

QUESTION ONE

Your name is Madson Lusanga, a manager in Mupanga Associates, a firm registered with the Zambia Institute of Chartered Accountants (ZiCA) to provide non-audit services. For the current year, you have been assigned to a new client, Zambia Metal Crafts Ltd (ZMC). ZMC operates from the Industrial area and is specialized in the design and fabrication of various metal and plastic ornaments, as well as the manufacture of industrial chemicals. The assignment has been e-mailed to you as below

To : Madison Lusanga
From : Michael Mupanga – Managing Director
Subject : Professional services for Zambia Metal Crafts Ltd (ZMC)

ZMC has been operating for the last six years and the Chairman and managing director, Mr. Ize Lamisu, would like to improve the profile of the company in order to exploit export opportunities in the region, especially given the poor performance achieved in the last one year. The chairman is particularly concerned that the poor business showing has been characterized by weak control environment. Accordingly, he has requested for the following services:

Accounting services

- Reconstruction of the closing statement of financial position for the year ended 31 March 2018

Taxation services

- Tax advice for Mr Lamisu's personal tax affairs
- Advice on Value Added Tax (VAT) Implications for planned new business venture

Control environment

- Recommendations for general computer controls

As you may be aware, we assisted ZMC in preparing business plans for the loan they obtained from Atlas Mara Bank earlier this year. As it turns out ZMC over paid the invoice for this service by K45,000. I have taken liberty to treat this money as advance payment for the accountancy and taxation services that we are providing this year. Although Mr. Lamisu, the chairman of ZMC, has contacted me several times about the over payment, I have avoided to respond to his queries. If this issue comes up, please assure Mr. Lamisu that I will be contacting him as soon as possible

MM

To clarify the terms of reference for the above services, you have since had contact with the management of ZMC and you have noted a number matters that should be considered in the provision of these services

A. Accounting services

Destroyed records - Pastel Evolution ERP

ZMC uses Pastel Evolution ERP for processing billing and accounting transactions. The version in use was version 7.10.0.99 and was supplied by SAVANA Solutions at a total cost of K54,000 in 2013. The Company has not adopted any IT framework to manage the operations and administration of the Information and Communication Technology (ICT) environment. Patson Daka, IT manager, who has a diploma in information technology from NIPA is in charge of the strategic, tactical and operations of the systems.

In January 2018, a fire broke out at ZMC's the premises. The computer room was badly affected with all hardware and software destroyed. As the fire extinguished malfunctioned, it took a while before the fires could be put out completely. The only records salvaged were the opening trial balance for the year ended 31 March 2017 and the cash flow statement prepared by the management accounted for the year ended 31st March 2018. These documents were printed out for use by the management accountant and are provided below

Zambia Metal Crafts Ltd (ZMC) – Statement of financial position as at 31st March 2017

	K	K
Non- Current assets		
Land and Buildings (at Valuation of K492,000 less accumulated depreciation of K50,000)		442,000
Plant (at cost of K700,000 less accumulated depreciation of K225,000)		475,000
Investment at cost		<u>169,000</u>
		1.086000
Current Assets		
Inventories	574,000	
Trade receivables	286,000	
Bank	12,000	
	-----	<u>872,000</u>
Total Assets		<u>1,958,000</u> =====
Equity and Liabilities		
Share capital		
Ordinary shares of K1 each		250,000
Reserves:		
- Share premium	50,000	
- Revaluation reserve	120,000	
- Retained profits	703,000	
	-----	<u>873,000</u>
		1,123,000
Non-current liabilities		
8% Loan notes		432,000

Current Liabilities

Trade Payables	314,000	
Taxation	89,000	
	-----	<u>403,000</u>
		<u><u>1,958,000</u></u>

- (i) There were no disposals of land and buildings during the year. The increase of K60,000 in the revaluation reserve was entirely due to the revaluation of the company's land
- (ii) Plant with a net book value of K120,000 (Cost K235,000) was sold during the year for K78,000. The loss on sale has been include in the profit before interest and tax
- (iii) Investments with a cost of K87,000 were sold during the year for K110,000. There were no further purchase of investments. These investments are all in unquoted companies and therefore their fair values cannot be readily estimated. The profit of K23,000 has been reported separately on the trial balance
- (iv) On 10 October 2017, a bonus issues of 1 for 10 ordinary shares was made utilizing the share premium account. The remainder of the increase in ordinary shares was due to an issue for cash on 30 October 2017 at a total premium of K55,000
- (v) The balance on the taxation account is after settlement of the provision made for the year ended 31 March 2017. A provision for the current year has not been made

Zambia Metal Crafts Ltd (ZMC) – Cash flow statement for the year ended 31st March 2018

	K	K
OPERATING ACTIVITIES		
Profit before tax		156,000
Add back:		
- Depreciation on Land and buildings	18,000	
- Depreciation on plant	266,000	
	-----	284,000
Add back loss on sale of asset		42,000
Decrease in inventories		141,000
Increase in receivables		(218,000)
Decrease in trade payables		(47,000)

Cash generated from operating activities		358,000
Interest paid		(14,000)
Taxation paid		(100,000)

		244,000
INVESTING ACTIVITIES		
Purchase of land	(71,000)	
Purchase of plant	(381,000)	
Investment income	4,000	
Proceeds from sale of plant	78,000	
Proceeds from sale of investment	110,000	

Net cash from investing activities		(260,000)

FINANCING ACTIVITIES

Loan repaid	(34,000)	
Proceeds from share issue	280,000	
Dividends paid	(261,000)	

Net cash used in financing activities		(15,000)

Net decrease in cash and cash equivalents		(31,000)
Cash and cash equivalents at 1 April 2017		12,000

Cash and cash equivalents at 31st March 2018		(19,000)
		=====

B. Taxation services

Mr. Ize Lamisu – Personal tax affairs

As a result of the destroyed records, ZMC has not been able to submit the various returns to ZRA on time and the chairman is concerned that ZMC may suffer penalties. At a personal level, Mr. Lamisu is not very clear about the difference between tax avoidance and tax evasion and the implications of each. Mr. Lamisu would also like to implement a personal financial protection plan, either himself or to be implemented through ZMC. Mr. is still in active employment and has a mortgage to support.

Planned project

The chairman is particularly interested in VAT mechanism and computation in relation to the planned product development

ZMC intends to start making copper trays which will be sold through wholesalers to selected retail supermarket and then on to the consumer. The VAT rate is 16%: ZMC will be selling each copper tray to the Wholesaler for K2, 900.00 VAT inclusive, being K2, 500 for the item and K400.00 VAT. ZMC will be using their own labour both to mine the copper and make the trays so ZMC will not be making any purchases. It is expected that the wholesaler will sell the copper tray to the supermarket for K4,640 VAT inclusive and the retailer will sell the copper tray at K5,800 VAT inclusive

C. Control Environment

Following the destruction of the records and equipment, the Chairman would like advice on steps to take to ensure that there is continuity of operations and speedy disaster recovery at ZMC.

Matters arising from the review of correspondence and initial contact with ZMC

Waste disposal

You have become aware of a press report appearing in the Nation newspaper alleging that ZMC has been disposing of waste in a stream nearby. The stream eventually feeds into the Kafue river. The report also suggests that this irresponsible disposal of waste may explain why there is spate of unexplained vomiting by residents in the nearby compound. Further enquiries suggest that management of ZMC are fully aware of the allegations and are hoping that the report in the newspaper will not attract any more negative publicity

Transactions with the Chairman

Whilst you were agreeing the cash book balance to the bank statement and the bank reconciliation statement, you noticed an unusual amount that was credited to the ZMC account on 21st of March 2018. Further enquiries revealed that this was a loan from the Chairman of the company. You have also become aware the chairman also takes frequent trips overseas and buys various pieces of equipment and machinery for the company.

QUESTION TWO

LUENA FARMS

Your name is Martha Luwena and you are one of the managers in MJM Accountants, a firm registered with the Zambia Institute of Chartered Accountants (ZiCA). MJM is registered to provide a range of services including accountancy, taxation and general business consultancy. You previously worked for the Ministry of Finance as a senior accountant and are therefore familiar with public sector accounting. It is for this reason that you have been invited by ZiCA to give a presentation on the introduction of accruals accounting in the public sector, in Zambia.

You have been manager allocated to Luena Farms (LF) for the last four years. LF is a company engaged in farming in the Mkushi block, in Central Province of Zambia. LF has been in the farming business for over 10 years. Recently, LF's activities have extended into installation of irrigations systems and construction of green houses for other farmers. The farm director, Mr. Lime Lukasu, has approached your firm with a request to provide the following services:

A. Forensic Service

B. Taxation

- Submission of tax and provisional payments
- Calculation of tax payable for the year ended 31 December 2017

C. Accounting

- Accounting treatment of specific items

A. Forensic service

You have received the following e-mail from Mr. Lukasu

To	:	Martha
From	:	Lime Lukasu
Subject	:	Suspected fraud

Martha,

I wish to bring the following to your attention

Several new employees have been added to the company's payroll during the year, with combined payments of K125,000 being made to them. There does not appear to be any authorisation for these additions. When I questioned the payroll supervisor who made the amendments, she said that no authorisation was needed because the new employees are only working for the farm on a

temporary basis. Other farm managers seem to think that authorisation was required both temporary and contractual staff.

I am aware that farm managers have the authority to employ casual workers, but only to a certain limit. I suspect that fraud may have occurred. I have since suspended the payroll supervisor pending further investigation. I would like your firm to help us determine the implications of this event. I have every intention of taking this case to the police and proceed with prosecution.

As you come to discuss the other professional services, let us meet to clarify our requirements with regard to this investigation. Additionally, my accountant has been requesting some information relating to provisional tax. I am not sure I fully understand what this is all about. Maybe you can enlighten me.

Thank you in advance for your favourable response

LK

B. Taxation

The management accountant has provided the following information relating to the farming operations for the year ended 31 December 2017

Luena Farms

Statement of profit or losses (income statement) for the year ended 31 December 2017

	K	K
Gross profit		600,250
Other income:		
Bank interest received (Note 1)		59,925
Rent received (Note 1)		91,800
Royalties received (Note 1)		38,250
Dividends received (Note 1)		21,250
Profit on disposal of land (Note 2)		<u>49,200</u>
		860,675
Less: Expenses		
Wages and salaries (Note 3)	250,000	
Bad debts (Note 4)	40,000	
Depreciation	86,400	
Motor expenses (Note 5)	32,350	
Professional fees (Note 6)	10,700	
Loss on disposal of motor car (Note 9)	8,500	
General expenses (Note 7)	136,400	
Provision for taxation (Note 8)	<u>70,920</u>	
		<u>(635,270)</u>
Net profit		<u>225,405</u>

The following additional information is available:

- These amounts shown of investment income in the income statement above, represent the actual amounts received by the company. Withholding tax has already been deducted at source.

- b) The company sold a piece of land for K60,000 during the charge year 2017. This land was acquired at a cost of K10,800 ten years ago. The company paid appropriate taxes on the disposal of this land.
- c) The wages and salaries include K140,000 paid to the company's directors as directors' emoluments. The company has accommodated these directors in company owned houses. The balance of wages and salaries relate to other employees.

- d) Bad debts comprise the following:

	K
Trade debts written off	16,500
Loans to former employee written off	28,000
Increase in General provision	2,300
Decrease in Specific provision	(2,200)
Trade debts previously written off now recovered	<u>(4,600)</u>
Profit/(Loss)	<u>40,000</u>

- e) Motor car expenses include K20,000 which was incurred in respect of two motor cars; a Toyota Caldina and a Toyota Vista used by the Chief Finance Officer and the Managing Director respectively. These cars both have cylinder capacities of 2900cc. Each Director had 60% private use in each car in the tax year 2017. (refer to note 9 below)

- f) Professional fees comprise the following:

	K
Accountancy fees	4,000
Penalty for late payment of income tax	5,600
Legal fees in connection with breach of labour laws	<u>1,100</u>
	<u>10,700</u>

- g) General expenses comprise the following:

	K
Entertaining customers	26,900
Entertaining suppliers	17,200
Staff canteen	11,000
Other allowable expenses	<u>81,300</u>
	136,400

The canteen is situated within business premises.

- h) The provisional income tax in the income statement is an estimate of the tax payable. The provision tax paid for the charge year 2017 was K25,900

- i) Capital expenditure

The following were the implements, plant and machinery at 1 January 2017:

Asset	Income Tax Value (K)	Original cost (K)
Tractor	60,000	120,000
Toyota Hilux van	30,000	60,000
Toyota corolla	21,000	35,000

The following transactions took place in implements, plant and machinery during the year:

Asset	Purchase cost/(disposal proceeds)
	K
Farm implements	30,000
Ploughs	25,000
Mistubishi canter	90,000
Toyota caldina	45,000
Toyota vista	40,000
Toyota corolla	(40,000)

The Toyota caldina and Toyota vista are used by directors on personal-to-holder basis (refer to note 5 above).

In addition to the above capital expenditure, the company also incurred the following expenditure:

	K
Dwelling houses (5 units at a cost of K16,000 each)	80,000
Fencing	19,000
Boreholes	15,000
Clearing and stumping	17,000

C. Accounting

The management accountant for Luena Farms resigned during the year to pursue full time studies in accountancy at the Zambia Centre for Accountancy Studies (ZCAS), since turned into a university. The following transactions occurred after he left and LF would like advise on the accounting treatment to be applied

(i) Valuation of cows

On 1 January 2017, Luena Farms had a herd of 100 cows, all of which were 2 years old. At this date, the fair value less point of sale costs of the herd was K10,000 each. On 1 July 2017, the farm purchased 20 cows (each two and half years old) for K6,000

As at 31 December 2017, three- year old cows sell at market for K9,000 each.

Market auctioneers have charged a sales levy of 2% for many years.

(ii) Construction of green houses

When customers place an order for the construction of a greenhouse, they are charged a deposit equivalent to 40% of the total price. The remaining 60% is settled on completion of the green house.

Construction of a greenhouse typically takes five months to complete. The construction takes place on the customer premises and the customer immediately takes control of the green house once construction begins. On 1st November 2017 Macho Farms Ltd ordered the construction of a greenhouse at a price of K230,000. Luena charges a mark-up of 25% on the cost of constructing a greenhouse. By 31st December 2017, Luena Farms had incurred a total cost of K90,000 on the constructing the greenhouse for Macho Farms

(iii) Lease of combined harvester

On 1 January 2017, Luena Farms entered into a five-year finance lease for a second-hand combined harvester from Agro-Sara Holdings. The machinery has a remaining useful life of six years. The annual lease payments are K50,000 per annum, with the first payment made on 1 January 2017. To obtain the lease Luena incurred initial direct costs of K10,000 in relation to the arrangement of the lease but the lessor agreed to reimburse Agro-Sara K5,000 towards the costs of the lease.

The rate implicit in the lease is 5%. The present value of the minimum lease payments is K227,300.

APPLICABLE TAX TABLES ARE PROVIDED AT THE END OF THE QUESTION

Requirements

- 1) In relation to the request for forensic investigation at Luena Farms
 - a) Accountants are bound by ethical requirements regardless of the type of assignment they undertake. Identify and comment on the ethical issues arising from the request to undertake the forensic investigation at Luena Farms
(10 marks)
 - b) Explain the matters that should be discussed in the meeting with Mr. Lime Lukasu for the purpose of planning the investigation into the alleged fraudulent activity.
(6 marks)
 - c) Recommend the procedures to be used in performing the forensic investigation on the suspected fraud at Luena Farms
(6 marks)
- 2) In relation to LF's farming operations for the year ended 31st December 2017:
 - a) Calculate the capital allowances for the charge year 2017
(12 marks)
 - b) Calculate the tax adjusted farming profit for the charge year 2017
(12 marks)
 - c) Calculate the income tax payable by LF for the charge year 2017
(6 marks)
 - d) In relation to provisional tax
 - i) State the requirements to submit provisional tax returns and the information that such a return should contain
(5 marks)
 - ii) State the due dates for submission of provisional tax returns for both electronic and manual returns
(4 marks)
- 3) In relation to the provision of accounting services, advise LF on the accounting treatment to be applied to the following for the year ended 31st December 2017, including financial statement extracts
 - a) Valuation of cows
(6 marks)
 - b) Construction of Greenhouses
(7 marks)
 - c) Lease of combined harvester
(8 marks)
- 4) With regard to the introduction of accruals accounting in the public sector
 - a) Explain the difference between cash accounting and accruals accounting

- (4 marks)
- b) State THREE reasons why accruals accounting should be considered more useful for the public sector in Zambia (6 marks)
- c) Comment on the challenges that the public sector is likely to face as they transition to accruals accounting (8 marks)

Total Marks: 100

TAXATION TABLE

Standard personal income tax rates

Income band	Taxable amount	Rate
K1 to K36,000	first K36,000	0%
K36,001 to 45,600	next K9,600	25%
K45,601 to K70,800	next K25,200	30%
Over K70,800		35%

Income from farming for individuals

K1 to K36,000	first K36,000	0%
Over K36,000		10%

Company Income Tax rates

On income from manufacturing and other	35%
On income from farming	10%

Capital Allowances

Implements, plant and machinery and commercial vehicles:

Wear and Tear Allowance – Plant used normally	25%
Used in Manufacturing, Farming, Leasing	50%

Non-commercial vehicles

Wear and Tear Allowance	20%
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Industrial Buildings:

Wear and Tear Allowance	5%
Initial Allowance	10%

Investment Allowance	10%
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Low Cost Housing (Cost up to K20,000)

Wear and Tear Allowance	10%
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Initial Allowance	10%
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Commercial Buildings

Wear and Tear Allowance	2%
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Farming Allowances

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

- 1) With regard to the transactions of ZMC with its chairman, state your responsibilities in the context of the requirements of the Financial Intelligence Centre (FIC)
(6 marks)
- 2) Apart from the transactions of ZMC with its chairman, evaluate FOUR other ethical and other professional issues arising from the provision of various services to ZMC and recommend the action that your firm should take for each issue identified
(16 marks)
- 3) In relation to Mr. Lamisu's personal tax affairs
 - a) Explain the possible causes of, and the differences between tax avoidance and tax evasion and discuss the practical consequences of practicing each of them.
(8 marks)
 - b) Provide three examples of Three (3) personal financial planning protection products that would be of use in Ize's situation. Justify your selections by reference to the type of protection provided.
(6 marks)
 - c) Briefly outline the tax consequences for Ize if the types of protection identified in (b) were to be provided for him by ZMC Ltd compared to providing them for himself. You are not required to discuss the company Income tax consequences for ZMC Ltd.
(4 marks)
- 4) With to the new project and VAT
 - a) Highlight the essential mechanisms of how the VAT system works in Zambia
(6 marks)
 - b) In relation to the expected sale of a copper tray, compute the VAT payable by
 - i) ZMC
(4 marks)
 - ii) The wholesaler
(4 marks)
 - iii) The retailer
(4 marks)
 - c) Based on this example, illustrate that although VAT is collected in stages, by a VAT registered business, it is a tax on consumer expenditure, stating clearly the total VAT to be paid by the consumer
(6 marks)
- 5) In relation to destroyed records:

- a) Based on the opening balances as at 31st March 2017 / 1 April 2017 and the cashflow statement for the year ended 31 March 2018, reconstruct the closing trial balance for ZMC as at 31st March 2018 (21 marks)
- b) Recommend to ZMC what procedures they should put in place to ensure:
- i) Continuity of operations (5 marks)
 - ii) Speedy recovery of data (5 marks)
- 6) Explain the difference between an engagement to compile financial statements and assurance engagement (5 marks)

Total Marks: 100