PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

PFM 1: PUBLIC SECTOR ACCOUNTING

MONDAY, 9 DECEMBER 2019

TOTAL MARKS – 100; TIME ALLOWED: THREE (3) HOURS

INSTRUCTIONS TO CANDIDATES

1. You have fifteen (15) minutes reading time. Use it to study the examination paper carefully so that you understand what to do in each question. You will be told when to start writing.

2. This paper is divided into TWO sections:
   Section A: One (1) Compulsory questions.
   Section B: There are four (4) questions. Attempt any three (3) questions.

3. Enter your student number and your National Registration Card number on the front of the answer booklet. Your name must **NOT** appear anywhere on your answer booklet.

4. Do **NOT** write in pencil (except for graphs and diagrams).

5. **Cell Phones** are **NOT** allowed in the Examination Room.

6. The marks shown against the requirement(s) for each question should be taken as an indication of the expected length and depth of the answer.

7. All workings must be done in the answer booklet.

8. Present legible and tidy work.

9. Graph paper (if required) is provided at the end of the answer booklet.

DO NOT OPEN THIS QUESTION PAPER UNTIL YOU ARE INSTRUCTED BY THE INVIGILATOR.

SECTION A

This question is compulsory and must be attempted.

QUESTION ONE

Trial Balance of the Consolidated Fund for the year ended 31December, 2018

	Debit K'million	Credit K'million
Treasury Bills		12,100
Government Bonds		14,500
Euro Bond		8,500
Multilateral Creditors		12,900
Bilateral Creditors		5,500
Export & Suppliers Creditors		3,200
Accumulated Fund	45,800	
Other Expenditure	1,000	
Superscale Salaries	7,800	
Division 1 & 2	3,000	
Wages	330	
PAYE		6,300
Corporation tax		4,900
VAT		6,500
Commissions		600
Skills Development Levy		450
Fines		450
Fuel Levy		700
Grants	930	2,300
Social Assistance Benefits	740	
Burial Benefits	500	
Domestic Debt Interest	2,500	
External Debt Interest	2,700	
Purchase of Solar Equipment	350	
Purchase of fixtures & fitting	50	
Purchase of Motor vehicles	470	
Construction of Offices	660	
Loans & advances	1,080	
Equity investments	660	
Cash and Bank	80	
Reserves	960	
Petrol, Oil & Lubricants	4,400	
Conference & seminars	2,300	
Local travel	2,590	
	78,900	**78,900**

The Director of Finance has sent an internal memo requesting that you analyze the information given in the Trial Balance of the Consolidated Fund for the year ended 31 December, 2018.

Additional information:

(i) The Current Chart of Accounts based on the GFS 2001 is used to classify revenues and expenditure.

(ii) It's Government policy to adopt accrual basis of reporting for public accounts of the Consolidated Fund. In addition, the financial accounts for the financial year ended 31 December, 2018 are prepared in compliance with the provisions of the Public Finance Act of 2018 and in accordance with Generally Accepted Accounting Principles (GAAPs)

(iii) The Ministry of Health during 2018 recruited new health workers who were posted in various health centres in the country. However, a number of newly recruited nurses were left out from the payroll resulting in salary arrears of K300 million and accommodation arrears of K800 million as at 31 December, 2018.

(iv) A grant funding of K150 million for the purchase of various medical supplies for Shantubo Health Centre was not transferred and remained outstanding as at end of year.

(v) Invoices amounting to K600 million due to African Development Bank for interest payments due on 1 December, 2018 remained unpaid as at 31 December, 2018.

(vi) Corporate Tax due to government but not received at 31December, 2018 amounted to K500 million.

(vii) Motor vehicles depreciation of 20% pa was unaccounted for at end of year.

Required:

(a) (i) Using the information from the Trial Balance and using IPSAS Accrual Basis of Accounting, prepare Statement of Financial Performance of the Consolidated Fund for the year ended 31 December, 2018. (13 marks)

(ii) Prepare Statement of Financial Position of the Consolidated Fund as at 31 December, 2018. Show all the workings clearly. (11 marks)

(b) Most developing countries have faced difficulties in adopting Full Accrual of International Public Sector Accounting Standards (IPSAS).

Required:

Discuss the challenges being faced by developing countries in adopting full IPSAS?

(10 marks)

(c) Zambia Revenue Authority is a critical player in the management and collection process of public funds.

Required:

Explain why it is important to have a good tax system in Zambia? (6 marks)

[Total: 40 Marks]

SECTION B

Attempt any THREE (3) questions in this section.

QUESTION TWO

The public sector accounting is done through the use of various financial records. Recently, the government has become committed to managing all its records in an electronic environment and is in the process of achieving paperless office. At the moment, some government departments are managing records in mixed environment while others still manage paper environment.

Required:

(a) Explain 'mixed environment' in relation to management of financial records. (2 marks)

(b) What challenges would the government departments face with a switch to total electronic environment for its financial records? (8 marks)

(c) To ensure integrity and availability of information, the government has embarked on development of various systems for managing financial records.

Explain the main objectives of a financial records management system. (10 marks)

[Total: 20 Marks]

QUESTION THREE

(a) Section 19 of the Public Finance Management (PFM) Act of 2018 states that there shall be established for each public body an Audit Committee.

Required:

(i) What is an audit committee? Briefly explain the functions of the Audit Committee? (6 marks)

(ii) What is the composition of the Audit Committee as prescribed in the PFM Act of 2018? (4 marks)

(b) It is crucial that audit activities are configured appropriately and have a broad mandate to achieve these objectives.

Required:

Describe five (5) key elements that should be in place to empower auditors effectively carry out their mandate in an organization. (10 marks)

[Total: 20 Marks]

QUESTION FOUR

In preparing accounts, accountants working in the public sector need to adhere to certain principles that guide the preparation of accounting information.

Required:

Explain the following as applied in in Public sector accounting, giving a practical transactional example of each.

(i) Comparability (4 marks)

(ii) Periodicity concept (4 marks)

(iii) Materiality (4 marks)

(iv) Matching principle (4 marks)

(v) Cash basis of accounting (4 marks)

[Total: 20 Marks]

QUESTION FIVE

(a) The Fundamental Principle of Confidentiality imposes an obligation on Public Sector Accountants to refrain from disclosing information to third-parties. However, there are circumstances when the Public Sector Accountant is required by law to disclose confidential information.

Required:

(i) Identify circumstances where a Public Sector Accountant is obliged by law to disclose confidential information? (3 marks)

(ii) Give examples where a Public Sector Accountant has a professional duty to disclose confidential information which isin thepublic interest and is not prohibited by the law? (4 marks)

(b) Briefly describe what safeguards are, **and** give examples of safeguards created by the profession legislation or regulation situations? (13 marks)

[Total: 20 Marks]

END OF PAPER

PFM1 SOLUTIONS

SOLUTION ONE

a)

i) **STATEMENT OF FINANCIAL PERFORMANCE OF THE CONSOLIDATED FUNDS FOR THE YEAR ENDED 31 DECEMBER 2018.**

	K'm
Revenue:	
Direct taxes	18,200
Non tax revenue	2,200
Grants	2,300
	22,700
Expenditure:	
Personal emoluments	11,430
Goods and services	10,090
Depreciation	94
Financial charges	5,800
Social benefits	1,240
Grants	1,080
Other expenses	1,000
	30,734
Deficits/surpluses	**(8,034)**

ii) **STATEMENT OF FINANCIAL POSITION AS AT 31ST DECEMBER 2018**

Assets:

Non-financial assets NBV	1,436
Equity and security investments	660
Loans and advances	1080
Revenue and receivables	500
Reserves	960
Cash and bank	80
Accumulated funds	53,834
	58,550

Liabilities and funds:

Payables	1,850
Domestic debt	26,600
External debt	30,100
	58,550

	Workings				
	Expenditure				
	Personnel Emoluments			**Non-Financial Assets**	
	Superscale	7,800		Purchase of Solar Equipment	350
	Division I &11	3,000		Purchase of fixtures & fitting	50
	Wages	330		Purchase of Motor vehicles	470
		11,130		Construction of Offices	660
	Add: Outstanding salary arrears	300			**1,530**
		11,430		Depn: MV @ 20%	**94**
					1,436
	Uses of Goods and Services				
	Petrol, Oil and Lubricants	4,400		**Domestic Debt**	
	Conference and Seminars	2,300		Treasury Bills	12,100
	Local travel costs	2,590		Bonds	14,500

	9,290		**26,600**
Accommodation arrears	800		
	10,090	**External Debt**	
		Euro Bond	8,500
Tax Revenue		Bilateral	5,500
PAYE	6,300	Multilateral	12,900
Corporation tax	4,900	Export & Suppliers Creditors	3,200
VAT	6,500		**30,100**
	17,700		
Add: rec'ble	500	**Accumulated Fund**	
	18,200	Bfwd	45,800
		Deficit	8,034
Non Tax Revenue			53,834
Commissions	600		
Skills Development Levy	450		
Fines	450	**Payables**	
Fuel Levy	700	Salary arrears	300
	2,200	Accommodation arrears	800
		Grant arrears	150
Social Benefit		External Interest outstanding	600
Social Assistance Benefits	700		**1,850**
Burial Benefits	500		
	1,200		
Financial Charges			
Domestic debt Int	2,500		
External Debt Int	2,700		
	5,200		
Interest outstanding	**600**		
	5,800		
Grants			
Balance	930		
Grant arrears	150		
	1,080		

(b) **Challenges in adopting Full Accrual** of International Public Sector Accounting Standards (IPSAS).

- Accrual accounting information is difficult and costly to produce and use.
- Significant amount of training is required to understand data requirements of IPSASs
- Significant amount of preparatory work of reconciliation is required
- Adjustments and revaluation of assets and liabilities is required
- Complex and time- consuming to produce financials
- Information systems and processes need to be upgraded
- Lack of accounting skills to produce accrual financial statements

(c) Zambia Revenue Authority **- importance of a good tax system**

- Tax system should bear as lightly as possible on production
- Taxes should be easy and cheap to collect
- Taxes should be certain
- Taxes should be borne equally
- Taxes should not hinder efficiency
- Taxes should be compatible with relevant foreign tax systems - e.g. SADC and Comesa
- Taxes should adjust with changes in inflation

SOLUTION TWO

a) Mixed environment in relation to maintenance of financial records refers to environment in which some records are maintained in paper form and some in electronic form. Usually payroll is computerized as the benefits are substantial. Other functions like stores management may be an electronic.

b) Challenges of total switch to electronic records management would include:
   - The electronic storage media is fragile and changes with time.
   - Electronic record may only be understood in future if there is sufficient accurate contextual and structural information about the record
   - Changes in technology mean that records that were generated on computers 10 years ago may not be accessible today. Electronic records need to continually be moved to new computer systems so that they remain accessible.
   - Often, the responsibility for the management of the integrity of electronic records has not been assigned, making it difficult to ensure they are cared for adequately.
   - Many people easily gain access to information on computers so it may not be totally secure.
   - Destruction of records by damage to computers.

c) Objectives of financial records management include:
   - Maintaining the financial records throughout its life in a consistent and structured manner.
   - Supporting the audit function and external accountability of the organization
   - Enabling the organization to meet its legislated financial obligations
   - Meeting the accounting, including economic and fiscal planning needs.
   - Protecting the integrity and accuracy of the record to guarantee the organization of a reliable source of financial information.
   - Providing ready access to and retrieval of financial information
   - Making cost effective use of resources allocated to the creation, maintenance and use of financial records, thus ensuring timely disposal of financial records without compromising their integrity and utility as an information source.

SOLUTION THREE

(a) **Audit Committees**

i. **Audit Committee and composition of the Committee**

Audit committee – an independent committee made up of independent members with the responsibility to provide oversight of management practice in key governance areas such as risk management, internal control, governance

Composition – 5 Members consisting of

- former public officer with vast knowledge in auditing or accounting
- member of ZICA
- member of LAZ
- representative from Internal Audit Institute
- member for any other relevant professional body

ii. **Main functions of an Audit Committee**

- receives reports from internal auditors
- review audit policies and plans
- review management procedures regarding
    - internal controls
    - financial reporting
    - external audit reports
    - risk management
    - ethics and governance
- make recommendations to Secretary to the Treasury or Controlling Officer

(b) **Five (5) key fundamentals** that should be in place for auditors to effectively carry out their functions

i. **Organizational independence** – the audit function should be performed with sufficient independence and without interference from the entity under audit.

ii. **Formal mandate** – the auditor's powers and duties should be established by a formal charter or legal documentation that address the obligations of an auditor, the procedures and requirements of reporting.

iii. **Unrestricted access** – the audit should be conducted with complete and unrestricted access to employees, property, and records.

iv. **Sufficient funding** – the audit activity must have sufficient funding to perform its responsibility.

v. **Objective staff** – Audit staff must be impartial and avoid any conflict of interest. Conflict of interest may impair the auditors ability to perform audit duties and responsibilities objectively.

vi. **Competent staff** – the audit staff must have the necessary qualifications and competences to conduct an audit.

vii. **Competent leadership** – the head of the audit team must be knowledgeable of applicable audit standards, professionally qualified and competent to oversee and manage an audit function.

viii. **Stakeholder support** – the legitimacy of the audit activity must be understood and supported by range of stakeholders such as media, public sector officials and citizens.

ix. **Professional audit standards** – the audit function must be conducted in accordance with recognized standards.

SOLUTION FOUR

i) **Comparability**

Comparability is accounting information characteristic to enhance their usefulness to users of accounts. It entails that financial information from one period to another must have been prepared on the same basis, using same accounting policies if performance from one period to another is to be fairly measured.

Practical example

If government measures its inventories of materials in one year using FIFO method, it needs to maintain the same method for subsequent years unless changing makes information more reliable.

ii) **Periodicity concept**

This concept states that while true performance of the public sector can best be measured at the end of its lifespan, there is need to measure performance at some agreed time intervals as waiting for end of government lifespan may be impracticable for purpose of continuous improvement of public sector operations.

Practical example

Public sector requires quarterly performance reports from line ministries.

iii) **Materiality**

Information is material if its omission or misstatement is likely to affect the decision made by the user of it.

Practical example

If an accounting officer forgets to include the cost of money clips of K5 in the accounts, information will not be misleading even if this remains uncorrected. On the other hand, misstating a salaries bill of K10,000 to K100,000 would definitely require correction as lack of correction will be very misleading to users and will render financial information not true and not fairly presented due to size of error that is substantial.

iv) **Matching principle**

Matching concept states that revenues and expenses shall be recognized in the accounting period in which they are earned and expensed and not when they are received or paid. Any profit earned or loss suffered in an accounting period should be as a result of both cash and credit transactions

Practical example

The government lets out rooms of its lodges at a cost of K1,500 per quarter to tenants and K15,000 was due from tenants in the first quarter. However only 5 tenants had paid a sum of K7,500in the quarter. Based on matching principle, the entire K15,000 should be recognized as income in the quarter under review.

v) **Cash basis of accounting**

It is a method of accounting that recognizes revenue and expenses at the time physical cash is actually received or paid out. This contrasts accruals or matching concept which requires expenses to be recognized when incurred and income when earned.

Practical example

If invoices are issued for goods sold in a quarter to the value of K200,000 but only K20,000 has been received from clients of the service, cash basis requires income of K20,000 only to be recognized in the financial statements.

SOLUTION FIVE

(a) **The Principles of Confidentiality**

i. **Circumstances obliged by law**

- Provision of evidence in the courts of law
- Disclosure to appropriate public authorities
- Evidence of money laundering or terrorist financing

ii. **Examples of professional duty to disclose,** which is in the public interest and is not prohibited by the law.

- When complying with quality reviews of relevant professional bodies
- Responding to an inquiry or investigation
- Protecting members interest in legal proceedings
- Complying with technical and professional standards including ethical requirements

(b) **Safeguards**

- Actions or measures that eliminate threats or reduce them to acceptable levels.
- Categorized into two (2) categories that is
    - created by profession, legislation or regulator
    - created in the work environment

Safeguards created by professional, legal and regulations

- Educational, training and experience requirement for entry into the profession
- Continuous Professional Development
- Corporate governance regulations
- Professional standards
- Professional or regulatory monitoring and discipline procedures
- External reviews of reports, returns and communications carried out by a legally empowered 3rd party.

PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

PFM 3: GOVERNANCE AND MANAGEMENT IN PUBLIC SECTOR

TUESDAY, 10 DECEMBER 2019

TOTAL MARKS – 100; TIME ALLOWED: THREE (3) HOURS

INSTRUCTIONS TO CANDIDATES

1. You have fifteen (15) minutes reading time. Use it to study the examination paper carefully so that you understand what to do in each question.

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SECTION A

This question is compulsory and must be attempted

QUESTION ONE (Compulsory)

Scenario

The overall purpose of a public corporation is to provide members of the public with goods and services at reasonable prices. Such corporations are funded with public funds and therefore members of the public are concerned with how the organisation is managed and the extent to which such organisations adhere to good corporate governance principles, how transparent and accountable they are. These organisations are entrusted with the responsibility of looking after the interests of the public. The critical aspect in the administration of public corporations is good corporate governance which is primarily concerned with how well the public organisation is managed and the extent to which there is participation in the governance of the organisation by stakeholders. Other issues of concern are the adherence to public financial regulations, public procurement regulations, with clear separation between the roles of management, the Board of Directors and the appointing authority, the Minister in most cases.

Required:

(a) Discuss any **five** (5) principles of good corporate governance. (10 marks)

(b) The Charter for the Public Service in Africa defines ethics as the standards which guide the behaviors and actions of personnel in public institutions.

Identify any **five** (5) ethical values and principles according to The Charter for the Public Service in Africa. (5 marks)

(c) Recent policy, legislative and regulatory reform in most government institutions is focused on enhancing service delivery to all. This requires good contract management.

Outline **twenty** (20) factors that must be considered for best practice in Contract management. (20 marks)

(d) Suggest **five** (5) ways that administrators in the public sector can use to manage ethics at workplaces. (5 marks)

[Total: 40 Marks]

SECTION B

Answer any Three (3) Questions in this section

QUESTION TWO

(a) In order to reform the civil service and public administrations, governments all over the world have in the last decades debated on the best way to recruit civil servants. Every manager or administrator should recognize the importance of planned and systematic approach to resourcing the organisation and to the recruitment, selection and induction of staff. To date interviewing still remains the central and indispensable element of the selection process.

Explain any **five** (5) potential biases of the interview process. (10 marks)

(b) Delegation is the process of entrusting authority and responsibility to others throughout the various levels of the organisation. Effective delegation leads to optimum use of human resources and improved organisational performance.

Discuss any **five** (5) benefits of delegation. (10 Marks)

[Total: 20 Marks]

QUESTION THREE

A manager requires to be armed with appropriate managerial skills in order for him/her to play the various roles expected of him/her. As a management student, explain these various skills a manager is required to play and relate them to the managerial roles. (20 marks)

[Total: 20 Marks]

QUESTION FOUR

(a) Leadership is a vital ingredient in developing the purpose and strategy of organizations both in the private and public sectors. Leaders have potential to influence the overall direction of the organization. However, despite the extensive research reaching back to the 1950s, there is no general agreement on leadership analysis.

Discuss **three** (3) main approaches to leadership. (15 marks)

(b) In recent studies, Emotional Intelligence (EI) has been found to be a more accurate predictor of who would become a leader more than the technical expertise.

Outline **five** (5) factors that influence Public Policy Formulation (5 marks)

[Total: 20 Marks]

QUESTION FIVE

(a) Centralisation and Decentralisation are common systems used to effect government control.

(i) Outline **five** (5) merits of Centralisation (5 marks)

(ii) State any **five** (5) factors that would make government to centralize its operations/systems (5 marks)

(b) State **five** (5) metrics Contract managers would use to evaluate the value of the contract. (5 marks)

(c) Communication is necessary for effective business growth and policy implementation.

Required:

State **five** (5) functions of communication (5 marks)

[Total: 20 Marks]

END OF PAPER

PFM 3 SUGGESTED SOLUTIONS

SOLUTION ONE

(a) Corporate governance is how well the public organisation is managed and the extent to which there is participation in the governance of the organisation by stakeholders. The following are some of the principles:

Accountability: Accountability is the ultimate responsibility and cannot be delegated. Corporate managers have to accept ultimate responsibility for the control of their organisations for the performance of all duties allocated to the company within the corporate governance structures.

Transparency: Transparency goes side by side with accountability. When an organisation is public, it should operate in the most transparent manner possible. There should be full disclosure of all financial affairs of the company, earnings of directors, compliance with good corporate governance principles, regular Board meetings in accordance with the law. Transparency is one of the key performance indicators for good corporate governance of public corporations.

Independence: Procedures and structures should be put in place so as to minimise, or avoid completely conflicts of interest among Board of Directors and management. There should be independence of mind and independence of appearance. Directors should be independent i.e. free from the influence of others in decision making.

Fairness: This entails the treatment of shareholders especially the minority shareholders. Fairness is usually considered with various stakeholders of a company in mind. The choice as to what is fair will most likely be made by taking into account the stakeholder's position on the power-interest matrix. Some of the stakeholders of an organization include; shareholders (including institutional investors), suppliers (creditors), employees, customers and the community at large.

Principle of Rule of Law: The term rule of law refers to a principle of governance in which all persons, institutions and entities, public and private, including the state itself, are accountable to laws that are publicly promulgated, equally enforced and independently adjudicated, and which are consistent with international human rights norms.

(b) Some values and principles according to the Charter include:

I. Efficiency
II. Professional discipline
III. Dignity
IV. Equity
V. Impartiality
VI. Public spiritedness, and
VII. Courtesy in the discharge of duties

(c) Best practice in contract management requires that the management of contracts takes into account the following:

i) Optimises delivery of large capital projects;
ii) Specifies management techniques and processes for all types of contracts;
iii) Encourages achievement of value for money and continuous improvement;
iv) Identifies savings and additional revenue opportunities;
v) Enhances risk management;
vi) Provides clear and complete records for audit;
vii) Encourages communication between all parties to contracts
viii) Failure to implement adequate contract management could result in:
ix) Paying for goods and services which do not meet the standards set out in the contract;
x) Significantly higher costs;
xi) Revenue collection delays;
xii) Customer and supplier dissatisfaction;
xiii) Overcharges by suppliers or underpayments by buyers;
xiv) Erroneous payments
xv) Service delivery issues
xvi) Missed savings opportunities
xvii) Failed compliance with regulatory provisions
xviii) Accidental renewal of goods or services
xix) Verification of timelines and accuracy of payments, receipts or deliverables
xx) Monitoring of use of discounts or rebates.

(d) Five (5) ways that administrators in the public sector can use to manage ethics at workplaces.

i) Understand the benefits of ethical conduct
ii) Focus on ethical conduct
iii) Develop a code of ethical conduct
iv) Promote process
v) Link ethics to other management practices
vi) Demonstrate ethical practices.

SOLUTION TWO

(a) Some of the biases would include the following:

i) Prior knowledge of the applicant will bias the interviewer's evaluation

ii) The interviewer tends to hold a stereotype of what represents a good applicant.

iii) The interviewer tends to favour applicants who share his or her own attitude.

iv)The order of interviewing applicants may influence the evaluators

v)Negative information is given unusually too much weight.

vi)The interviewer gets the impression of the candidate's suitability within the first four to five minutes of the interview

vii) The interviewer may forget much of interview content within minutes after its conclusion.

(b) Some of the benefits of delegation include:

- Best use of managerial time, as time is very valuable but limited. Delegation allows the manager more time on strategic issues of the organisation.
- A means of training and development of staff, testing the subordinates' suitability for promotion. Managers should delegate in order to make themselves dispensable.
- Specialist knowledge and skills are developed and enables specific aspects of management to be brought within the province of a number of specialist staff for greater efficiency. It improves the quality of decision-making.
- Geographical location of departments or operations of the organisation are facilitated by delegation of authority.
- Sound economics, because it benefits both the manager and subordinates and enables them both to play their roles in improving organisational effectiveness. The principle of delegation allows decisions to be made at the lowest levels in the organisation compatible with efficiency.
- Strength of the workforce. It will give subordinates greater scope for action and opportunities to develop their aptitudes and ability and increase their commitment to the goals of the organisation.

SOLUTION THREE

The managerial skills or qualities of a manager shall revolve around people (human and social) skills, technical skills or competence and conceptual skills irrespective of whether the organisation is private or public.

i) Technical Competence/Skills relate to the application of specific knowledge, methods and skills to implement various tasks. This type of skill is very important for those at supervisory levels and responsible for day-to-day operations like an Assistant Accountant, human resources officer, sales manager, workshop foreman etc.

ii) Social and human (people) Skills refer to interpersonal relationships in working with and through other people and exercise of judgement. A manager requires excellent people management skills to secure the effective use of human resources of the organisation. The leadership style of a manager has an effect on team work and the attainment of coordination among staff. The suitability of the management styles will have a bearing on the willingness of staff to do what the manager wants.

iii) Conceptual Skill or ability is required in order to view the complexities of the operations of the organisation as a whole including external factors. This involves decision-making skills.

Managerial roles may be categorised into three groups, namely **interpersonal roles**, **informational roles** and **decisional roles.**

I. Interpersonal roles:

Figurehead role - most basic and simple managerial role is being the public face of an organisation. The manager is a symbol and represents the organisation in matters of formality, ceremonial nature, signing documents, etc.

Leadership role is one of the significant roles and it permeates all activities of a manager. Due to the formal authority vested in the manager, there is responsibility for staffing, motivation and guidance of employees.

Liaison role involves relationships that the manager develops within and outside the organisation thus linking the organisation to its environment.

II. Informational roles

Monitor Role identifies the manager in seeking and receiving information. The information enables the manager to develop an understanding of the working of the organisation and its environment.

Disseminator Role involves the manager in transmitting external information through the liaison role into the organisation, and internal information through the leader role between the subordinates, which information may be factual or value judgement.

Spokesman Role involves the manager as formal authority in transmitting information to the people outside the unit such as Board of Directors, or other superiors and general public.

III. Decisional roles

Entrepreneurial Role is the manager's function to initiate and plan controlled change through exploiting opportunities or solving problems and taking actions to improve the existing situation.

Disturbance Handler Role involves the manager in reacting to involuntary situations and unpredictable events. The manager takes action to deal with unpredictable events.

Resource Allocator Role involves the manager in using formal authority to decide where effort will be expended and making choices on the allocation of resources such as money, time, material and staff. The Manager decides the programming of work and maintains control by authorising important decisions before implementation.

Negotiator Role is participation in negotiation activity with other individuals or organisations e.g. trade unions, suppliers or customers.

SOLUTION FOUR

(a) Three main approaches to leadership are:

i) Trait Theories

Trait theory is based on the assumption that good leaders are born leaders with a list of characteristics that differentiate leaders from non-leaders. Some of the characteristics or qualities of leaders include intelligence, charisma, decisiveness, enthusiasm, strength, bravery, integrity and self-confidence. The search for leadership traits preoccupied early scholars. Individuals who have been acknowledged as world leaders include Nelson Mandela, Margaret Thatcher, Martin Luther King, Bill Gates, Ted Turner, Kenneth Kaunda, Bill Clinton etc these individuals possess some of these qualities but probably not all the qualities.

ii) Behavioural Theories

Behavioural theories attempt to identify behaviours that differentiate effective from ineffective leaders. One key question is; do leaders tend to be more democratic than autocratic? Under this theory, once behaviour for good leaders is found, people can be trained to be leaders.

Ohio State Studies and the Michigan University, which led to the development of what is called the managerial grid, have carried out a number of studies.

iii) Contingency theories

In the study of leadership, it became very clear that predicting leadership success involved something more complex than isolating a few traits or preferable behaviours. The failure to obtain consistent results led to a new focus on situational influences. The relationship between leadership style and effectiveness suggested that under condition a, style x would be appropriate, whereas style y, would be more suitable for condition b, and style z for condition c.

(b) (i) Public opinion

(ii) Economic conditions

(iii) Technological change

(iv) Interest groups

(v) business associations

(vi) Political situations

SOLUTION FIVE

(a)(i) Reduced cost

(ii) Flexibility

(iii) Better coordination

(iv) Reduced conflict

(v) Personal leadership

(vi) Uniformity in action

(b) Factors that influence centralisation

- Size and dispersal of operation
- Nature of business
- Nature of growth
- Quality of executive
- Management by exemption
- Effective control system
- Level of diversity

(c) Functions of communication:

- Motivation
- Control
- Information
- Direction
- planning

PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

PFM 4: PUBLIC SECTOR FINANCIAL MANAGEMENT

FRIDAY, 13 DECEMBER 2019

TOTAL MARKS – 100; TIME ALLOWED: THREE (3) HOURS

INSTRUCTIONS TO CANDIDATES

1. You have fifteen (15) minutes reading time. Use it to study the examination paper carefully so that you understand what to do in each question.

2. This paper is divided into TWO sections:
   Section A: One (1) Compulsory question.
   Section B: There are four (4) questions. Attempt any three (3) questions.

3. Enter your student number and your National Registration Card number on the front of the answer booklet. Your name must **NOT** appear anywhere on your answer booklet.

4. Do **NOT** write in pencil (except for graphs and diagrams).

5. **Cell Phones** are **NOT** allowed in the Examination Room.

6. The marks shown against the requirement(s) for each question should be taken as an indication of the expected length and depth of the answer.

7. All workings must be done in the answer booklet.

8. Present legible and tidy work.

9. Graph paper (if required) is provided at the end of the answer booklet

DO NOT OPEN THIS QUESTION PAPER UNTIL YOU ARE INSTRUCTED BY THE INVIGILATOR.

SECTION A: COMPULSORY

This question is compulsory and must be attempted.

QUESTION ONE

You have been currently recruited as a Mining investment Analyst at the Ministry of Mines. The Head of the Mining Investment Department has tasked you to provide advice on an investment of the new exploration machinery proposed by one of the major mining companies Gold Exploration Plc.

Gold Exploration Plc, was recently established after the discovery of gold in Mwinilungu District of the North Western Province and is involved in mining exploration. The board of directors of the Gold Exploration Plc has recently passed a board resolution to invest in a new gold extracting equipment costing K8,450,000. As a newly established mining company, Gold Exploration Plc is considering to finance the investment, in the gold extraction equipment. The investment will be financed through public domestic borrowing to be arranged by the Ministry of Mines, as the cost of foreign debt financing is perceived to be higher.

The Finance Department of Gold Exploration Plc has determined the financial for data year one (1) of the expected revenues and expenditures (annually), which are clearly associated with the investment in the gold extraction equipment as follows:

	K '000
Revenue	3,400
Repairs & maintenance	750
Wages and salaries for equipment operation	900
Insurance of equipment	450

The following assumptions were made when undertaking the investment decision in the gold extraction equipment.

(i) The revenue is expected to increase every year at ten (10) per cent;
(ii) Repair and maintenance costs are expected to increase every year at the rate of ten (10) per cent.
(iii) Wages and salaries for equipment operations is expected to increase at the rate of inflation.
(iv) The insurance cost is expected to be constant throughout the investment period.

The Ministry of Mines uses the social opportunity cost (SOC) discount rate of fifteen (15) per cent to evaluate capital expenditure projects. The inflation rate is expected to be constant at eight (8) per cent throughout the investment period. The gold extraction equipment is expected to be in operational use for an initial period of five (5) years. At the end of this period, the Gold

Exploration Plc plans to sell the plant to another private investor company for an estimated K1,250,000.

Required:

(a) Explain why capital budgeting is important in the public sector. (8 marks)

(b) Estimate the Net Present Value (NPV) of the gold extraction equipment. (12 marks)

(c) Advice on whether the investment gold extraction equipment is financially viable based on your calculations in (b). (2 marks)

(d) State two (2) strengths and two (2) weaknesses of the Net Present Value (NPV). (4 marks)

(e) Discuss the different types of domestic debt financing and recommend the most appropriate for Gold Extraction Plc. (10marks)

(f) Explain any four (4) components of Enterprise Risk Management.(4 marks)

[Total: 40 Marks]

SECTION B

Attempt any THREE (3) questions in this section.

QUESTION TWO

As a consultant specialized in risk management, you have been contracted by the Permanent Secretary of Ministry of Higher Education of Country Z, to undertake a comprehensive review of risks facing the management of Public Universities.

You are told that Public Universities have been struggling to pay salaries on time and that Government has been providing monthly grants which are not sufficient to meet the operational needs of the universities. Due to current huge debt burden, the Government has not been able to meet their obligations of paying monthly grants. Public Universities have also experienced a situation where employees abscond from work and engage in part time lecturing in Public Universities. This has resulted in students not being taught regularly.

Stakeholders have argued that they do not understand why Public Universities were struggling to meet their obligations while the Public Universities were meeting their operational needs.

Further, the Report of the Auditor General for the year ending 31 December 2018 revealed that Public Universities were not able to service their debt, they were overstaffed and they did not have any risk register in place.

Required:

(a) Identify and discuss the range of risks that public universities are facing. (10 marks)

(b) Suggest the appropriate improvements that could be in place to control the risks identified. (10 marks)

[Total: 20 Marks]

QUESTION THREE

The Government of Lusangazi has rolled out Public Financial Management (PFM) reforms to streamline government practices in Local Government. The reforms were premised on the existence of infrastructure for example connectivity to reliable power, existence of the Integrated Financial Management System (IFMS) and access to internet which are not available in some Local Government.

A recent assessment undertaken by the World Bank in 2018 revealed that the Government of Lusangazi planned to roll out IFMS to 133 Local Authorities by 31 December 2017. However, by the end of December 2017 only 100 Local Authorities were connected. The other Local Authorities were subjected to batching their transactions and uploading them at the main system at Ministry of Finance Headquarters. This has increased the operational costs at the districts.

Network failures, inadequate computers and limited office space are still a challenge and this was slowing down the process of implementing reforms. Other issues noted were adaptive management as most staff were performing functions for administrative purposes. The reforms on fiscal transparency have stalled due to none availability of websites and notice boards in districts.

Required:

(a) State the functions of Government in the context of economic development. (4 marks)

(b) Explain the importance of the PFM reforms (6 marks)

(c) Explain the importance of IFMIS as a tool in these reforms. (4 marks)

(d) Suggest recommendations on how to address the current challenges of implementing PFM reforms in the Local Governments. (6 marks)

[Total: 20 Marks]

QUESTION FOUR

The Government of country Z has contracted a loan $11.1 million from a multilateral institution to assist in capacity building of Public Officers managing finances in the public sector. This proposed amount arose from recent evaluation which was undertaken by an expert revealing Governments' low investments in skills, systems and processes.

The experts report further noted that with Government pronouncement to migrate from Cash Basis International Public Sector Accounting Standards (IPSAS) to Accrual IPSAS, there was need for government to build capacity in its personnel.

The contraction of the loan has attracted debate across various sections of society. Stakeholders strongly argued that government should have allocated the resources to health, education and social security. They have since called for a meeting to discuss the loan that has been contracted.

Required:

a) Discuss the non-tax revenues that can be used as an alternative source of finance to the loan the Government of country Z has contracted to finance capacity building. (6 marks)

b) Explain the role of financial leadership in public finances. (8 marks)

c) Suggest measures to be undertaken by Government in order to attract right skills. (6 marks)

[Total: 20 Marks]

QUESTION FIVE

The Government of Country A is one of the largest Copper Producers and achieved middle income status in 2015, due to impressive economic growth of 9.5% per year. However, faster economic growth has been undermined by lower crop harvest, accumulation of new public expenditure debt and government domestic borrowing. The budget deficit of country A is currently 7.9% of GDP.

The current account is estimated to have remained above 4.5% of the GDP. With reduced foreign direct investment (FDI) and portfolio in flows in 2018, the current account was largely financed by a draw down on foreign currency reserves which fell to $1.6 billion. The foreign exchange rate of the kwacha against the US dollar has depreciated by 6.8% in the last six months.

Required:

a) Explain what the budget deficit implies and how it can be financed. (8 marks)

b) Explain the impact of financing a budget deficit has on the economy. (4 marks)

c) Discuss why national development plans are critical to the budgeting in the public sector. (8 marks)

[Total: 20 Marks]

END OF PAPER

Formulae

Modigliani and Miller Proposition 2 (with tax)

$$k_e = k_e^i + (1 - T)(k_e^i - k_d)\frac{V_d}{V_e}$$

Two asset portfolio

$$s_p = \sqrt{w_a^2 s_a^2 + w_b^2 s_b^2 + 2w_a w_b r_{ab} s_a s_b}$$

The Capital Asset Pricing Model

$$E(r_i) = R_f + \beta_i (E(r_m) - R_f)$$

The asset beta formula

$$\beta_a = \left[\frac{V_e}{(V_e + V_d(1 - T))}\beta_e\right] + \left[\frac{V_d(1 - T)}{(V_e + V_d(1 - T))}\beta_d\right]$$

The Growth Model

$$P_o = \frac{D_o(1 + g)}{(r_e - g)}$$

Gordon's growth approximation

$$g = br_e$$

The weighted average cost of capital

$$WACC = \left[\frac{V_e}{V_e + V_d}\right]k_e + \left[\frac{V_d}{V_e + V_d}\right]k_d(1 - T)$$

The Fisher formula

$$(1 + i) = (1 + r)(1 + h)$$

Purchasing power parity and interest rate parity

$$S_1 = S_0 x \frac{(1 + h_c)}{(1 + h_b)} \qquad F_0 = S_0 x \frac{(1 + i_c)}{(1 + i_b)}$$

Modified Internal Rate of Return

$$MIRR = \left[\frac{PV_R}{PV_I}\right]^{\frac{1}{n}}\left(1 + r_e\right) - 1$$

The Black-Scholes option pricing model

$$c = P_a N(d_1) - P_e N(d_2) e^{-rt}$$

Where:

$$d_1 = \frac{\ln(P_a / P_e) + (r + 0.5s^2)t}{s\sqrt{t}}$$

$$d_2 = d_1 - s\sqrt{t}$$

The Put Call Parity relationship

$$p = c - P_a + P_e e^{-rt}$$

Present Value Table

Present value of 1 i.e. $(1 + r)^{-n}$

Where r = discount rate
n = number of periods until payment

Discount rate (r)

Periods (n)	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	
1	0·990	0·980	0·971	0·962	0·952	0·943	0·935	0·926	0·917	0·909	1
2	0·980	0·961	0·943	0·925	0·907	0·890	0·873	0·857	0·842	0·826	2
3	0·971	0·942	0·915	0·889	0·864	0·840	0·816	0·794	0·772	0·751	3
4	0·961	0·924	0·888	0·855	0·823	0·792	0·763	0·735	0·708	0·683	4
5	0·951	0·906	0·863	0·822	0·784	0·747	0·713	0·681	0·650	0·621	5
6	0·942	0·888	0·837	0·790	0·746	0·705	0·666	0·630	0·596	0·564	6
7	0·933	0·871	0·813	0·760	0·711	0·665	0·623	0·583	0·547	0·513	7
8	0·923	0·853	0·789	0·731	0·677	0·627	0·582	0·540	0·502	0·467	8
9	0·941	0·837	0·766	0·703	0·645	0·592	0·544	0·500	0·460	0·424	9
10	0·905	0·820	0·744	0·676	0·614	0·558	0·508	0·463	0·422	0·386	10
11	0·896	0·804	0·722	0·650	0·585	0·527	0·475	0·429	0·388	0·305	11
12	0·887	0·788	0·701	0·625	0·557	0·497	0·444	0·397	0·356	0·319	12
13	0·879	0·773	0·681	0·601	0·530	0·469	0·415	0·368	0·326	0·290	13
14	0·870	0·758	0·661	0·577	0·505	0·442	0·388	0·340	0·299	0·263	14
15	0·861	0·743	0·642	0·555	0·481	0·417	0·362	0·315	0·275	0·239	15

(n)	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	
1	0·901	0·893	0·885	0·877	0·870	0·862	0·855	0·847	0·840	0·833	1
2	0·812	0·797	0·783	0·769	0·756	0·743	0·731	0·718	0·706	0·694	2
3	0·731	0·712	0·693	0·675	0·658	0·641	0·624	0·609	0·593	0·579	3
4	0·659	0·636	0·613	0·592	0·572	0·552	0·534	0·516	0·499	0·482	4
5	0·593	0·567	0·543	0·519	0·497	0·476	0·456	0·437	0·419	0·402	5
6	0·535	0·507	0·480	0·456	0·432	0·410	0·390	0·370	0·352	0·335	6
7	0·482	0·452	0·425	0·400	0·376	0·354	0·333	0·314	0·296	0·279	7
8	0·434	0·404	0·376	0·351	0·327	0·305	0·285	0·266	0·249	0·233	8
9	0·391	0·361	0·333	0·308	0·284	0·263	0·243	0·225	0·209	0·194	9
10	0·352	0·322	0·295	0·270	0·247	0·227	0·208	0·191	0·176	0·162	10
11	0·317	0·287	0·261	0·237	0·215	0·195	0·178	0·162	0·148	0·135	11
12	0·286	0·257	0·231	0·208	0·187	0·168	0·152	0·137	0·124	0·112	12
13	0·258	0·229	0·204	0·182	0·163	0·145	0·130	0·116	0·104	0·093	13
14	0·232	0·205	0·181	0·160	0·141	0·125	0·111	0·099	0·088	0·078	14
15	0·209	0·183	0·160	0·140	0·123	0·108	0·095	0·084	0·074	0·065	15

Annuity Table

Present value of an annuity of 1 i.e. $\frac{1 - (1 + r)^{-n}}{r}$

Where r = discount rate
n = number of periods

Discount rate (r)

Periods (n)	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	
1	0·990	0·980	0·971	0·962	0·952	0·943	0·935	0·926	0·917	0·909	1
2	1·970	1·942	1·913	1·886	1·859	1·833	1·808	1·783	1·759	1·736	2
3	2·941	2·884	2·829	2·775	2·723	2·673	2·624	2·577	2·531	2·487	3
4	3·902	3·808	3·717	3·630	3·546	3·465	3·387	3·312	3·240	3·170	4
5	4·853	4·713	4·580	4·452	4·329	4·212	4·100	3·993	3·890	3·791	5
6	5·795	5·601	5·417	5·242	5·076	4·917	4·767	4·623	4·486	4·355	6
7	6·728	6·472	6·230	6·002	5·786	5·582	5·389	5·206	5·033	4·868	7
8	7·652	7·325	7·020	6·733	6·463	6·210	5·971	5·747	5·535	5·335	8
9	8·566	8·162	7·786	7·435	7·108	6·802	6·515	6·247	5·995	5·759	9
10	9·471	8·983	8·530	8·111	7·722	7·360	7·024	6·710	6·418	6·145	10
11	10·37	9·787	9·253	8·760	8·306	7·887	7·499	7·139	6·805	6·495	11
12	11·26	10·58	9·954	9·385	8·863	8·384	7·943	7·536	7·161	6·814	12
13	12·13	11·35	10·63	9·986	9·394	8·853	8·358	7·904	7·487	7·103	13
14	13·00	12·11	11·30	10·56	9·899	9·295	8·745	8·244	7·786	7·367	14
15	13·87	12·85	11·94	11·12	10·38	9·712	9·108	8·559	8·061	7·606	15

(n)	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	
1	0·901	0·893	0·885	0·877	0·870	0·862	0·855	0·847	0·840	0·833	1
2	1·713	1·690	1·668	1·647	1·626	1·605	1·585	1·566	1·547	1·528	2
3	2·444	2·402	2·361	2·322	2·283	2·246	2·210	2·174	2·140	2·106	3
4	3·102	3·037	2·974	2·914	2·855	2·798	2·743	2·690	2·639	2·589	4
5	3·696	3·605	3·517	3·433	3·352	3·274	3·199	3·127	3·058	2·991	5
6	4·231	4·111	3·998	3·889	3·784	3·685	3·589	3·498	3·410	3·326	6
7	4·712	4·564	4·423	4·288	4·160	4·039	3·922	3·812	3·706	3·605	7
8	5·146	4·968	4·799	4·639	4·487	4·344	4·207	4·078	3·954	3·837	8
9	5·537	5·328	5·132	4·946	4·772	4·607	4·451	4·303	4·163	4·031	9
10	5·889	5·650	5·426	5·216	5·019	4·833	4·659	4·494	4·339	4·192	10
11	6·207	5·938	5·687	5·453	5·234	5·029	4·836	4·656	4·486	4·327	11
12	6·492	6·194	5·918	5·660	5·421	5·197	4·988	4·793	4·611	4·439	12
13	6·750	6·424	6·122	5·842	5·583	5·342	5·118	4·910	4·715	4·533	13
14	6·982	6·628	6·302	6·002	5·724	5·468	5·229	5·008	4·802	4·611	14
15	7·191	6·811	6·462	6·142	5·847	5·575	5·324	5·092	4·876	4·675	15

PFM4 SOLUTION

SOLUTION ONE

a) **Importance of capital budgeting of Capital budgeting**

Capital budgeting is a process that helps in planning the investment projects of an organization in long run. It takes all possible consideration into account so that the company can evaluate the profitability of the project. It is useful for evaluating capital investment project such as purchasing equipment, the rebuilding of equipment etc.

Importance of capital budgeting of Capital budgeting are highlighted below:

Capital budgeting process enables the firm to:

- **Develop and formulate long-term strategic goals**

  For the growth & prosperity of the business, long-term goals are very important for any organization. A wrong decision can be disastrous for the long-term survival of the firm. Capital budgeting has its effect in a long time span. It also affects companies future cost & growth.

  The ability to set long term goals is essential to the growth and prosperity of any business. The ability to appraise/ value investment projects via capital budgeting creates a framework for businesses to plan out future long term direction.

- **Involvement of a large number of funds**

  Capital Investment requires a large number of funds. As the companies have limited resources, the company has to make a wise & correct investment decision. The wrong decision would harm the sustainability of the business. The large investment includes the purchase of an asset, rebuilding or replacing existing equipment.

- **Seek out new investment projects.**
  Knowing how to evaluate investment projects gives a business the model to seek and evaluate new projects, an important function for all entities as they seek to compete and profit in their industry.

- **Estimate and forecast future cash flows Future cash flows are what create value for businesses over time.**

  Capital budgeting enables executives to take a potential project and estimate its future cash flows, which then helps determine if such a project should be accepted.

- **Facilitate the transfer of information**

  The time that project starts off as an idea, it is accepted or rejected; numerous decisions have to be made at a various level of authority. The capital budgeting process facilitates the transfer of information to appropriate decision makers within a company.

- **Monitoring & controlling the expenditure**

  Capital budget carefully identifies the necessary expenditure and R&D required for an investment project. Since a good project can turn bad if expenditures aren't carefully controlled or monitored, this step is a crucial benefit of the capital budgeting process.

- **Maximization of wealth**

Long-term investment decision of the organization helps in safeguarding the interest of the shareholder in the organization. If the organization has invested in a planned manner, the shareholder would also be keen to invest in that organization. This helps in the maximization of wealth of the organization. Any expansion is fundamentally related to further sales and future profitability of the firm and assets acquisition decisions are based on capital budgeting.

b) Calculation of the Net Present Value (NPV)

CALCULATION OF NET PRESENT VALUE

	'Year 1 ZMW'000	**'Year 2 ZMW'000**	**'Year 3 ZMW'000**	**'Year 4 ZMW'000**	**'Year 5 ZMW'000**
Revenue	3,400.00	3,740.00	4,114.00	4,525.00	4,977.00
Costs	2,100.00	2,247.00	2,426.70	2,624.37	2,841.81
Net cash flows	1,300.00	1,493.00	1,687.30	1,900.63	2,135.19
Salvage value					1,250.00
Total cash flows	**1,300.00**	**1,493.00**	**1,687.00**	**1,900.63**	**3,385.19**
Present value factor	0.8700	0.756	0.658	0.572	0.497
	1,131.00	**1,128.7**	**1,110.05**	**1,087.16**	**1,682.44**
Total PV of cash flows	**6,139.35**				
Initial Investment	**8,450.00**				
Net Present Value	**2,310.65**				

Working for NPV Calculation

	'Year 1 ZMW'000	'Year 2 ZMW'000	'Year 3 ZMW'000	'Year 4 ZMW'000	'Year 5 ZMW'000
Revenue	3,400.00	3,740.00	4,114.00	4,525.40	4,977.94

	'Year 1 ZMW'000	'Year 2 ZMW'000	'Year 3 ZMW'000	'Year 4 ZMW'000	'Year 5 ZMW'000
Pepairs& Maintenance	750	825	907.5	998.25	1098.075

	'Year 1 ZMW'000	'Year 2 ZMW'000	'Year 3 ZMW'000	'Year 4 ZMW'000	'Year 5 ZMW'000
Wages and Salaries	900	972	1069.2	1176.12	1293.732

	'Year 1 ZMW'000	'Year 2 ZMW'000	'Year 3 ZMW'000	'Year 4 ZMW'000	'Year 5 ZMW'000
Insurance	450	450	450	450	450

Total cost	**2,100.00**	**2,247.00**	**2,426.70**	**2,624.37**	**2,841.81**

c) Advice of the investment decision

Gold Extraction plc, should go ahead and invest in the gold extraction equipment, as the Net Present value of the cash flows is positive.

d) Strengthen and weakness of the NPV

Strengthen of Net Present Value

- NPV gives important to the time value of money.
- In the calculation of NPV, both after cash flow and before cash flow over the life span of the project are considered.

- Profitability and risk of the projects are given high priority.
- NPV helps in maximizing the firm's value.

Weakness Of Net Present Value (NPV**)**

- NPV is difficult to use.
- NPV cannot give accurate decision if the amounts of investment of mutually exclusive projects are not equal.
- It is difficult to calculate the appropriate discount rate.
- NPV may not give correct decision when the projects are of unequal life

e) The different types of Domestic Debt financing

i. Treasury bills

A treasury bill is a short term instrument that the Zambian government issues in order to borrow money through the Bank of Zambia for a period of one year or less.

The amounts on offer are determined based on the liquidity of the market, the financing requirements of government and the maturities needed to be rolled over.

ii. Government bond

government bond or sovereign bond is a bond issued by a national government, generally with a promise to pay periodic interest payments called coupon payments and to repay the face value on the maturity date. Currently there are five (5) types on issue mainly: 12 months, 18 months and 24 months as short term, 3 years and 5 years as medium terms and 15 years as long term.

The aim of a government bond is to support government spending. Government bonds are usually denominated in the country's own currency, in which case the government cannot be forced to default, although it may choose to do so.

iii. Government consolidated (Consols) bond

The consolidated bond is a consolidation of various debt owed by government to the Central Bank. A consol (originally short for consolidated annuities, but subsequently taken to mean consolidated stock) was a name given to certain government debt issues in the form of perpetual bonds, redeemable at the option of the government.

The long term bond agreement has a 10-year period with o coupon rate of 6% with an option to roll over for another 10 years.

iv. Kwacha Bridging Loan

The kwacha bridging loan is an advice to government against further revenues to meet budgeting allocations.

It is borrowed for short period and is paid back to the Central Bank within the fiscal year.

I recommend the use of bonds rather than treasury bills because treasury bills are short term instruments. It is important to match the maturity of the loan with the period of the investment. Since the investment is long term, Gold Exploration plc should use long term debt finance.

f) Discuss the steps involved in the risk management process

The risk management process also helps to resolve problems when they occur, because those problems have been envisaged, and plans to treat them have already been developed and agreed. You avoid impulsive reactions and going into "fire-fighting" mode to rectify problems that could have been anticipated.

Below are the risk management processes steps combine to deliver a simple and effective risk management process.

Step 1: Identify the Risk. You and your team uncover, recognize and describe risks that might affect your project or its outcomes. There are a number of techniques you can use to find project risks. During this step you start to prepare your Project Risk Register.

Step 2: Analyze the risk. Once risks are identified you determine the likelihood and consequence of each risk. You develop an understanding of the nature of the risk and its potential to affect project goals and objectives. This information is also input to your Project Risk Register.

Step 3: Evaluate or Rank the Risk. You evaluate or rank the risk by determining the risk magnitude, which is the combination of likelihood and consequence. You make decisions about whether the risk is acceptable or whether it is serious enough to warrant treatment. These risk rankings are also added to your Project Risk Register.

Step 4: Treat the Risk. This is also referred to as Risk Response Planning. During this step you assess your highest ranked risks and set out a plan to treat or modify these risks to achieve acceptable risk levels. How can you minimize the probability of the negative risks as well as enhancing the opportunities? You create risk mitigation strategies, preventive plans and contingency plans in this step. And you add the risk treatment measures for the highest ranking or most serious risks to your Project Risk Register.

Step 5: Monitor and Review the risk. This is the step where you take your Project Risk Register and use it to monitor, track and review risks.

SOLUTION TWO

a. **Identify and discuss the range of risks that public universities are facing.**

i. Risks which these public universities are subject to

- Financial Risk: This risk is mainly due to the university enrolling lower than expected numbers and low uptake on accommodation which results in the university not being able to generate sufficient revenue.
- Operational risk: This risks arises from the university raising lower than expected cashflows hence not able to meet various operational costs such as salaries, teaching aids, failure to pay statutory requirements and not paying gratuity on time. Other issues related to operational risks are reliance on students that are sponsored by government who in most cases do not pay their tuition on time, overstaffing in most institutions especially the general workers and failure to collect debt.
- Physical risks: This arises from thefts. Most public university do not have proper security systems. Power fluctuations and breakdown of computers impact on efficient and effective delivery of courses.
- Information Technology risk: This arises mainly due to technological obsolescence and is usually costly to replace, hacking of the system and absence of disaster preparedness plan
- Fraud Risk: Due to weak internal controls that have been highlighted by the Office of the Auditor General, there is likely hood of theft of cash by employees and collusion with suppliers of goods and service through overcharging on procurements.

b. **Suggest the appropriate improvements that could be in place to control the risks identified.**

- Financial Risks: Plan and execute various marketing strategies, introduction of short term courses instead of relying on academic courses and introducing incentives to students paying for both accommodation and tuition.
- Operational Risks: Continuous identification of loss making programs and initiate cost control, continuous monitoring of cashflows, monitor trends in client portfolio and advise management and consider outsourcing services such as cleaning.
- Physical Risks: Hedge through insurance of assets and effective internal controls, enter into service level agreements and preventive maintenance and buy UPS for computers in an event of power cuts.
- Information Technology Risks: Regularly review passwords, put in place ICT replacement plan for continual replacement and identify offsite backup center.
- Fraud Risk: Monitor and review adherence to internal checks and controls and quarterly or frequent internal audit checks.

SOLUTION THREE

a. Describe the functions of Government in the economy

The role of Government is to provide the legal framework and services needed for the effective operation of a market economy. In the context of economic development with five parts: i.e.

- Providing a legal and social framework for economic activity-
- Providing public goods
- Regulating economic activity
- Reallocating resources; and
- Stabilising the economy

b. The importance of the PFM reforms and the using IFMIS as a tool
Importance of PFM Reforms

- Public Financial Management reforms aimed at increasing compliance with rules and regulations, transparency in the use of public funds and reducing opportunities for corruption.
- Bring about accountable use of public resources as a basis to improved service delivery.
- PFM system ensures that aggregate levels of tax collection and public spending are consistent with targets for the fiscal deficit, and do not generate unsustainable levels of public borrowing
- A PFM system ensures that public resources are allocated to agreed strategic priorities, in other words that allocative efficiency is achieved
- The PFM system ensures that operational efficiency is achieved, in the sense of achieving maximum value for money in the delivery of services

c.

- The PFM system follows due process and is seen to do so, by being transparent, with information publicly accessible, and by applying democratic checks and balances to ensure accountability.

Importance of IFMIS

- Provision of a successful fiduciary framework for the management of government funds, including as a steward of donor funds;

d.

- Preparation of annual financial statements and submission for audit within a reducing and reasonable period of fiscal year end;
- Maintain accountability for the government's revenue, budget and expenditures, including of donor funds; and
- Allowing the capability to record transactions and produce periodical and annual financial reports by individual government entities.

Propose recommendations on how to address the current challenges of implementing PFM reforms in the Local Governments

- Government should invest in infrastructure and rapid roll out of IFMS, improve Internet services that can serve all LGs and central government in order to maintain a system that is consistently run. This should curb persistent network failures.

- Training programme to continuously build capacity of the human resources at local and central government to have these reforms fully operational.
- Government should promptly update the MoF website with budget information e.g detailing breakdown of funds released and other budget related communication as an alternative measure to faster access of information.

SOLUTION FOUR

a. Discuss the non-tax revenues as an alternative source of finance to the loan the Government of country X can use to finance capacity building.

These include:

- Fees. A fee is charged by public authorities for rendering a service to the citizens. Unlike taxation there is no compulsion involved. Examples include charges for issuing of passports, driving licenses etc.
- Fines or penalties. These are imposed as a form of punishment for breach of law or non-fulfilment of certain conditions or for failure to observe some regulations. These are compulsory payments.
- Surplus from public enterprises in the country. Profits earned from public enterprises. Examples include profits from government owned companies.
- Special assessment and betterment levy. It is a kind of special charge levied on certain members of the community who are beneficiaries of certain government activities or public projects. For example. Due to a public park in a locality or due to the construction of a road people in that locality may experience an appreciation in the value of their property or land. Thus due to public expenditure some people may experience unearned increments in their asset holding.
- Grants and gifts. These are voluntary contributions by individuals or institutions to the government. These are significant source of revenue during war and emergency. A grant to country X will be an important source of revenue to it .Grants from foreign countries are known as foreign aid.
- Deficit financing. This means an excess of public expenditure over public revenue.

b.

i. Role of Financial Leadership in Public Finances

- Financial leadership assures accountability in the management of public finances involving, but not limited to, budget processes and strict adherence to financial rules and regulations in the management of public resources.

- Financial Leadership results in sustainable public finances which entails ability of governments to sustain optimal spending, tax collection and sound macro-economic policies that, in the long run, do not threaten government solvency or lead to governments defaulting on debt obligations.

- Financial leadership that will ensure a government does not go into the red. There are institutions such as Supreme Audit Institutions (SAIs), controllers of budget and internal audit; and above all parliamentary oversight structures such as the Parliamentary Accounts Committee that play critical roles in this process.

- Citizens in most Jurisdiction participate in the budget proposals and prioritisation of essential services. The effectiveness of this process can only be assured by good financial leadership that is underpinned by technical competency, high levels of integrity and honesty in financial management. With such technical competency and personal integrity, the perennial wastages and corruption loopholes in the public sector would be checked to a great deal.

- Effective public financial and resource management is also important for decision-making. Accurate financial information is often used as the mechanism to support decisions and ensure effective resource allocations. This can only be attained with sound financial leadership in place.

- Financial leaders are responsible for the development of a stronger government finance profession through improving government systems and ensuring continuous capacity building of staff that will be responsible for assisting policy makers in management of the nation's resources.

ii. What was needed for government to attract the right skills?

- Introduction of reward system that can come in forms beyond financial - government can offer, training and personal development opportunities**.**

- Make employees feel valued in the workplace through recognition. Recognition in terms of public acknowledgement that what someone is doing is worthwhile, valued and an important part of the activities of the organization.

- Improve financial rewards to make them competitive to what the private sector is offering.

- Government should build a sense of being part of a shared undertaking through consistent messaging. Lack of a shared vision could lead to frustration for some of the people with right skills.

SOLUTION FIVE

Explain what the budget deficit implies and how it can be financed

a. A budget Deficit and what it relates to.

- Budget deficit occurs when expenses exceed revenue and indicate the financial health of a country.

- The budget deficit generally relates to the government's expenditure and not the business or individuals spending. The government's collective deficits are termed as national debt. In the case of a budget deficit, be it the government or any business, it has to resort to the external borrowings in order to escape bankruptcy**.**

How to finance a deficit.

- Borrowing: Domestically or externally. Domestic borrowing can be from banks, individuals, others. External Borrowing comes from banks, financial institutions, Governments.

- Not building up arrears. This can be achieved by government enforcing rules and regulations on financial planning and commitment control system.

- Selling Assets: Government could target floating of shares in its parastatals and identifying others assets that could easily be turned into cash.

- Printing money: Government can direct the central bank to print money to finance some of the critical services and also payment of public service workers to avert civil unrest.

b. The impact of financing a budget deficit has on the economy.

- Crowding out effects: Crowding out is the reduction of private sector consumption or investment resulting from addition government financing.

- Additional tax reduces disposable incomes for private sector

- Domestic borrowing that is effect of increasing the interest rate and cost of borrowing for private sector (or directly limits availability of finance in countries with weak financial markets.

- Primary deficit is kept stable, but debt increases none the less.

c. Discuss as to why national development plans are critical to the budgeting in the public sector.

- **Resource Mobilisation**

Annual plan incorporates the instruments of economic policy and organization and institutional measures required to mobilize resources and achieve planned objective..

- **Legal and Institution frameworks in budgeting**

Implementation Framework for the National Budget and Development Planning Policy are informed by the National Plan that is developed. This ensures that the legal framework pertaining the budgeting process is not conflicting**.**

- **Institutional Arrangements**

National Plan also inform the responsible Ministries in the implementation of the National Planning and Budgeting policy so that they facilitate the putting in place of enabling legislation for smooth implementation of the policy.

- **Oversight function within the National Assembly**

The institutional framework that governs the legislature's scrutiny of the executive's budget proposals will be reviewed to enhance the oversight function of the National Assembly and allow it to more effectively undertake independent fiscal policy and budget analysis. National Plan provided the basis for scrutinizing the proposed budgets.

- **Resource Allocation**

National plans take into consideration all resources available in the country in totality. These include physical resources such as manpower, natural resources, existing productive capacities, as well as financial resources and apportions them among sectors.

SOLUTION SIX

a The key tools for managing liquidity in the public sector.

- Cash management: Prudent use of cash resources and short-term liquid investments to ensure that payment obligations can be met.
- Managing supplier payments, receivables, and inventories to optimize the use of resources.
- Organizing and managing borrowing facilities: Using cash flow forecasts, building in planned/ required new funding and maturing funding that must be repaid or refinanced.

b. Incentives for good cash management.

- Annual budget appropriations should be deposited into each Ministry Province or Agency's interest-bearing account, at the rate of one-twelfth each month. If Ministry, Province or agency spends its appropriations at a slower rate, it is paid interest on the balance in the account.

- Similarly, if Ministry, Province or Agency spends its appropriations at a faster rate, then it must pay interest to reflect the government's cost of borrowing. Ministry, Province or Agencies, of course, vary greatly in their ability to time individual transactions precisely but this system has served to increase their cash-consciousness.
- Another measure used in order to improve cash management is to allow Ministry, Provinces or Agencies to carry forward their unused appropriations. This is designed to avoid end-of-year spending "surges"; increase discipline among managers, since any overspending in the year gets carried over as well; and gives rise to efficiency gains in agencies beyond those assumed in the budget, since any gains would be retained by the Ministry, Province or Agency.

c. Elements Ministries and Provinces should take into account when preparing budget implementation plan and cash plans

- The financial needs of ongoing commitments need to be included.
- Regulating cash flows without regulating commitments generates arrears. Ensure that Ministries, Provinces and Agencies are guided on whether they are allowed to make commitments up to the ceiling given in the budget appropriations or up to the monthly cash limits.
- The budget implementation plan and the cash plan should take into account the timing of payments and payment obligations arising from commitments over the fiscal year. Dividing the budget into four quarterly parts, or release one-twelfth of the budgeted amount every month may not be satisfactory. For example, the monthly schedule of disbursements for investment projects can be highly variable depending on various factors such as contractual payment schedules or the physical advancement of works.
- Adjustment of commitments needs time. Imposing monthly limits is generally more of a regulation of cash payments through float than a regulation of commitments, since even for non-personnel goods and services, one month may be too short a period to adjust commitments. To avoid arrears generation, monthly cash limits should be consistent with quarterly cash and annual commitment limits. A period of at least three months is needed to regulate non-permanent commitments, while issues related to permanent commitments should be addressed during budget preparation.

END OF SOLUTIONS

PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

PFM 5: PUBLIC SECTOR AUDITS

THURSDAY, 12 DECEMBER 2019

TOTAL MARKS – 100; TIME ALLOWED: THREE (3) HOURS

INSTRUCTIONS TO CANDIDATES

1. You have fifteen (15) minutes reading time. Use it to study the examination paper carefully so that you understand what to do in each question.

2. This paper is divided into TWO sections:
   Section A: One (1) Compulsory question
   Section B: There are four (4) questions. Attempt any three (3) questions.

3. Enter your student number and your National Registration Card number on the front of the answer booklet. Your name must **NOT** appear anywhere on your answer booklet.

4. Do **NOT** write in pencil (except for graphs and diagrams).

5. **Cell Phones** are **NOT** allowed in the Examination Room.

6. The marks shown against the requirement(s) for each question should be taken as an indication of the expected length and depth of the answer.

7. All workings must be done in the answer booklet.

8. Present legible and tidy work.

9. Graph paper (if required) is provided at the end of the answer booklet.

DO NOT OPEN THIS QUESTION PAPER UNTIL YOU ARE INSTRUCTED BY THE INVIGILATOR.

SECTION A

This question is compulsory and must be attempted.

QUESTION ONE

You work for the Office of the Auditor General (OAG) and you have been assigned to the audit of Lukanga City Council (LCC). You joined the Office of the Auditor General (OAG) two years ago having previously worked as Director of Finance for Lukanga City Council (LCC).

At the beginning of the year, the Office of the Auditor General (OAG) selected items to audit in the current year and Lukanga City Council (LCC) was not one of the subjects planned to be audited. The audit of Lukanga City Council (LCC) has been prompted by a request by the Republican President that a financial and compliance audit be conducted. The directive follows public media reports concerning gross mismanagement and misapplication of funds which were appropriated for the construction of new offices. At the time of your leaving Lukanga City Council (LCC), the first 25% of the funding for the construction of the new offices had been disbursed.

You are leading a team of four Assistant Auditors who were recently employed by the Office of the Auditor General (OAG). All the four Assistant Auditors recently graduated from university and are currently pursuing the Public Sector Financial Management programme. This will be the first audit that they will participate in. You have obtained the allowances for the two weeks that you are going to spend in Lukanga and each of the four Assistants have also obtained their allowances.

On arrival, you book accommodation at one of the hotels and the Assistant Auditors book accommodation at a lodge near the existing City Council offices. During a meeting with the Director of Finance and the Town Clerk, the dual on learning of the lodging arrangements that you made suggested that you together with the Assistant Auditors should relocate and instead lodge at a guest house owned by the City Council. They indicated that since the guest house is currently not fully occupied the audit team could stay there free on full board and lodging basis.

During the meeting with the Director of Finance and the Town Clerk you also agreed that your team will spend the first three days of your visit gaining an understanding of the operations of the council and in so doing assess the risks of material misstatements of the financial statements.

During the pre-audit debrief with the audit team, one of the Assistant Auditors asked you on whether fraud should be considered a significant risk at Lukanga City Council (LCC).

Required:

(a) Explain three (3) beneficiaries of a public sector audit such as the one for Lukanga City Council (LCC). (3 marks)

(b) Explain how the constitution of Zambia ensures the independence of the Office of the Auditor General (OAG). (9 marks)

(c) (i) Identify and explain four (4) ethical matters affecting the audit team of Lukanga City Council. (12 marks)

(ii) Suggest suitable safeguards that may be applied to mitigate the ethical issues in (i) above. (4 marks)

(d) Explain the implication of the request by the President that the OAG performs an audit of Lukanga City Council not originally on its program. (2 marks)

(e) (i) Explain the meaning of the risk of material misstatement in the audit of the financial statements of Lukanga City Council (LCC). (4 marks)

(ii) Explain the importance of assessing risk at the planning stage of the audit of the Lukanga City Council and state four (4) matters your team will need to gain an understanding of. (6 marks)

[Total: 40 Marks]

SECTION B

Attempt any THREE (3) questions in this section.

QUESTION TWO

The International Organization of Supreme Audit Institutions (INTOSAI) is a global body whose main objective is to assist member countries to hold governments and other government agencies accountable for the public funds that they collect and spend.

Parliament, which comprises the representatives of the people, confers responsibilities on the executive and the Office of the Auditor General (OAG).

The INTOSAI issued the Mexico Declaration which deals with the independence of the Supreme Audit Institutions. The aim of the Mexico Declaration is to ensure that the Supreme Audit Institution and the staff that work for it maintains independence so that they can be objective in the performance of their work. It is expected that member countries of INTOSAI will adhere to these principles and possibly incorporate them in the legal frameworks of the individual countries.

Zambia is a member of INTOSAI and to a large extent has included the majority of the principles of the Mexico Declaration in the constitution and other laws.

Required:

(a) Explain the meaning of parliament conferring responsibilities to the executive and other government agencies and the Office of Auditor General (OAG). (6 marks)

(b) Explain three (3) benefits of the SAI of Zambia belonging to the International Organization of Supreme Audit Institutions (INTOSAI). (3 marks)

(c) Explain the provisions of the constitution and other legislation in Zambia with regards to the following:

(i) Accessibility to information and documents (2 marks)
(ii) Reporting (2 marks)
(iii) Financial and administrative autonomy of the Office of the Auditor General (OAG). (3 marks)

(d) Distinguish between modified and unmodified opinions that the public sector auditor may issue. (4 marks)

[Total: 20 Marks]

QUESTION THREE

(a) Public sector auditors are required to obtain sufficient appropriate audit evidence in the performance of financial audits.

The evidence that is obtained forms the basis for the audit opinion. The form of documentation should be such that an auditor who was not involved in the audit can reach an appropriate conclusion.

Documentation is maintained by the auditor in the current and permanent audit files.

Required:

(i) Explain the meaning of sufficient appropriate audit evidence in public sector auditing. (2 marks)

(ii) Explain current and permanent audit files stating four (4) matters that should be contained in each. (6 marks)

(b) Public sector auditors base their opinions and conclusions on the evidence that is obtained during the audit.

The reliability of evidence depends much on the source and type of evidence. Generally, written evidence is considered more reliable than oral evidence just as third party evidence is more reliable than evidence obtained from the client entity.

At the conclusion of financial audits, the auditors issue an audit report in which the audit opinion is contained and also issues a management letter to management.

Required:

(i) Explain the meaning of external confirmations in public sector auditing and state four (4) examples when they may be used. (4 marks)

(ii) Define a management letter and state its use in public sector auditing. (4 marks)

(iii) Explain the use of written representations by public sector auditors in the performance of public sector audits. (4 marks)

[Total: 20 Marks]

QUESTION FOUR

In line with all government ministries, the Ministry of Gender is in the process of putting in place an Audit Committee.

The Permanent Secretary organized a three days workshop for all Directors discuss the establishment of the Audit Committee shall be held. On the second day of the workshop the meeting came up with a list of nominees who will sit on this committee and it was agreed that because the work of the Audit Committee is outside the normal duties of staff, a sitting allowance shall be paid to the members.

The Permanent Secretary guided that the Audit Committee should only comprise people who do not work for the Ministry. This did not go well with the attendees who felt that it was not fair that people from other ministries who do not know how the Ministry of Gender operates should be the ones to get the allowances.

It was clear from the deliberations that a majority of the people in attendance did not know the difference between the proposed Audit Committee and the Public Accounts Committee (PAC) and so they felt this was a duplication of work. The Permanent Secretary has contacted the Auditor General (AG) to attend the workshop on the last day so that he explains the distinction between the Public Accounts Committee (PAC) and the Audit Committee.

You work for the Office of the Auditor General (OAG) and the Auditor General (AG) has requested you to represent him.

Required:

(a) Explain the difference between the Public Accounts Committee (PAC) and the Audit Committee. (7 marks)

(b) Explain how the Public Accounts Committee (PAC) fulfills its oversight regarding public expenditure. (4 marks)

(c) Explain the reasons why members of the Audit Committee should have a mixture of staff from the Ministry of Gender and others from other ministries. (5 marks)

(d) Explain four (4) duties of the proposed Audit Committee to the Ministry of Gender and other stakeholders. (4 marks)

[Total: 20 Marks]

QUESTION FIVE

(a) The Norwegian government has funded the Office of the Auditor General (OAG) to enable it train its staff on quality control in carrying out of public sector audits. This is in response to the observation made in the past where Controlling Officers disputed most of the observations made during the public accounts hearings. It was clear from the deliberations that there was poor documentation of the work carried out by staff of the Office of the Auditor General (OAG).

Required:

(i) Explain why it is important for the public sector auditors to discuss their findings with the audited entities before finalizing their report. (3 marks)

(ii) State and explain four (4) benefits of documenting the work performed by the staff of the Auditor General (AG) during the performance of public sector audits. (5 marks)

(b) The government of Zambia embarked on a nationwide immunization of girl children between the ages of thirteen (13) and twenty (20) years against cervical cancer.

A total of K9.1 million has been allocated and released by the Ministry of Finance to the Ministry of Health which will undertake the exercise.

A committee of Provincial Health Officers and staff from the Ministry of Health was set up with the mandate of coming up with a detailed budget of expenditure for each of the ten (10) provinces. The target was to immunize a total of 2 million girls country-wide, ensuring that composition of this number per province will be determined before embarking on the exercise.

Funds were transferred to each Provincial Health Officer who was made accountable for the use of the funds in line with the approved budget. Each province was allowed to purchase a vehicle to be used for the exercise and the maximum cost of the vehicle was set at K400,000.

Staff participating in the immunization were paid allowances in accordance with the current rates for government employees. All funds were supposed to be spent in accordance with the financial regulations of the government. Provincial Medical Officers were required to submit a detailed report of the outcome of the program in each province.

It was established from the reports received from the Provincial Health Officers that only 1.8 million girls were immunized as against a target of 2 million girls. Out of the ten (10) provinces targeted only three (3) provinces met the target set for immunization. Despite not being able to meet the desired number all funds allocated to provinces were fully utilized.

Required:

(i) Explain performance audits using information in the scenario. (7 marks)

(ii) Explain compliance audits using the information in the scenario. (5 marks)

[Total: 20 Marks]

END OF PAPER

PFM 5 PUBLIC SECTOR AUDITS

SUGGESTED SOLUTIONS

SOLUTION ONE

a) **Beneficiaries of the audit of Lukanga City Council (LCC):**
   1. Those charged with the responsibility of oversight on the use of public funds namely the Public Accounts Committee (PAC).
   2. The local community who live in Lukanga who contribute taxes and levies which the City Council spends.
   3. The general citizenry of the country to whom public funds belong and in whose interest they must be spent. Central government appropriates public funds to run the council.
   4. The management of the city of Lukanga benefit from the public sector audits as they get an independent view of how the council is spending the money and this helps the management perform its function of running the council.

b) **How Zambian government assures SAI independence:**
In line with the provisions of the International Organization for Supreme Audit Institutions (INTOSAI), the Zambian government through constitutional and other legislation provides thus:
   - The mandate of the Office of the Auditor General (OAG) (OAG) is enshrined in the constitution.
   - The Auditor General should be independent and so is appointed in accordance with the provisions of the constitution and security of tenure is enshrined in the constitution which states the circumstances under which he may be removed.
   - The OAG will determine its own program of work for the year and will not be dictated by someone else.
   - The AG shall be given access to all documents and information that he/she requires in the performance of audits without any restrictions.
   - The AG has the right to report on findings from public sector audits and will make public its findings.
   - The OAG shall decide the format and content of the reports without interference except where the law prescribes specific reporting requirements.
   - The OAG receives funding for its activities from government and is not responsible to a line ministry.
   - The OAG shall determine the scope and extent of the work that will perform.

- The AG and staff in the OAG shall have immunity against litigation arising from them carrying out their work.

c) i. Ethical issues in the audit of Lukanga City Council (LCC):

1. **Auditor previously worked for Lukanga City Council (LCC):**
   The fact that the team leader of the team previously worked for the Lukanga City Council (LCC) poses a self-interest and self-review threat. This will impact on the objectivity of the team leader. Further, there is likely to be a familiarity threat having recently worked for Lukanga City Council (LCC).

2. **Professional competences of the audit assistants:**
   One of the ethical principles of public sector auditors is that of professional competence and due care.

3. It is doubtful that the four assistant auditors who are recent graduates on their first audit will have the necessary skills and competences to carry out the audit of Lukanga City Council (LCC). It is unlikely, therefore, that the team will perform an efficient audit of the financial statements of Lukanga City Council (LCC).

4. **Lodging at the City Council lodge:**
   Ethical guidance requires that unless clearly insignificant, auditees should not accept gifts and hospitality from a client organization. Clearly boarding and lodging for two week cannot be considered insignificant and this may impact on the objectivity of the audit team in carrying out the audit of Lukanga City Council (LCC).

5. **Audit team accepting free hospitality having obtained allowances:**
   By accepting to lodge at the City Council Lodge, the audit team has not complied with the ethical principle of integrity. This is because the team obtained the necessary allowances for use for boarding and lodging and so the team is not acting in a straight forward and honest manner.

   Public sector auditors are required to adhere to the fundamental principles in the performance of their work.

ii. Suitable safeguards to address ethical matters:

1. **Auditor previously worked for Lukanga City Council (LCC):**
   A different team leader who has not previously worked for Lukanga City Council (LCC) should be assigned to lead the audit team.

2. **Professional competences of the audit assistants:**
   The selection of the audit team should have included audit assistants who have experience and competences in public sector auditing rather than use all newly recruited assistants with no work experience.

3. **Lodging at the City Council lodge:**
   The team should have declined the offer for free board and lodging at the council guest house. This has an impact on their objectivity.

4. **Audit team accepting hospitality:**
   The audit team should not have accepted free board and lodging when they obtained full allowances meant for lodge and boarding. They should be straightforward and honest and should have disclosed this to the City management.

d) **Request by the President for an audit of Lukanga City Council (LCC):**
One of the general principles of public sector auditors is that the public sector auditor should be independent of the entities that will be audited. This includes the fact that the auditor should be free to decide on the subject matters to be audited without any influence of others.

In this case the audit of the LCC was not on the program of the OAG. It should be noted that the president is at liberty to request the OAG to carry out audits on subjects as he may determine. The fact that he has requested for the audit of LCC does not amount to interfering with the independence of the OAG.

Had the president asked the OAG to disregard its own program that would have amounted to interference and not in line with the principles of public sector auditing.

e) i. **Meaning of the risk of material misstatement:**
Misstatements in the financial statements are considered material if they will impact on the decision making of the users of financial statements.

The objective of the audit of the financial statements of Lukanga City Council (LCC) is to obtain reasonable assurance that the financial statements are not materially misstated.
Material misstatements may be caused by two factors as follows:

- Inherent risks that may exist in the client company as well the financial statements assertions and
- Poor internal controls in the client organizations which may fail to detect and prevent fraud and error.

The risk of material misstatements is on the financial statements before the auditors perform the audit.

ii. **Importance of assessing risk at the planning stage of the audit of LCC:**

- To enable the auditors to identify risky areas early before the audit so that they can respond appropriately.
- To enable the auditors concentrate their efforts on areas with the highest risk.

- Identification of risk areas will help in the assigning of audit work to staff with the necessary skills. For example more experienced staff will be assigned to the risky areas.

Matters that need to gain an understanding on:

- The public sector auditors need to gain an understanding on the operations of the Lukanga City Council (LCC)
- The corporate governance structures of the Council
- The internal controls that exist within the City Council.
- Identify the risks that exist in the operations of City Council.

SOLUTION TWO

a) Parliament conferring responsibilities to the executive and other general agencies:

The government collects taxes from the people. Parliament appropriates funds to ministries and other government agencies. The funds appropriated are contained in the annual budgets presented by the Minister of Finance.

By appropriating funds to ministries and other government agencies, what parliament is doing is conferring the responsibility on the proper use of those funds onto the government. This means that the ones entrusted with the use of public funds are accountable to parliament for use of those funds.

Those entrusted with the use of public funds are required to maintain financial records which will be evidence of how public funds have been spent and it is this information that is subject to audit by the SAI. The spending agencies are accountable to the people through the Public Accounts Committee (PAC) of parliament.

At the same time, parliament confers responsibility to the Auditor General (AG) to give an independent view of how those entrusted with the use of public funds have fulfilled their role of being stewards. On behalf of the Public Accounts Committee (PAC) the AG performs financial, performance and compliance audits and report their findings to the President and the Public Accounts Committee (PAC).

b) Benefits of OAG belonging to INTOSAI:

- The OAG will benefit from the technical expertise that the INTOSAI possesses which is for the benefit of member countries.
- The OAG can adopt the good practices of INTOSAI regarding transparency and accountability over the use of public funds.
- It is a forum where member countries can share experiences with regards to accountability in the use of public funds.
- The OAG will benefit through training arrangements spearheaded by the INTOSAI and will learn of new risks in the public sector.
-

c) Provisions of the constitution/legislation-independence of the OAG:

i. **Accessibility of information and documents:**
The Public Finance Act provides that the OAG should have access to all documents and records that that it requires to carry out audits.

No restrictions to accessing information and documents shall be made to requests by the OAG.

ii. **Reporting:**
The constitution provides that the AG shall have the right to report on its finds annually to the President and the national assembly.

Further, the AG has the right to make public its findings and publish its report for public scrutiny.

iii. **Financial & administrative autonomy:**
The OAG is funded by government and operates independently of line ministries and other departments.

The Public Audit Act provides that funds to the OAG will consist of whatever money will be appropriated by parliament.

The constitution provides that the OAG shall not be subject to control or direction of another person or entity. This provision gives it the autonomy that is needed for it to perform audits independently and objectively.

d) Modified opinion in public sector audit:
This is a form of opinion that is issued by the public sector auditor after a financial audit for which a reasonable assurance is required.

ISSAI 1705 together with the Practice Note gives guidance in this area and contains three forms of modifications of the opinion that the public sector auditor may issue as follows:

Qualified opinion
Adverse opinion and
Disclaimer of opinion.

The opinion that the auditor will give depends on the materiality of the matter of concern and the pervasiveness to the financial statements.

Unmodified opinion in public sector audits:
ISSAI 1700 and the relevant Practice Note gives guidance on the unmodified opinion.

An unmodified opinion is given by the public sector auditor when he has no matter of concern and the financial statements have been prepared in accordance with the applicable financial reporting framework.

In this case the public sector auditor concludes that the financial statement show a true and fair view.

SOLUTION THREE

a) i. Meaning of sufficient appropriate evidence:

Sufficient evidence concerns the quantity of evidence that the public sector auditor is required to obtain.

It is a matter of professional judgment for the public sector auditor to determine the level at which evidence will be considered sufficient.

Appropriateness of evidence relates to the relevance and quality of the evidence obtained by the public sector auditor. The evidence should be of the quality that is relevant considering the audit objective.

ii. The current audit file:

This is a file that contains all the work that has been performed by the public sector auditor for the year under review.

The current file contains:

- Draft financial statements for the year under audit.
- Details of the work that has been performed in each audit area.
- The audit plan stating how the audit objective will be met by the public sector auditor.
- Conclusions reached in each area that has been audited.
- Review points that have been made arising from the review of work that has been carried out.

The permanent audit file:

The permanent audit file contains information of a long term nature and that will be relevant over a number of years.

The permanent file will contain:

- The memorandum and articles of association where relevant.
- The chart of accounts.
- Details of the nature of the audited entity.
- Organizational structure of the audited entity.
- The letter of engagement detailing the scope of work to be carried out.
- Copies of documents such as lease documents.

b) i. Meaning of external confirmations:

External confirmations are part of the evidence that the auditor obtains during the audit. This forms part of third party evidence which is considered to be more reliable than the evidence from within the entity.

Examples of when external confirmations can be used:

1. Confirming bank balances held by the client company.
2. Confirming receivables balances at the year end.
3. Confirming payables balances
4. Confirming assets held by third parties.
5. Confirmation of title deeds held by the bank as security for a loan.

ii. Management letter:

A management letter is a letter written by the auditor at the end of a financial audit.

During the course of the audit the auditor comes across weaknesses in internal controls and lack thereof. The management letter is used to communicate these weaknesses to the client management.

The management letter will usually contain details of the weaknesses observed, the implication of the weakness and recommendations by the auditor.

iii. Meaning of written representations:

Written representations are a form of evidence that is obtained by the auditor.
This happens when the auditor wishes to collaborate other evidence and wishes management to confirm the auditor's understanding and this evidence becomes part of the working papers.

ISSAI 1580 gives guidance to the auditor on written representation and the standard specifies the following for which the auditor should obtain written representations:

- Management's acknowledgement that it is responsible for the preparation of the financial statements.
- Management acknowledgement that it is responsible for putting in place internal controls in the entity.
- Confirmation that management has given the auditors all the information that they require.

SOLUTION FOUR

a) **The difference between Public Accounts Committee (PAC) and the Audit Committee:**

Public Accounts Committee (PAC):

The Public Accounts Committee (PAC) is a committee of parliament comprising members of parliament whose role is provide oversight on the government and government agencies on how they spend public funds.

The Public Accounts Committee (PAC) receives reports from the OAG and holds those responsible for the public purse accountable for their decisions on how they use these funds.

Being part of parliament which is the people's representatives, the PAC acts on behalf of the general citizenry.
The PAC holds those entrusted with the use of public funds in all government ministries and agencies accountable on how they have used the funds.

The Audit Committee:

This is a committee of the board or government agency which is part of the controls put in place by management.
The main duty of the Audit Committee is to advise the main board or the entity on the financial statements and also the effectiveness or lack of effectiveness of the internal controls.

The jurisdiction of Audit Committees is restricted to the organizations or entities that they belong to. As such most ministries and government agencies have Audit Committees under them.

b) **How the PAC fulfills its mandate:**

The Public Accounts Committee (PAC) is responsible for providing oversight on how public funds are spent by government and other government agencies.

This is how this mandate is carried out:

- Parliament confers responsibility on government and other government agencies to spend public funds in the best interest of the citizenry
- Government and other agencies collect revenue and spends funds in accordance with the budget. The responsible parties prepare financial information detailing how they have fulfilled their role as stewards.
- Parliament confers authority to the Office of the Auditor General OAG), an independent body, to perform independent audits on the financial information prepared by the responsible party.
- The OAG evaluate the evidence gathered during the audit and issues a report which is submitted to parliament.
- PAC then arranges hearings at which controlling officers of the spending agencies appear before it. PAC then decides in further action that should be taken against those found wanting and if there is need to prosecute they refer the matter to investigative wings of government.

c) Composition of the Audit Committee:

The Audit Committee of the Ministry of Gender has as its main objective to oversee compliance with laws and regulations in the management of public funds in the ministry.

The importance of having a balance in membership between employees of the ministry and others is as follows:

- Since the role of the Audit Committee involves oversight on the management of public funds in the Ministry, there is need for objectivity. Those members of the committee who do not work for the ministry will bring to bear their independence.
- The members who are not employees will not be easily intimidated in performing their task.
- The employees of the Ministry of Gender who are also members of the Audit Committee will be in a position to answer concerns that the rest of the committee may have.
- The committee members who do not work for the Ministry of Gender may bring with them experiences from their work places which may benefit the ministry.

d) Duties of proposed Audit Committee of the Ministry of Gender:

- To review the financial information of the Ministry on behalf of the management of the ministry.
- To monitor and ensure adherence by staff in the Ministries' code of ethics.
- To monitor the control activities of the Ministry ensuring that suitable internal controls are in place and updated as necessary.
- To review financial and procedures manual of the Ministry.
- To carry out risk assessment if no separate Risk Committee is in place.

SOLUTION FIVE

a) i. Need to discuss findings with auditees:

- The public sector auditor will avoid any misunderstanding between them and the audited entity.
- The principles of public sector auditing require that the public sector auditor should maintain communication with the audited entity. This is from the start of the audit at the planning stage, during the audit and at the end of the audit.
- The communication helps the public sector auditor to confirm his understanding of specific matters and it may just be that the auditor had a wrong understanding of a particular matter.

ii. Benefits of documenting work performed by public sector auditors:

- Documentation is the evidence of the work that has been performed by the public sector auditor.
- Documentation of the audit work can facilitate quality control reviews to be carried out and also independent evaluations of the SAI which may be carried out by external evaluators.
- The opinion or conclusion of the public sector auditors is based on the work that has been documented.
- Documentation of the work carried out by the auditor facilitates coordination and review of the work that has been carried out.
- In the case of litigation the documented working papers may be used as evidence of the work that was carried out.

b) i. **Performance audits** in the public sector are carried out with the objective of establishing how a responsible party has fulfilled its responsibilities in spending public funds to ensure that there is value for money.

Performance audits consider the three E's namely economy, efficiency and effectiveness in the use of public funds.

The public sector auditor will consider the following in a performance audit:

Economy relates to the cost of the activity considering whether the best price has been paid for the activity.

In the case in the question, the public sector auditors will wish to establish whether the price paid for the purchase of the vehicle was the best price.

Efficiency This relates to the input into a process to the output with a view to ensure maximum output from a given input.

In reviewing for efficiency, consideration will be given to the relationship of the output to the input of resources. The audit question will be to determine whether the output achieved could have been achieved using less resources.

In this case, the total number of girls immunized is 1.8million. In testing for efficiency the question that needs to be answered is whether the 1.8million girls could have been immunized at a lower cost. This could be based on experience elsewhere where a similar program has been undertaken with the same amount of resources.

Effectiveness refers to the objective of the process and establishing whether the intended objectives have been met.

This is achieved by comparing the desired outcome with the actual output from the program. The outcome is related to the desired objective of the program. In this case, the desired outcome was to immunize 2 million girls out of whom only 1.8 million have been immunized. Clearly the program has not met its objectives and the report will clearly state this.

ii. **Compliance audits** are audits carried out by the public sector auditor with a view to establish whether the responsible party has complied with a given criteria which may be laws, regulations or standards.

In the case at hand, the following will be considered in establishing whether there has been compliance:

- The expenditure is supposed to be in line with the approved budget. The public sector auditor will obtain evidence to confirm expenditure is within approved budget.
- The allowances paid to staff participating in the program should be within the approved current rates.
  The public sector auditor will gather evidence that allowances were paid per guidelines.
- There are financial regulations which are required to be followed and the public sector auditor will gather evidence that financial regulations have been adhered to.

END OF SUGGESTED SOLUTIONS

PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

PFM6: FINANCIAL REPORTING FRAMEWORK FOR PUBLIC SECTOR ENTITIES

MONDAY, 9 DECEMBER2019

TOTAL MARKS – 100; TIME ALLOWED: THREE (3) HOURS

INSTRUCTIONS TO CANDIDATES

1. You have fifteen (15) minutes reading time. Use it to study the examination paper carefully so that you understand what to do in each question.

2. This paper is divided into TWO sections:
   Section A: One (1) Compulsory question.
   Section B: There are four (4) questions. Attempt any three (3) questions.

3. Enter your student number and your National Registration Card number on the front of the answer booklet. Your name must **NOT** appear anywhere on your answer booklet.

4. Do **NOT** write in pencil (except for graphs and diagrams).

5. **Cell Phones** are **NOT** allowed in the Examination Room.

6. The marks shown against the requirement(s) for each question should be taken as an indication of the expected length and depth of the answer.

7. All workings must be done in the answer booklet.

8. Present legible and tidy work.

9. Graph paper (if required) is provided at the end of the answer booklet.

DO NOT OPEN THIS QUESTION PAPER UNTIL YOU ARE INSTRUCTED BY THE INVIGILATOR.

SECTION A

This is a compulsory question and must be attempted.

QUESTION ONE

In the financial year ended 31 December 20X6, Chingo Municipality raised ZMW2,500 in local rates and taxes, and received ZMW3,000 from central government. The council also raked in ZMW500 in other miscellaneous revenue and received ZMW300 as its share of revenue from an Associate. Revenue from exchange transactions amounted to ZMW1,250, fines, ZMW120, fees ZMW240 and licenses ZMW250.

The council incurred ZMW1,100 on social housing, ZMW950 on adult social care, ZMW600 on public order and safety, ZMW300 on Culture and environment and ZMW250 on health. After an assessment of the carrying value of property, plant and equipment, an impairment provision of property was estimated at ZMW130.The total wages and salaries paid was ZMW1,900. Finance costs were ZMW250 and its share of expenses related to an Associate amounted to ZMW300.Miscellaneous expenses were ZMW100.

All these amounts are in '000's.

Required:

(a) Present the above information using function of expense method in line with IPSAS 1. (15 marks)

(b) Discuss the considerations to determine whether function of expense method or the nature of expense choice of method for presentation should be used. (5 marks)

(c) Distinguish between exchange and non-exchange transactions in public sector accounting and give three (3) examples of parties involved in non-exchange transactions. (10 marks)

(d) Explain the Authority and scope of International Public Sector Accounting Standards. (5 marks)

(e) Contrast the going concern considerations for public and private sector entities. (5 marks)

[Total: 40 Marks]

SECTION B

Attempt any THREE (3) questions in this section.

<u>QUESTION TWO</u>

Kasempa District Council is scheduled to hold their council meeting after three years of not preparing the financial accounts. The discussions will be focused on the 2017 financial results.

Below are the financial results of Kasempa District Council.

Statement of Comprehensive Revenues and Expenditure for the Year ended 31 December 2017

	2016		**2017**	
	K'000	**K'000**	**K'000**	**K'000**
Revenue	Actual	Budget	Actual	Budget
Rates	17,700	17,900	15,260	17,700
Subsidies	2,300	1,600	1,500	2,300
Development & Financial Contribution	570	560	100	570
Fees and Charges	4,400	4,000	2,900	5,600
Interest on Revenue	760	700	540	640
Other Revenue	5,500	4,000	4,600	5,300
Total Revenue	**31,230**	**28,760**	**24,900**	**32,110**
Expenses				
Personnel Costs	4,500	4,400	4,300	4,800
Depreciation and Amortisation Expenses	4,300	4,100	3,000	4,700
Finance Costs	2,300	2,400	2,200	2,400
Other Expenses	16,100	14,900	17,900	16,200
Total Expenses	**27,200**	**25,800**	**27,400**	**28,100**
Surplus/Deficit	**4,030**	**2,960**	**(2,500)**	**4,010**

Statement of Financial Position as at 31 December 2017

	2016	**2017**
Assets	**K'000**	**K'000**

Current Assets:		
Cash and Cash Equivalents	900	1,000
Receivables	4,500	4,300
Prepayments	21	20
Inventory	1,100	1,090
Other Financial Assets	5,100	4,400
Total Current Assets	**11,621**	**10,810**
Non-Current Assets:		
Property, Plant and Equipment	200,000	223,800
Intangible Assets	280	530
Investment Property	8,090	8,090
Total Non-Current Assets	**208,370**	**232,420**
Total Assets	**219,991**	**243,230**
Liabilities		
Current Liabilities		
Payables and deferred revenue	3,190	3,800
Borrowings and other financial liabilities	8,800	3,200
Employee Benefits	580	450
Provisions	470	460
Total Current Liabilities	**13,040**	**7,910**
Non -Current Liabilities		
Payables and deferred revenue	600	650
Loan	24,400	25,400
Employee Benefits	290	280
Provisions	2,400	3,180
Deferred Tax Liabilities	0	0
Total Non – Current Liabilities	**27,690**	**29,510**
Total Liabilities	**40,730**	**37,420**
Net Assets	**179,261**	**205,810**
Equity		
Accumulated Funds	159,270	154,300
Reserves	19,991	51,510
Total Equity	**179,261**	**205,810**

Required:

(a) Calculation of the following ratios:

(i) Receivable days (2 marks)
(ii) Gearing Ratio (2 marks)
(ii) Non- Current Asset Turnover (2 marks)
(iii) Current Ratio (2 marks)

(b) Advise the management at Kasempa District council on the Advantages and Disadvantages of assessing the performance of the council using ratios. (12 marks)

[Total: 20 Marks]

QUESTION THREE

In today's global economy, standards such as IPSAS 4 *The Effects of Changes in Foreign Exchange Rates* are essential in accounting for public sector transactions that would normally be accounted for under IAS 21 if they were done in private sector entities. You are requested to answer the following using your public sector accounting knowledge:

(a) Define each of the terms according to relevant IPSAS: Asset, liability, Presentation currency, Functional currency. (8 marks)

(b) Explain the rates at which the following are translated: 1. Assets 2. Liabilities 3. Revenues 4. Expenses (8 marks)

(c) Explain the rates that are supposed to be used for each of the following under the fair value model: 1. non-monetary items. 2. Monetary items (4 marks)

[Total: 20 Marks]

QUESTION FOUR

Great Hope District Council of Country A was declared a district a year ago and has been operating without a qualified accountant. The Office of the Auditor General undertook an audit and queried the district for non availability of financial statements.

Your firm has been engaged to assist the district prepare Financial Statements in accordance with International Public Sector Accountants Standards (IPSAs).

Below is an extract of the Trial Balance as at 31 December 2017.

	Debit	**Credit**
	K'000	**K'000**
Property rates		580
Basic rates		300
Special rates		100
Parking fees		70
Marriage and Divorce registration		20
Building permits		510
Penalties		50
Market levy		820
Common fund		1,980
District Development Fund		450
Compensation for employees	100	

Herbalist licence		35
Hawkers licence		25
Other licences		24
Royalties		70
Share of land revenue		750
Other rentals		60
Interest on investments		50
Salaries	2,080	
Wages	500	
Goods and Services	1,950	
Interest expense	400	
Social benefits	200	
Other expenditure	460	
Bank and Cash	389	
Advances and loans	200	
Investments	1,000	
Property, Plant and Equipment	1,500	
Payable		430
Short term loans		520
Deposits		778
Accumulated funds		1,157
	8,779	**8,779**

Additional Information

1. Revenues are classified as follows: Rates, Land revenue, fees and fines, licences, Rent income, investment income and grants
2. The expenditure classification is accordance with approved chart of accounts by the council
3. Depreciation of fixed assets for the year is computed at K100,000.00

Required:

(a) Prepare Statement of Comprehensive Income and Expenditure for the year ended 31 December 2017. (12 marks)

(b) Prepare Statement of Financial Position as at 31 December 2017. (8 marks)

[Total: 20 Marks]

QUESTION FIVE

In 2013, the Zambian government proclaimed that, as part of its public finance Management reforms, IPSAS would be adopted as its reporting framework by 2020.

(a) Explain five major benefits of IPSAS for Zambia's public sector accounting. (10 marks)

(b) With reference to recognition criteria under IPSAS 9 *Revenue From Exchange Transactions* and IPSAS 23 *Revenue From Non-Exchange Transactions*, explain five major sources of revenue into the treasury of the government of the republic of Zambia.

(10 marks)

[Total: 20 Marks]

END OF PAPER

PFM6 MODEL SOLUTIONS

SOLUTION ONE

(a) IPSAS 1 Classification of Expense by Function

Revenue (000's)	20X6
Taxes	2,500
Fees, fines, penalties, and licenses	610
Revenue from exchange transactions	1,250
Transfers from other government entitie	3,000
Other revenue	500
Total revenue	7,860
Expenses	
Public order and safety	600
Culture and environment	300
Health	250
Social protection	950
Housing and community amenities	1,100
wages and salaries	1,900
Other expenses	100
Impairement	120
Finance costs	250
Total expenses	5,570
Operating surplus	2,290
Share of surplus of associates*	300
Surplus for the period	2,590

b) **Discussion of presentation choice of method**

When choosing between the nature of expense and function of expense method, consideration must be made for:

- The entity type
- Historical factors

- Regulatory factors

Each of the methods (nature of expense and function of expense)indicates costs which vary (either directly or indirectly) with the entity's outputs.

Each presentation method has advantages for diverse entity types. IPSAS 1imposesresponsibility on management to choose the most reliable and relevant method. Since nature of expenses data is however valuable in forecasting future cash flows, additional disclosure is mandatory if function of expense is utilised.

c) Exchange and non exchange transactions

i. An exchange or exchange-like transaction is one in which each party receives and sacrifices something of approximate equal value.

   A non-exchange transaction is one in which one party receives something of value without directly giving value in exchange.

   In a non-exchange transaction, a public entity receives value from another party without directly giving approximately equal value in exchange.

   The primary function of governments and other public sector entities is to provide services that enhance or maintain the well-being of citizens and other eligible residents. Those services include, for example, welfare programs and policing, public education, national security and defense services. In most cases, these services are provided as a result of a non-exchange transaction and in a non-competitive environment. These services provided by public sector entities are funded (primarily by taxation revenues or other non exchange transactions).

   Non-exchange transactions may include, but are not limited to:

   a) Taxation
   b) Fines & penalties
   c) Gifts/donations
   d) Certain grants entitlements
   e) Promises to give (pledges)

   An individual or group may have to pay a charge or fee and/or may have had to make specified contributions to access certain services.

Taxation is a legally mandated, compulsory non-exchange transaction between individuals or entities and the government.

Governments and other public sector entities are accountable to resource providers, particularly to those that provide resources through taxes and other compulsory transactions.

Most governments and other public sector entities prepare budgets. The approved budget is often the basis for setting taxation levels, and is part of the process for obtaining legislative approval for spending.

Reporting against budget is commonly the mechanism for demonstrating compliance with legal requirements relating to the public finances.

ii. Service recipients and resource providers will also require information as input for making decisions. The following are examples:

a) Lenders, creditors, donors:

These and others provide resources on a voluntary basis, including exchange transactions. They make decisions about whether to provide resources to support the current and future activities of the government or other public sector entity.

b) Members of the legislature or similar representative body who depend on GPFRs for the information they need, can make or influence decisions about the service delivery objectives of government departments, agencies or programs and the resources allocated to support their achievement; and

c) Taxpayers do not usually provide funds to the government or other public sector entity on a voluntary basis or as a result of an exchange transaction. In addition, in many cases, they do not have the discretion to choose whether or not to accept the services provided by a public sector entity or to choose an alternative service provider. Consequently, they have little direct or immediate capacity to make decisions about whether to provide resources to the government, the resources to be allocated for the provision of services by a particular public sector entity or whether to purchase or consume the services provided.

d) Authority and Scope of IPSAS

a) Generally, the term Public Sector refers to national government, regional government, local governments (e.g. city, town, and municipality) and related government entities (e.g., agencies, boards, commissions and enterprises). In Zambia these would include Electoral Commission of Zambia, Energy Regulation Board, and Zambia Revenue Authority etc.

Each jurisdiction has regulations, which govern the issue of general-purpose financial reports by Public sector entities. These regulations may be in the form of statutory reporting requirements, financial reporting directives and instructions, and/or accounting standards promulgated by governments, regulatory bodies and/or professional accounting bodies in the jurisdiction concerned. In Zambia, both ZICA and the Minister of Finance issue such guidelines.

e) Going concern considerations

Financial statements shall be prepared on a going concern basis unless there is an intention to liquidate the entity or to cease operating, or if there is no realistic alternative but to do so.

When those responsible for the preparation of the financial statements are aware, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, those uncertainties shall be disclosed.

When financial statements are not prepared on a going concern basis, that fact shall be disclosed, together with the basis on which the financial statements are prepared and the reason why the entity is not regarded as a going concern.

In assessing whether the going concern assumption is appropriate, those responsible for the preparation of financial statements take into account all available information about the future, which is at least, but is not limited to, twelve months from the approval of the financial statements.

Assessments of the going concern assumption in the public are not solely predicated on the solvency test usually applied to business enterprises. There may be circumstances where the usual going concern tests of liquidity and solvency appear unfavourable, but other factors suggest that the entity is nonetheless a going concern. For example:

a. In assessing whether a government is a going concern, the power to levy rates or taxes may enable some entities to be considered as a going concern, even though they may operate for extended periods with negative net assets/equity; and
b. For an individual entity, an assessment of its statement of financial position at the reporting date may suggest that the going concern assumption is not appropriate. However, there may be multi-year funding agreements or other arrangements in place that will ensure the continued operation of the entity.
c. current and expected performance,
d. potential and announced restructuring of organizational units,
e. estimates of revenue or the likelihood of continued government funding, and

f. potential sources of replacement financing before it is appropriate to conclude that the going concern assumption is appropriate

The determination of whether the going concern assumption is appropriate is primarily relevant for individual entities rather than for a government as a whole.

Examples:

a. In assessing whether a government is a going concern, the power to levy rates or taxes may enable some entities to be considered as a going concern, even though they may operate for extended periods with negative net assets/equity; and
b. For an individual entity, an assessment of its statement of financial position at the reporting date may suggest that the going concern assumption is not appropriate. However, there may be multi-year funding agreements or other arrangements in place that will ensure the continued operation of the entity. E.g. ZESCO and Zambia Railways Euro bond liabilities

SOLUTION TWO

(a) Report for the council meeting:

		2016	**2017**
i. Receivable Days			
	Receivables/Revenue x 365	4,500/31,230 X 365	4,300/24,900 X 365
		52.6 days	**63 days**
ii. Gearing Ratio			
Loan/ Equity + Loan		24,400/179,261+24,400	25,400/205,810+25,400
		12%	**11%**
iii. Non- Current Asset Turnover			
	Revenue/Non Current Assets	31,230/208,370	24,900/232,420
		0.14	**0.10**
iv. Current Ratio			
	Current Assets/Current Liabilities	11,621/13,040	10,810/7,910
		0.89	**1.36**

(b)	Advise the management at Kasempa District council on the Advantages and Disadvantages of assessing the performance of the council using ratios.
	Advantages: i. Communicate aspects of an entity's overall economic situation more broadly and succinctly than financial data alone ii. Facilitate understanding on how certain variables may influence each other help determine a variety of financial aspects. **Disadvantages:** i. Distort comparisons by over – reliance on book values rather than market values ii. Involve comparative norms which are statistically unreliable due to bias and / or

	small sample iii. Costly to track over time, especially when norms change iv. Difficult to obtain for use in public sector auditing

SOLUTION THREE

IPSAS 4 Effects of Foreign Currency translations

a) (i) An asset is a resource presently controlled by an entity as a result of a past event.

(ii) A liability is a present obligation of the entity for an outflow of resources that results from a past event.

(iii) A presentation currency is the currency in which financial statements are presented.

(iv) Functional currency is the currency of the primary economic environment in which the entity operates.

b) Assets and Liabilities: translated at the exchange rate of the reporting date; while Revenues and expenses; translated at exchange rates at the dates of the transactions.

c) (1) Where non-monetary items are measured under the fair value model they should be recorded at the exchange rate prevailing at the date of the latest revaluation to fair value.

(2) Monetary items resulting from past transactions should be translated at the closing exchange rate at each reporting date.

SOLUTION FOUR

WORKINGS

WK 1:

Rates	**ZMK**
Basic Rates	300
Property Rate	580
Special Rates	100
Total	**980**

WK 2:

Land Revenue	
Royalties	70
Share of Land	750
Total	**820**

WK 3:

Fees and Fines	
Parking fees	70
Marriage and Divorce	20
Building Permit	510
Penalties	50
Market Levy	820
Total	**1,470**

WK 4:

Licenses

Herbalist	35
Hawkers	25
Others	24
Total	**84**

WK 5:

Rental Income

Other Income	60

WK 6:

Investment Income

Interest on Income	50

WK 7:

Grants

Common Fund	1,980
District Development Fund	450
Total	**2,430**

WK 8:

Compensation of Employees

Compensation	100

STATEMENT OF COMPREHENSIVE INCOME AND EXPENDITURE AS AT 31ST DECEMBER 2017		
REVENUES:		
ZMK		
Rates (WK1)		980
Land Revenue (WK2)		820
Fees and Fines (WK3)		1,470
Licenses (WK4)		84
Rentals (WK5)		60
Investment Income (WK6)		50
Grants (WK7)		2,430
Total Revenue		**5,894**
Expenditure		
Compensation (WK8)	100	
Goods and Services	1,950	
Depreciation	100	
Salaries	2,080	
Wages	500	
Interest expense	400	
Social benefits	200	
Other Expenditure	460	
Total Expenditure		**5,790**
Surplus/(Deficit)		**104**

STATEMENT OF FINANCIAL POSITION AS AT 31ST DECEMBER 2017		
NON-CURRENT ASSETS:		
Property, Plant and Equipment (1,500-100)		1,400
CURRENT ASSETS		
Bank and Cash	389	
Advances and Loans	200	
Investments	1,000	1,589
Total		**2,989**
Liabilities		
Payables	430	
Loans	520	
Deposits	778	1,728
Equity		
Accumulated Fund	1,157	
Surplus	104	1,261
Total		**2,989**

SOLUTION FIVE

(a) Benefits of IPSAS

Area	Benefit
1. International recognition	IPSASs are the international financial reporting standards for public sector
2. Accrual basis	Many IPSAS are developed on an accruals basis
3. Applicability	The standards are designed for Public Sector entities other than Government Business Enterprises (which should use IFRS), i.e. IPSASs are for non-commercial organizations
4. Public sector specific standards	Standards include sector specific standards where transactions are specific to the public sector – Disclosure of Information about the GGS (Financial Statistics) – Revenues from Non-Exchange Transactions (Transfers and Taxes) – Presentation of Budget Information – Service Concession Arrangements: Grantor
5. Transaction Neutral Approach	If the transaction is the same in private and public sector, the accounting should be the same – Substantial convergence of all relevant IFRS at December 31,2009 with IFRSs at December 31, 2008
Total maximum (Other valid answers can also score marks)	

(b) Sources of revenue into the Zambia treasury

Exchange transactions are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.

Non-exchange transactions are transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.

Revenue source	IPSAS & recognition
1. Tax	Compulsory financial contribution imposed by government on

	its citizens in order to raise revenue. Examples include: Income tax, Sales tax, Property transfer tax etc
2. Toll gate fees	Payments made by motorists for usage of a section of a road.
3. Land rates	Payments made to government (usually local councils) for the property they own. Rates are calculated on the land valuation of a property.
4. Court fees	Court costs are the costs of handling a court case.
5. Grants	Governments can also receive donations from other governments and donor agencies