



COMPETENCE PRACTICE EXAMINATION

NON-AUDIT

JUNE 2012

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 ½ 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.

NON-AUDIT

QUESTION ONE

1.0.BACKGROUND

Filimina Retail Ltd is a company which specialises in selling groceries, bakery products, and fresh fruits and vegetables. It was incorporated on 1 January, 2006 and started operations immediately.

The company has two outlets, one in Lusaka and the other in Livingstone. Sales for both outlets have been rising, but the profits have not been impressive. Accounts are prepared to 31st December each year.

The current shareholding is as follows:-

	%
1. Mr Abraham Chiwempale	60
2. Mrs Beauty Chiwempale	15
3. Mrs Bibi Lutula	10
4. Mr Charles Pinky	15
TOTAL	<u>100</u>

Mr Abraham Chiwempale is the chairman and chief executive officer, while Mrs Beauty Chiwempale is the Finance Director. The other two shareholders do not take part in the management of the company.

Filimina Retail Ltd employs 12 people distributed as follows:-

1. Head office (situated in Lusaka)
 - a) Mr Mayandi Julia – Human Resource Manager (also in charge of procurement)
 - b) Mrs Rosette Lutula – Accountant (ZICA Part qualified)
 - c) Mr Francisco Mahungu – Sales Manager
 - d) Miss Ndombe Mulenga – Receptionist
2. Lusaka outlet
 - a) Mr Ensure Hamuto – Manager
 - b) Mrs Sisy Baobab – Cashier
 - c) Miss Marvy Kalulu – Sales representative

- d) Mr Able Nyali – Messenger/cleaner
- 3. Livingstone outlet
 - a) Mrs Lungo Zerrick – Manager
 - b) Mr Liks Ng'one – Cashier
 - c) Mrs Tourism Choolwa – Sales representative
 - d) Mr Change Hamalanji – Messenger/cleaner

There are no clear lines of reporting responsibilities. Mr Chiwempale gets information from anyone at anytime.

Mr Abraham Chiwempale is a Marketer by profession, and has worked with a number of reputable advertising agencies for over 10 years. He inherited the shares on the passing on of his father Mr Evaristo Mandebwe Chiwempale in 2008. He is resourceful and has worked hard to increase the company's sales. He believes in "spending big, to earn big". He does not believe in elaborate planning processes.

Mrs Beauty Chiwempale, the wife to the chairman and chief executive officer has no formal qualification in Accounting. She relies on the "little experience" she has acquired over the past few years. The ZICA part qualified accountant has also been of great help to her. However, she is now beginning to see the part qualified accountant's inadequacies given the increased business activity and demands of the various accounting standards. She has brought this to the attention of her husband, who has promised to assist in the recruitment of a qualified accountant or outsource the accountancy services to some degree.

The part qualified accountant is doing the ZICA programme and still has to write examinations in Financial Reporting (L1), Integrated tax (L3) and Corporate Financial Management (L6) in order to complete the Licentiate level and proceed to ZICA professional level.

Last month, Mr Abraham Chiwempale attended a workshop for non-finance managers on corporate governance and selected international accounting standards, organised by ZICA. He feels the company cannot afford to employ a full-time qualified accountant and has therefore opted to outsource some accountancy services.

He has now approached you as a ZICA qualified accountant, with a non-audit practising certificate to give professional guidance on the following issues:-

- 1. Corporate governance
- 2. Leasing
- 3. Inventories

4. Research and development
5. Government grant
6. Investment properties
7. Cashflow
8. Preparation of financial statements according to IAS 1

He has promised to compensate you adequately. You have done the necessary customer due diligence (CDD) and have gathered sufficient “know your client” (KYC) information. There are no major issues and you have accepted the appointment.

2.0.CORPORATE GOVERNANCE

Mr Chiwempale remembers that one of the presenters at the ZICA workshop did emphasize that good corporate governance starts with the formulation of an appropriate business strategy which clearly outlines the mission statement, the objectives and gives direction to the company in all areas. However, he is unable to remember what the presenter said on internal audit but strongly believes that this function can also add value to the business.

He approached his wife for advice. The wife categorically said internal auditors are a waste of time and other resources, especially where a company already has external auditors. Accountants do perform most of the internal checks and internal auditors are being used as internal consultants, especially in large corporations.

3.0. LEASING

During the year ended 31st December, 2011, the company acquired 4 point of sale equipment on lease from Chitwe Leasing Company. The chairman and chief executive officer is not sure whether the part qualified accountant knows how to treat this transaction according to recommended professional guidance.

The accountant has confided in Mrs Chiwempale that she knows nothing about leasing and has begged her not to tell her husband for fear of being dismissed. She hopes to consult one of her friends who has already passed Financial Reporting (L1).

4.0. INVENTORIES

The Chief Executive Officer thinks this is an easy area but he is very annoyed that the presenter on IAS 2 just managed to confuse him. He confesses that he understood absolutely nothing in this area.

5.0. RESEARCH AND DEVELOPMENT

During the year ended 31st December, 2011, the company started developing a computerised refrigeration system. Indications are that the project will be successful. However, the part-qualified accountant has proposed to write-off the full amount spent on the basis of prudence.

The Chief Executive Officer is not happy since he definitely knows that this will result in reduced profitability or even a loss which will effectively deny him the much needed dividends. He thinks the part qualified accountant is up to something and suspects financial wrong doing, including possibility of tax evasion.

6.0. GOVERNMENT GRANT

Mrs Beauty Chiwempale is the chairperson of the Food Democratic Party and was able to use her influence to secure a grant from the government towards the purchase of equipment for the bakery section.

The part qualified accountant has proposed to net off the grant against the cost of the equipment but Mrs Chiwempale believes this is totally inappropriate. She has demanded that the grant be credited to her equity account which will effectively increase her shareholding, since she personally convinced the government through her connections to release the grant. Mr Chiwempale believes that this is a brilliant idea and has in fact heard one of his friends in England talk about it.

7.0. INVESTMENT PROPERTIES

Mr Chiwempale personally owns properties in Ndola, Kitwe and Solwezi. He has been making alot of money through letting these properties to banks and other reputable organisations.

On 31st December, 2011 a number of properties were bought using company funds. He believes that since he is the major shareholder, he effectively owns the company and the properties must be registered in his name.

The part-qualified accountant is unable to convince him otherwise since she is not aware of any standard which deals with investment properties. She thinks that the Chief Executive's suggestion will simplify the accounting process.

8.0. STATEMENT OF CASHFLOW

Mr Chiwempale has come to appreciate from the ZICA workshop what determines a company's destiny. The statement of cashflow is such a key document. However, the part-qualified accountant has not drawn this important statement to his attention over the years. He intends to dismiss her from employment and report her to ZICA.

9.0. PERFORMANCE FOR THE YEAR ENDED 31ST DECEMBER 2011

The part-qualified accountant has extracted the following details from the accounting records:-

	K'million
Inventory (1.1.2011)	40,000
Purchases	60,000
Income tax overprovision	2,000
Distribution costs	45,000
Investment income	10,000
Administration costs	21,400
Lease rentals	33,000
Interest paid	800
Bank overdraft	20,000
Development expenditure	500
Grant	600
Plant and equipment	50,000
Accumulated depreciation on plant and equipment (1.1.2011)	12,000
Land	2,000
Investment property	50,000
Sales	226,000
Ordinary shares K1 each	20,000
Share premium	1,000
Revaluation reserve	30,000
Buildings	70,000
Receivables	140,500
Payables	80,000
Suspense account	2,600
Retained earnings	6,000

Deferred taxation	15,000
2% Debenture 2015-2017	88,000

Additional information

- a) The inventory valuation at 31st December, 2011 was K30,000million. Included in this figure were damaged inventories costing K500million. It is estimated that if they were cleaned, weighted and properly repackaged, at a cost of K 4 million, they could be sold for K494million.
- b) The income tax overprovision relates to the previous year.
- c) A payment of K3,000million for insurance for the year to 30th June, 2012 is included in distribution cost. (last year to 30th June, 2011 K2,000million)
- d) Administration costs includes a rental amount for 7 months of K 3,500million. The balance for the year is still outstanding.
- e) The debenture was issued last year and interest is paid half yearly.
- f) Filimina Retail Ltd bought 4 modern point of sale equipment with a list price of K13,500million each. The agreement states that the company will pay a deposit of K9000million on 1 January, 2011, and two annual instalments of K24,000million on 31 December 2011,2012 and a final instalment of K20,391million on 31 December 2013.

The auditors have advised that this is a finance lease and have calculated the implicit interest rate in the lease as 25% per annum. Point of sale equipment is depreciated on a straight line basis over a 4 year period, and an assumed scrap value of K1,000million for each point-of-sale equipment at the end of its useful life.

- g) The figure for development expenditure represents the amount spent this year on development of the computerised refrigeration system. It is probable that future economic benefits will flow to the entity and the cost of the asset is said to have been measured reliably.
- h) The grant was received on 1 January 2011. This was towards the cost of a new piece of equipment for the bakery section costing K1,200million. The equipment has a useful life of 5 years, with nil residue value. The cost of the equipment is included in the figure for equipment given above. The directors decided to depreciate this piece of equipment on a straight line basis. Other machines are depreciated at the rate of 25% using the reducing balance basis because the functions are totally different. The external auditor supports this view.

- i) Land and buildings were revalued to the amounts shown above, on 1st January, 2011. The revaluation reserve of K30,000million represents this revaluation. No further change in valuation has occurred since 1st January, 2011, the remaining life of the building was 35 years and is depreciated on a straight line basis.
- j) On 31 December 2011, the investment properties were valued at K46,000million. This figure does not include properties worth K1,000million bought using company funds on 31.12.11. The company uses the fair value model.
- k) Items sold on a sale or return basis for the Kuomboka ceremony had been omitted from the inventory as at 31st December 2011. The cost of these items was K520million and their sale price was K600million. All these items were returned in good condition to Filimina Retail Ltd upon cancellation of the Kuomboka ceremony on 5th January 2012.
- l) The suspense account is in respect of the following items:

	K'million
Proceeds from issue of 1,000,000 shares	3600
Investment properties bought using company funds	(1,000)
Total	<u>2,600</u>

- m) During the year, the company purchased vegetables worth K1,000million from Mrs Chiwempale.
- n) Provision should be made for tax and dividends at K17,661million and 2 ½ ngwee per share respectively.
- o) All depreciation must be included in cost of sales.

QUESTION ONE

SECTION A

- 1) Good corporate governance is key to the economic development of any country. This was even emphasized recently in a press statement released by the Institute of Directors (IoD) in Zambia.

Required:

Identify and explain any five corporate governance issues raised in Filimina Retail Ltd, and discuss ways of resolving them.

[10 marks]

- 2) Mr Abraham Chiwempale does not believe in elaborate planning processes.

Required:

Use appropriate academic models to discuss the statement above, and reach a conclusion.

[10 marks]

- 3) Using the details extracted from the accounting records and the additional information given, prepare the following:-

- a) Statement of comprehensive income for the year ended 31st December, 2011.

[12 marks]

- b) Statement of financial position as at 31st December, 2011.

[20 marks]

- 4) Discuss the usual business of an Annual General Meeting (AGM) and give the legal requirements of the fiduciary duty.

[8 marks]

Sub-total 60 marks

SECTION B

- 5) Evaluate Mr Abraham Chiwempale's statement that "cash is what determines a company's destiny."

[4 marks]

- 6) Assume Filimina Retail Ltd is contemplating listing on the Lusaka Stock Exchange (LuSE), and draft a suitable introductory paragraph for the statement on corporate governance. This will be included in the Financial Statements of the company.

[3 marks]

- 7) The modern role of the internal auditor in Zambia has expanded beyond accounting and finance issues. Consultancy projects (one-off projects designed to address ad-hoc issues) are playing an increasing role in the work of internal audit. Taking on these projects enables internal auditors to extend their skills, and the organisation to draw on the knowledge of internal auditors.

Required:

- a) Discuss the dangers in internal auditors becoming too involved in consultancy projects.

[6 marks]

- b) Suggest the actions (steps) that need to be taken in order to avoid these problems.

[6 marks]

8) The sale of vegetables by Mrs Chiwempale to the company may require “special attention”, if the financial statements are to show a true and fair view. The potential for profit manipulation is quite high.

Required:

Discuss ways in which such transactions and others may be used to manipulate profitability AND explain, using an appropriate international accounting standard, the recommended treatment of such transactions when preparing the financial statements.

[11 marks]

9) Suggest ways in which inventories can be effectively managed and controlled by Filimina Retail Ltd.

[10 marks]

Sub-total 40 marks

Overall total 100 marks

QUESTION TWO

1.0.BACKGROUND

AMQ plc is a mining company (listed on the Lusaka Stock Exchange) which was formed in 1990, when the copper prices were low. The mining company was given a large piece of land in the North-western Province. The land has high grade copper and other precious minerals.

The large piece of land belonged to a minority tribe which was asked by the government to give way to development. The tribe protested but the company promised to compensate them adequately.

In 2000, the company paid out K100million as compensation. This money was given to one of the representatives, who vanished with the money into a neighbouring country. The tribe has been asking the company to assist in tracing their representative but the company believes this is beyond their jurisdiction. The company has since informed the tribe of its position. The tribe is however, considering suing the company in the Zambian courts or asking the company to make good the whole loss or part of it.

Over the past few years the copper prices have been rising steadily and the company believes it can in fact do more in terms of CSR. However, it's intentions were "dealt a blow" when the government introduced windfall tax. This was contrary to the development agreement the company signed with the government.

Windfall tax has since been abolished by the government but the government still maintains a variable profit tax rate and one of the highest mineral royalty tax in Africa. The government believes these measures can still ensure adequate revenues are captured into the national treasury. Some civil societies, however, believe otherwise.

AMQ's chief financial officer Mrs Kidney Phiri has just passed on and the company is desperately trying to find a replacement. They have advertised the position on the company's website and the response has been overwhelming.

In the meantime, the Chief Executive Officer, Mr Nilesh Nzolo would like you to urgently attend to some outstanding issues, including the recruitment of a replacement. You are a senior member of ZICA (FZICA), holding a valid non-audit practising certificate, and running an accountancy firm called Barotse Associates as a sole partner. You were recently elected as a ZICA council member. You have few administrative staff but most of qualified personnel are recruited on a commission basis once an assignment is found.

All recommended appointment procedures have been carried out and you are convinced there are no professional or ethical issues to worry about. An engagement letter was signed two weeks ago, and your juniors commenced work on the various assignments.

They have now presented the various working papers to you.

WORKING PAPER	REFERENCE
Recruitment of Chief Financial Officer	BA11-LK1
Company income tax computations	BA11-LK2
Investment appraisal	BA11-FA1
PAYE computation	BA11-FA2
Personal income tax computations	BA11-IA1

2.0.RECRUITMENT OF CHIEF FINANCIAL OFFICER

Name	Luke Kusanya	Working paper reference
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Subject	Recruitment of chief financial officer	BA11-LK1
Date	14th May, 2012	

Luke has established that the deceased Chief Financial Officer was not a member of ZICA. However, she was a chartered accountant from one of the commonwealth countries. The company was advised that ZICA has a reciprocal recognition arrangement with the said commonwealth country, which enables chartered accountants from such a country to practice without going through the formal recognition process.

A recent advertisement by ZICA does not support this position. Management want you as a ZICA council member to handle the recruitment process and ensure everything is in compliance with legal and professional requirements. Luke has short-listed 10 candidates for your attention.

3.0.COMPANY TAX COMPUTATIONS

Name	Luke Kusenya	Working paper reference
Subject	Company income tax computations	BA11-LK2
Date	29 th May, 2012	

Luke obtained AMQ's financial performance for the year ended 31st March, 2012, and the details are as follows:-

	K'million
Sales	400,000
Cost of sales	(100,000)
Gross profit	<u>300,000</u>
Distribution costs	(50,000)
Administration costs	(20,000)
Finance cost	(5,000)
Profit before tax	<u>225,000</u>

Income tax expense	(13,000)
Net profit	<u>212,000</u>

Notes:-

- a) The sales figure shown above is gross.
- b) The cost of sales includes the depreciation figure of K3,000million for the year.
- c) The indexed loss and capital allowances are K40,000million and K80,000 respectively.
- d) The administration cost includes an exchange gain of K250million on the translation of a US dollar loan.
- e) The finance cost relates to interest on a loan used to buy mining equipment. The debt : equity ratio of the company is 8:1.
- f) All the remaining expenses are tax allowable.
- g) The income tax expense is the estimated figure for the year.
- h) Included in Administration costs is motor car expenses. The expenses relating to the Chief Executive Officer's car are K51million and it has been agreed with the Commissioner General that 30% relates to private use.

4.0.INVESTMENT APPRAISAL

Name	Far Aluna	Working paper reference
Subject	Investment Appraisal	BA 11-FA1
Date	14 th May, 2012	

AMQ plc is considering investing in new mining equipment so as to improve efficiency of processing copper and reduce unnecessary overtime. The alternatives being considered have the following cashflows:-

Year	E	F	G
	K'million	K'million	K'million
0	(50,000)	(60,000)	(70,000)
1	20,000	10,000	50,000

2	30,000	40,000	40,000
3	35,000	40,000	30,000
4	40,000	20,000	20,000

The machines will be sold at the beginning of the fifth year for their residual values of K10,000million, K5,000million and K2,000million respectively.

5.0.PAYE COMPUTATION

Name	Far Aluna	Working paper reference
Subject	PAYE computations	BA11-FA2
Date	4 th June, 2012	

The company's payroll is computerised but the chief executive officer wants a confirmation, manually that the system is working well.

The details for one of the employees for the month of March 2012 whose 3 year contract comes to an end in March 2012 were as follows:-

	K
Salary	10,000,000
Medical allowance	8,000,000
Fuel allowance	5,200,000
Uniform allowance (K2,000,000 was used to buy uniform required in the performance of his duties)	2,500,000
NAPSA	500,000
Loan deduction	1,200,000
Canteen deduction	310,000

His gross pay for March, 2012 included a gratuity of K 140million. No salary increments were given during the period of the contract.

The total taxable pay to the previous pay day was K400million while the total tax to the previous pay day was K117.5million.

The computer has computed the net pay as K101,107,000.

6.0.PERSONAL INCOME TAX COMPUTATIONS

Name	Ilutula Azedi	Working paper reference
Subject	Personal income tax computation	BA11-IA1
Date	22 May, 2012	

The chief executive officer, Mr Nilesh Nzolo owns a shop in the town centre of Solwezi. The shop is operated by the wife on a full time basis. The results for the year ended 31st March 2012 are as follows:-

	Notes	K'000
Sales	(1)	464,000
Cost of sales		(101,500)
Gross profit		<u>362,500</u>
Other expenses		
Salaries and wages	(2)	(55,000)
Depreciation		(11,000)
Motor car expenses	(3)	(15,000)
Bad debts	(4)	(1,200)
Repairs and renewals	(5)	(2,200)
Mr Nilesh Nzolo-bonus		(17,500)
Telephone		(5,820)
Rent		(12,550)
Stationery		(4,000)
Miscellaneous expenses	(6)	(5,810)
Profit before tax		<u>232,420</u>
Tax expense @ 35%		(81,347)
Profit for the year		<u><u>151,073</u></u>

Notes:-

1. The sales are standard rated and the sales figure is inclusive of VAT.
2. Included in the salary is a monthly salary of K2,500,000 for Mrs Nzolo. The Commissioner General feels a reasonable salary would have been K2,475,000 for the type of work she is carrying out.
3. Motor car expenses include expenses for Mr and Mrs Nzolo of K6,000,000 and K3,000,000 respectively. It has been agreed with the Commissioner General that the private use on both cars is 40% and 20% respectively.
4. The bad debts can be analysed as follows:-

	K'000
Increase in Specific provision	3,800
Decrease in General provision	(3,000)
Trade debts written off	1,800
Trade debts previously written off recovered	(1,400)
Total	<u>1,200</u>

5. Repairs and renewals is made up of the following:-

	K'000
Redecoration of shop	500
Fixtures and fittings	1,000
Cash register repairs	700
Total	<u>2,200</u>

All figures are exclusive of VAT.

The cash register was bought from an auctioneer for K9,000,000. The repairs were necessary to make the cash register usable.

6. Miscellaneous expenses are made up of the following:-

K'000

Entertaining auditors	1,000
Entertaining foreign suppliers	1,300
Christmas gifts of bottles of Mosi to important customers	2,200
Donation to U.T.H	1,310
Total	<u>5,810</u>

7. The assets owned by the business are as follows:-

Date of purchase	Asset	Cost K'000	I.T.V K'000
1.7.07	Motor van (used as a delivery vehicle)	116,000(VAT inclusive)	-
3.9.08	Cash register (old)	29,000(VAT inclusive)	6,250
4.12.10	Motor car (used as a pool car)	29,000 (VAT exclusive)	26,912
1.3.12	Printer	12,500 (VAT exclusive)	-
4.3.12	Computer	6,960 (VAT inclusive)	-

The cost of Mr and Mrs Nzolo's motor car were K69.60million (inclusive of VAT,3900CC) and K30million (exclusive of VAT, 2900CC) respectively. The vehicles were bought on 7th August, 2011 and belong to the entity.

Additional information:-

For the tax year 2011/12, Mr Nzolo was paid gross emoluments of K420million by AMQ plc (PAYE 139,788,000).

N.B. Ignore NAPSA.

*Income tax tables for 2011/12:

Income bands	Tax rates
First K12,000,000	0%
Above K12,000,000 up to K20,820,000	25%
Above K20,820,000 up to K50,400,000	30%
Above K50,400,000	35%

QUESTION TWO

SECTION A

- 1) CSR is one of the topical issues especially in large corporations.

Required:

- a) State with reasons whether you could advise an enterprise to spend money on CSR.

[2 marks]

- b) Identify and explain effective ways of compensating communities.

[2 marks]

- c) Briefly discuss the legal implications of the lost compensation money, and whether the company's position is appropriate.

[5 marks]

- 2) With specific reference to working paper BA11-LK1, identify and explain three main professional and ethical issues relating to the recruitment of the Chief Financial Officer, and suggest additional procedures you will undertake.

[7 marks]

- 3) With specific reference to working paper reference BA11-LK2:

- a) Compute the company income tax payable and the mineral royalty tax for the charge year 2011/12.

[10 marks]

N.B. The variable tax rate is:

$$Y = 30\% + [a - (\frac{ab}{c})]$$

Where:

Y=the tax rate to be applied per annum (variable tax rate)

a=15%

b=8% ,and

c=the percentage ratio of the assessable income to gross sales.

b) Discuss, in general, whether windfall tax could lead to maximum revenue collection for the government.

[6 marks]

4)a) Evaluate the investment proposal given in working paper reference BA11-FA1, using the following investment appraisal techniques:-

i) Payback period (to the nearest month)

[2 marks]

ii) Accounting rate of return (using average investment)

[2 marks]

iii) Net Present Value (using a cost of capital of 10%)

[3 marks]

b) Recommend with reasons the investment to be undertaken.

[2 marks]

c) If the IRR (Internal rate of return) were E 67%, F 43%, G 60%, state with reasons whether your recommendation would change.

[4 marks]

N.B. Using the following discount factors where appropriate

Year	10%
1	0.909
2	0.826
3	0.751
4	0.683
5	0.621

d) Briefly explain the tax implications of issuing shares to finance the above-mentioned project.

[5 marks]

Sub-total 50 marks

SECTION B

5) With specific reference to working paper reference BA11-FA2:

a) Show the net pay for the employee in a suitable payslip format reflecting the total tax for the month of March, 2012.

[10 marks]

b) Discuss, in detail, the year-end procedures for the PAYE system.

[2 marks]

6) Using the details given in working paper reference BA11-IA1:

a) Compute the income tax payable and state the due date.

[20 marks]

b) Discuss the consequences of paying income tax late.

[2 marks]

7) VAT's contribution to the national treasury has drastically reduced.

Required:

a) Discuss two main reasons behind this.

[4 marks]

b) Suggest ways of practically improving VAT's contribution.

[4 marks]

c) State, with reasons the advantages of value added tax (VAT) to the country and business, and in the Zambian scenario, state the 4 main obligations of the VAT registered suppliers.

[8 marks]

Sub-total 50 marks

Overall total 100 marks