



# **COMPETENCE PRACTICE EXAMINATION**

## **NON AUDIT**

**DECEMBER 2010**

**TIME ALLOWED: 5 HOURS**

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### **INSTRUCTIONS TO CANDIDATES**

1. This paper has Two Questions.
2. You are required to attempt ALL the two questions
3. Each question has Sections:  
  
    Question one has two sections: A and B  
    Question two has two sections: A and B
4. All the two questions carry equal marks.
5. The Examination is divided into sessions of 2½ hours each. There will be a 30 Minutes break in between the sessions.
6. Please use your Membership number and your National Registration Card number on the front of the answer booklet. Your name must NOT appear anywhere on your answer booklet.
7. This is an open book examination.

## QUESTION ONE

Bob & Jere operate a medium sized company (BJ & CO.) dealing in mining activities in the lower Zambezi of Zambia. The two have an engineering background in metallurgical mining. The company has a sizeable workforce with two Accountants employed as Senior Accountant and Assistant Accountant respectively. The position of Senior Accountant is a senior position within the company. However, the Senior Accountant has been sick for the past five (5) months or so and this has made it difficult for the company to produce the Trial Balance for the year ended 31 March 2010. Similarly, the company has not been able to carry out its treasury management as efficient and effective considering their low appreciation of financial management aspects. The Assistant Accountant who was employed six (6) months ago has not yet had a grip on the accounting package – Navision used by the company, thus making it difficult to finalize the preparation of the Trial Balance. The Senior Accountant graduated from the Copperbelt University and has since been admitted by ZICA as licentiate member of the institute. The Assistant Accountant has a Diploma in Business Administration and has enrolled to do ZICA technician with a few exemptions in management subjects.

PABs are a firm of consultants specialized in advisory and consultancy services and are licenced accountants under ZICA to offer this kind of services. Due to the gaps created by the absence of the Senior Accountant, BJ & CO. has decide to engage PABs to provide advisory and consultancy services for its year ending 31 March 2010. This is one way of preparing for the year - end audit to be undertaken immediately after the consultants have done their work in accordance with the terms of the engagement.

According to the engagement requirements, PABs' focus is supposed to be on activities for the year ending 31 March 2010 and to include issues pertaining to:

- Company operations during the year
- Draft accounts for the year
- Accounting adjustments and,
- Information pertaining to tax computations and advisory

Following the engagement, Mr. Joe Banda, the managing director of PABs has assigned Kelvin, a trainee Consultant, the task of attending to the issues at hand and to ensure that the mining company is ready for audit. Kelvin has done a preliminary review of the company operations in order to keep himself abreast of the activities of the client and be more focused when it comes to dealing with accounting issues. During the process of review, Kelvin has discovered the following issues:

- a) BJ & CO. procured some protective clothing for its workers in fulfilment of the mining safety requirements. The protective clothing were supplied by Mr. Joe Banda, the managing director of PABs at the cost of K35 million and the amount was paid in full. Information available indicates that one of the directors queried the poor quality of the protective clothing and sought for a refund of at least 40% of the total cost from Mr. Joe Banda. Information also indicates that in fact Mr. Joe Banda was contacted and his

response was that he discussed with Bob one of the directors of the company over the same issue. It was agreed that the 40% will be recovered from the advisory and consultancy services to be provided during the year. Kelvin wants to seek more information on this issue and possibly how the whole transaction should be dealt with.

- b) As part of the process to obtain a mining licence from the Ministry of Mines and Mineral Resources, BJ & Co. were requested to provide a justification in terms of financing of the project. Considering their background, BJ & Co. requested Mr. Joe Banda to provide a justification on condition that once the licence is obtained and mining activities start, Mr. Joe Banda will be entitled to 5% of the profits for a period of five years after which they will consider extending 10% of the shareholding in the company. Kelvin is excited with this kind of information hoping that he one day will benefit from similar arrangements.
- c) BJ & CO. has been operating in line with the licence requirements except on one aspect. According to the licence, the mining activities include those relating to precious stones. Any other discoveries are supposed to be reported to the Ministry of Mines and Mineral Resources. However, during the mining activities for the year, BJ & CO. discovered Uranium and the company is trying to find a market for it. Kelvin is not sure whether to report this to relevant authorities or not.

<b>Client:</b>	<b>BJ &amp; CO</b>	<b>Working paper Reference</b>
Subject:	Draft Accounts Balances	DAB – 10 – FS 1
Date	20 April 2010	
Prepared by:	Kelvin	

Before joining PABs as a Trainee Consultant, Kelvin had a chance of appreciating how the Navision Accounting Package works. He was able to extract the account balances from the system as presented below:

BJ & CO. list of accounting balances as at 31 March 2010 as per extract:

	<b>K' 000</b>	<b>K' 000</b>
Sales revenue (Note 1)		716,900
Cost of sales	370,100	
Distribution costs	57,400	
Administration expenses	30,000	
Lease rentals (Note 2)	40,000	
Loan note interest paid	4,000	
Dividend paid	24,000	
Property at cost (Note 3)	400,000	
Plant and equipment cost	309,600	
Depreciation 1 April 2009 – plant and equipment		69,600
Development expenditure (Note 4)	60,000	

Profit on disposal of non-current assets (Note 3)		90,000
Trade accounts receivable	110,000	
Inventories: 31 March 2010	56,480	
Cash and bank	21,320	
Trade accounts payable		58,800
Taxation: over provision in year to 31 March 2009		4,400
Equity shares of K50 each		300,000
8% loan note (issued in 2009)		100,000
Retained earnings 1 April 2009		143,200
	<u>1,482,900</u>	<u>1,482,900</u>

<b>Client:</b>	<b>BJ &amp; CO</b>	<b>Working paper Reference</b>
<b>Subject:</b>	Account Balances Adjustments	ABA – 10 – FS 2
<b>Date</b>	20 April 2010	
<b>Prepared by:</b>	Kelvin	

The following additional notes were provided by BJ & CO. and form part of the account balances extracted from the system.

1. Sales revenue includes K54 million relating to sales made to customers under sale or return agreements. The expiry date for the return of these goods is 30 April 2010. BJ & CO. has charged a mark – up of 20% on cost for these sales.
2. A lease rental of K40million was paid on 1 April 2009 being the first of the five annual payments in advance for the rental of an item of equipment that has a cash purchase price of K160 million. According to the professional advice got, this is considered to be a finance lease and the implicit interest rate in the lease has been calculated at 12% per annum. Leased assets should be depreciated on a straight-line basis over the life of the lease.
3. On 1 April 2009, BJ & CO. acquired a new property at a cost of K400 million. For the purpose of calculating depreciation only, the asset has been separated into the following elements:

<b>Separate asset</b>	<b>Cost K' 000</b>	<b>Life</b>
Land	100,000	freehold
Heating system	40,000	10 years
Lifts	60,000	15 years
Building	200,000	50 years

The depreciation of the elements of the property should be calculated on a straight line basis. The new property replaced an existing one that was sold on the same date for K190 million. It had cost K100 million and had a carrying value of K160 million

at the date of sale. The profit on the property has been calculated on the original cost. It had not been depreciated on the basis that the depreciation charge would not be material.

Plant and machinery is depreciated at 20% on the reducing balance method.

4. The figure of development expenditure in the list of account balances represents the amounts deferred in the previous years in respect of the development of a new product. Unfortunately, during the current year, the government has introduced legislation which effectively bans this type of product. As a consequence of this the project has been abandoned. The directors of BJ & CO. are of the opinion that writing off the development expenditure, as opposed to its previous deferment, represent a change of accounting policy and therefore wish to treat the write off as a prior year period adjustments.
5. A provision for income tax for the year to 31 March 2010 of K30 million is required.

<b>Client:</b>	<b>BJ &amp; CO</b>	<b>Working paper Reference</b>
<b>Subject:</b>	Tax Computations	TC – 10 – TW 1
<b>Date</b>	20 April 2010	
<b>Prepared by:</b>	Kelvin	

Before Bob partnered with Jere, he had been doing farming in the Southern Province for not less than six years. He operates a big shop in Choma and has a sizable number of employees. Bob wants PABs to do some tax computations to assist him determine the provisional tax to be paid to ZRA. PABs and Bob have agreed in principle for this kind of service.

Bob has provided the following statement of comprehensive income for the year ended 31 March 2010 which indicates a net profit before taxation of K148, 750.

	<b>K' 000</b>	<b>K' 000</b>
Gross profit for the year		878,720
Profit on sale of property (Note 1)		37,200
Exchange gain (unrealized)		<u>7,347</u>
		<b>923,267</b>
Less expense:		
Donations (Note 2)	17,200	
Legal and Professional fees (Note 3)	7,234	
Salaries and Wages	81,700	
Fines and penalties (Note 4)	11,300	
Depreciation	58,000	
Audit fees	51,000	
Licenses, insurance & Levies (Note 5)	11, 900	
Rates	3,700	
Consulting fees	37,000	

Entertainment (Note 6)	21,000	
Office expenses	198,850	
Loss on sale of motor vehicles	9,500	
Provision for bad debts (Note 7)	7,050	
Other expenses (Note 8)	<u>259,083</u>	
<b>Total expenses</b>		<b><u>774,517</u></b>
<b>Net Profit</b>		<b><u>148,750</u></b>

In addition to the statement of comprehensive income, Bob has provided the following notes to assist in comprehending some figures provided above:

**Note 1:**

Bob sold some land which he considered not useful for cultivation of Maize at K72 million considered to be the fair value. The land was bought a few years ago at K34.8 million.

**Note 2:**

**K' 000**

Donations are broken down as follows:

• Donations to a political party (MMD)	5,250
• Donation to approved charity	7,850
• Donation to Zambia Agency for Disabilities	<u>4,100</u>
	<u>17,200</u>

Bob had initially talked to the Chairperson of the Charity and there are indications that some land will be extended to Bob for cotton cultivation for a period of one year.

**Note 3:**

Legal and professional fees consist of:

- 75% payable to debt collector for farm produce not settled, and
- 25% payable to debt collector for pursuing a former farm worker.

**Note 4:**

**K' 000**

Fines and penalties:

• NAPSA penalties	8,100
• PAYE penalties	<u>3,200</u>
	<u>11,300</u>

**Note 5:****K' 000**

Licenses, insurance and levies:

• Choma municipal Council	1,900
• Motor Vehicle insurance	4,900
• Farm insurance	3,100
• Renewal of trading license	<u>2,000</u>
	<u>11,900</u>

**Note 6:**

Entertainment includes:

• Entertaining auditors	4,250
• Entertaining political cadres with meat worth	3,750
• Entertaining farmers at farmers day	<u>13,000</u>
	<u>21,000</u>

**Note 7:**

Provision for bad debts includes:

• Increase in general provision	2,400
• Reduction in general provision	1,750
• Bad debts written off	<u>2,900</u>
	<u>7,050</u>

**Note 8:**

Other expenses include:

• Sundry allowable expenses	135,000
• Subscription to Farmer Union	27,500
• Subscription to ZICA for accountant	800
• Repair costs of farm equipment	<u>95,783</u>
	<u>259,083</u>

**Note 9:**

During the year Bob undertook some the following activities at the farm:

• Development activities for orange and other citrus fruits.	70,000
• Farm improvements for farm dwelling construction	<u>40,000</u>
	<u>110,000</u>

Bob expects to obtain some capital allowances.

<b>Client:</b>	<b>BJ &amp; CO</b>	<b>Working paper Reference</b>
Subject:	Tax Advisory	TA – 10 – TW 2
Date	20 April 2010	
Prepared by:	Kelvin	

Bob has read somewhere in the Zambian tax system that when one engages in farming, some capital allowances are given and therefore reduces the tax burden. However, Bob is not sure of the extent to which these capital allowances are given.

The following list of farm implements, plant and machinery has been lined up for purchase:

- Pivot Center and combine harvester implements
- Farming implements
- Tractor to be used in Bob's farm and lease out
- Commercial and non-commercial vehicles
- Ploughs.

Bob expectations are that the consultant will provide sufficient advice on these issues.



<b>SECTION A</b>
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- 1) In relation to the acceptance to act as professional accountant and advisors for BJ & CO, identify and discuss FOUR professional and ethical issues that should have been considered before accepting the assignment. You are also required to propose **safeguards** that need to be put in place to avoid future recurrence

**(20 marks)**

- 2) With specific reference to working paper reference **(DAB – 10- FS 1 and ABA – 10 – FS2)**

- (a) Prepare for BJ & CO an income statement for the year ended 31 March 2010

**(15 marks)**

- (b) A statement of financial position as at 31 March 2010.

**(20 marks)**

- (c) Discuss the acceptability of the company's previous policy in respect of non-depreciation of property and the proposed treatment of the deferred development expenditure.

**(10 marks)**

**(Sub-total: 65 marks)**

<b>SECTION B</b>
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- 3) Bob wants to know how much tax is likely to pay for the year ending 2009/2010. In relation to working paper **TC – 10 – TW1**, compute the adjusted profit/ (loss) and the tax payable by Bob for the tax year 2009/2010. Also explain what may happen if Bob makes a loss in terms of tax obligations

**(20 marks)**

- 4) As tax advisors, explain in brief for each of the items listed in working paper **TA – 10 – TW2** to what extent capital allowances can be given.

**(8 marks)**

- 5) Apart from the capital allowances that may arise from the items listed in working paper **TA – 10 – TW2**, what other allowances can be given to a farming enterprise?

**(7 marks)**

**(Sub-total: 35 marks)**

**(Total: 100 Marks)**

## QUESTION TWO

Mr. Driver Tembo is a Zambian national and has been living in the United States of America (USA) for 20 years. He was running a medium retail company dealing in various merchandize and employing about 50 employees. For the 20 years he has been in the USA he managed to save not less than US\$ 5 million (K25 billion) which he intends to use for investments in Zambia. Mr. Tembo has been reading the Zambian newspapers and magazines in which various investment opportunities have been outlined. In January 2010, Mr. Tembo has decided to visit Zambia for possible relocation hoping to set up a powerful business to do manufacturing trade and venture in commercial farming activities whose produce would be sold to the USA and UK markets.

Before setting up his business, he had an opportunity to visit the following organizations. The Zambia Revenue Authority (ZRA); Zambia Development Agency (ZDA); Registrar of Companies; Chamber of Commerce; Citizens Economic Empowerment Commission (CEEC), and Ministry of Commerce, Trade and Industry (MCTI). His main aim was to appreciate the Zambian business environment. However, due to his busy schedule while in Zambia, he was not able to analyze the information provided to him especially that pertaining to the Taxation requirement. This did not bother him so much as he had another option to engage a Consultant to assist him understand and appreciate this.

Forthwith, Leo Consulting, registered Management Consultants and Tax Advisors with ZICA have been engaged to assist provide adequate information to Mr. Tembo, that will make him make a choice as to what type of business he should venture in. Mr. Tembo has also advised that he is acceptable to any other recommendations that the consultant may feel to be beneficial on issues of taxation. The consultancy will fall in three categories:

- Tax planning and advisory services
- Accounting related issues
- Ethical issues.

### **1. Tax Planning and advisory services**

A number of issues have been submitted to the consultant on which advice should be provided.

- (a) Mr. Tembo wants to know the main taxes found in Zambia and allowances that could be obtained in the event that he invests in Zambia
- (b) What benefits he would get if he decided to invest part of the K25 billion in a business venture and commercial farming, taking into account the information provided below:

### **Commercial farming**

Mr. Tembo wants to use K2 billion to buy a farm and procure farm implements such as tractors, ploughs, and irrigation and harvesting. He also wants to buy a commercial vehicle. An amount of K500 million will be used to buy a tractor that will be used for ploughing and also lease out to other farmers and K200 million will be used to buy a non-commercial vehicle. K100 million will be used to buy ploughs and another K500 million for irrigation and harvesting implements.

Mr. Tembo also wants to use an additional K200 million for farm improvements and spend K100 million on fencing the farm whereas the remaining K100 million will be spent on constructing a farm dwelling.

Similarly, Mr. Tembo wants to use an additional K50 million on farm works by digging two boreholes and a well. Furthermore, an amount of K10 million will be spent on developing an orange and other citrus fruits plantation.

### **Manufacturing trade**

As part of Mr. Tembo's plan, he intends to construct an industrial building at a cost of K1 billion. It is estimated that K300 million will be used to purchase land on which the building would be constructed. He also intends to apply for a government grant of K150 million to assist with the construction work. A show room costing K60 million will form part of the industrial buildings. The building will be put to use for business purposes in June 2010.

### **Planning and advisory**

Mr. Tembo has heard about efficient tax planning that ensures that less tax is paid through proper planning. Normally, two terms are used, tax avoidance and tax evasion. Mr. Tembo wants to be a good citizen by paying all the taxes required by ZRA. He has been informed that tax evasion is criminal and can land him in prison for many years.

He wants to engage a Consultant to advise him on how best to avoid tax through careful planning and use of tax efficient methods. He has therefore requested the Consultant to provide him with information on what type of income is taxed and persons exempt from paying tax. He wants to use this so that he could basically know what type of activities would be suitable to conduct.

## **2. Accounting related issues**

During the 20 years that Mr. Tembo lived in USA, the preparation of accounts were done under the local accounting standards applicable in the country of residence. The accounts were done by some local accountant using the GAAP accounting

requirements. He is aware that in Zambia, all accountants are regulated by the Zambia Institute of Chartered Accountants and are also members of IFAC by virtue of ZICA membership. The institute has therefore adopted the International Financial Reporting Standards (IFRSs) for use in the preparation of financial statements.

Mr. Tembo wants some highlights on a few IFRSs that he feels may impact on his business once started. He has therefore presented a number of areas and questions that need to be answered or clarified to you as a professional accountant registered with ZICA. Below are his submissions.

- (a) I have heard about Cash Flow Statement, which I suppose is IAS 7. I will need to know how cash flows are classified and defined; and reporting methods. I also want answers and clarifications on the following:
  - (i) I want to invest a substantial part of my saving in shares at the Lusaka Stock Exchange, how would my dividends received be disclosed in this cash flow statement?
  - (ii) I want to sale one of the assets owned by the business, how should the gain be reported
  - (iii) Finally, I want to know if there is any room for manipulation in terms of classifying cash flows to enhance operating cash flows.
- (b) As part of my investment plan, part of the investment will be in property, plant and equipment. I want to be sure on issues pertaining to property, plant and equipment in as far as the IAS is concerned. To be more specific, what will be categorized as plant and equipment and their recognition? This is what I intend to do:
  - (i) I want to purchase plant and equipment to be used for the business operations. The plant will be constructed and not purchased. As for equipment, this will be bought from America. I will also bring in 100 cattle to be used at the farm.
  - (ii) In three years time, I intend to revalue the plant in order to determine its market value.
- (c) I am also aware that the International Accounting Standards Board (IASB) issued IFRS for Small and Medium-Sized Entities (IFRS for SMEs) to be applied by eligible entities in place of the full set of IFRSs. I may contemplate coming in as an SME so that I could avoid complications arising from standards such as IAS 39, Financial Instruments: Recognition and Measurement on aspects of “held – to

maturity”. I want to know how different the IFRS for SMEs are from the normal IFRSs.

### **3. Ethical issues**

Mr. Tembo has a friend in Zambia who he intends to introduce to you as his Consultant assisting in answering and clarifying a number of accounting related issues as outlined in (2) above. The friend has been a very successful business man for a period of one year. He was then brought to you and introduced as Mr. Todd.

Upon seeing the friend, you realize that he happens to be a person reported in one of the daily paper as facing money laundering charges with the Drug Enforcement Commission (DEC). Preliminary information suggests that Mr. Todd has been trafficking in high grade prohibited substances through a friend in the USA.

As part of the discussion with Mr. Todd, he has promised a trip away to Dubai for a meeting to discuss business prospects.

As a consultant, you are now in a dilemma as to whether the business dealing with Mr. Tembo is genuine or not considering that Mr. Tembo has been in the USA for some time now.

<b>SECTION A</b>
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- 1) In line with tax planning advisory services, and for the benefit of Mr. Tembo, outline the type of taxes found in Zambia and classify them accordingly into direct, indirect, capital, revenue, and progressive taxes as appropriate.

**(15 marks)**

- 2) In line with tax planning advisory services, write a report to Mr. Tembo, clearly **outlining** and **explaining** the benefits that may arise from the commercial farming and manufacturing trade Mr. Tembo wants to venture in. You should clearly show the calculations, where necessary, to justify the information you will provide in the report. A detailed analysis is therefore expected based on the information provided. Assumptions and suggestions are allowed.

**(35 marks)**

- 3) List five (5) types of taxable income and five (5) persons/organizations exempt from paying tax.

**(10 marks)**

**(Sub-total: 60 marks)**

<b>SECTION B</b>
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- 4) As a Consultant, with sufficient knowledge in IFRSs, assist Mr. Tembo by addressing his concerns as raised on accounting related issues. A detailed understanding of the standard is not required, and the answers and clarifications must be limited to the marks allocated.

Cash flow issues (15 marks)

Brief issues pertaining to IAS 16 on issues raised (7 marks)

Brief issues pertaining to IFRS for SMEs on what they are (8 marks)

**(30 marks)**

- 5) As a Consultant, discuss some ethical issues that may arise due to the continued dealings with Mr. Tembo based on ethical issues in paragraph 3.

**(10 marks)**

**(Sub-total: 40 marks)**

**(Total: 100 marks)**

**END OF EXAMINATION**