funding to match budget cycles.
Financial managers should also seek to influence payments to contractors that limit price rises through the life of the contract, thus reducing the volatility of spending, so that smoothing of budgets can take place where volatile funding is likely.

Diverse sources of income
Financial strategy should ensure that a range of income sources is used wherever

possible to help smooth peaks and troughs in funding needs, and spread risk of funding loss. Reliance on one source – be it central government or one main benefactor – places an organisation in a much more financially risky position than one that is able to obtain smaller amounts of funding from a range of funding streams.

Seeking opportunities
The most successful organisations that rely on external funding sources are those who:

- keep aware of funding streams available
- have enough resources to seek funding (which can be time consuming)
- complete applications on time, as often the time frame for application can be tight

Examples of local authorities who have a dedicated officer for seeking grant funding from any source demonstrate that they are much more successful in obtaining funding, and obtain more funding than those councils who rely on officers applying for grants on a more ad-hoc basis as a small part of their day job. This has been seen in practice, where an external funding officer is employed and targets are usually set for generating grant income. Charities and third sector organisations employ dedicated staff to generate donations and fundraising and apply for grants.

Managing reserves
Managing reserves is a key activity for financial managers in all types of organsiations. Making decisions or recommendations regarding when to hold reserves (and where to invest them), and when to spend, are especially important when formulating strategies to cope with volatile funding.

1 mark per well-made point, should include some examples or limit to 7 marks. Answer should also be across all four headings to gain full mark

(max 10 marks)

Maximum 30 marks

Question 2

Syllabus Ref C2 WB11

Strategic case
The Strategic Case demonstrates how the proposal fits with the strategic objectives of the organisation, and how it will support the achievement of those objectives. It should present a robust and evidence-based case for change. This includes the rationale of why intervention is required, as well as a clear definition of outcomes and the potential scope for what is to be achieved.

Commercial case
The Commercial Case demonstrates how the preferred option will result in a viable procurement and well-structured project.
This section of the business case includes the planning and management of the procurement. It requires the organisation to set out how the preferred option for spend will be procured competitively, in accordance with European Union (EU) and Word Trade Organisation (WTO) rules and the current regulations for public sector procurement.
It also requires the organisation to clearly specify the service requirements for the spending proposal in output terms, together with the anticipated charging regime and the allocation of risk in each of the design, build, financing and operational (DBFO) phases of the proposed scheme. In addition it includes the contractual arrangements and specifies the accountancy treatment to be used for the proposed service.

Financial case
The Financial case demonstrates that the preferred option will result in a fundable and affordable project.
This section of the business case requires the organisation to set out the capital and revenue requirement for the spending proposal over the expected life span of the project, together with an assessment of how it will impact upon the balance sheet, income and expenditure account and pricing (if applicable) of the public sector organisation.
Any requirement for external funding must be supported by clear evidence of support for the scheme, together with any funding gaps.

Management case
The Management case demonstrates that the preferred option is capable of being delivered successfully, in accordance with recognised best practice.
This section of the business case requires the organisation to demonstrate that the spending proposal is being implemented in accordance with a recognised Programme and Project Management (PPM) methodology and that there are robust arrangements in place for:

- change management
- contract management
- the delivery of benefits
- the management and mitigation of risk.

It also requires the organisation to specify the arrangements for monitoring during implementation and for post implementation evaluation, as well as for Gateway reviews (if applicable), and the contingency plans for risk management of the scheme.

This case requires the organisation to demonstrate how the spending proposal fits in relation to national, regional and local policies, strategies and plans and furthers the required outcomes.

2 marks per case, must describe PURPOSE of each
(Total 8 marks)

b) **Syllabus Ref C3 Workbook 11**

Economic case
The main purpose of the Economic Case is to demonstrate that the spending proposal optimises value for money (for public services as a whole, rather than the individual organisation).
It explains how this is achieved by identifying and appraising a wide range of realistic and achievable options, known as the long list, in terms of how well they meet the spending objectives and critical success factors agreed for the scheme; and subjecting a reduced number of options, known as the short list, to cost benefit analysis (CBA)

The economic case should include the following:

Element to include	Why
critical success factors (the attributes essential to the successful delivery of the scheme, against which the available options are assessed)	So that the reasons for doing the project can be clearly established. Identifying the criteria by which success can be measured - Did we get what we wanted?
long listed options	To ensure the full range of options is at least considered in the first instance
short listed options (including do minimum. Three or four is the recommended number)	To enable useful comparison of the viable options
status quo; do nothing option (unless this is not credible)	So we can measure whether it is worthy doing the project - will it be better than what we have now, this might be financial savings or improved quality, or both.
economic appraisals of costs and benefits with CBA	To fully understand the comparative costs, and identify the benefits
distributional analysis (where relevant)	To enable the comparisons and ranges of outcomes
optimism bias adjustment	To ensure that the project is realistic
risk assessment	To ensure the risks are properly documented so they can e appropriately managed

sensitivity analysis	To establish the impact of changing some of the variables, so the variables with the most impact can be managed where possible
the preferred option	T give clear indication of the best option based on all the analysis above to support a decision

1 mark for defining the purpose of the Economic Case. ½ mark per element identified (left column) up to 4 marks that should be include in the case. Up to 5 further marks for explanation why these areas are important (right column).
(max10 marks for this part)

Optimism bias
Within both the public and private sectors, there is tendency for project appraisers to be overly optimistic, whereby appraisers tend to overstate benefits and understate timings and costs, both capital and operational.
To redress this tendency, appraisers should make explicit adjustments for this bias. These will take the form of increasing estimates of the costs and decreasing and delaying the receipt of estimated benefits.
Sensitivity analysis should be used to test assumptions about operating costs and expected benefits.

Adjusting for optimism provides a better and earlier estimate of key project parameters. Adjustments for optimism bias is designed to complement, rather than replace, existing good practice in terms of calculating project specific risk. It is also designed to encourage more accurate costing. Accordingly adjustments for optimism bias may be reduced as more reliable estimates of relevant costs are built up and project specific risk work is undertaken.

Adjustments should be empirically based – for example, using data from past projects or similar projects elsewhere, and adjusted for the unique characteristics of the project. Guidance for generic projects is available in the 'Public Sector Business Cases Using The Five Case Model' guidance, and should be used in the absence of more specific evidence.

Project appraisers should review all the contributory factors that lead to a cost and time over-run, as identified by the research.

The main strategies for reducing the bias are:

- Full identification of stakeholder requirements (including consultation).
- Accurate costing.
- Effective project management and risk management.

1 mark per point for depth around how to manage optimism bias up to 2 marks.

c) **Syllabus Ref B2 Workbook 8**

Morals and values lie at the heart of ethical leadership. Our morals come into play when we are called upon to make a judgement. Within the financial leadership role the decisions are seldom clear-cut as to whether the decision is 'good' or 'bad', as we must factor in the needs and requirements of a multitude of stakeholders.
Our values come from our experiences in life and the culture and societies we live in. Again, for a leader in public service he or she will be dealing with employees and citizens from a wide variety of cultures and backgrounds.

Ethical leadership is therefore not just about following the rules: it is about acknowledging the rules and setting boundaries for action, while treating people fairly and with respect.
For all of these reasons, leading a public service organisation comes with a lot of pressure and difficult decisions to be made. Solutions must be supported by evidence, and stand up to scrutiny, as well as be within the legal parameters for the sector.
For example, when developing a business case, the CFO must scrutinize all the financial and economic calculations, assess for accuracy and for optimism bias, and alignment with strategic plans.

CFO Role
The specific financial responsibilities in the economic case will include identifying financial constraints and dependencies such as grant conditions that may be attached to funding. The CFO will normally have responsibility for providing suitable financial calculations, including cost benefit analyses, for the options that are selected. They may not be involved in the option selection itself, depending on the nature of the project. The CFO will take some responsibility for ensuring the risk assessments have been properly carried out, and particularly that the financial risks have been appropriately evaluated. The CFO has a critical role in challenge around optimism bias, and performing sensitivity analysis.

1 mark per point, must cover ethical issues, and the general role of CFO in economic case development for full marks 4 marks for general role, up to 6 marks for ethical issues
(Total 10 marks)

Maximum 30 marks

Question 3

Syllabus ref C5 Workbook 12

a) Characteristics of joint ventures

- A JV is 'an arrangement between two or more parties who pool their resources and collaborate in carrying on a business activity with a shared vision and a view to mutual profit'.
- When two organisations invest funds into creating a third jointly owned organisation, it is called a joint venture. As the joint venture can access assets, knowledge and funds from both of its partners it can combine the best features of those organisations without altering the parent organisations. The new organisation is an on-going entity that will be in business for itself, but profits are owned by the parents, in the proportions specified in the set-up agreement.
- In the context of public services, we find several key ingredients. There is a contribution of resources, assets and skills from both parties. Public bodies must consider carefully the terms on which they make their staff and assets (land, equipment, brand, intellectual property rights etc) available to the new venture. Does the organisation have the necessary powers and consents to set up the arrangements? Specific protections apply to the workforce under TUPE (the Transfer of Undertakings – Protection of Employment regulations) and the Cabinet Office Statement of Practice.
- The JV is usually about starting a new business, which must have a clear business plan, identifying risks, and the demand for services or products to be supplied. The JV may also consider if there is a wider market beyond the host area that can be exploited to generate more revenue.
- In most cases, the JV involves establishing a new limited company in which the public sector organisation and the private or third sector partner each take a stake. The terms of the joint venture agreement are very important. Areas to consider are the agreed strategy and business plan, relative shareholdings and capital contributions, policies on reinvestment of profits versus distribution, decisions on which unanimity is required versus decisions taken by majority and, crucially, the exit provisions if things don't go to plan or if one party wants to sell its stake.

1 mark per well described characteristic up to a total of 4 marks.

b)

- Some authorities with long-standing JVs have found it difficult to extricate themselves from arrangements that are no longer fit for purpose or perceived as too expensive. For example, Liverpool City Council's JV for IT services with BT plc is ending after reports that BT would not agree to cutting the cost of the £70m-a-year deal any further than the £5m a year over three years they had negotiated.
- There must be genuine joint working around a shared vision. Many JVs come unstuck because the partners have not invested enough time initially in considering explicitly both parties' objectives. The public sector organisation may wish to achieve a step change in affordable service provision by levering in new investment, technology and improved business processes; the private sector partner may desire a defined level of profit and to use the contract as a springboard to capture more market share. A good JV has an appropriate balance of shared risks and rewards. The public sector organisation should negotiate an

appropriate share of future rewards, but must also expect to shoulder some of the risks of making the business successful.

- JVs are useful vehicles to combine resources and skills, to secure greater market power or better access to markets. A new corporate entity can help to ring-fence more risky trading activities, or develop a distinct brand or business culture outside the strictures of the host authority (such as borrowing controls, pay scales and corporate overheads).
- Partnering with an outside organisation may bring access to new technology, lean business processes and technical knowhow. Kent County Council is currently exploring a JV model for its legal services function. Having developed a successful in-house trading unit, the next logical step has been to seek an external partner who can bring investment in new case management systems, marketing and business development techniques to achieve greater reach in public sector legal markets, beyond simply servicing the host authority.
- For a public sector organisation, a JV in which they hold a shareholding provides an opportunity for 'value capture' – as the business takes off, their shareholding should increase in value. The shareholding and directors on the board provide a 'seat at the table', visibility and transparency on the money flows and activities of the business: areas of obscurity frequently criticised in more traditional outsourcing and PFI arrangements
- Authorities must think carefully about governance and accountability arrangements. There is still an expectation from the public and media that senior officers and politicians should be accountable for services.
  They must have appropriate mechanisms to monitor the JV's performance and risks. Structured correctly, around a true shared goal, JVs can be very effective ways for authorities to leverage investment and new skills to transform infrastructure and service delivery.

	Advantages		Disadvantages
i)	A JV would normally have a distinct organisation is created, a limited liability company or partnership	i)	Authorities that own the JV lose some control to the JV
ii)	The JV is owned by at least 2 parties who share the risks and rewards of ownership	ii)	Responsibilities for services are transferred to the JV
ii)	The parties can either be public or private sector organisations	iii)	Legal responsibility rests with the owners
iv)	The JV can focus on particular services and objects	iv)	There should be reconcilable differences between shareholders, particularly on service standards and levels as well as financial investment and financial levels
v)	Directors and staff can create a distinct culture, style and approach that best serves its purpose	v)	Additional governance arrangements required to reconcile any differences of opinion by owners over future direction of the JV
vi)	Delivery of services avoids political interference	vi)	Staff may need to transfer employment to the JV
vii)	The JV can trade further afield with other public sector to generate economy of scale and diversity		
viii)	Shareholders benefit from any dividends paid		

½ mark per point to cover both advantages and disadvantages with explained examples. ***(6 marks)***

Maximum 10 marks

Question 4

Syllabus ref A6 Workbook 6

a) The following list of charging methods that may be used in public services is not exclusive and there will often be some overlaps between the methods being described. The key thing for finance managers is that they should be aware of the different types of methods, consider when it is appropriate to use that method, depending on the nature and the charge, and the purpose of that charge.

Variable costing
Only charging clients with the variable/incremental costs of the services rendered. This would be appropriate for a service where the fixed costs are incurred regardless of the number of people using the service. An example might be use of a chapel for a memorial service at a cemetery. The fixed costs of the building will be the same whether it in use or not, the variable costs would be related to utilities and staff to open and supervise its use.

Partial overhead charging
All variable/incremental costs are recovered, but only a proportion of fixed costs. The same proportion of overheads could be applied to chargeable services or could differ in relation to the services being provided. This is similar to above, but might be used where the service is less sensitive, like the hire of a hall rather than the use of a chapel. Using a hall for a party and adding some costs for recovering general maintenance could be considered appropriate charging.

Full cost charging
All costs incurred in the provision of a service should be charged in this instance. Thus no subsidy will be required. This would normally be for a completely discretionary service, and where you did not want to make a profit (or were prohibited from doing so in law), but also had no interest in influencing behaviour or usage.

Full cost plus a profit margin
A charge is set in order to create a surplus that will subsidise other services. This could be used for peripheral services that occur as a side issue in an organisation's service provision. For example, the pricing-out of halls of residences during student vacations. However, there may be an argument for charging these on a marginal cost plus basis. This would gain competitive advantage and recognise that colleges need to have the residences regardless of vacation use, so any extra contribution which can be earned is a bonus.

Going rate charges
This rate would reflect that set by other public sector service providers in other localities. It ignores any differences in service and the specific cost structures of the different localities.
It may be based on the idea of inter-jurisdictional equity, meaning that the public should be able to receive the same service as is available in other similar locations, at the same charge. Things like charges for leisure facilities, as wildly different charges in localities might drive users to cross boundaries to get a cheaper swim.

Demand - orientated charging
At its simplest this is where charges will link to levels of demand. If an organisation had a policy of recovering full costs – then very high demand would enable low charges to be set. If demand was low then higher charges would be needed to recover costs.

Charges dependent on service need
In developing charging policies and choosing methods of pricing, organisations will need to consider the impact of their charges on the outcomes they are trying to achieve for their communities. This is particularly the case with social care charges which have a direct impact on vulnerable members of society. Another example would be the use of free swimming to try and encourage children to be more active and reduce obesity.

Minimum standards
Minimum standards could be set and provided free for the public. If individuals wished a higher level of service they could pay some form of charge for this. Charges could therefore be used to finance discretionary increases in service provision. Many local authorities apply this principle to domestic refuse collection: normal household refuse is collected free of charge, but bulky items require a special collection for which there is a charge.

Customised value-added model
This could be applied where there is substantial discretion shown by service users in deciding how they wish their service to be provided. An organisation could for example provide 'gold/silver/bronze' levels of service for corresponding gold/silver/bronze prices or charges.

Differential pricing
This is similar to the private sector, where different prices are set for different customers to help drive different behaviours. For example, peak/off peak, adult/child, disadvantaged/advantaged.

Penalty pricing
Higher prices may be set in order to reduce the number of people using a facility. The London congestion charge illustrates this idea and is set to discourage driving of polluting vehicles. The opposite behaviour is encouraged, whereby electric vehicles do not pay the congestion charge.

Subsidised pricing
This could be used where the public sector body wishes to promote a service and encourage users of the service. An example of this may be the charges set for recreational facilities in a bid to promote good health.

½ mark per pricing method identified. ½ mark per appropriate service identified for that kind of pricing method, 1 mark per reason why the method is appropriate for that service to gain full marks.

Maximum 10 marks

Question 5

Syllabus Ref A5 Workbook 5

a) Candidates can use any capital project – real of fictitious – and should give a brief description of the project such as:

Building a school
Cost: £25.5 million
Duration: 18 months
Partners: Education Funding Authority(EFA-public), ABC Academy Trust (private), XYZ Construction (private)
Assuming the building is commissioned jointly by EFA and ABC, operated by ABC over 50 years, and owned and maintained by XYZ.

Up to 2 marks for outlining a project and assumptions

b) The risks identified by candidates may vary from the examples given below, but the reasoning should focus on which partner the candidate believes should own the risk based on their ability to control it, benefit from it, and / or their legal responsibility. It is likely that some risks will not be solely the responsibility of one partner.

Risk Type	Risk	Who	Why
Design	Does not meet user requirements	ABC EFA	The end user and other interested party approves design as it needs to be fit for their purposes, the builder will not be involved in using the end product.
Construction & development	Late delivery and over budget	XYZ	Builder bears the risk as they should have control over this stage, and it is their responsibility to agree a budget and timetable that they can achieve.
Performance	Services not available when required or of an appropriate standard	ABC EFA XYZ	Operator bears most of the risk as they have control over service delivery. EFA bears some risks as they have ultimate statutory responsibilities for ensuring availability of appropriate educational facilities. Builders bear some risk initially, linked to delivering the building on time, but also to an appropriate standard so it is fit for use.
Operating cost	Cost overrun	ABC	The Academy Trust is responsible for operating costs once the building is operational.
Variability of revenue	Variable performance resulting in variable revenue	ABC	The operator bears this risk as they are responsible for the day to day use of the facilities, including letting of the spare capacity, and income generated from evening use such as sports facilities and hall hire.

Termination	PFI not viable	XYZ	The original bid for construction by the builder should be sufficient to deliver the building as an operational asset for the Academy. If they fail to do this, the risk and consequences should be borne by them.
Technology & obsolescence	Out of date service facilities	ABC XYZ	The operator is responsible for the content of the building. The builder is ensuring the facilities that are built into the building - wiring, telephony, heating arrangements, toilets etc. are suitable for the users of the building over the long term and can keep pace with potential changing needs.
Residual value	Assets have no value at the end of the contract	XYZ	The owner bears this risk as although they may not be able to control market value, they can control the condition of the building, and will ultimately benefit from the residual value of the land and building.

The other issue to consider in such analysis is how the retained risks could be managed. The usual procedure would be to follow the "Four Ts" approach – treat, tolerate, transfer or terminate.

½ mark per risk identified, ½ mark for allocation and 1 mark explanation why (6 marks)

c) PPP has continuing appeal for several national Governments on the basis of the strong interrelationship between public sector investment and private sector achievement and success. The ability for Government's to achieve both public service objectives and support the growth of the economy through the mechanism of PPP has been accepted by many countries. The challenge is one of implementation, how best to ensure that the twin objectives are satisfactory to all parties.

The PPP mechanism is, however, complex and moreover, it can be a time consuming process with no guarantee of success. The response by some Governments has been to address these obstacles head on. The UK, Japan and Canada are examples were a persistence has been shown in trying to adapt the PPP, and in particular the PFI mechanisms, for their contribution to increase. PPP has not yet achieved the status of a 'panacea' for addressing public service ills as its market is still relatively small but it is true to say that its contribution to public services worldwide is a net positive and likely to increase.

Up to 2 marks for discussion

Maximum 10 marks

Question 6

Syllabus reference A2 WB2

A.

i) One of the key questions that has perplexed donors is how to ensure that their donor funds achieve its intended objectives. A key concept in this debate is the **fungibility** of money which is concerned with funds intended for one purpose being used for a different purpose. The concept is best explained by a simple example:

Let us consider a university student who has a fixed budget and has set aside a sum of money for books in the second term. It is a friend's birthday and they would like to buy them a nice present. The student knows if they write and ask their parents for some money to buy a birthday present the answer will be no. However, if they ask for books for the second term the answer is likely to be yes. So the student asks their parents for some book money and the reply comes back that the parents will purchase the books required and send them to the student. The student can now use the money initially put aside for books to buy a birthday present – so the money is fungible, being used for a different purpose than originally intended.

A similar situation can occur internationally where aid provided to improve health, by building a new hospital, may actually be used to purchase arms for military forces. Although an extreme example, such fungibility of aid funds of course means that the donated financial aid is not meeting the donor's intended purpose.

Up to 2 marks for clear explanation

ii) **Corruption risks**

It could be argued that aid is 'useless' if the government of the recipient is corrupt. No-one denies that corruption in developing countries can sometimes lead to aid money or resources going missing. But the answer is not giving less, but giving smarter. One way of reducing the danger of corruption is to donate to programmes that do not deal in valuable goods that officials could divert. Another is to give to charities with strict distribution controls and robust impact assessments, ensuring that their work is actually making a difference rather than simply lining a few pockets. For example, Against Malaria Foundation (AMF) is particularly careful to avoid and discourage corruption while carrying out its distributions. AMF does this by:

- Receiving and reviewing requests for mosquito nets from local ministries of health.
- Carrying out pre-distribution surveys to establish the number of nets needed.
- Working with local health leaders to educate populations on all elements of malaria prevention, including the correct use of malaria nets.
- Purchasing the nets and delivering them (through its distribution partners). It also provides independent supervisors to ensure that the nets are not misappropriated and go to the people who need them.
- Monitoring local malaria rates, and carries out post-distribution surveys to monitor the use and condition of the nets.
- (Depending on the outcomes of these surveys) providing further malaria education and additional nets as needed.
- Publishing its pre- and post-distribution reports

1 mark per risk, with explanation how it could be mitigated – important that the mitigations are identified rather than a range of risks (up to 5 marks)

B.

i) Disadvantages from using PEFA PIs

- The focus on results comes with some risks that will be familiar from debates around results-based management in any public services, and whether quantitative targets can have unhelpful unintended consequences. One method of measurement may not fit all circumstances, some of the standard PIs might not always be relevant.
- In the context of aid, there is a risk of projects being chosen because it will be easy to demonstrate impact, as opposed to doing what is best to promote development.
- There is also the possibility of 'what gets measured gets done' rather than focusing on the actual needs of the recipients, and the outcomes that will improve their well being and development opportunities.
- The cost of monitoring and evaluating the effects of aid can result in difficult trade-offs for donors. Oversight can be expensive, and cause aid workers to be behind a computer screen filling out forms when they should be out in the field, diverting resources away from delivering the services required, in favour of number crunching to demonstrate records have been kept and processes have been followed. Showing compliance with the system and processes for donors to see, may actually reduce the chance of achieving the best outcomes for the recipients.

1 mark per disadvantage explained, (up to 3 marks)

(Maximum 10 marks overall)