

PUBLIC FINANCE

Diploma stage examination

11 June 2007

From 2.00pm to 4.00pm
plus ten minutes reading time from 1.50pm to 2.00pm

Instructions to candidates

*There are **four** questions on this question paper*

*Answer **three** questions in total*

One compulsory question from Section A

Two of the three questions from Section B

*The question in Section A carries **40** marks*

*The questions in Section B each carry a total of **30** marks*

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.



SECTION A (Compulsory)

1

Ashfield University is a well-established university. Whilst having received excellent ratings for its teaching and research, it has suffered from a steadily deteriorating financial position in recent years. In two weeks' time, the senior management team is meeting to review the university's financial position and Jim Slatford, Finance Director, is finalising the papers for the meeting. One paper concerns the level of the university's grant income and how that might be enhanced. The university has recently appointed a bids writer to seek to improve the content of its grant applications.

However, the new bids writer has complained of inadequate systems being in place to support the work of grant application and monitoring. He also feels that the university is failing to tap into sources of funding from the European Union's structural funds, which could be a much more significant source of income now that the region, within which Ashfield is located, has been reclassified as an Objective One area. The new bids writer has requested Jim to allocate more resources to the university's grants unit but Jim has yet to decide whether to agree to the request.

A second major area of concern is the performance of the university's treasury management team. Jim has been frustrated for some time at the poor quality of reports emanating from the unit and more recently at its poor financial performance when benchmarked against that of comparable universities.

He intends to present these benchmarked figures to the senior management team but must first update them to take account of two recent transactions by the unit which were as follows:

1. A tranche of 91 day treasury bills with a value at redemption of £500,000, which were bought on the secondary market at a price of £497,500 thirty days from their redemption.
2. A tranche of government bonds with a par value of £100 paying a coupon rate of 5%, purchased for a price of £98.

• **Requirement for question 1**

- (a) Describe the European Union (EU) structural funds and their purpose and explain the significance to Ashfield of it being located within an Objective One area. 5
- (b) Describe the main tasks and responsibilities that Ashfield University would need to undertake to source EU grants. 6
- (c) In order to assist Jim's decision about the allocation of resources to the grants unit, use appropriate criteria to evaluate and compare grant income and borrowing as sources of revenue. 14
- (d) Outline the best practice reporting arrangements that the Cross-Sectoral Guidance Notes of the CIPFA Treasury Management Code of Practice would suggest. 8
- (e) (i) Calculate the discount rate on the treasury bills recently purchased from the secondary market. 3
- (ii) Define 'coupon rate' and 'running yield', calculating the latter for Ashfield University's recent purchase of government bonds. 4

(40)

SECTION B (Answer two from three questions)

2

After years of relative stability, characterised by the meeting of fiscal targets and the steady increase in rates of 'stealth taxes', the UK fiscal scene is in a degree of flux. Concerns continue to be expressed about the risks of the Chancellor's golden rule not being met, while the Liberal Democrats have voted to remove their long-term commitment to an increased marginal rate of income tax for the better paid. Finally on the local tax scene the full report of the Lyons Inquiry on local government funding in England, having been subject to several extensions of its terms of reference, could herald quite significant changes.

• **Requirement for question 2**

- (a) Explain the circumstances under which the golden rule is deemed to be met. 4
- (b) If fiscal adjustments need to be made to ensure that the golden rule is met, what might be the political and economic consequences of these? 6
- (c) Using appropriate economic theory, state the rationale which lies behind the Liberal Democrats' long held commitment to increase taxation upon activities that cause significant environmental damage. 4
- (d) Outline the other aspects of market failure, which can justify the raising of taxation by government. 10
- (e) What were the main terms of reference of the Lyons Inquiry? 6

(30)

3

New Labour's period in office has been characterised by increased public sector borrowing and investment in response to its view that the public services had suffered from historic under-investment. Consistent with its ongoing commitment to modernisation, New Labour has also reformed a number of the institutions involved in the administration of government borrowing and investment. However, despite this commitment to modernisation, the regulation and scope of treasury management activity continues to vary across the public sector.

• **Requirement for question 3**

- (a) Explain why responsibility for the issue and management of government bonds and bills was, in 1998, taken from the Bank of England and given to the newly established Debt Management Office (DMO). 6
- (b) What are the main considerations that the DMO would take into account in carrying out its responsibilities for issuing bonds and bills and managing debt? 6
- (c) Compare and contrast the treasury management activities of local government with those typically carried out in the higher and further education sectors. 8
- (d) Describe how government policy concerning public sector borrowing has evolved from pre-Keynesian days until now. 10

(30)

4

Significant features of New Labour's reform of public services have been the introduction of contestability between actual and potential providers and choice for consumers. These reforms have amounted to an extension of the role of market forces within the public services beyond that generated by the policies of marketisation of previous administrations.

• **Requirement for question 4**

- (a) With reference to the National Health Service (NHS) discuss the two different roles that prices play in its financial affairs. 4
- (b) Describe the system of Payment by Results in the English NHS, commenting upon its contribution to the two roles identified in section (a). 8
- (c) Public services are often required to price at full cost.
 - (i) Explain the economic justification for this requirement. 4
 - (ii) Explain any problems this creates for the pricing policies of the organisations concerned. 4
- (d) With reference to the theory of Baumol's disease, explain why technological investment may reduce upward pressure on prices of public services. 10

(30)
