DECEMBER 2019 NON-AUDIT COMPETENCE PRACTICE EXAMINATION

TAXATION TABLE

INCOME TAX

STANDARD PERSONAL INCOME TAX RATES

Income band	Taxable amount	Rate
K1 to K39,600	first K39,600	0%
K39,601 to 49,200	next K9,600	25%
K49,201 to K74,400	next K25,200	30%
Over K74,400		37.5%

INCOME FROM FARMING FOR INDIVIDUALS

K1 to K39,600	first K39,600	0%
Over K39,600		10%

COMPANY INCOME TAX RATES

On income from manufacturing and other	35%
On income from farming	10%
On income from mineral processing	30%
On income from mining operations	30%

CAPITAL ALLOWANCES

Implements, plant and machinery and commercial vehicles:	
Wear and Tear Allowance – Standard wear and tear allowance	25%
Wear and tear allowance if used in manufacturing and leasing	50%
Wear and tear allowance if used in farming and agro-processing	100%
NON- COMMERCIAL VEHICLES	
Wear and Tear Allowance	20%
INDUSTRIAL BUILDINGS:	
Wear and Tear Allowance	5%
Initial Allowance	10%
Investment Allowance	10%
LOW COST HOUSING (COST UP TO K20,000)	
Wear and Tear Allowance	10%
Initial Allowance	10%
COMMERCIAL BUILDINGS	
Wear and Tear Allowance	2%
FARMING ALLOWANCES	
Development Allowance	10%
Farm Works Allowance	100%
Farm Improvement Allowance	100%

PROPERTY TRANSFER TAX

Rate of Tax on Realised Value of Land, Land and Buildings and shares	5%

Rate of tax on the Realised value on the transfer of intellectual property	**5%**
Rate of Tax on Realised Value on a transfer or sale of a mining right	**10%**

QUESTION ONE

FUMBUSHE ASSOCIATES

Your name is Lexon Munshi, a director of accountancy and taxation services in Fumbushe & Associates – a firm registered with the Zambia Institute of Chartered Accountants specialised in providing non-audit services. Mr. Bob Fumbushe is the founder and managing director of the firm

One of your bigger clients is Kulima Ltd. Kulima Ltd is a manufacturer of farming implements in Zambia, including the assembly of tractors. For the tractors, prospective customers have the option of buying the tractors or renting them. The company is incorporated abroad, but its directors are based in Zambia and hold their board meetings in Zambia. Although fees for the previous year are outstanding, you have agreed to provide the following services for the current year

1) Preparation of the cash flow and profit forecast
2) Determination of resident status of its directors
3) Determination of income tax and property transfer tax payable
4) Advice on the accounting treatment to be applied to a number of issues in the finalisation of their accounts

1) PREPARATION OF THE CASHFLOW AND PROFIT FORECAST

Kulima Ltd has enjoyed rapid growth in the last two years. In order to service the increasing order book, the company decided to finance the purchase of additional plant and equipment through a bank loan from ZANACO, their long-standing bankers. ZANACO has not insisted on audited financial statements but they require a cash and profit forecast for five years ending 31 December 2023 to presented to support the loan application. Accordingly, your firm has been invited to assist in the preparation of the cashflow and profit forecasts

Mr. Fumbushe has indicated that it is in the interest of your firm to agree to help to prepare the cashflow forecast as a way of continuing and sustaining the business relationship between Kulima Ltd and Fumbushe & Associates. In addition, the loan proceeds would partly be used to settle outstanding professional fees.

Maambo Bola – the financial accountant at Kulima Ltd - has been requested to compile the information required for the preparation of the cashflow and profit forecast

Further, Mr Fumbushe has indicated that the professional team allocated to Kulima Ltd would be allowed to rent the use of tractors at ½ the price during the duration of the business relationship between the two parties.

In the process of preparing the cashflow and profit forecast, It has now come to your attention that:

a) Maambo Bola, the accountant who compiled the required information for the preparation of the cashflow and profit forecast is your nephew from your mother's side
b) The sale proceeds from the sale of an asset have been included as part of operating activities
c) The profits and the cash position appear to have been overstated to increase the chances of receiving the loan approval

2) DETERMINATION OF INCOME TAX AND PROPERTY TRANSFER PAYABLE

Kulima Ltd's summarised statement of profit or loss for the year ended 31 December 2018 is as follows:

	K	K
Gross profit		1,913,600
Operating expenses:		
- Depreciation	119,800	
- Gifts and donations (note 1)	8,200	
- Professional fees (note 2)	17,600	
- Repairs and renewals (note 3)	81,600	
- Other expenses (note 4)	668,000	
		(895,200)
Operating profit		1,018,400
Income from investments:		
- Dividends (note 5)		90,000
- Profit from sale of non-current assets:		
Disposal of industrial building (note 6)		120,000
		1,228,400
Interest payable (note 7)		188,400
Profit before taxation		1,040,000
		========

NOTES

Note 1 – Gifts and donations

Gifts and donations are as follows:

	K
Gifts to customers (small hoes costing K20 each displaying Kulima Ltd's name)	4,080
Gifts to customers (food hampers costing K15 each)	1,540
Gifts to employees	540
Donation to an approved public benefit organisation	1,200
Donation to a local charity as a result of which Kulima Ltd received free advertising in the chartity's magazine	240
Donation to a political party	600
	8,200
	====

Note 2 – Professional fees

Professional fees are as follows:

	K
Accountancy and audit fee	4,600
Legal fees in connection with the issue of share capital	6,200
Legal fees in connection with the issue of a 12% debenture loan that was subsequently cancelled	3,600
Legal fees in connection with the defence of the company's internet domain name	3,200
	17,600
	======

Note 3 – Repairs and renewals

The figure of K81,600 for repairs and renewals includes K29,600 for replacing the roof of a warehouse, which was in a bad state of repair, and K27,800 for initial repairs to an office building that was acquired on 20 December 2018. The balance represents allowable expenses.
The office building was not usable until the repairs were carried out, and this fact was reflected by a reduced purchase price.

Note 4 – Other expenses
The figure of K668,000 for other expenses includes K7,400 for entertaining customers, K3,400 for entertaining employees, K800 for counselling services provided to an employee who was made redundant, and a fine of K5,200 for publishing a misleading advertisement. The remaining expenses are all allowable.

Note 5 – Dividends received
During the year ended 31 December 2018 Kulima Ltd received dividends of K54,000 from Muyombo Ltd, an unconnected Zambian company, and dividends of K36,000 from Nokenu Ltd, its 100% Zambian subsidiary company. Both figures are the actual cash amounts received. Withholding Tax had been deducted at source.

Note 6 – Disposal of industrial building
The profit of K120,000 is in respect of a factory that was sold on 31 March 2018 for K600,000. The factory had been purchased on 1 April 2012 for K480,000. The cost of K480,000 and the selling price of K600,000 are made up as follows:

	Cost	Selling price
	K	K
Land	90,000	112,000
Factory	290,000	360,000
General offices	100,000	128,000
	480,000	600,000
	======	======

Note 7 – Interest payable
The interest payable is in respect of the company's 10% debenture loan stock that was issued in the year 2008. The proceeds of the issue were used to finance the company's trading activities. Interest of K94,200 was paid on 30 June 2018 and again on 31 December 2018.

Note 8 – Implements, plant and machinery
On 1 January 2018, the income tax values of implements, plant and machinery were as follows:

	K
Office furniture	16,400
Audi motor car	19,600
Old equipment	27,600

The office furniture was bought for K65,600 while the Audi motor car was bought for K49,000. The old equipment was bought for K55,200.

The following transactions took place during the year ended 31 December 2018:

Date	**Cost/(Proceeds)**
	K
4 June 2018 Purchased Nissan Tiida motor car	36,400
4 June 2018 Purchased Mercedes Benz E240 motor car	62,800
4 June 2018 Purchased Toyota Camry motor car	60,400
18 August 2018 Purchased new equipment	80,600
12 October 2018 Sold old equipment	(25,400)
20 December 2018 Sold Audi motor car	(22,200)

The Nissan Tiida motor car purchased on 4 June 2018 is a pool car in the operations department but it has private use of 25% by the company's Operations Director and it has a cylinder capacity of 2,000 cc. The Mercedes Benz E240 motor car is the Managing Director's personal to holder motor car and it has a cylinder capacity of 2,600 cc. The Toyota Camry motor car is the Finance Director's personal to holder motor car and it has a cylinder capacity of 2,000 cc.

Note 9 – other information
Kulima Ltd's capital allowances on other buildings in the tax year 2018 amount to K29,730.

3) ADVICE ON THE ACCOUNTING TREATMENT TO BE APPLIED TO A NUMBER OF ISSUES IN THE FINALISATION OF THEIR FINANCIAL STATEMENTS

a) Repairs and warranties

Kulima Ltd manufactures and sells some farming implements on which it gives a standard one year warranty to all customers. The company has extended the warranty to two years for certain major customers and has insured against the cost of the second year of the warranty. The warranty has been extended at nil cost to the customer. The claims made under the extended warranty are made in the first instance against Kulima Ltd and then Mukuni in turn makes a counter claim against the insurance company. Past experience has shown that 80% of the farming implements will not be subject to warranty claims in the first year, 15% will have minor defects and 5% will require major repairs. Kulina Ltd estimates that in the second year of the warranty, 20% of the items sold will have minor defects and 10% will require major repair.

In the year to 31 December 2018, the following information is relevant:

	Standard Warrant (units)	Extended Warranty (units)	Selling price per unit (both)(K)
Sales	2,000	5,000	1,000

	Major repair K	Minor defect K
Cost of repair (average)	500	100

Assume that sales of equipment are on 31 December 2018 and any warranty claims are made on 31 December in the year following the same. Assume a risk adjusted discount rate of 4%.

b) Sale of non- current assets

Kulima Ltd has an asset that has been designated as held for sale in the financial year to December 2018. During the financial year to December 31, 2019, the asset still remains unsold, but the market conditions for the asset have deteriorated significantly. The entity believes that market conditions will improve and has not reduced the price of the asset, which continues to be classified as held for sale. The fair value of the asset is K5 million, and the asset is being marketed at K7 million

c) Sale agreements

Kulima enters into certain sales contracts for the manufacture of farming implements customers whereby the customers pay an initial deposit. The deposit is refundable only if Kulima fails to complete the manufacture of the implement. The remainder is payable on delivery of the implement. If the customer defaults on the contract prior to completion, Kulima has the right to retain the deposit.

The managing director of Kulima Ltd believes that, as completion of the asset is performed over time, revenue should be recognised accordingly. He has persuaded the accountant to include the deposit and a percentage of the remaining balance for construction work in revenue to date.

d) Financing and interest payable

On 1st January 2018, Kulima Ltd entered into a financing security arrangement with ZANACO with a stated principal of K50,000, which will be repaid in five years at an interest of 6% per year payable on the stated principal annually at the end of each year. Kulima Ltd receives K46,700 on 1 January 2018 being net proceeds. The loan is to be accounted for using amortised cost. The effective interest rate is approximately 7.65%. This is the discount rate that will give a present value of the future cash flows that equals the purchase price

REQUIREMENTS

1) In relation to the requests for the preparation of the cash and profit forecast,

a) Describe the nature of such an engagement **(3 marks)**

b) Using the information provided:

i) Identify and comment on any **FIVE** ethical and professional issues that should be considered **(10 marks)**

ii) For each issue, recommend the steps that your firm should take **(10 marks)**

2) In relation to the resident status of Kulima Ltd

a) Explain why Kulima Ltd is treated as being resident in Zambia. **(3 marks)**

b) State what difference it would make if the directors were based abroad and were to hold their board meetings abroad and briefly explain why that difference would arise. **(5 marks)**

3) In relation to the taxation position of Kulima Ltd

a) Calculate the following values for Kulima Ltd for the tax year 2018:

i) The capital allowances on buildings **(8 marks)**

ii) The capital allowances on implements, plant and machinery **(10 marks)**

iii) The taxable business profit after capital allowances. Your computation should commence with the profit before taxation figure of K1,040,000. **(10 marks)**

b) Calculate the amount of company income tax payable by Kulima Ltd for the tax year 2018 and explain how it must have been properly paid under the self-assessment system, specifying the relevant due dates and the amounts payable.

(8 marks)

c) Advise Kulima Ltd of the Property Transfer Tax implications of the disposals of assets made in the tax year 2018 and calculate the amount of property transfer tax payable.

(5 marks)

4) In relation to the finalisation of financial statements for the year ended 31 December 2018, advice Kulima Ltd on the accounting treatment to be applied to the following issues, including financial statement extracts where applicable

a) Repairs and Warranties **(10 marks)**
b) Sale of non-current assets **(5 marks)**
c) Sale agreements **(5 marks)**
d) Financing and interest payable – the amount of interest and liability to reflected in the financial statements for the years ended December 2018 and 2019 **(10 marks)**

(TOTAL MARKS 100 MARKS

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CAPITAL ALLOWANCES

Implements, plant and machinery and commercial vehicles:

Wear and Tear Allowance – Standard wear and tear allowance	25%
Wear and tear allowance if used in manufacturing and leasing	50%
Wear and tear allowance if used in farming and agro-processing	100%

NON- COMMERCIAL VEHICLES

Wear and Tear Allowance	20%

INDUSTRIAL BUILDINGS:

Wear and Tear Allowance	5%
Initial Allowance	10%
Investment Allowance	10%

LOW COST HOUSING (COST UP TO K20,000)

Wear and Tear Allowance	10%
Initial Allowance	10%

COMMERCIAL BUILDINGS

Wear and Tear Allowance	2%

FARMING ALLOWANCES

Development Allowance	10%
Farm Works Allowance	100%
Farm Improvement Allowance	100%

PROPERTY TRANSFER TAX

Rate of Tax on Realised Value of Land, Land and Buildings and shares	5%
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QUESTION TWO

MULUBWA ASSOCIATES

Your name is James Katungu, a senior manager in Mulubwa Associates. Mulubwa Associates is a firm of chartered accountants registered with the Zambia Institute of Chartered Accountants. They are non-audit practicing firm specialised in the provision of other related services such as taxation, accountancy and general business advisory. Mike Mulubwa is the managing director of the firm.

For 2018, you have been assigned to three engagements

- Han Construction Ltd (HCL)
- Mukumpe Farm
- St Joseph Schools

A. Han Construction Ltd

Mr Han Leng, a Chinese national is the managing director of Han Construction Ltd. Mr Han Leng recently attended a taxation seminar at which he learnt that when preparing financial statements it is important to ensure that the tax consequences of all transactions are appropriately recognised. IAS 12 – Income Taxes – details the requirements relating to the accounting treatment of both current and deferred tax assets and liabilities. He also understood that current tax is the amount of income tax payable or recoverable in respect of the taxable profit or tax loss for a period.

However, although deferred taxation was discussed during the seminar, Mr Han had difficulties in coming to term with the concept.

Mr Han has therefore requested you to provide specific explanations relating to deferred tax and also to comment on the difference between taxable profit and accounting profit for the year ended 31st December 2018 and advise on the deferred tax implications of the of item of plant described below:

Plant

HCL had acquired an item of plant at a cost of K250 million on 1 April 2016. The plant's useful economic life and the residual value at end of its life were initially estimated at 10 years and K10 million respectively.

Subsequently, the plant was revalued, for the first time, to a fair value of K210 million on 31 December 2017, the total useful economic life of the plant has been revised to 8 years and the residual value at the end of that life to K5 million. Management further reviewed the asset and reliably determined that the fair value of the asset at 31 December 2018 was K130 million. The company is liable to income tax at 30%.

For tax purposes, HCL is given tax depreciation (wear and tear allowances) at 25% on cost per annum starting with the year of acquisition (in full).

Work Permit for Mr. Cheng

Mr. Cheng from China has recently been employed as operations director of Han Construction. You have become aware that the work permit for Mr. Cheng may have been obtain by corrupting a government official. Another client of yours, Mr. Bruce Lee has approached you to find out how Mr. Cheng managed to obtain his work permit. Mr. Lee considers that releasing such information is in the public interest

B. Mukumpe Farm

Miss Mukumpe runs a farming business in Mkushi and prepares accounts to 31 December each year. Her annual turnover has always exceeded K800,000. In January 2018, she estimated the taxable farming profit from her farming business for the year ending 31 December 2018 to be K860,000. Due to a poor crop yield in March 2018, Mukumpe revised the provisional taxable business profit, from the original estimate of K860,000 to only K550,000.

The actual net profit from the business as per accounts for the year ended 31 December 2018, was K680,000. This profit figure was arrived at after taking into account the following items:

(1) Wages and salaries for workers comprising:

	K
Salaries and wages for farm employees	46,000
Employer’s Pension contributions	2,300
Loans to former farm employees written off	12,000
Mukumpe’s salary	90,000
	150,300
	======

(2) Maintenance expenses of K55,600 which included the following:

	K
Repairing storage facilities for farm produce	6,800
Repair and maintenance work on farm dwellings for farm employees	4,300
Stumping and clearing of fields in readiness for planting	9,700
Construction of a wire fence around the farm	16,300
Expenditure on works for the prevention of soil erosion	18,500
	55,600
	=====

(3) Motor vehicle running expenses of K23,300 comprising:

	K
Servicing and fuel for farm tractor	13,800
Repairs and fuel for motor van	9,500
	23,300
	=====

It has been agreed with the Commissioner General that Mukumpe has private use of 20% of the motor van.

(4) General expenses of K53,900, which included:

	K
Depreciation of assets	14,400
Increase in general provision for bad debts of	2,600
Increase in specific provision for bad debts of	3,300
Loss on disposal of farm implements	7,100
Miscellaneous allowable business expenses	26,500
	53,900
	=====

(5) Farm produce with a cost of K15,000 withdrawn from the business by Miss Mukumpe for personal use. She makes a mark-up of 20%. This transaction was recorded as sales at cost in her books.

Additional information

At 1 January 2018, the only asset qualifying for capital allowances was the motor van which was purchased in March 2016 at a cost of K90,000.

During the year, Mukumpe purchased a Tractor at a cost of K130,000 and sold some farm implements for K6,400. The farm implements had an income tax value of nil at 1 January 2018, whilst the original cost was K60,000.

Desired taxation position

Miss Mukumpe is of the opinion that she pays too much tax and would like to increase the amount of allowable expenses to reduce the profit to the revised amount of K550,000.

Advise on accounting treatment

a) Land

Miss Mukumpe has control over a piece of land she has rented out in Chongwe. The fair value at 1st January 2018 was estimated at K240,000 and increased to K314,000 at 31st December 2018. She uses the fair value model.

b) Harvested maize

There are 200 50kg bags of maize waiting to be sold. The estimated fair value of each bag is K80 Point of sale costs and transaction costs are estimated at 2% per bag and 1.5% per bag respectively, of the fair value of each bag

c) Hire of farming implements

During the planting and harvesting seaons, Miss Mukumpe hires various farming implements for periods less than 1 one year. The value of these faming implements is not considered material. During the lease period, Mukumpe farms enoys the right of use and control over these implements.

For the 2018 planning and harvesting seasons the total rental payables for the rental of implements amounted to K4,500

C. St Josephs Schools

Mr. Silas Chanda is the Superintendent of St Joseph Schools, a group of schools owned by the Catholic Church. In terms of reporting, the schools currently only prepare receipts and payments. However, given the growth in revenue (estimated at K5 million) and assets over the last ten years, the board of trustees have recommended that the schools should now start preparing complete financial statements comprising:

- Statement of Profit or loss and other comprehensive income
- Statement of financial position
- Statement of cash flows

The board of trustees also recognise their limitations in terms of qualified personnel to be able to compile these financial statements. For the current year, they have requested you to help them in determining an appropriate framework for the preparation of financial statements, as well as preparing the first set of accounts. For the future, they have also requested you to assist them with the recruitment of a group chief accountant and an accountant for each school. You aware that your firm has never been involved in recruitment of professional accountants.

You have also been informed that the schools are experiencing an increasing number of fraud incidents relating to the purchasing system, especially with regard to the purchase of stationery A brief description of the purchasing system is as follows:

- Each school purchases its own requirements
- Quotations are obtained from various suppliers
- The headmaster and the administrator of each school select a supplier
- Payment is prepared and sent to the supplier awaiting supply

REQUIREMENTS

1) In relation to Han Construction Limited (HCL), draft a briefing memo to Mr Han in which you should
   a) Explain the purpose of accounting for deferred tax and briefly outline the requirements of IAS 12 – Income Taxes – relating to deferred tax

      (10 marks)
   b) Explain the deferred tax implications for the plant and prepare relevant financial statement extracts for the year ended 31st December 2018

      (15 marks)
2) In relation to Mukumpe Farm
   a) Calculate the amount of provisional income tax paid by Mukumpe in respect of the tax year 2018 and state the due dates and amounts paid on each due date.

      (7 marks)
   b) Compute the maximum amount of capital allowances claimable by Mukumpe in the tax year 2018. (8 marks)
   c) Calculate Mukumpe's actual taxable farming profit for the tax year 2018.

      (6 marks)

d) Calculate the final amount of income tax payable by Mukumpe for the tax year 2018. (5 marks)

3) In relation to Mukumpe farm, comment and advise on the accounting treatment that should be applied to:
   a) The Land (5 marks)
   b) Harvested (5 marks)
   c) Hire of farming implements (8 marks)

4) In relation to St Joseph's schools
   a) Suggest FIVE improvements that can be made to the purchasing systems to reduce incidences of fraud and error (5 marks)
   b) Advise the Mr Silas Chanda on the reporting framework options available to the schools (6 marks)
   c) Recommend with reasons which reporting framework is suitable for the schools (2 marks)

5) Comment on the ethical and other professional issues raised, and recommend any action which should be taken in respect of:
   a) Han Construction Limited (6 marks)
   b) Mukumpe Farms (6 marks)
   c) St Joseph Schools (6 marks)