The Chartered Institute of Public Finance & Accountancy

STRATEGIC PUBLIC FINANCE

September 2021

Duration: 3 hours

Marking Scheme

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

Answer **all 6** questions

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

1

Case Study- Budget setting in uncertain times

The National Audit Office report published in March 2021 concluded that the government, led by MHCLG, managed

to support local authorities to respond to the pandemic. The action they took has averted system-wide financial failure at a very challenging time and means that the Department has managed the most severe risks in the short term.

The total support to the sector totalled £9.1bn, which even by 'pandemic standards', is a sizable amount of extra funding. One positive development was the department's successful monthly collection of data from the sector and continued intensive engagement. This has underpinned the financial support from government and improved relationships with the sector.

A major problem is uncertainty: authorities did not know when to expect another tranche of Covid-19 emergency funding in 2020-21, or if to expect it at all.

Local authorities were already facing high uncertainty, with issues such as the unclear future of the Improved Better Care Fund or what was going to happen to the New Homes Bonus forcing them to constantly rework budgets.

The lack of clarity on emergency funding alongside the one-year spending review only exacerbated this uncertainty. Regardless of what has been done this year to support the sector (and the £9.1bn of COVID-19 emergency funding is no doubt welcome), there still remains a forecast £600m funding gap.

Some 30% of authorities are forecasting a gap of more than 5% of their revenue expenditure last year. Many authorities will be relying on reserves to balance their 2020-21 year-end budgets and, despite continuing support into 2021-22, the outlook for next year is uncertain. Many authorities are setting budgets for 2021-22 in which they have limited confidence, and which are balanced through cuts to service budgets and the use of reserves. A small proportion of councils are not confident that they can avoid a section 114 notice, which indicates an authority may not be able to meet its financial commitments. Government needs to co-design a plan with the sector that helps local authorities recover from the Covid-19 pandemic and addresses the need for financial reform.

Source – Public Finance Opinion March 2021, Aileen Murphie

Requirement for question 1

		Marks
(a)	Briefly discuss why annual (or short term) budgeting may have advantages for all organisations, both in the public and private sector.	(5 marks)
(b)	Explain the annual budget setting process for local government in the UK, given there is a legal framework for setting a balanced budget each year in this sector.	(12 marks)
(c)	With reference to setting a balanced budget, describe the circumstances where a section 114 notice might be issued by the Chief Finance Officer and the legal requirements of this process. Use examples to illustrate your understanding.	(3 marks)
(d)	Explain, with examples, why the following can help maintain a public sector organisation's ability to be financially sustainable and continue to deliver services: • Long term agreements • Diverse sources of income • Seeking opportunities • Managing reserves	(10 marks)
Total		(30 marks)

2

Case Study - Measuring the benefits of a major change project.

Insourcing project misses savings target

Insourcing ICT services has saved the Welsh Government two thirds less than expected, and the full benefits are yet to be realised, according to a report from Audit Wales. The new model, in place since January 2019, has allowed the workforce to adapt with relative ease to home-working, but pressures such as understaffing are holding progress back, the Welsh Auditor General Adrian Crompton said.

Savings were a "fundamental part of the business case" for the change, but in 2019-20 the savings of £4.9m fell significantly short of the anticipated £8.1m, the report found. In the two years leading up to the switch, the Welsh government spent £12.7m on the project with an "invest-to-save" approach.

"In addition to financial savings, the business case anticipated a range of non-financial benefits," the watchdog's report explained.

"Some, but not all, of the non-financial benefits are being delivered, although it is difficult to judge success because the Welsh Government did not set specific targets for these."

Since the change, the number of serious ICT incidents has gradually fallen, and user satisfaction with ICT services has improved, but ICT service desk performance has fallen – "most likely due to understaffing", the report said. "The job is not complete, however, with further action required to secure all of the intended benefits, to address the pressures caused by understaffing, and to ensure lessons are learnt for future projects."

Source PF March 2021 – Cullum Rutter

Requirement for question 2

		Marks
(a)	Define the term 'insourcing' and discuss the advantages and disadvantages of this approach to service delivery	*(5 marks)*
(b)	The article refers to the business case for the insourcing of ICT services. Provide a brief explanation of the **purpose** of each of the 5 cases within the Treasury's 5 Case Model for business cases. In the context of the business case for insourcing the ICT services, explain in more detail **what** should be included in the Financial Case, and **why** these considerations are important in the decision-making process.	*(15 marks)*
(c)	In the context of the case of insourcing by the Welsh Government, provide an explanation of the term 'Benefits Realisation'. You should refer to the types of benefits that may arise, and the potential barriers / blockages to realising the expected benefits.	*(10 marks)*
Total		***(30 marks)***

3

Requirement for question 3

Third or voluntary sector organisations are frequently used to deliver services to customers on behalf of public sector organisations. Sometimes grants can be used to fund these activities, other times, a contract might be more appropriate.

In the context of paying the voluntary sector to deliver services, discuss:

- differences between grants and contracts
- factors to be considered when giving grants to other organisations
- reasons why grants might be chosen over awarding contracts when deciding on funding arrangements for delivering services.

Use examples to illustrate your understanding.

(10 marks)

4

Requirement for question 4

As with many governments, the UK faces tough choices about how to deliver services within available resources. The UK's current approach is that many services are funded through taxation, and are free at the point of delivery, particularly for health and welfare. Should the government be looking at other countries and contemplating a different approach?

Explain the following terms:

- Pigouvian taxes

(2 marks)

- Externalities (positive and negative)

(4 marks)

- Market failure

(4 marks)

(10 marks)

5

Requirement for question 5

To balance budgets, many public sector organisations charge for some of their services, where the law allows. Introducing or changing charges is usually preceded by attempting to manage the expectations of stakeholders.

Describe briefly how stakeholders should be mapped and managed. Discuss, with reference to examples, **why** managing stakeholders is important when introducing or changing public service charges.

(10 marks)

6

Requirement for question 6

Risk management and performance management should form part of the wider governance framework that helps us plan how we do things, (strategic planning and setting objectives), determine what might prevent us from achieving those objectives (managing our risks) and measuring whether we have achieved them or not (performance measurement).

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

(5 marks)

Using examples from a service you are familiar with, explain why measuring outcomes can be more complex than measuring outputs.

(5 marks)

(10 marks)

Marking Scheme

Question 1

Workbook 9 Syllabus ref B4 a)

A budget is a plan expressed in money terms. When an annual budget is set, it should link to the organisation's strategy, and demonstrate how the delivery of that strategy will be delivered and funded. There should be co-ordination and communication between those delivering the plans and those setting and approving the budget to ensure that all appropriate financial considerations have been incorporated. The use of annual budgeting is helpful in all organisations that are interested in managing their costs and income streams (targets) and the impact to cash flow in the short term.

In the private sector, budgeting helps control spending by monitoring and reporting on where money is being spent, where income is being generated and where profits are being made. This information is critical for business development to identify:

- profitable activities
- non-profitable activities
- areas of growth or weakness.

These can be used to help focus resources, or to inform decisions about which activities to increase, decrease or stop doing.

Annual budgets and targets, and the monitoring of spending or income against them, is also useful for analysing and comparing month to month, and year to year trends.

Annual budgets, and the monitoring of those budgets can also be used for other decision making such as performance related pay. Note that there is no legal requirement for private sector organisations to set or monitor budgets. It is good practice, for the reasons outlined above.

1 mark per valid point regarding advantages of short-term budgets

(max 5 marks)

b)

In many public service organisations, budgeting is a requirement that is set out in relevant legislation, particularly for UK local government. Other public services are less regulated in relation to forming budgets, and may not have to set a balanced budget for each individual year.

Example: local government in the UK

The Local Government **Finance Act 1992** Section 32 refers to budget setting and determining the 'budget requirement'. The Dedicated Schools Grant for education is a ring-fenced grant and is not part of the overall Revenue Support Grant. Local Government Finance Act requires a balanced budget to be set for each year.(Local variations exist and may be awarded credit, although candidates should be able to refer to UK rules as per the learning material)

Budget preparation involves planning and **alignment of budget** requirements to deliver the organisation's strategic objectives. The budget setters will take into account all the **grant funding** (such as Local Government Financial Settlement from central Government) and any other grants applicable. It must also take into account any planned **reductions** in services, and other known and financially measurable amounts, **fees** and charges likely to be collected and any other known income or expenditure.

Usually there will be **discussion** with budget holders about their services, any changes expected due to **internal** or external factors, and potentially any items of **growth** or new expenditure.

Once the calculations are completed as per Section 32, the Local Government Act 2003 requires the Chief Finance Officer to report to the authority on the **robustness of the estimates** made for the purposes of the calculations and the **adequacy of the proposed financial reserves**. This will include estimates and reserves used for the purpose of the Executive's recommendations to Council and for the purpose of any amendments to those recommendations. The Council has a statutory duty to have **regard to the Chief Finance Officer's report** when making decisions about the Section 32 calculations. From these calculations, the level of Council Tax can be set to meet the budget need. Note that there are usually **limitations on how much the Council Tax** can be raised from one financial year to the next, a referendum may be required for any 'excessive' increases. (2021/22 figures are 5% overall – 3% increase for Social care, 2% for other). The **referendum** would need to be won to impose the increases.

If the calculation of the budget requirement is insufficient to meet budget commitments, there are obvious practical as well as legal consequences for the Council.

It is appropriate at this point to mention the further legal duties imposed on the Chief Finance Officer of the Authority. Section 28 of the Local Government Act 2003 imposes a statutory duty on the Council to monitor during the financial year its expenditure and income against the budget calculations. If the monitoring establishes that the budgetary situation has deteriorated, the Council must take such action as it considers necessary to deal with the situation. This might include, for instance, action to reduce spending in the rest of the year, or to increase income, or to finance the shortfall from reserves.

Public services budget setting

As stated already, local authorities must:

- set an annual budget
- have it approved by its relevant governing body by a given date (which varies by sector – e.g. by 11 March each year for Local Government)
- set it as a **balanced budget** – i.e. affordable spending over an agreed time period, on service delivery through grants, sustainable use of reserves, and other income
- **Maintain minimum reserve balances** to cope with unexpected events. Note that the monetary value of minimum reserve balances is not specified explicitly. Guidance is that Local Councils should retain reserves at least equivalent to approximately 3-6 months annual revenue requirement if possible.

One other major consideration in the annual budget setting process in the public sector is **time pressure**. In recent years in the UK, the central government grant settlements are released in mid-December, which provides a very short time frame for budgets to be finalised and approved by the organisation's decision- making body.

1 mark per point to include reference to the appropriate statutory requirements. Must cover legal requirements, balanced budget and what this means, reference to council tax rise limitations, other sources of income, the process/mechanics of how to set a budget up to 12 marks

c)

Under Section 114 of the Local Government Finance Act 1988, where it appears to the Chief Finance Officer that the expenditure of the authority incurred (including expenditure it proposes to incur) in a financial year is likely to exceed the resources (including sums borrowed) available to it to meet that expenditure, the Chief Finance Officer has a duty to make a report to the Council.

The report must be sent to the Council's Auditor and every member of the Council and the Council must consider the report within 21 days at a meeting where it must decide whether it agrees or disagrees with the views contained in the report and what action (if any) it proposes to take in consequence of it. In the intervening period between the sending of the report and the meeting which considers it, the authority is prohibited from entering into any new agreement which may involve the incurring of expenditure (at any time) by the authority, except in certain limited circumstances where expenditure can be authorised by the Chief Finance Officer. Failure to take appropriate action in response to such a report may lead to the intervention of the Council's Auditor.

3 marks for clear explanation of S114 with at least one example (3 marks)

Workbook 10 Syllabus ref B5 c)

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 organisations. 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. Answers can be across any PSO examples. Answer should also be across all four headings to gain full marks. (max 10 marks)

Question 2

WB12 Syllabus Ref C4

a)

Whilst considering collaboration and outsourcing, it is useful to remember the alternative. The term insourcing in this context refers to providing a service in-house by staff employed by the organisation they serve. This is the opposite of outsourcing, and usually occurs after outsourcing has been abandoned.

This can happen as a result of political or management decision, a change in strategic direction, or failure of a provider to deliver the required level of service.

You may have come across an alternative meaning of insourcing – where an external entity provides a service on your premises and integrates with your processes and staff, for example a print and copier company operating their own machinery and staff in your building.

The advantages and disadvantages in the next table refer to bringing a service back in-house.

Advantages	Disadvantages
Organisation is in control of its own staff and service standards.	Limited access to expertise that is not already in the team.
Potentially lower costs, and less likely to incur unpredictable or additional	Resources between organisations may not be split fairly, which may lead to
Less likely to have cultural compatibility issues over common goals.	Organisation is liable for any increases in staff costs and any HR related problems such as sickness and staff
Improved staff morale and ownership of	

Total 5 marks

Workbook 11 Syllabus Ref C2

b) **Five cases – the purpose of each case Strategic Case**

What is the strategic fit with government/organisational policies? Is there a robust case for change?

Is it 'fit-for-purpose'?

Economic Case

Does the proposal optimise value for money? Is it appropriate?

Have different options been considered during this process?

Commercial Case

Is the proposal commercially viable? How will it be procured?

Is it attractive?

Financial Case

Is the proposal financially viable? Is it affordable?

Where will project match funding come from?

Management Case

Can the management structure deliver the project on time and budget? How will it be achieved?

(max 5 marks for this part, 1 per case)

Workbook 11 Syllabus ref C2

Financial case - details

The Financial case follows on from the Economic Case, and 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.

The Financial case therefore will include:

- public capital and revenue requirements
- net effect on prices (if applicable)
- impact on balance sheet
- impact on income and expenditure account (if applicable)
- overall funding and affordability.

More details for each of these areas including why they should be included:

- A **budget statement**, which should be based on **resource accounting and budgeting (RAB)** principles, as this shows the resource costs over the life time of the proposal. For strategic initiatives, the budget will often comprise the forecast RAB financial statements of the whole organisation over a number of years so the full financial impact is visible to aid decision making.
- **A cash flow statement**, which should show the cash which will be spent on the lead option, if it goes ahead. The existing spend (if any) and the additional spend should be shown separately, so a comparison can be made.
- A **funding statement**, which should show which internal departments, partners and external organisations will provide the resources required. Where external funding is required, a written statement of support from the project's stakeholders or commissioners is needed. This helps decision making on what to do about sourcing additional funds.

The above should include the contingencies (in £s) necessary to ensure that there is sufficient financial cover for risks and uncertainties.

Financial modelling

For larger, more significant and complex schemes, a financial model of the proposed spend needs to be constructed. In its early stages this comprises of a best guess of the likely impact and outcomes of the proposed deal. However, the model should be revised as new and better information becomes available. The organisation's CFO should play a lead role in building and maintaining the model. If external management consultants are appointed to undertake this work, the structure of and inputs to the model still need to be vetted by the senior responsible owner and the director of finance.

The minimum requirements for most projects are as follows:

- recording a description of the model and the associated methodology
- agreeing and recording the underlying assumptions (for example, interest rates, inflation, taxation, capital charges, depreciation etc.)
- detailing the proposed funding structure
- preparing the inputs schedules (financial costs, cash-releasing benefits and risk contingencies)
- preparing the projected 'profit and loss'
- preparing balance sheet projections
- undertaking cash flow projections
- preparing funding schedules
- calculating project returns for the different elements of financing
- preparing supporting schedules – i.e. for loans, fixed assets, taxation, and payments.

Capital and revenue requirements

Following on from the modelling exercise, a statement showing the capital and revenue requirements for the recommended deal should be prepared.

This should set out:

- the capital and revenue consequences of the preferred option over the life span of the service and/or contract period
- how this compares with the original capital ceiling for the scheme (if any)
- any shortfall in capital and revenue requirements (the 'funding gap').
- Impact on the income and expenditure account
- The impact of the project on the organisation's income and expenditure should be assessed. Both the current position and the likely outcome should be fully recorded in the OBC by a qualified accountant who understands the project and the organisation's business.

Impact on the balance sheet

- The impact of the project on the organisation's balance sheet should also be assessed. Both the current position and the likely outcome should be fully recorded in the OBC by a qualified accountant who understands the project and the organisation's business.
- Where significant assets are an integral part of the spending, their accounting treatment will need to be examined (see commercial case). This will require an independent opinion from the organisation's auditors.

Assessing affordability

- Assessing affordability requires sound judgment of the organisation's business and requires that the:
- balance sheet has been correctly organised and properly accounts for current assets, current liabilities, long-term liabilities and capital
- balance sheet of the organisation is in a healthy state
- organisation is solvent
- organisation is not over-trading
- cash flow of the organisation is sound

- necessary allowance has been made for risks. Judging affordability

Various techniques can be used by public sector organisations to help judge affordability. These are in extensive use within the private sector but can be useful for the public sector too.

The balance sheet

This involves an assessment of working capital, which is defined as follows: Working capital = current assets – current liabilities

An organisation should never run short of working capital or over-capitalise. This is a common reason for business failure. A ratio of current assets to current liabilities of 2:1 is generally agreed to be the minimum working capital ratio.

Solvency

This means that the organisation can meet any debt obligation in the near future without jeopardising the liquidity of the business.

Candidates may not cover all these areas in the time available. 1/2 mark per relevant point for listing content, cap at 5 marks if no reference to why some of the areas are included in the Financial Case. 1 mark per 'why' explanation - must include reference to impact on financial statements, and aiding decision making on affordability. (10 marks for this part) (total 15 marks)

c)

Workbook 13 syllabus Ref C5

Benefits realisation is the process of managing and ensuring that all the anticipated and expected benefits (be that service improvements, outcomes or savings) do actually arise. Benefits Realisation (BR) is defined as:

'Measurable improvement resulting from an outcome which is perceived as an advantage by a stakeholder'

A more practical way to describe it might be:

'Why we are going through this process of change / project'

As a concept, BR arose from the growth in major change projects and the need for accountability / VFM. It provided a link to show results arising from change, although sometimes, the savings and benefits were not the ones planned – or 'one-offs' (e.g. vacant posts or windfall income from the sale of assets).

If an organisation is going to go through a process of change or embark on a major project, it needs to be **worth it**. BR allows you to show stakeholders why you've gone through the change, and can demonstrate that the project or change has succeeded in meeting its aims.

The advantage of BR is that it aids business decisions - so we know **where** to look for the benefits and can show that the organisation has achieved what it wanted (and has garnered the yields it wanted). BR can also show that the benefits were down to **our** actions, not external factors.

When establishing the benefits from insourcing the ICT services we need to think about **what** the benefits would be, we should also think about **where** the benefits will arise and **who** they will affect.

Benefits might include:

- Better productivity through time saving– for both cost centre / budget managers and the Finance function itself
- Reduced errors as a result of better service knowledge and knowledge of individuals
- Quicker processing of expense claims, etc.
- Improved satisfaction for staff (and service managers)
- More immediate management information about budgets to budget holders and real time access to it
- Better incentive to improve budgetary control and authorisation of expenses with tighter preventative controls
- Better education of staff and service managers on requirements for processes and limits on remaining budgets for example.
- IT system can bring in tighter parameters (as opposed to subjective human approvals) such as automatic prompting for authorisation over certain spending limits, or preventing expenditure that exceeds budget limits.

Blockages / Barriers to realisation of benefits

Though it may sound counter-intuitive, thinking about negative issues and problems can be useful, as it allows to consider what the solutions can be.

Potential issues that could acts as barriers to progress and success could include:

- Delays or removal of funding for the investment in the services
- Delays in processes from service manager being unavailable (sick or on leave… or they're 'too busy')
- Lack of engagement (or actual opposition) from service managers and/or staff
- Lack of training, awareness capabilities within the team
- Major errors and/or fraud arising from poor implementation of the service
- Failure to implement appropriate controls associated with use of the new system
- Controls established cause significant delays rather than speeding up the process.

Summary

Realisation of benefits has an important impact on the strategic financial planning for any organisation. Most benefits, will have a financial cost (or saving) associated with them. The quantification and validation of the cashable benefits needs to be robust, so it can be reliably fed into the strategic financial plans in the short and medium term. By doing this, we can help predict whether a project is likely to have a positive effect, and we should also be able to measure whether the expected benefits have been achieved once the project is complete.

2 marks for definition and explanation of the concept of benefits realisation. 1 mark per typical benefit identified, 1 mark per barrier identified. Need to cover both parts of the question to get all 8 marks for this part.
(Total 10 marks)

Question 3

Workbook 5 Syllabus reference A4

Difference between a grant and a contract

A grant is a payment to help the recipient (e.g. charity). In return, the grant funder (a public body) gets no services delivered directly. A grant is usually provided subject to conditions that state how the grant must be used (for example to support the wider objectives of the public body in promoting the social, economic, or environmental well-being of their area).

Grant funding is usually preceded by a call for proposals. One example would be a grant to support a local community centre holding activities for children during the summer holidays. The grant offer letter will normally set out general instructions as to how this is to be achieved, for example, that children need to be kept entertained by taking them on excursions and have sporting activities, but not be overly specific, or require detailed reporting.

A ‘contract’ on the other hand is an agreement between two or more parties, which is intended to give rise to legal relations. Under a contract, payment is made in return for the delivery of goods or services. The agreement is defined by terms and conditions set out in the contract, which is different from the grant, as it involves a mutual bargain involving reciprocal obligations.

There are clear legal and procurement reasons why it is necessary to distinguish between a contract and a grant. Much will depend on the individual facts and circumstances surrounding the relationship. The lack of clear definitions means that the terms are sometimes used interchangeably, when they should not be.

The Public body must however decide which funding channel is the most suitable for their programme, service or intended outcome and is likely to provide the better value for money. There may also be scope and good reasons to use both in some situations especially in respect of Payment by Results contracts. Whether a service is delivered under contract or grant will depend on the nature of the services to be provided and the relationship the public body wishes to have with the service provider, and the level of control. For example, grant funding will not be appropriate if a public body requires a specific service to be delivered and wishes to specify, in detail, how the service should be delivered. Grant funding may, however, be appropriate if a public body wishes to provide financial support for a particular activity or project.

Factors to consider

- Legal Power – The public body must make sure that it has the legal powers to make a grant. The power to make grants may be in specific terms, such as ‘a council may make grants for the improvement of its local environment’.
- Value for money – This allows for the inclusion, as appropriate, of wider environmental, social and economic objectives within the procurement process. It will not be possible to include detailed terms and conditions in a grant funding relationship to deliver social services as will be the case in a contract. In addition, whilst some monitoring arrangements can be put into place under a grant scheme, it will not be very extensive as will be the case in a contract. This may be a material factor as public bodies need to evidence clear accountability and transparency.
- Legal risks – A key question for the public body is whether the user/ authority needs/ requirements can be delivered and secured by a grant or a contract. Some

service areas will include high legal risks as regards delivery and to mitigate any risks the public body will need to secure appropriate terms and conditions to protect it from potential eventualities (reputational risks, litigation, not complying with statutory duty etc). In the past there have been EU procurement litigation risks if an arrangement is treated as a grant when it should have been procured. Post Brexit, this risk may be different in the UK.

- Complexity of Service – The public authority is under a duty to ensure that the chosen supplier is providing best value for money, are technically and commercially capable of offering an acceptable quality of service, financially sound and likely to remain so over the duration of the term and whether it will be able to have a good working relationship. The more detailed and complex issues that arise, the greater the move towards a contractual relationship rather than a grant scheme.
- State Aid – Any award of grant funding should comply with the European Commission’s rules on the provision of State aid to economic undertakings. As outlined in Article 107(1) of the Treaty on the Functioning of the European Union, grant funding may constitute State aid if it strengthens the position of the service provider relative to other competitors and therefore has the potential to distort competition.
- This means that grant funding may not be the appropriate route for establishing and maintaining most social care services.
- Breach – The basic consequence of breaking a grant agreement is that the grant money becomes repayable. In practice, it may be difficult to recover monies paid out as grants and any recovery process will be timely and expensive. Breach of a contract provision means the service provider will be required to compensate for the loss caused under an action for damages. Any potential recovery may be higher than the mere repayment of invoices received.
- VAT Liability – There are different tax consequences for grants and contracts. A grant may be eligible for Gift Aid and VAT is not payable on the grant. Payments under a contract do not attract Gift Aid and are subject to VAT. If an agreement is documented as a grant when it is in fact a contract, it can result in an unplanned VAT liability for the charity and may result in risk to the future viability of the charity. If the contract does not state that VAT is payable in addition to the price then the service provider (usually the charity) will be liable to pay the VAT to HMRC and so will lose 20% of the income. Prices should be stated “exclusive of VAT” in all agreements. If VAT is payable then the charity will receive this in addition to the price.
- State of the market – The market for the service required may be highly competitive, with many potential service providers with high levels of capacity. Alternatively, there may be no real market, with perhaps a single organisation with limited capacity (or even no potential provider). Generally, the more competitive the market, the more likely it is that public bodies will choose a contractual relationship – as opposed to a grant – as the basis for receiving a service. An important factor is competition. In some cases, the ‘market’ may consist solely or largely of community or volunteer groups, for example bereavement support. In these cases, a competitive grant process may be appropriate rather than a procurement process.

One reason public bodies give grants to public service organisations is to build their capacity to deliver public services. Often, these services will be for people in great need and who are hard to reach.

Sometimes, a particular public service organisation may be the only organisation that can reach the group. They may, however, lack capacity in areas such as governance, HR and premises. In such cases, the public body may decide on a capacity building grant.

There has been a long standing move away from grants to contracts in the past 15 years or so, which has impacted on voluntary sector organisations ability to both bid for the work and have the capacity to monitor the contract once in place. The austerity era has further compounded this phenomenon, as local authorities have come under financial pressure and reduced the grants they award.

(1 mark for describing grant, 1 mark for contract, 1 mark for distinguishing differences. 1 mark per factor to consider in decision – explained, other marks available for relevant examples up to maximum of 10) (Max 10 marks)

Question 4

Syllabus ref A1

Pigouvian taxes:

This is the concept that taxes can be used to alter behaviour. This is where the externalities of an activity are internalised. The main aim is to include the social cost in the price of a product. If we think of environmental taxes, for example, it links to the concept of 'polluter pays' whereby the cost of cleaning up pollution that is borne by others is included in the cost of the product.

An **externality** is where there is a spill over to others from the economic transaction. So, for example, smoking can have an impact that is not reflected in the price of producing the cigarettes due to social and health impacts. This creates allocative inefficiencies in the economy where price does not reflect the true cost of a good. This can be rectified by taxation.

It is important to remember that a Pigouvian tax is about reflecting true economic/social cost. There may be additional taxes to encourage social or public policy changes that may increase (or reduce) the taxes levied such as tax relief on children's clothing.

Notice this is about correcting the market in terms of cost, so that the cost of making good the externalities fall on the consumer/producer rather than being subsidised by the taxpayer.

The other approach would be to use taxes to protect domestic interests such as key or strategic industries, or to meet social policy such as the taxing of luxury goods. These approaches collectively are known as market failure.

- **Externalities** – these are the side effects of economic activity:
  - costs which are not borne by the supplier and thus not charged to the consumer (negative externalities) or
  - benefits which are not enjoyed by the purchaser (positive externalities)

Examples of negative externalities are:

- pollution
- the health effects of smoking.

Positive externalities could be:

- training
- education.

Taxation is used as a way of placing the full costs of negative externalities onto the supplier and therefore the consumer, to discourage consumption and therefore reduce their damaging effects.

Taxation is also used to subsidise the provision of goods with positive externalities (or to fund them completely) to encourage their wider consumption and to place the cost of their provision on the wider community who benefit from them. We all benefit from the training of doctors, so we all contribute to the costs of their training via taxation, rather than the cost falling on trainee doctors themselves - which might limit their supply. Similarly, employers often receive subsidies, or tax rebates, in connection with providing training schemes for young people or retraining the long-term unemployed.

Market failure

The term **market failure** refers to situations where, left to its own devices, the market would not supply certain goods in quantities and/or at prices the government would desire (too much, too little, not at all, or too expensive/cheap).

The main examples of market failure are related to:

- **Public goods** – the key features of public goods are that they are:
- non-excludable - you cannot prevent people using them
- non-depletable - they are not used up through their use.

Good examples of public goods are street lighting and common land.

It is not possible to charge for public goods, so the market will not provide them. Non-paying individuals cannot be excluded from their use and neither would the free use of these services deplete the benefit others receive: this is known as the 'free-rider' problem.

It is argued that they must be funded via taxation:

- because they will not be supplied by the market and
- so that all potential users pay their share.
- Merit goods – those goods which, left to their own devices and at market prices, people would consume less of than the government considers desirable. A good example is education. Related to these are demerit goods, which are those that people (if left to their own devices) would consume more of at market prices than the government considers desirable. A good example is alcohol.

Taxation can be used to subsidise the provision of merit goods to encourage consumption, or to increase the market price of demerit goods to discourage consumption. Many merit and demerit goods also have positive and negative externalities, but the explanations for the use of taxation in respect of each are different, so do not confuse them.

2 marks for explanation of Pigouvian taxes.
4 marks for positives and negatives of Externalities
4 marks for explanation of Market Failure
(up to total of 10 marks)

Question 5
Workbook 6 Syllabus Ref A6

a)
Public sector charging is a complex area that is often trying to meet multiple objectives at the same time. Organisations will have to make choices about which objectives they wish to deliver through their charging policies. They must also balance the views of various stakeholders regarding which services should be charged for (and hence the level of charge deemed acceptable), and which services should be subsidised, either fully or in part, by taxpayers.

Culturally, UK citizens are familiar with receiving many public services free at the point of use and are less used to paying for them so have minimal knowledge of the true cost of some services. When planning any introduction of charges or changes to existing services it is critical to know who will be affected and by how much. We can do this by mapping the service users and other stakeholders. This helps us manage their expectations and minimise problems and complaints later on.

Stakeholder mapping includes:

- identifying key groups of current and potential customers for the services being provided
- analysing them by gaining an understanding of their perspectives, power and interests
- mapping their relationships to your objectives and to other stakeholders
- ranking and prioritising their relative needs and issues.

Once stakeholder mapping has been undertaken, stakeholder management techniques vary by each group depending on their power and interest.
Although the main focus of the question is on those stakeholders receiving the charge, it should be recognised that stakeholders could include a wide array of internal and external interests and not just those who may be receiving the charge. Stakeholder groups could include:

- Service users (individuals and businesses etc.)
- Elected members
- Grant funding bodies
- Other public bodies (that may be directly or indirectly affected by the charges)

The most effective way to manage expectations of service users with high power and / or interest is to ensure they are engaged in any process of change and that they are properly consulted.

It is critical that those affected by changes to charges understand the reasons for charges, and are satisfied that the charges are necessary, fair and justified. The stakeholder engagement activities, including taking into account the views of stakeholders helps to deal with problems and resistance at an early stage.

It is also important to demonstrate good leadership and people management skills when undertaking stakeholder engagement activities, to ensure they are properly understood, and that the process is managed in a fair and equitable way to record all views and comments in a standard format. Those leading the stakeholder engagement must be clear and focused on key issues and themes, and not allow a particular pressure group to direct the engagement process and skew the outcomes unfairly.

Public service organisations make an important political decision when deciding how charges are used - which services should be charged for, which users should pay, and which services should be subsidised (or paid for in full) by taxpayers. Stakeholders' responses to the introduction of a new charge or the increase of an existing charge can make charging decisions politically difficult. Politicians often have conflicting views with officers and each other on introducing charging policies.

Stakeholders, such as pressure groups, can influence decisions on price setting. For example, Macmillan Cancer Support has a campaign for free parking at all English hospitals for cancer patients. Macmillan administers an online petition, and, in March 2011, wrote to the Health Secretary and all hospitals in England asking them to offer free parking to cancer patients.

Management of stakeholders is important for a range of reasons. Grant providers may also influence price setting for specific services. For example, grant monies may be provided with the stipulation that the service being funded by the grant is provided free of charge.

It is important that a charging policy is clear, structured and consistent with the service objectives set. There is a need to align the pricing structure to the policy and objectives of the service; for example, if the policy is to encourage participation in leisure activities, then low charges might be set. To reduce traffic in a town centre, higher parking charges might be used. An annual review of charges is desirable, including a review of usage of the service.

A key factor to consider is that charges should reflect costs: therefore, the costs of a service must be established before charging decisions can be made. However, it is debatable whether a charge can always represent the full cost of service provision – for example could a local authority with a brand-new swimming pool really charge the £20 per swim (say) which full cost might deem necessary?

An alternative system for setting charges could be to construct a method of relating the charge to the benefit received; however, output, consumption and benefit received are often difficult to quantify.

Kirklees Council provides a good example of consultation. They posed a series of questions to their residents, asking them their thoughts on charging for services, when the alternative was not being able to supply the service. The results showed that when consultation is undertaken and explanation of why charging might be needed, the users were more open and supportive of charging than might previously been expected. This is useful and reassuring to managers and board members when considering introducing or raising charges for public services.

1 mark per well-made point regarding stakeholder management and mapping limit to 5 marks if no examples are used to illustrate points.
Some candidates may do stakeholder mapping and analysis in some detail and could have inferred from the question that this was part of the answer – as asked to 'discuss with examples'. If candidates ignore the 'why is it important' then credit can be given for good relevant stakeholder analysis but limited to 3 marks.
(maximum 10 marks)

Question 6
Workbook 3 Syllabus reference B1

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

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

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

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

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

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

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

1 mark for definition of risk appetite, 1 mark per relevant point about different risk appetites for different activities, must include reference to examples for explanation (up to total of 5 marks)

Syllabus ref C5

b)
As relatively simple measures of what an organisation has achieved, it is unsurprising that outputs can be attractive indicators of success. For example, the outputs from the body that looks after roadworks might include the number of repairs completed, miles of roadway refurbished or newly built, and at what cost.

Outcomes can be more complex. They require an organisation to consider whether what it is doing is making a difference and to what. For example, this could include looking to

see whether traffic flow is better, journey times shorter, if there are fewer accidents, or if the works contributed to wider economic development.
Another example, improving the wellbeing of children in a certain area might require an improvement across a range of areas – from housing standards to access to pre-school care and education. As a result, collaboration might be required to achieve the best outcomes.

Benefits (rather than requirements) may arise across multiple organisations in the long term. For example, links between outcomes across education, social care and health. Also, conflicts can arise across public bodies due to conflicting objectives – social care and long-term benefits of recipients staying in their community compared to the Police's need to reduce crime which could lead to arrest and subsequent imprisonment through the criminal justice system.

1 mark each for explanation of output and outcome (and therefore difference)
1 further mark for each example provided (max 5 marks) (maximum 10 marks overall)