COMPETENCE PRACTICE EXAMINATION

NON AUDIT

JUNE 2010

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 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 $2^1/_2$ 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. You name must NOT appear anywhere on your answer booklet.

7. This is an open book examination.

QUESTION ONE

1) BACKGROUND

Sparkles Ltd is a new and second hand motor vehicle dealer with branches throughout Zambia. The company is owned 50% by Jason Kapela, 25% by his wife Veronica and 10% by Bernard Shaka, and the remainder 15% is owned by Bernard's sister Monica Shaka. Jason is the chief executive and Bernard the finance director. The directors are entitled to profit related remuneration.

New cars are purchased on a consignment basis from single suppliers. Sparkles Ltd pays the invoice price six months after delivery, or on sale of the vehicle if sooner. All new cars come with a manufacturer's warranty of three years or 40,000 km whichever is sooner. Second hand cars are offered with a six month guarantee. The Finance Director believes that despite the increase in the number of cars sold, there is no need to increase the warranty provision because the company has focused more heavily on new car sales.

In the last two years Sparkles Ltd has diversified into agricultural production supplying sugar cane and other agricultural produce to Zambia Sugar and other such manufacturing companies.

2) PLANNED ACQUISITIONS FOR THE FUTURE

In its quest for further expansion and diversification, Sparkles Ltd has identified and targeted three companies for additional acquisitions. The Kapelas wish to increase their shareholding in the new acquisitions beyond their current holdings. The planned acquisitions have generated a lot of disagreement with Monica deciding to resign from Sparkles Ltd.

The board of Sparkles Ltd is aware that International Accounting Standards make it clear that that the treatment in consolidated financial statements of investments in other enterprises is dependent on the extent of the control or influence the investing entity is able to exercise over the other enterprise. Sparkles Ltd has now entered into negotiations to make investments in three companies.

3) RESIGNATION OF DIRECTOR

Bernard Shaka's sister Monica Shaka has recently resigned from the executive board, following a disagreement with the Kapelas. Monica has now formed her own company, Spakos Ltd, dealing in new and second hand cars, and in direct competition with Sparkles Ltd.

Monica is currently negotiating with her former co-executives the profit-related remuneration due to her and the sale of her 15% holding shares in Sparkles Ltd to one or all of them

Monica has approached your firm and has made the following requests:

a) Find out Jason's current remuneration package since he refuses to disclose this to her
b) Your firm should continue to act as her personal advisor
c) Your firm should become professional adviser to Spakos Ltd
d) Your firm to provide some taxation advise on Value Added Tax (VAT)

4) PROFESSIONAL SERVICES

You are the Managing Consultant for Nkuta Financial Services (NFS). NFS is a firm registered with the Zambian Institute of Chartered Accountants and provides a range of financial services, including accountancy, taxation and related consultancy.

Your firm acts as accountants and advisor to Sparkles Ltd and to its four directors. For the current year, you have been requested to assist with the resolution of outstanding matters in order to finalise the financial statements for the year ended 31 March 2010.

5) WORKING PAPERS

Your senior consultant, Mr. Bob Ziwa (bz), has extracted and summarised the following working papers to enable your firm plan to provide the necessary financial and advisory services:

a) Planned investments and acquisitions **(SP/2010/bz/1**
b) Accounting queries to finalise the financial statements for Sparkles for the year ended 31 March 2010 **(SP/2010/bz/2)**
c) Tax information for Monica Shaka **(SP/2010/bz/3**

Client: Sparkles Ltd	**Year-end:** 31/03/2010	**SP/2010/bz/1**
Prepared by: Bob Ziwa	**Date:** 15/04/2010	
Subject: Planned Investments		

a) **Malido Farms Ltd**
Sparkles Ltd plans to purchase 40 million K2,000 shares in Malido Farms Ltd. The issued share capital of Malido is 50 million shares K2,000 equity shares.

b) **Fresh Produce Ltd**
Sparkles Ltd plans to purchase 30 million K1,000 shares in Fresh Produce Ltd. The issued share capital of Fresh Produce Ltd is 75 million K1,000 equity shares. The remaining equity shares in Fresh Produce Ltd are held by a large number of investors – none with more than 5 million equity shares

c) **Kalimba Cars Ltd**
Sparkles Ltd plans to purchase 25 million K2,000 equity shares in Kalimba Cars Ltd. The issued equity share capital of Kalimba Cars Ltd is 80 million K2,000 equity

shares. Another investor owns 50 million equity shares in Kalimba Cars Ltd. The investor takes an active interest in directing the operating and financial decisions of Kalimba Cars Ltd. This investor is in a position to make decisions that will require Kalimba Cars Ltd to follow policies that may not meet with the approval of Sparkles.

Equity shares in all of the above enterprises carry one vote per share at general meetings. No party can control or influence the composition of the board of directors of any of the enterprises other than through ownership of equity shares. There should not be any instances where shareholders in any of the enterprises should act together to increase their control or influence. All of the enterprises are not expected to issue further shares after Sparkles Ltd has finalised its proposed investments. All of the enterprises are separate legal entities

Client: Sparkles Ltd	**Year-end:** 31/03/2010	**SP/2010/bz/2**
Prepared by: Bob Ziwa	**Date:** 20/04/2010	
Subject: Accounting Queries		

The draft financial statements for year ended 31 March 2010 have been completed. However, the following matters are outstanding and require resolution before the financial statements can be presented for audit. The issues relate to the following transactions that have not yet been accounted for in the financial statements of Sparkles Ltd:

a) Sparkles Ltd has grown a field of a special type of sugar cane and as at 31 March 2010, it is assessed that the sugar cane would take another three years before it is ready for harvesting. On 1 January 2010, Sparkles Ltd sold the field of sugar cane to Investment trust bank for K1.5 billion kwacha. The conditions of sale were that Sparkles Ltd would have the right to buy back the field in three years time at a price of K2 billion. Sparkles Ltd will also be responsible for the general care and maintenance of the field for the next three years. At the time of sale the fair value of the field was assessed to be K4 billion and this value is expected to increase to K6 billion in three years time. The accumulated cost of the sugar cane field showed that a total of K900 million had been incurred as at 1 January 2010. The Management Accountant for Sparkles Ltd has proposed that a profit on sale of K600 million should be reported.

b) During the year Sparkles Ltd sold a piece of plant with a carrying value of K200 million and immediately leased it back over a period of four years. The lease requires four equal rental payments of K87 million at the beginning of each financial year. The normal cost of such a lease without the residual value would have been K95 million per annum. The fair value and selling price of the plant was K 330 million and remaining useful life of the plant is five years. The lease cannot be cancelled and Sparkles Ltd was to be responsible for any insurance and repairs and maintenance cost of the plant. Sparkles Ltd has guaranteed a residual value of K30 million and the plant is to be sold for scrap at the end of the lease. Sparkles Ltd was to be liable for any shortfall in the residual value. The present value of the minimum lease payments and the guaranteed residual amount is approximately equal to K325 million

c) Sparkles Ltd has a building that has been designated as held for sale in the financial year to 31 March 2010. During the year to 31 March 2010, the building still remains unsold, but the market conditions for the asset have deteriorated significantly. The entity believes that market conditions will improve and has not reduced the price of the asset, which continues to be classified as held for sale. The fair value of the building is K3 billion, and it is being marketed at K5 billion. The accountant is not sure whether conditions for treatment of the building as 'held for sale' have been met.

d) Sparkles Ltd believes in working with reliable and dependable vendors and also sells only to distributors that it can either control or exercise significant influence over. The following information is relevant:

   (i) Sparkles Ltd buys its second hand cars from Japan Exports (JE). Due to the high quality of the second hand cars, materials JE has provided over the last few years, Sparkles Ltd has never purchased from any other supplier. Thus it may be considered dependent on JE, in this regard.
   (ii) Sparkles Ltd sells 70% of its output to a company owned by one of its directors and the balance to another entity in which Sparkles Ltd owns 35% of the share capital
   (iii) Sparkles Ltd stores its inventory in a warehouse that is leased from the wife of its director. The lease rentals are at arm's length

The board is anxious to resolve these matters as quickly as possible and have requested your firm to review the above issues and recommend appropriate accounting treatment.

Client: Sparkles Ltd	**Year-end:** 31/03/2010	**SP/2010/bz/3**
Prepared by: Bob Ziwa	**Date:** 23/04/2010	
Subject: Tax information for Monica		

Monica has registered her company for Value Added Tax and for the month of March 2010, her accountant produced the following extract from management accounts:

	K'000	**K'000**
Sales		99,950
Cost of sales:		
Opening inventory	500	
Purchases	62,800	
	63,300	
Less closing inventory	(650)	
		(62,650)
Gross profit		37,300
Less Expenses:		
Depreciation	1,250	
Bad debts written off	6,500	
Overheads	10,600	
General Expenses	12,300	
		(30,650)
Profit before tax		6,650

The following additional information is also relevant:

a) Exempt supplies taken as a proportion of total sales amount to 10%. Included in the remainder are zero rated supplies of K12.5 million
b) 20% of the standard rated sales were made to customers who are not registered for VAT purposes
c) Purchases include exempt supplies whose value is K15 million. The remainder of the purchases are standard rated for VAT purposes.
d) 50% of the standard rated purchases were from non-Value Added Tax registered suppliers
e) The bad debts were written off on 31 March 2010. The figure consist of two invoices of K3.250 million each in respect of which payment was due on 1 September 2008 and 31 December 2008
f) The overheads are all standard rated supplies for the purposes of VAT
g) The figure for general expenses is inclusive of VAT and is made up of:

	K'000
Entertaining customers who are VAT registered	2,650
Telephone bills	4,000
Diesel	5,650

Unless otherwise stated, all of the above figures are VAT exclusive. Monica is also not sure how making exempt supplies differs from making zero rated supplies for the purposes of VAT.

QUESTION 1

SECTION A

1) Monica has requested that your firm should disclose Jason's remuneration, continue to act as her personal advisor and accept appointment as professional advisor to Spakos Ltd.

   a) List and briefly describe the ethical and professional matters raised by Monica's three requests.

   (6 marks)

   b) Comment on whether or not your firm can comply with each of the above mentioned three requests.

   (12 marks)

   c) Conclude as to your final position with regard to providing professional services for Sparkles Ltd and Spakos Ltd.

   (6 marks)

2) With reference to working paper **(SP/2010/bz/3)**

   a) Calculate the amount of VAT payable or repayable for the month of March 2010. **(15 marks)**

   b) State the latest date by which VAT for the month of March 2010 should have been paid and explain the implications of paying VAT later than that date. **(5 marks)**

   c) Explain how making exempt supplies differs from making zero supplies for purpose of VAT. **(6 marks)**

(Sub-total: 50 marks)

SECTION B

3) Prepare a briefing paper to the board of Sparkles Ltd explaining how each of the above transactions should be accounted in the financial statements of Sparkles Ltd for the year ended 31 March 2010, so as to comply with applicable International Accounting Standards. Your paper should clearly indicate where appropriate, relevant figures to be included in the statement of comprehensive income and the statement of financial position. Marks are allocated as follows:

   a) Repurchase contract **(12 marks)**

   b) Sale and lease back **(9 marks)**

   c) Non-current asset held for sale **(8 marks)**

   d) Extent of influence from working relationships **(6 marks)**

4) Advise how the following planned acquisitions will be accounted in the consolidated financial statements of Sparkles Ltd:

   a) Malido Farms Ltd **(5 marks)**

   b) Fresh Produce Ltd **(5 marks)**

   c) Kalimba Cars Ltd **(5 marks)**

(Sub-total: 50 marks)

(Total: 100 Marks)

QUESTION TWO

A. Background

Petwe Holdings is a parent company to several companies including Sweeney Investments Ltd and Lusaka Traders Ltd. The Chairman and founder of Petwe Holdings is Mr. Enok Kapindele. The wife, Mrs. Evelyn Kapindele is the Executive Director.

Petwe Holdings deal in electronic equipment, parts and components. It also undertakes related repairs. The company continues to expand its operations throughout Zambia

B. Appointment of professional advisors

You are the managing director of Musonda Associates, firm of professional accountants and tax advisors. Your firm has been providing accountancy, taxation and other secretarial services to the Petwe group for several years. You are also expected to provide personal financial and taxation advice to the Kapindele family. Accordingly you have been retained to provide the following services:

COMPANY	SERVICES REQUIRED
Sweeney Investments	Accountancy – finalization of financial statements for the year ended 31 March 2010
Lusaka Traders	Preparation of tax computation for the year ended 31 March 2009
Mrs. Evelyn Kapindele	Tax advice

C. Special Requests

As part of the provision of these services, and as conditions of your continued business relationship with Petwe Holdings, Mr. Kapindele has requested that:

a) Your firm should employ his son so that you can mentor him in accounting and business matters. It is the intention of Mr. Kapindele that his son takes over the control of the company once he is ready

b) Your firm should help Petwe holdings to reduce its tax burden He has indicated that his companies have, in the last few years, paid “too much tax” to Zambia Revenue Authority.

c) The fee discussion should be finalized at the year end once all the tax liabilities are determined as he would like to pay a reasonable “bonus” to your firm depending on the reduction in the tax liability

d) Your firm should help to determine a transfer pricing policy between the companies in the group so as to minimize the tax liability. However, you are aware that there have been no inter-company transactions that have taken place during the year.

Sweeney Investments Ltd (SI)

The following trial balance relates to SI at 31 March 2010:

	K'million	**K'million**
Revenue		213,800
Cost of sales	143,800	
Closing inventories – 31 March 2010 [note(i)]	10,500	
Operating expenses	22,400	
Rental income from investment property		1,200
Finance costs [note(ii]	5,000	
Land and building – at valuation [note(iii)]	63,000	
Plant and equipment – cost [note(iii)]	36,000	
Investment property – valuation 1 April 2009 [note(iii)]	16,000	
Accumulated depreciation 1 April 2009–plant and equipment		16,800
Plant held for sale	8,000	
Trade receivables	13,500	
Bank		900
Trade payables		11,800
Ordinary shares of K 2,000 each		20,000
10% Redeemable preference shares of K1,000 each		10,000
Deferred tax (note(v))		5,200
Revaluation reserve (note(iii))		21,000
Retained earnings 1April 2009		17,500
	318,200	318,200

The following notes are relevant:

(i) An inventory count at 31 March 2010 listed goods with a cost of K1.5 billion. This includes some damaged goods that had cost K800 million. These would require remedial work costing K450 million before they could be sold for an estimated K950 million.

(ii) Finance costs include overdraft charges, the full year's preference dividend and ordinary dividend of K3.2 billion that was paid in September 2009.

(iii)Non-Current Assets

a. **Land and buildings**

The land and building were revalued at K15 billion and K48 billion respectively on 1 April 2009, creating a K21 billion revaluation reserve. At this date the building had a remaining life of 15 years.

Depreciation is on a straight line basis. SI does not make a transfer to realized profits in respect of excess depreciation on revalued property.

b. **Plant**

All plant is depreciated at 12.5% on the reducing balance basis.

Depreciation on both building and the plant should be charged to cost of sales

c. **Investment property**

On 31 March 2010 a qualified surveyor valued the investment property at K13.5 billion. SI uses the fair value model in IAS 40 *Investment Property* to value its investment property

(iv) The plant held for sale is valued in the trial balance at its carrying value in the statement of financial position. A broker has found a buyer for the plant for K 6 billion and will charge a fee of 5% of the sales proceeds. The sale should take place in April 2010

(v) The directors have estimated the provision for income tax for the year ended 31 March 2010 at K8 billion. The deferred tax provision at 31 March 2010 is to be adjusted (through the statement of comprehensive income) to reflect that the tax base of the company's net assets is K12 billion less than their carrying amounts. The applicable rate of income tax is 30%

D. Lusaka Traders Ltd

Lusaka Traders limited, a Zambian company that is not listed on the Lusaka Stock Exchange prepares its accounts annually to 31 March. In the year ended 31 March 2009, the company's profits before tax as shown in the statement of comprehensive income were K125 million. The profit was arrived at after dealing with the following items:

1) **General expenses of K160 million.** This figure included K10 million being the travelling expenses of staff, including Directors, and K6 million being expenditure incurred on entertaining suppliers.

2) **Repairs and renewals, which were made up as follows:**

	K million
Redecorating existing business premises	3.0
Renovations to new premises to remedy wear and tear of previous owner	5.0
	8.0

The premises were usable before the renovations were made.

3) **Legal and accountancy charges**

	K million
Debt collection service	2.0
Staff service agreements	5.0
Parking fines on company cars	9.5
Audit and accountancy fees	10.9
	27.4

4) **Subscriptions and donations included the following**

	K million
Donation to UGG, a political party	8.000
Sports facilities for staff	9.850
Donation for scientific research at UNZA	9.500
Subscription to Chamber of Commerce	9.900
	37.250

5) **Depreciation** of plant and machinery amounting to K35.4 million as well as depreciation of land and buildings of K25 million were charged in the statement of comprehensive income.

6) **Bad debts** charged in the statement of comprehensive income were arrived at as shown in the bad debts account below

DEBIT		**CREDIT**	
Item	**Amount K'm**	Item	**Amount K'm**
Trade debts written off	12.500	Balance b/d:	
Loans to employees written off	8.500	General provision	1.850
Balances c/d:		Specific provision	2.500
General provision	5.800		
Specific provision	3.000	Income statement	25.450
	29.800		29.800

7) **A profit on disposal** of a motor van of K21 million was credited to the statement of comprehensive income

8) **Dividends** received from another Zambian company of K15 million net, were credited to the statement of comprehensive income

Assets which the company owned as at 1 April 2008 were as follows:

Motor van: The income tax value as at 1 April 2008 was K93.750 million. The original cost as at 30 June 2007 was K125 million. The motor van was sold on 31 December 2008 for K13 million. The company's Sales Manager had private use of 25% in the Motor Van

Other assets: These included the following:

Date of purchase:	**Description**	**Original cost**
1 May 2000	Industrial Building	K890 million
1 August 2002	Motor Car (1)	K 75 million
1 June 2006	Motor Car (2)	K126 million
1 October 2006	Fixtures and fittings	K350 million

E. Mrs. Evelyn Kapindele

Mrs. E. Kapindele has been in business of selling cosmetics on her own account for many years making substantial amounts of profits. In the year ending 31st March 2011, she expects to make a final taxable business profit of K95 million

Her son, Kido Kapindele, has just completed his studies at the University of Zambia. Evelyn is considering bringing him into the business either as an employee or as a partner with effect from 1st April, 2010. If Kido is introduced as a partner, then there will be annual partnership salaries of K20 million for Evelyn and K18 million for Kido. Profits and losses would be shared between Evelyn and Kido in the ratio of 3:2 respectively. NAPSA contributions would not be payable by either party under this option.

If Kido is introduced as an employee, his annual salary would still be K18 million. He will then be required to pay NAPSA contributions of 5% to NAPSA as employer's contribution. Evelyn will also get K20 million as her own salary.

Mrs. Kapindele has approached you for advice on how best to proceed.

QUESTION 2

SECTION A

1) In relation to **special requests** from Mr. Kapindele

   a) List and briefly discuss ethical and other professional matters raised by each request.
   (12 marks)

   b) For each request, state clearly the action you should take
   (8 marks)

2) With reference to the **trial balance** for Sweeney Investments

   a) Prepare a statement of comprehensive income for Sweeney Investments Ltd for the year ended 31 March 2010.
   (15 marks)

   b) Prepare a statement of financial position for Sweeney Investment Ltd as at 31 March 2010.
   (15 marks)

(Sub-total: 50 marks)

SECTION B

3) Using the information provided on Lusaka Traders Ltd, prepare a tax computation and calculate the tax payable by Lusaka Traders Ltd for the year ended 31 March 2009
   (20 marks)

4) With reference to the request for taxation advice from Mrs. Evelyn Kapindele, calculate the income tax payable by Evelyn and Kido for 2010/2011 on the basis that:

   a) Kido is brought into the business as a partner
   (12 marks)

   b) Kido is brought into the business as an employee
   (12 marks)

   c) Advise Evelyn to which of the two options is beneficial from a tax point of view
   (6 marks)

(Sub-total: 50 marks)

(Total: 100 marks)

Note: Tax rates are included on the next page.

END OF EXAMINATION

Taxation Table – 2010/11

Income Tax

Personal income Tax rates for the Charge year 2010/11

	Chargeable income (Kwacha)	Rate (%)
First	9,600,000	0
Next	6,420,000	25
Next	33,180,000	30
Excess over	49,200,000	35
Income from farming		15

Company income tax rates

	Rate (%)
On income from manufacturing and other	35
On income from non-traditional exports	15
On income from farming	15

Capital Allowances

Implements, plant and machinery and commercial vehicles:

Wear and Tear Allowances – Used normally 25%
Used in Manufacturing, Farming, Leasing 50%

Non – commercial vehicles
Wear and Tear Allowance 20%

Industrial Buildings:

Wear and Tear Allowance 5%
Initial Allowance 10%
Investment Allowance 10%

Low Cost Housing: (Cost up to K20, 000, 000)

Wear and Tear Allowance 10%
Initial Allowance 10%

Commercial Buildings

Wear and Tear Allowance 2%