

QUESTION TWO

CHANI ENTERPRISES

Introduction

Chani Enterprises was founded by Mr Beyani Jilala. Over the last four years Mr. Jilala has initiated two business ventures, namely Jilala Farms and Jilala Supermarket in Mpika.

Jilala Farms (JF)

Jilala farm is located in the Mkushi farming block area. JF is a fully- integrated broiler producer that breeds and rears its own livestock which it feeds from its own feeding mills. JF also processes, distributes and markets fresh, frozen, value added chicken.

As an integrated broiler producer, JF focuses on the entire growing cycle, allowing the company to oversee every step of the farming and production process. Bio-security, flock health, body weight control and uniformity management are core issues that drive the optimal performance of the farm. JF produces three generations of birds in order to provide consistent high quality broiler meat. Birds are farmed at grandparent, parent (broiler-breeder) and broiler level.

At the grandparent level, day-old chicks are reared under strict environment controls. Fully grown birds are transferred to laying sites where for 10 months they produce eggs. Eggs are then collected and transported to the hatchery. At broiler level, broiler birds are grown purely for meat production by providing them with an energy and protein rich, high nutritious diet.

Competence

Mr Jilala prepares financial statements to 31 March each year. For the year ended 31 March 2013, he incurred the following expenditure:

	(KR)
Employee accommodation	56,000
Fencing farm	44,000
Stumping costs	22,000
Purchase of harvesting equipment	156,000
Purchase of Nissan Van	180,000
Purchase of furniture and fittings for office use	50,000
Digging of a well for watering purposes	11,000

The tax adjusted profit before deducting capital allowances for the tax year 2012/2013 amount to KR815,000.

Jilala Supermarket

Jilala started the building of a new store during the year. The construction was financed by a loan of KR1,000,000 obtained from Zambia National Commercial Bank (ZANACO) on 1st April 2012, at an interest rate of 18% per annum. The loan is redeemable at a premium which means

that the loan has an effective finance cost of 20%. Construction of the supermarket commenced on 1 May 2012 and it was completed and ready for use on 28th February 2013, but did not open for trading until 1 April 2013. During the year Mpika experienced torrential rains and construction of the new supermarket was suspended for a two month period during July and August 2012.

The proceeds of the loan were temporary invested for the month of April 2012 and earned interest of KR30,000.

Importation of Nissan Patrol

Mr Jilala imported a Nissan Patrol from the UK at a cost of \$15,000. He paid insurance charges of \$1,500 and transportation costs of \$4,500. Both the insurance charges and the transportation costs cover the car up to Chirundu border post. Once declared, the registration cost for the car in Mkushi was estimated at KR1,500 and the comprehensive insurance charge has been estimated at KR6,000. The car has a cylinder capacity of 5.0

The car reached Chirundu on December 22, 2012 and all import taxes were paid. The Commissioner general had advised that for the period from 15th November to 31 December 2012, the exchange rate to be used was KR4.8 per \$US. However, the Kwacha depreciated around 22 December 2012 and on that date, the average exchange rate quoted at Barclays Bank was KR4.850.

Appointment as Financial Consultant

Your name is Festus Kabwe and you are the managing director of Novel Business Solutions (NBS), a firm registered with the Zambia Institute of Chartered Accountants (ZICA). Mr. Jilala is your personal friend, having attended the same university and occasionally you play squash together. You have since held several discussions and you have now agreed to act as financial advisor for Mr. Jilala. It is clear that Mr. Jilala feels particularly confident that, being friends, you will do everything possible to help him

Your firm boasts of a number of accounting and taxation clients, none of which is involved in farming. You have received the following e-mail from Mr. Jilala:

To : Festus
From : BJ
Subject: Confirmation of appointment

12 March 2013

Festus,

Following our discussion last week, I am very happy that your firm has accepted to act as our financial consultant. I am still in process of recruiting the full complement of staff at the farm. This has meant that I am involved in all the aspects of running the farm at the moment. As I am not accountant, I have not done a very good job ensuring that proper accounting records are maintained. The absence of complete accounting and taxation information has attracted undue attention from Zambia Revenue Authority (ZRA) in the past. As I intimated during the meeting, I need your assistance with various taxation and business issues as below:

a) Jilala Farms

My accounting personnel have prepared draft financial statements for the year ended 31 March 2013 and provided relevant taxation information you requested to enable your firm prepare the estimated taxable profits payable on Jilala Farms for the tax year 2012/2013. I understand that I can be allowed to average my farming income and also be allowed to combine non-farming income with my farming income. As you are aware, I go around other farms to conduct training in new farming technologies.

b) Valuation of the land

I have recently acquired another piece of land on the eastern side of Mkushi. This virgin land which has never been used before and I am in the process of securing title deeds from the Ministry of Lands. My intention is to build a block of flats for the use of my employees. Alternatively, I can rent them out at an economic rent. Additionally, my preference would be to retain the flats as close to market fair value as possible.

c) Jilala Supermarket

As indicated during our meeting I have also decided to start running a supermarket chain. For this purpose, I obtained a loan from ZANACO to finance the construction. I have recently bought a Nissan Patrol for the store manager. I think I paid more money for the Nissan than I expected. My clearing agent mentioned something about ZRA using a method called the transaction value for the purpose of determining duty on the vehicle. I would appreciate if you could re-compute relevant costs for me.

Again I thank you for your help and I hope the next visit from the Zambia Revenue Authority (ZRA) officers will demonstrate that I have no intention of evading tax.

Your friend,

BJ.

Requirements

SECTION A

- 1) Identify and explain SEVEN ethical and professional issues that should have been considered before accepting the position of financial consultant for Mr. Jilala
(21 marks)
- 2) In respect of Jilala farms,
 - a) Explain the circumstances under which farming income may be averaged
(4 marks)
 - b) Compute the final taxable farming profits on Mr. Jilala for the tax year 2012/2013
(20 marks)
 - c) Explain the effect of combining farming income with non-farming income.
(5 marks)

SECTION B

- 3) In respect of the construction of the supermarket
 - a) Explain whether borrowing costs incurred as part of the cost of the construction supermarket qualify to be capitalized. You should support your answer by reference to relevant International Financial Reporting Standards (IFRS)
(5 marks)
 - b) Calculate the net borrowing cost should be capitalized as part of the cost of the new store
(8marks)
 - c) Calculate the financial cost that should be reported in the profit or loss for the year ended 31 March 2013.
(2 marks)
- 4) In respect of importation of the Nissan Patrol
 - a) Explain what is meant by transaction value for customs duty purposes and state FOUR conditions that should be met in order for the transaction value method to be used
(10 marks)
 - b) Re-compute the total amount of import taxes that should have been paid for the Nissan Patrol
(5 marks)
- 5) It would appear that Mr Jilala would like to adopt the valuation model for the flats. Advise the recognition and measurement rules, assuming
 - a) The flats are used by his employees
(10 marks)
 - b) The flats are rented out at economic rent
(10 marks)

You should refer to relevant International Financial Reporting Standards (IFRS) and any Guidance issued by the Zambia Institute of Chartered Accountants (ZICA)