NON-AUDIT

QUESTION 1

BACKGROUND

Natwange Plc is an investment company which holds controlling interests in three Zambian companies, namely:

a) Zamcem Ltd
b) Clinker Ltd
c) Crusher Ltd

It also owns non-controlling interests in other companies in Zambia and overseas. The Zambian companies above, distribute cement while the other companies deal in a variety of goods and services.

Natwangwe Plc was incorporated in 1980 and is now listed on the Lusaka Stock Exchange. The Chief Executive Officer has stated that the major opportunities for the company especially in Zambia lie in the following areas:-

a) Selling off Zamcem Ltd, which is situated in Livingstone and using the proceeds to develop a Cement manufacturing plant in Solwezi.
b) Expansion of Clinker Ltd which is based in Lusaka and partnering with the other distributors in Livingstone.
c) Mondernising Crusher Ltd which is based in Ndola and establishing a web-based marketing strategy.

The Chairman is also convinced that there are real opportunities for the whole company. He strongly believes that the impressive economic growth being recorded by the country is indicative of enormous opportunities available. However, the Chairman is not sure how the formation of the IDC recently announced by the government will impact on private investment. The IDC is a government initiative meant to accelerate development through parastatals.

ZAMCEM LTD

Zamcem Ltd is currently experiencing an erosion of its market share and faces increasingly strong completion. The market for the distribution of cement in Livingstone is perceived to be static. However, a Chinese investor has expressed interest in buying Zamcem Ltd and the board is waiting for the financial statements for the year ended 31 December 2013 to enable it come up with an informed decision.

The balances extracted from the general ledger at 31 December 2013 were as follows:-

	K'000
Inventories at 1 January	800
Purchases	32,000
Administrative expenses	9,000
Distribution costs	10,000
Interim dividend paid	6,000
Loan note interest paid	400
Revenue	64,500
Land and buildings:-	
Cost (including K10,000,000 for land)	45,000
Accumulated depreciation at 1 January 2013	4,200
Plant and equipment:-	
Cost	41,600
Accumulated depreciation at 1 January 2013	6,800
Investment property at 1 January 2013	50,000
Trade receivables	10,750
Trade payables	9,320
Cash and cash equivalents	1,070
Rental income	1,000

Profit on sale of a non-current asset	400
Allowance for receivable 1 January 2013	1,700
K1 ordinary shares	20,000
Share premium	30,000
General reserve	40,000
Retained earnings	20,200
10% loan notes	8,000
Taxation : overprovision in year to 31 December 2012	500

The following notes are relevant:-

1. The inventory valuation as at 31 December 2013 was K 2,000,000. The company uses a reliable perpetual inventory system and there was no physical inventory count at the year end. In early January 2014, the company received invoices for credit purchases totaling K22,000 for cement delivered before 31 December 2013. These invoices (which relate to cement not sold at 31 December 2013) have not been included in the accounts. In addition, on 15 January 2014, cement which cost K50,000 was sold for K42,000. The allowance for receivables must be increased to K2,000,000.
2. Distribution costs include K2,000 in relation to spending on research and development in connection with a new invoicing system. This expenditure meets the criteria for recognition as an intangible asset.
3. A final dividend of 60 ngwee per share was declared by the directors on 30 January 2014.
4. Special imported Fondu cement, which cost of K15,000 a long time ago, was sold to another distributor for K17,300,000 on 1 December 2013. Zamcem Ltd has an option to repurchase the cement from the distributor at anytime within three months. The repurchase price will be K17,300,000 plus interest charged at 0.161% per annum from the

date of sale to date of repurchase. It is expected that Zamcem Ltd will repurchase the cement.

5. In early December 2013, one of the company's delivery lorry was damaged in an accident. After carrying out the necessary repairs, management decided to designate the lorry as a utility vehicle for the human resources department. The carrying amount (after adjusting for depreciation for the year) is K1,500,000. An impairment test conducted on 31 December 2013, revealed that its fair value less costs to sell to be K1,000,000. The asset is now expected to generate an annual net income stream of K260,000 for the next 4 years at which point the asset would be sold for K350,000. A suitable discount rate is 15%. 4 year discount factors at 15% are:-

Simple	0.572
Cumulative	2.855

Impairment loss should be charged to administrative expenses.

6. Depreciation should be provided as follows:-

Land	Nil
Building	2 per cent per year on cost
Plant and equipment	10% reducing balance

All depreciation is to be shared equally between distribution costs and administrative expenses.

7. Investment property at 31 December 2013 had a fair value of K55,000,000. The company uses the fair value model.
8. Income tax on profit for the year is estimated at K5,250,000 and is due for payment on 30 June 2014.

Natwange plc was granted a licence (Licence No 453/2) for the development of a cement manufacturing plant in Solwezi on 25 September, 2013. The application for the licence had been pending for several years. The Chief Executive Officer of Natwange plc was able to use his former classmate who was recently appointed as Board Chairman at Zambia Environmental Management (ZEMA), to facilitate the issuance of the licence.

Solwezi is situated in the North Western Province of the Republic of Zambia, and is close to the DRC and Angola. The town is developing rapidly and demand for cement has been increasing at an average of 15% per year. The projected increase in the future is even more, given the opening of two new mines and the planned relocation of the entire central business centre.

The council officials and the community at large did protest the issuance of the licence.

You are a manager in CR Associates which is a firm recently licenced by ZICA to carry out non-audit engagements. CR Associates has been engaged by Zamcem Ltd to prepare financial statements, and give advice on a few important issues.

CLINKER LTD

Clinker Ltd has been failing to meet demand for the past two (2) years. The warehouses are too small and the distribution fleet is inadequate. Expansion and development of the relevant partnerships will result in increased profitability.

A business case has been developed and two reputable financial institutions have expresses willingness to fund the expansion. The financial institutions have requested for the latest statements of cash flow.

The chief accountant of Clinker Ltd has just resigned and your newly formed accountancy firm (ZAP Accountants), has been retained to prepare the

statements of cash flow. You only have limited experienced. Nevertheless, you have been able to obtain the following extracts:-

Statement of comprehensive income for the year ended 31 December 2013

	K'000
Revenue	60,000
Cost of Sales	(25,000)
Gross Profit	35,000
Administration Costs	(2,000)
Distribution Costs	(7,000)
Profit before tax	26,000
Tax	(10,200)
Profit after tax	15,800

Statement of financial position as at 31 December

	2012	2013
	K'000	K'000
Current Assets		
Inventory	12,000	9,525
Receivables	6,700	9,800
Short term Investments	4,000	2,000
(less than 2 months to maturity)		
Current liabilities		
Payables	5,200	6,900

The acting Accountant has also told you the following:-

i)A delivery vehicle was sold for K10,000,000 realizing a profit on disposal of K2,000,000. This profit has been netted off against the distribution costs.

ii)Administration costs include:-

	K'000
Depreciation	1,100
Employment costs	1,500
Bad debt written off	500

CRUSHER LTD

Crusher Ltd's board is concerned about its ineffective downstream supply chain management. This has been compounded by a manual accounting system. Management strongly believe that modernization of the company and establishing a web-based strategy will produce the required value for the shareholders. This transformation will entail changing the organization's culture and acquisistion of appropriate hardware and software.

Your firm (CC Associates) has been appointed by the board of directors of Crusher Ltd to spearhead the change process.

Preliminary discussions with management have revealed that the hardware and software will be acquired on lease. At one of the meetings called to prepare for the change, an invited government official presented a paper on how the government agencies are changing from IFRS to IPSAS.

SECTION A

1. a) Discuss the regulatory framework for financial reporting in Zambia.

[6 marks]

b) Outline the benefits which multi-national companies could derive from the Zambian financial reporting framework.

[8 Marks]

2.a) Prepare the statement of comprehensive income for Zamcem Ltd for the year ended 31 December 2013.

(Work to the nearest K'000)

[13 Marks]

b) Prepare the statement of financial position for Zamcem Ltd as at 31 December, 2013.

(Work to the nearest K'000)

[16 Marks]

c) Briefly discuss why the rules on exclusion of subsidiaries from consolidation are necessarily strict.

[7 Marks]

[Total 50 Marks]

SECTION B

3. a) Identify some common barriers to the successful adoption of ethical standards which are relevant to Natwange plc.

[8 Marks]

b). Explain the practical steps that Natwange plc can take towards creating an ethical framework of governance.

[8 Marks]

c) Discuss the main purpose of a business case.

[2 Marks]

4.a) Discuss the methods of reporting cashflows from operating activities.

[4 Marks]

b) Prepare extracts of the statement of cashflows for Clinker Ltd, showing the cashflows from operating activities, using the methods discussed in (a) above.

[13 Marks]

5.a)Briefly discuss what is meant by downstream supply chain management.

[2 Marks]

b) Comment on the main purpose of an accounting system and give key advantages of a computerized integrated accounting system.

[3 Marks]

c) As the manager in charge of the team spearheading the change process in Crusher Ltd, discuss why middle managers may be central to the process.

[4 marks]

d) Briefly discuss two key developments regarding IPSAS 6 “Consolidated and separate financial statements”.

[6 marks]

[TOTAL 50 MARKS]

QUESTION TWO

BACKGROUND

Joseph Muyunda was born on 28 January 1964, in Mongu, in the Western province of Zambia. He graduated from the Copperbelt University in 1980 with an upper class (distinction) degree in accounting.

He started working for one of the big four firms in 1981, and rose through the ranks, to be a partner in charge of non-audit assignments. Joseph has enjoyed his work over the years and greatly contributed to the profitability of the firm. In 2005, he resigned from the firm and was given a handsome separation package.

In 2007, he and his family decided to resettle in Mongu. He immediately noticed that Mongu was underdeveloped and lacked access to quality accounting services. However, Mongu is now undergoing a period of change, and investment in vital infrastructure is at last happening although many of the surrounding areas still remain under developed. Joseph has seen this as an opportunity and now runs JM Delmac Associates, a firm licenced by ZICA to offer non-audit services. He is the Managing Partner.

JM Delmac Associates was formed a year ago following the merger of two small competing accounting firms. Joseph Muyunda strongly believes that combining the two small firms will result in improved profitability mainly as a result of the inevitable rationalization and better utilization of resources.

You are a recently recruited manager in JM Delmac Associates and your name is Charles Nyangu. You have been requested by Joseph Muyunda to consider a number of issues for the following clients.

a) Velcare Ltd.

b) Rose Mwansa boutique
c) Mineral Mining and Processing Ltd
d) Chilanga district council

VELCARE LTD

Velcare Ltd is situated in Mongu and was incorporated in 2010. It is wholly owned by Savior Nyambe who is the chairman and chief executive officer. Nyambe was Joseph Muyunda's classmate at Sefula Secondary School. Velcare Ltd mainly manufactures, and supplies stationery and printing materials to government institutions.

Joseph Muyunda sits on the board of Velcare Ltd and is the Chairperson of the newly introduced audit committee. Nyambe is planning to list on the Lusaka stoke exchange (LUSE) and has informed the board of his intention. Joseph Muyunda has informed his wife to keep enough money for acquisition of shares, since Velcare Ltd has a lot of potential.

Nyambe is happy that the company is benefiting from Muyunda's exposure and experience. The company's controls have been strengthened and losses due to theft have reduced drastically. The future outlook is promising. He has appointed JM Delmac Associates as internal auditors and tax consultants in recognition of Joseph Muyunda's contribution. Velcare Ltd's detailed income statement for the year ended 31 December 2014 was as follows:

	K'000	K'000
Sales		67,500
Cost of sales		(15,300)
Gross profit		52,200

Bank interest (net)		1,270
Rent received (gross)		2,240
		55,710
Wages and salaries (note 1)	26,600	
Depreciation (note 2)	1,570	
Insurance	500	
Repairs and renewals (note 3)	8,620	
Donations (note 4)	25	
Impaired debts (note 5)	373	
Architects' fees	90	
Entertainment (note 7)	40	
Motor car expenses (note 8)	182	
Legal and professional fees (note 9)	265	
Telephone	48	
Amortisation of grant (note 10)	(80)	
Miscellaneous expenses (all allowable)	2,777	
		(41,010)
Net profit		14,700
Provisional tax paid (note 11)		(385)
Profit after tax		14315

Notes

1) Nyambe is provided with free company accommodation in Mongu, near the town centre. He has also been provided with a personal-to holder vehicle which has a cylinder capacity of 3,000CC. The Chief Accountant has included the notional gross rent K48,000 which could have been paid of the house was not owned by the company, in the total wages and salaries shown in the accounts. The total emolument for Nyambe included in the wages and salaries figure is K2,448,000. This also includes the notional rent of K48,000 and private motoring expenses of K200,000. The private motoring accounts for 30% of the total mileage.

2) Depreciation relates to the following non-current assets:

	Cost K	Age at start of charge year
a) New manufacturing machinery	200,000 (VAT exclusive)	-
b) General machinery	696,000 (VAT inclusive)	3 years
c) M.D's personal-to-holder motor vehicle	900,000 (VAT exclusive)	1 year
d) General pool car motor vehicle (2)	42,500 (VAT inclusive)	2 years

e) Marketing pool car	60,000 (VAT exclusive)	6 years
f) Fixtures and fittings	120,000 (VAT inclusive)	10 years
g) Computer	10,000 (VAT exclusive)	2 years
h) Newly constructed building	39,800,000	-

The cost of the newly constructed building is made up as follows:

	K
Land	1,000,000
Site preparation	50,000
Drawing office	60,000
Canteen	900,000
General administration offices	10,790,000
Showroom	2, 000,000
Factory building	25,000,000

TOTAL	**39,800,000**

The company received a government grant of K4,000,000 to assist with the construction works of the factory building. The building was brought into use during the year.

(3) Repairs and renewals:

Included in this figure are the following amounts:-

	K
Decorating offices	540, 000
Installation of new machinery (VAT exclusive)	50,000
Repairs to an office building damaged by flood	2,000,000
TOTAL	**2,550,000**

The balance of K6,070,000 is all allowable expenditure.

(4) Donations:

	K
Donations to U.T.H (University Teaching Hospital)	2,000
Donation to a political party	10, 000
Donation to an approved charitable organization	3,000
Donation for scientific research at C.B.U (Copperbelt University)	10, 000

TOTAL	**25,000**

(5) Impaired debts:

	K
Customer loan written off	95,000
Trade debts written off	290,000
Decrease in allowance for receivables	(10,000)
Trade debts recovered that was written off last year	(2,000)
TOTAL	**373,000**

(6) Architect's fees:

This relates to the designs for the newly constructed building (refers to note 2 (h)).

(7) Entertainment:

	K
Entertaining auditors	5, 000
Entertaining overseas customers	8, 000
Entertaining local suppliers	2,000
Entertaining staff	25,000
TOTAL	**40, 000**

(8)Motor car expenses:

This does not include the K200,000 private motoring expenses for Nyambe.

(9) Legal and professional fees:

This is made up of the following:

	K
Accountancy	120,000
Cost of renewing a 10 year lease in respect of the business premises	10,000
Special tax advice in a successful appeal against an assessment by ZRA	5,000
Defending court action by an employee in respect of constructive dismissal	5,000
Others (all allowable)	125,000
TOTAL	**265,000**

10) Amortisation of grant

This relates to the grant of K4,000,000 received to assist with the construction of the factory building.

11)The provisional tax is based on estimated taxable business profit of K1,100,000. This was deliberately understated by Nyambe. You have assured Nyambe not to worry because most companies use this as a

strategy to improve their cashflows. You have also mentioned that the current fax audit being done by ZRA may not reveal anything since the tax inspectors are inexperienced.

You are aware from the grapevine that Muyunda has included two trainees in the audit team in order to save costs and raise money for his upcoming holiday to Asia next month.

ROSE MWANSA BOUTIQUE

Rose Mwansa boutique is wholly owned by Rose Mwansa. It was formed and started operating in 2008. Rose Mwansa is resident in Zambia but during the charge year 2014, she bought a house in China and opened a bank account in the U.K. Her friend has told her about the Tax Online recently introduced by the Zambia Revenue Authority (ZRA).

The following were her incomes for the charge year 2014

	K
Tax adjusted business profits	42,500
Rent from China (gross)	9,200
Bank interest from UK (net)	8,100

The rent and bank interest was received net of 8% and 10% withholding tax respectively. No Provisional tax was paid.

You have just received the following email from Rose Mwansa

To: Charles Nyangu

From: Rose Mwansa

Date: 2.3.2015

Subject: Special tax advice

Kindly draft a report for me on tax evasion, tax avoidance and treaty relief. I have already discussed the issue with Muyunda, your boss. You may confirm this with him. A nominal fee of K800 has been agreed.

Best regards,

Rose Mwansa

MINERAL MINING AND PROCESSING LTD

Mineral Mining and Processing Ltd is resident in Zambia and is a part of a group which has mining interests worldwide. It has over the years demonstrated its reputation for consistently achieving above average returns for its shareholders. The Chief Executive Officer is basically a risk seeker and is supported by a competent senior management team.

During the year ended 31 December 2014, however, the company incurred a loss of K6,000,000. This was mainly due to excessive interest deductions on loans obtained to finance the acquisition of computer controlled mining equipment.

The Chief Executive Officer has requested JM Delmac Associates to advise on a number of issues relating to loss relief, thin capitalization and how his company can maintain the real values for losses and capital allowances. He also wants to know the key reasons for environmental reporting.

CHILANGA DISTRICT COUNCIL

This is a newly created district in the Republic of Zambia. The offices for the council are being constructed and the works may take at least two years.

The operations are currently conducted in rented offices. The council has a small computer system in the accounting office. The computer system operates a standard accounts package comprising billing, purchase, payroll and general ledger modules, and supports three users. The Mayor is worried about the security of the system. A full council meeting approved the appointment of JM Delmac Associates to identify the potential risks and recommend appropriate controls which may help protect against them occurring. The council also wants JM Delmac Associates to advise whether the International Accounting Standards (IASs) and International Financial Reporting Standards (IFRSs) will apply in the preparation of financial statements for the council. He is particularly concerned above the governments' involvement in the regulation of the financial reporting process despite the fact that ZICA already regulates the activities of it's members.

The Mayor wants the council to develop best practices and be a role model in the Republic of Zambia. He is already planning the issuance of a number of financial instruments to finance the planned activities of the council. A number of his relatives, friends and MPS are eager to do business with the council.

SECTION A

1. a) Identify and explain the threats to ethical and professional behavior in Velcare Ltd, and discuss two directions of ethical responsibility for JM Delmac Associates, as an internal auditor for Velcare Ltd.

   [21 Marks]

   b) Outline the possible consequences to a professional accountant, in Zambia, of giving false or misleading information or disclosure to any investigating authority or the institute with the intention that it be acted on as a disclosure.

   [4 Marks]

2. a) Calculate the company income tax payable by Velcare Ltd for the charge year 2014.

   [21 Marks]

   b) State the due dates for the payment of the taxes for Velcare Ltd for the charge 2014, and state the consequences of paying the taxes late.

   [4 Marks]

[TOTAL 50 MARKS]

SECTION B

3. a) Write a short report to Rose Mwansa, responding to her e-mail.

[8 Marks]

b) Compute the income tax payable by Rose Mwansa for the charge year 2014.

[10 Marks]

c) Discuss the benefits of the Tax Online introduced by the Zambia Revenue Authority (ZRA).

[5 Marks]

4. Comment on the issues raised by the Chief Executive Officer of Mineral Mining and Processing Ltd.

[12 Marks]

5. a) Advise the Mayor on what system will be required to manage the council properly.

[6 Marks]

b) Explain why the Zambian government might wish to regulate the financial reporting process, despite the fact that ZICA already regulates the activities of it's members.

[5 Marks]

c) Discuss why Chilanga council would have to pay particular attention to the related party disclosures.

[4 Marks]

[TOTAL 50 MARKS]

NON – AUDIT

SOLUTION TO QUESTION ONE

SECTION A

1.a) On 15 December 2010, the Zambia Institute of Chartered Accountants (ZICA) adopted the use of the Three Tier Financial Reporting framework for entities in Zambia. Under the Three Tier Financial Reporting framework, entities have been grouped into three categories and are required to apply the reporting framework as follows:-

No.	Type of Entity	Applicable Financial Reporting Framework
1	Listed companies and public interest entities	Full International Financial Reporting Standards (IFRS)
2	Economically significant companies – companies that are not public interest entities or quoted on the stock exchange but with turnover of K20 million and above	IFRS for small and medium entities (SMEs) or full IFRS if the company opts to use it.
3	Micro and small entities – entities with turnover of less than K20 million.	Zambian financial Reporting standard for micro and small enterprises (MSEs).

It is important to note that if the entity trades financial instruments (including shares, derivatives and bonds) or if it is a real estate investment company, it must use the IFRS for SMEs, or full IFRSs.

(b) The benefit which multinational companies could derive from the Zambia financial reporting framework include:-

(i) Preparation of group accounts are easier.

(ii) A reduction in audit costs might be achieved.

(iii) Transfer of accounting staff across national borders is easier.

(iv) Management control is improved because harmonisation aids internal communication of financial information.

(v) Appraisal of foreign entities far takeover and mergers is more straight forward.

(vi) It is easier to comply with the reporting requirements of overseas stock exchanges.

2. (a) **ZAMCEM LTD**

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER, 2013

	K'000
Sales Revenue (64,500-17,300)	47,200
Cost of sales (W1)	(30,793)
Gross Profit	16,407
Distribution costs (W2)	(12,088)
Administrative expenses (W5)	(11,890)
Finance cost (W6)	(1,031)
Fair value gain on investment property (55,000 – 50,000)	5,000
Rental income	1,000
Profit on sale of non-current asset	400
Loss before tax	(2,202)
Income tax expense (5,250-500)	(4,750)
Loss after tax	(6,952)
Other comprehensive income	0
Total comprehensive loss for the year	**(6,952)**

STATEMENT OF FINANCILA POSITION AS AT 31 DECEMBER, 2013

	K'000	K'000
ASSETS		
NON – CURRENT ASSETS		
Property, plant and equipment (W7)		70,920
Investment property		55,000
Intangible assets		2
		125,922
CURRENT ASSETS		
Inventory (2,000 + 22 - 8 + 15)	2,029	
Receivables (10,750 – 2,000)	8,750	
Cash and cash equivalents	1,070	
		11,849
TOTAL ASSETS		**137,771**
EQUITY AND LIABILITIES		
EQUITY		
Ordinary shares		20,000
Share premium		30,000
General reserve		40,000
Retained earnings(20,200 – 6,952 – 6,000)		7,248
		97,248
LIABILITIES		
NON – CURRENT LIABILITIES		
10% loan notes		8,000
CURRENT LIABILITIES		
Trade payables(9,320+22)	9,342	
16% short-term loan	17,300	
Income tax	5,250	

Interest(400 + 231)	631	
		32,523
TOTAL EQUITY AND LIABILITIES		**137,771**

WORKINGS

1. Cost of sales

	K'000
Opening inventory	800
Purchases(32,000 + 22)	32,022
	32,822
Closing inventory(2,000 + 22 + 15-8)	(2,029)
	30,793

2. Distribution costs

	K'000
Balance given	10,000
Research and Development	(2)
Depreciation (4180 x $^{1}/_{2}$)	2,090
	12,088

3. Depreciation

	K'000
Buildings [2% x (45,000 – 10,000)]	700
Plant and equipment[(41,600 – 6,800) x 10%]	3,480
Total	**4,180**

4. Impairment loss

		K'000
Carrying value		1,500
Recoverable – higher of		
Value in use		
260,000 x 2,855	742.3	
350,000 x 0.572	200.2	
	942.5	
Fair value	1,000*	(1,000)
Impairment loss		500

5. Administrative expenses

	K'000
Balance given	9,000
Increase in allowance for receivables	300
Depreciation(½ x 4180)	2090
Impairment loss	500
	11,890

6. Finance cost

		K'000
Interest paid		400
Interest for the year		
(10% x 8,000)	800	
Interest paid	(400)	

Accrued interest	400
	800
Finance cost on repurchase agreement	
(17,300 x 16% x $^{1}/_{12}$)	231
	1,031

7. Property, plant and equipment

	Carrying value b/f	Accumulated Depreciation	Impairment	Carrying value c/f
	K'000	K'000	K'000	K'000
Land and buildings	45,000	4,900		40,100
Plant and equipment	41,600	10,280	500	30,820
				70,920

c)The rules on exclusion of subsidiaries from consolidation are necessarily strict, because this is a common method used by entities to manipulate their results. If a subsidiary which carries a large amount of debt can be excluded, then the gearing of the group as a whole will be improved. In other words, this is a way of taking debt out of the statement of financial position.

IAS 27 did originally allow a subsidiary to be excluded from consolidation where control is intended to be temporary. This exclusion was then removed by IFRS 5 "Non-current assets held for sale and discontinued operations".

Subsidiaries held for sale are accounted for in accordance with IFRS 5.

It has been agued in the past that subsidiaries should be excluded from consolidation on the grounds of dissimilar activities, i.e. the activities of the subsidiary are so different to the activities of the other companies within the group, that to include its results in the consolidation would be misleading. IAS 27 rejects this argument: exclusion on these grounds is not justified because better (relevant) information can be provided about such subsidiaries by consolidating their results and then giving additional information about the different business activities of the subsidiary.

The previous version of IAS 27 permitted exclusion where the subsidiary operates under severe long – term restrictions and these significantly impair its ability to transfer funds to the parent. This exclusion has now been removed. Control must actually be lost for exclusion to occur.

SECTION B

3. (a) Some of the common barriers to the successful adoption of ethical standards which are relevant to Natwange plc are:-

   (i) No clear definition of what constitutes ethics – issues to do with advertising content, whistle blowing, workplace safety etc are poorly addressed.

   (ii) Use of codes of ethics as a PR (Public Relation) exercise. People do not "walk their talk"

   (iii) Issues of globalisation, with challenges of varying cultures:– it may be culturally acceptable to promote by merit in one country, or by seniority in another. Paying custom officials may be acceptable in some cultures, but taboo in others.

   (iv) Ethical versus commercial interest – being ethical is seen as a means towards the end of gaining a better reputation and hence increasing sales. Ethics should generally be an end in itself.

   (v) Policies of others – not everyone in the sector plays by the same rules. Being ethical may adversely affect the business.

(b) Practical steps that Natwange can take towards creating an ethical framework of governance are:-

(i) Developing within the workforce a culture of ethics that has value and meaning for those in it. Hence promoting integrity based programmes (principles based) instead of rules – based programmes (or approach).

(ii) Adopting ethical committees who are appointed to rule on misconduct and to develop ethical standards for Natwange plc.

(iii) Kohlberg's framework can be used to assist in the development of moral reasoning.

(iv) Ensuring managers live by example.

(v) Enforcing a social contract, through a detailed code based on rights and values of society.

(vi) Rewarding ethical behaviour.

(c). The main purpose of a business case is to achieve approval for the project and to obtain adequate resources to achieve its goals.

4. (a) IAS 7 Statement of Cashflows offers a choice of method for reporting cashflows from operating activities:

(i) Direct method – this method discloses major classes of gross cash receipts and gross cash payments.

(ii) Indirect method – under this method, net profit or loss is adjusted for the effects of transactions of a non – cash nature, any deferrals or accruals of past or future operating cash receipts or payments and items of income or expense associated with investing or financing cashflows.

The direct method is the preferred method because it discloses information not available elsewhere in the financial statements, which could be of use in estimating future cashflows. However, in practice, the indirect method is more commonly used, since it is quicker and easier.

(b).

INDIRECT METHOD

CLINKER LTD

STATEMENT OF CASHFLOWS (EXTRACT)

	K'000	K'000
Profit before tax		26,000
Depreciation		1,100
Profit or disposal		(2,000)
		25,100
Changes in working capital		
Decrease in inventory	2,475	

Increase in receivables	(3,100)	
Increase in payables	1,700	
		1,075
Net cashflow from operation activities		**26,175**

DIRECT METHOD

CLINKER LTD

STATEMENT OF CASHFLOWS (EXTRACT)

	K'000
Cash received from customers (W1)	56,400
Cash paid to suppliers and for expense (W2)	(28,725)
	27,625
Cash paid to employees	(1,500)
Net cashflows from operating activities	**26,175**

WORKINGS

1. **Cash received from customers**

Receivables account

	K'000		K'000
b/d	6,700	Bad debts	500
Sales	60,000	Cash	56,400
		c/d	9,800
	66,700		**66,700**

2. Cash paid to suppliers and expenses

Payables account

	K'000		K'000
Cash	28,725	b/d	5,200
c/d	6,900	Purchases (w3)	22,525
		Administration costs (w4)	900
		Distribution costs	7,000
	35,625		**35,625**

3. Purchases

Inventory account

	K'000		K'000
Opening Inventory	12,000	Cost of sales	25,000
Purchases (balancing figure)	22,525	Closing inventory	9,525
	34,525		**34,525**

4. Administration

Administration account

	K'000		K'000
Per accounts	2,000	Depreciation(not cash)	1,100
Profit on disposal	2,000	Employee costs (shown separately)	1,500

	Bad debt written off (not cash)	500
	Payable (balancing figure)	900
4,000		4,000

5. (a) Downstream supply chain management is about managing relationships with both customer and consumer, as well as any other intermediaries along the way. It can improve customer loyalty and retention. It gives management increased market visibility, which is key in effective strategic management.

   (b). An accounting system is the formal method of gathering and communicating data. It should provide for the orderly assembly of accounting information and appropriate analysis to enable financial statements to be prepared. The management of the organisation will rely on the accounting system to help them:

   (i) Control the organisation,
   (ii) Safeguard the assets,
   (iii) Prepare the financial statements, and
   (iv) Comply with the relevant legislation and accounting regulation.

The usual pattern for financial accounting has been for computerisation on a piece-meal basis, tackling the aspects involving most work first e.g

(i) Sales ledger
(ii) Purchase ledger and
(iii) Payroll.

Piece-meal introduction of computerisation is no longer necessary as there are now many integrated accounting packages available. Integrated accounting packages handle all parts of the process and ultimately produce the financial statements.

The use of an integrated package has a number of advantages.

(i) Data need only be input once to the package and is automatically used to update all parts of the system. This eliminates duplication of effort and ensures that the different components of the package are not using different versions of the data set.

(ii) The use of a common data set means that all the decisions made on the basis of that data will be consistent, regardless of who makes them.

(iii) The consistent screen appearance and command structure will reduce the need for training and allow users to learn new components more quickly.

c)Middle managers are the linking pin between the senior management team and the rest of the organisation. They have responsibility for helping their staff through the change process while simultaneously undertaking change themselves. They need to

i) undertake personal change

ii)help their teams through change – build up and maintain the momentum of change until the change is completed and act as facilitator.

iii)implement the necessary changes in their parts of business – encourage individuals to use their initiatives and put emphasis on teamwork.

iv)keep the business going in the interim.

d)The two key developments relate to:-

i)Control – Exposure Draft 49 (ED 49)"Consolidated Financial Statements" proposes a new definition of control and considerably more guidance on assessing control. The definition of control focuses on an entity's ability to influence the nature and amount of benefits through power over another entity.

ii)ED49 no longer permits an exemption from consolidation for temporarily controlled entities.

The key part of the International Public Sector Accounting Standards Board's (IPSASB's) strategy is to converge International Public Sector Accounting Standards (IPSASs), to the extent appropriate, with the International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB).

NON-AUDIT

SOLUTIONS TO QUESTION TWO

SECTION A

1 a)

Threat	Explanation
i. The Chairman and Chief Executive Officer, Savior Nyambe, was Joseph Muyunda, Managing Partner's classmate.	- Joseph Muyunda's objectivity may be threatened as a consequence of this relationship. He is faced with self-interest and familiarity

	threats.
ii. Joseph Muyunda sits on the board and is the chairperson of the audit committee.	- Mr. Joseph Muyunda appears to have made managerial decisions which have greatly benefited the company. It is highly unlikely that he will question his recommendations as an internal auditor. He is faced with a self-review threat.
iii. Joseph Muyunda's advice to Nyambe, not to worry about the understated tax.	- This impacts negatively on his integrity. The fundamental principles require that members behave with integrity in all professional and business relationships.
iv. Using trainers to save costs	- Members have a continuing duty to maintain professional competence and due care. The use of trainees just to save cost is totally unacceptable. The trainees may not act diligently and in accordance with applicable technical and professional standards.
v. Disclosure of information to the wife.	- Members are required to respect the confidentiality of information acquired as a result of

	professional and business relationships. Joseph Muyunda's disclose of the business opportunity to his wife is unethical.

Internal auditors are basically employees of the organisation, even if the internal audit function maybe outsourced. Hence JM Delmac Associates as internal auditors, has two 'directions' of responsibility, one to their 'employer'. Velcare Ltd, and another to the highest standards of professionalism.

JM Delmac Associates' responsibilities to Velcare Ltd extend to acting with diligence, probity and with the highest standards of care in all situations. In addition, however, Velcare Ltd might reasonably expect JM Delmac Associates to observe "employee" confidentiality as far as possible.

In addition to JM Delmac Associates' responsibilities to Velcare Ltd, there is a further set of expectations arising from the membership of the Zambia Institute of Chartered Accountants (ZICA). For example, if JM Delmac Associates uncovers issues of tax evasion, it would clearly be unacceptable to be involved in any form of deceit and it would be JM Delmac Associates' duty to help to correct such malpractice if at all possible.

b) According to the Accountant Act, 2008, section 85 (2), any person who gives false or misleading information or disclosure, commits an offence and is liable, upon conviction-

i) If the offender is a natural person, to a fine not exceeding five hundred thousand penalty units or to imprisonment for a term not exceeding five year, or to both: or

ii) If the offender is a body corporate, to a fine of nine hundred thousand penalty units.

2 a) VELCARE LTD

COMPUTATION OF FINAL COMPANY INCOME TAX PAYABLE – CHARGE YEAR 2014

	K'000	K'000
Profit per accounts		14,700
ADD:		
Notional Salary for Nyambe	48	
Accommodation benefit		
30% x (2,448-48-200)	660	
Personal – to holder vehicle	20	
Depreciation	1,570	

Installation of new Manufacturing Machinery	10	
Donation to a political Party	10	
Customer loan written off	95	
Architects' fees	90	
Entertaining auditors	5	
Entertaining overseas customer	8	
Entertaining local supplier	2	
Special tax advice	5	
		2,523
		17,223

LESS:

Bank interest (net)	1,270	
Rent received (gross)	2,240	
Amortisation of grant	80	
Capital allowances (WI)		
Plant and Machinery	475	
Industrial building	6,025	
Commercial building	216	
Private Motoring Expense	200	
		(10,506)
Taxable business profit		6,717

COMPANY INCOME TAX	**K'000**
Business profits	6,717
Bank Interest 1,270 x $^{100}/_{85}$	1,494
Taxable income	8,211

Company income tax		
8,211 x 35%	=	2,874
Less tax already paid		
WHT-Bank interest 1,494 x 15%		(224)
Provision tax		(385)
Final Company income tax payable		2,265

WORKINGS

1. **COMPUTATION OF CAPITAL ALLOWANCES**

a)PLANT AND MACHINERY ALLOWANCES

	K
1. New manufacturing	
Machinery	
Wear and tear allowance	
210,000 x 50%	105,000
(Plus Installation cost)	
2. General Machinery	
Wear and tear allowance	
696,000 x $^{25}/_{29}$ x 25%	150,000
3. M.D's Car	
Wear and tear allowance	
900,000 x 1.16 x 20%	208,800
4. General Pool Car	
Wear and tear allowance	
42,500 x 20%	8,500

5. **Marketing pool car**

   Wear and tear allowance – not applicable, the car is more 5 years old

6. **Fixtures and Fittings**

   Wear and tear allowance – not applicable, the fixtures and fittings are more than 4 years old

7. **Computer**

   Wear and tear allowance

10,000 x 25%	2,500
	474,800

b) **BUILDING**	K	K
o Land		no allowances are given
o Industrial building		
o Site Preparation	50,000	
o Architect fees	90,000	
o Drawing Office	60,000	
o Canteen	900,000	
o Factory		
25,000,000 – 4,000,000	21,000,000	
Showroom		
(not more	2,000,000	

than10% –W1)		
Qualifying cost	24,100,000	
Initial allowance		
24,010,00 x 10%	2,410,000	
Investment allowance		
24,010,000 x 10%	2,410,000	
Wear and tear allowance		
24,010,000 x 5%	1,205,000	**6,025,000**

- General Administration Offices
  Wear and tear allowance
  10,790,000 x 2% **215,800**

NB

- 10% test for showroom

$$\left(\frac{2,000,000}{39,800,000 - 1,000,000 - 4,000,000} \times 100\% \right)$$

$$\frac{2,000.00}{34,800,000} \times 100\%$$

= 5.7%, not more than 10% and therefore qualifies as part of industrial building.

- 10% test for General Administration offices

$\frac{10,790,000}{34,800,000}$ x 100% = 31% - more than 10%, hence treated as commercial building(does not qualify as part of individual building.)

b) i) **Provisional tax**

			K'000
Each Installment	=	$\frac{385}{4}$	**96.25**

Installment	Amount K'000	Due Date
1st	96.25	31 March 2014
2nd	96.25	30 June 2014
3nd	96.25	30 September 2014
4th	96.25	31 December 2014

ii) Final Company tax
Due date 30 June 2015

The consequences of paying income tax late are as follows:

- Penalty of 5% of the amount of tax is charged per month or part thereof.
- Interest on overdue tax is also charged at the Bank of Zambia discount rate plus 2% per annum.

SECTION B

3 a) **REPORT**

To: Rose Mwansa

From: Charles Nyangu

Date: 6.3 2015

Subject: Special Tax Advice

Introduction

The aim of this report is to set out details on tax avoidance, tax evasion and treaty relief as requested by yourself. The report is exclusively for your use.

Tax Evasion

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. This is an offence and may be punishable by fines and /or imprisonment.

Tax Avoidance

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

Treaty Relief

This is one of the double taxation reliefs, which is only available if there is an agreement in force made between the President of the Republic of Zambia and the Presidents of foreign countries.

Conclusion

Tax issues are generally challenging and it is always advisable to get professional advise because ignorance of tax laws is no defence. Huge penalties and interests will apply to a number of tax offences.

Signed.
Charles Nyangu
JM Delmac Associates

b) **ROSE MWANSA**

PERSONAL INCOME TAX COMPUTATION FOR THE CHARGE YEAR 2014

	K
Business profits	42,500
Bank interest 8,100 x $^{100}/_{90}$	9,000
Taxable income	51,500

Income Tax	
51,500	
(36,000) x 0%	0
15,500	
(9,600) x 25%	2,400
5,900	
(5,900) x 30%	1,770
0	4,170
Less DTR (WI)	(729)
Income tax payable	**3,441**

WORKING

1. Double Taxation Relief (DTR)

- Lower of

a) Foreign tax on foreign income

9,000 x 10% = K900

b) Zambian tax on foreign income

9,000 x 4,170 = K729

51,500

Therefore the DTR is the lower figure, which is K729

c) Tax Online is a web-based taxation system. It's introduction has generally made compliance easier. The following are some of the specific benefits:-

i) e-Registration – online registration of Taxpayer's Identification Number (TPIN).

ii) e-Dissemination of information –E-mails and SMS alerts.

iii) e-payment – online payment.

iv) e-inquiry – online inquiries, interactive facility and frequently asked questions.

v) e-filing - online filing.

These are efficient and a taxpayer can avoid long queues.

4) **Loss Relief**

When a mining company incurs a loss, that loss, is carried forward and relieved against the future profits arising from the same business.

The loss is carried forward for a maximum period of ten years unlike the five years allowed for other businesses. Any loss incurred on hedging can only be deducted from the income from hedging arising in the future. The loss can also be carried forward for a period not exceeding ten years.

Thin capitalization

In tax terms, a mining company resident in Zambia and which may be part of a group, with companies resident abroad, may be said to be thinly capitalized when it has excessive debt in relation to its arm's length borrowing capacity, leading to the possibly of excessive interest deduction being made.

The thin capitalization rules are an anti-avoidance measure aimed at preventing companies from using excessive debt so that taxable profits are reduced to a minimum since interest is allowable for tax purposes.

In order to ensure that mining companies are not financed by excessive debt relative to their equity base, interest on debt where the debt: equity ratio exceed 3:1 is not an allowable expense.

Maintenance of losses and capital allowances in real terms.

If the accounting records are maintained by a mining company in United States Dollar (USD or US $), then the losses or capital allowances may be indexed in order to maintain their real values. The formula used to index is:-

$$1 + \frac{(R_2 - R_1)}{R_1} \times \text{loss (or capital allowance) brought forward}$$

Where: R_1 is the Kwacha per US Dollar exchange rate ruling on the last day of the accounting year preceding that in which the loss relief (or capital allowance) is being claimed, and

R_2 is the Kwacha per US Dollar exchange rate ruling on the last day of the accounting year in which the loss relief (or capital allowance) is being claimed.

Key reasons for environmental reporting

An entity may publish an environmental report for the following reasons:-

i) To differentiate it from its competitors.

ii) To acknowledge responsibility for the environment.

iii) To demonstrate compliance with regulations.

iv) To obtain social approval for its activities.

The first environmental reports were largely a public relations exercise and the aim was to demonstrate a company's commitment to the environment. Some entities continue to view them in this light. However, many others now view the environmental report as a vehicle for communicating an entity's performance in safeguarding the natural environment.

5. a) The council is already faced with a number of risks e.g. the computer system is inadequate. To be able to manage the council properly, it will be advisable to develop and implement an enterprise risk management system. This is a process, effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identity potential events that may affect the entity and manage risks to be within its risk appetite, to provide reasonable assurance regarding the achievement of the entity's objectives.

b) The financial statements input may come from many sources. Government is always responsible for the regulations of the activities of its citizens, both individual and corporate, and for their protection. It would be irresponsible for any government to delegate all of its duties for an issue as important as financial reporting to an interested party such as ZICA. ZICA also has a role to protect its members.

Aggrieved parties who claim to have suffered because of an irregularity are likely to blame the government for being too lax.

ZICA has very little power over non-accountants who may have participated either directly or indirectly in the financial reporting. Government has the power to set laws and enforce them on all preparers and auditors.

c) The financial statements would be very difficult to understand if readers were not informed of any related party transactions. It is unlikely that transactions with related parties would happen at arm's length prices. Related Party disclosures may be enough to enable a reader to adjust for the effects of any mispricing or other concessions and thereby obtain a better insight into the "real" performance of the council.

In addition, some of the transactions with related parties may involve fraudulent activities-knowledge of the related parties could also enable relevant bodies and the public to raise questions about these transaction. This will strengthen the governance system within the council.