



PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

PFM 2: LEGAL ASPECTS OF PUBLIC SECTOR FINANCE AND ADMINISTRATION

2022

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

INSTRUCTIONS TO CANDIDATES

1. You have fifteen (15) minutes reading time. Use it to study the examination paper carefully so that you understand what to do in each question.
2. This paper is divided into TWO (2) sections:
Section A: One (1) Compulsory question.
Section B: There are four (4) questions. Attempt any three (3) questions.
3. Enter your student number and your National Registration Card number on the front of the answer booklet. Your name must **NOT** appear anywhere on your answer booklet.
4. Do **NOT** write in pencil (except for graphs and diagrams).
5. **Cell Phones** are **NOT** allowed in the Examination Room.
6. The marks shown against the requirement(s) for each question should be taken as an indication of the expected length and depth of the answer.
7. All workings must be done in the answer booklet.
8. Present legible and tidy work.
9. Graph paper (if required) is provided at the end of the answer booklet.

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

SECTION A

QUESTION ONE (COMPULSORY)

(a) After a decision was given by a public body that public buildings will only be accessed with evidence of Covid19 Vaccination Certificate, Human Rights Movements feel the decision is an abrogation and a breach to constitutional guarantees. They have come to you to ask if there is any way the state can be made to vacate their decision.

Required:

Explain to the Human Rights Movements on the grounds they may need to prove for such a decision to be vacated. (30 marks)

(b) In its strict sense, discuss the difference between administrative law and Constitutional law. (10 marks)

[Total: 40Marks]

SECTION B

There are FOUR (4) questions in this section.

Attempt any THREE (3) questions.

QUESTION TWO

Making reference to the Constitution, discuss the function of the three organs of government in relation to their governance of a country. **[Total: 20Marks]**

QUESTION THREE

Write notes on the following;

- (a) Constitution (5 marks)
- (b) Magna Carta 1215 (5 marks)
- (c) Statutory Instruments (5 marks)
- (d) Judicial Review (5 marks)

[Total: 20 Marks]

QUESTION FOUR

- (a) Discuss the difference between referendum and constituent assembly as a mode of adopting the Constitution (10 marks)
- (b) Explain the supremacy of the Constitution in Zambia (6 marks)
- (c) Explain the effect of a quashing order on a public body. (4 marks)

[Total: 20Marks]

QUESTION FIVE

- (a) Explain how the Courts control Administrative bodies. (8 marks)
- (b) Explain by citing examples where administrative bodies derive their powers from.

(12 marks)

[Total: 20 Marks]

END OF EXAM

PFM2 SUGGESTED SOLUTIONS

SOLUTION ONE - COMPULSORY

This scenario falls under Judicial review and it is noted that the decision was given by a public body, the following grounds are proper to be shown for the decision to be vacated:

(a) ILLEGALITY

This is the first ground the Human Rights Movements need to prove. In Lord Diplock's words, this ground means that the decision maker "must understand correctly the law that regulates his decision-making power and must give effect to it". A decision may be illegal for many different reasons. There are no hard and fast rules for their classification, but the most common examples of cases where the courts hold administrative decisions to be unlawful are the following:

The decision is made by the wrong person (unlawful sub-delegation)-If the law empowers a particular authority, e.g. a minister, to make certain decisions, the Minister cannot sub delegate this power to another authority, e.g. an executive officer or a committee. This differs from a routine job not involving much discretion being done by civil servants in the Minister's name, which is not considered delegation.

The decision maker went beyond their power: ultra vires- The classic example of this is **Attorney General v Fulham Corporation (1921)** where Fulham council had the power to set up wash-houses for those without the facilities. They decided to charge people to use it. The court held they went beyond their power by trying to benefit commercially from something that was supposed to be for everyone.

IRRATIONALITY

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. Whether the decision falls within this category is a question that judges by their training and experience should be well equipped to answer.

The second condition is irrationality. Under Lord Diplock's classification, a decision is irrational if it is "so outrageous in its defiance of logic or of accepted moral standards that no sensible person who had applied his mind to the question could have arrived at it." This standard is also known as Wednesbury unreasonableness, after the decision in **Associated Provincial Picture Houses Ltd v Wednesbury Corporation**, where it was first imposed.

Unlike illegality and procedural impropriety, the courts under this head look at the merits of the decision, rather than at the procedure by which it was arrived at or the legal basis on which it was founded. The question to ask is whether the decision "makes sense". In many circumstances listed under "illegality", the decision may also be considered irrational.

Proportionality is a requirement that a decision is proportionate to the aim that it seeks to achieve. E.g. an order to forbid a protest march on the grounds of public safety should not be made if there is an alternative way of protecting public safety, e.g. by assigning an alternative route for the march. Proportionality exists as a ground for setting aside administrative decisions in most continental legal systems. However, it is not as yet a separate ground of judicial review, although Lord Diplock has alluded to the possibility of it being recognized as such in the future. At present, lack of proportionality may be used as an argument for a decision being irrational.

PROCEDURE IMPROPRIETY

The couple must also prove that there was procedural impropriety. A decision suffers from procedural impropriety if in the process of its making the procedures prescribed by statute have not been followed or if the "rules of natural justice" have not been adhered to.

Statutory procedures

An Act of Parliament may subject the making of a certain decision to a procedure, such as the holding of a public hearing or inquiry, or a consultation with an external adviser. Some decisions may be subject to approval by a higher body. Courts distinguish between "mandatory" requirements and "directory" requirements. A breach of mandatory procedural requirements will lead to a decision being set aside for procedural impropriety.

Breach of natural justice

The rules of natural justice require that the decision maker approaches the decision making process with "fairness". What is fair in relation to a particular case may differ. As pointed out by Lord Bridge in **Lloyd v McMahon [1987] AC 625**, "the rules of natural justice are not engraved on tablets of stone".

10 Marks

- (b) In the strict sense Administrative and Constitutional Law can be differentiated as follows: 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. Constitutional Law does not make any specific provisions as to the manner the Administrative functions of the state are to be conducted and it is because of that that Constitutional law is referred to as Static Law.

Administrative Law on the other hand looks at the day to day administrative institutions and ensures there is a benchmark against which these administrative institutions would be assessed by to ensure there is Conformity with the law as they perform their functions and any act contrary to law or without legal authority for performance of that function, Administrative law also provides checks by way of judicial review. It is this aspect of being applied on a daily basis that Administrative Law is therefore considered Law in motion. Although, therefore Constitutional Law is considered to be supreme in status, nonetheless, Administrative Law may qualify to be more important in the day running of a Country as it is applied regularly than Constitutional Law.

SOLUTION TWO

The constitution in Zambia establishes the three organs of government which collectively are referred to as government. The three are legislature the executive, and the judiciary.

- (i) The Legislature – this body is established under Part VI of the constitution. The legislature has been established to perform two functions in the governance of the republic of Zambia. First, in accordance with article 63(1) it is Parliament and performs the function of law making that is, legislative function. Second, in accordance with article 63(2) it is the National Assembly and performs oversight functions over the executive in the manner the executive performs its functions. The National Assembly is made up of the Speaker and two Deputy Speakers and 156 elected Members of Parliament plus 8 nominated by the President. The Members of Parliament are directly elected from the 156 constituencies that Zambia is divided into for purposes of representation of the people.
- (ii) The Executive – this is the body established under Part VII of the constitution. The executive is headed by the President. The executive is made up mainly of the Cabinet which is the nucleus of government. The executive is constituted by the constitution to perform functions of formulating the policies of the government and cause the same to be implemented. The civil services and armed forces are all under the charge of the executive. The civil service is one of the most important of the wings of the executive as it is the one that ensures all the policies as formulated by the cabinet are implemented to their intended objectives. The executive through the president also appoints dignitaries from Zambia to other countries and equally welcomes foreign dignitaries accredited to Zambia by other countries. It is an important organ as it is entrusted with the performance of all administrative functions of running the affairs of the state.
- (iii) The Judiciary – the judiciary is established under Part VIII of the constitution. The judiciary consists of all the courts in the country that is, the Supreme Court, the Constitutional Court, The Court of Appeal, The High Court, the Industrial Relations Court, the Magistrate Courts and the Local Courts. This organ of government is charged with the function of interpreting the law made by Parliament and adjudicating over matters that people may bring against the government. It also hears cases of a criminal nature brought by the State against individuals that commit crimes. The judiciary is very important in the governance of the country as it ensures that the governance of the country is done according to the provisions of the law and any action that contravenes the law is adjudged to be null and void. It is headed by a Chief Justice and other judges appointed by the President on recommendation of the Judicial Service Commission.

SOLUTION THREE

- (a) **A constitution** is an aggregate of fundamental principles or established precedents that constitute the legal basis of a polity, organization or other type of entity and commonly determine how that entity is to be governed. When these principles are written down into a single document or set of legal documents, those documents may be said to embody a written constitution; if they are encompassed in a single comprehensive document, it is said to embody a codified constitution. The Constitution of the United Kingdom is a notable example of an uncodified constitution; it is instead written in numerous fundamental Acts of a legislature, court cases or treaties.
- (b) **Magna Carta**, English **Great Charter**, charter of English liberties granted by King John on June 15, 1215, under threat of civil war and reissued, with alterations, in 1216, 1217, and 1225. By declaring the sovereign to be subject to the rule of law and documenting the liberties held by "free men," the Magna Carta provided the foundation for individual rights in Anglo-American jurisprudence and one of the sources of the British Constitution.
- (c) A **statutory Instrument** is law made under Delegated Legislation by ministers under powers conferred on them by an Act of parliament. Statutory instruments mainly supplement provisions in Acts of Parliament. Henceforth, inferior to Acts of parliament.
- (d) **Judicial review** is a type of court proceeding in which a judge reviews the lawfulness of a decision or action made by a public body. In other words, judicial reviews are a challenge to the way in which a decision has been made, rather than the rights and wrongs of the conclusion reached.
- It is not really concerned with the conclusions of that process and whether those were 'right', as long as the right procedures have been followed. The court will not substitute what it thinks is the 'correct' decision. This may mean that the public body will be able to make the same decision again, so long as it does so in a lawful way

SOLUTION FOUR

- (a) By Referendum, it means voting where the voter gives a "Yes" or a "no" to a question. Only voters who are eligible to vote in Presidential and Parliamentary elections may take part in a Referendum. Every citizen eligible to vote in a presidential and parliamentary election is eligible to cast a yes or no vote in a referendum. It is also vital that before a referendum, takes place, the state must conduct a census to find out the number of people eligible to vote, while a Constituent Assembly represents different interest groups, such as farmers, businessmen, and teachers and so on. This is a demarcation made by the electoral commission of Zambia under the powers conferred on them by the electoral commission Act. The demarcations are for purposes of representation to the national assembly. Thus, it is an assembly of individual not necessary members of parliament but ordinarily individual from constituencies.
- (b) In Zambia constitutional supremacy entails that the Zambian Constitution is the supreme law of the land. Article 1 of the Zambian constitution makes a declaration of its supremacy in relation to other laws. The supremacy of the Zambian constitution was illustrated in *Christine Mulundika and Seven Others v The Attorney General*. The principle of law established by the case is that the constitution in Zambia is the supreme law of the land and should any other law be inconsistent with it, that other law is to the extent of the inconsistency to be declared void.
- (c) A quashing Order is an order of the court nullifying the decision of a public body to the extent that it appears as though the decision was never made. The decision must have already been made for this order to qualify. Thus, the decision quashed must be one that affects a certain group of citizens or an individual but made in bad faith.

SOLUTION FIVE

- (a) The court controls administrative tribunal via Judicial Review- this looks at the powers conferred on the body and ascertains whether the body has acted within the confines of its powers. In an instance where power exists, it assess whether procedure laid down by the Act was followed when performing its functions. Judicial proceedings may be brought against the board to question the legality, propriety and reasonableness of the decision made were it is found that trivialities were taken into account when making a decision and consequently affecting a person adversely.
- (b) Administrative Bodies derive their powers from statutes under which they are established. All administrative Agencies are created by statutes. The existence of Administrative agencies is determined by the need arising in a department of government of government. The powers and functions they have therefore are stipulated in the statute that establishes them. For instance, The Zambia Revenue Authority Act Cap321 of the Laws of Zambia establishes the Zambia Revenue Authority Agency and S. 9 states that, 'there is hereby established the Zambia Revenue Authority which shall be a body corporate with perpetual succession and a common seal, capable of suing and of being sued in its corporate name and with power, subject to the provisions of this Act, to do all such acts and things as a body corporate may by law do or perform.' Also the Public Procurement Authority is established under the Public Procurement Act S. 5 (2) of which stipulates that, 'the authority shall be a body corporate with perpetual succession and a common seal, capable of suing and being sued in its corporate name, and with the power, subject to the provisions of this Act, to do all such acts and things as a body corporate may, by law do or perform'.

END OF SOLUTIONS



PUBLIC SECTOR FINANCIAL MANAGEMENT EXAMINATIONS

DIPLOMA LEVEL

PFM4 - PUBLIC SECTOR FINANCIAL MANAGEMENT

2022

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SECTION A

This question is compulsory.

QUESTION ONE

In the recent times, the world has been faced with a serious Covid 19 pandemic. This pandemic affected almost all nations. At one point the virus spread like "wild fire" and economies were negatively affected. A number of sectors had to devise and develop strategies to survive including innovation and technological development like in the education, health and agriculture sectors to survive and counteract the negative impact thereof.

Country A had allocated significant resources in its budget to provide goods and services to its citizens, while considering the role of the private sector as well. During the pandemic, the Government of Country A found a greater need to intervene in the reallocation of resources so that some funds approved in the budget are redirected towards the needy and vulnerable and also to the greater population. This also meant that the Government of Country A ensured that they addressed issues relating to Market Failure so that the citizens would accrue benefits from the available resources.

The situation that arose as a result of Covid 19 necessitated Country A to prepare supplementary budgets which were subsequently approved by parliament. The Minister of Finance emphasized the need to ensure that Treasury Management functions are effectively operational in order to ensure accountability of the resources available that have been allocated to each ministry. There was an increase of donor funds in country A due to the Pandemic which required proper accountability.

The Government of country A encouraged Public Private Partnerships (PPPs). The Ministry of Health working in conjunction with the Ministry of Agriculture engaged a private company known as Kion Plc as consultants to come up with a project to import irrigation equipment (Project X). The irrigation equipment was to be sold to small-scale farmers at market price and another project (Project Y) to import laptops to be used by private schools. These Laptops were also to be sold at market price to these schools. The funds were loaned to Kion Plc from the allocation from the supplementary budget approved by parliament.

Kion Plc was requested to carry-out an analysis of the two projects in order to determine which of the two should be selected. The Chief Executive Officer requested the Finance Manager to use any of the capital investment methods. The Results were to be presented to both the permanent secretaries of the Ministry of Health and the Ministry of Agriculture and a decision will be made only based on the recommendations of the consultants; Kion Plc.

The Finance Manager decided to use both the Payback Period and the Net Present Value methods. He and his finance team determined the net cash flows of each proposed capital investment i.e Project X and Y (as per table below). Each project has an initial cost of K10,000,000 and the cost of capital for each project is 12%.

The projects expected net cash flows are as follows:

Expected Net Cash Flows		
Year	Project X	Project Y
	K,000	K,000
0	(K10,000)	(K 10,000)
1	6,500	3,500
2	3,000	3,500
3	1,000	1,500
4	1,000	1,500

Required:

- (a) Describe the role of the Government of Country A in the economy. (10 marks)
- (b) Explain what is meant by supplementary budgets and why countries need them. (5 marks)
- (c) Identify the role of treasury management in an economy as it relates to investment and management and Banking Services. (15 marks)
- (d) Calculate for each project the Payback Period and Net Present Value and decide which project the Consultants should recommend to the Permanent Secretaries of the Ministry of Agriculture and Ministry of Education. (10 marks)

[Total: 40 Marks]

SECTION B

There are FOUR (4) questions in this section.

Attempt any THREE (3) questions.

QUESTION TWO

The Government of country Y through the Ministry of Finance has resolved during a senior management meeting to acquire shares in one of the mining companies. In order to increase shareholder value, the mining company signed agreements with neighbouring countries for transacting copper ores, gold, diamond and other valuable minerals. The main objective is maximize the value of shareholders.

Required:

- (a) Explain the Six (6) non-financial objectives that the government of country Y should pursue in order to maximize shareholder value. (12 marks)
- (b) Advise the management at the Ministry of Finance on any four (4) risks Associated with investing in neighbouring countries and how the risks could be mitigated.

(8 marks)

[Total: 20 Marks]

QUESTION THREE

The National Hospitals Limited (NHL), a parastatal body, is in the process of reviewing its performance for the previous year. As part of the review process the Managing Director and other directors of the company have been holding several meetings at the headquarters.

During a recent meeting, the Director of Finance expressed the following concerns for the year just ended:

- (1) Medical equipment imported by the NHL from Europe three months ago and delivered last month into the country are due for payment. Currently there is a depreciation of the Kwacha exchange rate against the dollar.
- (2) Goods imported several months ago from China could be lost in the sea as the ship that was carrying them was taken over by some terrorists who have also held the crew and passengers hostage.
- (3) An investment made last year in real estate by the NHL is not yielding as much returns as expected.
- (4) The Health Ministry supplied less than budgeted for drugs to NHL last year. The Managing Director of NHL is worried that this shortfall may continue this year.

- (5) There was a fire in one of the hospital wards last year and the cause of the fire has not yet been identified.
- (6) Uncertainty whether the hospitals have enough qualified members of staff to operate the medical equipment when they are delivered.
- (7) There was an increase in the import price of drugs last year and there is a possibility that there will be a further increase this year.

Required:

- (a) Distinguish between risk and uncertainty. (4 marks)
- (b) Explain any two types of risks that NHL is facing. (4 marks)
- (c) Advise the NHL board of directors of two measures they could put in place to mitigate such risks. (4 marks)
- (d) List and explain any four components of Enterprise Risk Management. (8 marks)

[Total: 20 Marks]

QUESTION FOUR

Governments prepare annual budgets to ensure that the resources are prudently managed and that there is proper accountability in managing these resources. In some instances, a country will be faced with a budget deficit and in certain instances, a balanced budget is obtained. On the other hand companies operating in the public sector contribute greatly to the running of economies by creating employment opportunities and generating revenue. Further, individual households also need to budget for their income and its utilization.

Required

- (a) Identify the various methods of budgeting and explain clearly each of the methods you have identified. (10 Marks)
- (b) Explain what is meant by a budget deficit and its probable causes. (5 Marks)
- (c) Explain clearly what is meant by a "Balanced Budget" and a "Cash Budget". (5 marks)

[Total: 20 Marks]

QUESTION FIVE

The Government of the Republic of Zambia intends to appraise the following projects in various parts of the Country. In addition to undertaking these projects the government needs to source for financing of the projects.

Project	Initial Investments	Year 1 Cash Inflows
A	1,300,000	700,000
B	1,600,000	1,900,000
C	1,700,000	1,770,000
D	700,000	950,000

The Cost of Capital is 10%.

Required:

- (a) Explain the four (4) factors government should consider when selecting financing for the four projects. (8 marks)
- (b) Advise Government on any two (2) benefits of developing an investment plan. (4 marks)
- (c) Calculate the NPV and advise which project they should undertake. (8 marks)

[Total: 20 Marks]

END OF PAPER

Formula Sheet

Economic order quantity

$$= \sqrt{\frac{2C_n D}{C_H}}$$

Miller – Orr Model

$$\text{Return point} = \text{Lower limit} + \left(\frac{1}{3} \times \text{spread}\right)$$

$$\text{Spread} = 3 \left[\frac{\frac{3}{4} \times \text{transaction cost} \times \text{variance of cash flows}}{\text{interest rate}} \right]^{\frac{1}{3}}$$

The Capital Asset Pricing Model

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

The asset beta formula

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

The Growth Model

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

Gordon's growth approximation

$$g = b r_e$$

The weighted average cost of capital

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

The Fisher formula

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

Purchasing power parity and interest rate parity

$$s_1 = S_0 \times \frac{(1+h_c)}{(1+h_b)} \qquad f_0 = S_0 \times \frac{(1+i_e)}{(1+i_b)}$$

Present Value Table

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

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

Periods (n)	Discount rate (r)										
	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909	1
2	0.980	0.961	0.943	0.925	0.907	0.890	0.873	0.857	0.842	0.826	2
3	0.971	0.942	0.915	0.889	0.864	0.840	0.816	0.794	0.772	0.751	3
4	0.961	0.924	0.888	0.855	0.823	0.792	0.763	0.735	0.708	0.683	4
5	0.951	0.906	0.863	0.822	0.784	0.747	0.713	0.681	0.650	0.621	5
6	0.942	0.888	0.837	0.790	0.746	0.705	0.666	0.630	0.596	0.564	6
7	0.933	0.871	0.813	0.760	0.711	0.665	0.623	0.583	0.547	0.513	7
8	0.923	0.853	0.789	0.731	0.677	0.627	0.582	0.540	0.502	0.467	8
9	0.914	0.837	0.766	0.703	0.645	0.592	0.544	0.500	0.460	0.424	9
10	0.905	0.820	0.744	0.676	0.614	0.558	0.508	0.463	0.422	0.386	10
11	0.896	0.804	0.722	0.650	0.585	0.527	0.475	0.429	0.388	0.350	11
12	0.887	0.788	0.701	0.625	0.557	0.497	0.444	0.397	0.356	0.319	12
13	0.879	0.773	0.681	0.601	0.530	0.469	0.415	0.368	0.326	0.290	13
14	0.870	0.758	0.661	0.577	0.505	0.442	0.388	0.340	0.299	0.263	14
15	0.861	0.743	0.642	0.555	0.481	0.417	0.362	0.315	0.275	0.239	15
(n)	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	
1	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833	1
2	0.812	0.797	0.783	0.769	0.756	0.743	0.731	0.718	0.706	0.694	2
3	0.731	0.712	0.693	0.675	0.658	0.641	0.624	0.609	0.593	0.579	3
4	0.659	0.636	0.613	0.592	0.572	0.552	0.534	0.516	0.499	0.482	4
5	0.593	0.567	0.543	0.519	0.497	0.476	0.456	0.437	0.419	0.402	5
6	0.535	0.507	0.480	0.456	0.432	0.410	0.390	0.370	0.352	0.335	6
7	0.482	0.452	0.425	0.400	0.376	0.354	0.333	0.314	0.296	0.279	7
8	0.434	0.404	0.376	0.351	0.327	0.305	0.285	0.266	0.249	0.233	8
9	0.391	0.361	0.333	0.308	0.284	0.263	0.243	0.225	0.209	0.194	9
10	0.352	0.322	0.295	0.270	0.247	0.227	0.208	0.191	0.176	0.162	10
11	0.317	0.287	0.261	0.237	0.215	0.195	0.178	0.162	0.148	0.135	11
12	0.286	0.257	0.231	0.208	0.187	0.168	0.152	0.137	0.124	0.112	12
13	0.258	0.229	0.204	0.182	0.163	0.145	0.130	0.116	0.104	0.093	13
14	0.232	0.205	0.181	0.160	0.141	0.125	0.111	0.099	0.088	0.078	14
15	0.209	0.183	0.160	0.140	0.123	0.108	0.095	0.084	0.074	0.065	15

Annuity Table

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

Where r = discount rate
 n = number of periods

Periods (n)	Discount rate (r)										
	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909	1
2	1.970	1.942	1.913	1.886	1.859	1.833	1.808	1.783	1.759	1.736	2
3	2.941	2.884	2.829	2.775	2.723	2.673	2.624	2.577	2.531	2.487	3
4	3.902	3.808	3.717	3.630	3.546	3.465	3.387	3.312	3.240	3.170	4
5	4.853	4.713	4.580	4.452	4.329	4.212	4.100	3.993	3.890	3.791	5
6	5.795	5.601	5.417	5.242	5.076	4.917	4.767	4.623	4.486	4.355	6
7	6.728	6.472	6.230	6.002	5.786	5.582	5.389	5.206	5.033	4.868	7
8	7.652	7.325	7.020	6.733	6.463	6.210	5.971	5.747	5.535	5.335	8
9	8.566	8.162	7.786	7.435	7.108	6.802	6.515	6.247	5.995	5.759	9
10	9.471	8.983	8.530	8.111	7.722	7.360	7.024	6.710	6.418	6.145	10
11	10.37	9.787	9.253	8.760	8.306	7.887	7.499	7.139	6.805	6.495	11
12	11.26	10.58	9.954	9.385	8.863	8.384	7.943	7.536	7.161	6.814	12
13	12.13	11.35	10.63	9.986	9.394	8.853	8.358	7.904	7.487	7.103	13
14	13.00	12.11	11.30	10.56	9.899	9.295	8.745	8.244	7.786	7.367	14
15	13.87	12.85	11.94	11.12	10.38	9.712	9.108	8.559	8.061	7.606	15
(n)	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	
1	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833	1
2	1.713	1.690	1.668	1.647	1.626	1.605	1.585	1.566	1.547	1.528	2
3	2.444	2.402	2.361	2.322	2.283	2.246	2.210	2.174	2.140	2.106	3
4	3.102	3.037	2.974	2.914	2.855	2.798	2.743	2.690	2.639	2.589	4
5	3.696	3.605	3.517	3.433	3.352	3.274	3.199	3.127	3.058	2.991	5
6	4.231	4.111	3.998	3.889	3.784	3.685	3.589	3.498	3.410	3.326	6
7	4.712	4.564	4.423	4.288	4.160	4.039	3.922	3.812	3.706	3.605	7
8	5.146	4.968	4.799	4.639	4.487	4.344	4.207	4.078	3.954	3.837	8
9	5.537	5.328	5.132	4.946	4.772	4.607	4.451	4.303	4.163	4.031	9
10	5.889	5.650	5.426	5.216	5.019	4.833	4.659	4.494	4.339	4.192	10
11	6.207	5.938	5.687	5.453	5.234	5.029	4.836	4.656	4.486	4.327	11
12	6.492	6.194	5.918	5.660	5.421	5.197	4.988	4.793	4.611	4.439	12
13	6.750	6.424	6.122	5.842	5.583	5.342	5.118	4.910	4.715	4.533	13
14	6.982	6.628	6.302	6.002	5.724	5.468	5.229	5.008	4.802	4.611	14
15	7.191	6.811	6.462	6.142	5.847	5.575	5.324	5.092	4.876	4.675	15

PFM4 SUGGESTED SOLUTIONS

SOLUTION ONE

1(a) Describe the role of Government of Country A in the economy

Governments play a very essential role in any country, including country A. In any economy, Governments essentially provide a legal framework and essential and appropriate services necessary for the effective operation of a market economy. The economy of any country is expected to operate smoothly hence the Governments intervenes by the provision of a legal and social framework for economic activity, the provision of public goods, the regulation of economic activity, reallocating of resources equitably and stabilization of the economy.

Country A's government will be expected to reallocate resources in order to redistribute income generated. This is to ensure that those societal members who are unable to meet the daily needs due to different types of challenges, are also catered for, for instance in terms of drought and floods and any other economic hardships. This is to ensure that everyone has access to a minimal standard of living.

Another way of redistributing income is the use of the tax system. In certain times, those than earn more are taxed more, however, this has in some aspects negative consequences as those that are taxed more will be demotivated.

The other essential role, which of stabilizing the economy involves the development and implementation of stabilization policies. These policies address acute fluctuations in the country's economic activities like reduction on exports or disruption of supply-side shocks like increase in oil prices on the international market by implementing fiscal and monetary policies.

The monetary policies is implemented by government in the event that they want to take actions to either decrease or increase the money supply and subsequently raise or reduce short-term interest rates, making it more difficult or easier to borrow money.

As for fiscal policy, it relies on government's powers of spending and taxation. These can be used to increase or reduce the supply of money in the economy. In a recession, the policy to be adopted is to increase spending, reduce taxation or implement both. These are known as expansionary policies as more money is expected to be available to businessmen and women.

When the country is experiencing inflation, the government will be expected to decrease spending by contractionary measures which include increases taxes or reducing spending.

(b) Explain what is meant by supplementary Budgets and why countries need them

The main purpose of preparation of the budget for a particular country is allocate resources in conformity with both fiscal and policies. These budgets are mostly prepared on an annual basis and in order to facilitate their formulation, they must take into account events outside the annual cycle particularly macroeconomic realities, as well as expected revenue, cost of programs and government policies.

A supplementary budget arises in the event where during the budget year, unexpected event has arisen which was not taken into account during the budgeting by a particular agency. A revised budget will therefore be required to be prepared and subject to be approved. The proposals for the revised budget are submitted by government in April and September.

(c) Identify the role of treasury management in an economy as it relates to investment and debt management and Banking Services

The government of country A as part of its sources of funds in the budget will rely on sources that will include debt financing like the Euro Bonds. The sovereign debt management is critical because if appropriately managed, it will result into the country not managing its debt portfolio properly. The government must ensure sustainability of its debt so that it is serviced as contracted.

In the event that the debt is poorly structured in terms of maturity, currency, or interest rate composition, this has the potential of creating economic crises. The country is exposed to degrading in the country's credit ratings on the international markets.

It should be noted that Risky Debt structures are usually the consequences of inappropriate economic- monetary and exchange rate.

The main objective of the public debt management is to ensure that the government financial requirements and its meeting of the obligations are fulfilled at the lowest cost over medium to long-term and this should be consistent with a good aspect of risk.

The authorities responsible for debt management, fiscal and monetary, should share information on the government's current and future liquidity needs. There must be transparency and clarity of roles, responsibilities of financial agencies responsible for debt management.

In the event that there are material aspects of debt management operations, public disclosure of these is important. The public should be aware on the past, current government funds. No hiding of information to the public of the sources, and conditions of the debt.

These debts, in order to create assurance, they should be annually audited by external auditors.

(d) Calculate for each project their payback period and Net Present Value and decide which project the Consultants recommended to the Permanent Secretaries of the Ministry of Agriculture and Ministry of Education.

The two projects have an uneven cash flow and the calculation of the payback period is as follows:

INITIAL INVESTMENT=K10,000('000)

PROJECT X(K'000)

PROJECT Y(K'000)

Year	Net Cash Flows	Cummulative Flows	Cash	Net Cash Flows	Cummulative Cash Flows
1	6,500	6,500		3,500	3,500
2	3,000	9,000		3,500	7,000
3	1,000	10,000		1,500	8,500
4	1,000	11,000		1,500	10,000

The payback period for project X is 3 years. This is because the cumulative cash flow at the end of the 3rd Year becomes equal to the initial amount of investment. The payback period for project Y is 4 years because the cumulative cash flow at the end of the 4th year becomes equal to the initial amount of investment.

Using the Net Present Value Method:

$$\begin{aligned}
 NPV_x &= -K10,000 + \frac{6,500}{(1.12)^1} + \frac{3,000}{(1.12)^2} + \frac{1,000}{(1.12)^3} + \frac{1,000}{(1.12)^4} \\
 &= -K10,000 + \frac{6,500}{(1.12)^1} + \frac{3,000}{(1.12)^2} + \frac{1,000}{(1.12)^3} + \frac{1,000}{(1.12)^4} \\
 &= -K10,000 + 5,803.57 + \frac{3,000}{1.1244} + \frac{1,000}{1.404928} + \frac{1,000}{1.5735} \\
 &= -K10,000 + 5,803.57 + 2,106.68 + 711.78 + 635.526 \\
 &= \underline{\underline{K(456)}}
 \end{aligned}$$

$$\begin{aligned}
 NPV_y &= -K10,000 + \frac{3,500}{(1.12)^1} + \frac{3,500}{(1.12)^2} + \frac{1,500}{(1.12)^3} + \frac{1,500}{(1.12)^4} \\
 &= -K10,000 + \frac{3,500}{(1.12)^1} + \frac{3,500}{(1.12)^2} + \frac{1,500}{(1.12)^3} + \frac{1,500}{(1.12)^4} \\
 &= -K10,000 + 3,125 + \frac{3,500}{1.1244} + \frac{1,500}{1.404928} + \frac{1,500}{1.5735} \\
 &= -K10,000 + 3,125 + 2,391 + 1,067.67 + 953.29 \\
 &= \underline{\underline{KI(2,062)}}
 \end{aligned}$$

Using the Net Present Value method, both Project X and Y have negative NPVs. However, Project Y has a higher negative than project X.

In this particular scenario, the consultant should advise the Permanent Secretaries to embark of Project X. This is because using the Payback period, Project X has a lower payback period and using NPV project X has a lower negative NPV than Project Y.

SOLUTION TWO

- (a) Explain the Six (6) non-financial objectives that the government of country Y should pursue in order to maximize shareholder value.
- Customer Satisfaction - Keeping customers satisfied provides the opportunity for repeat business. Satisfied customers are likely to tell their friends or associates about the positive experience they had, generating additional customers. In the case of a company that sells to other businesses, being able to provide endorsements from customers can be crucial to closing a sale with new customers
 - Planning and Reporting Systems - The business plan will also give you an idea of non-financial performance indicators, such as marketing plans or research and development plans.
 - Employee Training and Development - Revenue growth and business expansion inevitably create additional complexities and responsibilities for the management team. Give existing staff members educational opportunities to improve their skills and capabilities as managers. Expect each key employee to create a career development plan to make certain they acquire the skills needed to be part of the team as the company grows.
 - Long-Range Vision - The goal should be to create a company-wide emphasis on identifying opportunities that are emerging so the company can pursue them before competitors do.
 - Policies and Procedures - Documenting work flow and methods and articulating company policy becomes a higher priority. New employees need direction about the company's business philosophy, the company culture and what you expect of them so they can step in and be immediately effective.
 - Community Involvement - Non-financial aims of a business often include contributing time and financial support to improving the quality of life in their community – being a good corporate citizen. This support could include sponsoring charity events and encouraging employees to get involved in worthy causes..
- (b) Advise Management of Ministry of Finance on the risks Associated with investing in neighboring countries and how the risks could be mitigated
- Intellectual Property Risk - This risk involves third parties making unauthorized use of the strategic information of a business or property that affects the value of services or products offered by a business, either directly or indirectly. These risks increase tenfold when doing business overseas because of the difficulties that exist in defeating business rights remotely.
 - Foreign Exchange Risk - This usually concerns the accounts payable and receivable for contracts that are, or soon would be, in force.
 - Ethics Risks - It is vital to maintain a high ethical standard when offering any product or service in a global market. Companies may face certain questions pertaining to their values at any point while doing international trade.
 - Country and Political Risks -These are risks such as non-tariff trade barriers, central bank exchange regulations, or ban on the sale of certain products in specific countries. For instance, several countries have banned products obtained from threatened animal species. There would be certain things that would never be under your control, such as sanctions, and you must be prepared in order to overcome them
 - Prohibited Goods - You need to make sure to carry out basic research on the

import/export allowances offered by the country you are interested to carry out your business in. Many products are prohibited or restricted in some countries. For instance, what is acceptable in China may not be allowed in New Zealand. You need to make sure to check out all the rules pertaining to your target market in the country you are interested to carry out trade with.

SOLUTION THREE

(a) RISK AND UNCERTAINTY

Risk involves situations or events which may or may not occur, but whose probability of occurrence can be calculated statistically and the frequency of their occurrence predicted from past records.

Uncertain events are those whose outcomes cannot be predicted with statistical confidence. Uncertainty applies to circumstances where there is very little or no experience of a similar situation.

(b)

TYPES OF RISKS

(1) Currency Risk.

It is the risk of making a loss on a transaction as a result the movements in the exchange rate of one currency relative to another. For example in NHL case the depreciation of the kwacha against the dollar might increase the cost of the equipment in kwacha terms. This will result in the cost of the equipment becoming more costly than budgeted.

(2) Physical Risks.

These may destroy the product that you have created or purchased. This could be as a result of fire (as in the NHL fire in the hospital ward) or the terrorists attack on the ship in NHL case.

(3) Fiscal Risks.

These are deviations of fiscal outcomes from those expected at the time of a government budget or other macroeconomic forecast that impact on a government's finances and ability to fund public goods and services. An example in the NHL case is shortfall in the supply of drugs by the Health Ministry.

(4) Technical Risks.

These are associated with an entity's lack of technical capability to implement programmes e.g possibility of inadequate skills and competence to operate the medical equipment in NHL case.

(c)

MEASURES TO MITIGATE THE RISKS

(1) Insurance.

Physical risks can be insured against e.g fire insurance in NHL case. NHL could have insured the hospital against fire.

(2) Hedging.

Exchange rate risk can be insured against using several hedging instruments such as forward contracts. NHL could enter into a three months forward contract to exchange the kwacha for the dollar at the forward exchange rate agreed three months in advance.

(3) Diversification. NHL can diversify their investment by investing in additional industries instead of investing all their money in real estate. This will average their returns over time.

(d) Components of Enterprise Risk Management

(1) Internal Environment.

The internal environment encompasses the tone of an organization, and sets the basis for how risks are viewed and addressed by an entity's people including risk management philosophy and risk appetite, integrity and ethical values and the environment in which they operate.

(2) Objective Setting.

Objectives must exist before management can identify potential events affecting their achievements. Enterprise risk management ensures that management has in place a process to set objectives and that the chosen objectives support and align with the entity's mission and are consistent with its risk appetite.

(3) Event Identification.

Internal and external events affecting achievement of an entity's objectives must be identified, distinguishing between risks and opportunities. Opportunities are channeled back to management's strategy or objective-setting processes.

(4) Risk Response.

Management selects risk responses – avoiding, accepting, reducing, or sharing risk, - developing a set of actions to align risks with the entity's tolerance and risk appetite.

(5) Control Activities.

Policies and procedures are established and implemented to help ensure the risk responses are effectively carried out.

(6) Information and Communication.

Relevant information is identified, captured, and communicated in a form and timeframe that enable people to carry out their responsibilities. Effective communication also occurs in a broader sense, flowing down, across, and up the entity.

(7) Monitoring.

The entirety of enterprise risk management is monitored and modifications made as necessary. Monitoring is accomplished through ongoing management activities, separate evaluations, or both.

SOLUTION FOUR

(a) Identify the various methods of budgeting and explain clearly each of the methods you have identified

There are different methodologies in the preparation of budgets and these are as follows:

- i. Traditional Historic Budgeting- This is based on historical data and involves an incremental approach. The budget sets use previous year's figures and adjusts them for growth and/or inflation. The process can be either top-down or bottom-up approach, depending on the management's inclination.
- ii. Activity based Budgeting- This approach is centered on the factors that drive the costs and not just historical figures for either income or expenditure.
- iii. Incremental Budgeting- The budget is prepared using the previous year's budgeted figures or actuals.
- iv. Zero-Based Budgeting- This type of budgeting requires that expenditure above zero base be justified and that costs be estimated for differing levels of output and service.
- v. Priority-Based Budgeting- This involves the ranking of which activities should be spent first. This method involves budgeting where activities are re-evaluated each time a budget is prepared.

(b) Explain what is meant by a budget deficit and its probable causes

Once a budget has been drawn by sector heads and approved by the budget committee and eventually by management for a firm, it is ready to be implemented. As for governments, the budget estimates have to be debated in parliament and eventually endorsed.

A budget deficit will occur when the spending is more than what was allocated over a period of time. There are various reasons as to why there are budget deficits. The deficit for government occurs when it spends more than it has collected in taxes for example. In certain instances, reducing tax rates may result into a deficit if it does not correspond in reduced expenditure.

Sometimes it is as a result of situations where there have been unforeseen circumstances like the Covid 19 where tourism was affected negatively as there were travel restrictions worldwide. Unplanned expenditures as a result of natural disasters such as droughts, floods and army worms.

(c) Explain clearly what is meant by a balanced budget and a cash budget.

A balanced budget refers to a budget where the revenues are equal to expenditure. This means that there is neither a budget deficit nor a budget surplus. In general terms it means that the budget has no deficit, but may have a budget surplus. A cyclically balanced budget that is not ideally balanced year in year out, but is balanced over the economic cycle, running a surplus in boom years and running a deficit in lean years, with these offsetting over time. A cash budget represents the expected future cash inflow of an organisation over a defined period of time. It is an estimate of cash receipts expected in the future over the budget period, the expenditure to be incurred in cash and finally the cash balance with the company at the end of the period.

SOLUTION FIVE

- (a) The factors government should consider when selecting financing of the four projects.
- The amount required – some sources of finance are not suited for long term projects for example bank overdrafts
 - The type of expenditure / purpose for which capital is required – long term sources of finance are better suited to finance capital expenditure projects for example a new factory
 - The length of time for which money is required – where money will be tied up in the project for a very long period of time its prudent to use long term sources of financing such as debentures
 - The ability of the investment to yield positive results in the shortest period.
- (b) Advise Government on the need for them to develop an investment plan.
- Investment planning provides direction and meaning to one's financial decisions.
 - It allows one to understand how each financial decision affects other areas of finances.

(c)

Project	Initial Investment (ZMW)	Inflows (ZMW)	Net Amount (ZMW)	DF 10%	NPV	
A	(1,300,000)	700,000	(600,000)	0.909	-545,400	
B	(1,600,000)	1,900,000	300,000	0.909	272,700	
C	(1,700,000)	1,770,000	70,000	0.909	63,630	
D	(700,000)	950,000	250,000	0.909	227,250	

The government should embark on implementing project B because it will yield the highest positive NPV

END OF SOLUTIONS



PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

PFM 5: PUBLIC SECTOR AUDITING

THURSDAY 16 JUNE 2022

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

INSTRUCTIONS TO CANDIDATES

1. You have fifteen (15) minutes reading time. Use it to study the examination paper carefully so that you understand what to do in each question. You will be told when to start writing.
2. This paper is divided into TWO (2) sections:
Section A: One (1) compulsory question.
Section B: There are four (4) questions. Attempt any two (3) questions.
3. Enter your student number and your National Registration Card number on the front of the answer booklet. Your name must **NOT** appear anywhere on your answer booklet.
4. Do **NOT** write in pencil (except for graphs and diagrams).
5. **Cell Phones** are **NOT** allowed in the Examination Room.
6. The marks shown against the requirement(s) for each question should be taken as an indication of the expected length and depth of the answer.
7. All workings must be done in the answer booklet.
8. Present legible and tidy work.
9. Graph paper (if required) is provided at the end of the answer booklet.

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

SECTION A

This question is compulsory and must be attempted.

QUESTION ONE

You work for the Office of the Auditor General (OAG) as a Principal Auditor. You have been assigned to lead a team of auditors on the audit of the Kafue District Council.

Because of staffing challenges in the Office of the Auditor General (OAG), the Kafue District Council was last audited five (5) years ago. During this period there has been a complete change in the management of the Council. The last time that the Council was audited, only a financial audit was carried out and the terms and conditions were stated in the letter of engagement. In the previous year, the Council received a grant of K150 million from the Ministry of Finance for the supply of water to three (3) newly established residential locations. This is a two (2) year project which is ending in the current year.

The Auditor General (AG) requested you that in addition to a financial audit, you should perform compliance and performance audits of the water installation project of the three (3) residential locations.

As part of audit planning and gaining an understanding of the project you gather the following information:

The grant of K150 million is net of materials that have been purchased and supplied to the council by the Ministry of Local Government. The Ministry provided all the piping required to connect water in all the three (3) locations together with the meters.

The K150 million is meant for the rest of the materials required, for payments of the contractor to be engaged by the council and for the casual workers that will be employed and paid by the council. The agreement with the Ministry of Finance is that the selection of the contractors to carry out the work will be by way of competitive bidding in accordance with the government procurement procedures. The final selection of successful bidders will be done by a technical committee which will carry out a technical and financial evaluation of the bids. The agreement provides that the minimum wages should be paid to casual employees that will be engaged by the council.

The Architects' report for the status of the water project shows that of the three (3) residential sites, the project is 95% complete in two (2) of the sites. Works for the third site are 45% complete notwithstanding the fact that all material allocated to it have been used. The budget

for this site is almost exhausted. The report states that the contractor demobilised during the year and appears to have abandoned the project.

The last financial audit of the Kafue District Council resulted in an unmodified audit opinion. Considering the fact that there has been no audit in the last five (5) years you have requested the audit team to apply professional skepticism throughout the audit. You are of the view that the audit findings may require that a modified opinion be issued.

Required:

- (a) (i) Explain the purpose of an engagement letter in public sector auditing. (2 marks)
- (ii) Explain the factors that indicate that a revised engagement letter is needed in the planned audit of the Kafue District Council. (4 marks)
- (iii) Explain five (5) benefits of planning the audit of the Kafue District Council. (5 marks)
- (b) (i) Explain compliance auditing using the information in the scenario. (3 marks)
- (ii) Describe four (4) audit procedures that should be performed in the compliance audit of the water project. (6 marks)
- (c) (i) Explain performance auditing using the information in the scenario. (4 marks)
- (ii) Describe the audit procedures that should be performed in the performance audit of the water project in terms of value for money. (6 marks)
- (d) (i) State any eight (8) elements of an unmodified auditor's report. (4 marks)
- (ii) Explain the forms of audit opinions that the public sector auditor may give in accordance with ISSAI 1700: *Forming an opinion and reporting on financial statements* and ISSAI 1705: *Modifications to the opinion in the independent auditor's report*. (6 marks)

[Total: 40 Marks]

SECTION B

There are FOUR (4) questions in this section.

Attempt any THREE (3) questions.

QUESTION TWO

- (a) You are a Principal Auditor in the Office of the Auditor General (OAG). You are responsible for training of staff in the office.

The Office of the Auditor General (OAG) recruited thirty (30) Audit Assistants to be assigned to its regional offices. A majority of these newly recruited auditors do not have practical auditing experience and you have planned an induction workshop before they are deployed. In opening the induction workshop, the Auditor General (AG) emphasised the need to obtain sufficient appropriate audit evidence which must be documented.

The concern of the Auditor General (AG) arose from past experience; whereby Controlling Officers disputed some of the findings contained in the audit reports. This came to light when the Controlling Officers appeared before the Public Accounts Committee of Parliament. When these are referred back to the controlling officers, there have been instances where the Controlling Officers were correct and there was no evidence on file to support the conclusions in the audit reports.

Required:

- (i) Explain the meaning of 'sufficient' and 'appropriate' audit evidence in public sector auditing. (4 marks)
- (ii) Explain four (4) benefits of documenting evidence in public sector auditing. (4 marks)
- (iii) Explain the role of the Public Accounts Committee in public sector auditing. (2 marks)

- (b) You are leading a team of auditors performing a financial audit of the financial statements of a publicly owned railway company in the country.

The audit for the year ended 31 December 2021 is nearing completion and is in the final stages. The following matters have been extracted from the working papers:

Inventory sold after the period end:

The statement of financial position contains inventory valued at cost at an amount of K1.7 million. Soon after the period end, before finalization of the audit, the inventory is sold for K1.2 million. Management has not made any adjustment in the figures in the financial statements.

Legal case by former employees:

The company was been dragged to court by a group of employees who claim to have had their terminal benefits underpaid.

The company did not make any provision in the financial statements because it believed that it does not owe these employees any money according to the agreed conditions of service. On 24 March 2022 before finalization of the financial statements, the high court ruled in favor of the employees and the company is liable to pay the former employees an amount of K5.8 million.

Fire in the warehouse:

A fire swept through the stores warehouse and destroyed warehouse worth K1.0 million a day after signing the audit report. The warehouse was completely destroyed and had no scrap value after the event.

Required:

- (i) Explain the meaning of subsequent events in an audit of financial statements. (1 mark)
- (ii) Explain the audit risk with regards to subsequent events in the audit of the financial statements of the railway company. (3 marks)
- (iii) Explain the audit implications for each of the three (3) matters above and suggest the impact on the audit report if not resolved. (6 marks)

[Total: 20 Marks]

QUESTION THREE

You are part of a committee comprising member countries of the International Organization for Supreme Audit Institutions (INTOSAI) that has been assigned to carry out an evaluation of the operations of a Supreme Audit Institution (SAI) recently established by a newly independent country in the Far East.

The country attained its independence two (2) years ago and held its elections one (1) year ago. The Government Ministries and other semi Government Institutions established Audit Committees whose main responsibility is to monitor the use of public funds. The INTOSAI is providing technical support in helping the Government set up an effective Supreme Audit Institution (SAI). The Committee assigned by the INTOSAI received resistance from many stakeholders in trying to help set up a Public Accounts Committee (PAC) from among the newly elected members of parliament. The argument by those opposed to the establishment of the Public Accounts Committee is that this will be a duplication of effort in view of the existence of the Audit Committees. Further, all public institutions have internal audit departments which enhance the principles of transparency and accountability in the public sector.

The objective of the International Organization for Supreme Audit Institutions (INTOSAI) is to assist member countries establish effective Supreme Audit Institutions (SAIs) in their respective countries. The guiding principle of effective public sector auditing is that of independence which is lacking in the newly independent country. Another concept of effective public sector auditing is that of carrying out risk assessment before conducting public sector audits. Risk assessment is important because it helps the Supreme Audit Institution (SAI) set materiality levels that are reflective of the existing risks.

Required:

- (a) Distinguish the roles of Audit Committees and the Public Accounts Committee in public sector auditing. (4 marks)
- (b) Explain two (2) challenges that Audit Committees in the public sector face in executing their duties. (2 marks)
- (c) Explain the two (2) levels of assurance that the public sector auditor may give. (4 marks)

(d) (i) Explain three (3) reasons for carrying out a risk assessment in the performance of public sector audits. (6 marks)

(ii) Explain the relationship between risk and materiality in the planning of public sector audits. (4 marks)

[Total: 20 Marks]

QUESTION FOUR

The International Organization of Supreme Audit Institutions (INTOSAI) is an inter-governmental organization whose members are Supreme Audit Institutions (SAIs). Nearly every Supreme Audit Institution (SAI) in the world is a member of INTOSAI.

The International Standards of Supreme Audit Institutions (ISSAIs) are a benchmark for auditing public entities. The INTOSAI auditing standards provide guidelines to professional standards used by SAIs.

Required:

(a) Describe the purpose of public sector audits and explain the importance of transparency and accountability. (6 marks)

(b) Describe the contents of the Mexico Declaration on Supreme Audit Institutions (SAIs) independence. (8 marks)

(c) Explain any six (6) general principles of public sector auditing as per ISSAI 100. *Principles of public sector auditing.* (6 marks)

[Total: 20 Marks]

QUESTION FIVE

Malaiti Co-operative (MC) is involved in farming and fertiliser distribution. It receives significant material and financial support from the Ministry of Agriculture. You are an Audit Senior in the National Audit Office and you are responsible for the audit of the wages system for casual workers and bank balances.

The following information is available concerning the wages system for casual workers:

1. The Production Supervisor has the authority to engage casual workers.
2. Casual workers are paid using a time-based system. There is a reliable system for recording attendance time by staff.

3. Casual workers are not entitled to overtime payment as any excess hours worked are considered to be compensation for any idle time.
4. Casual workers are not closely supervised as most of them are former permanent workers for Malaiti Co-operative.
5. Wages are computed using a dedicated personal computer by an Accounts Assistant.
6. The Financial Accountant is responsible for making amendments to wages system.
7. Cash is delivered to the wages office by secure reliable courier. The Accounts Assistant distributes cash wages to the employees.
8. No reconciliations are performed and the Accounts Assistant gives any unclaimed wages to the Production Supervisor, who is required to give the casual workers in question.

You have obtained a copy of the bank reconciliation from the Financial Accountant and the Audit Manager has directed you to guide the Junior Auditor on the audit procedures to perform.

Required:

- (a) (i) Identify and explain four (4) deficiencies in the wages system for casual workers.

(6 marks)

- (ii) Recommend appropriate controls which may be put in place to address the deficiencies identified in (a) (i) above.

(4 marks)

- (b) Explain four (4) substantive audit procedures that should be performed on the bank reconciliation.

(4 marks)

- (c) Explain three (3) advantages of using Computer-Assisted Audit Techniques (CAATs) when auditing the bank reconciliation.

(6 marks)

[Total: 20 Marks]

END OF PAPER

PFM 5 SUGGESTED SOLUTIONS

SOLUTION ONE

(a) (i) **The purpose of an engagement letter in public sector auditing:**

An engagement letter is a letter written by the public sector auditor specifying the terms of the engagement between the public sector auditor and the entity subject to audit.

The purpose of the engagement letter to spell out the scope of the audit engagement in order to avoid any misunderstanding between the public sector auditor and the entity that will be subject to the audit.

(ii) **Need for revising the engagement letter of the audit of Kafue DC.**

Usually engagement letters last for more than one year and the terms of the engagement are valid for a number of years unless there are conditions that may necessitate revision of the engagement letter.

In the case of the audit of the financial statements of Kafue District Council by the public sector auditors, the following matters may necessitate a revision of the engagement letter:

- The change in management of the council may justify a revision of the engagement letter in order to ensure that management of the council knows the terms of the engagement.
- The change in the scope of the engagement from a financial audit to requiring that the public sector auditors perform compliance and performance audits.

(iii) **Benefits of planning the audit:**

- Efficient and effective audit will be performed.
- Auditor will devote more time to risk areas.
- Auditors will identify risk areas timely.
- Allows direction supervision and review of audit work.
- Auditors can select staff with appropriate skills and allocate audit work.
- Enables reviewing of the work of experts/ auditors of components.

(b) (i) **Meaning of compliance auditing:**

This is an audit aimed at providing the intended users with information about whether the audited entity is following the relevant rules and regulations such as:

- Agreements with ministry of finance
- Minimum wage agreement
- Agreed upon procedures.

(ii) **Audit procedures in the compliance audit of the water project:**

- Review the committee minutes to confirm that selection of contractor was by way of competitive bidding as per agreement.
- Inspect the selection criteria terms of reference to confirm that there were technical and financial review of the bids before awarding.
- Review the casual payroll to confirm that minimum wages are paid to the casual workers that are engaged.
- Obtain the expenditure schedule to confirm that all expenditure is correctly allocated and within the approved budget.

(c) (i) **The meaning of performance auditing:**

These are audits which provide the intended users with information about whether programs, activities are performing in accordance with the principles of economy, efficiency and effectiveness.

- Acquiring resources at the lowest possible cost- economy.
- Completing the projects on time-efficiency.
- Connecting all the location with water and meters.

(ii) **Audit procedures in the performance audit of the water project:**

Efficiency:

Confirm that procurement procedures of obtaining three (3) quotations and that the best price was paid without compromising on quality of goods or services.

Efficiency:

- Evaluate the input resources and the output to confirm is as expected using suitable criteria.
- Establish whether the output could have been achieved using lesser resources.

Effectiveness:

- Establish whether the intended objective has been achieved by enquiry and observation.
- Compare the output with the desired outcome and find out reasons for difference.

(d) (i) **Elements of an unmodified audit opinion:**

The following are the elements of an unmodified auditor's report:

- Title
- Addressee
- Opinion paragraph
- Basis for opinion paragraph
- Going concern paragraph
- Key audit matters paragraph
- Responsibilities of management for the preparation of the financial statements.
- The auditor's responsibilities for the audit of the financial statements
- Other reporting responsibilities

- Name and signature of the engagement partner
- Date of the report.

(ii) **Forms of audit opinions:**

The public sector auditors have the following options as forms of opinion in a financial audit.

ISSAI 1700 gives guidance if the auditor wishes to issue an unmodified audit opinion. The public sector auditor will issue an unmodified opinion when the auditor concludes that the financial statements have in all respects been prepared in accordance with the relevant financial statements framework and the financial statements show a true and fair view.

The auditor may wish to modify the audit opinion and ISSAI 1705 gives guidance in this area and states the circumstances that each of the three forms of modification may be used as follows:

Qualified opinion – This is given under two circumstances when the auditor has obtained sufficient appropriate audit evidence and when there is a limitation of scope. In either case, the auditors have a matter of concern which is material but not pervasive to the financial statements.

Adverse opinion – This is given when the auditor has obtained sufficient appropriate audit evidence and the matter of concern is both material and pervasive.

Disclaimer of opinion – This is issued when the public sector auditor has not been able to obtain sufficient appropriate audit evidence and has a matter of concern which is both material and pervasive.

SOLUTION TWO

(a) (i) **Meaning of sufficient appropriate evidence in public sector auditing:**

Sufficient audit evidence refers to the size of the audit evidence that should be obtained by the public sector auditors upon which he/she will form the opinion.

Appropriate - refers to the relevance and reliability of the evidence that the public sector auditor obtains.

(ii) **Benefits of documenting evidence in public sector auditing:**

- Documenting forms the evidence of the work that was carried out.
- Documentation of audit work facilitates review of the work performed.
- Documented work is the basis upon which the opinion of the auditor is based.
- Documenting work will make it possible for future auditors to refer back to what work was done in the past.

(iii) **The role of the Public Accounts Committee in Public sector auditing:**

The Public Accounts Committee is a committee of parliament. This is the committee which gets copies of the public sector audit reports and it is responsible for following up audit findings with the controlling officers of the responsible party.

(b) (i) **Meaning of subsequent events:**

Subsequent events are events that take place between the period end and the date that the audit report is signed. Such events could have implications on the figures contained in the financial statements and require to be accounted for in accordance with IAS 10 *Subsequent events*.

(ii) **Audit risk with regards subsequent events:**

There is an audit risk with regards subsequent events in that they may be incorrectly accounted for resulting in the misstatement of the figures contained in the financial statements.

(iii) **Audit implications of the three matters:**

Inventory sold after the period end:

The inventory has been sold after the period end for K1.2million when it was valued at cost at the period end at K1.7 million. This means that the inventory should have been valued at net realizable value of K1.2million and this is an adjusting event. The financial statements figure for inventory should be reduced by K0.5 million so that the inventory is correctly valued at K1.2million which is lower than cost.

Action if management refuses to adjust inventory amount:

The public sector auditor will need to consider the materiality of the amount of K0.5million to the financial statements and what the impact is to the users of the financial statements. If the amount is considered material the public sector auditor will consider modifying the audit opinion.

Legal case by former employees:

A determination of a legal case by the courts after the period end will necessitate that the company provides a provision of K5.8million in the financial statements. This is because the matter relates to events that took place before the period end and it is an adjusting event.

If management refuses to make the provision:

This amount is most likely material to the financial statements. If management refuses to make the provision, the opinion of the public sector auditor shall be modified.

A fire in the warehouse destroying warehouse worth K1.0million

The warehouse that was destroyed in the fire existed at the period end. The fact that it was completely destroyed after the period end is not relevant to the valuation at the period end. This is an example of a non-adjusting event.

Implication on the auditor's report:

If the amount involved is material the auditors may refer to the event in the other matter paragraph of the report so that the users of the financial statements are made aware of it.

SOLUTION THREE

(a) Roles of the audit committees and the PAC:

The role of the **Audit Committees** is to help in ensuring that custodians of public funds use the funds in accordance with laid down procedures and also to ensure that suitable controls are put in place. The Audit Committees strengthen oversight of the financial and ethical integrity of publicly held enterprises.

The **Public Accounts Committee** is a committee of parliament whose role is to hold the custodians of public funds account on how they administer the funds. This is done by the committee requiring the controlling officers explain audit finding made by the public sector auditors.

(b) Challenges faced by Audit Committees:

- Lack of commitment by some members of the Audit Committees resulting in them not being as effective as they are expected.
- Pressure from politicians who may see the Audit Committee as interfering with the operations of the institutions they are in.
- Getting committee members who are willing to serve on these committees and have the required skills to offer oversight to publicly owned entities may be a problem.

(c) Levels of assurance that public sector auditors may give:

Reasonable assurance:

This is a high but not absolute level of assurance that public sector auditors give. It is based on substantial amount of work done by the auditor and the evidence gathered forms the basis of the opinion/conclusion.

The form of conclusion reached for a reasonable assurance is positive with the public sector auditors expressing positively their opinion for example by stating that the financial statement show a true and fair view. Audit risk in this form of assurance is reduced to a lower acceptable level.

Limited assurance:

This is a lower level of assurance and audit risk is higher than that for a reasonable assurance. The public sector auditor mainly uses enquiries and analytical procedures to obtain evidence. The form of reporting is negative with the public sector auditors stating that nothing has come to their attention to suggest that financial statements do not show a true and fair view.

(d) (i) **Reasons for risk assessment:**

Risk assessment is carried out at the planning stage of audits for the following reasons:

- To enable the public sector auditor to identify the risks that may exist.
- Risk assessment enables the auditors to respond appropriately to the identified risks.
- Risk assessment helps the auditor to place more effort and resources to the areas where risk is high.
- Risk assessment will help the auditor come up with a suitable audit strategy.

(ii) **Relationship between risk and materiality:**

Risk is something that is undesirable and may cause the financial statements to be misstated. As part of planning audits, public sector auditors evaluate the risks that may exist so that they can respond to that risk and obtain evidence on whether it has impacted the information under audit.

Another requirement in public sector auditing is for the public sector auditors to determine a materiality figure during the planning stage of the audit. This is the amount above which the public sector auditor will consider the subject information to be misstated.

The relationship between risk and materiality is as follows:

If the risk assessed at the planning stage of the audit is high, then materiality will be set at a low figure. This is because the public sector auditor is concerned about the likelihood of things going wrong.

If on the other hand risk is low, the materiality amount is expected to be high. This is because the auditor concludes that there is a lesser chance of things going wrong because of the assessed low risk.

SOLUTION FOUR

(a) The purpose of public sector audits:

The purpose of public sector audit is to improve transparency and accountability in the public sector audited entities and government ministries and other public sector organizations which are accountable to parliament. An independent audit organ of government conducts audits of public sector entities and report to parliament. There are three types of public sector audits, i.e. financial audits, performance audits and compliance audits.

Transparency refers to openness and full disclosure in the public sector bodies. Citizens should be made aware of the activities and operation of the public sector which can have significant effects in their lives.

Accountability is about exercising power in a way that is true to the values, and duties for which that power is entrusted to or held by public entities and individual office-holders. Accountability is an essential aspect of public sector organization as a number of different stakeholders by the actions of the public sector officials.

(b) Principles of the Mexico Declaration:

1. The existence of an appropriate and effective constitutional, statutory and legal framework.
2. The independence of SAI heads and members, including security of tenure and legal immunity in the normal discharge of their duties.

The legislation should specify the condition of appointment, re-appointment, employment, removal and retirement of the heads of the SAI and members of collegial institution.

3. A sufficiently broad mandate and full discretion in the discharge of SAI functions
4. SAIs should have adequate power to obtain timely unfettered, direct and free access to all the necessary documents and information for the proper discharge of their responsibilities
5. The right and obligation to report on their work, the SAI should be required by law to report at least once a year on the results of their audit work.
6. The freedom to decide the content and timing of audit reports and to publish and disseminate them.
7. The SAI should submit its reports to the legislature, one of its commissions or an audited entity's governing body, as appropriate, for review and follow-up on specific recommendations for corrective action.

8. Financial and managerial and administrative autonomy and the availability of appropriate human, material and monetary resources .The executive should not control or direct the access of the resources.

(c) **General principles of public sector auditing:**

Ethics and independence:

The SAI should consider the relevant ethical requirements to ensure that they are truly independent of the audited entity.

Professional judgment and professional skepticism:

SAI staff must apply professional skepticism, professional judgment and due care throughout the audit exercise.

Quality control:

The audit exercise should be carried out having regards to ISSAI 40 Quality Control.

Audit team skills and management skills:

Members of the audit team should exhibit the necessary skills and competences to carry out the audit effectively.

Audit risk:

Members of the audit team should manage audit risk and ensure that it is reduced to an acceptable level.

Materiality:

Materiality should be considered at all levels of an audit exercise and should proceed from risk assessment.

Documentation:

All audit work which provides evidence should be appropriately recorded and retained accordingly.

Communication:

There should be communication amongst audit team members. There should also be communication between the audit team and management of the audited entity about matters related to the audit.

SOLUTION FIVE

(a) Deficiencies and recommended controls

(i)	(ii)
Deficiencies	Recommended controls
(1) The Production Supervisor has the authority to engage casual workers and the unclaimed wages are given to him.	The Production Supervisor is in a position to set up fictitious employees on to the wages system. This will allow him to collect cash for fictitious employees.
(2) Casual workers are not supervised.	The Production Supervisor should monitor the casual workers.
(3) Casual workers are not paid overtime.	Overtime should be authorised by the Production Manager and paid as guided by the Employment Act.
(4) An Accounts Assistant is responsible for computing the wages.	The Financial Accountant should check the gross pay and deductions for a sample of employees to gain assurance that the calculations are correct.
(5) No segregation of duties.	The Accounts Assistant computes the wages and also distributes cash wages to the employees. There is a risk that he could include ghost workers when computing the wages since no checks his work.
(6) No reconciliations are performed	Frauds or errors could go unnoticed.

(b) Substantive audit procedures that should be performed on the bank reconciliation

- Re-perform arithmetic of bank reconciliations
- Agree the balance per bank accounts to the bank reconciliation and to the financial statements and the ledger
- Trace outstanding cheques per the bank reconciliation to the cash book and to after-date bank reconciliation
- Agree any uncleared lodgements to after-date bank statements

- Obtain explanations for any large or unusual items not cleared at the time of the audit
- Compare cash book and bank statements in detail for the last month of the year and confirm items outstanding at the reconciliation date cleared by inspecting the bank statements after the year-end
- Confirm that uncleared bankings have been paid in prior to the year-end date by examination of paying-in-slips.

(c) **Advantages of using Computer-Assisted Audit Techniques CAATs) when auditing the bank reconciliation**

- **Reduction in risk** – larger samples can be tested, giving greater confidence that material errors have not been missed
- **Time savings** – potentially time-consuming procedures such as checking casts of ledgers can be carried out much more quickly using CAATs
- **Cost effective** – many CAATs have low set-up costs, such as where information is downloaded from the client's system onto the auditor's copy of the same system. Even where CAATs have had to be written specially for a particular audit, the on-going costs will be minimal as they can be reused until the client changes its systems.
- **Testing programmed controls** – without CAATs many controls within computerised systems cannot be tested, as they may not produce any documentary evidence. This gives greater flexibility of approach.

END OF SUGGESTED SOLUTIONS



PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

PFM 6: FINANCIAL REPORTING FRAMEWORK FOR PUBLIC SECTOR ENTITIES

MONDAY 13 JUNE 2022

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

INSTRUCTIONS TO CANDIDATES

1. You have fifteen (15) minutes reading time. Use it to study the examination paper carefully so that you understand what to do in each question. You will be told when to start writing.
2. This paper is divided into TWO (2) sections:
Section A: One (1) Compulsory questions.
Section B: There are four (4) questions. Attempt any three (3) questions.
3. Enter your student number and your National Registration Card number on the front of the answer booklet. Your name must **NOT** appear anywhere on your answer booklet.
4. Do **NOT** write in pencil (except for graphs and diagrams).
5. **Cell Phones** are **NOT** allowed in the Examination Room.
6. The marks shown against the requirement(s) for each question should be taken as an indication of the expected length and depth of the answer.
7. All workings must be done in the answer booklet.
8. Present legible and tidy work.
9. Graph paper (if required) is provided at the end of the answer booklet.

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

SECTION A

This question is compulsory and must be attempted.

QUESTION ONE

Kitwe District Council Management submitted the following results as at 31 December 2021.

	K'000
Local Licenses	46,398
Local Rates on Taxes	37,492
Statutory Allocation	307,108
Grants from Government	70,115
Grants from CPs	127,707
Office of the Town Clerk	70,645
Office of the Director Finance	77,895
Office Expenses	13,490
Primary Health Care	44,510
Rural Electrification Expenses	10,440
Capital Expenditure	360,060
District Administration	117,525
Rent of Property	119,260
Miscellaneous Expenses	1,330
Planning and Budget Expenses	6,301
Interest Payments from Dividends	7,350
Earnings from Commercial Undertakings	130,642
Legislative Deposit	37,308
Pay As You Earn Dues	1,375
Deposit for Purchase of Computers	25,130
Pension Balance	1,649
Revenue B/F	6,306
Bank Balance	121,773
Cash in Hand	3,108
Withholding Tax	14,660
Funding from Central Government for Projects	183,357

Required:

- (a) Prepare
- (i) Trial Balance for Kitwe District Council for the Year ended 31 December 2021. (13 marks)
 - (ii) Statement of Income and Expenditure for the year ending 31 December 2021. (10 marks)
 - (iii) Statement of Assets and Liabilities as at 31 December 2021. (4 marks)
- (b) Give examples of cash and cash equivalent. (3 marks)

- (c) Explain circumstances in which the council may have cash and cash equivalents not available for its use. (1 mark)
- (d) Explain the requirements of segment reporting and additional disclosure requirements as per IPSAS 18. (9 marks)

[TOTAL: 40 Marks]

SECTION B

There are **FOUR (4)** questions in this section.

Attempt **THREE (3)** questions.

QUESTION TWO

The former Auditor General for Country Z was invited to a conference of Professional Accountants to discuss service delivery. In his presentation, the Auditor General said that poor service delivery in the public service was due to poor governance and lack of proper scrutiny of its activities and finances and people power. This has really affected service delivery despite government enacting appropriate laws to govern management of public funds. He further indicated declining public services have affected the social well - being of our citizens. It was therefore imperative that government invests in improving management of public resources.

Required:

- (a) Explain the roles and responsibilities of Internal and External Auditors in ensuring Accountability and Transparency in Public Service. (6 marks)
- (b) Explain the strategic responsibilities of Director of Finance in the Public Service. (8 marks)
- (c) Explain the objectives of Public Financial Management. (6 marks)

[Total: 20 Marks]

QUESTION THREE

The following has been extracted from the draft financial information of Chileshe Ltd, a public utility company which was formed in 2000 by the Government of the Republic of Zambia. It is run by the community as a Government Business Enterprise (GBE):

Statement of profit or loss for the year ended 31 December 2021

Income	K'000
Revenue from contracts with customers	8,000
Other income	2,000
Finance income	6,000
Capital grant amortised	1,300
Total income	17,300
Expenditure	
Finance cost	3,400
Operating expenses	4,950
Depreciation	2,450
Employee benefits expenses	1,870
Total expenditure	12,670
Surplus before taxation	4,630
Income tax expense	-

Surplus for the year	4,630
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Statements of financial position as at 31 December

	2021	2020
Descriptions	K'000	K'000
Assets		
Non-current assets	10,080	5,900
Current assets		
Inventory	400	900
Trade receivables	2,320	1,890
Cash and bank	300	120
Total assets	13,100	8,810
Members' funds and liabilities		
Members' funds		
Accumulated funds	8,230	3,600
Other reserves	200	200
Total members' funds	8,430	3,800
Non-current liabilities		
10% Loan notes	3,000	4,000
Bank loan	700	0
Total non-current liabilities	3,700	4,000
Current liabilities		
Trade payables	860	900
Accruals	110	110
Total members' funds and liabilities	13,100	8,810

Some stakeholders are concerned that Chileshe Ltd could face going concern problems if the COVID-19 pandemic persists. However, a number of stakeholders are of the view that this is almost impossible since Chileshe Ltd is a public sector entity.

Required:

- Prepare a statement of cash flows for the year ended 31 December 2021, using the indirect method. (12 marks)
- State any four (4) characteristics of a Government Business Enterprise in line with IPSAS. (2 marks)
- Discuss the going concern assessment considerations for public sector entities. (6 marks)

[Total: 20 Marks]

QUESTION FOUR

The International Public Sector Accounting Standard Board (formerly Public Sector Committee(PSC) is a board of the International federation of Accountants (IFAC) which is in charge of developing and issuing standards that all public sector entities are expected to follow when they are preparing public sector financial statements. The IPSAB has authority to enhance

transparency and promotes quality in financial reporting for public sector organisations. They also issue various publications that public sector entities are expected to follow.

The IPSAB has also adopted a conceptual framework for public sector organisation so that the preparation of General Purpose Financial Reports (GPFRs) of public sector entities such as Government Ministries, Commissions, Authorities, Trusts and International organisations conforms to requirements of the IPSAB. They are all expected to prepare GPFRs that meet the certain desired qualitative characteristics.

A public sector entity can either prepare its financial reports by either cash basis or accrual basis. It is also unique in nature as it holds certain key characteristics that differentiate it from private sector organisations.

Required:

- (a) Explain briefly three (3) publications that are issued by the IPSAB that support the convergence of public sector accounting standards. (3 marks)
- (b) Explain any five (5) qualitative characteristics of information included in the GPFRs of public sector entities. (5 marks)
- (c) Explain the difference between cash and accrual bases of accounting, giving two (2) examples of information that is excluded in the financial statements when a cash basis is used. (5 marks)
- (d) Explain why IFRSs are not suitable when preparing Public Sector Financial Reports. (5 marks)
- (e) Explain briefly two (2) key characteristics of a public sector reporting entity. (2 marks)

[Total: 20 Marks]

QUESTION FIVE

The Government of Zambia has a huge debt burden that need to be dismantled by paying debt holders. Consequently, out of the resources earned, a huge part of it goes to service foreign loans. This leaves the Government with few resources to meet the demands of its citizens such as providing clean water and proper medical services.

In order to increase the revenue for infrastructural and social needs, a number of initiatives have been put in place. One of these initiatives, is the construction of Toll gates that are used to collect fees when motorists are driving in and out of each district. The Toll gates will be constructed by a private company, Trek Construction Ltd, and they will be managed by the public sector organisation known as the Toll Gate Agency (TGA), an agency of the Ministry of Finance.

TGA had employed new accountants some of them will be preparing public sector financial statement for the first time. One of the respective standards to be applied in relation to contract TGA entered into is IPSAS 32 *Service Concession Arrangements*.

TGA has not set up a pension scheme and workers have been fearing what would happen in an event one retires. Consequently, the branch union at TGA had proposed to the Finance Director of TGA to either consider a defined contribution benefit plan or a defined Benefit plan. When the proposal was taken to the board for consideration, some of the Board members wanted to know the difference between the two pension schemes and how such benefit payments will be treated in the financial statements by the newly recruited accountants.

You work for the Public Service Advisory Board (PSAB), and have been approached by the Board of TGA to organize a workshop at which you will be required to orient newly recruited accountants for TGA on the treatment of transactions and presentation of information under IPSAS 32 *Service Concession Arrangement* and IPSAS 25 *Employee Benefits*.

Under IPSAS 32, you will be required to talk about the main elements of the standard and disclosure requirements. As for IPSAS 25, the contents of the talk should include an explanation of two categories of employee benefits, the treatment of employee benefits in the financial statements and the differences between Contribution Benefit and Define pension plans.

Required:

- (a) Identify the two parties to a Concession regarding the construction of the Toll gate. (2 marks)
- (b) Explain two (2) control tests for assets to be recorded in the books of the grantor, giving two (2) examples, in accordance with IPSAS 32 Service Concession Arrangements. (6 marks)
- (c) Explain four (4) key disclosures with respect to IPSAS 32 Service Concession Arrangements. (4 marks)
- (d) Explain how a grantee can recognize a Liability under IPSAS 32 Service Concession Arrangements. (2 marks)
- (e) Explain briefly the difference between a Contribution benefit plan and a Defined benefit plan. (6 marks)

[Total: 20 Marks]

END OF PAPER

PFM 6 SUGGESTED SOLUTIONS

SOLUTION ONE

(a)

(i) **Trial Balance as at 31 December 2021**

	K'000	K'000
	DR	CR
Local Licenses		46,398
Local Rates on Taxes		37,492
Statutory Allocation		307,108
Grants from Government		70,115
Grants from CPs		127,707
Office of the Town Clerk	70,645	
Office of the Director Finance	77,895	
Office Expenses	13,490	
Primary Health Care	44,510	
Rural Electrification Expenses	10,440	
Capital Expenditure	360,060	
District Administration	117,525	
Rent of Property	119,260	
Miscellaneous Expenses	1,330	
Planning and Budget Expenses	6,301	
Interest Payments from Dividends		7,350
Earnings from Commercial Undertakings		130,642
Legislative Deposit		37,308
Pay As You Earn Dues		1,375
Deposit for Purchase of Computers	25,130	
Pension Balance		1,649
Revenue B/F		6,306
Bank Balance	121,773	
Cash in Hand	3,108	
Withholding Tax		14,660
Funding from Central Government for Projects		183,357
	971,467	971,467

(ii) INCOME AND EXPENDITURE STATEMENT FOR THE YEAR ENDING 31 DECEMBER 2021

	K'000	K'000
Local Licenses	46,398	
Local Rates on Taxes	37,492	
Statutory Allocation	307,108	
Grants from Government	70,115	
Grants from CPs	127,707	
Interest Payments from Dividends	7,350	
Earnings from Commercial Undertakings	130,642	
Funding from Central Government for projects	183,357	
		910,169
LESS: EXPENDITURE		
Office of the Town Clerk	70,645	
Office of the Director Finance	77,895	
Office Expenses	13,490	
Primary Health Care	44,510	
Rural Electrification Expenses	10,440	
Capital Expenditure	360,060	
District Administration	117,525	
Rent of Property	119,260	
Miscellaneous Expenses	1,330	
Planning and Budget Expenses	6,301	
		821,456
Surplus/(Deficit)		88,713
Revenue B/F		6,306
Revenue C/F		95,019

(iii) STATEMENT OF ASSETS AND LIABILITIES AS AT 31 DECEMBER 2021

ASSETS	
Bank Balance	121,773
Cash in Hand	3,108
Deposit on Purchase of Computers	25,130
	150,011
LIABILITIES	
Legislative Deposit	37,308
Pay As You Earn Dues	1,375
Withholding Tax	14,660
Pension Balance	1,649
Revenue C/F	95,019

(b) **Give examples of cash and cash equivalent**

- Cash on Hand
- Non – Equity Investments that matures in 2 months
- Demand Deposits

(C) **Explain circumstances in which the council may have cash and cash equivalents not available for its use**

- When there are restrictions or collections on behalf of other entities

(d) **Explain the requirements of segment reporting and additional disclosure requirements as per IPSAS 18.**

- Revenue and expenses – Revenue should be split between budget appropriations or allocations, external sources and internal sources
- Total carrying amount of segment assets and liabilities for each segment
- Total costs incurred during the period on assets to be used during more than one period, which would be primarily property, plant and equipment
- Aggregate net surplus/deficit and aggregate of investment in associates, joint ventures and other investments accounted for under the equity method, if substantially all their operations are within single segment.
- Reconciliation of external revenues, expenses, assets and liabilities disclosed for segments and total amounts disclosed in the financial statements.
- The basis of pricing inter- segment transfers
- Changes in accounting policies with a material effect on segment information, including nature of and reasons for change, with restatements or reasons why these cannot be made.

Additional Disclosures

- Significant amounts of segment income or expenses
- Segment Cash flows
- Segment Depreciation expenses and other significant non-cash expenses or revenue
- Additional information about the service or geographical segments if main segments are chosen on the other basis
- Broad operating objectives for each segment

SOLUTION TWO

(a) **Roles and responsibilities of Internal and External Auditors in ensuring Accountability and Transparency in Public Service.**

- Provide opinion on whether the Financial Statements are true and fair. External Auditors will not necessarily report that the organization is well run. They will only tell you that the numbers add up correctly.
- External auditors have a duty to report if they consider the organization is not a going concern – financially unstable and unable to sustain its normal business and services its debts.
- Internal Auditors are more focused on the governance framework and the internal controls and risk management processes

(b) **Strategic responsibilities of Director of Finance in the Public Service.**

- They are also responsible for compliance with the laws relating to the financial operation of the Public Service
- Ensure standards of ethics and behavior that must be upheld to maintain the integrity of the professional and the individual are adhered to
- Director of Finance should take their financial stewardship responsibilities seriously should demonstrate strong leadership and negotiating skills. They should be able to resist short-term pressures, especially where there are political or social agendas.
- Demonstrate political awareness and be sensitive to what will and will not be acceptable to the decision making body that they serve.

(c) **Objectives of Public Financial Management**

- To maintain aggregate fiscal discipline. Fiscal discipline pertains to effective control of the budget totals, by setting ceilings on expenditure that are binding both at the aggregate level and on individual spending entities.
- To allocate resources in accordance with government priorities. Allocative efficiency is the capacity to establish priorities within the budget, to distribute resources based on the government's priorities and the programme's effectiveness and to shift resources from old priorities to new ones, or from less to more productive activities, in correspondence with the government's objectives.
- To promote the efficient delivery of services. Technical or operational efficiency in the use of budgeted resources refers to the capacity to implement programmes and deliver services at the lowest cost (e.g. minimizing costs per unit of output).

SOLUTION THREE

(a) **Chileshe Ltd**

Statement of cash flow for the year ended 31 December 2021

Details	K'000	K'000
Cash flows from operating activities		
Surplus for the year		4,630
Depreciation		2,450
Loss on disposal of non-current assets		0
Capital grant amortised		(1,300)
Interest received		(6,000)
Interest paid		3,400
Dividend received		
Cash flow from operating activities		3,180
Decrease in inventory (900 – 400)		500
Increase in trade receivables (2,320 – 1,890)		(430)
Decrease in trade payables (900 – 860)		(40)
Net cash flow from operating activities		3,210
Cash flow from investigating activities		
Purchase of non-current assets (W1)	(6,630)	
Grant received	1,300	
Dividend received		
Interest received	6,000	
Net cash flows utilised in investing activities		670
Cash flows from financing activities		
Repayment of long term loans	(1,000)	
Interest paid	(3,400)	
Proceeds from borrowing	700	
Net cash flow from financing activities		(3,700)
Increase/(Decrease) in cash and cash equivalents		180
Cash and cash equivalents at the beginning of the year		120
Cash and cash equivalents at the end of the year		300

Workings

(1) Purchase of non-current assets

	K'000
Opening carrying amount	(5,900)
Depreciation	2,450
Closing carrying amount	<u>10,080</u>
Purchase of non-current assets	<u>6,630</u>

(b) Government Business Enterprise (GBE) in line with IPSAS

Government Business Enterprise (GBE) means an entity that has all the following characteristics:

- Is an entity with the power to contract in its own name;
- Has been assigned the financial and operational authority to carry on a business
- Sells goods and/or services, in the normal course of its business, to other entities at a profit or full cost recovery;
- Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length; and
- Is controlled by a public sector entity.

GBEs apply IFRSs issued by IASB.

(c) Going concern assessment considerations for public sector entities

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

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

(1) In assessing whether a government is a going concern, the power to levy rates or taxes may enable some entities to be considered as a going concern, even though they may operate for extended periods with negative net assets/equity; and

(2) For an individual entity, an assessment of its statement of financial position at the reporting date may suggest that the going concern assumption is not appropriate. However, there may be multi-year funding agreements or other arrangements in place that will ensure the continued operation of the entity;

(3) Current and expected performance;

(4) Potential and announced restructuring of organisational units;

(5) Estimates of revenue or the likelihood of continued government funding; and

(6) Potential sources of replacement financing before it is appropriate to conclude that the going concern assumption is appropriate.

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

Examples:

(1) In assessing whether a government is a going concern, the power to levy rates or taxes may enable some entities to be considered as a going concern, even though they may operate for extended periods with negative net assets/equity; and

(2) For an individual entity, an assessment of its statement of financial position at the reporting date may suggest that the going concern assumption is not appropriate. However, there may be multi-year funding agreements or other arrangements in place that will ensure the continued operation of the entity e.g. ZESCO and Zambia Railways Eurobond liabilities.

SOLUTION FOUR

(a) **There publication issued by IPSAB are:**

- (I) IPSAS are recommended by IPSAB to apply when preparing, presenting and disclosing of financial information for public sector entities.
- (ii) IPSAB has come up with the best practice for public sector entities that they must abide by when conducting affairs for public sector entities.
- (iii) IPSAB publish any research papers, works by scholars and practitioners from the public sector that enhances the knowledge and issues any current developments that concern public sector entities.

(b) **Public sector financial statements should be meet the following qualitative characteristics:**

- (i) Relevance –public sector information should be capable of changing previous views held by users of financial information for public sector entities. This is known as having a confirmatory value. In this way it must influence economic decisions of user of such information.
- (ii) Faithful representation-in order for the users of public information to rely on it should not be biased and should not contain errors and must be complete.
- (iii) Understandability –the users of public sector information should be able to clearly understand the contents and explanations that relate to contents of public sector financial statements. The language and terms used in the financial statements should be clear for user to make informed economic decisions and prepared at the appropriate knowledge level of the users.
- (iv) Timeliness-for the users of public sector information to make appropriate use and take actions, information whether non-financial and financial should be prepared on time. Information that is prepared and presented late will be rendered of no use. For instance, statistics of census collected by the central statistics office about the population of the country should not be delayed. Otherwise Government will not be able to plan efficiently for the country.
- (v) Comparability –the users of information need information that is presented in a way that makes it possible for them to compare performance of one public sector entity to another on a yearly basis.

(c) **The difference between Accrual and Cash basis are as follows:**

Accrual basis - the financial information that is prepared for private sector entities involves taking certain expenditure whose services have been used but have not been paid for to be included in the financial statements. In the end, the profits or surplus earned is a nominal amount that does not represent the amount of cash received. It is just an amount that is a measure of income and expenditure relating to an accounting period.

A cash basis of accounting when used for accounting purposes, excludes transactions that do not have a cash effect on the public sector operations. Only information about actual receipts and actual payments are reflected in the financial statements. This will inform the users of the sources of cash and its equivalents, the use and amount appearing in the current assets of the balance sheet.

Examples of information that is excluded from the financial statements are prepared are depreciation and the value of services used but not yet paid for.

(d) The reasons why IFRS may not be suitable in public sector organizations are:

- (i) The terminology that is used in IFRS are not appropriate for public sector entities
- (ii) The public sector accounts are prepared using cash basis of accounting unlike IFRS which promotes the use of accrual basis of accounting.
- (iii) The stakeholders in public sector organizations are different from those in private sector who feel IFRS are suitable for them due to varied needs and expectations of users.
- (iv) Nature and characteristics of public sector also dictates the application and use of IPSAS as opposed to IFRS.
- (v) Disclosure requirements are different as additional commentaries are needed for public sector entities.

(e) The two key characteristics of a public sector reporting entity are:

- (i) Source of funding- the source of funding for a public sector reporting entity comes from the stakeholders in most cases. It also means the sources are meant for the needs of the same stakeholders.
- (ii) Stakeholder's decision making-the stakeholders are only expected to make decisions that will depend on the outcomes from the financial reports of the public sector entity.
- (iii) Public sector entities exist to provide services to the public at often no profit but at a level to enable them make it possible to continue with the provision of that service.

SOLUTION FIVE

- (a) (i) Grantor –this is a public sector entity which is TGA
- (ii) Concession operator in this case the company that constructed the Toll gates.
- (b) **The following are the control tests for the assets to be recorded in the books of the Grantor:**
- (i) The services that the operator gives, are all determined by what the operator is going to give whilst using the Toll gates or concession assets.
- (ii) When the term of the concession comes to an end, then the Grantor can record the concession assets in its book since the benefits and risk associated with the Toll gates have passed on to the grantor.

Examples of assets are:

- Assets that the operator constructed with assistance from a third party for the purpose of the concession arrangement
 - The assets to which the operator has been given access to by the grantor that are correctly existing.
- (c) **The following are the five key disclosures that are permitted under IPSAS 32 Concession Arrangements:**
- (i) A description or details of the actual concession arrangement
- (ii) Details of the significant terms of the arrangement that may affect the amount, timing and certainty of future cash flows between the concession operator and TGA
- (iii) Any changes in the arrangement during the accounting period.
- (iv) The nature and extent of;
- Right to use Toll gates
 - Obligations to provide or rights to expect provision of services by the concession operator.
 - Obligations to deliver or rights to receive specified assets at the end of the concession period
 - Renewal and termination options
 - Other rights and obligations regarding the Tollgates
- (d) **The following are the conditions for a grantor to recognize a liability under I.A.S 32 Concession Arrangements:**

- Upon identifying and recognizing a service concession asset, it can be recognized it as a financial liability or as a right to the operator or as revenue under unearned income. They take the forms of the following models:

The financial liability model:

Using this model, a financial liability is recognized and then future payments shared to a reduction of liability, the recognition of an imputed finance charge

and of charges for services provided by the operator under the service concession arrangements.

The grant of a right to the concession operator:

Under this model the grantor would recognize revenue and reduce the liability according to the economic substance of the service concession arrangement.

(e) **Distinction between defined benefit plan and defined contribution plan**

- Under a defined benefit plan the company guarantees post-employment benefits to the employees. In this case the amount of pension benefits may depend on the number of years worked.
- That is, if the fund's assets are not adequate to cover employees' benefits, then the employer may be required to settle the shortfall. This means that investment risk of the plan rests with the employer.
- Under a defined contribution plan, the employer's obligation is limited to what has been agreed as its contribution to the plan. The investment risk, therefore, rests with the employees.
- A defined contribution plan is always funded whilst a defined benefit plan can either be funded or unfunded

END OF SOLUTIONS