MAY 2019

Q & A

FINAL LEVEL

Contents

EXAMINATION	**:**	**FINAL LEVEL**
SUBJECT	**:**	**CORPORATE REPORTING**
CODE	**:**	**C1**
EXAMINATION DATE	**:**	**WEDNESDAY, 8TH MAY 2019**
TIME ALLOWED	**:**	**THREE HOURS (9:00 A.M. – 12:00 NOON)**

GENERAL INSTRUCTIONS

1. There are **TWO** Sections in this paper. Sections **A** and **B** which comprise **SIX** questions.
2. Answer question **ONE** in Section **A.**
3. Answer **ANY THREE** questions in Section **B.**
4. In total, answer **FOUR** questions.
5. Show clearly all your workings in the respective answers where applicable.
6. Calculate your answers to the nearest one decimal point where necessary.
7. This question paper comprises **11** printed pages.

SECTION A
Compulsory question

QUESTION 1

(a) On 1st January 2019, DJ Co. acquired 75% of Loo Co's equity shares by means of a share exchange of two shares in DJ Co. for every three Loo Co. shares acquired. On that date, further consideration was also issued to the shareholders of Loo Co. in the form of a TZS.100,000, 8% loan note for every 100 shares acquired in Loo Co. None of the purchase consideration, nor the outstanding interest on the loan notes at 31st March 2019, has been recorded by DJ Co. At the date of acquisition, the share price of DJ Co. and Loo Co. is TZS.3,200 and TZS.1,800 respectively.

The following is the Statements of Financial Position of the two Companies as at 31st March 2019:

Assets	**DJ Co. TZS. '000,000'**	**Loo Co. TZS. '000,000'**
Non-Current assets		
Property, Plant and equipment (note (i))	75,200	31,500
Investment in AM Co. at 1st April 2017 (note (iv))	4,500	nil
	79,700	31,500
Current assets		
Inventory (note (iii))	19,400	18,800
Trade receivables (note (iii))	14,700	12,500
Bank	1,200	600
	35,300	31,900
Total assets	**115,000**	**63,400**
Equity and liabilities		
Equity		
Equity shares of TZS.1,000 each	50,000	20,000
Retained earnings – at 1st April 2018	20,000	19,000
Retained earnings for year ended 31st March 2019	16,000	8,000
	86,000	47,000
Non-current liabilities		
8% loan notes	5,000	nil
Current liabilities		
Accounts payable	24,000	16,400
	29,000	16,400
Total equity and liabilities	**115,000**	**63,400**

The following information is relevant:

(i) At the date of acquisition, the fair values of Loo Co.'s assets were equal to their carrying amounts. However, Loo Co. operates a mine which requires to be decommissioned in five years' time. No provision has been made for these decommissioning costs by Loo Co. The present value (discounted at 8%) of the decommissioning is estimated at TZS.4 billion and will be paid five years from the date of acquisition (the end of the mine's life).

(ii) DJ Co.'s policy is to value the non-controlling interest at fair value at the date of acquisition. Loo Co.'s share price at that date can be deemed to be representative of the fair value of the shares held by the non-controlling interest.

(iii) The inventory of Loo Co. includes goods bought from DJ Co. for TZS.2.1 billion. DJ Co. applies consistent mark-up on cost of 40% when arriving at its selling prices.

On 28th March 2019, DJ Co. dispatched goods to Loo Co. with a selling price of TZS.700,000,000. These were not received by Loo Co. until after the year end and so have not been included in the above inventory at 31st March 2019.

At 31st March 2019, DJ Co.'s records showed a receivable due from Loo Co. of TZS.3 billion, this differed to the equivalent payable in Loo Co.'s records due to the goods in transit.

The intra-group reconciliation should be achieved by assuming that Loo Co. had received the goods in transit before the year end.

(iv) The investment in AM Co. represents 30% of its voting share capital and DJ Co. uses equity accounting to account for this investment. AM Co.'s profit for the year ended 31st March 2019 was TZS.6 billion and AM Co. paid total dividends during the year ended 31st March 2019 of TZS.2 billion. DJ Co. has recorded its share of the dividend received from AM Co. in investment income (and cash).

(v) All profits and losses are assumed to accrue evenly throughout the year.

(vi) There were no impairment losses within the group for the year ended 31st March 2019.

REQUIRED:

Prepare the consolidated Statement of Financial Position for DJ Co. as at 31st March 2019. **(20 marks)**

(b) Chui Ltd acquired majority shareholding in Pundamilia Ltd. and settled the consideration both in cash and a share issue at acquisition date which was 1st December 2017. At that date, there was an option on the remaining Non-Controlling Interest (NCI), which could be exercised at any time up to 31st December 2019. On 30th April 2019, Chui acquired the remaining NCI which related to the purchase of Pundamilia. The payment for the NCI was structured such that it contained a fixed initial payment and a series of contingent amounts payable over the following two years. The contingent payments were based on the future profits of Pundamilia up to a maximum amount. Chui felt that the fixed initial payment was an equity transaction. Additionally, Chui was not sure whether the contingent payments were equity, financial liabilities or contingent liabilities.

After a board discussion which resulted into disagreement about the accounting treatment, Chui is preparing to disclose the contingent payments in accordance with IAS 37: *Provisions, contingent liabilities and contingent assets*. The disclosure will include the estimated timing of the payments and the directors' estimate of the amounts to be settled.

REQUIRED:

Advise Chui on the difference between "equity", "liability", and "contingent liability" and on the proposed accounting treatment of the contingent payments on acquisition of the NCI of Pundamilia. **(10 marks)**

(c) Papa is a holder of 60% of equity interest in Nyangumi since 2016. It disposed off an 8% equity interest in Nyangumi at 30th April 2018 for a cash consideration of TZS.54 million.

REQUIRED:

Explain how the sale of the 8% interest in Nyangumi should be dealt with in the group financial statements for the year ended 30th April 2018. You should assume that Papa obtained control over Nyangumi by virtue of holding majority of the equity interest. **(6 marks)**

(d) "Full" consolidation (as opposed to proportionate consolidation) is required when a parent controls a subsidiary, even where the parent owns less than 100% of equity interest in the subsidiary entity.

REQUIRED:

State the justification of this requirement with suitable reference from the IASB Conceptual framework. **(4 marks)**

(Total: 40 marks)

SECTION B

There are **FIVE** questions. Answer any **THREE** questions

QUESTION 2

(a) Ngalawa Ltd is an international hotel group that owns and operates a chain of hotels in different countries. You are given the following information relating to transactions conducted by Ngalawa:

(i) One of the hotels owned by Ngalawa is a hotel complex which includes a theme park, a casino and a golf course, as well as a hotel. The theme park, casino and hotel were sold during the year ended 31st May 2017 to Conquest, a public limited Company, for TZS.2 billion but the sale agreement stated that Ngalawa would continue to operate and manage the three businesses for their remaining useful life of fifteen years. The residual interest in the business reverts back to Ngalawa after the fifteen years period. Ngalawa would receive 75% of the profit of the business as operator fees and Conquest would receive the remaining 25%. Ngalawa has guaranteed Conquest that the net minimum profit paid to Conquest would not be less than TZS.150 million.

(ii) Ngalawa has recently started issuing vouchers to customers when they stay in its hotels. The vouchers entitle the customers to a TZS.30,000 discount on a subsequent room booking within three months of issue. Historical experience has shown that only one in five vouchers are redeemed by the customer. At the Company's year end of 31st May 2018, it is estimated that there are vouchers worth TZS.20 billion which are eligible for discount (redemption). The income from room sales for the year is TZS.300 billion and Ngalawa is unsure how to report the income from room sales in the financial statement.

REQUIRED:

Discuss how the above items would be treated in the financial statements of Ngalawa for the year ended 31st May 2018. Include the amounts to be reported in relevant components of financial statements in relation to each of the items.

(10 marks)

(b) International Financial Reporting Standards (IFRSs) are primarily designed for use by publicly listed companies. In many countries, the majority of companies using IFRSs are listed companies. In some other countries, IFRSs are used as national Generally Accepted Accounting Practices (GAAP) for all Companies including unlisted entities. It has been argued that the same IFRSs should be used by all entities or alternatively a different body of standards should apply to Small and Medium Entities (SMEs) and thereafter the IASB published an IFRS for SMEs.

REQUIRED:

(i) Discuss whether it was necessary to develop IFRS specifically for SMEs. **(5 marks)**

(ii) Explain how existing standards could be modified to meet the needs of SMEs. **(5 marks)**

(Total: 20 marks)

QUESTION 3

(a) Mererani Co. sells jewellery through stores in retail shopping centres throughout the country. Over the last two years the company has been experiencing declining profitability and it is wondering whether this is related to the sector as a whole. It has recently subscribed to an agency that produces average ratios across many businesses in the sector.

The latest Financial Statements of Mererani Co. include the following:

Statement of Profit or loss for the year ended 30th September 2018.

	TZS '000,000'	**TZS '000,000'**
Revenue		56,000
Opening inventory	8,300	
Purchases	43,900	
Closing inventory	(10,200)	
Cost of sales		(42,000)
Gross profit		14,000
Operating costs		(9,800)
Finance costs		(800)
Profit before tax		3,400
Income tax		(1,000)
Profit for the year		2,400

Statement of Financial Position as at 30th September 2018

	TZS '000,000'
ASSETS	
Non-current assets	
Property and shop fittings	25,600
Deferred development expenditure	5,000
	30,600
Current assets	
Inventory	10,200
Bank	1,000
	11,200
Total assets	**41,800**

	TZS '000,000'
EQUITY AND LIABILITIES	
Equity	
Equity shares of TZS.1,000 each	15,000
Property revaluation reserve	3,000
Retained earnings	8,600
	26,600
Non-current liabilities	
10% loan notes	8,000
Current liabilities	
Trade payables	5,400
Current tax payable	1,800
	7,200
Total equity and liabilities	**41,800**

Below are the ratios that have been provided by the agency for Mererani Co's business sector based on a year ended on 30th September 2018.

	Sector average
Return On year-end Capital Employed (ROCE)	16.8%
Net asset turnover (total assets less current liabilities)	1.4 times
Gross profit margin	35%
Operating profit margin	12%
Current ratio	1.25:1
Average inventory turnover	3 times
Trade payables' payment period	64 days
Debt to equity	38%

The deferred development expenditure relates to an investment in a process to manufacture artificial precious gems for future sale by Mererani Co. in the retail jewellery market.

REQUIRED:

(i) Prepare for Mererani Co. the equivalent ratios to those provided by the agency. **(4 marks)**

(ii) Assess the financial and operating performance of Mererani Co. in comparison to its sector averages. **(5 marks)**

(iii) Explain four possible limitations on the usefulness of the above comparison. **(3 marks)**

(b) There is a need to ensure that management's policies and decisions are environmentally friendly. Similarly, it is desirable that the performance indicators on this front are reported to investors and other stakeholders.
A document entitled 'Sustainability Reporting Guidelines' was published in 1999 by the Global Reporting Initiative (GRI). The GRI is a worldwide, multi-stakeholder network. Diverse groups, e.g. businessmen, civil servants, labourers, investors and accountants, work together in order to create and continuously improve the reporting framework. The involvement of different stakeholders lends the credibility and trust required of a global disclosure framework. The framework is intended for voluntary use by organizations.

REQUIRED:

Explain important performance indicators expected to be reported regarding environment and social factors under Global Reporting Initiative (GRI).

(8 marks)
(Total: 20 marks)

QUESTION 4

(a) IAS 33: *Earnings Per Share (EPS)* requires listed entities to disclose basic earnings per share as well as diluted earnings per share. In calculating diluted earnings per share, any financial instrument which potentially dilutes earnings per share should be taken into account.

REQUIRED:

State the importance of disclosing Diluted Earnings Per Share (DEPS).

(2 marks)

(b) You are given the following information for Mazombi, a Company whose shares are traded on a stock market.

Accounting data for the year ended 31st May 2018:

Profit after tax and non-controlling interest	TZS.18,000,000
Ordinary shares of TZS.1,000 (fully paid)	TZS.40,000,000
Average fair value for year of ordinary shares	TZS.1,500

(1) Share options have been granted to directors giving them the right to subscribe for ordinary shares between 2019 and 2021 at TZS.1,200 per share. There were 2,000 options outstanding at 31st May 2018.
(2) Mazombi has TZS.20 million of 6% convertible bonds in issue: The terms of conversion of the bonds per TZS.250,000 nominal value of bond at the date of issue (1st May 2012) were:

31st May 2018	24 shares
31st May 2019	23 shares
31st May 2020	22 shares

None of the bonds have as yet been converted.

(3) There are 1,600 convertible preference shares in issue. The cumulative dividend is TZS.100 per share and each preference share can be converted into two ordinary shares. The preference shares can be converted in 2020.

(4) Assume a tax rate of 30%.

REQUIRED:

According to IAS 33: *Earning Per Share (EPS),* calculate the basic and diluted EPS for the year ended 31st May 2018. **(12 marks)**

(c) For enterprises that are engaged in different business with differing risks and opportunities, the usefulness of financial information concerning these enterprises is greatly enhanced if it is supplemented by information on individual business segments.

REQUIRED:

(i) Explain why the information content of financial statements is improved by the inclusion of segmental data on individual business segments. **(3 marks)**

(ii) Discuss how IFRS 8: *Operating Segments* requires that segments be analysed. **(3 marks)**

(Total: 20 marks)

QUESTION 5

(a) IAS 8: *Accounting Polices, Changes in Accounting Estimates and Errors* lays down criteria for the selection of accounting policies and prescribes circumstances in which an entity may change an accounting policy. The standard also deals with accounting treatment of changes in accounting policies, changes in accounting estimates and correction of errors.

REQUIRED:

(i) Define an accounting policy according to IAS 8 and explain briefly the difference between an accounting policy and an accounting estimate. **(4 marks)**

(ii) Outline the required treatment for:

(1) a change in accounting policy,

(2) a change in accounting estimate and

(3) a correction of an error. **(6 marks)**

(b) You are involved in preparing financial statements of Sigma plc for financial year ended 31st July 2018. During August 2018, prior to the authorization of the financial statements for issue, it was discovered that a fraud had been taking place in the Company for the past three years.

The chief finance officer had been misappropriating monies paid to the Company by its customers. The amount instead continued appearing as receivables. The effect of the fraud was that amount shown in the financial statements as receivables need to be written off as they were in fact paid. There is no prospect of recovering the money as the employee lost it in gambling and is now bankrupt. The amounts were as follows for each period ending on the following dates:

31st July 2016: TZS.14,000,000
31st July 2017: TZS.16,000,000
31st July 2018: TZS.20,000,000

Summarized draft of financial statements for Year ended 31st July 2018 and 2017 comparatives were as follows:

Statement of Profit or Loss and Other Comprehensive Income for year ended 31st July 2018 and 2017

	2018 TZS.'000'	**2017 TZS.'000'**
Revenue	300,000	275,000
Cost of Sales	(225,000)	(212,000)
Gross Profit	75,000	63,000
Expenses	(30,000)	(26,000)
Profit for year	**45,000**	**37,000**

Statements of Changes in Equity (Retained Earnings only) for year ended 31st July 2018 and 2017

	2018 TZS.'000'	**2017 TZS.'000'**
Balance 1st August	258,000	236,000
Profit for the year	45,000	37,000
Dividends declared	(16,000)	(15,000)
Balance 31st July	287,000	258,000

Statements of Financial Position as at 31st July 2018 and 2017

	2018 TZS.'000'	**2017 TZS.'000'**
Non-current Assets	294,000	306,000
Net Current Assets	143,000	102,000
	437,000	**408,000**
Equity Share Capital	150,000	150,000
Retained Earnings	287,000	258,000
	437,000	**408,000**

REQUIRED:

Restate the above figures from financial statements, including comparatives, incorporating the adjustments you deem necessary as a result of the fraud. Ignore the effect of taxation. Disclosure notes are not required. **(10 marks)**

(Total: 20 marks)

QUESTION 6

(a) On 1st April 2018, the Board of Alpha Ltd granted share options to some key employees. The options are subject to vesting conditions. Details of the award are as follows:

About 100 employees will receive 10,000 options each on 31st March 2020. This will allow the employees to purchase the shares of the Company any time during the year ending 31st March 2021. The share has a nominal value of TZS.1,000 per share but the fair value per share will be TZS.30,000. The scheme will be valid only if the employee remains with the Company until 31st March 2020 and the share price is at least TZS.40,000 by 31st March 2020. On 1st April 2018, the price of the share was TZS.30,000. By 31st March 2019, the price had risen to TZS.36,000 and the Board is reasonably confident that the price will reach TZS.40,000 by 31st March 2020.

The management of the Company on 1st April 2018 had estimated that 10 employees would leave the Company in the next 2 years. However, 6 employees left in the year ended 31st March 2019 and management estimates that 6 more will leave in the year to 31st March 2020.

On 1st April 2018, the directors estimated that the fair value of each granted option was TZS.9,000. This estimate had risen to TZS.10,000 by 31st March 2019.

REQUIRED:

Show the impact of granting the share options on the financial statements of Alpha Ltd for the year ended 31st March 2019. Ignore deferred tax. **(8 marks)**

(b) Hopus Ltd is having more than 200 employees under different terms of employment. Some are under temporary terms, some under contract and the rest under permanent terms. For retention purposes, the Company has very attractive remunerations with complex packages including bonus, defined benefits and defined contributions. The accountant of the Company was allowed to outsource the service of a Consultant to advise on some issues related to accounting for defined benefits and defined contribution plans.

REQUIRED:

Advise the accountant on the comprehensive disclosure requirements as per IAS 19: *employee benefits* in relation to the two items above. **(12 marks)**

(Total: 20 marks)

EXAMINATION	**:**	**FINAL LEVEL**
SUBJECT	**:**	**AUDITING AND ASSURANCE**
CODE	**:**	**C2**
EXAMINATION DATE	**:**	**TUESDAY, 7TH MAY 2019**
TIME ALLOWED	**:**	**THREE HOURS (9:00 A.M. – 12:00 NOON)**

GENERAL INSTRUCTIONS

1. There are **TWO** Sections in this paper**.** Sections **A** and **B** which comprise a total of **SIX** questions.

2. Answer question **ONE** in Section **A.**

3. Answer **ANY THREE** questions in Section **B.**

4. In total answer **FOUR** questions.

5. Marks are shown at the end of each question.

6. Presentation, clarity of expression, logic of arguments and the use of lucid English will be taken into account in the assessment of candidates' performance.

7. This question paper comprises **10** printed pages.

SECTION A
Compulsory question

QUESTION 1

(a) Al-amry Co. 'owns' and operates an electric power station, which produces electricity 24 hours a day, seven days a week. The Company's year end is 30th June. You are an audit manager of Hikman & Associates, the auditors of Al-amry Co. The interim audit has been completed and you are reviewing the documentation describing Al-amry Co's payroll system.

Payroll Systems notes
Al-amry Co employs over 250 people and approximately 70% of the employees work in production at the power station. There are three shifts every day with employees working eight hours each. The production employees are paid weekly in cash. The remaining 30% of employees work at the head office in non-production roles and are paid monthly by bank transfer.

The Company has a Human Resources (HR) Department, responsible for setting up all new employees' records. Pre-printed forms are completed by HR for all new employees and, once verified, a copy is sent to the Payroll Department for the employee to be included in the payroll for payment. This form includes the staff employees number and employees payroll cannot set up new department without this information. To encourage staff to attend work on time for all shifts, Al-amry Co. introduced a discretionary bonus, paid every three months, for production staff. The production supervisors determine the amounts to be paid and notify the Payroll Department. This quarterly bonus is entered into the system by a clerk and each entry is checked by a senior clerk for input errors prior to processing. The senior clerk signs the bonus listing as evidence of undertaking this review.

Production employees are issued with clock cards and are required to swipe their cards at the beginning and at the end of their shift. This process is supervised by security staff 24 hours a day. Each card identifies the employee's number and links it with the hours worked report produced by the payroll system, which automatically calculates the gross and net pay along with relevant deductions. These calculations are not checked.

In addition to tax deductions from payroll, some employee's wages are reduced for such items as repayments of student loans owed to the central government. All employers have a statutory obligation to remit funds on timely basis and to maintain accounting records which reconcile with annual loan statements sent by the government to employers. At Al-amry Co. student loan deduction forms are completed by the relevant employee and payments are made directly to the government until the employee notifies HR that the loan has been repaid in full.

On quarterly basis, exception reports relating to changes to the payroll standing data are produced and reviewed by the payroll director. No overtime is worked by employees. Employees are entitled to take 28 days leave annually. Holiday request forms are required to be completed and authorized by relevant line managers, however, this does not always occur. On a monthly basis, for employees paid by bank transfer, the senior payroll manager reviews the list of bank payments and agrees this to the payroll records prior to authorizing the payment. If any errors are noted, the payroll senior manager amends the records.

For production employees paid in cash, the necessary amount of cash is delivered weekly from the bank by a security Company. Two members of the Payroll Department arranges the pay packets, where one is responsible for preparing the pay packets and the other checks and verify them. Both members of staff are required to sign the weekly payroll listing on completion of this task. The pay packets are then delivered to the production supervisors, who distribute them to employees at the end of the week, as they know each member of their production team.

Monthly management accounts are produced which details variances between budgeted amounts and actual. Revenue and key production costs are detailed, however, as there are no overtime costs, wages and salaries are not analysed.

REQUIRED:

(i) In respect of the payroll system for Al-amry Co. identify and explain any four key controls which the auditor may seek to place reliance on. For each control identified, describe a test of control the auditor should perform to assess if the control is operating effectively. **(8 marks)**

(ii) Identify and explain any four deficiencies in Al-amry Co's payroll system and provide recommendations to address each of these deficiencies. **(8 marks)**

(b) Dibal Associate, an audit and assurance firm, has been engaged as auditors for the M & B Bank Ltd, a public limited liability Company for some time now. M & B Bank has sixty branches throughout the country including branches in Dodoma, Mwanza, Tanga and Zanzibar. The Bank is one of the banks in the country which can boast of large landed properties. Dibal Associate receives about 20% of its income from this particular client. Before last year's audit, the bank engaged the audit firm to value its land and buildings in all its branches and headquarters. This work was executed by the audit firm and a report has been issued to management. The report has been incorporated in this year's financial statements to be audited in the near future. Dibal Associate. see M & B Bank Ltd. as a very important client whose works are always executed with dispatch.

REQUIRED:

Identify and evaluate any two significant threats as per the Code of Ethics for Professional Accountants raised in the case and recommend the safeguards to either eliminate or reduce the threats to an acceptable level. **(4 marks)**

(c) You are a partner in Kurwa and Doto Associates, a firm of Certified Public Accountants. You have just been nominated for the audit of Nassir & Nizar Ltd. a catering Company in Tanzania. The Company and its officers are not known to the firm. The Company has just been incorporated and hence have never been audited before. You are considering whether to accept the nomination.

REQUIRED:

Discuss why is it important for auditors to carry out some procedures before accepting such nomination for appointments. **(5 marks)**

(d) Ngezi Ltd enjoyed sales revenue of TZS.400 million and profits of TZS.60 million for the financial year ended 31st December 2017. However, the financial accountant of the firm has recently been dismissed for allegedly misappropriating Company funds. The fraud was carried out over a five-month period in 2017 during which the accountant allegedly colluded with one of the Company's salespersons and with a member of staff in an independent debt collection agency engaged by Ngezi to misappropriate individual sums totaling to TZS.22,200,000 received from some of Ngezi's 1,900 customers.

The fraud was uncovered in the course of a business conversation in March 2018, when the chief executive of Ngezi was hosting a day party for some customers.

The Directors of Ngezi assert that the auditor was negligent in failing to discover the fraud when auditing the financial statements for the year ended 31st December 2017.

The auditors have stated that any system of internal controls has inherent limitations, and that they reject the allegation of negligence. They strongly claim that any reasonable independent review of their audit documentation will confirm that they were not negligent in their audit work.

REQUIRED:

(i) Evaluate the inherent limitations in both internal controls and the audit process itself. **(5 marks)**

(ii) Explain why these limitations may result into failure to detect a fraud even when the audit is properly performed. **(5 marks)**

(e) Auditors have a responsibility to communicate deficiencies in internal control as per the requirements of ISA 265: *Communicating Deficiencies in Internal Control to those Charged with Governance and Management*. In particular, significant deficiencies in internal controls must be communicated in writing to those charged with governance.

REQUIRED:

Explain any five matters the auditor should consider in determining whether a deficiency in internal controls is significant. **(5 marks)**

(Total: 40 marks)

SECTION B

There are **FIVE** questions. Answer **ANY THREE** questions

QUESTION 2

(a) Identify and explain any four financial statement assertions relevant to classes of transactions and events for the year under audit; and for each identified assertion describe a substantive procedure relevant to the audit of revenue.

(8 marks)

(b) Hazogo Enterprises Co (Hazogo) manufactures and distributes fashion clothing to retail stores. Its year ends on 31st March. You are the audit manager responsible for auditing Hazogo and the year-end audit for the year ended 31st March 2019 is due to commence. The following three matters have been brought to your attention:

(i) Supplier statement reconciliations
Hazogo receives monthly statements from its main suppliers and although these have been retained, none have been reconciled to the payables ledger as at 31st March 2019. The engagement partner has asked the audit senior to recommend the procedures to be performed on supplier statements.

(ii) Bank reconciliation
During last year's audit of Hazogo's bank and cash accounts, significant cut off errors were discovered with a number of post year-end cheques being processed prior to the year end to reduce payables. The finance director has assured the audit engagement partner that this error has not occurred again this year and that the bank reconciliation has been carefully prepared. The audit engagement partner has directed the bank reconciliation to be comprehensively audited.

(iii) Receivables
Hazogo's receivables ledger has increased considerably during the year, where the year-end balance is TZS.230 million compared to TZS.140 million last year. The finance director of Hazogo has requested you to no carry out that a receivables circularization as a number of their

customers complained about the inconvenience involved in responding when the exercise was carried out last year. The engagement partner has agreed to this request, and tasked you with identifying alternative procedures to confirm the existence and valuation of receivables.

REQUIRED:

Describe substantive procedures you would perform to obtain sufficient and appropriate audit evidence in relation to each of the above three matters.

(12 marks)
(Total: 20 marks)

QUESTION 3

(a) You as the audit partner of MM Associates, an auditing firm, have been reviewing audit work for one of your clients. During the process, you came across the following proposed audit opinion:

Adverse Opinion on the Financial Statements:
"As more fully explained in note 10, the financial statements include an amount of 96 billion representing the cost of property, plant and equipment. No provision for impairment has been made against these assets and no valuation appraisal has been undertaken by the directors. Published information concerning comparable properties indicates very significant reductions in valuations have been experienced. In our opinion, these circumstances indicate that provision should be made for impairment in values as required by International Accounting Standard 36: Impairment of Assets. Whilst the extent of impairment is subject to factors whose outcome cannot be determined with certainty, based on information relating to comparable properties, the effect of its omission is likely to materially overstate the carrying value of the Group's assets at 31st December 2018; and understate its loss for the year then ended.

In view of the effect of the failure to provide for the impairment referred to above, in our opinion the financial statements do not give a true and fair view, in accordance with …."

REQUIRED:

Critically appraise the appropriateness of this audit opinion. **(7 marks)**

(b) Length of audit reports has undergone some drastic changes ranging from a one paragraph audit report some thirty years ago to about three pages. Three decades ago, a typical statutory audit reports consisted of one paragraph which informed the reader whether or not the financial statements showed a true and fair view, with perhaps a second paragraph to offer explanation if the report was modified in some way. However, for an accounting period beginning on or after 15th December 2016 a typical audit report even for a typical private Company runs to three closely-typed pages even without content specific for a particular client.

REQUIRED:

(i) Explain the reasons for the apparently inevitable lengthening of the audit report in recent decades. **(10 marks)**

(ii) With specific reference to the most recent changes, discuss the extent to which readers have benefited or otherwise as a result of the longer audit report format. **(3 marks)**

(Total: 20 marks)

QUESTION 4

(a) You have been requested by your audit senior to prepare training materials for audit trainees on ISA 560: *Subsequent events*.

REQUIRED:

Prepare a brief presentation which discusses:

(i) The two types of subsequent events, giving examples of each. **(5 marks)**

(ii) The relationship between "going concern" and the "types of subsequent event". **(3 marks)**

(b) Mapato Ltd is one of your audit clients whose financial reporting year ends on 31st July. The financial statements are always due to be approved on 18th September each year.

While reviewing the audit work for the financial year ended 31st July 2018 the following events have come to your attention:

1. On 2nd August 2018, Mapato sold inventory for a price which was less than its cost (the inventory was recorded in the financial statements to 31st July 2018 as closing inventory).
2. Mapato issued new shares on 3rd August 2018.
3. A fire in the warehouse destroyed all of Mapato's inventory on 8th August 2018.
4. A major customer that owed Mapato TZS.150 million at 31st July 2018 was declared bankrupt on 10th August 2018.
5. Mapato purchased an asset for TZS.800 million on 21st August 2018.
6. On 27th August 2018, Mapato's lawyer received a claim from an employee who fell on Mapato's office premises on 1st March 2018. The Lawyer estimates the value of the claim, indicating legal fees, to be TZS.75 million.

REQUIRED:

Review each of the six events above and advise with reasons:

(i) If it is an adjusting or non-adjusting event, and

(ii) The impact of the above events (if any) on Mapato's financial statements. **(12 marks)**

(Total: 20 marks)

QUESTION 5

The audit senior in-charge at A & S Associates, firm of chartered accountants, currently engaged in the audit of Kilimani hotels for the year ended 31st March 2019. Kilimani runs a chain of boutique hotels.

Apart from the overall supervision of the audit, he has been assigned to perform audit procedures over non-current assets, revenue and trade receivables. The following information was gathered during your field work:

Non-current assets

Land and buildings

- Kilimani accounting policy for land and buildings is to revalue them at the end of each five-year period.
- As at 31st March 2019, land and buildings of Kilimani were revalued by independent external valuer at a value of TZS.625 million.
- The value of land and buildings at the previous revaluation in 2014 was TZS.500 million

Kitchen equipment

- An advance of TZS.15 million paid for purchasing new kitchen equipment has been included under plant and machinery. The final installment of TZS.5 million was not paid to the supplier until 15th April 2019 which was the day of delivery of the equipment to the hotel. Kilimani has depreciated this equipment at 20% per annum on a straight line basis.

New restaurant

- During the year Kilimani built a new restaurant at cost of TZS.85 million. This amount has been included in buildings as at 31st March 2019.

  The engagement partner is concerned about the large increase in the value of land and buildings since the last valuation, and decided to get help of Haris, the chief valuer of Hekima Associate, to check the reliability and accuracy of valuation. He is aware that ISA 620: *Using the work of an Expert* could guide him in obtaining assistance from Haris.

Revenue

Kilimani revenue consists of hotel rooms revenue, income from food and beverage and banquet sales.

- Kilimani uses the Hotel Management Services System (HMSS) for front office functions such as processing reservations, guest checking in and out assigning rooms, guest management and billing and the Myacc system as its general ledger application.

- HMSS and Myacc systems are not integrated.

- 80% of the hotel revenues are from room revenue.

- The night shift clerk is responsible for accounting the day's transactions. He extracts revenue reports (text files-in soft copy form) from the HMS system and uploads them to the Myacc-system and believe they are effective.

Trade receivables

- During the last two-year period, a number of Companies and travel agents opened corporate accounts with credit facilities. As such, the trade receivables balance has risen significantly and has now become a material balance.

  The auditor has been asked by the partner to obtain confirmation for all material debtors. He has posted positive confirmation requests to a selected debtor sample. One debtor has called him and provided an oral representation confirming that his balance payable to Kilimani, indicated in the confirmation request is accurate.

REQUIRED:

(a) Discuss any six factors that A & S Associates should consider when placing reliance on the work of Haris. **(6 marks)**

(b) Analyse the acceptability of the accounting treatment adopted by Kilimani for kitchen equipment. **(4 marks)**

(c) Explain any five appropriate substantive procedures that the auditor could perform in order to verify:

(i) Land and buildings and

(ii) New restaurant **(10 marks)**

(Total: 20 marks)

QUESTION 6

(a) The Controller and Auditor General (CAG) is required by the Public Audit Act No.11 of 2008 Section 28 to undertake the Value for Money Audit. Value for money audits are conducted to establish whether the management of an entity has developed appropriate systems and procedures to achieve value for money that is economy, efficiency and effectiveness in their operations.

REQUIRED:

(i) Describe the duties of the CAG in pursuing value for money audit. **(6 marks)**

(ii) Briefly discuss the usefulness of value for money audits in public sector. **(4 marks)**

(b) Saluti is a limited liability Company engaged in manufacturing and selling of high quality garments.

At the beginning of 2018 Saluti's Board of Directors decided to list 80% of its shares on the Dar es Salaam Stock Exchange. The listing was completed by the end of 2018. The management of Saluti has been advised by external auditor about the need for compliance with the corporate governance code and the internal audit function.

Saluti's Board of Directors' structure comprises seven executive directors and two non executive directors. Saluti has approached the following two persons to request them to join the board as non executive directors:

1. Ms Herieth – She is currently the marketing director of multinational company and the sister of Mr. Meremeta, Chief Executive Director of Saluti Company ltd.

2. Mr. Hassan – He is currently the Chief Operation Officer of a listed Company and former manager of operations of Saluti Company ltd. He left Saluti on 30th November 2017.

Salute also intends to form the audit committee. It intends to appoint Ms. Kasheshe who is currently the finance director of Saluti to be the Chairperson of the Audit Committee, as she is a Fellow Certified Public Accountant.

REQUIRED:

(i) Identify any four deficiencies in the Saluti's Board structure and proposed new non-executive directors. **(4 marks)**

(ii) Explain the suitability of Ms. Kasheshe to serve as the Chairperson of the Audit Committee. **(2 marks)**

(iii) State any four factors an entity might consider when assessing the need for an internal audit function. **(4 marks)**

(Total: 20 marks)

EXAMINATION	**:**	**FINAL LEVEL**
SUBJECT	**:**	**BUSINESS AND CORPORATE FINANCE**
CODE	**:**	**C3**
EXAMINATION DATE	**:**	**THURSDAY, 9TH MAY, 2019**
TIME ALLOWED	**:**	**THREE HOURS (9:00 A.M. – 12:00 NOON)**

GENERAL INSTRUCTIONS

1. There are **TWO** Sections in this paper. Sections **A** and **B** which comprise a total of **SIX** questions.
2. Answer question **ONE** in Section **A**.
3. Answer **ANY THREE** questions in Section **B.**
4. In total answer **FOUR** questions.
5. Marks are shown at the end of each question.
6. Show clearly all your workings in the respective answers where applicable.
7. This question paper comprises **7** printed pages.

SECTION A
Compulsory Question

QUESTION 1

(a) Soft Life Limited is a Tanzanian company that had its humble beginning from the idea that people's life experience can be enhanced and good memories created from the dinner tables. This, they believed, could be achieved through the delicious dishes coming out of the kitchens of African homes. Soft Life's role in the pursuit of this belief would be to supply the best ingredients from the locally grown produces from the fertile lands of the local growers. Soft Life's first line of business as they decided was to be in the processing of pastries (baked foods made of dough).

After a series of failed products, Soft Life settled for a wheat flour product they gave brand name 'Yummy' baking flour. Yummy is having a lackluster performance in the market, despite being supplied all over the country for four years now. Soft Life aims to improve domestic performance of Yummy baking flour to make it a dominant household name. On the other hand, Soft Life management is deliberating a plan to introduce Yummy baking flour to Kenya; a market that they believe is large and diversified enough to give them regular business.

Upon visiting an Asian country, the Soft Life Business Development Manager stumbled across an exciting idea of supplying a special product that is used for polishing cake fondants (a candy made of creamy sugar paste used for decorating cakes). A mild market research convinced the manager that though the product is new and virtually unknown to the market, it will nevertheless enjoy a favourable reception since the art of making cakes is now on the rise. The proposed product won approval of Soft Life management and its production was scheduled to commence in few months to come. The Production Manager and his team came up with the name 'Shynit' for the product.

The preliminary marketing objective for Shynit is to first make it available in the domestic market on the ground that Soft Life is already relatively known in the market. Their further objectives include supplying it to Uganda. They all consented that Uganda is having a more enterprising population that might provide the right market for a new product.

Soft Life management want to position itself to be able to capitalize on whatever mistake that is preventing them from achieving their objectives. They have hired you as a Consultant to see them through their challenges.

REQUIRED:

By using Ansoff's model, advise Soft Life management on the strategies they should use to grow their business, specifying at least three actions or approaches they should take to maximize their chances of success for each strategy you propose. **(20 marks)**

(b) Discuss the key characteristics of the maturity stage of a product life cycle. Suggest viable strategic choices for a product in this stage. **(10 marks)**

(c) According to literature, financial planning techniques and models are themselves free of emotion. However, their administration requires education, persuasion and intelligent interpretation. The planning process entails the attainment of goal congruence between the individual employees and the goals of the organization.

The divergences in goals always involve conflicts. This occurs because many behavioural problems related to factors such as inadequate communication, job expectations, performance evaluations, reward, and relationship among the implementers.

REQUIRED:

(i) Explain the nature and extent to which human and behavioral relations affect financial planning and control. **(4 marks)**

(ii) Explain some of the conflicts of interest which could exist between management and employees, and between management and shareholders. **(6 marks)**

(Total: 40 marks)

SECTION B

There are **FIVE** questions. Answer **ANY THREE** questions.

QUESTION 2

(a) Using the exchange rate between the Tanzanian shillings (TZS) and the US dollar (USD) as a case, discuss any four (4) fundamental causes of exchange rate fluctuations. **(10 marks)**

(b) An interest rate swap is to be arranged between Sepide Company, an AA credit rated company, and Everis Company, a BB+ rated company. Sepide Company can borrow at a fixed rate of 10.1% or floating rate at the LIBOR plus 1%. Everis can borrow at a fixed rate of 11.5% or floating rate at the LIBOR plus 1.4%. Mipango Bank is willing to act as an intermediary to facilitate a five year swap. The swap arrangement is summarized below:

Size of the Swap TZS.100 million

Payment to Mipango Bank (Payable by each of the Companies)

- Upfront Fee TZS.50,000
- Annual Fee 0.25% of the Swap Value

The overall swap benefit is to be shared as follows; Sepide Company, 70%; Everis Company, 30%.

REQUIRED:

(i) Evaluate, whether or not an interest rate swap that is beneficial to both firms may be arranged. Ignore taxation. **(3 marks)**

(ii) Calculate the net savings made by each party in each of the first two years of the swap. **(4 marks)**

(iii) Comment on the possible benefits to a company of undertaking an interest rate swap. **(3 marks)**

(Total: 20 marks)

QUESTION 3

(a) Jumbo Limited, a construction company, is planning to acquire new earthmoving equipment at a cost of TZS.10 million. The following alternative sources of finance are being considered:

1. A bank loan for the full cost of the equipment, repayable over four years in equal annual instalments incorporating interest at a rate of 5% per annum, the first instalment to be paid one year from the date of taking out the loan.

2. A finance lease with a monthly lease rental of TZS.223,000. The first rental is payable in advance, followed by further monthly rental payments for the next four years. The equipment would have no residual value at the end of the period of four years.

The Company Secretary has a friend visiting from overseas, who has advised that it would be preferable to lease the equipment rather than buy it. The friend's argument is that leasing would avoid Jumbo's own capital being locked up, since it would be the lessor who would buy and own the equipment. Jumbo Limited is highly geared, and the friend has also suggested that leasing the equipment (instead of borrowing to buy it) would make Jumbo Limited's statement of financial position look better. As an example of the convenience of leasing, the friend points to the rental car they have been using while visiting Tanzania.

REQUIRED:

(i) Calculate the annual instalment that would be payable under the bank loan. Also calculate how much would represent the principal repayment, and how much would represent interest charges, in each of the four years and in total. **(4 marks)**

(ii) What is the before-tax rate of return to the lessor implied by the terms of the proposed lease agreement, and how does it compare with the rate of interest on the bank loan? **(6 marks)**

(iii) Discuss the possible advantages to a company like Jumbo Limited of leasing the equipment rather than acquiring it with a bank loan. **(6 marks)**

(b) Compare and contrast a finance lease and an operating lease as a form of short - to medium term financing. **(4 marks)**

(Total: 20 marks)

QUESTION 4

(a) Over the past few decades, derivatives and derivative markets have grown to be an integral and a significant component of financial markets.

(i) Briefly explain the different categories of participants in derivative markets. **(4 marks)**

(ii) Discuss any three (3) key functions of derivative instruments and markets. **(6 marks)**

(b) Beseni Company is an importer/exporter of heavy machinery for a variety of industries. It is based in Tanzania but trades extensively with the USA. The company does not have separate treasury function and it is part of your duties to assess and manage currency risks. You are concerned about the recent fluctuation in the exchange rate between US$ and TZS and you are considering various methods of hedging the exchange risk involved.

Assume it is now the end of March, 2019. The following transactions are expected on 30th June, 2019:

Sales receipts	US $450,000
Purchases payable	US $250,000

The following information is also available:

- The spot rate of exchange is TZS.2,314 – TZS.2,330 per US$
- The three-month forward rate that will apply for this contract is TZS.2,310 – TZS.2,320 per US$
- Annual interest rates for three months' borrowing are: Tanzania 6 per cent; United States 8 per cent
- Annual interest rates for three months' lending are: Tanzania 4 per cent; United State 6.5 per cent

REQUIRED:

(i) Calculate the net TZS. receipt that Beseni Company can expect from its transactions if the company hedges the exchange risk (after carrying out exposure netting) using each of the following alternatives:

a. The forward foreign exchange market. **(3 marks)**
b. The money market **(4 marks)**

(ii) Recommend the most financially advantageous alternative for Beseni Company. **(3 marks)**

(Total: 20 marks)

QUESTION 5

(a) Explain the concept of securitization, its main objectives and how it is used by financial institutions. **(8 marks)**

(b) In a recent board meeting at Twiga Company, it was deliberated that the Company should raise some finance to cater for planned expansion. The total amount required for expansion is TZS.112,000,000 and is to be raised through a right issue. The new shares will be offered at a 20% discount to the current share price of Twiga Company, which is TZS.35 per share. The rights issue will be on a 1 for 5 basis and issue costs of TZS.2,800,000 will be paid out of the cash raised. The Company has TZS.5 ordinary shares amounting to TZS.100 million and a reserve of TZS.750,000,000. The Company also has an 8% loan notes of TZS.300,000,000.

The net cash raised by the rights issue will be used to redeem part of the loan note issue. Each loan note has a nominal value of TZS.1,000 and an ex interest market value of TZS.1,040. A clause in the bond issue contract allows Twiga Company to redeem the loan notes at a 5% premium to market price at any time prior to their redemption date. The price earnings ratio of Twiga Company is not expected to be effected by the redemption of the loan notes.

The earnings per share of Twiga Company is currently TZS.4.2 per share and total earnings are TZS.84,000,000 per year. The company pays corporate tax of 30% per year.

REQUIRED:

(i) Evaluate the effect of using the net rights issue funds to redeem the loan notes on the wealth of the shareholders of Twiga Company. **(6 marks)**

(ii) Discuss whether Twiga Company might achieve its optimal capital structure following the rights issue. **(6 marks)**

(Total: 20 marks)

QUESTION 6

(a) Working capital management is among key functions in financial management.

REQUIRED:

(i) Briefly discuss the objectives and the central role of working capital management in financial management. **(5 marks)**

(ii) Explain any three policies with regard to the level of investment in working capital. **(5 marks)**

(b) Bravo Company which is based in Britain has two issues that need immediate solutions. The two issues are outlined below:

ISSUE 1
During the financial year ended 31st December 2018 Bravo Company, had created a cash surplus amounting to £60 million. The Company is planning to invest the surplus in £ denominated securities in three months' time for a six month period. Bravo worried company can normally invest surplus at LIBOR – 0.2%. The company is worried about the risk of a sharp decline in lending rates in the near future.

ISSUE 2
It is now 31st December 2018. The company wishes to borrow £60 million in three months' time for a six month period. The company can normally borrow from its bank at LIBOR + 0.5%. The company is worried about the risk of a sharp rise in borrowing rates in the near future.

Bruce Commercial Bank, a bank trading in Forward Rate Agreements (FRAs), quoted prices for the £ as follows:

FRA Terms and Prices:

1.	3/9:	4.45 – 3.40
2.	6/9:	4.30 – 3.25
3.	6/12:	4.14 – 3.12

Principal:	£60 million
Reference rate:	LIBOR

You are hired as an investment advisor for Bravo Company and the Managing Director wants your advice on the matter.

REQUIRED:

(i) Provide a brief explanation on how FRAs work. **(2 marks)**

(ii) Estimate the effective lending and borrowing rates should the LIBOR turn out to be 3.5%. Advise the Managing director accordingly.

(8 marks)
(Total: 20 marks)

EXAMINATION	**:**	**FINAL LEVEL**
SUBJECT	**:**	**PUBLIC FINANCE AND TAXATION II**
CODE	**:**	**C4**
EXAMINATION DATE	**:**	**FRIDAY, 10TH MAY, 2019**
TIME ALLOWED	**:**	**THREE HOURS (2:00 P.M. – 5:00 P.M.)**

GENERAL INSTRUCTIONS

2. There are **TWO** Sections in this paper. Sections **A** and **B** which comprise a total of **SIX** questions.

2. Answer question **ONE** in Section **A**

3. Answer **ANY THREE** questions in Section **B**.

4. In total answer **FOUR** questions.

5. Marks are shown at the end of each question.

6. Show clearly all your workings in the respective answers where applicable.

7. Calculate your answers to the nearest one decimal point where necessary.

8. Applicable tax rates are provided in Appendices on page **10** of **10**.

9. This question paper comprises **9** printed pages.

SECTION A
Compulsory Question

QUESTION 1

(a) Tumaini, Jumanne and Magai have traded in partnership for many years as Chaukucha manufacturing local crafts. The partnership made an accounting profit for the year ended 31st December 2018 as shown below:

	Note	**TZS. ('000')**
Revenue		60,000
Less:		
Depreciation	(1)	24,200
Car lease costs	(2)	4,000
Fines	(3)	300
Legal and professional fees	(4)	5,700
Rent	(5)	13,500
Profit before tax		12,300

Notes:

(1) The total depreciation charge of TZS.24,200,000 includes depreciation on vehicles that were acquired for use by Tumaini and Magai on 1st December 2018:

- Tumaini used a Mark X car that cost the partnership TZS.32,600,000 in 2018. Tumaini used the car 40% for business purposes.
- Magai used a five ton Nissan Truck which cost the partnership TZS.24,000,000 in 2018. Magai did not use the Truck for private purposes.

(2) Jumanne used a BMW car which the partnership took out on a three-year lease at a cost of TZS.4,000,000 per annum. Jumanne used the car 30% for business purposes. The partnerships sold all its previously owned cars in 2017.

(3) Fines of TZS.300,000 are made up of a TZS.200,000 tax penalty, and a TZS.100,000 fine incurred by an employee upon contravening road traffic law when visiting a client.

(4) Legal and professional fees:

	TZS.'000'
Recovery of bad debts	700
Costs of registering a copyright with a useful life of 10 years	3,000
Legal costs on 10-year lease on factory (Note 5)	2,000
	5,700

(5) Until 31st December 2017, the partnership leased factory premises for TZS.12,000,000 annually. However, as the business was expanding another lease was signed on 1st January 2018 and the partnership moved into larger factory premises with an annual rent of TZS.13,500,000.

(6) Capital allowances have not yet been calculated. Tax written down value as at 1st April 2017 were:

	Cost Allowances TZS. '000'	**Tax Allowances b/f TZS. '000'**
Furniture & fittings	43,000	17,200

The following additional information is available:
In addition to the vehicles mentioned in notes (1) and (2), the partnership incurred other capital expenditure in January 2018 when the business moved to the new factory premises:

	TZS. '000'
Heavy machinery for use in manufacturing	40,000
Accounting computer package useful life of 4 years	2,500

Tumaini, Jumanne and Magai's original partnership agreement provides for all partners to receive interest on capital at 4% per annum based on the balance at the start of the accounting period. The partners' capital accounts as at 1st January 2018 were TZS.50,000,000 each for Tumaini and Jumanne, and TZS.100,000,000 for Magai. Tumaini receives a salary of TZS.20,000,000 per annum. The balance of any profit is shared 30% to Tumaini, 50% to Jumanne and 20% to Magai.

Magai left the partnership on his 50th birthday on 31st December 2017, to take early retirement. From that time Tumaini and Jumanne agreed to share profits and losses equally, with no salary or interest on capital for either partner.

REQUIRED:

(i) Calculate the chargeable income for Chaukucha for the year ended 31st December 2018. **(13 marks)**

(ii) Calculate each partner's share of the taxable income for the year ended 31st December 2018. **(4 marks)**

(iii) Briefly explain the tax implications of partners making loans to partnerships. **(3 marks)**

(b) Salum works for Leopard Tours Ltd as a Business Development Manager and received the following employment package for year of income 2018:

- Basic salary of TZS.2.400,000 per month
- A general round sum allowance of TZS.150,000 per month. During 2018, Salum spent TZS.1,580,250 of the allowance on entertaining clients for which he was not required to account for.
- A felt-driver car with engine capacity of 999cc. this can was purchased in 2017 for TZS.7,500,000. Leopard Tours Ltd pays for all of the petrol for the car.
- Private medical insurance that costs the company TZS.679,500. This insurance is available to all staff on non-discriminatory basis.
- Christmas present of vouchers to use in a local department store to purchase goods up to the value of TZS.1,000,000. However, the vouchers cost Leopard Tours Ltd only TZS.800,000.
- Contributions equal to 10% of Salum's salary paid by Leopard Tours Ltd into Salum's approved pension scheme. Salum himself pays 10% of his basic salary into the scheme.
- Salum also pays an annual subscription fee of TZS.150,000 to the Institute of Marketing. Leopard Tours Ltd does not reimburse him for this. Salum purchased a computer preloaded with a graphics package on 1st July 2017 for use in his employment. The computer cost TZS.750,000 and Salum uses it 80% for business.

Other income and payments

Salum owns a furnished house that he let throughout 2018 for rental income of TZS.1,200,000 gross, the tenant had deducted withholding tax of TZS.120,000. His costs of letting were as follows:

	TZS. '000'
Insurance premium paid on 1st January 2018 for the year to 30th June 2018	100
Insurance premium paid on 1st July 2018 for the year to 31st December 2018	140
Land rates for 2018	160
Paving of driveway	1,200
Repair of broken windows	400

During 2018 Salum received bank interest of TZS.1,600,000 from Bank of China. Also in 2018 Salum provided some consultancy work for a company and was paid a fee of TZS.24,000,000 gross, no tax was deducted at source.

REQUIRED:

(i) Calculate Salum's chargeable employment income for 2018. Show treatment of each item. **(10 marks)**

(ii) Calculate Salum's total taxable income for 2018. **(6 marks)**

(c) Explain the main methods of giving double taxation relief to entities with overseas earnings. **(4 marks)**

(Total: 40 marks)

SECTION B

There are **FIVE** questions. Answer **ANY THREE** questions

QUESTION 2

(a) Describe what is meant by the term "transfer pricing" and explain why it is a major issue in international taxation. **(5 marks)**

(b) Give two examples of how a transfer pricing arrangement might work. **(5 marks)**

(c) Do you agree with the statement that "the principal means of countering transfer pricing arrangements is through entering into a double taxation agreement based on the OECD Model Agreement." Explain your answer. **(10 marks)**

(Total: 20 marks)

QUESTION 3

(a) The assessment for income tax is based on the income generated during the year of income.

REQUIRED:

Explain the meaning of 'year of income' for tax purposes. **(2 marks)**

(b) DUCAA is an association of the Dar es Salaam University College of Agriculture Lecturers. The Association's income depends on contribution from its members, investment income, donations and some business income. Below is the statement of financial performance of DUCAA for the year ended 31st December 2018.

	TZS.
Sales – to members	180,000,000
Sales to non-members	100,000,000
Total sales	**280,000,000**
Cost of sales (Note 1)	100,000,000
Gross Profit	**180,000,000**
Other Income (Note 2)	144,000,000
Total Income	**324,000,000**
Less: Expenses	
Operating expenses (Note 3)	107,000,000
Administrative expenses (Note 4)	30,000,000
Marketing and finance cost (Note 5)	15,000,000
Total Expenses	**152,000,000**
Net Income	**172,000,000**

Note 1: Cost of sales includes:

(i) Exchange loss of TZS.143,000 on the importation of goods
(ii) 30% of depreciation cost

Note 2: Analysis of other income revealed the following:

(i) TZS.12,000,000 as dividends being:
  - Dividend from Kwanza Ltd a resident corporation amounting to TZS.4,000,000. The DUCAA owns 40% of the shares of Kwanza Ltd.
  - Dividends amounting to TZS.1,000,000 were received from Kazi Ltd, which is listed on DSE, and owned at 22% by K100 Ltd a non-resident company.
  - Dividends amounting to TZS.7,000,000 received from Wakwetu Company Ltd a resident company.

(ii) Other Investment income TZS.12,000,000
(iii) Members' fees TZS.70,000,000
(iv) Donations from members TZS.50,000,000

Note 3: Operating expenses includes:

(i) Penalties for VAT – TZS.3,500,000
(ii) Cost to prepare revised accounts – TZS.1,200,000
(iii) Salaries to staff for future services – TZS.6,000,000
(iv) Compensation of TZS.1,600,000 to terminated employees
(v) Incentives and staff promotions costs – TZS.1,400,000
(vi) 70% of deprecation cost
(vii) Tax expense TZS.30,150,000

Note 4: Administrative expenses include the following:

(i) Amortized amount to replace a roof – TZS.3,000,000
(ii) Legal cost for unsuccessful recovery of salaries from terminated employees – TZS.1,000,000
(iii) Management meetings expenses – TZS.4,000,000
(iv) Management team travelling cost abroad for holiday vacation TZS.19,000,000
(v) Cost to raise donation TZS.3,000,000

Note 5: Marketing and finance costs include:

(i) Political parties contributions – TZS.2,000,000
(ii) Cancellation of contract – TZS.7,000,000
(iii) Managing Directors personal visitors entertainment expenses – TZS.1,000,000
(iv) Payments made to remove erroneous terms of a loan contract – TZS.82,000
(v) Interest on loan to Bank – TZS.3,500,000

(vi) Additional information includes:

- As part of DUCAA's initiative to speed up morale of Management team, it was decided to give them a vacation abroad. The travelling cost for management team was financed by a 10% Bank loan.
- The DUCAA charged TZS.10,000,000 as depreciation. Only 75% of the depreciation charges qualify for tax deductions.

REQUIRED:

From the above information:

(i) Does the income of DUCAA qualify for tax exemption according to Income Tax Act CAP 332? Justify your answer with necessary computations. **(5 marks)**

(ii) Apply the provisions of the Income Tax Act CAP 332 to determine the adjusted taxable income for DUCAA, (if any) for the year 2018.
(13 marks)
(Total: 20 marks)

QUESTION 4

(a) The main argument is that taxation rotates around utility and equitable distribution of resources. The capitalists say individuals who pay tax should enjoy the lion's share. The socialists say those who have, should pay the tax and those who do not pay should also enjoy the tax benefits. In between the two extremes, individual states formulate appropriate policy frameworks to adopt.

REQUIRED:

Describe four main factors that determine tax incidence **(4 marks)**

(b) After quick review of Mambosasa's tax documents you find that he did not submit provisional tax estimations and has in actual fact paid less on 30th June 2018 when filing the statement of estimated tax. His documents show that he had estimated to realize TZS.35,000,000 profit for the year running from 1st January 2018 to 31st December 2018.

REQUIRED:

Calculate penalties and interest that will be required to be paid on 30th June 2018. Assume statutory interest rate is 1% per annum. **(6 marks)**

(c) The following information relates to Statement of Financial Position of DUNDEE investment, a domestic permanent establishment:

	2015		**2016**	
Non-Current assets at cost	35,000,000		40,000,000	
Less: accumulated depreciation	17,000,000		20,000,000	
Written Down Value (WDV)		18,000,000		20,000,000
Other Assets:				
Stock	3,000,000		5,000,000	
Debtors	5,000,000		6,000,000	
Cash	2,000,000		3,000,000	
Investment assets	17,000,000		19,000,000	
		27,000,000		33,000,000
Total Assets		**45,000,000**		**53,000,000**
Financed by:				
Equity shares @ 1000		20,000,000		22,000,000
Share premium		2,000,000		3,000,000
Retained earning		4,000,000		6,000,000
Liabilities:				
15% Loan		15,000,000		15,000,000
Accruals		1,000,000		2,000,000
Bank overdraft		3,000,000		5,000,000
		45,000,000		**53,000,000**

Further information to financial statements revealed that:

(i) The amounts derived from incurring liability and realizing liability was as follows:

Year	**Incurring liability**	**Realizing liability**
2012	6,000,000	4,000,000
2013	7,000,000	3,000,000

(ii) Share price was quoted at 20% higher at the end of the period.

(iii) No dividend was declared during the year.

REQUIRED:

Compute repatriated income during the year. **(10 marks)**

(Total: 20 marks)

QUESTION 5

(a) Amanda is a government employee, placed in the Ministry of health as a cashier. She does not have any business or other source of income apart from her employment. During the year 2018 she received a gift worth TZS.2,500,000 from her husband (a business man in the real estate sector) on their 10^{th} wedding anniversary. She has been advised that she was supposed to file a return of income in 2018.

REQUIRED:

Advise Amanda on whether she is required to file a return, referring to the relevant provisions in the income tax law. **(5 marks)**

(b) There has been a widely held view that one has no option but paying the tax assessed by the Commissioner when it comes to income taxes. Mdetelwa Bank Ltd (MBL) has filed a tax objection against the amount of income tax TZS.320,000,000 assessed on it for the year 2017. The objection is centered on treatment of allowance for impairment of receivables, TZS.150,000,000 that it has expensed in its financial statement as per International Financial Reporting Standards (IFRSs) and treated as deductible in computing the tax payable. The Commissioner did not agree with this treatment and thus issued the assessment that disallowed the deduction. The argument by MBL is that there is no way such deduction should be denied, while IFRSs require expensing such allowance.

REQUIRED:

(i) Calculate the amount of tax as per MBL's self-assessment. **(2 marks)**

(ii) Calculate the minimum amount of tax that MBL must have paid to get ahead with filling the objection, and state the other conditions MBL, must have complied with to make the objection admitted. **(5 marks)**

(iii) Explain your understanding of treatment of the allowance for impairment of receivables, referring to the principles of deductions under the Income Tax Act CAP 332. **(5 marks)**

(iv) Comment on MBL's position that they should be allowed the deduction on grounds that IFRSs required expensing the amount. **(3 marks)**

(Total: 20 marks)

QUESTION 6

(a) The economy of any nation can be measured by its National Income.

REQUIRED:

Explain what do you understand by the terms, "National and Gross Domestic Product (GDP)". **(5 marks)**

(b) You have been provided with the following National Income (NI) data for analysis.

DETAILS	TZS (Billion)
Capital consumption	100
Fixed capital formation	250
Government expenditure	500
Exports	150
Imports	200
Wages and salaries	600
Net income from abroad	50
Profits	100
Government expenditure	200
Rent	140
Indirect taxes	60

REQUIRED:

Compute the country's

(i) Net National Product at Market Price. **(11 marks)**

(ii) Net Domestic Product at Market Price. **(4 marks)**

(Total: 20 marks)

Appendices

(1) Applicable resident individual income tax rates:

Monthly income	Tax rate
Where total income does not exceed TZS.170,000/=	NIL
Where total income exceeds TZS.170,000/= but does not exceed TZS.360,000/=	9% of the amount in excess of TZS.170,000/
Where total income exceeds TZS.360,000/= but does not exceed TZS.540,000/=	TZS.17,100/= plus 20% of the amount in excess of TZS.360,000/=
Where total income exceeds TZS.540,000/= but does not exceed TZS.720,000/=	TZS.53,100/= plus 25% of the amount in excess of TZS.540,000/=
Where total income exceeds TZS.720,000/=	TZS.98,100/= plus 30% of the amount in excess of TZS.720,000/=

(2) Applicable presumptive income tax rates:

Annual turnover	Tax payable when section 80 is not complied with	Tax payable when section 80 is complied with
Where turnovers does not exceed TZS.4,000,000	NIL	NIL
Where turnover exceeds TZS.4,000,000 but does not exceed TZS.7,500,000	TZS.150,000	3% of the turnover in excess of TZS.4,000,000
Where turnover exceeds TZS.7,500,000 but does not exceeds TZS.11,500,000	TZS.318,000	TZS.135,000+3.8% of the turnover in excess of TZS.7,500,000
Where turnovers exceeds TZS.11,500,000 but does not exceed TZS.16,000,000	TZS.546,000	TZS.285,000+4.5% of the turnover in excess of TZS.11,500,000
Where turnover exceeds TZS.16,000,000 but does not exceed TZS.20,000,000	TZS.862,500	TZS.487,000+5.3% of the turnover in excess of TZS.16,000,000

(3) Car benefit quantification table as per the 5th Schedule

ENGINE SIZE OF VEHICLE	QUANTITY OF PAYMENT PER YEAR	
	Vehicle up to 5 years old	Vehicle more than 5 years old
Not exceeding 1000cc	TZS.250,000	TZS.125,000
Above 1000cc but not exceeding 2000cc	TZS.500,000	TZS.250,000

Above 2000cc but not exceeding 3000cc	TZS.1,000,000	TZS.500,000
Above 3000cc	TZS.1,500,000	TZS.750,000

(4) Statutory rate to be used is 9%

(5) 1 currency point = TZS.15,000

(6) Standard rate of VAT = 18%

SUGGESTED SOLUTIONS
C 1- CORPORATE REPORTING
MAY 2019

ANSWER 1

(a) **DJ Co – Consolidated statement of financial position as at 31 March 2019**

	TZS. '000	TZS. '000
Assets		
Non-Current Assets:		
Property, plant and equipment (75,200 + 31,500 + 4,000 mine – 200 depreciation $\left(4{,}000\ x\ \frac{3}{12}\ x\ \frac{1}{5}\right)$		110,500
Goodwill (w(i))		11,000
Investment in associate (4,500 + 1,200 (w (iii))		5,700
		127,200
Current Asset		
Inventory (19,400+18,800 +700 GIT – 600 URP (w (ii))	38,300	
Trade receivables (14,700 + 12,500 – 3,000 intra group)	24,200	
Bank (1,200 + 600)	1,800	64,300
Total Assets		**191,500**
Equity and Liabilities		
Equity attributable to owners of the parent		
Equity shares of TZS.1 each (50,000 + 10,000 (w (i))		60,000
Other equity reserves (share premium) (w (i))	22,000	
Retained earnings (w (iii))	37,590	59,590
		119,590
Non-controlling interest (w (iv))		9,430
Total equity		129,020
Non-current Liabilities		
8% loan notes (5,000 consideration)	20,000	
Accrued loan interest (w (iii))	300	
Environmental provision (4,000 + 80 interest (w (iii))	4,080	24,380
Current liabilities (24,000 + 16,400 – (3,000 – 700 GIT) intra group (w (ii))		38,100
Total equity and Liabilities		**191,500**

Workings (figures in brackets are in TZS. ‘000’)

(i) Goodwill in Loo Co.

Controlling interest	**TZS. ‘000**	**TZS. ‘000**
Share exchange (20,000 x 75% x 2/3 = 10,000 x TZS.3.20)		32,000
8% loan notes (20,000 x 75% x TZS.1000/1,000)		15,000
Non-controlling interest (20,000 x 25% x TZS.1.80)		9,000
		56,000
Equity shares	20,000	
Retained earnings at 1 April 2016	19,000	
Earnings 1 April 2019 to acquisition (8,000 x 9/12)	6,000	
Fair value adjustments – asset re mine	4,000	
- Provision re mine	(4,000)	(45,000)
Goodwill arising on acquisition		11,000

The share exchange of TZS.32 million would be recorded as share capital of TZS.10 million (10,000 x TZS.1) and share premium of TZS.22 million (10,000 x (TZS.3.20 – TZS.1.00)).

Applying the group policy to the environmental provision would mean adding TZS.4 million to the carrying amount of the mine and the same amount recorded as a provision at the date of acquision. This has no overall effect on goodwill, but it does affect the consolidated statement of financial position and post-acquisition profit.

(ii) The inventory of Loo Co. includes unrealized profit (URP) of TZS. 600,000 (2,100 x 40/140).

(iii) Consolidated retained earnings:

	TZS.’000’
DJ Co’s retained earnings	36,000
Loo Co’s post-acquisition profit (1,720 x 75% see below)	1,290
Unrecorded share of Am Co. retained profit (6,000 – 2,000) x 30%)	1,200
Outstanding loan interest at 31 March 2019 (15,000 x 8% x 3/12)	(300)
URP in inventory (w (ii))	600
	37,590
The adjusted post-acquisition profits of Loo Co. are:	
As reported and time apportioned (8,000 x 3/12)	2,000
Interest on environmental provision (4,000 x 8% x 3/12)	(80)
Additional depreciation re mine (4,000/5 years’ x 3/12)	(200)
	1,720

(iv)	Non-controlling interest	**TZS.'000'**
	Fair value on acquisition (w (i))	9,000
	Post-acquisition profit (1,720 x 25% (w (iv))	430
		9,430

(b) **Contingent payment**

The ***Conceptual Framework*** defines a liability as a present obligation, arising from past events and there is an expected outflow of economic benefits. IAS 32 ***Financial instruments: presentation*** establishes principles for presenting financial instruments as liabilities or equity. IAS 32 does not classify a financial instrument as equity or financial liability on the basis of its legal form but the substance of the transaction.

The key feature of a financial liability is that the issuer is obliged to deliver either cash or another financial asset to the holder. An obligation may arise from a requirement to repay principal or interest or dividends. In contrast, equity has a residual interest in the entity's assets after deducting all of its liabilities. An equity instrument includes no obligation to deliver cash or another financial asset to another entity. A contract which will be settled by the entity receiving or delivering a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument. However, if there is any variability in the amount of cash or own equity instruments which will be delivered or received, then such a contract is a financial asset or liability as applicable.

The contingent payments should not be treated as contingent liabilities but they should be recognized as financial liabilities and measured at fair value at initial recognition. IAS 37 ***Provisions, contingent liabilities and contingent assets,*** excludes from its scope contracts which are executory in nature, and therefore prevents the recognition of a liability. Additionally, there is no onerous contract in this scenario. Contingent consideration for a business must be recognized at the time of acquisition, in accordance with IFRS 3 ***Business combinations.*** IFRSs do not contain any guidance when accounting for contingent consideration for the acquisition of a NCI in a subsidiary. The contract for contingent payments does meet the definition of a financial liability under IAS 32. Leopard has an obligation to pay cash to the vendor of the NCI under the terms of a contract. It is not within Leopard's control to be able to avoid that obligation. The amount of the contingent payments depends on the profitability of Spine, which itself depends on a number of factors which are uncontrollable. IAS 32 states that a contingent obligation to pay cash which is outside the control of both parties to a contract meets the definition of a financial liability which shall be initially measured at fair value. Since the contingent payments relate to the acquisition of the NCI, the offsetting entry would be recognized directly in equity.

(c) Papa had control of Nyangumi by virtue of 60% equity holding in the subsidiary. A sale of 8% of such interest (reduction to 52% equity) does not therefore lead to losing its control over Nyangumi.
The requirement of the standards (IFRS 10 & IFRS 3 are that:

(i) The carrying amounts of the controlling & non-controlling interest are adjusted to reflect the changes in their relative interest in the subsidiary.

(ii) Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid is recognized directly in equity and attributed to the owners of the parent.

(iii) There should be no change in the carrying amounts of subsidiary's assets (including goodwill) to be recognized as a result of such transaction.

The transaction will be treated as an equity transaction, with owners in their capacity as owners.

(d) Full consolidation where a parent owns less that 100% of equity interest:

The ground for consolidation comes from ***CONTROL*** rather than ***OWNERSHIP.*** When an entity consolidates financial statements, it takes into account the subsidiaries it controls rather than entities where it simply owns shares. This is consistent with the definition of assets, that they are actually resources "controlled" by an entity rather than resources owned by the entity.

Since the parent entity has powers to control decisions made by the subsidiary entity, the powers include powers to decide what the subsidiary does with its assets.

Full consolidation is therefore consistent with not only the definition of assets as per IASB framework, but also the application of the "substance over form" principle in the framework.

ANSWER 2

(a) **Sale of hotel complex**
The issue here is one of ***revenue recognition,*** and the accounting treatment is governed by IFRS 15 ***Revenue from contracts with customers.*** Stage (v) of the standards revenue recognition process requires that ***revenue is recognized when (or as) a performance obligation is satisfied.*** The entity satisfies a performance obligation by transferring ***control*** of a promised good or service to the customer. A performance obligation can be satisfied ***at a point in time,*** such as when goods are delivered to the customer, or over time. In the case of the hotel transfer, the issue is that of a performance obligation ***satisfied at a point in time.*** One of the IFRS 15 indicators of control is that significant risks and rewards of ownership have been transferred to the customer.

It can be argued in some cases where property is sold that the seller, by continuing to be involved, has ***not satisfied the performance obligation by transferring control,*** partly because the seller has not transferred the risks and rewards of ownership. In such cases, the ***sale is not genuine,*** but is often in substance a ***financing arrangement.*** IFRS 15 requires that the substance of a transaction is determined by looking at the transaction as a whole. If two or more transactions are linked, they should be treated as one transaction to better reflect the commercial substance.

Ngalawa continues to operate and manage the hotel complex, receiving the bulk (75%) of the profits, and the residual interest reverts back to Ngalawa; effectively, Ngalawa ***retains control*** by retaining the risks and rewards of ownership. Conquest does not bear any risk: its minimum annual income is guaranteed at TZS.150m. ***The sale should not be recognized.*** In substance it is a ***financing transaction.*** The ***proceeds*** should be treated as a ***loan***, and the payment of ***profit*** as ***interest***.

Discount vouchers
The treatment of the vouchers is governed by IFRS 15 ***Revenue from contracts with customers.*** The principles of the standard require that:

(i) The voucher should be accounted for as a ***separate component*** of the sale;

(ii) The promise to provide the discount is a ***performance obligation*;**

(iii) The entity must estimate the ***stand-alone selling price*** of the discount voucher in accordance with paragraph B42 of IFRS 15. That estimate must reflect the discount that the customer would obtain when exercising the option, adjusted for both of the following:

1) Any discount that the customer could receive without exercising the option
2) The likelihood that the option will be exercised.

The vouchers are issued as part of the sale of the room and redeemable against future bookings. The substance of the transaction is that ***the customer is purchasing both a room and a voucher.***

Vouchers worth TZS.20 billion are eligible for discount as at 31 May 2018. However, based on past experience, it is likely that only one in five vouchers will be redeemed, that is vouchers worth TZS.4 billion. Room sales are TZS.300 billion, ***so effectively, the company has made sales worth TZS. (300 billion + 4 billion) = TZS.304 billion in exchange for TZS.300 billion.*** The stand-along price would give a total of TZS.300 billion for the rooms and TZS.4 billion for the vouchers.

To allocate the transaction price, step (iv) of IFRS 15's five-step process for revenue recognition, the proceeds need to be split proportionally pro-rata the stand-alone prices, that is the discount of TZS.4 billion needs to be allocated between the room sales and the vouchers, as follows:

Room sales:
300/304 x TZS.300 million = TZS.296.1 billion

Vouchers (balance) = TZS.3.9 billion

The TZS.3.9 billion attributable to the vouchers is only recognized when the performance obligations are fulfilled, that is when the vouchers are redeemed.

(b) **Whether it was necessary to develop a set of IFRSs specifically for SMEs**
Originally, International Accounting Standards (IASs) issued by the International Accounting Standards Committee (IASC) were designed to be suitable for all types of entity, including small and medium entities (SMEs) and entities in developing countries. Large listed entities based their financial statements on national GAAP which normally automatically complied with those IASs due to choices permitted in the past. In recent years, IASs and IFRSs have become increasingly complex and prescriptive. They are now designed primarily to meet the information needs of institutional investors in large listed entities and their advisers. In many countries, IFRSs are used mainly by listed companies.

There is a case for continues use of full IFRSs by SMEs. It can be argued that the main objectives of general purpose financial statements are the same for all types of company, of whatever size. Compliance with full IFRSs ensures that the financial statements of SMEs present their financial performance fairly and gives them greater credibility. It also ensures their comparability with those of other entities.

There were also many arguments for developing a separate set of standards for SMEs, and these have been taken into account (see below). Full IFRSs have become very detailed and onerous to follow. The cost of complying may exceed the benefits to the entity and the users of its financial statements. At present, an entity cannot describe their financial statements as IFRS financial statements unless they have complied with every single requirement.

SME financial statements are normally ***used by a relatively small number of people.*** Often, the investors are also ***involved in day to day management.*** The ***main external users*** of SME financial statements tend to be lenders and the tax authorities, rather than institutional investors and their advisers. These users have different information needs from those of investors. For these users, the accounting treatments and the detailed disclosures required may sometimes obscure the picture given by the financial statements. In some cases, ***different, or more detailed information may be needed.*** For example, related party transactions are often very significant in the context of SME activities and expanded disclosure may be appropriate.

(i) The ***IFRS for Small and Medium-Sized Entities*** (IFRS for SMEs) was published in July 2009, and therefore falls to be examinable in 2010. It is only 230 pages, and has simplifications that reflect the needs of users of SMEs' financial statements and cost-benefit considerations. It is designed to facilitate financial reporting by small and medium-sized entities in a number of ways:

i. It provides significantly less guidance than full IFRS.

ii. Many of the principles for recognizing and measuring assets, liabilities, income and expenses in full IFRSs are simplified.

iii. Where full IFRSs allow accounting policy choices, the IFRS for SMEs allows only the easier option.

iv. Topics not relevant to SME are omitted.

v. Significantly fewer disclosures are required.

vi. The standard has been written in clear language that can easily be translated.

(ii) **How existing standards could be modified to meet the needs of SMEs**

The starting point for modifying existing standards should be the most likely users of SME financial statements and their information needs. SME financial statements are mainly used by lenders and potential lenders, the tax authorities and suppliers. In addition, the owners and management (who are often the same people) may be dependent on the information in the financial statements. SME financial statements must meet the needs of their users, but the costs of providing the information should not outweigh the benefits.

There is considerable scope for simplifying disclosure and presentation requirements. Many of the existing requirements, for example those related to financial instruments, discontinues operations and earnings per share, are not really relevant to the users of SME financial statements. In any case, lenders and potential lenders are normally able to ask for additional information (including forecasts) if they need it.

The SME standards are a simplified version of existing standards, using only those principles that are likely to be relevant to SMEs. The IASB has proposed that the recognition and measurement principles in full IFRSs should remain unchanged unless there is a good argument for modifying them. Clearly the SME standards will have to be sufficiently rigorous to produce information that is relevant and reliable. However, many believe that there is a case for simplifying at least some of the more complicated measurement requirements and that it will be difficult to reduce the financial reporting burden otherwise placed on SMEs.

ANSWER 3

(a) (i) **Mererani Co. the equivalent ratios to those provided by the agency**

Return on year-end capital employed (ROCE)	12/1%
Net asset (total assets less current liabilities) turnover	1.6 times
Gross profit margin	25%
Operating profit margin	7.5%
Current ratio	1.5:1
Average inventory turnover	4.5 times
Trade payable's payment period	45 days
Debt to equity	30%

(ii) **Analysis of financial and operating performance of Mererani Co compared to sector average**

Profitability
Mererani has a ROCE significantly lower at 12.1% than the sector average of 16.8%. This is mainly due to the lower than average gross profit margin and consequent low operating profit margin. The operating expenses are actually lower (17.5%) as a percentage of revenue than the sector average of 23% (35% - 12%) so the problem lies between revenue and cost of sales. Inventory turnover is quite brisk (4.5 times compared to a sector average of three times) but Mererani's mark-up of 33.3% (25/75) x 100) is significantly below the sector average of 54% (35/65) x 100). Mererani is suggestively maintaining turnover by keeping prices down.

The other component of ROCE, net asset turnover, is slightly higher than the sector average. This is due to the buoyant turnover, as the ratio will have been depressed by the property revaluation and the capitalization of the development expenditure, which have increased the asset base. It to be hoped that the development expenditure will generate the expected revenue. If it had been necessary to expense it for the year ended 30 September 2018 Mererani would have reported a loss before tax of TZS. 1.6 billion.

Liquidity
Mererani has a current ratio of 1.55:1 compared to the sector average of 1.25:1. Both appear low, but satisfactory for the retail sector as the cash cycle is fairly rapid. Inventory can be turned into immediate cash and this is particularly true for Mererani with its high inventory turnover level. The lower than average payables days (45 compared to 64) and the absence of an overdraft suggest that Mererani is not suffering liquidity problems.

Gearing
Mererani's debt to equity ratio is 30%, well below the sector average of 38% and the interest rate on the loan notes is below the ROCE of 12.1%, meaning that the borrowings are earning a good return for the business. The interest cover of 5.25 times (4,200/800) is satisfactory. Mererani is not having any problems servicing its loan and is unlikely to give lenders any particular concern.

Conclusion

There are no going concern worries for Mererani but it does have an issue with low profitability. It appears to be positioned at the bottom end of the jewellery market selling high volume cheap items rather than more valuable pieces on which there would be significantly higher profit margins. This may or may not be the most advantageous strategy in a period of recession.

(iii) **The following factors may limit the usefulness of comparisons based on business sector averages.**

The companies included in the average may have used different accounting policies. Some may be applying the revaluation basis to their assets and some may not. This will affect asset turnover and ROCE.

The average may include a wide variety of entities with different trading methods and risk profiles. Very high-end companies may even operate on an invoice rather than a cash basis and will have receivables included in their current assets. Very large chains will probably have more access to cheap borrowing.

Some ratios, in particular ROCE and gearing, can be calculated in different ways. It is up to the analyst carrying out the comparison to ensure that a standard definition is used, and they may or may not do this.

(b) **Important performance indicators expected to be reported regarding environment and social factors under Global Reporting Initiative (GRI).**

Indicators	**Reporting requirements**
	Environmental performance indicators
Emissions, effluents and Waste	Total direct and indirect greenhouse gas emissions by weight
	Initiatives to reduce greenhouse gas emissions and reductions achieved
	Emissions of ozone-depleting substances by weight
	And other significant air emissions by type and weight
	Total water discharge by quality and destination
	Total weight of waste by type and disposal method
	Total number and volume of significant spills
	Weight of transported, imported, exported or treated waste deemed hazardous under the Terms of the Basel Convention
	Identity, size, protected status and biodiversity value of water bodies and related habitats significantly affected by the reporting discharges of water and runoff
Products and services	Initiatives to mitigate environmental impacts of products and services, and extent of impact mitigation
	Percentage of products sold and their packaging materials that are reclaimed by category
Compliance	Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with environmental laws and regulations

Transport	Significant environmental impacts of transporting products and other goods and materials used for the operations and transporting members of the workforce
Overall	Total environmental protection expenditure and investments by type
	Social performance indicators
Community	Nature, scope and effectiveness of any programs and practices that assess and manage the impacts of operations on communities (this would include the impact of entering, operating and discontinuing any operations)
Corruption	Percentage and total number of business units analyzed for risks related to corruption.
	Percentage of employees trained in anti-corruption policies and procedures.
	Actions taken in response to incidents of corruption
	Public policy positions and participation in public policy development and lobbying.
Public policy	Total value of financial and in-kind contributions to political parties, politicians and related institutions by country
Anti-Competitive Behavior	Total number of legal actions for anti-competitive behaviour, anti-trust and monopoly practices and their outcomes.
Compliance	Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with laws and regulations

(Total: 20 marks)

ANSWER 4

(a) **The importance of disclosing diluted Earnings Per Share (DEPS**

Many entities issue financial instruments that allow the holder to buy shares at a price that is less than the market price. Such instruments include convertible debt, options and warrants. When the holders exercise their rights and obtain the equity, the original EPS measure will be diluted. This is because the shares have been issued at below their market price and so will provide the entity with less cash and so less earnings per share. IAS 33 requires disclosure of both the basic and diluted EPS. The diluted earnings per share figure is calculated using the current earnings and assuming the worst dilution arises. This will assist existing and prospective investors with their investment decisions.

For example, a convertible bond provides the holder with a regular coupon plus the option to convert the bonds into ordinary shares at during a certain time frame. Most investors will probably choose to convert rather than to redeem their bonds and hence this will affect the EPS. Firstly, the number of shares in issue will increase; secondly, the earnings will increase because the coupon will no longer need to be paid, Typically, convertible bonds will be issued at a low coupon because of the opportunity to take the shares. Therefore, the impact on earnings is minimal, and the EPS will typically decrease.

(b) **Calculation of diluted EPS**

Assuming Preference shares are treated as liabilities

Basic EPS

Net profit after tax and non-controlling interests		TZS 18,000,000
		÷
Ordinary shares		40,000
EPS	=	TZS450

It is assumed that the preference dividend is included in finance costs; therefore the profit after tax represents total earnings.

In order to determine the diluted EPS, the potential ordinary shares must first be ranked in order of their diluted effect.

Dilutive effects	Effects on earnings (TZS)	Effects on number of shares	Extra EPS (TZS)
Options (w1)	Nil	400	Nil
Convertible bonds (w2)	840,000	1,840	456.52
Convertible preference shares (w3)	112,000	3,200	35

Diluted EPS must be calculated starting with the most dilutive (options) and finishing with the least dilutive (bonds).

Diluted EPS	Earnings	Ordinary shares	EPS (TZS)
Basic EPS	18,000,000	40,000	450
1. Options	Nil	400	
	18,000,000	40,400	445.54
2. Convertible	112,000	3,200	
Preference shares	18,112,000	43,600	415.41
3. Convertible bonds	840,000	1,840	
	18,952,000	45,440	417.01

The convertible bond is seen to have an anti-dilutive effect and therefore must be excluded from the calculation, giving a diluted EPS of TZS.415.41. This must be disclosed alongside the basic EPS together with the statement of profit or loss and other comprehensive income

Workings

1. Options

Number of options	2,000
Proceeds from exercise at TZS 1,200 per option	TZS 2,400,000
Market price of a share	TZS 1,500
Effective number of shares at full price (TZS 2.4m/1,500)	1,600
Effective number of free shares (2,000 – 1,600)	400

2. Convertible Bonds

Where more than one conversion rate applies, IAS 33 requires the calculation to be based on the most advantageous rate to the holder. This will be in the next year at a rate of 23 shares per TZS 250,000 nominal value of bonds. Resulting in an addition 1,840 shares (20million x 23/250,000). Post tax interest saved on conversion = TZS 840,000 (6% x TZS 20m x 0.70).

3. Convertible preference shares

Additional ordinary shares created = 3,200 shares i.e. (2 x 1,600)
Preference dividend saved = TZS 160,000 i.e. (TZS.100 x 1,600 shares)
Adjusting for tax = TZS 112,000 i.e. (160,000 x 0.7)

OR

Assuming Preference shares are treated as equity

Basic EPS

$$\frac{\text{Net profit after tax and non-controlling interests}}{\text{Ordinary shares}} = \frac{\text{TZS } (18{,}000{,}000 - 160{,}000)}{40{,}000}$$

EPS = TZS 446

It is assumed that the preference shares are equity instruments, therefore the profit after tax represents total earnings before deducting preference share dividend.

In order to determine the diluted EPS, the potential ordinary shares must first be ranked in order of their diluted effect.

Dilutive effects	Effects on earnings (TZS)	Effects on number of shares	Extra EPS (TZS)
Options (w1)	Nil	400	Nil
Convertible bonds (w2)	840,000	1,840	456.52
Convertible preference shares (w3)	160,000	3,200	50

Diluted EPS must be calculated starting with the most dilutive (options) and finishing with the least dilutive (bonds).

Diluted EPS	Earnings	Ordinary shares	EPS (TZS)
Basic EPS	17,840,000	40,000	446
1. Options	Nil	400	
	17,840,000	40,400	441.58
2. Convertible	160,000	3,200	
Preference shares	18,000,000	43,600	412.84
3. Convertible bonds	840,000	1,840	
	18, 840,000	45,440	414.61

The convertible bond is seen to have an anti-dilutive effect and therefore must be excluded from the calculation, giving a diluted EPS of TZS. 412.84. This must be disclosed alongside the basic EPS and the statement of profit or loss and other comprehensive income

Workings

1. Options

Number of options		2,000
Proceeds from exercise at TZS 1,200 per option	TZS	2,400,000
Market price of a share	TZS	1,500
Effective number of shares at full price (TZS 2.4m/1,500)		1,600
Effective number of free shares (2,000 – 1,600)		400

2. Convertible Bonds

Where more than one conversion rate applies, IAS 33 requires the calculation to be based on the most advantageous rate to the holder. This will be in the next year at a rate of 23 shares per TZS 250,000 nominal value of bonds. Resulting in an addition 1,840 shares (20million x 23/250,000). Post tax interest saved on conversion = TZS 840,000 (6% x TZS 20m x 0.70).

3. Convertible preference shares

Additional ordinary shares created = 3,200 shares (2 x 1,600)
Preference dividend saved = TZS 160,000 (TZS.100 x 1,600 shares)

(c) (i) **Reasons for the information content of financial statements is improved by inclusion of segmental data on individual business segments**

Many entities carry out several classes of business and operate in a number of countries across the world. Each of these businesses and geographical segments carries with it different opportunities for growth, different rates of profit and varying degrees of risk. Some business segments may be strongly influenced by the health of the economy whereas other segments may be unaffected by recession. One country may be experiencing growth; another country may be less stable because of political events. Awareness of these cultural and environmental differences is important to investors in order to allow them to fully understand the performance and position of the entity over the past, its prospects for the future and the risks that it faces.

IFRS 8 requires that segmental information should be provided to enable investors to understand the impact that the different segments of a business may have on the business as a whole. If the user of financial statements is only provided with figures for the entity as a whole, this might hide the risks and problems or profits and opportunities of the underlying business segments. The disaggregate financial information provided by segmental reporting allows for analytical review on a segment by segment basis which will provide greater understanding of the entity's position and performance and allow a better assessment of its future.

(ii) **Analyzing segments**

IFRS 8 defines an operating segment as a component of an entity that engages in business activities from which it may earn revenues and incur expenses, whose operating results are reviewed regularly by the chief operating decision maker in the entity and for which discrete financial information is available.

Not every part of a business is necessarily an operating segment or part of an operating segment. Head office is an example, since head office does not usually earn revenues. Generally, an operating segment has a segment manager who is directly accountable to and maintains regular contact with the chief operating decision-maker, to discuss the performance of the segment.

IFRS 8 requires that entities should report information about each operating segment that is identified and that exceeds certain quantitative thresholds for size of revenue, operating profit or loss or assets. Financial information about operating segments with similar characteristics can be aggregated.

IFRS8 sets out the information about each reportable operating segment that should be disclosed, including total assets, profit or loss, revenue from external customers, revenue from sales to other segments, interest income and expense, depreciation, material items of income or expense and tax. The amount reported for each item should be the same measure that is reported for the segment to the chief operating decision maker of the entity**.**

ANSWER 5

(a)(i) **Definition of an Accounting Policy:**

Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

When an IAS/IFRS (or an Interpretation) specifically applies to a transaction, other event or condition, the accounting policy or policies applied to that item shall be determined by applying the Standard or Interpretation and considering any relevant Implementation guidance issued by the IASB for the Standard or Interpretation.

An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless a Standard or an Interpretation specifically requires or permits otherwise.

The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. Examples include: Bad debts, inventory obsolescence, fair values of assets, useful live of assets, warranty obligations. A change in accounting estimate is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities.

(ii) (1) **The required treatment for the change in Accounting Policy is that:**
The entity shall apply the change **retrospectively.** This means that the accounts must be altered so that they contain the numbers which would have been there had the new policy always been in force. However, this will not apply if it is impracticable to determine either the period specific effects or the cumulative effect of the change. The initial application of a policy to revalue assets is not dealt with in this manner.

(2) **Change of Accounting Estimate:**
The effect of a change in an accounting estimate shall be recognized **prospectively** (i.e. from the date of the change onward) by including it in profit or loss in the period of the change and future periods, if relevant.

(3) **The required treatment for the Correction of an Error:**

- Restate the comparative amounts for the prior period(s) presented in which the error occurred; or
- If the error occurred before the earliest prior period presented, restate the opening balances of assets, liabilities and equity for the earliest prior period presented,
- Adjust the opening balance in the statement of changes in equity.

(b) The effect of the fraud existed in previous periods although the directors of sigma plc were unaware of it. Hence, the financial statements should be corrected retrospectively. As the current financial statements will show one comparative year, both of these years will be restated. Any effect predating the earliest period presented will be adjusted for through opening equity balances. The incremental effects of the fraud will be reported through profit or loss each year, appearing as additional expenses. The cumulative effects will appear in the Statement of Financial Position, through a reduction of the trade receivables and retained earnings figures. The opening equity balances in the statement of changes in equity should show the original balances, adjusted by the cumulative effect of the adjustment. This is so users can reconcile the figures with those published the previous year.

Statement of Profit or Loss and Other Comprehensive Income for year ended 31st July 2018 and 2017

	TZS.	TZS.
	2018	**2017**
Revenue	300,000	275,000
Cost of Sales	(225,000)	(212,000)
Gross Profit	75,000	63,000
Expenses (30 + 20); (26 + 16)	(50,000)	(42,000)
Profit for year	**25,000**	**21,000**

Statements of Changes in Equity (Retained Earnings only) for year ended 31st July

	TZS.	TZS.
	2018	**2017**
Balance 1st August	258,000	236,000
Prior period adjustment (14 + 16)	(30,000)	(14,000)
Adjusted opening balance	228,000	222,000
Profit for the year	25,000	21,000
Dividends declared	(16,000)	(15,000)
Balance 31st July	**237,000**	**228,000**

Statement of Financial Position as at 31st July

	TZS.	TZS.
	2018	**2017**
Non-current Assets	294,000	306,000
Net Current Assets(143 – 14 – 16 – 20); (102 – 14 – 16)	93,000	72,000
	387,000	**378,000**
Equity Share Capital	150,000	150,000
Retained Earnings (287 – 14 – 16 – 20); (258 – 14 – 16)	237,000	228,000
	387,000	**378,000**

ANSWER 6

(a) **Extracts from financial statements for year ended 31st March 2019**
Estimate of total cost of awards

(i) 1,000,000 share options (100 employees x 10,000 share options) can potentially be awarded.

(ii) Based on estimates of employees retention at the latest reporting date it is likely that 880,000 (88 employees x 10,000 share options) will actually be awarded, it is appropriate to take account of changes estimates of this nature.

(iii) The total expected cost of this award is TZs.7,920 million (880,000 x TZS.9,000). This cost is estimated using fair value of the option at the grant date and is not adjusted here the fair value of the option subsequently changes.

(iv) The target share price is a market condition and so is ignored when assessing the amount vesting.

Treatment in financial statements for the year ended 31st March 2019

(i) TZS.3,960 million (1/2 of total cost i.e. TZS.7,920 million) are recognized in the financial statements.

(ii) The debit entry is made either to the statement of profit or loss as an employment cost (taken to cost of sales, distribution costs or administrative expenses as appropriate) or to an asset such as inventory or PPE on the statement of financial position.

(iii) The credit entry is made to a share option account as a separate component of equity.

(b) (i) **Disclosure in the statement of financial position**

An entity shall recognize the net defined benefit liability (asset) in the statement of financial position.

(ii) **Disclosure in the statement of profit or loss**

Paragraph 120 requires an entity to recognize service cost and net interest on the net defined benefit liability (asset) in profit or loss. This standard does not specify how an entity should present service cost and net interest on the net defined benefit liability (asset). An entity presents those components in accordance with IAS 1: *Presentation of financial statements.*

(iii) **Disclosure in the notes to the financial statements**

An entity shall disclose information that:

1] Explains the characteristics of its defined benefit plans and risks associated with them;

Characteristics and risks associated with defined benefits plans

(i) Information about the characteristic of the entity's defined benefit plans, including:

- The nature of the benefits provided by the plan.
- A brief description of the regulatory framework in which the plan operates; and
- Details of any other entity's responsibilities for the governance of the plan, for example responsibilities of trustees or board members of the plan.

(ii) A description of the risks to which the plan exposes the entity, focused on any unusual, entity-specific or plan-specific risks, and of any significant concentrations of risk.

(iii) Descriptions regarding plan amendments, curtailments and settlements.

2] Identifies and explains the amounts in its financial statements arising from its defined benefit plans

Explanation of amounts in the financial statements

Numerical reconciliation from the opening balance for each of the following:

(i) The net defined benefit liability (asset), showing separate reconciliations:

- Plan assets;
- The present value of the defined benefit obligation; and
- The effect of the asset ceiling; and

(ii) Any reimbursement rights (together with an explanation of the relationship between any reimbursement right and the related obligation).

For these reconciliations each of the following should be shown:

(i) Current service cost;

(ii) Interest income or expenses;

(iii) Re-measurements of the net defined benefit liability (asset), showing separately;

- The return on plan assets, excluding amounts presented as interest income;
- Actuarial gains and losses and experience gains and losses arising from changes in demographic assumptions;
- Actuarial gains and losses and experience gains and losses arising from changes in financial assumptions; and
- The effect of the asset ceiling limit on a defined benefit asset (together with details of how the entity determined the maximum economic benefit available, i.e. whether those benefits would be in the form of refunds, reductions in future contributions or a combination of both);

(iv) Past service cost (which includes curtailments) and gains and losses arising from settlements, which need not be distinguished if they occur together;

(v) The effect of changes in foreign currency exchange rates;

(vi) Contributions to the plan, showing separately those by the employer and by plan participants;

(vii) Payments from the plan, showing separately the amount paid in respect of any settlements; and

(viii) The effect of business combinations and disposals.

3] Describes how its defined benefits plans may affect the amount, timing and uncertainty of the entity's future cash flows.

Other disclosures

(i) Numerical disclosure disaggregating the fair value of the plan assets into classes that distinguish the nature and risks of those assets, subdividing each class of plan asset into those that have a quoted market price in an active market and those that do not.

(ii) The fair value of the entity's own transferable financial instruments that are held as plan assets and fair value of plan assets used by the entity.

(iii) The significant actuarial assumptions used to determine the defined benefit obligation, such disclosure is in absolute terms, i.e. as an absolute percentage.

SUGGESTED SOLUTIONS
C2 – AUDITING AND ASSURANCE
MAY 2019

ANSWER 1

(a) (i) **Key controls and tests of control**

	Key Control available	**Test of Control to undertake**
i.	Al-amry Co. has a separate human resources (HR) department which is responsible for setting up all new employees.	Review the job descriptions of payroll and HR to confirm the split of responsibilities with regards to setting up new joiners.
ii.	Pre-printed forms are completed by HR for all new employees, and include assignment of a unique employee number, and once verified, a copy is sent to the payroll department. Payroll is unable to set up new joiners without information from these forms.	Select a sample of new employees added to the payroll during the year, review the joiner forms for evidence of completion of all parts and that the information was verified as accurate and was received by payroll prior to being added to the system
iii.	The use of pre-printed forms ensures that all relevant information, such as tax IDs, is obtained about employees prior to set up. This minimizes the risk of incorrect wage and tax payments. In addition, as payroll is unable to set up new joiners without the forms and employee number, it reduces the risk of fictitious employees being set up by payroll	Select a sample of edit reports for changes to payroll during the year; agree a sample of new employees added to payroll to the joiners forms.
iv.	The quarter production bonus is input by a clerk into the payroll system, each entry is checked by a senior clerk for input errors prior to processing, and they evidence their review via signature.	If attending Al-amry Co. at the time of bonus processing, observe the clerk inputting and senior clerk checking the bonus payments into the payroll system.
v.	This reduces the risk of input errors resulting in over/underpayment of the bonus to employees.	In addition, obtain listings of quarterly bonus payments and review for evidence of signature by the senior clerk who checks for input errors.
vi	Production employees are issued with clock cards and are required to swipe their cards at the beginning and end of their shift,	Observe the use of clock cards by employees when entering the power station.

	this process is supervised by security staff 24 hours a day.	
vii	For production employees paid in cash, cash is received weekly from the bank by a security company.	Enquire of payroll clerks how cash is delivered to Al-amry Co. for weekly pay packets.
viii	On a quarterly basis, exception reports of changes to payroll standing data are produced and reviewed by the payroll director.	Select a sample of quarterly exception reports and review for evidence of review and follow up of any unexpected changes by the payroll director.
ix	The pay packets are prepared by two members of staff with one preparing and one checking the pay packets and this is evidenced by each staff member signing the weekly listing.	The pay packets are prepared by two members of staff with one preparing and one checking the pay packets and this is evidenced by each staff member signing the weekly listing.

(ii) **Deficiencies and recommendations**

	Deficiency	**Recoomendation**
i.	Production supervisors determine the amount of the discretionary bonus to be paid to employees. Production supervisors should not determine this as they could pay extra bonuses to friends or family members, resulting in additional payroll costs.	The bonus should be determined by a responsible official, such as the production director and should be formulated based on a written policy. If significant in value, the bonus should be formally agreed by the board of directors. The bonus should be communicated in writing to the payroll department.
ii.	The wages calculations are generated by the payroll system and there are no checks performed. Therefore, if system errors occur during the payroll processing, this would not be identified.	A senior member of the payroll t4am should recalculate the gross to net pay workings for a sample of employees and compare their results to the output from the payroll system.
iii.	This could result in wages being over or under calculated, leading to an additional payroll cost or loss of employee goodwill	These calculating should be signed as approved before payment are made
iv.	Holiday request forms are required to be	Employees should be

	completed and authorized by relevant line managers.However, this does not always occur.	informed that they will not be able to take holiday without completion of a holiday request form, with authorization from the line manager.
v.	This could result in employees taking unauthorized leave, resulting in production difficulties if an insufficient number of employees are present to operate the power plant. In addition, employees taking unauthorized leave could result in an overpayment of wages.	Payroll clerks should not process holiday payments without agreement to the authorized holiday form.
vi.	The senior payroll manager reviews the bank transfer listing prior to authorizing the payments and also amends the payroll records for any changes required.	The senior payroll manager should not be able to process changes to the payroll system as well as authorize payments.
vii.	There is a lack of segregation of duties as it is the payroll team which processes the amounts and the senior payroll manager who authorizes payments. The senior manager could fraudulently increase the amounts to be paid to certain employees, process this payment as well as amend the records.	The authorization of the bank transfer listing should be undertaken by an individual outside the payroll department, such as the finance director.
viii.	The pay packets are delivered to the production supervisors, who distribute them to employees at the end of their shift.	All pay packets should be distributed by the payroll department, directly to employees, upon sight of the employee's clock card and photographic identification as this confirms proof of identity.

(b) As the audit firm receives about 20% of its income from just one audit client, there is a *self-interest or intimidation threat.* This is because the firm will be concerned about losing the client. The self-interest and intimidation threats are significant considering the nature and duration of the breach – that is the high percentage of income from a single client received for some time now; and the knowledge of the audit firm of such interest. Secondly, the valuation services provided by the audit firm. If an audit firm performs a valuation which will be included in financial statements audited by that firm, a *self-review threat arises*. This threat is significant as the valuation of Land and Buildings of all branches of the bank including the head office is material to the financial statement to be audited.

The possible safeguards for the self-interest or intimidation threats include:

- Reducing the dependence on the client
- Implementing external quality control reviews; or
- Consulting a third party, such as a professional regulatory body or a professional accountant, on key audit judgments.

(c) The code of ethics for professional accountants requires that professional accountants or auditors accept only engagement which they are competent and capable of performing. In addition they must ensure that they comply with the relevant statutory and legal requirements. **It is therefore necessary for them to carry out procedures before accepting the engagement for following reasons:**

- It determines whether they are professionally and legally qualified to accept the engagement.
- It also determines whether there are any ethical issues that may confront them if they accept the nomination. E.g. threats to the objectivity and independence.
- It determines whether they have the time and resources including expert knowledge and skills to serve the client.
- It enables to know whether they have been properly nominated and any outgoing auditor has properly parted with his client.
- They must also fulfil the professional etiquette requirement of communication with the outgoing Auditor if any as a sign of courtesy and to required information as to whether there are professional reasons for not accepting the nomination.
- The procedures also enable the auditors to determine whether the prospective client has integrity and falls within the risk appetite of the firm.
- The procedures are carried out to enable the auditor make an informed decision whether to accept or reject the nomination.
- Setting of audit fees—once the total time and staff required for the assignment is ascertained, it should be easy for the auditor to determine appropriate fee to be charged.

(d) (i) **Limitations in the audit process can be listed as follows**:

Inherent Limitations

Due to the inherent limitations of audit, auditors are only able to offer 'reasonable assurance' over the truth and fairness of the financial statements rather than absolute assurance. Inherent limitations of audit are discussed below.

Use of Professional Judgment

Audit involves the use of judgement in the identification of audit risks, selection of appropriate auditing procedures and the interpretation of audit evidence. Although auditing standards provide guidelines to assist auditors in forming should professional judgements, it is inevitable that an auditor may at times misjudge a situation which may cause the auditor to overlook a misstatement in the financial statement.

Use of Sampling
Auditors apply sampling techniques to limit the number of transactions and balances selected for audit testing in order to perform the audit efficiently and cost effectively. The results derived from the selected transactions and balances may not however be representative of the entire population. There is therefore, an inherent risk that the audit procedures may fail to detect a material misstatement in the financial statements due to the inability of auditors to perform detailed testing of the entire population of transactions and balances.

Management Representations
Generally, external evidence is considered to be a more reliable form of audit evidence than internal evidence produced by the management. Although auditors collect audit evidence from a range of sources, too often they have to rely on the representations of management in order to assess the reasonable of the matters concerning financial statements. This is particularly the case in matters that involve the use of judgement by the management as it is usually difficult to corroborate management representations about the appropriateness of their judgements with external evidence.

Risk of Fraud
By their very nature, frauds are intended to be concealed by the perpetrators and therefore pose a very high risk of remaining undetected by the auditors even in spite of the application of should audit methodology and procedures.

Time Constraints
In practice, auditors face strict time constraints within which they have to provide their opinion on the financial statements. Auditors tend to priorities tasks that are essential for the effective performance of the audit. In some cases, particularly where there is legal requirement for companies to publish their financial A reports within a certain time frame, the auditors may, in a bid to meet the assignment deadlines, fail to consider an important matter in the finalization of the audit report.

Independence Threats
Whereas the ethical guidelines issued by IFAC and other professional bodies attempt to minimize the instances of loss of objectivity of auditors, certain level of conflicts of interest are inevitable in practice. The perceived independence of an auditor is for instance impaired where a client accounts for a significant portion of the revenue of the audit firm.

Reliance on Internal Controls
In the vast majority of audits, auditors rely on the internal control system as a critical source of audit evidence. However, internal control systems have inherent limitations of their own as follows:

- Most internal control systems rely on separation of duties and thus can be overcome by collusion between employees, or employees and outsiders.
- Internal control often relies on checking or double-checking; but even double-checking is subject to human error.

- Internal controls are only of benefit if they are cost-effective so it may be unwise to attempt to stop all errors and frauds.
- Internal controls are typically designed to deal with routine, repetitive transactions hence non-routine or once-off transactions (e.g. sales of property, plant, and equipment) may not be subjected to proper controls.
- Internal controls can sometimes be overridden by management especially in smaller or non-profit organizations.

(ii) **The following are reasons for these limitations resulted to the failure to detect a fraud even when the audit is properly performed:**

a) The amount of the fraud was fairly immaterial in the context of the size of the business being approximately 3.67% of net profit and 0.55% of revenue. It would not, therefore, have been very evident in the analytical review of the financial statements.

b) We are not told how the fraud was perpetrated nor the extent to which it was covered up by the financial accountant but if TZS.22,000,000 was spread evenly across 1,900 customers the amount at stake for each customer would have been less than TZS11,600 which, in this context, is a trivial amount unlikely to attract a great deal of attention.

c) The fraud was carried out in the year to December 2016 and discovered in March 2017. This is a reasonably short period and it is not even clear that the audit would have been finalized by the time the fraud was discovered by another means.

d) We are told that the fraud was carried out by collusion and collusion will undermine most systems of control because such systems rely, to a large extent, on segregation of duties.

e) In addition, there appear to have been two strands to the collusion – one with a salesperson but the other with a member of staff in an independent debt collection agency. This would have made the fraud fiendishly difficult to discover.

(e) **ISA 265 state the matters to be consider when determining whether a deficiency in internal control is a significant deficiency. These include:**

i. The likelihood of the deficiencies resulting in material misstatements in the financial statements in the future.
ii. The importance of the controls to the financial reporting process
iii. The susceptibility to loss or fraud of the related asset or liability
iv. The interaction of the deficiency with other deficiencies in internal control
v. The amounts exposed to the deficiencies
vi. The cause and frequency of the exceptions identified as a result of the deficiencies.
vii. The volume of activity that has occurred or could occur
viii. The subjectivity and complexity of determining estimated amounts.

ANSWER 2

(a) Assertions for classes of transactions and events

(i) **Occurrence**

Transactions and events that have been recorded have occurred or disclosed have occurred and such transactions and events pertain to the entity.

Substantive procedures

- Select a sample of sales transactions recorded in the sales day book; agree the details back to a goods dispatched note (GDN) and customer order.
- Review the monthly breakdown of sales per key product, compare to the prior year and budget and investigate any significant differences.

(ii) **Completeness**

All transactions and events that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.

Substantive procedures

- Select a sample of GDNs raised during the year; agree to the sales invoice and that they are recorded in the sales day book.
- Review the total amount of sales, compare to the prior year and budget and investigate any significant differences.

(iii) **Accuracy**

The amounts and other data relating to recorded transactions and events have been recorded appropriately, and related disclosures have been appropriately measured and described.

Substantive procedures

- Select a sample of sales invoices and recalculate that the totals and calculation of sales tax are correct.
- For a sample of sales invoices, confirm the sales price stated agrees to the authorized price list.

(iv) **Cut-off**

Transactions and events have been recorded in the correct accounting period.

Substantive procedures

- Select a sample of pre and post year-end GDNs and agree that the sale is recorded in the correct period's sales day books.

- Review the post year-end sales returns and agree if they relate to pre year-end sales that the revenue has been correctly removed from the sales day book.

(v) **Classification**

Transactions and events have been recorded in the proper accounts.

Substantive procedure

Agree for a sample of sales invoices that they have been correctly recorded within revenue nominal account odes and included within revenue in the financial statements.

(vi) **Presentation**

Transactions and events are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

Substantive procedures

For an entity applying IFRS 15 Revenue from contracts with customers, obtaining a breakdown of trade receivables and for a sample of receivables, reviewing the related sales contract to ensure that the entity's right to consideration is not conditional.

(b) (i) **Substantive procedures for supplier statement reconciliations**

- Select a representative sample of year-end supplier statements and compare the balance to the purchase ledger of Hazogo. If the balance agrees, then no further work is required.
- Where differences occur due to invoices in transit, confirm from goods received notes (GRN) whether the receipt of goods was pre year end, if so confirm that this receipt is included in year-end accruals.
- Where differences occur due to cash in transit from Hazogo to the supplier, confirm from the cashbook and bank statements that the cash was sent pre year end.
- Discuss any further adjusting items with the purchase ledger supervisor to understand the nature of the reconciling item, and whether it has been correctly accounted for.

(ii) **Substantive procedures for bank reconciliation**

- Obtain Hazogo's bank account reconciliation and cast to check the additions to ensure arithmetical accuracy.
- Compare the balance per the bank reconciliation to an original year-end statement and to the bank confirmation letter.
- Compare the reconciliation's balance per the cash book to the year-end cash book.

- Trace all the outstanding lodgments to the pre year-end cash book, post year-end bank statement and also to paying-in-book pre year end.

- Trace all unpresented cheques through to a pre year-end cash book and post year-end statement. For any unusual amounts or significant delays, obtain explanations from management.

- Examine any old unpresented cheques to assess if they need to be written back into the purchase ledger as they are no longer valid to be presented.

(iii) **Substantive procedures for receivables**

- Review the aged receivable ledger to identify any slow moving or old receivable balances, discuss the status of these balances with the credit controller to assess whether they are likely to pay.

- Select a significant sample of receivables and review whether there are any after date cash receipts, ensure that a sample of slow moving/old receivable balances is also selected.

- Review customer correspondence to identify any balances which are in dispute or unlikely to be paid.

- Review board minutes to identify whether there are any significant concerns in relation to payments by customers.

- Calculate average receivable days and compare this to prior year, investigate any significant differences.

- Inspect post year-end sales returns/credit notes and consider whether an additional allowance against receivables is required.

- Select a sample of goods dispatched notes (GDN) before and just after the year end and follow through to the sales ledger to ensure they are recorded in the correct accounting period.

- Select a sample of year-end receivable a balances and agree back to valid supporting documentation of DGN and sales order to ensure existence.

ANSWER 3

(a) We have no way of judging the substance of this report in the sense that we are not aware of the facts that lie behind it. However, we can see that it is reasonably well constructed and that it appears to have a high degree of internal consistency. The situation here appears to be that the directors of the company in question have refused to carry out a revaluation on the property plant and equipment. We have no idea of the materiality of the property, plant and equipment in the context of the company as a whole but at nearly TZS.100 billion it surely must be material. The auditors are obviously of the opinion that this valuation is seriously impaired. In an ideal world a reader of the audit report might wish to be informed about the extent of that impairment. In this case this is not forthcoming probably because it is unknown to the auditors but nevertheless they do state that published information concerning comparable properties indicates that very significant reductions in the value have been experienced. They further go on to state, in essence, that in their opinion the extent of the impairment is such as to render the financial statements as a whole misleading and therefore it is necessary for them to issue an adverse opinion on the financial statements. This is consistent with the heading to the paragraph which is "adverse opinion on the financial statements". Appropriate reference is also made to the relevant International Accounting Standard 36 – *Impairment of Assets*.

Whilst this audit report does not contain all of the information that perhaps it would in ideal circumstances it does seem like a reasonable report and reasonable opinion for the auditors to have formed given the lack of information.

The alternative presumably would have been for them to disclaim the opinion of the financial statements on the basis of a lack of information. However, they have obviously been convinced that an adverse opinion is more appropriate in the circumstances. There is nothing in the information provided to suggest that there is any reason why they should not have come to this conclusion.

(b)(i) Three decades ago the opinion paragraph of the audit report was the entire report and, indeed even then, it was shorter than the opinion paragraph of today. Arguably the opinion paragraph was, and still is, the only thing that a reader needs in an audit report.

Other paragraphs were added around 1993. These included the "basis of opinion' paragraph; the ''responsibilities of directors" paragraph; and various other paragraphs that have come and gone over the years.

No reasonably sophisticated reader of the financial statements will discover anything from these paragraphs of which they were not already aware. All of these paragraphs use what is described as boilerplate language meaning that they use a certain set form of wording which is more or less prescribed by the professional accounting bodies. One has to wonder about how many naïve readers of financial statements there actually are.

The most recent set of additions to paragraphs of the audit report are somewhat different. One of them mandates that there should now be a going concern paragraph in every audit report and the argument could certainly be made that this information is useful to readers. It also prevents auditors from skirting round or not addressing the subject of going concern.

We now also have the inclusion of the so-called "key audit matters" paragraph which will be mandatory for public interest entities. The guidance that is being produced by the accounting bodies emphasizes that these paragraphs should not use boilerplate language and should be unique to each set of financial statements.

The requirement for key audit matters paragraphs applies only to financial statements for periods beginning on or after 15th December 2016. However, these key audit matter paragraphs have been used for a number of years by several listed companies. It would appear that they provide useful extra information to users of the financial statements and that they help to demystify the process of auditing by, for example, discussing how the auditor for has obtained the materiality figures used for the purposes of the audit.

In the same way these are also some new requirements about matters on which the auditors are supposed to report by exception. In the past these items would have been not highlighted in the financial statements and hence readers, unless they were very familiar with company aw, would have been unaware that these matters were implied by virtue of their omission from the audit report.

(ii) The downside of these additions to the report is that the audit report is now very long, even a prototype report runs to 3 closely typed pages. It is to be wondered therefore if readers will actually plough through that information. However, one advantage of the new report is that the *opinion paragraph has been repositioned to the very beginning of the audit report.* So, even a reader who does not wish to examine the entire report will at least be very quickly made aware of the auditor's overall opinion on the financial statement.

ANSWER 4

(a)(i) The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of or disclosure in, the financial statements are appropriately reflected in those financial statements.

Two types of subsequent events – Adjusting and Non-Adjusting
Adjusting – **Adjusting events** are those events providing additional evidence relating to conditions existing at the reporting date they require adjustment in the financial statements.

Examples
- Trade receivables going bad
- Credit notes relating to sales made before the reporting date
- Inventory at the year-end sold lower than cost

Non-adjusting-events are those events concerning conditions which arose after the reporting date, but which may be of such materiality that disclosure is required to ensure that the financial statements are not misleading.

Examples
- Takeover
- Legal issues after the year end
- A fire after the year end

(ii) If a non-adjusting event impacts the going concern assumption, the event becomes an adjusting event as the going concern basis of preparation may no longer be appropriate or disclosures may need to be included.

Example
If the non-adjusting event is a i.e. a flood or fire which destroys the premises and inventory and adequate insurance is not in place, the company may not be able to replace the plant and equipment or inventory it needs to trade. It may not be able to buy or lease premises to operate from. In this case, the financial statements would have to be prepared on a break up basis.

(b)

1. On 2nd August 2018 had a sale of inventory for a price which was less than its cost (the inventory was recorded in the FS to 31 July 2018 as closing inventory): **Adjusting:** new evidence on something that existed on 31th July 2018: action write stock down to its net realizable value.

2. The issue of new shares on 3rd August 2018: **Non -adjusting:** event did not exist at 31 July 2018: disclose as a note.

3. A fire in the warehouse destroyed the entire inventory on 8th august 2018: **Non- adjusting:** the stock existed at 31st July – it was only destroyed after year end.

4. A major credit customer that owed us TZS150 million per financial statements at 31st July 2018, was declared bankrupt n 10th August 2018: **Adjusting**: balance existed at 31st July – event just gives us new evidence on the balance: action write off TZS150 million as a bad debt.

5. The purchase of an asset on 21st August 2018: **Non -adjusting:** event occurred after 31 July: action disclose only.

6. On 27th August 2018, Mapito's solicitor received a claim from an employee who fell at our premises on 1st March 2018. The solicitor estimates a claim against Mapito of TZS.75 million. **Adjusting:** the event (the fall) occurred before 31st July – we just now have the evidence-action provide for an expense and a liability.

ANSWER 5

(a) Factors that A & S Co. should consider when placing reliance on the work of

1. Auditor should evaluate whether the auditor's expert has the necessary competence and capabilities.
2. Auditor should evaluate the objectivity of the auditor's expert. This will include an inequity of interest and relationships that would create a threat to objectivity.
3. Auditor should determine the nature scope and objectives of the work of the expert by obtaining an understanding of the field of expertise of the expert.
4. Auditor should agree the nature, scope and objectives of the work, roles and responsibilities, nature, timing and extent of communications, confidentiality requirements etc. in writing with the expert.
5. Auditor should evaluate the relevance and reasonableness of the expert's work and consistency with the other evidence obtained by the auditor.
6. Auditor should evaluate relevance and reasonableness of any assumptions and methods used by the expert.
7. Auditor should evaluate the relevance, completeness and accuracy of any source data used by the expert.

(b) Acceptability of the accounting treatment adopted by Kilimani for kitchen equipment

Kitchen equipment
As the equipment was not actually in the company's possession and available for use at the year-end the advance paid should not have been accounted under plant and machinery but rather as a pre-payment. Further, asset cannot be depreciated as it is not available for use by the company during the year.

(c) Three (03) appropriate substantive procedures each that you could require to perform in order to verify;

(i) **Land and Buildings**

- Physical verification of the building
- Examine documents of title to confirm ownership.
- Enquire about any charges on the building and confirm that these have been properly recorded and disclosed.
- Review the valuer's certificate and agree to the amount used in the financial statements, with consideration also being given to his qualifications experience and reputation.
- Assess the reasonableness of the valuation by comparison with many similar properties which may have recently changed hands on the open market.

(ii) **New restaurants**

- Physical verification of the asset.
- Ascertain and confirm the details of any security granted/mortgage over the asset, ensuring that this is properly recorded and disclosed.
- Review the detailed costing of the building and obtain explanations for any material variances from the original budget.
- Particular care should be taken in assessing the reasonableness of any overheads included as an element of cost.
- Review the depreciation policy for adequacy and consistency.
- Check the compliance with laws and regulations (e.g. Operating licenses)

ANSWER 6

(a) (i) **Duties of CAG in Value for Money (VFM) Audit**

- Review, appraise, monitor and report on clarity of objectives, target and performance measures.
- Review of management controls
- Suggest possible improvements of operational methods
- Monitor external regulatory requirements
- Suggest ways of minimizing unnecessary or wasteful practices and avoid duplication of efforts within or between departments or ministries.
- Help in establishing criteria for measuring results, unit cost and comparative statistics

(ii) **Value for Money (VFM) audits are more useful in audits in public sector due to the following**:

- It provides checks on mismanagement, misuse and underutilization of resources, both financial and non-financial resources.
- It improves accountability in public sector thus reducing fraud and embezzlement of funds.
- It assists in controlling expenditure.
- It provides assurance that the financial, physical and human resources entrusted to the government by the parliament and operating officers by government are being managed in due regard to economy, efficiency and effectiveness.

(b) (i) **The four deficiencies in the Saluti BOARD and proposed new non-executive directors are as follows:**

- In this case the total number of directors is 9. However, non-executive directors are only 2.
- Advice: there should be at least 3 non-executive directors
- In this case Ms. Herieth and Mr. Hassan are not independent because of their relationship with staff or salute as an organization.
- Advice: They should not belong to the Board of Directors of Saluti.

(ii) **The suitability of Ms. Kasheshe to serve as the chairperson of the Audit committee:**

In this case Ms. Kasheshe is not a non-Executive Director therefore does not deserve to be appointed as chairperson of the audit committee.

(iii) **Factors that entity might consider when assessing the need for internal audit function are as follow**:

- The cost of setting up an internal audit department versus the predicted benefits
- Predicted savings in external fee, where work carried out by consultants
- The complexity and scale of the organization's activities and the systems supporting those activities
- The ability of existing managers and employees to carry out assignments that internal audit may be asked to carry out
- Whether it is more cost-effective or desirable to outsource the work
- The pressure from external stakeholders to establish an internal audit.

SUGGESTED SOLUTIONS
C3 – BUSINESS AND CORPORATE FINANCE
MAY 2019

ANSWER 1

The management of the Soft life should use, following strategies to grow their business

(i) **Marketing Development strategy**

Yummy Baking Flour
Market development is a growth strategy where the business seeks to sell its existing products into new markets. Soft Life may adopt a market development approach to maximize its chances of success in introducing Yummy backing flour to Kenya.

There are many possible ways of approaching this strategy, including:
- New product dimensions or packaging
- Different pricing policies to attract different customers
- Create new market segments

Market development is a more risky strategy than market penetration because of the targeting of new markets. Soft Life should therefore approach this market with caution especially in terms of quantity and speed with which it allocates resources for this new market.

(ii) **Product Development strategy**
Shynit fondant polish.

Product development is a growth strategy where a business aims to introduce new products into existing markets. This strategy may require the development of new competencies and requires the business to develop modified products which can appeal to existing markets. Since Soft Life is introducing a new product in Shynit, it should focus on the product development strategy. A successful product development strategy places the marketing emphasis on:

- Research and development and innovation
- Detailed insights into customer needs (and how they change)
- Being first to market

(iii) **Diversification strategy**
Diversification is the name given to the growth strategy where a business markets new products in new markets. This is a fitting strategy for the plan to introduce a new product ‘Shynit’ Uganda market.

This is an inherently more risk strategy because the business is moving into a market in which it has little or no experience. For a business to adopt a diversification strategy, therefore, it must have a clear idea about what it expects to gain from the strategy and an honest assessment of risks.

The approaches to this strategy are;
- Internal development of new product
- Acquisition of firm
- Licensing of new technology

(b) **Product Life Cycle**

The maturity stage of Product Life Cycle is characterized by the following:
- The sales growth slows down or levels off after reaching the peak due to arkey saturation.
- It lasts longer than the preceding stages.
- Poses strong challenges to marketing management and needs careful selection of product life strategies.
- High competition
- High advertising costs to sustain the growth.
- The major focus is towards extending the life cycle and maintaining market share.

The following are marketing and distribution strategic choices for maturity stage of product life cycle:

i. Intensification of brand promotion by means of
   - More intensive and brand-stressing advertising
   - Heavier point-of-sale effort
   - More attractive design and functional packaging
   - Advertising messages and media for different market segments
   - More after-sales service for the product; and
   - Increase in sales promotion expenditure rather than advertising to hold customer loyalty rather than seek out new buyers.

ii. Trading down through
   - Entering a fighting brand on the market at a lower price to avoid jeopardizing an established premium brank
   - Introduction of low-priced models of an established brand;
   - Lowering of prices of the entire product line and keeping prices close to private levels; and
   - Production for private levels

iii. Proliferation, exclusive or radical, by
   - Offering more variety in features and designs, etc;
   - Seeking more exclusive and innovative features;
   - Creating more radical and distinct package designs; and
   - Making more options available in accessories, and design, etc

iv. Trading up (strategy opposite to item 2) through
- Improvement of quality, appearances, etc. to offer better product;
- Use of prestige packages, branch name, etc; and
- Increase of prices to cream market labels (in order to increase penetration of markets willing to pay higher prices, earn more margin on possibly lower sales, and keep greater differentiation over competitive products)

v. Increase of product availability and point-of-sale service through
- More distribution centers closer to the point of use or sale;
- Longer channels to make the product more available at wholesale level;
- More outlets and different channels; and
- Improvement of services offered by dealers (where applicable) or establishment of own service centrers.

(c)(i) The following are how the nature and extent to which human and behavioral relations affect financial planning and control:

1. Diverse interest of individuals and parties in contact with firm and firm interest. (Agency problem) and desire to merge these interests in order to achieve goal congruence.
2. Behavioral aspect during the planning stage
   - At setting objectives.
   - Choice of strategies.
   - Implementation and evaluation.
3. Behavioral aspect during the control
   - At setting standards
   - Measurement
   - Evaluation
   - Corrective action
4. Need for participatory planning and control to achieve:
   - Goals and motivation
   - Facilitation of communication
   - Fair allocation of resources

5. Internal and external environment affecting organization.

(ii) Conflicts of interest between management and employees are follows:
- Employee demand high salary from the organization
- Employees demand other incentives apart from salary such as bonus, loan, and accommodation allowance.
- Management demand compliance with work regulation and by laws
- Management demand high productivity from employees.
- Employee demand time to stay with their families while at the same time management needs them at the office.

The conflict of interest between management and shareholder

The management demands their interest such as to have good salaries; working environment and good incentives for improving their personal life while Shareholder demand higher return from investment for retained earnings and higher dividend. This conflict of interest between management and shareholder create agency problems which results into the agency cost.

ANSWER 2

(a) There are several causes of TZS/US$ exchange rate fluctuations the most important being:

(i) *Currency Supply and Demand*

The exchange rate between two currencies will fluctuate in response to changes in demand for and supply of the currencies in the foreign exchange markets. *The higher supply of the US dollar in the market relative to its demand will result into depreciation of its value relative to TZS and vice-versa.*

(ii) *Interest rates*

Changes in interest rate affect the domestic currency value relative to the foreign currency. The currency of a country with relatively high interest rates is expected to depreciate against that with lower interest rates, because the higher interest rates are considered necessary to compensate for anticipated currency depreciation. Accordingly, a rise in the Tanzania inflation rate relative to that of USA will be associated with increase in its *interest rate* relative to US interest rates and a fall in the Tanzanian Shillings' value.

(iii) *Inflation*

Purchasing power parity theory predicts that the exchange value of foreign currency depends on the relative purchasing power of each currency in its own country and that spot exchange rates will vary over time according to relative price changes. IF Tanzania experiences lower interest rate compared to United State of America (USA) the Tanzania shillings will appreciate relative to US dollar and vice-versa.

(iv) *Country's Current Account / Balance of Payments*

A country's current account reflects balance of trade and earnings on foreign investment. It consists of total number of transactions including its exports, imports and debt. Country's deficit in current account due to spending of more foreign currencies for importing products than it is earning through sale of exports causes depreciation of domestic currency. Specifically, if Tanzania experiences a deficit balance of payment would imply depreciation of TZS relative to foreign currencies.

(v) *Political stability and performance*

A country's political state and economic performance can affect its currency strength. A country with less risk for political turmoil is more attractive to foreign investors, as a result, drawing investment away from other countries with more political and economic stability. Increase in foreign capital, in turn, leads to an appreciation in the value of its domestic currency. A country with sound financial and trade policy does not give any room for uncertainty in value of its currency. But, a country prone to political confusions may see depreciation in exchange rates.

(b) (i) **Evaluation of the Interest Rate Swap**

	FIXED RATE	**FLOATING RATE**
Everis Company	11.5%	LIBOR + 1.4%
Sepide Company	10.1%	LIBOR + 1%
Difference	1.4%	0.4%

The Overall Swap Benefit (QSD) is 1.4% - 0.4% = 1%

Sharing: Sepide: 0.7 x 1% = 0.7%

Everies: 0.3 x 1% = 0.3%

Thus an interest rate swap may be arranged that is beneficial to both firms.

(ii) **Calculating the net savings by each party in the two years of the swap:**

Sepide Company

Year 1

Gross Benefit	0.7% x TZS100m	TZS 70, 000,000
Less: Upfront Fee		TZS 50,000
Annual fee	(0.25% x TZS100m)	TZS 250,000
Net Savings		**TZS 69,700,000**

Year 2

Gross Benefit	0.7% x TZS100m	TZS 70,000,000
Less: Annual fee	(0.25% x TZS100m)	TZS 250,000
Net savings		**TZS 69,750,000**

Everis Company

Year 1

Gross Benefit	0.3% X tzs100m	TZS 30,000,000
Less: Upfront fee		TZS 50,000
Annual fee	(0.25% x TZS100m)	TZS 250,000
Net savings		**29,700,000**

Year II

Gross Benefit	0.3% x TZS100m	TZS 30,000,000
Less: Annual Fee	(0.25% x TZS100m)	TZS 250,000
Net savings		**TZS 29,750,000**

(iii) **Comments on the Possible Benefits on Interest Rate Swap to a Firm**

Interest rate swaps may provide several benefits to companies including:

- The ability to obtain finance at a cheaper cost than would be possible by borrowing directly in the relevant market.
- The opportunity to effectively restructure a company's capital profile without physical redeeming debt.
- Long-term hedging against interest rate movements as swaps may be arranged for periods of several years.
- The ability to access a type of finance which could not be accessed directly, for example because the borrower is relatively unknown in the market or has a relatively low credit rating.

ANSWER 3

(a) (i) **PV = Equated Annual Instalment x $\text{PVIFA}_{5\%,4}$**

$\text{PVIFA}_{5\%,4} = 1 – 1.05^{-4}/0.05 = 3.5460$

R = 10m $\div$ 3.5460 = TZS.2, 820,079.

Annual loan payment required: TZS. 2, 820,079.

Break-up of interest and principal payments (TZS millions):

Year	Opening balance of loan (million)	Interest rate at 5% (million)	Principal repayment (million)
1	10.000	0.500	2.320
2	7.680	0.384	2.436
3	5.244	0.262	2.558
4	2,686	0.134	2.686
Total		1.280	10.000

(ii) The before-tax rate of return to the lessor implied by the terms of the proposed lease agreement as follows:

Month	**0**	**1-48**
Cost of equipment	(10.000)	
Lease Rental	0.223	0.223 per month
Total	**(9.77)**	**0.223 per month**

The rate of return earned by the lessor is the IRR of these cash flows. Try 4.8% (i.e. 0.4% per month):

Monthly $\text{PVIFA}_{0.4\%,48}$ = 1-1.004 = 43.5942

NPV = (0.223 x 43.5942) – 9.777 = 9.7215 – 9.777 = -0.0555m. This is negative, so try a lower rate say 4.2% (i.e. 0.35% per month):

Monthly $PVIFA_{0.35\%,48}$ = 1-1.0035-48/0.0035 = 44.1138

NPV = (0.223 X 44.1138) – 9.77 = 9.8374 – 9.777 = 0.0604m

Using interpolation, monthly IRR = (9.0604 ÷ 0.1159) x 0.05) + 0.35 = approximately 0.376% before tax.

This is the periodic rate of return per month. The effective annual rate would be: $(1.00376)^{12} - 1 = 4.6$

This is lower than the rate of interest on the bank loan.

(iii) **Advantages of leasing – the essential points are: -**

- Because the lessor retains legal title to the assets, credit assessment is usually less rigorous than for a bank loan. Access to finance is relatively easy and quick, and lease finance is often available when other forms of finance are not.

- For the same reason lease finance generally carries fewer covenants and restrictions than other forms of finance like loans and debentures.

- Specialist leasing companies may gain economies of scale in asset purchases, and pass on some of the cost savings to lessees through competitive lease rental terms.

- Lease finance can be flexibly structured, with the rentals front-ended or back ended as desired.

- Although not so in the case of Jumbo Limited, finance leases often require smaller down payments than other forms of finance.

- Techniques like sale and leaseback can generate liquidity for cash-strapped firms. The most important advantage is that, because (for example) the lessor may gain the benefit of capital allowances or their equivalent, differences in the tax-paying status of lessor and lessee can create comparative advantages that offer scope for tax trading. Scope for such tax trading also arises particularly when the lessee is tax-exhausted or non-tax-paying. The time lag between when taxes are incurred and when they are actually paid can also have an advantageous impact. The benefits gained through tax trading can result in.

(b) **Operating Leases**

Operating leases are in essence rental agreements between a lessor and a lessee in which the lessor tends to be responsible for servicing and maintaining the leased asset. The lease period is substantially less than the expected economic life of the leased asset so assets leased under operating leases can be leased to a number of different parties before they cease to have any further use. The types of asset commonly available under operating leases include cars, computers and photocopiers. The leased asset does not appear in the financial position statement and for this reason operating leases are referred to as off-balance-sheet financing.

Finance Leases
A finance lease is a non-cancellable contractual agreement between a lessee and a lessor and exists, according to the accounting standard, in all cases where the present value of the minimum lease payments constitute 90 per cent or more of the fair market value of the leased asset at the beginning of the lease period. The intention is to require the financial statements to recognize what the lessee owns. The substance of the finance lease agreement is that, even though, under its legal form, title to the leased asset remains with the lessor, the lessee will recognize it on the statement of financial position.

ANSWER 4

(a) (i) **Categories of participants in the derivative markets:**

Hedgers
Hedgers are those who enter into a derivative contract with the objective of covering risk arising from price fluctuations. Farmer growing wheat faces the uncertainty about the price of his product at the time of harvest. Similarly, a flourmill needing wheat also faces uncertainty of price of input. An exporter faces the risk of exchange rate volatility. In this regard these people participate in the derivative market to mitigate the risk associated with their activities.

Speculators
Are those who enter and participant into a derivative contract and derivative market in view of making profit from the subsequent price movements. They operate at a high level of risk in anticipation of profits and provide liquidity in the market.

Arbitrageurs
A third category of participants is an arbitrageur. While hedgers and speculators want to eliminate and assume risk respectively, the arbitrageurs take a risk-less position and yet earn profits. They are constantly monitoring the prices of different assets and identify opportunities to make profits that emanate from mispricing of products. The most common example of arbitrage is the price difference that may exist at different stock markets.

(ii) **Functions of Derivative markets/instruments**
Price discovering
With broadening of the market, the changes in price of the product are watched by those who trade on the slightest reason. Even a minor variation in price prompts action on the part of speculators. Active participation by a large number of buyers and sellers ensures fair price. The derivative markets therefore facilitate price discovery of assets due to increased participants, increased values, and increased sensitivity of participants to react to smallest of price changes.

Facilitate Transfer of risk and risk management (Risk diversification)
Hedgers amongst themselves could eliminate risk if two parties face risk from opposite movement of price. The wheat farmer needing to sell his products face risk from the fall in price while the flourmill needing to buy wheat was worried about the rise in price. When speculators enter the market, they discharge an important function and help transfer risk from those wanting to eliminate to those wanting to assume it.

Leveraging/Investment cost reduction
Taking position in derivatives involves only part of capital outlay when compared to the position in underlying asset in the spot market. Derivatives as products and their markets provides exceptional exist routes by permitting neutralization of risk involved in the underlying assets.

(b) (i) **Calculating Net Receipts**
The company has sales receipts amounting to US$450,000 and payables amounting to US$250,000 both maturing on 30th June, 2019. Exposure netting results into a net receipt to the tune of US$200,000. The company will then hedge US$200,000 Net Receivables.

Expected TZS Receipts of the US$ in June, 2019

a. **Forward Market Hedge**
To use the forward market hedge Beseni Company would sell the US$200,000 three months forward at the rate of TZS2,310/US$. The expected receipts of this transaction in three months would be:

Expected Receipts = US$200,000 x TZS2310/US$ = TZS 462m (Receivable in three months)

b. **Money Market Hedge**
To hedge the US$200,000 receivables in the money market the company would borrow the US$ at 8% p.a for three months. The US$ so borrowed would be converted into TZS spot.

The amount to be borrowed so that US$200,000 become payable in three months would be:

US$ (1 + 8/4%) = US200,000
US$ (1.02) = 200,000

US$ = US$196,078.4

Selling the US$196,078.4 spot at the rate of TZS2,314/US$ would yield: US$196,078.4 x TZS2,314/US$ =TZS453,725,417.6 (Receivable Now).

(ii) **Recommendation of the most financially advantageous alternative for Beseni Company are as follows:**

Assuming the TZS453, 725,417.6 (Receivable Now) under the Money Market Hedge could be invested at the TZS deposit rate of 4% per annum (or 1% for three months) for three months the amount receivable at the end of the three months would be:

TZS453,725,417.6 (1.01) = TZS458,262,671.8

Comparing Forward Market Hedge and Money Market Hedge

	Now	3 months' time
Forward market		TZS462,000,000.0
Money market	TZS453,725,417.6	TZS458,262,671.8

Thus the forward market hedge appears to be more profitable. It is therefore recommended.

ANSWER 5

(a) Securitization is the process of packaging of designated pools of financial instruments (such as loans or receivables) with an appropriate level of credit enhancement and the redistribution of these packages to investors.

- The loans or receivables are homogenized and packaged into units (securities) that are then sold. Investors buy the repackaged assets in the form of securities which are effectively collateralized (secured) on the underlying pool of loans and their associated income streams.

- The main objectives of securitization
  (i) To develop an investment vehicle that isolate a defined loan pool, segment the credit risk, and structure the cash flows from the underlying loans to suit the needs of some particular/target investors

  (i) Converting illiquid assets into liquid (and marketable) assets.
  (ii) Credit enhancement which can be achieved through aspects such as collateralization, composition as well as pooling and distribution of risks.

- **How it is used by financial institutions** (This is primarily to clear their balance sheets, transfer risk and allow continuous origination of loans)

  - Securitization is often used by financial institutions to effectively sell loans and other obligations such as mortgage to individual investors.

  - Securitization enable banks to release funds tried into loans and other obligations. Most of mortgages issued by banks are funded principally by deposits, and sometimes by debt. These are direct obligations of the bank (rather than claims on specific assets).

- o Allows a bank to "clean" its balance sheet by disposing off loans and other obligations. This also allows originating more loans or even changing its focus with respect to assets it wants to hold in its balance sheet.

(b) **Twiga Company**

(i) **Effect on wealth**

Rights issue price = 35 x 0.8 = TZS.28 per share

Twiga Co. currently has 20 million shares in issue (100m/5). The number of new shares issued = 20m/5 = 4 million shares

Cash raised by the rights issue before issue costs = 4m x TSZ.28 = TZS.112, 000,000. Net cash raised by the rights issue after issue costs = 112,000,000 – 2,800,000 = Tshs.109, 200,000.

Revised number of shares = 20m + 4m = 24 million shares

Market value of Twiga Co. before the rights issue = 20,000,000 x 35.0 = TZS.700, 000,000.

Market value of Twiga Co. after the rights issue = 700,000,000 + 109,200,000 = TZS.809, 200,000.

Theoretical ex rights price per share = 809,200,000/24,000,000 = TZS.33.7 per share.

Redemption price of loan notes = 1,040 x 1.05 = TZS. 1,092 per loan note.

Nominal value of loan notes redeemed = 109,200,000/ (1,092/1000) = 100,000,000

Before-tax interest saving = 100,000,000 x 0.08 = 8,000,000 per year.

After-tax interest saving = 8,000,000 x (1 – 0.3) = TZS. 5,600,000 per year.

Earnings after redeeming loan notes = 84,000,000 + 5,600,000= 89,600,000 per year

Revised earnings per share = (89,600,000/24,000,000) = 3.73 per share.

Price/earnings ratio of Twiga Co. before the rights issue = 35/4.2 = 8.33 times. This price/earnings ratio is not expected to be affected by the redemption of loan notes. Share price of Twiga Co. after redeeming loan notes = 8.33 x 3.73 = TZS .31.1 per share.

The wealth of shareholders of Twiga Co. has decreased as they have experienced a capital loss of TZS.2.6 per share (33.7 – 31.1) compared to the theoretical ex rights price per share.

(ii) The capital structure is considered to be optimal when the weighted average cost of capital (WACC) is at a minimum and the market value of a company is at a maximum. The goal of maximizing shareholder wealth might be achieved if the capital structure is optimal.

The question of whether Twiga Co. might achieve its optimal capital structure following the rights issue can be discussed from a theoretical perspective by looking at the traditional view of capital structure, the views of Miller and Modigliani on capital structure, and other views such as the market imperfections approach. It is assumed that a company pays out all of its earnings as dividends, and that these earnings and the business risk of the company are constant. It is further assumed that companies can change their capital structure by replacing equity with debt, and vice versa, so that the amount of finance invested remains constant, irrespective of capital structure. The term 'gearing up' therefore refers to replacing equity with debt in the context of theoretical discussions of capital structure.

Traditional view

The traditional view of capital structure, which ignores taxation, held that an optimal capital structure did exist. It reached this conclusion by assuming that shareholders of a company financed entirely by equity would not be very concerned about the company gearing up to a small extent. As expensive equity was replaced by cheaper debt, therefore, the WACC would initially decrease. As the company continued to gear up, shareholders would demand an increasing return as financial risk continued to increase and the WACC would reach a minimum and start to increase. At higher levels of gearing still, the cost of debt would start to increase, for example, because of bankruptcy risk, further increasing the WACC.

View of Miller and Modigliani

Miller and Modigliani assumed a perfect capital market, where bankruptcy risk does not exist and the cost of debt is constant. In a perfect capital market, there is a linear relationship between the cost of equity as gearing increases exactly offsets the decrease in the WACC caused by the replacement of expensive equity by cheaper debt, so that the WACC is constant. The value of a company is therefore not affected by its capital structure.

When Miller and Modigliani included the effect of corporate taxation, so that the after-tax cost of debt was used instead of the before-tax cost of debt, the decrease in the WACC caused by the replacement of expensive equity by cheaper debt was greater than the increase in the cost of equity, so that the WACC decreased as a company geared up. The implication in terms of optimal capital structure as that a company should gear up as much as possible in order to decrease its WACC as much as it could.

Market imperfections view
When other market imperfections are considered in addition to the existence of corporate taxation, the view of Miller and Modigliani that a company should gear up as much as possible is no longer true. These other market imperfections relate to high levels of gearing, bankruptcy risk and the costs of financial distress, and they cause the cost of debt and the cost of equity to increase, so that the WACC increases at high levels of gearing.

Practical Perspectives
The question of whether Twiga Co. might achieve its optimal capital structure following the rights issue can also be discussed from a practical perspective, by considering it increasing the gearing of the company would decrease its WACC. This would happen if the marginal cost of capital of company were less than its WACC. Unfortunately, there is no information provided on the marginal cost of capital of Twiga Co. although its gearing is high or low is a relative concept – especially use peen in the industry. Before the rights issue, the debt/equity ratio of Twiga Co. was 35% on a book value basis and 45% on a market value basis, while after the redemption of loan notes the debt/equity ratio would fall to 21% on a book value basis and 28% on a market value basis.

ANSWER 6

(a) (i) **Working Capital Management**

The objectives of working capital management are usually taken to be *profitability and liquidity*. Profitability is allied to the financial objective of maximizing shareholder wealth, while liquidity is needed in order to settle liabilities as they fall due. A company must have sufficient cash to meet its liabilities, since otherwise it may fail. However, these two objectives are in conflict, since liquid resources have no return or low levels of return and hence decrease profitability. A conservative approach to working capital management will decrease the risk of running out of cash, favouring liquidity over profitability and decreasing risk. Conversely, an aggressive approach to working capital management will emphasize profitability over liquidity, increasing the risk of running out of cash while increasing profitability.

- First, cash is the life-blood of a company's business activities and without enough cash to meet short-term liabilities, a company would fail.

- Second, current assets can account for more than half of a company's assets, and so must be carefully managed. Poor management of current assets can lead to loss of profitability and decreased returns to shareholders.

- Third, for SMEs current liabilities are a major source of finance and must be carefully managed in order to ensure continuing availability of such finance.

(ii) **The following are three policies with regard to the level of investment in working capital**

Aggressive Policy
An aggressive policy with regard to the level of investment in working capital means that a company chooses to operate with lower levels of inventory, trade receivables and cash for a given level of activity or sales. An aggressive policy will increase profitability since less cash will be tied up in current assets, but it will also increase risk since the possibility of cash shortages or running out of inventory is increased.

Conservative policy
A conservative and more flexible working capital policy for a given level of turnover would be associated with maintaining a larger cash balance, perhaps even investing in short-term securities, offering more generous credit terms to customers and holding higher levels of inventory. Such a policy will give rise to a lower risk of financial problems or inventory problems, but at the expense of reducing profitability.

Moderate Policy
A moderate policy would tread a middle path between the aggressive and conservative approaches. It should be noted that the working capital policies of a company can be characterized as aggressive, moderate or conservative only by comparing them with the working capital policies of similar companies. There are no absolute benchmarks of what may be regarded as aggressive or otherwise, but these characterizations are useful for analyzing the ways in which individual companies approach the operational problem of working capital management.

(b) **FRA Mechanism**
FRA is an agreement between two partied to lock in an interest rate for a predetermined period of time. It is a contract which fixes the future interest rate on borrowing or lending. If on the agreed date (fixing date) the FRA rate differs from the current market rate (reference rate) a settlement payment depending on the difference must be paid by one of the contractors.

ISSUE 1: The Effective Lending Rate
The company wants to fix a lending rate, so it should sell an FRA on a notional principal account of £60m, The FRA rate is for a 3v9 FRA, and is 3.4%. If the LIBOR is 3.5% at settlement, the company must make a cash settlement payment to the bank. The size of the payment is:

Payment amount = P(R – F) x L/12

Given: P = £60m R = 3.5%, F = 3.4% L = 6

Then payment amount will be:
Payment amount = 100(0.035 – 0.034) x 6/12 = £30,000

The company will lend £60m for six months at LIBOR – 0.2% I.E. 3.5% - 0.2% = 3.3%

Thus:

Gross interest income = 3.3% x £60m x 6/12	=	£990,000
Less: Loss on FRA Deal		<u>£30,000</u>
Net Interest Income		<u>£960,000</u>

The effective lending rate would be:

Effective Borrowing rate	=	Net Interest Income/Principal x 2
	=	£960,000/£60,000,000 x 2
	=	0.032 or 3.2%

ISSUE 2

The company wants to fix a borrowing rate, so it should buy an FRA on a notional principal account of £60m. The FRA rate is for a 3v9 FRA, and is 4.45%.

If the LIBOR is 3.5% at settlement, the FRA bank must make a cash settlement payment to the company. The size of the payment is:

Payment Amount = P(R – F) x L/12

Given: P = £60m R = 3.5%, F = 3.4% L = 3

Then payment amount will be:

Payment amount = £60(0.035 – 0.034) x 6/12 = £30,000

The company will borrow £60m for six months at LIBOR + 0.5% i.e. 3.5% + 0.5% = 4%

Thus:

Gross interest cost = 4% x £60m x 6/12	=	£1,200,000
Less: Profit on FRA Deal		£30,000
Net Interest Cost		£1,170,000

The effective borrowing rate would be:

Effective Borrowing Rate	=	Net Interest Cost/Principal x 2
	=	£1,170,000/60,000,000 x 2
	=	0.039 or 3.9%

SUGGESTED SOLUTIONS
C4 – PUBLIC FINANCE AND TAXATION II
MAY 2019

ANSWER 1

(a) **To calculate the chargeable income for Chaukucha for the year ended 31st December 2018**

(i) Chaukucha

Computation of taxable income in TZS. '000'

Year of income 2018

	TZS. '000'	**TZS. '000'**
Profit (loss) as per account		12,300
Add: non-allowable expenses		
Depreciation	24,200	
Fines	300	
Car lease costs 70%	2,800	
Copy rights	3,000	30,300
Less: Non-taxable income and other expenses		
Capital allowances		(33,325)
Taxable partnership profit		9,725

(ii) **To calculate each partner's share of the taxable income for the year ended 31st December 2018**

Partnership income distribution

	Tumaini TZS. '000'	**Jumanne TZS. '000'**	**TZS. '000'**
Partnership income			9,725
Equal sharing 50:50	4,637.5	4,637.5	(9,725)
			-

W1) Capital Allowance schedule

Class	1	3	7	Total
Rate	37.50%	12.50%	1/n	
	TZS'000'	**TZS'000'**	**TZS'000'**	**TZS'000'**
TWDV	-	17,200	-	
Additions				
Computer package			2,500	
Copyright			3,000	
Nissan Truck	24,000			
Mark X	30,000			
	54,000	17,200	5,500	
Annual allowance	**20,250**	**2,150**	**925**	**23,325**
Initial Allowance(50%*40,000*1/2)				**10,000**
Total allowances				**33,325**

(iii) All arrangements between a partnership and a partner are recognized except a loan made by a partner to a partnership and any interests are not deductible (section 48(6) of the Income Tax Act, 2004).

(b) (i) Taxpayer: Salum
Source of income: Employment
Year of income: 2018

		TZS.
Salary		28,800,000
General round sum allowance		1,800,000
Pension contribution employer		2,880,000
Car benefit		250,000
Medical Insurance (exempt)		
Christmas present		1,000,000
Commission		
Total Income		34,730,000
Pension contribution –Employee	(2,880,000)	
-Employer	(2,880,000)	(5,760,000)
Subscription-not deductible		-
Computer-not deductible		-
Total taxable income		28,970,000

(ii) To calculate Salum's total taxable income for 2018

(A) Computation of payment of taxable investment income of Salum in TZS.

	TZS.
Rent of furnished house (final withholding payment)	0
Bank interest (final withholding payment)	0
Total investment income	0

(B) Computation of payment of taxable Employment income of Salum in TZS 28,970,000

(C) Computation of payment of taxable business income of Salum in TZS.

	TZS.
Consultancy fees	24,000,000

Therefore, the total income is summation of business income investment income and employment income which is TZS.52,970,000

(c) OECD has provided two methods that a nation can use to relieve foreign income tax of their taxpayers.

(i) **Exemption method**

The first method is through exemption. The exemption method can be implemented either unilaterally or bilaterally by contracting countries: where certain income is completely exempted in the taxpayers' countries of residence. Subsequently, the countries of residence give up the taxing rights to the countries where income is derived, so the former countries get no income from the foreign income.

However, exemption method can be divided into full exemption and exemption with progression.

Full exemption method

In the full exemption method, the country of residence omits the foreign income from its own tax system and taxes only domestic income.

Exemption with progression

On the other hand, the exemption with progression method includes the exempted income when determining the tax rate to apply to domestic income in case of progressive tax rate systems.

(ii) **Foreign income tax relief method**

The second approach to foreign income tax relief is the tax credit method. The credit method does not exempt the income earned in foreign countries but it taxes it and provides for foreign tax credit for any foreign countries.

Under this method the country of residence has the subsidiary right to tax the income when the tax rates in the sourced countries is lower than the tax rates in the residence countries. So in that case, the country of residence may collect some taxes from the foreign income when the worldwide income is computed. Likewise credit method is divided into full credit and ordinary credit.

Full Credit method

In the full credit method, the countries of residence allow deduction of the total amount of foreign tax when computing the tax liability of resident taxpayers.

Ordinary credit method

Yet, in the ordinary credit method the deduction of foreign tax is restricted i.e. maximum deduction to the proportional of taxes that could have been paid on the foreign income if the income were earned in the residence country.

ANSWER 2

(a) Transfer pricing usually refer to setting terms of transactions between related parties on a non-arm's length basis in order to move income, profits or expenses between group companies which are subject to different tax rates so as to reduce the overall tax burden of a corporate group. The types of transactions which may be subject to transfer pricing arrangements include the sale of goods, the provision of services, the sharing of expenses, the apportionment of profit between jurisdictions and interest on loans and advances. A transfer pricing arrangement may also involve the interposition of a company in a zero tax jurisdiction between two other group companies in order to derive a portion of the overall profit from a transaction in manner whereby no tax is suffered. If there were no limits on transfer pricing, corporate groups acting nationally would shift all profits away from high tax jurisdictions to low or nil tax jurisdictions.

(b) There are numerous examples of how transfer pricing arrangement may work including the following:

   (i) Sale of goods from a high taxed company to a low taxed company at an artificially reduced price.
   (ii) Loaning money from a high taxed company to a low taxed company at an artificially low interest rate.
   (iii) Provision of management services by a low-taxed company to a high taxed company at an artificially high price.

(c) Disagree. The principal means of countering transfer pricing is through domestic tax law provisions addressing the issue. Nonetheless, because transfer pricing is fundamentally a cross-border issue, the OECD has taken an interest in the issue. In particular, the OECD has published guidelines for determining arm's-length prices in an effort to encourage all countries to adopt a consistent approach to the question and, therefore, minimize double taxation which may otherwise arise where countries adopt different bases for determining such prices. The OECD has also worked to ensure that the OECD Model DTA does not prevent the application of domestic transfer pricing provisions, but also that where justified transfer pricing adjustments are made by one jurisdiction, the other jurisdiction will make corresponding adjustments to the taxation of the related party.

Accordingly, although the OECD promotes the adoption of fair transfer pricing rules and the inclusion of associated provisions in DTAs, these measures are not the primary means of countering transfer pricing. Rather, domestic tax legislation is the principal means by which transfer pricing is countered.

ANSWER 3

(a) **The meaning of "Year of income"**

(i) The year of income for tax purposes is the accounting period for which income tax is assessed.

(ii) According to the section 20 of income tax act, the year of income for every person is calendar year.

(iii) However, an entity may apply in writing to the commissioner for approval to change the year of income from the calendar year to any another 12 months period.

(b) DUCAA

(i) **Test for tax exemption is whether 75% or more of receipts of the Association is from members**

Receipt from members:		
Sales to members		180,000,000
Members Fees		70,000,000
Donation from members		50,000,000
Total receipt from members		**300,000,000**
Total receipts:		
Receipt from members		300,000,000
Dividend		12,000,000
Other investment income	12,000,000	
Sales to non-members		100,000
Total receipts		424,000,000

Ratio: $\frac{300,000,000}{424,000,000} \times 100\%$

= 70.5%

The income is not exempt as members contributions is less than 75%

(ii) DUCAA

Computation of Income from Investment		
Dividend from Kwana (FWP)	Nil	
Dividend from Kazi Ltd (FWP)	Nil	
Dividend from Wakwetu (FWP)	Nil	
Other investment income	12,000,000	
Total Income from Investment		**12,000,000**

Computation of business Income

	TZS	TZS
Gain from business		
Net Income as per accountants/return		172,000,000
Add:		
Amortized amount to replace a roof	3,000,000	
Penalties for VAT	3,500,000	
MD's personal visitors entrainment expenses	1,000,000	
Political parties contributions	2,000,000	
Board Members travel cost	19,000,000	
Cost to prepare revised accounts	1,200,000	
Cancellation of contract	7,000,000	
Salaries for future services (This is not salary advance)	6,000,000	
Depreciation **(Add back 10m and Allow 7.5m)***	2,500,000	
Legal cost for unsuccessful recovery	1,000,000	
Tax	30,150,000	
Adjusted Income		**78,350,000**
		250,150,000
Less: Non – business income		
Other investment income	12,000,000	
Dividend **(4m+1m+7m)****	12,000,000	
		24,000,000
Revised gain from the business		**226,150,000**

Computation of total Income

Income from the investment	12,000,000
Income from business	226,150,000
Total income for the year	**230,150,000**

ANSWER 4

(a) Four main factors that determine tax incidence

- The type and character of tax (level of tax rate, narrow or far-reaching scope of tax, being indirect or direct).
- Difference of the market in which activities are being carried out (perfect competition market, monopolist competition, oligopoly, monopoly, etc.)
- Cost conditions (fixed cost conditions, increasing cost condition, decreasing cost condition)
- Supply and demand elasticity, conjuncture periods (crisis, welfare, war and interim periods) all affect the extent of incidence.

The factors determining the incidence are comprised of such micro economic factors as the elasticity of supply and demand, the structure of the market, the type and character of the tax, as well as macro-economic factors like the conjecture situation that the economy is in. Institutional, informational, and behavioral factors may influence tax incidence. Furthermore, there is no accounting in the theoretical literature for the potential influence of the type of market institution on tax incidence. Markets need institutions to function, and these institutions specify how buyers and sellers interact to determine prices and quantities. Different market institutions are known to have different price formation and quantity determination properties; there is no reason to believe a *priori* that these different properties will not affect the incidence and excess burden of a tax.

(b) Penalty on late submission of provisional tax statement

Was supposed to be submitted on 31st March 2018
Was submitted on 30th June 2018
Months late 3 months
Penalty on late submission is 2.5% of the tax assessable or 5 currency points whichever is higher for each month (or part of month) late.
In this case tax is TZS. 1,177,200 + 30% (26,360,000) = TZS. 9,085,200/=
Penalty 2.5% * 9,085,200 = 227,130/=
Penalty is TZS. 227,130 * 3 = 681,390/=.

Due date of the 1st Installment 31/03/2018
Date paid 30/06/2018
Amount of 1st installment TZS 9,085,200/4= TZS 2,271,300.
Duration of failure 3months
Rate is 1%
Interest of failure to pay tax is calculated compounded for the month late installment tax paid will be

$= \text{Tax } ((1 + 1\%/12)^3 – 1))$

$= 2,271,300 ((1 + 0.01/12)^3 – 1)) = \text{TZS. } 5,682.98$

(c) DUNDEE investment, a domestic permanent establishment.
Repatriated income = A + B - C

Where:

A = Net Asset of APE at the start + capital contributed during the year (Net Assets at the start of the year = WDV of the assets plus net cost of other assets less net incoming of the liabilities.

B = total income of APE for the year
C = net Asset at the end of the year plus any unrelieved loss

Therefore,

A = WDV of Asset + Net cost of other Assets + Net incoming from realization of liability + capital contributed
= 45,000,000 + (6,000,000 – 4,000,000) + (22,000,000 – 20,000,000) x 1200/1000

= 45,000,000 + 2,000,000 + 2,000,000 x 1.2

= 47,000,000 + 2,400,000

= **49,400,000**

B = Net income during the year (increase in retain earning)

= 6,000,000 – 4,000,000
= 2,000,000

C = Net Assets at the end + any unrelieved loss

= 53,000,000 + (7,000,000 – 3,000,000) + 0

= 5**7,000,000**

Therefore A + B – C = 49,400,000 + 2,000,000 – 57,000,000

= (5,600,000)

The repatriated loss is **TZS.5,600,000**

ANSWER 5

(a) It is true that section 92 of the Income Tax Act (2004) exempts from the requirement to file a return a person whose income of the year of income consists exclusively from any employment where the employer is required to Withhold tax under section 81 from payments made to the individual that are included in calculating the individual's income from the employment.
However, the definition of business includes granting of gift, benefits in cash, kind or any other way as a source of income received by a person

For this reason, Amanda's gift from husband is legally an income from business. This makes her liable to file a return as her income for the year of income does not come solely from employment.

(b) MBL

(i) Amount of Tax as per MBL's self-assessment (Figures in TZS.)

	TZS.
Tax assessed	320,000,000
Allowance for impairment of receivables	150,000,000
Tax rate	30%
Tax shield on the allowance	45,000,000
Tax per MBL's self-assessment (320m – 45m)	275,000,000

(ii) **Amount to be paid and conditions for valid objection**

MBL is required to pay the amount of tax deemed not to be in dispute in order to file for a valid objection. This amount is calculated as the greater between tax not in dispute and one-third of the tax assessed.

This is calculated as under (Figures in TZS.)

Tax not in dispute	275,000,000
One-third of tax assessed (1/3 of 320m)	106,666,666.67
Greater	275,000,000

In addition to paying TZS.275m, other conditions for valid objection are:

- It must be in writing**.**

- It must contain a precise statement of grounds for such objection
- Must be filed with the commissioner general within 30 days from the date of service of notice of assessment **.**

(iii) **Treatment of allowance for impairment of receivables**

Section 25 (2) of the Income Tax Act (2004) specifies conditions for one to disclaim the entitlement to receive an amount or write off as bad a debt claim of the person. The conditions are that:

- In the case of a debt claim of a financial institution after the debt claim has become a bad debt as determined in accordance with the relevant standards established by the Bank of Tanzania and that such institution has taken all reasonable steps in pursuing payment and the institution reasonably believes that debt claim will not be satisfied; and,

- In any other case, only after the person has taken all reasonable steps in pursuing payment and the person reasonably believes that the entitlement or debt claim will not be satisfied.
- MBL is in the former, i.e. financial institution. The question therefore remains as to whether this amount has met the relevant BOT standards. This will have to be proven and validated by the commissioner before deciding on the objection.

(iv) **MBL's position**

- The position does not have appropriate premises
- There are a lot of differences between treatment of items for financial statements preparation and treatment of items for income tax computations. This is why there are adjustments necessary to adjust the accounting profit to business income for tax purposes.
- Requirement by IFRSs to expense something has nothing to do with the required treatment for income tax purposes.

ANSWER 6

(a) **National and GDP Domestic Product**

Is the total income of Tanzania, whether it was earned in the United Republic of Tanzania (URT) or abroad. **Conceptually, National Income** is the money value of all final goods and services produced in a country during a period of one year/one **financial year. And Gross Domestic Product (GDP) Gross Domestic Product (GDP)** refers to the total value of goods and services produced within a geographical area of a country by both residents and non-residents in one financial year. **OR** is the total market value of all final goods and services produced within a given period by factors of production located within a country. Simply, we can also say that **GDP** refers to economic product within physical borders and **GNP** is the output by citizens of a country.

(b) The question is silent on which method to use, hence using the data available, one my use either expenditure method or income method of computing National Income

Expenditure method *(all figures in Billion TZS)*

GDP_{mp} = C+G+I+(X-M)

=700+250+ (150-200) =900

(i) NDP_{mp}= GDP_{mp}-Depreciation

=900-100= 800

(ii) NNP_{mp}= NDP_{mp}+NIFA

=800+50= 850

OR

Income method *(all figures in Billion TZS)*

GDP_{fc}= W+R+I+P+Depreciation

=600+140+100+100=940

(i) NDP_{mp}= GDP_{fc}+Indirect taxes –subsidies-Depreciation

=940+60-100= 900

(ii) NNP_{mp}= NDP_{mp}+NIFA

=900+50= 950