



## **COMPETENCE PRACTICE EXAMINATION**

### **NON AUDIT**

**JUNE 2009**

**TIME ALLOWED: 5 HOURS**

---

#### **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 three Sections: A, B and C  
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 1

### 1. Introduction

You are the managing director of Zulu Accounting Services; a firm registered under the Zambia Institute of Chartered Accountants (ZICA) licenced to provide accountancy and other related services. You act as advisor and consultant for a number of small and medium companies, including a company called Kalundu Holdings.

Kalundu Holdings is a recently established company that sells automobile parts and carries out repair works in Lusaka. Sales and profits have expanded rapidly in the last two years and the prospects for future years are every bit as encouraging. Infact the Kalundu brothers are currently considering opening further branches in Kitwe and Livingstone.

The company started in 2006 when Solomon Kalundu Jr stopped working for Motor World where he was their sales engineer and decided to open his own auto shop. Although it has never been necessary to expand facilities, space problems have recently become severe and expanded facilities will be necessary.

Kalundu Holdings have not found it necessary to employ a full complement of accounting staff and rely on you to prepare financial statements for presentation to their auditors. You also act as their tax and general business consultants.

It is now April 2009 and your accounting staff have collected and compiled the following information from Kalundu Holdings in relation to the preparation of financial statements for the year ended 31 March 2009, including some tax planning issues. The information has been compiled into the following working papers:

- Accounting policies
- Draft Statement of Financial Position
- Accounting adjustments
- Tax planning issues

<b>Client:</b> Kalundu Holdings	<b>Year-end:</b> 31/03/2009	<b>FebA1001</b>
<b>Prepared by:</b> Andrea Kwete	<b>Date:</b> 22/04/2009	
<b>Subject:</b> Accounting Policies		

### 2. Accounting policies

For the 2009 financial statements, Kalundu Holdings' accounting policies conform to the Zambian Statements of Generally Accepted Accounting Practice (GAAP). This comprises:

- Applicable laws and regulations
- International Financial Reporting Standards (IFRS)
- International Accounting Standards (IASs)

The financial statements are prepared on the basis of historical cost and modified to include fair values in respect of specific non-current assets and liabilities as required by the GAAP.

No changes are proposed to the accounting policies for the year ended 31 March 2009, except where it is necessary to comply with the new or revised accounting standards. However policies related to revenue recognition will continue to reflect the substance of transactions based on the agreement with customer.

### **2.1. Tangible Non-Current Assets**

Tangible property, plant, and equipment are recognized as assets if and only if it is probable that future economic benefits associated with the assets will flow to the entity; and the cost of the items can be measured reliably. The fair value model of valuation is followed for investment properties. Results of such revaluations are carried forward as unrealised until such property is sold. For other tangible assets, the fair valuation is followed on selected items, with no depreciation provided on such items.

### **2.2. Intangible assets**

Any significant expenditure on specialized training and expenditure on advertising that is separately identifiable is capitalized and amortised over the estimated period in which related benefits are expected to be realized.

### **2.3. Provision for asset replacement**

The company operates some heavy excavating plant which requires a major overhaul every three years. The cost of such overhaul is estimated at the beginning of each year and provision is made accordingly. The provision is made on the basis of the actual amount expected to be paid in the future.

### **2.4. Inventories**

Inventories are valued at the lower of cost and net realisable value. Net realisable represents the estimated selling price in the normal course of business less estimated cost to complete and estimated cost to make a sale. Cost comprises:

- The purchase price
- Import duties
- Transportation costs
- Handling costs directly pertaining to the acquisition of goods

In cases of inventories that are not ordinarily interchangeable and goods or services produced and segregated for specific projects, costs are assigned using LIFO.

<b>Client:</b> Kalundu Holdings	<b>Year-end:</b> 31/03/2009	<b>FebA1002</b>
<b>Prepared by:</b> Brian Chanda	<b>Date:</b> 22/04/2009	
<b>Subject:</b> Draft Statement of Financial Position		

### **Draft Statement of Financial Position**

Draft Statement of Financial Position of Kalundu Holdings as at 31 March 2009

(K'Million) (K'Million)

#### **Non-current assets**

Freehold property		12,600
Plant		11,000
Investment property at 1 April 2008		1,500
		-----
		25,100

#### **Current asset**

Inventory	6,040	
Trade receivables and prepayments	3,120	
Bank	1,380	
	-----	
		10,540

#### **Total assets**

35,640

=====

#### **Equity and Liabilities**

Ordinary shares of K1 each		15,000
Share premium	1,000	
Retained earnings – 1 April 2008	5,250	
Retained earnings – Year to 31 March 2009	4,750	
	-----	
		11,000
		-----
		26,000

#### **Non-current liabilities**

Deferred tax – at 1 April 2008		1,870
--------------------------------	--	-------

#### **Current liabilities**

Trade payables	4,740	
Provision for plant overhaul	1,200	
Taxation	420	
	-----	
		6,360

Suspense account		1,410
------------------	--	-------

#### **Total equity and liabilities**

35,640

=====

<b>Client:</b> Kalundu Holdings	<b>Year-end:</b> 31/12/2008	<b>FebA1003</b>
<b>Prepared by:</b> Grace Phiri	<b>Date:</b> 16/02/2009	
<b>Subject:</b> Accounting Adjustments		

### **Accounting Adjustments**

- i) The Statement of Comprehensive Income has been charged with K320 million being the first of four equal annual rental payments for an item of excavating plant. This first payment was made on 1 April 2008. Kalundu Holdings has been advised that this is a finance lease with an implicit interest rate of 10% per annum. The plant had a fair value of K1,120 million at the inception of the lease.
- ii) None of the non-current assets have been depreciated for the current year. The freehold property should be depreciated at 2% on its cost of K13,000 million, the leased plant is depreciated at 20% on the reducing balance basis.
- iii) Kalundu Holdings adopts the fair value model for its investment property. Its value at 31 March 2009 has been assessed by a qualified surveyor at K1,240 million.
- iv) During an inventory count on 31 March 2009 items that had cost K600 million were identified as being either damaged or slow moving. It is estimated that they will only realize K400 million in total, on which sales commission of 10% will be payable. An invoice for materials delivered on 12 March 2009 for K50 million has been discovered. It has not been recorded in Kalundu Holdings's bookkeeping system, although the materials were included in the inventory count.
- v) Kalundu Holdings operates some specialised plant which requires a major overhaul every three years. The overhaul is estimated to cost K1,800 million and is due to be carried out in April 2009. The provision of K1,200 million represents two annual amounts of K600 million made in the years to 31 March 2008 and 2009.
- vi) The deferred tax provision required at 31 March 20X9 has been calculated at K2,250 million.
- vii) The suspense account contains the credit entry relating to the issue on 1 October 2008 of a K1,500 million 8% loan note. It was issued at a discount of 5% and incurred direct issue costs of K15 million. It is redeemable after four years at a premium of 10%. Interest is payable six months in arrears. The first payment of interest has not been accrued and is due on 1 April 2009. The effective interest rate on the loan note is 6% per half year.

<b>Client:</b> Kalundu Holdings	<b>Year-end:</b> 31/03/2009	<b>FebA1004</b>
<b>Prepared by:</b> Mwenya Kupo	<b>Date:</b> 10/04/2009	
<b>Subject:</b> Tax Planning Issues		

### **Tax Planning issues**

The following information is provided related to key tax issues under consideration:

- Remuneration packages
- Choice of business medium

### **Remuneration packages**

Kalundu Holdings is in the process of revising remuneration packages for their employees. In a briefing prepared by the Human Resources Director, the following suggestions have been proposed:

- a) All benefits should be withdrawn in preference for a much higher salary and a bonus at the end of each year. A number of suggestions have been proposed. Benefits in kind withdrawn include personal to holder motor vehicles and free accommodation.
- b) Share option schemes and pension schemes should be considered, but it is not clear what the tax advantages might be.

### **Choice of business medium**

Kalundu Holdings is contemplating opening a business development and consultancy wing. What is not clear is the choice of the most appropriate trading medium. Some directors have suggested that given the personal nature of consultancy services, a partnership would be the most appropriate medium. Additionally, limited companies tend to have much higher compliance and regulatory costs.

<b>Client:</b> Kalundu Holdings	<b>Year-end:</b> 31/03/2009	<b>FebA1005</b>
<b>Prepared by:</b> Kabwe Musonda	<b>Date:</b> 18/04/2009	
<b>Subject:</b> Ethical Dilemma		

Brian Chanda has been working 6 months as an assistant accountant for Zulu Accounting Services (ZAS). Currently he is assigned to prepare financial statements for several companies falling under Kalundu Holdings, under the supervision of Charles Lengwe, an experienced accountant. There are three accountants assigned to this task, including Brian, Cheswa, and a more experienced assistant, Martha Kombe. During lunch on the first day, Charles says, “it will be necessary for us to work a few extra hours on our own time to make sure that we finish our work within the budget. These assignments are not very profitable anyway, and we do not want to upset our boss by going over budget. We can accomplish this easily by coming in a half hour early, taking short lunch breaks, and working an hour or so after normal stoppage time. We just won’t enter that time on our time sheets”

Brian recalls reading in the company’s policy manual that working hours not charged on the time sheets is a violation of Zulu Accounting Services (ZAS) employment policy. He also knows that senior accountants are paid bonuses, instead of overtime, whereas junior staff are paid for overtime but get no bonuses.

Later, when discussing the issue with Martha, she says, “Charles does this on all of his assignments. He is likely to be promoted to manager because the managing director thinks he is good because his assignments always come under budget. Charles rewards us by giving us favourable appraisal reports, especially under the co-operative category. Several of the other supervisors follow the same principle”

## QUESTION 1

### REQUIRED

<b>SECTION A</b>
------------------

1. With reference to the ethical dilemma referred in working paper (**FebA1005**), identify key ethical issue and discuss the implications of the issue on the accounting team involved in the assignment. Faced with same situation as Brian, suggest the action that you would take. **(20 marks)**
2. With reference to working paper (**FebA1003**), prepare a schedule of adjustments required to finalise the financial statement of Kalundu Holdings for the year ended 31 March 2009. Support your answers with reference to appropriate accounting standards **(20 marks)**

<b>SECTION B</b>
------------------

3. Using the draft statement of financial position provided by Kalundu Holdings at working paper (**FebA1002**) and taking into account the adjustments in (2) above,
  - a. Show the adjustments that should be made to the retained earnings for the year ended 31 March 2008 and 2009. **(5 marks)**
  - b. Prepare the final statement of financial position for Kalundu Holdings Ltd as at 31 March 2009. **(20 marks)**
4. With reference to working paper reference (**FebA1001**), evaluate and discuss the company's accounting policies relating to:
  - a) Tangible non-current assets
  - b) Intangible non-current assets
  - c) Provisions
  - d) Inventories **(25 marks)**

<b>SECTION C</b>
------------------

5. Prepare memorandum to the managing director of Kalundu Holdings in which you set out your proposals on how each of the matters arising from tax planning issues on working paper reference (**FebA1004**) should be approached in order to minimise KH's liability. For each matter, provide reasons for your proposal **(10 marks)**

**Total**

**(100 marks)**

## QUESTION 2

Thandiwe is a former employee of one of the leading hotels in Lusaka. She recently opted for early retirement so that she could set up her own business. She always wanted to be her own boss and had the idea that she could produce a range of alternative sports trophies whose originality would command a premium price and compete easily with the bland gold and silver trophies. Accordingly she registered a business under the name Alternative Sports Trophies Ltd in June 2008

You are the managing director of Facts and Figures Professional Services Ltd, a small firm registered with the Zambia Institute of Chartered Accountants (ZICA) to provide non-audit services. It is now June 2009 and Thandiwe's business has been running for one year. She has now come to see you for some professional assistance and advice relating to:

- Preparation of Statement of Cash Flows for presentation to the bank
- Potential fraud
- Remuneration packages and VAT obligations

### 1) Preparation forecast Statement of Cash Flows for presentation to the bank

Thandiwe says:

“I am opening a branch in Solwezi and I want some advice with the cash flow and budget part of my business plan. I have done some research.

- a) I need two machines to help me cut and shape the trophies. These two machines would cost K12 million. I can purchase second hand office furniture for K8 million and a new computer with software and printer for K9.5 million, with a year's warranty. This all seems like a lot of money to pay out.
- b) My raw materials are quite cheap, being metal wire, hardwood cut-offs, old broken sports gear, paints, cardboard packaging and other odds and ends. I reckon that K700,000 per month should cover raw materials.
- c) I will need to employ one worker and one part time secretary at a total wage bill of K6 million per month.
- d) I want to pay a full time manager a salary of K7.5 million per month.
- e) Oh yes, and other costs include K2.5 million insurance fees payable in July 2009.
- f) Advertising in the business sections of the Post and the Times of Zambia would be the heaviest at the beginning. I've decided to spend K400,000 in the first two months, then reduce this to K160,000 per month.

g) Telephone bills would be K500,000 payable every three months. Other overheads include electricity and water would be about K900,000.

h) I expect to make and sell the following quantities over the next six months:

Month/	July	August	September	October	November	December
Quantity	250	275	275	310	330	270

I am concerned that the business is seasonal. The main sales will be in the later part of the year with a smaller peak in October and November. I have done some research and predicted sales in Solwezi for a six-month period. Each trophy will sell for about K70,000, including postage and packing. I have saved K25 million from my operations so far which can initially be invested in the Solwezi operations. I have also found a place to rent for K3 million per month. I will need to pay you K2.5 million for helping me with the cash flow. I think I will need to borrow some money, only I am not sure and what the interest cost might be?”

## **2) Potential Fraud**

Thandiwe has also informed you that her bank has recently returned a number of cheques due to insufficient funds. Your preliminary interview with her revealed the following:

- a) All receipts from sales of trophies are banked in a specially designated account, from which related expenses are paid. There are no other receipts deposited in this account
- b) The banking is done by one of the assistants. The cash book is written from deposit slips by the same assistant who also performs bank reconciliations. Thandiwe understands very little about the meaning and purpose of a bank reconciliation and relies on the assistant.
- c) The bank reconciliations are not always done on a monthly basis.
- d) Apart from unpresented cheques and uncredited lodgements, the bank reconciliation contains a figure referred to as ‘adjusting balances’ reconciling the difference between the cash book and the bank statement.
- e) On all the reconciliations done, the cash book balance is significantly higher than the bank balance.

## **3) Tax and VAT obligations**

In the course of registration of her business for tax purposes, Thandiwe came across some tax information in a leaflet published by the Zambia Revenue Authority. The leaflet explained that the difference between tax avoidance and evasion was important due to the legal implications.

Thandiwe has been contemplating the following actions:

- a) Selling some capital assets in May 2010 instead of July 2009?
- b) Altering a bill of K700,000 to K7million on the tax return

Thandiwe needs advise on the implications of the two actions. Additionally, now that she has registered for VAT, Thandiwe is not sure about the obligations that should follow.

Before accepting to assist Thandiwe, your firm has carried out a preliminary research, from which the following has emerged:

- a) Thandiwe was actually asked to resign from the Hotel because she was suspected to have been involved in fraudulent activities. The Hotel was in the process of taking her to court.
- b) Although, the new business had been set up, it was still not possible to distinguish between her personal financial affairs and those of the new business. For example, a cheque for the purchase of a wedding gift for her young sister was drawn on the business bank account
- c) A number of invoices have been issued to a company based in Bermuda for the sale of trophies. There is no evidence to confirm that such trophies were manufactured and sent to Bermuda.
- d) Other people employed by Thandiwe were not able to answer any questions without permission from Thandiwe. All questions had to be referred to Thandiwe.
- e) Although Thandiwe has excellent business acumen, she knew very little about accounting.
- f) Thandiwe has approached you because she expects that she can pay you any professional fee charged as long as you will help with her financial and taxation affairs so that she pays the minimum tax possible.

## QUESTION 2

### REQUIRED

<b>SECTION A</b>
------------------

- 1) In relation to the acceptance of the role of personal financial and tax advisor for Thandiwe,
  - a. Comment on the basis of charging professional fees and on your expected role to ensure that Thandiwe pays as little tax as possible.  
**(5 marks)**
  - b. Evaluate the arguments for and against your firm accepting to provide professional services to Thandiwe and her company.  
**(10 marks)**
- 2) Using a tabular format and with specific reference to the information contained on potential fraud
  - a. Identify potential weaknesses in the receipts and banking system.  
**(10 marks)**
  - b. For each weakness, recommend appropriate control procedure(s) that should be included to reduce the incidence of fraud and error.  
**(10 marks)**
- 3) List and briefly describe investigative procedures you would undertake to quantify the possible maximum fraud on bankings.  
**(15 marks)**

<b>SECTION B</b>
------------------

- 1) In relation to the two remuneration options and VAT obligations:
  - a. Explain to Thandiwe the difference between tax evasion and tax avoidance, and the implications of the actions she is contemplating.  
**(10 marks)**
  - b. State the obligations of Thandiwe after she has registered her business for VAT purposes.  
**(10 marks)**
- 2) Using the cash flow information provided by Thandiwe,
  - a. Draw up a cash flow forecast for Thandiwe for six months to December 2009.  
**(20 marks)**

- b. Suggest FIVE specific actions that Thandiwe could take to improve the forecast cash flow position. Assume that no decision has yet been made on the loan.  
(10 marks)

**Total**

**(100 marks)**

**END OF EXAMINATION**