MAY 2019
Q & A

INTERMEDIATE LEVEL

Contents

EXAMINATION	**:**	**INTERMEDIATE LEVEL**
SUBJECT	**:**	**FINANCIAL MANAGEMENT**
CODE	**:**	**B1**
EXAMINATION DATE	**:**	**TUESDAY, 7TH MAY 2019**
TIME ALLOWED	**:**	**THREE HOURS (2:00 P.M. – 5:00 P.M.)**

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 **FOUR** questions in Section **B**.
4. In total answer **FIVE** questions.
5. Marks are shown at the end of each question.
6. Calculate your answers to the nearest two decimal points.
7. Show clearly all your workings in respective answers where applicable.
8. This question paper comprises **8** printed pages.

SECTION A
Compulsory Question

QUESTION 1

(a) Discuss any four (4) factors to be considered in deciding to change credit policy. **(8 marks)**

(b) AJEX Ltd is a small firm which purchases and sells electronics equipment. The company annual sales for the previous year was TZS.14,400,000 of which 80% was credit sales. According to the credit terms, debtors have one month period to pay their dues. Due to collection problems experienced in previous years, the company has contracted ABM Ltd, which is an experienced debt collection firm. ABM Ltd is willing to offer factor services with advance of 90% of the total credit sales for a fee of 2% a month plus a commission of 4% on total amount of the debts. This arrangement is expected to save TZS.51,840 annually in management costs and avoid bad debts at 1% of in credit sales. AJEX Ltd Finance Manager considers the factoring services to be unfavourable and has consulted BOCM Bank which is ready to make an advance equal to 90% of the debts at an interest rate of 18% per annum. The bank requires a processing fee of 2% on the debts.

REQUIRED:

Should AJEX Ltd accept factoring services from ABM Ltd or the advance from BOCM Bank? **(6 marks)**

(c) TELCO Ltd is a manufacturing company which sells most of its product on credit. Due to problem experienced on credit collections, the company is considering to change its credit policy. The information on the current credit policy and proposed one are provided below:

Particulars	**Current Policy**	**Proposed Policy**
Credit terms	Net 30	2/10, Net 30
Credit sales	TZS.2,880,000	Increase sales by TZS. 80,000
Average collection period	30 days	Decline in period by 10 days
Bad debts	2%	2%

According to the Sales Manager, about 60% of the customers will take discount. The variable cost ratio is 70%, while the opportunity cost of investment in receivable is 10% (pre-tax) and the tax rate is 30%.

REQUIRED:

By using the information above, do you think the company should change its credit policy? **(6 marks)**

(Total: 20 marks)

SECTION B

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

QUESTION 2

(a) Discuss the merits of short term and long term sources of financing the working capital. **(6 marks)**

(b) Wakili Ltd. which manufactures a special chemical is contemplating replacing its existing machine. The new machine would cost TZS.2,500,000. The company's current production is 80,000 units, and it is expected to increase to 100,000 units if the new machine is bought. The selling price of the product would remain unchanged at TZS.80 per unit.

The following is the cost of producing one unit of the product using both the existing and new machines;

		Unit cost (TZS.)	
	Existing machine (80,000 units)	**New Machine (100,000 units)**	**Difference**
Material	30.0	25.5	(4.5)
Wages and salaries	20.5	15.0	(5.5)
Supervision	8.0	10.0	2.0
Repairs	4.5	3.0	(1.5)
Power and fuel	6.2	5.7	(0.5)
Depreciation	0.1	2.0	1.9
Allocation of corporate overheads	4.0	5.0	1.0
	73.3	**66.2**	**(7.1)**

The existing machine has an accounting book value of TZS.40,000 and is fully depreciated for tax purposes. It has a remaining economic life of five years, while its market price is TZS.60,000 today and TZS.15,000 after five years. The supplier of the new machine has offered to accept the existing machine in exchange for TZS.100,000.

The new machine has a life of five years and a salvage value of TZS. 100,000 at the end of its economic life. Assume that the tax rate is 50 per cent and written down depreciation rate is 25 per cent per annum. The after tax required rate of return is 20 per cent.

REQUIRED:

Advise the management of Wakili Ltd as to whether the project of replacing its existing machine should be accepted or not. **(14 marks)**

(Total: 20 marks)

QUESTION 3

(a) Jumbo corporation is a newly established manufacturing company that deals with bio-degradable products. The company has been exploring ways to improve its performance as its growth has been relatively slow in the past five years.

Upon policy amendments on the use of plastic bags, the company anticipates to increase its sales by 4% in its third year while in the first two years the growth rate will just be moderate at 2% per annum. The company annual sales is TZS.3 billion. The company has a special customer who prepays 25% of sales every year and the company cost of goods sold represent 60% of sales.

Jumbo has been offering goods in terms of 3/10 net 60 to its customers and it holds an average inventory of 2% of all sales to ensure timely product delivery. The company has been holding a reasonable amount of cash to ensure payment to its suppliers and receives 2/10 net 25 from major suppliers. The company excess cash has been used to take up the suppliers discounts when available. The company assumes 360-days in a year.

REQUIRED:

(i) Determine the cash conversion cycle of Jumbo for the third year of operation under the anticipated sales increase. **(4 marks)**

(ii) Determine the amount of money that has been invested in the accounts receivables in the third year of the anticipated sales increase. **(3 marks)**

(iii) Comment on the amount of the investment in account receivables relative to the total investment amount if the investment in account payables is TZS.29.3 million. **(3 marks)**

(b) Ms. Witness, the Chief Financial Officer of FCM Company Ltd has created the firm's pro forma Statement of Financial Position for the next fiscal year. Sales are projected to grow at 10 percent annually to the level of TZS.330 million in the next year. Current assets, non-current assets and short-term debt are 125 percent, 150 percent and 35 percent of the total sales, respectively. FCM Company Ltd profit margin on sales is 12 percent and it pays out 40 percent of net income as dividend. Currently the company operates at 90 percent of the non-current assets.

REQUIRED:

(i) Estimate the amount of funds that the company is required to raise from external sources to support the sales growth. **(2 marks)**

(ii) The firm is thinking of changing the dividend payout ratio to 30 percent to increase its plough back. Determine the external fund that will be needed under the new policy. Explain your answer. **(2 marks)**

(iii) With the new sales level, will the firm be operating at fully capacity? Explain. **(2 marks)**

(iv) Determine the amount of assets of the company at this new sales level. **(2 marks)**

(v) Determine the external financing that will be required for the sales growth in the second year. **(2 marks)**

(Total: 20 marks)

QUESTION 4

(a) With examples, briefly explain how the level of gearing of a company influences the perception of non-financial stakeholders. **(6 marks)**

(b) In a recent departmental meeting, the Finance Manager of Pamoja Manufacturing Company Ltd requested you, the Finance Officer, to prepare a statement showing the working capital requirement. The company has an annual level of activity of 30,000 units of output. The cost structure for the company's product for the above mentioned activity level is as given below:

DESCRIPTIONS	**Cost per unit (TZS.)**
Raw materials	20,000
Direct labour	5,000
Overheads	15,000
Total cost	**40,000**
Profit per unit	10,000
Selling price per unit	**50,000**

The Finance Manager was also able to gather the following information:

(i) Past experience indicates that raw materials are held in stock, on an average for 2 months.

(ii) Work in progress (100% complete in regard to materials and 50% for labour and overheads) will be half a month's production.

(iii) Finished goods are in stock, on an average, for 1 month.

(iv) Credit allowed by suppliers is 1 month.

(v) Credit allowed to debtors is 2 months.

(vi) A minimum cash balance of TZS.25,000,000 is expected to be maintained.

REQUIRED:

Prepare a Statement of Working Capital requirement. **(9 marks)**

(c) A small manufacturing company bought a piece of equipment for TZS.2 million on 1st January. The expected useful life is 6 years and zero salvage value is estimated. The company intends to replace the equipment identically. The average expected price increase is 8% yearly. For this purpose, the company creates a special fund with annual equal payments at the end of each year during the lifetime of the equipment. Cost of capital and earnings of the fund is 10%.

REQUIRED:

Compute the annual payment into the fund. **(5 marks)**

(Total: 20 marks)

QUESTION 5

(a) Discuss the key financial management decisions and how each relates to the value of the firm. **(10 marks)**

(b) Nyati Ltd is one of companies listed at the local stock exchange with the following capital structure:

Long term capital	**TZS.**
Preferred shares (5% coupon + nominal value of 100)	15,000,000
Convertible debt (5% years, 8%)	25,000,000
Common equity (Nominal value TZS. 10 per share)	10,000,000
Retained earnings	23,000,000

The current dividend paid by the company is TZS.50 per share which is expected to grow at 3% per year in the foreseeable future. The equity share are currently trading at TZS.450 per share while the preferred shares trade at TZS.104 per share. The convertible debt current trades at TZS.950 and has a conversion privilege of 2 shares per TZS.1,000 face value at maturity. The company income tax rate is 30%.

REQUIRED:

(i) Compute the cost of capital for each component of Nyati's long term capital. **(7 marks)**

(ii) Compute the firm's Weighted Average Cost of Capital (WACC). **(3 marks)**

(Total: 20 marks)

QUESTION 6

(a) A shareholder of TATU Co. is concerned about the recent performance of the company and has collected the following financial information:

Year to 31 May	**2016 TZS.**	**2017 TZS.**	**2018 TZS.**
Revenue	6.800,000	6.800,000	6.600,000
Earnings per share	58.90	64.20	61.70
Dividend per share	40.0	38.50	37.00
Closing ex-dividend Share price	648.00	835.00	740.00
Return on equity predicted by CAPM		12%	8%

The current cost of equity of TATU Co. is 10% per year.
Assume that dividends are paid at the end of each year.

REQUIRED:

(i) Calculate the dividend yield, capital gain and total shareholder return for 2017 and 2018. **(4 marks)**

(ii) Briefly discuss your findings with respect to the returns predicted by the Capital Asset Pricing Model (CAPM) and the other financial information provided. **(6 marks)**

(b) Mtukwao Corporation is in the process of making financial forecasting. As a Consultant you are provided with the statement of financial position below:

	Forecast for 2018		**Forecast for 2019**	
	TZS.	**TZS.**	**TZS.**	**TZS.**
Non-current assets	100,000		120,000	
Less: Depreciation	40,000	60,000	52,000	68,000
Current Assets:				
Stocks	10,000		12,000	
Debtors	12,000		13,000	
Cash	3,000		-	
	25,000		**25,000**	
Less: Current Liabilities:				
Creditors	8,000		9,000	
(Bank overdraft)	-		10,000	
	8,000	17,000	**19,000**	6,000
		77,000		**74,000**
Ordinary share capital		60,000		60,000
Retained earnings		17,000		14,000
		77,000		**74,000**

REQUIRED:

Prepare cash forecast from the above given information, clearly showing the net change in liquidity between the two years. Further, show the breakdown of change in working capital for each of its components that is debtors; inventory and creditors.

(10 marks)

(Total: 20 marks)

EXAMINATION	**:**	**INTERMEDIATE LEVEL**
SUBJECT	**:**	**FINANCIAL ACCOUNTING**
CODE	**:**	**B2**
EXAMINATION DATE	**:**	**WEDNESDAY, 8TH 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 FOUR** questions in Section **B**.

4. In total answer **FIVE** questions.

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

6. Calculate your answers to the nearest two decimal points where necessary.

7. Show clearly all your workings in respective answers where applicable.

8. This question paper comprises **8** printed pages.

SECTION A
Compulsory Question

QUESTION 1

ALEXIS Plc holds shares in YAVA Plc. On 1st April 2014, ALEXIS purchased 600,000 shares in YAVA at a cost of TZS.1,600 per share. The fair value of YAVA's tangible assets on 1st April 2014 was TZS.126,000,000 more than book value. The retained profits of YAVA on 1st April 2014 were TZS.120,000,000. The excess of fair value over book value was attributed to buildings held by YAVA.
On 1st April 2014, the buildings had an estimated remaining useful life of 21 years. The draft summarized financial statements for the two entities as of 31st March 2018 are given below:

Summarized Statement of Financial Position as at 31st March 2018:

	ALEXIS TZS.'000'	YAVA TZS.'000'
Non-current assets		
Property, plant and equipment	1,210,000	700,000
Investment in YAVA at cost	960,000	0
	2,170,000	**700,000**
Current assets		
Sundry debtors	1,780,000	620,000
Current a/c with YAVA Ltd	80,000	0
	1,860,000	620,000
Total assets	**4,030,000**	**1,320,000**
Equity and reserves		
Equity shares of TZS.1,000 each	2,000,000	600,000
Retained earnings	400,000	300,000
	2,400,000	900,000
Current liabilities		
Trade payable	1,630,000	360,000
Current account with ALEXIS plc	0	60,000
	1,630,000	420,000
Total Equity and Liabilities	**4,030,000**	**1,320,000**

Summarized Statement of Profit or Loss and other Comprehensive Income for the year ended 31st March 2018:

	ALEXIS TZS.'000'	YAVA TZS.'000'
Revenue	910,000	390,000
Cost of sales	(461,000)	(171,000)
Gross Profit	**449,000**	**219,000**
Other income – dividends received	50,000	0
Expenses	(110,000)	(43,000)
	389,000	176,000

Finance cost	(30,000)	(22,000)
	359,000	154,000
Taxation	(43,000)	(12,000)
Profit for the year	**316,000**	**142,000**

Additional information:

i. YAVA paid an interim dividend of TZS.50,000,000 on 31st December 2017.

ii. YAVA sent a cheque for TZS.20,000,000 to ALEXIS on 30th March 2018.

iii. ALEXIS occasionally trades with YAVA. In November 2017 sold goods to YAVA for TZS.90,000,000. ALEXIS uses a mark up of 50% on cost. On 31st March 2018, YAVA had not paid for the goods and they were all still in YAVA's closing inventory.

REQUIRED:

(a) Prepare a consolidated Statement of Profit or loss and other Comprehensive Income for the year ended 31st March 2018 and a consolidated Statement of Financial Position for the ALEXIS group of entities as at 31st March 2018. **(15 marks)**

(b) Prepare brief notes for the directors to answer the following questions:

(i) What is a "business combination"? **(2 marks)**

(ii) How is the acquirer in a business combination identified? **(3 marks)**

(Total: 20 marks)

SECTION B

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

QUESTION 2

(a) Conceptual framework is a structure which helps an "entity to decide on how to treat" items that need to be included in the financial statements.

REQUIRED:

Explain the importance of conceptual framework (Give three points). **(6 marks)**

(b) The Statement of Income of KG Co. Ltd for the year ended 31st December 2016 appears as follows:

	31st December 2015 TZS.	**31st December 2016 TZS.**
Sales	60,144,000	104,550,000
Cost of Sales	42,960,000	83,640,000
Gross profit	**17,184,000**	**20,910,000**
Expenses		
Salaries	4,716,000	5,172,000
Rent	720,000	720,000
Advertising	390,000	540,000
Bad debts	60,000	180,000
Other expenses	1,866,000	1,830,000
Depreciation	2,712,000	2,104,800
Loss on disposal of fixtures	-	283,200
Total expenses	**10,464,000**	**10,830,000**
Net profit for the year	6,720,000	10,080,000
Taxation	(3,360,000)	(5,040,000)
Dividends	(1,800,000)	(3,600,000)
Profit b/f	2,220,000	3,780,000
Profit c/f	**3,780,000**	**5,220,000**

The Statement of Financial Position of KG Co Ltd appears as follows:

	31st December 2015 TZS.	31st December 2016 TZS.
Current Assets		
Stock in trade	3,390,000	6,972,000
Trade debtors (Net)	4,092,000	5,748,000
Prepayment	-	720,000
Cash	690,000	198,000
Total Current Assets	**8,172,000**	**13,638,000**
Current Liabilities		
Trade creditors	2,310,000	2,808,000
Accrued expenses	108,000	-
Tax payable	1,272,000	900,000
Dividend payable	750,000	990,000
Bank overdraft	-	1,680,000
Total current liabilities	**4,440,000**	**6,378,000**
Net current assets	3,732,000	7,260,000
Non-current assets	10,848,000	10,140,000
	14,580,000	**17,400,000**
Financed by:		
Ordinary shares capital	9,000,000	10,800,000
Share premium	-	180,000
Profit and loss account	3,780,000	5,220,000
Long term loan	1,800,000	1,200,000
	14,580,000	**17,400,000**

It has been ascertained that fixtures acquired at a cost of TZS.3,600,000 on 1st April 2014 and depreciated at 20% per annum on reducing balance basis has been disposed off on 30th June 2016 for TZS.1,920,000.

REQUIRED:

By using indirect method, prepare Statement of Cash Flows of KG Co. Ltd for the year ended 31st December 2016. **(14 marks)**

(Total: 20 marks)

QUESTION 3

The following is the trial balance of the Orchid Limited for the year ended 31st March 2019

Items	DR TZS.'000'	CR TZS.'000'
Sales revenue		384,840
Cost of sales	258,840	
Expenses	40,320	
Closing inventories: 31st March 2019 (Note (i))	18,900	
Finance costs (Note(ii))	9,000	
Land and building: at valuation (Note (iii))	113,400	
Plant and equipment: at cost (Note (iii))	64,800	
Accumulated depreciation 1st April 2018 – plant and equipment		30,240
Investment property: valuation 1st April 2018 (Note (iii))	28,800	
Investment in equity instruments financial asset	20,000	
Rental income from investment property		2,160
Trade receivables	38,700	
Bank		21,620
Trade payable		21,240
Ordinary shares of TZS.1,000 each		36,000
10% Redeemable preference shares of TZS.1,000 each		18,000
Deferred tax at 31st March 2018 (Note (iv))		9,360
Revaluation surplus (Note (iii))		37,800
Retained earnings: 1st April 2018		31,500
	592,760	**592,760**

The following notes are relevant:

(i) At 31st March 2019, an inventory list based on a physical count had a total cost of TZS.18.9 million. Some damaged goods that had cost TZS.1.44 million were included in these. The realizable value of these goods is expected to be TZS.1.7 million, provided that remedial work costing TZS.0.81 million is done before they can be sold.

(ii) Finance costs consist of interest on overdraft, the full year's preference dividend and an ordinary dividend of TZS.160 per share that was paid in September 2018.

(iii) **Non-current assets:**

1. Land and building: a professional valuer submitted a report on 1st April 2018, revaluing the land at TZS.27 million and building at TZS.86.4 million. The directors decided to incorporate these values in the accounts.
2. On that date, the land and building had a carrying value of TZS.75.6 million and the building had a remaining life of 15 years. You should charge depreciation on a straight line basis.
3. Plant: Plant is depreciated at 12.5% on the reducing balance basis. Depreciation is to be charged to cost of sales.
4. Investment property: on 31st March 2019, the investment property was revalued at TZS.24.3 million. Orchid Limited uses fair value model in IAS 40 to value its investment property.

(iv) The provision for income tax for the year ended 31st March 2019 is estimated to be TZS.14.4 million. The tax base of the Company's net assets is TZS.21.6 million less than their carrying amounts. Deferred tax is to be adjusted to reflect this. Carrying amounts do not include revaluation adjustments above. The rate of income tax is 30%.

(v) The investment in equity instruments financial asset was valued at TZS.16 million at the end of the reporting period, 31st March 2019.

REQUIRED:

(a) Prepare the Statement of Profit or Loss and Other Comprehensive Income for Orchid Ltd for the year ended 31st March 2019. **(10 marks)**

(b) Prepare the Statement of Financial Position for Orchid Ltd as at 31st March 2019. **(10 marks)**

(Total: 20 marks)

QUESTION 4

(a) In order to fulfil their purpose, the financial statements must possess certain qualities. As per the Conceptual Framework for the preparation and presentation of financial statements, the qualitative characteristics of financial statements are divided into two main groups which are fundamental and enhancing qualitative characteristics.

REQUIRED:

Explain any four (4) enhancing qualitative characteristics of financial statements. **(6 marks)**

(b) The role of the accountant under certain situations is to consider the public interest before the interest of his client or employer so as to protect the society against some forms of financial risk. In executing this role, the accountant is required to ensure that the codes of ethics of professional accountant are complied with. Such compliance should lead to the highest levels of integrity and objectivity.

REQUIRED:

Explain any five (5) means by which accountants can be encouraged to act in the public interest. **(5 marks)**

(c) Jumanne Enterprise is in the process of negotiating the acquisition of machinery for the production of maize flour. The following activities are accordingly carried out:

(i) A special site has to be prepared for the machinery installation. Hence, the old machines, which the Company was using earlier on site, were dismantled at a cost of TZS.5,000,000 and the required modifications were done for the new machinery. Scrap recovered from this process was sold for TZS.400,000. Cost of construction of the special site amounted to TZS.30,000,000

(ii) Negotiations were successful and it was decided that the old machinery which had a carrying value of TZS.25,000,000 but was now valued a TZS.20,000,000 will be exchanged for new specialized machinery valued at TZS.100,000,000. The difference will be settled in cash.

(iii) The Enterprises TZS.2,000,000 was incurred on freight and TZS.1,500,000 on installation.

(iv) It spent materials worth TZS.1,500,000 and wages TZS.600,000 on the trial run.

(v) Machinery was finally installed but owing to low capacity utilization, it incurred loss of TZS.50,000,000

(vi) Jumanne Enterprise incurred the costs of TZS.2,500,000 for launching the new product.

REQUIRED

Compute the financial cost of the new machinery and give journal entries to record its acquisition as per the requirements of IAS 16: *Property Plant and Equipments*.

(9 marks)
(Total: 20 marks)

QUESTION 5

The Managing Director of KCL Limited has approached your Bank requesting a substantial increase in their credit facilities in order to fund an expansion programme. You are presented with the latest set of bridged accounts as shown below:

KCL Limited
Statement of Profit or Loss and Other Comprehensive Income for the year ended 31st March 2018

	2018	**2017**
	TZS."000"	**TZS."000"**
Revenue	1,247,000	890,000
Cost of sales	(839,500)	(576,000)
Gross profit	**407,500**	**314,000**
Administrative expenses	(56,800)	(51,000)
Distribution costs	(118,700)	(79,000)
Profit from operations	**232,000**	**184,000**
Finance cost	(49,800)	(24,500)
Profit before tax	**182,200**	**159,500**
Taxation	(29,800)	(22,250)
Profit for the year	**152,400**	**137,250**
Other comprehensive income		
Gain on revaluation	36,800	16,550
Total comprehensive income for the year	**189,200**	**153,800**

KCL Limited
Statement of Financial Position at 31st March 2018

	2018 TZS."000"	2017 TZS."000"
Non-current assets		
Property, plant and equipments	425,000	319,000
Current assets		
Inventory	89,300	52,000
Receivables	198,600	108,900
Cash and cash equivalents	0	17,100
Total assets	**712,900**	**497,000**
Equity and liability		
Share capital	100,000	100,000
Revaluation reserve	65,800	29,000
Retained earnings	214,400	142,000
	380,200	**271,000**
Non-current liabilities		
Loan	260,000	170,000
Current liabilities		
Trade payables	57,700	56,000
Overdraft	15,000	0
	72,700	56,000
Total equity and liabilities	**712,900**	**497,000**

REQUIRED:

(a) Assess the viability of this proposition by calculating the following financial ratios:

(i) Gross profit margin

(ii) Operating margin

(iii) The return on capital employed

(iv) Current ratio

(v) Quick ratio

(vi) Debtor days (receivables)

(vii) Creditor days (payable)

(viii) Stock turnover in day's inventory
(16 marks)

(b) Identify any four (4) limitations of the analysis stated above and show how these could be overcomed. **(4 marks)**

(Total: 20 marks)

QUESTION 6

(a) Explain main advantages and obstacles to the harmonization of International Financial Reporting Standards (IFRSs). **(8 marks)**

(b) As per the requirement of the Conceptual Framework for Preparation and Presentation of Financial Statements published by the International Accounting Standards Board (IASB):

(i) Define an asset and a liability **(4 marks)**

(ii) Explain with reasons, whether a motor vehicle and a bank loan obtained to purchase a motor vehicle conforms to the definition of an asset and liability respectively. **(4 marks)**

(c) Write brief notes on the following:

(i) The IFRS Advisory Council; and **(2 marks)**

(ii) The IFRS Interpretations Committee. **(2 marks)**

(Total: 20 marks)

EXAMINATION	**:**	**INTERMEDIATE LEVEL**
SUBJECT	**:**	**AUDITING PRINCIPLES AND PRACTICE**
CODE	**:**	**B3**
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 FOUR** questions in section **B**.

4. In total answer **FIVE** questions.

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

6. In marking candidates' scripts, examiners will take into account clarity of exposition, logic of arguments, proper arrangement and presentation of answers together with the use of relevant examples.

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

SECTION A
Compulsory Question

QUESTION 1

(a) Audit evidence can be obtained either through basic accounting records or documents obtained from third parties upon request by the auditor. This technique of obtaining information from the third part is normally referred to as direct confirmation.

REQUIRED:

(i) Discuss the quality of audit evidence generated by direct confirmation techniques, giving three examples where the techniques might be used. **(6 marks)**

(ii) Identify the sequence of steps involved when directly seeking debtors' confirmation. **(7 marks)**

(b) It is always emphasized that one of the major audit objectives in the audit of liabilities is that of 'completeness' and that auditors should ensure that their audit work adequately cover this objective.

REQUIRED:

Explain why 'completeness' is a major objective in the audit of liabilities. **(4 marks)**

(c) Auditors are required to plan and perform an audit with professional skepticism to exercise professional judgement and to comply with ethical standards.

REQUIRED:

Define 'professional judgement' and describe two areas where professional judgement is applied when planning an audit of financial statements. **(3 marks)**

(Total: 20 marks)

SECTION B

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

QUESTION 2

(a) Upon completion of his audit works for different clients, the Engagement Partner reviewed the audit working papers and came across the following:

Client 1. There was material inconsistency between the financial information and other information in documents containing the financial statements and the auditor's report thereon. The material inconsistency has been traced to the financial information but management has refused to affect any change when requested to do so.

Client 2. Stocks worth TZS.5 million were valued at cost in the financial statements. The review of the events after the reporting date indicated that not all the stocks could be sold in the normal course of business. Some were damaged and some have become obsolete and slow moving. The total assets of the Company are TZS.20 million. If the stocks were valued at net realizable value, the value would have been reduced by TZS.2.0 million. The Directors have refused to allow the stocks to be valued at lower of cost and net realizable value and valued all the stocks at cost.

Client 3. Management refused to allow auditors to carry out circularization of debtors. The receivables figure was material in the financial statements. In addition, the auditors have not received a reply to the letter of enquiry sent to the Company's solicitors in respect of a major litigation affecting the Company. The auditors assessed that the effect of the two items is both material and pervasive.

Client 4. Subsequent events indicated that a major debtor has become insolvent. The amount involved was material. The directors of the entity have refused to recognize an allowance for a write-off of the amount.

REQUIRED:

(i) For each of the items above, explain with reasons the type of audit opinion to be issued. **(12 marks)**

(ii) Explain the action that should be taken by the auditors against management after refusing to allow the auditors to carry out the necessary audit procedures. **(2 marks)**

(b) Misunderstanding of the auditor's in respect of the audit process is a major component of the "expectations gap".

REQUIRED:

(i) Explain the term "expectations gap" **(3 marks)**

(ii) How can this gap be narrowed? **(3 marks)**

(Total: 20 marks)

QUESTION 3

(a) Compliance with fundamental principles of professional ethics may potentially be threatened by a wide range of different circumstances.

REQUIRED:

State any five (5) ethical threats and for each threat give one example of a circumstance that may create the threat. **(5 marks)**

(b) Assume you are the audit manager of Island Associate Auditors and you are planning to audit MAM Plc, a listed Company at Dar es Salaam Stock Exchange and which has been your audit client for four years. MAM specializes in manufacturing luxury mobile phones.

During the planning stage of the audit you have obtained the following information: The employees of MAM Plc are entitled to purchase mobile phones at a discount of 10%. The audit team has in previous years been offered the same level of staff discount. During the year, the financial controller of MAM was ill and hence unable to work. The Company had no appropriate staff to perform his duties. Hence, a qualified audit senior from Island Associate Auditors was seconded to the client for three months.

The audit partner has recommended that the audit senior to be included in the team to audit MAM Plc as he has good knowledge of the client.

The fee income derived from MAM was boosted by this engagement of seconding the audit senior to MAM to 16% of the firm's total fees. From a review of the correspondence files, you have noted that the audit partner of Island Associate Auditors and the finance director of MAM have known each other for many years and in fact went on holiday together last summer with their families. As a result of this friendship the partner has not yet spoken to the client about the fee for last year's audit, 20% of which is still outstanding.

REQUIRED:

Explain the specific ethical threats which may affect the independence of Island Associate Auditors during the audit of MAM Plc, and for each threat explain how it might be avoided. **(10 marks)**

(c) Describe the steps an audit firm should undertake prior to accepting a new audit engagement. **(5 marks)**

(Total: 20 marks)

QUESTION 4

(a) Mikocheni Pumps is a newly small Company which manufactures pumps. The Company has software which records all inventories, purchases, sales and accounting transactions. Sales orders are received through mail, fax or telephone. The sales orders received are not monitored through the computer software. The software can be used by authorized persons only. The dates of transactions are only recorded in the format (MM/DD/YY) set by the software. The software has a provision through which transactions cannot be cancelled. Transactions can be cancelled only by recording journal entries.

REQUIRED:

With examples, explain the types of control procedures which the company must adopt so as to ensure effective and efficient internal controls at the work place.

(8 marks)

(b) Smart Collections is a garment manufacturing Company situated in Arusha, Tanzania. The Company has procured new ERP software. The Board of Directors has not reviewed the risk associated with the utilization of the new software. The Company has an Internal Audit Department which is headed by the Chief Internal Auditor. There is no internal audit charter in place. The Chief Internal Auditor decides to proceed with audit based on his assessment of the risks faced by the Company.

There is no specific frequency for the preparation of internal audit reports i.e. sometimes reports are prepared quarterly and sometimes half yearly. During 2018, the Company's quarterly financial performance results when compared with the audited financial statements showed a fall of 20% in the net profit.

The following are the policies and practices of the company with respect to the evaluation of the effectiveness of internal controls:

1. The Board of Directors satisfies itself that the Company has a system of internal controls, which ensures effective monitoring on a continuous basis.

2. In addition, the Board of Directors is required to carry out an annual assessment of the internal controls.

   During the Board of Director's annual assessment, the following factors were taken into consideration:

   (i) The scope and quality of management's method of monitoring risks, the system of internal control and the work of its internal audit function (if available) and other providers of assurance.

   (ii) The frequency of occurrence of significant failures or weaknesses that have been identified at any time during the review period and their impact on the financial statements of the entity.

3. The controls which are to be reviewed include compliance controls.

REQUIRED:

Evaluate the methods adopted by the Board of Directors relating to the effectiveness of the internal control system of the Company. **(12 marks)**

(Total: 20 marks)

QUESTION 5

(a) Every auditor has to determine the sufficient appropriate type and level of audit evidence to accumulate in order to be satisfied that the client's financial statements are fairly presented. This judgement is important because cost of examining and evaluating all available evidences is too high.

REQUIRED:

(i) Explain the factors that influence the sufficient and appropriate audit evidence. **(3 marks)**

(ii) Identify and explain the factors affecting the persuasiveness of audit evidence. **(4 marks)**

(b) Financial audit and operational audit are not mutually exclusive and are interconnected.

REQUIRED:

Discuss the difference between the financial audit and operational audit. **(6 marks)**

(c) Internal control refers to the design and utilization of all the means whereby management is enabled to effectively safeguard the company's assets and to administer current operations and plan for the future.

REQUIRED:

State the main components and objectives of an internal control structure in an organisation. **(7 marks)**

(Total: 20 marks)

QUESTION 6

(a) Explain the concept of Value for Money (VFM) audit and briefly discuss the meaning of each of the major components of value for money. **(8 marks)**

(b) What are the powers that the Controller and Auditor General (CAG) have according to the Public Audit Act of 2008. **(6 marks)**

(c) The Controller and Auditor General provide assurance to the Parliament on the accountability and performance of the public sector.

REQUIRED:

Describe any five (5) main issues addressed by the CAG's audit findings and recommendations. **(6 marks)**

(Total: 20 marks)

EXAMINATION : INTERMEDIATE LEVEL

SUBJECT : PUBLIC FINANCE AND TAXATION I

CODE : B4

EXAMINATION DATE : THURSDAY, 9TH MAY, 2019

TIME ALLOWED : THREE HOURS (2:00 P.M. – 5:00 P.M.)

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 FOUR** questions in Section **B**.

4. In total answer **FIVE** questions.

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

6. Calculate your answers to the nearest two decimal points where necessary.

7. Show clearly all your workings in respective answers where applicable.

8. Applicable tax rates are provide in **Appendices** on page **11** of **11**

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

SECTION A
Compulsory Question

QUESTION 1

(a) Describe the circumstances under which a jeopardy assessment may become necessary in the administration of income tax in Tanzania. **(4 marks)**

(b) Mpambanaji is an employee of Tuungane Ltd and runs a part-time business. The income generated from all his income generating activities in the year 2018 is as detailed below:

	TZS.	
Salary	3,500,000	per month
Dividends from an unlisted resident company	1,000,000	
Rent	1,600,000	
Interest	400,000	
Gross profit from business	55,900,000	

In respect of his employment, Mpambanaji also enjoys the following benefits:

(i) Utilities (water, electricity and telephone) TZS.450,000 per month

(ii) Life insurance payable by company TZS.150,000 per month

(iii) Lunch allowance TZS.84,000 per month

(iv) Medical services to insurance company of TZS.45,000 per month available to all staff as per the company's staff regulations.

(v) A fully furnished residential quarter for which Mpambanaji pays no rent, but the company claims a deduction of TZS.100,000 per month. The market rent of the house in the area is TZS.200,000 per month, while the cost of the house to the company was TZS.18,000,000

His business expenses for the year were as follows:

	TZS.
Administration expenses (including bad debts of TZS.200,000 Income tax of TZS.40,000, and wages and salaries of TZS.10,000,000)	22,500,000
Traffic fines	40,000
Donations to political allies' election preparations (note 1)	10,000,000
Donations under Education Fund Act, 2001	4,000,000

Note 1:
The political donations were made within the provisions of the Election Expenses Appropriations Act, 2010

REQUIRED:

Calculate Mpambanaji's total income showing clearly the distinction between investment income, employment income and business income. **(16 marks)**
(Total: 20 marks)

SECTION B

QUESTION 2

(a) Daudi came to you for advice, he is about to commence a business on 1st December, 2019 as a sole trader. He will be engaged in selling motor vehicle accessories which are all standard rated for VAT purpose. His business plan indicates that his turnover will be approximately TZS.45,000,000 for the first three months. He will have substantial expenditure on equipment and stocks. He is new in the business and seeks your advice on the VAT implication of running this sort of business.

REQUIRED:

Draft a report advising Daudi on the VAT implication on his business. **(10 marks)**

(b) Below is the extract of the business transactions from the shop of Asha for the month of January 2019, who deals with mixed business and is VAT registered.

The purchases made (VAT Exclusive)

1. Sugar whole sale TZS.2,750,000
2. Bags for packing wheat flour for retail selling TZS.759,000
3. Goat milk TZS.890,000
4. Packed cow milk TZS.685,000
5. Body lotion 50 pieces TZS.150,000
6. Artificial hair for ladies TZS.850,000
7. Hay making machine TZS.2,100,000
8. Electricity TZS.260,000

Also, the sales book has the following detail (VAT Exclusive)

1. Sugar TZS.3,000,000
2. Bags for packing wheat flour TZS.720,000
3. Goat milk TZS.800,000
4. Packed milk TZS.590,000
5. Medicated soap TZS.600,000
6. Soft drinks TZS.200,000
7. Sorghum TZS.300,000
8. Rice TZS.200,000

Additional information

- Goat milk purchased was not processed.
- Owner took packed cow milk costing TZS.65,000 for home consumption

REQUIRED:

Calculate the amount of input tax refunded in the filing of the VAT return.

(10 marks)
(Total: 20 marks)

QUESTION 3

(a) A registered taxpayer operates the following tax schemes:

(1) PAYE (Pay As You Earn)
(2) Provisional tax
(3) Skills Development Levy and withholding tax

REQUIRED:

(i) State the dates on which the tax in each of the three schemes is payable. **(3 marks)**

(ii) State the interest rate at which a penalty for late payment is charged in respect of each of the above tax schemes **(2 marks)**

(b) Pamba Limited is a Company involved in ginning cotton in Simiyu. It has the following details in connection with its Property Plant and Equipment for the year ended 31st December 2018.

Tax Written down Values (TWDV) as at 1st January 2018 were as follows:

	TZS.
Factory Building (costing TZS.50 million)	13,201,016
Ginning machinery	4,000,001
Motor vehicles (8 tons Commercial vehicles)	58,000,000
Furniture and fittings	1,439,234
Computers	2,000,567
Motor vehicles (saloon)	9,500,000

The following transactions took place during the year:

(i) The company extended the factory building and brought it into use in February 2018. The extension cost the company TZS.35,500,000 in total, out of which TZS.3,050,000 was spent on partitioning a storeroom in the factory building.

(ii) Purchased ginning plant for TZS.32,400,000 through leasing on 25th October 2018 but brought it into use on 4th January 2019.

(iii) Additions to the property plant and equipment were as follows:

		TZS.
February 2018	Second hand ginning machinery	40,800,000
April 2018	Second hand 10 ton truck	30,000,000
June 2018	Motor vehicles (Saloon)	22,000,000

(iv) Disposals during the year were as follows;

July 2018 Motor vehicle (saloon) for TZS.7 million with tax written down value of TZS.700,000.

(v) **Fencing**
Fencing of the factory which started in 2017 was completed and brought into use during the year under review and an amount of TZS.20,655,000.00 was spent in the entire fencing.

(vi) **Plant and Machinery**
One aging ginning machinery was sold for TZS.14,550,000. This sale resulted in a capital loss of TZS.1,800,000. New replacement machinery was acquired at a cost of TZS.60,560,000.

(vii) **Furniture and Fittings**
Additional furniture and fittings were acquired at a cost of TZS.1,750,000.

(viii) **Staff Housing**
One staff house was constructed at a cost of TZS.25,750,000. It is the taxpayer's programme to construct at least one staff house every year until pressure on staff housing is eases.

REQUIRED:

(i) Calculate the tax written down value of the aging ginning machinery that was sold. **(2 marks)**

(ii) Calculate the capital gain or loss from disposal of assets that were sold for tax purposes. **(2 marks)**

(iii) Calculate capital allowances due for the year ended on 31st December 2018. **(11 marks)**

Note:
Assume that the initial allowances claimed were appropriate

(Total: 20 marks)

QUESTION 4

In readiness for Christmas day on December 25, 2018, a business lady had earlier on 10th October 2018, ordered 2,500 Christmas Cards from India costing US $ 2 per card. When they arrived, the business lady was required to pay 20% import duty, 10% excise duty and 18% value added tax despite the trade agreement existing between Tanzania and India. Assume the exchange rate applicable was TZS 2,300 to US $ 1.

REQUIRED:

(a) Calculate how much the Lady will pay as import duties, excise duty, value added tax to the Tanzania Revenue Authority. **(8 marks)**

(b) Assuming that the business lady in part (a) above has information to the effect that according to the trade agreements between Tanzania and Indian governments, she was not supposed to pay import duties except for Value Added Tax and she wants to appeal.

REQUIRED:

(i) Which three players would be involved in the appeal case assuming the case has gone all the way to the last player? **(3 marks)**

(ii) Why is it important to have appeals procedures in a tax system? **(4 marks)**

(c) Discuss briefly any five methods of customs valuation under the new General Agreement on Tariffs and Trade (GATT) valuation system that can be used to value market goods in Tanzania. **(5 marks)**

(Total: 20 marks)

QUESTION 5

(a) Government expenditure in Tanzania is classified into two main categories; recurrent expenditure which includes wages and salaries, interest payment and goods and services transfer and development expenditure which includes expenditure which are domestically and foreign financed development projects.

REQUIRED:

(i) What are the main principles of public expenditure? **(5 marks)**

(ii) Describe public sector expenditure management tools **(5 marks)**

(iii) Explain various factors affecting the structure and composition of government expenditure. **(5 marks)**

(b) Taxation is one of the oldest functions of the Tanzanian government in running her affairs. By definition, a tax is a compulsory contribution from a person to the state to defray the expenses incurred in the common interest of all without any reference to the special benefits conferred. It is a compulsory contribution or payment for the support of governmental or other public purposes. The Tanzania Revenue Authority (TRA) is the government agency, charged with the responsibility of managing the assessment, collection and accounting of all central government taxes in Tanzania.

REQUIRED:

Explain three different classifications of taxes. **(5 marks)**

(Total: 20 marks)

QUESTION 6

Mbususu Company Limited is a resident company which deals with manufacturing of shoes. The following is the statement of income of the company relating to the year of income ended on 31st December, 2018.

DETAILS	TZS.	TZS.
Sales		1,007,578,200
Other income		38,004,308
Total Income		1,045,582,508
Opening Stock	234,000,000	
Purchases	482,601,134	
Cost of goods available for sales	716,601,134	
Less: Closing stock	202,485,000	
Cost of goods sold		514,116,134
Gross profit		531,466,374
Less: Expenses		
Administrative Expenses		

Salaries and wages	54,300,000	
Provisions for NSSF	12,400,000	
Traveling expenses	4,692,000	
Repair and maintenance	7,800,000	
Rent	5,200,000	
Printing and stationery	3,297,000	
Political parties contribution	15,200,000	
Donation and gifts	25,000,000	
Training expenses	11,150,000	
Depreciation	6,019,800	
Motor car expenses	5,400,000	
Electricity and water	2,100,000	
Fines and penalty	500,200	
Net loss (un relieved) for year of income 2017	22,500,000	
General expenses	1,500,000	
Loyalty fees	700,000	
Office expenses	5,000,000	182,759,000
II. Selling Expenses		
Motor vehicle expenses	15,000,000	
Stamp duty	4,325,000	
Export duty	460,200	
Salaries and wages	11,492,000	
Depreciation	5,620,000	
Business promotion	20,000,000	
Traveling and hotel expenses	11,328,000	
Advertisement	23,400,000	
Provision for bad debts	8,479,000	
Other selling expenses	13,000,000	113,104,200
III: Financial Expenses/changes		
Interest on loan	12,556,000	
Interest on bank o/d	6,572,000	
Audit fees	22,718,000	
General expenses	15,000,000	
Legal fees	700,000	
Office expenses	5,000,000	
Management fees	12,000,000	74,546,000
Net profit before tax		161,057,174
Tax (30%)		48,317,152
Net profit after tax		112,740,022

Additional information

(i) General expense includes the following:-

   (a) Travel expenses of the financial controller of the company to Toronto-Canada for Christmas shopping amounting to TZS.5,000,000.

   (b) Medical expense for Mrs. Tweve, the Managing Director's wife TZS.1,000,000.

(ii) It is estimated that 1/5 of the motor car expenses represents personal and private motor car expenses of the sales manager.

(iii) Legal fees including TZS.250,000 being legal fees incurred in the acquisition of godown of a business.

(iv) Closing stock value excluded the cost of goods in transit of TZS.7,500,000. The market value of these goods was TZS.7,200,000

(v) The Company also incurred TZS.2,500,000 for prevention of soil erosion and TZS.3,000,000 correction with remedy damage caused by mining extractions near the business premises. All these costs included the cost of repair and maintenance.

(vi) In general expenses there is also TZS.490,000 being a penalty paid for being late in preparing and submitting the income tax return on due dates to the tax authority.

(vii) Business promotion includes TZS. 15,000,000 used for the construction of a new laboratory building for experiment designed to improve the quality of the company product.

(viii) During the same year of income, 2018 the company incurred expenditure for research and development. However, the company decided to apportion these costs in four years starting from this year i.e 2018, by providing 25% of the cost, in each year. For the year of income 2018, TZS.2,500,000 was provided in the statement of income and this amount was also included in the cost of business promotion.

(ix) The amount of donation and gifts include the following:-

   (a) TZS.17,400,000 being a donation made to MAMA B as charitable organization recognized by the Commissioner for Domestic tax to help it fight against the spread of HIV/AIDS in the community.

   (b) TZS.4,000,000 being an amount donated to Makonde cement company to help it in its research project.

(x) Printing and stationary expenses include TZS.1,207,000 being a donation made to Tosamaganga Secondary School for printing books under the Education Fund Act, 2001.

(xi) Interest expense on loan is in respect of the loan of TZS.89,400,000. Out of this loan TZS.24,138,000 was used by the director to go abroad on a vacation, TZS.35,900,000 was used for building a private house of the Personnel Manager, the balance was used to acquire office furniture and equipment which was used in the business.

(xii) Annual depreciation allowance was TZS.2,603,100.

REQUIRED:

Calculate the taxable income as well as the tax liabilities of Mbususu Limited for the year of income 2018. Cite the appropriate provisions of the Income Tax Act CAP 332.

(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%

EXAMINATION	**:**	**INTERMEDIATE LEVEL**
SUBJECT	**:**	**PERFORMANCE MANAGEMENT**
CODE	**:**	**B5**
EXAMINATION DATE	**:**	**FRIDAY, 10TH MAY, 2019**
TIME ALLOWED	**:**	**THREE HOURS (9.00 A.M. – 12.00 NOON)**

GENERAL INSTRUCTIONS

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

(e) Answer question **ONE** in Section **A**

(f) Answer **ANY FOUR** questions in Section **B**.

4. In total answer **FIVE** questions.

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

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

7. State clearly any assumptions made in your answers.

8. Graph papers will be provided, where applicable.

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

SECTION A
Compulsory Question

QUESTION 1

The Selefa Ltd is a Company specializing in the provision of CCTV Camera systems for commercial clients. There are two parts of the business: installing CCTV Camera systems in businesses, either first time installations or replacement installations and supporting the CCTV Camera systems with annually renewable maintenance contracts. Selefa Ltd has been approached by a potential customer, Mwangaza Co. who wants to install a CCTV camera system in its new offices. Although the work will not earn a big profit, Selefa Ltd is hopeful of future business in the form of replacement systems and support contracts for Mwangaza Co. Selefa Ltd, is therefore keen to quote a competitive price for the job. The following information should be considered:

(i) One of the Company's salesmen has already visited Mwangaza Co. to give them a demonstration of the new system together with a complementary lunch, the costs of which totaled TZS.400,000.

(ii) The installation is expected to take one week to be completed and would require three technicians, each of whom is paid a monthly salary of TZS.4,000,000. The technicians have just had their annually renewable contract renewed with Selefa Ltd. One of the three technicians has spare capacity to complete the work, but the other two would have to be moved from contract X (in order to complete this one). Contract X generates a contribution of TZS.5,000 per technician hour. There are no other technicians available to continue with contract X if these two technicians are taken off the job. It would mean that Selefa Ltd. would miss its contractual completion deadline on contract X by one week. As a result, Selefa Ltd. would have to pay a one-off penalty of TZS.500,000. Since there is no other work scheduled for their Technicians in one week's time, it will not be a problem for them to complete contract X at this point.

(iii) Selefa Ltd's technical advisor would also need to dedicate eight hours of his time to the job. He is working at full capacity, so he would have to work overtime in order to do this. He is paid an hourly rate of TZS. 40,000 and is paid for all overtime period at a premium of 50 per cent above his usual hourly rate.

(iv) Two visits would need to be made by the site inspector to approve the completed work. He is an independent inspector who is not employed by Selefa Ltd, and charges Mwangaza Co. directly for the work. His cost is TZS.200,000 for each visit made.

(v) Selefa's system trainer would need to spend one day at Mwangaza Co. delivering training. He is paid a monthly salary of TZS.1,500,000 but also receives commission of TZS.125,000 for each day spent delivering training at a client's site.

(vi) 120 cameras would need to be supplied to Mwangaza Co. The current cost of these is TZS.18,200 each, although Selefa Ltd already has 80 Camera in inventory. These were bought at a price of TZS.16,800 each. The handsets are the most popular model on the market and frequently requested by Selefa Ltd's customers.

(vii) Mwangaza Co. would also need a computerized control system called 'Catch 2'. The current market price of Catch 2 is TZS.10,800,000, although Selefa Ltd. has an older version of the system, 'Catch 1' in inventory, which could be modified at a cost of TZS.4,600,000. Selefa Ltd. paid TZS.5,400,000 for Catch 1 when it ordered it in error two months ago and has no other use for it. The current market price of Catch 1 is TZS.5,450,000, although if Selefa Ltd, tried to sell the one they have, it would be deemed to be 'used' and therefore only worth TZS.3,000,000.

(viii) 1000 metres of cable would be required to wire up the system. The cable is used frequently by Selefa Ltd, and it has 200 metres in inventory, which cost TZS.1,200 per metre. The current market price for the cable is TZS.1,300 per metre.

(ix) You should assume that there are four weeks in each month and that the standard working week is 40 hours long.

REQUIRED:

(a) Prepare a cost statement using relevant costing principles showing the minimum cost that Selefa Ltd. should charge for the contract. Make detailed notes showing how each cost has been arrived at and explaining why each of the costs above has been included or excluded from your cost statement. **(14 marks)**

(b) Explain the relevant costing principles used in part (a) and explain the implications of the minimum price that has been calculated in relations to the final price agreed with Mwangaza Co. **(6 marks)**

(Total: 20 marks)

SECTION B

There are **FIVE** questions. Answer **ANY FOUR** question**s**

QUESTION 2

(a) (i) Briefly explain what you understand by the term 'transfer pricing'.

(ii) Explain how the existence of transfer pricing can distort performance appraisal within a divisionalised organization structure. **(6 marks)**

(b) Explain four methods which are used to determine transfer prices. **(4 marks)**

(c) OMEGA Ltd has two divisions PRODUCTION and FINISHING. Production division manufactures product Alpha-200 which it sells in outside market as well as to Finishing division that processes it to manufacture Zelfa-100. The Manager of the Finishing division has recently expressed his concern that transfer price charged by Production division is too high. During the management meeting, the company's CEO ordered the two Divisional Managers to discuss and resolve the conflict to ensure the goal of the firm is achieved. The following information is anticipated and made available:

i. Production division has been selling 50,000 units to outsiders and 10,000 units to Finishing Division, all at TZS.5,000 per unit. It is not anticipated that these demand will change. The variable cost is TZS.3,000 per unit and the fixed costs are TZS.60,000,000. Divisional investment in assets is TZS. 240,000,000.

ii. The Manager of Production division anticipates that Finishing division will want a transfer price of TZS.4,400.

iii. If Production division does not sell to Finishing division then, TZS.8,000,000 of fixed costs and TZS.40,000,000 of assets can be avoided.

iv. The Manager of Production division has no control over the proceeds from the sale of the assets and is judged primarily on his rate of return on investment.

REQUIRED:

(i) Should the Manager of Production division transfer its products at TZS.4,400 to Finishing division? **(5 marks)**

(ii) Determine the lowest price that the Production division should accept. **(5 marks)**

(Total: 20 marks)

QUESTION 3

(a) Allan, the Managing Director of Kwetu Co. Ltd failed to understand the variance report prepared by his accountant. He has approached you as a professional Consultant to highlight external requisites of variance report.

REQUIRED:

Explain requisites that need to be fulfilled for the variance report to be meaningful. **(10 marks)**

(b) A Company produces three (3) products with the following budgeted information:

PRODUCT	**A**	**B**	**C**
Selling Price	TZS.2,170	TZS.2,325	TZS.2,790
Standard Full Cost	TZS.1,550	TZS.1,550	TZS.2,015
Budget Production (unit)	10,000	13,000	9,000

The actual sales price and production were:

PRODUCT	**A**	**B**	**C**
Sales Price	TZS.2,247.50	TZS.2,402.50	TZS.2,945
Budget Production	9,500	13,500	8,500

REQUIRED:

Determine the following managerial control variances.

(i) The Sales Price Variance **(2 marks)**

(ii) The Sales Volume Profit Variance **(2 marks)**

(iii) The Sales Mix Variance **(3 marks)**

(iv) The Sales Quantity Profit Volume Variance **(3 marks)**

(Total : 20 marks)

QUESTION 4

(a) PAMELA Company Limited processes materials into finished products. After process one, two main products PAM and ELA are produced. The production processes allow for 10% normal loss at process one and 5% for each product if it is to be processed further. The scrap at process one can be sold for TZS.13,200 per unit. The standard prices of the products are as follows; PAM to be sold at split off point TZS.34,000 per unit but can be sold for TZS.56,000 per unit after further processing. A unit of ELA can also be sold for TZS.32,000 at split off point or TZS.50,000 after further processing. Further processing costs are; PAM; direct materials TZS.8,000 per unit and conversion TZS.7,000 per unit. The materials and conversion costs per unit for ELA are TZS.10,000 and TZS.8,000 respectively.

In the month of August 2018, 6,000 units were processed through process one at the following costs; direct materials TZS. 40,000 conversion TZS.32,000. The output at the end of process one were 3,000 units for PAM and 2,000 units for ELA.

REQUIRED:

Advise management which of the products should be processed further and which should be sold at split off point if volume is used to share common cost.

(10 marks)

(b) Identify and explain briefly **THREE** similarities and **TWO** differences between activity based costing and the traditional system of assigning overheads to products. **(5 marks)**

(c) Explain the following concepts and describe their application in responsibility accounting:

(i) The controllability principle **(2.5 marks)**

(ii) Budgetary slacks **(2.5 marks)**

(Total: 20 marks)

QUESTION 5

(a) NGUZO Ltd is specialized in purchase and sale of different electronics products from abroad. The company has experienced increased market share and decided to increase its stock in order to capture more customers. The company has recently ordered and received a large consignment of products of various types from one of its suppliers in Asia for a total cost of TZS.80,000,000/=. The company storekeeper has sorted the products into the following categories.

PRODUCT	Units	Selling Price per Unit
Category A	12,000	8,000 TZS.
Category B	8,000	6,000 TZS.
Category C	14,000	4,000 TZS.
Total	**34,000**	

The following information is also available:

i. The percentage of profit in each of the product categories is the same.

ii. Purchase cost is the only variable cost, and fixed costs are higher than variable costs by 19%.

iii. Fixed costs are allocated to product categories basing on unit purchased and sold.

iv. All product purchased were sold, the company does not keep stocks.

REQUIRED:

(i) Compute the number of units for each product category that should be purchased for the company to breakeven. **(8 marks)**

(ii) If the Company wishes to attain a target profit of TZS.49,600,000, determine units of each category to be purchased and sold. **(4 marks)**

(b) BELTA Ltd is a manufacturing Company of wedding jewels. The Company has Profit/Volume (P/V) Ratio of 50% and margin of safety of 40%.

REQUIRED:

(i) Compute breakeven point and net profit if the sales volume is TZS.5,000,000. **(4 marks)**

(ii) If 25% of the variable costs of the Company is labour cost, what will be the effect on breakeven point and the profit when labour efficiency decreases by 5%? **(4 marks)**

(Total: 20 marks)

QUESTION 6

Kunguru Co. Ltd has recently won a design award for their KAZI boots. The Company has established and commenced production of the footwear. The KAZI boots have an innovative design and are made of a resilient, cushioning material which reduces the possibility of injury. The Director of Kunguru has read a newspaper article about the importance of cash budgets in highlighting the finances required for business operations. Consequently, he has asked for your assistance in preparing a cash budget for the first four months of operations, from June to September 2019. The following information has been obtained from a planning meeting with the Kunguru management.

KAZI boots are produced for men and women. Details of selling prices and projected sales for the four months period are shown below:

Type of Kazi boots	Selling Price	Pairs of Kazi boots sold			
		June	**July**	**August**	**September**
Men's	TZS.80,000	2,000	2,400	3,000	3,200
Women's	TZS.70,000	1,400	1,800	2,400	3,000

1. It is expected that all sales will be on credit to department stores and shops specializing in outdoor wear. Kunguru estimates that 30% of customers will pay in one month's time while the remaining customers will take two months to pay.

2. Production of the KAZI boots is based on sales demand. The Company requires a closing inventory of 200 pairs of women's boots and 400 pairs of men's boots at the end of each month. As the Company is just commencing operations there are no opening inventories of KAZI boots.

3. The KAZI boots comprise cushioning fabric and special treated rubber for the soles. The materials and labour required to make each pair of boots are shown in the table below:

Type of Kazi boots	**Cushioning fabric @ TZS. 28,000 per metre**	**Rubber @ TZS. 8,000 per metre**	**Labour @ TZS. 14,000 per hour**
Men's	0.4m	0.15m	0.25 hours
Women's	0.3m	0.10m	0.20 hours

(g) Both of the materials are supplied by one Company based in Uganda. This supplier requires that 50% of the purchase total amount to be paid in cash with the order and allows one month's credit for the remaining amount. Labour costs are paid in the month incurred.

(h) Each pair of KAZI boots produced will be packed in a biodegradable cardboard box using environmentally friendly packaging costing, TZS.1,850 per box. The Company will buy the packaging materials from Burundi Company based in Bujumbura and it has agreed one month's credit for these purchases.

(i) The Company has signed a rental agreement for the production facility. The total factory rent for the year will be TZS.360,000,000, which will be paid in equal monthly installments.

(j) A security deposit amounting to TZS.25,000,000 must also be paid in June.

(k) Other operational costs including power, insurance, and administration expenses which must be paid monthly are expected to be TZS.93,600,000 for the year.

(l) To promote the KAZI boots, the marketing campaign for television, radio, newspaper and social media has been organized. The total cost of the marketing campaign has been agreed at TZS.33,600,000 for the four-month period payable in equal installments from June 2019. A commission of 5% of projected sales is also payable one month in arrears.

(m) The Director will introduce capital of TZS.50,000,000 at the commencement of the Company's operation.

REQUIRED:

Prepare a Cash Budget for Kunguru Co. Ltd for four months of operations from June to September 2019.

(Total: 20 marks)

EXAMINATION	**:**	**INTERMEDIATE LEVEL**
SUBJECT	**:**	**MANAGEMENT, GOVERNANCE AND ETHICS**
CODE	**:**	**B6**
EXAMINATION DATE	**:**	**FRIDAY, 10TH MAY 2019**
TIME ALLOWED	**:**	**THREE HOURS (2:00 P.M. – 5:00 P.M.)**

GENERAL INSTRUCTIONS

(n) 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 FOUR** questions in Section **B**.

4. In total answer **FIVE** questions.

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

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

SECTION A
Compulsory Question

QUESTION 1

(a) Some business managers have been heard talking of strategic management and they believe that they carry out strategic management activities. But when they are asked about the inspiration behind engaging in the strategic management activities, they remain silent, the situation which exposes their ignorance of the inspirational forces.

REQUIRED:

Describe the driven forces that will require the business managers to engage themselves in the strategic management activities. **(10 marks)**

(b) A public Company has a number of different stakeholder groups. These can be categorised as internal, external and connected stakeholders. Another method of categorization is to divide stakeholders into: financial stakeholders and other stakeholders. The value of any Company before these stakeholders is based on how good the governance of the Company is.

REQUIRED:

(i) Briefly explain the four categories of stakeholders who fall under the categories of connected stakeholders. **(2 marks)**

(ii) Explain the link between good corporate governance and the stakeholders who fall under connected stakeholders' group mentioned in (b) (i) above. **(3 marks)**

(c) The term "Ethics" and "Morality" are used interchangeably, as if they bear the same meaning. Literally they communicate different meanings.

REQUIRED:

State the correct meaning of "Ethics" and "morality" as used in the real world. **(1 mark)**

(d) Globalization has greatly posed several business ethical challenges.

REQUIRED:

Evaluate the five business ethical challenges that have attracted global concern. **(4 marks)**

(Total: 20 marks)

SECTION B

There are **FIVE** questions in this section. Answer **ANY FOUR** questions

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QUESTION 2

(a) An organizational structure as a visual diagram of a Company describes what employees do, whom they report to, and how decisions are made across the business.

REQUIRED:

Name and discuss various types of organizational structure that can be adopted by business companies. **(10 marks)**

(b) Kisarawe Plc is a listed Company with a wide range of shareholders including six institutional shareholders who each hold between 5% and 9% of total share capital. The Chairman of the Company wrote to stakeholders asking if they would be willing to attend briefing meetings with him and some of the board members.

The letter from the Chairman followed a newspaper advertisement in which one of the institutions criticized the Company and its strategy in an open letter. The advertisement claimed that the Board had failed to deliver a long term sustainable strategy by reinvesting in its core businesses and that the directors have gained themselves by a short term growth of shareholder value. The investor believes that changes are needed at the top and calls for both the Chairman and Chief Executive Officer (CEO) to resign; they also call for a change in strategy and improved alignment in remuneration packages for directors.

REQUIRED:

Discuss the importance of institutional shareholders in promoting good governance practices in their Companies. **(5 marks)**

(c) Some ethical theories have tried to give solutions to the problems but ethical pluralism does not give direct answers to the problems. According to this theory, a solution to a problem depends on one's decision, the prevailing circumstances and even the moral values of a particular person. The theory suggests that your actions may be in opposition to local norms, or you might be expected to act in opposition to your own norms.

REQUIRED:

With an example, show how Ethical Pluralism Theory applies in the decision making in a particular case. **(5 marks)**

(Total: 20 marks)

QUESTION 3

(a) Strategic implementation is the process by which strategies and policies are put into actions to enhance achievement of objectives. For the implementation to be effective, a number of activities need to be carried out.

REQUIRED:

Elaborate five activities that can facilitate effective strategic implementation process. **(10 marks)**

(b) 'Agency theory is based on the separation of ownership and control in a Company. The ownership of a Company by its shareholders and control over the Company's actions by its directors and senior management executives, which give rise of the agency contract'. Ideally, the contract is to ensure that the managers always act in the best interests of the owners. However, it has been impossible to arrange 'perfect' contract because any decisions managers make affect their personal welfare as well as the interests of the owners. The situation leads to existence of agency conflict.

REQUIRED:

Apply the theory to show different ways in which "agency conflict" can arises. **(5 marks)**

(c) A junior member of staff has just returned to work after taking special leave to care for her elderly mother. For financial reasons she needs to work full-time. She has been having difficulties with her sick mother, causing her to miss a number of management meetings (which usually take place at the beginning of each day). She is very competent in her work but her absences are putting pressure on her and her overworked colleagues. You are her manager, and you are aware that the flow of work through the practice is coming under pressure. One of her male colleagues has raised comments such as "a woman's place is in the home", and is undermining her at every opportunity, putting her under even greater stress.

REQUIRED:

Explain the possible course of action you would take as a manager to solve this ethical dilemma. **(5 marks)**

(Total: 20 marks)

QUESTION 4

(a) A strategy is developed by evaluating alternatives and choosing one of the best alternatives. Strategies exist at different levels of the organization. They include: corporate business and functional level strategies. Corporate strategy alternative can be classified as growth, harvesting, defensive and combination/ hybrid strategies. Defensive strategies are considered by both managers and employees to be an appropriate painfully strategy.

REQUIRED:

(i) Analyse how defensive strategy is used as a way to achieve organizational intended results. **(8 marks)**

(ii) Demonstrate how defensive strategy is linked to painful feelings of both the management and employees. **(2 marks)**

(b) One of the major objectives of a commercial Company is to make profit, and the Company's strategies should be directed towards this objective. In order to achieve this objective, effective strategies need to be designed. Any designed business strategy involves taking risks, which can influence actual profits to be higher or lower than expected depending on risk appetite and risk tolerance.

REQUIRED:

(i) Define the terms "Risk appetite" and Risk tolerance" as used in corporate governance. **(2 marks)**

(ii) Show how Board of Directors is responsible for managing risks. **(3 marks)**

(c) Business Ethics or Ethical standards are the principles, practices and philosophies that guide business people in the day to day business decisions. It relates to the behaviour of a person in a business environment.

REQUIRED:

Discuss the importance of emphasizing the use of ethical standards at workplaces.
(5 marks)
(Total: 20 marks)

QUESTION 5

(a) Great Customer Service is an important factor to bring about success at any business endeavor. Every business man has to identify the essential requirements to achieve this goal.

REQUIRED:

Enumerate essential requirements which shall be applied to create maximum customer satisfaction and retention. **(10 marks)**

(b) Ms. Kimboi joined the board of Kimbiro Company, a large retailer, as finance director earlier this year. Whilst she was glad to have finally been given the opportunity to become the finance director after several years, she also quickly realized that the new appointment would offer her a lot of challenges. In the first board meeting, she noted that she was the only woman in the Company and also very young among the employees.

Kimbiro Company was established almost 100 years ago. Members of the Rosh family have occupied the senior positions since the outset and even after the Company's flotation 20 years ago, each member of the Rosh family had assumed either the Chairman or chief executive position.

The current Chairman, Timothy Kimbiro, (who overstayed) has already prepared his slightly younger brother, Kasala (also a overstayed member of the board) to succeed him in two years' time when he plans to retire.

Kimbiro family, who still own 40% of shares, consider it right to occupy the most senior positions in the Company. So they have never been very kin to entertain external recruitment. They only appointed Ms. Kimboi because they felt they needed a qualified accountant on the Board to deal with changes in International Financial Reporting Standards (IFRSs).

Several former executive members have been recruited as non-executives immediately after they retired from full-time service. A recent death, however, has reduced the number of non-executive directors to two.

Ms. Kimboi noted that the Board meetings rarely contain any significant discussions of strategy and never involve any debate or disagreement. When she asked the reason behind this she was told that the directors had all known each other for so long that they understood each other.

She was also told that other directors had worked for the Company for so long that they all knew what was 'best' for the Company in any given situation. Ms. Kimboi observed that notes on strategic issues were not presented at board meetings and she asked Timothy Kimbiro whether the existing Board was fully equipped to formulate strategy according to the changing environment. She did not receive a reply.

REQUIRED:

Explain the characteristics of directors as board members and briefly state whether the board of Kimbiro Company displays any trails of an ideal board of directors.

(5 marks)

(c) Recently, Tanzanians have witnessed a tag of war between the government and some artists. The government has forbidden certain types of clothes and music/songs. Some of the human rights activists argue against the government that it contravenes the whole concept of human rights. But the main argument here is that something may be right in one society but immoral in another society. This means that those things which are forbidden or banned by the Tanzanian government are not appropriate to the Tanzania culture.

REQUIRED:

Using Relativism Ethical Theory argue for or against the decision of Tanzanian Government to ban some artistic works in the country. **(5 marks)**

(Total: 20 marks)

QUESTION 6

(a) Large organization's activities can be segmented as business units. An organization's business unit which operates by offering a distinct set of products to a distinct market with a well-defined set of competitors is normally referred to as a Strategic Business Unit (SBU).

REQUIRED:

Demonstrate how would you distinguish a Strategic Business Unit (SBU) from normal business units? **(10 marks)**

(b) Sometimes senior management and members of Board of directors find themselves in several misunderstanding, which is caused by failure to understand the scope of their duties. Each group complains of the other group doing their duties. Being an expert in corporate governance you want to make clear on the roles of each to stop the conflict.

REQUIRED:

Advise the board of directors on the scope of their roles and duties in ensuring compliance with good corporate governance principles. **(5 marks)**

(c) Apply the golden rule model to elaborate ethical ways of treating people in different organizations. **(5 marks)**

(Total: 20 marks)

SUGGESTED SOLUTIONS
BI – FINANCIAL MANAGEMENT
MAY 2019

ANSWER 1

(a) Factors to be considered in deciding to change the credit policy (Discussion of any 4 of the followings in terms of relaxing or tightening credit standards and how each translates to cost or benefit to the firm.

- Change in sales,
- Change in timing of settlement of accounts receivables,
- Change in bad debts
- Change in administrative costs.

(a) **AJEX LTD**

Working

	TZS.
Total sales per annum	14,400,000
Less Cash Sales 20%	2,880,000
Credit Sales 80%	11,520,000
Credit Sales per Month x	960,000
Amount eligible for factoring or advance by the bank 90%	**864,000**
	(10,368)

Alternative 1: Factoring

Net cost of factoring

Cost of Factoring Book Debts	**TZS.**
Fee payable for factoring (2%x864,000)	17,280
Commission 4% x 960,000	38,400
Total	**55,680**
Less	
Saving of management cost per month	4,320
Bad debt 960,000x 1%	9,600
Net cost of Factoring	**41,760**

Alternative 2: Offer from the Bank

Net cost of Bank Offer

Cost of Bank Advance Against Book Debts	**TZS.**
Interest Charges 864,000 x 18% x 1/12	12,960.00
Processing Fee 960,000 x2%	19,200.00
Bad debts loss unavoidable	9,600.00
Management cost	4,320
Total cost	**46,080.00**

Recommendation: AJEX LTD should opt for factoring services since the resulting cost is lower than that of Bank option.

ALTERNATIVE SOLUTION
Amount eligible for factoring
80% x 14,400,000 = 11,520,000
⇨ 90% x 11,520,000 =10,368,000

Annual	Factoring	
Fee (2%x 10,368)	207,360	17,280
Commission 4% x 11,520	460,800	38,400
Total Cost	**668,160**	**55,680**
Less:		
Saving of management	51,840	4,320
Bad debt 1% x 11,520	115,200	9,600
Net cost of Factoring	**501,120**	**41,760**

Bank

	TZS.	**TZS.**
Interest 10,368,000 x 18% x 1	155,520	12,960
Processing Fee 2% x 11,500	230,400	19,200
Bad debts	115,200	9,600
Management cost	51,840	4,320
Total cost	**552,960**	**46,080**

(b) **TELCO LTD**

Statement showing the Evaluation of Debtors Policies:

Particulars	**Current Policy**	**Proposed Policy**
A. Expected Profit	**TZS.**	**TZS.**
i. Credit Sales	2,880,000	2,960,000
ii. Total costs other than bad debts and cash discount	2,016,000	2,072,000
iii. Bad debts	57,600	59,200
iv. Cash Discount		35,520
Profit before tax	806,400	793,280
Less Tax	241,920	237,984
Profit after tax	564,480	555,296
Less opportunity cost of investment	8,400	5,756
Net benefit	**556,080**	**549,540**

Recommendation: The proposed policy should not be adopted because its net benefit (TZS 549,540) is lower than those under the present policy (TZS 556,080).

Working notes:

(i) Total costs other than bad debts & cash discount = 70% of credit sales.
Present Policy = 0.7 x 2,880,000 = 2,016,000 TZS.
Proposed Policy = 0.7 x (2,880,000 + 80,000) = 2,072,000 TZS.

(ii) Opportunity cost of investments: Opportunity cost = Total cost x collection Period /360 x Rate of return / 100
Present policy = 2,016,000 x [30/360] x [10% - (10% / 2)] = 8,400.
Proposed policy = 2,072,000 x [20/360] x [10% - (10% / 2)] = 5,756.

(iii) Cash discount = Total credit sales x % of customers who take UP discount x Rate /100
= 2,960x 60% x 2% = TZS 35,520.

ANSWER 2

(a) The merits of short-term and long term debt sources for the financing of working capital.

Short-term sources of finance include overdraft and short-term loans while long term sources of finance include loans notes and long term loans. The choice is between cheaper but riskier short- finance and more expensive but less risky long-term debt. A customer might ask the bank for a shorter term overdraft facility when the bank would wish to suggest a loan instead. However, when a customer wants to borrow from a bank, but cannot see his way to repaying the bank except over the course of a few years, the required financing is best catered for by the provision of a loan rather than an overdraft facility.

Merits of an overdraft over a loan

- The customer only pays interest when his/her account is overdrawn
- The bank has the flexibility to review the customer's overdraft facility periodically, and perhaps agree to additional facilities, or insist on a reduction in the facility.
- An overdraft can do the same job as a loan: a facility can simply be renewed every time it comes up for review.
- Being short-term debt, an overdraft technically is repayable on demand, so they are cheaper than longer term sources of debt finance, but more risky.

Merits of a long term loan

- Both the customer and the bank know exactly what the repayments of the loan will be and how much interest is payable and when. This makes planning (budgeting) simpler
- The customer does not have to worry about the bank deciding to reduce or withdraw an overdraft facility before he is in a position to repay what is owned.
- There is an element of security or peace of mind in being able to arrange a loan for an agreed term. However long term finance is generally more expensive than short term finance.
- Less risky compared with short term loan

(b) (i) Net cash outlay of new machine

	TZS.
Purchase price	2,500,000
Less: Exchange value of old machine	100,000
	2,400,000

(ii) Market value of old machine

Note that old machine could be sold for TZS. 60,000 in the market. Since the exchange value is more than the market value, this option is not attractive. This opportunity will be lost whether the old machine is retained or replaced. Thus, on incremental basis, it has no impact.

(iii) Depreciation

Old machine is fully depreciated for tax purposes. As for a new machine, it has a salvage value of TZS.100, 000. Therefore, its depreciation base will be:

TZS.2, 500,000 + 0 – TZS.100,000 = TZS.2, 400,000

(iv) Net cash flows

Unit cost includes depreciation and allocated overheads. Allocated overheads are allocations from corporate office, therefore they are irrelevant. Depreciation is calculated on the basis of straight line depreciation while written down depreciation should be adjusted for calculating tax saving. Excluding depreciation and allocated overheads, differential costs can be calculated. The company will obtain additional revenue from 20,000 additional units sold. Thus, after tax saving, excluding depreciation tax shield would be;

= [100,000(80 – 59.2) – 80,000 (80-69.2)] (1 – 0.5)
= (2,080,000 – 864,000)0.5
= **TZS.608,000**

After adjusting depreciation tax shield and salvage value, NCF and NPV are calculated as follows;

Net cash flows (TZS. '000)									
	0	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**
After tax savings		608	608	608	608	608	608	608	608
Depreciation		600	450	338	253	190	142	107	80
Tax shield on depreciation (tax rate *dep.)		300	225	169	127	95	71	53	40
Net cash flows from operations (1+3)		908	833	777	735	703	679	661	648
I costs	-2,400								
Salvage value									85*
NCF (4+5+6)	-2400								
PVF at 20%	1.000	.833	.694	.579	.482	.402	.335	.279	.233
PV	-2400	756	578	450	354	283	227	184	171
NPV	**+603**								

*salvage value of the old machine will be forgone. Thus, on differential basis, salvage value will be: SV of new – SV of old = 100000 – 15000 – TZS.s. 85000. No tax adjustment is made on the assumption that the salvage value would be adjusted in the depreciable base of the gross block as per the existing tax laws.
ADVICE: The proposed project will add a net present value of TZS.s. 603,000. Also it has IRR of 28.7 percent. It should be accepted.

ANSWER 3

(a) (i) What would be the cash conversion cycle of Jumbo for the third year of operation under the anticipated sales increase?

Figure in Millions.

Year	**0**	**1**	**2**	**3**
Growth (g)	nil	2%	2%	4%
Total sales = (sales *(1 + g))	3,000.00	3.060.00	3,121.20	**3.246.05**
Credit Sales = ((100% - 25%)* (Total sales))	2,250.00	2.295.00	2,340.90	**2,434.54**
Cost of goods sold = (0.6*Total sales)	1,800.00	1,836.00	1,872.72	**1,947.63**
Inventory = (0.02*Total sales)	60.00	61.20	62.42	**64.92**

In the 3rd year
Cash conversion cycle = ICP + RCP – PDP

- ICP = 360/ Inventory Turnover
  But, Inventory Turnover = COGS/Av. Inventory
  =1947.63/64.92
  =30 times
  Thus, ICP = 360/ Inventory Turnover
  = 360/30
  = **12 days**
- Receivable Collection Period, is given as **60days**
- Payable Differed Period is given as **25days**

CCC= 12+ 60-25) Days **= 47days.**

(ii) What is the amount of money that has been invested in the accounts receivables in the third year of the anticipated sales increase?

If the collection period is 60 days, then amount invested =
=60/360*credit sales

=60/360* 2,434.54
=**405.7million**

(iii) Comment on the amount of the accounts receivables investment over total investment amount if the investment in payables is 29.3 million.

Total amount invested = Inventory + Receivables + Payables

= 64.92 + 405.7 + 29.3

= 500million.

The overall number of receivables in far much greater to inventory and payables as it accounts for 81% of total investment amount. This is due to longer collection period offered to customers which accounts for high cash levels to be in the hands of customers and increase the firm need for finance unnecessary and greater cash conversion cycle.

(b) Ms. Witness, the Chief Financial Officer (CFO) of FCM Company Ltd has created the firm's pro forma balance sheet for the next fiscal year. Sales are projected to grow at 10 percent annually to the level of TZS. 330 million next years. Current assets, fixed assets and short-term debt are 125 percent, 150 percent and 35 percent of the total sales, respectively. FCM Company Ltd profit margin on sales is 12 percent and the pays out 40 percent of net income.

(i) (or S1 – So)

AS

AFN = (A* - L*)dS/So – PM*S1*(l-d)

= (1.25-0.35)*30 – 0.12*330*0.6

= TZS.. 3,240,000

(ii) AFN = (A* – L*)dS/So – PM*S1* (l-d)

= (1.25 – 0.35)*30 – 0.12*330*0.7

= TZS.. 720,000

The company will not require external finance as it has excess fund of TZS.720,000.

(iii) At full capacity the sales level will be 300m/0.9 = TZS.333.333 million. The Company is not still at its full capacity as the sales level is TZS.330 million

(iv) Total assets = Current Assets + Fixed Assets

= 1.25S + 1.5S

= 2.75* Sales

= 2.75*330m

= TZS**. 907.5 million**

(v) AFN = (A* - L*)dS/S o – PM*S1*(l-d)

In second year, the firm will be operating at full capacity, A* = Total assets.

So =

330 million and growth = 10%

AFN = (2.75-0.35)*33 – 0.12*363*0.7

= TZS**. 48.708 million**

ANSWER 4

(a) Non-financial stakeholders are the business associates who have no direct financial stake in the company but are concerned with the financial status of the company. This is because any financial crisis would impact them negatively and vice-versa. Therefore, capital structure decisions influence them and they also play a role in financing decisions. It is important that these interests are kept in mind while making financing decisions.

The level of gearing has an influence on the perception which non-financial stakeholders have about a company.

For example:
Employees may view a highly geared company negatively and the management may stand to lose good talent due to this negative perception on employee growth prospects.

In the event of liquidation (due to non-payment of debt), customers may not be able to obtain the required products and after- sales service.

Suppliers may go out of business in the event the company goes through financial crisis.

Therefore, the above stakeholders may demand compensation for increased risk while dealing with the firm.

(b) **Pamoja Manufacturing Company Ltd**

Output per month = 30,000/12 = 2,500 units

Raw material p.m. = 20,000x2,500	=	TZS.50,000,000
Labour p.m. = 5000x2,500		TZS.12,500,000
Overheads p.m. = 15,000x2,500		TZS.37,500,000
		TZS.100,000,000

Statement of Working Capital Requirements

Particulars	TZS.'000'	TZS.'000'
Current assets		
Stock of raw materials (2months) 50,000 x 2		100,000
Work-in-progress (1/2 months)		
Raw materials = 50,000 x ½	25,000	
Labour = 12,500 x ½ x 50/100	3,125	
Overheads = 37,500 x ½ x 50/100	9,375	37,500
Stock of finished goods (1 month) 100,000 x 1		100,000
Debtors (2 month) 100,000 x 2		200,000
Cash balance required		25,000
		462,500
Less: current liability		
Creditors (1 month) 50,000 x 1		50,000
Working capital required		**412,500**

(c) **Small Manufacturing Firm**

Price at replacement time (or future value) = 2,000,000 x 1.08^6 = TZS.3,174,000

$$FV = \text{Annuity x } \left(\frac{(1+i)n-1}{i}\right)$$

$$3{,}174{,}000 = \text{Ax } \left(\frac{(1+0.1)6-1}{0.1}\right)$$

$$A = \text{TZS.}411{,}370$$

ANSWER 5

(a) Key financial management decisions

- Investment Decision – identification of assets/activities in which to commit resources; with expectations of future cashflows.
- Financing decision – the best way to raise funds to finance the identified investment avenues.
- Dividend decision – to providing return to equity holders and/or deciding on the best way to use the generated return.

Relating with the goal of the firm

The goal is maximization of shareholder's wealth.

Investment decision – positive NPV project generate cashflows that increase the value of the firm $\rightarrow$ and consequently shareholder's wealth/risk is also considered.

Financing decision – focuses on the cost of funds and risk which affect the value of the firm.

Dividend decision is about both cost and cashflows as it touches financing firms project (retained earnings) and the best way to invest the shareholder's return generated from firms' profitable operations.

(b) **Nyati Limited**

(i) Computation of cost of capital for each component of Nyati's long term capital

Workings

$$Ke = \frac{Div(1+g)}{Mg} + g$$

$$= \frac{50 \times 1.03}{450} + 3\%$$

$$= 4.8\%$$

$$KPS = \frac{PS\ \ DIV}{MV} \times 100\%$$

$$= \frac{5\% \times 100}{104} \times 100\%$$

$$= 4.8\%$$

KD = IRR of after tax interest and higher of face value redemption at maturity or "in the money" conversion. 1,000 vs. 450 x (1.03)5 x 2 = 1,043 = "in the money"

IRR

Interest flows: 8% x 1,000 x (1 – T%) = 80 x 70% = 56

	7%	DF	9%	DF
MV	-900	1	-900	1
PV: Interest	230	4.1=AF(7%/5Years)	217	3.89=AF(9%/5Years)
PV: Maturity	744	0.713=DF(7%/5Years)	678	0.65=DF(9%/5 Years)
NPV	124		-5	

$$IRR = \%L + \frac{NPVL}{NPVL - NPVH} \times (\%H - \%L)$$

= 7% + [124/124 – (5)] x (9% - 7%)

= 7% + [.96 x 2%]

= 8.9%

(c) (ii) Calculation of Nyati Limited WACC

Weights

		TZS Millions	
Debt	25x900/100	23.5	28%
Preferred shares	15000000/100x104	15.6	18%
Equity	10000000/100x450	45	54%
		84.1	100%

WACC = Kd x Wd + KPs x WPs + Ke x We

= 8.9% x 0.28 + 4.8 x 0.18 + 14.4% x 0.54

= **11.13%**

ANSWER 6

TATU Co.

(a) (i) Dividend Yield, Capital Gain & Total Returns

	2017		2018	
Dividend Yield	$\frac{38.5}{648}$ x 100	$\Rightarrow$ 5.94%	$\frac{37.0}{835}$ x 100 =	4.43
Capital Gain	$\left(\frac{835-648}{648}\right.$ x100	$\Rightarrow$ <u>28.86%</u>	$\left(\frac{740-835}{835}\right)$x100=	-11.38
Total Returns		34.80%		-6.95

(ii) Return as per CAPM

- The returns as predicted by CAPM are very much different from those actually observed. However returns are showing decline from 2017 to 2018 for both approaches.

- The dividend yield has declined though it is still positive. This is partly because the company is paying more or less constant dividend which is a result of earnings per share not changing significantly.

- Over the two years the average of the return as predicted by CAPM is equal to the firms cost of equity. However the actual average return of 13.9% appears to be higher than the average cost of capital.

- Revenues have remained fairly stable. As the variation in actual returns is attributable to change in prices this may suggest the presence of abnormal returns. On the other hand, it may also suggest that the asset does not lie along the securities market line hence it has a significant level of firm specific/diversified risk. Such assets cannot be easily priced by the CAPM.

(b) Long term cash forecast for Mtukwao corporation:

Planned source of funds:

Net loss (reduction in Retained earnings (17,000 – 14,000)	(3,000)	
Add back depreciation (52,000 – 40,000)	12,000	9,000
Funds generated internally		
Planned deployment of funds:		
Purchase of non-current assets outflow	(20,000)	
Increase in debtors "	(1,000)	
Increase in stocks "	(2,000)	
Increase in creditors inflow	1,000	(22,000)
Net increase in liquidity (cash plus overdraft)		**(13,000)**

SUGGESTED SOLUTIONS
B2 - FINANCIAL ACCOUNTING
MAY 2019

ANSWER 1
(a)

ALEXIS GROUP
CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

	TZS. Millions
Revenue (910+390-90 [w4 (ii)])	1,210
Cost of sales (461 + 171-90 [w4ii] + 30 [w4ii] + 24 [w2])	(596)
Gross profit	614
Expenses (110+43)	(153)
	461
Finance cost (30 + 22)	(52)
	409
Taxation (43 + 12)	(55)
Profit for the year	**354**

ALEXIS GROUP
CONSOLIDATED STATEMENT OF FINANCIAL POSITION AT 31 MARCH 2018

	TZS.Millions
Non-current assets	
Goodwill	114
Property, plant and equipment	2,012
(1210 + 700 + 126 [w2] – 24 [w2])	
Sundry Current Assets (1780+620+20-30)	2390
	4,516
Equity and reserves	
Ordinary shares 2,000	2,000
Retained earnings [W5] 526	526
	2,526
Current liabilities	
Trade payables (1,630 + 360)	1,990
	4,516

WORKINGS (All figures are in Millions)

W1: Calculate group holdings:

ALEXIS's holding in YAVA is 600,000 shares out of 600,000; therefore treat YAVA as a wholly owned subsidiary of ALEXIS.

W2: Fair value of net assets of YAVA at acquisition

Fair value of the net assets is the same as the total of share capital plus all pre-acquisition reserves. As buildings are revalued upwards at acquisition it will create a revaluation reserve at the date of acquisition. This must be treated as a pre-acquisition reserve and included in the fair value of net assets at acquisition.

Shares:	600
Retained earnings at 1 April 2006:	120
Fair value adjustment:	126
Total	**846**

The fair value of the buildings increased by 126 and has a useful life of 21 years. Assuming straight line depreciation with no residual value, that is, 126/21=6. YAVA was purchased four years ago, so the amount of extra depreciation since acquisition is 6 x 4 = 24. Debit: Consolidated retained earnings and Credit: Property, plant and equipment by 24.

W3: Goodwill – YAVA

Cost of shares acquired:	960
Fair value of net assets acquired (W2):	(846)
Goodwill:	114

W4: Intra/inter-group activities

(i) Current accounts

YAVA sent a cheque to ALEXIS. When this is received and banked it will increase bank balance and reduce the current account. Therefore in the consolidated statements bank balance will be adjusted by TZS. 20.

(ii) Intra-group trading

As the mark up is given in the question we will have to convert it to the selling price margin.

Mark up on cost 50% = 33 1/3% margin on selling price.

Selling price 90; unrealized profit = 90 x 33 1/3% = 30.

As all the goods are in closing inventory we need to cancel the unrealized profit of 30 from closing inventory in both the statement of comprehensive income and the statement of financial position.

(iii) Interim dividend paid by YAVA

Cancel the other income item in ALEXIS against the dividend paid by YAVA, then ignore in the financial statements as it has no effect. Note that the dividend paid by YAVA would be shown in its statement of changes in equity.

Consolidated retained earnings
Make sure that you collect all the adjustments above that effect the post-acquisition profit of the group

Balance – ALEXIS from question	400
YAVA – group share of post acquisition profits (300 – 120)	180
Deduct post-acquisition increase in depreciation due to fair value adjustment (W2)	(24)
Cancel unrealized profit in inventory (4ii)	(30)
Total	526

(b) (i) Business Combination

- This is the bringing together of separate entities or businesses into one reporting entity or is a transaction in which the acquirer obtain control of another business (the acquiree). Business Combination is a common way for companies to grow in size, rather than growing through organic (internal) activities.

- Business Combination is not the formation of a joint venture nor does it involve the acquisition of a set of assets that do not constitute a business.

- When there is a business consolidation, the acquirer thereafter reports consolidated results that combine its own financial statements with those of the acquiree.

(ii) Identity an Acquirer - the combining entity that obtains control of the other combining entities or business or which obtain control of the entity. If this cannot be established from shareholding, IFRS 10 provides additional indicators which are:

i Power over more than one half of the voting right of other entity by virtue of an agreement with investor.

ii Power to govern the financial and operating policies of the other entity under a statute or an agreement.

iii Power to appoint or remove the majority of the members of the board of Directors.

iv Power to cast the majority of notes at the meeting of the Board.

ANSWER 2

(a) The Importance of the IASB Conceptual Framework (any 3)

(i) To assist the IASB in the development of future IFRSs and in review of existing IFRSs in order to enhance consistency across standards, and over period as members change and provide benchmark for judgment.

(ii) To assist the national standard-setting bodies – such as the National Board of Accountants and Auditors (NBAA) - in developing national standards, e.g. TFRS 1.

(iii) To assist the IASB in promoting harmonization of regulations, accounting standards and procedures - through reduced number of alternative accounting treatments permitted by IFRSs – could lead to creativity in accounting.

(iv) To assist preparers of FSs in applying IFRSs and - dealing with topics that have yet to form the subject of an IFRS, e.g. consider CF when developing accounting policies for such topics (IAS 8: Para. 10-12; IAS 1: 22).

(b) The following is the cash flows statement of KG Co Ltd

KG Co Ltd
Cash flows Statement for the year ended 31st December2016

	TZS.
Cash flow from Operating activities	
Operating profit before tax	10,080,000
Depreciation	2,104,800
Loss on disposal of Fixtures	283,200
Increase in stock	(3,582,000)
Increase in trade debtors	(1,656,000)
Increase in prepayments	(720,000)
Increase in trade creditors	498,000
Decrease in accrued expenses	(108,000)
Tax paid	(5,412,000)
Net cash inflow from operating activities	1,488,000
Cash flow from investing activities	
Sales proceeds from disposal of assets	1,920,000
Purchases of new fixed assets	3,600,000
Net cash outflow from investing activities	(1,680,000)
Cash flow from financing activities	
Cash proceeds from issue of shares	1,980,000
Cash paid for long term loan	(600,000)
Dividend paid	(3,360,000)
Net Cash outflow from financing activities	(1,980,000)
Net cash outflow during the year	(2,172,000)
Cash and cash equivalent at the start	690,000
Cash and cash equivalent at the end	**1,482,000**

Workings

Working 1: NCA	**TZS '000'**
Opening Balance	10848
Less: Asset Disposed (W2)	(2203.2)
Depreciation	(2104.8)
Cash (Balancing Figure)	3600
Closing Balance	10140

Working 2: Asset Disposed	**TZS '000'**
Cost	3600
Less: Depreciation 31st Dec. 2014 (20% *3600)*9/12	(540)
Carrying Amount 1st Jan. 2015	3060
Less: Depreciation 31st Dec. 2015 (20% *3060)	(612)
Carrying Amount 1st Jan. 2016	2448
Less: Depreciation 31st Dec. 2015 (20% *2448) *6/12	(244.8)
Carrying Amount 30th June. 2016	**2203.2**

Working 3: Tax Payable	**TZS '000'**
Opening Balance	1272
Add: Profit and loss (Current tax)	5040
Total	6312
Cash (Balancing Figure)	5412
Closing balance	900

Working 4: Dividend Payable	**TZS '000'**
Opening Balance	750
Add: Profit and loss (dividend for the year)	3600
Total	4350
Cash (Balancing Figure)	3360
Closing balance	990

ANSWER 3

(a) **Orchid Ltd – Statement of Profit or Loss and Other Comprehensive Income for the year ended31 March 20X9**

	TZS '000'
Revenue	384,840
Cost of sales (W4)	(269,470)
Gross profit	115,370
Operating expenses	(40,320
Investment income	2,160
Loss on investment property (W1)	(4,500)
Finance cost (W6)	(3,240)
Profit before tax	69,470
Income tax expense (W5)	(11,520)
Profit for the period	57,950
Other comprehensive income – not reclassified subsequently	
Gain on revaluation of land and building (TZS. 113,400 – TZS.75,600)	37,800
Loss on investment in equity instruments financial assets (20,000 – 16,000)	(4,000)
Income tax relating to components of other comprehensive income (TZS. 37,800 – TZS. 4,000) x 30%	(10,140)
Other comprehensive income for the year	**23,660**
Total comprehensive income for the year	**81,610**

Loss on fair value adjustment of equity investment highlighted above could have alternatively be charged to profit/loss as it is not stated whether the financial instrument should be measured at fair value through Profit or Loss OR through OCI.

(b) **Orchid Ltd – Statement of Financial Position as at 31 March 20X9**

	TZS '000'	**TZS '000'**
Assets		
Non-current assets		
Property, plant and equipment (W3)		137,880
Investment property (W1)		24,300
Financial assets		16,000
		178,180
Current assets		
Inventories (W2)	18,350	
Trade receivables	38,700	57,050
Total assets		**235,230**

Equity and liabilities		
Ordinary shares of 25c each		36,000
Retained income (W7)		107,350
Non-current liabilities		
Deferred tax (W5) 6,480 + 10,140	16,620	
Redeemable preference shares of TZS. 1,000 each	18,000	34,620
Current liabilities		
Trade payables	21,240	
Bank overdraft	21,620	
Current tax payable (W5)	14,400	57,260
Total equity and liabilities		**235,230**

Workings

W1 Investment property

Carrying value, per question	28,800
Valuation 31 March 20X6	(24,300)
Loss on valuation, to be transferred to profit for the period (IAS 40)	**4,500**

W2 Adjustment for damaged closing inventories

	TZS '000'
Cost of damaged inventories	1,440
Recoverable amount	1,700
Additional remedial costs	(810)
Fair value Less Costs to Sell	890
Value of inventories per question	18,900
Write down = TZS. 1,440 – TZS. 900 per above (as NRV is lower)	(550)
Adjusted CV for the SOFP	**18,350**

W3 Non-current assets

		TZS '000'
A	Land	27,000
	Buildings: per IAS 16, depreciation is based on revalued amount:	
	Revalued amount (a)	86,400
	Remaining life at the revaluation date in years (b)	15
	Depreciation on straight line basis = (a)/(b)	(5,760)
B	Net carrying amount of building	80,640
	Plant and equipment	
	Cost per question	64,800
	Accumulated depreciation, per question	(30,240)
	Carrying value 31 March 20X9, before depreciation	34,560
	Depreciation for the year on the above at 12.5%	(4,320)

W4 – Cost of Sales	**TZS. '000'**
Cost of Sales – TB	258,840
Add: Depreciation – Building (W3)	5,760
Depreciation –Plant & Equipment (W3)	4,320
Inventory Write down (W2)	550
Cost of Sales to P & L	269,470

W5Deferred Tax	**TZS. '000'**
Opening Bal. – TB	9.360
Less: Closing Bal. Required (30% x 21.6m)	6,480
Prior Tax exps to be paid	2,880
Tax Exps – Balancing Figure	11,520
Provision for Income Tax	14,400

W6Finance Costs	**TZS '000'**
Finance Cost – TB	9,000
Less: Div.– Ordinary Shares (160 x 36)	5,760
Finance Cost – to P & L	3,240

W7: Retained Earnings	**TZS '000'**
Opening Balance	31500
add: Total Comprehensive Income	81610
less: Dividend	(5760)
Closing Balance	107,350

Note: Dividends to redeemable Preference shares is treated as an expense as these are liabilities rather than equity.

ANSWER 4

(a) The following are enhancing qualitative characteristics of financial statements:

(i) **Comparability**

Comparability is one of the enhancing qualitative characteristics in accordance with the Conceptual Framework for Financial Reporting 2010. Comparability helps the users to identify and understand similarities in, and differences among items on the entity's financial statements and in comparison with other entities.

Comparability in financial statements is of two kinds

- Within the entity over time: the user should be able to compare the amounts of different periods and identify trends, if any, in the financial position and performance.
- Between different entities: the user should find it possible to evaluate the relative financial position, changes in financial position and performance of the entity.

In order to make the financial statements comparable in this manner, certain requirements have to be fulfilled. There should be consistency in the measurement and display of the financial effects of like transactions and events. Users should be informed of the accounting policies, changes in those policies and effects of the changes. Compliance with IFRSs helps in ensuring comparability. (This is an important issue and is discussed separately in the next sections of this Study Guide). Corresponding information for the previous period should be disclosed.

(ii) **Understandability**

Financial statements are intended to provide certain information to users. These users are likely to use the information to make economic decisions and must therefore be able to understand the contents of the statements.

The objective of understandability is achieved with the help of the following essential components: Those preparing the statements present and make full disclosure of information that is essential for the understanding of the statements, and present it in an understandable manner.

(iii) **Verifiability**

Information has the quality of verifiability when different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation. If users are to take decisions based on the financial statements, the information in the statements has to be verifiable; otherwise it would not be of any help even if it is relevant.

(iv) **Timeliness**

Timeliness means having information available to decision-makers in time to be capable of influencing their decisions. Generally, the older the information is, the less useful it is. For the users of general purpose financial statements, the information is useful for decision making only if it is timely.

(b) The following are means by which accountants can be encouraged to act in the public interest.

(i) Compliance with the requirements of accounting standards so as to protect public interest.

(ii) Professional bodies clearly defining regulations so as to guide accountants to act in the public interest.

(iii) Professional bodies such as the NBAA, IFAC and ICAEW can inform the public about the actions expected from the members of the accounting bodies so as to act in the public interest.

(iv) Professional bodies can have a strict process so as to identify breaches of the public interest.

(v) Breaches due to unprofessional behavior must be subjected to suitable disciplinary action.

(vi) Accountancy firms can develop and implement codes of business conduct of professional codes of ethics. Such codes specify that is right and wrong and thereby guide accountants to act in an ethical manner in the interests of the public.

(c) Cost to be capitalized of new machinery

	TZS
Cost of construction of new site	30,000,000
Cost of new machinery	100,000,000
Cost of installation	1,500,000
Freight	2,000,000
Trial run cost	2,100,000
Total cost of Machinery	**135,600,000**

Journal Entries

The new machinery is valued at the fair value given. Accordingly, the journal entry for acquisition of new machinery will be:

Dr	New Machinery	TZS 100,000,000	
Dr	Loss on old machinery	TZS 5,000,000	
		(TZS 25,000,000-TZS 20,000,000)	
Cr	Old machinery		25,000,000
Cr	Cash		80,000,000

Being new machinery purchased

ANSWER 5

(a) Calculation of financial ratios

			2015	2014
i.	Gross Profit Margin	Gross Profit x 100 Sales revenue	407,500,000 x 100 = 32.68% 1,247,000,000	314,000,000 x 100 =35.28% 890,000,000
ii.	Operating Profit Margin	Operating Profit x 100 Sales revenue	232,000,000 x 100 =18.60% 1,247,000,000	184,000,000 x 100 = 20.67% 890,000,000
iii.	ROCE	Operating Profit x 100 Capital employed	232,000,000 x 100 = 36.24% 380,200,000+260,000,000	184,000,000 x 100 = 41.72% (271,000,000+ 170,000,000)
iv.	Current ratio	Current assets Current liabilities	287,900,000= 3.96 72,700,000	178,000,000= 3.18 56,000,000
v.	Quick ratio	Quick asset Current liabilities	198,600,000=2.73 72,700,000	126,000,000=2.25 56,000,000
vi.	Debtors days	Receivables x 365	198,600,000 x 365	108,000,000x 365

	(Receivables)	Credit sales	1,247,000,000 = 58.13 days	890,000,000 = 44.66 days
vii.	Creditors days (Payables)	Payables x 365 Credit Purchases	57,000,000x365 839,500,000 =25.09 days	56,000,000x365 576,000,000 = 35.49 days
viii.	Inventory days	Inventory x 365 Cost of sale	89,300,000x365 839,500,000 =39days	52,000,000x365 576,000,000 =32.95 days

(b) **Limitation of ratio analysis**

Analysis of ratios

1. **Profitability ratios**

   Help to analyse the profitability of a company. Gross profit margin decreased by 2.6%, operating profit. Margin decreased by 2.07% and ROCE decreased by 5.48%. these ratios indicate that KCL capacity to generate profit on its sales has been impaired (decreased) and hence the ability of KCL to pay back the loan is also in doubt in future if this situation shall persist (continue).

2. **Liquidity ratio**

   Helps to assess the liquidity and cash position of the company. It is an indicator of whether the business has the capacity to pay its trade payables, expenses, loans as well as current liabilities at the current point of time. Current ratio increased by 0/78% and Quick ratio increased by 0.48%. This indicates that KCL has the capacity to pay the loan is the Bank decides to provide that facility.

3. **Working capital efficiency ratios**

   This set of ratios help to analyse how efficiently the asset of company are being used in generating revenue. Receivable days increased by 13.5 days when indicates the number of customers to pay has increased by hence efficiency in collection, payable days decreased by 10 days which indicates that KCL has improved in days for setting their bills. Inventory turnover has increased by 6 days this indicates that the number of times the inventory is being turned over in a year has increased.

   ∴ Generally based on the above analyzed ratios KCL is in good position to continue pay back the Loan (Credit facility) to the Bank and therefore can be recommended for increase in their credit facilities to fund an expansion programme.

Limitation of ratio analysis and how these could be overcomed;

(i) It is important to note that this analysis is based on historic data and they may not be a good indicator of the future performance of the business. To improve the analysis budgets or up to date management information would be useful.

(ii) The analysis is restricted by the lack of information about the sector that KCL (T) Ltd operates in and its Key customers and suppliers. It may also be useful to compare KCL (T) Ltd ratios with industry averages or competitors.

(iii) Further limitation is that there is only two years of data and there isn't a statement of cash flows. Ideally more data could be available to build up trends.

(iv) The ratio analysis has also been limited by the revaluation. Ideally the ratio should be calculated to adjust for the revaluation to improve capability.

(v) Changes in accounting policies and practices of the company and differences in accounting policies and practices between two entities may lead to an incorrect comparison of entities. To ensure that accounting policies are the same for compared entities.

(vi) Companies may have different accounting periods. Comparison should base on same accounting period.

(vii) Entities sometimes apply creative accountingin order to show good financial performance or position which can be misleading. Consider use of cashflow information when making assessment of entity performance.

ANSWER 6

(a) **Advantages of International Harmonization**

(i) Investors have greater comparability of financial statements which enables easier investment decisions. This is important in the context of global investing which has become more significant in the last decade;

(ii) Governments will have reduced funding requirements as they will not have to develop accounting standards for their own country;

(iii) Accounting firms with international practices will find it easier to deal with staff resourcing in countries experiencing boom or recessionary times due to common accounting standards allowing staff transferability between countries with no major impact on services delivered;

(iv) Companies
- Management control of foreign subsidiaries will be easier;
- Consolidation of financial statements of subsidiaries will be easier as they will operate under the same standards;
- Easier to comply with stock exchange reporting requirements;
- Investment more likely as investors will have greater knowledge and reliance on the financial statements.

Obstacles to International Harmonization

(i) Different purposes of financial statements i.e. IFRS's aimed at investment decision making whereas many countries use financial statements for tax purposes.

(ii) Nationalism – possible unwillingness to accept another countries standard.

(iii) Different legal systems whereby some countries require certain accounting practices and policies and other countries do not;

(iv) Different users of financial statements. Countries vary in the importance they place on users groups

(v) Lack of strong accountancy bodies. Many accountancy bodies in various countries are not independent or strong enough to press for harmonization of accounting standards in their jurisdiction;

(vi) Language and cultural differences. Both of these can cause difficulties in the adoption of standards accounting standards.

(b) (i)

- As per the Conceptual Framework, an asset is a resource controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity.

- As per the Conceptual Framework, a liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

(ii) A motor car is owned and controlled by the company as a result of purchasing it in the past. The company will obviously expect the use of the car to contribute positively to the company in the future for example, a sales representative of a company will have the use of a car to drive around and make sales and receive cash on behalf of the company.

The bank loan received by the company from a bank is the past event. The company has a present obligation through monthly loan repayments to the bank and these repayments.

(c) (i) **The IFRS Advisory Council**

The IFRS Advisory Council is the formal advisory body to the IASB and the Trustees of the IFRS Foundation. It consists of a wide range of representatives from groups that are affected by and interested in the IASB's work. These include investors, financial analysts and other users of financial statement, as well as preparers, academics, auditors, regulators, professional accounting bodies and standard-setters. Members of the Advisory Council are appointed by the Trustees.

The Advisory Council normally meets three times a year for a period of two days, in London. The Chairman of the IASB, the Director of Technical Activities, the Director of Research, the Director of Implementation Activities, and IASB members and staff who are responsible for items on the Advisory Council meeting agenda are normally required to attend the meetings.

(ii) **The IFRS Interpretations Committee**

The IFRS Interpretations Committee is the interpretative body of the IASB. The Interpretations Committee comprises 14 voting members appointed by the Trustees and drawn from a variety of countries and professional backgrounds. The mandate of the Interpretations Committee is to review on a timely basis widespread accounting issues that have arisen within the context of current IFRSs and to provide authoritative guidance (IFRICs) on those issues. Interpretation Committee meetings are open to the public and webcast.

In developing interpretations, the Interpretations Committee works closely with similar national committees and follows a transparent, thorough and open due process.

SUGGESTED SOLUTIONS
B3 – AUDITING PRINCIPLES AND PRACTICE
MAY 2019

ANSWER 1

(a) (i) The quality of audit evidence generated by direct confirmation is very high because:

- **It is obtained from independent external source** and audit evidence ismore reliable when it is obtained from independent sources outside the entity.
- It is documentary evidence and audit evidence is more reliable when it exists in documentary form, whether paper, electronic, or other medium. Typically, 3rd party confirmation calls for the evidence to be received **through Debtors circularization process and Bank Standard letter**.

Examples other than debtors' confirmation techniques might also be used are as follows:

- Bank balances and other information from bankers
- Inventories held by third parties
- Property deeds held for safe keeping by third parties or purchased from stock-brokers but not delivered at the end of the reporting period
- Loans from lenders
- Accounts payable balances

(ii) The sequence of steps involved in debtors' circularization process.

(1) Obtain a written permission from management to write the circularization letters,

(2) Write the circularization letters yourself in the client letter heads.

(3) Take a sample of debtors balances from the sales ledger to be circularized.

(4) Have the letters signed by the client officers?

(5) Receive the replied directly from the debtors circularized.

(6) For debtors who have not replied send a second request and telephone the debtor concern.

(7) If the debtor does not respond including the second request have no otherwise except to perform any one of the following:

- Review the sales ledger and perform listing of the sales invoices to such a debtor.
- Observe the cut-off procedures of over the sales made by the company to such a debtor.
- Request the company to provide a provision where the balance cannot be confirmed.
- Obtain the representation letter from management where the provisions have been provided.
- Include such non-replies in the management letter presented to the directors.

(b) The assertion of completeness is critical for liabilities such as trade creditors and accrual salaries and wages because such liabilities are usually an audit area of significant risk as it is usually easier for a company to understate liabilities (intentionally or in error) than it is to overstate assets. This is because it is harder to identify items that are not there (i.e. gain comfort that the figure of creditors is complete) than it is to prove that a listed item is genuine (i.e. that is exists).

Finally, Auditors are more concerned that liabilities may be understated rather than overstated.

Management may decide to understate liabilities deliberately to improve something like the current and solvency ratios.

(c) Professional judgement is the application of relevant training, knowledge and experience in making informed decisions about the appropriate courses of action in the circumstances of the audit engagement. The auditor must exercise professional judgement when planning an audit of financial statements.

Professional judgement will be required in many areas when planning. For example, the determination of materiality for the financial statements as a whole and performance materiality levels will require professional judgement.

Professional judgement will also be required when deciding on the nature, timing and extent of audit procedures.

ANSWER 2

(a) (i) The following audit opinions are recommended:

(1) Since the inconsistency is traced to the financial statements, it may be considered that the financial statements are materially misstated. The pervasiveness of the effect of the matter will be considered and if it is only material**, a qualified opinion "except for**" will be issued. On the other hand, if the effect is considered as being both material and pervasive, **an adverse opinion will be appropriate.**

(2) TZS 2.0 million reduction in the value of stocks amount to 10% of the total assets of the company. This is material. This amounts to material misstatement in the financial statements and non-compliance with applicable financial reporting framework. The recommended audit opinion will be an **"except for" qualified opinion.**

(3) Since the auditors consider the effect of the matter to be both material and pervasive, it means that there was a significant inability to obtain sufficient appropriate audit evidence to determine misstatements in the financial statements. The auditors will be unable to express an opinion and therefore **a disclaimer of opinion will be appropriate**.

(4) Since management refused to make an allowance for the write-off of the debtor, the requirement of IFRSs has not been complied and thus will be materially misstated. **An "except for" qualified opinions recommended.**

(ii) The auditor may consider the reason behind the directors' refusal to effect the changes and determine whether it borders on the directors wanting to commit fraudulent financial reporting which will reflect on their integrity. It could also mean the directors are difficult and just do not want to cooperate with the auditor's. Whatever the case, the auditors may want to bring this to the attention of the shareholders in the annual general meeting.

(b) (i) Expectation gap is most commonly explained as, 'the difference between what the public expects from the auditing profession and what the auditing profession actually provides'. It can also be defined as the difference between what the general public thinks auditors do and what the general public would like auditors to do'.

Expectation gap can be more broadly explained by discerning its three components, i.e. knowledge gap, performance gap and evolution gap.

(ii) NARROWING THE EXPECTATIONS GAP

The expectations gap could be narrowed in the following ways:

(1) **Educating users** – The auditor's report as outlined in ISA 700 forming an opinion and reporting on financial statements includes an explanation of the auditor's responsibilities, but also quite extensive discussions of the key matters arising from the audit.

(2) **Extending the auditor's responsibilities** – Research indicates the extra work by auditors with the inevitable extra costs is likely to make little difference to the detection of fraud because:

- Most material frauds involve management.
- More than half of frauds involve misstated financial reporting but do not include diversion of funds from the company.
- Management fraud is unlikely to be found in a financial statements audit.
- Far more is spent on investigating and prosecuting fraud in a company than on its audit.

(3) Improving quality control

(4) Strengthening the role of Audit committee

(5) Improving the audit methodology

ANSWER 3

(a) **Ethical threats and examples**

Compliance with the fundamental principles of professional ethics may potentially be threatened by a wide range of different circumstances. These threats generally fall into five categories

- Self-interest
- Self-review
- Advocacy
- Familiarity
- Intimidation

The list of threats associated with an example of a circumstance that may create each threat is given in the table below:

Threat category	**Example**
Self-interest	A financial interest in a client's affairs where an audit firm owns shares in the client
Self-review	A firm prepares accounting records and financial statements and then audits them
Advocacy	Acting as an advocate on behalf of an assurance client in litigation
Familiarity	Senior members of staff at an audit firm with a long association with a client.
Intimidation	Client threatens to sue the audit firm for previous work

(b)

	Ethical threat rising	How threat may be avoided
i.	**Self-interest threat** The audit team have previously been offered a 10% discount on luxury phones from MAM Plc which will potentially have a high value. As only goods with a trivial and inconsequential value can be received, if the same discount is again offered, it will constitute a self-interest threat.	The offer for the discount should be declined if the value is significant.
ii.	**Self-review threat** An audit senior was seconded to MAM Plcto cover the financial controller role for three months during the year. The audit senior probably prepared a significant proportion of the records to be audited; this creates a self-review threat as he will review his own work during the audit.	Only if it turns out the senior was only involved on areas unrelated to the financial statements being audited should be allowed to remain on the audit team, otherwise he should be removed from the assignment to avoid the threat to independence.
iii.	**Self-interest threat** The fee income from MAM Plc is 16% of Island Associate Auditors' total fees. If, after accounting for non-recurring fees such as the secondment, it remains at this percentage of total fees on a recurring basis there is likely to be a self-interest threat because of undue dependence on this client. Where this exceeds 15% for listed companies, objectivity is impaired to such as extent that mandatory safeguards are needed..	The firm should consider whether the further work should be accepted and also consider appointing an external quality control reviewer. Going forward, the firm needs to assess the recurring fee position for MAM Plc and consider refusing further offers of work where this will take them over the 15% threshold. If the threshold is breached for two consecutive years the threat can be mitigated by applying the mandatory safeguards of disclosing the position to the board and arranging an independent pre-issuance or post-issuance engagement review.
iv.	**Familiarity and self-interest threat** The partner and finance director of MAM Plc have been on holiday together and appear to have a longstanding close relationship. This result in a familiarity and self-interest threat. Both are senior in their respective organizations and any onlooker would perceive independence to be threatened.	The partner should be replaced with another partner in an audit of MAM Plc to remove both the actual and perceived familiarity threat.

v.	**Self-interest threat** As result of close relationship partner failure to claim on the 20% of outstanding audit fees from MAM Plc	The reasons for non-payment should be determined, and if possible an agreement reached whereby MAM Plc repays the fees prior to the commencement of any further audit work.

(c) **Steps prior to accepting a new audit engagement**

(i) Ensure that there are no independence threats or other ethical problems likely to cause conflict with the Code and other applicable ethical guidelines.

(ii) Ensure the firm is professionally qualified to act, considering whether the firm may be disqualified on legal or ethical grounds.

(iii) Ensure the firm's existing resources are adequate, including consideration of available time, staff and technical expertise.

(iv) Communicate with present auditors having obtained the client's permission and enquire whether there are reasons/circumstances behind the change which the new auditors ought to know.

(v) Consider the response from the existing auditor for any issues that could impact on the acceptance decision.

(vi) Undertake client screening procedures such as considering management integrity and assessing whether any conflict of interest with existing clients would arise.

(vii) Carry out further client screening procedures such as assessing the level of audit risk of the client and whether the expected engagement fee would be sufficient for the level of anticipated risk

ANSWER 4

(a) The various types of controls which the company can adopt can be classified as follows:

(i) Voluntary and mandatory controls
(ii) Financial and non-financial controls
(iii) Manual and computerized controls
(iv) Administrative and accounting controls
(v) Discretionary and non-discretionary controls
(vi) General and application controls
(vii) Preventive, detective and corrective controls

1. **Voluntary and mandatory controls**

   (i) **Voluntary controls are controls which are not enforceable by law.** In other words the company lays down the controls so that the business can run smoothly. MIKOCHENI should implement a policy with respect to authorization of transactions and processes such as raising purchase orders, accepting materials from vendors, approving the quality of materials and signing cheques.

   The controls in these areas may include the following:

   - MIKOCHENI should set limits on who can make purchase orders and up to what amount. The CEO may have a limit of TZS.10 million whereas the accountant may only have a limit of TZS. 2 million.

   - The quality engineers and quality manager must be authorized to approve the quality of the raw materials, semi-finished and finished goods of the factory.

   (ii) **Mandatory controls are controls which are enforceable by law.** MIKOCHENI should ensure that the company's manufacturing process meets the standards laid down by the pollution control authorities. This will ensure that the company will not have to face penalties due to statutory non-compliance

2. **Financial and non-financial controls**

   (i) **Financial controls are controls which lead to safeguarding of the assets of the company and maintaining and providing proper and reliable financial information.** MIKOCHENI should maintain records of financial information such as purchases, sales, expenses incurred and purchases of non-current assets.

   The information must be reliable and lead to reliable financial statements. So for example, all sales orders must have a unique sequential reference, to ensure all of the orders are recorded and missing orders can be identified.

   (ii) **Non-financial controls deal with areas which are not directly reported in the financial statements.**Mikocheni should set the following controls in this connection: organization structure, strategic policies, policies and procedures for various activities of the company such as the company's HR policy. These controls will help the company to achieve its objectives. For example, having an organization structure will help management ensure that all tasks that need to be carried out are assigned to someone in the organization chart.

3. **Manual and computerized controls**

   (i) **Manual controls are controls which are monitored manually.** MIKOCHENI is a newly set up company which has a manual system of monitoring sales orders i.e. the orders are received by telephone, mail or fax. These will have to be recorded in a register and monitored manually. This will ensure that all orders are fully executed.

   (ii) **Computerized controls are controls which are programmed to prevent, detect and correct errors.**MIKOCHENI has "inn built" controls in the software e.g. the software can be used by authorized persons only. This will help to prevent errors. The software has a provision through which transactions cannot be cancelled.

   Transaction can only be cancelled by recording journal entries. Hence, the software has a provision through which audit trails can be established. This can help to detect errors.

4. **Administrative and accounting controls**

   (i) **Administrative controls are controls established to accomplish the objectives of the company.** The administrative controls for MIKOCHENI would include preparing an appropriate organization structure which should specify the various reporting levels of the company. Responsibilities must be clearly set out e.g. the responsibilities of the purchase department must be entrusted to an appropriate level of authority.

   (ii) **Accounting controls are controls which lead to accurate and reliable financial statements.** The accounting controls of MIKOCHENI should include ensuring that all transactions are supported with appropriate documentation and recorded properly. This will require the company to have policies and procedures for the various activities of the company. So for example, as soon as an invoice is received from a supplier, it is recorded in the payables ledger.

5. **Discretionary and non-discretionary controls**

   (i) **Discretionary controls are controls which are based on judgement** i.e. based on discretion. The discretionary controls of MIKOCHENI should include not making purchases from vendors who have a bad reputation in the market and raising sales invoices only at the time of dispatch of goods. This would ensure that the company does not face the risk of purchasing poor quality products.

   (ii) **Non-discretionary controls are controls which are automatically generated by the computer system.These controls cannot be evaded.** The non-discretionary controls of MIKOCHENI include access to software by authorized persons and recording the date of a transaction only in the format (MM/DD/YY) set the software. These controls will ensure that transactions are properly authorized and recorded according to the requirements of the software.

6. **General and application controls**

IT controls are grouped under two categories: application controls and general IT controls.

(i) **General controls** are controls over the environment in which the computer functions. They enable the continues proper operation of information systems by ensuring the effective functioning of application controls. Some of the general controls for MIKOCHENI should be:

- **System need to be used for authorized purposes only:** MIKOCHENI needs to have a system of password access to the system. This will ensure that the data is not misused or corrupted.

- **Authorized programs need to be used:** MIKOCHENI must have a system whereby the programs (e.g. SAP) which are run are authorized by the IT department and ratified by the board of directors. This would require maintaining a library of programs which is accessed only with the approval of the librarian. Such a control will ensure that data are processed correctly.

(ii) **Application controls** relate to the processing of individual applications. Applications are the computer programs and processes, including manual processes that will enable MIKOCHENI to conduct it essential activities. **Application controls help to ensure that transactions are authorized, complete and accurately recorded.**

MICHENI should implement application controls with respect to transactions relating to buying products, paying vendors, accounting for travelling expenses and forecasting and monitoring budgets.

For example, MIKOCHENI can adopt a system of giving access to the purchase module to the purchase manager to raise purchase orders up to an amount of TZS.10 million and for amounts more than TZS. 10 million to the CEO.

The system must ensure that:

- Materials are accepted only if they are supported by valid purchase orders.
- Payments are made only if they are supported by vouchers duty authorized by the accounts manager and accompanied with valid goods received notes authorized by the quality department and purchase orders.

- MIKOCHENI can adopt the system of recording travel expenses as follows:
  - ✓ The company must set limits on the amount of expenses which as employee can claim e.g. TZS. 100,000 per day.

  - ✓ Vouchers should be authorized by the purchase manager.

- ✓ Vouchers should be supported by a travel expense report (giving details of days of travel and nature of expenses) and bills to support the expense, etc.

7. **Preventive, detective and corrective controls**

(i) **Preventive controls are controls to prevent errors from occurring.** The preventive controls for MIKOCHENI should include preparation of goods received notes only if purchase orders are available, together with verifying the authorization of purchase order, salary sheets, overtime sheets, etc. by appropriate personnel.

These controls will ensure that the purchase transactions recorded are physically received, unnecessary purchases are not made by the company and the salaries and overtime paid have been correctly calculated and made to real people who have worked the hours stated.

(ii) **Detection controls are controls which enable detection of errors.** The detection controls for MIKOCHENI should include bank reconciliation statements and surprise cash counts. For example:

- A monthly bank reconciliation will ensure that MIKOCHENI will be able to detect any transactions relating to the bank which have either not been recorded or are wrongly recorded. The company can then take the required corrective action.

- Surprise cash verification by persons from outside the accounts department such as the sales executive, purchase manager or administration manager will enable the company to confirm the genuineness of the availability of cash.

(iii) **Corrective controls are controls to correct errors.** The corrective controls for MIKOCHENI should include virus protection for all programs and back-up of all system programs.

(b) **The following are the methods adopted by the Board of Directors of Smart Collections ltd relating to the effectiveness of the internal control system of the company:**

(1) The annual assessment of internal controls does not include:

(i) The changes in the nature and extent of significant risks, and the company's capacity to respond to the changes. The changes to be considered are since the last period of assessment. This is because the company has newly set up ERP software, however the board has not considered the significant risks faced by the company due to failure of the software.

(ii) The level and frequency of reporting by management on the internal controls and risk management. This is because there is no specific frequency for preparation of internal audit reports i.e. sometimes reports are prepared quarterly and sometimes half yearly.

(iii) The effectiveness of the company's public reporting processes. This is because, during 2018, the company's quarterly results when compared with the audited financial statements showed a fall of 20% in the net profits.

(2) The charter for the internal auditor has not been prepared. The CIA decides the charter based on his assessment of the risks faced by the company. Therefore, the areas where controls are weak can be ignored by the CIA, either purposely or erroneously.

(3) The internal auditor normally verifies internal financial controls and compliance controls only.

However, the controls which are to be reviewed should include operational controls.

(4) The board should state the method adopted to review the effectiveness of the internal controls. The method must include the scope of internal audit, the frequency of reports received from management and the method of assessment of the effectiveness of the controls. Hence, to support its assessment regarding internal controls, the board must be provided with documentary evidence.

ANSWER 5

(a) (i) **The sufficient appropriate audit evidence is influenced by a number of factors such as:**

- Experience from previous audit including knowledge of business;
- The degree of audit risk which results from the assessment of inherent risk and control risk;
- The persuasiveness of the evidence which depends on the source and reliability of the available information;
- Materiality of item involved; and
- Results of audit procedures.

(ii) **The factors affecting persuasiveness of audit evidence are**:

- **Competence of evidence**
  Competence of evidence refers to the degree to which evidence can be considered reliable and relevant.

- **Relevance to the audit objective**
  Audit evidence must be relevant to the audit objective that the auditor is testing before it can be reliable. Relevance should be considered in terms of specific audit objectives.

  Timeliness
  For example, evidence obtained from physical inventory count is usually more reliable for balance sheet value when it is obtained at a date as close to the balance sheet date as possible.

- **Sufficiency** of evidence – it is measured primarily by:
  - Adequate sample size
  - Appropriate sampling method – samples containing large value items, are usually considered to be sufficient.

(b) The financial audit and operational audit are not mutually exclusive. These are interconnected. The object of financial audit is to look into the correctness of financial accounting data and compliance of internal control system. The operational audit on the other hand through appraisal, review and evaluation of the operating control records and management information systems, aims at better performance to achieve better profit. A clear distinction between operational audit and financial audit cannot be drawn in many cases. However, the difference between the two may be stated as under:

	Financial Audit	**Operational Audit**
i.	To look into the correctness of financial data and records along with correctness of the accounting procedure followed.	To see that the financial accounting records have been properly designed and maintained to furnish the management with timely information to help them in judging the extent to which the profitability goals have been achieved.
ii.	To see that the internal control system has been working properly.	To see that the internal control system has been designed from the point of view of achieving better efficiency and whether the same have been functioning effectively.
iii.	To see that the credit control has been strictly followed.	To study the credit control system for suggesting better measure where considered accessary.
iv.	To see that all payments have been made with proper authorization and approval.	To study whether some expenditure of sizeable magnitude could have been avoided and reduced.
v.	To see that purchases have been made	To study whether expenditure has

	following the procedure approved by the management.	remained within the budgetary provisions.
vi.	To see that any abrupt variations as for example in sales/purchases etc. in comparison with the immediate previous year/years are not due to any manipulation/irregularity.	To study the reasons for unfavorable/favorable variances.
vii.	To see that proper records have been maintained for the fixed assets of the concern.	To study the return on assets employed along with the question of underutilization of assets and idle assets.
viii.	To see that the financial statements have been prepared following the established procedure and that the same display a true and fair view of the business transactions as also of the position of the concern as on particular date.	To examine whether the operational functions are in tune with the management objectives and to carry out the cost benefit analysis for helping the management in taking decisions.
ix.	To see whether scrap, salvaged and surplus material have been properly accounted for etc.	To study whether scrap/loss of material has remained within the permissible limits etc. and the methods of their disposal are bringing adequate revenue.

(c) Internal control is an important tool of management to achieve organizational objectives effectively. It does not restrict itself to the accounting functions only, but extend to the administrative and other function also. With the effective utilization of internal control structure prevailing in the organization, management can most effectively safeguard the company's assets, administrate the current operations and plan for the future. Internal control structure has the following components:

(i) **Control environment:** The collective effect of various on establishing and enhancing, the effectiveness of specific policies and procedures.

(ii) **Accounting systems:** The methods and records established to identify, assemble, analyses, classify, record, and report an entity's transactions and to maintain accountability for the related assets and liabilities.

(iii) **Control Procedures:** Policies and procedures that the management has established to provide reasonable assurance that specific entity objectives will be achieved.

(iv) Entity Risk assessment process.

(v) Information system and communication.

(vi) Monitoring.

The following are the main objectives of internal control structure:

(i) To ensure the orderly and efficient conduct of business.

(ii) To ensure that transactions are executed in accordance with management's general or specific authorization.

(iii) To ensure that transactions are promptly and correctly recorded, in the appropriate accounts and in the accounting period in which executed, so as to permit preparation of financial information within a frame work of recognized accounting policies.

(iv) To ensure that access to assets is permitted only in accordance with management's authorization and recorded assets are compared with the existing assets at reasonable intervals and appropriate action is taken with regard to any differences.

(v) To ensure accountability for assets.

(vi) To ensure adherence to policies of the entity.

(vii) To ensure confidence to the users of information.

(viii) To ensure timely corrective actions through feedback information.

(ix) To prevent and detect errors and frauds.

ANSWER 6

(a) Value for Money audit is a comprehensive examination that provides an objective and constructive assessment of the extent to which financial, human and physical resources are managed with due regard to economy, efficiency and effectiveness; and accountability relationships are served.

(i) **Economy** – this is minimizing the cost of resources used for an activity having regard to the appropriate quality. Economy refers to all types of resources such as physical, financial, human and information. The question of economy is relevant to the acquisition of resources. Auditors try to determine whether the resources have been acquired in the right amount, at the right place, and the right time, of right kind and at the right cost. It is presumed that there are standards available to judge whether considerations of economy were kept in view in acquiring resources.

(ii) **Efficiency –** refers to the quality of outputs from a given input. It is relevant to the use of resources. Examples of efficiency are: teacher-pupils' ratio in a school and machine-hours to output ratio in a factory. An increase in output without a corresponding increase in input or getting the same output as before with a reduced input indicates an increase in efficiency. But measuring efficiency presumes the existence of acceptable standards/criteria. It is often necessary for auditors to develop such standards if they do not exist.

(iii) **Effectiveness** – this is the concept that measures the degree to which predetermined goals and objectives for a particular activity or program are achieved. Of all the meanings attached to the word effectiveness, probably the most common is related to the achievement of goals.

(b) Powers of the Controller and Auditor General

(i) Call upon any public officer to give any explanation and information which the CAG may require to enable him perform his functions and responsibilities.

(ii) Summon and examine any person in connection with the receipts or expenditure of public monies.

(iii) Authorize any person as an auditor to conduct, inquire, examine or audit on his behalf and get a report thereon.

(iv) Order a search or that extracts are taken from any book, document or record from any public office.

- Seek professional opinion or advice from the Attorney General.
- Use the Public Procurement Regulatory Authority (PPRA) and stock verifier's findings as guidance to reach his conclusions.
- Disallow an item of expenditure to be charged to the government account or call into question any as per relevant law or irregularity occurred in the receipt, custody or control issues.

(c) Main issues addressed by audit findings and recommendations of the CAG re as follow:

(i) The degree to which value for money has been achieved for taxpayers money.

(ii) The effectiveness of organization in meeting government objectives.

(iii) The quality of management and use of resources.

(iv) Improvement in management practices and systems of government organizations.

(v) The fair presentation of annual financial statements prepared by agencies.

(vi) Compliance with legislative and other requirements.

SUGGESTED SOLUTIONS
B4 – PUBLIC FINANCE AND TAXATION I
MAY 2019

ANSWER 1

(a) The circumstances that may result into the Commissioner General making a jeopardy assessment:

- In the exercise of the Commissioner General's powers (Section 40(3) of the Tax Administration Act 2015).
- Where a taxpayer fails to file a tax return on time (Section 47 (1) of the Tax Administration Act, 2015).
- When a taxpayer wants to leave the URT indefinitely.
- When a taxpayer wants to cease doing business.

(b) **Name of Tax payer:** Mr Mpambanaji
Year of income: 2018
Computation of Total income *(figures in TZS)*

Business		
Gross profit		55,900,000
Deductible expenditure		
Administration expenses	22,500,000	
Less: income tax	40,000	(22,460,000)
Donation under the Education Fund Act 2001		(4,000,000)
		29,440,000
Employment		
Salary (3,500,000 x 12)		42,000,000
Utilities (450,000 x 12)		5,400,000
Life Insurance (150,000 x 12)		1,800,000
Lunch allowance (84,000 x 12)		1,008,000
Total employment income before housing allowance		50,208,000
Housing Allowance		2,400,000
		52,608,000

Working for Housing allowance
15% of (50,208,000 + 29,440,000) = 11,947,200
and
Amount claimed (100,000 x 12) = 1,200,000
Take the higher i.e. 11,947,200

With market value of rental (200,000 x 12) = 2,400,000
Take the lower, which 2,400,000

Investment Income	
Dividend from unlisted resident company (final withholding)	0
Rent (Non-FWP-the individual business)	0
Interest (Non-FWP-the individual business)	0
	0

Total Income

Business	29,640,000
Employment	52,608,000
Investment	0
	82,048,000

ANSWER 2

(a) The report is

From: John John – Tax Consultant Date: 16/2/2019

To: Mr. Daudi

VAT IMPLICATION ON YOUR BUSINESS

Any business in Tanzania which has sales or turnover of TZS 100 million or above per annum for zero rated or standard-rated goods or services is required by the law to be registered as a VAT trader. Among the registration categories we have compulsory and intending traders. Compulsory registration applies to traders who have met the required criteria for registration. These are required to register immediately.

For businesses which are likely to reach the minimum threshold for VAT registration, the requirement is that they apply to the Commissioner of Domestic Revenue to register as intending trader. The application should explain that the business movement shows that it will reach the required threshold, thus the need to be registered early as intending trader.

Records from your business for three months have indicated sales of TZS. 45 million, this shows that, at the end of the year sales will are likely to be above TZS. 100 million. It is therefore recommended that you apply for VAT registration and become a VAT registered trader.

After registration, you will be required to submit VAT return and make any relevant payments. You will need to comply with all the VAT law requirements, including observing the due dates, issuing of receipts and invoices, as well as maintaining the prescribed records.

Lastly, register and pay tax for the development of the country.

John John
Tax Consultant

(b) Computation of the Input VAT

Purchase

Item	**Value**	**VAT**	**Relating to both**
Sugar	2,750,000.00	495,000.00	
Bags for Parking Wheat	759,000.00	136,620.00	
Cow Milk	685,000.00	123,300.00	
Body Lotion	150,000.00	27,000.00	
Electricity	260,000.00		46,800
Artificial Hair for Ladies	850,000.00	153,000.00	
Goat Milk	890,000.00	Exempt	
Hay Machine	2,100,000.00	Exempt	
Total	8,444,000.00	934,920.00	46,800

Sales

	Taxable sales	**Exempt sales**	**Total**
Sugar	3,000,000.00		
Goat Milk	-	800,000.00	
Packed Milk (Cow Milk)	590,000.00		
Medicated Soap	600,000.00		
Soft Drinks	200,000.00		
Sorghum	-	300,000.00	
Rice	-	200,000.00	
Home Consumption	65,000.00		
Bags for Parking Wheat	720,000.00		
	5,175,000.00	**1,300,000.00**	**6,475,000.00**

Ratio of T/A = 5,175,000/6,475,000 = 0.799 ≈ 79.9% ≈ 80%

Input Computation

Deductible input tax (DIT) = 934,920+0.799 × 46,800=972,313

$$DIT = \frac{\text{Value of Taxable Supplies}}{\text{Value of Total Sales}} \times C + A$$

Where C = Value of taxable supplies.

A = value of total supplies.

ANSWER 3

(a) (i) The tax in the three schemes is due for payment as follows:

(1) **PAYE -** 7 days after the end of the month in which the tax was deducted.
(2) **Provisional Tax –** before or at the end of each quarter in the year of assessment.
(3) **Withholding Tax –** 7 days after the end of the month in which deduction was made.

(ii) Taxpayer who pay any taxes late will be liable to pay interest compounded monthly at the statutory rate i.e. Bank of Tanzania discount rate which is currently at 7% per annum.

(b) (i) The tax written down of the machinery was TZS.14,550,000 + TZS.1,800,000 = TZS.16,350,000.

(ii) The Income Tax Act, 2004 does not recognize losses or gains on realizing individual assets which are pooled together like in this case. So, gain or losses happen when the entire pools is dissolved or realized or when incoming assets exceeds the depreciation basis. In this case, there is no losses neither gain from realization as the incomings are lower that the depreciation basis.

Pamba Limited					
Calculation of Depreciation Allowances					
Year of Income 2018					
Class	1	2	3	6	Total
Rate	37.5%	25.0%	12.5%	5.0%	
TWDV at start					
Factory Building				13,201,016.0	
Ginning machinery		4,000,001.0			
Motor vehicles		58,000,000.0			
Furnitures			1,439,234.0		
Computers	2,000,567.0				
Motor vehicles (saloon	9,500,000.0				
	11,500,567.0	**62,000,001.0**	**1,439,234.0**	**13,201,016.0**	
Additions					
Factory Buildings				35,500,000.0	
Ginning plant not employed		-			
Second hand ginning Machinery (initial allowance)					
10 ton truck		30,000,000.0			
Saloon car	22,000,000.				

	0				
Fencing				20,655,000.0	
New replacement of ginning machinery (initial allowance)		-			
Staff housing				25,750,000.0	
Furniture			1,750,000.0		
Realization/ incomings					
Aging ginning plant		(14,550,000.0)			
Saloon car	(7,000,000.0)				
Depreciation basis	26,500,567.0	77,450,001.0	3,189,234.0	95,106,016.0	
Annual allowances	**9,937,712.6**	**19,362,500.3**	**398,654.3**	**6,595,250.0**	36,294,117.1
Initial allowance 50%*1/2*(4080000+60560000)		25,340,000.0			**25,340,000.0**
Total Capital Allowance					**61,634,117.1**

Depreciation allowances –Class 6
= 5 % × (50,000,000 + 35,500,000 + 20,655,000 + 25,750,000) = 6,595,250

ANSWER 4

(a) **Computation of Customs Taxes**

Item	**Costs in TZS**
Cost (USD 2*2500*2,300)	11,500,000.00
Import duty (20%)	2,300,000.00
	13,800,000.00
Excise duty (10%)	1,380,000,00
	15,180,000.00
Value added tax (18%)	2,732,400,00
Total taxes (import duty + excise duty + value added tax)	**6,412,400.00**

(b)

(i) After objecting to the Commissioner, the lady would appeal to Tax Revenues Appeal Board, Tax Revenues Appeals Tribunal and Court of Appeal.

(ii) The appeals process is important and it encourages taxpayer to use it if she/he has an objection. Everyone should pay their fair share of taxes, no more and no less. The appeal system resolves tax controversies at the appellate court levels which mostly are results from tax laws which are complex but, whose administration is based on a system of self-assessment. Resolution of controversies at the administration stage makes it imperative that unnecessary uncertainty and delay in interpretation be minimized through establishment of an independent, efficient and fairer tax appeal system.

(c) **There are six methods that are available for establishing the Customs value for your goods.**

Use one of these six methods to determine the Customs value to be imported. You must use them in strict hierarchical order.

Method one – transaction value

If your import is the result of a sale for export to Tanzania, the transaction value is the primary method. You should use this method first, whenever possible. It includes what you paid (or will pay) for the item, but also includes:

- Commissions and brokerage fees, except buying commissions.
- Packing and container costs and charges.
- The value of any items or services you supplied free – or at reduced cost – to the seller to get the product made or sold.
- Royalties and licence fees.
- Any proceeds from resale, disposal or use that you must then pay to the seller.
- The value of any materials, parts, and services used to repair or refurbish the item before importing it.
- Transport and shipping costs, including loading/unloading and handling charges, before the item leaves the country you're exporting from.

You can deduct the following charges – if you paid them, and they're clearly separated from the price of your item(s):

- Transport and insurance costs, including loading/unloading and handling charges, after the item leaves its country of export.
- Any (reasonable) costs related to constructing, maintaining or getting technical help with the item when it arrives in Tanzania.
- Any (reasonable) costs for transport or insurance of the item(s) within Tanzania.
- Any Tanzania Customs duties or other Tanzania taxes.

To use the transaction value method

- You must have evidence of a sale for export to Tanzania, for example, a commercial invoice, contract or purchase order. If there are multiple sales for export, then the Customs value is to be based on the 'last sale' that occurs immediately before the goods enter New Zealand, and not on any other sale that occurred prior in the supply chain. Any relationship between the buyer and seller mustn't have affected the item's price.
- The item's price or sale mustn't be subject to any condition or consideration where a value can't be determined.

- There mustn't be any restrictions in the sale about how the buyer will dispose of or use the item, except for those:
    - Imposed by law
    - That limit where the item can be sold
    - That don't have a substantial effect on the item's value.

When you can't use the transaction value method
Examples of items where you can't use the transaction value method include:

- Gifts
- Free samples
- Anything on consignment
- Anything imported by a company branch that isn't a separate legal entity to the seller
- Items that were imported under a hire or leasing contract.

Other valuation methods
If you cannot use the transaction value method, then you need to identify which of the following five methods would apply:

Method two – transaction value of identical goods ("identical goods method")
Based on the transaction value of identical items brought into Tanzania at the same time (or nearly). You must have proof of the identical items' value.

Method three – transaction value of similar goods ("similar goods method")
Based on the transaction value of similar items brought into Tanzania at the same time (or nearly). You must have proof of the similar items' value.

Method four – deductive value
Applies if the imported goods are sold in Tanzania within 90 days of arriving in the country. The resale price of the item in Tanzania is reduced to the Customs value if the item had initially been sold for export to Tanzania.

Method five – computed value
Based on the production cost of the imported goods, plus an amount for profit and general expenses. This method is generally restricted to cases where you have access to the producer's factory costs and profit margins.

You must get our approval first if you want to use this method.

Method six – residual basis of valuation/Fall back method
If you cannot use any of the methods above, you can flexibly interpret – within reason – one of the previous methods to get the Customs value for your goods, for example:

- There is a sale in Tanzania but it occurs 110 days after the goods arrive in Tanzania.

- It would be reasonable to use method four – deductive value, by flexibly interpreting the timeframe specified in the method.

Depending on the items, how they're imported and the documents you have, you might be able to determine their Customs value based on:

- The valid list price of the items.
- 'List price' is what the seller in the country of export would charge a buyer in Tanzania.
- A valuation from an independent assessor.

ANSWER 5

(a) **I.** Main principles of public expenditure

(i) **Maximum Social Benefit:** it is necessary that all public expenditure is utilized for the general welfare of the society at large and not for the benefit of a particular section of the society.

(ii) **Economy:** public expenditure has to ensure economy, i.e. all wasteful and unprofitable expenditure has to be avoided and it has to be ensured that the tax-payer is not burdened to the extent that his savings are affected.

(iii) **Approved expenditure:** it is necessary to ensure that public expenditure is approved by a competent authority and that funds are used for the purpose for which they were approved.

(iv) **Flexibility:** it is necessary that an element of flexibility exists so that expenditure can be varied according to needs and circumstances.

(v) **Effectiveness**

(vi) **Efficiency**.

II Public sector expenditure management tools.

(i) **Accuracy in budget preparation**
Budget planning and preparation is very critical to good public expenditure management. While formulating a budget, it is necessary to obtain consistent and reliable data on past public expenditures in order to budget for the current period. Past experience should be taken into account so that past errors may be rectified.

A number of other factors need to be taken into account to ensure a sound budget:

(a) Completeness of coverage of all expected expenditure
(b) Usage of realistic and reasonable assumptions
(c) Usage of realistic projections for expected revenue
(d) Inclusion of provision for change in costs
(e) Inclusion of provision to meet unexpected expenditure

It is necessary to ensure proper control over total expenditure and minimize the cost of budget management.

Productive efficiency and efficient allocation of resources also helps in public expenditure management.

Disclosure of all relevant public revenue and expenditure information is important for accountability of government and to reduce corruption.

Public participation in the budget process for a pre-defined part will also help in better accountability and transparency.

Priority areas need to be identified at the time of budget preparation itself so that funds are not spent excessively on non-priority areas. It is also necessary that proper classification is made between implementing agency (administrative function), purpose of expenditure (functional classification) and use of expenditure (economic classification).

(ii) **Budget execution**

Once the budget is approved at the Central Government level, the responsibility of execution generally lies with the ministries and other appointed agencies. The ministries should ensure that they adhere to the spending limits laid down by the Central Government and regularly report to the government. Monitoring is generally done at the central level on an aggregate basis and appropriate responsibility should be placed for the monitoring. It is necessary for the Ministry of Finance to ensure that it obtains reliable data on expenditure from the executing agencies at regular intervals and analyze it effectively. This will help in overall control of expenditure.

Factors that are important in budget execution are whether the targets are likely to be met and whether the expenditure is likely to exceed budgets. It is important that the monitoring process is such that expenditure incurred will be within the budgeted amount and appropriate measures, if required, are taken to control expenditure.

(iii) **Cash planning**

Adequate cash planning is necessary to so that the government is able to meet budgeted expenses and unexpected expenditures without resorting to additional borrowings. It also helps in ensuring that the budget targets are met and the economic policies are implemented smoothly. Even though the budget has been prepared well and with adequate planning, liquidity problems may arise as the timing of cash inflows and outflows may vary. In order to ensure timely availability of cash for meeting expenditure, the government needs to prepare an annual cash flow forecast (bifurcated month-wise) at the beginning of each year.

It can take into account the past experience and future projections while preparing the cash flow forecast. If a shortfall of cash is expected in a particular month, the government can either postpone the expenditure or make arrangement for collecting additional revenue. The monthly projected cash flow should be updated with actual figures on a regular basis so that it helps in achieving budgeted targets. Quick updating of information is possible only with a well-established reporting system.

(iv) **Well-defined expenditure policies**
Policies that are well defined need to be framed along with projections of estimated expenditure to be incurred in relation to those policies.

(v) **Information on public revenue**
It is necessary to inform the citizens about the sources and amounts of public revenue and how these are managed by the government since the quantum of revenue determines the amount available for public expenditure. This will help citizens to monitor how public funds are being used and managed.

(vi) **Public expenditure tracking**
The tracking of public funds will ensure that funds are used for the purpose for which they were allocated and were intended to be use. This tracking must be quantitative as well as qualitative. Quantitative tracking is in the form of verifying records, whereas qualitative tracking may be in the form of assessing from beneficiaries their opinion on the quality of services, technical reviews etc.

(vii) **Accounting**
The accounting categories and classification for budgeting as well as actual accounting should be common at the Central Government level so that accurate analysis is feasible. Accounting needs to be done on a timely basis and should be reliable. Appropriate processes for analysis of the accounts should be established.

(viii) **Audit**
An independent authority should be responsible for undertaking the audit of the entire process of public expenditure management.

III. Structure and Composition of government expenditure is influenced by the following factors:

(i) **Structure of the economy** is an important factor that influences government expenditure. For example, an agriculture-dominated economy may require more expenditure on the agricultural sector to bring about developments in the sector.

(ii) **Technological factors** also influence the composition of public expenditure. For example, a technologically backward economy would need more government funds for inventions in technology.

(iii) **Environmental factors** like higher pollution in particular areas may lead to water contamination; hence more funds may be required to be diverted to provide clean water.

(iv) **Demographic factors** like life expectancy, population growth, proportion of old-age population etc. will affect the amount of expenditure in these areas.

(v) Government policies

(vi) **Laws and regulations** such as Public Finance Act, Procurement Act and regulation.

Economic development in the society also plays an important part in determining the composition of public expenditure. For example, in a low income country, more funds will have to be diverted towards increasing productivity.

(b) **Explain different classification taxes can be categorized.**

(i) **Direct and Indirect Taxes**

On the basis of assessment, rather than on the point of assessment, taxes are classified into direct and indirect.

Direct taxes are imposed by the government upon persons who are expected to bear the burden of these taxes and who are not expected to be able to shift the tax burden to other persons. In other words, in the case of direct taxes, impact and incidence are on the one and the same person.

Indirect taxes are taxes which are imposed upon persons, who are expected to shift the burden of the tax to other persons. In other words, in the case of indirect taxes, usually the impact and incidence will be on different persons.

(ii) **Proportional, Progressive, Regressive and Digressive Taxation**

On the basis of method, that is the rate of taxation; taxes are classified and compared into proportional, progressive, and regressive.

(iii) **Ad-Valorem and Specific Duty**

1. **Ad-Valorem Duty:**
   When a tax is levied on the basis of the value of a commodity or property it is known as Ad-valorem duty. This duty is expressed as a percentage of the value of a commodity. In this case irrespective of the weight and size of the commodity, tax is charged purely according to its value. e.g. VAT Rate = 18%. Import Duty Rate = 15% and Excise Rate = 10%.

2. **Specific Duties:**
   When a tax is imposed on a commodity as per its weight or volume, it is called specific duty. Specific duties are expressed as definite sums to be paid for the definite weight of a commodity. (E.g. The duties is 5000 TZS./kg or 10,000TZS/M^3).

ANSWER 6

NAME OF TAXPAYER:	MBUSUSU COMPANY
NATURE OF INCOME:	BUSINESS INCOME
TYPE OF BUSINESS:	MANUFACTURING BUSINESS
RESIDENTIAL STATUS:	RESIDENT PERSON
YEAR OF INCOME:	2018

Adjustment of Business Income

	TZS	TZS
Profit as per accounts		161,057,174
Add: Dis-allowable expenditure		
Travel expenses of financial controller	5,000,000	
Medical Expense for Mrs Tweve)	1,000,000	
Motor Car (Private and personal) = (1.5*5,400,000)	1,080,000	
Legal Fees	250,000	
Closing stock for goods in transit	7,200,000	
Prevention of Soil Erosion	2,500,000	
Remedy damage caused by mining extraction	3,000,000	
Interest paid as penalty	490,000	
Construction of new laboratory	15,000,000	
Provision for profit and loss Account	2,500,000	
Donation made to Mama B.	17,400,000	
Donation made to Makonde	4,000,000	
Donation made to Tosamaganga	NIL	
Interest for loan used by Director to Abroad	3,390,120	
Interest for loan used by Personnel Manager	5,042,063	
Political parties contribution	15,200,000	
Depreciation	6,019,800	
Fine and penalty	500,200	
Provisions for NSSSF	12,400,000	
Depreciation	5,620,000	
Provision for bad debts	8,479,000	
Total Disallowable Expenses	116,071,183	116,071,183
Less: Allowable Transactions		
Depreciation		-2,603,100
		274,525,257
Donation to Mama Bs = (2%*274,525,257) VS 17,400,000 =		-5,490,505
Adjusted Business Income		269,034,752

Tax liability	=	Taxable income x tax rate
Taxable Income	=	Business Income + Investment Income
	=	269,034,752+ NIL
	=	269,034,752

Tax Rate = 30%

Therefore tax Liability = 269,034,752 x 30%

= **TZS. 80,710,426**

SUGGESTED SOLUTIONS
B5 – PERFORMANCE MANAGEMENT
MAY 2019

ANSWER 1

(a) C**ost statement of relevant showing minimum cost that SELEFA Ltd should Charge**

COST ITEMS	**TZS**
Technician's costs	500,000
Technical advisor	480,000
Training costs	125,000
Handsets	2,184,000
Control system	7,600,000
Cable	1,300,000
Total relevant cost	**12,189,000**

Notes

(i) Complimentary lunch is a sunk cost and is therefore not relevant to the decision.

(ii) One of the technicians has spare capacity so there will be no additional cost in undertaking the contract. Undertaking the contract will result in Contract X being delayed by one week so that Selefa's costs will increase by TZS.500,000.

(iii) The overtime costs represent the additional costs that will be incurred if the contract is undertaken TZS.480,000 (TZS.60,000 x 8 hours).

(iv) Site visit. The customer will pay this cost so Selefa Ltd. will incur no additional site visit costs.

(v) The monthly salary cost is irrelevant since it will be paid whether or not the contract is undertaken. However, the commission of TZS.125,000 is an incremental cost associated with the contract.

(vi) The Cameras are in regular use and undertaking the contract will necessitate replacement of 80 Cameras at TZS.18,200 cash. The remaining 40 Cameras will be purchased as TZS.18,200 so the relevant cost is TZS.2,184,000 (120 x TZS.18,200).

(vii) The original cost of the Catch 1 is a sunk cost and not relevant. However, since the company could sell it for TZS.3,000,000 if it did not use it for this contact. It represents an opportunity cost. The current market price for Catch 1 is not relevant since the company does not intend to replace it. In order to use Catch 1 on the contract, it must be converted at a cost of TZS.4,600,000. The relevant cost is TZS.7,600,000 since this is less than the cost of new Catch 2 (TZS.10,800,000).

(viii) The cost of the inventory represents a sunk cost and is not relevant. The replacement cost of TZS.1,300 per metre is the relevant cost.

(b) Relevant cost represents the minimum price and starting point for determining a price. It represents a price at which Selefa Ltd will be no better or worse off if it did not carry out the work. Prices based on covering relevant costs represent short-run price but that the final agreed price should be attractive enough to encourage repeat orders. Any bid for one-time special orders that is based on covering only short-term incremental costs must meet all of the following conditions:

(i) Sufficient capacity is available for all resources that are required to fulfil the order. If some resources are fully utilized, opportunity costs of the scarce resources must be covered by the bid price.

(ii) The bid price will not affect the future selling prices and the customer will not expect repeat business to be priced to cover short-term incremental costs.

(iii) The order will utilize unused capacity for only a short period and capacity will be released for use on more profitable opportunities. If opportunities that are more profitable do not exist and a short-term focus is adopted to utilize unused capacity, then the effect of pricing a series of special order over several periods to cover incremental costs constitutes a long-term decision.

ANSWER 2

(a) (i) **Transfer Pricing**

Transfer price is the cost of buying the product in the buying division and is the sales revenue for the selling division. The level of the transfer price will affect the profitability of both divisions and thus has performance appraisal implications. Transfer pricing occurs where an organizational structure itself into separate independent divisions. When separate divisions within the organization buy and sell to and from one another, then transfer pricing occurs.

(ii) The existence of transfer pricing can distort the performance appraisal within a divisionalised organization structure:

When the selling division set a high transfer price then its profits will increase, but the profits of the buying division will decrease. Thus, some agreed price must be fair to both divisions. The alternatives are:

- Set full cost price as the transfer price. This however, is very harsh on the selling division and undermines its profitability and hence its performance appraisal.
- Set cost plus a mark-up as the transfer price. This system would help ensure the selling division has some element of profit on the transaction.
- Set market price as the transfer price. This is a feasible option where prices would be set, based on listed prices of identical products or services, or, on a price, a competitor is quoting.
- Set a transfer price based on negotiation between the managers of the buying and selling divisions.

The option often has behavioural benefits, as managers develop an understanding of each other's problems. Transfer pricing is important as the transfer price affects both the buying and selling division profits. It unrealistic transfer pricing exists within an organization, it can result in divisional consequences.

(b) **Four methods which transfer price may be set**

(i) A transfer price may be set equal to the additional outlay cost incurred because goods are transferred, plus the opportunity cost to the organization because goods are transferred.

(ii) A transfer price may be based on the external market price.

(iii) A transfer price may be set on the basic pricing negotiation among the division manager.

(iv) A transfer price may be based on the cost of producing the goods or service to be transfer to be transferred

Methods used to determine Transfer Pricing

Others:

- Transactional net margin method
- Comparable uncontrolled price
- Resale price method
- Transactional profit split method

(c) **Omega Ltd Transfer pricing**

(i) **Production Division Decision**

	Sales at 5,000	**Transfer at 4,000**	**Do not transfer**
	TZS	**TZS**	**TZS**
Sales Revenue (50,000 x 5,000)	250,000,000	250,000,000	250,000,000
Transfer to Finishing division 10,000 units	50,000,000	44,000,000	
Total Revenue	**300,000,000**	**294,000,000**	**250,000,000**
Variable cost (at 3,000 per unit)	180,000,000	180,000,000	150,000,000
Fixed costs	60,000,000	60,000,000	52,000,000
Total costs	**240,000,000**	**240,000,000**	**202,000,000**
Total Profit	60,000,000	54,000,000	48,000,000
Total Asset	240,000,000	240,000,000	200,000,000
ROI	**25%**	**22.5%**	**24%**

The Manager of Production division should not accept the transfer price of TZS.4,000 per unit, because it lowers down its rate of return (ROI) which will be used to assess the division performance.

(ii) **The lowest transfer price acceptable**

The lowest transfer price acceptable to Production division is the one that maintains its rate of return of 24% (ROI) without selling to Finishing division)

ROI = (Total sales Revenue – Total cost)/ (Total Assets) = 0.24**.**

OR

$$\frac{((250{,}000{,}000 + 10{,}000 \text{ x Transfer price}) - 240{,}000{,}000)}{240{,}000{,}000} = 0.24.$$

250,000,000 +10,000TP-240,000,000= 0.24*240,000,000**.**

10,000,000 + 10,000TP= 57,600,000

10,000 **TP** = 57,600,000 -10,000,000

TP=47,600,000/10,000

TP = 4,760

Therefore, the minimum transfer price that Production division should accept is TZS.4, 760.

(c) (ii) **ALTERNATIVE SOLUTION**

Variable Cost per Unit	3,000
Fixed Cost ($\frac{80{,}000{,}000}{10{,}000{,}000}$)	800
ROI (0.24 x $\frac{40{,}000{,}000}{10{,}000{,}000}$)	
	960
Minimum Transfer Price	**4,760**

ANSWER 3

(a) **Reporting of Variances:**

For the variance reporting to be effective, it is essential that the following requisites are fulfilled:

(i) The variances arising out of each factor should be correctly segregated. If one factor of variance is wrongly attributed to or merged with that of another, the analysis report submitted to the management would be misleading and wrong conclusions may be drawn from it.

(ii) Variance, especially, controllable variances should be reported promptly (as soon as they occur). Mere operation of Standard Costing and reporting of variances is of no avail.

(iii) For effective control, the line of organisation should be defined properly and the authority and responsibility of each individual laid down in clear terms. This will avoid 'passing on the buck' and shrinking of responsibility and will enable the tracing of the causes of variances to the appropriate levels of management.

(iv) In certain cases, a particular variance may be the joint responsibility of more than one individual or department. It is obvious that if corrective action has to be effective in such cases, it should be taken jointly,

(v) Analysis of uncontrollable variances should be made with the same care as for controllable variances. Though a particular variance may not be controllable at the lower level of management, a detailed analysis of the off-standard situation may reveal far-reaching effects on the economy of the concern. This should compel the top management to take corrective action, say, by changing the policy, which gave rise to the uncontrollable variance.

(b) To determine the following managerial control variances:

(i) **Sales Price Variance**

	Actual Selling Price	**Standard Selling Price**	**Difference**	**Actual Quantity Sold**	**Variance**
A	2,247.5	2,170	77.5	9,500	736,250F
B	2,402.5	2,325	77.5	13,500	1,046,250F
C	2,945.0	2,790	155	8,500	1,317,500F
				Total	**3,100,000F**

(ii) **Sales Volume Profit Variance**

	Actual Quantity Sold	**Budgeted Sales**	**Difference**	**Standard Profit Margin (W1)**	**Variance**
A	9,500	10,000	500A	620	310,000A
B	13,500	13,000	500F	775	387,500F
C	8,500	9,000	500A	775	387,500A
				Total	**310,000A**

W1: Standard Contribution Profit (Margin per Unit)

	A	**B**	**C**
Standard Price	2,170	2,325	2,790
Standard full cost	(1,550)	(1,550)	(2,015)
	620	775	775

(iii) **Sales Mix Variance**

	Actual Sales Volume	**Actual Sales Volume @ Standard Mix (W_1)**	**Difference**	**Standard Profit Margin (W_1)**	**Variance**
A	9,500	9,843.75	344A	620	213,280A
B	13,500	12,796,875	703F	775	544,825F
C	8,500	8,859,375	359	775	278,225A
				Total	53,320F

W2: Actual Sales Volume at Standard Mixing Ratio

A: $\frac{10,000}{32,000} \times 31,500 = 9,843.75$

B: $\frac{13,000}{32,000} \times 31,500 = 12,796.875$

C: $\frac{9,000}{32,000} \times 31,500 = 8,859.375$

(iv) **Sales Quantity Profit Volume Variance**

	Actual Sales Volume @ Standard Mix (W2)	**Budgeted Sales Volume**	**Difference**	**Standard Profit Margin**	**Variance**
A	9,844	10,000	156	620	96,720A
B	12,797	13,000	203	775	157,325A
C	8,859	9,000	141	775	109,275A
				Total	**363,320A**

ANSWER 4

PAMELA Company Limited

(a) Process further or Sell at split off

		PAM		**ELA**
Incremental revenue				
Sale at Further Process	(3,000 x 0.95 x 56,000)	159,600	(2,000 x 0.95 x 50,000)	95,000
Sale at split-off	(3,000 x 34,000)	102,000	(2,000 x 32,000)	64,000
Incremental revenue		**57,600**		**31,000**
Incremental Costs	**(3,000 x 15,000)**	**45,000**	**(2,000 x 18,000)**	**36,000**
Incremental Profit/ (Loss)		**12,600**		**(5,000)**
DECISION		**PROCESS FURTHER**		**AT SPLIT -OFF**

ALTERNATIVE SOLUTION

PAM

	Split off	Further Processing	Difference
Sales	34,000	56,000	
Further Processing			
Direct material		(8,000)	
Conversion cost		(7,000)	
Normal loss			
5% x 56,000)		(2,800)	
	34,000	38,200	4,200
		X No of units	3,000
		Total Contribution	**12,600**

ELA	Split off	Further Processing	Difference
Sales	32,000	50,000	
Further Processing			
Direct material		(10,000)	
Conversion cost		(8,000)	
Normal loss			
5% x 50,000)		(2,500)	
	32,000	29,500	(2,500)
		X No of units	2,000
		Total Contribution	(5,000,000)

(b) **Similarities between ABC and traditional costing system**

- They all apply allocation, apportionment and absorption
- There may be over and under absorbed overheads if pre-determined rates are used.
- They all use cost centres that are consistent with the operating system.
- The same subjective bases of apportioning some overheads are applied.

Differences between ABC and traditional costing system

- Traditional uses a single rate ABC multiples rates
- Traditional apportions costs to cost centrers, ABC put cost into cost pools
- ABC will look for cost drivers as bases of establishing the absorption rate traditional may use any acceptable base.

(c)

(i) **The controllability principles**

This principle requires that managers of responsibility centres be evaluated based on only items (revenues and costs) that they control. The principle is implemented by:

1. Eliminating uncontrollable items from the areas for which managers are held accountable.
2. Calculating the effect of uncontrollable items so that the performance assessment reports distinguish between the controllable and uncontrollable items

(ii) **Budgetary slacks**
This is the process by which managers seek to obtain the budget targets that can easily be achieved by either understating revenues and/or overstating costs.

Some of the ways in which budgetary slacks arise include the following:
1. Managers avoid risky but profitable projects
2. Managers negotiate for lower targets
3. Managers dispute performance assessment reports.

ANSWER 5

(a) **Number of Units of each product category to be purchased for the company to Break even**

(i) **Calculation of variable costs per unit**

Total fixed costs = 80,000,000 x 1,19 = **95,200,000**

Fixed costs per unit = 95,200,000/34,000 = 2,800

Category	**Units**	**Selling price**	**Revenue**
A	12,000	8,000	96,000,000
B	8,000	6,000	48,000,000
C	14,000	4,000	56,000,000
Total	**34,000**		**200,000,000**
Cost			
Purchase cost			80,000,000
Fixed costs	(80,000,000 x 1.19)		95,200,000
Total profit			**24,800,000**

Percentage of profit on sales = $\frac{24,800,000}{200,000,000}$ x 100% = 12.4%

Variable costs per unit

Category	**SPCW**	**Cost(a)**	**Fixed cost per unit**	**Variable cost per unit**
A	8,000	7,008	2,800	4,208
B	6,000	5,256	2,800	2,456
C	4,000	3,504	2,800	704

Weights Contribution

Category	**Weights**	**Contribution per level**	**Weighted contribution**
A	0.35	3,792	1,327.2
B	0.24	3,544	850.6
C	0.41	3,296	1,351.4
Total			**3,529.2**

Break Even Point
BEP = TFC/Weighted Average of Contribution Margin

= 95,200,000/3,529.4 = **26,975**

Contribution per Unit

A	0.35 x 26975	=	9,441
B	0.24 x 26975	=	6,474
C	0.41 x 26975	=	11,060

(ii) Units to be purchased to arrive at targeted profit of TZS 49,600,000

$$= \frac{\text{TFC + Profit}}{\text{Weighted CPM}} = \frac{95{,}200{,}000 + 49{,}600}{3{,}529}$$

= **41,0291**

A	0.35 x 41,029	=	14,360
B	0.24 x 41,029	=	9,847
C	0.41 x 41,029	=	16,822

(b) **BEP**

(i) Margin of Safety 40% of Sales

BEP Sales = Sales – Margin of Safety)

= 5,000,000 – 2,000,000
= 3,000,000

Net Profit

TFC = BEP Sales *P/V ratio. = 3,000,000 x 0.5 = 1,500,000

Contribution = Sales x P/V Ratio = 5,000,000 x 0.5 = 2,500,000

Net Profit = Contribution – FC

= 2,500,000 – 1,500,000

= **1,000,000**

(ii) **Effect of decrease in labour efficiency by 5%**
Variable cost = Sales - Contribution
= 2,500,000

Labour cost = 2,500,000 x 25% = 625,000

New labour cost
Efficiency decreases by 5%
= 625,000 x 100/95 = 657,895

Increase in labour cost 657,895 – 625,000 = 32,895

Net Variable costs = 2,500,000 + 32,895 = 2,532,895

New Contribution = 5,000,000 – 2,532,895 = 2,467,105

Profit = 2,467,105 – 1,500,000 = 967,105

Net P/V = 2,467,105/5,000,000 x 100 = 49.3421%

New BEP = Fixed Cost /P/V = 1,500,000/49.3421 =3,040,000

The effect of 5% decrease lead to:

(i) Increase in BEP from 3,000,000 to 3,4040,000
(ii) Decrease in Profit from 1,000,000 to 967,105.

ALTERNATIVE SOLUTIONS (5a)
OPTION I
(i) Break Even Point
- Compute the total Fixed Cost
  Total Fixed Cost = Purchase Cost x 1.19
  = 80,000,000 x 1.19
  Total Fixed Cost = 95,200,000

- Since Total Revenue and Total Variable Costs can be computed, then establish the C/S Ratio

Category	Units (A)	Selling Price Per Unit (B)	Total Revenue (A x B)
A	12,000	8,000	96,000,000
B	8,000	6,000	48,000,000
C	4,000	4,000	56,000
			2,000,000

$$\text{C/S Ratio} = \frac{\text{Total Revenue} - \text{Total Variable Cost} \times 100}{\text{Total Revenue}}$$

$$= \frac{200{,}000{,}000 - 80{,}000{,}000}{200{,}000{,}000} \times 100$$

C/S RATIO = 60%

- Since Total Fixed Cost and C/S Ratio are known, then compute the Break even Sales

FROM: BE Sales = $\frac{\text{Total Fixed Cost}}{\text{C/S Ratio}}$

Break Even Sales = $\frac{95{,}200{,}000}{60\%}$

Break Even Sales = TZS.158,666,667

- In order to obtain Break Even Sales for Each Category, Establish Sales Mix based on total sales made per each category.

Category	**Total Revenue**	**Mix**
A	96,000,000	$\frac{96{,}000{,}000}{200{,}000{,}000}$ x 100 = 48%
B	48,000,000	$\frac{48{,}000{,}000}{200{,}000{,}000}$ x 100 = 24%
C	56,000,000	$\frac{56{,}000{,}000}{200{,}000{,}000}$ x 100 = 28%
Total	200,000,000	100%

- Establish Break Even Sales for Each Category and then Break Even Units

Category	**A Total BE Sales**	**(B) Weight**	**(A x B) Weighted Breakeven Sales**	**C Selling Price**	**(A x B)/C BE Units**
A	158,666,667	48%	76,160,000	8,000	9,520
B	158,666,667	24%	38,080,000	6,000	6,347
C	158,666,667	28%	44,426,667	4,000	11,107

(ii) Targeted Profit

Sales Revenue = $\frac{\text{TFC + Targeted Profit}}{\text{C/S Ratio}}$

= $\frac{95{,}200{,}000 + 49{,}600{,}000}{60\%}$

= $\frac{144{,}800{,}000}{60\%}$

Sales Revenue = TZS. 241,333,333

Category	(A) Sales Revenue	(B) Weight	(A x B) Weighted Sales Revenue	C Selling Price	(A x B)/C Units
A	241,333,333	48%	115,840,000	8,000	14,480
B	241,333,333	24%	57,920,000	6,000	9,653.3
C	241,333,333	28%	67,573,333	4,000	16,893.3

OPTION II (5a)

(i) Break Even Point

- Computer Total Fixed Cost

  Total Fixed Cost = Purchase Cost x 1.10

  = 80,000,000 x 1.10

  Total Fixed Cost = TZS.95,200,000

- Since Break Even Point (Unit) = Total Fixed Cost/Contribution Margin

- Determine the contribution Margin

Category	Units	Selling Price	Total Revenue
A	12,000	8,000	96,000,000
B	8,000	6,000	48,000,000
C	14,000	4,000	56,000,000
Total			**200,000,000**
Less: Variable Cost			80,000,000
Total Contribution			**120,000,000**

Contribution per unit = $\frac{\text{Total Contribution}}{\text{Total Units}}$

= $\frac{120,000,000}{12,000 + 8,000 + 14,000}$ $\frac{120,000,000}{34,000}$

Contribution Per Unit = 3,529.4

Break Even Units = $\frac{95,200,000}{3,529.4}$

= 26,973 Units

Category	A Weight	B Total BEP (Units)	A x B BEP (Units) for each Category
A	35%	26,973	9,441
B	24%	26,973	6,474
C	41%	26,973	11,059

(ii) **Targeted Profit**

No of Units = $\frac{95,200,000 + 49,600,000}{3,529.4}$

No of Units = 41,031

Category	**A** **Weight**	**B** **Total Sales (Units)**	**A x B** **No of Units for each Category**
A	35%	41,031	14,361
B	24%	41,031	9,847
C	41%	41,031	16,823

ANSWER 6

Kunguru Co. Ltd
Cash Budget June to September 2019

CASH RECEIPTS:	**June TZS. '000'**	**July TZS. '000'**	**August TZS. '000'**	**September TZS. '000'**
Cash receipts from customers (W1)	-	77,400	276,000	345,000
Other receipts	0	0	0	0
Total receipts from customers	**0**	**77,400**	**276,000**	**345,000**
CASH PAYMENTS:				
Materials Purchased (W3)	22,240	45,400	52,800	63,280
Labour Costs (W4)	12,880	13,440	17,220	19,600
Packaging Costs (W5)	0	7,400	7,770	9,990
Marketing Costs (W6)	8,400	21,300	24,300	28,800
Rate of Production facility(in 25,000 deposit in June)	55,000	30,000	30,000	30,000
Other Costs (operated)	7,800	7,800	7,800	7,800
Total Cash Payment (B)	106,320	125,340	139,890	159,470
Net Cash Flow (A – B)	(106,320)	(47,940)	136,110	185,530
Opening Cash Balance	50,000	(56,320)	(104,260)	31,850
Closing Cash Balance	**56,320**	**104,260**	**31,850**	**217,380**

Workings

(W1) Receipt from customers

	June TZS'000'	July TZS '000'	August TZS '000'	September TZS '000'
Sales				
Men's boots	160,000	192,000	240,000	256,000
Women's boots	98,000	126,000	168,000	210,000
Total sales	**258,000**	**318,000**	**408,000**	**466,000**
Received				
- Due within 1 month (30% of Total)		77,400	95,400	122,400
- Due after 2 months (70% of total)		0	180,600	222,600
Total receipts from customers		**77,400**	**276,000**	**345,000**

(W2) Production required

	June	July	August	September
Men's boots (in pairs of boots)				
Closing inventory	400	400	400	400
Plus sales	2,000	2,400	3,000	3,200
Total inventory required	2,400	2,800	3,400	3,600
Opening inventory	0	400	400	400
Production required	2,400	2,400	3,000	3,200
Women's boots				
Closing inventory	200	200	200	200
Plus sales	1,400	1,800	2,400	3,000
Total inventory required	1,600	2,000	2,600	3,200
Opening inventory	0	200	200	200
Production required	1,600	1,800	2,400	3,000

(W3) Material purchases required

	June	July	August	September
Cushioning fabric				
Men's boots (production required x 0.4m x TZS.28,000)	26,880	26,880	33,600	35,840
Women's boots (production required x 0.3m x TZS.28,000)	13,440	15,120	20,160	25,200
	40,320	42,000	53,760	61,040
Rubber				
Men's boots (production required x 0.15m x TZS.8,000)	2,880	2,880	3,600	3,840
Women's boots (production required x 0.10m x TZS.8,000)	1,280	1,440	1,920	2,400
	4,160	4,320	5,520	6,240
Total material purchases (Cushioning fabric & Rubber)	44,480	46,320	59,280	67,280
Payable in Cash (50%)	22,240	23,160	29,640	33,640
Payable after one month (50%)	0	22,240	2,160	29,640
Total material purchase payments	22,240	45,400	52,800	63,280

(W4) Labour costs

	June TZS. '000'	July TZS. '000'	August TZS. '000'	September TZS. '000'
Men's boots (production required x 0.25hr x TZS.14,000)	8,400	8,400	10,500	11,200
Women's boots (production x 0.2hr x TZS.14,000)	4,480	5,040	6,720	8,400
Total labour costs payable in month	12,800	13,400	17,220	19,600
(W5) Packaging costs				
Men's boots packaging costs (required production x TZS.1,850)	4,440	4,440	5,550	5,920
Women's boot produced and packaged (required production x TZS.1,850)	2,960	3,330	4,440	5,550
Total packaging costs	7,400	7,770	9,990	11,470
Payable after one month	0	7,400	7,770	9,990
(W6) marketing campaign costs				
Fixed monthly fee (TZS.33,600/4 month) – payable in month	8,400	8,400	8,400	8,400
Commission – 5% of total monthly sales – one month in arrears	0	12,900	15,900	20,400
Total marketing costs	8,400	21,300	24,300	28,800

SUGGESTED SOLUTIONS
B6 – MANAGEMENT, GOVERNANCE AND ETHICS
MAY 2019

ANSWER 1

(a) Strategic management is defined as the set of decisions & actions in formulation and implementation of strategies designed to achieve the objectives of an organization.

Important:
They are driven by a number of gains, such as:

(i) **Financial Benefits:**
It results into financial benefits to the organizations in the form of increased profit even in the face of environmental threats.

(ii) **Offsetting Uncertainties:**
This is done by prescribing the future course of action.

(iii) **Clarity in objectives and directions:**
It is used for achieving those objectives; they focus on clarity of objectives.

(iv) **Increased organizational effectiveness:**
Its concept is that the organization is able to achieve its objectives within the given resources.

(v) **Personnel satisfaction:**
If the decisions are systematized in the organization everyone knows how to proceed, how to contribute towards objectives this clarity brings satisfaction.

(b) Stakeholders who fall under Connected stakeholder group are:

(i) These are stakeholders who have close connections with the company without being inside it, such as shareholders:
- **Lenders:** these are the source of company capital/credit financing,
- **Customers:** use of company's product – they are the reason for company to exist
- **Suppliers:** they make the source of company's production inputs for production of products:
- **Distributors:** they enhance availability of goods and services to consumers.

(ii) The link between good governance and the stakeholders under connected group.

- **Lenders:** these are the source of company capital/credit financing. Therefore, when the companies practice good governance which ultimately leads to good performance, they can be paid on time and in full amount depending on the sale agreement, generates trust and influence long lasting relationship.

- **Customers:** use of company's product – they are the reason for company to exist. Good governance emphasizes on ethical behavior. Through ethical behavior customers use quality products, low purchase costs, and other customer rights.
- **Suppliers:** they make the source of company's production inputs for production of products: with good governance, they can be paid on time and in full amount depending on the sale agreement, generates trust and influence long lasting relationship.
- **Distributors:** they enhance availability of goods and services to consumers. Good governance which ultimately lead to increased performance through continued production and quality products give assurance of continued demand in the market, which on the other hand guarantee employment to distributors.

(c) Clarifying the meaning of "Ethics" and "Morality", the meaning includes:

- Ethics are the rules or codes of behavior that individuals and organisations apply in their decision-making and actions. It involves the study of values and customs of a person or group. It covers the analysis and employment of concepts such as right and wrong, good and evil, and responsibility.

- Morality involves what we ought to do, right and wrong, good and bad, values, justice, and virtues, it is concerned with values, norms and beliefs embedded in social processes which define right and wrong for individual or community.

(d) The areas that have attracted global business ethical concern are:

- **Environmental pollution:** This is caused by production activities, transport activities and use of products such as cars, refrigerators, air conditioners, newspapers etc.

- **Problems of waste disposal and management:** these have caused dumping problems, environmental pollution as a result of dominance of "throw away culture" and human health hazards due to poor quality products (harmful products)

- **Devastation consequences** – for individuals and communities as a result of plant closure and downsizing (leads to employment problems)

- **Erosion of local culture** caused by influx of People due to tourism activities

- **Discrimination problems:** racism, employment based gender, employment based on ethnic groups and religious values and beliefs

- **Increasing corruption practices** in situation where people need favors in place of their own rights. Corruption in employment aspects, investment aspects, public health, etc.

ANSWER 2

(a) **Types of organizational structures**

1. **Functional Organizational Structure**
One of the most common types of organizational structures, the functional structure departmentalizes an organizational based on common job functions.

An organization with a functional organization structure, for instance, would group all of the marketers together in one department, group all of the sales people together in a separate department, and group all of the customer service people together in a third department.

2. **Product-Based Division Structure**
A divisional organizational structure is comprised of multiple, smaller functional structures (i.e. each division within a divisional structure can have its own marketing team, its own sales team, and so on). In this case, each division within the organization is dedicated to a particular product line.

This type of structure is ideal for organizations with multiple products and can help shorten product development cycles. This allows small businesses to go to market with new offerings fast.

3. **Market-Based Divisional Structure**
Another variety of the divisional organization structure is the market-based structure, wherein the divisions of an organization are used around markets, industries, or customer types.

The market-based structure is ideal for an organization that has products or services that are unique to specific market segments, and is particularly effective if that organization has advanced knowledge of those segments. This organizational structure also keeps the business constantly aware of demand changes among its different audience segments.

4. **Geographical Divisional Structure**
The geographical organizational structure establishes its divisions based on geography. More specifically, the divisions of a geographical structure can include territories, regions, or districts.

This type of structure is based-suited to organizations that need to be near sources of supply and/or customers (e.g. for deliveries or for on-site support). It also brings together many forms of business expertise, allowing each geographical division to make decisions from more diverse points of view.

5. **Process-Based Structure**
Process-based organizational structures are designed around the end-to-end flow of different processes, such as “Research & Development,” “Customer Acquisition,” and “Order Fulfillment.” Unlike a strictly functional structure, a process-based structure considers not only the activities employees perform, but also how those different activities interest with one another.

6. **Matrix structure**
   Unlike the other structures, a matrix organizational structure doesn't follow the traditional, hierarchical model.

   The main appeal of the matrix structure is that it can provide both flexibility and more balanced decision-making (as there are two chains of command instead of just one). Having a single project overseen by more than one business line also creates opportunities for these business lines to share resources and communicate more openly with each other, things they might not otherwise be able to do regularly.

(b) **The Participation of Institutional Shareholders in Corporation's Governance**
Shareholders, and more particularly institutional shareholders, can play an important role in ensuring that companies adhere to sound and effective corporate governance standards. Institutional shareholders are particularly important to the purchasing of shares, as they can afford to buy a larger volume than individual investors.

Institutional shareholders have an important role to play in the management of a company and due to their size; they can potentially play a large role in ensuring good corporate governance standards. Institutional shareholders own large blocks of shares and have an incentive to develop specialized expertise in making and monitoring investments. Holding these large blocks of shares therefore gives them the power to hold management accountable for actions that do not promote the shareholders' welfare. It is furthermore much easier for institutional shareholders to have meetings with the directors of a company on a regular basis than it is for individual shareholders.

Institutional shareholders also hold a duty to act in the best interests of their clients, as in addition to their duties arising from a contract and statutory obligations, institutional shareholders and their clients are in a fiduciary relationship.

Institutional shareholders also play an important role in enhancing corporate governance principles. This owes largely to the size of their shareholding and the fact that their influence is likely to increase over time. The consideration of the interests of other stakeholders, in accordance with good corporate governance principles, will be in the best interest of other stakeholders, in accordance with good corporate governance principles, will be in interests of shareholders over the long term. The primary obligation of institutional shareholders can therefore said to be to monitor a company's management and to ensure that the interests of their clients are protected.

(c) Moral pluralism is the idea that there can be conflicting moral views that are each worthy of respect.

Moral pluralists tend to be open-minded when faced with competing viewpoints. They analyze issues from several moral points of view before deciding and taking action.

Moral pluralists believe that many moral issues are extremely complicated. Thus, no single philosophical approach will always provide all the answers.

For example, assume a building is on fire, a woman has the opportunity to rush inside and save the children trapped in the burning building. But in doing this she may die, and leave her own child an orphan. A moral pluralist would conclude that there is no definitive ways to decide which the correct course of moral action is. Indeed, moral pluralism declares that it is sometimes difficult to choose between competing values.

So, moral pluralism occupies a sensible middle ground between "there is only one right answer" as moral absolutism says, and "there is no wrong answer" as moral relativism claims.

ANSWER 3

(a) During strategic implementation process, the following activities need to be carried out to ensure effective implementation.

(i) **Setting Objectives:** these are targets (level of achievement) of an organization. So in order to achieve effective strategic management, organizations need to plan for their intended expected achievement as yard stick of performance.

(ii) **Preparing Programs:** It is a statement of the activities or steps needed to accomplish a single-use plan. It makes the strategy action oriented. It may involve restructuring the corporation, changing the company's internal culture or beginning a new research effort.

(iii) **Preparing Budgets:** A budget is issued in planning & control, a budget lists the detailed cost of each program. The budget thus not only serves as a detailed plan of the new strategy in action, but also specifies through Performa financial statements the expected impact on the firm's financial future.

(iv) **Development of Procedures:** Procedures, sometimes termed Standard Operating Procedures (SOP) are a system of sequential steps or techniques that describe in detail how a particular task or job is to be done. They typically detail the various activities that must be carried out.

(v) **Setting policies:** policies serve as guideline and control mechanism of decision making process. Therefore, during implementation process policies play a greater role in put implementers on the track of what is required and not required to be dome.

(b) The following are different ways in which "agency conflict" can arise.

(i) **Moral hazard:**
A manager has an interest in receiving benefits from his or her position in the company. These include all the benefits that come from status, such as a company car, use of a company plane, a company house or flat, attendance at sponsored sporting events, and so on. It is suggested that a manager's incentive to obtain these benefits is higher when they have no shares, or only a few shares, in the company. For example, senior managers may pursue a strategy of growth through acquisitions, in order to gain more power and 'earn' higher remuneration, even though takeovers might not be in the best interests of the company and its shareholders.

(ii) **Level of effort:**
Managers may work less hard than they would if they were the owners of the company. The effect of this lack of effort could be smaller profits and a lower share price.

(iii) **Earnings retention:**
The remuneration of directors and senior managers is often related to the size of the company (measured by annual sales revenue and value of assets) rather than its profits. This gives managers an incentive to increase the size of the company, rather than to increase the returns to the company's shareholders. The Management is more likely to want to reinvest profits in order to expand the company, rather than pay out the profits as dividends. When this happens, companies might invest in capital investment projects where the expected profitability is quite small, or propose high-priced takeover bids for other companies in order to build a bigger corporate empire.

(iv) **Time horizon:**
Shareholders are concerned about the long-term financial prospects of their company, because the value of their shares demands on expectations for the long-term future. In contrast, managers might only be interested in the short term. This is partly because they might receive annual bonuses based on short-term performance, and partly because they might not expect to be with the company for more than a few years.

(c) The possible course of action you would take as a manager to solve this ethical dilemma

(i) Check the relevant facts. If necessary, clarify staff procedures with the personnel department. Take legal advice if required.

(ii) Discuss the matter with the junior member of staff. Possible solutions may include suggesting a more flexible approach to team meetings. Do these always have to be in the morning? At times, working from home may be an option for the junior member of staff.

(iii) You also need to deal with the other member of staff, who needs to be reminded about proper conduct and how such behavior may amount to harassment and be in breach of the practice's code of conduct.

(iv) Considering the issues and trying to identify a solution enables you to demonstrate that you are behaving professionally and attempting to resolve the difficulties faced by the junior member of staff.

(v) Having considered all reasonable compromises, if the conclusion is reached that the junior employee is unable to carry out the work for which she was employed, you must turn your attention to her on-going employment within the practice. This will probably be out of your hands, and you should deliver the relevant facts to the personnel department or the owners of the practice. Appropriate confidentiality must be maintained at all times.

(vi) You should document, in detail, the steps that you take in resolving your dilemma, in case your ethical judgement is challenged in the future.

ANSWER 4

(a) The building blocks of defensive strategy as way to achieve organizational intended results.

(i) **Defensive/turnaround strategies**

These are strategies used when the company needs to reduce its operations, to reverse a negative trend or to overcome a crisis or problem. The firm may be having financial problems or it forecasts hard times ahead in terms of new competitors entering the market, new products or changes in government regulations.

The strategies include; retrenchment, divestment, liquidation and bankruptcy

- **Retrenchment/restructuring/downsizing**

  A firm can find itself with declining profits because of recessions, production inefficiencies or innovative breakthroughs by competitors. Such a firm can survive if it fortifies its distinctive competencies. This is often achieved in two ways:

  ✓ **Cost reduction;** e.g. laying off employees, leasing rather than purchasing new heavy equipment, eliminating promotional activities and dropping unprofitable items from the product line.

  ✓ **Asset reduction;** e.g. the sale of land, buildings and equipment not essential to the basic activity of the firm.

- **Divestiture:**

  It is the sale of a firm or a major component of a firm because the company has financial needs where its cash flow can be greatly improved if business with high market value are sacrificed, or because of government action when a firm is perceived to monopolize or unfairly dominate a particular industry.

- **Liquidation:**
  It is where a firm is sold in parts for its tangible asset value. As a strategy, it minimizes the losses of all the firm's shareholders. The proceeds of the sale are then distributed to creditors, the remainder of which ca then be distributed to shareholders.

- **Bankruptcy:**
  A company can go to the courts to ask for a reorganization bankruptcy. It persuades its creditors to temporarily freeze their claim while it undertakes to reorganize and build the company's operations back to profitability. The company may close down unprofitable business divisions, reduce its workforce or negotiate employee contracts to affordable salary levels.

(ii) **Why painful strategy?**
It involves losing on the side of employees and organization – retrenchment techniques make employees lose their jobs and on the other hand organization lose parts of assets through selling.

(b)

(i) Elaboration of the terms risk appetite and risk tolerance

- Risk appetite is the level of risk that a company (or any other organization) is willing to take in the pursuit of its objectives. It is the combination of the amount and type of risk that the board of directors would like the company to have exposure to.

- Risk tolerance is the amount of risk that the company is prepared to accept in order to achieve its financial objectives, expressed as a quantitative measure, such as a permitted range of deviation from a specified target, or a maximum limit. Risk tolerance is therefore a quantified expression of the amount of risk that a company's board of directors allows the company to accept.

(ii) The responsibilities of board of directors in managing risks include:

- They decide on the risk appetite of the company

- They ensure the company management manages risks within the board guidelines of the set risk appetite.

- Monitors the performance of management to ensure range of permitted risk is not violated

- Monitors the risk management system and to ensure that they operate effectively to achieve the intended purpose

(c) The motivation or advantages for emphasizing ethics management at workplaces include:

(i) **Significant improvement to society**
Application of business ethics helps to avoid many evils from the society. It includes child labour, unscrupulous price fixing, harassment of employees, poverty and starvation of employees etc.

(ii) **Cultivate strong team work and productivity**
Ethical program helps to tune employee behavior in accordance with the values preferred by leaders of the organization. It helps to build openness, integrity and a sense of oneness among all. Employees feel strong alignment between their values and those of the organization and they react with strong motivation and performance.

(iii) **Support Employee Growth**
Ethics program helps employees to face reality, both good and bad in the organization and themselves. They feel full confidence to admit and deal with whatever comes their way.

(iv) **Ethical programs help to ensure that policies are legal**
Ethical principles are often applied to current, major ethical issues and become legislation. A major intent of well designed personnel policies is to ensure ethical treatment of employees.

(v) **Avoid Penal action**
Ethical programs help to detect issues and violations early so that they can be reported or addressed which helps to avoid subsequent penal actions and lower fines.

(vi) **Helps in Quality Management**
Strategic planning and diversity management helps in ensuring quality management practices at workplaces. For example, if employees behave ethically by showing commitment fulfilling their duties it is easier to plan future achievements for organizations.

(vii) **Ethical program** identify favorite values and ensure organizational behaviors which are associated with those values. This complex effort can be aligned with values, including quality.

ANSWER 5

(a) **Greater Customer Service**

(i) **Reliability**
Customers expect product/service provided to be dependable and accurate during interactions. Make the customers to believe that you will do what you say. Make your services reliable.

(ii) **Competence**
This characteristic measures knowledge and skill level in regards to one's product/services. Make sure that everyone within your organization is a product/services expert in order to receive a high rating for competency.

(iii) **Responsiveness**
When customers enter your brick and mortar location, call on the phone, email or initiate a web chat, how long does it take for someone to acknowledge their presence? One of the most dreaded customer experiences is waiting to be serviced or even just to be acknowledged! How long are your customers waiting for service? When issues arise, how long before the situation is addressed and a resolution provided to the customer?

(iv) **Courtesy**
This one is the easiest characteristic to exhibit. If there is one thing that we can all control is our ability to be kind and polite. All customers deserve common courtesy. Courtesy goes a long way with customers, especially when they're unhappy with your product/service. Body language and facial expressions also contribute to the courtesy factor.

(v) **Credibility**
Can your customer deem your organization as credible? This characteristic is an image builder. We're talking about trustworthiness here! Does your performance match what you advertise? Does your organization deliver on its promises? Choosing to take the steps necessary to ensure credibility helps to create a reputation for believability. One act by one person which puts your organization's credibility into question can be an image killer. Protect your organization's future by insisting that everyone perform their duties in a manner that possess the credibility test.

(vi) **Consistency**
This is the glue that holds it all together. Consistency creates long term customers, if your organization is consistently reliable, competent, responsive, courteous and credible, you're probably providing many great customer experiences. Consistency means establishing a pattern of behavior. Does your customer's rating of your organization indicate great behavior? Does your customer's rating of your organization indicate pattern of greater behavior in regards to the customer experience? Can your customer depend upon your organization to provide a high level of service every time they choose to utilize your products/services?

(b) **Characteristics of directors**

The directors should possess the following characteristics to be effective business managers:

(i) **Proactive:**

They should have the ability to look beyond the physical facts to foresee challenges and opportunities and come up with ideas to resolve issues as well as to advance the business. The directors of Rosh and company do not play a proactive role since they hardly discuss strategy. This has also placed the company in a weak position to handle the changing world of retailing, according to Mary.

(ii) **Motivating:**

They should have the ability to motivate the team working under their leadership to perform in order to achieve the best results possible. The directors of Rosh, being accustomed to each other for years, normally do not discuss much on any decisions but agree with each other.

(iii) **Experienced:**

The directors should have adequate experience in dealing with the circumstances he will face as directors. They should be well-versed with the industry conditions and the way of overcoming problems. Companies should not however be afraid to promote gifted young managers with new ideas. Mary, being the youngest of the directors, has been still appointed on the board and this proves that Rosh and Company have respect for new and experienced talent. All the other directors are also quite experienced, working with /Rosh for over 10 years.

(iv) **Good listening and questioning skills:**

Directors should have tolerance, and more importantly learn from others and have the requisite knowledge and attitude to question the areas where they have doubt. The typical board meeting at Rosh and company does not involve any questioning on any issues relating to strategy. This is ideal board behaviour since it may lead to company instability in the long term.

(v) **Good negotiating skills:**

Directors should be able to exercise their influence to negotiate deals for the benefit of company. Rosh and company has well experienced directors on board and hence they must be possessing good negotiation skills.

(vi) **Leadership:**

These skills are essential for the chairman and the chief executive. Rosh and company being a family dominated company, has always had a family member in the seat of a CEO and chairman. The training for leadership is also given in the family in order to prepare members of family as successors to the position of CEO/chairman. This ensures that the person in position is well trained to take up this role.

(vii) **General knowledge of business:**
The executives and the Board of Directors should be well-versed with general knowledge relating to the business of the company. Rosh and company has experienced directors onboard and hence business knowledge should be of a high degree.

(viii) **Expertise in relevant areas:**
Directors should have expertise in the areas relevant to the operations of the company. Rosh and company's board of directors is well versed with many members of the family being in the business for many years.

(c) **Ethical relativism**
Ethical relativism is the theory that holds that morality is relative to the norms of one's culture. That is to say, whether an action is right or wrong depends on the moral norms of the society in which it is done. The same action may be morally right in one society but be morally wrong in another. For the ethical relativist, there are no universal moral standards – standards that can be universally applied to all peoples at all times. The only moral standards against which a society's practices can be judged are its own. If ethical relativism is correct, there can be no common framework for resolving moral disputes or for reaching agreement on ethical matters among members of different societies.

Most ethicists reject the theory of ethical relativism. Some claim that while the moral practices of societies may differ, the fundamental moral principles underlying these practices do not. For example, in some societies, killing one's parents after they reached a certain age was common practice, stemming from the belief that people were better off in the afterlife if they entered it while still physically active and vigorous. While such a practice would be condemned in our society, we would agree with these societies on the underling moral principle – the duty to care for parents. Societies, then, may differ in their application of fundamental moral principles but agree on the principles.

Also, it is argued, it may be the case that some moral beliefs are culturally relative whereas others are not. Certain practices, such as customs regarding dress and decency, may depend on local custom whereas other practices, such as slavery, torture, or political repression, may be governed by universal moral standards and judged wrong despite the many other differences that exist among cultures. Simply because some practices are relative but does not means that all practices are relative.

ANSWER 6

(a) **An organizational SBU often has the following characteristics:**

(i) **It has its own set of customers - i**t must have its own set of customers because each strategic business unit serves its own strategic customers who are different from other business units.

(ii) **It should have a clear set of competitors,** which it is trying to outperform. SBUs are sometimes called strategic competitive units. This is because the unit deals with competition issues related to creation of competitive advantage for the organization. It must clearly set its competitors because outperform competitors, competitors must be known and the strategies they are using must also be known.

(iii) It should have its own strategic planning manager responsible for its success. The manager should be a specialist in the area the SBU is set to compete.

(iv) Its performance must be measureable in terms of profit and loss, i.e. it must be a true profit center. Justification is required to confirm the unit is set strategically on general profits. Hence if there are no clear ways of measuring performance, justification may be difficult.

(v) It must have its own strategic planned performance achievement – there should be clearly set levels of achievement like SMART objective to guide direction of effort and performance for the SBU.

(b) The board should play a central role in the governance of the company by performing the following functions:

(i) Guiding corporate strategy

(ii) Monitoring managerial performance and replacing managers if necessary

(iii) Ensuring that the corporation obeys the applicable laws

(iv) Establishing a code of corporate ethics

(v) Overseeing systems to achieve an adequate return for shareholders

(vi) Monitoring and managing potential conflicts of interest of management, board members and shareholders

(vii) Planning for recruitment and recruiting management executives

(viii) Planning for remuneration and compensation of key executives

(ix) Oversee the integrity of the company's accounting and financial reporting systems, including the external audit, and the effectiveness of systems of control and risk management;

(x) To oversee the process of information disclosure and communication of information

(xi) To make sure that the company's obligations to its shareholders are understood and met

(c) **The golden rule model**

The Golden Rule model is derived from the New Testament and it states that one should treat other people in the same way that he or she would want to be treated. It is a fundamental principle found in every culture and religion and it is the most important basis for the modern concept of human rights. It is also called the ethics of reciprocity as it stimulates an individual to put oneself in the other person's shoes and then evaluate how one would wish to be treated in that particular situation.