COMPETENCE PRACTICE EXAMINATION

NON-AUDIT PRACTISING CERTIFICATE

JUNE 2013

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.

<u>QUESTION ONE</u>

BACKGROUND

MZ & Co has a non-audit practising certificate issued by ZICA. It was formed by DR Charles Muze and Mr Debit Zuze 15 years ago.

The firm has a staff establishment of 20 and the two founding partners believe this is more than adequate since staff productivity ratio is only 70%.

The firm has over 50 clients and its performance has been comparatively impressive. However, the recent business forecasts show a reduction in revenue due to increased competition. The firm hired a business development consultant last month on a 2 year renewable contract to ensure performance remains impressive. The business development consultant is a Chartered Marketer registered with ZIM. He has developed a world-class advert, where the firm's superior performance is appropriately articulated. He has gone further to highlight the main competitor's inability to offer quality services due to a questionable resource base.

The advert has impressed both existing and potential clients. Last week he had lunch with the M.Ds' of potential clients (Ndonji Ltd, Mwansa plc and Bbenkele plc) and this week all of them have engaged MZ & Co on a number of assignments. The firm has given him a budget of K36,000 to use at his discretion to ensure the firm's objectives are achieved.

You are one of the managers in MZ & Co and have been given the responsibility by DR Muze to handle assignments for the three new clients, and a long standing client (Justina Ltd). He has emphasized that MZ & Co should deliver to their expectation at whatever cost, and you must not let him down.

NDONJI LTD

This is a small company which was formed 4 years ago. Senior management comprise, the Managing Director (Mr George Mambwe), the Finance Director (Mr Gabriel Kabaso) and the Marketing manager (Mrs Pinkie Lilayi).

The company supplies stationery to government departments. In June 2013, the company borrowed K20,000 from Lusaka bank to finance an urgent order which was facilitated by the marketing manager's brother-in-law, who works at the ZPPA.

The bank is worried that the loan has not been serviced ever since it was obtained in June 2013. It has requested Ndonji Ltd to submit an updated financial forecast verified by an accountant holding a valid practising certificate issued by ZICA. BoZ inspectors will soon be visiting the bank to review non-performing loans.

Mr George Mambwe has managed to talk to Mr Zuze, who has assured him of a good report.

Mr Gabriel Kabaso, a ZICA Chartered Accountant believes Mr George Mambwe's request can be handled professionally within the guidelines issued by ZICA.

MWANSA PLC

Mwansa plc has engaged MZ & Co to prepare Financial Statements, which will be audited by one of the big four audit firms. The Finance Director resigned last month and an unqualified accountant is acting in his place. The directors have stated in the terms of reference that they will prepare the accompanying notes to the Financial Statements. Therefore you are not expected to draft the notes to the Financial Statements. However, they expect MZ & Co to attach a note explaining the key accounting standards used in the preparation of the Financial Statements.

The following trial balance prepared by the unqualified accountant relates to Mwansa plc as at 31 December, 2012:-

	K	K
Investment property (note 1) (1 January, 2012)	200,000	
Loan note interest	6,000	
Trade receivables and payables (note 2)	158,300	67,400
Cost of sales	400,000	
Rental income		45,000
Lease rentals (note 3)	45,000	
Dividends (note 4)	28,000	
Sales revenue (note 5)		1,100,000
Distribution costs	60,000	
Property at cost (note 6)	500,000	
Proceeds on disposal of equipment (note 7)		70,000
Inventories (31 December, 2012)	68,500	
Cash and bank	27,200	
Plant and equipment at cost	425,000	
Administration costs	30,000	
Development expenditure(note 8)	290,500	
Depreciation on equipment (note 9)		85,200
Taxation : overprovision in year to December, 2011		10,530
Equity shares of 50 ngwee each		400,000
Share premium		40,000
9% Loan note (issued in 2009)		100,000
Retained earnings (1 January, 2012)		184,870

Allowance for receivables (January, 2012)		10,000
Patents and trademarks	170,000	
Legal and professional expenses (note 10)	30,000	
General reserve (note 11)		205,500
Revaluation surplus		120,000
	2,438,500	**2,438,500**

Notes

1.The fair value of investment property as at 31st December, 2012 was K250,000. The company uses the fair value model.

2.No impairment is expected in receivables at 31st December, 2012.

3.The lease rental represents the first of four annual payments in advance for the rental of an item of equipment. A four year lease agreement was signed on 1st January, 2012 and the company made the lease payment on the same date. The cash price of the equipment is K150,000.

Dr Muze has evaluated the terms of the agreement and concluded that it is a finance lease. He has calculated the implicit interest rate in the lease as 13.7%. Leased assets are depreciated on a straight line basis over the life of the lease. The depreciation charge should be included in administration cost.

4.No final dividends have been declared by the directors.

5.Included in the figure is K12,000 sales to a customer in Kitwe made on a sale or return basis. The customer has up to 31st March, 2013 to either confirm the sale or return of the goods. The company's mark-up is 20% on cost.

6.On 1st January, 2012 the company purchased a newly constructed building at a cost of K500,000 in Kabulonga. For the purpose of calculating depreciation only, the asset has been separated as follows:-

		K	Life
Land	Cost	80,000	Freehold
Building	Cost	320,000	50 Years
Air conditioners	Cost	40,000	8 Years
Elevators	Cost	60,000	20 Years

The company uses straight-line depreciation for all elements of the property and all depreciation charges should be included in the cost of sales. The figure for cost of sales in the trial balance does not include depreciation charges.

7.During the year, the company sold equipment for K70,000. The equipment cost K100,000 and had accumulated depreciation of K25,000 as at 1st January, 2012.

8.This represents costs deferred in previous years in respect of the development of a new production process. However, during the year the directors decided to abandon the project due to financial constraints. The directors want to treat the write-off as a prior period adjustment since it relates to previous years.

9.Plant and equipment is depreciated at 25% on the reducing balance basis. The depreciation is charged to cost of sales.

10.The expenditure includes K5,000 solicitors' fees for the purchase of the property. It specifically relates to the freehold land as advised by the legal experts.

11.The company is yet to account for a 1 for 4 bonus issue which was approved at the last board meeting held on 1st September, 2012. The fair value of the shares on the date of issue was K1.00 each and the bonus issue is to be "financed" from the general reserve.

12.A provision for company income tax for the year to 31st December, 2012 of K82,000 is required.

BBENKELE PLC

Bbenkele Plc is a company listed on the Lusaka stock exchange. At the last annual general meeting held at the Accountants Park, the members were happy with the information provided in the statement of cashflow. They stated that the statement of cashflow clearly gives information on the company's ability to pay dividends.

One of the members, however, requested management to change from the direct method they were using to the indirect method and also explore the possibility of adopting integrated reporting. He assured the directors that the indirect method is easier to prepare and more commonly used in practice. This makes comparison with other companies' performance meaningful.

Set out below are the financial statements of Bbenkele Plc:-

INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2012

	K
Revenue	1,500,000
Cost of sales	(810, 000)
Gross profit	690,000
Other income (interest received)	50,000
Distribution costs	(170, 000)
Administrative expenses	(250,000)
Finance cost (interest paid)	(90,000)
Profit before tax	230,000
Income tax expense	(110,250)
Profit for the year	**119, 750**

STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER

ASSETS	**2012**	**2011**
	K	K
Non-Currents Assets		
Property, plant and equipment	2,400,000	1,900,000
Intangible assets	600,000	400,000
Investments	60,000	-
Current Assets		
Inventories	400,000	450,000
Receivables	205,000	190,000
Short-term investments	40,000	100,000
Cash in hand	80,000	100,000
TOTAL ASSETS	**3,785,000**	**3,140,000**

EQUITY AND LIABILITIES		
Equity		
Share capital (K1 ordinary shares)	1,500,000	1,000,000
Share premium	800,000	700,000
Retained earnings	400,000	320,000
	407,250	352,500
Non-current liabilities		
30% Debentures	300,000	85,000
Current liabilities		
Trade payables	127,700	482,375
Bank overdraft	150,000	110,000
Taxation	100,050	90,125
TOTAL EQUITY AND LIABILITIES	**3,785,000**	**3,140,000**

The following information is relevant:-

a) Depreciation charged for the year totalled K200,000 and equipment with an original cost of K150,000 (net book value K95,000) was sold for K75,000.
b) Amortization on intangible assets during the year was K50,000.
c) There was no accrual of interest at the beginning or at the end of the year.
d) The short-term investments are highly liquid and will mature in the next 2 months.
e) Dividends of K65,000 were paid during the year.
f) 500,000 K1 ordinary shares were issued during the year, using an offer for sale by tender.

JUSTINA LTD

This company sells Jewellery at Manda Hill shopping centre. It was established in 2010 by a group of Zambians in Diaspora. Only 4 of them sit on the board as non-executive directors.

At a recent board meeting, management was informed that most of the Zambians in Diaspora were looking for investment opportunities in Zambia. Most contracts of employment are expiring soon and hefty gratuities will be paid.

The board directed management to engage a firm of qualified accountants to carry out an in-depth analysis of the company's performance, and also prepare reliable prospective financial information. This will be used to market Justina Ltd overseas. The economic growth rates recorded in recent years, including the governance and democratization process embarked on by the government is making Zambia an attractive destination for foreign direct investment.

MZ & Co was engaged following a direct bidding process which was authorized by the board.

The Finance Director has E-mailed the following information to DR.Muze.

EXTRACTS FROM THE INCOME STATEMENT FOR THE YEARS ENDED 31 MARCH

	2013	**2012**
	K'000	K'000
Sales	20,000	15,000
Cost of Sales	17,500	13,100
Net profit	800	650
This is after charging:		
Rentals	6,000	4,800
Depreciation	200	200
Interest	300	450
Audit fees	2,000	1,700

Justina Ltd is at the moment exempt from Income tax since it holds a valid ZDA certificate, which was granted after the Ministry of Finance intervened following a number of representations made by the Zambians in Diaspora at various fora with various government officials.

STATEMENTS OF FINANCIAL POSITION AS AT 31 MARCH

	2013	2012
	K'000	K'000
ASSETS		
Non-current assets	4,000	3,000
Current assets		
Inventory	6,000	5,000
Receivables	10	20
Cash	5	2
TOTAL ASSETS	**10,015**	**8,022**
EQUITY AND LIABILITIES		
Equity		
Ordinary share capital	3,000	3,000
Retained earnings	2,600	1,800
Non-current liabilities		
15% loan stock	2,000	3,000
Current liabilities		
Payables	718	30
Accruals	1,600	100
Bank overdraft	97	92
TOTAL EQUITY AND LIABILITIES	**10,015**	**8,022**

The Jewellery industry is not well developed in Zambia and therefore the Finance Director is unable to provide industry statistics. The 4 Zambians in diaspora however, have managed to submit the following information from Italy:-

ROCE	20%
Profit Margin	40%
Asset Turnover (times)	5
Current ratio	6
Quick ratio	0.5
Gross profit margin	70%
Accounts receivable collection period	NIL
Accounts payable payment period	60 days
Inventory turnover (times)	16
Gearing (Debt ÷ Total capital)	45%

SECTION A

1.Identify and explain any ethical and professional issues raised in the scenario and recommend any appropriate safeguards. Also comment on whether the assignment for Ndonji Ltd could be delivered within the guidelines issued by ZICA.

(15 Marks)

2.Prepare the following for Mwansa Plc:

a) Statement of comprehensive income.

(12 Marks)

b) Statement of financial position.

(18 Marks)

c) A note identifying the accounting standards used in the preparation of financial statements, and the recommended accounting treatment.

(5 Marks)

3.a)Prepare a statement of cashflow for Bbenkele Plc, using the indirect method.

(10 Marks)

b) Comment on what is meant by integrated reporting.

(5 Marks)

Total 65 Marks

SECTION B

4.Suggest the key information which overseas investors will need about Zambian companies in order to make informed decisions.

(3 Marks)

5.a)Calculate comparative ratios for Justina Ltd for the years ended 31st March, 2012 and 31st March, 2013.

(10 Marks)

b)Write a report to the board of directors analyzing the performance of Justina Ltd, comparing the results against the previous year and against the given industry average.

(13 Marks)

6.Explain the nature of “prospective financial information” (PFI) and distinguish between a “forecast”, a “projection”, a “hypothetical illustration” and a “target”.

(9 Marks)

Total 35 Marks

QUESTION TWO

BACKGROUND

Zade Accountancy services is a medium-sized firm which has been operating for over 15 years in Zambia. All the five partners are registered with ZICA and hold valid non-audit practising certificates.

The firm has experienced increased demand for its services following increased monitoring by ZICA aimed at ensuring all organisations operating in Zambia are in compliance with the Accountants Act (2008), which requires all accountants to be registered with ZICA.

You are one of the Partners in Zade Accountancy services, responsible for quality control and training. You are currently conducting a workshop for 20 new recruits who will be deployed in Solwezi, where the firm intends to open an office soon following increased economic activity in the North-western province. The workshop material is based on 3 of the firm's clients (CPL Metals International Plc, Kanda Ltd and Nambi Ltd) and topical issues relevant to the Zambian environment.

CPL Metals International Plc

CPL Metals International Plc is involved in mining copper and other precious metals in Zambia. It is a subsidiary of a foreign mining giant resident in Chile. The foreign mining giant also has 3 subsidiaries in Europe, Asia and South America respectively.

CPL Metals International Plc has invested heavily in Zambia in the last 4 years. The benefits are now beginning to show. Output has doubled and repair costs are almost negligible.

The recent financial results show a profit before tax of K10,580,000 but only K5,000 tax was paid. A tax audit was carried out last month with the assistance of foreign experts but the report has not been released. The general public outcry is mining firms, especially foreign multinationals are not ethical in their operations. A number of NGOs have suggested the reintroduction of windfall tax.

Kanda Ltd

Kanda Ltd is a company which is registered for VAT and specialises in selling cars to retirees on the Copperbelt. It also has a small manufacturing plant for engineering spares. All its output is standard-rated for VAT purposes.

The tax authorities have expressed concern in the way the company handles its tax affairs. The tax computations are wrong and the tax payments are in most cases wilfully delayed or not paid at all.

The directors have engaged Zade accountancy services to regularise this and ensure the company complies with the tax laws.

Kanda Ltd has submitted the following information:

a)Income statement summary for the year ended 31st December, 2013:-

	K	K
Turnover		2,800,000
Cost of sales		(1,300,000)
Gross profit		1,500,000
Expenses:-		
Salaries and wages (note 1)	800,000	
General expenses (note 2)	40,000	
Canteen	110,000	
Repairs and renewals (note 3)	50,000	
Subscription (note 4)	10,000	
Legal and professional fees (note 5)	19,000	
Bad debts (note 6)	15,000	
Depreciation (note 7)	60,000	
Motoring expenses (note 8)	75,000	
		(1,179,000)
Net profit		**321,000**

Notes

1.Salaries and wages

This is made up of the following:

	K
Managing Director's (M.D's) emoluments*	120,000
Finance Director's (F.D's) emoluments*	96,000
Salary for 2 full-time differently abled persons	76,000
Irrecoverable loans to employees	8,000
Others (all allowable)	500,000
Total	800,000

*Both the M.D and the F.D are provided with free company accommodation and personal-to-holder vehicles.

2.General expenses

This is made up of the following:-

	K
Entertaining customers	5,000
Entertaining auditors	2,000
Parking fines on company cars	570
Gifts to foreign investors of Local foodstuffs	4000
Others (all allowable)	28,430
Total	40,000

3.Repairs and renewals

This is made up of the following:-

	K
Redecorating existing business offices	20,000
Fitting new doors to a recently built Storeroom	20,000
Renovation to newly acquired premises to make them habitable	10,000
Total	50,000

4.Subscription

This is made up of the following:-

	K
Subscription to the golf club run by the company*	2,000
Subscription to ZACCI (Zambia Chamber of Commerce and Industry)	4,000
Subscription to a political party-WIN party	4,000
Total	10,000

*Almost 60% of the company's business deals are concluded at the golf club, since most retirees are golfers.

5.Legal and professional fees

This is made up of the following:-

	K
Acquisition of a non-current asset	2,000
Factoring services for the company's debts	5,000
Staff service agreements*	2,000
Accountancy and audit	10,000
Total	19,000

*This followed labour disputes with employees as a result of the revised minimum wages and conditions of Employment Act (CAP 276).

6.Bad debts

This is made up of the following:-

Bad debts Account			
	K		K
Non-trade debts written off	15,000	Balances b/d	
Trade debts written off	15,000	General provision	22,000
Loan to former employee written off	2,000	Specific provision	10,000
Balances c/d		Loan to former employee recovered	9,000
General provision	20,000	Trade debts previously written off now recovered	9,000
Specific provision	13,000	Income statement	15,000
	65,000		65,000

7.Depreciation

This relates to both plant and buildings. One of the buildings was constructed during the year. The building was brought into use on 1st October, 2013 and the breakdown of the cost is as follows:-

	K
Land	60,000
Digging foundations	20,000
Architects fees	15,000
Staff canteen	30,000
General administration offices	70,000
Showroom	25,000
Factory	380,000
Total	600,000

The company intends to extend the factory in 2 years' time.

Capital allowances on assets apart from the building bought on 1st October, 2013, have been agreed at K45,000.

8.Motoring expenses

30% of expenditure relates to the M.D's and F.D's personal-to-holder vehicles. The balance (70%) is for the company pool vehicles used by the marketing staff.

Out of the 30% given above, 85% is for the M.D, while 15% is for the F.D. The details on the personal-to-holder vehicles for the tax year 2013 can be summarised as follows:-

Position	Vehicle	Engine capacity	Private use	Total mileage
1.M.D	Toyota Prado	3,400 C.C.	65%	35,000
2.F.D	Hyundai Elantra	2,200 C.C.	35%	15,000

9.Provisional tax was paid by the company on the due dates using an estimated income of K250,000.

10.The PAYE on the M.D's emoluments was paid on the due dates by Kanda Ltd. The M.D had no other income during the tax year 2013.

b)The details in respect of VAT for the month of April, 2013 were as follows:-

Sales

The sales were K125,000 (VAT exclusive). A cash discount of 10% was given to all customers for payments within 15 days. However, only 25% of the customers paid within the 15 days.

90% of the sales were to customers not registered for VAT.

Purchases

On 1st April, 2013 the company bought 10 motor cars for resale at K5,800 each (VAT inclusive).

Bad debts

An amount of K10,000 (VAT inclusive) owed by one retiree was written off. The credit sale was made on 1st October, 2011 but payment was only due on 1st December, 2011.

Machinery

A machine costing K2,000 (VAT exclusive) was purchased on 15th April, 2013. The monthly depreciation charge is K48.33.

General expenses

	K
Entertaining customers who are VAT registered	3,200
Telephone bills	600

Miscellaneous items

All the miscellaneous items valued at K200 were standard-rated items and were bought from suppliers at Soweto market who are not registered for VAT.

Closing inventory

On 30th April, 2013, the company had inventory of motor cars worth K870,000 (VAT inclusive).

c)The company imported a saloon car from Dubai for a newly appointed Head of Engineering operations. The cost was $6,000 and the car has a cylinder capacity of 2,000 C.C. Insurance and freight charges up to Nakonde border post were $500 and $200 respectively.

The car reached Nakonde border post on 21st March, 2012 and the total taxes amounting to K26,277,400 were paid.

The Head of Engineering operations has just seen the taxes paid in the company's management accounts and is of the view that the company was overcharged or the clearing agent is stealing from the company. In February, 2012 his friend imported the same model and only paid K8,355,200.

On 21st March when the vehicle arrived, the exchange rate as advised by the Commissioner General was K5,300 per $. However, in one of the banks in Nakonde, the exchange rate was K5,100. The clearing agent has confirmed having used the bank to exchange US Dollars for Kwacha which was used to pay the import taxes.

NAMBI LTD

The managers in Nambi Ltd consider cash management as a key aspect of financial management. Financial Institutions in Zambia are reluctant to lend due to an increase in non-performing loans, and the recently introduced stringent BoZ regulations regarding non-performing loans.

Nambi Ltd has engaged Zade accountancy services to advise on effective cash management. The statement of financial position as at 31st December 2012 was as follows:-

	K
ASSETS	
Non-current assets	
Plant and machinery	400,000
Current assets	
Inventory	60,000
Receivables	220,000
Bank	20,000
TOTAL ASSETS	700,000
EQUITY AND LIABILITIES	
Equity	
Ordinary shares (K1 each)	250,000
Retained earnings	20,000
Current liabilities	
Trade payables	270,000
Dividend payable	115,000
Taxation	45,000
TOTAL EQUITY AND LIABILITIES	700,000

Additional relevant information:-

i)The company's policy is to depreciate plant and machinery on a straight-line basis at 25%. The cost of plant and machinery on 31st December, 2012 was K600,000 and the company intends to buy machinery worth K50,000 during the year to 31st December, 2013. No disposals will be made.

ii)The economy is expected to grow by more than 7% and this means the company's business activity is also expected to increase. Hence, it is forecast that inventories will increase by 15%, while receivables will decrease by 2% since management intends to implement the recommendation by the credit controller to restrict credit to a few reputable organisations.

iii)The retained earnings are expected to increase by 35%.

iv)50,000 K1 ordinary shares will be issued at par.

v)Trade payables will decrease by 20% and dividends will increase by 10%.

vi)Taxation will increase by 12%.

No other changes are expected during the year to 31st December, 2013.

TOPICAL ISSUES RELEVANT TO THE ZAMBIAN ENVIRONMENT

a)Fair values and split accounting

Most Zambian companies have not adopted fair values in their financial statements and rarely use split accounting. Stakeholders are now questioning whether the financial statements prepared in Zambia do show a true and fair view and can be relied upon for decision-making.

The big GAAP/little GAAP divide is seen as one of the possible solutions, but the issue is obviously far from being concluded.

b)Capital budgeting

Mining companies have observed that most accountants in Zambia lack detailed knowledge on capital budgeting. Capital budgeting, especially investment appraisal became redundant when the inflation levels in the country were too high. However, the government has managed to maintain single digit inflation in recent years. This means appropriate tools of analysis can now be used when undertaking investments.

ZICA recently organised a workshop where international speakers and experts were invited. ZICA has assured the mining companies, including all other organisations in Zambia that, ZICA registered accountants can undertake assignments in capital budgeting and deliver according to acceptable world-wide benchmarks.

SECTION A

1.a) Distinguish between tax audit and tax investigation.

(4 Marks)

b) With reference to CPL Metals international and other multinationals operating in Zambia, explain whether they may be involved in tax evasion and if so, state any measures put in place by the government to prevent this.

(7 Marks)

c)Assess the mining sector's contribution towards the country's GDP and if necessary suggest how the Zambian government can ensure increased contribution.

(3 Marks)

d)Comment on whether mining companies in Zambia are ethical in their operations.

(8 Marks)

2.Using an example of your choice, demonstrate how variable profit tax rate operates.

(10 Marks)

3.a)Distinguish between personal-to-holder vehicles and pool cars.

(5 Marks)

b)Compute the provisional company income tax paid by Kanda Ltd and state the due dates.

(4 Marks)

c)Compute the final income tax payable by Kanda Ltd and state the due date.

(20 Marks)

d)Assuming the MD only has income from Kanda Ltd, compute his income tax payable for the tax year 2013, under PAYE.

(2 Marks)

4.Compute the VAT payable by Kanda Ltd for the month of April 2013, and clearly explain the treatment of each item. You are also required to state the due date for submission of the VAT return and payment.

(9 Marks)

5.Show, with supporting calculations whether the K26,277,400 import taxes computation is wrong and briefly state why value for duty purposes is important.

(3 Marks)

Total 75 Marks

SECTION B

6.a)Distinguish between a cash forecast and a cash budget.

(2 Marks)

6.b)Produce a statement of financial position forecast as at 31 December, 2013 and predict what the cash balance or bank overdraft will be at that date.

(8 Marks)

7.a)Explain what is meant by fair value, and compare and contrast fair values with historical costs.

(5 Marks)

b)Briefly describe when split accounting is used.

(3 Marks)

8.Explain the role of investment appraisal in the capital budgeting process and suggest the most appropriate investment appraisal technique in the Zambian environment, giving your justification.

(7 Marks)

Total 25 Marks

NON-AUDIT

SOLUTIONS

QUESTION ONE

SECTION A

1) The fundamental principles which apply to accountants are:-
   a) Objectivity – members should not allow bias; conflict of interest or undue influence of others to override professional or business judgments.
   b) Professional behavior – members should comply with relevant laws and regulations and should avoid any action that discredits the profession.
   c) Professional competence and due care – members have a continuing duty to maintain professional knowledge and skill at a level required to ensure that a client or employer receives competent professional service based on current developments in practice, legislation and techniques.
      Members should act diligently and in accordance with applicable technical and professional standards when providing professional services.

   d) Integrity – members should be straight forward and honest in all professional and business relationships.
   e) Confidentiality – members should respect the confidentiality of information acquired as a result of professional and business relationships and should not disclose any such information to third parties without proper and specific authority or unless there is a legal or professional right or duty to disclose.
      Confidential information acquired as a result of professional and business relationships should not be used for the personal advantage of members or third parties.

      Practitioners need to “behave and be seen to behave” in an ethical professional manner. This means complying with the code of ethics in every professional situation.

The ethical and professional issues in the scenario mainly relate to the following:-

1. Objectivity
2. Professional behavior
3. Professional competence and due care
4. Integrity

The specific issues in the scenario are as follows:-

ISSUE	EXPLANATION	SAFEGUARDS
1. Advertising	The IFAC code of ethics for professional accountants does not prohibit advertising. However, a professional accountant must not bring the profession into disrepute. Discrediting services offered by others either directly or indirectly is unprofessional behavior. The aim of adverts should be "to inform rather than impress."	The advert must be discontinued immediately and reviewed by partners. The business development consultant must be inducted into the firm by the partners. If the firm does not have an induction program for non-accountants, this must be put in places to avoid unprofessional conduct.
2. Marketing budget	MZ & Co is not a large firm to afford such a huge budget. For the partners to authorize such an amount for undisclosed marketing activities brings their integrity into question. It is possible that corruption, bribes and other vices are being encouraged.	The partners must clearly specify what the budget is meant to cover. Any unprofessional act should not be encouraged.

3. Long- lasting client – Justina Ltd	Long association with a client may create familiarity and self-interest threats. The quality of the audit is likely to suffer. The firm may be found wanting in respect of professional competence and due care.	The firm must rotate senior staff to maintain the professional competence and due care. If this is not possible due limitation in manpower, the partners must take a keen interest and review the working papers for Justina Ltd.
4. Delivery to client expectation at whether cost	This is clearly unprofessional. An accountant is guided by professional standards. His focus must not be to meet client expectations at whether cost. The accountant's objectivity must be beyond question.	A meeting should be arranged with both partners to discuss this issue. The need to maintain objectivity and guard against reputational risk must be emphasized. If both partners are in support of unprofessional conduct then the manager must consider resigning
5. Mr. Zuze's assurance of a good report	This assurance is likely to impair objectivity and the work may not be performed to the expected standard.	A second partner review is strongly recommended to ensure work is performed to the required standard.

Given the facts in the scenario, it is unlikely that the assignment could be delivered within the guidelines issued by ZICA. The reputation risk seems to be on the higher side. According to the guidance in ISAE 3400 "The examination of prospective financial information", an auditor should always consider risk of an assignment prior to acceptance and decline to act if the risk is deemed unacceptable.

2. a) MWANSA PLC

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR END 31 DECEMBER 2012

	K
Revenue (W1)	1,088,000
Cost of sales (W2)	(470, 600)
Gross profit	617, 400
Other Income (W3)	55,000
Distribution costs	(60, 000)
Administration expenses (W4)	(97,500)
Increase in the value of investment property	50,000
Development cost written off	(290,500)
Finance cost (W5)	(23,385)
Profit before tax	251, 015
Income tax expense (82,000 – 10,530)	(71,470)
Profit for the year	179, 545

2.b)MWANSA PLC
STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2012

ASSETS	**K**	**K**
NON-CURRENT ASSETS		
Tangible non-current assets		
Property, plant and equipment (W10)		801,700
Investment properties		250,000
Intangible non-current assets		
Patents and trade marks		170, 000
		1,221,700
CURRENT ASSETS		
Inventories (68,500 + 10, 000)	78,500	
Receivables (158,300 – 12,000)	146,300	
Cash	27,200	
		252,000
TOTAL ASSETS		**1,473, 700**
EQUITY AND LIABILITIES		
EQUITY		
Share capital (400,000 + 100, 000)		500,000
Share premium		40,000
General reserve (205,500 – 100,000)		105,500
Revaluation surplus		120,000

Retained earnings (184,870 + 179,545 – 28,000)		336, 415
		1,101,915
NON-CURRENT LIABILITIES		
Leasing obligations (W9)	74, 385	
9% loan note	100, 000	174, 385
CURRENT LIABILITIES		
Trade and other payables (W11)	115, 400	
Income tax payable	82, 000	197, 400
TOTAL EQUITY AND LIABILITIES		**1,473, 700**

WORKINGS

1. Sales revenue	K
Per question (T.B)	1,100,000
Less sale or return	(12,000)
	1,088,000

2. Cost of sales	K
Per question (T.B)	400,000
Adjustments:-	
Sales or return 12000 x 100/120	(10,000)
Depreciation of new property elements	14,400
Depreciation of plant and equipment	66,200
	470,600

3. Other income	K
Rental income	45,000
Reversal of allowance for receivables	10,000
	55,000

4. Administrative expenses	K
Per question (T.B)	30,000
Legal and professional expenses (30,000-5,000)	25,000
Depreciation on leased assets	37,500
Loss on disposal of equipment	5,000
	97,500

5. Finance cost	K
Interest on loan note (9% x 100,000)	9,000
Finance lease (150,000-45000) x 13.7%	14,385
	23,385

6. Depreciation

	K
Building (320,000/50)	6,400
Air conditioners (40,000/8)	5,000
Elevators (60,000/20)	3,000
	14,400
Owned plants and equipment (w7)	66,200
Leased assets (150,000/4)	37,500
	118,100

7. Depreciation of plant and equipment

	K
Cost (425,000- 100,000)	325,00
Accumulated depreciation (85,200-25,000)	60,200
Net book value	264,800
Depreciation 264,800 x 25%	**66,200**

8. Leased equipment

Year	Opening balance	Installment	Sub-total	Interest at 13.7%	Closing balance
	K	K	K	K	K
2012	150,000	(45,000)	105,000	14,385	119,385
2013	119,385	(45,000)	74,385	10,191	84576

9. Leasing obligations

	K
Due within one year	45000
Due within one year (119,385-45,000)	74,385

10. Property, plant and equipment

	New property	Leased equipment	Plant and equipment	Total
	K	K	K	K
Cost/valuation				
b/d	-	-	425,000	425,000
Additions	505,000*	150,000	-	655,000
Disposals	-	-	(100,000)	(100,000)
c/d	505,000	150,000	325,000	980,000
Depreciation				
b/d	-	-	85,200	85,200
Charge for year	14400	37,500	66,200	118,100
Disposal	-	-	(25,000)	(25,000)
c/d	14400	37,500	126,400	178,300
Carrying value at 31 December 2012	490,600	112,500	198,600	801,700

*Includes solicitors' fees of K5,000 for purchase of property

11. Trade and other payables	**K**
Per question (T.B)	67,400
Accrued interest (9,000-6,000)	3,000
Lease obligations (w9)	45,000
	115,400

c) Note on accounting standards used:

i. IAS 18 Revenue

Revenue from the sale of goods should only be recognized when the conditions stated in the standard are satisfied. In the case of the goods on sale or return basis, the entity has not transferred the significant risks and rewards of ownership of the goods to the buyer and therefore, at this stage, it is not probable that the economic benefits associated with the transaction will flow to the entity.

Hence the goods are still part of Mwansa Plc's inventory.

ii. IAS 36 IMPAIRMENT OF ASSETS

The reversal of an impairment loss should be recognized immediately as income in profit or loss. This has been applied to the reversal of the allowance for receivables at 1 January, 2012.

iii. IAS 16 PROPERTY, PLANT AND EQUIPMENT

The depreciable amount of an item of property, plant and equipment should be allocated on a systematic basis over its useful life. This has been applied to non-current assets.

iv. IAS 17 LEASES

Under finance leases, assets acquired should be capitalized, and interest element of installments should be charged against profit.

This has been applied to the leased asset.

v. IAS 40 INVESTMENT PROPERTY

When an entity adopts the fair value model, any gain as loss arising from a change in the fair value of an investment property should be recognized in the net profit or loss for the period in which it arises. This has been applied in Mwansa Plc.

3 a) **BBENKELE PLC**

STATEMENT OF CASHFLOW FOR THE YEAR ENDED 31 DECEMBER 2012

	K
Casflows from operating activities	
Profit before tax	230,000
Adjustment for:-	
Interest paid	90,000
Interest received	(50,000)
Depreciation	200,000
Loss in disposal of equipment(w1)	20,000
Amortization	50,000
	540,000
Decrease in inventory	50,000
Increase in receivables	(15,000)
Decrease in payables	(354,675)
Cash generated from operations	220,325
Interest paid	(90,000)
Income tax paid(w2)	(100,325)
Net cash from operating activities	**30,000**
Cashflow from investing activities	
Purchase of property, plant and equipment (w3)	(715,000)
Purchase of investment (w4)	(60,000)
Proceeds from sale of equipment	75,000
Purchase of intangible assets (w5)	(250,000)
Interest received	50,000
Net cashflow from investing activities	**(900,000)**
Cashflow from financing activities	
Proceeds from issues of shares (w6)	600,000
Proceeds from borrowing (300,000-85,000)	215,000
Dividends paid	(65,000)
Net cash flow from financing activities	**750,000**
Net decrease in cash and cash equipment	**(120,000)**
Cash and cash equivalents at 1 January 2012	**90,000**
Cash and cash equivalents at 31 December 2012	**(30,000)**

WORKINGS

1.Loss of disposal of equipment

Disposal account			
	K		K
Property, plant and equipment (NBV)	95,000	Bank	75,000
		Loss	20,000
	95,000		95,000

2.Income taxes paid

Income tax account			
	K		K
Bank	100,325	b/d	90,125
c/d	100,050	Income statement	110,250
	200,375		200,375

3.Property, plant and equipment

i)Property, plant and equipment (P.P.E) Account			
	K		K
b/d	1,900,000	Disposal	95,000
Revaluation surplus	80,000	Depreciation	200,000
Bank	715,000	c/d	2,400,000
	2,695,000		2,695,000

ii)Revaluation surplus account			
	K		K
c/d	400,000	b/d	320,000
		P.P.E	80,000
	400,000		400,000

4.Investments

Investments account			
	K		K
b/d	-	c/d	60,000
Bank	60,000		

	60,000		60,000

5.Intangibles

Intangible assets account			
	K		K
b/d	400,000	Amortization	50,000
Bank	250,000	c/d	600,000
	650,000		650,000

6.Proceeds from issue of shares

i)Share capital account			
	K		K
c/d	1,500,000	b/d	1,000,000
		Bank*	500,000
	1,500,000		1,500,000

ii)Share premium account			
	K		K
c/d	800,000	b/d	700,000
		Bank*	100,000
	800,000		800,000

*The proceeds from issue of shares is K600,000 (K500,000 + K100,000)

3.b)Integrated reporting brings together material information about an organisation's strategy, governance, performance and prospects in a way that reflects the commercial, social and environmental context (3ps-profit, people and planet) within which it operates. It provides a clear and concise representation of how an organization creates value, now and in the future.

SECTION B

4. The information needed include:
a) Current financial strengths and weaknesses of the company
b) Opportunities e.g. tax incentives and anticipated growth
c) Risk exposure e.g. exchange controls

d)Dividend policy
e)Political and economic stability
5 a) **JUSTINA LTD**

Comparable ratios

	2013	2012	Industrial avarage
i)ROCE=profit before interest /capital employed x 100%	(800+300)÷10,015 x100%	(650+450)÷ 8,022 x 100%	
	=10.98%	**=13.71%**	**20%**
ii)Profit margin= profit before interest/sales x 100%	(800+300)÷20,000 x100%	(650+450)÷ 15,000 x 100%	
	=5.5%	**=7.3%**	**40%**
iii)Assets turnover=sales/Capital employed	20,000÷10.015	15,000÷8022	
	=1.997 times	**=1.870times**	**5**
iv)Current ratio= Current asset/Current liabilities	6,015÷2,415	5,022÷222	
	=2.49	**=22.62**	**6**
v)Quick ratio=current assets-inventory/Current liabilities	(6,015-6,000) ÷2415	(5,022-5000) ÷222	
	=0.0062	**=0.099**	**0.5**
vi)Gross profit margin=gross profit/sales x 100%	$\frac{2,500}{20,000}$ x100%	$\frac{1,900}{15,000}$ x 100%	
	=**12.5%**	=**12.67%**	**70%**
vii)Account receivable collection period = $\frac{\text{receivable}}{\text{sales}}$ x 365days	$\frac{10}{20,000}$ x 365days	$\frac{20}{15,000}$ x 365days	
	=0.1825days	**=0.4867days**	**Nil**
viii)Account payable payment period = $\frac{\text{payable}}{\text{Cost of sales}}$ x 365days	$\frac{7.18}{17,500}$ x 365days	$\frac{30}{13,100}$ x 365days	
	=14.98days	**=0.836days**	**60days**
ix)Inventory turnover = $\frac{\text{cost of sales}}{\text{inventory}}$	$\frac{17,500}{6,000}$	$\frac{13,100}{5,000}$	
	=2.92 times	**=2.62 times**	**16 times**
x)Gearing = $\frac{\text{debt}}{\text{Total capital}}$ x 100%	$\frac{2,000}{7,600}$ x 100%	$\frac{3,000}{7,800}$ x 100%	
	=26.3%	**=38.5%**	**45%**

5.b) **REPORT**

To: Board of directors

From: Consultants- MZ & Co

Date: 6 June, 2013

Subject: Analysis of performance of Justina Ltd

1.0. Introduction

In accordance with the terms of reference, we set out an analysis of the performance of Justina Ltd over the last 2 years.
The appropriate comparative ratios are included in the attached appendix.

2.0. Analysis of performance

2.1 Profitability and return

The return on capital employed has decreased and is less than the figure for the industry average. The gross profit margin and the net profit margin have also decreased. However, the assets turnover has increased marginally. This may suggest a slight improvement in the efficiency with which assets are used or it might indicate that the asset have started to contribute positively towards the business.

The drop in profitability (ROCE) by approximately 20% is mainly due to reduced margins. This is likely to be due to the company's inability to increase selling prices due to an elastic market demand (typical of developing countries like Zambia) and increasing cost of jewellery. Most jewellery is imported and any adverse movement in the exchange rate does have negative impact on the profitability. The industry average is reflective of developed countries which may not be comparable to developing countries like Zambia.

2.2 Liquidity and working capital management

Both current ratio and quick ratio have decreased. However, the huge decrease in the current ratio may be due to increased payables, and needs investigation. The payables payment period has increased significantly. The collection period and inventory turnover changes have been minimal. It is likely that the purchase of non-current assets and the repayment of part of the loan has had an impact on the company's capacity to pay its debts, especially its high rentals.

2.3 Gearing

The gearing level has reduced by 32%. However, its gearing level is significantly less than the given industry average. This is generally reflective of the Zambian environment which has strict lending procedures and prefer short-term to long-term lending.

3.0. **Conclusion**

The company's performance is not impressive compared to the industry average, inspite of an increase in sales of 33%. It appears the company is not managing its costs properly and may well not have the necessary managerial skills and expertise to give the required strategy focus to the company. However, the comparison of the company's results with the industry average for Italy may not be valid. The two environments are very different. It may be advisable to find out how other jewellery shops, especially at Arcades shopping mall and Levy junction are performing. We could assist in carry out a market research in order to gather the required data. The increase in sales may be indicative of the potential in the market.
Please do not hesitate to contact us, should you require more details.

Consultants

Signed: MZ & Co.

6. Prospective financial Information (PFI) is information based on assumptions about events that may occur in the future and possible actions by an entity. Markets and investors need PFI that is understandable, relevant, reliable and comparable.

Forecast is PFI based on assumptions as to future events which management expects to take place and the actions management expects to take (best-estimate assumptions).

Projection is PFI based on hypothetical assumption about future events and management actions, or a mixture of best estimate and hypothetical assumptions.

Hypothetical illustration is PFI based on assumptions about uncertain future events and management actions which have not yet been decided on.

Target is PFI based on assumptions about the future performance of the entity.

<u>QUESTION TWO</u>

<u>SECTION A</u>

1.a)Tax audit is an examination of a tax return; a declaration of liability or a repayment claim; a statement of liability to stamp duty; or the compliance of a business with tax and duty legislation.

Tax investigation is carried out purely because some tax evasion or tax fraud has been reported in connection with a tax payer. It can also be carried on where a business consistently reports losses.

1.b)Tax evasion refers to the use of illegal means to avoid tax. Such means include failing to disclose the relevant amounts of income and other forms of fraud. The aim of the tax payer practicing tax evasion is to defraud the government of the revenue. Most multi-national companies have well developed corporate governance structures and may find it difficult to practice tax evasion. Multinational companies in general, employ tax experts who engage in effective tax planning (tax avoidance). Others are even granted tax incentives by the government.

Tax avoidance is concerned with identifying any loop holes in the taxes legislation, and using them to minimize or defer tax liabilities.

For a few multinational companies who may engage in tax evasion, government has enacted tax laws which make tax evasion an offence punishable by fines and/or imprisonment.

1.c)The mining sector's contribution towards Zambia's GDP is relatively small (approximately 3%) compared to other sectors. The Zambian government can ensure increased contribution by:

i. Strengthening the legal framework, especially anti-avoidance legislation
ii. Educating the mining companies on the possible dangers of excessive tax avoidance.
iii. Developing and implementing an effective monitoring mechanism for production and sales.
iv. Strict application of the law to those multi-nationals found wanting.
v. More focused dialogue with multinationals based on a win-win agenda

1.d)Johnson, Scholes and Whittington define ethical stance as "the extent to which an organization will exceed its minimum obligations to stakeholders."

Most mining companies in Zambia try to be ethical. There are however differences of opinion about what is and is not ethical, especially in developing countries like Zambia. The revelations in the press on emissions, taxation, procurement policies, employment policies etc. means some mining companies in Zambia are far from attaining the internationally acceptable standards although improvements are beginning to show e.g. investment in emission reduction, rehabilitation of roads, refurbishment of stadia etc.

2. Under variable profit tax, mining companies pay company income tax at the rate of 30% when the taxable profits are not more than 8% of the total revenue. When a mining company's taxable profits exceed 8% of the total revenue, then additional tax would be charged on the excess profits over 8% of the total revenue.

   Calculation of the variable profit tax rate to be applied when computing the company income tax payable uses the following formula:

$$Y = 30\% + [a - (ab/c)]$$

Where: Y = the tax rate to be applied per annum

a = 15%

b = 8%

$$c = \frac{\text{Assessable Income}}{\text{Gross Sales}} \times 100\%$$

Example

Wusakile Ltd is a copper mining company operating in Zambia. During the year ended 31 December 2012, the summarized results were as follows:-

	K
Turnover (Gross)	100,000
Cost of Sales	(20,000)
Gross Profit	80,000
Other costs(all allowable)	(35,000)
Net Profit	45,000
	=======

Required

Assuming the net profit is the same as assessable profit, compute the company income tax payable.

Solution

Taxable mining profit as a percentage of Gross Sales $= \frac{\text{Taxable Profit}}{\text{Gross Sales}} \times 100\%$

$$= \frac{45,000}{100,000} \times 100\% = 45\%$$

The taxable mining profit as a percentage of gross sales is more than 8%, therefore the company will pay company income tax at the variable tax rate as follows:-

Variable tax rate $= 30\% + [a - ab/c\ ]$
$= 30\% + [15 - (15x8/45)]$
$= 30\% + [15-2.67]$

Variable tax rate = 30% + 12.33% = 42.33%**= 42% (rounding off)**

Company income tax payable = 42% x K45,000 = **K18,900**

3.a)A personal-to-holder vehicle is car available for use by an employee or director without unnecessary restrictions imposed by the employer as the owner of the motor car.

A pool car is one:

i. That is not available for use by one employee or director to the exclusion of others.
ii. That is not normally kept overnight at, or near the residence of one employee or director.
iii. That is specifically meant for business use, any private use being incidental to the business use.

There are no taxable values in respect of the use of pool motor cars. However when employees and directors are provided with personal-to-holder vehicles, the values on which the company is assessed in respect of each motor car are as follows:-

i. Cars with cylinder capacity of less than 1800cc: K9,000 per annum
ii. Cars with cylinder capacity from 1800cc, but less than 2,800CC K15,000 per annum.

iii. Cars with cylinder capacity of 2800cc and over: K20,000 per annum.

3.b)**KANDA LTD**

COMPUTATION OF PROVISION COMPANY INCOME TAX

		K
Estimated taxable Income		= K250,000
Company Income tax		
250,000 x 35%		= K87,500
Each Installment	= $\frac{K87,500}{4}$	= K21,875

Installment	**Amount (K)**	**Due Date**
1st	21,875	31 March, 2013
2nd	21,875	30 June, 2013
3rd	21,875	30 September, 2013
4th	21,875	31 December, 2013

3.c)**KANDA LTD**

COMPUTATION OF THE FINAL COMPANY INCOME TAX PAYABLE CHARGE YEAR 2013

	K	**K**
Net profit as per accounts		321,000
ADD		
Accommodation benefit		
M.D.'S 30% x 120,000	36,000	
F.D'S 30% x 96,000	28,800	
Irrecoverable loans to Employees	8,000	
Personal-to-holder vehicles		
M.D's (3400cc)	20,000	
F.D's (2,200cc)	15,000	
Entertaining customers	5,000	
Entertaining auditors	2,000	

Parking fines on company Cars	570	
Gifts to foreign investors of Local foodstuffs	4,000	
Canteen	110,000	
Fitting new doors	20,000	
Renovation to newly Acquired premises To make them habitable	10,000	
Subscription to golf club	2,000	
Subscription to political Party	4,000	
Legal fees on acquisition of a Non-current assets	2,000	
Non trade debts written off	15,000	
Loan to former employee Written off	2,000	
Depreciation	60,000	
		344,370
		665,370

LESS

Decrease in general provision	2,000	
Loan to former employee recovered	9,000	
Capital allowances: plant	45,000	
Building (W1)	118,900	
Differently abled person Allowance K1,000 x 2	2,000	
		(176,900)

Taxable business profits	**488,470**	
	========	

Company Income Tax	K
488,470 X 35%	170,964.50
Less tax already paid	
Provision tax	(87,500)
Final company Income tax payable	**83,464.50**
	=========

Due date 30th June, 2014

WORKINGS

1. COMPUTATION OF CAPITAL ALLOWANCES ON BUILDINGS

	K
Land (does not quality for Capital allowances)	-
Qualifying expenditure as Industrial buildings:-	
Digging foundation	20,000
Architects fees	15,000
Staff Canteen	30,000
Showroom (not more 10% of the total construction cost) (w3)	25,000
Factory	380,000
	470,000
	=======
Initial allowance (470,000 x 10%)	47,000
Investment allowance (470,000 x 10%)	47,000
Wear and tear allowance (5% x 470,000)	23,500
	117,500
General administration offices (w2):	
Wear and tear allowance (2% x 70,000)	1,400
Total capital allowance	118,900

========

2. 10% test for general administration cost

   $\frac{70,000}{600,000 - 60,000}$ x 100% = **12.96%***

   *Exceeds 10% of the total construction cost, therefore does not quality as part of an industrial building. It is taken as a commercial building.

3. 10% test for showroom

   $\frac{25,000}{600,000 - 60,000}$ x 100% = **4.6%***

   *Does not exceed 10% of total construction cost and therefore qualifies as part of industrial building.

3.d)**M.D**

COMPUTATION OF PERSONAL INCOME TAX PAYABLE –TAX YEAR 2013

	K
Salary	120,000
Less NAPSA	(3,060)
Taxable Income	116,940
	========

Income tax

116,940	
(26,400) x 0% =	0
90,540	
(9,600) x 25% =	2,400
80,940	
(34,800) x 30% =	10,440
46,140 x 35% =	16,149
0	28,989

Income tax payable 28,989 - paid under the PAYE System.

4. **COMPUTATION OF VAT PAYABLE**
VAT RETURN – APRIL 2013

OUTPUT TAX (VAT)	K	K
Standard –rated sales		
125,000 x 90% x 16%		18,000
INPUT TAX (VAT)		
Motor vehicles purchases		
5,800 x 10 x 4/29	8,000	
Machine 2,000 x 16%	320	
		(8,320)
VAT PAYABLE		**9,680**
		======

Due date for payment and submission of April 2013 return is 21st May 2013

Notes on tax treatment

i. Where the consideration for a supply is in the form of money, VAT is charged on the selling price net of any cash discount whether the cash discount has been taken or not.

ii. VAT charge is not based on registration status of customers. It is based on the status of the good being sold, and registration of the supplier.

iii. Input VAT on motor cars is recoverable if the motors are acquired for resale by a car dealer.

iv. Bad debt relief applies only if specific conditions are satisfied e.g. at least eighteen months have elapsed since the time when the payment was due .In the question , bad debt relief does not apply because there is only 17 months from the due date of 1 December 2011 to 30 April 2013 when it is written off.

v. Depreciation is irrelevant when computing VAT. VAT is based on cost of the machine.

vi. VAT on entertaining customers and telephone bills is irrecoverable.

vii. Non-registered suppliers do not charge VAT. Hence there is no VAT to claim on miscellaneous items

viii. VAT is not computed on closing inventory. It is computed on purchases.

KANDA LTD

COMPUTATION OF IMPORT TAXES

	$	
Cost	6,000	
Insurance	500	
Freight	200	
C.I.F Value	6,700	
	K	Import taxes K
Value for duty purposes		
96,700 x K5,300	35,510,000	
Customs duty at 25%	8,877,500	8,877,500
	44,387,500	
Excise duty at 20%	8,877,500	8,877,500
	53,265,000	
VAT at 16%	8,522,400	8,522,400
	61,787,400	
	=========	--------------
Total Import Taxes paid		**26,277,400**
		===========

The tax computation is correct. VDP is important because if it is wrong, then even the tax computations will also be wrong.

SECTION B

6.a)A cash forecast is an estimate of cash receipts and payments for a future period under existing conditions before taking account of possible actions to modify cash flows, raise new capital, or invest surplus funds.

A cash budget is a commitment to a plan for cash receipts and payments for a future period after taking any action necessary to bring the preliminary cash forecast into conformity with the overall plan of the business.

6.b)**NAMBI LTD**

Financial Position Statement Forecast as at 31 December 2013

ASSETS	**K**
Non-Current Assets	
Plant & Machinery (W1)	287,500
Current Assets	
Inventory (60,000 x 1.15)	69,000
Receivables (220,000 x 0.98)	215,600
Bank (Balancing figure)	147,800
TOTAL ASSETS	**719,900**
	=======
EQUITY AND LIABILITIES	
Equity	
Ordinary shares (250,000 + 50,000)	300,000
Retained earnings (20,000 x 1.35)	27,000
Current liabilities	
Trade payables (270,000 x 0.8)	216,000
Dividends (115,000 x 1.10)	126,500
Taxation (45,000 x 1.12)	50,400
TOTAL EQUITY AND LIABILITIES	**719,900**

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WORKING

1. Plant and Machinery

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Current Value	400,000
Addition – Machinery purchases	50,000
Depreciation	
25% x (600,000 + 50,000)	(162,500)
Expected Value	287,500
	=========

7.a)Fair value is generally defined as the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms length transaction. According to IFRS 13: fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Fair values and historical costs can be compared and contrasted as follows:-

FAIR VALUES	**HISTORICAL COST**
Relevant to users decisions	Less relevant to users decisions
Subjective (not reliable)	Reliable
Predicts future cashflow	Does not predict future cashflow
Easily manipulated	Less open to manipulation

Fair value is still a topical issue as this measurement basis is used in new IFRS.

7.b)Split accounting is used to measure the liability and the equity components upon initial recognition of the financial instrument which contain elements of both a liability and equity e.g. convertible bond. This method allocates the fair value of the consideration for the compound instrument into its liability and equity components. The fair value of the consideration in respect of the liability component is measured at the fair value of a similar liability that does not have any associated equity conversion option. The equity component is assigned the residual amount.

8.The capital budgeting process consists of a number of stages, which includes investment appraisal . The role of investment appraisal is to assess costs and benefits of the project (investment) over its life.

The main investment appraisal techniques are:-

a. Payback method – the payback period is the time a project will take to pay back the money spent on it.

b. Accounting Rate of Return (ARR) method - this is the same as Return on Capital employed (ROCE)

c. Net Present Value (NPV) method – NPV represents the surplus funds (after funding the investment) earned on the project.

d. Internal Rate of Return (IRR) method –this represents the actual yield on the investment. It is the discount rate at which the NPV of an investment is Zero.

The most appropriate appraisal technique in the Zambian environment is NPV. It is technically superior to all others because it:-

i. Considers the time value of money
ii. Is an absolute measure of return
iii. Is based on cashflows not profit
iv. Considers the whole life of the project
v. Should lead to maximization of shareholder wealth

Zambia is adopting best practices in all areas e.g. corporate governance, risk management, etc. and therefore investment appraisal cannot be left behind. The best investment appraisal technique which is NPV is the most appropriate given the direction Zambia has taken. The economic fundamentals e.g. inflation rate, exchange rate etc. have generally stabilized.