NON AUDIT

QUESTION ONE

BACKGROUND

Your name is Ruth Mutale and you are an experienced manager in T182 accountancy firm. The firm is registered with ZICA and has a non audit practicing certificate. You have been with T182 for over 8 years.

T182 is owned by two partners (Paul Ngombe and Dominic Chanda) and has an establishment of 13 employees. The firm has focused on various non audit assignments for small and medium sized companies(SMEs). Most of the firm's income, is from taxation and preparation of accounts. However, the recent management accounts show that margins are being eroded by increased competition and uncontrolled staff costs. The only office is in Lusaka.

Paul Ngombe is a retired Chief accountant, who recently worked in the USA for four (4) years. He is very conversant with the USA regulatory systems. He is currently preparing for his ZICA CPE examinations.

Dominic Chanda is the founder member of T182. He is a graduate from CBU and holds a ZICA non audit practicing certificate. He has been able to grow the client base from three (3) to forty five (45).

The other employees involved in non audit assignments are unqualified but with experience, they are able to handle work which should, ideally, be handled by qualified personnel.

The Partners have made a decision to downsize and drop any loss making assignments. They have also decided to introduce Activity Based Budgeting (ABB) as part of an elaborate process to reduce costs. At a management meeting held last week, the Partners directed you to be in charge of the ABB implementation. They also requested you to come up with a report on the main features and advantages of ABB to be used at a workshop for junior members . The aim is to make ABB an instant success . T182 has been using incremental budgeting.

You are also working on the assignments for the following clients:

(1) Mwinilunga Industrial Minerals Ltd (MIM)
(2) Mazabuka Sugar Ltd (MS)
(3) Lundazi Maize Marketing Cooperative (LMMC)
(4) Lusaka Electronics Co. (LEC).

MWINILUNGA INDUSTRIAL MINERALS LTD (MIM)

MIM has commissioned T182 to conduct a thorough review of its tax affairs. The company is being investigated by the Tax authorities for tax evasion. This has had an impact on the company's public image and market position. Last week, T182 was visited by three police officers ,in connection with MIM's tax evasion allegations. On Monday, this week, a truck loaded with undeclared goods destined for MIM was impounded by the Tax enforcement centre. The good's VDP was K350,000. Management of MIM has indicated to you that the Tax authorities and police are willing to talk. Although this is predominately a tax review, T182 has also been requested to compute the current year's company income tax payable.

MIM is a Zambian resident company involved in the mining of industrial minerals. The summarized statement of comprehensive income for the year ended 30 June 2015 is as follows:

	Notes	K'000
Revenue	1	432,980
Cost of sales	2	(229,850)
Gross profit		203,130
Depreciation	3	(64,600)
Patent royalty	4	(3,000)
Exchange loss	5	(400)
Entertaining auditors	6	(10)
Finance cost	7	(24)
Profit before tax		135,096
Company income tax	8	(31,065)
Profit for the financial year		104,031
Dividends	9	(52,015)
Retained earnings		52,016

The following additional information is available:

Note 1

The figure is the gross sales for the year ended 30 June 2015. Mineral royalty of K25,979,000 has been paid but has not been taken into account in the figures above.

Note 2

The figure includes capital expenditure which account for 40% of the total cost of sales. Of this amount, 20% does qualify for capital allowances. The remainder of the cost of sales comprise allowable expenditure.

Note 3

This relates to assets which are wholly and exclusively used for business purposes. The income tax values on the respective assets is nil.

Note 4

The figure relate to a patent, acquired for 10 years, involving the latest mining techniques, which are cost effective. The whole amount has been charged to the Income statement.

Note 5

This represents a loss on translation of the US $ 45,000 held in a local bank at the year end.

Note 6

This was incurred after an important audit planning meeting held with the audit committee.

Note 7

The company has a Debt : Equity ratio of 12:2.

Note 8

The company income tax represents the provisional company income tax paid.

Note 9

This represents the final dividends declared for the year ended 30 June 2014 but paid in September 2014.

MAZABUKA SUGAR LTD (MS)

MS was incorporated in 1999, in response to the many opportunities that arose after the liberalisation of the economy. Paul Ngombe owns 20% of the ordinary share capital. T182 have been engaged to prepare the financial statements for the year ended 31 March 2015.

MS has increased sugar production from 2,030 metric tonnes in 2006 to 7,859 metric tonnes in 2015. Sugar cane production has also increased significantly. The margins are currently being adversely affected by cheap imports and stiff competition being offered by new companies in Luapula province.

The Finance Director resigned two (2) weeks ago and the Managing Director considers the preparation of the financial statements as an emergency. He has therefore requested your firm to do everything possible to recover lost time. Paul Ngombe has assured him that the assignment will be completed on time, since farming enterprises are not required to follow elaborate accounting standards.

You have drafted an engagement letter, which is about to be signed by Paul Ngombe.

LUNDAZI MAIZE MARKETING COOPERATIVE (LMMC)

LMMC was created by the local community in partnership with five (5) Chiefs in Lundazi district. The main objective was to improve the production and marketing of maize in order to reduce poverty in the area. LMMC's cash management is poor and T182 has been engaged to provide appropriate advice,

LMMC is too dependent on the Government's FISP programme and it can collapse if the programme was to end. Politicians and the Auditor General have been pushing for the programme to end due to massive corruption and unquantified impact on the country's GDP.

You have already done the field work and the preliminary conclusion is LMMC is technically insolvent.

LUSAKA ELECTRONICS Co. (LE)

LE is a Zambian resident company. It imports electronic equipment from the middle east and sells them in Lusaka at wholesale prices. The ZRA PAYE inspectors have visited the company and raised serious concerns on the operation of PAYE.

In addition, LE management has identified the following risks to its business:

(1) Some managers have been offering unauthorized credit to a few regular customers. However, most of them are uncreditworthy.
(2) The labour turnover for Cashiers has been high due to dismissals over misappropriations of cash.
(3) LE's computerized transfer of accounting information from invoicing to the general ledger is usually incomplete or wrong.
(4) Customers have started refusing to pay for items ordered, claiming they are not according to the specifications given.
(5) There is a risk that LE may be sued for importations which do not meet ZABS specifications.

The company has requested you to demonstrate how PAYE works using the details for one of the employees. The name of the employee is Connie Chooma and her details for three (3) months are as follows:

Description	January 2015	February 2015	March 2015
	K	K	K
Basic salary	10,000	10,000	10,000
Overtime	5,000	500	2,000
Education allowance	6,000	-	-
Housing allowance	1,400	1,400	1,400
Funeral grant	-	6,800	-
Salary advance	4,000	-	-
Loan deduction	2,320	2,320	2,320
NAPSA	500	500	500

SECTION A

(1) (a) Identify and explain any four (4) ethical issues in the scenarios and suggest the necessary safeguards for each issue. (8 marks)

(b) Explain six (6) business risks in T182. (12 marks)

(c) Write a report to the Partners describing the main features and advantages of ABB. (10 marks)

(2) (a) Explain what is meant by Tax evasion and Tax avoidance. (4 marks)

(b) Discuss the main reasons for amending VAT rule 18. (3 marks)

(c) Explain the tax treatment of non attributable input VAT. (4 marks)

(3) (a) Explain the importance of thin capitalisation rule. (5 marks)

(b) Calculate the company income tax payable for Mwinilunga Industrial Minerals Ltd (MIM) for the charge year 2015. (14 marks)

(c) State the importance of VDP. (2 marks)

SECTION B

(4)(a) State the type of assignment requested by Mazabuka Sugar Ltd (MS) and outline the importance of an engagement letter in such assignments. (5 marks)

(b) Draft a report which will be given to Mazabuka Sugar Ltd (MS) at the end of the assignment. (6 marks)

(5) (a) Explain what is meant by insolvency, and describe three (3) methods which Lundazi Maize Marketing Cooperative (LMMC) can use to manage its cash flows. (7 marks)

(b) Suggest five (5) controls which could be put in place to address each of the risks identified in Lusaka Electronics Co. (LE). (5 marks)

(c) Explain who is responsible for tax compliance under the PAYE system and state the penalties for non compliance. (3 marks)

(d) Compute the Net Pay for Connie Chooma, for January 2015, February 2015 and March 2015 respectively. (12 marks)

(TOTAL: 100 marks)

QUESTION TWO

BACKGROUND

Charles Zimba owns 80% of Lupososhi Ltd. Lupososhi Ltd was incorporated in 2004 and specializes in the supply of solar power to the Northern part of Zambia. It was the first company to install a 15 Kilo Watt (KW) solar plant, complete with Photo Voltaic (PV) panels, batteries, Charger controller, Inverter and Change – over switch in Zambia. In an effort to be "extra – Green", the company has just installed another 15 KW mini Solar Power plant at the recently built Robert Makasa University.

Lupososhi Ltd is a highly geared company. The latest installation was financed using 9 % convertible loan stocks and 10% of the cost was in the form of a government grant. The loan stocks were issued on 1 April 2014. The total cost of the entire installation was K900,000 (nine hundred thousand kwacha). The current financial position of the company is relatively stable. Charles Zimba is ZICA chartered accountant, who has successfully implemented a culture of prudential management in Lupososhi Ltd.

Charles Zimba is the Managing Director, while a former Chief Executive Officer of ZESCO is the Chairman of the Board. The Board consists of four (4) Executive Directors (EDs) and four (4) Non Executive Directors (NEDs). The NEDs have been with the company since inception and they have always satisfied themselves that financial information is accurate and that financial controls and systems of risk management are robust. Charles has performed relatively well as the Chairman of the Audit committee. His wide experience as a chartered accountant has made the Audit committee very effective.

The company has an Internal audit department headed by the Director Internal Audit, who reports to the Chairman of the Audit Committee. Internal audit has been instrumental in the following areas:

(i) Review of the accounting and internal control systems.
(ii) Review of the implementation of corporate objectives.
(iii) Review of the economy, efficiency and effectiveness of operations.
(iv) Monitoring of the risk management strategies.

FINANCIAL STATEMENTS

The company's Finance Director is a recently qualified ZICA graduate who has prepared the following financial statements for the year ended 31 March 2015:

Statement of comprehensive income for the year ended 31 March 2015

	K'000
Revenue	10,800
Cost of sales	(5,675)
Gross profit	5,125
Administration	(1,231)
Distribution	(2,432)
Operating profit	1,462
Finance cost	(660)
Interest receivable	7
Investment income	54
Profit before tax	863
Income tax expense	(338)
Profit for the year	525
Other comprehensive income	
Gain on Land revaluation	150
Total comprehensive income for the year	675

Statement of changes in equity

	Share Capital K'000	Share premium K'000	Revaluation surplus K'000	Retained earnings K'000	Total equity K'000
B/f	10,000	2,000	0	5,560	17,560
Total comprehensive income for the year			150	525	675
Dividends				(500)	(500)
C/f	10,000	2,000	150	5,585	17,735

Statement of financial position as at 31 March 2015

	K'000
Non – current assets:	
Property, plant and equipment	34,112
Current assets:	
Inventory	4,855
Receivables	2,790
Bank	433
Total assets	**42,190**

Equity:	
Share capital	10,000
Share premium	2,000
Revaluation reserve	150
Retained earnings	5,585
	17,735
Non – current liabilities	**20,140**
Suspense balance	**860**
Current liabilities	**3,455**
Total equity and liabilities	**42,190**

The company has, however, engaged your firm, Lilayi Associates to include the following transactions which the Finance Director was unable to deal with:

(1) The government grant received - The company depreciates all plant and machinery at 10% pa on a straight line basis. The government grant is included in the suspense balance. Depreciation is included in the cost of sales. The company uses the deferred income approach. The full cost of K900,000 for the installation has already been debited to the non – current assets and the relevant depreciation charged.

(2) Lupososhi Ltd issued 9% convertible loan stocks at their nominal value of K810,000. This is also included in the suspense balance.

Each loan stock is convertible at any time up to maturity into 200 ordinary shares. Alternatively, the Loan stocks will be redeemed at par after 4 years. Interest of K72,900 was paid on 31 March 2015.

The market rate applicable to non – convertible loan stocks is 12%.

The present value of K1 payable at the end of year, based on rates of 9% and 12% are as follows:

End of year	9%	12%
1	0.917	0.893
2	0.842	0.797
3	0.772	0.712
4	0.708	0.636

(3) The year end provision for damages caused by unannounced interruptions in electricity supply has been estimated at K100,000.

(4) Included in the inventory figure were stores and spares at a cost of K250,000, which were damaged. These were sold to ZESCO for K100,000 on 15 April 2015.

(5) The company leased computers under an operating lease. The initial deposit of K20,000 was made on 1 April 2014. The company made another payment of K20,000 on 31 March 2015. Three more payments of K20,000 each, will be made on 31 March 2016, 31 March 2017 and 31 March 2018. The payments made so far, are also part of the suspense balance.

SECTION A

(1) (a) Discuss seven (7) benefits of good corporate governance in a utility company like Lupososhi Ltd. (14 marks)

(b) Evaluate the corporate governance framework in Lupososhi Ltd. (18 marks)

(c) Explain why "Accounts and audit" are generally considered to be the cornerstone of corporate governance. (6 marks)

(2)(a) Give two examples of the specific audit work, an Internal auditor will carry out in respect of each area mentioned in the scenario, under internal audit. (8 marks)

(b) State three (3) key benefits of a robust risk management system. (6 marks)

SECTION B

(3)(a) Discuss two fundamental characteristics required for Lupososhi Ltd to use gearing successfully. (5 marks)

(b) Discuss "Prudential management" and "Prudential controls" (6 marks)

(c)Explain the accounting treatment for the issues which the Finance Director has been unable to deal with. (18 marks)

(d)Discuss whether Lupososhi Ltd is in breach of the Accountants Act (2008) by employing the Finance Director. (3 marks)

(4) (a) Redraft the financial statements, so that they show a true and fair view.

(16 marks)

(b)State the main purpose of the statement of changes in equity. (2 marks)

(Total: 100 marks)

NON – AUDIT

SUGGESTED SOLUTION

QUESTION ONE

SECTION A

(1) (a)

Ethical threats	Explanations	Suggested safeguards
• Use of unqualified staff	• 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. Unqualified manpower may not match the expected standards.	• Employ more qualified staff. • Detailed review of work carried out by unqualified staff
• Tax review and computation of company income tax payable.	• Since the Tax authorities are willing to talk, there is a danger that integrity, objectivity and professional behavior may be adversely affected. Members should not allow bias, conflicts	• Use an external tax expert. • Decline appointment, since the threat is too significant.

	of interest or undue influence of others to override professional or business judgements.	
• Visit by the police.	• T182 may release confidential information. Members should respect the confidentiality of information acquired as a result of professional and business relationships and should not disclose such information to third parties without proper and specific authority or unless there is a legal or professional right or duty to disclose.	• Enquire under what statutory authority the information is demanded. • Seek legal advice
• Shareholding in client company.	• Paul Ngombe, one of the partners owns 20 % of the shares for Mwinilunga Industrial Minerals Ltd (MIM). There is a serious self interest threat. Mr Paul Ngombe's objectivity may be threatened or appear to be threatened.	• The other partner, Dominic Chanda should be in charge of the assignment. • Decline the appointment since the firm is small and use of "Chinese walls" may not be effective.
• Planned cost reduction programmes.	• The quality of the work could be adversely affected, since some key tasks may not be undertaken in order to reduce costs.	• Ensure enough resources are provided for quality control. • Publicise an ethical code of conduct and partners should demonstrate visible ethical leadership.

(b)

Business risks	Explanations
• Focus on SMEs	• Excessive reliance on SMEs may adversely affect operations, since SMEs are by nature not stable. In addition, their activities are highly unpredictable which could also adversely affect T182 planning and effective delivery of assignments.
• Increased competition	• This could result in reduced business and margins. The going concern status of T182 could be under threat.
• Uncontrolled staff costs	• This has a negative impact on both profitability and cashflow.
• Dropping of loss making assignments	• Some of the loss making assignments could be loss leaders. Hence, discontinuing them could affect business for some profitable assignments.
• Introduction of ABB	• This could face serious resistance both directly and indirectly. Most non value adding activities are likely to be discontinued. The activities could be important to employees e.g. recreation. The introduction of ABB could have a negative impact on staff morale and operations of T182, if not managed properly.
• Downsizing the workforce	• Key staff could leave as well. This could impact negatively on the operations of T 182.
• Lack of knowledge of Zambian regulatory system	• One of the partners does not know the Zambian regulatory system. This increases the risk of non – compliance with the necessary regulations.
• Dominance by the two partners	• There is an increased risk of override of controls and misappropriation of assets.

(c) **REPORT**

To: The Partners

From: Manager

Subject: Activity Based Budgeting (ABB)

Date: 15 July, 2015

1.0 INTRODUCTION

Further to our meeting, I set out below the main features and advantages of ABB.

2.0 MAIN FEATURES

ABB is basically the use of costs determined using Activity Based Costing (ABC) as a basis for preparing budgets. According to "CIMA Official Terminology", ABB is a method of budgeting based on an activity framework and utilising cost driver data in the budget – setting and variance feedback processes.

T182 has more overheads in its cost structure and ABB could enable greater control, unlike an incremental approach which simply adds a percentage to the current year's budget or actual to allow for inflation. A cost driver is any factor which causes a change in the cost of an activity. ABB could be implemented as follows:

- Identify cost pools and cost drivers.
- Calculate a budgeted cost driver rate based on budgeted cost and budgeted activity.
- Produce a budget for each department or service by multiplying the budgeted cost driver rate by the expected usage.

A cost pool is the point of focus for the costs relating to a particular activity in ABC system (CIMA Official Terminology).

3.0 ADVANTAGES OF ABB

These include :

- ABB draws attention to the costs of overhead activities . This useful in T182, since overhead costs are a large proportion of total operating costs.
- It will ensure that T182's overall strategy and any actual or likely changes in that strategy will be taken into account , because it attempts to manage the business as the sum of its interrelated parts.

- Critical success factors will be identified and performance measures devised to monitor progress towards them. A critical success factor is an activity in which a business must perform well if it is to succeed, for example controlling costs without sacrificing quality.
- Because concentration is focused on the whole of an activity, not just its separate parts, there is more likelihood of getting it right first time. For example, what is the use of being able to produce reports in time for the partner's review, if he or she is currently too busy with other assignments which will only be finished after two (2) weeks.
- Other writers link ABB to what is known as Business Process Re-engineering (BPR) – re-organising a business according to the processes it performs rather than the functions it performs. BPR is indeed closely linked with ideas like TQM and employee empowerment, and ABB may quite legitimately be seen as one of the tools of BPR. In some circumstances, ABB may be the initiative that prompts a more wide ranging examination of business processes.

4.0 CONCLUSION

The current incremental budgeting is an inefficient form of budgeting, although administratively it is fairly easy to prepare. It encourages slack and wasteful spending to creep into budgets and to become a normal feature of actual spending. I am sure ABB will make a huge difference.

If you require any further information on this matter, please do not hesitate to contact me.

Signed: Manager

(2) (a) 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. It is punishable by fines and/or imprisonment.

Tax avoidance is concerned with identifying loopholes in the taxes legislation, and using them to minimise or defer tax liabilities. It is not an offence, though to discourage its practice, the government may issue anti – avoidance legislation.

(b) VAT rule 18 requires exporters to provide the specified documents in order for their VAT refunds to be processed. Some exporters have been having difficulties in providing the specified documents, and ZRA has been unable to process the VAT refunds. This has had a significant impact on their cashflows and operations.

The VAT rule 18 has therefore be amended to address the negative impact on cashflows and operations. The sectors affected are very important to the Zambian

economy and continued enforcement of VAT rule 18 could therefore stifle economic activities.

(c) A taxable person can only recover input VAT on supplies made to him if that VAT is attributable to taxable supplies made by him. Where a person makes a mixture of taxable and exempt supplies, he cannot recover in full the input VAT as some of it will be attributable to the exempt supplies. Input VAT that is attributable to the exempt supplies is not generally recoverable.

In order to attribute non – attributable input VAT to the taxable supplies, various methods are used. One of the methods that can be used is the one where the basis of apportionment is the turnover of the supplies made. The formula that is used is as follows:

$$\text{Recoverable non – attributable input VAT} = \frac{\text{Total taxable supplies}}{\text{Total supplies}} \times 100\%$$

The resulting percentage is multiplied by the non – attributable input VAT in order to determine how much of that VAT is attributable to the supplies. The amount that is attributable to the taxable supplies using the above formula is then recovered while the rest is treated as being attributable to exempt supplies and therefore not recoverable.

(3) (a) A company is said to be thinly capitalized if it is financed by excessive debt, such that the debt to equity ratio is more than 3 to 1. Most companies may be motivated to finance their operations using debt, because the interest is allowed as a deduction when computing taxable profits. Equity capital will be low because the dividends are not deductible when computing taxable profit. In short, excessive debt can significantly lower tax payable.

Thin capitalisation rule is effectively an anti – avoidance legislation. It prevents tax avoidance by limiting the debt to equity ratio to 3 to 1. Interest on the excess debt is not an allowable expense.

(b) **Mwinilunga Industrial Mineral Ltd**

Computation of company income tax payable – 2015

	K'000	K'000

Net profit per accounts		135,096
ADD:		
Capital expenditure (40 % X 22,850)	91,940	
Patent royalty ($\frac{3000}{10}$ X 9)	2,700	
Exchange loss	400	
Entertaining auditors	10	
Finance cost (3/6 X 24)	12	
		95,062
		230,158
LESS:		
Mineral royalty	25,979	
Capital allowances (20% X 91,940 X 25%)	4,597	
		30,576
Taxable income		199,582

Company Income Tax

199,582 X 42.4 %	84,623
Less Income Tax already paid:	
Provisional company tax paid	(31,065)
Company Income Tax payable	53,558

WORKINGS

(1) INCOME TAX RATE

Check whether the assessable income exceeds 8 % of gross sales.

$$\frac{199,582}{432,980} \times 100\ \% = 46\ \%$$

Since the percentage exceeds 8 % , variable profit tax applies. The income tax rate is therefore computed as follows:

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

$$Y = 30\ \% + (15\ \% - (15\% \times 8\ \% / 46\ \%)$$

Y = 42.4 %.

(c) VDP is an abbreviation for Value for Duty Purposes. Most duties are calculated as a percentage of the VDP. Hence, it is important that importers and manufacturers establish accurate VDP in order to pay the correct taxes.

SECTION B

(4) (a) The type of assignment requested by Mazabuka Sugar Ltd is a compilation engagement. In such assignments, an accountant uses his accounting expertise (not his auditing skills) to collect, classify, and summarise financial information. T182 has been asked to prepare (compile) financial statements from the underlying accounting books and records. This is one of the typical examples of a compilation engagement. ISRS 4410 regulates this work.

An engagement letter should be issued to ensure there is a clear understanding of the terms of the engagement. For example, the letter should include the nature of the engagement – that it is not an audit nor a review, that no assurance will be provided, that it will not detect fraud, etc.

(b) **DRAFT COMPILATION REPORT TO DIRECTORS OF MAZABUKA SUGAR LTD**

On the basis of information provided by management, we have compiled, in accordance with the International Standard on Related Services (ISRS) 4410, the Statement of financial position of Mazabuka Sugar Ltd at 31 March 2015 and Statement of comprehensive income and cash flows for the year then ended. Management is responsible for these financial statements. We have not audited or reviewed these financial statements and accordingly express no assurance thereon.

T182 Accountancy firm

2 May 2015

LUSAKA.

(5) (a) Insolvency simply means not having enough money to pay what is owed. The liabilities are significantly higher compared to assets. Some of the ways which can be used by Lundazi Maize Marketing Cooperative (LMMC) to manage its cash flows are:

- Cash forecast – this is a detailed forecast of cash inflows and outflows incorporating both revenue and capital items. It shows the cash effect of all plans made within the forecastary process and hence its preparation can lead to a

modification of flow forecasts if it shows that there insufficient cash resources to finance the planned operations. It can also give management an indication of potential problems that could arise and allows them that opportunity to take action to avoid such problems.

- Miller – Orr model – this manages to achieve a reasonable degree of realism while not being elaborate. It simply limits the fluctuations in the cash balance by imposing the upper limit and lower limit. If the cash balance reaches the upper limit, the firm buys sufficient securities (invests) to return the cash balance to a normal level (called the "return point"). When the cash balance reaches a lower limit, the firm sells securities (divests) to bring the cash balance to the return point. This model saves management time which might otherwise be spent to respond to those cash inflows and outflows which cannot be predicted.
- Baumol model – this is based on the idea that deciding on optimum cash balances is like deciding on optimum inventory levels. It assumes that cash is steadily consumed over time and a business holds a stock of marketable securities that can be sold when cash is needed.
- Probability analysis – a knowledge of probability distribution of possible outcomes for cash position will allow a more accurate estimate to be made of minimum cash balances, or the borrowing power necessary, to provide a satisfactory margin of safety.

It important to note that for any of the methods to operate successfully, qualified manpower will need to be employed or LMMC could consider outsourcing the cash management function to reputable firms.

(b) The controls to address the risks identified in LE are as follows:

- Offering unauthorized credit – introduce a formal senior management team to authorise credit to creditworthy customers. This should be backed by the necessary credit policy and procedures. Investigation of potential customers (e.g. credit checks, regular review of credit limits) are key aspects of credit control.
- Misappropriation of cash – use of cash registers or point of sale devices. Daily independent check and reconciliation by a senior person ,of cash summaries, deposit slips and cash in hand. In addition, the recruitment system for cashiers should be strengthened e.g. a requirement for elaborate reference checks.
- System unreliability – procure a more reliable system after carrying out the relevant investigations. Also improve on the supervisory skills.
- Customers refusing to pay – Ensure all customer orders are written and confirmed by customers. A copy should be sent to the dispatch. In addition, all complaints must handled independently by a senior manager.
- Imports may not meet ZABS specifications – Introduce formal procurement authorisation procedures and policies which incorporate checks for ZABS

specifications where relevant. In addition, obtain and publicise ZABS standards to all appropriate employees, managers and procurement staff.

(c) Under the PAYE system, the procedures relating to tax compliance are transferred from the employees to the employer. It is the duty of the employers to deduct tax from payments of emoluments to their employees, whether or not they have been directed to do so by ZRA. All employers are under an obligation to operate PAYE.

Penalties are chargeable under the Income Tax Act on any employer who fails to comply with the PAYE regulations. The employer's responsibility under these regulations does not end with the deduction. The tax deducted must be remitted to ZRA by the 14th of the following month. If the tax is not remitted on time, a penalty of 5% per month or part thereof, of the unpaid amount is chargeable under the Income Tax Act and interest is chargeable at 2% above the Bank of Zambia rate. If there is a loss of tax due to fraud, willful default or negligence of an employer, the employer may be liable to penalties amounting to 52.5%, 35% or 17.5% respectively of the omitted income.

(d) **CONNIE CHOOMA**

Computation of NET PAYS

	January 2015		February 2015		March 2015	
	K	K	K	K	K	K
GROSS PAY						
Basic Salary		10,000.00		10,000.00		10,000.00
Overtime		5,000.00		500.00		2,000.00
Education allowance		6,000.00		0		0
Housing allowance		1,400.00		1,400.00		1,400.00
Sub – total		22,400.00		11,900.00		13,400.00
DEDUCTIONS						
PAYE (W1)	6,515.75		2,840.75		3,365.75	
NAPSA	500.00		500.00		500.00	
Advance	4,000.00		0		0	
Loan	2,320.00		2,320.00		2,320.00	
Sub - total		13,335.75		5,660.75		6,185.75
NET PAY		9,064.25		6,239.25		7,214.25

NON AUDIT

SUGGESTED SOLUTIONS

QUESTION TWO

SECTION A

(1) (a) Benefits of good corporate governance in a utility company like Lupososhi Ltd:

- Ensure adherence to and satisfaction of strategic objectives of Lupososhi Ltd.
- Promote integrity .
- Possible improvement in performance.
- Offers safeguards against misuse of resources.
- Attract new investment into Lupososhi Ltd.
- Improves accountability to all stakeholders, not just shareholders.
- Maintains independence of external and internal auditors.
- Encourage pro active involvement of all stakeholders.
- Provide more accurate and timely financial and operational reporting.

(b) The governance framework in Lupososhi Ltd has both strengths and weaknesses. The strengths are as follows:

- The presence of a balanced board – this gives confidence to various stakeholders.
- Prudential management – the culture of prudential management means management is careful when making decisions.
- Qualified and experienced owner – as a qualified accountant, the Charles Zimba knows the corporate governance best practices.
- Separation of two powerful positions – the positions of Chairman, and Chief Executive Officer have been separated. This is recommended best practice, which ensures no one individual dominates decision making.
- Scrutiny of reporting – the independent scrutiny of reporting by the NEDs increases the reliability of the various reports.
- Scope of work for internal audit – the focus is more value adding.

The weaknesses are as follows:

- Dominant owner – Charles Zimba owners 80% of the share capital and may dominant most decisions, even through legitimate ways like voting.
- Chairman of the Audit committee – the Managing director (Charles Zimba) is also the Chairman of the Audit committee. The independence of the committee is highly questionable.

- NEDs have been around since inception – the levels of professional scepticism could have been impaired due to familiarity, with the executive directors.
- Director Internal Audit reporting – the Director Internal Audit effectively reports to the Managing Director, who is the Chairman of the Audit committee. Their independence is significantly impaired.
- Recently qualified accountant – the Finance Director may not have the necessary experience in governance issues.

The company must work on its weaknesses to ensure the governance framework matches best practice and enables Lupososhi Ltd to meet its objectives. The strengths should also be consolidated to guard against them becoming weakness over time.

(c) Accountability and audit are important matters in all major governance codes. Good disclosure helps reduce the gap between the information available to directors and the information available to shareholders, including other stakeholders. In many corporate scandals, the board were not given full information.

The Bank of Zambia identified poor transparency and a lack of disclosure as important factors associated with the collapse of a number of banks in mid 1990s. Accountability and audit is therefore, at the heart of corporate governance.

The board should present a balanced and understandable assessment of the company's position and prospects. External auditors are expected to carry out an independent scrutiny of the financial statements. However, in some cases they have been found wanting e.g. in the case of Enron, the auditors, Arthur Andersen, failed to spot or question dubious accounting treatment. Hence, lack of proper accountability and audit significantly affects the governance framework adversely.

(2) (a) Specific audit work is as follows:

- Review of the accounting and internal control system.
- Reviewing the design of the systems.
- Recommending cost effective improvements.

- Review of implementation of corporate objectives.
- Review of effectiveness of planning.
- Review the relevance of standards and policies.
- Evaluate the economy, efficiency and effectiveness for any given business system or operation in Lupososhi Ltd.
- In searching for value for money, present methods of operation and uses of resources must be compared with alternatives.

- Monitoring of risk management strategies.
- Identification of business objectives and the risks that may prevent Lupososhi Ltd from achieving its objectives.
- Consider Lupososhi Ltd's risk tolerance and assess whether the risk management is adequate and effective for dealing with risks.

(b) Key benefits of a robust risk management system:

The Committee of Sponsoring Organisations of the Treadway Commission (COSO), highlights the following benefits:

- Alignment of risk appetite and strategy.
- Link growth, risk and return.
- Choose best risk response.
- Minimise surprises and losses.
- Identify and manage risks across the organisation.
- Provide responses to multiple risks.
- Seize opportunities.
- Rationalise capital.

SECTION B

(3) (a)Fundamental characteristics required for Lupososhi Ltd to successfully use gearing:

- Relatively stable profits – Loan interest must be paid whether or not profits are earned. A company with erratic profits may have insufficient funds in a bad year with which to pay the interest. This would result in the appointment of a receiver and possibly the liquidation of the company.
- Suitable assets for security – Most issues of loan capital are secured on some or all of the company's assets which must be suitable for the purpose. A company with most of its capital invested in fast depreciating assets or inventory subject to rapid changes in demand and price would not be suitable for high gearing.

It is important to note that in a highly geared business:

- A large proportion of fixed – return capital is used.
- There is a greater risk of insolvency.
- Returns to shareholders will grow proportionately more if profits are growing.

(b) Prudential management refers to exercising prudence, good judgement or common sense.

This is a key requirement in financial institutions. The risk of misappropriation of client funds is significantly high compared to other industries. Management is expected to

exercise caution in the management of such institutions and client funds in particular. This concept can also be used in other organizations, like Lupososhi Ltd, to improve the control environment.

Prudential control refers to the monitoring of banks and other financial institutions by the authorities (e,g . Bank of Zambia) to ensure that they have an adequate capital structure, liquidity (asset portfolio) and/or foreign exchange exposure.

(c) Accounting treatments are as follows:

- **Government grant**
  IAS 20 permits two accounting treatments for capital grants:
  (i) Write off the grant against the cost of the non – current asset and depreciate the reduced cost.
  (ii) Treat the grant as a deferred credit and transfer a portion to revenue each year, so offsetting the higher depreciation charge on the original cost.

- **9 % convertible loan stock**
  IAS 32 requires compound financial instruments, like the 9 % convertible loan stock issued by Lupososhi Ltd, to be split into their component parts:
  (i) A financial liability (the debt)
  (ii) An equity instrument (the option to convert into shares).

- **Provision**
  IAS 37 states that a provision should be recognized when:
  (i) An entity has a present obligation (legal or constructive) as a result of a past event.
  (ii) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and
  (iii) a reliable estimate can be made of the amount of the obligation.

- **Inventory**
  IAS 2 states that inventories should be valued at lower of cost and net realisable value (NRV). IAS 10 gives allowances for inventories due to evidence of net realisable value as an example of an adjusting event. Adjusting events require the adjustment of amounts recognized in the financial statements.

- **Leasing**

IAS 17 gives guidance on the accounting treatment for operating leases as follows:

(i) An asset is not recognized in the statement of financial position.

(ii) Instead, rentals under operating leases are charged to the income statement on a straight – line basis over the term of the lease, unless another systematic and rational basis is more appropriate.

(iii) Any difference between amounts charged and amounts paid will be prepayments or accruals.

(d) Lupososhi Ltd is in breach of the Accountants Act (2008) by employing a recently qualified person as Finance director. The law is very clear on who should hold such senior positions. A person is required to have the necessary experience before being appointed to such senior positions. ZICA also requires its members to exhibit professional competence and due care. Members are required to maintain professional knowledge and skill at a level required to ensure that a client or employer receives the advantage of 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.

(4) (a) **Lupososhi Ltd**

Redrafted Financial statements

Statement o comprehensive income for the year ended 31 March 2015

	K'000
Revenue	10,800
Cost of sales (5,675 + 150)	(5,825)
Gross profit	4,975
Administration (1,231 + 100)	(1,331)

Distribution		(2,432)
Operating profit		1,212
Operating lease rentals	(W 1)	(25)
Finance cost	(W 2)	(675)
Interest receivable		7
Investment income		54
Government grant	(W 3)	9
Profit before tax		582
Income tax expense		(388)
Profit for the year		244
Other comprehensive income		
Gain on land revaluation		150
Total comprehensive income for the year		394

WORKINGS

(1)

	JANUARY 2015	FEBRUARY 2015	MARCH 2015
	K	K	K
Gross pay for the month	22,400.00	11,900.00	13,400.00
Less NAPSA (restricted)	(255.00)	(255.00)	(255.00)
Chargeable pay for the month	22,145.00	11,645.00	13,145.00
Add Previous total chargeable Pay	0	22,145.00	33,790.00
Current total chargeable pay	22,145.00	33,790.00	13,145.00

INCOME TAX

3,000.00 X 0%	0	6,000.00 X 0%	0	9,000.00 X 0%	0
800.00 X 25%	200.00	1,600.00 X 25%	400.00	2,400.00 X 25%	600.00
2,100.00 X30%	630.00	4,200.00 X 30%	1,260.00	6,300.00 X 30%	1,890.00
16,245.00 X 35%	5,685.75	21,990.00 X 35%	7,696.50	29,235.00 X 35%	10,232.25
Total income tax payable	6,515.75		9,356.50		12,722.25
Less Total income tax already paid	0		(6,515.75)		(9,356.50)
PAYE for the	6,515.75		2,840.75		3,365.75