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African Footprint

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Inside This Issue

Audit / Tax / Advisory

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Is Mozambique the next oil and gas hub?

Mozambique is returning to a state of normality and consequently its upstream oil and gas industry is of growing importance in the region. Mozambique's potential appears to lie in natural gas and oil. The critical factor in the future exploitation of the country's gas, however, is the emergence of sound commercial criteria for the establishment of a south-east African gas-gathering network capable of serving developing markets in the region.

Oil and gas prices have been on a steady decline over the years, creating major concerns for global leaders. But for Mozambique, there's hope during these turbulent times as an estimated 20 billion barrels of natural gas has been found off its coast.

The country sits seventh on the table of poorest countries in the world, but this discovery could add $39 billion dollars to its economy by 2035, according to a Standard Bank estimation in 2015. Although only a fraction of the reserves of a country like Russia, which has more than 48.7 trillion barrels, Mozambique's 20 billion barrels raises its energy profile to rank as the seventh largest reserve in Africa.

The nation emerged as a giant in natural gas in 2012 when 85 trillion cubic feet of natural gas was found in the Rovuma basin, which has been described as "one of the largest gas finds in years." The government of Mozambique determined that a portion of the gas should be used locally to address the domestic market and the Ministry of Mineral Resources and Energy is already working towards this.

The country has made significant steps towards economic stability with increased focus on key sectors such as resources, infrastructure and agriculture and the promulgation of supportive regulation in areas such as the development of Public Private Partnership (PPP) frameworks and mining concessions.

The future of Mozambique looks promising as natural resources will play a central role in driving the economy forward. Mozambique holds a wealth of opportunities for foreign investors, developers and contractors. And while there is undoubtedly still some residual risk involved in investing in emerging economies such as Mozambique, all evidence points to the fact that this will likely become a market for foreign infrastructure players over the next decade.

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IFRS 15 - Do Hotel Operators have an obligation to perform?

IFRS 15 (Revenue from Contracts with Customers) applies to an annual reporting period beginning on or after 1 January 2018. In our opinion, there are two key considerations to make when hotel operators are drafting or updating contracts with customers.

The first is to identify the performance obligations in the contract, as these would determine when revenue can be recognised. Management contracts typically are for a bundle of services and may often involve the supply of goods to be used on the hotel premises. It is advisable to identify a series of goods or services that are transferred to the customer, as such management contracts typically last several years.

The second key consideration is to allocate transaction prices to the performance obligations in the contracts. This is relatively straight forward for goods, since the costs are typically based on a cost plus or mark-up model, though several institutions would like to see value-based pricing.

How this would be implemented will be interesting to note, especially when the entity recognises revenue over time. The standard effectively sticks to the basis of the risk and rewards related to ownership. In summary, the new framework provides a more pragmatic approach to recognising revenue.

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Overhaul of the Kenya Income Tax Act [Part Two of Two]

This is the second part of an article, the first part of which appeared in the May 2017 issue of African Footprint - Issue 23.

1 Capital Gains Tax (CGT)

CGT was restored in 2015 after 30 years of suspension. The regime relies on a law that was enacted in the 1970's and 1980's and is not in tandem with current business models and automated Government and tax administration procedures. The tax rate of 5% is the lowest in the region whose rates range from 20% to 30%. Cost indexation is not provided for. There is a need to review the CGT law and align it with international practice.

2 Business Re-Organisation

In the past, businesses have been reorganizing through mergers, acquisitions and amalgamations in order to expand capital base, enhance efficiency, be competitive and expand their market share. There is need to review the law to capture such business reorganization and allow for benchmarking.

3 Insurance

The taxation law for insurance business was enacted in 2007/8. The Kenya Income Tax Act has a section which specifically provides for taxation of insurance companies. Under that section, questions arise regarding the taxation of investment income and the reintroduction of Capital Gains Tax. There is need to review the taxation of insurance business in light of these developments.

4 Unit Trusts And Collective Investment Schemes

The number and type of investment vehicles have increased in the past decade. The tax law exempts these vehicles from corporate tax but taxes them at the withholding tax rate when they receive income from their investments. There is need to review this law, and where applicable, align it with internationally accepted practice.

5 Retirement Benefit Schemes

There is need to address Exemptions, Allowable Contributions, Taxation of withdrawals, Processes of Registration of Exemptions, Taxation of Resident and Non-Resident (resident 10%-30%, non-resident 5%) as well as Widows and Children Pension Schemes (WCPS). The review should address any practical challenges noted in this taxation regime.

6 Extractive Industries

There is a need to review the provisions applied to Mining and Oil and Gas enterprises in light of the Production Sharing Agreements and how they affect tax legislation, the taxation rates, tax incentives and taxation of contractors and sub-contractors. In addition, there is need to evaluate the new Mining and Energy legislation as well as the EAC Domestic Taxes harmonization policy. The review should also test the allegation that transfer of interest is highly taxed when compared to other sectors.

7 Losses Carried Forward

Tax losses are carried forward for ten years which can be extended only after approval by the National Treasury. The review should involve periods of losses carried forward, nature of losses (capital/revenue) and taxation of foreign exchange gains and losses. The new tax framework should create certainty by removing the discretionary powers granted to the Minister for Finance to extend the period for losses to be carried forward.

8 Compensating Tax

Compensating tax was introduced in the 1990's after the Government realized that some companies were paying dividends from capital gains. Such companies were giving a return to shareholders yet they had a corporate tax loss position which denied the exchequer corporate taxes.

With the reintroduction of Capital Gains Tax (CGT) in 2016, there is need to review the compensating tax legislation and also evaluate the effect of “recouping” the tax incentives through the compensating tax regime.

Investors in loss making companies have been arguing that it is in order for them to expect a return from their investment even if their companies made a tax loss because their commercial profit was converted to a tax loss as a result of tax incentives.

9 Withholding Tax

There is need to review the persons and incomes chargeable to withholding tax as well as the definitions of incomes taxable under this regime and the exemptions and exclusions from taxation. The numerous rates for a single item such as interest and the disparity between the non-resident rates, (rent at 30% and pension at 5%) should be reviewed and, if necessary, the gap reduced. It is worth noting that most non-resident rates in Uganda and Tanzania are pegged at 15%.

10 Tax Rates

Kenya has numerous tax rates for withholding - resident and non-resident rates, as well as corporate rates- ranging from 10% for Special Economic Zones (SEZ), 15% for housing developers, 20-27% for listed companies and 30% and 37.5% for resident and non-resident companies respectively. The CGT rate is 5%, Turnover Tax (TOT) 3% and Simplified Residential Rental rate is 10%. There is need to review and simplify the tax rates so as to promote equity and fairness, bring the informal sector into the net, encourage voluntary compliance and expand the tax base in line with KRA's Vision 2018.

11 Deemed Dividends

The provision for shortfall distribution of dividends was enacted many years ago. There is need to review this provision in light of international practice.

12 Employment Income And Taxable Benefits

Taxable benefits have not been reviewed for many years. There is need to review the taxation/exemption of meals, housing, health and other welfare benefits granted to employees. The review should be benchmarked with economies similar to Kenya.

13 Informal Sector Taxation

The informal sector has eaten into the business areas of the formal sector hence eroding the tax base while the Turnover Tax (TOT) has not been an effective taxation regime. There is need to review and amend the legislation so as to enhance compliance in the informal sector and bring more taxpayers into the net and reach the targeted tax base in line with KRA's Vision 2018 strategy.

14 Penalties

Some penalties unique to income tax have not been reviewed for a number of years. Although the Kenya Tax Procedures Act attempted to harmonize the tax penalties as from January 2016, the penalties unique to various tax heads were not reviewed. The overhaul of the Act is an opportunity to review the penalties imposed by the Act and address any inconsistencies and inequity.

[The above are exact extracts, with minor edits in some places, as given by the Kenya Revenue Authority in its guiding principles and thematic areas for review of the Kenya Income Tax Act in the first quarter of this year]

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Feedback from our Readers!

Should you wish a specific topic to be covered in our next issue, please let us know by emailing your request to our editor kent.karro@crowehorwath.co.za

Emerging Trends in Accounting:
Sustainability Reporting

The Accountancy profession has contributed to the development and growth of ancient civilizations. From the Babylonians to the Egyptians, the need for records has satisfied the need to keep day to day affairs well structured, managed and planned for. The development of accounting has over the years since then developed to be a necessity for modern day trade, governance and every day operations.

Owing to how integral the service is, it is no wonder that there have been remarkable developments in that space. Scholarly articles, research papers, development of courses and other avenues have been utilized to further advance this field. In line with this development, Accounting has also benefited from the advancements in other fields as well.

The Enron Scandal brought to light the evils of poor accounting practices and the need for greater accountability and transparency in the operations of business. While the move for Sustainability has lasted longer than this, the need for business to take up more responsibility has since then been more greatly appreciated.

What Is Sustainability?

That business does not operate in a vacuum is a basic understanding of Systems Theory. Business operates in an ecosystem consisting of the Government, the general public, suppliers, employees, customers, suppliers, investors, shareholders, the natural environment, the media and other stakeholders. These are the persons who are affected by the business and/or may affect the business.

Sustainability brings the business to be more aware of this. This understanding of business on a greater scope will require business to be more aware of its actions and how they directly or indirectly affect the stakeholders. Sustainability is thus a balance of the needs of these stakeholders and founded on three pillars:

- Economic or Profit – The core purpose of business and looking at more than just how much money is made but how it is made. Embracing good business practices for better relationships and thus more profit in future.
- Environment or Planet – As business draws from nature to run its operations, the reliance on these resources will need efficiency to ensure their availability in future. Business must thus look to reduce, recycle and reuse where it can.
- Social or People - This involves the human aspect of the business. How well does the business take care of its people? Does it value human rights? Does the business appreciate diversity in the workplace?

What Is Sustainability Reporting?

Having understood what sustainability involves, sustainability reporting is thus the process of capturing the impact of sustainability initiatives undertaken. It is preparing this report in a set format under specific guidelines and sharing the same with stakeholders.

These guidelines have been developed by international organizations that have advanced sustainability in different ways. They endeavour to develop new advancements in the field, train personnel and create awareness on Sustainability. The major providers of sustainability reporting guidelines are:

- Global Reporting Initiative (GRI)
- Integrated reporting by the International Integrated Reporting Council
- The United Nations Global Compact (The communication on progress)
- The Organization for Economic Co-operation and Development (OECD guidelines for Multinational Enterprises)
- The International Organization for Standardization (ISO 26000, International standards for Social Responsibility

Benefits of Sustainability Reporting

Sustainability reporting practices creates transparency and assists markets to function more efficiently. It also indicates the health of the economy and drives progress by organizations towards smart, sustainable and inclusive growth.

Companies and organizations seeking sustainability from a global point of view can have the numerous benefits. One of these is increased understanding of risks and opportunities, streamlining processes, reducing costs and improving efficiency. The very nature of the sustainability reporting process delves into every part of the organization and can offer much needed expertise especially from a stakeholder's perspective.

An additional benefit of sustainability reporting is that it emphasizes the link between financial and non-financial performance. Tracking performance against environmental and social indicators will show an organization how well or how poorly it is doing in more than just monetary terms.

Preparing sustainability reports allows an organization to compare performance internally and between organizations and industry sectors using a global yardstick. The international standards allow for benchmarking on a greater scale pushing organizations to strive for excellence and efficiency.

Enabling external stakeholders to understand the organization's true value is another benefit. Stakeholders will look to see what more the organization is doing in addressing pressing issues such as global warming, eradicating poverty, encouraging diversity in the workplace, etc. By preparing the sustainability report, these stakeholders such as investors are well informed on the organization's progress in these areas.

The transparency and accountability created by the preparation of sustainability reports does well to improve reputation and brand loyalty of an organization. More and more employees and customers are interested to see what organizations are doing. This alone influences the attraction of top talent as well as sales. A recent Nielsen global online study showed that up to 72% of millennials were willing to pay more for products from companies that are committed to social and environmental impact. This points to a growing crop of individuals that will influence what to buy and where to work.

Who is Sustainability Reporting For?

Contrary to popular belief, sustainability reporting is not a preserve of private sector and large companies at that. Sustainability reporting can be undertaken by any organization regardless of the industry it operates in, its size and geographical location. The international guidelines such as GRI take this into account and have specific disclosures to be made by different sectors e.g. financial services or Not For Profit sector. These considerations and adjustments allow for more organizations to report on their sustainability efforts while maintaining international standards.

Where to start?

The journey to sustainability reporting will begin with a commitment from senior management like the Board of Directors or CEO or Managing Director to integrate sustainability in the running of the organization. This commitment may take the form of a statement of commitment or a sustainability policy.

This commitment must then be shared and communicated throughout the organization to ensure that employees and stakeholders are well aware of the vision and goals of the organization with regard to sustainability. This will involve public declarations by the senior management as well as information sharing sessions for employees at all levels.

Having done so, the organization may undertake stakeholder engagement. This process involves open communication with stakeholders in order to identify their main sustainability concerns. The organization may then identify the material concerns and embark on reporting on these aspects.

The final step will be gathering the data on the material concerns and preparing the sustainability report.

As simple as this process may seem, greater detail is paid to these individual steps so as to ensure a complete and accurate sustainability report. Professional diligence must be exercised throughout the process.

To this end, Horwath Erastus and Co. will be offering Sustainability Reporting services to local organizations with the promise of quality international service delivered with an understanding of local organizations.

Undertaking sustainability reporting will aid in the push for sustainable development and indeed a better world for generations to come.

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About Us

Our African network of firms serve clients worldwide as independent members of Crowe Horwath International.

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