COMPETENCE PRACTICE EXAMINATION

NON-AUDIT PRACTISING CERTIFICATE

DECEMBER 2020

TIME ALLOWED: 5 HOURS

INSTRUCTIONS TO CANDIDATES

1. This paper has Two Questions.

2. You are required to attempt ALL the two questions

3. Each question has Sections:
   Question one has two sections: A and B

   Question two has two sections: A and B

4. All the two questions carry equal marks.

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

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

7. This is an open book 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%

PRESUMPTIVE TAX FOR TRANSPORTERS

Seating capacity	Tax per annum	Tax per day
	K	K
From 64 passengers and over	10,800	29.55
From 50 to 63 passengers	9,000	24.60
From 36 to 49 passengers	7,200	19.50
From 22 to 35 passengers	5,400	15.00
From 18 to 21 passengers	3,600	9.90
From 12 to 17 passengers	1,800	4.95
Less than 12 passengers and taxis	900	2.40

VALUE ADDED TAX

Registration threshold	K800,000
Standard Value Added Tax Rate (on VAT exclusive turnover)	16%

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%**

NON-AUDIT – QUESTION ONE

PACK AND BASH Co

Your name is Boston Choongwe and you are a manager in Pack and Bash & Co. Pack and Bash & Co specialises in the provision of non-audit services. You have been assigned to deal with 3 clients as follows:

- Makelele University - Accounting Services
- Best Millers Ltd - Working capital management
- Mayela Enterprises - Business incorporation and various tax obligations

MAKELELE UNIVERSITY

The University has been operating in Zambia for the last four years. The University generates annual revenue in excess of K500 million per annum and has adopted the FULL IFRS (International Financial Reporting Standards) as its reporting framework. The university prepares its financial statements to 31st December each year

The University has approached its bankers – ABBSA for a loan to purchase a server, recapitalise its farming activities as well as the construction of a new hostel wing. The negotiations are undergoing with the bank indicating that the profitability and gearing position of the University will be significant in the decision to provide the required financing

The University has a fully functional finance unit headed by a Finance Manager. The Finance Manager is a CA Associate member of ZiCA. The Financial Accountant and other personnel deal with the day to day management and financial accounting requirements. The University uses the PASTEL accounting software

For the year ended 31st December 2020, the Finance Manager is not sure about the implementation of certain standards that have now become applicable to the University. The Finance Manager is keen to comply with the FULL IFRS – at the same time as projecting the affairs of the University in the best possible light

Accordingly, the following issues have arisen as part of the process of providing accountancy and taxation services to the university

a) Leased Assets

In order to exploit the opportunities available with BIG DATA, the University leased a big server from Media Pro at the beginning of the year. The server is housed at the University and the University is responsible for its security, maintenance and insurance.

The initial agreement is for one year. The University intends to be renewing this lease every year until it is able to purchase its own server in four years-time. A loan is being negotiated for this purpose. The terms of the lease are:

- Inception of lease 1st January 2020
- Lease term – annual renewable at K78,864 p.a. payable in arrears
- Present value of future lease payments K250,000 – assuming a 4-year lease
- Interest rate implicit in the 10% - a preferential rate extended to learning institutions
- The useful economic life of the server is estimated at 10 years

The University still applies *IAS 17, Leases* and treats the lease as an operating lease as the one-year lease term is significantly less than the useful economic of the server. Accordingly, the annual lease payment of K78,864 has been expensed to the profit.

The financial accountant is aware of the accounting requirements of *IFRS 16, Leases* and has advised the University to university to implement the new standard. The finance manager has insisted that the University should continue to apply IAS 17, Leases and continue to treat leases of this nature as operating leases. The financial accountant has been told that his promotion depends on him promoting accounting treatments that put the financial position of the University in the best possible light.

b) Revenue

The University operate four semesters as follows:
1st Semester – 1st October – 31st December
2nd Semester – 1st January – 31st March
3rd Semester – 1st April – 30th June
4th Semester – 1st July – 30th September

The University has continued to operate under very strict COVID-19 regulations

Category of Students and revenue contribution

Government sponsored students – 35%

These are students sponsored by the government and their 100% fees are paid by the Bursaries Department.

Given the unpredictability of payments from the government, the Finance Manager has proposed that revenue should be accrued as follows:

50% - should be accrued on enrolment during the first semester
25% - Should be accrued during the second semester
15% - Should be accrued during the third semester
10% - Should be accrued during the last semester

No provision is required as it is expected that the Government will eventually make payments

Company sponsored students – 25%

For company sponsored students, sponsoring companies

- Make advance payments for tuition, board and lodging
- Purchase Makelele Gift cards that allow students to purchase books and other sundry items from the University. These Gift Cards are supposed to be utilised within 3 months of purchase, after which they expire and are not refundable

The Finance Manager has proposed that both the advance payments and gift cards should be recognised as revenue in full from the date the amount is due and from the date the gift card is purchased.

Self-sponsored students: 40%

These students are sponsored by their parents or guardians. These students are required to pay their annual fees in 12 equal instalments. Throughout 2019, the University did not experience any problems with the payments. However, since the onset of COVID-19, the University noted a significant level of defaults. At the beginning of September 2020, it was clear that 40% of the students would not be able to pay their fees for COVID related reasons

The Finance Manager has proposed that the University should continue to recognise revenue receivable from the 40% students as Covid-19 will pass at some stage.

Although the Financial Accountant has expressed concern on the proposed accounting treatment for revenue, he has been reminded of the need to show improved revenue and profitability for the purpose of securing financing from the bank

c) Production Unit

As part of the agricultural development economics syllabus, the university runs a production unit to provide practical training to students. The produce from the unit is used in the canteen and any excess is sold on the open market.

The unit has expanded to include the following activities:

a) Gardening – a variety of vegetables
b) Maize Production
c) Goat Reproduction

Goat Reproduction

This is a recent venture and the following transactions have taken place since the beginning of the year

On 1 January 2020, Makalele University had a herd of 100 goats, all of which were 2 years old. At this date, the fair value less point of sale costs of the herd was K10,000. On 1 July 2020, the university purchased 20 goats (each two and half years old) for K60 each

As at 31 December 2020, three- year old cows are expected to sell at market for K90 each.

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

REQUIRED

In relation to the finalisation of the financial statements of Makelele University for the year ended 31st December 2020

a) Explain the FOUR main differences between the new requirements of IFRS 16, Lease and the previous IAS 17, Leases – from the perspective of the University as a lessee (8 marks)

b) Advise the University how the leasing transaction should be accounted for and prepare expected relevant financial statement extracts for the year ending 31 December 2020 (10 marks)

c) Comment on the treatment applied to the fees receivable during the year. Support your answer with reference to applicable International Financial Reporting Standards – IFRS
   i) Government sponsored students – (3 marks)
   ii) Company sponsored students – Advance payments (4 marks)
   iii) Company sponsored students – Gift Cards (5 marks)
   iv) Self-sponsored students - (4 marks)

d) Identify and explain FOUR ethical and other professional issues arising from the accounting treatment applied to the lease and revenue, taking into account the comments from the Finance Manager of Makelele University (10 marks)

e) For the production unit of the university:
   i) Discuss whether the income generated from its production unit activities should be included as part of the University Revenue (3 marks)

ii) **Assuming the reproduction of goats is considered as part of the extended business of the University, discuss the accounting treatment to be applied to the goats for the year ended 31st December 2020, including relevant financial statement extracts** **(4 marks)**

f) **In relation to BIG DATA**
   i) **Comment on the opportunities available to the University** **(3 marks)**
   ii) **Comment on the challenges of utilising BIG DATA** **(3 marks)**
   iii) **Comment on the potential ethical issues arising from the use of BIG DATA** **(3 marks)**

BEST MILLERS LIMITED (BML)

BML has been your client for the last three years. You have provided them with accountancy and taxation services. The manager of the plant, Mr. Israel Tampa, is not an accountant He has recently attended a course on working capital management organised by the Zambia Institute of Chartered Accountants (ZiCA)and is now very keen to apply what he has learn to the plant

He is particularly interested in establishing the importance of working capital management to a milling plant, as well as assessing the working capital position of BML

The table below gives information extracted from the annual financial statements of BML for the past year.

BML - Extracts from annual accounts:

- Inventories:
    - Raw materials K108,000
    - Work in progress K75,600
    - Finished goods K 86,400
- Purchases of raw materials K518,400
- Cost of production K675,000
- Cost of goods sold K756,000
- Sales K864,000
- Receivables K172,800
- Payables K 86,400

REQUIRED:

a) **Explain the meaning and importance of working capital management for a business such as BML** **(4 marks)**

b) **Assuming 365 days in a year, determine the following working capital ratios for BML**
   i) **Receivable days** **(2 marks)**
   ii) **Payable days** **(2 marks)**
   iii) **Raw material days** **(2 marks)**
   iv) **Work-in-progress days** **(2 marks)**
   v) **Finished goods** **(2 marks)**

c) **Based on the ratios computed above, comment on the quality of working capital management for BML and recommend appropriate action that should be taken** **(6 marks)**

MAYELA ENTERPRISES

Mayela Enterprises has been running as a sole trader operating five night clubs located in Chilenje, Matero, Mutendere, Kabwata as well as Chainda. Mr.Mayela is the sole proprietor. Each night club is housed in a spacious rented property complex. Apart from income from night clubs, ME also receives a monthly management consultancy fee for being the database manager for all affiliated night clubs in Zambia. The database provides access to the latest music and re-known DJ's in Zambia and in the region

Until the onset of COVID-19, these night clubs have been operating profitably and this measure of success has prompted Mr. Mayela to consider the following growth options:

1. Start operating a fleet of taxis and minibuses – under Mayela Auba

2. Incorporate another retail business – Mayela Trading(MT)
   MT will also open a retail outlet which will be registered for VAT in one of the following business sectors:
   i) Where all the supplies she will make will be zero rated for VAT purposes or;
   ii) Where all the supplies she will make will be standard rated for VAT purposes or;
   iii) Where all the supplies she will make will be exempt for VAT purposes.

   The annual sales are estimated at K900,000, excluding VAT. MT is considering applying for VAT registration immediately, where applicable. In any of the three sectors that MT is considering, the VAT inclusive annual purchases and expenses are expected to be K464,000.

   All the purchases and expenses will be directly attributed to the supplies in each respective sector.

   MT would like to find out the VAT implications, if it were to trade in a sector where the company would make both taxable and exempt supplies and incur overheads that would not be directly attributed to neither taxable nor exempt supplies.

Mr Mayela has decided to seek advice from your firm before proceeding with these ventures.

REQUIRED

a) Advise Mr Mayela of the potential tax obligations relating to the fleet of taxes (5 marks)

b) With regard to MT and VAT:

i) Explain to Mr Mayela whether, he will be required or be permitted to register for VAT in each of the three business sectors, and outline the tax consequences of being registered for VAT. (9 marks)

ii) For each of the business sectors that are being proposed, calculate the estimated annual amount of VAT payable or repayable. (6 marks)

TAXATION TABLE

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STANDARD PERSONAL INCOME TAX RATES

Income band	Taxable amount	Rate
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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%**

PRESUMPTIVE TAX FOR TRANSPORTERS

Seating capacity	Tax per annum	Tax per day
	K	K
From 64 passengers and over	10,800	29.55
From 50 to 63 passengers	9,000	24.60
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From 18 to 21 passengers	3,600	9.90
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VALUE ADDED TAX

Registration threshold	K800,000
Standard Value Added Tax Rate (on VAT exclusive turnover)	16%

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 TWO

MDM & Co

You name is Lumwena Maini, and you are an assistant director in MDM & Co, a non-audit firm registered with the Zambia Institute of Chartered Accountants (ZiCA) specialised in providing accountancy and taxation related services. Your firm also provides training for non-finance executives.

Mr. Michael Daka is the Managing Director

For the year 2020, you have been allocated the following assignments

- ZIM ELECTRICAL - Various
- Bwacha Transportation Services – Cash flow statement
- Mobile Bonanza - Zambia Revenue Authority – Tax Inspection

ZIM ELECTRICAL LTD (ZEL)

ZEL has recently been incorporated in Zambia and is owned by three Zambians and Mr. Ezra Chinduzi from Zimbabwe. The mission statement of ZEL reads

"To manufacture and assemble electrical appliances for sale and export within the COMESA region"

Mr. Chinduzi has been appointed as Chief Operating Officer (CEO). Last week, ZEL appointed MDM & Co as its accounting and taxation advisers.

Your Managing Director, Mr Daka has just received the following email from Mr Chindunzi, which he has passed on to you for action

To	**:**	**Mr. M Daka**
From	**:**	**Ezra Chinduzi – CEO - ZEL**
Subject	**:**	**Various**

Mr. Daka

It was a delight to have the opportunity to conclude our business relationship last week. As you are aware, I am originally from Zimbabwe. As CEO of ZEL, part of my remit is to have hands-on knowledge of strategic issues that are likely to affect our company. For now, I seek your expert guidance in the three areas:

- Fiscal policy management
- Transfer pricing
- Reporting Framework

Fiscal policy management.

In Zimbabwe, the fiscal policy is managed by a government ministry, in conjunction with the central bank and the Zimbabwe Revenue Authority. As ZEL it is in our interest to appreciate the fiscal management framework that operates in Zambia

Transfer Pricing

As ZEL trades with associated companies within the region, I am not sure about the practice of transfer pricing in Zambia and whether it is regarded as a tax evasion or tax avoidance mechanism.

Reporting Framework

I also understand there are three reporting frameworks in Zambia that can be used as a basis for the preparation of financial statements. As ZEL we are not sure which one may be applicable to us

Best Regards

EC

Required

Write briefing notes in which you

a) **Briefly explain the role of the Ministry of Finance in the Fiscal policy management in Zambia (3 marks)**

b) **In relation to Transfer Pricing**
   i) **State how transfer pricing may be used for tax avoidance (3 marks)**
   ii) **State the current requirements to prevent companies from using transfer pricing for tax avoidance (4 marks)**

c) **Explain the reporting framework applicable in Zambia and recommend which one may be appropriate for ZEL (5 marks)**

BWACHA TRANSPORTATION SERVICES Ltd

Mr. Haggrey Bwacha has been operating BTS services for several years now. He recently attended a finance for non-executive officers conducted by your firm. He now has a good appreciation of the following components of financial statements which are always prepared by his accountant

- Statement of financial position
- Statement of profit or loss and other comprehensive income
- Statement of changes in equity

Form the workshop, he has now become aware that there is another statement – the cash flow statement – which his accountant has never prepared as he has never considered it necessary.

He is now interested in a cash flow statement prepared for BTS for the year ended 31st December 2020 and also would like to appreciate the benefits that such a statement would bring to BTS.

He has provided you with the following

Statement of profit or loss and other comprehensive income for the year ended 31st March

	2020	2019
	K'000	K'000
Revenue	31,000	25,000
Cost of sales	(21,800)	(18,600)
	----------	----------
Gross profit	9,200	6.400
Distribution costs	(3,600)	(2,400)
Administration expenses	(2,200)	(1,600)
Finance costs	(400)	(350)
	---------	----------
Profit before tax	3,000	2,050
Income tax	(1,000)	(750)
	---------	--------
Profit for the year	2,000	1,300
Other comprehensive income	1,350	0
	---------	--------
	3,350	1,300
	=====	=====

Statement of financial position as at 31st March	**2020**	**2019**
	K'000	**K'000**
Non-current assets		
Property, Plant and Equipment	14,000	10,700
Deferred development expenditure	1,000	0
	---------	---------
	15,000	10,700
Current assets		
Inventory	3,300	3,800
Receivables	2,950	2,200
Bank	50	1,300
	---------	---------
	21,300	18,000
	=====	=====
Equity		
8,000 Equity shares of K1 each	8,000	8,000
Revaluation reserve	1,350	nil
Retained earnings	3,200	1,750
	--------	--------
	12,550	9,750
Non-Current liabilities		
8% loan notes	1,400	3,125
Deferred tax	1,500	800
Finance lease obligation	1,200	900

	--------	--------
	16,650	14,575
Current liabilities		
Finance obligations	750	600
Trade payables	2,650	2,100
Current tax payable	1,250	725
	--------	---------
	21,300	18,000
	======	=====

Notes

1. On 1 July 2019, BTS acquired additional plant under finance lease that had a fair value K1.5 million. On this date it also revalued its property upwards by K2 million and transferred K650,000 of the resulting revaluation reserve this created to deferred tax. There were no disposals of non-current assets during the period. The capitalisation of the additional plant is in accordance with *IFRS 16 Leases*

2. Depreciation of property, plant and equipment was K900,000 and amortisation of the deferred development expenditure was K200,000 for the year ended 31 March 2020

3. The recomputed cash generated from operating activities for 2019 has been determined at K2.5million

Required:

a) Prepare the cash flow statement for BTS for the year ended 31 March 2020 **(20 marks)**

b) Analyse the cash flow performance of BTS for the year ended 31 March 2020 **(7 marks)**

c) Explain to Mr Bwacha:
- **i) The difference between a cash and profit** **(4 marks)**
- **ii) The benefits of a cash flow statement to his business** **(4 marks)**

MOBILE BONANZA

Magic Lumpa is self-employed running a mobile phone shop- Mobile Bonanza. The business of Mobile Bonanza is buying and selling mobile phones and providing related services such as repair.

For a long time now, Mr Lumpa has relied on Bupe Lende to deal with all the accounting and taxation issues for Mobile Bonanza. Bupe is part qualified accountant having just completed a Diploma in Accountancy with the Zambia Institute of Chartered Accountants (ZiCA). Apart from being in charge of finance and administration, Bupe prepares financial statements and submits all the required tax returns to the Zambian Revenue Authority (ZRA). Mr Lumpa is a degree holder in Economics and Business Administration

In the current year, Mr Lumpa approached his bank – Light Finance Bank– for a bank overdraft to tidy him over the trying Covid-19 period. The bank promised to extend the facility if the bank balance as at the end of 31st December was at least K80,000.

Mr Lumpa instructed Bupe to make sure that the balance in the cash book at the end of the month of December was at least K80,000. Bupe explained to Mr. Lumpa that this would amount to window dressing and was against professional rules to present misleading information to users. Mr. Lumpa reminded Bupe that his job depended upon him helping Mobile Bonanza to secure required financing.

Being a student member of ZiCA, Bupe's is fully aware of the ethical and other professional issues arising from the request to manipulate the cash book and he is afraid that he may be cited for professional misconduct. Bupe has therefore since resigned

In the meantime, Mr. Lumpa has received a visitation from the tax inspection department of the Zambia Revenue Authority (ZRA) with a number of queries relating to the tax returns submitted for the year ended 31st December 2019. This is a routine inspection where the ZRA selects tax payers at random and requests for detailed evidence and workings to verify figures and information submitted on returns.

For Mobile Bonanza, evidence and workings is being sought for the following figures appearing on the tax returns for 2019 and correspondence with the ZRA

ITEM	**DESCRIPTION**	**AMOUNT (Kwacha)**
1	Provision income tax paid	240,810
2	Capital allowances – Motor vehicles	25,450
3	Capital allowances – Furniture and equipment	11,100
4	Capital allowances – Commercial Buildings – Old Mobile shop- Balancing figure	(170,000)
5	Capital allowances – Commercial Buildings – New Mobile shop	24,000
6	Tax adjusted business profit	632,500
7	Taxable business profit	741,950
8	Income Tax payable (Paid on 21st September 2020)	19,481
9	Penalty	2,922
10	Interest	864
11	Property transfer tax	95,000

Mr. Magic Limpa has now approached your firm to help with the tax inspection queries and other accountancy matters– since Bupe Lende is no longer in the employ of Magic Shops

You have been provided with the relevant information to support the computation of

- Provision tax
- PAYE
- Tax adjusted profits
- Capital allowances

a) Provision tax

For the tax year 2019, Magic paid provisional income tax that was calculated on an amount of provisional income of K690,000. The whole of this amount of provisional income was made up of provisional business profit from the Mobile shop.

b) PAYE

In February 2019, Magic got employment as a part time lecturer in Economics and Business Administration music at Unilus University. He was paid at a gross rate of K540 per session and he had a total of 120 sessions in the period from February 2019 to 31 December 2019. The university deducted income tax of K24,300 from Magic's salary under the Pay As You Earn system. The University paid the income tax to the Zambia Revenue Authority on the appropriate due dates.

The Bank of Zambia discount rate for the year ended 31 December 2019 is 15.75% per annum.

c) Tax adjusted profits

The profit before tax for the year ending 31st December was K392,00. This amount was arrived after taking into account the following expenses.

Description	**Amount** K
Depreciation	52,800
Motor expenses (20% relates to private journeys as agreed with ZRA	294,000
Professional fees - Personal financial advice	10,800
Repairs and renewals – Cost of new printer	11,900
Travelling and entertaining- entertainment of suppliers	9,600
Wages and salaries (Paid to Mrs Lumpa in excess of normal rates)	80,000
Subscription to squash club for Magic Lumpa	14,200
Donation to a political party – Patriotic Forward Party	1,200

Other information

Drawings and Private telephone use

During the year, Magic took mobile phones out of the Mobile shop for his personal use without paying for them, and no entry has been made in the accounts to record this. The goods cost K12,000, and had a selling price of K19,000.

Magic uses his private telephone to make business telephone calls. The total cost of the private telephone for the year ended 31 December 2019 was K13,600, and 25% of this related to business telephone calls. The cost of the private telephone was not included in arriving at the profit after tax of K392,000

Magic also uses one of the six rooms in his private house as an office when he works at home. The total running costs of the house for the year ended 31 December 2019 were K86,400, which have not been included in the statement of profit or loss.

d) Capital Allowances

Investments – Buildings, Motor vehicles and furniture and equipment

i) Buildings

On 31 August 2019, Magic sold his shop for K1,900,000 to an unconnected third party. The disposal proceeds of K1,900,000 include the disposal proceeds attributed to the land of K500,000. Magic purchased this Mobile shop on 1September 2009 for K1,100,000, including the cost of land of K250,000. Magic had always used the Mobile shop for business purposes throughout the period of its ownership and at 1 January 2019, the Mobile shop had an income tax value of K680,000 for capital allowances purposes.

Magic does not manufacture any Mobile phones and related products

On 1 August 2019, Magic had relocated his business into a new Mobile shop that he had constructed at a cost of K1,850,000, including land costing K650,000. Construction of the new Mobile shop commenced in May 2018 and completion was in June 2019

ii) Motor vehicles

The income tax values for capital allowances purposes at 1 January 2019 were as follows:

	K
Old Delivery Van	56,250
Magic's Camry motor car	30,000

The purchase costs of the above assets were:

- K75,000 for the old delivery van,
- K50,000 for Magic's Camry motor car

Transaction during the year ended 31 December 2019 were as follows:

Date	**Transaction**	**Cost/ (proceeds)** **K**
1 February 2019	**Bought Magic's BMW motor car for**	**70,000**
1 March 2019	**Sold old delivery Van for**	**(50,000)**

Magic used both the Camry motor car and the BMW motor car for both business and private purposes and agreed with the Commissioner General that 20% of the mileage done by Magic during the year ended 31 December 2019 related to private journeys

iii) Furniture and Equipment

The income tax values for capital allowances purposes at 1 January 2019 were as follows:

	K
Old office furniture	5,000
Old office computer	1,500

The purchase costs of the above assets were:

- K20,000 for the old office furniture

- K6,000 for the old office computer.

Transaction during the year ended 31 December 2019 were as follows:

Date	**Transaction**	**Cost/ (proceeds)**
		K
30 June 2019	**Bought new office furniture for**	**36,000**
1 August 2019	**Sold old office furniture for**	**(9,000)**
1 November 2019	**Bought a new office computer for**	**6,500**

Required:

a) In relation to the circumstances leading to Bupe Lende resigning
   - **i) Identify and describe FOUR ethical and other professional issues arising (8 marks)**
   - **ii) Describe the sanctions that ZiCA would impose on a member found with a case of professional misconduct (4 marks)**

b) Determine how the provision Income Tax paid of K240,810 for the year 2019 was arrived and prepare a schedule showing the due dates when the payments were made (5 marks)

c) Determine how the capital allowances were computed for each of the following for the year 2019
   - **i) Motor vehicles = K25,450 (4 marks)**
   - **ii) Furniture and Equipment = K11,100 (5 marks)**
   - **iii) Commercial buildings – Old Mobile shop - Balancing charge = (K170,000) (2marks)**
   - **iv) Commercial buildings – New Mobile shop = K24,000 (2 marks)**

d) Determine how the tax adjusted profit of K632,500 and the taxable business profit of K741,950 were arrived at (8 marks)

e) For the income tax payable. Determine how:
   - **i) The income tax payable of K19,481 was computed (4 marks)**
   - **ii) The penalty of K2,922 was computed (2 marks)**
   - **iii) The interest of K864 was computed (2 marks)**

f) During the year, Magic disposed of the old delivery van, office equipment and the Mobile shop. Advise Magic on the Property Transfer Tax issues arising and show how the property transfer tax of K95,000 was arrived at (4 marks)

Zambia Institute of Chartered Accountants

Competence, Integrity and Virtue

COMPETENCE PRACTICE EXAMINATION

NON-AUDIT PRACTISING CERTIFICATE

SUGGESTED SOLUTIONS

DECEMBER 2020

TIME ALLOWED: 5 HOURS

INSTRUCTIONS TO CANDIDATES

8. This paper has Two Questions.
9. You are required to attempt ALL the two questions
10. Each question has Sections:
    Question one has two sections: A and B

    Question two has two sections: A and B
11. All the two questions carry equal marks.
12. The Examination is divided into sessions of $2^1/_2$ hours each. There will be a 30 Minutes break in between the sessions.
13. Please use your Membership number and your National Registration Card number on the front of the answer booklet. Your name must NOT appear anywhere on your answer booklet.
14. This is an open book examination.

NON-AUDIT

SUGGESTED SOLUTIONS

QUESTION ONE

MAKELELE UNIVERSITY

g) differences between the new requirements of IFRS 16, Lease and the previous IAS 17, Leases – from the perspective of the University as a lessee

	IFRS 16 – Leases (Lessee accounting)	IAS 17 – Leases (Lessee accounting)
1	**Period of the Lease**	
	The period of the less is irrelevant. The main criteria for determining type of lease is based on the transfer of the right to use and control the asset	A lease period which substantially the same as the estimated useful life of the related asset is an indicator of a Finance lease. A period of less than 12 months assumed to be an operating lease
2	**Election for leases less than 12 months or of low value assets**	
	The lessee can elect to account for leases of low value or of less than 12 months as operating leases and account for lease payments on a straight line over the term of the lease	No such election was available
3	**Basic criteria for lease classification**	
	The transfer of the right of use and control of the asset regardless of the period and amount of the lease payments	Transfer of economic benefits (rewards) and associated risks to the lessee and the net present of the minimum lease payments is approximately the same as the fair value
4	**Direct costs**	
	Now capitalised as part of the cost of the asset where the right of use and control of the asset has been transferred – but not included in the lease obligation	Expensed in the profit and loss
5	**Depreciable assets**	
	Capitalised asset depreciated over the lease term	Capitalised asset depreciated over the shorter of the lease term and the estimated useful economic life

h) Accounting for leasing transaction

According to IFRS 16, Lease, a transfer that transfers the right of use and control should be capitalised in the books of the lessee based on the net present value of lease payments

In the scenario, Makelele University is responsible for the security, maintenance and insurance costs of the server which is housed and its premises. This implies that this is a finance lease which initially should be accounted as below:

Financial statement extracts:

Profit or loss and Other Comprehensive Income

	2020 (Kwacha)
Depreciation (wkg1)	62,500
Interest (wkg2)	25,000

Statement of Financial Position

		2020 (Kwacha)
Non-current Assets		
PPE - Server: Cost		250,000
: Acc. Depreciation		(62,500)

		187,500
		======
Non-current liabilities		
Obligations under leases	(196,136-59250)	136,886
Current liabilities		
Obligations under finance leases	(78,864-19,614)	59,250

Workings

Wkg 1

At inception of the lease

Dr. Asset – PPE 250,000

Cr. Liability 250,000

Asset to be depreciated over 4 years

250,000/ 4 = 62,500 per annum

Wkg 2

Liability

Year end December	Opening Balance	Interest at 10%	Sub-total	Instalment	Closing balance
2020	250,000	25,000	275,000	(78,864)	196,136
2021	196,136	19,614	215,750	(78,864)	136,886

i) Accounting treatment for fees receivable

i) Government sponsored students

According to IFRS 15 Revenue from Contracts with Customers, revenue should be recognised when or as a performance obligation is satisfied by transferring the promised good or service to the customer.

For each performance obligation that is satisfied over time, revenue is recognised by measuring progress towards completion of that performance obligation. This is achieved based on either:

- ***Output methods -*** These include appraisals of results, milestones reached, units produced and units delivered, or
- ***Input methods -*** These include resources consumed, labour hours expended, costs incurred, time lapsed or machine hours used.

Only those goods or services for which the vendor has transferred control of are included in the assessment of progress to date.

For each separate performance obligation, the same input or output method of assessing progress to date is required to be used. The same method is also required to be applied consistently to similar performance obligations and in similar circumstances.

As the University satisfies its obligation for each semester and at the end of the year, it seems that the input method of revenue recognition should be used AND not the arbitrary percentages prescribed by the Finance Manager

According to IFRS 9 Financial Instruments, non-payment is an indicator that the outstanding receivables are credit impaired. A loss allowance should be recognised equivalent to the difference between the gross carrying amount of the receivables and the present value of the expected future cash flows receivable from the Government. Any increase or decrease in the loss allowance is charged to profit or loss.

The contention that Government will make the payment is not supported by accounting standards

ii) Company sponsored students – Advance payments

According to IFRS 15 Revenue from Contracts with Customers, revenue should be recognised when or as a performance obligation is satisfied by transferring the promised good or service to the customer.

For each performance obligation that is satisfied over time, revenue is recognised by measuring progress towards completion of that performance obligation. This is achieved based on either:

- ***Output methods -*** These include appraisals of results, milestones reached, units produced and units delivered, or
- ***Input methods -*** These include resources consumed, labour hours expended, costs incurred, time lapsed or machine hours used.

Only those goods or services for which the vendor has transferred control of are included in the assessment of progress to date.

Accordingly, the amounts received in advance should be treated as deferred income until the performance obligation has been satisfied.

iii) Company sponsored students - Gift cards

IFRS 15 Revenue from Contracts with Customers says that revenue should be recognised when or as a performance obligation is satisfied by transferring the promised good or service to the customer. When a customer buys a gift card they are pre-paying for a product. Revenue cannot be recognised because the entity has not yet transferred control over an asset and so has not satisfied a performance obligation.

As such, cash received in respect of gift cards should be initially recognised as a contract liability.

IFRS 15 refers to a customer's unexercised rights as breakage. The guidance for variable consideration is followed when estimating breakage. In other words, the expected breakage is included in the transaction price if it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur once the uncertainty is subsequently resolved. This means that if the company is unable to reliably estimate the breakage amount, then revenue for the unused portion of the gift card is recognised when the likelihood of the customer exercising their remaining rights becomes remote.

However, if the entity is able to reliably estimate the breakage amount, then it recognises the expected breakage amount as revenue in proportion to the pattern of rights exercised by the customer.

For the University, revenue should be recognised at the end of the expiry period comprising:
– The redeemed value of the gift card
– The expired value of the gift card

iv) Self-sponsored students

According to IFRS 15, an entity should only account for revenue from a contract with a customer when it meets the following criteria:
- The contract has been approved;
- Rights regarding goods and services can be identified;
- Payment terms can be identified;
- It is probable the seller will collect the consideration it is entitled to.

As such, it would seem that the above criteria were met except for the 40% of the students with effect from September 2020.

Whether a contract with a customer meets the above criteria is only reassessed if there is a significant change in facts and circumstances.

From September 2020, it is assessed that 40% of the self-sponsored students will not able to make payments. As such, it was no longer probable that the University would collect the consideration it was entitled to. From September 2020, no further revenue from these students be recognised. Any amounts

According to IFRS 9 Financial Instruments, non-payment is an indicator that the outstanding receivables are credit impaired. A loss allowance should be recognised equivalent to the difference between the gross carrying amount of the receivables and the present value of the expected future cash flows receivable from the students. Any increase or decrease in the loss allowance is charged to profit or loss.

j) Ethical and other professional requirements

The following ethical and other professional issues arise from the accounting treatment proposed by the finance manager

Revenue recognition Off balance sheet finance– Professional Behaviour

Professional accountants are required to comply with all applicable laws, regulations and accounting standards. The proposed accounting treatments are not in accordance with the requirements of *IFRS 16, Leases* and *IFRS 15, Revenue from Contracts with Customers*

Intimidation – Promotion of Financial Accountant

Although the Financial Accountant has questioned the accounting treatments being proposed by the Finance Manager, he has been threatened that he would not be promoted. This is intimidation and is not considered professional behaviour

Integrity – Dishonesty

The Finance Manager is blatantly dishonesty as he is aware that his proposed accounting treatments are not in accordance with the adopted reporting framework. Accountants are required to be forthright and sincere in their dealings

Misleading users – reputation risk – Provision of finance

The purpose of preparing financial statements is to provide useful information to a wide range of users, including banks. To be useful, information should be relevant and should be faithfully presented. This implies that there should not be any deliberated intent to mislead the users.

The Finance Manager of Makelele University is aware that discussions are underway to provide finance to the University based on the profitability and gearing ratios.

The proposed accounting treatments are likely to overstate profitability and understate gearing and will not result in faithful presentation of the profitability and gearing of the company.

k) Production unit activities

i) Income

According to IFRS 15, Revenue from Contracts with Customers, the revenue is that generated from the ordinary activities of the business for which it was established. The University was established to provide academic education to its clients and not as a farming enterprise. In any case, the production unit activities are designed to supplement academic education and not as a source of revenue

Accordingly, any revenue realised from the agricultural activities should be treated as other income

ii) Goat Reproduction – Accounting treatment

According to *IAS 41, Agriculture*, biological assets are initially and subsequently measured at fair value less point of sale costs. The difference between the initial and subsequent recognition is transferred to the profit or loss – whether gain or loss

Goats are biological assets and should therefore initially be measured at fair value less costs to sell

The Goats purchased in the year should initially be measured at K1,176 (K20 * 60) * 98%. This will give rise to an immediate loss of K24 ((20 * K60) - K1,176 in the statement of profit and loss

At the year end, the whole herd of goats is 3 years of age and should be re-valued to fair value less costs to sell. Any gain or loss will be recognised in the statement of profit or loss

The herd of Goats will be held at K10,584 ((120 * K90)) * 98% on the statement of financial position

This will give rise to a further loss of K592 (W1) in the statement of profit or loss

Financial statement extracts:

Statement of financial position as at 31 December 2020
Non-Current Assets

Biological assets	10,584

Profit or loss for the year ended 31st December 2020

Loss on valuation of goats	(24 + 592)	614

(W1) Loss on revaluation

	K
Value at 1 January 20X1	10,000
New purchases	1,176
Loss (bal. Fig)	(592)
Value at 31 December 20X1	10,584

l) **BIG DATA**

i) **Opportunities available to the University re BIG DATA**

- **Transparency creation: -** Creating data transparency within the University enables data to be shared more easily among departments. For example, data from research and development, engineering, and other faculties can be integrated to enable concurrent product and service re-engineering, reducing time to market and improving quality

- **Performance improvement**: - Big data can provide more accurate and detailed performance data in real-time or near real-time, allowing managers to analyze performance and understand causes of performance compared to plans and expectations such as course costs and profitability

- **Population segmentation:** - In respect of market segmentation and customisation - While market segmentation has been used for years, big data can provide highly specific segmentations enabling production of tailored courses and related services

- **Decision making support**: - Increasingly sophisticated analytics can be employed using big data to support decision makers in minimizing risks and finding new insights, thus improving the decision making process. For example, by automating the decision making process relating to the performance of various academic programs

ii) Challenges of utilising BIG DATA

Despite the examples of the use of big data in commerce, particularly for marketing and customer relationship management, there are some potential dangers and drawbacks.

- **Cost**: It is expensive to establish the hardware and analytical software needed, though these costs are continually falling. In the context of the University, it has become necessary to secure a server at a significant cost

- **Regulation:** Some countries and cultures worry about the amount of information that is being collected and have passed laws governing its collection, storage and use. Breaking a law can have serious reputational and punitive consequences.

- **Loss and theft of data**: Apart from the consequences arising from regulatory breaches as mentioned above, companies might find themselves open to civil legal action if data were stolen and individuals suffered as a consequence.

- **Incorrect data (veracity)**: If the data held is incorrect or out of date incorrect conclusions are likely. Even if the data is correct, some correlations might be spurious leading to false positive results.

iii) Ethical issues arising

The following ethical issues arise from the utilisation of BIG DATA

Veracity – integrity
One of the of the characteristics of BIG DATA is the term veracity – which suggests that the information may not be true. Using false information exposes the University to integrity and other adverse conditions. Professional accountants are required to be sincere and truthful

Confidentiality – disclosure of information
Professional rules of confidentiality place restrictions on the use and sharing of information. The use of BIG DATA may expose the University to questions of confidentiality

Professional behaviour – laws and regulations
The use of BIG DAT may be protected by laws and regulations and it is not always possible to recognise this. This exposes the University to unprofessional behaviour which requires compliance to all applicable laws and regulations

BEST MILLERL LIMITED

a) Importance of working capital

Increased profitability is one of the primary goals of financial managers. Without an acceptable level of profitability, businesses will find it very difficult, if not impossible, to survive in the long run. Managers are therefore continuously adopting and adapting strategies to improve profitability.

And one of such strategies is through working capital management. Working capital is a financial metric which indicates the operating liquidity of a milling company such as BML. Working capital is seen as a part of an organization operating capital, referring to as current assets such as cash at hand, cash in bank, raw materials, work in progress, finished goods and accounts receivable. Management of working capital which aims at maintaining an optimal balance between each of the working capital components, that is, cash, receivables, inventory and payables is a fundamental part of the overall corporate strategy to create value and is an important source of competitive advantage in businesses. In practice, it has become one of the most key performance indicators, especially from processing and manufacturing companies such as BML

The major purpose of working capital management is to keep sufficient liquidity to sustain operations and to meet obligations. Hence, traditionally, efficiency of working capital management is based on the principle of speeding up collections as quickly as possible and slowing down disbursements as slowly as possible in order to minimize the risk of having insufficient funds to pay for the short term liabilities.

However, holding too much liquidity will work to reduce the risk at the cost of decreased profitability. This trade-off between profitability and risk is the key to working capital management which aims at maintaining a balance between liquidity and profitability while conducting the day-to-day operations of a business

b) Working Capital ratios and Operating cycle

Ratio	Calculation	Days
Receivable days	172,800 ---------- X 365 days 864,000	73
Inventory days – Finished goods	86,400 ---------- X 365 days 756,000	42
Inventory days – Work-in-progress	75,600 ---------- X 365 days 675,000	41
Inventory days – Raw materials	108,000 ---------- X 365 days 518,400	76
		---------- 232
Less: Payable days	86,000 ---------- X 365 days 518,400	(61)
Net Operating Cycle		------ 171 =====

c) Comment

BML is taking 159 days between purchase of raw materials and conversion into finished goods. It then takes another 73 days between selling and collections from receivables. In the meantime, it is expected to pay for raw materials within 61 days. This is before any collections are made. This clearly puts BML under severe strain to raise the required liquidity to settle payables – suggesting that it has to source this money elsewhere

Additionally, the inventory holding of 73 days for raw materials appear inordinately too long a period before the commencement of the conversion process.

The quality of working capital management at BML requires improvement.

Recommendation

To improve its working management BML would need to consider:

a) Holding as less inventory as possible between purchase and conversion. This can be achieved by utilising just-in-time principles – in collaboration with suppliers. This should be combined with a more efficient inventory management system – the EOQ (Economic Order Quantity) model can be utilised for this purpose

b) Improving the conversion process from the current 83 days. A value chain analysis should be carried out to determine value adding and value destroying activities within the conversion process

c) Reducing the receivable days and increasing the payable days by utilising the principle of speeding up collections as quickly as possible and slowing down disbursements as slowly as possible in order to minimize the risk of having insufficient funds to pay for the short term liabilities.

MAYELA ENTERPRISES

a) Fleet of taxis and minibuses

Mr. Mayela will be expected to pay presumptive tax on the fleet of taxis and minibuses- depending on capacity as follows:

The rates below apply

Type of vehicle(sitting capacity)	**Amount of tax per vehicle per annum effective 1st June 2018**	**Tax per day**
64 seater and above	K10,800	K29.95
50-63 seater	K9,000	K24.60
36-49	K7,200	K19.50
22-35	K5,400	K15.00
18-21	K3,600	K9.90
12-17	K1,800	K4.95
Below 12 seater (including taxis)	K900	K2.40

Mr. Mayela will be required to:

- Comply with the law by registering for presumptive tax at the nearest ZRA office or using the e-services
- Pay the applicable presumptive tax regularly preferably on a weekly or monthly basis to avoid accumulating tax arrears

- Obtain a Tax Clearance Certificate from ZRA as a pre-requisite for obtaining a licence from the Road Transport and Safety Agency (RTSA)

b) Value Added Tax (VAT)

i) Sector implications

1) If Mr. Mayela commenced in business in a sector where all his supplies will be zero rated for VAT purposes, he will be permitted to register for VAT because zero rated supplies are taxable supplies and the turnover of these supplies excluding VAT is expected to exceed the registration limit of K800,000 for a twelve-months period.

2) If Mr. Mayela commenced in business in a sector where all his supplies will be standard rated for VAT purposes, he will be required to register for VAT because his VAT exclusive taxable turnover is expected to exceed the registration limit of K800,000 for a period of twelve months.

3) If MR. Mayela commenced in business in a sector where all his supplies are exempt supplies for VAT purposes, he will not be required to register for VAT because traders who make exempt supplies cannot register for VAT.

If MR. Mayela was to register for VAT, the consequences would be as follows:

a) He will be required to issue a tax invoice for all supplies he makes.
b) He will be required to charge VAT on all taxable supplies that he makes.
c) He will be required to recover input VAT where applicable.
d) He will be required to file VAT returns and pay VAT by the 16th day of every month in respect of the previous month.

ii) VAT computations for the tax year 2020

1) If Mayela commenced a business in a sector where all his supplies are zero rated

	K
Output tax K900,000 x 0%	0
Less recoverable input tax K464,000 x 4/29	(64,000)

VAT repayable	(64,000)
	======

2) If Mayela commenced a business in a sector where all his supplies are standard rated

	K
Output tax K900,000 x 16%	144,000
Less recoverable input tax K464,000 x 4/29	(64,000)

VAT payable	80,000
	======

3) If Mayela commenced in business in a sector where all his supplies are exempt supplies, he will not charge VAT and he will not be able to recover his input VAT. Therefore, he will not have any VAT payable or repayable.

MDM & Co

ZIM ELECTRICAL LIMITED (ZEL)

Briefing notes

Subject : Fiscal Policy Management in Zambia – Role of Ministry of Finance, Transfer Pricing and New revenue measures

Introduction

The purpose of these briefing notes is to:

- Highlight the role of the Ministry of Finance in the Fiscal Policy management in Zambia
- Transfer pricing – tax avoidance and current rules
- Financial Reporting Framework for Zambia

a) Role of the Ministry of Finance in Fiscal management

The Ministry of Finance derives its mandate from the Constitution of Zambia (Amendment) Act, 2016 Part XVL. It is also guided by statutory and portfolio functions stipulated in the Government Gazette Notice No. 76 of 2016. The Ministry of Finance is charged with the responsibility of economic management to foster sustainable national development. Through the Economic Management Department (EMD), the Ministry of Finance plays a pivotal role in the fiscal policy of Zambia:

- To put in place or design a macroeconomic policy framework that would facilitate sustainable economic growth and stability.
- To develop effective monetary and fiscal policies that would guide domestic resource mobilization, as well as Government medium and long-term expenditure.
- To spearhead economic monitoring and analysis in consultation with national financial institutions and other government agencies.
- To undertake and co-ordinate external financial resource mobilization.

b) Transfer Pricing

i) Meaning and Tax avoidance

Transfer prices are the prices at which different but associated or related entities trade. Entities often acquire other companies to establish market advantage in their industry or achieve it through organic growth. Market advantage can be achieved through lowering the cost of raw material, acquiring, developing intellectual property and other intangible assets to strengthen the longevity of their business. For example, to minimize its input costs, Trade Kings Zambia can have a subsidiary in South Africa that sells raw materials to Trade Kings Zambia.

Through Transfer Pricing, entities located in high-tax jurisdictions can "transfer the prices" of income and expenses and shift their income to a low-tax jurisdiction in order to avoid or reduce taxation. This transfer is done by selling goods and/or services to affiliates in the low-tax jurisdictions at cheaper rates resulting in low revenues for the high-tax jurisdiction company and high revenues and profits in the low tax jurisdiction.

Correspondingly, the high-tax jurisdiction company purchases goods and/or services from low-tax jurisdiction affiliates at a high price resulting in high expenses for the high-tax jurisdiction company.

These transactions all result in income tax avoidance.

ii) Current requirements

Zambia's Transfer Pricing Rules provide for the application of the 'arm's length principle' to controlled transactions. This means that the results of a controlled transaction should be consistent with the results that would have been realised in a comparable transaction between independent persons dealing under comparable conditions.

Section 97A of the Income Tax Act and the Transfer Pricing Regulations require that assessable (taxable) income of a person is calculated on the basis that the arm's length principle is applied in relation to all controlled transactions. In cases where the conditions of a controlled transaction are not in accordance with the arm's length principle, then the taxpayer must make the appropriate adjustments to ensure that the assessable income of such a person is calculated in accordance with the arm's length principle.

Where a calculation of assessable income is not in accordance with the arm's length principle and the result is that the measure of assessable income is understated, or a measure of assessable loss is overstated, then the Commissioner-General shall make the necessary adjustment to calculate the assessable income in a manner consistent with the arm's length principle. The most appropriate transfer pricing method must be used to determine arm's length conditions, or to test whether arm's length conditions have been applied.

Recently, the Tax Appeals Tribunal (TAT) issued a decision for the Zambia Revenue Authority ("ZRA") in the case of: **Nestlé Zambia Trading Limited v. Zambia Revenue Authority [2018] TAT 03**, regarding transfer prices used with respect to its cross-border related-party transactions and business model. The decision provides the first substantive judicial guidance in Zambia with respect to arm's length arrangements between related parties.

c) Reporting Framework

Zambia uses a three-tier Financial Reporting Framework. Entities are required to use one of the three frameworks depending on the type the entity. Under the three tier financial reporting framework, Entities are categorized as follows:

No.	Type of Entity	Financial Reporting Framework
1.	Listed Companies, Public Interest Entities and Government Owned Enterprises	Full IFRS
2.	Economically Significant Companies – companies that are not public companies or quoted on the stock exchange with turnover of K20 million and above.	IFRS for SMEs or Full IFRS if the Company opts to use it

No.	Type of Entity	Financial Reporting Framework
3.	Micro and Small Entities – entities with Turnover of less than K20 million.	Zambian Financial Reporting Standard for Micro and Small Entities

ZEL is a limited company and intends to conduct its operations within the region. Given this profile it would seem appropriate that ZEL adopts Full IFRS. ZEL will be expected to operate more on international based standards.

BWACHA TRANSPORTATION SERVICES Ltd (BTS)

BTS

a) BTS – Statement of cash flows for the year ended 31 March 2020:

	K'000	K'000
Cash flows from operating activities:		
Profit before tax		3,000
Adjustments for:		
depreciation of non-current assets		900
amortisation of non-current assets		200
finance costs		400
decrease in inventories (3,800 – 3,300)		500
increase in receivables (2,950 – 2,200)		(750)
increase in payables (2,650 – 2,100)		550
Cash generated from operations		4,800
Finance costs paid		(400)
Income tax paid (w (i))		(425)
Net cash from operating activities		3,975
Cash flows from investing activities:		
Purchase of property, plant and equipment (w (ii))	(700)	
Deferred development expenditure (1,000 + 200)	(1,200)	
Net cash used in investing activities		(1,900)
Cash flows from financing activities:		
Redemption of 8% loan notes (3,125 – 1,400)	(1,725)	
Repayment of finance lease obligations (w (iii))	(1,050)	
Equity dividend paid (w (iv))	(550)	
Net cash used in financing activities		(3,325)
Net decrease in cash and cash equivalents		(1,250)
Cash and cash equivalents at beginning of period		1,300
Cash and cash equivalents at end of period		**50**

Workings

(i) Income tax paid

		K'000
Provision b/f	– current	(725)
	– deferred	(800)
Tax charge		(1,000)
Transfer from revaluation reserve		(650)
Provision c/f	– current	1,250
	– deferred	1,500
Balance – cash paid		(425)

(ii) Property, plant and equipment

	K'000
Balance b/f	10,700
Revaluation	2,000
New finance lease	1,500
Depreciation	(900)
Balance c/f	(14,000)
Balance – cash purchases	(700)

(iii) Finance leases

Balances b/f	– current	(600)
	– non-current	(900)
New finance lease		(1,500)
Balances c/f	– current	750
	– non-current	1,200
Balance cash repayment		(1,050)

(iv) Equity dividend

	K'000
Retained earnings b/f	1,750
Profit for the year	2,000
Retained earnings c/f	(3,200)
Balance – dividend paid	(550)

b) Analysis of cash performance

Cash from operating activities

BTS has made profits of K3 million from its operating activities during the year from which it has managed to generate K4.8 million cash. This is a favourable position which is supported by a favourable net working capital position of K300,000

This performance appears much better than last year when only K2.5 million cash was generated from operating activities

Cash from investing activities

BTS has invested K700,000 in property, plant and equipment and K1.2 million in the development of new projects. This would seem to be an excellent achievement and bodes well for future periods. Also, it seems likely that some of the improvement is due to the development project coming on stream (as it is being amortised) and generating revenues. These factors are likely to increase revenue generation in future.

With little long term financing during the year, it is safe to assume that all the investments were financed internally from cash generated from operating activities, which is a more favourable position

Cash from financing activities,

At the beginning of the period BTS started with long term debt of more than K4.6 million. This has been reduced to K3.350m, including repayment of liabilities from finance leases arising during the year. In addition, BTS has managed to pay dividends of K550,000 which indicates a favourable financing position.

Again it appears that the financing has been reduced substantially from cash generated from operating activities

Conclusion
BTS started with a favourable cash and cash equivalent balance of K1.3 million, but with a higher level of debt. By the beginning of the year the cash position has been reduce to only K50,000 but with a significant level of new investments, reduction in debt and payment of a dividend.

Overall, although the cash and cash equivalent position has reduced from the previous year, it is fair to say the BTS has performed reasonably well. The seemingly surplus cash from the previously year has been wisely invested and used to reduce debt

c) Cash and profit

i) Difference between cash and profit

Profit may also be referred to as net income, and can be defined as revenue less expenses. It is arrived by the application of the accruals and matching concept where expenses are accounted for when incurred and not paid and income accounted for when earned and not when received

Cash flow, on the other hand, refers to the money coming in and the money going out for a particular business. Earning revenue does not always bring in cash immediately, and incurring an expense does not always mean that you need to pay out cash immediately.

According to *IAS 7 Cash flow statements,* cash and cash equivalents represent bank and cash balances at hand and other short term investments that can be redeemed at short notice and at little or no additional cost

ii) Benefits of cash flow statement

- Cash flow Statements help in knowing the liquidity / actual cash position of BTS which funds flow and P&L are unable to specify.
- As the liquidity position is known, any shortfalls can be arranged for or excess can be used for the growth of the business
- Any discrepancy in the financial reporting can be gauged through the cash flow statement by comparing the cash position of both.
- Cash is the basis of all financial operations. Therefore, a projected cash flow statement will enable the management to plan and control the financial operations properly.
- Cash Flow analysis together with the ratio analysis helps measure the profitability and financial position of business.
- Cash flow statement helps in internal financial management as it is useful in formulation of financial plans.

MOBILE BONANZA

g) In relation to the circumstances leading to Bupe Lende resigning

i) FOUR ethical and other professional issues

There are several ethical and other professional issues arising from the circumstances leading up to Bupe's resignation

Professional Behaviour
According to ZiCA ethical guidelines, members are required to comply with all applicable rules and regulations and standards. Window dressing is against accounting standards and would amount to unprofessional behaviour. This is would result in unfaithful and misleading information being presented to the users, especially the Light Finance Bank

Integrity
Members are cautioned against associated with clients with negative publicity and questionable integrity. Mr Lumpa's instruction to have the cash balance manipulated places doubts on his integrity.

This would be a good reason to discontinue any professional relationship with Mr. Lumpa. Accordingly, Bupe may be justified in resigning

Intimidation and integrity
Mr. Lumpa has threatened Bupe with losing his job if does not manipulate the cashbook. This is gross intimidation and also further re-enforces Mr. Lumpa's questionable integrity

Potential risk of error
For a long time, Mr. Lumpa has relied on Bupe to deal with accounting and taxation issues of Magic Mobiles. Now that he has resigned, it is likely that the accounting and taxation issues may not be dealt with accurately and may contain errors.

MDM will be expected to approach all work with heightened professional scepticism because of this.

ii) Sanctions that ZiCA would impose on a member found with a case of professional misconduct

Matters of professional misconduct are handled by the Standards & Regulatory Board of the Zambia Institute of Chartered Accountants (ZiCA). The Board is an independent committee of the Council of ZiCA which feeds into the Disciplinary Committee (DC).

The DC is provided for under the Accountants Act No. 13 of 2008 (as amended). The Act empowers the DC to investigate and if necessary hear any allegations of improper conduct against a member and if found guilty, to impose one of the prescribed punishments that include:

- A caution
- A reprimand
- A fine not exceeding 100,000 penalty points
- Removal of the member's name from the register of members

h) Computation of provision Income Tax paid of K240,810 for the year 2019

	K
Provisional income	690,000
Provisional Income Tax	
On the first K39,600 x 0%	0
On next K9,600 x 25%	2,400
On next (K25,200 x 30%)	7,560
On the balance (K690,000 – K74,400) x 37.5%	230,850

Provisional Income Tax paid	**240,810**
	=======

Schedule of payments

Due date	**Amount K**
10 April 2019: 25% x K240,810	60,202
10 July 2019	60,202
10 October 2019	60,203
10 January 2020	60,203

Total provisional income tax paid	**240,810**
	======

i) Capital Allowances for the year 2019

i) Motor vehicles = K25,450

	K	**Capital Allowances K**
<u>Old Delivery Van</u>		
Income Tax Value b/f	56,250	
Disposal	(50,000)	

Balancing Allowance		6,250
<u>Camry Motor Car</u>		
Wear and Tear Allowance 20% x K50,000	10,000 x 80%	8,000

BMW Motor Car		
Wear and Tear Allowance 20% x K70,000	14,000 x 80%	11,200

Total		25,450
		======

ii) Furniture and Equipment = K11,100

	K	Capital Allowances K
Old office furniture		
Income Tax Value b/f	5,000	
Disposal	(9,000)	

Balancing Charge		(4,000)
Old Office Computer		
Wear and Tear Allowance 25% x K6,000		1,500
New Office Furniture		
Wear and Tear Allowance 25% x K36,000		9,000
New Office Computer		
Wear and Tear Allowance 25% x K6,500		1,625
Office Printer		
Cost (K13,400 – K1,500)	11,900	
Wear & tear allowance (K11,900 x 25%)	(2,975)	2,975

	36,550	
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Total		11,100
		======

iii) Commercial buildings – Old Mobile shop - Balancing charge = (K170,000)

	K	Capital Allowances K
Old Mobile Shop		
Income Tax Value b/f	680,000	
Disposal (K1,100,000 – K250,000)	(850,000)	

Balancing Charge		(170,000)

iv) **Commercial buildings – New Mobile shop = K24,000**

	K	Capital Allowances K
Total Construction Cost	1,850,000	
Less cost of land	(650,000)	

Qualifying cost	1,200,000	

Wear and Tear Allowance 2% x K1200,000		24,000

j) **Computation of the tax adjusted profit of K632,500 and the taxable business profit of K741,950**

	K	K
Net profit as per accounts		392,000
Add: Depreciation	52,800	
Motor car Expenses 294,000x 20%	58,800	
Personal financial planning advice	10,800	
Cost of computer printer	11,900	
Entertaining suppliers	9,600	
Excess salary- Mrs Lumpa	80,000	
Magic' Squash Club subscription	14,200	
Donation to political party (PF)	1,200	
Goods for personal use	19,000	

		258,300

		650,300
Less: Use of office at home (K86,400 x 1/6)	14,400	
Private telephone (K13,600 x 25%)	3,400	

		(17,800)

Tax adjusted business profit		**632,500**
Capital allowances		
Capital allowances on Motor vehicles (See part ©i)	25,450	
Furniture and Equipment (See cii)	11,100	
Old Mobile Shop (See ciii) – Balancing charge	(170,000)	
New Mobile shop (See civ)	24,000	

		109,450

Taxable business profit		**741,950**
		=======

k) **Income tax payable, penalty and interest**

i) **The income tax payable of K19,481 was computed**

	K
Taxable business profit (part d)	741,950
Emoluments from part time employment (K540 x 120)	64,800

	806,750
	=======

On the first K39,600 x 0%	0
On next K9,600 x 25%	2,400
On next (K25,200 x 30%)	7,560
On excess(K806,750 – K74,400) x 37.5%	274,631

	284,591
Less: tax already paid	
Provisional income tax	(240,810)
Pay As You Earn (PAYE)	(24,300)

Income tax payable	19,481
	======

ii) How the penalty of K2,922 was computed

Magic paid the income tax of K19,481 on 21 September 2020, this was overdue by three months because the due date is 21 June 2020. The consequences of this late payment result in penalty and interest charges

A penalty at the rate of 5% of the unpaid tax per month or part thereof will be charged.

The amount of penalty would be = 5% x K19,481 x 3 = K2,922

iii) How the interest of K864 was computed

Interest on over-due tax will also be charged at the Bank of Zambia discount rate plus 2% per annum. The rate of interest on overdue tax will be 15.75% + 2% = 17.75%.

The amount of interest charged will be = 17.75% x K19,481 x 3/12 = K864

l) Property Transfer Tax issues arising and show the property transfer tax of K95,000

The Property Transfer Tax issues are as follows:

i) In respect of the disposal of the old delivery van on 1 March 2019, Magic is not required to pay Property Transfer Tax because motor vehicles are not chargeable property for the purposes of Property Transfer Tax.

ii) In respect of the disposal of the office furniture on 1 August 2019, Magic is still not required to pay Property Transfer Tax because office furniture is not chargeable for the purposes of Property Transfer Tax.

iii) In respect of the disposal of the music shop on 1 November 2019, Magic is required to pay Property Transfer Tax because the disposal of a music shop is a transfer of property.

The realized value is the actual disposal proceeds amount of K1,900,000 and the Property Transfer Tax payable is = 5% x K1,900,000 = K95,000.