INFORMATION AND FINANCIAL MANAGEMENT

Professional 1
December 2001

MARKING SCHEME

CIPFA

Question 1

(a) Risks encountered by public service organisations:

- Theft
- Fire
- Flood
- Physical and technical obsolescence
- Unfitness for use due to changing requirements
- Health and safety regulations.

Other reasonable answers accepted
½ mark for each relevant point made, with a maximum of 2

Risk identification:

Gathering knowledge of the business. This done by a process including:
- Document examination
- Flow chart analysis – used to identify interdependencies within business
- Physical surveys
- Interviews with key personnel.

Risk analysis:

Consideration of the risk-generating event, as well as the underlying causes and the knock on effects of the event. The development of a contingency plan which might include elements of:
- Reviewing hazards and assessing impacts on the organisation
- Development, maintenance and testing of the plan
- Crisis management – implementation of the plan during and after an incident
- Recovery to normal operations.

Risk quantification:

Using sources of information:
- Internal sources: records of claims and past events
- External sources: statistics available which classify risk within an organisation. For example, the Swiss Re rating scale which weights factors in exposure to risk and factors resistance to risk.

½ mark for each relevant point made, up to 2 marks per category with a maximum of 6

(8)

(b) Having identified, analysed and quantified the risks, the public service organisation needs to decide whether to: accept (and control) the risk, transfer the risks, or cease activity. Two factors underlie this decision: the likelihood of loss, and the severity of individual losses.

Where the severity of individual losses is small, regardless of the likelihood of individual losses, the organisation will probably choose to accept the risk. However, when the severity of individual losses is regarded as medium to large and the probability of individual losses is irregular or infrequent, the organisation will probably choose to insure.

When the severity of loss is large or catastrophic and the probability of loss can be thought of as irregular to certain, it may choose to cease activity in the area of concern. In this case, the cost of insurance could be prohibitive, if an insurer is prepared to take the risk.

1 mark for describing risk decision rule
2 marks for explaining how such a decision might be made
(3)

(c) An analysis of claims history can identify likely future claims, identify problems areas, monitor performance against budget and assist with the negotiation of insurance premiums.

Having done this, the possibility of reducing or eliminating risk can be considered. A commercial organisation might consider the risk of some activities is so great they eliminate these activities from their business. However, a public service organisation may not be able to exercise such an option, with specific duties to the public or other beneficiaries.

2 marks for identifying the benefits of keeping claims records
1 mark for an explanation why this may not be feasible for a PSO
(3)

(d) Self-insurance occurs where an organisation makes a conscious decision not to insure a particular risk and is prepared to take the risk of loss itself. This is often the case for low-level losses, which are likely to occur on a relatively frequent basis.

Benefits:

- Saving external premiums
- Speedy settlement and replacement/repair of damaged assets
- Investing surplus funds generates additional income.

Problems:

- Risk of claims exceeding revenue or fund balances
- Administration costs
- Requirement for insurance expertise.

1 mark for definition of self-insurance
½ mark for identification of each problem benefit
Up to a maximum of 4

(e) The standards of performance that are expected by CIPFA of members who are responsible for the management and execution of a treasury function are outlined in "Standard of Professional Practice on Treasury Management" (CIPFA, May 1995).

Importance of the treasury function

The treasury function manages an organisation's cash flows, its borrowings and its investments, in such a way as to control the associated risks, and to achieve a high level of performance or return, consistent with those risks. A failure to recognise the significance and implications of inappropriate treasury policies and practices, and a lack of management systems and procedures to cope with them, can and have led to financial losses of significant proportions.
As such, it is important that those responsible for treasury management, at whatever level, should be properly equipped to undertake successfully the roles required of them. This will include being conversant with market practices, instruments and terminology: including "The London Code of Conduct for Principals and Broking Firms in the Wholesale Money Markets".

Treasury analysis

It is essential that financial control systems and procedures are set in place to assist the organisation define, measure and control the treasury risks to which the organisation is exposed. This will ensure that:

- All relevant risks (and possible financial implications) of planned treasury decisions are identified, analysed and understood, before decisions are made.
- The financial implications of past policy decisions are monitored and kept under review.
- The organisation is responsive and flexible to change in market or economic conditions.
- Treasury decisions at a strategic and tactical level use robust methods of technical and financial analysis.
- Access is sought wherever necessary to independent and reliable sources of information and advice.

Treasury performance and accounting

Treasury performance is measured against appropriate data and benchmarks. The actual performance of the treasury function should be established against these benchmarks and any actions that are deemed necessary or desirable are considered and implemented where necessary.

All reasonable steps should be taken to ensure the organisation considers the benefit of fiscal and currency incentives/subsidies including Government and European Union grants which might be available from time to time.

Furthermore, the results of treasury activities should be accounted for in accordance with appropriate accounting practices. Adequate records should be kept for purposes of internal and external audit.

Treasury responsibilities

It is essential to ensure:

- Duties for treasury activities are properly defined and allocated to staff.
- Adequate checks and safeguards exist to minimise the risk of fraud and error, and undue exposure to losses.
- Treasury management policy and treasury performance are reviewed and reported upon regularly.
- Treasury activities should comply with all statutory and regulatory requirements and any other statements of best practice.

½ mark for each relevant point, to a maximum of 7

(25)

Question 2

(a)

(i) **Capital projects**

The scope of capital projects is quite broad: from the development of new buildings to the installation of a new computer system. The distinguishing features of a capital project are that they usually have the following elements:

- They have a specific budget
- They have long-term implications for the organisation and consequently will create a capital asset
- They need to be completed within a specific time frame
- They will have a specific project manager
- They will have sponsors from within, and sometimes, outside the organisation
- They require inputs from a range of individuals and groups, some internal and some external to the organisation (contractors).

½ mark for example
½ mark for each relevant point made
Up to a maximum of 2

(ii) **Contracts**

Contract management sometimes involves the management of capital projects. However, the concept can also be applied to revenue projects where particular function or service is contracted out. Contracts are a common feature of public service organisations, where the organisations often work as a contractor (as a provider of a service) and act as a contractee (a purchaser of a service).

An example of a contract might be the outsourcing of cleaning services in local authorities' schools.

1 mark for example; ½ mark for each relevant point made
Up to a maximum of 3 marks

(iii) **Best Value**

Best Value has particular significance to local authorities in England and Wales, but has growing relevance to other public service organisations. The key features of Best Value are:

- The duties of local authorities to demonstrate Best Value and consult with taxpayers, users and businesses in doing so

- The adoption of a rigorous performance measurement framework, linking stated corporate objectives to service delivery, subject to external audit and inspection.
- A rolling programme of systematic review of all services every four to five years and a test of competitiveness with other providers.
- The creation, publication and implementation and review of performance plans, developed in consultation with local people.

An example could be the development of a new further education college. The project manager would need to consult with relevant stakeholders; identify the most appropriate partnership and funding package for its creation, gaining the necessary support from within the local authority and government itself, the setting of appropriate targets for its development and operation.

1 mark for example; ½ mark for each relevant point made
Up to a maximum of 4 marks

(b) **Private Finance Initiative (PFI) and Public Private Partnerships (PPP)**

PFI was launched in 1992 as a new initiative by the then Chancellor of the Exchequer Norman Lamont in his Autumn Statement. A major driver for the scheme came from the "Sackville" pledge, which required that NHS bodies would not be given access to public capital unless they had properly explored PFI options (universal testing).

Three types of project may be described as PFI:

1. Financially free-standing contracts – where the public sector body's (PSB) involvement is limited to enabling the project to go ahead. The private sector partner recovers all costs through direct charges to the end-user (eg a toll road or bridge are good examples of this type of project).
2. Services sold to the public sector – costs are met by charges to the PSB that let the contract.
3. Joint ventures – partly public, partly private finance.

A fundamental difference between conventional capital asset procurement and PFI is that with a PFI project, the private sector becomes responsible for the design, build, finance, and operation; rather than the public sector. However, the public sector body still remains accountable to itself and/or Parliament for the resulting service.

Fundamentally, PFI turns a publicly-funded capital programme into a publicly funded revenue programme. This has the following potential advantages:

1. The project becomes off-balance sheet and doesn't attract capital charges.
2. It will not count against restricted capital spending limits.

For PFI to be successful, it should achieve:

1. A lower overall cost, that is, it should improve 'value for money'. The private sector will seek profit or 'financial attention'; the Treasury will seek the cheapest source of funding. PFI offers an opportunity for: a different source of funds, private sector expertise and management skills and the transfer of risks; that is, it provides a value for money trade-off.
2. A level of service better than that delivered to customers when the assets have been procured and operated by the public sector. In the invitation to tender, the private sector operator is challenged to identify how best the service should be provided, seeking more creative solutions to service delivery.
3. Transfer of risks. The private sector takes on many of the risks of delay and potential cost increase which it is claimed it is best placed to manage.

Other key features of PFI are:

- The PSB is procuring services, not assets. As such, this requires different skills in defining outputs and managing the delivery of that service.
- A need to create partnerships for a consortium approach.
- The need for appropriate payment mechanisms.
- The need for negotiating skills in the contract letting process to allow for flexibility in the development of a service specification.
- Being accountable for a service the PSB is not actually providing.

1 mark for each relevant point made, with a maximum of 6

Specific issues relating to the management of PFI projects include:

- The process of gaining approval and obtaining commitment from the banks to fund the project is likely to take much longer than with a publicly funded scheme.
- Once approved, the private sector partner will probably need to bring together several specialists companies to create a consortium which will provide much of the expertise.
- The consortium approach is likely to mean the public sector organisation is likely to take on the role of a client. Therefore the public sector organisation will wish to manage the project from the 'client side'. As such, the project management team for the public service organisation will wish to include an individual on the project team with legal and project management experience.

1 mark for each relevant point made, maximum of 5 marks

(20)

Question 3

(a)

From: Administration and Finance Manager

Date: 6^{th} December 2001

Subject: Quality Management in Housing Associations

Quality means different things to different people, and the concept has been widely applied to both commercial and public service organisations. Various approaches to defining quality include:

- The transcendent approach viewing quality as meaning something of excellence, an absolute quality standard of excellence
- A manufacturing-based approach, where quality is equated with freedom from errors – a technical judgement
- A user-based approach, where quality means ‘fit for purpose’ which is at least in part a subjective judgement
- A product-based approach, where quality relates to a measurable set of characteristics, which describe the product
- A value-for-money-based approach where quality achieves the right balance between cost and price

Other reasonable answers accepted. ½ mark for each relevant point made.
Up to 5 marks.

However, using private-sector quality approaches in the public sector can be problematic for a number of reasons:

- As identified above, quality can have different meanings for different people. In the public sector, it may be difficult to balance the different meanings due to the difficulty of identifying consumer expectations. For instance, residents and their families may have differing views of what they expect from sheltered housing.
- Quality assessment in the public sector is not value free. Decisions concerning outputs may also involve political, social, ethical and equality considerations, which are less likely to be found in commercial organisations. Harmer Hill Housing Association might need to consider how it can help disabled residents and the range and degree of disabilities it can safely care for.
- A consumer of a public service has a different relationship to the service provider than the consumer of a commercial organisation. In some cases, public service consumers are not willing consumers (eg elderly people who cannot be cared for at home in sheltered housing and have to be placed in specialist care accommodation) or are passive consumers (eg elderly people drawing their state pension).

- The outputs of public service organisations cannot be defined in a uniform way. This is true both of the services themselves and their impact. For example, Harmer Hill Housing Association must provide a benefit not only to those individuals receiving sheltered housing but provide economic and social benefits to society as a whole.

Other reasonable answers accepted. ½ mark for each relevant point made. Maximum 4 marks.

The quality assurance approach developed out of a traditional approach to quality with an emphasis on inspection-based quality control. The aim of a quality assurance system is not only to achieve quality but also to prove and demonstrate it. This requires a consistency of approach. Systems and procedures need to be fully documented. Following this there will need to be an audit and review to ensure people operate according to the documented system, and that the system continues to meet quality requirements. For example, Harmer Hill Housing Association will develop a quality manual which clearly documents how residents queries and complaints are to be dealt with.

An example of a quality assurance standard is ISO 9000. ISO 9000 is a universally recognised method of assessing the accuracy and competence of a business in meeting certain occupational standards. In summary, ISO 9000 is concerned with: the systems and procedures which support quality, and to assure producers and consumers that goods and services have been produced in such a way to meet customer requirements.

Other reasonable answers accepted. ½ mark for each relevant point made. Maximum 4 marks.

Total quality management is an extension of the quality assurance standard approach. It assumes customers' needs and expectations should be considered first before measuring quality. It takes an organisation wide view of quality. That is, all parts of the organisation must contribute to overall quality. The concept of the internal customers and supplier chain are central to the fulfilment of this. Total quality management aims to achieve continuous improvement. As such, quality is a moving target.

Total quality management aims to improve the: competitiveness, effectiveness and flexibility of the organisation. It does this by planning, organising and understanding each activity to ensure that they are all directed towards organisational goals. Total quality management creates a strategic view of quality, which is supported by strategic information. For example, Harmer Hill Housing Association will develop a series of statements of strategic intent, outlining their mission, vision, values and goals. All planning and operational activity will be geared to achieving these goals.

Other reasonable answers accepted. ½ mark for each point. Up to 4 marks.

Up to a maximum of 15

3 (b)

(i) The Late Payments of Commercial Debts (Interest) Act 1998

1 mark, ½ mark for nearly correct answer or year.

Rate of interest = Debt x (Base Rate + 8%) x No. Days Late / 365

= £125,000 x (.06 + .08) x 60 / 365

= £2,877

Maximum 2 marks, ½ mark for correct method
Deduct 1 mark for incorrect identification of no. Days Late

(ii)

- Credit vetting – the organisation makes an informed decision who to offer credit to
- Terms of credit offered – the terms under which credit is offered to the debtor including incentives to pay
- Collection procedures – the procedures and documentation used by the organisation, including the payment methods available
- Follow-up procedures where payment has not been made in accordance with the terms of sale.
- Outsourcing of debt collection

Other reasonable answers accepted.
Maximum 2 marks. ½ mark for each relevant point made.

(5)

(20)

Question 4

(a)

(i) It is likely the four managers require an exception report. Exception reports only show data that meet certain criteria. In this case, the report would only show products which have fallen below their re-order level or which are likely to do so in the next week. *2*

(ii) The systems concept is called filtering. A filtering mechanism removes 'noise' from the environment so the recipient can act on the relevant information. Where too much noise exists (in this scenario, too much unnecessary data) may lead the managers to make a wrong decision.

Alternatively, the report could be considered as the sensor element within the model of feedback control.

1 mark for filtering/sensor, 2 marks for explanation with a maximum of 3

(b) Immediate cut-off. In this changeover method the current system is withdrawn completely and replaced by the new system. For example, processing may finish on the last Friday of the month and transactions processed through the new system on the following Monday. Such changeovers bear none of the cost and time overheads associated with parallel running. However, there is no fallback system if the new system does not operate as expected. Immediate cut-off is most appropriate when there is little similarity between the new and replacement systems. This is not the case in this scenario.

Parallel running. In this implementation method, both the old and new systems are run together simultaneously for a specific period of time. Therefore, transactions will be entered into both systems. During the period of parallel running outputs of both system are compared and verified. A problem with this implementation method is that it is expensive in terms of the administrative resources it consumes. However, it does provide a backup system should the new Personnel system fail.

Ideally, the Trust should use a combination of both methods. For the new modules, where only paper-based or little in the way of formal systems exist (eg Employee Development database) immediate cut-off would be appropriate as there is great dissimilarity between the old and new systems. However, for systems such as payroll, which are very similar, parallel running would be most appropriate, until the bureau contract ends.

4 marks for description of immediate cut-off
4 marks for description of parallel running
2 marks for identification of most appropriate method
Marks awarded for either method, providing a valid reason is given
Maximum of 10

(c)

(i) The legal issues concern who owns the program and the Copyright Designs and Patents Act 1988. This provides organisations with protection from unauthorised copying of designs, software, printed materials and other works. The ethical issues relate to whether it is professional for the auditor to market a program developed whilst in the organisation's employ using the organisation assets, and from the organisation's side whether it is fair not to allow the redundant auditor not to make a living from his invention.

1 mark for each point made, with a maximum of 3

(ii) The employee is likely to own the program. Unless it is stated in the employee's contract (which we are not told) or implied in the basis of the employee's usual work for the Council, the Council will have no rights to the program.

1 mark for employee, 1 mark for justification

(20)

Question 5

(a) Decentralising the finance staff means that those staff seconded to the relevant division would gain a much better picture of how the employing division operates. This understanding will enable them to provide much better operational support.

As such they should develop a relationship with the division and become committed to the particular division. As such their new colleagues may perceive them as an ally and less of a hindrance. If the seconded accountant becomes part of the management team, front-line managers are more likely to see the benefits of financial control, regulations and adherence to policy.

Other reasonable answers accepted
1 mark for each relevant point made, with a maximum of 3

However some disadvantages exist. One disadvantage relates to the professional development and career paths for professional staff. Being seconded to an 'off-beat' division may jeopardise their promotion prospects. If finance staff perceive this as a risk they are likely to resist attempts to move to departments. This problem can be reduced if the secondments are reduced to short periods of one to two years. Also, seconded finance staff may feel conflicting loyalties created by the "solid" line management relationship with the division, and the "dotted" functional management relationship with the Finance Directorate.

Another disadvantage is the lack of flexibility the solution presents. In a centralised department, colleagues can cover for one another and work on projects as needed. When staff are seconded away this becomes less possible.

1 mark for each relevant point made, with a maximum of 3

(6)

(b) Simply apportioning the cost of the finance department across divisions according to the size of their budget is a relatively crude method. Such an approach is unlikely to consider the real cost drivers. An alternative would be to adopt an activity-based costing approach.

Examples of cost drivers might be:
Number of transactions processed (accounts payable department)
Number of wage and salary payments (payroll)

This approach should lead to a more realistic basis for allocating costs and provide a more accurate picture of the costs of operating a police division. This may also encourage divisional managers to reduce their costs when they understand the charge basis.

Another approach would be to introduce a service level agreement (SLA) or trading agreement (TAG). The SLA sets out what service the internal user will receive and indicates what the cost of the service will be. This focuses attention on what the finance department is expected to provide. After costing the functions required a formal internal agreement is created between the finance department and the user department. This increases transparency in the relationship between the two departments, creates a purchaser/provider relationship between the two parties, and encourages the finance department to become more customer focused. TAGs extend the concept of SLAs where the specification is generally set out in more detail and incorporate performance targets.

Other reasonable answers accepted. 1 mark for each relevant point made
Maximum 3 marks.

Disadvantages of the ABC approach include the risk that the finance department may not recover all its costs. The charge per transaction approach assumes that the finance department will process a given number of transactions. Obviously this can only be an estimate. Another significant disadvantage is the resource requirements of operating such a system. Putting in place such a costing system will require an analysis of previous transactions, staff time spent. The charging system will require an administrative resource to measures transactions, time spent by staff and so forth, to allocate costs correctly.

A problem with SLAs and TAGs is that they can lead to a low take-up of certain financial services. This could be beneficial in the medium to long term if there is no real need for that service. However, if managers buy these services elsewhere in the short-term, it could lead to these services being financed twice. In addition, managers might be required to fund services the benefits of which they may not appreciate or understand (eg statutory financial reporting, internal audit).

Other reasonable answers accepted. 1 mark for each relevant point made.
Maximum 3 marks.
(6)

(c) Effective performance indicators should be:

- Easy to calculate
- Utilise reliable and robust data
- Identify issues which are meaningful to management or the public
- Avoid excessive short-term focus
- Flexible, and capable of adjustment in a changing environment
- Use a mix of leading and lagging indicators
- Include qualitative and well as quantitative measures
- Controllable by those being measured against them

½ mark for each point made, with a maximum of 3

(15)