



PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

PFM 1: PUBLIC SECTOR ACCOUNTING

MONDAY 22 JUNE 2020

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 (2) 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

The summarised information below relates to a government spending agency and was compiled over a period of three years:

Draft Statement of financial performance

Revenue	2018 Kb'	2017 Kb'	2016 Kb'
Tax revenue	1,500	2,200	900
Non-Tax Revenue	1,800	800	700
Other Income	100	300	250
Total revenue	3,400	3,300	1,850
Less Expenditure	(4,000)	(2,000)	(1750)
Surplus/deficit	(600)	1,300	100

The information above was shared in a management meeting and many attendees including the chairperson raised concerns over the inability of the public spending agency to improve on its collections of funds required to finance recurring obligations. As a public sector management accountant, you are expected to explain the numbers above and possibly give insights to the management team on why the spending agency is currently spending more resources compared to what is being collected from the different sources of revenue.

Additional information:

- The figures above strictly adhere to cash accounting system
- 90% of other income is derived from donor aid.
- 80% percent of the expenditure represents payroll costs.

Required:

- Analyse the information above and recommend how performance in the spending agency is to be improved. (8 marks)
- Describe the two (2) main sources of revenue for the public sector and give three examples under each source. (5 marks)
- List the three (3) steps involved in preparing public sector financial reports.(3 marks)
- State and explain five (5) measures which the government can take to improve tax compliance. (10 marks)
- Describe seven (7) principles of financial records management in the public sector. (14 marks)

[Total: 40 Marks]

SECTION B

Answer any Three (3) Questions in this section

QUESTION TWO

Since early 2014, Zambia has been implementing a robust Public Financial Management Reform Program. One of the key component of this reform has been strengthening Integrated Financial Management Information System (IFMIS) and Cash Management through Treasury Single Account (TSA). The component's aim is to enhance financial management systems and standards in order to promote good corporate governance practices in the public service. With this in mind;

- (a) What do you understand by Treasury Single Account? (3 marks)
- (b) Identify the five (5) major benefits of TSA for Zambia's public sector accounting. (5 marks)
- (c) State five (5) key considerations to make while adopting TSA in Zambia. (5 marks)
- (d) Bring out three (3) key challenges that have contributed to the slow pace with which TSA is being adopted in Zambia. (3 marks)
- (e) Briefly explain four (4) ways in which the challenges identified in part (d) can be addressed. (4 marks)

[Total: 20 Marks]

QUESTION THREE

A conceptual framework in the context of financial reporting is a statement of generally accepted reporting principles which form the frame of reference for financial reporting. The International Public Sector Accounting Standards Board (IPSASB) has developed a conceptual Framework for General Purpose Financial Reporting (GPFR) by Public Sector Entities (the Conceptual Framework) which includes qualitative characteristics of financial information.

Required:

- (a) Briefly explain the five (5) main advantages of a conceptual framework. (5 marks)
- (b) Identify and briefly explain the five (5) qualitative characteristics of useful financial information. (10 marks)
- (c) Identify the key constraints on information included in General Purpose Financial Reports. (5 marks)

[Total: 20 Marks]

QUESTION FOUR

Transitioning from cash accounting to accruals accounting systems comes with significant costs. Many public sector financial officers argue that it is difficult to see how the benefits of accruals surpass those of cash accounting.

Required:

- (a) Define cash accounting and explain five (5) advantages of cash accounting. (12 marks)
- (b) Distinguish accruals from modified cash basis of accounting. (4 marks)
- (c) Describe the two (2) types of expenditure in public sector. (4 marks)

[Total: 20 Marks]

QUESTION FIVE

Mabvuto Nyau a trainee accountant at a named public institution wishes to appreciate how public sector accounting differs from private sector accounting. He feels the two sectors should adopt one accounting system for accountability purposes.

Required:

- (a) Explain three (3) differences between public and private sector accounting. (6 marks)
- (b) Explain the five (5) elements of financial statements in the public sector. (10 marks)
- (c) List four (4) core functions of treasury management (4 marks)

[Total: 20 Marks]

END OF PAPER

SUGGESTED SOLUTIONS

SOLUTION 1

Part (a)

In 2017, the tax revenue increased by 144% but reduced by 32% in 2018. This reduction is indicative of reduced levels of tax compliance. Initiatives which encourage full tax compliance should be adopted including further simplifying the procedures relating to tax payment.

The non-tax revenue has consistently increased (14% in 2017 and 125% in 2018). This increase may imply that government is leveraging on non-tax revenue to cover the deficit which resulted from a drop in tax revenue in 2018.

Other income which mainly consist of donor aid registered a reduction of 67% in 2018 which is far less good than the increase of 20% recorded in 2017. This reduction could reflect adverse concerns from the donor community on how resources have been deployed in the past.

Expenditure has risen by 100% in 2018 compared to only 14% in 2017. This increase could be in part attributed to increased payroll costs of the spending agency. More employees were recruited during the year 2018 and perhaps salaries for civil servants were increased.

Recommendations:

- As tax revenue reduced in 2018, there is need to enhance tax collection going forward. This may be through introduction of wider tax base or enhancing collection methods by using what is known as 'at source' collection.
- Enhance the controls involved in handling donor funds for continued support.
- Employment freeze temporarily may be the option until agency expenditure stabilizes.
- Salary increments to be frozen as well

Part (b)

Tax revenue – revenue raised from the various taxes charged on income and expenditure.

- Examples here include, income arising from pay as earn, sales tax, property transfer tax, corporation tax etc.

Non tax revenue – revenue raised from other sources other than tax.

- Examples here include, fuel levy, ground rent, fines, fees etc.

Part (c)

Steps in preparing public sector reports include:

- Review compliance with the country legal framework
- Adoption of relevant accounting standards and policies

- Developing integrated financial management systems in capturing financial transactions to facilitate financial reporting

Part (d)

Tax revenue collection is improved by:

- Tax awareness: tax sensitisation programs, workshops and adverts should be rolled out whenever a new tax is introduced or a change is made to an existing tax.
- Communicating tax benefits: Tax payers should be made aware of the benefits of tax which includes provision of public goods and services.
- Late payers' penalties: late payments should be penalised by imposing clear communicated penalties. The threat of a penalty fee can greatly deter late payments.
- Tax amnesty: A period should be given to defaulting clients for clearance of outstanding tax obligations. This gesture should encourage late payers to clean their book.
- Tax audits and inspections: surprise visits and regular inspections should be conducted in order to discourage possible under declaration of income.
- Equal treatment of all tax clients: All tax payers should be given equal treatment regardless of income size. The same rules should apply to all defaulters regardless of social status in society

Part (e)

Record keeping principles include:

- Managing records is mutual task of accounts, audit and records personnel
- Financial records are to be managed throughout their life until the point of ultimate disposition
- Records identified should relate to the relevant financial function
- The stored records should be easy to retrieve when need arises
- Records should not be accessible by all and sundry. Only authorised staff should have access to records
- Deliberate controls should be implemented over structure, content, location and flow of records.
- Records and record systems should be subject to audit and review
- Records should be retained until the expiry date of legally imposed custodial period which may fall in between five to ten years.

SOLUTION TWO

(a) TSA

Unified structure of government bank accounts that gives a consolidated view of government cash position. **Objectives:** Ensure aggregation control over all government cash balances; Minimize transaction costs; Facilitate reconciliation between banking and accounting data; Efficient control and maintenance of funds.

(b) Benefits of implementing TSA.

oversight and efficient management and control over all Government cash resources; consolidations of cash position; minimize transaction costs & reduce idle balances; facilitates reconciliation between banking and accounting data; facilitates provision of real-time financial information from the bank and any financial management system; Improves appropriation control and operational control; Enables efficient cash management; Reduces bank fees and transaction costs; Facilitates efficient payment mechanisms; Improves quality of fiscal data.

(c) Five (5) key considerations to make while adopting TSA in Zambia

Some of the considerations to make while adopting TSA include:

- i) Stakeholder engagement- to gain buy in;
- ii) Structural and legal transformation; Transformation and change management;
- iii) Skills capacity; Cost;
- iv) Technology and infrastructure;
- v) Implementation approach- Phased or big bang;
- vi) External support- private sector, donors, professional firms; If these considerations are not well factored, they become challenges.

(d) Five (5) key challenges that have contributed to the slow pace with which TSA is being adopted in Zambia.

- Vested interest by Banks;
- lack of political will;
- limited trust in government by donors;
- Capacity;
- Weak internal control environment;
- Change management;
- Stakeholder support and government buy in;
- Legislation;
- Implementation cost and infrastructural challenges.

(e) Four (4) ways in which the challenges identified in part (d) can be addressed

Political will; build Capacity; strengthen weak internal control environment; change management; stakeholder support and government buy in; revise legislation which is inconsistent; improve infrastructural.

SOLUTION THREE

(a) Five advantages of conceptual framework for financial reporting

1. Avoids fire-fighting approach when developing IPSAS.
2. Less Open to criticism of political/external pressure.
3. Some standards may concentrate on statement of financial position; others on statement of profit or loss.
4. Financial statements are more consistent with each other.
5. Has a principle based approach rather than rule based approach.

(b) Five (5) qualitative characteristics of useful financial information.

1. **Understandability** - Taking into account that users have a reasonable knowledge of business and a willingness to study information with reasonable diligence, the financial statements should be prepared in such a way as to be easily understood by such users. This can be enhanced by avoiding use of words that are too technical and use of easy to follow presentations.
2. **Comparability** - Use of accounting methods/measurements should be consistent from one year to another or from one company to another whose results are subject to comparison. Inconsistent methods of accounting for similar transactions will render the financial results incomparable.
3. **Timeliness** - Every time financial statements are to be prepared, they need to be prepared more quickly in good time for their use for specified decisions to be passed.
4. **Verifiability** - Financial statements need to be supported by written or verbal representation for them to be deemed valid and hence useful.
5. **Relevance** – Information is capable of making a difference to users of such information if it has predictive value, confirmatory value or both. For information to be relevant it should be material and provided timely.
6. **Faithful representation** – information must be complete, neutral and free from material error. Substance over form is implied.

(C) Key constraints on information included in General Purpose Financial Reports.

1. Materiality
2. Cost benefit
3. Balance between the qualitative characteristics.

SOLUTION FOUR

Part (a)

Cash Accounting

Cash accounting is a system that recognises revenue and expenses upon reception or payment of cash. This system disregards credit transactions.

Advantages

- Cheap to implement - cash accounting requires simple systems when compared to accruals system and is therefore inexpensive to implement.
- Easy to understand and apply - this is true particularly for non-financial officers who may not appreciate the technical language of the accruals concept.
- Easy to audit - Cash receipt and payments are easy to validate for both internal and external audit purposes.
- Objective – cash accounting eliminates to a greater extent the element subjectivity in accounting.
- Promotes budgetary discipline – public sector institution discourages the practice of spending cash on items outside the budget. If it is not in the budget, then do not spend cash on it.

Part (b)

- The accruals concept states that transactions should be recognised regardless of whether cash changes hands or not. Credit and cash transactions are to be given the same recognition. If an organisation buys goods on credit, an expense should be recognised in the books of accounts before payment is made.
- A modified cash basis of accounting on the other hand is an intermediate basis between cash accounting and accruals basis. It captures all financial assets and liabilities and the flows relating to such assets and liabilities. This accounting basis is one step away from moving to the full accruals' basis of accounting.

Part (c)

The two types of expenditure in the public sector

Direct expenditure - This is expenditure which is charged to a specific head as approved parliament and reflected in the estimates of revenue and expenditure a given financial year. This expenditure includes personal emoluments, grants and capital expenditure.

Recoverable advances - generally refer to advances which cannot be charged or traced to any direct expenditure code or allocation. Such expenditure may include loans, advances and imprest. These advanced are repayable to government over a given period of time.

SOLUTION FIVE

Part (a)

Differences between public and private sector Institutions:

Public sector	Public sector
- Exists to provide a service	- Exists to make profits for owners
- Fiscal accountability is a legal requirement	- Fiscal accountability is mainly done to enhance profits
- Accountable to the tax payers	- Accountable to shareholders (owners as appropriate)
- Mainly employs receipts and expenditure accounting	- Uses accruals accounting in most cases
- Funded through taxes, fees and government	- Financed by business owners and debt providers
-	-

Part (b)

The five Qualitative characteristics of public sector information include:

Asset	Present resources controlled by a public sector entity.
Liability	Present obligation of a public sector entity whose settlement will result in the outflow of economic benefits
Income	Increase in economic benefits during an accounting period.
Expenses	Decrease in economic benefits during an accounting period
Accumulated fund	The difference between the total assets and total liabilities of a public sector entity

Part (c)

Four core functions of treasury management include:

- Cash management
- Financial asset management
- Debt management
- Accounting and reporting
- Revenue collection
- Account management
- Central bank and commercial bank relations

END OF SOLUTIONS



PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

PFM 2: LEGAL ASPECTS OF PUBLIC SECTOR FINANCE AND ADMINISTRATION

FRIDAY 26 JUNE 2020

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

INSTRUCTIONS TO CANDIDATES

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SECTION A

This question is compulsory and must be attempted.

QUESTION ONE (Compulsory)

Scenario

Analyse the following scenario and answer the questions that follow.

Mr. Chikankata, the proprietor of Millenium Bus Station located in the centre of Lusaka, has ordered the City Council Police to enforce a recently enacted by-law against street vending and interference of political cadres in the running of markets and bus stations in the city. But the Minister of Local Government uses his Ministerial powers to overrule Mr. Chikankata, arguing that the by-law was an inferior instrument to the Local Government Act, and that Mr. Chikankata lacked the legal standing to instruct council police, and had acted ultra vires. Mr. Chikankata storms into the office of the Minister demanding an apology, and to stop the Minister from mixing politics with council matters which was the concern of everybody. Both parties have approached you as a student of Administrative Law.

Required:

- (a) Explain to Mr. Chikankata the meaning of Administrative law. (4 marks)
- (b) With reference to the above scenario, explain to Mr. Chikankata if Administrative Law is applicable to them and if this is a matter suitable for Judicial Review. (8 marks)
- (c) State any two (2) Administrative Agencies and their functions (2 marks)
- (d) Explain the following sources of Administrative Law
 - (i) Constitution (5 marks)
 - (ii) Acts of parliament (5 marks)
 - (iii) Statutory Instruments (5 marks)
 - (iv) By-laws (5 marks)
- (e) Explain what separation of powers is. (6 marks)

[Total: 40 Marks]

Section B

Answer any Three (3) questions in this section

QUESTION TWO

- (a) Explain the functions of law in society. (8 marks)
- (b) With the aid of an example, explain an administrative agency (6 marks)
- (c) Discuss the term Referendum in relation to the Zambian legal system (6 marks)

[Total: 20 Marks]

QUESTION THREE

- (a) Define judicial Review. (2 marks)
- (b) By citing examples, explain the elements a person seeking leave for judicial review needs to satisfy the court with for it to be granted. (15 marks)
- (c) Identify the three (3) functions of law in society. (3 marks)

[Total: 20 Marks]

QUESTION FOUR

- (a) Identify the three (3) organs of government and explain their functions in the governance of a country. (18 marks)
- (b) Identify any three (3) remedies granted under Judicial Review. (2 marks)

[Total: 20 Marks]

QUESTION FIVE

- (a) What were the achievements of the Chona Commission and the Mvunga Commission in the constitution making process of Zambia? (10 marks)
- (b) What is meant by adopting a constitution by either a referendum or a constituent assembly? (10 marks)

[Total: 20 Marks]

END OF PAPE

SUGGESTED SOLUTIONS

SOLUTION ONE

(a)

i. Public law which concerns itself with the establishment and regulation of administrative agencies that perform quasi-judicial functions or public functions.

It is also a branch of public law governing the exercise of powers and duties by public authorities.

(b)

Mr. Chikankata is a private citizen and has no authority over council police. Yes, the Minister is in order to overrule him. It can be argued that applying Administrative law helps to demonstrate that the issue of street vending and cadres is public and can be solved by administrative law if either the mayor or the Town clerk issued the order, and if they are reluctant to do so, Mr. Chikankata may apply for leave to commence proceedings under Judicial Review, to compel the public body to perform its functions.

[8 marks]

(c)

Two administrative agencies and their functions:

- Zambia Revenue Authority –assessing, charging and levying revenue due to government.
- Public Procurement Authority – procurements on behalf of government.
- Road Transport and Safety Agency (RTSA) –road safety

(d) i. Constitution – Supreme Law

A constitution is a set of rules or fundamental principles of a nation. This is the most fundamental source of law. The Zambian Constitution is Chapter 1 of the Laws of Zambia.

'This Constitution is the supreme law of the Republic of Zambia and any other written law, customary law and customary practice that is inconsistent with its provisions is void to the extent of the inconsistency.' The Constitution sets out the structure and powers of government. It indicates people's rights and duties in relation to the State. The supremacy of the Constitution has been pronounced upon by the Zambian judiciary in a number of cases.

ii. Acts of Parliament – regulate public bodies

The second source of law in Zambia is Acts of Parliament that are enacted by the Legislature by the powers vested in it by the Constitution. Note that the constitution is legislation but for purposes of hierarchy, it stands alone then followed by other legislation. Thus, legislation is superior to case law in that Parliament can overrule or modify case law that has been developed in the Courts. However, judges have to interpret legislation and they may find a meaning in it that those who promoted the legislation did not intend.

iii. Statutory Instruments—lesser laws to re-inforce statutes

The complexity of modern legislation means that, in many instances, there is a great deal of detail which cannot be included in the Act of Parliament. Therefore, much legislation in Zambia expressly gives powers to a Minister or public body, such as a local authority, to make laws for specified purposes. When they exercise these powers they enact laws that are called delegated legislation. Delegated legislation refers to the exercise of a legislative power, granted ultimately by Parliament, through an enabling Act, and the powers may be repealed or withdrawn at any time.

iv. By-laws- laws by local authorities to regulate public functions within locality

When parliament is not sitting, there is need for other entities to make law. Therefore, the constitution expressly gives powers to public bodies such local authorities (Lusaka city Council) to make laws. These powers are conferred by a parent statute and are thus called delegated legislation. The laws made by local authorities do not bind the entire country but only a locality within which they were made.

(e) Montesquieu a French philosopher observed that the liberty of individuals can only be secure if the legislative, executive and judicial functions of government were exercised by distinct and independent organs, namely the Parliament, Judiciary and the Executive. He further said that if these functions were vested in one organ, then the freedom of an individual would be compromised.

Thus, he came up with a theory of separation of powers to address this issue. The rationale of separation of powers is to ensure that each of the three organs uses its powers on the process of governing a country to bring the other in line where the other would act contrary to the powers conferred by the statute or by the constitution. The doctrine is justified by the principle of checks and balances which require that each of the three instruction work too check and keep on balances the powers of the other. Of the three, the judiciary has a bigger role to play in keeping checks and balances than the other two.

SOLUTION TWO

(d) The functions of law can be seen from what law is, that is a tool for social control. Thus, its function is to control society. Law brings about order and peace, and the 2 are importance prerequisites for the realization of man's pursuit for happiness and self-development. Societies without laws, cannot attract investment both locally and from foreign investors. The absence of law for example; to curb crime, corruption and other vices that are detrimental to society would mean a collapse of the social fabric.

An individual citizen is only free to do as helices as long as he does not injure the rights of other citizens and does not disturb the public. The first purpose of law in society, therefore, is for the preservation of life and protection of property. The other purpose is to balance conflicting interests in dispensing justice. The administration of justice becomes possible only through law, because law demands equality for all.

Therefore, law has the following functions:

To do justice

To preserve peace and order

To enforce morality

(e) Administrative agencies are sometimes called administrative bodies which are government bodies created by statute with functions of performing public administrative functions. The aim is to ensure that administrative bodies that work under the executive in order to ensure effective and smooth running of administrative functions of government. An example of tan administrative body is the Zambia revenue authority.

(f) A referendum is a vote where electorates give a yes or no answer to a question. Every citizen eligible to vote in a presidential and parliamentary election is eligible to cast a yes or no vote in a referendum. In the same manner, what transpires at constituent assembly, is akin to what takes place in a referendum. People must make their submission via the review stage and as already stated the submissions are reduced into a report and draft constitution. Therefore, for a referendum to pass, it must carry the county's vote of more than 50% of the voters eligible who would have to vote yes if the draft is to be adopted.

SOLUTION THREE

- a) Judicial Review refers the supervisory powers of the High Court to review administrative functions of public authorities established by Acts of parliament in accordance with the doctrine of Ultra Vires.
- b) A person seeking leave for Judicial Review before the court should satisfy the following grounds:

Locus standi- it is a requirement under the supreme Act 1981 that for a judicial review application to be given leave, the applicant must show sufficient interest in the matter or have locus standi to bring the application. No application for judicial review shall be made unless the leave of the High Court has been obtained in accordance with rules of the court, and the court shall not grant leave to make such an application unless it considers that the applicant has a sufficient interest in the matter to which the application relates. Henceforth, where an applicant cannot show to have sufficient interest in a matter to which the application relates, the court will refuse to grant leave to proceed with the application. In **R. V Inland Revenue Commission Ex parte National Federation of Self-Employed and Small Business Ltd [1982] A.C 617**, some casual workers in fleet street were nominated by their trade unions to work for dockets to enable them draw their pay from their employers but a substantial number of them gave false names and addresses so that it was impossible for the Inland Revenue to collect the tax which was due from them. In view of the fraud the Revenue after discussions with the employers and the unions, introduced a special arrangement which was to ensure that the future tax would be either deducted at source or be properly assessed and subject to certain other conditions, investigation into tax lost in certain previous years would not be carried out. A federation representing the self-employed and small businesses, who contrasted the attitude taken by the Revenue to the tax evasion of the Fleet Street casuals with that adopted by the Revenue in other cases where tax evasions were suspected, applied for judicial review and claimed a declaration that the Inland Revenue acted unlawfully in granting the amnesty and an order of mandamus directed to the Inland Revenue's objection that the federation had no locus standi. It was held that the federation had no sufficient interest.

The body should be amenable to judicial review- the position of which bodies are amenable to judicial review was considered in the case of **Ludwig Sondashi V Godfrey Miyanda as Secretary General of the Movement for Muiltly-party**

Democracy [1995] S.J. 1 (S.C) where the appellant had been expelled from the respondent political party and he sought a judicial review and a declaration that he had been wrongly expelled. The application was dismissed on the ground that the party was not amenable to judicial review as it was a private association, its tribunals were dealing with private not public law.

(c) The following the functions of law in society:

- To do justice
- To preserve peace and order
- To enforce morality

SOLUTION FOUR

a) (i) The Executive and functions

- Execute laws made by the legislature.
- Formulate laws for the approval of the legislature.
- To prepare the budget for the approval of the legislature and determine the rates of taxation and other revenue rising.
- To handle foreign policy and relations.
- The operational command of the military.

(ii) The Judiciary and functions

- Interpret laws which apply to Zambia (Constitution and Statutes).
- Insure impartial justice under the law.
- Provide mechanism for dispute resolution.
- Administration of justice through resolving disputes between individuals or between individuals and the state.

(iii) The Legislature and functions

- Make new laws.
- Amend existing laws.
- Repeal laws
- Approve appointments made by the Executive.
- Approve the budget prepared by the executive.

b) Certiorari, Mandamus, declaration and Injunction

SOLUTION FIVE

- (a) The Mainza Chona Constitutional Review Commission of 1972, opened the way for institutionalization of the One Party State. Many of the public submissions which included the limitation of the presidential term of office were thrown out by the government. A new constitution which abolished multi-partism and declared UNIP as the only recognised party by law was passed in 1973. The new constitution concentrated all executive and legislative powers in the president. The president became the key player in politics. All appointments in the public service and the parastatal companies were made by the president.

After 18 years of One Party rule, the UNIP government was forced by events from within and outside the country to return to multi party politics. Then Dr. Kaunda instituted second Constitutional Review Commission led by Professor Patrick Mphanza Mvunga. The Mvunga Commission led to the promulgation of the 1991 Constitution which reintroduced multi party rule and included the limitation of the presidential term of office to two terms of 5 years each.

- (b) Adoption of a constitution by a Referendum, means voting where the voter gives a "Yes" or a "no" to a question. Only voters who are eligible to vote in Presidential and Parliamentary elections may take part in a Referendum. Every citizen eligible to vote in a presidential and parliamentary election is eligible to cast a yes or no vote in a referendum. It is also vital that before a referendum, takes place, the state must conduct a census to find out the number of people eligible to vote.

A Constituent Assembly represents different interest groups, such as farmers, businessmen, and teachers and so on. This is a demarcation made by the electoral commission of Zambia under the powers conferred on them by the electoral commission Act. The demarcations are for purposes of representation to the national assembly. Thus, it is an assembly of individual not necessary members of parliament but ordinarily individual from constituencies.

END OF SOLUTIONS



PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

PFM 3: GOVERNANCE AND MANAGEMENT IN PUBLIC SECTOR

TUESDAY 23 JUNE 2020

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

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SECTION A

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QUESTION ONE (Compulsory)

The World Bank's work on governance and public sector management

"The measure of successful Public Sector Management (PSM) reforms is no longer simply the introduction of new laws and regulations. The Bank's Public Sector Management approach emphasizes that success is to be found in what the public sector actually does its behavior and the outcomes it produces not its formal legal or organizational structure. Similarly, the Bank's updated Governance and Anti-corruption strategy notes that improvements in the governance environment are assessed by results at the country level with transparency, integrity and probity strengthened throughout government, and by improvements in the responsiveness of Country Assistance Strategies and projects to the distinctive country context through governance diagnostics and risk assessments

To assist governments in their efforts to improve transparency, accountability and service delivery, the Bank's work on governance and public sector management has two main focus areas. It helps strengthen public sector management systems within the executive branch, including the management of public finances and public employment. It also seeks to improve the broader governance environment within which the public sector operates, supporting institutions for public accountability, such as parliaments and offices of the ombudsman, and tracking improvements by measures of the rule of law, state legitimacy and trust in government institutions. Efforts to reduce the risk of corruption are prominent in both of these.

Improving public sector management (PSM) is ultimately about providing firms and households with better services, such as health and education. It's also about managing infrastructure and other public investments which the private sector may be unable to finance or for which the private sector may be unwilling to bear all the risk. In Cameroon, for instance, the introduction of individual performance contracts in the two largest customs offices led to a sharp decrease of port clearance time and a 22 percent increase in revenues in the first quarter of 2011 over the comparable quarter in 2010."

Source: <http://siteresources.worldbank.org/PUBLICSECTORANDGOVERNANCE/Resources/285741-1348676611027/PSGDataSheet.pdf>

Required:

- (a) Define good governance and explain four (4) principles of good governance. (10 marks)
- (b) Identify and discuss some of the World Bank's major concerns on governance and public sector management by most third world countries like Zambia. (20 marks)
- (c) Identify the five (5) bottlenecks that may arise when the government and the private sector do not work in harmony. (10 marks)

[TOTAL: 40 Marks]

SECTION B

Answer Any Three (3) Questions in this section.

QUESTION TWO

Management is responsible for using the organization's resources to meet its goals. Henri Fayol one (1) of the management gurus held that there is a single "administrative science", whose principles can be used in all management situations no matter what kind of organization.

Required:

- (a) Explain any two (2) roles performed by Managers according to Henry Mintzberg and give two (2) examples of each role. (10 marks)
- (b) Outline any five (5) specific Human Resources Management functions. (10 marks)

[Total: 20 Marks]

QUESTION THREE

Public policy is a complex and multifaceted process. It involves interplay of many parties. This includes many businesses, interest groups, and individuals competing and collaborating to influence policymakers to act in a particular way. As a result of the wide variety of influencing factors that tend to pull and push policy in different directions, public policy change often happens slowly.

Required:

- (a) Discuss the five (5) factors that influence Public Policy. (10 marks)
- (b) Outline any five (5) conditions beneficial for effective policy implementation. (10 marks)

[Total: 20 Marks]

QUESTION FOUR

Every contract requires a contract manager who is accountable for the activities under that contract. A contract manager must possess the required skills necessary to be able to manage a given contract to avoid problems. Every contract is a project which must be managed efficiently and effectively from inception to completion.

Required:

- (a) Explain some of the abilities and skills required for an effective contract manager. (10 marks)
- (b) Explain the activities associated with Contract life Cycle. (10 marks)

[Total: 20 Marks]

QUESTION FIVE

The Government has initiated a lot of projects which needs good leadership supervision. Many foreign contractors are of Asian origin Chinese who can hardly speak good English. This has created a challenge to both in the communication with the local contractors. These challenges range from labor recruitment related to contract negotiations.

Required:

- (a) List down five (5) barriers to effective communication and how you can overcome the barriers. (10 marks)
- (b) Identify some of the rules of negotiating. (10 marks)

[Total: 20 Marks]

END OF PAPER

SUGGESTED SOLUTIONS

SOLUTION ONE -COMPULSORY

- (a) Define good governance and explain four (4) principles of good governance

Definition: Governance has more to do with ethics and is evaluated with reference to specific norms and objectives laid down. It is the moral principles required in the functioning of certain segments of the society.

- (i) The principal of meritocracy: is a political and governance philosophy stating that power should be vested in individuals almost exclusively based on ability and talent.
 - (ii) The principal of racial and religious harmony: is a political philosophy stating that there should exist different races and religion should be allowed to core exist if harmony in the governance process.
 - (iii) The principle of clean government; Elements of corruption and other negative vices cannot be part to the definition of good governance.
 - (iv) The principle of the 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 can follow fairly.
 - (v) The principle of inclusiveness; Good governance is embodied in the idea of inclusiveness meaning there should equal or fair participation in the matter of governance by all stakeholders regardless of social and economical status.
 - (vi) The principle of the care of the environment; Environmental governance is a concept in political ecology and environmental policy that advocates sustainability as the supreme consideration for managing all human activities.
- (b) Identify and discuss some of the World Bank’s major concerns on governance and public sector management by most third world countries like Zambia
- (i) **Accountability:** concerns that those who hold power must be accountable. Accountability is responsibility of the government and its agents towards the public resource allocations and management. This must be both internal and external accountability

- (ii) Transparency: this means oppresses by the holder of the public office in the execution of the duties. All the decisions and actions they take, they must give reasons and only restrict information when the public interest demands it. It is the principal of inclusiveness
 - (iii) Corruption: the World Bank is concern on the corruption. This is based on the principal of clean government.
 - (vii) Rule of law and integrity: 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.
- (c) Identify the five bottlenecks that may arise when the government and the private sector do no work in harmony.
- (i) Poor performance of private sector due to lack of guiding policy
 - (ii) Development and implementation of public policy may be frustrated.
 - (iii) Programs may stall due to deadlocks arising from disagreements.
 - (iv) Political influence can derail objectives of collaborations.
 - (v) Lack of adequate budget allocation for such programs.

SOLUTION TWO

- (a) Outline the three (3) roles performed by Managers giving two examples of each role
- (i) interpersonal roles (figurehead, leader, liaison)
 - (ii) Informational roles (monitor, disseminator, spokesperson)
 - (iii) Decisional roles (entrepreneur, disturbance handler, resource allocator, negotiator)

(b) Outline any five (5) specific Human Resources Management functions

- (i) Procurement/acquisition/recruitment;
- (ii) Training and development
- (iii) Compensation
- (iv) Integration
- (v) Maintenance
- (vi) Separation

SOLUTION THREE

- (a) Discuss the five (5) factors that influence Public Policy
- (i) **Public Opinion:** Public opinion and priorities have strong influence on public policy over time. Relevant to sustainable businesses is the increasing public concern about the environment, volatile energy prices and global climate change. This is influencing public policy through electoral politics, citizen rallies, and actions that affect government decision makers.
 - (ii) **Economic conditions:** Economic conditions also significantly affect the policy environment and operating context for businesses.
 - (iii) **Technological change:** Technology advancement often motivated by market and business opportunities also affects public policy. Technology is constantly changing and this affects the business environment directly and also indirectly as public policies change with technological inventions. New, lower-cost, and easier-to-use technologies can increase public support for policies that promote renewable energy and energy efficiency and that reduce environmental damage.
 - (iv) **Interest groups:** Interest groups include business and trade associations, professional organizations, labor unions, environmental advocacy organizations, and cause oriented citizen groups and lobbies. Individuals and businesses also organize into associations and interest groups for other reasons than to try to influence government.
 - (v) **Business associations:** Business efforts to influence public policy and government include not only individual company efforts but also business associations. These associations act collectively to promote public policies in the best interest of business in general and also in the interest of specific industries and localities.
- (b) Outline any five (5) conditions beneficial for effective policy implementation
- (i) The program should be based on a sound theory relating to changes in target group behavior.
 - (ii) Policy decisions have to contain unambiguous policy directives and structure the implementation process in a way that increases the chances of good performance to target groups.

- (iii) The leaders and implementing agencies require significant managerial and political skills and commitment to the goals.
- (iv) The program should be supported by organized constituency groups and few key legislators throughout the process.
- (v) The priority of objectives is not undermined over time by conflicting public policies or changes in socio-economic conditions.

SOLUTION FOUR

- a) Explain some of the abilities and skills required for an effective contract manager
- (i) Financial skills sufficient to be able to understand financial implications of contracts
 - (ii) Change management skills to successfully manage changing relationships and contract modification
 - (iii) Analytical skills to ensure sufficient analysis and reporting of contract progress and judgment regarding escalation of issues
 - (iv) Risk management skills
 - (v) Performance management and legal understanding around contracts skills

(a) Explain the activities associated with Contract life Cycle.

- (i) Planning stage: includes strategic objectives made and converted into approved budgets and operational plans with sufficient details.
- (ii) Creation stage: the stage involves preparing the first draft of the contract documentation
- (iii) Collaboration stage involves drafting and negotiating the process which includes internal and external reviews to ensure legal effect and financial requirements are agreed with stakeholders.
- (iv) Execution stage: this is the act of signing the contract, making it legally enforceable and formalizing the terms of the contract.
- (v) Administration stage: this stage involves administration and monitoring the contract to ensure that all planned objectives and activities are done. And where necessary amendments are done

SOLUTION FIVE

(a) List down five (5) barriers to effective communication and how you can overcome the barriers.

- (i) Semantic problems
- (ii) Status effects
- (iii) Physical direction
- (iv) Information overload
- (v) Time pressures
- (vi) Culture differences
- (vii) Trust levels
- (viii) Selective perception
- (ix) Absence of two-way communication

(b) Identify some of the rules of negotiating

- (i) Prepare
- (ii) Pay attention to timing
- (iii) Leave behind your ego
- (iv) If you don't ask you don't get
- (v) Anticipate compromise
- (vi) Offer and expect commitment
- (vii) Do not absorb their problems
- (viii) Stick to your principles
- (ix) Close with confirmation

END OF SOLUTIONS



PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

PFM 4: PUBLIC SECTOR FINANCIAL MANAGEMENT

FRIDAY 26 JUNE 2020

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 (2) 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 (Compulsory)

Kairos Limited a state owned enterprise is considering whether or not to invest in the development of a new product. This will require acquisition of specialized processing machinery. The total cost of investment in the machinery is expected to be K3bn. The company will use an existing factory to manufacture the product.

The company's managing director Mr. Steven Kera estimates the accounting profits before tax to be K450 million in the first year. The accounting profits before tax are estimated to be 5% of the annual sales. Variable costs are approximately 45% of sales. The machinery will have a disposal value of K50 million at the end of its useful life of five years. Taxation is payable at 35% one year in arrears and capital allowances are estimated at 20% of the cost of the machinery per annum. Annual overhead costs are estimated at 15% of the sales figure. Annual depreciation is approximately 20% of the cost of the machinery. The accounting profits before tax are expected to grow by 6% per annum. If the project is not undertaken, the initial cost of machinery and the existing factory could be used for real estate business. The real estate business is expected to generate net cash flows of K100 million per annum to perpetuity.

Additional information is provided in table 1 and table 2.

Table 1

Year	0	1	2	3	4
Working capital for the project K'm	200	240	280	320	360

Table 2

Details	%
Selling price inflation per annum	5
Overhead expenses inflation per annum	10
Variable cost inflation per annum	10
Working capital inflation per annum	4
Risk free rate of return	2

Kairos Limited has in issue 7% secured bonds with a market value of K28 million. The cost of equity of KP Limited, a company in the same industry as Kairos is estimated to be 8% per annum. The nominal value of Kairos Limited share capital is K45 million. Kairos Limited shares have a nominal value of K10 each and a market value of K15 each. The equity risk premium is 3%.

As the finance director of Kairos you have been requested by the chairperson of the board to provide a thorough financial evaluation of the proposed investment to be presented to the board at its next meeting.

Required:

- (a) Calculate the weighted average cost of capital of Kairos Limited. (4 marks)
- (b) Estimate the Net Present Value (NPV) of the project, and recommend, on the basis of the NPV whether or not the project should be undertaken. (20 marks)
- (c) Discuss why some organizations may not prefer to use the Net Present Value (NPV) method to appraise their investments. (4 marks)
- (d) Describe the capital budgeting process determining whether the expenditure is in Kairos Limited's best interest. (8 marks)

[Total: 40 Marks]

SECTION B

Attempt any THREE (3) questions in this section.

QUESTION TWO

Governments require funds to carry out effectively their operations and provide public goods and services to its population. These funds are appropriated through parliament upon budget approval. The main sources of Government revenue is through taxation and non-tax revenue.

It is critical to have accountants in the public sector so that they account for all financial transactions and activities of the Government. The Government accountant in the public sector is expected to have authority to supervise and control the financial activities of all departments at the macro level. In Zambia, the Public Finance Act of 2004 defines the functions of the accountant.

Required:

- (a) Describe the main characteristic features of tax revenue. (6 marks)
- (b) Identify and explain the major sources of funds to finance the national budget. (8 marks)
- (c) Explain the functions of a public sector accountant in accordance with the Public Finance Act of 2004. (6 marks)

[Total: 25 Marks]

QUESTION THREE

The Government of the Republic of Zambia has contracted a loan for lending to women's clubs who are implementing projects in aquaculture. Funds disbursed to the women's clubs will be used for construction of ponds, marketing of the business and other operating costs. Rockfield women's club is one of the women's clubs that has benefited from the funds and government is in the process of disbursing the funds.

According to the current Planning and Budgeting Act, all government projects should be appraised before funds are disbursed. It is estimated that it will take approximately two years to construct the ponds. Construction of ponds would mean immediate outlay of K2.4 million, Investment of K40 million in fingerlings and equipment in the first year and K30 million for expenditure to operationalize the project in the second year. The women's club will also invest K4 million in marketing in the third year and it is expected to increase to K6 million in the fifth year.

Commercial production is expected to start in year 3. Below are the estimated operation cash flows before tax in the first three (3) years of production.

Year	3	4	5
Revenue	200	300	420
Variable costs	80	100	160
Fixed Costs	40	50	60

The income tax is at 30% and the cost of capital after tax in Zambia is 25%.

Required:

- (a) Role of public finance in development of an economy. (6 marks)
- (b) Evaluate the project using Net Present Value (NPV) approach and recommend whether the investment proposal should be accepted for implementation. (10 marks)
- (c) Explain briefly why Government should appraise projects before they are implemented? (4 marks)

[Total: 20 Marks]

QUESTION FOUR

The Treasury of country Z has been faced with imbalances between the amount of cash in its accounts and the demands to pay current bills and outstanding arrears. This fiscal stress has been caused by contraction of debt and increased wage bill for the public service. The Secretary to the Treasury has been advised by the International Monetary Fund (IMF) team that visited the country to implement the cash management reforms. The Secretary to the Treasury informed senior management team that the treasury has been implementing cash management reforms for the past five (5) years yet there have been no improvements. In addition to cash management reforms, the Treasury has been implementing Output Based Budget (OBB) which has been rolled out to all Ministries, Provinces and Spending Agencies (MPSAs). Senior management at the Ministry of Finance has requested for clarifications as to why the impact of cash management reforms is not being appreciated.

Required:

Explain:

- (a) Cash management and why it is important. (2 marks)
- (b) How cash management differ in high and low income countries. (14 marks)
- (c) Common Cash Management Reforms. (2 marks)
- (d) How cash management reforms be tailored to the needs of low-income countries. (2 marks)

[Total: 20 Marks]

QUESTIONS FIVE

The Secretary to the Treasury nominated you to attend a meeting at the African Union on Public Financial Management (PFM) reforms and risk management in the Public Sector. In the report that was submitted to the Secretary to the Treasury, there was a paragraph that caught the attention of the Secretary to the Treasury that read:

“Despite countries implementing PFM reforms major challenges still remain. Progress made has been very uneven and a number of countries in Africa still suffer from poor management of resources. Lack of co-operation, complete and accurate information about government finances continues to be a major cause of concern and continues to impact on accountability and decision making by decision making policy makers.”

The paragraph also emphasised on the need for Governments to incorporate risk management into the strategic planning process, as a way of managing and reducing the risk to acceptable levels. It clearly pointed out that Government’s risk-taking level (risk appetite) is a cardinal matter for risk assessment, i.e. the level of risks the Government entity is ready to accept before it deems necessary to take response measures. This is because the decision on measures is correlated to the degree of risk the Government entity accepts.

Required:

- (a) Explain to the Secretary to the Treasury, the objective of public financial management reforms and what government can do to accelerate implementation of the reforms. (4 marks)
- (b) Identify the benefits of implementing public financial management reforms for a developing country. (6 marks)
- (c) Describe the process of managing risk in the public sector. (10 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

$$P_0 = \frac{D_0(1 + g)}{(r_e - g)}$$

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

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

Modified Internal Rate of Return

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

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

<i>Periods</i> (n)	<i>Discount rate (r)</i>										
	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

Periods (n)	Discount rate (r)										
	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

SUGGESTED SOLUTION

SOLUTION ONE

a) The role of Government in an economy

- The role of Government in an economy is to provide the legal framework and services needed for the effective operation of the market economy by doing the following:
 - Reallocating Resources
 - Stabilizing the Economy
 - Monetary Policy
 - Fiscal Policy

b) Calculation of the weighted average cost of capital of Kairos Limited

SUGGESTED SOLUTION									
WEIGHTED AVERAGE COST OF CAPITAL									
$Ke = Rf + b(Rm - Rf)$									
$8\% = 2\% + b * 3\%$									
$b = (8 - 2) / 3$									
$b = 6 / 3$									
$b = 2$									
Therefore Ke of Kairos									
$Ke = 2\% + 1.33 * 3\%$									
$ke = 6\%$									
$WACC = Ke * E / (D + E) + kd * D / (D + E)$									
Market value of equity (K45/10)									
67.5									
E + D = 67.5 + 28 = 95.5									
$kd = 7 * (0.65)$									
4.55									
WACC = $6 * (67.5 / 95.5) + 4.55 * (28 / 95.5)$									
4.24 + 1.3									

		3									
5.57		Approx =6%									
c) NPV COMPUTATION											
1)	SALES										
		1	2	3	4	5					
profits 6% growth rate		45 0	477	505. 62	535.9 57	568.11 46					
convert to sales		45 00	477 0	5056 .2	5359. 57	5681.1 46					
Effect of inflation		47 25	525 9	5853 .2	6514. 59	7250.7 42					
2)	OPERATING COSTS										
	Variable costs 45%	202 5	214 7	2275 .3	2411. 81	2556.5 16					
	Overheads 15%	675	715. 5	758. 43	803.9 36	852.17 19					
	TOTAL	270 0	286 2	3033 .7	3215. 74	3408.6 88					
Effect of inflation		297 0	346 3	4037 .9	4708. 17	5489.7 26					
3)	Investment in WC	249. 6	302. 8	360	421						
		49.6	53.2	57.1	61.2						
4)	Capital Allowances										
	year						tax saved	Timin g			
	0	cost			3000						
	1	capital allowances			600	210					
		income tax value			2400						
	2	capital allowances			600	210	210				
		income tax value			1800						
	3	capital allowances			600	210	210				
		income tax value			1200						
	4	capital allowances			600	210	210				
		income tax value			600						
		disposal			50						
	5	balancing allowance			550	192.5	210				

NPV COMPUTATION		0	1	2	3	4	5	6	
		km	km	km	Km	Km	km	Km	
Sales			4725	5258.9 25	5853. 18	651 4.59	7250.7 4		
operating costs			2970	3463.0 2	4037. 88	470 8.17	5489.7 3		
Contribution			1755	1795.9 05	1815. 3	180 6.42	1761.0 2		
Tax @ 35% cost of equipment				614.25	628.5 67	635. 356	632.24 8	616.356	
working capital			- 3000				50		
tax savings									
net cash flow			- 3200	1705. 4	1338.4 07	1339. 63	131 9.88	1809.7 7	808.856
Discount factor @ 6%			1	0.943	0.89	0.84	0.79 2	0.747	0.705
Present Values			- 3200	1608. 19	1191.1 82	1125. 29	104 5.34	1351.9	570.243
								3692.14	
Less the opportunity cost	100/0.06							1666.67	
Net Present Value								2025	

d) **Preference for the use of the NPV method to appraise their investments**

1) One reason for the failure of many businesses to use NPV is that its (sometimes long term) nature may conflict with judgments on a business that are concerned with its (short term) profits. Managers' remuneration may depend upon the level of annual profits, and they may thus be unwilling to risk large initial expenditure on a project that only offers good returns in the significantly uncertain long term.

2) The NPV method is based on the assumption that businesses seek to maximize the wealth of their shareholders. This may conflict with the interests of other stakeholders such as directors whose interest may be to increase their allowances and bonuses. Also public sector organizations will be concerned with social opportunity costs or social time preference rate methods. These are not necessarily based on seeking to understand whether a project will provide a return relative to the cost of financing. The social time preference method looks at the value that society places on current rather than future consumption.

3) Even when maximization of shareholder wealth is the key objective, there may be factors that help maximize wealth, but cannot be quantified for NPV purposes, for example investment in a loss making project for strategic reasons such as obtaining an initial share in an important market.

e) **Capital budgeting process of determining whether the expenditure is in Kairos Limited's best interest**

Capital budgeting is the process of determining whether a big expenditure is in Kairos Limited's best interest

Here are the basics of capital budgeting and how it works.

Capital Budgeting Basics

Kairos Limited should plan to undertake capital budgeting in order to make the best decisions about utilizing its limited capital. The acquisition of specialized processing machinery it is considering, the issue of capital budgeting will be essential. It will help Kairos Limited decide if the proposed project or investment is actually worth it in the long run.

Identify Potential Opportunities

The first step in the capital budgeting process is to identify the opportunities that you have. Many times, there is more than one available path that your Kairos Limited could take. It has to identify which projects it want to investigate further. If Kairos Limited overlook a viable option, it could end up costing you quite a bit of money in the long term.

Evaluate Opportunities

Once Kairos Limited have identified the reasonable opportunities, it need to determine which ones are the best. Look at them in relation to your overall business strategy and mission. See which opportunities are actually realistic at the present time and which ones should be put off for later.

Cash Flow

Kairos Limited should determine how much cash flow it would take to acquisition of specialized processing machinery. It will also need to estimate how much cash would be brought in by the acquisition of specialized processing machinery. This process is truly one of estimating--it takes a bit of guesswork. It need to try to be as realistic in this process.

Select Projects

After Kairos Limited has look at all of the possible projects, it is time to choose the right project mix. It has to evaluate all of the different projects separately on their own merits. It needs to come up with the right combination of projects that will work immediately. Choose only the projects that mesh with your Kairos Limited goals.

Implementation

Once the decisions have been made, it is time to implement the projects. Implementation is not really a budgeting issue, but you will have to oversee everything to be sure it is done correctly. After the project gets started, you will need to review everything to make sure the finances still make sense.

Solution Two:

a) The main characteristic features of tax revenue

A fund raised through the various taxes is referred to as tax revenue. Taxes are compulsory contributions imposed by the government on its citizens to meet its general expenses incurred for the common good, without any corresponding benefits to the tax payer. The essence of a tax, as distinguished from other charges by government, is the absence of a direct quid pro quo between the tax payer and the public authority.

A tax is a compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all, without reference to specific benefits conferred.

- a) A tax is a compulsory payment to be paid by the citizens who are liable to pay it. Hence, refusal to pay a tax is a punishable offence.
- b) There is no direct, quid pro quo between the tax-payers and the public authority. In other words, the tax payer cannot claim reciprocal benefits against the taxes paid. However, as Seligman points out, the state has to do something for the community as a whole for what the tax payers have contributed in the form of taxes.
- c) "But this reciprocal obligation on the part of the government is not towards the individual as such, but towards the individual as part of a greater whole."
- d) A tax is levied to meet public spending incurred by the government in the general interest of the nation. It is a payment for an indirect service to be made by the government to the community as a whole.
- e) A tax is payable regularly and periodically as determined by the taxing authority.

Taxes constitute a significant part of public revenue in modern public finance. Taxes have macro-economic effects. Taxation can affect the size and mode of consumption, pattern of production and distribution of income and wealth.

Progressive taxes can help in reducing inequalities of income and wealth by lowering the high income group's disposable income. By disposable income is meant the income left in the hands of the tax payer for disbursement after tax payment. Taxes imply a forced saving in a developing economy. Thus, taxes constitute an important source of development finance.

b) There are various sources of funds to finance the national budget and these include:

- Revenues from both tax and non-tax sources
- Borrowing from both domestic and foreign sources.
- Withdraws from available cash balances

The role of an accountant in the public sector in accordance with the Public Finance Act of 2004 include the following:

- Ensure that systems of financial management and internal control established for a government institution are implemented.
- Responsible for the effective, efficient, economic and transparent use of financial and other resources within that officer's area of responsibility
- Take effective and appropriate steps to prevent within that officer's area of responsibility, any unauthorized, irregular and wasteful expenditure.
- Manage and safeguard the assets of the republic and management of the liabilities within that officer's responsibility
- Collect, receipt, bank public funds in the accounting officer's custody.
- Issue or pay public money's whether such money's are the property of the Republic or are entrusted to the Republic or to the accounting officer in the officer's capacity either alone or jointly with any other officer or person.
- In performing the duties the accounting officer's shall ensure that they use prescribed financial management information systems.
- Compilation and submission of the monthly, quarterly, biannual and annual, financial management reports. The accountant is supported by officers of various branches of the departments in the execution of these functions.

SOLUTION THREE

a) The role of public finance in development of an economy

- The main role of public finance is to ensure economic and financial stability in an economy. Economic stability is the absence of excessive fluctuations in the economy, whereas financial stability can be achieved by efficient allocation of resources by appropriate policy making.
- Public finance ensures optimum utilization of scarce and limited resources by adopting suitable monetary policies.
- It is an effective tool to tackle unemployment, i.e. the government sets up fiscal policies which increase employment opportunities.
- It helps to reduce economic imbalances on account of unequal distribution of income and wealth among the public. For example, the government imposes heavy income taxes on higher income groups and uses the tax to provide subsidized food and cheap housing to lower income groups.
- Public finance involves raising funds from the public. Furthermore, such investment in such funds are sometimes linked to tax benefits for general public. This in turn helps in increasing the income and savings of an economy, thereby helping in its development.

b) Evaluate the project using Net Present Value (NPV) approach and recommend whether the investment proposal should be accepted for implementation

Year	0	1	2	3	4	5
K' million						
Construction of Ponds	(2.4)					
Fingerlings and Equipment		(40)				
Operationalization Costs			(30)			
Marketing				(4)		(5)
Operating Cashflows:						
Revenue				200	300	420
Variable Costs				(80)	(100)	(160)
Fixed Costs				(40)	(50)	(60)
Taxable operating Income				60	150	200
Tax @30%				(18)	(45)	(60)
After tax Net Operating Income				42	105	140
Net Cashflows	(2.4)	(40)	(30)	38	105	135
DCF @25	1	0.800	0.640	0.512	0.410	0.328
PV	(2.4)	(32)	(19.2)	19.45	43.05	44.28

NPV = 52.08

Comment:

Positive NPV suggests that the business is viable. Therefore government should proceed to finance the project.

c) **Why Government should appraise projects before they are implemented?**

- Assist government in defining problems and finding solutions that offer best value for money and satisfy public accountability.
- Systematic process for examining alternatives of resources, focusing on assessment needs , objectives , options , costs, benefits , risks , funding , affordability and other factors relevant to decisions.
- A way of thinking through public expenditure , right from emergence of the need for policy, programme or project , until its implementation.

SOLUTION FOUR

Explain:

a) Cash Management and Why it is important

- Cash management refers to the processes involved in efficiently transferring money from those who collect it to those who spend it – in order to pay creditors, suppliers, service delivery units, public sector workers and others.
- It is important because it is a tool Governments uses to manage their financial activities to deal with timing gap of revenues and expenditure.

b) How cash management differ in high and low income countries

The following are the characteristics of cash management in high income countries:

- The adopted budget is credible and provides a reasonably accurate forecast of what will be received as revenue and what will be paid as expenditure over the year, although there will still be differences in timing.
- There is typically a strong political commitment to delivering the budget as approved by parliament.
- There are well-established systems of budgetary controls to manage commitments and payments.
- Ministries are held accountable for staying within their budgets, and systems are often sufficiently developed so that the responsibility for periodic authorization of spending is delegated to line ministries. This makes the ability to make payments when and where required is taken as a given.
- Deep domestic debt markets and a liquid money market mean that if there is a shortfall in revenues on any given day the government can borrow to finance this gap.
- Sophisticated banking systems mean that payments can be made electronically through country-wide branches of the central bank (as in France) or the commercial banking network (as in the UK).
- Vendors and employees almost always have bank accounts, so only a few payments are made in cash. Tax and other receipts also flow rapidly through the banking system into government accounts.
- The focus of cash management in these countries tends to be on minimizing the net interest costs paid by the government. This is achieved by trying to

keep the balances in government accounts as close to zero as possible.

- When revenues are higher than expenditures, the balances are invested to earn interest or used to pay down other debts (which thereby lowers the total amount of interest that needs to be paid).
- When expenditures are higher than revenues, the government will issue securities or borrow in the money markets to make up the difference.
- There are two common features in the ways that advanced countries try to minimise interest payments. One is that cash balances are pooled in a 'treasury single account', even if expenditures are managed by line ministries. A TSA typically allows cash managers to automatically use surpluses in one part of government to cover shortfalls in another and therefore reduce the need to borrow overall. Through arrangements for linking and sweeping sub-accounts, the government targets a zero or near-zero balance on all accounts at the end of the day.
- The other common feature is that cash managers are able to forecast cash flows into and out of the TSA, looking weeks or months ahead, in order to identify when and how much the government should borrow. Using this information, the government is able to engage actively with debt markets by providing information in advance on the planned auctions of different types of debt. This will involve a mix of longer-term securities (e.g. treasury bonds) and shorter-term securities (e.g. treasury bills), although treasury managers often retain some flexibility.
- The following are the characteristics of cash management in low income countries:
 - The structure of economies in low-income countries means that revenues tend to be more erratic. Countries may be reliant upon donor funding to finance large proportions of the budget and this funding is often uncertain. This makes the gap between revenues and expenditures in any given week, month or year large and unpredictable.
 - Donors may also require separate bank accounts or other arrangements to handle their funds, which can have the effect of making this money less fungible across government accounts. Institutional weaknesses and issues of political economy often contribute to failings in the upstream PFM processes around planning and budgeting.
 - These failings might include perennial over-optimistic revenue forecasts during budget formulation to justify higher expenditure plans. If the forecasted revenue then fails to materialise, this creates pressure to identify savings when executing the budget.
 - The budget department may come under pressure to 'find money' for powerful spending entities over and above initial budget allocations.
 - Systems for controlling spending by line ministries may also be ineffective: for example, ministries may enter into commitments without having been given

prior authorisation to spend.

- The institutional architecture necessary for modern systems of cash and debt management may also be absent in low-income countries. Governments in such countries typically cannot rely on a developed banking sector and deep money markets to access finance as and when it is needed.
- These political, economic and institutional weaknesses contribute to the following two key differences in the way cash management operates in low-income countries as compared to high-income countries: The processes by which cash is managed tend to be less efficient and Cash limits are commonly used as a way to control spending.

c) Common Cash Management Reforms:

- Management of government bank accounts to minimize 'idle balances' . This is done by consolidating bank accounts and adopting TSAs.
- Improving cash-flow forecasting and planning Effective cash-flow forecasts are a critical requirement for more efficient cash management. Accurately forecasting cash inflows and outflows allows governments to go a step further and actively target a specific balance (or at least a range) in the TSA. This allows the government to minimize its overall borrowing and at the same time ensure there is enough cash available when payments fall due each day.

d) How cash management reforms be tailored to the needs of low-income countries.

- Be realistic about whether a full TSA can be implemented in the country context. At a technical level, electronic payment and banking systems may not be sufficiently developed to allow transactions to be made on a daily basis, or may cover only a proportion of expenditures. At an administrative level it is also not uncommon to see reform efforts stall after early progress because ministries do not want to give up control over their accounts. This may be a particular challenge in ministries that generate their own fee income. Keeping certain accounts separate can also serve political interests by reserving some funds outside of public scrutiny.
- Good cash-flow forecasts require effective coordination across a range of players. A common recommendation for strengthening cash-flow forecasting in low-income countries is to form a 'cash management committee' supported by a 'cash management unit' in the treasury department. The committee might

comprise senior officials from the finance ministry and the central bank and major government departments responsible for warrants, revenue, payments, debt and financial markets (many of whom may be in the finance ministry). In many low-income countries the challenge for the finance ministry is to use its coordinative and regulatory powers to facilitate effective coordination among the wider policy network.

SOLUTION FIVE

- a) Explain to the Secretary to the Treasury, the objective of public financial management reforms and what government can do to accelerate implementation of the reforms.
- b) Identify the benefits of implementing public financial management reforms for a developing country.

a) Objective of public financial management reforms

- To ensure that aggregate levels of revenue collection and public spending are consistent with targets for the fiscal balance, and do not generate unsustainable levels of public borrowing.
- To ensure that public resources are allocated in accordance with agreed strategic priorities.
- To ensure maximum value for money in the delivery of services
- To avoid leakages and wastage in the use of resources through defined checks and balances.
- To ensure compliance with processes by being transparent, with information and ensuring that information is publicly accessible to all stakeholders

What government can do to accelerate the reforms

- Prioritize reforms to match capacity,
- Increase capacity in order to allow more to be achieved. A desire for capacity enhancement can come from within government, perhaps motivated by the prospect of additional donor funds, or from external actors.

b) Identify the benefits of implementing public financial management reforms for a developing country

- Helps achieve development objectives and reduce poverty.
- Helps funds to be managed and spent efficiently and with integrity and helps give stakeholders confidence.
- Help in raising of revenue effectively, planning and execution of the budget decision reliably and to build trust for donors and investors

c) Describe the process of managing risk in the public sector?

• Risk identification

Risks must be mapped to actual processes and activities, as generalisations on risks will lead to analyses for their own sake. The identification of risks can be aided by answering questions like: What kind of process error can impede the achievement of goals? Which are the factors that need to be present and appropriately applied in

order for the process to be completed properly? Does the process inherently include any criteria that may result in financial or other losses? Specifying the root causes of risks (risk sources) can help in identifying risks.

- **Risk analysis**

In every case, the general purpose of risk analysis is to identify the risks to achieving goals, and to assess them in the interest of specifying responses (measures). During risk analysis, the probability of occurrence and potential impact of various risks is estimated, and any factors that may influence the risks are listed. There are essentially two kinds of methodology used for this. Qualitative analysis, which determines risk severity levels, can be broadly used primarily in the case of risks that cannot be quantified, but it is less exact and also includes subjective elements. The resolution of the quantitative analysis of specific quantifiable risks is much finer and has a mathematical background.

- **Risk assessment**

Risk matrices comprise the most widespread method of risk assessment, and serve to determine the significance of risks and their order of priority. The matrix is a two-variable "weighting" procedure, where one variable is the extent of impact, and the other is the probability of the risk occurring. Risk values are most often expressed in textual form (low, medium, high). Using a risk matrix reflects the practice-oriented approach of analysis, but it has the drawback of taking only two factors into consideration. Materiality level can be determined once the resulting risk values are known, and it serves as the baseline for identifying the relevant (material) risks of the various processes/activities, as well as for the ranking of processes by risk.

- **Responses**

Planning decisions on response measures can be facilitated by questions like: "What measures are there to ensure that such process errors or deficiencies will occur less frequently?" and "Are these actions suitable for reducing risks to an acceptable level?" Risk assessment also sees the determining of whether or not appropriate protection (control) is available, how efficiently it functions in the interest of preventing and reducing risks (assigning controls to risks), as well as the kind and amount of resources any possible measures will require. In the case of public sector institutions, the efficiency of control points that can be identified in the processes and that of their operation, i.e. the "coverage of risks" is one of the key issues.

- **Monitoring**

Responses for managing risks are suitable if their implementation actually results in the reduction of risks, and the more efficient and budget friendly achievement of objectives. This is why the implementation of actions and their effects must be tracked continuously with particular attention, and reviewed as necessary. Risk management will only achieve its goal if it does not only appear in the organisation's operation as a required element of the internal control system that must be implemented as a rule, but as an organic part and an active tool of management.

END OF THE SOLUTIONS



PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

PFM 5: PUBLIC SECTOR AUDITS

THURSDAY 25 JUNE 2020

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 (2) 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

The Office of the Auditor General (OAG) is the Supreme Audit Institution (SAI) in Zambia and is headed by the Auditor General. The Office of the Auditor General is an independent body and is not under the responsibility of any government Ministry. The Auditor General is responsible to the appointing authority who is the President and Parliament.

The National Insurance Company (NIC) is a wholly owned government company that was established five (5) years ago. The mandate of NIC is to administer a pension fund of public service workers in the country as well as sell insurance services to the public. The pension fund industry is highly regulated in order to protect the funds of pensioners. NIC has an integrated information technology system which is used for the preparation of financial statements in addition to maintaining a data base of all pensioners. The organization has an internal audit department as part of the controls established by management of the National Insurance Company.

The year-end of National Insurance Company is 30 April 2017. The draft financial statements have just been prepared and include material figures of K230 million with respect to properties owned by the company. The company carries out actuarial valuations every three years in order to ensure that it has sufficient assets to meet the future pension requirements. An actuarial valuation has been carried out in the current year.

The Office of the Auditor General (OAG) plans to carry out a financial audit of the financial statements of NIC. This will be the first time that the company will be subject to an audit by the Office of the Auditor General. You have been assigned to lead a team of auditors to carry out the financial audit of NIC. Your Director has asked you to draft an engagement letter which should be signed and delivered to the management of NIC before the commencement of the audit.

Your office does not have the skills required to perform an audit on the actuarial valuation that has been conducted in the year under review. Your Director has suggested that you consider the possibility of engaging an auditor expert to do this on behalf of the Office of the Auditor General.

Your Director has asked you to call a pre-audit meeting with all the team members who have been assigned on this audit. He has requested you to emphasize the need to obtain sufficient appropriate audit evidence. This can only be achieved if all audit procedures conducted are aimed at testing the financial statement assertion in the figures contained in the financial statements.

You intend to take a risk audit approach in this audit and you plan to carry out a risk assessment in accordance with ISSAI 1315 *Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment*. The standard requires that auditors should gain an understanding of matters relating to audit clients.

Required:

- (a) Explain why the Office of the Auditor General (OAG) is not a department of any government ministry. (4 marks)
- (b) Explain the need for an engagement letter in a public sector audit and state the situations when an engagement letter may be revised. (4 marks)
- (c) Discuss the responsibilities of management of National Insurance Company (NIC) and the Office of the Auditor General (OAG) with regards compliance with relevant laws and regulations. (6 marks)
- (d) Explain six (6) matters that your audit team should gain an understanding of in the audit of the NIC. (9 marks)
- (e) Explain who an auditor expert is and explain the issues that you will consider in selecting an auditor expert. (8 marks)
- (f) Explain the connection between financial statement assertions and the audit procedures conducted by the public sector auditor. (2 marks)
- (g) Explain using the figure for properties, the assertions of Valuation, Existence and Rights and obligations and suggest suitable two (2) audit procedures. (7 marks)

[Total: 40 Marks]

SECTION B

Attempt any THREE (3) questions in this section.

QUESTION TWO

You have been assigned to carry out a financial audit for the year ended 31 December 2017 of a water utility company in one (1) of the provinces of Zambia. The utility company is fully computerized with an integrated computer system which handles all operations including the financial aspects.

The finance department of the water utility company is headed by a Chief Accountant with a complement of supervisors enabling segregation of duties to be in place. There are documented financial regulations which contain internal controls in existence.

During the planning stage of the audit, it was agreed that tests of controls should be undertaken for the first half of the year during the interim audit. At the final audit, the rest of the tests of controls will be undertaken together with substantive tests.

You have been provided with draft financial statement for the year just ended. (SAI 1720 *The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements*) gives guidance on opening balances and it is your intention to carry out relevant tests on the opening balances during the interim audit.

You will use Computer Assisted Audit Techniques (CAATs) for the first time in the audit of the financial statements of the water utility company.

Required:

- (a) Explain the meaning of Computer Assisted Audit Techniques (CAATs) and explain the benefits to the SAI of using CAATs. (6 marks)
- (b) Explain the use of tests of control and substantive tests in the audit of the financial statements of the water utility company. (6 marks)
- (c) Explain the meaning and significance of opening balances in the financial statements of the water utility company. (4 marks)
- (d) State the audit procedures that you will undertake in the audit of the opening balances for the year ended 31 December 2017. (4 marks)

[Total: 20 Marks]

QUESTION THREE

- (a) Governments world over manage public funds on behalf of their citizens. The risk of public funds being misapplied is much higher in the public sector than in the private sector.

In an effort to ensure accountability in the use of public funds, the International Organization of Supreme Audit Institutions (INTOSAI) was established. This organization comprises Supreme Audit Institutions (SAIs) of various countries.

The INTOSAI issued the following ethical values that Supreme Audit Institutions (SAIs) and their staff should follow to enable them perform public sector audits efficiently:

1. Integrity
2. Objectivity
3. Professional competence and due care
4. Confidentiality and
5. Professional behavior.

Required:

Explain how each of the five (5) ethical values issued by INTOSAI apply in the public sector audits. (10 marks)

- (b) Game Conservation Ltd is a publicly owned entity whose mandate to protect wildlife in a game management area. The funding to Game Conservation Ltd is from international conservation non-governmental organization based in the United States of America.

You have been assigned to conduct the audit of Game Conservation Ltd for the year ended 31 June 2020. During the planning stage of the audit you conclude that there are significant accounting estimates made by the Management of Game Conservation Ltd in determining some figures contained in the financial statements.

You are concerned about the reliability of the evidence obtained in relation to the accounting estimates. Your Audit Manager has advised you that you need to be alert all the way until the conclusion of the audit in the following year. He has stated that you should look out for subsequent events that take place between the period end and the date of signing the audit report.

During the period after signing the audit report and the date of issue of the financial statements, there was determination in the high court of a matter that had not been concluded at the period end. Management gave written representations supporting an estimate of the outcome of the case which was much less than the amount determined by the courts.

Required:

- (i) Explain the meaning of accounting estimates and why they are considered a risky area for the auditor. (4 marks)
- (ii) Explain the meaning of subsequent events in the audit of financial statements. (2 marks)
- (iii) Describe the responsibilities of the auditor with regard to:
 - (a) Events that take place between the period end and the date of the auditor's report. (2 marks)
 - (b) The determination by the High court of the case outstanding at the period end during the period between the signing of the audit report and the issue of the financial statements. (2 marks)

[Total: 20 Marks]

QUESTION FOUR

- (a) The Office of the Auditor General (OAG). It is mandated to conduct audits of the expenditure of public institutions in order to ensure accountability of funds.

Required:

List, giving one (1) example each, five (5) types of organizations that are subject to audit by the Office of the Auditor General. (5 marks)

- (b) The audit of the financial statements of Telecommunication Plc. is almost complete. You have just completed the review of the working papers and have concluded that an unmodified audit opinion would not be appropriate under the circumstances.

There are matters of concern arising from audit and it is your view that a modified opinion would be appropriate. The form of modification of the opinion depends on two matters namely the materiality of the matter of concern and the pervasiveness of the matter to the financial statements.

You have identified a matter that could be reported in the Emphasis of Matter (EOM).

ISSAI 1705 *Modifications to the Opinion in the Independent Auditor's Report* and the relevant Practice Note gives guidance in terms of the forms of modification of the audit opinion.

Required:

- (i) Explain the meaning and use of the Emphasis of Matter (EoM) paragraph in the audit report. (5 marks)
- (ii) Explain the three (3) forms of modifications of the auditor's opinion. (6 marks)

- (iii) List the basic elements in an unmodified audit report.

(4 marks)

[Total: 20 Marks]

QUESTION FIVE

The Ministry of Health is responsible for the provision of health services of the people. Among other responsibilities, the Ministry of Health is responsible for the procurement and distribution of drugs countrywide.

The Ministry has a Finance Directorate under the supervision of the Director of Finance. Within the Finance Directorate falls the internal audit department. The operations of the finance directorate are guided by the general financial guidelines issued by the Ministry of Finance.

You are a Senior Auditor in the Office of the Auditor General. Your supervisor has tipped you that there is a suspected fraud in the Ministry of Health.

The Ministry received donor funding amounting to \$1.5 million for immunization against polio for children below the age of six (6). There is an agreement between the Ministry and the donor agency which stipulates how the funds should be spent and controlled. The target for immunization is to immunize a total of 2 million children countrywide. The suspected fraud involves misapplication and theft of the program funds.

Arising from the information from a whistle blower, you have been assigned to lead of team of auditors to conduct compliance and performance audits. A different team of experts from the Office of the Auditor General (OAG) has also been assigned to carry out a forensic investigation.

Required:

- (a) Distinguish between the roles of the Public Sector Auditor from the Office of the Auditor General (OAG) and those of the Internal Auditor in the Ministry of Health. (6 marks)
- (b) Explain the difference between a forensic investigation and a financial audit in public sector audits. (6 marks)
- (c) Define a compliance audit and explain its objectives in public sector auditing. (4 marks)
- (d) Define a performance audit and explain its objectives in public sector auditing. (4 marks)

(4 marks)

[Total: 20 Marks]

END OF PAPER

SUGGESTED SOLUTIONS

SOLUTION ONE

a) **Reasons why the Office Auditor General (OAG) is autonomous and independent of government ministries:**

The Office of the Auditor General is autonomous and independent of the government line ministries.

This autonomy is necessary for the following reasons:

- The Office of the Auditor General is mandated to give an objective opinion on how government and public sector entities spent public funds.
- If the OAG was made part of any ministry, then it would lack independence and its objectivity would also be compromised.
- Autonomy means that the officers of the OAG cannot be intimidated by the ministries and other agencies as they are not responsible to them.
- By being accountable to the president and parliament, ministries and other government agencies know the importance of using public resources prudently in line with laws and regulations and that deviations will be reported to the president and legislature through the Auditor General's reports.

b) **Need for an engagement letter in public sector engagements:**

In the case of public sector audits, the objectives, scope, responsibilities of the parties and the form of report are all set out in laws and regulations or the audit mandate.

An engagement letter sets out the objective of the assignment and the responsibilities of the parties to the engagement. The issuance of an engagement letter will reduce the chance of disputes arising between the entity being audited and the Office of the Auditor General.

Situations when the engagement letter may be revised:

- When there is a disagreement between the OAG and the entity subject to the audit.
- When the scope of the engagement changes from that originally agreed upon.
- When there is a change in management of the audited entity.

c) **Responsibilities for compliance with laws and regulations:**

ISSAI 1250 *Consideration of Laws and Regulations in an Audit of Financial Statements* gives guidance in relation to responsibilities.

Management of National Insurance Company (NIC) is responsible for ensuring that the organization conduct its operations in line with applicable laws and regulations.

They are responsible for putting in place necessary controls to ensure that this is achieved. Those responsible for oversight of the management of the entities subject to audits should ensure that management adheres to this guidance.

The responsibility of the OAG:

Is to obtain reasonable assurance that the financial statements are not misstated due to non-compliance with laws and regulations. The auditors are expected to be on the lookout throughout the audit for any evidence of non-compliance with laws and regulations.

The OAG is not responsible for preventing non-compliance with laws and regulations.

**d) Matters that the public sector auditors should gain an understanding of :
Structure of National Insurance Company (NIC) group:**

It is necessary for the auditors to know structure of NIC. There is need to establish the relationships as this has audit significance.

The industry:

It is important to know the industry that the audit client is in so that the auditor can assess the risks that exist.

Financial statement framework:

The financial framework applicable should be known by the auditor because this will form the basis for the preparation of the financial statements.

Laws and regulations:

It is important to know the laws and regulations relevant to the company under consideration. The auditors will need to be on the lookout for any non-compliance with laws and regulations.

The internal controls:

It is necessary that the auditors have an understanding of the internal controls that exist in the audit client. This will assist in assessing risk.

Business risks that exist:

These are the risks that may cause the organization to fail. The auditors should in gaining an understanding of the entity identify the risks that exist.

e) Meaning of an auditor expert:

An auditor expert can be described as anyone with expertise in a field other than auditing and accounting. In the case in question an actuarial valuer engaged by the auditors would be considered an auditor expert.

Matters to be considered by public sector auditor before engaging auditor expert:

- The independence of the expert from the auditor and also from the entity subject to audit.
- The qualifications held by the expert in the relevant field.

- Membership with the professional body to which the expert belongs such as the body to which Actuarial Valuers belong.
- Other similar work that the expert has performed in the past.

f) Link between financial statement assertions and audit procedures:

Financial statement assertions are claims or representations that management makes in the figures contained in the financial statements.

The auditor private or public sector aims at testing whether or not the assertions in the financial statements hold. The auditor design suitable audit procedures to test the assertions. This means that the auditor should first and foremost know the assertion he is testing before designing the work to be done to test that assertion.

g) Meaning of assertions and related audit procedures:

Using the figure of property in the financial statements:

Assertion of valuation:

This assertion means that the property represented by the figure in the financial statements has been valued appropriately in accordance with relevant accounting standards.

Audit procedures:

- Inspect the property at the period end to establish condition and relate to value.
- If property revalued in the year under review, confirm valuation calculations made and recalculate.

Assertion of existence:

This assertion means that the property existed at the period end.

Audit procedures:

- Physically inspect the property for existence.
- For income yielding property confirm income received during the year under review.

Assertion of rights and obligations:

This assertion claims that the property representing the value in the financial statements belongs to the audited entity.

Audit procedures:

- For property there will be need to examine title deed to confirm ownership in the name of the NIC being audited.
- Where title is with lender as security for loans obtained, seek third party confirmation as appropriate.

SOLUTION TWO

a) Meaning of Computer Assisted Audit Techniques(CAATs):

This is the use of computer software in the performance of the audit. This is in response to increased use of computers by most organizations. The auditor can use these programs to make it easier for him to perform the audit.

Benefits to the SAI of using CAATs:

- Enables the SAI to perform tests on a larger sample than would otherwise be the case if manual methods were used.
- Enables the testing of the processing of data rather than the output.
- Able to test the general and application controls in the computer system in use.
- CAATs will enable the auditors perform their work much faster because of speeds that are inherent in computers.
- CAATs can be used to select sample items that can be subjected to audits.

b) Meaning of tests of control:

Tests of control are tests designed and performed with the objective of assessing the effectiveness or lack thereof of the internal controls set up by management.

Why tests of control are carried out:

The auditors test the effectiveness of the internal controls because if they are found to have been effective throughout the audit period the auditor may place reliance on their effectiveness.

When reliance is placed, the auditor may limit the extent of substantive procedures that may be undertaken.

Meaning of substantive tests:

Substantive tests are carried out in an audit on transactions and account balances contained in the financial statements.

Substantive tests include substantive analytical reviews and other tests of detail.

Purpose of substantive tests:

The purpose of conducting substantive tests is to test for material misstatements in the figures contained in the financial statements. Substantive tests should be carried out on all significant balances and transactions in the financial statements.

c) Meaning of opening balances in the financial statements:

Opening balances are the figures that the organization brings forward from the previous financial period.

These are the figures contained in the statement of financial position at the end of the period and they form the opening balances in the general ledger for the subsequent accounting period.

Audit significance of opening balances:

The opening balances from the previous financial year have audit significance for the current year financial statements. If the opening balances are misstated, then it means that even the current year figures are misstated.

The auditor has a duty to perform audit procedures on the opening balances.

d) Audit procedures on opening balances:

- Confirm that the prior year figures have been correctly brought forward in the general ledger for the current year.
- Determine whether the opening balances reflect the application of appropriate accounting policies.
- Evaluate whether the audit procedures in the current year under review provide evidence relevant to the opening balances.
- Perform any other audit procedures to obtain evidence regarding opening balances.

SOLUTION THREE

a) Ethical values in the public sector audits:

Integrity – this means that the public sector auditor should be straight forward and honest in the performance of their duties.

Objectivity – the public sector auditor should not be biased and influenced by others in the performance of their work. The pressure is more in the public sector where there can be political pressure to do certain things.

Professional competence and due care – the public sector auditor is required to have the necessary skills and competences to carry out the work. This is achieved through obtaining relevant qualifications and by continuous professional development.

Confidentiality – the public sector auditors comes across a lot of confidential matters in the performance of their work. They are not expected to disclose to third parties any information that comes to their attention by virtue of their position without appropriate authority.

Professional behavior – the public sector auditor should not conduct themselves in any manner that will discredit the Office of the Auditor General.

b) i. Accounting estimates:

ISSAI 1540 *Auditing Accounting Estimates, including Fair Value Accounting Estimates and Related Disclosures* gives guidance on accounting estimates. Some items contained in the financial statements cannot be measured precisely and can only be estimated. Estimation is done by management or where one has been engaged an expert.

Why accounting estimates is a risky:

Accounting estimates are a risky area because:

- Determination of the relevant figures is not based on evidence such as an invoice.
- The determination of the accounting estimates involves an element of judgment.
- It may not be easy for the auditor to detect accounting estimates that have been excluded in the financial statements.
- Can be subject to management bias in determination for any possible reason such as window dressing the financial statements.

ii. Meaning of subsequent events:

Subsequent events are events that take place after the end of an accounting period. Such events may have an effect on the figures that are contained in the financial statements.

c) i. Auditor responsibility – period end and date of report:

ISSAI 1560 *Subsequent events* gives guidance in this area.

The auditor has an active duty to perform procedures between the date of the financial statements and the date that the audit report is signed. The duty of the auditor is to look out for any subsequent events that have taken place between these dates and ensure that management has dealt with them appropriately in accordance with applicable regulations. The auditor will want to establish that Management have dealt with adjusting and non-adjusting events appropriately.

ii. Auditor responsibility – between signing audit report and issue of financial statements:

The auditor has a passive duty between the date of signing the audit report and the date that the financial statements are issued.

Management has a duty to inform the auditor of any matters during this period that they could affect the auditor.

If the auditor becomes aware of a matter that would have caused him to issue a different opinion then he will discuss this with management and find out how management intends to deal with the issue.

If financial statements are amended the auditor will perform audit procedures on the amendments and issued a new audit report. He will extend to the date of the new audit report his duty to look out for subsequent events.

SOLUTION FOUR

a) Organizations subject to OAG audits:

Entity:	Example:
i. Government Ministries	Ministry of Finance
ii. Grant Aided Institutions	The University of Zambia/UTH
iii. Local Authorities	The Lusaka City Council
iv. Donor Funded Programs	Child Immunization against Polio
v. Parastatal Companies	Zambia Electricity Supply Corporation
vi. Public Health Facilities	University Teaching Hospital

b) Telecommunication Plc.:

i. **The Emphasis of Matter Paragraph:**

ISSAI 1706 Emphasis of Matter paragraph and other Matter Paragraphs in the independent Auditors Report gives guidance in this area

This is a paragraph that can be used by the auditor to emphasize a matter that is disclosed in the financial statements and accounted for as per requirement. Because of its importance and the effect it might have on the users of the financial statements the auditor may wish to emphasize this matter in the audit opinion.

This will be done in the Emphasis of Matter Paragraph and the auditor will make reference to the note in the financial statements.

The Emphasis of Matter paragraph is not a modification of the audit opinion but it modified the audit opinion.

ii. **The three forms of modification of auditor's opinion:**

ISSAI 1705 *Modifications to the Opinion in the Independent Auditor's Report* gives guidance in this area.

Qualified opinion:

This is a form of opinion which states that 'Except for the matter of concern, the financial statements show a true and fair view.

There are two instances when a qualified opinion can be issued as follows:

- The auditor has obtained sufficient appropriate audit evidence but there is a matter of concern which is material but not pervasive to the financial statements.
- The second situation is when there is a limitation of scope and the auditor is unable to obtain sufficient appropriate audit evidence. When this is the case and the matter of concern is material but not pervasive to the financial statements a qualified opinion is appropriate.

Adverse opinion:

An adverse opinion is issued when the auditor concludes that the financial statements do not show a true and fair view.

This form of modification of the opinion will be given when the auditor has obtained sufficient appropriate audit evidence and the matter of concern is both material and pervasive to the financial statements.

Disclaimer of opinion:

In this situation the auditor is unable to express an opinion and he states this in the Disclaimer of Opinion paragraph.

The auditor will issue this form of modification when there has been a limitation of scope and is unable to obtain sufficient appropriate audit evidence and the matter of concern is both material and pervasive to the financial statements.

iii. Elements of an unmodified audit report:

- Title
- Addressee
- Opinion paragraph
- Basis of opinion
- Going concern
- Key audit matters
- Other information
- Responsibilities for the financial statements
- Auditor's responsibilities for the audit of the financial statements
- Other reporting responsibilities
- Name of the engagement partner
- Auditor's signature
- Auditor's address
- Date of the report.

SOLUTION FIVE

a) Role of the public sector auditor:

The role of the public sector auditor is to give an independent opinion on how public funds are spend by the line ministries.

The public sector auditor fulfills this role because of being independent of the entities being audited.

Role of the internal auditor:

On the other hand, internal auditors are part of the employees of the ministry they are attached to. They lack the independence that the public sector auditor has.

The role of the internal auditor is to check and monitor the use of funds in ministry on an ongoing basis.

b) Distinction between a forensic investigation and a financial audit in the public sector:

- A forensic investigation is usually conducted when either a whistle blower has indicated that there is a fraud that has taken place or it is carried out in order to confirm a fraud that has been carried out with the aim of establishing the extent of loss.

- Forensic investigations usually end up in matters being taken to court and the forensic investigator being a witness in the case.
- Forensic investigations are not predictable unlike financial audits which can be planned for in advance.
- In a financial audit the form of report is determined by guidance given. In a forensic investigation the form of report will depend on the circumstances at hand.

c) Definition of a compliance audit:

A compliance audit is an audit carried out by the public sector auditor is to gather evidence regarding compliance or non-compliance by the responsible party to a defined criteria.

Objectives of a compliance audit in the public sector:

The objective of a compliance audit is to provide the intended users with information about whether the audited entity is following parliamentary decisions, laws, legislation, established codes or agreed upon procedures.

d) Definition of a performance audit:

This is an independent, objective and reliable examination of whether government undertakings, systems, operations, programmes, activities or organizations are operating in accordance with the principles of *economy, efficiency* and/or *effectiveness* and whether there is room for improvement.

Objectives of a performance audit in the public sector:

The main objective of carrying out performance audits is to promote, constructively, economical, effective and efficient governance. This is to protect the general citizenry from abuse of public funds by those charged with running the affairs of the nation.

END OF SOLUTIONS



PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

PFM 6: FINANCIAL REPORTING FRAMEWORK FOR PUBLICSECTOR ENTITIES

MONDAY 22 JUNE 2020

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 (2) 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

Chamba Valley Electricity Corporation (CHAVECO) had prepared the following statements of Comprehensive Income and Statement of Financial Position for the years 2018 and 2019.

STATEMENTS OF FINANCIAL POSITION AT 31 DECEMBER.

	2019	2018
	K,000	K'000
Non-current assets		
Property, plant and machinery	327,000	264,000
Current assets		
Inventory	123,000	176,000
Trade receivables	95,000	87,000
Short term investments	65,000	30,000
Cash and bank in hand	<u>29,000</u>	-----
	<u>639,000</u>	<u>557,000</u>
Equity and liabilities		
Ordinary share capital(K1each)	200,000	120,000
Share premium	30,000	-----
Foreign exchange reserves	66,000	97,000
Retained earnings	<u>71,000</u>	<u>41,000</u>
	367,000	258,000
Non –current liabilities		
10% Loan stock	100,000	150,000
Current liabilities		
Sundry (note 3)	172,000	149,000
	<u>639,000</u>	<u>557,000</u>

CHAMBA VALLEY ELECTRICITY PLC

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2019

	K'000
Revenue	473,000
Cost of sales	<u>(229,000)</u>
Gross profit	244,000
Distribution costs	(75,000)
Administrative costs	(48,000)
Investment income	6,000
Interest paid	(17,000)
Retained earnings before tax	109,000
Income tax expense	(47,000)
Retained profit for the year	62,000

Dividends paid K 32,000,000

The following information should be taken into account:

Property, plant and equipment

1. The property, plant and machinery held by Chamba Valley Electrical Plc. Consist of Power Generation Turbines and freehold premises. During the year ended 31 December 2019, some pieces of Turbines costing K40,000 were disposed of which resulted in a loss of K6,000,000. The net book value disposed turbines amounted to K28,000,000.

2. *Short term investments*

The short -term investments meet the requirements of cash and cash equivalents as per IPSAS 2 Cash flow statements.

3. *Current liabilities*

Current liability consist of the following:

	2019	2018
	K'000	K'000
Bank overdraft		22,000
Trade payable	126,000	70,000
Interest payable	7,000	3,000
Income tax expense	<u>39,000</u>	<u>54,000</u>
	<u>172,000</u>	<u>149,000</u>

4. 10% Loan stock

On 1 August 2018 K50,000,000 of 10% Loan stock was converted into K50,000,000 of ordinary shares.

5. Depreciation

The depreciation charge for the year included in the statement of profit or loss was K43,000,000.

Required:

- (a) Using the indirect method, prepare a Statement of Cash Flows for CHEVECO Plc. for the year ended 31 December 2019. (24 marks)
- (b) Explain any five (5) advantages of preparing cash flow statements. (5 marks)
- (c) Explain two (2) benefits of reporting cash flows from operating activities using the direct method. (2 marks)
- (d) Explain how the following should be treated in the statement of cash flows:
 - (i) Foreign currency cash flows. (3 marks)
 - (ii) Investments in controlled entities, associates and joint ventures. (3 marks)
 - (iii) Components of cash and cash equivalentents. (3 marks)

[Total: 40 Marks]

SECTION B

Attempt any THREE (3) questions in this section

QUESTION TWO

The Ministry of General Education has issued a tender for the procurement of IT equipment in schools and colleges. The Controlling Officer has written to your office to participate in the evaluation of the procurement of IT equipment in your capacity as Director of Finance. You have discovered that the files submitted to your office with the analysis and quotations have been inflated with a potential to result in budget overruns. In addition, you have observed that the specifications of the computers are not aligned to what the colleges and schools had requested.

The Head Procurement has approached your office suggesting that you support the quotations that have been submitted and that issues of Budget overruns should not be raised in the evaluation and procurement committee.

Required:

- (a) Explain to the Head of Procurement, the IFAC's fundamental ethical principles that you would be violating if you support the inflated prices by not disclosing to senior management that the costs will result in budget over runs. (8 marks)
- (b) State and explain how the code of ethics can be internalized and enforced in the public sector. (12 marks)

[Total: 20 Marks]

QUESTION THREE

The Government can form a company through an enactment of parliament in order to provide social services or common goods that can be provided by private companies such as water and sanitation. Such entities are referred to as Government Business Enterprises (GBEs). However, for such an enterprise to be called GBE, it must meet and have certain characteristics. At the end of the year a GBE will account for its performance over a period of time. It must include certain components that should accompany its financial statements in order to increase understandability for the user of these statements. The information that should be included in the financial statements should be material and prepared using acceptable accounting policies. A GBE can prepare its financial statements on a cash basis or accrual basis.

Required:

- (a) Describe five (5) characteristic of any GBE. (5 marks)
- (b) Explain the three components that a GBE can include as part of its financial statements. (6 marks)
- (c) Explain the difference between cash basis and accrual basis of accounting. (6 marks)

- (d) Explain three conditions that should be met before a financial asset or financial liability is recognised in the financial statements. (3 marks)

[Total: 20 Marks]

QUESTION FOUR

The Secretary to the Treasury of Country X attended a meeting on Public Sector Accounting at which the presenter, indicated that IPSAS like International Financial Reporting Standards (IFRS) play an important role in fostering transparency and promoting public trust. The presenter indicated that the IPSAS standards are based on IFRS. It was expected that IPSAS will eventually be converged to IFRS to ensure financial reports generated by the private and public sectors are comparable in terms of accounting for similar types of transactions.

You are Accountant General, and the Secretary to the Treasury has written to you seeking further clarification on the following:

- (a) The Key difference between IFRS and IPSAS. (12 marks)
(b) Comparison of statement of cashflow under IAS 7 and IPSAS 2. (8 marks)

Required:

As the accountant General, prepare notes that will address the Secretary to the Treasury's concerns. **[Total: 20 Marks]**

QUESTION FIVE

The government through public sector organisations, can embark on capital projects such as construction of roads and schools which involve huge amounts of money. At times the public sector organisations have to use money borrowed by the government from either bilateral or multilateral cooperating partners. IPSAS 5, examines the issues relating to whether the costs of borrowing should be added to the capitalization costs of the asset in the statement of financial position or should be expensed in the statement of comprehensive income. In addition the public sector organisation should commence capitalization of borrowing costs as part of the costs of qualifying assets when it discovers that such costs are directly attributed to the acquisition, construction or production of a qualifying asset. However there are times when the borrowing costs can be suspended or cease to be capitalized.

Required:

- (a) Explain the criteria used by a public sector entity to recognise borrowing costs in the financial statement. (6 marks)
(b) Explain reasons why creation and suspension of capitalization of borrowing costs take place. (4 marks)
(c) Explain the two (2) types of construction contracts that a public entity can enter into. (4 marks)

- (d) On 1 January 2019, a government agency borrowed K3,000,000 to finance the production of two Toll gates, both of which were expected to be completed in two years' time. Work commenced during 2019. The loan facility was drawn down on 1 January 2019, and was utilised as follows, with the remainder of the funds invested in treasury bills.

	Toll gate A	Toll gate B
	K'000	K'000
1 January 2019	500,000	1,000,000
1 July 2019	500,000	1,000,000

The loan rate of interest was 10% and the agency invested surplus funds at 9%.

Required:

Ignoring compound interest, calculate:

- (i) The borrowing costs which may be capitalized for each Toll gate. (3 marks)
- (ii) Costs of each Toll gate in the statement of financial position as at 31 December 2019. (3 marks)

[Total: 20 Marks]

END OF PAPER

SUGGESTED SOLUTIONS

SOLUTION ONE

CHEVACO Plc. STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2019

	K'000	K'000
<i>Cash flow from operating activities</i>		
Profit before taxation	109,000	
Adjustments for:		
Loss on disposal	6,000	
Depreciation	43,000	
Interest income	(6,000)	
Interest expense	<u>17,000</u>	
	169,000	
Changes in working capital		
Decrease in inventory (176-123)	53,000	
Increase in trade receivables (95-87)	(8,000)	
Increase in trade payables (87-95)	<u>56,000</u>	
<i>Cash generated from operations</i>	270,000	
Accruals etc.		
Interest paid(wi)	(13,000)	
Income tax expense(wii)	(62,000)	
<i>Net cash generated from operating activities</i>		195,000
<i>Net cash flows from investing activities</i>		
Purchase of property ,plant and machinery(wiii)	(165,000)	
Proceeds from sales of property and equipment(28-6)	22,000	
Interest received	6,000	
Net cash outflow from investing activities		<u>(137,000)</u>
		58,000

Net cash flow from financing activities		
Proceeds from issue of shares (wiv)	60,000	
Dividends paid (per question)	(32,000)	
Nat cash inflows from financing activities		28,000
Net increase in cash and cash equivalents		86,000
Cash and cash equivalents at start (30, STI – 220, OD)		8,000
Cash and cash equivalents at end (65, STI – 29, OD)		94,000

(w i) property, plant and machinery

K'000	K'000
Balance b/d 264	Rev, surplus 51
Additions <u>165</u>	Deprec'n 43
<u>428</u>	Disposal 28
	Balancec/d <u>327</u>
(w ii) Interest pay	<u>428</u>
Paid in year 13	Balance b/d 3
Balance c/d <u>7</u>	Profit /loss <u>17</u>
<u>20</u>	<u>20</u>
(w iii) Income tax	
Paid 62	Balance b/d 54
Balance c/d <u>39</u>	Profit and loss <u>47</u>
<u>101</u>	<u>101</u>

(w iv) Share issues

	K'000
Ordinary shares	200
Share premium	30
Closing capital	<u>(120)</u>
Increase in share capital	110

Converted loan stock	(50)
Cash received from shares	60

(b) The following are the advantages of accounting for cash flows:

- (i) The survival of the business depends on the ability to generate cash. Cash flow accounting directs attention towards the critical areas.
- (ii) Cash flow is more comprehensive than net profit which depends on accounting conventions and concepts.
- (iii) Creditors and other funders are more interested in an entity's ability to repay them than in its profitability.
- (iv) It Helps the Government to evaluate liquidity and future cash flow requirement and accountability for its use of cash resources.
- (v) It is also an indicator of the timing and certainty of future cash flows.
- (vi) It can be a measure of the extent to which a government has generated sufficient cash flows to maintain programmes and services.
- (vii) Cash flow reporting provides a better means of comparing the results of different companies than traditional profit reporting.
- (viii) Cash flow reporting satisfies needs of all users better than profit and loss account.

(c) Benefits of reporting cash flow from operating activities using direct method are:

- (i) It provides information that maybe useful in estimating future cash flows
- (ii) Cash flows may provide information that may not be available under the indirect method.
- (iii) It also shows information about major classes of gross cash receipts and gross cash payments that may be obtained from records of the entity.

(d) **Foreign currency cash flows**

Cash flows arising from transactions in a foreign currency shall be converted to an entity's functional currency by applying the exchange rate between the functional currency and the foreign currency at that date of the cash flow. Cash flow denominated in foreign currency are reported in a manner consistent with IPSAS 4 *the effects of changes in foreign exchange rates*. This permits the use of an exchange rate that approximates the actual rate. Unrealized gains and losses arising from changes on cash and cash

equivalents held or due in a foreign currency is reported in the cash flow statement in order to reconcile cash and cash equivalents at the beginning and end of the period.

Investments in consolidated entities, associates and joint ventures

When accounting for an investment in an associate or a controlled entity, using the equity or cost method, an investor restricts its reporting in the cash flow statement to the cash flows between itself and the investee, for example, on dividends or similar distributions and advances. An entity that reports its interest in a jointly controlled entity using proportionate consolidation includes in its consolidated cash flow statements, its proportionate share of the jointly controlled entity's cash flows. An entity that reports such an interest using the equity method includes in its cash flow statement:

- (i) The cash flows in respect of its investments in the jointly controlled entity, and
- (ii) Distributions and other payments or receipts between it and the jointly controlled entity.

Components of cash and cash equivalents

An entity shall disclose the components of cash and cash equivalents, and shall present a reconciliation of the amounts in its cash flow statement with the equivalent items reported in the statement of the financial position. In order to comply with IPSAS 1, an entity shall disclose the policy that it adopted in determining the composition of cash and cash equivalents. An entity shall disclose, together with a complimentary by management in the notes to the financial statements, the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the economic entity.

SOLUTION TWO

(a) **Explain to the Head Procurement IFAC's fundamental ethical principles that you would be violating if you support the inflated prices and you do not disclose to senior management that the cost have resulted in budget over run.**

- **Integrity:** This requires members not to be associated with any form of communication or report where the information is materially false, provided recklessly or incomplete..
- **Objectivity :**This requires accountants to ensure that their judgment is not compromised because of bias or conflict of interest.
- **Professional competence and due care:** This requires accountants to follow all applicable technical and professional standards when providing services.
- **Professional Behaviour :**This principle requires accountants to avoid any activities that might bring the profession into disrepute.

(b) **State and explain how code of ethics can be internalized and enforced in the public sector**

- A mission statement that refers to quality or, more unusually, to ethics and defines how the organisation wants to be regarded externally
- Clear policy statements on ethics and anti-fraud, with explanations about acceptable behaviour in risk prone circumstances.
- A route through which suspected fraud can be reported
- A process of reminders about ethical and fraud policies – e.g. annual letter and/or declarations
- An aggressive audit process which concentrates on areas of risk
- Management who are seen to be committed through their actions.

SOLUTION THREE

- (a) The following are the characteristics of a GBE:
- (i) It is an entity with the power to contract in its own name.
 - (ii) It has been assigned the financial and operational authority to carry out business activities on its own behalf.
 - (iii) It can sell goods and services in the normal course of its business to other entities at profit or at a full cost recovery.
 - (iv) It is not reliant on government funding to be a going concern (or enter into purchases of outputs at its arm's length).
 - (v) It is controlled by a public entity sector entity.
- (b) The three components to be included within financials statements are:
- (i) A statement of cash receipts and payments.
 - (ii) Recognised cash receipts, cash payments and cash balances controlled by the entity.
 - (iii) Separately identifiable payments made by third parties on behalf of the entity.
 - (iv) Accounting policies and explanatory notes.

A comparison of budget and actual amounts either as separate additional financial statement or as a budget column in the statement of cash receipts and payments.

- (c) Cash accounting basis recognise transactions as and when cash (including cash equivalents) is reconciled or paid by the entity. Financial statements that are prepared under cash accounting basis provide the user with:
- (i) The information about the sources of cash raised during the period.
 - (ii) The purpose for which cash was used.
 - (iii) The cash balances at the reporting date.
 - (iv) The main focus in the financial statements is the balance of cash and changes therein.

Accrual basis for accounting means a basis of accounting under which transactions and other events are recognized when they occur and not only when cash or its equivalent is received or paid). Therefore, the transactions and event are recorded and recognised the financial statement of the period to which they relate. The elements recognised under accrual basis are assets, liabilities, net assets.

- (d) The following are conditions to be met for a financial asset to be recognised as an asset or a liability:
 - (i) If it is classified as held for trading.
 - (ii) If it is acquired or incurred principally for the purpose of selling or repurchasing in the near term.
 - (iii) On initial recognition, if it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit making.
 - (iv) If it is a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).

SOLUTION FOUR

a) The Key difference between IFRS and IPSAS.

- IPSASB develops accounting standards specifically for government entities. Although it is independent of IASB which develops and issues IFRS, the two standards setters are closely connected with IPSAS being based as far as possible on equivalent IFRS.
- IFRS is aimed at the private-profit seeking sector, where commercial transactions are presumed to take place subject to market conditions.
- IFRS focus is to provide investors, lenders and other users of the financial statements with information about the entity's financial performance and financial position to help those users make investment and credit decisions; IPSAS financial statements are designed to provide information about how entities utilize resources, and about the cost of service delivery.
- IPSAS standards are designed to take care of user's needs. For instance, information about how an entity has performed in relation to its authorized budget is of interest to users. Non exchange transactions and non - cash generating assets which are prevalent in the public sector, but almost unheard of in the commercial sector enterprises also need to be catered for.
- IPSAS recognizes the concept of non-exchange transactions and includes public sector specific standard that has been derived from IFRS- IPSAS23: Revenue from non-exchange transactions covers revenue arising from transfers, grants, taxes, fines and levies. IFRS has no equivalent standard and presumes such transactions are unlikely for private sector entity. One exception of this is IAS 20 government grants which recognizes that entities may receive various forms of government assistance and as such deals with accounting treatment thereof. In contrast, IPSAS has no IAS 20 equivalent and deals with government assistance as part of IPSAS 23. Consequently the treatment of government grants under IPSAS is significantly different from IFRS.
- In line with the increased focus on stewardship of, and accountability for, public funds, IPSAS 24 presentation of budget information in the financial statements requires entities that make their budgets publicly available to present a comparison of the budgeted and actual information as part of the financial statements (either separate statements or in the notes). This disclosure is not required under IFRS.
- IPSAS 21 impairment of non-cash generating assets provides additional guidance on the valuation methods that should be used when determining the value in use of non- cash generating assets. There is no equivalent guidance under IFRS.

b) Comparison of statement of cash flow under IAS 7 and IPSAS 2.

IPSAS 2, "Cash Flow Statements," is drawn primarily from IAS 7, "Cash Flow Statements." The main differences between IPSAS 2 and IAS 7 are as follows:

- Commentary additional to that in IAS 7 has been included in IPSAS 2 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 2 uses different terminology, in certain instances, from IAS 7. The most significant examples are the use of the terms entity, revenue,

statement of financial performance, statement of financial position and net assets/equity in IPSAS 2. The equivalent terms in IAS 7 are enterprise, income, income statement, balance sheet and equity.

- IPSAS 2 contains a different set of definitions of technical terms from IAS 7.
- In line with IAS 7, IPSAS 2 allows either the direct or indirect method to be used to present cash flows from operating activities. Where the direct method is used to present cash flows from operating activities, IPSAS 2 encourages disclosure of a reconciliation of surplus or deficit to operating cash flows in the notes to the financial statements.
- The Appendix to IPSAS 2 does not include an illustration of a Cash Flow.

SOLUTION FIVE

(a) Borrowing costs can be recognized in the following situations:

Borrowing costs can be recognised as an expense in the period in which they are incurred except to the extent that they are capitalized. Borrowing costs that are directly attributed to the acquisition, construction or production of a qualifying asset shall be capitalized as part of the costs of that asset. The capitalization of borrowing costs as part of the qualifying asset shall commence when;

- (i) Capital outlays of an asset are being incurred
- (ii) Borrowing costs are being incurred
- (iii) Activities that are necessary to prepare that asset for its use or sale are in progress.

(b) Cessation of capitalization of borrowing assets shall cease be substantially all the activities necessary to prepare the qualifying assets for its intended purpose or sale are complete. The suspension of capitalization of borrowing costs shall be done during extended periods in which active development is interrupted and such costs are expensed.

(c) The two types of contract are:

(i) Fixed price contracts-these are contract where the revenue arising at the outset of the contract either for the contract as a whole or for units of outputs. Under such contracts, there is an element of certainty about the revenue occurring, but not about the costs which will arise. Under the fixed contract, the contractor should measure reliably both the costs incurred and those incurred to complete the project. The contract should also assess whether it is probable that payments will be received under the contract.

(ii) Cost-plus contracts-are contracts where costs will be recoverable plus some agreed elements of profits. For such contracts, there is a high degree of certainty about the profit arising although there is no certainty about either the revenue or the costs. In this type of contract the outcome is capable of reliable measurement of which the contractor will receive payment for the revenues under the contract and the cost can be both clearly identified and measured.

(d) (i)	Toll gate A	Toll gate B
Borrowing costs:		
To December 2019:	K1, 000,000/K2, 000,000	100,000 200,000

Less: investment income K500, 000/K1, 000,000 x 9% x 6/12=	(22,500)	(45,000)
	<u>77,500</u>	<u>155,000</u>

(ii) Costs of assets in the statement of financial position;

Expenditure incurred	1,000,000	2,000,000
Borrowing costs	<u>77,500</u>	<u>155,000</u>
	<u>1,077,500</u>	<u>2,155,000</u>

END OF SOLUTIONS