



PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

PFM 1: PUBLIC SECTOR ACCOUNTING

MONDAY 10 JUNE 2024

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

INSTRUCTIONS TO CANDIDATES

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

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

SECTION A

This question is compulsory and must be attempted.

QUESTION ONE

You have received a quarterly magazine published by Ministry of Finance and National Planning that shows the following result, being performance of Government for the past three (3) years:

	2022	2021	2020
	K'billion	K'billion	K'billion
Government revenue	6,000	4,000	2,500
Government expenditures	<u>(4,500)</u>	<u>(2,000)</u>	<u>(1,100)</u>
Surplus	<u>1,500</u>	<u>2,000</u>	<u>1,400</u>

The following notes are relevant:

- (i) 75% of government revenue is tax revenue and the balance is non tax revenue.
- (ii) Government expenditure has not been broken down as record of the break down could not be retrieved from the files that contained the information as the files were reported missing.

Required:

- (a) Analyse the performance on public spending and revenue as reported in the article. (your analysis must include possible reasons for the movements). (12 marks)
- (b) Explain the principles that the Ministry of Finance and National Planning should follow in order to effectively manage financial records. (10 marks)
- (c) Distinguish between appraising financial records and disposing financial records. (6 marks)
- (d) Identify four (4) core functions of treasury management. (4 marks)
- (e) Describe cash accounting as used in public sector accounting and explain its three (3) advantages of cash accounting. (8 marks)

[Total: 40 Marks]

SECTION B

There are FOUR (4) questions in this section. Attempt any THREE (3) questions.

QUESTION TWO

Public sector accounting information is critical for influencing the quality of financial management decisions taken by policy makers. Policy makers include the internal and external users of public sector information.

Required:

- (a) Identify six (6) internal users of public sector accounting information. (6 marks)
- (b) Explain seven (7) purposes of public sector financial management system. (14 marks)

[Total: 20 Marks]

QUESTION THREE

Accounting regulation in the public sector may assist to improve credibility of public sector financial information. In order to secure public interest, Accountants in Zambia subscribe to a self regulatory system which is made of both local and international standards.

Required:

- (a) Identify four (4) standards which affect the form and content of public sector financial information in the public sector. (4 marks)
- (b) Explain three (3) objectives of the international public sector accounting standards board. (6 marks)
- (c) Explain any five (5) qualitative characteristics of public sector accounting. (10 marks)

[Total:20 Marks]

QUESTION FOUR

Besides the consistent application of elementary accounting concepts, the use of a chart of accounts in the public sector can help controlling officers to properly account for income and expenditure. However, some experts feel that a chart of accounts may still lead to ambiguity in the way financial activities are recorded particularly if the chart of accounts is influenced by international authorities.

Required:

- (a) Define a chart of accounts in the public sector. (2 marks)
- (b) Briefly explain four (4) purposes of a chart of accounts. (8 marks)
- (c) Explain the meaning of the following accounting concepts:
 - (i) Substance over form (2 marks)
 - (ii) Separate determination (2 marks)
 - (iii) Realization concept (2 marks)
 - (iv) Money measurement (2 marks)
 - (v) Consistency (2 marks)

[Total: 20 Marks]

QUESTION FIVE

Strict adherence to upholding the law of confidentiality may to some extent undermine the idea of transparency and disclosure in the utilization of public sector resources by controlling officers. Your Supervisor Mr. Zulu has asked you to explain situations which may justify the breach of this cardinal law in the public sector.

Required:

- (a) Explain four (4) situations which may justify the breach of the law of confidentiality. (12 marks)
- (b) Explain any four (4) threats to independence. (8 marks)

[Total: 20 Marks]

END OF PAPER

PFM 1: PUBLIC SECTOR ACCOUNTING SUGGESTED SOLUTIONS

SOLUTION ONE

- (a) Tax revenue increased by 60% in 2021 ($K3000 \text{ billion} - K1,875 \text{ billion} / K1,875 \text{ billion} \times 100$), and increased by 50% in 2022 ($K4,500 \text{ billion} - K3,000 \text{ billion} / K3,000 \times 100$). Despite 2022 increase being lower compared to 2021 increase. Overall tax revenue increased over the two years which is a positive stride. The same % increases apply to non-tax revenue but are a lower proportion of tax revenue, that is at 25%.

The increments in tax revenue could be attributed to increased tax compliance in various sectors of the economy as a result of sealed leakages in which taxes could easily be avoided. Further, increased recruitments of health and education and defense staff may have increased pay as you earn taxes (PAYE). Another contributing factor may have been a significant increase in motor vehicle taxes as well as corporation tax as 2021 was recovery period from the effects of COVID 19.

Further, expenditure increased by 82% ($K2,000 \text{ billion} - K1,100 \text{ billion} / K1,100 \text{ billion}$ in 2021 and increased by 125% ($K4,500 \text{ billion} - K2,000 \text{ billion} / K2,000 \text{ billion}$). The expenditure increased in 2022 probably due to additions to government payroll in new recruitments as well as payments to retirees.

The proportion of expenditure to revenue was greatest in 2022, at 75% compared to 50% in 2021 and 44% in 2020.

Overall, financial performance was best in 2021 when revenue increased by a greatest percentage and surplus was highest. Though revenue amount was greatest in 2022, the increase in expenditure to revenue ratio from 50% to 75% and an increase in expenditure of 125% in 2022 was higher compared to previous two years.

- (b) **Record keeping principles include:**
- Managing records is a combined task of accounts, audit and records personnel
 - Financial records are to be managed throughout their life until the point of ultimate disposition
 - Records identified should relate to the relevant financial function
 - The stored records should be easy to retrieve when need arises
 - Records should not be accessible by all and sundry. Only authorised staff should have access to records
 - Deliberate controls should be implemented over structure, content, location and flow of records.
 - Records and record systems should be subject to audit and review
 - Records should be retained until the expiry date of legally imposed custodial period which may fall in between five to ten years.
- (c) Appraising and disposing financial records are at the centre of records management. This means that records holding need to be minimized by either disposing of records that may never be used as evidence of accountability checks in the future, or appraising it to establish if it needs to be held further. The appraisal process will lead to identification of financial

records worth of ongoing retention because of their continued value to the government and the public, whereas the disposal process will lead to identification of financial records whose value has ended and hence done away with.

(d) **Core functions of treasury management include:**

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

(e) **Cash Accounting**

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

Advantages of cash accounting

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

SOLUTION TWO

(a) Internal users of public sector accounting information

- The republican President or Prime Minister
- The National Assembly
- Regulatory and oversight bodies
- Controlling officers
- Chief executives of parastatals
- Labor union activists
- Law enforcement agencies

(b) Purposes of public sector financial management system

- Macro fiscal planning – establishes policy objectives and needs for financial resources providing the basis for forward looking strategy for raising revenue and expenditure.
- Budget preparation – involves allocation of resources to achieve government objectives.
- Budget implementation – this involves actioning the budget items after obtaining approval from parliament.
- Budget monitoring and evaluation – this is a method of obtaining feedback to the fiscal planning and policy area.
- Cash management – provides a real picture of available cash in government accounts and the amount of cash needed for government expenditure.
- Debt management – requires management of debt related transactions as well as servicing loans.
- Revenue administration – helps to maximize the collection of tax and non-tax revenue.
- Accounts administration – helps government to assemble and analyse accounting information to help control business, safeguard assets and prepare financial reports.
- Auditing – a means of verifying the correct use of public resources.

SOLUTION THREE

(a) **Standards which influence the form and content of financial reporting**

- International public sector accounting standards (IPSAS).
- Local legislation.
- Directives and circulars issued by government.
- Generally accepted accounting practice.
- Professional judgement.

(b) **Objectives of the international public sector accounting standards board**

- Formulates high quality IPSAS.
- Promotes the use of IPSAS.
- Promotes financial transparency by compelling users to disclose more accounting information.
- Seeks to bridge the gap between local and international standards.
- Seeks to identify accounting needs of emerging markets.

(c) **Qualitative characteristics of public sector accounting**

- Relevance – information should be capable of making a difference in decisions made and should possess confirmatory and predictive value.
- Faithful representation – information should be neutral, complete and free from material errors for it to be reliable.
- Comparability – information should be capable of being analyzed and this made possible through consistence and transparency.
- Understandability – users should perceive the importance of public sector information.
- Verifiability – information should be capable of being subjected to audit procedures.
- Timeliness- information is relevant if it is provided in time to users.

SOLUTION FOUR

(a) **Definition of a chart of accounts in the public sector**

A chart of accounts is used to classify and code government financial transactions. The chart assists government in planning, resource allocation, management control, accounting and statistical evaluation.

(b) **Purposes of a chart of accounts**

- to differentiate between revenue, expenditure, assets and liabilities
- to provide a standard framework for the presentation and analysis of financial information
- to facilitate the preparation of financial reports
- serves as an index to easily locate a given account within the general ledger
- to facilitate comparison of financial information between organizations and governments

(c) **Accounting concepts**

- Substance over form
Business transactions or information should reflect the economic reality rather than the legal form.
- Separate determination
States that each component of an element of the financial statements should be valued separately when arriving at a total to be shown in the accounts under an appropriate category.
- Realization concept
States that only income or gain that has been earned should be recognized. Generally, income and gains are recognized when an organization meets its obligations towards its customers or third parties.
- Money measurement
States that only those transactions measurable in monetary value should be recognized within the financial statement. For an item to be recognized, that item should be assigned an objective value that is free from subjectivity or dispute.
- Consistency

States that accounting principles and policies should be consistently applied to items in the same class and from one period to another to facilitate meaningful comparisons of accounting information.

SOLUTION FIVE

(a) Reasons for breach of confidentiality

- Disclosure is permitted by law and is authorized by the employer or client
- Disclosure is required by law for instance as part of evidence in court proceedings
- The accountant is aware that his client/employer is engaged in money laundering offences
- The accountant has to respond to an inquiry from a recognized supervisory body
- The accountant needs to protect his interest in a legal case
- The accountant is required to comply with ethical and technical standards

(b) Threats to independence

- Self-interest threat – An accountant has financial or other interests with his client or employer which they need to protect
- Self-review threat – an accountant is found in a position where they may have to review or evaluate work done in the past
- Advocacy threat – an accountant may represent the client in business or legal matters over and above their normal duties
- Familiarity threats – an accountant's relationship with the client may crowd their judgment
- Intimidation threats – this may result from actual or perceived threats from the client or employer based on quality of work done in the past

END OF SUGGESTED SOLUTIONS



DIPLOMA IN PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

PFM2 : LEGAL ASPECTS OF PUBLIC SECTOR FINANCE AND ADMINISTRATION

FRIDAY 14 JUNE 2024

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.
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Section A: One (1) Compulsory scenario question.
Section B: Four (4) Optional Questions. Attempt any three (3) questions.
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SECTION A

This question is compulsory and must be attempted.

QUESTION ONE – (COMPULSORY)

Mr Maganizo is a politician and is the president of the "Ganizani" party. In the run up to elections to be held in three (3) months time in his country, Mr Maganizo and his party members have planned to hold a rally to drum up support in the fourth coming elections. However, in their country there is a law which requires that they apply for a permit before holding any political rally. Mr Maganizo excited about his popularity overlooks that requirement and holds a very successfully rally with about 30,000 people in attendance. Unfortunately, in the middle of the rally, they see a group of police men who arrested them and put them in custody. Mr Maganizo is now confused and doesn't know what to do. One of his colleagues advises him to see you as you are a well-known constitutional lawyer.

Required:

- (a) With reference to at least one decided case, advise Maganizo on all legal issues arising in this matter and tell him whether or not he is likely to succeed in this matter if he takes it to court. (20 marks)
- (b) Define the word "law" and discuss any four (4) functions of law in society. (10 marks)
- (c) Discuss the main disadvantages of judicial precedent. (10 marks)

[Total: 40 Marks]

SECTION B

There are FOUR (4) questions in this section. Attempt THREE (3) questions.

QUESTION TWO

Give a detailed explanation of the Legal Regulatory Framework of;

- (a) The Zambia Revenue Authority (10 marks)
- (b) The Public Procurement Authority (10 marks)

[Total: 20 Marks]

QUESTION THREE

Explain the following sources of Law:

- (a) The Constitution (10 marks)
- (b) Common Law and Equity (10 marks)

[Total: 20 Marks]

QUESTION FOUR

- (a) Point out circumstances under which the doctrine of separation of powers is violated in Zambia. (10 marks)
- (b) Explain the importance of judicial review in a democratic state like Zambia. (10 marks)

[Total: 20 Marks]

QUESTION FIVE

- (a) Describe the nature of administrative law. (5 marks)
- (b) State the three (3) main sources of administrative law? (5 marks)
- (c) Explain the importance of administrative law in public sector finance and administration. (5 marks)
- (d) Discuss the distinction between constitutional law and administrative law. (5 marks)

[Total: 20 Marks]

END OF PAPER

PFM2 : LEGAL ASPECTS OF PUBLIC SECTOR FINANCE AND ADMINISTRATION

SUGGESTED SOLUTIONS

SOLUTION ONE

- (a) **This scenario is similar to what obtained in the case of Christine Mulundika & 7 Others v The People,**¹ the appellant challenged the constitutionality of certain provisions of the Public Order Act Cap 104, especially section 5(4). The challenge followed on the fundamental freedoms and rights guaranteed by arts 20 and 21 of the Constitution. A subsidiary challenge related to the exemption of certain office-holders from the need to obtain a permit. Held: (i) Section 5(4) of the Public Order Act Cap 104 contravenes arts 20 and 21 of the Constitution and is null and void. (ii) The exemption granted to certain office-holders does not fall under the categories listed in the Constitution. However in the case at hand, Mr Maganizo did not follow the procedure of applying for a permit. Meaning he was acting in contravention of the law. Therefore he may not succeed in his action against the police in contrast with case above where the appellants applied for a permit but were just denied to hold the rally.
- (b) Law has several functions to perform in society today, which include:
- Promotion of regularity and certainty
 - Law as a mechanism of social control
 - It provides for adjudication of controversy
 - Promotion of order
 - The law is society's source of authority
 - Law is a medium of social integration
 - Law promotes fairness
 - Law is an instrument for serving the needs of society
 - Law promotes responsibility
- (c) The following are the disadvantages of judicial precedent:
- **Rigidity:** Precedent is rigid in the sense that once a rule has been laid down it is binding even if it is thought to be wrong.
 - ***Danger of illogicality:*** This arises from the rigidity of the system. Judges who do not follow a particular decision may be tempted to draw very fine distinction in order to avoid following the rule, thus introducing an element artificiality into the law.
 - ***Bulk and complexity:*** there is so much law that no-one can learn all of it. Even an experienced lawyer may overlook some important rule in any given case.
 - ***Slowness of growth:*** They system depends on litigation for rules to emerge. As litigation tends to be slow and expensive the body of case law cannot grow quickly enough to meet modern demands.

¹ (1995) S.C.Z. JUDGMENT No. 25 of 1995. S.C.Z. APPEAL No. 95 OF 1995.

- *Isolating the ratio decidendi*: where it is difficult to find the ratio decidendi of a case this detracts from element of certainty.

SOLUTION TWO

- (a) The Zambia Revenue Authority Generally like any other Administrative Institution, ZRA resolves its legal issues via Judicial Review which mainly looks at the powers conferred on a body and assessing whether the body has acted within the powers or where the power exists, assessing whether the procedure as laid down in a statute has been followed by the when performing its functions.

Aside from judicial review, ZRA also has a tribunal. This is created under The Revenue Appeals Tribunal Act; By S 190 (1) of the Act, any person who is aggrieved by the decision or determination made by the Commissioner-General under the Act or under any regulation, or rules made under this Act, may in respect of the matter set out an appeal to the Tribunal in such a manner and within such time as the Minister may by regulation prescribe.

- (b) The Public Procurement Authority

As a public body, PPA is amenable to judicial review as means of regulating functions. Aside from that, the Public Procurement Authority Act 2008 and subsidiary legislation such as Statutory Instrument No. 63 of 2011 and the Public Procurement Regulations 2011 all contain regulatory frameworks under which the authority is to operate.

SOLUTION THREE

- (a) A Constitution is a document which is used to govern people, and by which they (the people) have agreed to be ruled. It determines the fundamental principles of government; it gives power to government and the limit of that power. A Constitution is the fundamental law of a country. For example, in Zambia it is the supreme law of the land. The constitution is the fundamental law of the land. It consists of laws which govern a state. It is important to point out that every state or nation has defined objectives established to accomplish those objectives, needs a constitution to define powers, rights and duties of the state or nation. The laws also regulate the internal working of a nation or state which also makes provisions for the manner in which the nation or state relates to outside bodies. It can safely be said that a constitution looks both to internal and external regulation of the body which it relates. It sets out a form of government the State-Society relationship and the limits of government.
- (b) Common law is the body of law derived from judicial decisions, rather than from statutes or constitutions. Under the Anglo-Saxon there was no such thing as English law. Communities were small and isolated because travel was dangerous and difficult. The application of justice was done within each local community. Common law refers to laws created and upheld through the rulings of a judge or jury hearing a case. Equity, usually refers to judgments that deal with fairness in justice, often stemming from a sense of "natural law." Equity, on the other hand, came from the Courts of Chancery, which were presided over by the chancellor to the presiding monarch. This essentially evolved from the rights of English citizens to appeal a common law decision to the monarch, who was the final arbiter of justice. A king would often appoint his chancellor to act in his stead.

SOLUTION FOUR

- (a) The doctrine of separation of powers means that no one person should be vested with all the three types of powers. The idea of this theory stems from the logical concept that if the law-makers should also be the administrators of law and justice, then the people at large will be left without remedy in case any injustice is done as there will be no superior authority. But because of the complex nature of a modern state, where the process of law making, administration and adjudication cannot be clearly assigned to separate institutions, the application of this doctrine in strict sense is very difficult that's why there is functional and personal overlapping exist in our system. The basic concept behind this is that when a single person has a large amount of power, they can become dangerous to society and citizens.

In Zambia the following are the circumstances in which the doctrine of separation of powers is violated.

- The president belongs to all the three organs of government-executive legislature and judiciary.
 - The president appoints judges who perform judicial functions
 - Judges make laws through judicial precedent
 - Delegated legislation is a violation of the doctrine of separation of powers as the executive bodies make law
 - Offices such as Attorney general and DPP are executive offices performing judicial functions.
- (b) With reference to countries like Zambia, judicial review can be defined as powers conferred on courts to judicially review administrative functions of the executive and legislative acts of parliament. The former concerns action designed to keep those persons and bodies with delegated powers within the scope of the power conferred upon them by Parliament. Therefore, where the executive carries out administrative functions in a manner not stipulated by an Act of Parliament (*ultra vires*) the courts will adjudge the action of the executive null and void. The importance of judicial review therefore, is to question decisions made persons holding public offices ensuring that they act within the confines of the law.

SOLUTION FIVE

- (a) Administrative law is part of public law and concerns itself with the establishment and regulation of administrative bodies or agencies that perform functions of a public nature. It can also be defined as 'the body of public law which establishes administrative bodies and regulates how they perform their functions'. Some scholars also define it as 'the branch of public law governing the exercise of powers and duties by public authorities'. The two definitions show that administrative law concerns itself with public bodies and not private bodies. Administrative law does not therefore concern itself with issues arising between private persons (natural or artificial) as such are dealt with under private law.
- (b)
1. **Constitution** - the constitution is not literally a source of administrative law. What qualifies it to be considered a source of administrative law is the fact that the constitution establishes the institutions that make Acts of Parliament and confers on other bodies, authority to come up with the actual administrative laws (Acts of Parliament and delegated legislation). In countries where it is written, the constitution may be considered the primary source of administrative law which would require all other actual administrative laws to conform to its provisions and failure to which, the other laws would be rendered void. (*Christine Mulundika and Seven Others v The Attorney General* (1996) ZR)
 2. **Acts of Parliament** - Acts of Parliament are in actual fact, the primary sources of administrative law. In countries without a concrete constitution like the United Kingdom, Acts of Parliament stand as the ultimate source of administrative law. In Zambia and other countries with a concrete constitution, Acts of Parliament may be considered secondary to the constitution yet in fact qualifying for consideration as primary sources because of what has already been stated above. Acts of Parliament stand as sources of administrative law because all public administrative bodies are established by or under Acts of Parliament and it is the Acts of Parliament that provide for how they are to perform their public administrative functions. Equally, where they are said to have acted *ultra vires*, it is in relation to provisions of Acts of Parliament that their *ultra vires* conduct would be determined from. (*Attorney General v Fulham Corporation* [1921] 1 Ch 440 where the local authority was empowered under statute to establish washhouses for the non-commercial use of local residents but the corporation decided to open a laundry on a commercial basis.
 3. **Statutory Instruments and By-laws** - Statutory Instruments and by-laws are both delegated legislation that is, laws made pursuant to a higher law which is an Act of Parliament also known as the enabling Act. These are defined as 'any delegated legislation (not including sub-delegated legislation) (delegated legislation made by a body under the authority of a statutory instrument made by a minister) to which the Statutory Instruments Act 1946 applies'. The definition above indicates that any other legislation arising from

bodies that have been delegated with power to make delegated legislation does not qualify as statutory instruments. Regulations therefore made by institutions as Bank of Zambia, Zambia Revenue Authority, Road Transport Safety Agency (RTSA) pursuant to powers conferred on them by a minister in a statutory instrument, would not qualify for statutory instruments. Statutory instruments are very important sources of administrative law as they make the process of public administration smooth and supplement provisions of Acts of Parliament. The jurisdiction of statutory instruments extends to the country as a whole in the same manner Acts of Parliament do. By-laws on the other are equally delegated legislation but made by a local authority (councils) and their jurisdiction as opposed to statutory instruments is limited to the area of the local authority passing them. They are equally passed pursuant to Acts of Parliament and are required to conform to provisions of the enabling Act. Both statutory instruments and by-laws are intended to supplement provisions of enabling Acts and do not stand alone but to be in conformity with the enabling Act.

- (c) Administrative law is very important in public sector finance and administration. Acts of Parliament being the main source of administrative law establish all public administrative bodies including all bodies engaged in public sector finance and administration. Administrative law therefore confers on the said bodies the functions they have and prescribes how they are to perform the functions conferred on them by administrative law which is Acts of Parliament. Administrative law ensures arbitrariness in the performance of public administrative functions is curtailed and also ensures the bodies are accountable to the law. Administrative law sets the benchmark for all public bodies including those engaged in public sector finance and administration. It therefore establishes them and prescribes the perimeters within which they are to operate and any act outside what administrative law prescribes, is *ultra vires* and therefore invalid. Through the process of judicial review administrative law equally ensures all bodies are regulated by law as they perform their functions. *Attorney General v Fulham Corporation, William Harrington v Dora Siliya and the Attorney General*.
- (d) Constitutional law and Administrative law although both being branches of public law are nonetheless different. Their differences stem from mainly their sources and what effect each of the two has. Constitutional law comes from the constitution especially in countries like Zambia where it is codified (written). However in countries like the United Kingdom where they have an uncoded (unwritten) constitution, constitutional law comes from a number of sources which also includes Acts of Parliament which are considered the main source of administrative law. The effect constitutional law has which distinguishes it from administrative law is that it mainly concerns itself with the constitution of a state that is, establishment of a state to the extent that a state has been defined by law. Constitutional law therefore constitutes all the organs of governance and confers on them the functions and powers they have in the governance of a country. Constitutional law also regulates the manner the organs established under it relate with one another and how the government relates with the people. Administrative law however mainly comes from Acts of Parliament and other delegated legislation and, by virtue of constituting the body that

passes Acts of Parliament, from the constitution itself. However, in terms of effect, administrative law concerns itself with the day to day administrative functions of running the affairs of the state. It establishes public administrative bodies, confers on them the powers they have and how they are to exercise the powers conferred on them. Administrative law therefore is the law used in the daily running of the affairs of the state whereas constitutional law only concerns itself with the establishment of the state.

END OF SUGGESTED SOLUTIONS



PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

PFM 3 : GOVERNANCE AND MANAGEMENT IN PUBLIC SECTOR

TUESDAY 11 JUNE 2024

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

INSTRUCTIONS TO CANDIDATES

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SECTION A

This question in this Section is Compulsory.

QUESTION ONE

CASE STUDY OF A ROAD CONSTRUCTION PROJECT

The subject of the analysis consists in construction of a road on a privately-owned plot of land and its connection to the existing public asphalt road. Specifically, the road was to be used for transport to and from company premises. The road thus enables the entrance to the investor's premises, parking and the connection of the public road to the storage hall. The investor needed to bring the premises into operation quickly and, for this reason, it began to consider a change in the originally envisaged technological solution for the road. The investor and the contractor reached an agreement where the contractor proposed to use a non-standard construction process which promised to shorten the construction period and reduce price. The technology lacked binding rules according to the Government's construction regulations Act and there was no demonstrable experience with its use in other projects in the country.

The investor and the contractor entered into a contract for work, but the contract unfortunately contained serious shortcomings consisting, e.g., in the absence of proper project documentation concerning the new technological solution attached to the contract as its integral part. All the above-mentioned facts subsequently led to disagreements and disputes between the contractual parties.

The road was built by the contractor, but defects and faults appeared during handover, resulting in the investor's refusal to accept the road and its request for a repair of these defects and faults (consisting, e.g., of incorrectly implemented drainage). Although the work was neither officially accepted nor paid for, the investor started using it for its business activities, which involved heavy freight traffic on the road which had not been designed for that purpose. Consequently, the defects and faults deteriorated further, manifesting as faults on the road near the drainage sites, ruts in the covering layer, cracks and unevenness in the road and area deformations.

Since the parties were unable to agree on a solution to their dispute, they referred the matter to the court. As part of the investigation of the causes of the defects and faults and the liability for

them, the following factors were identified: inadequate preparation of the ground plane, incorrectly implemented drainage, uneven thickness of the asphalt layer, partially insufficient compaction of the underlying structure, insufficient binding between the covering and the supporting layer, and overloading the road by heavy freight traffic.

Source: <https://www.frontiersin.org/articles/10.3389/fbuil.2022.1009944/full>

Required:

- (a) Discuss seven (7) basics of good contract management and three (3) important factors to consider when dealing with its suppliers. (10 marks)
- (b) To facilitate good contract management, it is useful to classify the contracts.

Required:

- (i) Describe the contract life cycle activities. (10 marks)
 - (ii) Identify five (5) types of Contract agreements a company can enter into.
- (c) Describe the contract life cycle activities. (12 marks)
- (d) Outline any four (4) factors that must be taken into account to promote good practices in Contract Management. (8 marks)

[Total: 40 Marks]

SECTION B

There are FOUR (4) questions in this section.

Answer Any Three (3) Questions in this section.

QUESTION TWO

Like most African countries, Zambia at the time of independence was mainly an agrarian economy that heavily relied on agricultural yield. From 1972, the manufacturing sector's contribution to Gross Domestic Product (GDP) increased from 13.5% to about 35% in 1991, transitioning the country gradually into a modern society, evidenced by the growing number of manufacturing companies and the use of modern technologies. Furthermore, the country has evolved from the Command economy to Capitalism models. The Public corporations have been clouding in business with the Private companies creating a competitive environment in the economy.

Required:

- (a) Explain the four (4) advantages of private limited company form. (8 marks)
- (b) Identify four (4) main objectives and characteristics of the public corporations (12 marks)

[Total: 20 Marks]

QUESTION THREE

In recent times, we have seen a number of projects (schools/universities, hospitals/clinics, roads, etc.) which have been partially worked on and later abandoned by contractors. In some of these cases, it has been reported that these contractors received all or significant monies towards the said contracts.

Required:

- (a) Given the above scenario, explain five (5) roles of a Contract Manager. (10 marks)
- (b) Outline five (5) benefits of good practice contract management. (10 marks)

[Total: 20 Marks]

QUESTION FOUR

- (a) Define public policy (2 marks)
- (b) Policy demands are claims made by stakeholders in the political system for action or inaction on some perceived problems.

Required:

Write brief notes on the following examples of policy demands:

- (i) Electricity (2 marks)
 - (ii) Durable roads network (2 marks)
 - (iii) Employment opportunities (2 marks)
 - (iv) Health care facilities (2 marks)
- (c) (i) Define leadership. (4 marks)
- (i) Define what is meant by Democratic style of leadership. (6 marks)

[Total: 20 Marks]

QUESTION FIVE

Professionalism in Public sector is key to Government policy implementation and service delivery. It therefore become imperative civil servants upholds to ethics in the discharge of their duties. This will abet the challenges of corruption which has been characterized by lack of professionalism.

Required:

- (a) List down five (5) professional ethics for a public servant (5 marks)
- (b) Identify the five (5) points to consider in managing ethics at workplaces. (15 marks)

[Total: 20 Marks]

END OF PAPER

PFM 3: GOVERNANCE AND MANAGEMENT IN PUBLIC SECTOR SUGGESTED SOLUTIONS

QUESTION ONE

(a) The Basics of Good Contract Management

Best practice in Contract Management requires that the management of contracts should take into consideration the following items:

- Optimizes delivery of large capital projects.
- Specifies management techniques and processes for all types of contracts.
- Encourages achievement of value for money and continuous improvement.
- Identifies savings and additional revenue opportunities.
- Enhances risk management.
- Provides clear and complete records for audit.
- Encourages communication between all parties to contracts.
- Failure to implement adequate contract management could result in a number of negative consequences to the company.

The Importance of Good Contract Management

Good practice contract management has the capacity to increase revenue opportunities, decrease costs and enhance service delivery.

There are strong punitive measures for managers who are found to have been negligent or purposely fraudulent in their duties.

As the competences of managers and the resources at their disposal increase, it is essential that they strengthen their efforts to make compliance central to strategic objectives.

While in the past contracts may have been viewed as simple agreements to protect the parties from worst-case scenarios, contracts are now increasingly seen as vehicles for achieving value for money and fostering good relationships with partner and stakeholder organizations.

Since contracts are often managed manually and by multiple managers without an enterprise-wide approach, a multitude of rules and complex decision making can lead to inflexibility, poor planning, extended lead times and below par service delivery.

It is important to consider all transactions and record all types of contracts in use including those that may not have any formal written documentation. Once identified and classified the appropriate level of management intervention can then be applied.

(b) Classification of Contracts

Basis for Classification

- (i) To facilitate good contract management, it is useful to classify contracts or groups of contracts according to the level of management intervention required.

Such a classification system should take into account the following:

- Contract type or nature.
- Strategic importance of the goods and services being purchased or sold.

- Contract value.
- Contract duration.
- Contract complexity.

(ii) **Types of Contracts**

- Purchasing agreements
- Sales agreements
- Service agreements (internal and external)
- Insurance policies
- Warranties
- Loans
- Leases
- Non-disclosure agreements
- Collaboration agreements.

(c) **Contract Life Cycle Activities**

- Planning
This refers to planning and budgeting activities. During this time, strategic objectives are converted into approved budgets and operational plans. Budgets and operational plans will have sufficient detail to identify the need for contracts to carry out the approved operations.
- Creation
This is where the contract author will decide on the most appropriate wording to give effect to the intended outputs and outcomes. This involves preparing the first draft of the contract documentation.
- Collaboration
This is the drafting and negotiating process which includes internal and external reviews to ensure that the contract will give legal effect to the requirements of all parties to the contract. Internal review may include review by the following stakeholders; Legal, Finance, Risk management, Audit and Insurance.
External review will include one or more rounds of negotiation to arrive at a mutually agreeable set of terms and conditions that give effect to the requirements of all parties.
- Execution
This is the act of signing the contract, making it legally enforceable and formalizing the terms of the contract.
- Administration
The goal of contract administration is to monitor delivery under the contract to ensure that it achieves its original objectives and includes tracking and auditing of contract

terms like pricing and discounts, timeliness of payments and/or receipts, performance in delivering agreed service level or specification of goods and services and amendments.

- Closeout/Renewal

Contract closeout is a very important stage and one that often receives the least amount of attention. Regardless of whether a contract is being closed or renewed, a review process should be undertaken to various levels of detail depending on the classification of the contract.

This review will focus on performance under the contract and consider at least the following:

- Actual quantities, prices, total values vs budgeted quantities, prices, total values.
- Actual timeliness of delivery under the contract vs contracted timeframes.
- Actual service levels or specifications of goods and services vs those contracted.
- Review of procurement or sales methods.
- Future budgets.
- Change of supplier, buyer or other stakeholder.
- Outsourcing opportunities.
- Risk strategies.

(d) Factors that must be taken into account to promote good practices in Contract Management.

- Optimizes delivery of larger capital projects;
- Specifies management techniques and processes for types of contracts;
- Encourages achievement of value for money and continuous improvement;
- Identifies savings and additional revenue opportunities;
- Enhances risk management;
- Provides clear and complete records for audit; and
- Encourages communication between all parties to contracts.

SOLUTION TWO

- (a) Advantages of private limited company form.
 - 1. The owners are veiled from the activities of the company
 - 2. Profits are shared among the owners
 - 3. Companies can easily access loan or advances from financial institutions
 - 4. Operations are not controlled by the state
- (b) Objectives and characteristics of the public corporations
 - 1. Commercialization: providing Goods and services to the public at a marginal profit but fulfilling government interest in their business.
 - 2. Accountability: Board of directors appointed should be accountable to the stakeholders who are Zambians
 - 3. Transparency: All their business and financial activities are transparent
 - 4. Decentralization: Much of their operations are centralized
 - 5. Funding: funding is usually by the government

SOLUTION THREE

- (a) Contract managers oversee contracts that their employers/government are involved with, so they must have in-depth knowledge of contract features. A contract manager needs to understand the advantages and pitfalls of contracts and be familiar with a plethora of contract details. Here are some of their typical duties and responsibilities:
- Create, analyze, negotiate, and execute an array of contracts for various transactions
 - The legal contract correctly stipulates requirements in line with the contract owners request and the institution's strategic objectives.
 - The goods and services are delivered according to standards set out in the contract.
 - Build and maintain relationships with vendors, clients, and other business connections
 - Communication and negotiation at all levels. Ability to ensure excellent communication and where necessary to prevent and repair situations of poor communication.
 - Maintain and manage contract-related documents and correspondence throughout the contract life cycle.
 - Present contract information to relevant parties, such as stakeholders
 - Troubleshoot contract-related problems, such as breach of contract
 - Keep track of contracts and extend, renew, or close them out
 - Facilitating legal discussions around unresolved contract issues.
 - Directly negotiating pricing or insurance requirements.
- (b) Benefits of good practice contract management.
- It increases financial value.
 - It has the capacity to increase revenue opportunities.
 - Good contract management decreases costs.
 - It controls risk in the contract- portfolio-risk is an important element in the contract management equation.
 - Good contract management enhances service delivery.
 - Contract management software improves revenue and collaboration on contracts.

SOLUTION FOUR

- (a) **Public policy** is a set of actions the government decides to take when approaching a problem that affects society as a group, rather than on an individual level. Simply put, public policy refers to policies that the government makes on the public's behalf to resolve a specific issue.

Essentially, public policy is a set of laws, guidelines, and actions decided and taken by governments in order to work in favor of the public. Public policy can dictate things such as: which laws are passed, where funding goes, and which topics concern the general public.

(b)

- (i) **Electricity:** Government's involvement in the generation and provision of electricity, allows citizens to get this service at a more reasonable cost compared to if it were in private hands. Affordable electricity supply is critical to citizens and their contribution to economic growth. For example, The Rural Electrification Authority of Zambia (REA), created by an Act of Parliament in 2003, has a mandate to provide electricity infrastructure to all rural areas using appropriate technologies. The REA's aim is to increase the electrification rate to 51% by 2030, and thereby enhance living standards and productivity, while improving quality of life for all Zambians. In the next few years, the REA is the focal point of a number of initiatives – including capital subsidy support, solar, mini-grid and hydro projects – that will enable new and existing energy service providers to reach thousands of new customers in rural and peri-urban areas.
- (ii) **Durable roads network:** The government is responsible for ensuring that road networks are safe and durable. Road agencies such as the Road Transport and Safety Agency (RTSA), Road Development Agency (RDA), and National Road Fund Agency (NRFA) undertakes this role in the context of wider Government policies and objectives. Operating an effective and efficient strategic road network makes a significant contribution to the delivery of sustainable economic growth, helping to create the conditions that support the realization of the aspirations of businesses and communities. The government through the road agencies supports the economy through the provision of a safe and reliable strategic road network, which allows for the efficient movement of people and goods. Such a network can play a key part in enabling and sustaining economic prosperity and productivity, while also helping support environmental and social aims by contributing to wider sustainability objectives and improved accessibility to key economic and social services.
- (iii) **Employment opportunities:** The government has a responsibility to create employment for its citizens. They do this through public service employment, creation of factories/industries to ensure economic growth of its people and the nation as a whole. The recent employment by government of 11,000+ health workers and 30,000 teachers in Zambia is an example of government's intervention. Additionally, through the

Community Development Fund (CDF), government is training youths and women in various skills to enable them to start their own businesses.

- (iv) **Health care facilities:** Government's responsibility to protect and advance the interests of society includes the delivery of high-quality health care. Because the market alone cannot ensure all citizens' access to quality health care, the government must preserve the interests of its citizens by supplementing the market where there are gaps and regulating the market where there is inefficiency or unfairness. Government is responsible for building healthcare facilities even in the remote parts of the country to ensure equal access of healthcare to all its citizens.

(c)

- (i) In simple words, leadership is about taking risks and challenging the status quo. Leaders motivate others to achieve something new and better. Interestingly, leaders do what they do to pursue innovation, not as an obligation. They measure success by looking at the team's achievements and learning.
- (ii) In this type of leadership, team members and leaders equally contribute to actualizing business goals. Furthermore, they work together and motivate each other to achieve their personal goals too. This type of leadership leads to a positive working environment.
- Democratic leadership, also known as participative leadership or shared leadership, is a [leadership style](#) in which members of the group participate in the decision-making process. This type of leadership can apply to any organization, from private businesses to schools to the government.
 - With a democratic leadership style, everyone is given the opportunity to participate, ideas are exchanged freely, and discussion is encouraged. While this process tends to focus on group equality and the free flow of ideas, the democratic leader is still there to offer guidance and control.
 - The democratic leader is also charged with deciding who is in the group and who gets to contribute to the decisions being made. Research has found that the democratic leadership style is one of the most effective types and leads to higher productivity, better contributions from group members, and increased group morale.

SOLUTION FIVE

(a) Professional ethics for a public servant

1. Efficiency
2. Professional discipline
3. Dignity
4. Equity
5. Impartiality
6. Fairness
7. Public spiritedness
8. Courtesy in the discharge of duties

(b) Points to consider in managing ethics at workplaces.

1. Understand the benefits of ethical conducts
2. Focus on ethical conduct through building strong organization culture around ethics
3. Develop a code of ethical conduct that is documented and available to every employee of the organization.
4. Promote process should incorporate ethics as part of the evaluation
5. Link ethics to other management practices
6. Demonstrate ethical practices by leading by examples.

END OF SUGGESTED SOLUTIONS



PUBLIC SECTOR FINANCIAL MANAGEMENT EXAMINATIONS

DIPLOMA LEVEL

PFM 4 : PUBLIC SECTOR FINANCIAL MANAGEMENT

FRIDAY 14 JUNE 2024

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 scenario question.
Section B: Four (4) Optional 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.
10. Present Value and Annuity tables are attached at the end of this paper.

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

SECTION A

This question is compulsory.

QUESTION ONE

(a) The Provincial Education Office has set the following objectives in its strategic plan:

1. Provide capital grants to schools and cash transfers to girls who are enrolled in upper primary and secondary education
2. Advocate with communities to improve enrollment and retention for girls and children with disabilities
3. Recruit volunteer teachers to provide additional staffing especially in overcrowded classrooms
4. Provide assistive learning materials/devices for children with disability

The Provincial Education Office aims to achieve these objectives by continuously improving resource management to meet needs of stakeholders. Further, the Provincial Education office aims to remain within its funding limits. The Government mainly funds the Provincial Education Office but in the recent past it has engaged in some commercial ventures such as aquaculture. The provincial office uses funds from the commercial ventures to supplement the funding from the government. The government is contemplating on privatizing these commercial ventures and was already discussing with one of the commercial farmers. Some of the financial objectives of the commercial entity of the Provincial Education Office are to:

1. Increase earnings per share by 10% per annum
2. Achieve a 25% per annum return on its investments

Arguments put forward by government in favor of privatization focused on objectives between the mainstream operations of the Provincial Education Office and commercial activities, and savings to the tax payers. However proposals were strongly opposed by most of the stakeholders in the education sector.

Required:

(a) (i) State the differences between Public Sector and Private Sector organizations. (16 marks)

(ii) Discuss the effects of privatization of the commercial operations of Public Sector Institutions on various stakeholders. (6 marks)

(b) The Government of Country Y is in the process of establishing a Special Purpose Vehicle (SPV) for its Public University. The special purpose vehicle is meant to supplement the existing Public University. The Finance Director at the University has prepared an assessment of the four-year investment in the SPV. Below are the assessments done by the Director of Finance.

	Year 0	Year 1	Year 2	Year 3	Year 4
Revenue		2,560,000	2,560,000	2,560,000	2,560,000
Direct Costs		(700,000)	(700,000)	(700,000)	(700,000)
Overhead Costs		(250,000)	(250,000)	(250,000)	(250,000)
Depreciation		(450,000)	(450,000)	(450,000)	(450,000)
Working Capital	(800,000)				
Interest on Borrowing		(100,000)	(100,000)	(100,000)	(100,000)
R & D write off		(200,000)	(200,000)	(200,000)	
Total Cost	(800,000)	(1,700,000)	(1,700,000)	(1,700,000)	(1,500,000)
Profit/(Loss)		860,000	860,000	860,000	1,060,000
Tax 30%		(258,000)	(258,000)	(258,000)	(318,000)
Net Profit/(Loss)	(800,000)	602,000	602,000	602,000	742,000

The cost of capital is 10%.

Required:

Advise the University Council whether they should proceed with establishing the Special Purpose Vehicle. (4 marks)

- (a) Explain the concept of the time value of money and its components. (14 marks)

[Total: 40 Marks]

SECTION B

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

Attempt any **THREE (3)** questions.

QUESTION TWO

Ganga Water Authority is a government owned water utility company. It has a cash balance of K65 Million at the beginning of January 2022. The managing director has provided you with the following information so that you could assist him to prepare a cash budget.

- (1) Thirty percent of the sales are from prepaid customers while twenty percent pay at the end of the month and twenty five percent pay in the following month. The rest of the customers pay the month following.
- (2) Salaries and wages are settled at the end of the month.
- (3) All materials are purchased on credit. Two thirds of the materials are paid a month following purchases and the remainder are settled the month following.
- (4) Ganga Water Authority will receive a K78 million grant from the Ministry of Finance in February 2022.
- (5) A water purification machine will be purchased in March 2022 for K2.4 million.
- (6) Depreciation on the machine is expected to be 25% on reducing balance basis.
- (7) Rent and rates are payable one month in advance.
- (8) Operating expenses are paid in the month incurred.

The following is a forecast of revenue and expenditure for the six months period ending April 2022.

	Nov	Dec	Jan	Feb	March	April
Sales (Km)	92	90	84	104	124	130
Salaries and wages (Km)	28	30	40	35	70	76
Purchase Invoices (Km)	72	78	84	90	135	140
Rent and rates (Km)	26	28	30	25	35	40
Operating expenses (Km)	4	6	7	9	6	10

Required:

- (a) Prepare a cash flow forecast for the period January – March 2022. (16 marks)
- (b) Explain four (4) objectives of a cash budget to Ganga Water Authority Limited. (4 marks)

[Total: 20 Marks]

QUESTION THREE

A newly established private institution known as Jukiate Ltd engaged a consultant to develop its organizational structure and clearly define the responsibilities of its key management staff as part of its terms of reference. Jukiate Ltd consisted of five (5) Board members with varied skills. The company was involved in the importation of spare parts specifically for railway wagons and modern train engines for both local and regional demand after it carried out a research in this area and identified that there was potential demand for these items.

The Company wanted to ensure that it has a good start with a clearly and well defined management structure so that in the event that government ministries, including the Ministry of Transport and Entrepreneurs advertise for specific companies to bid for the supply of this equipment, Jukiate Ltd would bid and likely to win on account of its strong technical proposal.

Therefore, the Consultant recommended that the organizational structure should provide for the position of Financial Manager.

The Consultant had earlier on been given a task by one of the government ministries in which the terms of reference were to explain to management and government officials including directors on how the internal control systems (ICS) and system management operates and also the framework and functions of the Audit Committee.

Required:

- (a) Explain clearly the Role of a Financial Manager as it is applicable to both Government and Private institutions. (7 marks)
- (b) State the composition and functions of an Audit Committee. (8 marks)
- (c) Identify the characteristics of a good internal control system. (5 marks)

[Total: 20 Marks]

QUESTION FOUR

One of the Challenges that developing countries are facing after the Covid 19 pandemic is how to Finance their Budget deficit. Most countries have opted to revise the tax policies so that they increase their revenue. However, this has negatively impacted on the country's economies and the popularity of the party in power.

Required:

Explain to the policy makers;

- (a) Benefits of an effective tax policy to an economy. (8 marks)
- (b) Measures that a government can undertake to finance a budget deficit and disadvantages of each of the measures. (4 marks)
- (c) Purposes of a Public Budget. (8 marks)

[Total: 20 Marks]

QUESTION FIVE

The Government of the Republic of Zambia has in the past decades implemented the Public Sector Financial Management (PFM) Reforms whose objective is to improve Public Financial Management. However, following the lapse of the previous PFM reforms programme in 2015, the country has not formulated any public financial management reform strategies. This has raised concern with stakeholders as it casts doubt on the management of public resources and these have been brought to the attention of the new government.

Required:

- (a) Explain to the new administration the Public Financial Management Cycle and propose five (5) reform processes, which the new government may embark upon. (7 marks)
- (b) Explain to the new government seven (7) financial plans and budget processes it should implement whilst in office. (7 marks)
- (c) Explain the overall strategic direction of Zambia and the key principles it is anchored on. (6 marks)

[Total: 20 Marks]

END OF PAPER

Formulae

Modigliani and Miller Proposition 2 (with tax)

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

Two asset portfolio

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

The Capital Asset Pricing Model

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

The asset beta formula

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

The Growth Model

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

Gordon's growth approximation

$$g = br_e$$

The weighted average cost of capital

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

The Fisher formula

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

Purchasing power parity and interest rate parity

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

Modified Internal Rate of Return

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

The Black-Scholes option pricing model

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

Where:

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

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

The Put Call Parity relationship

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

Present Value Table

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

Where r = discount rate

n = number of periods until payment

		<i>Discount rate (r)</i>									
<i>Periods</i>		1%	2%	3%	4%	5%	6%	7%	8%	9%	10%
(n)											
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909	1
2	0.980	0.961	0.943	0.925	0.907	0.890	0.873	0.857	0.842	0.826	2
3	0.971	0.942	0.915	0.889	0.864	0.840	0.816	0.794	0.772	0.751	3
4	0.961	0.924	0.888	0.855	0.823	0.792	0.763	0.735	0.708	0.683	4
5	0.951	0.906	0.863	0.822	0.784	0.747	0.713	0.681	0.650	0.621	5
6	0.942	0.888	0.837	0.790	0.746	0.705	0.666	0.630	0.596	0.564	6
7	0.933	0.871	0.813	0.760	0.711	0.665	0.623	0.583	0.547	0.513	7
8	0.923	0.853	0.789	0.731	0.677	0.627	0.582	0.540	0.502	0.467	8
9	0.941	0.837	0.766	0.703	0.645	0.592	0.544	0.500	0.460	0.424	9
10	0.905	0.820	0.744	0.676	0.614	0.558	0.508	0.463	0.422	0.386	10
11	0.896	0.804	0.722	0.650	0.585	0.527	0.475	0.429	0.388	0.305	11
12	0.887	0.788	0.701	0.625	0.557	0.497	0.444	0.397	0.356	0.319	12
13	0.879	0.773	0.681	0.601	0.530	0.469	0.415	0.368	0.326	0.290	13
14	0.870	0.758	0.661	0.577	0.505	0.442	0.388	0.340	0.299	0.263	14
15	0.861	0.743	0.642	0.555	0.481	0.417	0.362	0.315	0.275	0.239	15
(n)	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	
1	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833	1
2	0.812	0.797	0.783	0.769	0.756	0.743	0.731	0.718	0.706	0.694	2
3	0.731	0.712	0.693	0.675	0.658	0.641	0.624	0.609	0.593	0.579	3
4	0.659	0.636	0.613	0.592	0.572	0.552	0.534	0.516	0.499	0.482	4
5	0.593	0.567	0.543	0.519	0.497	0.476	0.456	0.437	0.419	0.402	5
6	0.535	0.507	0.480	0.456	0.432	0.410	0.390	0.370	0.352	0.335	6
7	0.482	0.452	0.425	0.400	0.376	0.354	0.333	0.314	0.296	0.279	7
8	0.434	0.404	0.376	0.351	0.327	0.305	0.285	0.266	0.249	0.233	8
9	0.391	0.361	0.333	0.308	0.284	0.263	0.243	0.225	0.209	0.194	9
10	0.352	0.322	0.295	0.270	0.247	0.227	0.208	0.191	0.176	0.162	10
11	0.317	0.287	0.261	0.237	0.215	0.195	0.178	0.162	0.148	0.135	11
12	0.286	0.257	0.231	0.208	0.187	0.168	0.152	0.137	0.124	0.112	12
13	0.258	0.229	0.204	0.182	0.163	0.145	0.130	0.116	0.104	0.093	13
14	0.232	0.205	0.181	0.160	0.141	0.125	0.111	0.099	0.088	0.078	14
15	0.209	0.183	0.160	0.140	0.123	0.108	0.095	0.084	0.074	0.065	15

Annuity Table

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

Where r = discount rate
 n = number of periods

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

Standard normal distribution table

	0.00	0.01	0.02	0.03	0.04	0.05	0.06	0.07	0.08	0.09
0.0	0.0000	0.0040	0.0080	0.0120	0.0160	0.0199	0.0239	0.0279	0.0319	0.0359
0.1	0.0398	0.0438	0.0478	0.0517	0.0557	0.0596	0.0636	0.0675	0.0714	0.0753
0.2	0.0793	0.0832	0.0871	0.0910	0.0948	0.0987	0.1026	0.1064	0.1103	0.1141
0.3	0.1179	0.1217	0.1255	0.1293	0.1331	0.1368	0.1406	0.1443	0.1480	0.1517
0.4	0.1554	0.1591	0.1628	0.1664	0.1700	0.1736	0.1772	0.1808	0.1844	0.1879
0.5	0.1915	0.1950	0.1985	0.2019	0.2054	0.2088	0.2123	0.2157	0.2190	0.2224
0.6	0.2257	0.2291	0.2324	0.2357	0.2389	0.2422	0.2454	0.2486	0.2517	0.2549
0.7	0.2580	0.2611	0.2642	0.2673	0.2704	0.2734	0.2764	0.2794	0.2823	0.2852
0.8	0.2881	0.2910	0.2939	0.2967	0.2995	0.3023	0.3051	0.3078	0.3106	0.3133
0.9	0.3159	0.3186	0.3212	0.3238	0.3264	0.3289	0.3315	0.3340	0.3365	0.3389
1.0	0.3413	0.3438	0.3461	0.3485	0.3508	0.3531	0.3554	0.3577	0.3599	0.3621
1.1	0.3643	0.3665	0.3686	0.3708	0.3729	0.3749	0.3770	0.3790	0.3810	0.3830
1.2	0.3849	0.3869	0.3888	0.3907	0.3925	0.3944	0.3962	0.3980	0.3997	0.4015
1.3	0.4032	0.4049	0.4066	0.4082	0.4099	0.4115	0.4131	0.4147	0.4162	0.4177
1.4	0.4192	0.4207	0.4222	0.4236	0.4251	0.4265	0.4279	0.4292	0.4306	0.4319
1.5	0.4332	0.4345	0.4357	0.4370	0.4382	0.4394	0.4406	0.4418	0.4429	0.4441
1.6	0.4452	0.4463	0.4474	0.4484	0.4495	0.4505	0.4515	0.4525	0.4535	0.4545
1.7	0.4554	0.4564	0.4573	0.4582	0.4591	0.4599	0.4608	0.4616	0.4625	0.4633
1.8	0.4641	0.4649	0.4656	0.4664	0.4671	0.4678	0.4686	0.4693	0.4699	0.4706
1.9	0.4713	0.4719	0.4726	0.4732	0.4738	0.4744	0.4750	0.4756	0.4761	0.4767
2.0	0.4772	0.4778	0.4783	0.4788	0.4793	0.4798	0.4803	0.4808	0.4812	0.4817
2.1	0.4821	0.4826	0.4830	0.4834	0.4838	0.4842	0.4846	0.4850	0.4854	0.4857
2.2	0.4861	0.4864	0.4868	0.4871	0.4875	0.4878	0.4881	0.4884	0.4887	0.4890
2.3	0.4893	0.4896	0.4898	0.4901	0.4904	0.4906	0.4909	0.4911	0.4913	0.4916
2.4	0.4918	0.4920	0.4922	0.4925	0.4927	0.4929	0.4931	0.4932	0.4934	0.4936
2.5	0.4938	0.4940	0.4941	0.4943	0.4945	0.4946	0.4948	0.4949	0.4951	0.4952
2.6	0.4953	0.4955	0.4956	0.4957	0.4959	0.4960	0.4961	0.4962	0.4963	0.4964
2.7	0.4965	0.4966	0.4967	0.4968	0.4969	0.4970	0.4971	0.4972	0.4973	0.4974
2.8	0.4974	0.4975	0.4976	0.4977	0.4977	0.4978	0.4979	0.4979	0.4980	0.4981
2.9	0.4981	0.4982	0.4982	0.4983	0.4984	0.4984	0.4985	0.4985	0.4986	0.4986
3.0	0.4987	0.4987	0.4987	0.4988	0.4988	0.4989	0.4989	0.4989	0.4990	0.4990

This table can be used to calculate $N(d)$, the cumulative normal distribution functions needed for the Black-Scholes model of option pricing. If $d_i > 0$, add 0.5 to the relevant number above. If $d_i < 0$, subtract the relevant number above from 0.5.

PFM4 - PUBLIC SECTOR FINANCIAL MANAGEMENT SUGGESTED SOLUTION

SOLUTION ONE

(a)

(i) **Public Sector :**

- The section of a nation's economy, which is under the control of government, whether it is central, state or local, is known as the Public Sector.
- The objective is to serve the citizens of the country.
- Public Sector Institutions raise funds from Public Revenue like tax, duty, penalty
- The areas of operation are mainly Police, Army, Mining, Health, Manufacturing, Electricity, Education, Transport, Telecommunication, Agriculture, Banking and Insurance.

Private Sector:

- The section of a nation's economy, which owned and controlled by private individuals or companies is known as Private Sector.
- The main objective is to Earn Profit
- Funds are raised by Issuing shares and debentures or by taking loan
- The main area of operation are Finance, Information Technology, Mining, Transport, Education, Telecommunication, Manufacturing, Banking, Construction, Pharmaceuticals etc.

(ii) Effects of privatization of the commercial operations of Public Sector

Institutions on various stakeholders

- Government may loss potential additional revenue
- The private entity may choose not to invest in long term projects as a way of pleasing the shareholders.
- Public Interest – the education sector provides services that are of public interest. Depriving it of addition income may lead the public not being provided the best services.

(b)

	Year 0	Year 1	Year 2	Year 3	Year 4
Revenue		2,560,000	2,560,000	2,560,000	2,560,000
Direct Costs		(700,000)	(700,000)	(700,000)	(700,000)
Overhead Costs		(250,000)	(250,000)	(250,000)	(250,000)
Depreciation		(450,000)	(450,000)	(450,000)	(450,000)
Working Capital	(800,000)				
Interest on Borrowing		(100,000)	(100,000)	(100,000)	(100,000)
R & D write off		(200,000)	(200,000)	(200,000)	
Total Cost	(800,000)	(1,700,000)	(1,700,000)	(1,700,000)	(1,500,000)
Profit/(Loss)		860,000	860,000	860,000	1,060,000
Tax 30%		(258,000)	(258,000)	(258,000)	(318,000)
Net Profit/(Loss)	(800,000)	602,000	602,000	602,000	742,000
Add: depreciation		450000	450000	450000	450000
Interest on borrowing		100000	100000	100000	100000
R & D write off		200000	200000	200000	

incremental cash flows		1352000	1352000	1352000	1292000
DF 10%	1.00	0.909	0.826	0.751	0.683
NPV	(800,000)	1,228,968	1,116,752	1,015,352	882,436

NPV = 3,443,508.00

The Net Present Value is Positive. Management should proceed with establishment of the SPV

- Time value of money tells, what would be the worth of value of your present money in future. In other words, it tells about the worth of today's money in future. Money potential increases with time.
- If you invest your today's money, for which you will get interest, it will automatically increase the value of money. Factors like inflation and purchasing power are to be considered, while investing the money because both can erode the value.
- Time value of money helps investors to take decisions about where to invest, when to invest. It also helps us to understand about interest, inflation, risk and return.
- **Components of time value of money are as follows –**
- Number of discounting/compounding periods - With monthly compounding, for example, the stated annual interest rate is divided by 12 to find the periodic (monthly) rate, and the number of years is multiplied by 12 to determine the number of (monthly) periods.
- Rate of interest - The interest rate is the amount a lender charges a borrower and is a percentage of the principal—the amount loaned. The interest rate on a loan is typically noted on an annual basis known as the annual percentage rate (APR).
- Present value - the current value of a future sum of money or stream of cash flows given a specified rate of return
- Future value - Future value is a value of an investment or asset on a specific date in the future. To put it another way, the future value is the amount of money a given investment will be worth after a certain period, assuming a specific rate of return (interest rate).
- Periodic payments - periodic payment plan refers to an investment plan where an individual makes small payments over time in order to invest in mutual fund shares. These plans involve making contributions of a small, fixed sum over a period of time.

SOLUTION TWO

(a)

GANGA WATER AUTHORITY Cash Budget For The Three Months ending 31st March 2022

	JAN	FEB	MARCH
RECEIPTS	Km	Km	Km
Sales	87.5	95.5	109
Gov Grant		78	
Total	87.5	173.5	109
PAYMENTS			
Purchases	76	82	88
Salaries & Wages	40	35	70
Rent and Rates	25	35	40
Operating exp	7	9	6
Machine	-	-	2.4
Total	148	161	206.4
Net Cash flows	-60.5	12.5	-97.4
Cash Balance b/f	65	4.5	17
Cash Balance b/f	4.5	17	-80.4

Total

Working 1 Sales

	NOV	DEC	JAN	FEB	MAR	APRIL
	92	90	84	104	124	130
Prepaid 30%	27.6	27	25.2	31.2	37.2	39
mthend 20%	18.4	18	16.8	20.8	24.8	26
mth foll 25%		23	22.5	21	26	31
Rest 25%			23	22.5	21	26
To cash budget			87.5	95.5	109	

Purchases

	NOV	DEC	JAN	FEB	MAR	APRIL
	72	78	84	90	135	140
Two thirds		48	52	56	60	90
One third			24	26	28	30
To cash budget			76	82	88	

(b)

1. Used to estimate or plan future cash shortages or surpluses and allow time to make plans for dealing with them.
2. It can be used as a reference point for monitoring actual cash flows. Actual cash flows can be compared with budgeted cash flows. This comparison can help identify weaknesses in cash management, such as inadequate procedures for collecting money from receivables.
3. To set borrowing limits and maximize cost of funds. The knowledge that funds are required in advance gives the cash manager time to ensure adequate funds and borrowing limits are available.
4. To maximize interest earnings. This is a similar exercise to minimizing the cost of funds; knowing that a surplus will occur in advance enables the cash manager to look for the most effective ways to invest funds.
5. For Liquidity management. Forecasts provide an early warning of liquidity problems by estimating; the amount of cash required; the period when it is required; the length of time it will be required for; and whether it will be required from anticipated sources.

SOLUTION THREE

- (a) The role of a finance manager is very critical in both government and private institutions. The Finance Manager must be on top of things as any lapses will either elevate the institution or not. The finance manager must be a strategist, an agent of positive change and excise stewardship functions. Details of the main functions include; raising and allocation of the funds, ensuring that the institutions makes profit, he must be strategic by ensuring that he understands the capital markets. In order to meet the institutions obligations, the finance manager should have the skills to ensure that liquidity is properly managed by raising capital through equity or debt.

The funds so raised should be used at optimally; specific aspects need to be considered like the size of the company, status of the assets and the mode by which these funds are raised.

- (b) The composition of an audit committee consists of five members as determined by Finance Act of 2004;
1. two serving or retired public officers with extensive knowledge and experience in the civil service outside that institution;
 2. one representative from Zambia Institute of Chartered Accountants;
 3. one representative from the Law Association of Zambia;
 4. one representative from any other relevant professional body;

The Audit committee functions of the Audit Committee include the following:

1. receive reports from internal auditors;
 2. evaluate and review audit policy;
 3. evaluate the management procedures regarding;
 - i. internal controls
 - ii. financial reporting
 - iii. risk management
 4. and make recommendations to the Accounting Authority
- (c) A good internal control system must be based on a good framework and this includes;
1. Control environment- An effective control environment designed by management which will accommodate effective communication and good attitude. Management must focus of positivity in order to enhance integrity and a commitment to investigate exceptions. Management should also motivate its staff both intrinsic and external by paying what is due.
 2. Risk Assessment- It involves identifying potential risk areas where loss can occur.
 3. Monitoring and Reviewing- Management must periodically review areas of risk by carrying out an assessment
 4. Information and communication-A good internal control mechanism involves an effective communication system and clear communication procedures.
 5. Control activities- these activities include those that are preventive and those that are detective.

SOLUTION FOUR

(a) Benefits of an effective tax policy to an economy.

An effective tax system should have the following characteristics: Fairness, adequacy, simplicity, transparency and administrative ease.

- Fairness, or equity, means that everybody should pay a fair share of taxes. There are two important concepts of equity: horizontal equity and vertical equity.
 - Horizontal equity means that taxpayers in similar financial condition should pay similar amounts in taxes.
 - Vertical equity is just as important, however. Vertical equity means that taxpayers who are better off should pay at least the same proportion of income in taxes as those who are less well off. While no system of taxes is perfect, it is important to seek horizontal equity because taxpayers must believe they are treated equally. It is just as important to seek vertical equity so government does not become a burden to low-income residents.
- Adequacy means that taxes must provide enough revenue to meet the basic needs of society. A tax system meets the test of adequacy if it provides enough revenue to meet the demand for public services, if revenue growth each year is enough to fund the growth in cost of services, and if there is enough economic activity of the type being taxed so rates can be kept relatively low.
- Simplicity means that taxpayers can avoid a maze of taxes, forms and filing requirements. A simpler tax system helps taxpayers better understand the system and reduces the costs of compliance.
- Transparency means that taxpayers and leaders can easily find information about the tax system and how tax money is used. With a transparent tax system, we know who is being taxed, how much they are paying, and what is being done with the money. We also can find out who (in broad terms) pays the tax and who benefits from tax exemptions, deductions, and credits.
- Administrative ease means that the tax system is not too complicated or costly for either taxpayers or tax collectors. Rules are well known and fairly simple; forms are not too complicated; the state can tell if taxes are paid on time and correctly, and the state can conduct audits in a fair and efficient manner. The cost of collecting a tax should be very small in relation to the amount collected.

(b) There are three sources of deficit financing in our country namely foreign loan, domestic borrowing and cash balance.

Disadvantages:

- It leads to increase in inflationary rise of prices of goods and services in the country. Inflationary forces created by deficit financing are reinforced by increased credit conditions by banks

(c) Purposes of a Public Budget

- As a democratic tool, it shows the public how the Government intends to utilize public resources against which Government will be held responsible.
- As a political tool, a budget is an expression of the Government's ideological commitment, political philosophy and policy platform on how a country should move forward.

- As an economic tool, government budgets serve to shape the economic priorities of a country or entity. A budget is normally the most important document on policy for the year. In a modern economy the influence of government on the economy as a whole is immense as it is often the biggest employer, the biggest spender and the biggest single claimant on the country's resources. A government can influence the economy in numerous ways, but its own revenues, borrowing and spending are the major macroeconomic factors.
- A budget can influence the direction of investment, for example by lowering taxes for certain sectors of the economy, promote employment, and influence the redistribution of income between various parts of the society.
- As a legal tool, the budget has to be in line with constitutional requirements, relevant legislation and the spirit of participatory democracy. The point to keep in mind is that governments can only spend money after they have been authorized to do so by parliaments.
- As a management tool, the budget directs the administration in its daily operations and spending.

SOLUTION FIVE

- (a) Explain to the new administration the Public Financial Management Cycle and propose reform processes, which the new government may embark upon.

The PFM cycle comprise the Following:

- Formulation – Budgets are formulated based on a clear overall strategy and to support the implementation of policies to achieve public service goals. Annual budgets are aligned with medium term plans, and there is effective participation by stakeholders in the process.
- Approval – the budget is subject to approval by the legislature , which is able to effectively scrutinize government plans
- Execution – there is predictability and control in budget execution. Standard procedures and processes are followed , and there is ongoing monitoring in place to enable the effective application of controls
- Evaluation – Annual Financial reports are produced, and there are subject to independent external audit and scrutiny. They are used to assist in the formulation of future budgets.

Reforms which the Government may Implement:

- Enhance revenue mobilization in order sustain economic development
- Enhance policy based planning and budgeting
- Strengthen Public Investment Management
- Strengthen accountability and compliance in budget execution
- Strengthen Accountability and Transparency in PFM systems at Local Government

- (b) Explain to the new government what financial plans and budget processes it should implement whilst in office.

- Robust macro - economic and fiscal forecast and capacity to estimate the fiscal impact of changes in economic circumstances
- The capacity to develop and implement a clear fiscal strategy, and the ability to develop and assess the fiscal impact of revenue and expenditure policy proposals that support the achievement of the government fiscal goals.
- A medium – term perspective in expenditure budgeting, with annual budgets derived from medium term estimates and an alignment between medium term budget estimates and strategic plans.
- Effective , orderly and timely participation by relevant stakeholders in the budget preparation process
- Realistic government budgets
- Transparency in budget information and Legislative scrutiny of budget.

- (c) Explain to overall strategic direction of Zambia and the key principles it is anchored on. The overall strategic Direction of Zambia is vision 2030 which is anchored on the following principles:

- Sustainable Development

- Upholding Democratic principles
- Respect of Human Rights
- Fostering Family Values
- Positive attitudes to work
- Peaceful co-existence
- Upholding traditional values

END OF SUGGESTED SOLUTIONS



PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

PFM 5 : PUBLIC SECTOR AUDITS

THURSDAY 13 JUNE 2024

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

INSTRUCTIONS TO CANDIDATES

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

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

SECTION A

This question is compulsory and must be attempted.

QUESTION ONE – (COMPULSORY)

The Busaka City Council is the largest civic authority in the country employing over five thousand (5 000) employees. The main source of revenue for the City Council are the various levies collected including market levies, property rates and revenue from business ventures such as the running of paid for toilet facilities at the major bus stations and the management of car parking in the Central Business District.

The internally generated income of the City Council is not enough to meet the monthly budget of the Council. The Ministry of Finance supports the Busaka City Council by giving it a monthly equalization fund for specific use. The Busaka City Council sometimes uses equalization funds for purposes that the money is not supposed to be used.

Most of the transactions from the main lines of revenue are on cash basis. The council has Accountants at all the locations where cash is collected. Each Accountant is in custody of Council official receipts which are supposed to be raised for all receipts of cash. The Accountants are required to summarize the value of the receipts raised per day. The summary is supported by duplicate copies of the receipts and are supposed to agree with the cash on hand. A Cashier from the Council goes around and collects the money from the various points. The Cashier is accompanied by an unarmed Council Policeman and a driver of a Council labelled motor vehicle. The Cashier goes around with new receipt books which he gives the Accountants whose receipt books have been exhausted. The Accountants are not required to sign for the receipt books nor are they required to submit the completed receipt books.

An attendant at a busy public toilet fell ill and was off duty for a long time. A relief attendant was employed and since the employment of the relief attendant the Accountant noted a significant increase in the daily income from the use of the public toilet. This prompted the Council management to start to rotate staff who handle money.

The information regarding the increase in revenue arising from rotation of staff necessitated an investigation to determine the extent of the loss of revenue. A full Council meeting recommended that a forensic investigation be conducted by the Office of the Auditor General (OAG) to establish the extent of loss of revenue and make necessary recommendations to stop the loss of funds. The full Council meeting members were surprised that despite previous audits by the Office of the Auditor General (OAG) no fraud was detected. It was discovered that every year when the City Council is undergoing audits by the Office of the Auditor General, cash is withdrawn and paid to all audit team members and this money is not signed for. This was revealed by the cashier who makes the payments.

Required:

- (a) Explain the difference between misapplication of funds and misappropriation of funds using the information in the scenario. (4 marks)

- (b) (i) Identify and explain four (4) business risks in the operations of the Busaka City Council. (4 marks)
- (ii) Suggest suitable responses by the Council management to the identified business risks in (i) above. (4 marks)
- (c) (i) Explain the meaning of forensic investigations and state the objective of forensic investigations. (4 marks)
- (ii) Explain three (3) differences between the financial audits and forensic investigations. (6 marks)
- (d) Explain the types of fraud that exist in the operations of the Busaka City Council using the information in the scenario. (6 marks)
- (e) (i) Suggest four (4) matters that will form the criteria of the compliance audit of the Busaka City Council. (4 marks)
- (ii) Suggest four (4) audit procedures that should be performed in the compliance audit of Busaka City Council. (8 marks)

[Total: 40 Marks]

SECTION B

There are FOUR (4) questions in this section.

Attempt any THREE (3) questions.

QUESTION TWO

- (a) You are an Accountant responsible for payments in the Ministry of National Guidance. You are responsible for payments to suppliers as well as payment of business travel allowances to staff on business trips.

All business advances for travel are made as advances and are held on a suspense account until retirement of the advances by the staff concerned. A team of four (4) members of staff were planning for a business trip. They were supposed to undertake a business trip of ten (10) days. Each one of them made a request for twelve (12) days each. When you queried the team leader on why they were requesting for eight (8) days more than they required number of days, he informed you that the extra days will cover the days for the Controlling Officer who requested that allowances should be claimed on his behalf. Each of the four (4) members of staff will require to give the allowances for the extra two (2) days each to the Controlling Officer.

When you declined to make the payment for the extra eight (8) days you were threatened with transfer. The previous accountant before you came to this ministry facilitated such payments and it was common for staff to claim allowances for trips not undertaken.

Required:

- (i) Explain the ethical issue in the above case. (2 marks)
 - (ii) Explain the risk of abuse of authority in the public sector. (2 marks)
 - (iii) Discuss the action that you will take in view of the instruction that you should process the payment for travel allowances for the controlling officer. (4 marks)
- (b) Local Authorities across receive monthly grants to enable them pay salaries and wages to staff. This is because except for the City Councils, most of the Local Authorities do not generate sufficient revenue to enable them meet the wages bill.

Six (6) months ago the Government allowed Councils to retire on voluntary basis employees who had served for more than ten (10) years. This resulted in a total number of 5,000 employees retiring by the end of December 2022. The Central Government met the cost of the retirement.

A review of the wage bill for the first three (3) months of 2023 did not show a reduction in the total wage bill despite a significant reduction in the workforce. This raised serious concerns on the Central Government resulting in the Government requesting the Local Government Commission to investigate this. Preliminary investigations by the Local Government Commission revealed that despite a freeze on employment, the number of employees by the Local Authorities was much higher than the total number of employees on the establishment considering the retirements. The only possible reason for this state of affairs is that there is a high number of 'ghost workers' on the payroll which requires further investigation.

The Local Government Commission has written to the Auditor General (AG) requiring that a forensic investigation be conducted on all the Local Authorities with the objective of identifying and getting rid of ghost workers. Further, the audit should reveal the beneficiaries of the money paid to 'ghost workers' with a view to prosecuting all those involved in putting ghost workers on the payroll.

Required:

- (i) Explain the meaning of 'ghost workers' in the public sector and suggest two (2) ways in which they could arise. (4 marks)
- (ii) Explain four (4) audit procedures that you will perform to determine the extent of ghost workers in Local Authorities. (8 marks)

[Total: 20 Marks]

QUESTION THREE

- (a) The last five (5) years has seen a significant increase in Government and State Institutions computerizing their activities. Before computerization, audit procedures by the Office of the Auditor General (OAG) were manually performed. This is from the selection of sample items for testing and the performance of tests of controls and substantive audit procedures.

The Auditor General (AG) has arranged a workshop of recently newly recruited auditors whose objective is to instill skills in the auditors of auditing in a computerized environment. You run a Consultancy firm and the Office of the Auditor General (OAG) hired you to run the workshop. The terms of reference require that your firm to explain to the participants the meaning and use of Computer Assisted Audit Techniques (CAATs) and to describe the main types of Computer Assisted Audit Techniques (CAATs) available to the auditors.

Required:

- (i) Explain the meaning and use of Computer Assisted Audit Techniques (CAATs) in public sector auditing. (1 mark)
 - (ii) Explain two (2) benefits to the public sector auditor of using Computer Assisted Audit Techniques(CAATs) (1 mark)
 - (iii) Distinguish, giving examples, between audit software and test data in the use of Computer Assisted Audit Techniques (CAATs). (4 marks)
- (b) Zambia is a landlocked country with a lot of heavy-duty vehicles coming into the country and transiting to neighboring countries.

Over the last ten (10) years there has been a noted increase in damage to the main roads arising from trucks carrying cargo exceeding the legally allowed weight. The problem has been that at the border entry points there are no weighbridges to detect overloaded trucks and the functional weighbridges are located many kilometers from entry points. The law specifies the weight that is allowable and specifies the penalties for exceeding the limits. The number of trucks charged penalties for overloading has remained the same

The European Union has given the Zambian Government a low interest loan for the construction of electronic weighbridges at all the border entry points into Zambia. The contract includes the acquisition of closed-circuit television (CCTV) in order to capture traffic inflows and overloaded trucks.

Required:

- (i) Explain the objective of the intended performance audit of the weighbridge project. (2 marks)
- (ii) Explain the matters that you will consider in designing the work that should be performed in the performance audit of the weighbridge project. (6 marks)
- (iii) Suggest two (2) audit procedures for each of the three (3) elements of the performance audit of the weighbridge project. (6 marks)

[Total: 20 Marks]

QUESTION FOUR

The Government of Zambia collects money from its citizens and corporations through the Zambia Revenue Authority (ZRA). The money collected is meant for public use and the best interest of the citizens.

Parliament annually debates and approves the budget for the following year. This is done in response to the requirements for funds done by Government Ministries and Agencies. The Office of the Auditor General (OAG) like other government entities submits its financial requirements for consideration by Parliament.

The risk of public funds being misappropriated is high because of the large amounts of money being handled. This risk necessitates the requirement for independent audits of financial records which is the role of the Office of the Auditor General (OAG).

In order to fulfill its mandate, the Office of the Auditor General (AOG) is required to comply with the provisions of ISSAI 100: Fundamental Principles of Public Sector Auditing. This standard explains the basic elements of Public Sector audits and the general principles both of which apply to all the different types of public sector auditing regardless of the nature.

Required:

- (a)
 - (i) Explain the principles of transparency and accountability in relation to the operations of the Office of the Auditor General (OAG). (4 marks)
 - (ii) Explain the requirements of the three (3) general principles of Audit team and management skills, Audit risk and Documentation according the relevant International Standard on Auditing. (6 marks)
- (b) The quality of audits performed in the public sector is essential in order to enable the Supreme Audit Institution (SAI) conduct an audit that can be relied upon to arrive at an appropriate conclusion.

The Office of the Auditor General (OAG) in Zambia is headed by the Auditor General (OAG) at the Corporate Head Office. The Head Office is responsible for recruitment of staff with the required skills. The Auditor General takes full responsibility for the audits conducted and he delegates some of this responsibility to the Divisional Directors under him.

Audit teams with necessary qualifications and skills are assigned to perform individual audits in order to ensure that all audits conducted meet the requirements of ISSAI 40 *Quality controls for SAIs*. The Office of the Auditor General (OAG) in Zambia has a code of conduct for its staff. At the beginning of each year, the staff of the Office of the Auditor General (OAG) are required to sign a declaration that they complied with the code of conduct in the prior year.

Required:

- (i) Explain the responsibilities for quality control in the Office of the Auditor General (OAG) and at the individual audit level. (2 marks)
- (ii) Explain four (4) elements of quality for the Office of the Auditor General (OAG) in meeting the requirements of ISSAI 40: *Quality control for SAIs*. (8 marks)

[Total: 20 Marks]

QUESTION FIVE

You work for the Office of the Auditor General as a Senior Audit Assistant. You have been assigned to the audit of the financial statements of Bomba Ltd a company under the Industrial Development Agency for the year ended 31 March 2023.

Bomba Ltd prepares financial statements in accordance with the International Financial Reporting Standards (IFRSs). This is the first time that Bomba Ltd will be audited by the Office of the Auditor General (OAG). In the last two (2) years the company has been audited by private audit firms.

You have completed the risk assessment of Bomba Ltd and you wish to design suitable substantive audit procedures regarding the opening balances. In order to do this, you require to consider the financial statement assertions for the opening balances.

Being the first time that Bomba Ltd will be audited by the Office of the Auditor General (OAG), the Principal Auditor has stressed the need to obtain sufficient audit evidence which will form the basis of the audit opinion. In accordance with ISSAI 1315: *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment* you made a lot of inquiries from management and others within the company. You will be expected in obtaining evidence on the receivables balances to confirm the balances directly for a sample of receivables. The risk assessment review revealed that a significant number of original documents to support transactions are missing and the only evidence available are photocopies attached to the supporting documents.

Required:

- (a) (i) Explain the meaning of financial statement assertions, giving a suitable example. (4 marks)
- (ii) Explain how financial statements assertions help the auditors to design suitable audit procedures. (2 marks)
- (b) (i) Explain the meaning of sufficient appropriate audit evidence in an audit of Financial statements. (2 marks)
- (ii) Explain the reliability of the sources of evidence obtained in the audit of Bomba Ltd above. (4 marks)
- (c) (i) Explain the audit risk with regards opening balances in the audit of the financial statements of Bomba Ltd. (2 marks)
- (ii) Suggest three (3) audit procedures for the opening balances in the financial statements of Bomba Ltd. (6 marks)

[Total: 20 Marks]

END OF PAPER

PFM 5: PUBLIC SECTOR AUDITS SUGGESTED SOLUTIONS

SOLUTION ONE

(a) **Difference between misapplication of funds and misappropriation of funds:**

Misapplication of funds happens when funds available are used for a purpose other than what they were intended for. There may be no personal gain by the person who misapplies the funds. For example, in the case of Busaka City Council, the use of restricted funds meant for other purposes to pay wages and salaries of employees.

Misappropriation of funds on the other hand is the use of public funds for personal gain. For example, the under declaration of funds collected from the use of the public toilet amounts to a misappropriation of funds.

(b) (i)/(ii) Business risks in the operations of Busaka City Council:

Business risk	Response by management of BCC
1. The handling of large sums of cash: The handling of large sums of cash poses a business risk of money being stolen. This could be by members of the public or by the employees who are charged with receiving cash.	Cash should be collected more regularly on a daily basis to avoid cash accumulating to high amount creating a risk of robbery.
2. Low salaries paid to staff that handle large amounts of cash could result in a justification for misappropriation of funds by staff responsible.	The council should endeavor to remunerate staff who hand cash adequately to reduce the risk of them misappropriating council money.
3. The use of restricted funds meant for other activities to pay wages could result in the central government withholding the monthly equalization fund on account of misapplication of funds.	The council should not use funds for a different purpose without obtaining the necessary authorization.
4. The security used when the Head Office cashier goes around collecting cash is inadequate and could result in cash being stolen that would result in the council losing money.	Security should be enhanced possibly with the use of an armed security to accompany the team that goes around. Alternatively, the services of a security company could be hired to collect money on behalf of the council.

(c)

(i) **Meaning of forensic investigations:**

This is the use of auditing and accounting knowledge to investigate a crime or suspected crime with a view to establish its occurrence. It covers a broad spectrum of activities, with terminology not strictly defined in regulatory guidance. It refers to the specific procedures carried out in order to produce evidence. Audit techniques are used to identify and to gather evidence to prove, for example, how long the fraud has been carried out, and how it was conducted and concealed by the perpetrators. Evidence may

also be gathered to support other issues which would be relevant in the event of a court case.

The objective of a forensic audit is to gather evidence that is admissible before the courts of law. It also provides assurance to interested parties or organisations as to whether fraud occurred or not. In the case of an alleged fraud, the objective would be to discover if a fraud had actually taken place, to identify those involved, to quantify the monetary amount of the fraud (i.e. the financial loss suffered by the client), and to ultimately present findings to the client and potentially to court.

Forensic audit entails a process of resolving allegations from inception to disposition. Fraud examinations are done with the assumption that they will end up in litigation.

(ii) **Differences between financial audits and forensic investigations:**

	Financial audit	Forensic investigation
1. Objective	The objective of an audit is for the auditor to form an opinion on the financial statements.	The objective of a forensic investigation is to establish whether a crime has been committed.
2. Frequency	In most cases financial audits are routine and can be planned.	Forensic investigations are ad hock and can happen any time.
3. Skills required	To perform financial audits, the main requirements are financial and auditing skills.	In carrying out a forensic investigation, additional investigative skills such as interviewing people are required in addition to accounting and auditing skills.

(d) **Types of fraud in Busaka City Council:**

1. **Misappropriation of assets** – The fact that when the attendant at a public toilet went on leave and daily receipts increased suggests that there was misappropriation of council assets. In this case the attendant was stealing cash meant for the council for personal benefit.
2. **Fraudulent financial reporting** – This involves the alteration of financial records. The alteration of information on the receipts supporting cash handed in amounts to fraudulent financial reporting.
3. **Corruption fraud** – The giving of staff who work for the Office of the Auditor General (OAG) cash each time they go for an audit is an act of corruption by Busaka City Council. The payment is meant to get the auditors lose objectivity and possibly conceal any wrong doings that may be taking place in the council.

(e)

(i) **Criteria for compliance in use of equalization fund:**

The criteria for the planned compliance audit of the use of the equalization fund will be extracted from the regulations on the use of the fund issued by the Ministry of Finance.

The matters that will form the criteria against which the council compliance will be measured include the following:

1. The restricted use of the equalization fund by the Ministry of Finance.
2. Authorization of any misapplication of funds by the council prior to spending.
3. Submission of monthly returns by the council to the Ministry of Finance detailing how the previous month's equalization fund was spent.

(ii) **Audit procedures in compliance audit of equalization fund use:**

1. Obtain details of equalization funds to the Busaka City Council for a sample of months and confirm amounts and conditions by inspecting supporting remittance documentation from the Ministry of Finance.
2. Confirm accuracy of the equalization fund by confirming receipt in the Council bank account.
3. Review sample of payments made out of the equalization fund to ensure that they are used in accordance with the purpose intended by inspecting supporting documents.
4. Confirm submission of monthly returns to the Ministry of Finance by inspecting copies of such returns made.
5. Review the expenditure of the equalization fund and identify any expenditure outside intended purpose. Where this is the case inquire and obtain the written authority of the Ministry of Finance Permanent Secretary.

SOLUTION TWO

(a)

- (i) Ethical issue- Accountants are required to exhibit integrity in the performance of their work and also should adhere to the ethical principle of objectivity. The previous Accountant lacked integrity in that he made payments which he knew clearly were wrong resulting in misappropriation of public funds.

Accountants should not be pressured to do wrong things and so the threat of a transfer is meant to force the Accountant to allow the irregular payment.

- (ii) **Abuse of authority:**

Staff and in particular Accountants could be under pressure from supervisors and politicians not to follow laid down procedures. This is abuse of authority and results in misapplication and misappropriation of public funds.

- (iii) **Action in response to threats of transfer:**

When the Accountant is pressured to do a wrong thing such as processing a wrong payment such as in the scenario, the following should be done:

- The request for the extra days should not be processed for payment unless the Permanent Secretary will travel in which case the request should be in the name of the Permanent Secretary who should sign for the money and retire on return from the trip.
- The Accountant should not succumb to the pressure and should stick to the laid down regulations. This may require that this matter is brought to the attention of the Permanent Secretary and inform him that the request for payment will not be processed.
- The Accountants should observe the ethical values for Accountants notwithstanding pressure to do a wrong thing.
- If the pressure continues in the future it may be appropriate to seek advice of the Zambia Institute of Chartered Accountants on the action that should be taken.

(b)

- (i) **Meaning of ghost workers:**

These are workers that do not exist but are on the payroll. The salaries for the ghost workers benefit the people who are responsible for including non-existing workers on the payroll.

Examples of how ghost workers arise:

- Simply including in vacant positions workers who physically do not work for the organization on the payroll. This is a fraud whereby the money meant for these is paid in the personal accounts of the perpetrators.
- Ghost workers can arise due to lack of updating the payroll for deceased members of staff or staff who resign or are dismissed. Such categories of people may continue receiving salaries despite the fact that they are no longer in employment.

(ii) **Audit procedures to identify ghost workers:**

1. For the Councils under audit, obtain the approved establishment to determine the workforce that should exist.
2. For a sample of employees examine the personnel records and confirm that staff were engaged in accordance with the laid down procedures.
3. For a sample of employees extracted from the payroll records, enquire to meet the employees and confirm they are the ones whose information has been extracted.
4. For a sample of employees randomly picked from various departments, review personal records and confirm that they are correctly included on payroll.
5. Review the system in place for amending standing data on payroll and ensure that this is done by authorized staff.
6. Enquire of management about the system in place for identifying ghost workers and make recommendations on how this could be done in case of system weaknesses.

SOLUTION THREE

(a)

(i) **Meaning of Computer Assisted Audit Techniques (CAATs)**

This is the use by the public sector auditors of computers in conducting audits in a computerized environment.

The auditor will use computers to perform procedures that would have been performed manually.

(ii) **Benefits of using Computer Assisted Audit Techniques (CAATs) to the auditor:**

- Larger sample sizes can be extracted and tested by the public sector auditors. This will result in reduction in sampling risk.
- Controls in a computer environment can be subjected to audit tests rather than just testing the output from the computer system.

(iii) **Audit software** – This is software that could be tailor made or bought off the shelf.

The software is used to perform procedures the auditor would have performed manually.

For example, audit software could be used for:

- Extracting of samples for testing in a computer environment.
- Performing calculations on the accuracy of figures rather than doing so manually.

Test data – Is used to test a system to confirm whether it is operating as intended.

This involves the public sector auditor coming up with data and predetermined results and processing the data using the client computer system and then comparing the results.

For example, test data could be used:

To test the payroll system to confirm payroll figures are correctly calculated. This could be achieved by the public sector auditors coming up with details of dummy employees and manually computing the pay according to policy then request that the information be keyed in the client system and processed. A comparison of the result of the processing is made with the pre-determined result by the auditor. Differences may then be investigated.

(b)

(i) **Objective of performance audit:**

The objective of a performance audit is to obtain sufficient appropriate audit evidence that activities have been performed in line with the value for money principles of Economy, Efficiency and Effectiveness.

(ii) **Matters to consider in the performance audit:**

The following matters will be considered in carrying out a performance audit of the construction of the weighbridges.

Economy – This aspect will consider whether the construction and other expenditure incurred in the building of the weighbridges was the correct expenditure. The question

that requires to be asked and answered is whether the best prices were paid for materials acquired and the cost of building the weighbridges.

Efficiency – This aspect considers whether the weighbridges built could have been constructed using lesser resources. In other words, could it have been possible to build more weighbridges using lesser resources. This is a measure of the input of resources and the output.

Effectiveness – This is a measure of whether the intended objective of building the weighbridges has been achieved.

(iii) **Audit procedures for value for money audit:**

Economy:

- Inquire into the system used in selecting the contractors to do the work. Was it by way of competitive tender and was the best price considered without compromising on quality.
- Compare the cost of the CCTVs and compare with current prices to confirm whether the best price was spent.
- Confirm whether all procurement was done in such a way that the lowest cost was incurred by obtaining several quotations for all procurement and where necessary by use of tender method.

Efficiency:

- Seek the services of auditor experts to establish whether the weighbridges could have been constructed using lesser resources.
- Determine the number of weighbridges similar to the ones build in the region and establish whether more bridges could have been built using the same resources.

Effectiveness:

- Evaluate the rate of overweight trucks entering the country compared to the time before the building of the border entry weighbridges.
- Analyse the income arising from penalties for overloading compared to the period prior to the building of the weighbridges.
- Over a number of years obtain expert evaluation and advise on the condition of the main roads compared to prior the building of electronic weighbridges.

SOLUTION FOUR

(a)

- (i) Principle of transparency and accountability in the Office of the Auditor General (OAG):

The Office of the Auditor General (OAG) is a recipient of public funds like all other Government Ministries and Institutions. It is subject to the same principles of spending public funds.

Transparency – refers to the fact that the Office of the Auditor General (OAG) should be open in terms of how it spends money appropriated to it for its operations. It should maintain accountability reports which should be subject to independent audits just like other recipients of public funds.

Accountability – The Office of the Auditor General should be held accountable on how it uses funds appropriated to it. The financial records should be subject to audit and may be called to explain the use of the funds by Those charged with governance.

- (ii) **Requirements of general principles of public sector auditing:**

General principles of public sector auditing apply across all public sector audits regardless of the nature of the audit. The Supreme Audit Institution (SAI) is required to adhere to these general principles.

The following should be considered in relation to the following principles:

Audit team and management skills:

This principle relates to the appointment of audit team members to carry out audits. The Supreme Audit Institution (SAI) should select staff with the necessary skills and competences to perform audits. If the Supreme Audit Institution (SAI) does not have the required skills, it may engage experts to do the work.

Audit risk:

This principle requires that whenever an audit is about to be performed by the Supreme Audit Institution, consideration of audit risk must be considered before designing the nature and extent of further audit procedures.

It is necessary to assess the risk of issuing an inappropriate opinion/conclusion and this will enable the public sector auditor to respond appropriately to the risks identified at the planning stage of the audit.

Documentation:

This principle requires that all work performed by the Supreme Audit Institution (SAI) should be documented in sufficient detail as a basis for opinion/conclusion.

The audit documentation should be such that a person who was not part of the audit should be able to follow and reach the same conclusion as if they were involved in the audit.

(b)

- (i) **Responsibility for quality control:**

The responsibility for quality control in the **Office of the Auditor General (OAG)** falls on the Auditor General (AG). He is required to put systems that will give assurance that quality audits are conducted that form the basis for the audit opinion.

At the individual audit level, the Engagement Partner is responsible for quality control and ensuring that audits meeting the requirements of ISSAI 1220: *Quality Control for an Audit of Financial Statements*. In the public sector, the Engagement partner may be the Director or Principal Auditor who has overall responsibility for the audit and one (10 who will sign the audit report.

(ii) **Elements of quality control in the OAG ISSAI 40 requirements:**

Leadership responsibilities for quality – There should be procedures in place that promote a culture that recognizes the need for quality audits. There should be someone appointed responsible for quality and one who understands the provisions of the standards on quality and commanding sufficient authority.

Relevant ethical guidelines – The SAI should have policies and procedures that ensures that staff adhere to the SAI code of ethics which as a minimum should meet the requirements of ISSAI 30: Code of Ethics.

Human resources – In order to comply with the quality requirements, the SAI should have policies on recruitment of staff to ensure that staff with necessary skills and competences are employed. Performance should be rewarded and annual staff appraisals should be conducted in order to identify training needs.

Performance of individual audits – The SAI should have policies to ensure that individual audits are conducted in accordance with the provision of the relevant standard on quality control at the individual audit level. There should be clear policies on supervision and review of work performed.

Monitoring of quality control – The SAI should have policies in place that require continuous monitoring of quality control policies in order to ensure that they remain relevant and adequate. Improvements should be made where they policies are lacking.

SOLUTION FIVE

(a)

(i) **Meaning of financial statement assertions:**

Financial statement assertions are representations made by management in the figures contained in the expenditure reports.

For example, for an amount included under tangible non-current assets and contained in the non-current asset register, there is a representation that the related assets **existed** at the period end.

(ii) **How assertions assist in designing audit procedures:**

In designing audit procedures to be performed, the public sector auditors require to consider the assertions to be tested. The objective of the audit procedures is aimed at establishing whether or not the related financial statements assertions hold true.

The audit procedures should be designed in such a way that they respond to the audit objective. For example, in testing the existence of tangible non-current assets, the public sector auditors should physically inspect the related asset. Confirmation of ownership will not be appropriate to test for existence.

(b)

(i) **Meaning of sufficient appropriate evidence:**

Sufficient – This relates to the quantity of evidence required to reach an appropriate conclusion. More evidence will be required if it is considered poor. Less evidence will be required when the evidence is reliable.

Appropriate – This relates to the quality of the evidence. Consideration will be made to the quality and reliability of the evidence.

(ii) **Reliability of evidence:**

Oral evidence – obtained from inquiries of management and others within the organisation is less reliable than written evidence. This is because oral evidence may be retracted.

Third party evidence – is more reliable than evidence obtained from within the audited entity because it is coming from an independent party. The intended bank confirmation is an example of third party confirmation.

Original – of documents are more reliable than copies. This is because copies could be forged and may be copies of the original documents.

Auditor generated evidence – is more reliable than evidence from the company. For example, the auditor may wish to reperform the bank reconciliation for the year end rather than rely on reconciliations performed by the client staff.

Internally generated evidence – is more reliable if the related internal controls are operating effectively.

(c)

(i) **Audit risk with regards opening balances:**

Opening balances in the statement of financial position are brought forward from the previous financial year. The opening balances have an impact on current year figures. The audit risk with regards opening balances is that if they are materially misstated, they could affect the current year figures and cause a material misstatement of the current year figures.

In the case at hand the previous year financial statements were audited by private auditors. The audit risk is that if they are misstated, they will impact on the current year audit.

(ii) **Audit procedures for opening balances:**

- Ensure that the opening balances have been correctly transferred to the current year. This will be done by comparing the opening balances in the general ledger to the closing statement of financial statements for the previous year.
- Determine whether the opening balances reflect the application of appropriate accounting policies.
- Evaluate whether the audit procedures in the current year provide evidence on the relevant opening balances.
- Perform specific audit procedures to obtain evidence regarding the opening balances.
- Obtain written representations from management regarding the opening balances.

END OF SUGGESTED SOLUTIONS



PUBLIC SECTOR FINANCIAL MANAGEMENT PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

PFM 6: FINANCIAL REPORTING FRAMEWORK FOR PUBLIC SECTOR ENTITIES

MONDAY 10 JUNE 2024

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

Kabulobe Entrepreneurship Institute (KEI) is a membership body which was established in 1996 by the Zambian Government. Its main mandate is to regulate the activities of junior entrepreneurs, especially in rural areas. The following **trial balance** was extracted from the ledger of Kabulobe Entrepreneurship Institute (KEI) as at 30 September 2023:

	DR	CR
	K	K
Land at cost	3,000,000	
Property, at cost	9,000,000	
Provision for depreciation on Property as at 1.10.2022		6,300,000
Equipment at cost	5,400,000	
Provision for depreciation on Equipment as at 1.10.2022		750,000
Investment property	4,614,000	
Cash and cash equivalents	540,000	
Intangible assets	150,000	
Amortization of intangible assets as at 1.10.2022		60,000
Trade accounts receivables	85,000	
Trade accounts payables		30,700
General reserves		400,000
Accumulated fund		6,463,500
Investment securities (less than one year)	550,000	
Inventory of books on entrepreneurship as at 1.10.2022	70,000	
Purchases and sales of books on entrepreneurship	1,060,000	2,120,000
Subscriptions in arrears/advance	1,200,000	550,900
Employee benefit expenses	4,337,500	
Revenue grant		1,000,000
Capital grant		4,000,000
Interest paid/received	6,000	45,000
Subscriptions		17,000,000
Operating expenses	16,754,600	
Irrecoverable debts	1,000	
Allowance for receivables		3,000
Employee pension liabilities		8,045,000
	46,768,100	46,768,100

Additional information:

- (1) Inventory of books on entrepreneurship as at 30 September 2023 had a cost of K93,000 but a net realizable value of K78,000.
- (2) The accounting policies are as follows:

- (i) Increases or decreases in the value of Investment property is recognised in the statement of financial performance. The Investment property as at 30 September 2023 was valued at K4,650,000.
- (ii) Revenue grant is to be treated as a credit in the statement of financial performance, while Capital grant is treated as deferred income and 25% is transferred to statement of financial performance annually. Both grants were received on 1 October 2022.
- (iii) Depreciation and amortization policy:
 - Property 5% on cost
 - Equipment 20% on reducing balance basis
 - Intangible assets at 10% on cost.
- (3) The allowance for receivables is to be adjusted so that it is 4% of trade accounts receivables.
- (4) The figure for subscriptions includes K130,000 being the sale proceeds of an item of equipment that was sold in August 2023. The equipment had originally cost K200,000 and had been depreciated by K150,000 at the date of sale. Other than recording the proceeds in the subscriptions and cash, no other accounting entries for the disposal have been made.
- (5) On 30 September 2023, subscriptions in arrears and subscriptions in advance were K3,000,000 and K1,200,000 respectively.
- (6) At a meeting held on 20 September 2023 in one of the rural areas to sensitize the community members, the paramount chief pledged a total of K4 million towards operating expenses. The pledge was still outstanding on 30 September 2023.
- (7) Kabulobe Entrepreneurship Institute (KEI) is exempt from taxation under the Income Tax Act Section 5(i) of part III Second Schedule of CAP 323 of the Laws of Zambia.

Required:

- (a) Explain the recommended accounting treatment for pledges, using an appropriate IPSAS. (3 marks)
- (b) Discuss the acceptability of the accounting policies on:
 - (i) Investment property. (3 marks)
 - (ii) Capital grant. (6 marks)
- (c) Using the information above, prepare the following in accordance with IPSAS 1:
 - (i) Statement of Financial Performance for the year ended 30 September 2023. (16 marks)
 - (ii) Statement of Financial Position as at 30 September 2023. (12 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 is in the process of creating and merging certain Government ministries in order to improve service delivery. The newly created ministries do not have any system in place and staff appointed to these ministries are expected to set up controls both financial and administrative controls. You have been appointed to the new government ministry as Director Finance and you are expected to set up a new accounting system.

Required:

- (a) The Permanent Secretary has requested you to prepare a memo to the Minister outlining the following:
 - (i) The meaning of financial controls (1 mark)
 - (ii) The four (4) performance indicators that the ministry will require in the control process. (2 marks)
 - (iii) The objective of the financial control review process that will be instituted in the office to ensure sound financial management. (2 marks)
 - (iv) The four (4) public sector financial control systems that will be adopted in the operations. (4 marks)
 - (v) Benefits of each of the financial control systems identified above. (4 marks)
- (b) With reference to IPSAS 3: Accounting policies , Changes in Estimates and Errors:
 - (i) Explain the guiding principles for formulating accounting policy. (3 marks)
 - (ii) The conditions that mandate a change in accounting policy. (1 mark)
 - (iii) The treatment of changes in accounting policy required by IPSAS 3. (3 marks)

[Total: 20 Marks]

QUESTION THREE

Lilayi Construction Ltd was established on 1 January 2017 by Chilanga District Council (CDC). The company's main objective is to provide decent jobs to the youths of Chilanga District. On 10 June 2020, the company won a public tender to construct a Mother's shelter at one of the University Teaching Hospitals in Zambia. The agreed contract price is K7 million. It is one (1) year to the

general election for the country and the Government has promised in writing to pay a bonus of K500,000 upon successful completion of the project. The project is expected to take two (2) years.

The project was 75% complete at the end of the first accounting year. The costs incurred to date were K5 million and the estimated costs to completion is K1.8 million.

The Managing Director of Lilayi Construction Enterprise is a civil engineer by profession. He always complains that financial reports are generally difficult to understand. He recently attended a workshop for non-finance managers and he remembers that one of the presenters talked about "understandability" and "impairment of non-cash generating assets" but could not really comprehend what was presented.

Required:

- (a) Explain, in as much detail as possible, what is meant by:
 - (i) Understandability (6 marks)
 - (ii) Impairment of non-cash generating assets. (4 marks)
- (b) Using the information provided:
 - (i) Explain the recommended accounting treatment for the bonus. (3 marks)
 - (ii) Calculate the profit to be recognised at the end of the first accounting year. (4 marks)
 - (iii) Briefly explain how the construction contract above should be accounted for, assuming the estimated cost to completion is K2.8 million. (3 marks)

[Total: 20 Marks]

QUESTION FOUR

The Government of the Republic of Zambia through the Lusaka City Council embarked on The Lusaka City Decongestion Project which is a capital project.

Many capital projects require huge amounts of finance to an extent that the Government engages in borrowing of funds from its co-operating partners that are financiers. Such funds tend to be borrowed at some interest. The interest is described by IPSAS 5 as Borrowing Cost. The accounting treatment of such interest is guided by the same IPSAS 5.

Required:

- (a) Define qualifying asset, according to IPSAS 5. (2 marks)
- (b) Explain the accounting treatment of borrowing costs incurred in connection with a qualifying asset and outline conditions that must be met for borrowing costs to be capitalized. (7 marks)

- (c) The Ministry of Home Affairs (MoHA) embarked on the construction project of its office block this year using funds borrowed from a local commercial bank amounting to K780 million at an annual rate of interest of 10% per annum. The MoHA prepares its books to 30 September each year and the loan was acquired on 1 January 2023. Construction of the office block only commenced on 1 July 2023 and is still on going as initial estimates are that the project will be completed over a period of three years

Required:

Explain how MoHA will account for the borrowed funds in its financial statements for the year ended 30 September 2023. (5 marks)

- (d) Explain under what circumstances capitalization of borrowing costs would be:
- (i) Suspended (3 marks)
 - (ii) Ceased (3 marks)

[Total: 20 Marks]

QUESTION FIVE

You are the Accountant General in a country called Bbakasa, which uses accrual basis IPSAS. Five (5) public entities have encountered challenges during the preparation of the draft financial statements for the year ended 31 December 2023. They have brought the following matters to your attention and therefore require guidance from your office on how the matters should be treated in the financial statements for the year ended 31 December 2023:

Public entity one (PE1)

On 6 March 2024, one of the customers having an outstanding balance of K50,000 as at 31 December 2023, went into liquidation because of heavy trading losses due to the COVID 19 pandemic. The debt is not insured and the liquidator has confirmed that none of the amount due will be recovered.

Public entity two (PE2)

In order to avoid distortions in the gross profit margin, the directors decided to reclassify some of the expenses as distribution costs instead of the previous classification as cost of sales, effective 1 January 2023.

Public entity three (PE3)

This is a public university. During the year, the National Government transferred 350 hectares of land in a major city to the university. The transfer agreement states that the land is to be used for a university campus, but does not specify that the land is to be returned if not used for a campus.

Public entity four (PE4)

The public entity has developed a new vaccine for COVID 19 which has been approved for clinical use. The costs of developing the vaccine were K8 million. According to reliable expert advice, the vaccine is expected to be very profitable and will have an indefinite useful life.

Public entity five (PE5)

During the year ended 31 December 2023, the public entity gave a private operator access to existing buildings for the purpose of a service concession arrangement.

Required:

Explain how the directors of the public entities should treat the above matters in the financial statements for the year ended 31 December 2023.

[Total: 20 Marks]

END OF PAPER

PFM 6: FINANCIAL REPORTING FRAMEWORK FOR PUBLIC SECTOR ENTITIES SUGGESTED SOLUTIONS

SOLUTION ONE

(a) Recommended accounting treatment for pledges

IPSAS 23 *Revenue from non-exchange transactions* gives detailed guidance on how to account for pledges. The principle underlying the recognition of revenue from non-exchange transactions is that revenue should be recognised when control has passed to the receiving entity, on the basis of information which is sufficiently reliable. Pledges, promises or announcements of intention to pay are not generally regarded as sufficient to ensure an enforceable claim and thus control of an asset.

Hence, Kabulobe Entrepreneurship Institute (KEI) should not recognise revenue in respect of the paramount chief's pledge in the statement of financial performance for the year ended 30 September 2020 since it does not control the resources related to the pledge.

(b)

(i) Acceptability of the accounting policy on Investment property

IPSAS 16 *Investment Property* gives detailed guidance in this area. Provided that the property satisfies the definition of investment property under IPSAS 16, an entity should decide whether it wishes to follow a cost model or fair value model for all its investment property. The fair value model includes taking gains and losses through surplus or deficit for the period in which it arises.

Kabulobe Entrepreneurship Institute (KEI) uses the fair value model and therefore the accounting policy on investment property is acceptable.

(ii) Acceptability of the accounting policy on capital grant

IPSAS 23 *Revenue from non-exchange transactions* gives detailed guidance on accounting treatment for grants. The standard follows two (2) basic principles when determining the treatment of grants:

- Grants should not be recognised until the conditions for receipt have been complied with and there is reasonable assurance the grant will be received
- Grants should be matched with the expenditure towards which they were intended to contribute.

The standards allows two methods of dealing with capital grants:

- The capital grant could be set up as a deferred income account and amounts will be released to the statement of financial performance to match the usage of the assets
- The capital grant can be deducted from carrying amount of the asset.

The accounting policy is in line with the first method and therefore the accounting policy is acceptable. However, the policy is silent on stipulations, which could either be conditions or restrictions. The accounting policy must provide more details.

- (c)
(i)

KABULOB ENTREPRENEURSHIP INSTITUTE (KEI)	
STATEMENT OF FINANCIAL PERFORMANCE FOR THE YEAR ENDED 30 SEPTEMBER 2020	
	K
REVENUE	
Subscriptions (W1)	18,020,900
Revenue grant	1,000,000
Amortization of capital grant (W2)	1,000,000
Income from sale of books (W3)	1,068,000
Gain on disposal of equipment (W4)	80,000
Interest received	45,000
Gain on fair value of investment property (W5)	36,000
TOTAL REVENUES	21,249,900
EXPENDITURE	
Employee benefits	4,337,500
Operating expenses (W6)	16,756,000
Depreciation and Amortization (W7)	1,385,000
Finance cost	6,000
TOTAL EXPENDITURE	22,484,500
SURPLUS/(DEFICIT) BEFORE TAXATION	(1,234,600)
Income tax expense	-
SURPLUS/(DEFICIT) FOR THE YEAR	(1,234,600)

- (ii)

KABULOB ENTREPRENEURSHIP INSTITUTE (KEI)	
STATEMENT OF FINANCIAL POSITION AS AT 30 SEPTEMBER 2020	
	K
ASSETS	
NON-CURRENT ASSETS	
Property, plant and equipment (W8)	8,930,000
Investment property	4,650,000
Intangible assets (W9)	75,000
TOTAL NON-CURRENT ASSETS	13,655,000
CURRENT ASSETS	
Inventories	78,000
Trade accounts receivables (W10)	81,600
Subscriptions in arrears	3,000,000
Investment in securities	550,000
Cash and cash equivalents	540,000
TOTAL CURRENT ASSETS	4,249,600

TOTAL ASSETS	17,904,600
MEMBERS' FUNDS AND LIABILITIES	
MEMBERS' FUNDS	
Accumulated funds (W11)	5,228,900
General reserves	400,000
TOTAL MEMBERS' FUNDS	5,628,900
LIABILITIES	
NON-CURRENT LIABILITIES	
Employee pension liabilities	8,045,000
Deferred income (W12)	3,000,000
TOTAL NON-CURRENT LIABILITIES	11,045,000
CURRENT LIABILITIES	
Trade accounts payables	30,700
Subscriptions in advance	1,200,000
TOTAL CURRENT LIABILITIES	1,230,700
TOTAL LIABILITIES	12,275,700
TOTAL MEMBERS' FUNDS AND LIABILITIES	17,904,600

Workings:

W1 Subscriptions

	K	
Opening balance – Subscriptions in arrears	(1,200,000)	
- Subscriptions in advance	550,900	
Subscriptions per trial balance	17,000,000	
Proceeds from sale of equipment	(130,000)	
Closing balance – Subscriptions in arrears	3,000,000	
- Subscriptions in advance	<u>(1,200,000)</u>	
Statement of financial performance	<u>18,020,900</u>	

W2 Amortization of capital grant

K

Grant amount	4,000,000
Amortization 25% X 4,000,000	<u>(1,000,000)</u>

Statement of financial position (Deferred income) 3,000,000

W3 Income from sale of books

	K	K
Sales		2,120,000
Opening inventory		70,000
Purchases	<u>1,060,000</u>	
	1,130,000	
Closing inventory	<u>(78,000)</u>	
Cost of sales		<u>(1,052,000)</u>
Income		<u>1,068,000</u>

W4 Gain from disposal of equipment

	K
Accumulated depreciation	150,000
Proceeds from sale of equipment	130,000
Original cost of the asset	<u>(200,000)</u>
Statement of financial performance	<u>80,000</u>

W5 Gain on fair value of investment property

	K
Fair value on 1 October 2019	4,614,000
Fair value on 30 September 2020	<u>4,650,000</u>
Statement of financial performance	<u>36,000</u>

W6 Operating expenses

	K	K
Per trial balance		16,754,600
Irrecoverable debt		1,000
Increase in allowance for receivables:		
Current	3,000	
New 4% X 85,000	<u>3,400</u>	
	<u>400</u>	
Statement of financial performance		<u>16,756,000</u>

W7 Depreciation and amortization

	K	K	K
Property			
Depreciation 5% X 9,000,000			450,000
Equipment			
Cost	5,400,000		
Disposal	<u>(200,000)</u>		
	5,200,000		
Accumulated depreciation	650,000		
Disposal	<u>(150,000)</u>		
	<u>(600,000)</u>		
Reduced balance	<u>4,600,000</u>		
Depreciation 20% X 4,600,000			920,000
Intangibles			
Amortization 10% X 150,000			<u>15,000</u>
Statement of financial performance			<u>1,385,000</u>

W8 Property, plant and equipment

K K

Land at cost 3,000,000

Property at cost 9,000,000

Accumulated depreciation (6,750,000)

(6,300,000 + 450,000)

2,250,000

Equipment at cost 5,200,000

Accumulated depreciation (1,520,000)

(600,000 + 920,000)

3,680,000

Statement of financial position 8,930,000

W9 Intangibles

K

Per trial 150,000

Less amortization (60,000 + 15,000) (75,000)

Statement of financial position 75,000

W10 Trade accounts receivable

K

Per trial balance 85,000

Less allowance on receivables (4% X 85,000) (3,400)

Statement of financial position 81,600

W11 Accumulated funds

K

Per trial balance 6,463,500

Less Deficit for the year (1,234,600)

Statement of financial position 5,228,900

W12 Deferred income

K

Capital grant 4,000,000

Less amortization (25% X 4,000,000) (1,000,000)

Statement of financial position 3,000,000

SOLUTION TWO

(a)

(i) **What financial control is and the benefits.**

- Overall Process of reviewing and controlling financial resources.

(ii) **The four performance indicators that the ministry will require in the control process.**

- Income
- Expenditure
- Commitments
- Budget

(iii) **The objectives of financial control that the ministry will require in the control process.**

- It gives clear definition of responsibilities.
- It reflects current position of organization.
- It presents information that can easily assimilated and understood.
- It allows comparability of budgets with income and expenditure.

(iv) **The objective of the financial control review process that will be instituted in the office to ensure sound financial management.**

- It is concerned with receipting, custody, disbursement and transfer of public funds as required by law.
- Controlling measuring and analyzing the activities and lifeline of a specific project.
- Receipting, custody and disbursement of the financial donation of donors or support organizations.
- Ensuring that independent accounting entities that depend on government grants account for the resources in accordance with the laid down procedures.

(v) **Benefits of each of the financial Control systems identified above.**

- Help formulate the general objectives of the agency and coordinate the policies of individual's financial needs of various units.
- Relate each spending units requirements to the economic resources estimated to be available and the total claims to them.
- Keep expenditure within total resources of the year
- Advise management and each unit about financial control measures.

(b)

(i) **Guiding principles for formulating accounting principles:**

- Relevant to the decision making needs of users
- Reliable in that the financial statements :

- Represent faithfully the financial position , financial performance , and cashflows of the entity
 - Reflect the economic substance of transactions, other events and conditions , and not merely the legal form
 - Neutral free from bias
 - Prudent
 - Complete in all material aspects
 - Consistent
- (ii) **Change in accounting policy may occur under two accepted conditions:**
- When the change is required by an IPSAS
 - When the change is made by management on the grounds that it results in reliable and more relevant information
- (iii) **Treatment of changes in Accounting Policy required by IPSAS 3:**
- If a change in accounting policy is required by an IPSAS, follow that pronouncements transition requirements.
 - If none is specified , or if the change is voluntary , apply the new accounting policy retrospectively by restating prior periods
 - If restatement is impracticable , include the cumulative effect of the change in net assets/equity
 - If the cumulative effect cannot be determined, apply the new policy prospectively.

SOLUTION THREE

(a)

- (i) Understandability – this means information must be presented in a manner that responds to the needs and knowledge base of users, and to the nature of the information presented. Hence, this is the quality of information that enables users to comprehend its meaning. Understandability is enhanced when information is classified, characterised, and presented clearly and concisely. Comparability also can enhance understandability.

Explanations of financial and non-financial information and commentary on service delivery and other achievements should be written in plain language, and presented in a manner that is readily understandable by users.

However, users of GPFRs are **assumed** to have:

- a reasonable knowledge of the entity's activities and the environment in which it operates
- able to and are prepared to read GPFRs, and
- able to review and analyse the information presented with reasonable diligence.

Preparers of General Purpose Financial Reports (GPFRs) are expected to ensure that the information presented is understandable but the users must also strive to learn the basics so that they are in a position to understand it. Attending workshop organised for non-finance managers, especially by ZiCA is one of the recommended measures.

- (ii) Impairment of non-cash generating assets – IPSAS 21 *Impairment of non-cash generating assets* gives detailed guidance in this area. Non-cash generating assets is a public sector-only accounting concept.

An impairment loss of an asset is the amount by which the carrying amount of an asset exceeds its recoverable amount.

The recoverable amount of an asset is that which can be recovered through its continued use (value-in-use) or by selling it (whichever is higher). IPSAS 21 uses the term recoverable service amount as value of non-cash generating asset based on its service potential.

IPSAS 21 does not apply to non-cash generating assets carried at revalued amounts mainly because the requirement to ensure carrying amounts are accurate as at the reporting date would achieve the same result.

Value-in-use represents the amount that the entity will receive if it continues to use the asset. Professional judgement is required by management to establish when an asset's value is impaired and how to measure the impairment.

(b)

- (i) Accounting treatment of bonus

IPSAS 11 *Construction Contracts* gives detailed guidance in this area. The Government has agreed to pay a bonus upon satisfactory completion of the project. The project is not complete and the standard, based on the prudence concept, requires that revenue should not be recognised before it is earned. Hence, the bonus should be ignored. The bonus must be ignored until received on completion of the project

(ii) Computation of profit

	K
Revenue	
75% X 7,000,000	5,250,000
Cost of sales	
75% X 6,800,000	<u>(5,100,000)</u>
Profit	<u>150,000</u>

(iii) Accounting treatment if the estimated cost to completion is K2.8 million

Expected profit/(loss) on completion of the project

	K	K
Contract price		7,000,000
Cost of sales:		
Cost incurred to date	5,000,000	
Estimated costs	<u>2,800,000</u>	
		<u>(7,800,000)</u>
Expected profit/(loss) on completion		<u>(800,000)</u>

Since a loss is expected, no profit should be recognized and the loss must be recognized immediately.

SOLUTION FOUR

- (a) A qualifying asset is an asset whose construction necessarily takes a substantial period of time to get ready for its intended use or sale.
- (b) According to IPSAS 5, borrowing costs incurred in connection with the borrowing of funds meant to finance a qualifying asset must be capitalized when certain conditions are met. Further, for borrowing costs incurred during a period when the conditions are not met, they must be expensed in the statement of profit or loss. The following are conditions to be met for borrowing costs to be capitalized:
1. Expenditure on the qualifying asset is being incurred.
 2. Borrowing costs are being incurred
 3. Activities that are necessary to prepare the asset for its intended use or sale are in progress.
- (c) The reporting date for MoHA is 30 September 2020. Loans were acquired on 1 January 2020 and construction began on 1 July 2020. This means that the three conditions for capitalization of borrowed funds were only met for three (3) months, that is July, August and September, which is the period within which the construction works (activities) were ongoing, borrowing costs were being incurred and outlays being experienced. The total borrowing costs incurred from time loan acquired to reporting date was K58.5 million ($9/12 \times [10\% \times \text{K}780 \text{ million}]$). For the period under review, the borrowing costs eligible for capitalization are therefore K19.5 million ($3/12 \times [10\% \times \text{K}780 \text{ million}]$). The balance of the interest would therefore have to be expensed. This is K39 million (K58.5 million – K19.5 million).
- (d)
- (i) **Suspension of Capitalisation of Borrowing Costs**
- Capitalization of borrowing costs shall be suspended during extended periods in which active development is interrupted. The borrowing costs will instead be expensed.
- However, capitalization of borrowing costs is not normally suspended during a period when substantial technical and administrative work is being carried out.
- Capitalization of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting the asset ready for intended use or sale.
- (ii) **Ceasation of Capitalisation of Borrowing Costs**
- Capitalization of borrowing costs shall cease when substantially all activities necessary to prepare the qualifying asset for its intended use or sale are complete.
- For assets with different parts and each part can be used separately once completed without need to rely on other parts, then capitalization of their associated borrowing costs to cease on a part by part basis as each part's construction is completed.

SOLUTION FIVE

Public entity one

IPSAS 14 *Events after the reporting date* gives detailed guidance in this area. Two types of events that occur after the reporting date are adjusting events and non-adjusting events.

An adjusting event provides further evidence of conditions that existed at the reporting date while a non-adjusting event reflect conditions that arose after the reporting date.

Hence, adjusting events are recognised in the financial statements while non-adjusting events, if material are disclosed in the notes to the financial statements.

The liquidation of the customer provides more information about the condition which existed at the reporting date and therefore is an adjusting event. The receivable of K50,000 should therefore be written off in the financial statements for the year ended 31 December 2019.

Public entity two

IPSAS 3 *Accounting policies, changes in accounting estimates and errors* gives detailed guidance in this area. Changing classification of expenses is an example of a change in accounting policy. An entity is permitted to change an accounting policy only if the change:

- Is required by a standard for better interpretation or
- Results in the financial statements providing reliable and more relevant information

If it is accepted that this change does constitute a change of accounting policy according to IPSAS 3, then the proposed treatment by the directors is acceptable and the comparative results for the year ended 31 December 2018 must be restated as if the new policy had always been applied. If the proposals fail the test under IPSAS 3, then the expenses should continue to be included in cost of sales.

Public entity three

IPSAS 17 *Property, plant and equipment* gives detailed guidance in this area. The university should recognise the land as an asset in the statement of financial position as at 31 December 2019 since this is the period in which it obtained control of the land. According to IPSAS 17, the land should be recognised at its fair value.

The restriction does not meet the definition of a liability or satisfy the criteria for recognition as a liability. Therefore, the university should recognise revenue in respect of the land in the statement of financial performance for the year ended 31 December 2019.

Public entity four

IPSAS 31 gives detailed guidance in this area. The development cost of K8 million for the new vaccine should be capitalized as long as it meets all the criteria for capitalization specified under IPSAS 31.

However, since it has an indefinite useful life, it should not be amortized. This intangible asset should be assessed for impairment on an annual basis.

Public entity five

IPSAS 32 *Service arrangements: Grantor* guides detailed guidance in this area. It requires that assets should be included in the grantor's financial statements when the following control tests are met:

- The grantor controls or regulates what services the operator must provide with the infrastructure/service concession asset, to whom it must provide them, and at what price and
- The grantor controls – through ownership, beneficial entitlement or otherwise – any significant residual interest in the infrastructure/service concession asset at the end of the term of the arrangement.

Hence, if the above control tests are met, the public entity should recognise the assets in the statement of financial position. The public entity must therefore provide more details so that the appropriate accounting treatment may be recommended.

END OF SUGGESTED SOLUTIONS