NON AUDIT

QUESTION ONE

BACKGROUND

Mwandi Accountants is a medium-sized partnership which was set up by four (4) qualified ZiCA accountants five (5) years ago. The firm now has ten (10) partners and thirty (30) employees. All the partners have the ZiCA non-audit certification.

The turnover for Mwandi Accountants has been rising at an impressive average rate of 6% despite the slow growth in the economy at the beginning of the 2018. The firm's market share, however, is beginning to decline mainly due to the big accountancy firms now offering non-audit services on a large scale. The non-audit services offered by the big accountancy firms include modern innovative services which exploit internet technologies. The year 2017 was generally characterised by a challenging economic environment due to several factors including a fluctuating exchange rate and high inflation rate. Mwandi Accountants has one supplier of office equipment, stationery and consumables. The supplier has been increasing prices every month in order to address some of the economic challenges.

Mwandi Accountants only has offices in Lusaka. However, following the significant increase in copper prices, Mwandi Accountants is seriously considering expanding to Kitwe and Solwezi. The expansive strategy will require $2 million and the partners are considering various financings options. The company is hopeful that it will access affordable financing following the lowering of Government's policy lending rate from 12% to 9% which is likely to improve liquidity in the financial sector and spur economic growth.

Mwandi Accountants has created a loyal customer base and knows this is one of the reasons for the relatively sustained growth in turnover. The partners are hopeful that this loyalty will be strengthened if the business is expanded since most the clients have established strong networks in the Copperbelt and Northwestern Provinces of the Republic of Zambia.

The firm mainly specialises in the provision of the following:

1. Preparation of financial statements

2. Financing

3. Risk management

4. Taxation

At the moment, Mwandi Accountants is engaged in a number of assignments which include the following:

1. Preparation of financial statements for Mwenyo Ltd

2. Arrangement of financing arrangement for Tuyongola Plc

3. Risk management system and tax dispute for Veronique Ltd

The firm has continued to mobilise employees around community programmes using the Mwandi Accountants Foundation and has now become the channel through which it derives its Corporate Social Responsibility (CSR) programme based on the available resources and impact on the community. Mwandi Accountants recently joined the global network Charlie International. It now conducts its business as 'Mwandi Accountants, a member of the global network Charlie International'. As part of a global network, Mwandi Accountants is now able to sell services based on the value and reputation of this global brand name.

You are a senior manager in Mwandi Accountants responsible for all the assignments listed above.

MWENYO LTD

One of the members of the global network Charlie International is the external auditor for Mwenyo Ltd. Mwandi Accountants prepares accounting records and financial statements for Mwenyo Ltd. Mwenyo Ltd sells electronic equipment with a warranty covering customers for the cost of repairs of any defects that are discovered within the first three months after purchase. Past experience suggests that 70% of the goods sold will have no defects, 20% will have minor defects and 10% will have major defects.

The following trial balance of Mwenyo Ltd as at 31 August 2018 is available for attention:

	K	K
	Debit	Credit
Sales		912,000
Purchases	600,000	
Land and buildings – cost	600,000	
Plant and machinery – cost	309,000	
Motor vehicles – cost	220,000	
Land and buildings – accumulated depreciation		52,300
Plant and machinery – accumulated depreciation		123,600
Motor vehicles – accumulated depreciation		44,000

Ordinary share capital K1 each		400,000
Share premium		115,680
Warranty provision		78,000
Inventory	120,000	
Income tax	3,200	
Administration expenses	75,600	
Distribution costs	95,490	
Bank	6,600	
Allowance for trade receivables		6,540
Interest	3,000	
Trade receivables	20,230	
Trade payables		40,400
Cash	4,400	
10% loan note		60,000
Retained earnings		225,000
	2,057,520	2,057,520

Additional information

1. Inventory at the close of business on 31 August 2018 was valued at K140,000. Included in the inventory figure are some items at their cost of K8,000. Following damage that had taken place during the year, it is now thought that these items can be sold for K4,500 but only after they have been repaired and repackaged which will cost K1,500.

2. Buildings, plant and machinery and motor vehicles are depreciated as follows:

Buildings	2% on cost
Plant and machinery	10% on reducing balance basis
Motor vehicles	20% on cost

The cost for land and buildings includes K115,000 for land.

3. The depreciation charges for the year to 31 August 2018 are to be apportioned as follows:

Cost of sales	70%
Administration expenses	15%
Distribution costs	15%

4. As at 31 August 2018, the directors estimated that if minor defects were detected in all products sold, the cost of repairs would be K160,000; major defects were detected in all products sold, the cost would be K600,000. Warranty costs are charged to administration expenses.

5. The allowance for receivables is to be increased by K4,000

6. Two weeks before the year-end, a flood destroyed inventory worth K85,000. The insurers are contesting the claim since they believe Mwenyo Ltd did not comply with legislation.

7. Income tax in the trial balance is an under provision arising from the settlement of the previous year's tax charge. The directors have estimated the provision for income tax for the year to 31 August 2018 at K14,000.

8. The 10% loan note was issued on 1 September 2017.

TUYONGOLA PLC

The Company operates in an industry that is faced with fast rising costs especially due to the increasing power costs, a contracting market demand driven by low infrastructure development projects and pricing pressure in view of low market demand. The power deficit being experienced has an adverse effect on production.

The board of directors is currently concerned about the company's level of financial gearing, which is generally not as high by industry standards. There are three covenants attaching to the current 20% Loan notes, which state:

1. The company shall maintain a prudent level of liquidity and must maintain a quick ratio of at least 3:1.

2. The company shall maintain an interest cover of at least 4 times.

3. At no time shall the debt: equity ratio, exceed 60%.

The Company's finance department reviews the capital structure on a regular basis. As part of this review the cost of capital and the risks associated with each class of capital are considered. Tuyongola Plc's most recent set of financial statements are summarised below:

Statement of profit or loss (extract) for the year ended 31 December 2018

	K'm
Revenue	112
Operating profit	16
Interest payable	8
Profit before tax	8

Statement of financial position (extract) as at 31 December 2018

	K'm	K'm
Non-current assets		90
Current assets		
Inventory	5	
Receivables	7	
Bank and cash	3	
		15
Total assets		105
Equity and liabilities		
Ordinary shares K1 each		45
Reserves		10
20% Loan notes 2012 – 2019		40
Payables		10
Total equity and liabilities		105

The board recently appointed a new Managing Director who has promised to increase credit sales by more than 300% within one (1) year and improve working capital management by taking longer to pay suppliers.

The board has requested Mwandi Accountants to advise on raising appropriate finance which may be required and negotiate with any potential provider of finance on behalf of Tuyongola Plc.

VERONIQUE LTD

Veronique Ltd is a copper mining company, which was incorporated in the Republic of Zambia, in 2015. The current annual turnover for the company is approximately K250 million. Veronique Ltd has three (3) mines in Ndola rural and the internal auditors have identified the following risks:

1. Forecast decreases in copper prices.

2. Introduction of strict money laundering legislation in Zambia.

3. Increased highly organised thefts of copper.

4. Abuse of company internet facilities.

5. Increased penalties and fines due to non-compliance with environmental laws and regulations.

6. Increased cases of fraud by employees.

The board is determined to find suitable measures to reduce or eliminate these risks. Mwandi Accountants has been engaged to develop risk management strategies and recommend measures to reduce or eliminate the identified risks. The company has no audit committee.

On 1 March 2018, the company received a tax assessment on business profits based on the return of income for the previous year. The company has now appealed to the Tax Appeals Tribunal (TAT) and would like Mwandi Accountants to act as Veronique Ltd's tax advocate. The tax assessment is K60 million and the agreed fee for the tax assignment is K250,000 plus 50% of any tax saved.

SECTION A

(1) For each assignment, explain any possible ethical issues and suggest the necessary safeguards. (10 marks)

(2) Prepare the following for Mwenyo Ltd:

(a) Statement of profit or loss for the year ended 31 August 2018 (clearly explaining the accounting treatment of the insurance claim). (16 marks)

(b) Statement of financial position as at 31 August 2018. (18 marks)

(c) An appropriate note to the financial statements on the warranty provision and insurance claim. (3 marks)

(3) Discuss the concept of global networks and clearly advise Mwandi Accountants on the main danger of these networks. (3 marks)

(Total: 50 marks)

SECTION B

(4) Write a report advising the board of Veronique Ltd on:

(a) The contents of a risk management strategy for fraud. (10 marks)

(b) The actions, Veronique Ltd can take to minimise the identified risks. (10 marks)

(5) (a) Explain whether Tuyongola Plc's gearing is in any sense 'dangerous'. (8 marks)

(b) Discuss the risk of pursuing the Managing Director's proposed strategy. (4 marks)

(c) Suggest suitable financing to reduce the risk which may be faced by Tuyongola Plc. (4 marks)

(6) (a) Using an appropriate model or models, analyse the competitive environment of Mwandi Accountants. (10 marks)

(b) Recommend any two (2) appropriate additional actions to be taken by the partners of Mwandi Accountants to regain their market share. (4 marks)

(Total: 50 marks)

QUESTION TWO

BACKGROUND

Swebo & Co. was formed in 2012. It has two (2) partners, one (1) manager, two (2) supervisors, six (6) trainee accountants and three (3) support staff. Most of the complicated assignments are outsourced to reputable individuals and organisations.

You are the Manager in Swebo & Co. and you have just received the following email from one of the partners:

To: Manager

From: Partner

Date: 16 January 2019

Subject: **Outstanding assignments**

It has come to my attention that the following assignments are outstanding:

1. Tax computations for both Musonko Plc and John Nduna, the Managing Director.

2. Accounting Standards training for Masomo Agricultural Cooperative.

3. Preparation of the Statement of Cash flow for Ndalama Ltd.

4. Recruitment of accounting staff for Mwansa Import & Export Ltd.

Kindly have these assignments ready for me to review as soon as you can. If you need extra manpower do not hesitate to see me.

Regards

Partner

MUSONKO PLC

Musonko Plc is a Zambian company that is engaged in manufacturing explosives. The company is registered for Value Added Tax (VAT) and its accounts are prepared to 31 December each year. The company obtained a listing on the Lusaka Stock Exchange (LuSE) on 1 January 2018 and offered 500,000 shares out of 1,000,000 shares issued, to indigenous Zambians.

The company's results for the year ended 31 December 2018 are as follows:

	Notes	K'000
Adjusted profit before capital allowances	1	5,000
Royalties received	2	850
Rent received	2	9,000
Dividends received from a Zambian company	2	2,000
Dividends paid to shareholders	3	700
Debenture interest received	2	100

Notes

1. The following capital expenditure was incurred in the year to 31 December 2018:

	K'000
Purchase of Manufacturing Machinery ((VAT inclusive)	2,900
Purchase of Delivery Van (VAT exclusive)	120
Purchase Air Conditioner (VAT inclusive)	40
Purchase of Motor Car (VAT exclusive)	60
Purchase of Computer (VAT inclusive)	14

At 1 January 2018, all the non-current assets qualifying for capital allowances purposes had been completely written down to zero.

During the year, an old computer that had been acquired for K4,000 (VAT exclusive) was sold for K6,000 (VAT exclusive).

There were no other purchases or disposals of non-current assets during the year.

2. The amounts shown represent the actual amounts received. Withholding tax had been deducted at source at the appropriate rates.

3. The dividend was paid net of withholding tax at the standard rate of 15%.

4. The provisional income tax paid on the appropriate quarterly due dates for the tax year 2018, totalled K1,100,000.

The Managing Director of Musonko Plc, John Nduna is paid an annual salary of K480,000 in twelve monthly instalments on the last day of the each month. He works a five day week 50 weeks a year. He is also entitled to the following allowances:

	K
Lunch allowance per week	500
Children's education allowance per child (annually)	36,000
Medical allowance monthly	4,000
Accommodation allowance (monthly)	5,500
Servant's allowance (monthly)	2,200

John Nduna has three school going children. He received a performance related bonus of K25,500 in June 2018. This was in recognition of his effort for the company's financial quarter ended 31 March 2018. On 30 June 2018, John Nduna received a dividend of K680 (net) from Nandie Ltd, a Zambian Manufacturing Company.

John Nduna was reimbursed K2,548 medical expenses incurred by himself and his family at the employer's approved medical centre in the tax year 2018. The employer's policy is to reimburse all such fees incurred by employees. Munsoko Plc deducted PAYE and NAPSA contributions amounting to K212,176 and K11,940 respectively.

Management of Munsoko Plc also wants you to advise on the advantages of using the ZRA e-payment system.

MASOMO AGRICULTURAL COOPERATIVE

Swebo & Co. has been engaged by Masomo Agricultural Cooperative to conduct a workshop on selected international accounting standards for the cooperative's accounting officers country-wide. The Partner wants you to prepare solutions to the following illustrations which will be used during the workshop:

Illustration 1

Masomo Agricultural Cooperative acquired a herd of 600 dairy cattle on 31 March 2016 at a cost of K2,500 each. The market value of a dairy cow on 31 March 2017 was K3,000 and at 31 March 2018 was K3,500. Seller's auction costs for livestock amount to 5% of the selling price.

Extracts from Masomo Agricultural Cooperative financial statements for the year ended 31 March 2018 were as follows:

Statement of financial position	2018	2017
	K	K
Biological assets (dairy herd)	1,200,000	1,350,000

Statement of profit or loss	2018	2017
	K	K
Depreciation	150,000	150,000

Illustration 2

Masomo Agricultural Cooperative issued 10,000 convertible bonds on 1 April 2017. The bonds have a five year term, and are issued at par with a face value of K100 per bond. Interest is payable annually in arrears at a nominal annual interest rate of 8%. Each bond is convertible at any time up to maturity into 20 common shares at the option of the bondholder.

When the bonds were issued, the prevailing market interest rate for similar debt without conversion options was 12%.

Discount factors (five years)	8%	12%
Present value tables	0.681	0.567
Cumulative present value tables	3.993	3.605

Illustration 3

Information about a tractor is given below:

	K'000
Carrying amount	200
Fair value less costs to sell	100
Future cash flows (per annum) for 4 years	40
Discount rate	7%

Illustration 4

During the year ended 31 March 2018, Masomo Agricultural Cooperative revalued its ten (10) acre piece of land. The piece of land was revalued from K350,000 to K470,000. Its profit before tax for the year ended 31 March 2018, was K110,000, on which it paid tax at 35%.

The opening balance on the retained earnings reserve was K600,000, and there were no deferred tax balances brought forward.

NDALAMA LTD

Set out below are the financial statements of Ndalama Ltd.

Ndalama Ltd

Statement of profit or loss for the year ended 31 March 2018

	K'000
Revenue	10,500
Cost of sales	(7,256)
Gross profit	3,244
Distribution costs	(980)
Administrative costs	(750)
	1,514
Interest received	100
Interest paid	(300)
Profit before taxation	1,314
Taxation	(328)
Profit for the period	986

Ndalama Ltd

Statement of financial position as at 31 March

	2018	2017
	K'000	K'000
Assets		
Non-current assets		

Property, plant and equipment	5,900	4,020
Current assets		
Inventories	760	820
Receivables	1,750	1,300
Cash-in-hand	50	70
Total assets	8,460	6,210
Equity and liabilities		
Equity		
Share capital (K1 Ordinary shares)	1,500	1,000
Share premium account	500	-
Revaluation reserve	2,200	800
Retained earnings	228	720
Non-current liabilities		
Loan	1,800	1,240
Current liabilities		
Trade payables	800	1,200
Bank overdraft	232	250
Taxation	1,200	1,000
Total equity and liabilities	8,460	6,210

The following information is available:

(a) Dividends totalling K1,478,000 were paid during the year.

(b) The following information relates to property, plant and equipment.

	31.3. 2018	**31.3.2017**
	K'000	K'000
Cost	7,500	4,925
Accumulated depreciation	1,600	905

Carrying amount	5,900	4.020

(c) Machinery, with an original cost of K700,000 and a carrying amount of K600,000, was sold for K800,000 during the year.

(d) 500,000 K1 Ordinary shares were issued during the year at a premium of K1 per share.

MWANSA IMPORT & EXPORT LTD.

Swebo & Co. provides a number of non-audit services to Mwansa Import & Export Ltd. This business relationship started in 2013. Mwansa Import & Export has opened up a large branch in Ndola and has requested Swebo & Co. to recruit all accounting staff. The Partner has charged Mwansa Import & Export a fee based on each employee's salary. He wants you to identify and explain any ethical threats before finalising the contract.

Swebo & Co. does not have much experience in recruitment. The Partner has only agreed to recruit junior accounting staff.

CONFLICTS OF INTEREST IN THE PREPARATION OF ACCOUNTING INFORMATION

The other partner has noticed an increase in reports regarding conflicts of interest in the preparation of accounting information being experienced by supervisors and junior staff. It is possible that some of the members of staff do not report such incidences.

He has requested you to draft some briefing notes for use at the meeting called to discuss the issue in detail and give professional guidance to all members of staff. This will eventually be included in the firm's code of conduct for employees.

SECTION A

(1) Identify and explain any five (5) ethical threats in the recruitment assignment for Mwansa Import & Export Ltd. (7 marks)

(2) Calculate the final amount of income tax payable by:

(a) Musonko Ltd for the tax year 2018. (15 marks)
(b) Managing Director for the tax year 2018. (9 marks)
(c) State three (3) advantages of the Zambia Revenue Authority (ZRA) e-payment system. (3 marks)

(3) Prepare the Statement of Cash flow for Ndalama Ltd for the year ended 31 March 2018. (16 marks)

(Total: 50 marks)

SECTION B

(4) Prepare briefing notes for the partner regarding:

(i) Potential conflict of interest which may arise in the preparation of accounting information, giving three (3) relevant examples. (8 marks)

(ii) How the conflicts of interest could be resolved, and (6 marks)

(iii) The consequences of doing nothing about the conflict of interest as a professional accountant registered with ZiCA. (6 marks)

(5) For each illustration given in Masomo Agricultural Cooperative, answer the following questions:

(a) **Illustration 1**- Explain the accounting treatment adopted by Masomo Agricultural Cooperative for the herd of cattle and redraft the numerical extracts from the financial statements in order that they comply with an appropriate international accounting standard. (12 marks)

(b) **Illustration 2** – Calculate the liability and equity components in the bond. (7 marks)

(c) **Illustration 3** – Determine the outcome of the impairment review. (5 marks)

(d) **Illustration 4** – Prepare all relevant extracts from Masomo Agricultural Cooperative's financial statements for the year ended 31 March 2018. (6 marks)

(Total: 50 marks)

END OF PAPER

SOLUTIONS AND MARKING KEY

SOLUTION ONE

SECTION A

(1) Ethical issues and safeguards

Ethical issue	Explanations	Safeguards
1. Preparation of accounting records and financial statements for Mwenyo Ltd which are audited by a Network firm.	There is clearly a significant indirect risk of self-review threat if a network member prepares accounting records and financial statements and then another network member audits them. Mwandi Accountants may relax since the audit firm may not exercise the appropriate levels of professional scepticism. Both firms may be under pressure to impress Mwenyo Ltd and continue with the business relationship.	Mwandi Accountants should discuss this ethical threat with the network member. The ethical threat is significant and it may be appropriate for either Mwandi Accountants or the other network member to discontinue its relationship with Mwenyo Ltd.
2. Negotiating financing arrangements on behalf of Tuyongola Plc.	This will create an advocacy threat to Mwandi Accountants' objectivity, as the firm will be representing the client's interests to the potential providers of finance (third parties). Mwandi Accountants will not be seen to be impartial.	It may advisable for Mwandi Accountants not to be involved in negotiations but focus on assisting in identifying possible sources of capital and providing structuring advice.
3. Advice on risk management system for Veronique Ltd.	Risk management is a specialised field and it is highly likely that Mwandi Accountants may not have competent staff to handle this assignment. Professional accountants are required to provide clients with competent professional service.	If Mwandi Accountants has no competent staff, the firm should either decline or consider outsourcing.
4. Acting as an advocate for Veronique Ltd before the Tax Appeals Tribunal.	The amount involved of K60 million is material and the promised fee of K250,000 plus 50% of tax saved is significant. It creates self-interest and advocacy threats.	The self-interest threat and advocacy threat would be so great that no safeguards would be appropriate and the service must not be provided.

	This is likely to impair independence and objectivity. Mwandi Accountants is likely to promote Veronique Ltd's position to the point that it becomes too sympathetic to their interests, even if Veronique Ltd's position is wrong.	

[Award up to 1 ½ marks for each valid explanation (Maximum 6 marks) and 1 mark for each valid safeguard (Maximum 4 marks)]

(2) **Mwenyo Ltd**

(a) **Statement of profit or loss for the year ended 31 August 2018**

	K	Marks
Revenue	912,000	**½**
Cost of sales (W1)	(635,568)	**4**
Gross profit	276,432	
Distribution costs (W3)	(106,326)	**2**
Administrative expenses (W4)	(104,436)	**3**
Profit from operations	65,670	
Finance costs (3,000 + 3,000)	(6,000)	**1**
Profit before tax	59,670	
Tax (14,000 + 3,200)	(17,200)	**1**
Profit for the year	42,470	**½**

[Award marks as indicated and 1 mark for the format – Maximum 13 marks]

Insurance claim

This situation represents a contingent asset in accordance with IAS 37 *Provisions, contingent liabilities and contingent assets* . There is a possible asset, the insurance claim, arising as a result of a past event, that is, the flood damaging the inventory.

According to IAS 37, contingent assets should be ignored in the financial statements unless it is probable that there will be an inflow of benefits, in which case the matter may be disclosed by note.

In the case of Mwenyo Ltd, the insurers are contesting the claim and therefore it would seem that it is not probable that the company would receive the compensation.

The insurance claim has therefore been ignored.

[Award 1 mark for each relevant point – Maximum 3 marks]

(b) **Statement of financial position as at 31 August 2018**

	Marks	K	K
Non-current Assets			
Property (W5)	**2**		538,000
Plant and Equipment (W5)	**4**		298,860
			836,860
Current Assets			
Inventory	**1**	135,000	
Receivables (20,230 – 10,540)	**1**	9,690	
Bank and cash (6,600 + 4,400)	**1**	11,000	
			155,690
Total assets			
			992,550
Equity and liabilities			
Equity			
Share capital	**½**		400,000
Share premium	**½**		115,680
Retained earnings (225,000 + 42,470)	**1**		267,470
			783,150
Non-current liabilities			
10% loan notes	**½**	60,000	
Warranty provision (W6)	**3**	92,000	

			152,000
Current liabilities			
Payables	**½**	40,400	
Accrued loan note interest ((10% x 60,000)-3,000)	**1**	3,000	
Income tax	**1**	14,000	
			57,400
Total equity and liabilities			992,550

[Award marks as indicated and 1 mark for format – Maximum 18 marks]

Workings

(W1) Cost of sales

	K
Opening inventory	120,000
Purchases	600,000
	720,000
Closing inventory (140,000 – 8,000 + (4,500 -1,500))	(135,000)
Unadjusted cost of sales	585,000
Adjustment for depreciation (W2)	50,568
Adjusted cost of sales	635,568

(W2) Depreciation

	K
Buildings (600,000 – 115,000) X 2%	9,700
Plant and machinery (309,000 – 123,600) X 10%	18,540

Motor vehicles (220,000 X 20%)	44,000
Total depreciation charge for the year	72,240

Apportionment of depreciation

	K
Cost of sales (72,240 X 70%)	50,568
Distribution costs	10,836
Administration expenses	10,836
Total	**72,240**

(W3) Distribution costs

	K
Per Trial balance	95,490
Depreciation	10,836
Total	106,326

(W4) Administration expenses

	K
Per TB	75,600
Depreciation	10,836
Increase in allowance for receivables	4,000
Increase in warranty provision (92,000 – 78,000)	14,000
Total	104,436

(W5) Non-current assets

	Property	P & E
	K	K
Cost per TB		
Land and buildings	600,000	
Plant and machinery		309,000
Motor vehicles		220,000
Accumulated depreciation		
Buildings (52,300 + 9,700)	(62,000)	
Plant and machinery (123,600 + 18,540)		(142,140)
Motor vehicles (44,000 + 44,000)		(88,000)
Total	538,000	298,860

(W6) Warranty provision

	K
Minor repairs K160,000 X 20%	32,000
Major repairs K600,000 X 10%	60,000
Total	92,000

(c) **An appropriate note to the provisions**

Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of a past event, and it is possible that the Company will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the end of each reporting period, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

When some or all of the economic benefits required to settle provision are expected to be recovered from a third party, a receivable is recognised as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

[Award 1 mark for each valid point – Maximum 3 marks]

(3) Main danger of global networks

Several accountancy firms have moved towards network models over **recent years**. This is where member firms are part of a **larger structure**, often **sharing** a name (or using a similar name) and professional resources. As part of a global network, member firms have been able to **sell services** based on the value and **reputation of their global brand name**. However, in recent **liability cases**, some network firms have claimed the network is not liable for negligence in an individual member firm even though they appear to be operating under the same brand.

The **main danger** is that it is possible that the network model may disappear or be modified in future years. The current situation where network firms advertise under one brand and then claim they are separate firms when things go wrong may **not be sustainable** given the outcome of current legal activity.

[Award 1 mark for each valid point – Maximum 3 marks]

(Total: 50 marks)

SECTION B

(4) (a) & (b)

REPORT

To: The Board of Directors – Veronique Ltd

From: Consultant – Mwandi Accountants

Date: 12 June 2018

Subject: **Risk management**

I am writing to set out the contents of a risk management strategy for fraud and what the board must do to minimise the identified risks.

[Award 1 mark for format]

(a) **Contents of risk management strategy for fraud**

A **risk management strategy** for fraud will contain three elements:

- Fraud prevention
- Identifying fraud, and
- Responding to fraud

[Award 1 mark for introduction]

Fraud prevention

The fact that a risk management strategy for fraud is in place within an organisation will itself act as a **deterrent against fraud.** Fraud is less likely to be attempted if the potential perpetrators of that fraud know they are more likely to be caught.

Key methods of preventing fraud

(i) Having an anti-fraud culture in the organisation
This means that all **staff are encouraged to treat each other and external parties** such as customers and suppliers **with respect** and that reasons for decisions are transparent. The policy will be enforced partly by **contracts of employment** that will indicate actions that employees must take, e.g. ensuring security of client data, and partly by the **overall culture.** The latter point could be directors providing an example to staff in their dealings with customers.

[Award 1 mark for each relevant point on anti-fraud culture – Maximum 2 marks]

(ii) Risk awareness

There should be **awareness amongst staff that fraud could be taking place,** which will be reinforced by **appropriate training programmes** within the entity. In some situations, such as anti-money laundering regulations, annual refresher training on money laundering is necessary simply to maintain awareness of this issue. Where fraud has been identified, appropriate publicity could be given to this, again to maintain awareness of the issue.

[Award 1 mark for risk awareness]

(iii) Whistle blowing

This relates to **disclosing information on possible frauds** by people not involved in that fraud and where the fraud does not appear to have been identified and acted on by normal channels such as internal audit. **Maintaining an anti-fraud culture** may help whistle-blowers come forward with information, although fear of reprisals by management including inappropriate dismissal may limit the number of disclosures. The laws on 'Public Interest Disclosure' may provide some benefit to whistle-blowers.

[Award 1 mark for whistle blowing]

(iv) Internal control systems

Appropriate internal control systems will also help to prevent and detect fraud. The **use of controls** such as **segregation of duties** and **authorisation** controls ensure that fraud can only take place by collusion between staff. This will help to minimise the incidence of fraud.

[Award 1 mark for internal control systems]

Identifying fraud

As noted above, good internal control systems will assist in preventing and detecting fraud. Fraud identification normally results from the **work of internal audit** and internal investigation, rather than the **work of external auditors.** External auditors in their engagement letter recommend that their work cannot be relied upon to detect fraud.

Specific tasks of internal audit which will help to detect fraud include:

(i) Performing regular checks to ensure that assets are accounted for- e.g. inventory counts and cash counts.

(ii) Monitoring key ratios and other accounting indicators and transactions for unusual or unexplained movements eg receivable days increasing, payments made to an overseas subsidiary without justification.

(ii) Receiving information from whistle-blowers. The audit committee or the chief internal auditor is normally nominated as the person to receive whistle blowing reports from employees.

[Award ½ marks for each relevant point – Maximum 2 marks]

Responding to fraud

Where fraud is suspected, then an **appropriate investigation** should be carried out into those suspicions. Actions to be taken will depend on the outcome of the investigation, but could include internal disciplinary and/or legal proceedings.

[Award 1 mark for responding to fraud]

(b) **Actions to take for risks identified**

Avoidance of risk

Veronique Ltd may consider whether any of the risks can be **avoided.** However, given the nature of the risks identified this may not be an appropriate method.

[Award 1 mark for avoidance of risk]

Reduction of risk

The risks can be **reduced by taking appropriate measures.** In the case of Veronique Ltd these will include:

- Ensuring that employees receive **appropriate training in money laundering, fraud prevention etc,** and that the training is repeated on a regular basis.
- **Raising awareness** of the importance of good risk management and the potential consequences if risks were to crystallise.
- **Maintenance and enforcement of appropriate disciplinary procedures** where breaches of laws and regulations have been identified.

Veronique Ltd may also consider loss control options. These may include:

- **Hiring of lawyers** to defend Veronique Ltd.
- **Employing a qualified person in risk management**
- **Release of publicity material** on the work of Veronique Ltd showing extent of work carried out to eliminate or reduce pollution.

[Award 1 mark for each relevant point on reduction of risk – Maximum 4 marks]

Retaining risk

This is where the organisation retains the risk and if an unfavourable outcome occurs it will suffer the full loss. In the case of the highly organised theft of copper and abuse of company internet facilities, Veronique Ltd may have to **retain the risk** if **suitable insurance cannot be found.** Given the uncertainties regarding the costs resulting from the unfavourable outcome, insurers may be unwilling to insure for these types of event.

[Award 1 mark for each relevant point on retaining risk – Maximum 2 marks]

Transfer of risk

The risk is transferred to a third party. As noted above, this may not be possible if insurers are **not willing to accept the risk**. Alternative methods of risk transfer may have to be considered including asking the state for some sort of insurance.

The forecast decrease in copper prices could be addressed by using appropriate hedging methods, such as money market hedges, forward exchange contracts etc.

[Award 1 mark for each relevant point on transfer risk – Maximum 2 marks]

Conclusion

The board of directors should consider establishing an audit committee so that most of the recommendations can be considered in much more detail and implemented as a matter of urgency.

[Award 1 mark for conclusion]

Signed: Consultant

(5) **Tuyongola Plc**

(a) **Assessment of existing gearing level**

A **high gearing level** only constitutes a danger when the level and volatility of earnings is such that the company is at risk of being unable to meet the interest payments as they fall due. If this situation arises the company could be forced to **liquidate assets** to meet the demands of its payables, and this in turn could jeopardise its operating viability. It follows that the absolute level of gearing cannot be used to assess the financial risk faced by the company. It is more helpful to assess the level of interest cover in the light of the degree of volatility in earnings.

[Award 1 mark for introduction]

Interest coverage

Interest coverage can be calculated as the rate of operating profit: interest payable. In Tuyongola Plc's case, the cover is currently 2 times (K16m:K8m). This is significantly below the target of 4 times. There is evidence that earnings could be assessed as unstable given that the company operates in an industry that is faced with fast rising costs especially due to the increasing power costs, a contracting market demand driven by low infrastructure development projects and pricing pressure in view of low market demand. This may indicate that the existing level of gearing does appear to be dangerous.

[Award 1 mark for each relevant point – Maximum 2 marks]

Quick ratio

The quick ratio is 1:1 and this is also below the target of 3:1. The company is failing to maintain the agreed ratio due to reduced business activity. The power deficit being experienced has an adverse effect on production and possibly on liquidity as well. If this is the case, this also provides evidence that the existing gearing level could be dangerous.

[Award 1 mark for each relevant point – Maximum 2 marks]

Debt : Equity ratio

The debt : equity ratio is 73% (40/55 X 100%). This is above the target of 60%. In view of the operational difficulties, it may be advised to assess the quality of asset backing, since this may influence the attitude of its lenders. The existing loan notes are due for repayment next year (2019) and it highly likely that Tuyongola Plc could face serious problems if the asset backing is poor. If it is established that the asset backing is poor, then this may also indicate that the existing level of gearing could be dangerous.

[Award 1 mark for each relevant point – Maximum 2 marks]

Conclusion

The factors discussed above, when taken together, suggest that the **level of gearing** is particularly dangerous. However, the courses of action available to the Loan note holders and their attitude towards the situation will be of key importance in determining the true dangers of the Tuyongola Plc's position.

[Award 1 mark for conclusion]

(b) **Risk of pursuing new Managing Directors strategy**

A business seeking to increase its revenue too rapidly without an adequate capital base is the main **cause of overtrading. Other causes** are as follows.

(i) When a business repays a loan, it often replaces the old loan with a new one (refinancing). However a business might **repay a loan without replacing it**, with the consequence that it has **less long-term capital** to finance its current level of operations. Tuyongola Plc has a loan which is due for repayment next year.
(ii) A business might be profitable, but in a period of **inflation**, its **retained profits** might be **insufficient** to pay for **replacement** non-current assets and inventories, which now cost more because of inflation.

The Managing Director's strategy could be successful in boosting sales but may worsen the company's liquidity position. Suppliers will express their annoyance at the length of time they must wait for payment and some may sue the company. The level of bad debts could increase significantly. It may regularly start exceeding its overdraft limits just to pay suppliers, salaries and wages, statutory payments etc.

[Award 1 mark for each relevant point – Maximum 4 marks]

(c) **Suitable financing**

The following financing options could address risks of high financial gearing and possible overtrading.

(i) **New capital** from the shareholders could be injected.

(ii) **Better control** could be applied to inventories and accounts receivable. The company could **abandon ambitious plans** for increased sales and more non-current asset purchases until the business has had time to consolidate its position, and build up its capital base with retained profits.

If it does not sort out its cash flow and liquidity, it will not survive to enjoy future profits.

[Award up to 2 marks for each option – Maximum 4 marks]

(6) Mwandi Accountants' competitive environment

(a) Porter's Five forces model has been used AND candidates who use relevant alternative models should also be given appropriate marks.

Michael Porter suggests that the competitive environment of an industry, and hence its potential to earn profits, is determined by five forces: threat of new entrants; the bargaining substitutes products; and the level of rivalry among current competitors in the industry.

Each of these five forces affects the competitive environment of Mwandi Accountants.

The threat of new entrants

If new entrants join an industry they bring **extra capacity** and **increased competition** to that industry. However, whether potential new entrants choose to enter the market or not is likely to depend on the level of **barriers to entry** into the industry. In the case of Mwandi Accountants, ZiCA regulation has restricted the number of firms who can provide accountancy services.

The bargaining power of suppliers

Suppliers can exert power by increasing the price of their goods and services. The relative power of suppliers is highest in industries dominated by a few suppliers, because customers have limited scope for purchasing from other suppliers. Mwandi Accountants only has one supplier and this has given the supplier strong bargaining power. The monthly increases in prices are having a negative impact on the margins.

Threat of substitutes

Substitutes to the services offered by Mwandi Accountants could be the innovative services being offered by the big accountancy firms, which utilise internet technologies. These could add more value to the customers. Hence, the threat of substitutes is currently high.

The bargaining power of customers

Customers want better quality services at the lowest price possible. However, they are usually in a stronger position to achieve this when there are comparatively few buyers. Mwandi Accountants has created a loyal customer base and knows this is one of the reasons for the relatively sustained growth in turnover. It is likely that these customers have strong bargaining power. Moreover, these customers face few switching costs in moving from one accountancy firm to another.

Competitive rivalry

If competition between rivals is intense this may lower the profitability in an industry as competitors battle to increase their market share; for example, by lowering price, by advertising extensively, or by offering additional features at no extra cost. Competition is increasing and Mwandi Accountants' market share is declining.

[Award up to 2 marks for each force – Maximum 10 marks]

(b) **Regaining market share**

There are many ways of regaining market share. However, in the case of Mwandi Accountants the following are important:

1. Recruitment of a Business Development Manager with strong marketing knowledge and skills. The Business Development Manager should carry out a market analysis which will help identify appropriate marketing strategy.

2. Investment in appropriate technologies to facilitate e-marketing. Opportunities for e-marketing can be examined using the traditional 4Ps of product, price, promotion and place, plus an additional 3Ps – people/participants, processes, physical evidence. This can be financed using debt finance since lending rates have been reduced.

[Award up to 2 marks for each relevant recommendation – Maximum 4 marks]

(Total: 50 marks)

SOLUTIONS AND MARKING KEY

SOLUTION TWO

SECTION A

(1) Ethical threats

Providing a recruitment service to a client is not specifically prohibited by the International Ethics Standards Board for Accountants (IESBA) *Code of Ethics for Professional Accountants.* However, the code does say certain threats to independence could be created. **1 mark**

Self-interest threat

Swebo & Co. are considering the provision of recruitment services to Mwansa Import & Export Ltd. This creates a financial self-interest threat to independence. The firm may be tempted to recommend any individual to the company in order to earn a fee, and not consider whether that individual is suited to the role.

1 mark

Familiarity threat

The provision of recruitment services will create a familiarity threat. During the other assignments, Swebo & Co. will have to assess the work of individuals they helped recruit. Swebo & Co. may be or may be perceived to be less likely to criticise or challenge such individuals because this could discredit their recruitment services.

1 mark

Self-review threat

A self-review threat occurs where Swebo & Co. makes management decisions for Mwansa Import & Export Ltd. Swebo & Co. could be seen to be making such decisions by providing recruitment services to Mwansa Import & Export Ltd. The firm could review candidates' CVs and recommend individuals to interview but the final decision of who to recruit should always rest with the client.

1 mark

This threat is increased with the seniority of individuals being recruited. In the case of Swebo & Co. the threat is reduced by only providing services for the recruitment of junior accounting staff.

1 mark

Professional competence

Swebo & Co. does not have much experience in recruitment. Accountants are required to ensure that a client receives competent professional service based on current developments in practice, legislation and techniques and act diligently and in accordance with applicable technical and professional standards. The firm will have to either train or hire staff to assist.

1 mark

Damage to reputation

Swebo & Co.'s reputation could be damaged if the quality of recruitment services is low.

1 mark

[Award marks as indicated – Maximum 7 marks]

(2) Musonko Plc

(a) **Computation of taxable business profits and company income tax payable – 2018**

	K'000	K'000	**Marks**
Profit before capital allowances		5,000	**½**
Less:			
Capital allowances			
Old computer (0 – 4,000)	(4)		**1**
Manufacturing Plant 2,900,000 X 25/29 X 50%	1,250		**1 ½**
Delivery van 120,000 X 25%	30		**1**
Air conditioner 40,000 X 25%	10		**1**
Motor car 60,000 X 1.16 X 20%	14		**1 ½**
Computer 14,000 X 25/29 X 25%	3		**1 ½**
		(1,303)	
Taxable business profits		3,697	

	K'000	
Taxable profit	3,697	**½**
Royalties 850 X 100/85	1,000	**1**
Debenture interest 100 X 100/85	118	**1**

Taxable income	4,815	½

Company income tax

	K'000	
4,815,000 X 28%	1,348	**1**
Less: tax already paid		
Provisional tax	(1,100)	**½**
WHT on royalties 1,000,000 X 15%	(150)	**1**
WHT on debenture interest 118,000 X 15%	(18)	**1**
Company income tax payable	80	**½**

[Award marks as indicated – Maximum 15 marks]

John Nduna

Personal Computation of income tax payable – 2018

	K	**Marks**
Salary	480,000	**½**
Lunch allowance K500 X 50 weeks	25,000	**1**
Education allowance K36,000 X 3 Children	108,000	**1**
Medical allowance K4,000 X 12 months	48,000	**1**
Accommodation allowance K5,500 X 12 months	66,000	**1**
Servant's allowance K2,200 X 12 months	26,400	**1**
Bonus	25,500	**½**
Taxable income	778,900	

Income tax		
39,600 X 0%	0	**½**
9,600 X 25%	2,400	**½**
25,200 X 30%	7,560	**½**
704,500 X 37.5%	264,188	**½**
Income tax liability	274,148	
Less: tax already paid		
PAYE	(212,176)	**½**

Final income tax payable	61,972	½

[Award marks as indicated above – Maximum 9 marks]

(c) Advantages of ZRA e-payment system

The advantages include:

- Faster
- Safer
- Convenient – no more queuing to pay ZRA taxes
- Reliable
- Available 24/7 – you can pay from anywhere, anytime using your electronic device as long as there is internet connectivity

[Award 1 mark for each relevant point – Maximum 3 marks]

(3) Ndalama Ltd

Statement of Cash flow for the year ended 31 March 2018

	K'000	K'000	**Marks**
Net cash flows from operating activities			
Profit before tax	1,314		**½**
Depreciation charge (W2)	795		**2**
Interest expense (net)	200		**½**
Profit on sale of property, plant and equipment (W3)	(200)		**3**
Decrease in inventories	60		**½**
Increase in receivables	(450)		**½**
Decrease in payables	(400)		**½**
Cash generated from operating activities	1,319		
Interest paid	(300)		**½**
Dividends paid	(1,478)		**½**
Tax paid (W4)	(128)		**1**
Net cash flow from operating activities		(587)	

Cash flows from investing activities			
Payments to acquire property, plant and equipment (W1)	(1,875)		**3 ½**
Receipts from sales of property, plant and equipment	800		**½**
Interest received	100		**½**
Net cash flows from investing activities		(975)	
Cash flows from financing activities			
Issue of share capital	1,000		**½**
Long-term loan	560		**½**
Net cash flows from financing		1,560	
Increase in cash and cash equivalents (Note)		(2)	
Cash and cash equivalents at 1.4.2017 (Note)		(180)	
Cash and cash equivalents at 31.3.2018 (Note)		(182)	

[Award marks as indicated – Maximum 15 marks]

NOTES TO THE STATEMENT OF CASH FLOWS

Note. *Analysis of the balances of cash and cash equivalents as shown in the statement of financial position*

	2018	2017	Change *in year*
	K'000	K'000	K'000
Cash in hand	50	70	(20)
Bank overdraft	(232)	(250	18
	(182)	(180)	(2)

[Award 1 mark for the note to the statement of cash flow]

Workings

1 *Purchase of property, plant and equipment*

PROPERTY, PLANT AND EQUIPMENT

	K'000		K'000
1.4.2017 Balance b/d	4,925	Disposals	700
Revaluation (2,200 - 800)	1,400		
Purchases (bal. fig)	1,875	31.3.2018 Balance c/d	7,500
	8,200		8,200

2 *Depreciation charge for the year*

ACCUMULATED DEPRECIATION

	K'000		K'000
Disposal (700 – 600)	100	1.4.2017 Balance b/d	905
31.3.2018 Balance c/d	1,600	Depreciation (bal. fig)	795
	1,700		1,700

3 *Disposal of Machinery*

DISPOSAL

	K'000		K'000
Cost	700	Accumulated depreciation	100
Profit on disposal	200	Bank	800
	900		900

4 *Tax paid*

TAX

	K'000		K'000
Bank (bal. fig.)	128	1.4.2017 Balance b/d	1,000
31.3.2018 Balance c/d	1,200	SOPL	328
	1,328		1,328

(TOTAL: 50 marks)

SECTION B

(4) **Briefing notes**

To: Partner

From: Manager

Re: Ethical conflicts of interest

Introduction

These briefing notes contain an explanation of the potential ethical conflicts of interest which could arise in the preparation of accounting information, how they can be resolved and the consequences of doing nothing as a professional accountant registered with ZiCA.

(i) Ethical conflicts of interest

Ethics in the preparation of business information starts in the individual entity with those responsible for preparing the entity's financial statements. A key role for ZiCA professional accountants is to drive the ethics process from the bottom up, ensuring that the financial statements have been prepared in accordance with accounting standards and present a true and fair view.

Situations may arise in which an accountant might be asked to behave (or might be tempted to behave) in a way that conflicts with ethical standards and guidelines. Conflicts of interest could relate to unimportant matters, but they might also involve fraud or some other illegal activity. Examples of such ethical conflicts of interest are as follows:

- There could be pressure from an overbearing supervisor, manager or director, adversely affecting the accountant's integrity.
- An accountant might mislead his or her employer as to the amount of experience or expertise they have, when in reality the expert advice of someone else should be sought.
- An accountant might be asked to act contrary to a technical or professional standard. Divided loyalty between the accountant's superior and the required professional standards of conduct could arise.

- A conflict of interest could arise when the employer publishes (or proposes to publish) misleading information that will benefit the employer, and may or may not benefit the accountant personally as well.

[Award up to 2 marks for presentation and up to 2 marks for each example (Maximum 6 marks)]

(ii) Resolution of ethical conflicts of interest

Conflicts of interest can arise in so many different ways that it would be difficult to provide a detailed set of guidelines for their resolution.

Accountants faced with conflicts of interest should evaluate their significance. Unless they are so insignificant that they can be ignored, the accountant should consider the safeguards that are available for their elimination or reduction.

For example, it may be possible to:

- Obtain advice from within the employing organisation, an independent professional adviser or a relevant professional body like ZiCA
- Invoke a formal dispute resolution process within the employing organisation
- Seek legal advice.

[Award up to 2 marks for each relevant point – Maximum 6 marks]

(iii) Consequences of doing nothing about the ethical conflicts of interest

ZiCA believes in core values of protecting the public interest and take a zero tolerance view against undisciplined members found wanting. ZiCA has been running the public advisory note adverts in the media that members will from now onwards be required not to turn a blind eye to any acts that contravene the provisions of laws and regulations committed by management, those charged with governance and other relevant stakeholders employed by public or any other entities. This pronouncement has the effect of law and was issued in accordance with the Accountants Act of 2008 in as far as protective disclosure is concerned. The framework is not purposed to be used as witch-hunting exercise by accountants but to increase awareness and understanding among professional accountants of their legal and regulatory responsibilities when they face non-compliance with laws and regulations (NOCLAR – New standard). ZiCA has asked all stakeholders to forward the names of those of its members who are found guilty of professional misconduct to the Institute for disciplinary action.

Confidentiality is an issue here, but it may be overridden by the law, statute or the courts of law.

[Award up to 2 marks for each relevant point – Maximum 6]

(5) **Solutions to illustrations**

(a) **Illustration 1**

The herd of dairy cattle meets the IAS 41 *Agriculture* definition of a biological asset, being a living plant or animal. **1 mark**

IAS 41 requires that a biological asset is recognised by an entity when the entity controls the asset as a result of a past event, it is possible that future economic benefits will flow to the entity and the fair value or cost of the asset can be measured reliably. **1 mark**

Based on the information provided these criteria are met and the company is correct to capitalise the dairy cattle. **1 mark**

A biological asset is initially measured at fair value less costs to sell and the difference between cost and this amount is recognised in profit or loss. In this case fair value less costs to sell at 31 March 2016 is K1,425,000 (600 X K2,500 X 95%). The acquisition is therefore recognised by:

DEBIT	Biological assets	K1,425,000	
DEBIT	Profit/ loss	K75,000	
CREDIT	Cash		K1,500,000

2 marks

A biological asset is subsequently measured at fair value less costs to sell with any resulting gain or loss recognised in profit or loss. At 31 March 2017 fair value less costs to sell is K1,710,000 (600 X K3,000 X 95%) and a gain of K285,000(1,710,000 – 1,425,000) is recognised in profit or loss. At 31 March 2018 fair value less costs to sell is K1,995,000 (600 X K3,500 X 95%) and gain of K285,000 (1,995,000 – 1,710,000) is recognised in profit or loss.

2 marks

There is a presumption that the fair value of a biological asset can be measured reliably. This presumption is rebutted only if quoted market prices for the asset are not available and other fair value measurements are deemed unreliable. In this case a biological asset is measured at depreciated cost.

1 mark

Masomo Agricultural Cooperative has measured its herd at depreciated cost. The extracts of financial statements provided suggests that the herd was initially measured at its cost of K1,500,000 (600 x K2,500) and is being depreciated over a 10-year period. As explained above this treatment is only allowed if quoted prices are unavailable. In this case they clearly are and therefore the treatment applied by Masomo Agricultural Cooperative is incorrect.

2 marks

Statement of financial position (revised)	2018	2017	**Marks**
	K	K	
Biological assets (dairy herd)	1,995,000	1,710,000	**1**

Statement of profit or loss (revised)	2018	2017	
	K	K	
Gain on remeasurement to fair value	285,000	285,000	**1**

[Award marks as indicated – Maximum 12 marks]

(b) **Illustration 2**

The liability component is measured first, and the difference between the proceeds of the bond issue and the fair value of the liability is assigned to the equity component. **1 mark**

The present value of the liability component is calculated using a discount rate of 12%, the market interest rate for similar bonds having no conversion rights, as shown. **1 mark**

	Marks	K
Present value of the principal: K1,000,000 payable at the end of five years		
(K1,000,000 X 0.567)	**1**	567,000
Present value of the interest: K80,000 payable annually in arrears for five		
Years (K80,000 x 3.605)	**1**	288,400
Total liability component		855,400
Equity component (balancing figure)	**1**	144,600
Proceeds of the bond issue		1,000,000

The split between the liability and equity components remains the same throughout the term of the instrument, even if there are changes in the **likelihood of the option being exercised.** This follows the general pattern when accounting for equity instruments that their value is not amended after their initial recognition. **2 marks**

[Award marks as indicated – Maximum 7 marks]

(c) **Illustration 3**

Net selling price is lower than carrying amount, so it is necessary to calculate value in use:

	Marks	K'000
Cash flow Year 1 (40 x 0.935)	**½**	37
Cash flow Year 2 (40 x 0.873)	**½**	35
Cash flow Year 3 (40 X 0.816)	**½**	32
Cash flow Year 4 (40 X 0.763)	**½**	31
Value in use	**1**	135
Carrying amount	**½**	200
Recoverable amount (value in use)	**½**	135
Impaired loss	**1**	65

[Award marks as indicated – Maximum 5 marks]

(d) **Illustration 4**

Statement of profit or loss (extract) for the year ended 31 March 2018

	K	**Marks**
Profit before tax	110,000	**½**
Income tax expense @ 35%	(38,500)	**1**
Profit for the period	71,500	

Statement of other comprehensive income

Profit for the period	71,500	**½**
Gain on revaluation (470,000 – 350,000)	120,000	**1**
Tax relating to revaluation @ 35%	(42,000)	**1**
Other comprehensive income net of tax	78,000	**½**
Total comprehensive income	149,500	

Statement of financial position (extract) as at 31 March 2018

	K	
Non-current assets		
Property (350,000 + 120,000)	470,000	**½**
Non-current liabilities		
Deferred tax	42,000	**½**
Current liabilities		
Current tax	38,500	**½**

[Award marks as indicated – Maximum 6 marks]

(Total: 50 marks)

END OF SOLUTIONS AND MARKING KEY