



ACCOUNTING FOR DECISION MAKING

Diploma stage examination

11 June 2007

MARKING SCHEME



Question 1

This question relates to syllabus objective A1, A2, A4 and C1 and is covered in Study Sessions 1,2, 7 and 12

- (a) Based on the figures provided and using current price levels calculate the NPV of the three alternatives over ten years. Recommend the best alternative from a financial point of view. Assume an annual demand of 50,000 meals.

Option 1 – In house provision in Day Centres

	Year 0 £	Years 1-9 £	Year 10 £
Cash outflows			
Building work	(30,000)		
Employees		(210,000)	(210,000)
Lease	(10,000)	(10,000)	
Provisions		(130,000)	(130,000)
Total	(40,000)	(350,000)	(340,000)
Cash inflows			
Receipts		150,000	150,000
Net cash flow	(40,000)	(200,000)	(190,000)
PV factor @3.5%	1.0000	7.6077	0.7089
Present value	(40,000)	(1,521,540)	(134,692)

Net Present Value = (£1,696,232)

Due to an error in the question the employees and provisions figures may be shown as a total of £370,000 giving an NPV of £1,945,730.

4 marks for cash outflows, 1 mark for receipts, 1 mark for correct use of PVs and correct NPV up to a maximum of 6

Option 2 – In house central kitchen

	Year 0 £	Years 1-2 £	Years 3-10 £
Cash outflows			
Building work	(150,000)		
Employees		(150,000)	(150,000)
Lease		(50,000)	(50,000)
Premises		(12,000)	(12,000)
Rent			(20,000)
Provisions		(117,000)	(117,000)
Delivery		(5,000)	(5,000)
Total	(150,000)	(334,000)	(354,000)
Cash inflows			
Receipts		150,000	150,000
Net cash flow	(150,000)	(184,000)	(204,000)
PV factor @3.5%	1.0000	1.8997	6.4169
Present value	(150,000)	(349,545)	(1,309,047)

Net Present Value = **(£1,808,593)**

5 marks for cash outflows, 1 mark for receipts, 1 mark for correct use of PVs and correct NPV up to a maximum of 7

Option 3 – Use of contractor

	Year 0 £	Years 1-9 £	Year 10 £
Cash outflows			
Fixed	(95,000)	(95,000)	
variable		(100,000)	(100,000)
Net cash flow	(95,000)	(195,000)	(100,000)
PV factor @3.5%	1.0000	7.6067	0.7089
Present value	(95,000)	(1,483,307)	(70,890)

Net Present Value = **(£1,649,197)**

4

The calculations show that Option 3 should be recommended as the NPV is less than the other two options.

1 mark for recommendation based upon least cost

(18)

- (b) You are responsible to the senior accountant responsible for the Valuing People agenda and you have been given the responsibility for developing a weighted benefit analysis which reflects a range of non financial issues that should be taken into account in the investment appraisal. You have been given the task of arranging and managing the consultation process. The senior accountant has asked you to explain in a briefing note the approach you intend to take. In your note you should cover the management of the meetings and an outline of how you would use weighted benefit analysis. You should also include your own suggestions as to the criteria that might be used and the weighting system that you would favour. You also need to comment upon the balance that you would strike between financial and non financial factors and what you see as the possible limitations of this technique.**

Answer should be in the form of a briefing note to the senior accountant.

1 mark for use of appropriate form / style

The first area to be covered is the arrangement and management of the consultation process. The first step would be to identify the key stakeholders and determine how they can be consulted. It must be recognised that Valuing for People promotes consultation with clients and involving them in the decision making process (as mentioned in the question – 3rd paragraph).

Stakeholders can include:

- Officers and members responsible for Social Services and Day Centres in particular.
- Other staff who work with people with learning difficulties.
- The clients who attend the Day Centres.
- Catering staff and managers.
- Carers and other supporters of clients.
- Relevant community groups including access groups etc.
- Finance staff.
- Representatives of the Partnership Board.

1 mark for discussion and recognition of stakeholders plus 1 mark for listing relevant stakeholders up to a maximum of 2

Alternative methods of consultation should be considered. Meetings and workshops are mentioned in the scenario but there are other approaches that can be taken and feedback may be in written as well as verbal form. The chosen method seems to be the meeting / workshop as this is indicated in the scenario.

1 mark for mentioning alternative methods of consulting

It is important to determine exactly what is required from the consultation. In this case the consultation is not intended to be open ended. This is usually a good thing as there is always a danger in consulting that expectations can be raised too high. This may lead to disappointment and ultimately frustration and discontent about the process. A shortlist had already been determined and therefore a prime task will be to explain the basis of the shortlist and the constraints operating around the decision. It is unlikely that a technique such as brainstorming would be employed as the discussion needs to be focused upon what the options on the shortlist can offer and how they can be evaluated and compared.

2 marks for discussion of agenda setting

The most important objective of the consultation will be to gather information which can be used in the weighted benefit analysis. Not all the participants in the consultation will be capable or interested in fully understanding this form of analysis and therefore it is important not to get distracted by the technical details of the method itself. It will be necessary to distinguish between those participants who will need a technical briefing and those who will not. The main requirements are to:

- Identify the criteria or desiderata to be used in the analysis.
- Determine an appropriate system of weighting.
- To assign weightings to the criteria.
- To score the individual options.

1 mark for discussion of objectives plus 1 mark for listing of requirements up to a maximum of 2

Criteria that might be used in this case include:

- Financial implications.
- Quality of meal provision including choice.
- Opportunity for development of client skills.
- Reliability of the service.
- Flexibility eg of meal times / menus etc to meet needs of clients.
- Experience of providing service in this environment.
- Consistency with Valuing People agenda.
- Number of clients who take meals.

1 mark for each criterion subject to maximum of 2

Criteria need to be weighted and it may be necessary to distinguish between necessary and desirable characteristics. A percentage scale may be used or a simple multiplier. The same variations apply to scoring. An example of a weighting and scoring system should be set out as a suggestion.

1 mark for suggested weighting scoring system

The balance between financial and non financial factors needs to be discussed. A NPV calculation has already been requested in part (a) and this will obviously constitute an important element of the evaluation. But how will this be used alongside the other benefit criteria?

1 mark for discussion

(12)

This is not intended to be a proscriptive marking scheme. It is likely that answers may take different forms and may have different emphases. Some flexibility will be needed in awarding marks for this section although the above does include most of the important indicative points.

- (c) Using expected values assess the risk involved in increasing the price of meals. What is the effect of this upon the investment appraisal and what would you recommend? What impact would the worst case scenario have?**

Increasing the price of meals is likely to have an effect upon demand for meals. This will affect receipts from charges for the meals and will also have an impact upon variable costs. Most of the costs are fixed although there may be a point reached when there is step effect upon them as demand falls below a certain point. This is referred to as a possibility in the scenario but no threshold figure is given. Assume that stepped fixed costs will not come into consideration.

Calculate expected value (EV) of demand following an increase in price

EV of demand at £3.25 would be $12,000 + 17,600 + 14,100 = 43,700$

EV of demand at £3.50 would be $6,800 + 15,200 + 17,600 = 39,600$

1

Calculate contribution figures based upon price increases

Option 1

Present contribution (at £3) is $0.40 \times 50,000 = £20,000$

At £3.25 it would be $0.65 \times 43,700 = £28,400$ (inc. 8,400)

At £3.50 it would be $0.90 \times 39,600 = £33,480$ (inc. 13,480)

Option 2

Present contribution (at £3) is $0.56 \times 50,000 = £28,000$

At £3.25 it would be $0.81 \times 43,700 = £35,397$ (inc. 7,397)

At £3.50 it would be $1.06 \times 39,600 = £41,976$ (inc. 13,976)

2

Show PV effect of increases over 10 years

Option 1

$8,400 \times 8.3166 = 69,859$ - revised NPV is $1,696,232 - 69,859 = £1,626,373$

$13,480 \times 8.3166 = 112,108$ - revised NPV is $1,696,232 - 112,108 = £1,584,124$

Option 2

$7,397 \times 8.3166 = 61,517$ - revised NPV of $1,773,148 - 61,517 = £1,711,631$

$13,976 \times 8.136 = 113,709$ - revised NPV of $1,773,148 - 113,709 = £1,659,439$

2

This changes the result of the NPV analysis. If the price is increased Option 1 becomes preferable to Option 3. On financial grounds it can be recommended that Option 1 with a price of £3.50 per meal should be adopted. However, this is based upon expected value which is an average value based upon probabilities and is the stance which would be taken by a risk neutral decision maker. It should be borne in mind that the financial margins between the options are relatively small.

1 mark for comments

The worst case scenario would take a view that demand would be reduced more drastically than the expected value used above.

Using the same method as before

Demand at £3.25 would be 40,000

Demand at £3.50 would be 34,000

Calculate contribution figures based upon price increases

1

Option 1

Present contribution (at £3) is $0.40 \times 50,000 = £20,000$

At £3.25 it would be $0.65 \times 40,000 = £26,000$ (inc. 6,000)

At £3.50 it would be $0.90 \times 34,000 = £30,600$ (inc. 10,600)

Option 2

Present contribution (at £3) is $0.56 \times 50,000 = £28,000$

At £3.25 it would be $0.81 \times 40,000 = £32,400$ (inc. 4,400)

At £3.50 it would be $1.06 \times 34,000 = £36,040$ (inc. 8,040)

1

Show PV effect of increases over 10 years

Option 1

$6,000 \times 8.3166 = 49,900$ - revised NPV is $1,696,232 - 49,900 = \text{£}1,646,332$
 $10,600 \times 8.3166 = 88,156$ - revised NPV is $1,696,232 - 88,156 = \text{£}1,608,076$

Option 2

$4,400 \times 8.3166 = 36,593$ - revised NPV of $1,773,148 - 36,593 = \text{£}1,736,555$
 $8,040 \times 8.136 = 65,413$ - revised NPV of $1,773,148 - 65,413 = \text{£}1,707,735$ 1

Even taking a worst case scenario Option 1 would be the preferred option on financial grounds after implementing a price increase. However, the difference between Option 1 and Option 3 is now very small. The desirability of reducing the service by such an amount should also be questioned. If price increases to £3.50 demand decreases to 34,000.

1 mark for comments
Alternative calculations may be awarded marks but the aim should be to show the effect on NPV

(10)

(40)

Question 2

This question relates to syllabus objective A2 and is covered in Study Sessions 2 and 4

(a) Calculate the Net Present Value (NPV) and the Internal Rate of Return (IRR) of the proposed investment.

Capital allowances

Year	Capital allowance £	Balance £
1	200,000	600,000
2	150,000	450,000
3	112,500	337,500
4 Balancing allowance	337,500	0

1 mark for capital allowances and 1 mark for balancing allowance up to 2

Real cost of capital (P) is $(1 + M) / (1 + I) - 1 = 0.063 = 6\%$

1

	Year 0 £	Year 1 £	Year 2 £	Year 3 £	Year 4 £	Year 5 £
Cash outflows						
Machine	(800,000)					
Direct materials		(1,800,000)	(1,440,000)	(960,000)	(720,000)	
Other variable		(600,000)	(480,000)	(320,000)	(240,000)	
Advertising and marketing		(450,000)	(150,000)	(100,000)		
Fixed production costs		(900,000)	(900,000)	(900,000)	(900,000)	
Cash inflows						
Sales		4,500,000	3,600,000	2,080,000	1,560,000	
Net cash/profit	(800,000)	750,000	630,000	(200,000)	(300,000)	
Tax liability						
Pre tax Profit		750,000	630,000	(200,000)	(300,000)	
Less capital allowances		200,000	150,000	112,500	337,500	
Taxable profit		550,000	480,000	(312,500)	(637,500)	
Tax payable (30%)		165,000	144,000	(93,750)	(191,250)	

Cash Flow						
Cash flow pre tax	(800,000)	750,000	630,000	(200,000)	(300,000)	
Tax payable			(165,000)	(144,000)	93,750	191,250
Cash flow post tax	(750,000)	750,000	465,000	(344,000)	(206,250)	191,250
Discount factor @ 6%	1.0000	0.9434	0.8900	0.8396	0.7921	0.7473
Present value	(800,000)	707,550	413,850	(288,822)	(163,371)	142,921

Net present value = **£12,128**

Notes

- Direct materials will be £12 x 150,000, £12 x 120,000, £12 x 80,000, £12 x 60,000
- Other variable costs will be £4 x 150,000, £4 x 120,000, £4 x 80,000, £4 x 60,000
- Fixed production costs are £6 x 150,000 in year 1 and continue at that level throughout
- Sales will be £30 x 150,000, £30 x 120,000, £26 x 80,000, £26 x 60,000

½ mark for each of the above figures, 1 mark for tax payable, 1 mark for post tax cash flow, 1 mark for NPV. Subject to a maximum of 5

Use interpolation to calculate IRR

Recalculate NPV using a higher rate (to achieve a negative NPV).

Using 8% NPV is -£1,427

2

IRR = 6% + 12,128 / (12,128 + 1,427) x 2 = **7.8%**

2

This figure will vary depending on alternative rate used. Other answers using the correct method would be acceptable

(12)

(b) Make recommendations based upon your analysis and explain the basis of them. Comment upon the assumptions made and upon the choice of discount rate.

The recommendation would be to go ahead with the production based upon the sales and cost projections.

1

A positive net present value represents additional value above the rate of discount employed. In this case the company is using a real rate of 6% which is equivalent to its money cost of capital of 10%. The decision rule used for NPV is to proceed if the NPV is positive.

1

Assumptions are made on the level of sales and on costs. There is obviously a level of risk involved in making these assumptions. The discount rate should incorporate an element to cover risk. Many authors recommend that when capital allowances are used and taxation is incorporated into the NPV analysis an unadjusted cost of capital should be used. In this case a real rate has been used, as a simplifying assumption, and this may have had an effect upon the outcome of the calculation. The IRR gives a rate of 7.8% which indicates the margin that exists between the discount rate and the actual expected return on the investment.

1 mark for each relevant point subject to a maximum of 2

(4)

(c) What are the relative merits and demerits of the NPV and IRR methods of investment appraisal?

NPV

Merits

- Takes into account timing of all cash flows
- Takes into account the time value of money
- Simple decision rule
- Can be used to compare alternative projects
- Can be used for least cost situations

Demerits

- Need to calculate cost of capital
- May be more difficult for lay people to understand
- Basic model ignores inflation (OLM)
- Ignores timing of cash flows within individual years (OLM)

IRR

Merits

- No need to decide on cost of capital
- Provides margin of error when IRR is compared with hurdle rate
- Easier for lay people to understand

Demerits

- Investment may have more than one IRR
- Can not choose between alternative projects using IRR
- Can not be used for least cost situations

½ mark for each relevant point subject to a maximum of 2 marks for NPV and 2 marks for IRR. Other relevant points may be made and should be rewarded.

(4)

(20)

Question 3

This question relates to syllabus objective B3 and is covered in Study Sessions 10

Prepare a briefing note for the Company Financial Controller. This should include:

- **A calculation of the three suggested transfer prices and comments upon them**
- **An assessment of what action would benefit the company most**
- **Suggestions as to how negotiations between the two divisions should proceed**

1 mark for presentation in the form of a briefing note to the Financial Controller

The first section of the briefing note should concern the three suggestions and there should be a calculation of each of them. This will allow for comparisons between them and also with the existing external price and the price made available by the external supplier.

The three suggested approaches to transfer pricing are:

- Selling price less distribution costs
- Standard variable costs plus a 30% mark up
- Full unit cost

Selling price less distribution costs – suggested by Division M

Calculate variable distribution costs

Quarter 1 – 128,000 = a (fixed) + b (variable) x 60,000 (production units)

Quarter 2 – 143,000 = a + b (70,000)

This gives 10,000b = 15,000

b = 1.50

Transfer price would be 20 – 1.50 = **£18.50**

2

Standard variable costs plus 30% mark up – suggested by Division A

Standard variable costs include

	Quarter 1 £	Quarter 2 £
Direct costs	595,000	680,000
Repairs and maintenance	13,000	14,000
Marketing and sales	40,000	45,000
	648,000	739,000

Using the same method as above

10,000b = 91,000

b = 9.10

Transfer price = 9.10 + 30% = **£11.83**

n.b. distribution costs are specifically excluded

3

Full cost – suggested by Financial Controller

The fixed costs element of the variable costs calculated above would be:

$$a = 648,000 - (60,000 \times 9.10) \text{ [or } 739,000 - 70,000 \times 9.10 \text{]}$$

$$a = 102,000$$

2

Total fixed costs are 102,000 + 85,000 (administration) + 45,000 (premises) + 12,000 (company overheads) = 244,000 per quarter

For a full year this would be 244,000 x 4 = 976,000

1

Based upon the normal production of 250,000 this would be a unit fixed cost of 3.90

The full cost (excluding distribution) would be 9.10 + 3.90 = **13.00**

1

The three suggested prices differ. Division M's price of £18.50 is higher than Division A's price of £11.83. The Financial Controller's suggestion of £13.00 would lie between the two. These prices need to be compared with the existing external market price charged by Division M of £18 and the price at which units would be available from an external supplier - £14.

2 marks for comment on prices

The note should then consider the best action that should be taken from the company point of view.

Division M has spare capacity and can produce an additional 70,000 units. The standard variable costs are £9.10 (excluding distribution). It can be assumed that an internal transfer of products would have no or minimal distribution costs. As the additional cost is less than what the external supplier would charge Division M should be encouraged to produce the additional units for supply to Division A. Division A should take 70,000 units from Division M. The company as a whole will save 70,000 x (14 – 9.10) = £343,000.

Once the capacity has been reached Division A should use the external supplier. They should purchase 30,000 units at £14. The average cost of the 100,000 units to the company would be [(70,000 x 9.1) + (30,000 x 14)] / 100,000 = £10.57.

*2 marks for suggesting the best solution plus 1 mark for the company savings
and 1 mark for average unit cost up to a maximum of 4*

Finally the note needs to consider how the benefits to the company should be shared between the two division. Division M will benefit from being able to make use of its full capacity. It may be foregoing potential external income (if further orders were available during the course of the year) and this is the basis of the existing offer of £18.50. However, Division M will still receive a net contribution on any price above the standard variable cost of £9.10. This is the margin available for negotiation. Division A needs to take into account that they are presently paying £20 per unit. It can be assumed that they will make a profit anywhere within the range between £10.57 and £18.50 per unit in any case.

It is not necessary to reach a conclusion on price as this would be only achieved through negotiation. The important thing is to outline the issues and the clearly show the range available for negotiation.

1 mark per point subject to a maximum of 4

(20)

Question 4

This question relates to syllabus objectives D2, D3 and D4 and is covered in Study Sessions 16 and 17

(a) Prepare a brief report commenting upon the performance of Housing Association A as revealed by the above table.

The aim of this is to produce a brief report from a large amount of performance data. The best approach would be to concentrate upon areas of concern which might warrant further investigation or figures which might account for differences between the housing associations featured in the table. These could include:

- Housing Association appears to be much larger than the others.
- Average weekly rent is higher than the norm, but so are operating costs. There is, however, consistency with the national average figures, which is not the case with Housing Association B.
- The weekly investment in housing stock per dwelling is low. This is not reflected in the energy efficiency rating but the general condition of the stock is low in respect of the decent homes standard.
- The percentage of rent collected is poor. This is not reflected in the current level of arrears but the write offs are higher than other associations.
- The average re-let time is high and this ties in with the high percentage of vacant dwellings.
- Performance on repairs is not good, with both emergency and routine repairs being well down on target.
- Tenant satisfaction is good on both counts.

Overall there are some areas of concern which may need to be addressed. The association does not compare well with B or C or with the national statistics.

*1 mark for each relevant point made subject to a maximum of (7)
Other points may be equally relevant and should be rewarded*

(b) What are the limitations of your report, and what do you see as being the benefits and limitations of using performance indicators in general?

The limitations of the report lie with the lack of general information on the association and an inability to drill down to the basis of the figures. It is not known what kind of housing is being provided, the nature of the area, the make up of the tenants etc. it is also not known the extent to which the comparison between A, B and C are comparing like with like. There is no way of going beyond the figures to examine the reasons for them eg the re-let time is very high at 62 days but there may be some explanation of this. The figures also only provide a snapshot view of one year. It may be that whilst performance may be poor it is actually improving over a period of years. Of course, the reverse may also be true.

1 mark per point subject to a maximum of 2

Performance indicators can provide a basis for performance management. They can enable the setting of targets and can also be the basis of benchmarking activity. They can be devised to cover different aspects of performance and can be used both in planning and controlling organisational development. They can be linked to organisational strategy and objectives and can be a useful way of articulating the outcomes of strategy development. They can be used to promote accountability throughout the organisation and can be devolved to set targets for individual managers. They are a useful way in which government, the public, tenants and other stakeholders can judge the performance of the organisation.

1 mark per point subject to a maximum of 3

Against this, performance indicators can be the source of difficulties. They can only indicate performance and they do not always provide an explicit measure. They can be misused and particularly when over reliance is placed upon them, Over concentration on performance indicators, particularly by outside bodies, may cause them to be given too much importance to the detriment of actual performance management. There may be a temptation to misrepresent figures for external publication. There is an argument that it leads to a distortion of objectives as only what gets measured gets done.

1 mark per point subject to a maximum of 3

(8)

(c) How might the above indicators might be used within a balanced scorecard framework. Suggest two arguments in favour of using a balanced scorecard approach?

The balanced scorecard has been developed over a number of years and is based upon the work of Kaplan and Norton. The basic model devised in 1992 has been extended and a public service (or not for profit) model can also be used. Answers should take one or other of these models and see how the PIs used in the table could be incorporated within the model. There are clearly financial indicators eg operating cost as percentage of turnover) which could be used and also indicators showing the customer perspective (eg tenant satisfaction). Other PIs could be used for service of internal business perspectives. However, the use of a balanced scorecard would require a re-think of the PIs being used in order to make them more relevant and to provide a more balanced view.

1 mark per point subject to a maximum of 3

The balanced scorecard has a number of arguments in favour:

- It covers a wide range of performance measures.
- It links financial and non financial performance.
- It avoids over concentration on one area of performance.
- It allows performance measures to be linked to longer term objectives.

1 mark per point subject to a maximum of 2

(5)

(20)

Question 5

This question relates to syllabus objectives C2, E2 and E4 and is covered in Study Sessions 14 and 20

The question asks for a briefing note addressed to the Chief Executive. Answers should be in this format but no marks are awarded specifically for presentation. Candidates should follow the structure outlined in the question and should relate their answers to the scenario which is described. There may be some overlap between the sections and there may be other valid points in addition to those shown below.

(a) The potential beneficial financial implications to the organisation of outsourcing the administrative functions.

It is important to recognise that this organisation has already taken steps to produce cost reductions and has gone as far as they feel they can in this direction. Also, it is a small organisation which has realised its potential for internal economies of scale. The Administrative Services Department is already a centralised department combining the local authority's three main areas of administration.

- The OLM (page 588) claim that outsourcing can achieve a saving of 9% (although this figure is not referenced or evidenced). There would certainly be a potential for cost reduction.
- Outsourcing may release resources for better use in other areas. eg existing senior managers may be released to play a more strategic role. This could impact on value for money and the effectiveness of the authority.
- Outsourcing "buys in" to economies of scale available to large outsourcing companies. This would particularly be the case where specialist skills may be available from the outsourcer which could not be supported internally.
- The process of outsourcing forces a review of functions and allows for new specifications based upon outputs and not constrained by existing arrangements. This may also be a source of cost reduction.
- There may be potential for selling off some assets which are no longer required although this would be limited in this scenario, possibly to some building space and office equipment.

*1 mark for recognition of current position of the District Council plus
1 mark per valid point subject to a maximum of (5)*

(b) The possible problem areas and the implications for cost reduction and cost control.

- Potential reductions in cost may not be realised due to the attitude of staff and/or to problems with the integration of new systems and procedures into the council. Low morale may lead to cost increases elsewhere. eg through absenteeism, non co-operation.
- There may also be a loss of key personnel who may be hard to replace without increasing costs.
- There will be additional costs associated with control of the contract and also with additional security, audit and risk management.
- If the wrong decision is taken in awarding the contract this may have severe financial implications.

- A failure to specify outcomes may lead to a gap in service provision which could have financial consequences eg through the wrong advice being given, poor decisions being made or through having to buy in temporary short term assistance in the form of consultancy.
- Cost control should be improved in respect of contract payments but there may be difficulties in achieving this aim.
- Contract management may become top heavy and unwieldy and may cancel out some of the savings made elsewhere.

1 mark per point subject to a maximum of (5)

(c) An assessment of the main risks and uncertainties involved and comment briefly on how they might be assessed and managed.

Ultimately risk will affect the effectiveness of the outsourcing provision and the financial consequences of it. One of the aims of outsourcing would normally be to transfer some of the business risks of the council to the outsourcing contractor.

A risk management framework should be adopted. This could involve considering the different categories of risk which might impact on this decision eg political, managerial, technical and financial. The actual risks could then be identified and the nature and implications of each can be determined. This should lead to a consideration of the potential to transfer this risk, initially to the contractor eg financial risk can be transferred partially through fixed price elements in the contract. Other risks should then be considered to see whether they can be reduced or transferred or whether they simply need to be monitored and controlled. A major risk could be the council's lack of expertise in dealing with large contracting arrangements of this kind. This can be dealt with through the use of consultants with experience in this field. Risks may involve risks to assets including financial assets as well as capital assets and people. Risk can also cover operational areas eg in this case if incorrect legal or financial advice is given to decision makers.

Candidates may discuss specific risk management techniques as mentioned in the OLM. There are various ways in which this section could be approached. The marking approach will, therefore, have to be quite flexible.

1 mark per point subject to a maximum of (5)

As mentioned above a flexible approach will be required in assessing this section

(d) The principal areas which need to be addressed prior to the outsourcing taking place if the financial benefits are to be realised.

Prior to the outsourcing taking place there are a number of areas which need to be addressed:

- The aims and objectives of outsourcing should be clearly established and agreed upon. This will determine the extent to which the exercise is financially driven and the extent to which there are other considerations such as quality, capacity, expertise etc which are important.
- The activities that are to be outsourced need to be identified alongside those that will remain in house as core activities.
- Required outcomes and a basis for measurement and monitoring of quality needs to be established and fed into the contract specification.

- There should be an agreement on how the client/ contractor split is to be managed and who will be responsible for management issues.
- A full financial appraisal of the implications of outsourcing should be carried out. This will involve a full analysis of costs, ongoing and one off. It would identify the potential savings and the potential cost of the contract. It would also consider cost behaviour in the event of outsourcing.
- An effective process for tendering/ selection of contractors should be devised
- Planning of changeover/ implementation to minimise disruption and costs.

1 mark per point subject to a maximum of (5)

(20)