COMPETENCE PRACTICE EXAMINATION

NON AUDIT

DECEMBER 2009

TIME ALLOWED: 5 HOURS

INSTRUCTIONS TO CANDIDATES

1. This paper has Two Questions.

2. You are required to attempt ALL the two questions

3. Each question has Sections:

Question one has three Sections: A, B and C

Question two has two sections: A and B

4. All the two questions carry equal marks.

5. The Examination is divided into sessions of $2^1/_2$ hours each. There will be a 30 Minutes break in between the sessions.

6. Please use your Membership number and your National Registration Card number on the front of the answer booklet. You name must NOT appear anywhere on your answer booklet.

7. This is an open book examination.

QUESTION ONE

Xeng & Partners is a Chinese owned company involved in the provision of specialized survey and supervision of major construction works and owns several investment properties around Zambia. The firm is based in Siavonga and is run as a partnership between Mr. Xeng and Mr.Ping. The firm has not been able to attract a suitably qualified accountant to deal with the financial and management accounting affairs of the firm. The tax affairs for the partners are also incomplete

Mr.Xeng is particularly concerned about this state of affairs and has approached your firm Mfune & Associates to accept the position of professional accountants and advisors for Xeng & Partners. The partners have also requested that your firm should manage a special client deposits account. This account is used for the collection of the 50% deposit required before any survey or supervision works are commenced. Your name is Basil Mfune and as managing director, you immediately took charge of this account.

As managing director of Mfune & Associates, you decided to second one of your consultant accountants George Lupe. George Lupe has recently enrolled to do his ZICA technician exams.

After three weeks, George has completed his preliminary work and has presented the following information and findings for your further action. These findings have been documented in the following working papers:

Working Paper	Reference
Trial balance and adjustments	XP'09 – GL1
Capital allowance information for Mr.Zeng	XP'09 – GL2
Tax computation information for Mr. Zeng	XP'09 – GL3

During the three weeks spent at Xeng and Partners, George, given his qualification and experience, struggled to cope with the assignment. He had many queries including:

a) The managing director of Mfune & Associates had withdrawn an amount of K20 million from the client deposits account. On enquiry, George was told that this was advance payment on professional fees. However Xeng & Partners did not seem to be aware about this transfer of funds. He was not sure how this should have been dealt with.

b) Immediately after accepting the appointment, Mr. Mfune and family were taken on a holiday to Mauritius. The full cost was paid by Xeng & Partners. This was in full appreciation of Mr. Mfune's willingness to assist Xeng & Partners in their financial affairs. He is also hoping that such a gesture would be extended to him.

c) Xeng & Partners had been requested by the Environmental Council of Zambia (ECZ) to stop dumping rubbish in a nearby river as it was used for drinking and other domestic purposes by villagers nearby. Xeng & Partners seemed to have continued defying this request. George had read somewhere that he was under a professional obligation to report such cases to the Environmental Council of Zambia.

d) The client deposits account contained several receipts from abroad, mainly from China. The nature and purpose of these receipts could not be fully explained by the partners.

Name	George Lupe	Working paper reference
Subject	Trial Balance and adjustments	XP’09-GL1
Date	12 August 2009	

George has extracted the following trial balance from the nominal ledger of Xeng & Partners as at 30th June 2009:

K’million K’million

Land and buildings [Note (i)]
27,000

Plant – at cost [Note (i)]
15,600

Investment properties – Valuation at 1 July 2008 [note (i)]
9,000

Purchases
7,820

Operating expenses
1,550

Loan interest paid
200

Rental of leased plant [note (ii)]
2,200

Dividends paid
1,500

Inventories at 1 July 2008
3,780

Trade receivables
5,320

Revenue
27,840

Income from investment property
450

Equity shares of K2 each fully paid
15,000

Retained earnings at 1 July 2008
11,950

8% (actual and effective) loan note [note (iii)]
5,000

Accumulated depreciation at 1 July 2008 – Buildings
6,000

- Plant
2,600

Trade payables
3,340

Deferred tax
1,250

Bank overdraft
540

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73,970 73,970

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Mr. Xeng had provided the following additional notes to be taken into account before the financial statements can be finalized:

(i) The land and buildings were purchased on 1 July 1993. The cost of the land was K7 billion. No land and buildings have been purchased by Zeng & Partners since that date. On 1 July 2008, the land and buildings were professionally valued at K8 billion and K17.5 billion respectively. The partners wish to incorporate these values into the financial statements. The estimated life of the buildings was originally 50 years and the remaining life has not changed as a result of the valuation

Later, the valuers informed Xeng & Partners that investment properties of this type had increased in value

by 7% in the year to 30th June 2009. Plant other than leased plant (see below), is depreciated at 15% per annum using the reducing balance method. Depreciation of buildings and plant is charged to cost of sales.

(ii) On 1 July 2008, Xeng & Partners entered into a lease for an item of plant which had an estimated life of five years. The lease period is also five years with annual rentals of K2.2 billion payable in advance from 1 July 2008. The plant is expected to have a nil residual value at the end of its life. If purchased this plant would have a cost of K9.2 billion and be depreciated on a straight line basis. The lessor includes a finance cost of 10% per annum when calculating annual rentals

(iii) The loan note was issued on 1st October 2008 with interest payable six months in arrears.

(iv) The provision for income tax for the year to 30th June 2009 has been estimated at K2.83 billion. The deferred tax provision at 30th June 2009 is to be adjusted to a credit balance of K1.41 billion.

(v) The inventory at 30 June 2009 was valued at K4.32 billion.

Name	**George Lupe**	**Working paper reference**
Subject	**Taxation computation**	**XP'09-GL2**
Date	**12 August 2009**	

In addition to being partner in Xeng & Partners, Mr. Xeng and his wife run a retail-grocery business within Siavonga. The business premises consist of shop with living accommodation above, which houses Mr. Xeng and his family. For the year ended 31st March 2009, their statement of comprehensive income showed the following:

	K'000	K'000

Staff wages	74,160	Gross profit	303,260
Wife’s wages	6,240	Profit on sale	
Rent and rates	6,300	of plant	2,400
Light and heat	21,720	Profit on sale of	
Motor car expenses	3,360	Investments	10,320
Telephone	780	Bank interest	
Postage, stationery and wrapping	10,800	received	540
Repairs and renewals	4,760		
Bad debts written off	1,000		

Miscellaneous expenses	3,460	
Advertising	10,240	
Loan interest	11,300	
Depreciation- plant	4,800	
- Motor car	1,200	
Net profit	156,400	
	316,520	316,250

The following information is also relevant:

a) The Zambia Revenue Authority has agreed that one third of the expenditure on rent, rates, heat and light is applicable to the living accommodation.

b) One seventh of the motor car expenses relate to private motoring.

c) Repairs and renewals comprise:

K'000

Painting internally 1,550

Plant repairs 1,010

Construction extension to stock room
2,200

4,760

d) Bad Debts account

K'000 K'000

Bad debts written off	1,020	Balances b/f	
Balances c/f		General reserve	2,000
General reserve	4,000	Specific reserve	3,600
Specific reserve	3,980	Bad debts recovered	2,400
		Statement of Comprehensive Income	1,000
	9,000		9,000

e) Miscellaneous expenses included:

	K'000
Donation to local Charity (note f)	100
Subscription to chamber of commerce	180

Entertainment customers	900
Christmas gifts-bottles of gin and whisky	700
Payment to employee in lieu of notice	200
Legal expenses – debt collecting	150
Sundry allowable expenses	1,230
	3,460

f) The charity to which the donation was made is an approved one

g) The profit on sale on investment relates to the sale of a holding of ordinary shares in a company quoted on the Lusaka stock exchange. These shares were acquired by

Mr. Xeng on 1 January 2008 for K84,600,000 and sold on 30th June 2008 for K94,920,000.

h) Mr. Xeng estimates that during the year, he has withdrawn goods from stock costing K3,400,000 for personal use.

i) Mr. Xeng estimates that his gross profit percentage on turnover is 15%.

j) Mr. Xeng is entitled to a nominal salary of K4,000,000 per annum. This amount is included in the figure for staff wages. Mrs. Xeng worked full time in the business.

Name	**George Lupe**	**Working paper reference**

Subject	Capital Allowances – Year 2008/9	XP'09-GL3
Date	10 August 2009	

Mr. Xeng constructed the shop whose cost was made up as follows:

	K '000
Cost of land	25,000
Factory cost	99,000
Staff canteen	52,000
General Administrative offices	35,000
Total	211,000

The building was put to use on 1st April 2003 for business purposes. In the year ended 31st March 2009, an extension was added to the grocery shop at a cost of K80 million, excluding the cost of land.

QUESTION 1

SECTION A

1) In relation to the acceptance to act as professional accountants and advisors for Xeng & Partners, list and briefly discuss FIVE professional ethical issues that should have been considered before accepting the assignment.

(15 marks)

2) With specific reference to working paper reference (XP'09-GL1):

a) Prepare for Xeng & Partners a statement of comprehensive income for the year ended 30th June 2009

(15 marks)

b) A statement of changes in equity for the year ended 30th June 2009

(5 marks)

c) A statement of financial position as at 30th June 2009

(15 marks)

SECTION B

3) With specific reference to working papers GL2 and GL3, Calculate all the capital allowances which can be

claimed for the charge year 2008/9 by Mr. Xeng.

(10 marks)

4) With specific reference to working papers GL2 and GL3, Compute Mr. Xeng's tax adjusted business profits for the year ended 31 March 2009, giving reasons for any adjustments to be suggested. For this purpose, the capital allowances computed in (3) above, should be ignored.

(20 marks)

5) The partners are considering having an external audit for the first time. However, Mr. Ping is not sure how this would benefit the firm.

a) Explain FIVE benefits that partners would get from having their financial statements being externally audited

(10 marks)

b) State FIVE limitations of an external audit that the partners should be aware of.

(10 marks)

(Total: 100 Marks)

QUESTION TWO

Lindiwe Enterprises Ltd is a high street retailer that sells clothing and food. Lindiwe, the managing director, has recently submitted a business plan to the Citizen Economic Empowerment Commission (CEEC) to source funds to expand the operations of the company to other towns within Zambia. The business plan was prepared by the assistant accountant who is currently studying for his final level ZICA professional examinations.

Unfortunately the business plan was rejected for the following reasons:

a) The business plan did not sufficiently deal with issues relating to competition and marketing.

b) The business plan did not include the projected cash flows for the two years to 2011 as required by the CEEC guidelines. Additionally, there was no evaluation of the financial performance and financial position based on specific criteria specified by the CEEC. The evaluation report from the CEEC recommended that the evaluation should be supported by specific ratios/statistics

c) The CEEC were of the opinion that Lindiwe's ability to repay the funding requested for was not fully supported by relevant information.

You are the managing director of BGO professional services, a provider of accounting, business and other professional services other than auditing. Lindiwe, the managing director of Lindiwe Enterprises has approached you to provide her company with a range of professional services, namely:

a) Resolution of a number of items for the purposes of finalizing and submitting the tax computation for the 2008/9 financial year

b) Computation of ratios and statistics required by CEEC

c) Preparation of projected statement of cash flows

d) Evaluation of the financial performance and financial position to support the resubmission of the business proposal

You are aware that Lindiwe is married to Daniel, your very best friend. You have established that it was Daniel who encouraged Linidiwe to solicit for your help knowing that, being his best friend, you would readily oblige. It is also a

known fact that during the wedding of Daniel and Lindiwe, you were on the bridal party as the best man for Daniel.

From your contact with Lindiwe, she seems under pressure to re-submit the business plan to CEEC as soon as possible and she has expressed confidence that you would do everything possible to facilitate this. She has also indicated that she intended to use part of the funding from CEEC to finance her trip to China to explore strategic business relationships there. She has implied that your professional fees would be dependent upon, and would be paid from, the funding expected to be received from CEEC

This being your first major client, you have quickly accepted the position and you have assigned your senior accountant to immediately collect relevant information from Lindiwe Enterprises.

Relevant information has since been obtained by your senior accountant, Benson Kasonde, who has compiled it in the following working papers:

WORKING PAPER SUBJECT	**REFERENCE**
Taxation matters outstanding	**LE – 2009/BGO1**
Projected financial statements for 2010 and 2011	**LE – 2009/BGO2**
Ratios/Statistics from CEEC	**LE – 2009/BGO3**

Name	**Benson Kasonde**	**Working paper reference**
Subject	**Taxation matters arising**	**LE– 2009/BGO1**

Date	**23rd November 2009**	

In arriving at the profit and loss for the year ended 30th September 2009, the following items were charged in the statement of comprehensive income of Lindiwe Enterprises Ltd:

(a) In repairs and renewals, an amount of K80 million was included for the fitting of security bars over the factory windows as a precaution against theft.

(b) A loan of K5,000,000 to a former employee was written off.

(c) Gifts of Lindiwe Enterprises calendars in November/December 2008 costing K75,000 each.

(d) A donation of K5,200,000 was made to the Zambia Armature Athletics Association for the sponsorship of a race

(e) In repairs and renewals, an amount of K50 million to recondition a second hand stitching machine bought for K90 million. The repairs were necessary before the machine could be used in the business.

(f) Cost of a course in computer skills, costing K12 million for the managing director and two other senior managers who had no previous computer experience.

(g) A parking fine of K540,000 incurred by an employee on a business trip out of town.

(h) A lease rental of K14 million per annum on car provided for use by a senior employee.

(i) Payment of K13 million re-location expenses to a new employee.

(j) An amount of K6 million incurred in connection with the agreement of the taxation liability.

Name	**Benson Kasonde**	**Working paper reference**
Subject	**Projected financial statements for 2010 and 2011**	**LE– 2009/BGO2**
Date	**29th November 2009**	

Projected Financial Statements

Statement of comprehensive income

	(K'million)		(K'million)	
	Forecast Year to 30 September 2011		Forecast Year to 30 September 2010	
Revenue – clothing	16,000		15,600	
- Food	7,000	23,000	4,000	19,600
Cost of sales – clothing	14,500	(19,250)	12,700	(15,700)

- food	4,750		3,000	
Gross Profit		3,750		3,900
Other operating expenses		(2,750)		(1,900)
Operating profit		1,000		2,000
Interest expense		(300)		(80)
Profit before tax		700		1,920

Income tax expense	(250)	(520)
Profit for period	450	1,400

Movement on retained earnings

(K'million) Forecast Year to 30 September 2011	(K'million) Forecast Year to 30 September 2010

Retained earnings b/f	1,900	1,100
Profit for the period	450	1,400
Dividends paid	(600)	(600)
Retained earnings c/f	1,750	1,900

Statements of Financial Position	(K'million)	(K'million)

	Forecast Year to 30 September 2011	Forecast Year to 30 September 2010
Non-Current Assets		
Property, plant and equipment cost	17,000	9,500
Accumulated depreciation	(5,000)	(3,000)
	12,000	6,500
Current Assets		
- Clothing	2,700	1,360
- Food	200	140
Trade receivables		50

	100			
Bank				2,000
	Nil	3,000	450	8,500
		15,000		
Equity and Liabilities				
Issued ordinary capital ($1 share)		5,000		3,000
Share premium		1,000		Nil
Retained earnings		1,750		1.900
		7,750		4,900
Non-Current Liabilities				
Long term loans		3,000		1,000

Current Liabilities				
Bank overdraft			**Nil**	
	930			
Trade payables			**2,150**	
	3,100			
Current tax payable		**4,250**	**450**	**2,600**
	220			
		15,000		**8,500**

Note: The directors have signaled their intention to maintain annual dividends at K600 million for the foreseeable future.

(a) The increase in property, plant and equipment is due to the expected acquisition of five new stores and the refurbishment of some existing stores during 2011. The expected carrying value of fixtures to be scrapped at the refurbished stores is K1.2 billion; with an original cost of K3 billion. Lindiwe Enterprises expects to receive no scrap proceeds from the fixtures, but will incur costs of K50 million to remove and dispose of them. The expected losses on the refurbished have been charged to operating expenses. Depreciation is charged to cost of sales apportioned in relation to floor area (see below)

(b) The floor sales areas (in square metres) are expected to be:

30 Sept 2011	30 Sept 2010

	Clothing	
48,000		35,000
	Food	
6,000		5,000
54,000		40,000

Name	Benson Kasonde	Working paper reference
Subject	Ratios/Statistics recommended by CEEC	LE– 2009/BGO3
Date	1st December 2009	

Return on capital employed

Net asset turnover

Gross profit margin for Clothing and Food

Profit(after tax) margin

Current ratio

Inventory holding period

Accounts payable period

Gearing

Interest Cover

QUESTION 2

SECTION A

6) In relation to the invitation for you to accept the position of professional accountant and consultant for Lindiwe Enterprises Ltd:

a) List and briefly discuss FIVE ethical and other professional matters that should be taken into account before accepting the position.

(10 marks)

b) For each matter, state clearly the action you would take

(10 marks)

7) With reference to working paper (LE-2009/BGO1), relating to tax matters arising, advise how each of the stated items should be dealt with when preparing the business profits computation for Lindiwe Enterprises for the year ended 30th September 2009.

You should give a brief explanation for your treatment of each item

(20 marks)

SECTION B

8) Prepare, using the indirect method a projected statement of cash flows for Lindiwe Enterprises for the year ended 30th September 2011 based on projected financial statements in working paper (LE-2009/BGO2)

(20 marks)

9) With reference to the ratios recommended by CEEC,

a) Compute each of the ratios identified in working paper for the forecast year ended 30th September 2010 and 2011 (LE-2009/BGO3)

(20 marks)

b) With specific reference to the ratios computed in (a) above, write a report to the managing director analyzing the projected financial performance and financial position of Lindiwe Enterprises for the two years ended 30 September 2011.

(20 marks)

(Total: 100 marks)

END OF EXAMINATION