

SUGGESTED SOLUTION

SECTION A

Requirements

1) Ethical and Professional issues

All accountants (not just auditors) in public practice must adhere to prescribed rules of professional conduct. The following ethical and professional issues should have been considered by NBS in accepting the position as financial consultants:

a) The managing director of NBS and Mr Jilala are personal friends

According to the rules of professional conduct, NBS objectivity may be threatened by this close personal relationship as this creates a self interest where NBS may be inclined to “please” the friend instead of providing an objective and professional service

b) “Do everything possible”

NBS should only provide the range of services agreed with the client based on a signed letter of engagement. If terms of reference are not clear, this may lead to disagreements and a breakdown in the relationship between NBS and the client. In addition, unclear terms of reference expose NBS to possible litigation.

c) Lack of experience in farming

NBS does not appear to have any experience in providing professional services within the farming sector. Professional accountants have a continuing duty to maintain professional knowledge and skill at a level required to ensure that a client receives competent service based on current developments in practice, legislation and techniques. NBS’s ability to provide a competent service may be questioned

d) Dominance by Mr Jilala

There appears to be lack of segregation of duties with Mr. Jilala involved in almost all the activities. This increases the risk of misstatement arising from either fraud or error.

e) Absence of proper accounting records

Entities are required by law to maintain adequate accounting records. Absence of proper accounting records may suggest non-compliance and increases the risk of errors.

f) Completed in the next two weeks

The time to be taken on an assignment is determined by the professional accountant taking into account complexity of the assignment and the requisite experience and skill of personnel to be allocated on the assignment. Any attempt by the client to impose a fixed time on the assignment may amount to intimidation.

g) Visit by the ZRA – possible evasion of tax

It would appear that the ZRA have visited Mr. Jilala on a previous occasion. Evasion of tax is a breach of laws and regulations and may question the integrity of Mr. Jilala. NBS

should consider whether it is in the interest of the firm to continue to associate with a client that may be exposed to negative publicity through a possible investigation.

2) Jilala Farms

a) Circumstances under which farming income may be averaged

S.62A of the income tax act provides for averaging of farming income. A farmer can make an irrecoverable election to have farming income of the two consecutive charge years averaged. The irrecoverable election should be made before the end of the charge year that follows the second consecutive such charge year.

Where there is a loss in one year and a profit in another, the election to average the profit and loss can still be made by the farmer. The final taxable income is the averaged income for each of the two consecutive charge years and if there is a loss, the final loss in respect of each of the two consecutive charge years is the average loss.

b) Tax computation of farming taxable profits for the tax year 2012/2013

	KR	KR	KR
Tax adjusted profit before capital allowances			815,000
Less Capital allowances:			
Implements, plant and machinery:			
○ Nissan Van (25% 180,000)		45,000	
○ Furniture and fittings (25% *50,000)		12,500	
○ Harvesting Equipment (50% *156,000)		78,000	
Total capital allowances on plant and machinery		<u>135,500</u>	
Farm improvement allowances:			
○ Farm dwelling (restricted)	20,000		
○ Security fence	<u>44,000</u>		
Total farm improvement allowances		64,000	
Farm works allowance:			
○ Cost of stumping	22,000		
○ Cost of digging a well	<u>11,000</u>		
Total farm works allowance		<u>33,000</u>	
Total capital allowances			(232,500)
Final taxable farming income			582,500

c) Effect of combining farming income with non-farming income.

If a farmer has farming income and non-farming income, then the tax free band should be allocated to non-farming income first. If the non-farming income is more than KR9,600 the first KR9,600 of that income will be taxed at 0%, the next at KR6,420 at 25% and so on. The whole of the farming income be taxed at the rate of 15%

If the non-farming income is less than K9,600,000 then the whole of that amount will be taxed at 0% with part of farming income also being taxed at 0%. The balance of the farming income will then be taxed at 15%

3) Construction of the supermarket

a) Qualifying borrowing costs

Qualifying borrowing costs are borrowing costs incurred in the construction of qualifying assets. These are assets that necessarily take substantial period of time to get ready for intended use or sale. Since the revision of IAS 23, *Borrowing Costs* – such costs now must be capitalized

Where funds are borrowed specifically to finance the construction of a qualifying asset, the amount eligible for capitalization will be the borrowing costs incurred at the effective rate of interest, less any investment income earned on the temporary investment of those borrowings

Where funds are borrowed generally and the borrowing attributable to a particular asset cannot be readily identified, the amount eligible for capitalization will have to be estimated by applying a weighted capitalization rate to the funds used in constructing the asset

Capitalisation commences when expenditure and necessary activities begin on the asset and borrowing costs incurred. Capitalization is suspended during any period in which activities on the asset are suspended and it ceases when substantially all activities necessary to prepare the asset for its intended use or sale are complete.

b) Calculation of net borrowing costs

The total finance cost for the year are KR200,000 (KR 1,000,000 * 20%).

However, the finance costs can only be capitalized for those periods during which the activity was taking place. Capitalisation is not permitted:

- Before the construction begins
- While construction is suspended
- After construction is completed

Finance cost to be capitalized therefore

May – June (1,000 * 20% * 2/12)

(KR'000)
33

Sept 2012 – Feb 2013 (1,000 *20% * 6/12)

100
133

KR 133,000 will be debited to the cost construction as part of the cost of the store

c) Calculation of finance cost

The finance cost to be expensed (KR 200,000 – 133,000) = KR 67,000
These will be debited to the income statement

The period during which the funds were invested was before the construction began, so during a period in which finance costs were not being capitalized. Therefore the interest received of KR30,000 is not deducted from the capitalized finance costs, but is credited to the profit or loss as investment income.

4) Importation of Nissan Patrol

a) Transaction value and conditions

The term transaction value is used to refer to the actual price paid or payable in respect of imported goods, including insurance, freight and other incidental charges to the extent that they have been paid.

In order for the transaction value to be used for customs duty purposes, the following conditions should be met:

- (i) There should be no restrictions to the use of the goods
- (ii) There should be no conditions to deter the determination of Value for Duty Purposes (VDP)
- (iii) No part of the proceeds on resale would accrue to the seller, unless included in the value
- (iv) No relationship exists to influence the value

b) Re-computation of the total amount of import taxes that should have been paid for the Nissan Patrol

The customs value is:

	\$
Cost	15,000
Insurance	1,500
Freight	4,500

	21,000
	=====
VDP = 21,000*KR4.850	KR101,850,

Computation of import taxes paid

	Values KR	Taxes KR
VDP	101,850	
Customs duty @25%	25,463 -----	25,463
	127,313	
Excise duty @ 30%	38,194 -----	38,194
	165,507	
VAT @16%	26,481	26,481

		90,138
		=====

5) Recognition and measurement rules for the flats:**General guidance from ZICA**

Even though technically land in Zambia is on 'lease' from Government, in substance the tenant enjoys all the risks and rewards associated with the land. Therefore the cost of acquisition of land (for use in the production or supply of goods or services, or for administrative purposes) whether directly from Government or from another party should be recognised as Property under IAS 16, *Property, Plant and Equipment*. The cost of land acquired for capital appreciation whether directly from Government or from another party should be recognised as an Investment Property.

a) Flats used by employees

These flats would qualify leasehold land and buildings and would be accounted for according to IAS 16, *Property, plant and equipment* (PPE)

Recognition rules

According to IAS, PPE is defined tangible assets that are held for use in production or supply of goods and services, for rental to others, or for administrative purposes and are expected to be used during more than one period.

An item of property, plant, and equipment should be recognized as an asset if and only if it is:

- Probable that future economic benefits associated with the asset will flow to the entity; and
- The cost of the item can be measured reliably.

As the flats meet this definition and criteria, they should be recognized as PPE.

Measurement rules: initial measurement

An item of property, plant, and equipment that satisfies the recognition criteria should be recognized initially at its cost. IAS 16 specifies that cost comprises

- Purchase price, including import duties, non-refundable purchase taxes, less trade discounts and rebates
- Costs directly attributable to bringing the asset to the location and condition necessary for it to be used in a manner intended by the entity
- Initial estimates of dismantling, removing, and site restoration if the entity has an obligation that it incurs on acquisition of the asset or as a result of using the asset other than to produce inventories

For the land this cost will include:

- Consideration paid to acquire land
- Fees paid for title deed
- Any other fee incidental to the acquisition of the land such as legal fees

For the flats this cost will include

- Cost materials, labour and other direct expenses
- Cost of directly attributable overheads

Measurement rules – subsequent measurement- revaluation model

ZICA guidance provides that where an entity holds lands as PPE and adopts the revaluation model under IAS 16, land shall still be carried at cost less accumulated amortisation less any accumulated impairment losses. Land should not be revalued. The revaluation shall only apply to the improvements, in the case the construction of the flats. The gains and losses arising on the improvements should be accounted for in accordance with the guidance in IAS 16 under the Revaluation model, as explained below.

The revaluation model requires an asset, after initial recognition, to be measured at a revalued amount, which is its fair value less subsequent depreciation and impairment losses. In this case, fair value must be reliably measurable. Revaluations must be made with sufficient regularity to ensure that the carrying amount is not materially different from fair value. If the flats' carrying amount is increased as a result of a revaluation, the increase should be credited directly to equity under the heading of revaluation surplus. However, the increase should be recognized in profit and loss to the extent that it reverses a revaluation decrease of the same asset previously recognized profit and loss

If the asset's carrying amount is decreased as a result of a revaluation, the decrease should be recognized in the profit and loss. However, the decrease should be debited directly to equity under the heading of revaluation surplus to the extent of any credit balance existing in the revaluation surplus in respect of that asset

b) Flats rented out at economic rent

Recognition rules

According to IAS 40, *Investment Property* represents Land or building, or part of a building, or both, held by the owner or the lessee under a finance lease to earn rentals and/or for capital appreciation, rather

than for use in production or supply of goods and services or for administrative purposes or for sale in the ordinary course of business.

Investment property shall be recognized as an asset when and only when

- It is probable that future economic benefits will flow to the entity; and
- The cost of the investment property can be measured reliably.

As the flats meet this criteria and definition, they should be recognised as Investment Property.

Measurement rules: initial measurement

According to IAS 40, an investment property shall be measured initially at cost, including transaction charges. Again, the principles for determining cost are similar to those contained in IAS 16, in particular for replacement and subsequent expenditure.

Measurement rules – subsequent measurement- revaluation model

Where an entity holds lands as an Investment Property for capital appreciation and adopts the Fair Value model, subsequent measurement shall be as per the guidance in IAS 40 under the fair value model, as below

If the fair model value is selected, after initial recognition, investment property shall be measured at fair value. Fair value is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's-length transaction. However, ZICA guidance provides that the land portion should not be subjected to revaluation. Where the fair valuation model is adopted, the property is not subjected to depreciation.

Any gains or losses arising from changes in fair value shall be recognized in the income statement. If an entity measures investment property at fair value, it shall continue to do so until disposal, even if readily available market data become less frequent or less readily available.