



PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

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**DIPLOMA LEVEL**

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PFM 1: PUBLIC SECTOR ACCOUNTING

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MONDAY 14 DECEMBER 2020

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

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**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.
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8. Present legible and tidy work.
9. Graph paper (if required) is provided at the end of the answer booklet.

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## SECTION A

**This question is compulsory and must be attempted.**

### **QUESTION ONE**

(a) The following is the trial balance of the consolidated fund for the year ended 31 December 2019:

	K' million	K' million
Accumulated fund		14,600
GRZ bonds		10,000
Treasury bills		18,300
Multilateral Creditors		12,000
Other Creditors (Suppliers of goods & services)		4,600
Salaries and wages	17,200	
Allowances to Staff on local travel	6,080	
Allowances to Staff on foreign travel	4,000	
Other Expenses	5,000	
Social Assistance benefits	4,300	
Interest on debts	1,400	
Fuel and other Lubricants	2,300	
Purchase of Equipment	5,600	
Purchase of Motor Vehicles	8,700	
Construction Administration Building	12,300	
Investments in Equity shares	12,900	
Investments in Loans and Advances	4,650	
Value Added Tax		3,930
Pay As You Earn		6,700
Corporate Income Tax		4,430
Skills Development Levy		5,780
Fines		4,900
Commissions		4,760
Grants	1,850	
Cash and Bank	720	
Reserves	3,000	-
	<u>90,000</u>	<u>90,000</u>

#### **Additional Information:**

1. Salaries amounting to K150 million and Housing allowances of K70 million for newly employed civil servants were outstanding as at 31 December 2019.
2. Interest charges outstanding as at 31 December 2019 amounted to K40 million.
3. As at 31 December 2019 the amounts of taxes due to the government were as follows:

Value Added Tax	K98 million
Corporate Income Tax	K270 million
PAYE	K1,200 million

4. Depreciation on non-current assets was as follows:
- |                          |             |
|--------------------------|-------------|
| Administration buildings | K10 million |
| Equipment                | K30 million |
| Motor vehicles           | K60 million |
5. It's Government policy to prepare public financial statements of the Consolidated Fund using the accruals basis and in accordance with the Generally Accepted Accounting Principles (GAAPs).

**Required:**

- (i) Prepare the Statement of Financial Performance of the Consolidated Fund for the year ended 31 December 2019 using the accruals basis of accounting in accordance with the IPSAS. (14½ marks)
- (ii) Prepare the Statement of Financial Position of the Consolidated Fund as at 31 December 2019. (12½ marks)
- (b) Public Sector Accounting is a process of recording, communicating, summarizing, analyzing and interpreting Government financial statements and statistics in aggregate and details; it is concerned with the receipts, custody and disbursements and rendering of stewardship on public funds.

**Required:**

- (i) Explain any seven (7) objectives of public sector accounting. (7 marks)
- (ii) Explain four (4) differences between Private Sector and Public Sector Accounting. (6 marks)

**[Total: 40 marks]**

## **SECTION B**

**Attempt any Three (3) Questions out of Four (4).**

### **QUESTION TWO**

- (a) Integrated Financial Management Information Systems (IFMIS) is a computer based system which is used by the government to plan, process and report on the financial resources in a broad spectrum of financial management areas.

**Required:**

Explain the core functions (component) of IFMIS and how IFMIS is used to perform those functions. (12 marks)

- (b) Explain the auditing controls used to verify the accuracy and reliability of the information accumulated and aggregated in the IFMIS. (6 marks)
- (c) Explain what is meant by Legislative controls. (2 marks)

**[Total: 20 Marks]**

### **QUESTION THREE**

- (a) The chart of accounts is a tool used to classify and code government financial transactions. The chart provides the framework to classify, aggregate and report financial transactions, to assist in planning (budgeting), resource allocation, management control, accounting and statistical evaluation.

**Required:**

- (i) Explain the purpose of Chart of accounts. (5 marks)
- (ii) Explain the characteristics of Chart of accounts. (4 marks)
- (b) The Code of Ethics for Professional Accountants establishes ethical requirements for professional accountants, and sets out fundamental principles of professional ethics. The fundamental principles set out the obligations all members, whether or not they are in practice.

**Required:**

- (i) Explain the principles of Integrity, Objectivity and Professional Competence and Due Care as they apply in Public Sector Accounting. (6 marks)
- (ii) Explain the five (5) threats to compliance with fundamental principles. (5 marks)

[Total: 20 Marks]

**QUESTION FOUR**

- (a) The Regulatory Framework for public Sector Accounting should include adherence to international accounting standards and practices and use of qualified accounting staff to provide timely, relevant and reliable financial information that is needed to support fiscal and budget management, decision making, and reporting processes.

**Require:**

Explain the role of the International Public sector Accounting Standards Board (IPSASB).  
(4 marks)

- (b) Public Expenditure is spending made by the government of a country on public goods and services such as roads, railway lines, telecommunications etc.

**Required:**

Explain the two (2) types of public spending giving an example for each. (4 marks)

- (c) Explain the differences between the Accruals basis of accounting and the Cash basis of accounting. (6 marks)

- (d) The following information was extracted from the consolidated fund for the year ended 31 December 2019:

	Dr	Cr
	K'million	K'million
Tax revenue		10,000
Salaries and wages	9,780	
Stationery and Telephone	560	
Non-tax revenue		1,300

**Additional Information**

1. The above amounts represent the actual cash received and paid.
2. The amounts outstanding as at 31 December 2019 were as follows:

Tax revenue	K100 million
Non-tax revenue	K20 million
Salaries and wages	K500 million
Stationery expenses	K107 million

**Required:**

Prepare the Statement of Financial Performance extract for the year ended 31 December 2019 using the Cash basis of Accounting. (6 marks)

[Total: 20 Marks]

## **QUESTION FIVE**

(a) Government revenue is income received by Government from tax and non-tax revenue, grants and other receipts. The government spends its revenue on public expenditure such as education, health, national security etc.

### **Required:**

(i) Explain the two (2) main sources of Government (Public) revenue giving three (3) examples for each. (8 marks)

(ii) Explain the two (2) main types of Government expenditure. (2 marks)

(b) Governments and other public sector entities are accountable to those that provide them with resources and those that depend on them to use the resources to deliver services during the reporting period and over the long term.

### **Required:**

(i) Explain any three (3) internal and three (3) external users of public sector financial information. (6 marks)

(ii) Explain any four (4) reasons why the users would want to access the public sector financial information. (4 marks)

**[Total: 20 Marks]**

**END OF PAPER**

## SUGGESTED SOLUTIONS

### SOLUTION ONE

#### (a) Consolidated Fund

##### (i) Statement of Financial Performance for the year ended 31 December 2019

	K'million
Revenue:	
Tax revenue (w1)	16,628
Non-tax revenue (w2)	<u>15,440</u>
	<u>32,068</u>
Expenditure:	
Personnel Emoluments (w3)	17,420
Uses of Goods and Services (w4)	12,380
Depreciation charges (w5)	100
Finance costs (1,400 + 40)	1,440
Grants	1,850
Other expenses	5,000
Social Assistance benefits	<u>4,300</u>
	<u>42,490</u>
<b>Deficit for the year</b>	<b><u>(10,422)</u></b>

##### (ii) Statement of Financial Position as at 31 December 2019

Assets	K'million	K'million
Non-current Assets		
Property, Plant & Equipment (w6)		26,500
Investments (w7)		<u>17,550</u>
		44,050
Current Assets		
Receivables (w9)	1,568	
Cash and Bank	720	
Reserves	<u>3,000</u>	
		<u>5,288</u>
<b>Total Assets</b>		<b><u>49,338</u></b>
Funds and Liabilities		
Accumulated fund balance b/f		14,600
Deficit for the year		<u>(10,422)</u>
		4,178
Non-current Liabilities		
Domestic Debt	28,300	
Multilateral Creditors	<u>12,000</u>	
		40,300
Current Liabilities		
Other creditors	4,600	
Accrued Expenses (150 + 40+70)	<u>260</u>	

	<u>4,860</u>
<b>Total Funds and Liabilities</b>	<b><u>49,338</u></b>

### Workings

1. Tax revenue	K'million
Corporate Income tax	4,430
Value Added Tax	3,930
Pay as You Earn	6,700
Add:	
Amounts outstanding (w9)	<u>1,568</u>
Total tax Revenue	<u>16,628</u>
2. Non-tax revenue	K'million
Fines	4,900
Skills Development Levy	5,780
Commissions	<u>4,760</u>
Total non-tax revenue	<u>15,440</u>
3. Personnel Emoluments	K'million
Salaries and wages	17,200
Add:	
Salaries Accrued (150+70)	<u>220</u>
Total	<u>17,42</u>
4. Uses of Goods and Services	K'million
Fuel and other Lubricants	2,300
Allowances on local travel	6,080
Allowances on foreign travel	<u>4,000</u>
Total	<u>12,380</u>
5. Depreciation Charges	K'million
Administration Buildings	10
Equipment	30
Motor vehicles	<u>60</u>
Total	<u>100</u>
6. Property, plant & Equipment	K'million
Administration buildings	12,300
Motor Vehicles	8,700
Equipment	<u>5,600</u>
	26,600
Less:	
Depreciation	<u>(100)</u>
Carrying amount	<u>26,500</u>



7. Investments (Financial Assets)	K'million
Investment in Equity shares	12,900
Loans and Advances	<u>4,650</u>
Total	<u>17,550</u>
8. Domestic Debt	K'million
GRZ bonds	10,000
Treasury bills	<u>18,300</u>
Total	<u>28,300</u>
9. Tax revenue Receivables	K'million
Value Added Tax	98
Corporate income tax	270
PAYE	<u>1,200</u>
Total	<u>1,568</u>

(b) Public Sector Accounting

(i) The following are the objectives of Public Sector Accounting:

1. Ascertaining the legitimacy of transactions and their compliance with established norms, regulations and statutes.
2. Enhancing the appraisal of the efficiency of management
3. Highlighting the various sources of revenue and the expenditure to be incurred
4. Identifying the sources of funding capital projects
5. Evaluating the economy, efficiency and effectiveness with which Public Sector organisations pursue their goals and objectives.
6. Ensuring that costs are matched against, by at least, equivalent benefits accruing there from.
7. Providing the details of outstanding long-term commitments and financial obligations
8. Providing the means by which actual performance may be compared with the targets set
9. Providing solutions to the various bottlenecks and or problems identified.  
(1 mark per valid point up to 7 marks)

(ii) The following are the differences between Private Sector and Public Sector Accounting:

1. Private Sector businesses are established by citizens and exist to provide goods and services to the public in order to make a profit and maximize shareholder value, whereas public sector exists to provide goods and services to citizens including private sector and the goal is not to make a profit.
2. Private sector uses the budget as a tool in financial planning and this is not a mandatory requirement whereas Public sector has a responsibility of fiscal accountability in compliance with the budgetary requirements.

3. Financial statements of the private sector provide assurance to the shareholders that their investment is safeguarded and growing whereas Public sector financial statements provide a framework for accountability to the public who pay taxes.
4. Public sector accounting is governed by the Framework established Public Finance Laws and International Public Sector Accounting Standards (IPSASs) whereas Private sector accounting is governed by International Financial Reporting Standards (IFRSs) and other laws such as Companies Act, Stock market regulations etc.

## **SOLUTION TWO**

(a) The following are the functions of the Integrated Financial Management Systems (IFMS):

(1) Budgeting

Budgeting is planning for, implementing and evaluating policies, activities and programmes. Budgeting acts as a major performance indicator of how efficiently and effectively government funds are being used.

IFMS allows the organisation to formulate a budget, execute actions against that budget, reprogramme activities to accommodate changes in the amount of money available and evaluate the success of the budget at the end of the time.

IFMS also allows the organisation to decentralize budgeting down to the operating areas of departments, where responsibility for delivering services and products of government is located.

(2) Accounting

Accounting records and integrates the results of the individual financial transactions that occur daily, thus providing the basic data for other components of the system.

The accounting system allocates financial transactions against the agreed chart of accounts, which is based on the budgeting process.

IFMS allows comparison across government spending agencies and programme types, and reporting can be ad hoc or it can be structured to produce standardized reports.

(3) Cash Management

Cash management is about managing the flow of public sector resources in ways that minimize costs and maximize effectiveness.

The IFMS enables active monitoring of the cash reserves of government and helps to ensure that the resources are consolidated and managed so that they are available for distribution as required.

Cash management function has the capacity to produce cash flows projections based on the expected receipts and expenditures.

(4) Debt Management

There is a close relationship between cash management and public debt management. Public debt management system provides resources to cash management and also makes demands in terms of loan repayments.

Debt management has an integral relationship with the IFMS system as it often provides the budget resources to carry out such capital intensive programmes.

Working out what money is due for repayment, and when needs to be built into budget planning and cash flow projections to ensure that funds are available and that penalties for late payment are not incurred.

(b) The following are the Audit controls

- (i) Access controls: These are controls over access to the computer system by some form of identity recognition, such as password, card system, personal identification number etc.
- (ii) Input and Output controls: These are controls which ensure the accuracy and security of the information received and transmitted.
- (iii) Processing controls: controls which protect and ensure the integrity of the information processed by the system.
- (iv) Back-up controls: These are controls that guarantee the retention of back-up copies of computer files, computer programs and the recovery of computer records in case of system failure.

(c) Legislative Control

These controls are the various measures Parliament use for the purposes of controlling the use of public funds. This system of control is very important because Parliament is an independent body from the Executive where government is formed by the ruling party.

## **SOLUTION THREE**

### (a) Chart of Accounts

(i) The purpose of Chart of Accounts include the following:

1. To differentiate between Revenue, Expenditure, Assets and Liabilities.
2. To provide standard framework for presentation of financial information for easy of understanding and analysis.
3. To facilitate preparation of financial accounting reports.
4. To facilitate comparisons between organisation/governments.
5. To serve as an index to locate a given account within the ledger.

(1 mark per valid point up to 5 marks)

(ii) The following are the characteristics of Chart of Accounts:

1. Each Government/business entity develops its own Chart of Accounts to meet its own business requirements and financial structure.
2. It consists of Ledger Account names and numbers showing classifications and sub-classifications.
3. Each account in the Chart of Accounts is typically assigned a name and unique number by which it can be identified.
4. Account numbers are often five or more digits in length with each digit representing a division of the company, the department, the type of account etc.

### (b) Code of Ethics

(i) Integrity

The principle of integrity imposes an obligation on all professional Accountants to be straightforward and honest in all their professional and business relationships.

This means that Accountants should be truthful and should not be associated with reports, returns, communication or other information where they believe that the information contains a materially false or misleading statement, information furnished recklessly.

Objectivity

The principle of objectivity imposes an obligation on all professional accountants not to compromise their professional or business judgement because of bias, conflict of interest or undue influence of others.

This means that professional accountants should not allow bias, conflict of interest or undue influence of others to override professional or business judgements.

Therefore, relationships that bias or unduly influence the professional judgement of the professional accountant should be avoided.

Professional Competence and Due Care

This principle imposes an obligation on the professional accountants to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional services based on current developments in practice, legislation and techniques.

Therefore, a professional accountant should act diligently and in accordance with applicable technical and professional standards when providing professional services.

- (ii) The following are threats to compliance:
1. Self-interest threats: This may occur as a result of the financial or other interests of a professional accountant or of an immediate or close family member.
  2. Self-review threats: These may occur when a previous judgement needs to be revaluated by the professional accountant responsible for that judgement.
  3. Advocacy threats: These may occur when a professional accountant promotes a position or an opinion to the point that subsequent objectivity may be compromised.
  4. Familiarity threats: These may occur when, because of the relationship, a professional accountant becomes too sympathetic to the interests of others.
  5. Intimidation threats: These may occur when a professional accountant may be deterred from acting objectively by threats, actual or perceived.

## SOLUTION FOUR

(a) The role of the International Public Sector Accounting Standards Board (IPSASB) is as follows:

1. To develop IPSAS, accrual based standards used for the preparation of general purpose financial statements by Governments and other public sector entities around the world.
2. To enhance the quality, consistency, and transparency of public sector financial reporting worldwide.
3. To issue guidance and facilitate the exchange of information among accountants who work in the public sector and promotes the acceptance of and international convergence to IPSAS.
4. To raise awareness of the IPSASs and the benefits of their adoption.

(b) The following are the types of public spending:

1. Real spending  
This is spending by government to buy goods and services, e.g books for a school, medicine for a hospital etc.
2. Transfer payments  
This is spending made by government to households and private enterprises e.g payment of unemployment benefits, state pension, investment grants etc.

(c) The differences between the Accruals basis and Cash basis of accounting are as follows:

1. Accruals basis of accounting requires income and expenses to be recognised when earned and incurred whereas Cash basis of accounting recognises income and expenses when cash is received and paid.
2. Cash basis of accounting records transactions when a completed exchange of value has occurred. Therefore, cash basis of accounting is less accurate than accruals basis of accounting in the short-term.
3. Obtaining financing is more difficult under Cash basis of accounting due to its inaccuracies compared to the Accruals basis of accounting.
4. The Cash basis of accounting is simple and cheaper whereas Accruals basis of accounting is expensive.

(d) Statement of Financial Performance Extract for the year ended 31 December 2019

	K'million	K'million
Revenue		
Tax revenue		10,000
Non-tax revenue		<u>1,300</u>
		11,300
Expenditure		
Salaries and wages	9,780	
Stationery and Telephone	<u>560</u>	
		<u>(10,340)</u>
Surplus		<u><u>960</u></u>

## **SOLUTION FIVE**

### (a) Public revenue and expenditure

(i) The following are the sources of government revenue:

1. Tax revenue

This is income that is earned by governments through taxation. This revenue includes:

- i. Income tax which is charged on earnings of individuals such as Pay as You Earn.
- ii. Corporation tax which is charged on earnings of business enterprises
- iii. Value Added Tax which is charged on goods and services
- iv. Property Transfer Tax which is charged on the transfer of property
- v. Customs and excise duties charged on the importation and exportation of goods.
- vi. Mineral royalty tax which is charged on the extraction of minerals.
- vii. Road tax which is charged on all motor vehicles.

2. Non-tax revenue

This is revenue earned by Governments from sources other than tax. This includes:

- i. Ground rent which is charged on properties owned by individuals and organisations.
- ii. Fees, fines charges and fuel levy
- iii. Passport fees collected on the issuance of passports to individuals.
- iv. Income from investments made by the Government such as dividends from shares in companies.

(ii) The following are the types of Government Expenditure:

1. Direct Expenditure

This is expenditure charged to a particular Head as approved by Parliament and reflected in the Estimates of Revenue and Expenditure for that financial year.

2. Recoverable Advances

These are payments which cannot presently be charged to any direct expenditure code or allocation. E.g. Loans, imprest and advances to individuals and institutions.

### (b) User of public financial information

(i) The following are the users of public financial information:

1. Internal Users

- i. The Republican president and Ministers
- ii. The National Assembly/Parliament
- iii. Regulatory, oversight bodies and audit institutions
- iv. Public administrators such as Permanent Secretaries, Directors or Head of departments
- v. Labour Unions



2. External Users
  - i. Companies that do business with Government
  - ii. Donors and foreign countries
  - iii. Members of the public
  - iv. Financial institutions such as the World Bank, International Monetary Fund (IMF), Africa Development Bank (ADB) etc.
  - v. Local and foreign creditors
  - vi. Political parties, trade unions, civil society organisations etc.
  
- (ii) Users access public sector financial information because they would want to know the following:
  1. The source, allocation and uses of the public financial resources.
  2. Financing of public sector activities, projects and programs
  3. Budget performance
  4. Measurement of public sector performance against set goals
  5. Valuation of the public sector's ability to finance its activities and meet its financial obligations.

**END OF SOLUTIONS**



PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

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**DIPLOMA LEVEL**

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PFM 2: LEGAL ASPECTS OF PUBLIC SECTOR FINANCE AND ADMINISTRATION

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FRIDAY 18 DECEMBER 2020

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

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## **SECTION A**

**This question is compulsory and must be attempted.**

### **QUESTION ONE (COMPULSORY)**

- (a) Making reference to case law, explain the supremacy of the constitution in Zambia. (10 marks)
- (b) Explain the scope of Judicial Review. (4 marks)
- (c) Discuss the distinction between constitutional law and administrative law in relation to their functions. (6 marks)
- (d) Discuss any four (4) sources of law in Zambia. (10 marks)

**[Total: 40 Marks]**

## **SECTION B**

**Answer Three (3) questions in this Section.**

### **QUESTION TWO**

- (a) Identify the three (3) organs of Government. (3 marks)
- (b) Identify and explain which organ of the state is responsible for dispute resolution. (5 marks)
- (c) Explain the main function of the legislature in terms of providing checks and balances on the executive. (5 marks)
- (d) Katiyo, a student at ZICA is surprised about the lecture he had last week on separation of powers and its purpose. He has done a research and has realized that the Zambian President as Head of State is the Head of Parliament and it is the same President who heads the Executive as head of Government appoints Judges in the Judiciary.

#### **Required:**

With reference to the scenario above, explain to Katiyo to enable him understand.

(7 marks)

**[Total: 20 Marks]**

### **QUESTION THREE**

Explain the following sources of administrative law:

- (a) Constitution (5 marks)
- (b) Acts of parliament (5 marks)
- (c) Statutory Instruments (5 marks)
- (d) By-Laws (5 marks)

**[Total: 20 Marks]**

### **QUESTION FOUR**

- (a) Explain how Parliament controls financial management in Administrative bodies. (12 marks)
- (b) Explain how the court controls Administrative bodies. (8 marks)

**[Total: 20 Marks]**

### **QUESTION FIVE**

- (a) Explain the effect of discussing a subject matter which is before court. (5 marks)
- (b) Explain how the National Assembly can check the powers of the President directly. (5 marks)
- (c) A debate has ensued between John and Martha who just wrote their examination at ZICA. John has insisted that illegality, procedural impropriety and irrationality are remedies under judicial review which was the answer for question 4. Martha on the other hand has argued and submitted that question 4 was based on the grounds of judicial review which includes mandamus, certiorari, and declarations. The argument has come to you as their tutor.

#### **Required:**

- (i) With reference to the above scenario, explain to your students the correct position on the argument. (2 marks)
- (ii) With reference to the above scenario, explain to your students on any two (2) remedies and any two (2) grounds of judicial review identified. (8 marks)

**[Total: 20 Marks]**

**END OF PAPER**

## SUGGESTED SOLUTIONS

### SOLUTION ONE

- (e) The Constitution is the most important source of law in Zambia. It firstly is the most supreme law of the land and it also creates organs of government. The Constitution also creates several institutions and officers in a given state. It is the supreme law from which other laws derive force, and any law that is not consistent with the constitution is null and void. Article 1(1) of the Constitution of Zambia expressly provides that 'This Constitution is the supreme law of Zambia and if any other law is inconsistent with this Constitution that other law shall, to the extent of the inconsistency, be void.'

Examples can be seen in *Banda v the People*, 1998, the High Court struck down section 24(c) of the Penal Code Chapter 87 of the Laws of Zambia which provided for corporal punishment on the grounds that this section was unconstitutional as it offended Article 15 of the Constitution of Zambia which provided that a person shall not be subjected to torture or to inhuman or degrading punishment or other like treatment. The brief facts of the case are that on 14th November 1998 at about midnight, police were patrolling Mulamba Street in Libala Stage 4B in their motor vehicle, a Jetta. They met and challenged the appellant, who was in company of his friends to stop. The appellants and his friends did not stop, but ran away in different directions. The police gave chase and the appellant was apprehended. In the process of executing an arrest, the appellant became violent and broke the rear window of the police vehicle. The appellant pleaded guilty to, and was convicted of malicious damage to property. He was sentenced to one month simple imprisonment which was suspended for a period of twelve months, in addition to ten strokes of a cane. It is the latter part of the sentence that was appealed against successfully.

In countries where there is a written Constitution like Zambia, the constitution is considered the primary source of law which would require all other actual administrative laws to conform to its provisions and failure to which, the other laws would be rendered void. A further example can be seen in the case of *Christine Mulundika and Seven Others v The Attorney General* (1996) ZR)

*Examples maybe cases or any fictitious ones which connotes to the above*

- (f) Judicial review is a public law mechanism which entails that public bodies are the only ones that can be brought before the courts for judicial review. This means that private bodies are not subject to judicial review and as such are subject to the ordinary litigation at court. Therefore, one must first of all identify whether an institution is a public order or not for purposes of bringing judicial review against such body.

(

- (g) Administrative law is that branch of public law which concerns itself with establishment of government agencies that perform public functions and quasi-judicial functions. Administrative law regulates the manner in which public agencies carry out their functions. It makes sure that there is bench mark against which these administrative institutions will be assessed by to ensure there is comfort with the law as they perform their function while Constitutional law is mainly concerned with the aspect of constituting a state that is, establishing the institutions of government and conferring on them the power they have. Thus, constitutional law is referred to as static law while administrative law is referred to as law in motion as it looks at day to day administrative functions.
- (h) Discuss any four (4) sources of law in Zambia.

### **The Constitution**

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.

### **Other Legislation**

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.

### **Delegated Legislation**

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.

Delegated legislation can take several forms and the most vital ones are:

1 **Statutory Instruments (Sis)** are passed by Ministers and are the main form of delegated legislation. Where power is delegated to a government Minister to make rules

and regulation of a specific nature, such as the minimum wages and conditions of employment, these are brought into effect by SIs.

2 **By-Laws** are made by local authorities under powers given by Parliament. These only affect the activities of people living within the particular geographical area. Professional bodies such as ZiCA are also given powers to regulate members' conduct.

### **Common Law and Equity**

The earliest element of the legal system to develop in England was the COMMON LAW, a body of legal rules common to the whole country that is embodied in judicial decisions. A system of rigid rules applied by royal Courts developed, often with harsh consequences.

### **Judicial Precedent/Case Law**

The system of judicial precedent is based on a fundamental feature of law which is that principles of law do not become inoperative through the lapse of time. A precedent is a previous Court decision which another Court is bound to follow by deciding a subsequent case in the same way. The doctrine of consistency, following precedent, is expressed in the maxim stare decisis, which means to stand by a decision. In any later case to which a legal principle is relevant, the same principles should (subject to certain exceptions) be applied.

The doctrine of judicial precedent means that a Judge is bound to apply a decision from an earlier case to the facts of the case before him, provided, among other conditions, that there is no material difference between the cases and the previous case created a 'binding' precedent.

### **Customary Law**

African customary law is derived from traditional values and habitual courses of conduct that are held and observed routinely and uniformly by the 73 ethnic tribes of Zambia. Customary law has been handed down in oral traditions from one generation to the next over many years. It has great impact on issues affecting individuals and their rights within a group, such as marriage, property, inheritance and traditional authority.

Customary law is not made by Parliament and is usually not written down as such, although in some areas customary law has been unified into a single statute by Parliament. It is not subject to the same rules of interpretation as legislation. Customary law is administered by Local Courts in Zambia.

### **Any four of the above**



## **SOLUTION TWO**

- (a) Legislature, Executive and the Judiciary
- (b) The organ responsible for dispute resolution is the judiciary because it settles conflicts which arise from state institutions and individuals, and between individuals and individuals. The judiciary is the bedrock of democracy under the concept of the rule of law. Courts interpret laws and no other organ is independent of the judiciary. Therefore independence of the judiciary is of paramount importance.  
[5 marks]
- (c) The main function of the legislature is to make laws. It checks the power of the executive through approval of constitutional office holders appointed by the president, such as the Chief Justice and the Director of Public Prosecutions, making executive accountable to parliament through the Vice President's question time and the Minister's question time and public committees etc.
- (d) From the given scenario, it is indeed surprising that the President can be found in all the organs of the state. From a brief look of the same, it appears there is no separation of powers. The rationale of separation of powers is to ensure that each of the three organs uses its powers in the process of governing a country to bring the other in line where the other would act contrary to the powers conferred by statute or by the constitution. The doctrine is justified by the principle of checks and balances which require that each of the three institutions work to check and balance 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. Thus, there is need for separation of powers.

### **SOLUTION THREE**

#### **a) The Constitution**

Zambia has a written Constitution which is the supreme law of the land. Being the grundnorm of the legal system of the country, it conditions and overrides all legislative and administrative actions. Besides providing for functional organization and consequential growth in administrative process, the Constitution has also provided for an elaborate control mechanism. The Constitution demarcates the legislative and administrative power of government, conferring on the courts the power to review legislative and administrative action and adjudge their constitutionality.

The Constitution establishes State institutions and organs, confers on them and limits their powers. Some of the established bodies enact administrative law thus making the Constitution a source of administrative law.

#### **b) Acts of parliament**

Acts of Parliament are the principal source of administrative law. Acts of Parliament emanates from the Constitution. Under the Constitution, law-making power has been given to Parliament. Administration is given powers by statutes. All statutes must conform to the constitutional patterns in the same vein exercise of administrative powers must conform to statutory patterns. In Zambia, a great deal of legislation has been enacted to provide for administrative procedures, composition and procedures of tribunals, liability of state and its bureaucracy and for strengthening the control on the exercise of administrative powers.

#### **c) Statutory Instruments**

A Statutory Instrument is delegated legislation passed by ministers under the powers conferred on them by an Act of Parliament. These mainly supplement provisions in Acts of Parliament. However, they are supposed to comply with the provisions of the enabling Act failure to which they would be rendered ultra vires.

#### **d) By- Laws**

These are passed by Local Authorities and make up the bulk of administrative law especially for purposes of enabling Local Authorities to effectively provide services to the people. By-Laws are also passed compliant to enabling Acts and are rendered ineffective if they contradict the enabling Act just like Statutory Instruments.

#### **SOLUTION FOUR**

- a) Parliament controls administrative bodies via the Minister of Finance and the Auditor-General. At the end of every financial year for the authorities, a financial report is presented to the Minister of Finance who tables the reports before the National Assembly for debate. It should be noted that each authority will have its own mechanism as stipulated under the Act that establishes it, for instance, according to S 13 (1) of the Public Procurement Authority Act, the authority is required to submit the financial report before the Finance Minister as soon as practicable but not later than 90 days after the end of the financial year. The minister shall not later than 7 days after the first sitting of the National Assembly next after receipt of the report and by S 12 (2) the accounts of the Authority shall be audited annually by the Auditor-General in accordance with the provisions of the public Finance Act 2004. According to S 25 (2) of the Zambia Revenue Authority Act should any irregularities arise from the report in the course of debate, the National Assembly may summon the Chief Executive Officer of the agency to appear before the Public Accounts Committee to answer queries on the irregularities.
- b) The Court controls Public Authorities via judicial review. 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. The High Court has power both under Acts of Parliament and the Constitution to interfere in the decision-making process of public bodies to ensure they are following the laid down procedures as they execute their functions and equally to ensure there is no arbitrariness in their decision-making process.

## **SOLUTION FIVE**

- (a) The public is barred by the *Sub Judice* rule from debating matters before court or awaiting trial. If unchecked, this may influence the outcome of the judgment and this is not fair. Anyone who contravenes this rule is guilty of contempt and the punishment is imprisonment.
- (b) The National Assembly can directly provide checks on the President through impeachment. This follows a notice in writing to the speaker signed by not less than one third of MPs, on a motion that the president has violated the constitution or is guilty of gross misconduct and proposing that a tribunal be set up by the house to investigate the allegations. The motion is debated and if supported by two thirds votes, the impeachment is passed.
- (c) i. The correct position is what Martha said (mandamus, certiorari, declaration and injunction) are the remedies and what John said are the grounds (illegality, procedural impropriety and irrationality).

ii. Grounds of judicial review are as follows:

- a. Illegality –that the decision was made without legal authority, which means that the decision was made outside the confines of the law dealing with the matter at hand. Thus, by illegality as a ground for judicial review, it means that the decision maker must understand correctly that the law regulates his decision-making power and give effect to it.
- b. Procedural impropriety – that the public body failed to follow procedure as laid down by the statute. Procedural Impropriety is a failure to observe basic rules of natural justice or failure to act with procedural fairness towards the person who will be affected by the decision.
- c. Irrationality or Wednesbury unreasonableness – that the decision made was so irrational that no reasonable person is expected to make such a decision. It applies to a decision, which is so outrageous in its defiance of logic or of accepted moral standards that no sensible person who has applied his mind to question to be decided could have arrived at it.

Remedies.

- a. Certiorari (quashing order) this order has the effect of nullifying a decision of a public body to the extent as though the decision was not made. It is usually made where a public body makes a decision when they have no legal authority to make that decision.
- b. Mandamus (mandatory order) this is an order of the court against a statutory body compelling the body to act as required by statute.

- c. Declaration, this is an order of the court recognising a right of a party may claim to have and as such it is binding. It can be ordered in private as well as public law.

**END OF SOLUTIONS**



PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

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DIPLOMA LEVEL

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PFM 3: GOVERNANCE AND MANAGEMENT IN PUBLIC SECTOR

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TUESDAY 15 DECEMBER 2020

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

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**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 in this Section is Compulsory.**

### **QUESTION ONE (COMPULSORY)**

#### **Case study: Effective Controls in Organisations**

A system of effective internal controls is a critical component of company management and a foundation for the safe and sound operation of organizations. However, ineffective internal controls result in ineffective programs and losses (Financial Management Manual, 2005).

Internal control means different things to different people. This causes confusion among business people, legislators and others. The definition of Internal Control has evolved over recent years as different internal control models have been developed. According to Statement of Auditing Standards (SAS 300), Internal Control is defined as all the policies and procedures adopted by the directors and management of an entity to assist in achieving their objective of ensuring, as far as practicable, the orderly and efficient conduct of its business, including adherence to internal policies, the safeguarding of assets, the prevention and detection of frauds and errors, the accuracy and completeness of accounting records, and the timely preparation of reliable financial information.

That is why the Retired Executive Vice President of American Savings Bank, Mary Locatelli in September, 2003, made it known that, the recent rash of corporate failures and accounting frauds are mostly preceded by a failure in a company's internal control structures. A framework for internal control systems in Banking Organizations issued by the Bank of International Settlement (Basle Committee) on Banking Supervision in 1998 stated that, the heightened interest in internal controls is, in part, a result of significant losses incurred by several organizations. It explained that, an analysis of the problems related to these losses indicates that they could probably have been avoided had the organizations maintained effective internal control systems. Such systems would have prevented or enabled earlier detection of the problems that led to the losses, thereby limiting damage to the organization (Directorship Journal, 2003).

This same idea is reflected in Kaplan (2007), that poor standards of corporate governance had led to insufficient controls being in place to prevent wrong doing in the United States (US) in the 1990s, as demonstrated by the collapse of Enron and WorldCom. These in fact were described as a high-profile collapse by the Association of

Certified Chartered Accountants – ACCA, (Student Accountant, 2008). The chartered for the Public Service in Africa puts emphasis on the importance of ethics. From the above, it is therefore imperative to say that, Internal Controls play a significant role in helping managers in both public and private organizations.

**Required:**

- (a) Explain the functions of managements according to Henri Fayol (10 marks)
- (b) Discuss the terms good governance, accountability and transparency as it relates to the effective management of Government and the Public Sector. (15 marks)
- (c) Identify the five points to consider in managing ethics at workplaces. (15 marks)

**[Total: 40 Marks]**



## **SECTION B**

**Answer Any Three (3) Questions in this section.**

### **QUESTION TWO**

A public policy making process refers to the series of steps taken by Government to solve problems, make decisions, allocate resources or values, implement policies and in general, to do the things expected of them by their constituencies. (Robert and Clark 1928:16)

**Required:**

- (a) Explain the three (3) major stages involved in policy making process. (15 marks)
- (b) Give two (2) main approaches instrumental to policy implementation. (5 marks)

**[Total: 20 Marks]**

### **QUESTION THREE**

In 1991 Zambia changed its governance system into a free market economy as it transformed its political system into multiparty political structure. The economic policy advocated for private sector development. According to Arjoon (2006), the private sector is part of the economy, sometimes referred to as the citizen sector. It is run by private individuals whose primary objective is profit maximization.

**Required:**

- (a) Explain the difference between Private and Public governance. (15 marks)
- (b) Give five similarities between Public and Private Administration. (5 marks)

**[Total: 20 Marks]**

### **QUESTION FOUR**

The Contract Management Guide (CMG) provides practical guidance on application of Contract Management Framework (CMF). The CMG is intended for managers and practitioners in the national and provincial government departments and public entities who

are involved in policy making, strategic planning, management, and day to day contract management functions.

**Required:**

- (a) Contract management requires that the management of contracts takes into account best practices. List down eight (8) best practices required in management of Contracts. (16 marks)
- (b) List four (4) attributes of good Supply Chain Management (SCM) that are important for contract management. (4 marks)

**[Total: 20 Marks]**

**QUESTION FIVE**

In Zambia many former parastatals have now been privatized, and are part of the private sector. The Government is also working of the decentralization process.

**Required:**

- (a) Explain five (5) characteristics of parastatal organization. (10 marks)
- (b) Define decentralization and list four (4) advantages of decentralization. (10 marks)

**[Total: 20 Marks]**

**END OF PAPER**

## **SUGGESTED SOLUTIONS**

### **SECTION A**

**This question in this Section is Compulsory.**

#### **SOLUTION ONE**

##### **Case study: Effective Controls in Organizations**

##### **Required:**

- (a) Explain the functions of managements according to Henri Fayol
  - (i) Planning
  - (ii) Organizing
  - (iii) Leading (directing)
  - (iv) Controlling
  
- (b) Discuss the terms good governance, accountability and transparency as it relates to the effective management of Government and the Public Sector.

##### **Good Governance**

- (i) Good governance has to do with ethical grounding of governance.
- (ii) It looks at the functioning of the given segment of the society from the point of view of its acknowledged stakeholders and beneficiaries and customers.
- (iii) It must have a firm stand on certain moral values and principles.
- (iv) Good governance, as a concept is applicable to all sections of the public sector

##### **Accountability**

- I. Accountability concerns the processes by which those who exercise power must be able to show that they have exercised their powers and discharged their duties properly.
- II. It is the responsibility of government and its agents towards the public to achieve previously set objectives and to account for them in public.
- III. It is a commitment required from public officials individually and collectively to accept public responsibility for their own action and inaction.
- IV. It is the obligation to carry out assigned activities in a responsible and responsive manner, and being held answerable for success or failure.

V. It takes into account internal and external accountability.

### **Transparency**

- I. Transparency is built on the free flow of information.
- II. Transparency implies openness, communication, and accountability.
- III. With regard to public services, it means that holders of public office should be as open as possible about all the decisions and actions they take. They should give reasons for their decisions and restrict information only when the wider public interest demands it.

(c) Identify the five points to consider in managing ethics at workplaces.

- i) Understand the benefits of ethical conducts
- ii) Focus on ethical conduct through building strong organization culture around ethics
- iii) Develop a code of ethical conduct that is documented and available to every employee of the organization.
- iv) Promote process should incorporate ethics as part of the evaluation
- v) Link ethics to other management practices
- vi) Demonstrate ethical practices by leading by examples.

**(5 marks x 3 = 15 marks)**

**[TOTAL: 40 Marks]**

## **SOLUTION TWO**

(a) Explain the three major stages involved in policy making process

- (i) Policy formulation stage: this is the stage where policy makers take decisions as to what is to be done and how it is to be done.
- (ii) Policy implementation stage: it is the ability of the organization or the government to bring together men and materials in a cohesive organisational unit and motivate them in such a way as to carry out the stated objectives.
- (iii) Feedback and evaluation stage: this is the stage of comparison between intended outcome of the policy and the actual achievement on the basis of experience gained during the implementation stage

(b) Give two main approaches instrumental to policy implementation

(5 marks)

- (i) *Top-down approach*: policy designers are the central actors and concentrate their attention on factors that can be manipulated at the central level
- (ii) *Bottom-up approach*: emphasis target groups and service deliverers, arguing that policy is made at the local level
- (iii)**

### **SOLUTION THREE**

(c) Explain the difference between private and Public governance

- (i) Environmental factor: The role of the market is very important in the private sector. The structure is at the micro level and hierarchy is restricted. In contrast, the public sectors have a more political structure and are influenced by status and power. Markets hardly play any part as revealing mechanisms for information. In public sector there is open hierarchy between principal and agents.
- (ii) Organisation/environmental transactions: The private sector is driven by the motive to make profit. Their performance indicators are therefore clear and they are more open to taking risks. They are very competitive with other organizations and consumer expectations are clear. On the other hand, public sector organizations have no profit motive. They work purely in the interest of the public. Unlike the private sector, in the public sector performance is complex and may sometimes be conflicting. There is also competition because public services are often monopolistic.
- (iii) Organisational roles, structures and processes: In the private sector, the organisational goals and objectives are fixed and clear. In addition, there is elementary follow up on performance and there is a link between performance and reward. Public organizations on the other hand have qualitative, and sometimes irrational objectives, symbolic influence, and less clarity about follow up of performances. There is a tendency to focus on inputs and processes rather than output.

(d) Give five similarities between Public and Private Administration

- (i) Both public and business administration rely on common skills, techniques and procedures.

- (ii) In modern times the principle of profit motive is not peculiar to private administration, because it is now accepted as a laudable objective for public sector enterprises also.
- (iii) In personnel management, the private organizations have been influenced greatly by the practices of public organizations.
- (iv) The private concerns are also subjected to many legal constraints. Government is exercising much control over business firms through regulatory legislation such as taxation, monetary and licensing policies,
- (v) There is a similar type of hierarchy and management systems, both in public and private sectors. Both have same kind of organization structure, superior\_ subordinate relationships.
- (vi) Both public and private administration carries on continuous efforts to improve their internal working and also for efficient delivery of services to people or customers.
- (vii) Public and private administration serves the people, whether being called clients or customers. Both have to maintain close contact with people to inform them about their services and also to get feedback about services and product. In both cases, public relations help them to inform and improve their services to the people.

## **SOLUTION FOUR**

a) Contract management requires that the management of contracts takes into account best practices. List down eight (8) best practices required in management of Contracts

Optimizes delivery of large capital projects

- (i) Enhances risk management
- (ii) Identifies savings and additional revenue opportunities
- (iii) Customer and supplier dissatisfaction
- (iv) Revenue collection delays
- (v) Encourages communication between all parties to contracts
- (vi) Erroneous payments
- (vii) Service delivery issues
- (viii) Missed saving opportunities

b) List four (4) attributes of good Supply Chain Management (SCM) that are important for contract management

1. Achieving value for money;
2. Promoting open and effective competition;
3. Achieving the highest standards of ethics and fair dealing;
4. Supporting preferential procurement;
5. Delivering on government's social and economic policies;
6. Education of buyers and suppliers; and
7. measuring performance



## **SOLUTION FIVE**

(a) Explain five (5) characteristics of parastatal organization

- (i) There profit motive is within the government limits
- (ii) They produce essential good
- (iii) They are part of the government structure
- (iv) They obtain grants from the central government
- (v) They have a strong political influence

(b) Define decentralization and list four (4) advantages of decentralization

*Definition:* Decentralization refers to the systematic effort to delegate to the lowest levels all authority except that which can only be exercised by central points.

*Advantages*

- (i) It leads to competitive climate in the organisation
- (ii) It relieves the management of much workload
- (iii) Reduces the burden on top executives
- (iv) Promotes motivation
- (v) Facilitates diversification

**END OF SOLUTIONS**



PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

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DIPLOMA LEVEL

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PFM 4: PUBLIC SECTOR FINANCIAL MANAGEMENT

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FRIDAY 18 DECEMBER 2020

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

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## SECTION A: COMPULSORY

**This question is compulsory and must be attempted.**

### **QUESTION ONE**

NCZ Plc is a state owned enterprise that manufactures fertilizer in Zambia. The company owns a machine that can manufacture a maximum of 4,600 units per hour. The machine had costed the company K86 million some five years ago. Recently, there has been an increasing demand for fertilizer and the production department has proposed that the machine be upgraded in order to meet the demand. A machine upgrade can change the maximum capacity of the machine to 6,000 units per hour. The cost of this upgrade is K500 million, and it is expected that the machine will operate for a period of five (5) years after which a new major investment will be required. The machine is expected to continue being operated at the current level of 40 hours per week at full capacity. The historical profit margins for the past five years are shown below:

<b>Years</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
<b>Profit margin per unit (ZMW)</b>	44	49	55.4	57.9	60

The profit margin per year is expected to increase in line the historical profit margin growth rate. Corporate tax is payable in the year that taxable profit arises at 25% per year. Capital allowance is available on the machine at the rate of 25% on a reducing balance basis. NCZ Plc expects tax allowable losses for the company in the next ten (10) years. Working capital of K100 million will be required immediately and it is expected that working capital will be increasing by 5% per year.

NCZ Plc has ten million shares trading at K12 per share and a 15% redeemable debt trading at K119, with a book value of K43.5million and five (5) years to maturity. The debt was issued at a par value of K100 and redeemable at a premium of 5%. NCZ Plc has an asset beta of 0.89. The risk free rate is 7% and equity premium of 8.5%.

Recently, NCZ Plc received some trainee accountants who were not sure of what is involved in capital investment process and the meaning of relevant cash flows. You have been tasked by the Finance Director to prepare an investment evaluation report on the upgrade of the machine and help the trainee accountants to understand the investment decision making process.

Assume 365 days per year.

#### **Required:**

- Explain the key stages in the capital investment decision making process. (10 marks)
- Discuss the meaning of the term 'relevant cash flows' in the context of investment appraisal, giving examples to aid your discussion. (5 marks)
- Evaluate the financial viability of the proposed machine upgrade using the Net Present Value method. (25 marks)

**[Total: 40 Marks]**

## **SECTION B**

**Attempt any THREE (3) questions in this section.**

### **QUESTION TWO**

The National Development Planning Division for SKN Republic is responsible for social economic planning and development of the country in order to ensure equitable and sustainable development. The Ministry has four (4) departments namely: Planning; Monitoring and Evaluation; Accounting; and Human Resources. A separate director is responsible for executing the mandate in each department.

Each Director is tasked to prepare their budget based on the strategic plan and ceilings that have been allocated by Ministry of Finance (MoF). These budgets are then submitted to the Permanent Secretary who convenes a meeting with departmental heads before submitting to MoF for consolidation. In 2018, the Treasury upon realizing that the resource envelope was not enough, they proceeded to amend the budgets of the ministries without consultation.

In addition to budget preparation, the ministry launched its strategic plan which included the balance score card as a way of enhancing performance management. Most Directors are still grappling with understanding the new concept of balanced score card.

During performance review meeting, the Permanent Secretary of National Development Planning Division, requested for an explanation from Director Human Resources on why staff costs exceeded the budgeted cost in 2018. Her reply was as follows:

“My original budget estimate for staff costs was higher than the budget approved by parliament. In the original budget submitted to MoF, I allowed for recruitment of interns in view of the preparation of the next phase of the development plans. This would assist government finalize its plan on time. She further indicated that currently, MoF has been focusing on financial performance by analyzing expenditure trends of the previous year, as opposed to looking at the other performance indicators. ”

#### **Required:**

- a) Discuss present budget system and its likely effect on National Development Planning achieving its goals. (6 marks)
- b) Explain to the Directors the balance score card approach to performance management. (10 marks)
- c) Explain two non-financial indicators that could be used by National Development planning. (4 marks)

**[Total: 20 Marks]**

### **QUESTION THREE**

A newly elected government of Country Y which is a developing country recently swore in new Cabinet Ministers. The newly appointed minister of defense was assigned to attend a meeting of technocrats where the topic of public finance and sources of raising finances was

being discussed. During the discussions the presenter indicated that public goods had two principle characteristics namely: Non – exclusion meaning it is impossible to prevent people from using the goods/service and non – rival consumption – meaning the same goods can be used simultaneously by a number of people. The presenter indicated that public finance was key in development of an economy and Government should at all times ensure that its public financial management systems are being implemented in an efficient and effective manner.

The presenter also indicated that the funds raised through the various taxes are 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.

**Required:**

You are Director of Finance in the ministry of defence, the minister has requested for the following clarifications on the presentation that was mad during the meeting:

- (a) Whether the national defense is a public good. (2 marks)
- (b) Describe the main types of non-tax revenue in the public sector. (10 marks)
- (c) The functions of government relating to public finance in a developing economy. (8 marks)

**[Total: 20 Marks]**

**QUESTION FOUR**

The Government recently established a Ministry known as Ministry of Entrepreneurship and Innovation. The function of this Ministry was to largely coordinate and enhance entrepreneurship and Innovation activities in the country.

It was noted that the country was facing a number of challenges in terms of balance of payments which was in negative and the repayment of international debt. It was further established that the performance of public sector organisation was not clearly measured. This was because of the theory and practice of performance measurement which evident that it is a complex process and that the application of performance measurement systems in public sector is specific because all the functions of public sector organizations are focused to the satisfaction of public interests, i.e. it is more difficult to apply the performance measurement methods for measurement of public sector organizations, because such organizations are more process and not result-oriented.

The newly appointed Minister of Entrepreneurship and Innovation recently held a meeting with his permanent secretary. The permanent secretary, in the meeting, stated that there was need to create an internal audit department in the ministry. The permanent secretary explained that this was going to enhance Internal Control System in the Ministry. It was further reported that there was going to be an audit committee which was to meet at least once in three months.

**Required:**

- (a) Explain the purpose of the performance measurement system in the public sector

(b) Explain what an internal control system is stating its objectives and its benefits as summarized as defined in the Practices Board (APB) and the COSO guidelines. (4 marks)

(c) Explain the oversight functions of Audit Committees in the internal control systems. (10 marks)

(6 marks)

**[Total: 20 Marks]**

### **QUESTION FIVE**

You have been nominated by the Permanent Secretary of the Ministry of Finance to attend a conference on budgeting and cash management in the public sector. The discussion at the conference centered on the need to balance budget management with efficient cash management as a way of improving the budget credibility.

It was agreed in the meeting that budget management should be complemented by an adequate system for managing cash commitments, and it is not a substitute for sound budget preparation. For efficient budget implementation, it is necessary to ensure that claims are paid according to the contract terms and that revenues are collected on time; to minimise transaction costs; and to borrow at the lowest available interest rate or to generate additional cash by investing in revenue-yielding paper. It is also necessary to make payments on a timely basis by tracking accurately the dates on which they are due.

Often in the past, governments did not pay sufficient attention to issues related to efficient cash management. Budget execution procedures and the management of cash flows focused on issues of legal regularity and compliance, while daily cash needs were met by the central bank. Spending units were not concerned with borrowing costs since their interest payments were already taken account of in the budget prepared by the ministry of finance.

#### **Required:**

(a) Explain why it is important for the treasury to management the cash flows. (4 marks)

(b) Describe the capital budgeting process of determining whether the expenditure is in conformity with organizations' goals. (8 marks)

(c) Describe the main types of budgeting methods that are common in the public sector. (8 marks)

**[Total: 20 Marks]**

**END OF PAPER**



PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

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DIPLOMA LEVEL

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PFM 4: PUBLIC SECTOR FINANCIAL MANAGEMENT

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FRIDAY 18 DECEMBER 2020

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

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**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: COMPULSORY

**This question is compulsory and must be attempted.**

### **QUESTION ONE**

NCZ Plc is a state owned enterprise that manufactures fertilizer in Zambia. The company owns a machine that can manufacture a maximum of 4,600 units per hour. The machine had costed the company K86 million some five years ago. Recently, there has been an increasing demand for fertilizer and the production department has proposed that the machine be upgraded in order to meet the demand. A machine upgrade can change the maximum capacity of the machine to 6,000 units per hour. The cost of this upgrade is K500 million, and it is expected that the machine will operate for a period of five (5) years after which a new major investment will be required. The machine is expected to continue being operated at the current level of 40 hours per week at full capacity. The historical profit margins for the past five years are shown below:

<b>Years</b>	1	2	3	4	5
<b>Profit margin per unit (ZMW)</b>	44	49	55.4	57.9	60

The profit margin per year is expected to increase in line the historical profit margin growth rate. Corporate tax is payable in the year that taxable profit arises at 25% per year. Capital allowance is available on the machine at the rate of 25% on a reducing balance basis. NCZ Plc expects tax allowable losses for the company in the next ten (10) years. Working capital of K100 million will be required immediately and it is expected that working capital will be increasing by 5% per year.

NCZ Plc has ten million shares trading at K12 per share and a 15% redeemable debt trading at K119, with a book value of K43.5million and five (5) years to maturity. The debt was issued at a par value of K100 and redeemable at a premium of 5%. NCZ Plc has an asset beta of 0.89. The risk free rate is 7% and equity premium of 8.5%.

Recently, NCZ Plc received some trainee accountants who were not sure of what is involved in capital investment process and the meaning of relevant cash flows. You have been tasked by the Finance Director to prepare an investment evaluation report on the upgrade of the machine and help the trainee accountants to understand the investment decision making process.

Assume 365 days per year.

#### **Required:**

- (d) Explain the key stages in the capital investment decision making process. (10 marks)
- (e) Discuss the meaning of the term 'relevant cash flows' in the context of investment appraisal, giving examples to aid your discussion. (5 marks)
- (f) Evaluate the financial viability of the proposed machine upgrade using the Net Present Value method. (25 marks)

**[Total: 40 Marks]**



## **SECTION B**

**Attempt any THREE (3) questions in this section.**

### **QUESTION TWO**

The National Development Planning Division for SKN Republic is responsible for social economic planning and development of the country in order to ensure equitable and sustainable development. The Ministry has four (4) departments namely: Planning; Monitoring and Evaluation; Accounting; and Human Resources. A separate director is responsible for executing the mandate in each department.

Each Director is tasked to prepare their budget based on the strategic plan and ceilings that have been allocated by Ministry of Finance (MoF). These budgets are then submitted to the Permanent Secretary who convenes a meeting with departmental heads before submitting to MoF for consolidation. In 2018, the Treasury upon realizing that the resource envelope was not enough, they proceeded to amend the budgets of the ministries without consultation.

In addition to budget preparation, the ministry launched its strategic plan which included the balance score card as a way of enhancing performance management. Most Directors are still grappling with understanding the new concept of balanced score card.

During performance review meeting, the Permanent Secretary of National Development Planning Division, requested for an explanation from Director Human Resources on why staff costs exceeded the budgeted cost in 2018. Her reply was as follows:

“My original budget estimate for staff costs was higher than the budget approved by parliament. In the original budget submitted to MoF, I allowed for recruitment of interns in view of the preparation of the next phase of the development plans. This would assist government finalize its plan on time. She further indicated that currently, MoF has been focusing on financial performance by analyzing expenditure trends of the previous year, as opposed to looking at the other performance indicators. ”

#### **Required:**

- d) Discuss present budget system and its likely effect on National Development Planning achieving its goals. (6 marks)
- e) Explain to the Directors the balance score card approach to performance management. (10 marks)
- f) Explain two non-financial indicators that could be used by National Development planning. (4 marks)

**[Total: 20 Marks]**

### **QUESTION THREE**

A newly elected government of Country Y which is a developing country recently swore in new Cabinet Ministers. The newly appointed minister of defense was assigned to attend a meeting of technocrats where the topic of public finance and sources of raising finances was being discussed. During the discussions the presenter indicated that public goods had two principle characteristics namely: Non – exclusion meaning it is impossible to prevent people from using the goods/service and non – rival consumption – meaning the same goods can be used simultaneously by a number of people. The presenter indicated that public finance was key in development of an economy and Government should at all times ensure that its public financial management systems are being implemented in an efficient and effective manner.

The presenter also indicated that the funds raised through the various taxes are 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.

#### **Required:**

You are Director of Finance in the ministry of defence, the minister has requested for the following clarifications on the presentation that was mad during the meeting:

- (d) Whether the national defense is a public good. (2 marks)
- (e) Describe the main types of non-tax revenue in the public sector. (10 marks)
- (f) The functions of government relating to public finance in a developing economy. (8 marks)

**[Total: 20 Marks]**

### **QUESTION FOUR**

The Government recently established a Ministry known as Ministry of Entrepreneurship and Innovation. The function of this Ministry was to largely coordinate and enhance entrepreneurship and Innovation activities in the country.

It was noted that the country was facing a number of challenges in terms of balance of payments which was in negative and the repayment of international debt. It was further established that the performance of public sector organisation was not clearly measured. This was because of the theory and practice of performance measurement which evident that it is a complex process and that the application of performance measurement systems in public sector is specific because all the functions of public sector organizations are focused to the satisfaction of public interests, i.e. it is more difficult to apply the performance measurement methods for measurement of public sector organizations, because such organizations are more process and not result-oriented.

The newly appointed Minister of Entrepreneurship and Innovation recently held a meeting with his permanent secretary. The permanent secretary, in the meeting, stated that there was need to create an internal audit department in the ministry. The permanent secretary explained that this was going to enhance Internal Control System in the Ministry. It was further reported that there was going to be an audit committee which was to meet at least once in three months.

**Required:**

- (d) Explain the purpose of the performance measurement system in the public sector (4 marks)
- (e) Explain what an internal control system is stating its objectives and its benefits as summarized as defined in the Practices Board (APB) and the COSO guidelines. (10 marks)
- (f) Explain the oversight functions of Audit Committees in the internal control systems. (6 marks)

**[Total: 20 Marks]**

**QUESTION FIVE**

You have been nominated by the Permanent Secretary of the Ministry of Finance to attend a conference on budgeting and cash management in the public sector. The discussion at the conference centered on the need to balance budget management with efficient cash management as a way of improving the budget credibility.

It was agreed in the meeting that budget management should be complemented by an adequate system for managing cash commitments, and it is not a substitute for sound budget preparation. For efficient budget implementation, it is necessary to ensure that claims are paid according to the contract terms and that revenues are collected on time; to minimise transaction costs; and to borrow at the lowest available interest rate or to generate additional cash by investing in revenue-yielding paper. It is also necessary to make payments on a timely basis by tracking accurately the dates on which they are due.

Often in the past, governments did not pay sufficient attention to issues related to efficient cash management. Budget execution procedures and the management of cash flows focused on issues of legal regularity and compliance, while daily cash needs were met by the central bank. Spending units were not concerned with borrowing costs since their interest payments were already taken account of in the budget prepared by the ministry of finance.

**Required:**

- (d) Explain why it is important for the treasury to management the cash flows. (4 marks)
- (e) Describe the capital budgeting process of determining whether the expenditure is in conformity with organizations' goals. (8 marks)
- (f) Describe the main types of budgeting methods that are common in the public sector. (8 marks)

**[Total: 20 Marks]**

**END OF PAPER**

## **SUGGESTED SOLUTIONS**

### **SOLUTIONS ONE**

a)

1. The company should identify proposals or investment opportunities that are in line the organizational objectives

Investment opportunities or proposals could arise from analysis of strategic choices, analysis of the business environment, research and development, or legal requirements. The key requirement is that investment proposals should support the achievement of organizational objectives.

2. Investment proposals must be screened in order to select appropriate ones

In the real world resources are scarce so it is usual for companies to be restricted in the amount of finance available for capital investment. Companies therefore need to choose between competing investment proposals and select those with the best strategic fit and the most appropriate use of economic resources.

3. Investment proposals must be analyzed and evaluated in order to determine the most attractive

Candidate investment proposals need to be analyzed in depth and evaluated to determine which one offers the most attractive opportunity to achieve organizational objectives i.e. maximize shareholder wealth. This is the stage where investment appraisal plays a key role, indicating which investment proposals have the highest net present value.

4. Investment proposals must be approved by an appropriate authority in the organization

The most suitable investment proposals are passed to the relevant level of authority for consideration and approval. Very large proposals may require approval by the board of directors, while smaller proposals may be approved at divisional level, and so on. Once approval has been given, implementation can begin.

5. Investment proposals must be properly implemented, monitored and reviewed to ensure projects success

The time required to implement the investment proposal or project will depend on its size and complexity, and is likely to be several months. Following implementation, the investment project must be monitored to ensure that the expected results are being achieved and the performance is as expected. The whole of the investment decision-making process should also be reviewed in order to facilitate organizational learning and to improve future investment decisions.

b)

When appraising an investment project, it is essential that only those cash flows relevant to the project be taken into account, otherwise an incorrect investment decision could be made. A 'relevant cash flow' is an incremental cash flow that arises or changes as a direct result of the investment being made.

Some costs will be sunk before an investment decision is made. An example would be research and development or market research costs into the viability of a new product. Once

incurred, such costs become irrelevant to the decision as to whether or not to proceed, and so should be excluded from the analysis.

Cash flows that would be relevant include an increase in production overheads or labour costs, new purchases that are necessary, and any incremental tax effects.

It is important to note that any interest payments on the finance for a new project are relevant to the project decision, but are not taken into account in any NPV calculation. The interest payments will already be 'built in' to the calculation in the discount factor that is being applied.

c) NPV						
Year	0	1	2	3	4	5
	K	K	K	K	K	K
Units demanded		2,920,000	2,920,000	2,920,000	2,920,000	2,920,000
Profit margin		65	70	76	82	88
Taxable profits		189,216,000	204,353,280	220,701,542	238,357,666	257,426,279
Tax@25%		(47,304,000)	(51,088,320)	(55,175,386)	(59,589,416)	(64,356,570)
Tax savings		31,250,000	23,437,500	17,578,125	13,183,594	39,550,781
Working capital	(100,000,000)	(5,000,000)	(5,250,000)	(5,512,500)	(5,788,125)	121,550,625
Initial Investment	(500,000,000)	-	-	-	-	-
Net Cash flows	(600,000,000)	168,162,000	171,452,460	177,591,782	186,163,718	354,171,116
Discount@15%	1	0.87	0.756	0.658	0.572	0.497
Present values	(600,000,000)	146,300,940	129,618,060	116,855,392	106,485,647	176,023,044
<b>NPV</b>	<b>75,283,083</b>					
<b>Working capital</b>	<b>0</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
Incremental	100,000,000	105,000,000	110,250,000	115,762,500	121,550,625	127,628,156
	100,000,000	5,000,000	5,250,000	5,512,500	5,788,125	121,550,625
	<b>WDV</b>	<b>CA@25%</b>	<b>Tax saving @25%</b>			
1	500,000,000	125,000,000	31,250,000			
2	375,000,000	93,750,000	23,437,500			
3	281,250,000	70,312,500	17,578,125			
4	210,937,500	52,734,375	13,183,594			
5	158,203,125	158,203,125	39,550,781			

The NPV is positive and therefore, on financial grounds the upgrade of the machine should be undertaken.

#### Workings

- Additional units per year =  $(6000 - 4600) \times 40 \times 365/7 = 2,920,000$
- Growth rate =  $= 0.08$  Or 8%
- Cost of debt

$$\text{Interest} = 15\% \times 100 = 15$$

$$= 15 \times (1 - 0.15) = 12.75$$

Year		Cash flow	Discount@10% PV	Discount@5% PV
0	MV	(119)	1.000	(119)
1-5	Interest	12.75	3.791	48.34
			4.329	55.19

5	Redemption	105	0.621	<u>65.21</u>	0.784	<u>82.32</u>
	NPV			(5.45)		18.51

Cost of debt =  $5\% + 18.51 / (18.51 + 5.45) (10\% - 5\%) = 8.86\%$

- Market values:

$$\text{Equity} = 10\text{m} \times \text{K}12 = \text{K}120\text{m} \quad 70\%$$

$$\text{Debt} = 119/100 \times \text{K}43.5\text{m} = \underline{\text{K}51.77\text{m}} \quad 30\%$$

$$\underline{\text{K}171.77\text{m}}$$

- Cost of equity

$$\text{Equity beta: } 0.89 = \text{Be} \times 120/120 + 51.77(0.85)$$

$$= 1.22$$

$$\text{Cost of equity} = 7\% + 1.22(8.5\%)$$

$$= 17.37\%$$

- WACC =  $(17.37\% \times 0.70) + (8.86\% \times 0.30)$

$$= 14.8\% \text{ round off to } 15\%$$

## SOLUTION TWO

1.	<ul style="list-style-type: none"> <li>• Discuss present budget system and its likely effect on National Development Planning achieving its goals.</li> <li>• Explain to the Directors the balance score card approach to performance management</li> <li>• Explain two non-financial indicators that could be used by National Development planning.</li> </ul>	
	<ul style="list-style-type: none"> <li>• <b>Discuss present budget system and its likely effect on National Development Planning achieving its goals</b></li> <li>• Directors appear to be involved in the budgeting process as they are required to submit budgets to MoF through the Permanent Secretary. These are adjusted without the involvement of the Division or individual directors.</li> <li>• This is likely to demotivate the Directors who will feel they wasted their time and are likely not to feel responsible for achieving the targets of the department as they not involved in finalizing the budget.</li> <li>• They may deliberately fail to achieve the budgeted costs to prove their own budget was correct and budgets imposed by MoF were unrealistic.</li> </ul>	
	<p><b>(b) Explain to the Directors the balance score card approach to performance management</b></p> <ul style="list-style-type: none"> <li>• The balanced scorecard is a strategic management technique for communicating and evaluating the achievement of the strategy and mission of an organisation. It comprises an integrated framework of financial and non-financial performance measures that aim to clarify, communicate and manage strategy implementation. It translates an organisation's strategy into objectives and performance measurements for the following four perspectives:</li> <li>• Financial perspective The financial perspective considers how the organisation appears to shareholders. How can it create value for its shareholders? Kaplan and Norton, who developed the balanced scorecard, identified three core financial themes that will drive the business strategy: revenue growth and mix, cost reduction and asset utilisation.</li> <li>• Customer perspective The customer perspective considers how the organisation appears to customers. The organisation should ask itself: 'to achieve our vision, how should we appear to our customers?' The customer perspective should identify the customer and market segments in which the business units will compete. There is a strong link between the customer perspective and the revenue objectives in the financial perspective. If customer objectives are achieved, revenue objectives should be too.</li> <li>• Internal perspective The internal perspective requires the organisation to ask itself the question – 'What must we</li> </ul>	

	<p>excel at to achieve our financial and customer objectives?' It must identify the internal business processes that are critical to the implementation of the organisation's strategy. Kaplan and Norton identify a generic process value chain consisting of three processes: the innovation process, the operations process and the post-sales process.</p> <ul style="list-style-type: none"> <li>• Learning and growth perspective The learning and growth perspective requires the organisation to ask itself whether it can continue to improve and create value. If an organisation is to continue having loyal, satisfied customers and make good use of its resources, it must keep learning and developing. It is critical that an organisation continues to invest in its infrastructure – ie people, systems and organisational procedures – in order to provide the capabilities that will help the other three perspectives to be accomplished.</li> </ul>	
	<p>(c) <b>Explain two non-financial indicators that could be used by National Development planning.</b></p> <ul style="list-style-type: none"> <li>• National Development Planning choose staff turnover or analyzing qualification levels of newly recruited staff. Some information could be taken from internal sources but much would have to come from colleges or external recruiters. Exit interviews could also be used.</li> <li>• Another non- financial indicator could be non-compliance with financial regulations ;this would indicate problems with staff training.</li> </ul>	



### SOLUTION THREE

1.	<p>You are Director of Finance in the ministry of defence, the minister has requested for the following clarifications on the presentation that was mad during the meeting:</p> <p>a) Whether the national defense is a public good.</p> <p>b) Describe the main types of non-tax revenue in the public sector.</p> <p>c) The functions of government relating to public finance in a developing economy.</p>	
	<p><b>a) Whether he national defense is a public good</b>  National Defence is a public good as it has the characteristic of non-exclusion as well as non-rival consumption. Non- exclusion means that it is impossible to prevent some people from using national defence. It displays the characteristic of non-rival consumption as the use of public defence by one individual does not reduce the quantum available to others. Furthermore, the benefit of public defence is available simultaneously to a number of people.</p>	
	<p><b>b) Describe the main types of non-tax revenue in the public sector</b></p> <p>Public income received through the administration, commercial enterprises, gifts and grants are the source of non-tax revenues of the government.</p> <p><b>Thus, nontax revenue includes:</b></p> <p>(i) Administrative revenue  (ii) Profit from state enterprises  (iii) Gifts and grants</p> <p><b>Administrative Revenues:</b>  Under public administration, public authorities can raise some funds in the form of fees, fines and penalties, and special assessments.</p> <p><b>Fees:</b>  Fees are charged by the government or public authorities for rendering a service to the beneficiaries. A fee is a payment to defray the cost of each recurring service undertaken by the government, primarily in the public interest, but conferring a measurable advantage to the payer.</p> <p>Court fees, passport fees, etc., fall under this category. Similarly, licence fees are charged to confer a permission for something by the controlling authority, e.g., driving licence fee, import licence fee, liquor permit fee, etc. Fees are to be paid by those who receive some special advantages. Generally the amount of the fee depends upon the cost of services rendered.</p> <p><b>Fines and Penalties:</b>  Fines and penalties are levied and collected from offenders of laws as punishment. Here the main object of these levies is not so much to earn an income as to prevent the commission of offences and infringement of laws of</p>	

	<p>the country. Fines and penalties are arbitrarily determined and have no relation to the cost of administration or activities of the government. Hence, collections from such levies are insignificant as a source of public revenue.</p> <p><b>Special Assessments:</b>  A special assessment is a compulsory contribution levied in proportion to the social benefits derived to defray the cost of a specific improvement to property undertaken in the public interest. That is to say, sometimes when the government undertakes certain types of public improvements such as construction of roads, provision of drainage, street lighting etc., it may confer a special benefit to those possessing properties nearby.</p> <p>As a result, values of rents of these properties may rise. The government, therefore, may impose some special levy to recover a part of the expenses so incurred. Such special assessment is levied generally in proportion to the increase in the value of the properties involved. In this respect, it differs from a tax.</p> <p><b>Profits of State Enterprise:</b>  Profits of state undertakings also are an important source of revenue these days, owing to the expansion of the public sector. For instance, the central government runs railways. Surplus from railway earnings can be normally contributed to the revenue budget of the central budget.</p> <p>Likewise, profits from the state transport corporation and other public undertakings can be important sources of revenue for the budgets of state governments. Similarly, other commercial undertakings in the public sector.</p> <p>Earnings from state enterprises depend upon the prices charged by them for their goods and services and the surplus derived therefrom.</p> <p><b>Gifts and Grants:</b>  These form generally a very small part of public revenue. Quite often, patriotic people or institutions may make gifts to the state. These are purely voluntary contributions. Gifts have some significance, especially during war time or an emergency</p> <p>In modern times, however, grants from one government to another have a greater importance. Local governments receive grants from state governments and state governments from the centre. The central government gives grants-in-aid to local governments in order to enable them to carry out their functions. When grants are made by one country's government to another country's government it is called foreign aid. Usually poor countries receive such aid from developed countries, which may be in the form of military aid, economic aid, food aid, technological aid, and so on.</p>	
	<p><b>c) Functions of a government relating to public finance in a developing economy</b></p>	

- **Encouraging capital formation**

Industrialization is a key to development of an economy. This is brought about by investing in infrastructure such as machinery and tools, chemicals, iron and steel, iron and steel industry. Such investments carry high risks and returns are available only in the long run. Therefore private sector rarely makes such investment. government takes the responsibility to make investment in this sector. In the process the economy improves its capital formation

- **Complementing private investment**

Economic development requires industrialization which is brought about when an economy invests in the industrial goods. The process of investment in industrial goods is carried out by the private sector. However wherever there is insufficient investment by private sector, the government intervenes and makes good the shortage. Furthermore this also ensures a balanced development of the economy by government investing in less profitable sectors or backward areas where private investment is not forthcoming.

- **Making atmosphere conducive to development**

The government encourages private investment in areas of economic development by providing basic industries and by providing financial assistance, by developing banks, etc.

- **Conserving and efficiently utilizing natural resources**

Economic development depends on the efficient and effective utilization of its natural resources like oil, minerals, aquatic life and forestry. Developing economies are often faced with underutilization as well as inefficient utilization of its natural resources. government therefore intervenes to develop as well as conserve the natural resources.

## **SOLUTION FOUR**

### **a) Explain the purpose of the performance measurement system in the public sector**

The purpose of the performance measurement system is to measure and assess quantitatively the achievement degree of set goals and tasks. It is possible to state that the performance measurement system has two main functions – to provide information that would allow improving the performance of organization in public sector, and to account for the used funds.

The performance measurement system in the organizations of public sector should be based on the objectives set by strategic plans and it should measure their achievement. In such a way the preconditions are created for systemic observation of performance processes of organizations in public sector by collecting the information necessary to describe the present situation and to foresee the changes in case some tasks have not been implemented.

### **b) Internal control system is stating its objectives and its benefits as summarized as defined in the Practices Board (APB) and the COSO guidelines**

The internal control system (ICS) covers the whole range of procedures, methods and controls established by an organization's Board and Management for the purpose of ensuring proper functionalization of business operations.

The main objectives of an internal control system are summarized in the Auditing Practices Board (APB) and the COSO guidelines as follows:

- The orderly and efficient conduct of the company's business including adherence to internal policies.
- The safeguarding of assets of the business
- The prevention and detection of fraud and error.
- The accuracy and completeness of the accounting records, and
- The timely preparation of financial information.

Benefits of an internal control system are:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations

### **c) The functions of the Audit Committee include the following:**

- Receive reports from internal auditors
- Evaluate and review audit policy
- Evaluate the management procedures regarding:
  - Internal controls
  - Financial reporting
  - Risk management

- Make recommendations to the Accounting Authority.

## **SOLUTION FIVE**

### **a) Why it is important for the treasury to management the cash flows**

The objectives of cash management have the following purposes:

- controlling spending in the aggregate,
- implementing the budget efficiently,
- minimising the cost of government borrowing,
- and maximising the opportunity cost of resources.

Control of cash is a key element in macroeconomic and budget management.

### **b) The capital budgeting process of determining whether the expenditure is in conformity with organizations' goals**

Capital budgeting is the process of determining whether a big expenditure is in a company's best interest. Here are the basics of capital budgeting and how it works.

#### **Capital Budgeting Basics**

A company undertakes capital budgeting in order to make the best decisions about utilizing its limited capital. For example, if you are considering opening a distribution center or investing in the development of a new product, capital budgeting will be essential. It will help you 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 company could take. You have to identify which projects you want to investigate further and which ones do not make any sense for your company. If you overlook a viable option, it could end up costing you quite a bit of money in the long term.

#### **Evaluate Opportunities**

Once you have identified the reasonable opportunities, you 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**

Next, you need to determine how much cash flow it would take to implement a given project. You also need to estimate how much cash would be brought in by such a project. This process is truly one of estimating--it takes a bit of guesswork. You need to try to be as realistic as you can in this process. Do not use the best-case scenario for

your numbers. Most of the time, you need to use a fraction of that number to be realistic. If the project takes off and the best-case scenario is reached, that is great. However, the odds of that happening are not the best on new projects.

### **Select Projects**

After you look at all of the possible projects, it is time to choose the right project mix for your company. Evaluate all of the different projects separately on their own merits. You need to come up with the right combination of projects that will work for your company immediately. Choose only the projects that mesh with your company 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.

## **c) The main types of budgeting methods that are common in the public sector**

There are four common types of budgets that companies use: (1) incremental, (2) activity-based, (3) value proposition, and (4) zero-based. These four budgeting methods each have their own advantages and challenges, which will be discussed in more detail in this guide.

- **Incremental budgeting**

Incremental budgeting takes last year's actual figures and adds or subtracts a percentage to obtain the current year's budget. It is the most common method of budgeting because it is simple and easy to understand. Incremental budgeting is appropriate to use if the primary cost drivers do not change from year to year. However, there are some problems with using the method:

It is likely to perpetuate inefficiencies. For example, if a manager knows that there is an opportunity to grow his budget by 10% every year, he will simply take that opportunity to attain a bigger budget, while not putting effort into seeking ways to cut costs or economize.

It is likely to result in budgetary slack. For example, a manager might overstate the size of the budget that the team actually needs so it appears that the team is always under budget.

It is also likely to ignore external drivers of activity and performance. For example, there is very high inflation in certain input costs. Incremental budgeting ignores any external factors and simply assumes the cost will grow by, for example, 10% this year.

- **Activity-based budgeting**

Activity-based budgeting is a top-down budgeting approach that determines the amount of inputs required to support the targets or outputs set by the company. For

example, a company sets an output target of K100 million in revenues. The company will need to first determine the activities that need to be undertaken to meet the sales target, and then find out the costs of carrying out these activities.

This type of budget is prepared with the intention to identify the operations which generate cost to the business and how can be the said cost reduced from the current level. This kind of budgeting is mostly used in a matured organization.

Activity-based budgeting is a long exercise to find our cost of each and every activity in a large organization and assess the value addition of the same. This exercise also includes an alternative procedure to perform the same activity or reaching the same goal while reducing the cost. In almost every organization, directly or indirectly this budgeting is been prepared and performed. However, it depends on the management's focus to enlarge it or reduce it to a certain level.

- **Value proposition budgeting**

In value proposition budgeting, the budgeter considers the following questions:

- Why is this amount included in the budget?
- Does the item create value for customers, staff, or other stakeholders?
- Does the value of the item outweigh its cost? If not, then is there another reason why the cost is justified?

Value proposition budgeting is really a mindset about making sure that everything that is included in the budget delivers value for the business. Value proposition budgeting aims to avoid unnecessary expenditures – although it is not as precisely aimed at that goal as our final budgeting option, zero-based budgeting.

- **Zero-based budgeting**

The most commonly used budgeting methods, zero-based budgeting starts with the assumption that all department budgets are zero and must be rebuilt from scratch. Managers must be able to justify every single expense. No expenditures are automatically "okayed". Zero-based budgeting is very tight, aiming to avoid any and all expenditures that are not considered absolutely essential to the company's successful (profitable) operation. This kind of bottom-up budgeting can be a highly effective way to "shake things up".

The zero-based approach is good to use when there is an urgent need for cost containment, for example, in a situation where a company is going through a financial restructuring or a major economic or market downturn that requires it to reduce the budget dramatically.

Zero-based budgeting is best suited for addressing discretionary costs rather than essential operating costs. However, it can be an extremely time-consuming approach, so many companies only use this approach occasionally.

In ZBB, all the numbers reset to zero and given a fresh thought over all the items of the budget. The new numbers of every item shall be justified with proper reasoning and shall not be ad hoc figures.

## **END OF SOLUTIONS**





PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

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DIPLOMA LEVEL

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PFM 5: PUBLIC SECTOR AUDITS

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THURSDAY 17 DECEMBER 2020

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

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**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**

You are part of a group of newly recruited auditors in the Office of the Auditor General (OAG). All newly recruited auditors are required to undergo a two (2) week induction program covering a range of issues on public sector auditing. The current recruitment of auditors has been done in response to a shortage in staff in the Office of the Auditor General (OAG). As a result of staff shortages, instead of performing audits of financial statements of Government owned companies, reviews of the financial statements were being carried out and this has raised concern on the level of assurance arising from reviews.

You have been provided with the following information extracted from the working papers of the audit of the Road Development Agency (RDA). This information is meant to be used as a case study during the induction.

The audit was headed by Chulu as Principal Auditor and Chulu worked for the Road Development Agency (RDA), as Chief Accountant, before joining the Office of the Auditor General (OAG). The rest of the audit team comprised largely staff that had no experience in public sector auditing and needed close supervision by Chulu. During the period of the audit, the Road Development Agency (RDA) provided transport and board and lodging for all the trips that the audit team undertook on an inspection of work that was carried out.

After the conclusion of the audit but before the finalization and release of the audit report the Director of Audits in the Office of the Auditor General (OAG) was invited to a state function at State House. At this function the Director of Audits was introduced to the Head of the Anti-Corruption Commission. During the interaction, the Head of the Anti-Corruption Commission informed the Director of Audits that he was concerned about the contents of the audit report arising from the recent audit of the Road Development Agency (RDA).

The procedure at the Office of the Auditor General (OAG) is that draft reports are only discussed with the client after clearance by the Director of Audits. He was surprised that the report had been brought to the attention of the Head of the Anti-Corruption Commission before he saw and okayed the report. It became apparent from the discussion that the officer who leaked the report wanted financial gratification with a view to changing the content of the report and drop any contentious issues raised there. Efforts to establish who among the staff in the Office of the Auditor General (OAG) released confidential information failed.

Among the projects that were inspected and on which a compliance audit was carried out is the construction of township roads in Chinsali. A total of K25 million was appropriated for the construction of fifty (50) kilometers of township road which were required to meet specifications agreed upon. The agreement for the construction of the township roads provided that all purchases of materials should be through tender. The proceedings of the tender committee were to be in writing. Further, as a way of empowering citizens, the Government required that all casual and non-technical staff should be recruited from among the residents of Chinsali. Non adherence to this requirement could lead to punitive action being taken against the Site Engineer. It was a contractual requirement that each time that

ten (10) kilometers of road works are completed, the work should be inspected and certified by a qualified consultant.

A visit to two (2) construction sites revealed that there was poor security with regards to storage of construction materials and equipment. Materials were left in the open with only one (1) security guard manning the premises. Materials were issued to the construction teams based on verbal instructions of the Site Engineer and the only record of materials issued was an entry made by Chanda, the Stores Officer, who is responsible for receipt, custody and issue of materials. Interviews with selected employees at sites revealed that payment of salaries and wages was delayed and staff had not been paid for a period of over three (3) months. Each construction site had a fleet of vehicles and road construction equipment. The Site Engineer is solely responsible for assigning the equipment work and if the equipment is not required he allows the drivers to do private jobs at the nearby commercial farms with a view of raising money to pay for other expenses.

The Site Engineer is responsible for employing casual workers and determining the hourly rate depending on the work to be performed. The procedure for paying the casual workers employed is that the Site Engineer prepares a manual list of all casual workers that were employed during the month. This list is sent directly to the Financial Accountant at Head Office who prepares a cheque and withdraws cash amounting to the net pay. The Financial Accountant then prepares a schedule on which casual workers are required to sign as evidence of receipt of the money. Any uncollected wages are signed for by the Site Engineer so that the Financial Accountant does not return with any money. The Site Engineer gives the money signed for to the beneficiaries without any evidence of receipt by the beneficiaries.

**Required:**

- (a) Explain the principle of accountability and transparency in the context of the audit of the funds appropriated for Road Development Agency (RDA).  
(4 marks)
  
- (b) (i) Explain the meaning of Professional Competence and due care by the public sector auditor and explain how this may be achieved by the newly recruited staff.  
(4 marks)
- (ii) Identify and explain four (4) ethical issues in the scenario, for each issue suggest a suitable response.  
(6 marks)
  
- (c) Explain the meaning of audit risk and identify and explain four (4) fraud risk factors in the operations of the Road Development Agency (RDA). (10 marks)
  
- (d) Explain the difference between reasonable assurance and limited assurance arising from the audit of the financial statements of the Road Development Agency (RDA) and the review of the interim financial statements. (8 marks)

- (e) Explain the meaning of compliance auditing and suggest four (4) audit procedures required in the compliance audit of the township roads project. (8 marks)

**[Total:40 Marks]**

## **SECTION B**

**Attempt any THREE (3) questions in this section.**

### **QUESTION TWO**

You work for the Office of the Auditor General (OAG) and you are in charge of the directorate that is responsible for auditing donor funded projects. There has been a public outcry on the procurement of equipment meant for use by the Government in the construction of dams across the country. The perception by the public and a number of non-governmental organization is that there was corruption in the procurement of the earth equipment.

You have been requested to assemble a team of four (4) auditors to carry out a forensic audit on how the procurement of the earthmoving equipment was done.

You have been provided with the following background information with regards to the procurement of the earth moving equipment:

In response to the effects of climate change resulting in reduced rainfall in most parts of the country, the Government of the Republic of Zambia lobbied for donor funding for the construction of dams across the country.

The American Government agreed to enter into a partnership with the Government for this project and injected US\$50 million by way of a grant to be used for the procurement of earth moving equipment and servicing of the equipment. The project is for a duration of five (5) years and the money injected by the American Government is enough to acquire all the necessary equipment and maintain the equipment throughout the project period. The procurement of the earthmoving equipment was carried out by the Ministry of Works and Supply.

The agreement states that all procurement should be in line with the guidelines of the Public Procurement Guidelines of the Government. It is likely that litigation will be taken against anyone found responsible for any loss of money in the procurement of the earth moving equipment and the auditors may be required to give evidence in court.

The team that will be appointed to carry out the forensic investigation will be expected to follow the stages in a forensic investigation including:

- (i) Gaining an understanding of the fraud and matters to be investigated.
- (ii) Securing and safeguarding financial and other information.
- (iii) Inspecting financial information and documents and

(iv) Interviewing organizational staff and third parties.

**Required:**

(a) Explain the meaning of value for money (VFM) audits in the context of the procurement of earthmoving equipment.

(2 marks)

(b) Explain three (3) matters that should be considered in the performance audit of the procurement of earth moving equipment by the Ministry of Works and Supply.

(6 marks)

(c) Explain the quality control requirements with regards to the appointment of audit team members to carry out a performance audit of the procurement of earthmoving equipment.

(4 marks)

(d) Explain the work required in the forensic investigation under the four (4) stages above.

(8 marks)

**[Total:20 Marks]**

**QUESTION THREE**

The Government of the Republic of Zambia recently held general elections resulting in a change in the composition of members of parliament.

Parliament has committees through which it fulfills its function of oversight over the operations of the Government. One such committee is the Public Accounts Committee (PAC). Parliament composes the front bench which is made up of the Government Ministers appointed by the President and the back bench comprising the rest of the Members of Parliament from both the ruling party and the opposition.

The President of Zambia is in the process of setting up the Public Accounts Committee (PAC) and also appoint the Chairperson of the committee.

You work for the Office of the Auditor General (OAG) and you have been nominated by the Auditor General (AG) to sit on a committee of experts to make recommendations to the President on the composition of the Public Accounts Committee (PAC). Once the committee is constituted, you will be required to participate in the induction of the newly appointed committee members and you will specifically be required to explain the roles and responsibilities of the members of the Public Accounts Committee (PAC) and the reasons why the committee members need to exert their independence in the performance of their duty.

The previous cabinet recommended that some of the Public Accounts Committee (PAC) members should sit on selected Audit Committees of ministries and other Government agencies.

**Required:**

- (a) Explain the need for independence of the members of the Public Accounts Committee (PAC). (4 marks)
- (b) Explain four (4) functions of the Public Accounts Committee. (6 marks)
- (c) Distinguish the roles of the Public Accounts Committee (PAC) and the Audit Committees of spending agencies. (4 marks)
- (d) Explain the meaning of induction of Public Accounts Committee (PAC) members and give three (4) benefits of induction. (6 marks)

**[Total: 20 Marks]**

**QUESTION FOUR**

- (a) You work as Principal Auditor in the Office of the Auditor General (OAG) under the directorate responsible for the audit of parastatal companies that fall under the Industrial Development Corporation (IDC).

You have been presented with the following information regarding the results of financial audits for three (3) companies under the Industrial Development Corporation (IDC):

- (1) The audit team attended the year-end inventory count. Soon after the year end and before determining the inventory value, the bulk of the inventory count records were destroyed by fire. The audit team could not obtain sufficient appropriate evidence with regards to inventory valuation which was determined using perpetual inventory count records for the year end.

The audit senior is of the view that any misstatement of the inventory value could result in a material misstatement of the financial statements and could have adverse effects on decisions made by users of financial statements.

- (2) There is a disagreement with management and the auditors with regards to the treatment of development expenditure on research activities carried out. Management capitalized an amount of K75 million which is considered material to the financial statements. The audit team is of the view that the conditions required for capitalization do not exist and the amount should have been charged to income. Management is not willing to amend the financial statements and write off the amount against income.

The misstatement of profit arising as a result is likely to adversely affect the users of financial statements.

- (3) There is a matter appropriately accounted for and dealt with by management in the financial statements. Management has also made adequate disclosures in the notes to the financial statements. This matter relates to a legal case that has remained unresolved at the period end and a provision has been made in line with the provisions of ISA 37 *Provisions, contingent liabilities and contingent assets*.

The senior auditor is of the view that the matter giving rise to the provision is fundamental to the users of financial statements in making decisions and this should be reported in the auditor's report.

**Required:**

Explain the form of modification of the auditor's opinion and report that will be required in each of the three (3) cases above.

(6 marks)

- (b) The Office of the Auditor General (OAG) is the Supreme Audit Institution (SAI) in Zambia. In order to ensure accountability over the use of public funds, all Government ministries and other agencies have Internal Audit Departments who report to the Head of Internal Audit at Cabinet Office. Further, a new regulation has been put requiring all Government ministries to establish Audit Committees in order to strengthen the controls in Government operations.

In response to the requirements by the International Monetary Fund (IMF) to Government to cut down public expenditure, the Minister of Finance is considering doing away with the need for the Office of the Auditor General (OAG) performing audits of institutions that have internal audit departments and audit committees in place. He is of the view that if this recommendation is passed by Cabinet, there will be a net saving in Government expenditure of over K200 million annually from a reduced workforce and the expenses of performing audits by the Auditor General (AG).

Further, the Minister of Finance does not understand why the Office of the Auditor General (OAG) operates autonomously instead of being under the Ministry of Finance which oversees all Government revenue and expenditure. He is of the view that putting the Office of the Auditor General (OAG) to be under the Ministry of Finance will result in a substantial reduction in operational costs.

**Required:**

- (i) Explain two (2) arguments in favour of the need for the Office of the Auditor General (OAG) to perform financial audits of Government institutions with internal audit departments. (4 marks)

- (ii) Explain the Zambian constitutional requirements on the appointment of the Auditor General (AG). (2 marks)
- (iii) Explain the autonomy of the Office of the Auditor General (OAG) clearly stating why it does not report to any Government ministry or department. (2 marks)
- (iv) List, giving examples, six (6) institutions that are subject to audits by the Office of the Auditor General (OAG) in Zambia (2 marks)

**[Total: 20 Marks]**

### **QUESTION FIVE**

You work for the Office of the Auditor General (OAG) and you have been assigned to lead a team of auditors on the audit of the financial statements of the Livingstone City Council. In order to reduce costs, the Auditor General (AG) has requested you to supervise two (2) other audit teams whose objective will be to carry out performance and compliance audits on a number of projects that were undertaken by the Livingstone City Council.

Your supervisor has requested you to call for a pre-audit meeting of all the audit team members who will be involved in the financial, performance and compliance audits. The main objective of the meeting is to enable you to explain the importance of performing the audits in accordance with applicable International Standards of Supreme Audit Institutions (ISSAIs). One of the auditors attending the pre-audit meeting asked you to explain why they are required to adhere to the provisions of ISSAI 100: Principles of public sector auditing when they will be performing a compliance audit which does not involve financial statements.

During the year under review, the Livingstone City Council carried out a review of the property values in the city in order to update the valuation roll which forms the basis of calculating annual rates payable by landlords. In the past, the valuation roll was revised by employees of the city council and there were noted inconsistencies in the valuation of properties and many landlords appealed against the valuations. It was feared that the council was losing large sums of revenue arising from undervaluation of properties. For the most recent valuation roll, the Livingstone City Council resolved that the valuation services be outsourced. The valuation was put to tender and Mulenga & Associates won the tender and carried out the valuations and they submitted a revised valuation roll.

One of the areas that will be covered in the financial audit is that of property valuation. In view of the fact that there are no experts in this field in the Office of the Auditor General



(OAG), you are considering using the services of an auditor expert or if satisfied you may use the work of Mulenga & Associates who were engaged to carry out the valuation.

**Required:**

- (a) Explain the use of the Principles of public sector auditing as outlined in ISSAI 100 in public sector auditing. (2 marks)
- (b) Explain the application of the following General principles in public sector auditing according to ISSAI 100 in the proposed compliance audit of the Livingstone City Council:
- (i) Ethics and independence. (2 marks)
  - (ii) Professional judgment, due care and professional skepticism (2 marks)
  - (iii) Documentation. (2 marks)
  - (iv) Communication. (2 marks)
- (c) (i) Explain the meaning of the term auditor expert. (2 marks)
- (ii) Explain four (4) matters that you will take into consideration in deciding whether to rely on the work of Mulenga & Associates in the audit of the valuation roll of the Livingstone City Council. (8 marks)

**[Total:20 Marks]**

**END OF PAPER**

## **SUGGESTED SOLUTIONS**

### **SOLUTION ONE**

#### **(a) Principles of accountability and transparency in the Road Development Agency (RDA):**

Accountability is the principle that recipient of public funds should account for how the funds are spent.

Transparency on the other hand requires that the use of public funds should be made public and there should be nothing to hide by the spending agencies.

In the context of the projects under the RDA fifty (50) kilometres, the RDA has received a total of K25 million for use in the construction of township roads in Chinsali. The RDA has a responsibility of being accountable on how the funds will be spent. This will be through accountability reports which could be by way of financial statements.

The RDA will be expected to be transparent and open on how the money has been spent. The RDA should be open and be available for audit by the Office of the Auditor General whose objective is to ensure accountability and transparency in the manner in which the funds appropriated to the agency has been spent.

#### **(b)(i) Professional competence and due care:**

Public sector auditors are required to have the necessary skills and competences that are required to carry out public sector audits. Further, the public sector auditors are expected to apply due care in carrying out their work. Due care will have been applied if the auditors follow the public sector auditing standards in carrying out their work.

#### **How professional competence & due care achieved by the new staff:**

Professional competence and due care can be achieved by the newly recruited staff by:

- Taking the necessary education programs and passing the examinations and qualify as professional accountants.
- Through training within the Office of the Auditor General (OAG) in response to the risks that come up in the public sector.
- Through continuing professional development (CPD) courses and activities in order for the public sector auditors to be up-to-date with the latest developments in the profession.

#### **(ii) Ethical issues:**

##### **1. Chulu the leader of the audit team:**

Chulu who was assigned to lead the audit team on the audit of the Road Development Agency (RDA) previously worked for the Road Development Agency (RDA) before joining the Office of the Auditor General (OAG). He held a position of influence in the finance department. Assigning him to lead the audit team created a self-review and familiarity threat.

**Safeguard:**

Chulu should not have been assigned on the audit of the Road Development Agency (RDA). A different person should have been assigned to lead the audit team.

**2. Provision of transport and full board and lodging:**

The provision of transport to the audit team and paying in full for the audit team for board and lodging created a familiarity threat because it is tantamount to providing hospitality to audit team members.

**Safeguard:**

The audit team should have declined the offer of free transport and full board and lodging on inspection tours.

**3. Disclosing of confidential report to third party:**

The disclosure of confidential information by a member of the audit team is a breach of the ethical principle of confidentiality. It is clear that this was done outside the normal operations of the Office of the Auditor General (OAG) and not in line with the policy on confidentiality.

**Safeguard:**

Policy on disclosure of information should be reinforced and staff should be made to sign an undertaking not to disclose information without authority. The firm should put in place guidelines specifying the punitive measures that will be taken against any violation of ethical principles.

**4. Competences of the audit team of the Road Development Agency (RDA):**

This principle requires that the audit team members should have the skills and competences to carry out the work.

In the case at hand, only Chulu had some experience in public sector auditing while the rest of the audit team did not have any experience. The quality of the work performed by the other team members is doubtful and so the conclusions reached may not appropriate.

**Safeguard:**

The firms should have quality control policies in place to ensure that staff with appropriate skills and competences are assigned to perform audits. The composition of the audit team on this audit should have included experienced and less experienced staff and it is the responsibility of the principal auditor to ensure that the required levels of human resources are assigned to audits.

**(c) Meaning of audit risk:**

Audit risk is the risk that the public sector auditor may give an inappropriate audit opinion. Audit risk has three elements namely inherent risk, control risk and detection risks. The auditor is required to reduce risk to acceptable levels.

**Fraud risk factors in the audit of the Road Development Agency (RDA):****1. Poor security:**

There is poor security of the materials and equipment at the construction site. This could result in loss of materials and equipment through fraud and the accounting records may be falsified in order to hide any fraud that would have taken place.

**2. Verbal instructions when issuing materials:**

Verbal instructions on issue of materials could lead to fraud being carried out by stores staff. This would lead to loss of materials and financial records showing false figures.

**3. Lack of segregation of duties related to inventory control:**

The Stores Officer is responsible for procurement, storage and issue of stores items. There is clear lack of segregation of duties which could lead to fraud and falsification of records aimed at concealing the fraud.

**4. Delayed salaries for employees:**

Delays in paying wages and salaries will put pressure on employees to commit fraud through theft of materials and other items.

**5. Site Engineer responsible for hiring out equipment:**

The Site Engineer singularly decides to hire equipment and he also determines the charge. There is no control and this would be an opportunity for him to use the proceeds from hire of equipment for personal use.

**6. Site Engineer responsible for recruitment and rate determination:**

The Site Engineer is responsible for recruitment of casual workers, determining the rate to pay and he is also involved in paying the casual workers. This lack of segregation of duties could pressure the Site Engineer to engage ghost workers and pocket the money meant for them, for example.

## **7. Uncollected cash not signed for be recipients:**

Cash not collected by recipients from the Financial Accountant is left with the Site Engineer who hands over the money to the beneficiaries without any form of evidence that the money has been paid. This could lead to fraud and the Site Engineer could use for personal gain any such amounts.

- (d) Assurance engagements are engagements where the practitioner is required to give assurance as an outcome of the assignment. There are two levels of assurance as follows:

### **Reasonable assurance:**

This level of assurance is given by the auditor arising from an audit and has the following general characteristics:

- Is considered to be a high level of assurance but is less than an absolute assurance.
- Is arrived at after carrying out a substantial amount of audit procedures, the results of which help in arriving at the conclusion.
- It is a positive form of assurance with the auditor expressly stating that the financial statements show a true and fair view or that they do not show a true and fair view.

### **Limited assurance:**

This is a lower level of assurance compared to a reasonable assurance. It is arrived at by the auditor using procedures that are not similar to an audit largely comprising analytical procedures and enquiries.

Limited reviews have the following characteristics:

- Lower level of testing is carried out by the auditor.
- Audit risk is higher than the risk acceptable when giving reasonable assurance.
- The conclusion is in a negative form with the auditor stating that nothing has come to his attention suggesting that financial statements don't show a true and fair view.

- (e) Compliance auditing involves an independent assessment of whether a given subject matter is in compliance with 'applicable authorities'. This is achieved by assessing whether the activities, financial transactions and information comply with the authorities that govern the audited entity.

In the case of the township road project, the agreement with the Road Development Agency (RDA) provides the applicable authorities by which the project should have been carried out.

Audit procedures will be designed with a view to establish compliance with the authorities and among the audit procedures are the following:

- Evaluate the work that has been carried out and confirm that it complies with the specifications in the agreement.
- Confirm that all procurement was done through tender procedures as required in the contract agreement. Review minutes of tender committee meeting for selected procurement.
- Interview a number of casual workers engaged on the project and establish their residence with a view to confirm that locals were engaged as casuals.
- Confirm that at each stages and intervals of road construction works, the work was certified by a qualified consultant by reviewing the certificates issued for the work completed.

## **SOLUTION TWO**

### **(a) Meaning of value for money audits:**

These are audits that are performed with a view to establish whether the outcome of an activity or expenditure is worth the money that has been spent. It is the same term used to refer to performance audits whose objective is to consider the economy, efficiency and effectiveness of the expenditure.

In the context of the procurement of earthmoving equipment the questions would be:

**Economy** – Was the amount paid for the equipment the best price that should have been paid or they could have been procured at a lower amount?

**Efficiency** – Could it have been possible to acquire more earthmoving equipment with the amount available?

**Effectiveness** – Is the equipment that was acquired of the correct specifications in accordance with the specifications defined at acquisition?

### **(b) Matters that should be considered in the procurement performance audit:**

In carrying out the performance audit of the earth moving procurement, consideration will be made on how the principles of economy, efficiency and effectiveness have been achieved.

#### **Economy:**

The matter to be considered under this heading concerns whether the procurement of the earth moving equipment has been at the best price and the government has not been made to pay more money than should have been paid. Consideration will be made on whether more earth moving equipment could have been bought using the money available.

#### **Efficiency:**

This element compares the output of the activity with the resources input. In this case the \$50 million that was injected by the American government was for the purpose of acquiring specific earth moving equipment and also to be used for the purposes of maintaining the equipment during the duration of the project.

Consideration will be made to establish whether or not the required equipment has been bought and whether funds were available to service the equipment during the project duration. Consideration will also be made on whether the earth moving equipment could have been purchased using less resources or more equipment could have been acquired using the available resources.

#### **Effectiveness:**

This element considers whether the objective of the procurement and project have been achieved.

Consideration under this heading will be whether the equipment acquired meets the specifications that were made and will be able to do the work required.

**(c) Quality control with regards appointment of audit team members:**

Quality control in public sector audits aims at ensuring that all audits are conducted to a high standard and should be an integral part of all audits.

ISSAI 40 Quality control for SAIs sets the principles for establishing and maintaining a system of quality control that covers all the work that a Supreme Audit Institution (SAI) does.

One aspect of quality control is that of human resources and the assignment to work that is done. The following are some of the factors that will be considered in selecting audit team members to carry out a performance audit:

- The qualifications and experience of the audit team members in carrying out public sector audits.
- Ensuring that the audit team members selected meet the ethical principles particularly the one on independence.
- Team members should be those who have the competences and skills to carry out performance audits and possibly have previous experience in carrying out performance audits.

**(d)(i) Gaining an understanding of the fraud and the matters to be Investigated:**

This part of a forensic investigation required that the forensic auditor needs to have a full understanding of the facts surrounding the fraud or suspected fraud. The forensic auditor will need to use the information made available and also enquire from management and others within the organization on the facts of the case.

In the case at hand, the forensic auditor will require to have an understanding of the procurement procedures and the actual processes that were used in the procurement of earth moving equipment.

**(ii) Securing and safeguarding financial and other information:**

Most forensic investigation involve fraud and so it is likely that efforts will be made by the perpetrators to hide any information that may lead to the fraud being detected and found out.

This stage of the investigation involves that the forensic auditor should quickly move in and obtain for safe custody any documents relating to the procurement of earthmoving equipment. The documents are useful in determining whether or not there was fraud in the procurement of the equipment.



In a case which is likely to go before a court, such documentation may be required to be adduced as part of evidence and therefore should be secured early in the investigation. Information may be hard copies or in electronic form.

**(iii) Inspecting financial information and documents:**

This involves a critical examination of documents the forensic auditor comes across in the cause of the forensic investigation.

The aim of the critical examination of information and documents is to enable the forensic auditor to identify any forgeries that may have taken place and also evidence of tampering with the content of documents.

In the case of the procurement of the earth moving equipment the forensic auditors may require to examine papers regarding the procurement as well as supplier documents such as invoices.

**(iv) Interviewing organizational staff and third parties:**

This stage involves the interview of people suspected to be involved in the fraud and others within the organization who may have information which will help determine whether or not a fraud was committed. Interviews will also include other people outside the organization such as contacting the supplier of the earth moving equipment in this case.

## **SOLUTION THREE**

### **(a) Independence of the members of the Public Accounts Committee:**

The objective of public sector audits is to check on how those entrusted with the use of public funds have performed their duty as stewards on behalf of the public.

The Public Accounts Committee (PAC) plays a pivotal role of providing oversight on how public funds are used. It is important, therefore, that members of the Public Accounts Committee (PAC) should be independent of those over whom they give oversight.

Lack of independence of Public Accounts Committee (PAC) members is likely to impact on their objectivity in performing their duty.

Independence of Public Accounts Committee (PAC) members is achieved through having members drawn from the backbench and particularly the opposition who are not entrusted with the use of public funds. Back benchers are not directly involved in the administration of public funds and will be more objective in carrying out their duty in the Public Accounts Committee (PAC).

### **(b) Functions of the Public Accounts Committee (PAC):**

1. To provide oversight on behalf of parliament on how public funds are spent.
2. To monitor the implementation of the budget approved by parliament by spending ministries and agencies.
3. To seek to ensure that the recommendations made in the Auditor General's reports are followed and implemented by the executive.
4. To hold meetings with the controlling officers and other stakeholders and give them an opportunity to submit on the issues raised by the Auditor General in the reports.
5. To recommend to appropriate authorities on action to be taken where fraud is suspected. The Office of the Auditor General (OAG) does not have authority to prosecute but the Public Accounts Committee (PAC) can recommend prosecution to the Police, Anti-Corruption Commission or the Drug Enforcement Commission.

### **(c) Roles of the Public Accounts Committee and the Audit Committees:**

The Public Accounts Committee has the role of providing oversight on how government ministries and other agencies carry their role as stewards on behalf of the public. This function is achieved through the audits performed by the Office of the Auditor General (OAG) who operate independently of the spending ministries and agencies.

The Audit Committees are responsible for regular monitoring of how public funds are spent and whether government regulations are followed. These meet on a more regular basis and make the controlling officers accountable for their work.

**(d) Induction of Public Accounts Committee (PAC) members:**

Induction of Public Accounts Committee (PAC) members can be taken to mean training the new members on the role they are expected to play as members of the Public Accounts Committee (PAC). This is done early on the establishing of the committee before it commences performing its duties.

It is necessary that members of the committee are inducted in the sense that some of them may be coming into parliament for the first time.

**Benefits of Induction:**

1. The induction will give an opportunity to members of the committee to raise any matters of concern they may have as members of the committee.
2. Induction is a form of training for members of the committee who are getting into parliament for the first time and are appointed as members of the Public Accounts Committee (PAC). They are inducted on the role of the committee.
3. Induction is a forum where the skills required to perform the role of oversight is given to members of the committee so that it can fulfill its responsibilities efficiently and effectively.
4. During induction the members are inducted on the public sector audit process and the role of the Office of the Auditor General (OAG).

## **SOLUTION FOUR**

### **(a) Form of modifications of the audit opinion/report:**

1. The fact that the inventory count records were destroyed in a fire and that the auditors could not obtain evidence on inventory valuation using alternative procedures suggests that there is a limitation of scope.  
In view of the fact that inventory is a material figure in the financial statements and could result in a material misstatement of the financial statements and the fact that this would lead to an adverse effect on decisions made by users of financial statements suggests that the matter is both material and pervasive to the financial statements.  
The suitable form of opinion in this case is a modification of the opinion with a disclaimer of opinion.
2. In this case, there is a clear disagreement between the auditors and management on the treatment of the K75 million which is both material and pervasive to the financial statements.  
The disagreement does not arise because of a limitation of scope and as such the auditors have obtained sufficient appropriate evidence. The financial statements will be misstated as a result of capitalizing the development costs which should have been written off. The appropriate opinion in this case will be a modified adverse opinion suggesting that the financial statements do not show a true and fair view.
3. In this case, there is a matter appropriately accounted for and disclosed in the financial statements of the client company.  
In this case, an unmodified opinion will be appropriate. Since the auditors feel the matter is of such importance that they require to include it in the auditor's report, this will be done by inclusion of an emphasis of matter paragraph in accordance with the provisions of ISSAI 1706. The inclusion of an emphasis of matter paragraph results in the report being modified but with an unmodified opinion.

### **(b)(i) Arguments for OAG Audits of institutions with Internal Audit.**

1. The Office of the Auditor General (OAG) has a constitutional mandate to perform audit of all institutions who receive and spend public funds regardless of the corporate governance structure that exists.
2. The internal audit departments in the ministries are part of the operations of the ministries and lack independence. The Office of the Auditor General is autonomous and so its staff are independent of the spending ministries and are more likely to be objective in the performance of their work.
3. The staff of the Office of the Auditor General (OAG) are trained and have the skills and competences to carry out public sector audits which skill the internal auditors may lack.

### **(ii) Constitutional provision on appointment of the Auditor General:**

Article 249 of the Constitution of Zambia provides that the Auditor General shall be appointed by the President and shall be ratified by the National Assembly.

The constitution also specifies the grounds upon which the Auditor General can be dismissed.

The reasons for including these articles in the constitution is to ensure that the Auditor General's tenure of office is guaranteed and he will work objectively without fear of losing his job.

**(iii) Autonomy of the Office of the Auditor General (OAG):**

The Office of the Auditor General (OAG) operates independently of any government institution. Parliament confers responsibility on the Office of the Auditor General (OAG) to perform audits of all who receive and spend public funds. Budgetary requirements of the Office of the Auditor (OAG) are met by parliamentary allocation.

It is important that the Office of the Auditor General (OAG) is independent of any ministries and also have financial independence in order for it to remain objective in the performance of its work. If the Office of the Auditor General were to be under any ministry then it would be intimidated and fail to perform its role of giving oversight on spending ministries and agencies.

**(iv) Entities subject to audit by the Office if the Auditor General:**

1. All Government Ministries, for example, the **Ministry of Defence**.
2. Grant Aided Institutions, for example, the **University of Zambia**.
3. Local Authorities such as the Lusaka City Council.
4. Donor Funded Projects such as the Millennium Challenge for water reticulation in the City of Lusaka.
5. Any other organizations that receive Government money, for example, **development grant recipients**.
6. Parastatal organizations such as companies under the Industrial Development Corporation such as the **Zambia Electricity Supply Corporation**.

## **SOLUTION FIVE**

- (a) International Standards of Supreme Audit Institutions (ISSAIs) guide public sector auditors on the performance of public sector audits.

Among such standards is ISSAI 100: Principles of public sector auditing which deals with general principles in public sector and also principles related to the audit process. The principles under this standard are applicable across all the types of public sector audits namely financial, performance, compliance, IT and forensic audits.

**(b)(i) Ethics and independence:**

The members of the audit team that will carry out the compliance audit of the performance audit at Livingstone City Council should ensure that there are no ethical matters that would prevent them from being objective. This particularly involves matters of independence of the audit team members.

**(ii) Professional judgment, due care and Professional skepticism:**

The public sector auditors should apply professional judgment based on their training and experience in making professional decisions. They should also apply due care by following regulations and standards in the performance of their work bearing in mind to be alert and have a questioning mind for contradictory evidence.

**(iii) Documentation:**

This principle suggests that all work that is performed by the public sector auditors for all types of audits should be documented as evidence of the work that has been performed. Documenting the work carried out is important because this forms the basis of the conclusion to be reached.

**(iv) Communication:**

This principle requires that in all public sector audits there should be two way communication between the public sector auditor and the management of the audited entity. The management of the audited entity should be kept informed of the matters arising from the audit and should also be informed of the observations made and given an opportunity to respond as may be necessary.

**(c) (i) Meaning of the term auditor expert:**

The term auditor expert refers to anyone who has expertise in a field other than auditing and accounting. An auditor expert is engaged by the auditor to carry out work in which the auditor has no expertise and the auditor shall use the work of the expert in arriving at a conclusion.

**(ii) Matters to consider in relying on work of Mulenga & Associates:**

**1. The qualifications of Mulenga & Associates**

The qualifications of Mulenga & Associates are important in order to satisfy ourselves that the company has the skills and competences that are required to carry out the valuations of properties.

**2. Membership of Mulenga & Associates to appropriate association:**

It will be important to establish that Mulenga & Associates are members of the relevant professional body to which they belong. It is important to establish this in order to gain satisfaction that they are not prohibited from carrying out the work.

**3. Independence of Mulenga & Associates from Livingstone City Council:**

In order for Mulenga & Associates to carry out their work objectively without being biased, it is necessary that they are independent of Livingstone City Council. It will be necessary for the firm to establish whether there are any relationships with the council which could impact on their independence and ultimately objectivity.

**4. Previous work that Mulenga & Associates has done:**

Reference to work previously carried out by Mulenga & Associates will be considered in deciding whether to rely on their work at the Livingstone City Council. Reference may come from third parties and this will increase the confidence the auditors will have in the work of Mulenga & Associates.

**END OF SUGGETSED SOLUTIONS**



PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

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**DIPLOMA LEVEL**

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PFM 6: FINANCIAL REPORTING FRAMEWORK FOR PUBLICSECTOR ENTITIES

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MONDAY 14 DECEMBER 2020

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

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**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 Republic of Kudu is one of the least developed countries which significantly relies on donor support. On 1 January 2016, the Government of the Republic of Kudu incorporated Kudu Revenue Authority (KRA) in order to significantly improve domestic revenue collection.

The following trial balance was extracted from the accounting records of KRA as at 31 December 2019.

	DR (K)	CR (K)
Purchases of stationery and consumables	1,497,650	
Loan from Ministry of Finance (Note 1)		15,479,650
12% Debentures (Note 2)		2,500,000
Clinic	3,000,000	
Motor vehicles (Note 3)	2,700,000	
Funding from Central Government		6,435,618
Accumulated depreciation on Motor vehicles as at 1 January 2019		1,518,750
Asycuda processing fees (Note 4)		972,300
Other income		400,000
Computer hardware and Deferred income (Note 5)	1,000,000	1,000,000
Personnel expenses	1,052,000	
Administrative expenses	623,670	
Operating Expenses	3,120,800	
Tax refunds accounts (payable within one year)	2,567,800	2,567,800
Land at valuation	800,000	
Buildings at cost (Note 3)	9,200,000	
Fixtures & fittings at cost (Note 3)	2,645,000	
Intangible non-current assets (Note 6)	500,000	
Revaluation reserve		140,000
Accumulated depreciation on Buildings as at 1 January 2019		552,000
Accumulated depreciation on fixtures and fittings as at 1 January 2019		502,550
Accumulated amortization of Intangible non-current assets as at 1 January 2019		100,000
Interest paid and received	150,000	43,750
Suspense account	2,675,000	
Trade receivables and payables	651,900	1,320,962
Amounts receivable from Central Government	74,500	
Accumulated capital fund as at 1 January 2019		457,670
Bank and cash	995,000	815,870
Inventory as at 1 January 2019	953,600	
Employee loans and advances	600,000	
	<b><u>34,806,920</u></b>	<b><u>34,806,920</u></b>

**Notes:**

1. No Interest is charged on the loan obtained from the Ministry of Finance.

2. KRA constructed a clinic for its employees at a cost of K3 million over four (4) months from 1 June 2019 to 30 September 2019. In order to finance the project, KRA took out a K2.5 million 12% Debenture on 1 June 2019. The Debenture was repaid together with the interest on 31 December 2019. The Principal Accountant debited the payments to the suspense account. The clinic opened on 15 February 2020.
  
3. Depreciation is computed as follows:
 

• Buildings	2% (Straight line basis)
• Fixtures & fittings	10% (Reducing balance basis)
• Motor vehicles	20% (Reducing balance basis)
  
4. Asycuda processing fees are derived from the charge of K30 per transaction for processing of imported goods at the borders. This is used for various operational and administrative needs.
  
5. On 1 January 2019, KRA received grant assets from a foreign donor, in the form of computer hardware, amounting to K1,000,000. The Directors have resolved to depreciate computer hardware on a straight-line basis over an estimated economic useful life of five (5) years, with the associated deferred income being amortized.
  
6. Intangible non-current assets were acquired on 1 January 2017 and the Board of Directors estimated useful economic life of 9 years. They expect the intangible non-current asset to have a scrap value of K50,000 at the end of its useful economic life. Amortization provided on a straight line basis.
  
7. Inventory comprise stationery and other consumables. These are treated as part of administrative expenses. Closing inventory at 31 December 2019 was K380,000. However, stationery which was included in the closing inventory figure at a cost of K50,000 was sold to employees for K4,000 on 12 January 2020 due to poor quality.

In the year 2015, domestic revenues accounted for a mere 8% of Gross Domestic Product (GDP). For the year ended 31 December 2019, the domestic revenues were 12% of GDP representing an increase of 20% compared to the year 2018. KRA uses accrual-based IPSASs. A reputable regional body has strongly advised other countries to adopt accrual-based IPSASs.

**Required:**

- (a) Explain any three (3) key factors that normally affect the extent of adoption work required when moving to accrual-based IPSASs. (6 marks)
- (b) Using the information given above, explain the accounting treatments for the interest on the debenture and stationery sold to employees. (3 marks)
- (c) Prepare the following for Kudu Revenue Authority (KRA):
- (i) Statement of Financial Performance for the year ended 31 December 2019. (14 marks)
  - (ii) Statement of Financial Position as at 31 December 2019. (17 marks)
- [Total: 40 Marks]**

## **SECTION B**

**Attempt any THREE (3) questions in this section.**

### **QUESTION TWO**

The Ministry of Finance is preparing its financial statements for the year ended 31 December 2019, using accrual basis IPSASs. The Audit Committee of the Ministry of Finance has questioned the treatments of the following matters involving provisions, contingent liabilities and contingent assets:

#### **Matter one:**

On 30 December 2019, the Ministry of Finance lost K50,000 in a burglary. This is fully covered under the fidelity insurance cover and the insurance company is yet to perform an assessment. The Chief Accountant has included the K50,000 under current assets.

#### **Matter two:**

The Controlling Officer announced that the Ministry of Finance would contribute K1 million towards the assistance of the flood victims in one of the remote areas. The announcement was made on 7 November 2019 but no mention has been made in the financial statements. The Ministry of Finance has a published policy on such pronouncements and the victims are aware that it honours its promises.

#### **Matter three:**

During the year, a former employee sued the Ministry of Finance for wrongful dismissal. On 15 January 2020, the Industrial Court awarded damages worth K2 million. The Chief Accountant has only included K1 million which was budgeted. The other K1 million has been disclosed in the notes to the financial statements as a contingent liability.

#### **Matter four:**

The Secretary to the Treasury has written to all Controlling Officers that the Pay As You Earn (PAYE) liabilities for all ministries for the month of January 2020 will be paid late. The Chief Accountant has made a provision of K800,000 for the penalty and interest which may result.

#### **Required:**

(a) Define provision, contingent liability and contingent asset according to IPSAS 19 *Provisions, Contingent liabilities and Contingent Assets*.

(6 marks)

(b) Discuss the accounting treatments of the four (4) matters given in the scenario.

(10 marks)

(c) Explain any four (4) reasons for the rapid adoption of the International Public Sector Accounting Standards (IPSASs) in a number of countries. (4 marks)

**[Total:20 Marks]**

### **QUESTION THREE**

Performance & financial management in the public sector covers the management, process, and behavioural aspects of strategy execution, and managing and monitoring performance. This is important to professional accountants, both as employees or advisers, since many of them are focused on helping organisations deliver on objectives, goals and targets, and strategies using a range of approaches, tools, and techniques.

You have been engaged as a Financial Consultant by the Central Government of the Republic of Njamba to assist newly recruited civil servants understand the balanced scorecard and ratio analysis as they relate to the public sector. Most of the new recruits are from the private sector.

The Accountant General wants you to also use the following details for one of the public interest enterprise which produces essential drugs:

	Years ended 31 December	
	2019	2018
	K'000	K'000
Revenue	6,500	4,980
Operating profit	325	249
Non-current Assets	7,000	5,000
Current Assets	3,000	2,000
Current liabilities	4,000	1,500
Number of employees	1,200	600

The country is experiencing massive load shedding and the high unemployment rate is of great concern to Central Government.

#### **Required:**

(a) Explain the importance of performance and financial management in the public sector.

(8 marks)

(b) Discuss the use of the balanced scorecard and ratio analysis in performance evaluation in the public sector. (4 marks)

(c) Calculate and comment on any four (4) suitable ratios which can be used to measure the performance of the public interest enterprise. (8 marks)

**[Total: 20 Marks]**

#### **QUESTION FOUR**

Qualitative characteristics of information included in General Purpose Financial Reports (GPFRs) are the attributes that make that information useful to users and support the achievement of the objectives of financial reporting. One of the most important characteristic is faithful representation. This is attained when information is "complete", "neutral", and "free from material error".

Most state owned enterprises are facing significant challenges in meeting their post-employment benefits. Experts believe that most of the GPFRs for state owned enterprises do not faithfully represent post-employment benefits in their GPFRs.

The principle underlying all of the detailed requirements of IPSAS 25 *Employee Benefits* is crucial to faithful representation.

#### **Required:**

(a) Explain what is meant by "complete", "neutrality" and "free from material error" in respect of the information included in the General Purpose Financial Reports (GPFRs). (6 marks)

(b) State the circumstances when departure from equivalent IFRS is permitted under the accrual basis IPSASs. (4 marks)

(c) Distinguish defined contribution and defined benefit plans. (4 marks)

(d) Explain the following:

(i) The principle underlying all of the detailed requirements of IPSAS 25 *Employee Benefits*.

(2 marks)

(ii) The accounting treatment of the post-employment benefits for defined benefit plans. (4marks)

**[Total: 20 Marks]**

## **QUESTION FIVE**

The Government of the Republic of Zambia (GRZ) makes its approved budget publicly available. You are a Senior Financial Analyst in one of the credit rating agencies. The following extract from the GRZ Financial Report for the year ended 31 December 20X9 has been provided:

### **EXTRACT**

Government of the Republic of Zambia (GRZ)

Financial Report for the year ended 31 December 20X9

### **Statement of Budget execution**

	<b>Approved</b>	<b>Actual</b>
	K'billion	K'billion
<b>Revenue</b>		
Value added tax (VAT)	40	10
Fines	60	90
Multilateral external borrowing	11	30
Income tax	80	90
<b>Payments</b>		
Personal emoluments	150	200
Social benefits	30	5

There has been increased employment in the construction and health sectors.

### **Required:**

- (a) Explain the importance of budgets in the public sector.  
(5 marks)

(b) Describe the requirements, under IPSAS 24 *Presentation of Budget Information in Financial Statements*, for entities that make their budgets publicly available. (3 marks)

(c) Calculate variances and variance percentages between the approved budget and actual performance for the year ended 31 December 20X9. (6 marks)

(d) Comment on the performance of the Government during the year ended 31 December 20X9, using the variances calculated in (c) above. (6 marks)

**[Total: 20 Marks]**

**END OF PAPER**



## **SUGGESTED SOLUTIONS**

### **SOLUTION ONE**

#### **(a) Key factors**

The key factors that normally affect the extent of adoption work required when moving to accrual-based IPSASs are as follows:

(1) The level of political commitment to the adoption of accrual accounting. This is very important mainly because the adoption work requires resources and the tone at top must be supportive.

(2) The capability of existing information systems. A smooth transition in most cases requires a change of the existing information systems.

(3) The completeness and accuracy of existing information, particularly in relation to assets and liabilities. Countries must capture additional data/information and also clean up their existing data/information to ensure success.

(4) Any change to the basis of accounting for budgeting. It is usually important to align budgeting to the actual financial reporting.

(5) The capacity and skills of the people and organization(s) responsible for implementing changes. Most external donors and institutions do provide the required resources for building the necessary capacities.

#### **(b) Accounting treatments**

##### **Interest on the Debenture**

IPSAS 5 *Borrowing Costs* gives detailed guidance in this area. It states that borrowing costs shall be recognized as an expense in the period in which they are incurred, except to the extent that they are capitalized.

Borrowing costs that are directly attributable to the acquisition, construction, or production of a qualifying asset shall be capitalized as part of the cost of that asset. The interest cost of K100,000 ( $4/12 \times 2,500,000 \times 12\%$ ) should be capitalized.

The interest cost amounting to K75,000 ( $3/12 \times 2,500,000 \times 12\%$ ) relating to the period after the Clinic was completed should be expensed.

##### **[Award marks as follows:**

**1/2 mark for reference to IPSAS 5**

**1/2 mark for expense (K75,000)**

**1 mark for capitalize (K100,000)**

## Stationery sold to employees on 12 January 2020

IPSAS 12 *Inventories* gives detailed guidance on the accounting treatment. The standard states that Inventories shall be measured at the lower of cost and net realizable value (NRV). The stationery cost K50,000 but it was only sold for K4,000. The inventory must be valued at K4,000.

**[Award marks as follows:**

**½ mark for reference to IPSAS 12**

**½ mark for lower of cost and net realizable value (K4,000)**

**Maximum – 1 mark]**

(c) (i) **Kudu Revenue Authority (KRA)**

### **Statement of Financial Performance for the year ended 31 December 2019**

	K	K	Marks
<b>Revenue</b>			
Funding from Central Government		6,435,618	½
Deferred income		200,000	½
Asycuda processing fees		972,300	½
Other income		<u>400,000</u>	½
<b>Total operating income</b>		<b>8,007,918</b>	
<b>Expenditure</b>			
Personnel expenses	1,052,000		½
Administrative expenses (W1)	2,740,920		3
Operating expenses	3,120,800		½
Depreciation and amortization (W2)	<u>879,550</u>		5
<b>Total expenditure</b>		<b><u>(7,793,270)</u></b>	
<b>Results from operating activities</b>		<b>214,648</b>	
Finance income	43,750		½
Finance costs (150,000 + 75,000)	<u>(225,000)</u>		1
<b>Net finance income</b>		<b><u>(181,250)</u></b>	
<b>Surplus for the year</b>		<b><u>33,398</u></b>	1 ½

(c) (ii) **Kudu Revenue Authority (KRA)**

**Statement of Financial Position as at 31 December 2019**

<b>Assets</b>	K	K
<b>Non-current assets</b>		
Property, plant and equipment (W3)		16,042,150
Intangible assets (500,000 – 150,000)		<u>350,000</u>
<b>Total non-current assets</b>		<b>16,392,150</b>
<b>Current assets</b>		
Inventories	334,000	
Trade receivables	651,900	
Amounts receivable from the Government	74,500	
Employee loans and advances	600,000	
Tax refunds bank accounts	2,567,800	
Bank and cash	<u>995,000</u>	
<b>Total current assets</b>		<b><u>5,223,200</u></b>
<b>Total assets</b>		<b><u>21,615,350</u></b>
<b>Capital fund, reserves and liabilities</b>		
Capital fund and reserves		
Capital fund (457,670 + 33,398)		491,068
Revaluation reserve		<u>140,000</u>
<b>Total capital fund and reserves</b>		<b>631,068</b>
<b>Liabilities</b>		
<b>Non-current liabilities</b>		
Loan from Ministry of Finance	15,479,650	
Deferred income (1,000,000 – 400,000)	<u>600,000</u>	

**Total non-current liabilities** **16,079,650**

**Current liabilities**

Deferred income 200,000

Trade and other payables 1,320,962

Bank overdraft 815,870

Tax refunds bank accounts 2,567,800

**Total current liabilities** **4,904,632**

**Total capital, reserves and liabilities** **21,615,350**

**Workings**

1. Administrative expenses

	K	K
As per trial balance		623,670
Opening inventory	953,600	
Purchases of stationery and consumables	1,497,650	
	2,451,250	
Closing inventory (380,000 – 50,000 + 4,000)	<u>(334,000)</u>	
		<u>2,117,250</u>
<b>Total</b>		<b><u>2,740,920</u></b>

2. Depreciation and amortization

	K
Depreciation	
Buildings (9,200,000 X 2%)	184,000
Fixtures & fittings [(2,645,000 – 552,000) X 10%]	209,300
Motor vehicles [(2,700,000 – 1,518,750) X 20%]	236,250
Computer hardware (1,000,000/5 years)	200,000

Amortization	
Intangible non-current assets [(500,000 – 50,000)/9]	<u>50,000</u>
<b>Total</b>	<b><u>879,550</u></b>

### 3. Property, plant and equipment

<b>Cost/valuation</b>	<b>K</b>	<b>K</b>
Land		800,000
Buildings		9,200,000
Clinic (3,000,000 + 100,000)		3,100,000
Fixtures & fittings		2,645,000
Motor vehicles		2,700,000
Computer hardware		<u>1,000,000</u>
		<b>19,445,000</b>
<b>Accumulated depreciation</b>		
Buildings (552,000 + 184,000)	736,000	
Fixtures & fittings (502,550 + 209,300)	711,850	
Motor vehicles (1,518,750 + 236,250)	1,755,000	
Computer hardware	<u>200,000</u>	
		<b><u>(3,402,850)</u></b>
Total		<b><u>16,042,150</u></b>

## **SOLUTION TWO**

### **(a) Provision, contingent liability and contingent asset**

#### **Provision**

A provision is a liability of uncertain timing or amount. A liability is a present obligation as a result of past events and settlement is expected to result in an outflow of resources (payment).

#### **Contingent liability**

A contingent liability is a possible obligation depending on whether some uncertain future event occurs or a present obligation but payment is not probable or the amount cannot be measured reliably.

#### **Contingent asset**

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.

**[Award up to 2 marks for each definition – Maximum 6 marks]**

### **(b) Accounting treatments**

#### **Matter one:**

The insurance company has not confirmed that it will pay the K50,000. An assessment could reveal negligence on the part of the Ministry of Finance, in which case, the insurance company may not honour the claim. This is a contingent asset which will only be confirmed by the results of the assessment. It should not be recognized as a current asset.

#### **Matter two:**

The Ministry of Finance has a published policy and the victims are aware that it honours its promises. The Ministry of Finance has a constructive obligation towards the victims as it has created a valid expectation on the part of the victims that it will discharge its responsibility. The Ministry of Finance therefore has a present obligation and should make a provision of K1 million in the financial statements.

#### **Matter three:**

The Ministry of Finance has a present obligation as a result of a past event and settlement is expected to result in an outflow of K2 million not the budgeted K1 million. Hence, an additional provision of K1 million must be made. Disclosure as a contingent liability is wrong as there is no possible liability.

**Matter four:**

The Secretary to the Treasury is talking about what is expected in the future and therefore, the Ministry of Finance has no present obligation as a result of a past event. The expected event should not be provided for.

**(c) Reasons for the rapid adoption of the International Public Sector Accounting Standards (IPSASs)**

The adoption of IPSAS by governments improves:

- (1) Quality of financial reporting – IPSASs represent best practices aimed at improving the quality of financial reporting.
- (2) Comparability of financial information – IPSASs makes comparability of financial information a possibility.
- (3) Evaluation of performance – IPSASs enables governments to evaluate their performance through the provision of more reliable and acceptable financial information.
- (4) Decision making – IPSASs provides useful information for decision making.

## **SOLUTION THREE**

### **(a) Reasons for importance of performance and financial management in the public sector**

The reasons for importance of performance and financial management in the public sector include:

(1) Fiscal management – there is a symbiotic relationship between fiscal management and importance of performance and financial management in the public sector. Quality performance and financial management demands improved fiscal management. Fiscal planning is a key ingredient in fiscal management. It mainly involves understanding the linkages between intangible-or-non-financial-factors and financial outcomes, as well as ensuring that operational activities are carried out effectively and efficiently.

(2) Fiscal discipline – performance and financial management in the public sector is able to reveal inefficiencies and excessive expenditure which needs to be addressed. Many countries in both the developed and developing world are making important and impressive achievements in strengthening public financial management and governance.

(3) Prioritization of expenditure – the resource envelope is limited and performance management assists in ensuring effective allocation of resources to the right areas.

(4) Value for money – performance and financial management in the public sector enables stakeholders to evaluate whether the public sector is getting value for its money. It examines the 3Es (Economy, Efficiency and Effectiveness).

(5) Transparency and accountability – performance and financial management greatly contributes to improved transparency and accountability. International donors, governments, national and local institutions, including regulators and professional accountancy bodies want a credible system of measuring results and holding people accountable.

### **(b) Balanced scorecard and Ratio analysis in the public sector**

#### **The Balanced scorecard**

The balanced scorecard is a widely recognized strategy-management framework that, since its inception by Kaplan and Norton in the early 1990s, has been adopted, modified, and applied by many entities, both public and private, worldwide.

First developed as an enhanced performance measurement system, the balanced scorecard evolved into a holistic system for strategic execution.

The balanced scorecard incorporates both financial (financial perspective) and non-financial (Customer, internal processes, and innovative and learning perspectives) indicators of performance.

Ratio analysis is not as widespread in government as in the private sector. The primary problems are weaknesses in how key information needed for assessing financial condition is



reported. Generally, ratios in government are effective only for certain units and generalized ratios are hard to compare from state to state since the unit of government is so large and complex. However, some notable success has been achieved in developing applicable ratios for interpreting the financial condition of local government and institutions of higher education.

<b>(c) Suitable ratios</b>	<b>2019</b>	<b>2018</b>
<b>Calculations</b>		
Operating margin = $\frac{\text{Operating profit}}{\text{Revenue}} \times 100\%$	$\frac{325}{6,500} \times 100\%$	$\frac{249}{4,980} \times 100\%$
Revenue	6,500	4,980
	<b>= 5%</b>	<b>= 5%</b>

**Comments**

The operating profit is the same. This could indicate that pricing in the industry is regulated in order to protect the public.

**Calculations**

Asset turnover = $\frac{\text{Revenue}}{\text{Assets}}$	$\frac{6,500}{(7,000 + 3,000)}$	$\frac{4,980}{(5,000 + 2,000)}$
Assets	(7,000 + 3,000)	(5,000 + 2,000)
	= 0.65 times	=0.71 times

**Comments**

The asset turnover has decreased. This could be due to the presence of non-performing assets and/or assets bought during the year due to political pressure.

**Calculations**

Current ratio = $\frac{\text{Current assets}}{\text{Current liabilities}}$	$\frac{3,000}{4,000}$	$\frac{2,000}{1,500}$
Current liabilities	4,000	1,500
	= 0.75:1	=1.33:1

**Comments**

The current ratio has decreased. This could be due to reduced inventory due to load shedding.

**Calculations**

Revenue per employee = <u>Revenue</u>	<u>K6,500,000</u>	<u>K4,980,000</u>
No, of employees	1,200	600
	= K5,416.67	=K8,300

**Comments**

The revenue per employee has decreased. This could be due to a directive by Central Government to recruit more people and assist in reducing the unemployment rates.

## **SOLUTION FOUR**

### **(a) Meaning of complete, neutral, and free from material error**

#### Complete

This means there is no omission of some information. Both quantitative and qualitative information have been given.

#### Neutral

This means there is no bias in the information. Neutral information faithfully represents the economic and other phenomenon that it purports to represent.

#### Free from material error

This means there are no errors or omissions that are individually or collectively material in the information presented and the process used to produce the reported information. Information is material if its omission or misstatement could influence the accountability by the entity, or the decisions that users make on the basis of the entity's GPFRs prepared for that reporting period.

### **(b) Departure from equivalent IFRS**

The IPSASB's IFRS convergence program is an important element in the IPSASB's work program. The IPSASB policy is to converge the accrual basis IPSASs with IFRSs issued by the IASB where appropriate for public sector entities.

Accrual basis IPSAS's that are converged with IFRS's maintain the requirements, structure, and text of the IFRSs, unless there is a public sector specific reason for a departure. Departure from equivalent IFRS occurs when the following are not appropriate for the public sector:

- (1) Requirements in the IFRS are not appropriate for the public sector.
- (2) Terminologies in the IFRS are not appropriate for the public sector.
- (3) Inclusion of additional commentary is necessary to illustrate certain requirements in the public sector context.
- (4) Inclusion of examples is necessary to illustrate certain requirements in the public sector context.

### **(c) Defined contribution and defined benefit plans**

These plans are covered under IPSAS 25 *Employee Benefits*

#### **Defined contribution plans**

Defined contribution plans (where the entity's obligation for post-employment benefits for each reporting period is simply the amount to be contributed to a separate entity/fund for that period) present few difficulties for accounting but the standard does cover them.

## **Defined benefit plans**

Defined benefit plans are much more complicated, and a large part of the standard deals with them. Defined benefit plans are plans for post-employment benefits which are not defined contribution plans.

### **(d) Accounting treatment of the post-employment benefits**

#### **(i) The principle underlying all of the detailed requirements of IPSAS 25 *Employee Benefits***

The principle underlying all of the detailed requirements of IPSAS 25 *Employee Benefits* is that the cost of providing employee benefits should be recognized in the period in which the benefit is earned by the employee, rather than when it is paid or payable to the employee.

#### **(ii) The accounting treatment of the post-employment benefits for defined benefit plans**

For a defined benefit plan, a public sector entity recognizes a net defined benefit asset or liability comprising the present value of the defined benefit obligations at the end of the reporting period, based on actuarial assumptions, net of fair value of any plan assets at the end of the reporting period.

IPSAS 25 encourages the involvement of a qualified actuary in measuring defined benefit organisations, which are valued using the projected unit credit method. There is a limit on recognition of a net defined benefit asset.

There are three options as to how to recognize actuarial gains and losses:

- (1) They may be recognized in surplus or deficit immediately as they arise
- (2) They may be recognized immediately in the net assets/equity or
- (3) Some of them may be recognized in surplus or deficit over the average remaining working lives of the employees who are members of the plan.

## **SOLUTION FIVE**

### **(a) Importance of budgets in the public sector**

(1) The budget plays a dominant role in portraying public policy. It establishes estimates of revenue and expenses or expenditures.

(2) The budget includes financing requirements for both operating and capital spending. It is used to set tax rates and determine borrowing requirements.

(3) The budget is part of the process for obtaining legislative approval for spending.

(4) Legislators, investors and other users need information that helps them assess a government's results in the management of its resources and financial affairs. A comparison of the actual results with those originally forecast in the budget is necessary to identify significant differences. Hence, a government's budget is a crucial element in the accountability cycle and the standard against which subsequent performance is judged. Governments are thus held publicly accountable for the choices they have made, for their programs, the cost of services and the financial position of their jurisdiction.

### **(b) Presentation of Budget Information in Financial Statements**

IPSAS 24 *Presentation of Budget Information in Financial Statements* establishes the following requirements for entities that make their budgets publicly available:

(1) A comparison of the budget amounts to the actual amounts resulting from the execution of the budget; and

(2) A reconciliation of these actual amounts in the financial statements.

(3) Disclosure is required of the reasons for material differences between the budget and actual amounts.

### **(c) Calculation of variances and variance percentages between the approved budget and actual performance**

#### **EXTRACT**

Government of the Republic of Zambia (GRZ)

Financial Report for the year ended 31 December 20X9

#### **Statement of Budget execution**

	Approved	Actual	Variance	Variance
	K'billion	K'billion	K'billion	%
<b>Revenue</b>				
Value added tax (VAT)	40	10	-30	-75

Fines	60	90	+30	+50
Multilateral external borrowing	11	30	+19	+173
Income tax	80	90	+10	+13

### **Payments**

Personal emoluments	150	200	-50	-33
Social benefits	30	5	+25	+83

**(d) Comment on the performance of the Government during the year ended 31 December 20X9, using the variances calculated in (c) above**

### **Value Added Tax (VAT)**

The VAT collections were below budget. This could be due to fraudulent VAT refunds and a weak monitoring mechanism.

### **Fines**

The collections from fines have increased. This could be due to automated monitoring systems installed by Government and the requirement for offenders to deposit the money for the fines directly in Government bank accounts.

### **Multilateral external borrowing**

The multilateral external borrowing was above the approved budget. This could have been necessitated by the reduced domestic tax revenues and the need for balance of payment support.

### **Income tax**

The income tax collections were above the approved budget by 13%. This could have been due increased levels of employment especially in the construction and health sectors.

### **Personal emoluments**

The personal emoluments were above budget by 33%. This could have been due to increased employment of health workers.

### **Social benefits**

The social benefits were below budget by 83%. This could have been due to reduced donor support following a number of reported fraudulent activities concerning the social transfer funds.

## **END OF SUGGESTED SOLUTIONS**

