Strathmore
UNIVERSITY

STRATHMORE UNIVERSITY BUSINESS SCHOOL

MASTER OF SCIENCE IN DEVELOPMENT FINANCE

END OF SEMESTER EXAMINATION

MDF 8108: PUBLIC SECTOR FINANCE

Date: Monday, 15th October 2018 **Time**: 3 Hours

Instructions

1. This examination consists of **FIVE** questions.
2. Answer Question **ANY THREE** questions.

Question 1 (20 Marks)

(i) In Kenya, there have been a lot of concerns recently about the high increase in public debt. In your opinion, is an increase in public debt necessarily bad? What would determine whether the debt levels are bad or not? Explain your answer **(8 Marks)**

(ii) Suppose that you are in charge of a team that is conducting a Public Expenditure and Financial Accountability (PEFA) Assessment for your country. Below is a summary of some of the findings. Briefly discuss these findings and highlight the strengths and weaknesses of the country's PFM system. Provide recommendations for enhancing the PFM system **(12 Marks)**

Indicator	Score
Aggregate expenditure out-turn compared to original approved budget	C
Aggregate revenue out-turn compared to original approved budget	C
Stock and monitoring of expenditure payment arrears	D
Public access to key fiscal information	D
Comprehensiveness of information included in budget documentation	A
Extent of unreported government operations	D
Transparency of inter-governmental fiscal relations	B

Effectiveness of payroll controls	B
Effectiveness of internal controls for non-salary expenditure	B
Effectiveness of internal audit	D
Timeliness and regularity of accounts reconciliation	D
Legislative scrutiny of external audit reports	C

Question 2 (20 Marks)

(i) What is your understanding of public finance management? Briefly explain the rationale for a good public finance management system **(10 Marks)**

(ii) Please outline which ratios are important for rating agencies to assess the quality of public finance. Explain especially which risk categories are important for rating agencies to evaluate the strength and weaknesses of public finance **(10 Marks)**

Question 3 (20 Marks)

(i) Assume that you have been appointed as the Director of Finance in your country's Ministry of Finance. You have been briefed about the main goals of the government, key among them is achieving redistribution. What fiscal policies will you develop and implement to achieve redistribution? From empirical literature, what policy mix has been shown to be the most effective in achieving redistribution? **(10 Marks)**

(ii) The current debate in Kenya regarding the widening fiscal deficit is that government spending has significantly increased due to spending on constitutional provisions such as devolution. Yet, majority of Kenyans see devolution as the key to addressing existing regional disparities. Suppose the government wants to reconsider the issue of devolution and could call for a referendum to either reduce the number of counties or revert to the centralized form of governance. As a fiscal expert, advise the government on the pros and cons of fiscal decentralization **(10 Marks)**

Question 4 (20 Marks)

(i) There are a lot of concerns that the burden of taxes is borne by a few individuals, especially those in formal employment. Using practical examples, discuss the two major approaches that are used as principles in determining the distribution of the burden of government finance **(6 Marks)**

(ii) According to the Public Expenditure and Financial Accountability Assessment, there are seven pillars of an orderly public finance management system. With specific reference to the Kenyan public finance management system, briefly discuss the seven pillars **(14 Marks)**

Question 5 (20 Marks)

(i) The Kenyan devolution process has been lauded as the one of the most ambitious devolution programs in the world. Using specific examples from the Kenyan context, discuss the elements of fiscal decentralization **(10 Marks)**

(ii) The Danish utility Orsted invested a lot in renewables to shift from gas and oil to solar and wind. Meanwhile this company is the largest producer of green electricity. The reason for these huge investments was given, as the competition for oil & gas producers was tight and the margins were under pressure. As a result of the restructuring the cash flow of that company can be considered as stable and being the largest supplier of green electricity the competition for that company can be considered as low. Concerning the released figures, the situation looks as follows:

in EUR mln	Oils and Gas producer	Renewables
Long term debt	8383	9489
Cash and Cash equivalents	3512	1720
EBIT	1516	1130
Depreciation & Amortization	720	1327

Please comment on the earnings situation from a rating agency's perspective. Use the NetDebt/EBITDA ratio for an assessment of the financial risk and your own opinion for the assessment of the business risk for an initial rating (see table). What would be your rating opinion based on that available information?

Financial risk

Business risk

Business Risk \ Financial Risk	Minimal	Modest	Inter-mediate	Significant	Aggressive	Highly Leveraged
Excellent	AAA	AA	A	A-	BBB	-
Strong	AA	A	A-	BBB	BB	BB-
Satisfactory	A-	BBB+	BBB	BB+	BB-	B+
Fair	-	BBB-	BB+	BB	BB-	B
Weak	-	-	BB	BB-	B+	B-
Vulnerable	-	-	-	B+	B	CCC+