

CPA Common Final Examination

BOARD OF EXAMINERS' REPORT

PART A — The Day 2 and Day 3 Report

September 2024 Examination

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THE BOARD OF EXAMINERS' REPORT ON THE SEPTEMBER 2024 COMMON FINAL EXAMINATION

OBJECTIVES OF THE REPORT

The objective of this report is to explain the Common Final Examination (CFE) process and to assist the profession in improving the performance of candidates on the CFE.

The report sets out the responsibilities of the Board of Examiners, the methods used for guide setting and marking the CFE, and the results of the marking process. The report also includes recommendations to candidates from the Board of Examiners.

The September 2024 CFE Report is presented in two parts: Part A is the Day 2 and Day 3 report and Part B is the Day 1 report.

The appendices provide more detailed information on the design, guide setting, and marking of the CFE, as well as the board's expectations of candidates on the simulations. Readers are cautioned that the marking guides were developed for the entry-level candidate and that, therefore, all the complexities of a real-life situation may not be fully reflected in the content. The CFE report is not an authoritative source of GAAP.

RESPONSIBILITIES OF THE BOARD OF EXAMINERS

The Board of Examiners (BOE or the board) comprises a chair, two vice-chairs, and sixteen members appointed by the provincial bodies.

The board's responsibilities, as set out in its terms of reference, include the following:

- Setting the CFE in accordance with the *CPA Competency Map* (the *Map*) and other directions from the Professional Education Management Committee;
- Submitting the CFE and the marking guides to the provincial bodies for review;
- Marking the candidates' responses and recommending to the provincial bodies the pass or fail standing that should be given to each candidate; and
- Reporting annually on the CFE to various CPA committees and the provincial bodies, in such form and detail and at a time that is satisfactory to them.

The chair is responsible for the supervision of the evaluation process. A CFE subcommittee, made up of nine members of the board, is actively involved in the preparation of the CFE simulations, the preliminary marking guides, and the setting of the initial passing profile. The members of that subcommittee participate in the Preliminary Evaluation Centre where the marking guides are tested against candidate responses and finalized, and in the start-up of the marking centre. The BOE chair and vice-chair provide oversight throughout the entire marking process, consulting with subcommittee members as required. The full board is responsible for equating the difficulty of the examination to prior years' examinations and establishing the passing standard.

THE CFE

PREPARATION AND STRUCTURE OF THE CFE

The board staff works in conjunction with authors to ensure that the simulations presented to the board achieve the overall intent and design objectives set by the board, while adhering to the competencies and proficiency levels specified in the *Map*.

The full board provides guidance as to the content and nature of simulations to be included on the examination. The CFE subcommittee reviews and refines the simulations that make up the three-paper evaluation set.

NATURE OF THE SIMULATIONS

The CFE comprises a set of simulations, which are both essential and effective in evaluating the candidates' readiness to enter the profession:

Day 1 – The first paper is a four-hour examination consisting of a single simulation that is linked to the Capstone 1 group case. There are two versions of the linked cases, unless special circumstances require that a third version be provided. Version 1 is linked to the most current Capstone case and is written by first time writers and by repeat writers who chose to attempt the new case rather than Version 2 of the previous Capstone case. Version 2 is written by repeat writers and candidates who deferred and are writing Version 2 as their first attempt. The versions of the exams are calibrated to ensure the difficulties of all versions are comparable. For the September 2024 CFE, a Version 1 and a Version 2 were offered. The Version 2 case relates to JRP, for which a Version 1 was offered in September 2023.

Day 2 – The second paper is a five-hour case, with four different roles and requirements. Additional information, tailored to each role, is provided in four separate appendices.

Day 3 – The third paper is a four-hour paper, consisting of three multi-competency area simulations.

ASSESSMENT OPPORTUNITIES

The board applies competency-based marking procedures that enable it to decide which candidates demonstrate readiness to enter the profession.

Assessment Opportunities are designed to answer the question, “What would a competent CPA do in these circumstances?” To attain a pass standing, candidates must address the issues in the simulations that are considered significant.

Appendix A contains a comprehensive description of the evaluation process.

MARKING GUIDES

Marking centre leaders and assistant leaders provide valuable input during the testing and setting of the marking guides, before live marking begins. The vice-chair, selected member(s) of the CFE subcommittee and senior evaluations staff hold meetings with the leaders and their assistants during both the guide-setting and the marking processes. See **Appendix B** for the Day 1 simulations that appeared on the September 2024 CFE and **Appendix C and D** for the Day 2 and Day 3 simulations and marking guides. The marking results for Day 2 and Day 3, by Assessment Opportunity, appear in the statistical reports found in **Appendix E** of this report. See Part B of the CFE Report for details on Day 1, J.R. Pets Inc. Version 1 and Version 2.

Day 1 – The marking guide is designed to assess the candidate on the stages of the CPA Way: 1) situational analysis; 2) analysis of the major issues; 3) conclusions and advice; and 4) communication. Based on these four summative assessments, the candidate’s response is then holistically judged to be either a passing or a failing response.

Day 2 and Day 3 – Marking guides are prepared for each simulation. Besides identifying the Assessment Opportunities, each marking guide includes carefully defined levels of performance to assist markers in evaluating a candidate’s competence relative to the expectations set out by the board when developing the passing profile for a competent CPA.

Five categories of performance are given for each Assessment Opportunity. The candidate's performance must be ranked in one of the five categories:

- Not Addressed
- Nominal Competence
- Reaching Competence
- Competent
- Competent with Distinction

SETTING THE PASSING STANDARD

The chair of the board and vice-chair in charge of the examination monitor the live marking. Near the completion of the marking process, the CFE subcommittee satisfies itself that the markers applied the marking guides as intended by the board.

In determining which candidates pass the CFE, a candidate is judged in relation to the board's pre-established expectations of an entry-level chartered professional accountant. Any changes to the initial passing profile that were made throughout guide-setting and the marking centre are ratified by the full board. In setting the passing profile, the board considers the following:

- The competency area requirements described in the *Map*
- The level of difficulty of each simulation (set using a scale: Easy, Easy to Average, Average, Average to Hard, or Hard)
- The level of difficulty of each Assessment Opportunity (set using a scale: Easy, Easy to Average, Average, Average to Hard, or Hard)
- The design and application of the marking guides
- Comments from leaders and assistant leaders regarding any marking difficulties encountered or any time constraints noted
- Possible ambiguity of wording or of translation
- Input on critical decision factors from an independent board (i.e., those BOE members not on the CFE subcommittee and therefore not directly involved) who review the fair pass package

THE DECISION MODEL

The purpose of the CFE is to assess whether candidates possess the competencies required of an entry-level CPA through a written evaluation that is common to all CPAs. Each day of the CFE is unique and is designed specifically to assess different skills:

- Day 1 is linked to the Capstone 1 group case work. It assesses the candidates' ability to demonstrate professional skills. It is independent from Day 2 and Day 3.

- Day 2 assesses technical **depth** in one of four unique roles (that reflect the four CPA Elective choices) and also provides **depth** and **breadth** test opportunities in the common core competency areas of Financial Reporting and/or Management Accounting. Candidates pre-select one role and respond from that role's perspective.
- Day 3 supplements the **depth** and **breadth** tests in the common core areas of Financial Reporting and/or Management Accounting, and also provides **breadth** test opportunities for all other common core competency areas.

Candidates must pass all three days in order to qualify for entry to the profession. Those seeking licensure must obtain depth in Financial Reporting and in the Assurance Role.

DAY 1

Day 1 is assessed independently from Day 2 and Day 3. A pass or fail decision is made based on a holistic assessment of the candidates' performance in applying the CPA Way to demonstrate essential professional skills.

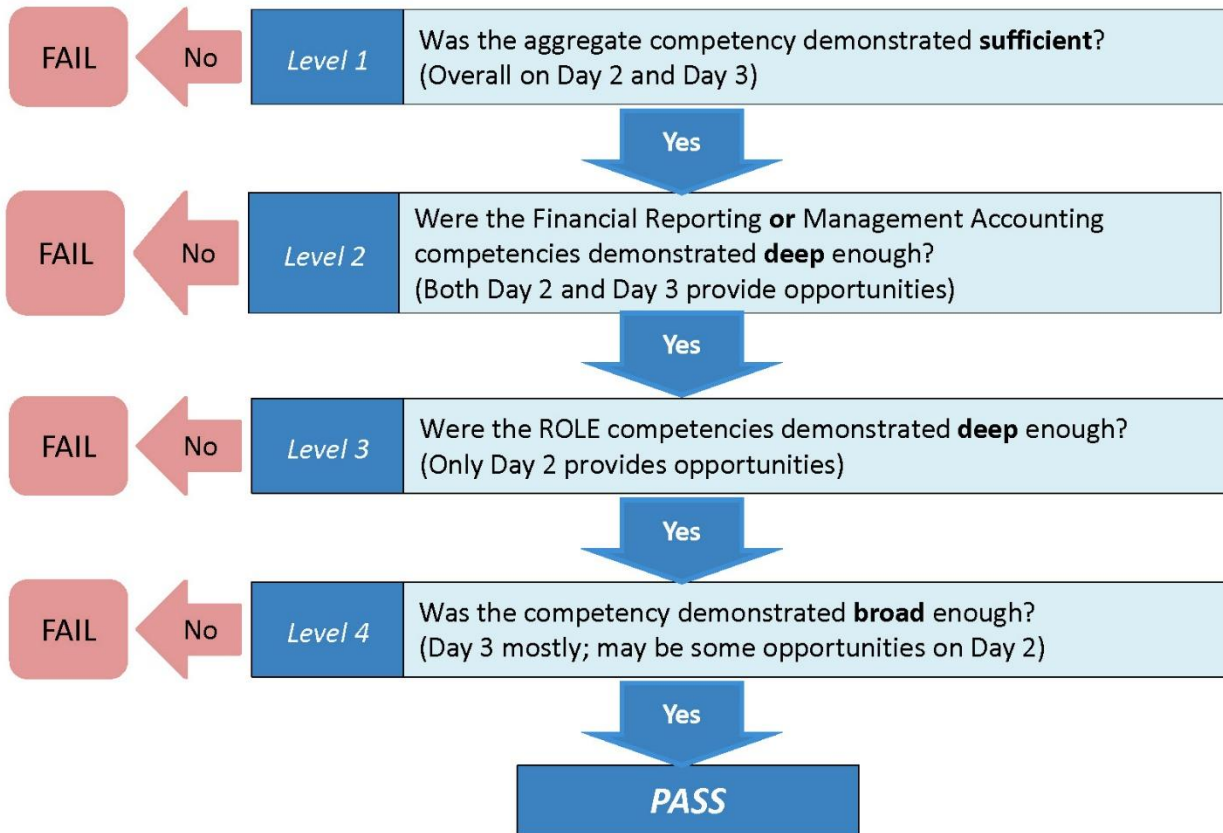
DAY 2 AND DAY 3

The decision model used by the board is presented in Exhibit I. Four key decision points, or levels, are applied in reaching a pass or fail decision, as follows:

1. The response must be **sufficient**; i.e., the candidate must demonstrate competence on the Assessment Opportunities presented on Day 2 and Day 3 (Level 1).
2. The response must demonstrate **depth** in the common core area of Financial Reporting or Management Accounting (Level 2).
3. The response must demonstrate **depth** in the pre-selected elective role (Level 3).
4. The response must demonstrate **breadth** across all competency areas of the *Map*, at a core level, by not having avoided a particular technical competency area (Level 4).

The BOE is responsible for equating the results from one examination to another to ensure that candidates have an equal chance of passing whichever examination they write. The BOE uses the factors listed above under setting the passing standard, in order to equate the examinations.

EXHIBIT I
DAY 2 AND DAY 3 PASS/FAIL ASSESSMENT MODEL



APPROVING THE RESULTS

The CFE subcommittee reviews and approves the marking results for each simulation. Day 1 is assessed separately from Day 2 and Day 3.

Day 1 – The CFE subcommittee discusses the profiles for both the marginally passing and the marginally failing candidates to confirm the board's pre-established passing profile has been appropriately applied by the markers.

Day 2 and Day 3 – As part of the development process, the CFE subcommittee sets preliminary requirements for the three levels (tests of depth and breadth) being assessed on the Day 2 and Day 3 simulations. After the marking is completed, the board reviews and finalizes those requirements. The board establishes the Level 1 (sufficiency) requirement for the combined Day 2 and Day 3 simulations.

During the approval process, the board continues to consider whether the results could be affected by any inconsistency in the evaluation or the board's processes.

REPORTING

In reaching its decision, the board determines which candidates pass on a national basis only, without regard to provincial origin or language. Similarly, the detailed comments are based on analyses of the performance of all candidates.

The board reports the following information by candidate number:

- Overall pass/fail standing and pass/fail standing for each of Day 1 and of Day 2 and Day 3 combined.
- A pass/fail standing for Day 1.
- A pass/fail standing for Level 1, Sufficiency. A decile ranking is provided for failing candidates.
- A pass/fail standing for Level 2, Depth in Financial Reporting and/or Management Accounting.
- A pass/fail standing for Level 3, Depth in Role.
- A pass/fail standing for Level 4, Breadth in all technical competency areas.

THANK YOU

All board members wish to express their warm and sincere appreciation for the outstanding energy, support, and commitment of the Board of Examiners staff members whose dedication and talent contributed in large measure to the achievement of our objectives and the fulfilment of our responsibilities.

We also wish to acknowledge the contributions made by the provincial reviewers, markers, authors, translators, and editors. The commitment, energy, and skill demonstrated by all the markers were outstanding, resulting in the sound application of marking procedures and producing an appropriate evaluation of the candidates. Everyone's commitment to the quality and fairness of the process is appreciated.

Jonathan Vandal, CPA
Chair
Board of Examiners

A MESSAGE TO CANDIDATES

To attain a pass standing, candidates needed to achieve a “Pass” on Day 1, and on Day 2 and Day 3 combined, demonstrate sufficient competence in all areas and meet the two depth standards and the breadth standards.

Introduction

The September 2024 CFE Report, Part A and Part B combined, presents detailed information on all candidates' performance for all the examination cases, except for the Day 1 linked case, API Version 1. Detailed commentary on the performance of candidates on the API cases (Version 1 and Version 2) will only be available after API Version 2 is written in September 2025. The simulations, marking guides, marking results, and Board of Examiners' (BOE) comments on the Day 2/Day 3 portion of the examination are found in Part A of the CFE Report. Similar information on Day 1 JRP simulations (Version 1 and Version 2) can be found in Part B of the CFE Report.

The intent of this message from the BOE is to help candidates improve their performance on future CFEs by drawing their attention to the most common detracting characteristics observed in candidate responses to the September 2024 CFE. The BOE's comments are based on the feedback of the marking teams, who see the entire candidate population, and reflect the broad themes noted by the markers that apply to all candidates who wrote this sitting of the CFE. More detailed AO-by-AO commentary on candidates' performance can be found in the BOE's comments in Appendix F of Part A, or Appendix H of Part B, of the CFE Report.

Nature of the CFE

The design of the CFE is such that each day of the examination allows candidates to demonstrate a different skill set. Day 1 allows candidates to demonstrate their high-level professional skills, such as analysis that is relevant and critical to strategic decision-making, professional judgment, and ability to synthesize information. Day 2 allows candidates to demonstrate their technical competence in the common Financial Reporting and Management Accounting competencies and in their chosen role, which is tied to one of the four elective areas. Day 2 typically, but not always, directs candidates to the work to be done and is not designed to be time constrained, allowing candidates to demonstrate depth. Day 3 allows candidates to further demonstrate depth and breadth in the common Financial Reporting and Management Accounting competencies, and provides multiple opportunities to demonstrate breadth in all the other core technical competency areas. Day 3 is typically time constrained, requiring candidates to prioritize the issues and manage the amount of time spent on each issue.

Both Day 2 and Day 3 require candidates to integrate the information found in the simulation in order to demonstrate competence. All three days require candidates to clearly communicate their thought process.

Strengths and Weaknesses

Time management

Overall, candidates demonstrated good time management skills. The Day 1 simulation was not time constrained in any way and, generally, the amount of time that candidates devoted to their situational analysis and their issue analysis was appropriate. Most candidates were able to address all the strategic alternatives presented, spending more time on the alternatives that required more analysis and discussion. The Day 2 simulation was also not time constrained, and most candidates managed their time appropriately on Day 2, attempting all the AOs and appropriately balancing their time between the common section and the role section. On Day 3, which is designed to be time constrained and required time management on the part of the candidates to ensure that all three simulations were completed within the four hours allotted, candidates seemed to be able to plan their time accordingly.

Unrelated discussions

The BOE was pleased to see that there were relatively few unrelated discussions on this exam. Candidates addressed the requireds and generally did not provide any analysis that was not necessary.

Technical ability

The pattern the BOE has seen for the past few CFEs has continued, with candidates generally avoiding or struggling with the complex topics. Candidates appeared to be more comfortable with the more common, straight-forward technical topics that were tested at the Core level.

Candidates generally performed well on these AOs: Day 2, Common, AO#2 (Lease), AO#4 (Cash budget), and AO#6 (Café pilot project); Day 2, Assurance role, AO#10 (Procedures — accounting issues); Day 2, Finance role, AO#7 (Capitalized earnings valuation) and AO#8 (Financing); Day 2, Performance Management role, AO#8 (Focus on online segment); Day 2, Taxation role, AO#7 (CCA), AO#8 (Taxable income, quantitative), and AO#11 (Employee benefits); Day 3, Simulation 1, AO#2 (Federal corporate taxes payable), AO#3 (Algorithm licensing agreement risks), AO#4 (Financing options), AO#5 (Intangible assets — algorithm), and AO#7 (CEO strategic fit); Day 3, Simulation 2, AO#1 (Revenue recognition) and AO#5 (Investment options); and Day 3, Simulation 3, AO#2 (Strategic fit of current operations), AO#4 (GST system and compliance), and AO#5 (Audit plan). Many of these AOs contained topics that are regularly tested on the CFE.

However, on certain of the remaining AOs, particularly on the Day 2 role AOs that are tested at the Elective level, there was more variability in the quality of the responses, with some candidates demonstrating a very poor understanding of the required technical knowledge. For example, on Day 2, Assurance role, AO#13 (MD&A), candidates seemed to struggle to provide commentary that aligned with the auditor's role and responsibilities in relation to the MD&A. On Day 2, Finance role, AO#11 (Lease-versus-buy NPV), many candidates did not perform an NPV and only looked at the total or first-year costs. On Day 2, Finance role, AO#13 (Distribution alternatives), candidates provided generic discussions and often focused on only one specific issue, demonstrating a lack of understanding of alternatives presented. On Day 2, Performance Management role, AO#7 (Divisional income statement), candidates often allocated the expenses, but their allocations did not sum up to the total expenditures. On Day 2, Performance Management role, AO#11 (Membership program), candidates typically missed the gross margin on additional sales of books and magazines and incorrectly determined the costs associated with running the program. On Day 2, Taxation role, AO#13 (GST/HST), candidates demonstrated weak technical knowledge of the GST/HST concepts related to employee benefits.

Candidates should expect to see a variety of issues of varying difficulty. The BOE encourages candidates to be balanced in studying and ensure they have a sufficient level of technical knowledge in all competency areas outlined in the CPA Competency Map, at the level it is expected to be tested at (i.e., Core or Elective). The BOE would also like to remind candidates that the expectations differ on the Day 2 role AOs, which are tested at the Elective proficiency level. These expectations are higher than those of the remaining AOs on the exam, which are tested at the Core proficiency level. Given that all roles are equated, the BOE strongly encourages candidates to select their Day 2 role carefully and to consider their ability to respond to that competency area at the Elective proficiency level.

Failure to consider the specific context of the simulations and integrate the information provided

Consistent with previous CFEs, and the main weakness noted by the BOE on this sitting, candidates on the September 2024 exam seemed to struggle with applying the specific context of the simulation to their response and integrating the information provided to them. For example, on Day 2, Common, AO#1 (Business combination), candidates typically only used the case fact of 100% ownership to discuss whether a business had been acquired, neglecting other case facts that could have been used in the analysis. On Day 2, Common, AO#3 (Lawsuit), many candidates did not discuss the conditions that existed after year end, even though there were clear case facts describing the situation. On Day 2, Assurance role, AO#7 (RSU plan), candidates recognized the correct Handbook section to use but struggled to apply the guidance to IBL's specific situation. On Day 2, Assurance role, AO#9 (Planning analytic), candidates calculated the variances but could not use case facts to analyze them appropriately. On Day 2, Performance Management role, AO#12 (Online segment incentive compensation plan), candidates were unable to apply a case-specific formula using specific case facts for the bonus calculation. On Day 2, Taxation role, AO#12 (Shareholder loans), candidates struggled to recognize specific case facts that differentiated the different loans. On Day 3, Simulation 1, AO#1 (Budget variance), candidates calculated the variances but had difficulty applying case facts to quantify the reasons for the variances. On Day 3, Simulation 2, AO#4 (Control weaknesses), candidates struggled to identify specific weaknesses within the process description provided, often not understanding the actual weaknesses presented.

The BOE emphasizes that the ability to adapt to unique scenarios and to integrate information from various parts of the case are important skills for an entry-level CPA. Candidates should ensure they have a good understanding of the specific context for any requests before addressing them and that any analyses performed incorporate elements specific to the case presented.

For more detailed commentary, see Appendix F of Part A of the CFE Report.

Additional Comments Specific to Day 1 — API (Version 1)

Most candidates dedicated the first section of their response to a relevant situational analysis. Most used this information later in their response, making relevant links back to the company's global situation when analyzing the specific strategic alternatives that were presented, and within their conclusion. However, the links that weak candidates made were typically to the more obvious case facts related to API's key success factors, mission, and vision, rather than to the more important factors, such as the decline in performance of API's two largest parks or the divergent preferences of young adults and API's most loyal customer demographic, parents with young families.

In the simulation, API had a \$9 million loan repayment that was due within five months. In addition, API only had \$1 million of cash on hand and no access to further debt financing. Given this significant financing constraint, candidates were expected to discuss how API could approach repaying the loan. In addition, API's main objectives were to increase the company's operating income, increase the number of visitors to API's parks and attractions, and make investments with the highest growth potential. Candidates were expected to integrate the critical elements of the company's broader situation and objectives within their qualitative and quantitative analyses of each strategic alternative.

There were four strategic alternatives to be analyzed in this case: whether to sell Magical Land to a Vancouver land developer, Beacon Builders; whether to enter into a licensing agreement with a well-known movie producer, Pioneer Pictures; whether to sign a leasing agreement with Pixel and open an arcade at Magical Land; and whether to develop a new Great Bear VR experience or sell the existing Arctic VR experience.

Within the analysis of the major issues, three main factors differentiated strong responses from weak responses. First, a strong response identified and provided an in-depth discussion on the most important decision factors for each issue. Weak candidates tended to list case facts, often failing to explain why those elements were important and how they affected the decision-making process. Second, strong candidates provided valuable quantitative analyses to help support their recommendations (such as by linking their calculations to the stated objectives of API). On the other hand, many weak candidates' quantitative analyses were unstructured and unclear and, therefore, challenging to follow. Many weak candidates also failed to perform the correct calculation to adequately assess each issue. These candidates often struggled to explain how the results of their quantitative analyses affected the decision at hand. Third, strong candidates routinely linked their analysis of each alternative to the prevalent entity-level issues presented in the case: the upcoming loan repayment, API's objectives, and the important considerations in the overall environment, such as the different demographics. Strong candidates incorporated these aspects into their discussion of each strategic alternative, whereas weak candidates either missed making these links altogether or provided a superficial discussion that failed to adequately highlight the significance of these aspects in relation to each of the strategic decisions that needed to be made. Strong candidates clearly outlined how API should address the upcoming loan repayment and then provided logical and supported recommendations, ensuring their proposals did not conflict with any mutually exclusive alternatives that API was considering.

Weak candidates tended to only perform an issue-by-issue analysis, without stepping back to consider the broader perspective and without integrating the key entity-level issues into their conclusions. As a result, they failed to make important links between the various aspects of each alternative, such as recommending that incompatible strategic alternatives be pursued together. Some weak candidates ignored the loan repayment entirely in their overall recommendation.

Most candidates approached their response in a coherent and organized fashion. Only a few candidates struggled to effectively communicate their ideas. These candidates tended to use poor sentence structure, confusing syntax, and an unorganized approach to their response.

Additional Comments Specific to Day 1 — JRP (Version 2)

As with API Version 1, most candidates dedicated the first section of their JRP response to a relevant situational analysis. Most used this information later in their response, making relevant links back to the company's global situation when analyzing the specific strategic issues that were presented, and within their conclusions.

One of the main situational factors to consider was the industry's supply chain issue and the uncertainty surrounding it. In addition, given JRP's continued decline over the past several years, the board's objectives are to increase the company's net income and to prevent the continued decline of the company's existing pet stores. JRP only had \$5 million of cash available for strategic investment, with no access to any further debt financing. Candidates were expected to integrate these critical elements of the company's broader situation into their analysis of the major issues.

There were five strategic alternatives that candidates were expected to analyze both qualitatively and quantitatively: whether to invest in a manufacturing facility and produce JRP-branded dry dog food; whether to expand e-commerce operations and acquire three fulfilment centres across Canada; whether to acquire 20% of BWF, a small manufacturer of premium pet food; whether to sign a purchase agreement with Koda and begin to sell JRP-branded pet supplies; and whether to engage PSC and invest in the development of a custom mobile application.

Similar to responses to API Version 1, strong candidates recognized and discussed the most important decision factors for each issue, provided valuable quantitative analyses, and linked their analysis to the significant entity-level issues presented in the case. Strong candidates tended to consider the supply shortage throughout each of their issue-by-issue discussions and within their conclusions and overall recommendations. These candidates also recognized that there were interrelationships between the various strategic alternatives. For example, strong candidates recognized that it made sound strategic sense for the company to acquire 20% of BWF if it also decided to invest in the manufacturing facility, given the benefits that BWF would likely bring to that new aspect of JRP's business.

One of the main differentiating factors between strong and weak candidates was the ability to identify and discuss in depth the most relevant aspects of each strategic alternative presented as part of their analysis. Weak candidates' analyses tended to focus on the minor implications. For example, for the e-commerce alternative, many weak candidates focused their analysis on the fact that e-commerce would make it a challenge for the company to provide its customers with strong customer service. While this is relevant, the more pertinent implication was that this compromise may be necessary to ensure JRP is keeping up with its competitors. Many weak candidates also did not step back and consider the entity-level issues within their analysis of the strategic alternatives.

As was the case with API Version 1, only a few candidates struggled to effectively communicate their ideas. These candidates tended to use poor sentence structure, confusing syntax, and an unorganized approach to their response.

APPENDIX A

**EXAMINATION DESIGN, MARKING GUIDE DEVELOPMENT, AND MARKING
OF THE COMMON FINAL EXAMINATION**

CFE DESIGN

Day 1 is one four-hour case that is linked to the Capstone 1 case, which is worked on in groups for eight weeks prior to the CFE. When writing the Day 1 case, candidates are allowed access to their Capstone 1 case but not their group's answer or any sample response. The Day 1 case is designed to assess the enabling (professional) skills. Candidates are directed to target a "board room and senior management" level of discussion, with high-level analytics and a strategic focus. There are typically two versions of the Day 1 case. Candidates pre-select the version they will write.

Day 2 is one case designed to be completed by an average candidate in three and one half hours that candidates are given five hours to respond. The extra one and one half hour gives candidates time to filter and find the information that they need to answer *their* role requirements from within the common information presented. Day 2 is designed to assess the technical competencies in **depth** (Level 2 and Level 3). Candidates pre-select a role (Assurance, Finance, Performance Management, or Taxation). All candidates work with the same case — it has a common section and four sets of appendices containing additional information applicable to each of the four unique roles. The required tasks, regardless of the role, are clearly directed unless there is an undirected/enabling issue in the case that the board expects candidates to identify on their own. Day 2 evaluates the competencies listed in the *CPA Competency Map* mostly in the Elective area in **depth** and in common Financial Reporting and/or Management Accounting areas in **depth** and **breadth**. The role **depth** test (Level 2) may also include coverage of other competency areas from the common core.

Day 3 is a four-hour examination containing a mix of small cases that evaluate the common Core competencies only. While the minimum allowable time for any one case is 45 minutes and the maximum is 90 minutes, historically the cases have ranged between 60 to 90 minutes. The Day 3 cases provide additional opportunities for **depth** and **breadth** in Financial Reporting and Management Accounting and **breadth** opportunities for all the other technical competency areas. Cases are time constrained and are designed to cover different competency areas within each case. A higher level of integration and judgment is required on Day 3 of the CFE than in the Core modules, although the technical competencies are tested at the common core level of expectation.

The assessment opportunities on the Day 2 case are given mark values such that each of Day 2 and Day 3 is weighted equally.

THE DEVELOPMENT OF MARKING GUIDES AND THE PROVINCIAL REVIEW CENTRE

Prior to the CFE being published, provincial reviewers, appointed by each region, meet to examine the simulations and the preliminary marking guides. The provincial reviewers' comments are then considered by the board when it finalizes the examination set and again when the leaders and assistant leaders review the marking guides in the context of actual responses at the Preliminary Evaluation Centre.

THE SEPTEMBER 2024 CFE EVALUATION CENTRE

The September 2024 CFE Evaluation Centre was run with both in-person and remote components. Approximately 200 individuals were chosen from the pool of applicants to participate in the CFE Evaluation Centre. The marking was supervised by the CPA Canada full-time CFE professional staff, with oversight by the CFE subcommittee vice-chair, and the chair of the BOE.

In advance of the marking centre, the members of the CFE subcommittee, staff, leaders, and assistant leaders participated in a three- to six-day preliminary evaluation centre (PEC). Participants reviewed the marking guides, applied them to randomly selected candidate responses, and made necessary revisions to the marking guidelines, taking into account the comments on the marking guides received from provincial reviewers.

The larger teams followed a set marking centre schedule, which included a start-up phase to train the markers. During the start-up phase, the leaders and the assistant leaders presented the marking guides to their teams, while staff and the BOE vice-chair monitored the discussions. The teams undertook a two-phase test-marking procedure prior to actual marking. Phase one consisted of marking guide familiarization, during which markers applied the marking guide to copies of candidates' responses and collectively reviewed their results. Phase one thus ensured that all markers understood the issues in the marking guide and the basis on which to apply each expectation level. Phase two consisted of an expanded test marking of several responses to establish marker congruence.

After the training and test-marking phases, and only when marker congruence was achieved, live marking commenced. All larger teams had a leader, and anywhere from one to four assistant leaders, and had both French-speaking and English-speaking markers. Each team had one or more markers who marked in both languages.

For smaller teams, all markers attended PEC, and moved directly from PEC to live marking. These teams had a leader, and two to three experienced markers, of which two were bilingual and marked all the French papers. These bilingual markers started in English and switched to marking in French once their marking was assessed as being consistent with the team. The bilingual markers arbitrated the French papers by discussing where there were differences in their markings.

The board strives for the highest possible marking consistency and quality control. Leaders and assistant leaders, therefore, devoted much of their time to cross-marking and other monitoring activities. Control papers were fed into the system daily to check marker consistency. Markers' statistics were reviewed to ensure that marking remained consistent throughout the centre. Based on analysis of the statistics, leaders reviewed and, if necessary, re-marked papers to ensure that the assessment opportunities were marked fairly for all candidates. Bilingual markers marked papers in both languages, and their results were compared to ensure that the marking was consistent in both languages. Additional audits were performed at the end of marking on any of the larger differences between markers.

BORDERLINE MARKING (DAY 1)

Each candidate's paper was marked once. All candidates' responses that were assessed as clear fail, marginal fail, or marginal pass were marked a second time by the team leader, an assistant team leader or a senior marker. Clear pass results were also audited to ensure accuracy of marking.

DOUBLE MARKING (DAY 2)

Each candidate's Day 2 paper was marked independently by two different markers. If the two initial markings differed on any assessment opportunity, an arbitrator (the leader, an assistant leader, or a senior marker) compared the two initial markings and determined the final assessment.

As an added measure to ensure that markers were consistently applying the marking guide, a two-day rule exists, which results in the second round of marking not beginning until two days have elapsed since the first marking. Adherence to this rule ensures that any movement in the application of the guides due to marker interpretations during the first two days of live marking are stabilized before the second marking and arbitration process begin.

BORDERLINE MARKING (DAY 3)

Day 3 was marked using a borderline model. All Day 3 responses were marked once, and then the Day 2 and Day 3 results were combined. All failing candidates who passed the Day 2 role test, had their Day 3 response marked a second time by an independent marker, and any differences between the first and second markings were arbitrated by a leader or senior marker.

SUBSEQUENT REQUEST FOR REMARK OF RESULTS AND REQUEST FOR PERFORMANCE ANALYSIS

Failing candidates may request a remark of their examination results and/or a detailed, personalized performance analysis for either Day 1, or Day 2 and Day 3 combined, or for all three days.

In an effort to provide failing candidates with more timely feedback, the Board of Examiners is providing an automated feedback report for Day 1 of the CFE. The report is automatically generated using the marking data collected for each response rather than being based on a personalized review of the response and is being provided at no cost to all failing candidates. This report is intended to allow for the identification of the key deficiencies in the candidate's Day 1 response, which then allows the candidate to decide whether to request the more detailed, and personalized performance analysis report noted above, for a fee.

Remarking of Results Approach

Great care is exercised in the original marking and tabulating of the papers and results. The following procedures are applied to all three papers constituting the CFE.

Under the supervision of the chair of the Board of Examiners and of CPA Canada CFE staff, the responses are reviewed by the leaders and assistant leaders who did the original marking. The leaders and assistant leaders read the responses and compare them to the marking guides used at the marking centre. In reviewing candidates' results, two aspects are considered. First, it must be determined that the basis of marking the papers has been consistent with that accorded other candidates who wrote the examination. Second, all responses reviewed are subjected to a careful check to ensure that the markers have indicated that consideration has been given to all material submitted by the candidate.

The results are tabulated and a decision made as to whether any candidates have been treated unfairly and should be granted a pass on the examination. The results are then forwarded to the provincial bodies for notification of the candidates.

APPENDIX B

SEPTEMBER 10, 2024 – DAY 1 SIMULATIONS

COMMON FINAL EXAMINATION
SEPTEMBER 10, 2024 – DAY 1

Case (API-Version 1)

(Suggested time: 240 minutes)

It is March 24, 2026, and you, CPA, are still working at Richmond, Lawrence & Co. LLP (RLC). Amuzu Parks Inc. (API) has again engaged RLC to assist with its strategic analysis and planning.

In 2024, API decided to invest with Arctica Outerwear Company (AOC) to develop the 4D virtual reality (VR) Canadian High Arctic Immersion Experience (Arctic VR experience) in downtown Winnipeg. The attraction uses VR to provide customers with an immersive virtual tour of the Canadian Arctic. Initial development proved more costly and time-consuming than originally planned. Despite the initial challenges, the attraction has been a huge success since opening in December 2025. Reviews from customers have been overwhelmingly positive, and the earnings have surpassed API's expectations. API did not move forward with any of the other potential strategic investments considered in 2024.

Since 2024, the performance of API's two largest amusement parks, Magical Land and Aqua Bleu Parc, has declined. This is partially due to API's inability to reinvest in its parks and introduce new, attractive rides. Many of API's competitors, which are large multinational companies with access to more investment capital, have made significant investments, to update their parks with the most advanced high-tech thrill rides. This has led to a drop in the number of API's visitors, given that some are choosing to go to more advanced parks instead.

Over the next several years and beyond, the popularity of high-tech attractions is expected to continue to increase. This increase in popularity has resulted in a steep increase in competition, since many companies are making significant investments in new technologies that harness the power of VR and augmented reality. However, there is also a growing demand among parents with young families for low-tech, family-friendly alternatives that encourage outdoor time and do not involve increased screen time.

API has not changed its vision, mission, or core values, which were established in 2021.

At present, API is faced with the considerable challenge of repaying a \$9 million loan to R&W Bank (R&W), which is due in roughly five months (August 2026). API planned to repay the loan sooner but was unable to, given the cost overruns associated with the development of the Arctic VR experience. API currently has \$1 million cash on hand, and no access to further debt financing.

API's Board of Directors agreed that, for any new strategic investments, the company's main objectives are to increase operating income and to increase the number of visitors to its parks and attractions. In addition, the board prefers investments that provide API with the highest growth potential.

API's board has asked you, CPA, to review the information provided and draft a report that discusses API's main strategic considerations, and includes a strategic analysis and recommendation for each proposal presented. For this engagement, ignore any tax implications within your analysis and recommendations.

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APPENDIX I
BOARD MEETING WITH CPA IN ATTENDANCE

March 24, 2026

Jacob: Thank you for joining us today, CPA.

API is facing several tough decisions. Not only is the performance of our two biggest parks on the decline, but we must also figure out how to repay the R&W loan that is quickly coming due. The decisions we make now will determine the future of this company.

On the bright side, our new Arctic VR experience has been a huge success since its launch.

Kenneth: That's right, Jacob. Although it took a bit longer than expected to develop the new attraction, it is clearly a hit. There is a huge demand for this type of attraction, and the market is quickly growing. I think API should align with this trend and further invest in immersive VR technology.

On that note, I have invited Lawrence from AOC to join us toward the end of today's meeting, to introduce an exciting new investment opportunity that will help API build on the initial success of the Arctic VR experience.

Natalie: I appreciate your enthusiasm, Kenneth, but how can we consider a new investment when we don't even have the necessary funds to repay the R&W loan?

Jacob: That's a good question, Natalie. I think now is a good time to discuss the recent offer we received from a Vancouver land developer, Beacon Builders (Beacon), to purchase the land that Magical Land sits on. They are willing to pay \$30 million for the property. By selling the land, we would have enough money to repay R&W and still have plenty left over for reinvestment.

Terri: Magical Land is API's flagship amusement park and our biggest earner. How can we consider selling it? Besides, we haven't exhausted our options for improving its performance.

APPENDIX I (CONTINUED)
BOARD MEETING WITH CPA IN ATTENDANCE

March 24, 2026

Kenneth: I understand it's uncomfortable to consider, but selling Magical Land seems like our best option, given that the area surrounding Magical Land is developing quickly and the value of the property has never been higher. As well, the development around the park has brought many new residents to the area, and some have filed noise complaints against the park. Other residents have complained about the traffic going to and from Magical Land. As the neighbourhood grows, I expect these complaints to only get worse. This could result in bad publicity for the API brand.

Terri: I see it a different way. Many of the new residents are young families—the demographic our recent visitor survey identified as API's most loyal customers. I expect that many of them will visit Magical Land, which will help improve the park's performance. As well, although we have received complaints, based on our discussions with the city authority, we have done nothing wrong and are operating well within all the applicable bylaws. In my view, a few complaints are no reason to sell our flagship park.

Jacob: It's not just the complaints, Terri. To turn the performance of Magical Land around, we need to make a significant reinvestment in the park and its attractions. Not only have we already fallen behind our competitors in this respect, but we don't have the necessary funds to introduce the high-tech thrill rides that are most in demand. The fact is that Magical Land can no longer effectively compete with the more advanced technologies our competitors have introduced.

Terri: Again, I see it differently. With all our competitors so focused on introducing high-tech thrill rides and attractions, not many options remain for people who want a traditional amusement park experience with classic rides that are fun for the whole family—something API has always excelled at.

As well, the cost to purchase low-tech, classic rides is declining because many amusement parks are selling theirs to replace them with newer, more advanced rides. This offers API the ability to introduce new rides at a reduced cost. Even better, the ongoing cost to service and maintain this type of ride is far lower than the more advanced thrill rides.

APPENDIX I (CONTINUED)
BOARD MEETING WITH CPA IN ATTENDANCE

March 24, 2026

Kenneth: That could be the case, but how can we ever expect API to grow if we only rely on amusement parks? We might be able to improve our existing attractions, but we will never be able to afford to open a new park. Real estate costs are simply too high.

Natalie: I agree with Terri. We still have options for improving the performance of our existing parks. For example, we could offer family-oriented seasonal events. We could also consider taking on a new licensing or sponsorship agreement.

Terri: Actually, we recently received an offer from Pioneer Pictures (Pioneer), a large and well-known movie producer, which wants to enter into a licensing agreement that will involve all our existing amusement parks, starting with Magical Land.

Jacob: Sounds interesting. Tell us more.

Terri: Pioneer will be releasing a new children's movie toward the end of this year and wants to promote it in our parks. Pioneer's offer has three main facets. First, it will build a new ride at each of our five parks, based on the new movie. These won't be high-tech, advanced thrill rides, but instead, more traditional rides designed for the whole family. Second, Pioneer requires API to sell merchandise for the movie at each of our parks. Third, Pioneer will introduce costumed characters attached to the movie during the main phase of the movie's marketing campaign.

Natalie: Pioneer is a household name. This is a great opportunity. How much of an investment would this require from API?

Terri: That's one of the best parts. The upfront cost is very low—only \$200,000. This is the cost of renovating Magical Land's existing merchandise shop to make way for Pioneer's merchandise. Pioneer will be responsible for the cost of the rides introduced.

APPENDIX I (CONTINUED)
BOARD MEETING WITH CPA IN ATTENDANCE

March 24, 2026

Kenneth: A children's movie won't help us retain the young adults who visit our parks. Does the agreement come with any restrictions?

Terri: It does. First, the agreement includes all five of our parks, so for the duration of the agreement, we won't be able to sell any of them. Second, because Pioneer will attach its brand name to our parks, it must approve any major changes to our parks' themes, to ensure that they remain in alignment with Pioneer's values and brand image.

Kenneth: It sounds like we would be giving up too much control over the direction of our company. And what if this movie isn't successful? I don't want to link API's name to an unpopular product.

Terri: Pioneer has a strong history of putting out popular, family-friendly movies that are both entertaining and educational, and its values align well with API's.

Jacob: Even if the movie isn't a blockbuster, just the addition of a new ride would entice people to return to our parks.

Terri: I agree, Jacob. And I haven't even mentioned yet that Pioneer wants this licensing agreement to extend beyond its upcoming movie release to include other future movies. For each new movie that Pioneer advertises within our parks, API will get more new rides and additional merchandise to sell.

Natalie: Sounds like a great opportunity. Speaking of which, I want to introduce another idea for how we could boost the performance of our existing parks. As we know, arcade games have always been popular, and this trend has shown no sign of slowing down.

With that in mind, Pixel Play Inc. (Pixel) provides a leasing service for a wide range of arcade games. From classic games released decades ago to brand new games and advanced simulators, Pixel has an incredible selection. We could choose the games that best fit what our visitors want.

APPENDIX I (CONTINUED)
BOARD MEETING WITH CPA IN ATTENDANCE

March 24, 2026

Jacob: What's the upfront cost? And are there any restrictions built into the agreement?

Natalie: It would have an upfront cost of around \$5 million to introduce an arcade at Magical Land. In the future, if the initial arcade proved successful, we could introduce them at the rest of the parks for a similar cost. In terms of restrictions, there aren't any, besides the fact that we would agree to only use games we lease from Pixel within our arcades.

Kenneth: I don't see how this offers API a strong growth opportunity. We might see a minor increase in the company's earnings, but how does this position the company for future growth? Arcades are certainly popular, but if we are going to revive this company's future, we need to think bigger. As well, there's nothing to stop other arcades from opening up in the surrounding area, so this investment wouldn't provide API with a competitive advantage.

Terri: I don't agree, Kenneth. Our research shows that our visitor numbers would go up by about 5% at each park with an arcade. That's a significant increase!

Kenneth: That could be, but why would we limit ourselves to only Pixel's games? With all the new high-tech advancements, it makes more sense to remain flexible so we could introduce whatever games we want without restriction.

Natalie: The lease agreement with Pixel offers significant advantages. For example, Pixel would maintain and repair all the games within our arcades. As well, the agreement is flexible, in that every three months, API can replace whatever games we want with something else from Pixel's warehouse. This ensures that the arcade would remain fresh and exciting for our visitors.

Kenneth: If you want fresh and exciting, then I have just the thing. Let's invite Lawrence from AOC into the meeting.

Lawrence joins the meeting via telephone.

APPENDIX I (CONTINUED)
BOARD MEETING WITH CPA IN ATTENDANCE

March 24, 2026

Jacob: Lawrence, it's great to have you with us. Congratulations on the initial success of the Arctic VR experience.

Lawrence: Thanks, it's an exciting time!

Kenneth: Lawrence, please introduce your idea.

Lawrence: Okay. Based on the success of our Arctic VR experience, my plan is to develop another attraction, using an upgraded version of the immersive technology. This attraction will showcase Canada's famous Great Bear Rainforest and the incredible variety of wildlife that inhabits it. I have many close friends who live in that area. With their knowledge plus our new immersive VR technology, this will be a truly one-of-a-kind experience!

Kenneth: But that's not all. There is also the opportunity to license the technology to other companies that wish to offer immersive experiences.

Lawrence: That's right. As part of this investment, our intention is to upgrade the technology so it can accommodate other types of immersive VR experiences without the need for costly hardware changes. Once upgraded, the technology could be used to transport people into all sorts of unique environments. It's not just nature tours—the upgraded technology could also be used for immersive musical and sporting experiences.

Kenneth: We already have the VR production team and engineers needed to begin the technology upgrade and design the new Great Bear VR attraction. All they need is funding to get started. API will need to contribute \$20 million to the upfront cost.

APPENDIX I (CONTINUED)
BOARD MEETING WITH CPA IN ATTENDANCE

March 24, 2026

Lawrence: Yes, and our team can use what we learned from the first attraction to make this one even better.

I should mention that a private equity company also wants to invest in the technology. So far, I have declined their offer because I prefer to work with API. Also, the same private equity company has expressed interest in buying API out of the Arctic VR experience for \$15 million, if you want to divest from the technology entirely.

Let me know one way or another, as we are eager to get started.

Lawrence leaves the meeting.

Terri: This sounds risky to me. If we move forward with this, API's future will rely heavily on the success of this technology. I think we should stick to what we know best—amusement parks.

Kenneth: But the technology has already proven successful, and Lawrence has proven himself highly capable. Because we could eventually license the technology to other companies, this investment offers API an opportunity for incredible growth.

Terri: What about the other companies that are making investments in new entertainment technologies? With how quickly technology changes, I fear API won't be able to keep up.

Kenneth: That's why we need to move quickly on this opportunity, to ensure that our technology is the one other entertainment companies use for their own immersive experiences. But even if that doesn't happen, the Great Bear VR experience is an almost guaranteed success. It's a bold move, but that's exactly what API needs right now.

Jacob: Wow, there's lots to consider, with these opportunities and the upcoming loan repayment. CPA, we look forward to reading your report. Meeting adjourned.

APPENDIX II SURVEY RESULTS

Prepared by Terri

Based on a recent survey conducted with API's current and former season pass holders, we discovered a number of common themes:

- API's customer service, park cleanliness, and ride safety consistently rate very well.
- API's parks remain a popular choice for families seeking a stress-free, enjoyable outdoor experience for their children. Parents particularly appreciate API's classic rides and attractions, which provide a refreshing alternative to screen-based entertainment, such as social media and video games.
- On the other hand, API's parks have become less popular with young adults who wish to experience the latest advancements in technology-driven attractions, which API currently does not offer at any of its outdoor parks. Young adults also listed thrill rides and arcades as their preferred types of attraction.
- Visitor numbers at API's parks have declined, mainly because the rides and attractions have not changed in the last two years. For parents with young children, this means their children are less excited to visit the parks because there is nothing new for them to experience.
- API's brand is most closely associated with classic amusement parks that provide outdoor fun for the whole family.

APPENDIX III POSSIBLE SALE OF MAGICAL LAND

Prepared by Jacob

Based on our research, an amusement park such as Magical Land should sell for at least three times its operating income. In addition, because the amusement park would be sold to a land developer that plans to build residential housing on the land, API could either sell the rides or redistribute them to its other existing parks.

Magical Land's Financial Information from 2025:

	2025	
Number of visitors	770,285	
In-park spending per visitor:		
Admission price	\$ 28.00	
Food and beverage	\$ 10.20	
Merchandise	\$ 4.75	
Revenues		
Ticket sales (admission)	\$ 21,567,980	
Food and beverage sales	7,856,907	
Merchandise sales	3,658,854	
Total revenue	33,083,741	
Expenses		
Variable operating expenses	16,175,985	75% of ticket sales revenue
Fixed operating expenses	4,550,900	
COGS: Food and beverage	2,357,072	30% of food & beverage sales
COGS: Merchandise	1,097,656	30% of merchandise sales
Total expenses	24,181,613	
Operating income	\$ 8,902,128	

In the first two months of 2026, the number of visitors has dropped slightly compared to the same period in 2025. This downward trend is expected to continue until API is able to offer new rides and attractions that will entice more people to visit.

APPENDIX IV LICENSING AGREEMENT WITH PIONEER PICTURES

Prepared by Terri

Extracts from Pioneer's licensing agreement are as follows:

- The agreement's term is five years, with the option to extend for an additional five years if both parties agree.
- Either party must pay a penalty if the terms of the agreement are violated.
- API must submit a quarterly earnings report for its sales of Pioneer's merchandise, which Pioneer reserves the right to audit.
- API will be entitled to half the profit from the sales of Pioneer's merchandise.
- API cannot enter into any licensing agreement with another movie producer throughout the life of the agreement.
- Pioneer cannot license its name or movies to any other entertainment companies that operate within the same provinces as API.

Based on my research, I am confident that, if we agree to the licensing agreement, our existing parks will attract more visitors. For example, I expect that Magical Land's number of annual visitors will increase by 30% relative to the park's current level of visitors, and then remain at that increased level over the duration of the agreement. I also expect that Magical Land will sell \$6 million of Pioneer's merchandise annually. One drawback to offering Pioneer's merchandise is that sales from our existing merchandise will likely fall by nearly 65%, given that many visitors will choose Pioneer's merchandise over what we currently offer.

APPENDIX V
INVESTMENT IN MAGICAL LAND ARCADE

Prepared by Natalie

The upfront investment includes a \$2 million cost to construct the building that will house Magical Land's arcade, and an initial \$3 million fee paid to Pixel. Once the arcade is up and running, API will pay Pixel \$500,000 annually to lease the arcade games, as well as 10% of the revenue earned by the games.

The arcade games are token-operated, and visitors will be charged a small fee to play each game. This is expected to generate \$3.5 million in annual revenue. The arcade's variable expenses are estimated to be 12% of revenue, and fixed annual expenses are estimated to be \$450,000. The cost of capital is 16%.

The initial term of the contract with Pixel will be five years; however, API will have the option to extend the contract for an additional five years without needing to pay the \$3 million upfront fee again.

APPENDIX VI
INVESTMENT IN NEW IMMERSIVE VR EXPERIENCE

Prepared by Kenneth

The total cost of the technology upgrade and development of the Great Bear VR experience is estimated to be \$30 million. API will contribute \$20 million, and AOC will contribute \$10 million. Based on this split in upfront investment, API will earn 67% of the income generated by the new attraction, which is expected to have a useful life of five years and a salvage value of \$3 million.

The attraction is expected to generate \$20 million in annual revenue, and will have variable expenses equal to 35% of revenue, and a fixed annual expense of \$2.25 million. The cost of capital is 16%.

Note from Jacob:

An independent valuator assessed the current value of the Arctic VR experience. They concluded that, based on the expected operating income of \$5.2 million that API will earn from the attraction in 2026, the \$15 million offer that API received to sell its portion of the project is fair and reasonable.

**COMMON FINAL EXAMINATION
SEPTEMBER 10, 2024 – DAY 1**

Case (JRP-Version 2)

(Suggested time: 240 minutes)

It is July 15, 2025, and you, CPA, are still working at Quinton and Sparks Consulting LLP (QSC). J.R. Pets Inc. (JRP) has again engaged QSC to assist with JRP's strategic analysis and planning.

Since QSC's last engagement with JRP in 2023, JRP's Board of Directors has remained hesitant to make any major strategic investments. Rather than expand, JRP's board has remained focused on securing the stability of the company's existing 20 pet stores. As a result, JRP's board decided against the acquisition of Bella's Pet Friends Ltd., and did not provide the loan to Osler Farms Pet Kitchen Ltd. The potential investment in the premium dog camp, Bonheur des Animaux au Lac Agathe, was also declined. However, the board decided to renovate five of the company's pet stores to allow for more pet services. Although some of JRP's customers appreciated the new pet services that became available, the overall impact to JRP's bottom line was small, so the board decided against converting the company's remaining 15 stores.

Also, since 2023, the number of sales that JRP has made through its website has continued to increase. Although the online store was introduced by necessity during the global pandemic, it has become increasingly popular with some of JRP's customers.

In March 2025, a new shareholder and board member, Abby Clarke, joined JRP. Abby is a long-time JRP customer who inherited a significant sum of money. She sees a lot of potential in the pet industry and wanted to be part of JRP's team. Before joining JRP, Abby had a long and successful career in e-commerce, where she specialized in logistics. Abby used \$5 million of her inheritance to buy shares of JRP.

For the past several years, JRP's net income has declined slightly from one year to the next. Given this continued decline, the board wants to implement a new strategic plan, to help ensure the company's survival and future success by increasing the company's net income. In addition, the board wants to prevent the continued decline of the company's existing pet stores.

The company's vision, mission, and core values have not changed. JRP currently has \$5 million to invest (the amount received from Abby for her share issuance). No other additional investment capital is available, and JRP has no desire to access any further debt financing. When comparing investments, JRP's board typically uses a five-year time horizon and a discount rate of 4.9%, the company's weighted average cost of capital.

JRP's board has asked you, CPA, to review the information that has been provided and draft a report, in which you analyze and make a recommendation for each proposal presented. The board would also like you to comment on JRP's overall strategic direction and on how each proposal could influence that direction. For this engagement, please ignore any tax implications within your analysis and recommendations.

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APPENDIX I
BOARD MEETING WITH CPA IN ATTENDANCE

July 15, 2025

- Julia: Thank you, CPA, for coming today. JRP is at a critical time. As the performance of JRP's stores continues to decline, a change is needed.
- Elaine: That's right, Julia. And these decisions will be made harder, given the changing conditions within the pet industry. Although our pet stores are still profitable, our income has been squeezed due to increased competition and ongoing supply chain issues that our entire industry has faced since the beginning of the global pandemic.
- Julia: Thankfully, our new shareholder and board member, Abby, has come at just the right time. The decisions made now will affect the business for years to come. Abby, I understand that you want to present an opportunity.
- Abby: Yes, Julia—it involves manufacturing. At present, only a few dry dog foods available on the market offer exceptional quality and nutrition. This represents a significant opportunity, since dry food is the most purchased type of dog food. JRP could get into the manufacturing business and fill the void that currently exists.
- Steve: That sounds interesting, Abby, but manufacturing food involves strict adherence to regulations that we know nothing about. Do we know what's involved in obtaining the necessary licences? Besides, JRP has always focused on selling fresh and frozen foods, which are viewed among pet owners as the most nutritious alternatives.
- Elaine: True, but that's because we've never been able to find a dry food that meets our high standards. That being said, I question whether we would be able to secure the supply of necessary ingredients to manufacture the proposed food. Given the ongoing supply chain issues, our ability to manufacture food is limited by the amount of ingredients we can obtain.
- Abby: Well, I happen to be friends with the owner of a nearby organic farm. She has offered to provide us with a significant supply of high-quality ingredients. From what I can tell, dry dog food made from these ingredients would be some of the best on the market. She currently sells her ingredients to a manufacturer overseas, but that contract is coming up for renewal, and she would rather work with a local company.

APPENDIX I (CONTINUED)
BOARD MEETING WITH CPA IN ATTENDANCE

July 15, 2025

Steve: I am worried, because we have no experience with manufacturing, or the process of developing product recipes, which would create extra challenges.

Richard: Yes, but I really like the idea. We could put our own brand on the product, which would help JRP build recognition. We could also supply other pet stores with this premium dry food.

Elaine: The upfront investment needed to begin this operation is \$3.9 million. With that amount, we would be able to acquire the facility needed, renovate it, and equip it with state-of-the-art manufacturing equipment that could be used for all types of pet food—both dry and fresh.

Richard: Abby, do we know the quantity of ingredients your friend could supply us with?

Abby: Yes. Working with Elaine, we determined that, with the amount of ingredients my friend can provide, we would use approximately 60% of the proposed facility's capacity. Therefore, once we are up and running, we could expand what we manufacture to include many kinds of premium food.

Richard: Sounds exciting! Let's turn our attention to the next investment opportunity.

Our sales via JRP's website have continually increased since its launch in 2022. Regardless, it's clear that we have fallen behind our competitors in this area. Our online ordering system is outdated and hard to use. It's time we upgraded and fully entered the e-commerce world alongside our competitors.

Elaine: Focusing more on online sales would certainly align with market trends. But if we do, we would be competing with the biggest national chains. As a result, we might need to lower our prices somewhat, and that would cause our margins to fall.

APPENDIX I (CONTINUED)
BOARD MEETING WITH CPA IN ATTENDANCE

July 15, 2025

Richard: That's true, but JRP could improve its fulfilment of online sales orders outside our local geographical region. This expansion would allow us to quickly ship our products all over Canada. Our sales would increase significantly.

If we decide to proceed with this investment, the upfront cost is \$4.05 million. With that amount, we would acquire three fulfilment centres across Canada, where our products would be shipped from. Our average delivery time would be reduced from five days to just three. Included in the upfront cost is also the amount needed to upgrade our existing website, to improve its function.

Julia: I like the idea of having dedicated fulfilment centres that are separate from JRP's existing stores. With our current process, our store employees are spending too much time packaging and shipping orders rather than helping in-store customers.

But I worry, because JRP's reputation was built on superior customer service, which is an advantage we have over our competitors. I don't think we can offer our customers the same type of experience online. And although some people do prefer to buy online, we hear from our customers all the time how much they love coming into one of our locations. We still have a strong demand for in-store purchases.

Elaine: And what about the ongoing industry-wide supply constraint? We are already having a hard time stocking our store shelves.

Steve: At some point, the supply chain will be restored to its pre-pandemic level, although experts don't know how long that will take. But it's not like JRP is the only company struggling with this, and we might be able to find other suppliers to help us build our inventory.

Abby: Regardless of the challenges, I think this is a great opportunity. With my background in e-commerce and logistics, I would be able to take the lead on this project. Over time, it could become a cornerstone of JRP's business.

APPENDIX I (CONTINUED)
BOARD MEETING WITH CPA IN ATTENDANCE

July 15, 2025

Julia: Okay. Let's move on. BeWild Foods (BWF) is a small and relatively new premium pet-food manufacturer that produces a unique product line consisting of 100% raw food. At present, they only sell their products at JRP stores. BWF's products have quickly become a favourite with JRP's customers, and we regularly sell out of them. But at BWF's current level of production, they only have enough inventory to stock a few of our Ontario stores. They want to expand production but need our help to do so.

Steve: In recent months, BWF has been in contact with me, asking for advice on the best way to find additional manufacturing space. To scale up production, they need a larger facility.

Abby: Logistically, it would be a challenge to ship BWF's fresh, raw-food products over even a short distance. There is a risk that the food spoils in transit.

Elaine: But this is a niche product line that is in high demand, and one that our competitors don't offer. Because BWF's products need to be kept refrigerated and fresh, they can only be offered in-store, which has drawn more customers to JRP locations.

Also, BWF has a lot of potential. One of BWF's owners is a pet nutritionist and the other is a food chemist, both of whom have a lot of experience. I expect they will continue to release new and innovative product recipes as time goes on. Julia, what has BWF proposed?

Julia: They want us to become part of their business! For \$578,000, JRP could acquire a 20% equity stake in BWF. They believe both companies have a better chance of success if we team up.

Abby: I'm not convinced. Although they have been successful so far, their business and team are not yet proven. I don't want us to sink our time and effort into helping a new company get on their feet. And with the ongoing industry supply constraint, how do they intend to find the additional ingredients they will need, to scale up their production?

APPENDIX I (CONTINUED)
BOARD MEETING WITH CPA IN ATTENDANCE

July 15, 2025

- Elaine: Although I like BWF, Abby raises a good point. And because BWF's food is of the highest quality, their ingredient costs are also high, so the profit margin of their products is lower than that of other food manufacturers.
- Steve: Moving on, we have an opportunity to change the way we offer pet supplies. Koda Co. (Koda) is a pet-supply company that produces private-label pet supplies for stores such as JRP. They are giving us the opportunity to sign a purchase agreement that would allow us to replace most of the pet supplies we currently offer with JRP-branded products.
- Richard: I have heard of Koda. They are a respected company that has been around for a while. Given their size, they have been less affected by the industry's ongoing supply chain issues.
- Steve: One thing to note is that the agreement comes with an annual minimum purchase guarantee, which means that JRP would face a penalty if we failed to purchase that amount of product from Koda. Based on the amount of pet supplies JRP purchased last year, we would have met this threshold if we made all those purchases through Koda.
- Julia: That means we will likely need to sever the long-standing relationships we have with our current providers of pet supplies if we agree to this purchase agreement. And how are we supposed to build a relationship with a company the size of Koda? What kind of quality can we expect from Koda's products?
- Richard: Their products have a standard, mid-range quality—not cheap, but not premium either. One advantage of this is that our overall cost to purchase pet supplies would go down somewhat.
- Julia: Our customers are used to high-quality products. This seems like a pretty big change from what JRP has historically been known for.
- Elaine: You're not wrong, Julia, but most of our current suppliers are smaller businesses than Koda, and are struggling to fill our orders because of supply chain issues. I would rather have a mid-range selection of pet supplies to stock our shelves with, than nothing at all.

APPENDIX I (CONTINUED)
BOARD MEETING WITH CPA IN ATTENDANCE

July 15, 2025

Steve: As well, the agreement has no upfront cost and would provide plenty of room for growth. Koda is confident that they would be able to fulfil our orders well above the minimum purchase guarantee. This contract offers us the ability to rid ourselves of the supply constraint for many years to come.

Abby: Okay, we have one last opportunity to discuss. My previous employer, Pro Software Consultants (PSC), builds mobile applications for small- to mid-size retail companies similar to JRP. The app is fully customizable and comes with a suite of modules to choose from. We could use this app to implement things such as an improved loyalty program, or to provide valuable information to customers. We could even use the e-commerce module to drive up our online sales.

Julia: My concern is that this would drive customers away from visiting JRP stores because they could just use the app to purchase our products. As well, we can't offer JRP's superior in-store customer service through a mobile application.

Steve: I hear what you're saying, Julia, but if we don't get with the times, we'll be left behind.

Abby: Also, I think you might be surprised at how well PSC's applications function. Typically, PSC receives great reviews from their customers. Plus, we could choose only the modules that make sense for our business and strategic direction. We might even be able to continue to provide exceptional service in different ways!

Julia: I am not opposed to upgrading our technology, but I just want to ensure that JRP remains known as a company that cares about its customers and serves them with great pride.

CPA, with all that in mind, can you have a look at the opportunities available?
Meeting adjourned.

APPENDIX II INDUSTRY UPDATE

During the global pandemic, online sales increased as it became harder for customers to visit physical stores. Large retailers who already had a strong online presence prior to the pandemic experienced a growth in sales, whereas smaller retailers struggled to keep up. At present, some customers have returned to making most of their purchases in-store, but others have become accustomed to purchasing items online. Online purchasing is especially prominent with the younger generations, who tend to use their mobile phones to make online purchases.

The effects of the pandemic on the global supply chain are still ongoing. It has become a challenge for many retail companies—especially small- to mid-size companies—to reliably stock their shelves with products. There is a debate about how long the supply chain issue will last. Some experts think the flow of goods and products should return to pre-pandemic levels within a year or two from today, while others estimate that it could take up to four years. In addition, some goods and products will become available before others.

Specific to the pet industry, it has become challenging for retailers to acquire their desired levels of both pet food and pet supplies, so those that have successfully secured their supply of products have experienced a growth in sales. Small retailers have struggled more than larger retailers in this respect—especially small retailers that do not have strong relationships with their suppliers. Manufacturers of pet food have also struggled due to supply chain issues, because of increased competition for the ingredients needed to produce pet food.

Finally, the trend toward purchasing premium, high-quality pet food and pet supplies has continued to increase. Fresh and frozen pet food is still the most popular premium choice for pet owners; however, the demand for premium dry food has also increased, given that it is less expensive and has a longer shelf life.

APPENDIX III
MANUFACTURE JRP-BRANDED DOG FOOD

Prepared by Elaine

The facility and equipment we would purchase for manufacturing JRP's new dog food has the capacity to produce a total of 1.8 million kilograms of dry food per year, whereas the quantity of ingredients from Abby's friend would only allow us to produce a maximum of 1.08 million kilograms of dry food. We have not developed a product recipe yet; however, we already know that, in addition to the ingredients that Abby's friend can provide, we will still require a few more ingredients before we have all that is needed to complete the production of the first 1.08 million kilograms of premium dry dog food. Because of that, we still need to find a few more suppliers that can provide these additional ingredients.

We estimate that we can sell this dry dog food for \$5.90 per kilogram. Given the product's superior quality, I estimate that we will be able to achieve a 60% gross margin on these product sales. We could even offer JRP's existing loyalty reward members a discount if they purchase this new product in stores. The annual fixed overhead costs of running the operation would total \$2.85 million.

**APPENDIX IV
EXPAND E-COMMERCE OPERATIONS**

Prepared by Richard

Given my market research, and the size of our three proposed fulfilment centres, I estimate that JRP's annual online sales could increase by as much as \$7,529,000. However, because of the ongoing supply constraint, I suspect we could currently achieve only 80% of that maximum increase in sales. In addition, I estimate that around 15% of the online orders we receive will be from customers who would have otherwise made that purchase within a JRP store.

The gross margin on these sales will equal 45%, the same margin that we currently earn from in-store sales. All applicable shipping costs will be added to the customer's bill at checkout. The annual overhead costs of running the operation would equal \$1.35 million.

APPENDIX V
PURCHASE EQUITY IN BEWILD FOODS

Prepared by Julia

During 2024, JRP's revenue from the sale of BWF's products was \$225,000, and had a gross margin of 25%. As part of BWF's proposal, if JRP becomes an equity investor, BWF will decrease what they charge JRP for their products so that JRP's gross margin would increase by 5%. BWF would also formally agree to only sell their products through JRP.

At BWF's current volume, JRP is only able to stock five of its Ontario store locations with BWF products. With JRP's investment, BWF would be able to expand production to the point that they could stock an additional 10 JRP stores (with roughly the same amount of product per store that they currently provide to JRP).

BWF intends to use JRP's investment to lease a bigger manufacturing facility, and buy the equipment necessary to increase their production volumes.

APPENDIX VI
KODA CO.'S AGREEMENT

Prepared by Steve

In 2024, JRP's total revenue from pet supplies was \$13.5 million, with a gross margin of 30%. If JRP were to have stocked and sold only Koda's products, there would have been a 15% drop in revenue, given that Koda's products are priced lower when compared to what we currently offer. However, that drop in revenue would have been offset by an increase in gross margin, which would equal 40% on all Koda products that are sold.

Additional terms provided by Koda are as follows:

- Total annual purchase minimum will be \$6.5 million.
- All products purchased will be branded with the JRP logo.
- The agreement has a term of eight years, with a \$1 million penalty if JRP cancels the agreement prior to the end of the term.

APPENDIX VII PRO SOFTWARE CONSULTANTS APP DEVELOPMENT

Prepared by Abby

The cost of the base mobile application platform is \$250,000, and its annual maintenance cost is estimated to be \$12,000. To give the application its functionalities, at least one module needs to be built on top of the base platform. PSC offers a series of modules that can be added, to increase the functionality of the mobile application. Here are some of the modules available that might be applicable to JRP:

Module	Investment	Annual Maintenance
E-commerce	\$ 236,000	\$ 95,000
Loyalty program and marketing	\$ 114,000	\$ 4,000
Learning and information library	\$ 74,000	\$ 3,000

Further details for each module are as follows:

E-commerce

This module will provide a user-friendly shopping experience for JRP customers who want to make purchases directly within the mobile application. The forecasted annual increase in JRP's gross profit from these mobile app sales is expected to be \$432,000.

Loyalty program and marketing

This module will allow customers to earn loyalty reward points for their online purchases, whereas this is currently only possible for in-store purchases. This module will also connect the loyalty program across all of JRP's stores. Finally, it will give JRP direct access to customers, to notify them of marketing initiatives such as discounts, sales, and promotions. The forecasted annual increase in JRP's gross profit from this module is expected to be \$87,000.

Learning and information library

This module will give JRP's customers access to a library of product information, advice, blog posts, and online courses on various pet topics. JRP would be responsible for producing the content. JRP could choose to make the information free, or charge a small subscription fee. If JRP charges a subscription fee, the forecasted annual increase in JRP's gross profit from this module is expected to be \$23,000.

APPENDIX C

**SEPTEMBER 11, 2024 – DAY 2
SIMULATION AND MARKING GUIDES**

Case

Assume the pre-selected role in which you will be formulating your response. Answer all requireds as specifically directed in your role. Within the requireds for each role, candidates are directed to look at specific additional appendices, which are unique to each role. Use only the information you have been directed to refer to.

Information that is shared by all roles is presented in the “Common Information” section. Additional information, customized to each role, is presented in the “Specific Information” section.

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BACKGROUND COMMON INFORMATION FOR ALL ROLES

Inspired Books Ltd. (IBL) is a publicly traded retail bookstore chain headquartered in Richmond, British Columbia. It operates 45 stores across Canada and maintains a small online presence. IBL focuses on selling printed books and magazines to a variety of customers.

Lately, IBL has focused on its online business; however, it has had difficulty converting website traffic to actual sales, and 85% of its sales continue to come from its retail stores. Further, its market share in the online space is poor compared to that of its competitors.

Companies that have invested heavily in technology have found success in attracting new customers and realizing incremental sales from existing customers. Along with the rise in e-business and technology, there has been a rise in consumer concern about data privacy: both the security of consumer data held by companies, and the use of data by those companies and unrelated parties.

Some of IBL's competitors have expanded their product offerings to include home furnishings. The traditional home decor industry was dominated by a few major companies but has been disrupted by younger generations with a strong interest in trendy, affordable home decor products. IBL has instead maintained its focus on traditional printed book and magazine sales.

Today is January 12, 2024, and IBL has not yet finalized the December 31, 2023, IFRS financial statements. Although Tina Parker, CFO, has been with the company for 15 years, IBL has gone through multiple controllers, and its external auditors have consistently found errors. The most recent controller was let go in May, and Jeff Lincoln was promoted from assistant controller to acting controller, doubling his workload. In addition, on December 31, 2023, IBL acquired Bookmarks Inc. (Bookmarks), a small chain of retail bookstores.

IBL has two broad groups of employees: corporate head office employees, and retail employees. It has had significant issues retaining retail employees in the last two years, which has strained daily operations. Stores are often understaffed, and there is high turnover of new staff, which requires significant training efforts on the part of existing staff.

BACKGROUND (CONTINUED)
COMMON INFORMATION FOR ALL ROLES

Warehouse operations are running smoothly, with orders filled and dispatched on a timely basis, but there have been reports of customers receiving damaged products—wrinkled pages, scratches on hardcovers, etc.

IBL's existing long-term debt, totalling \$15 million, bears interest at 7.5% with the principal due only at its maturity on March 31, 2025. IBL is subject to a 26% income tax rate.

Additional information, customized to your role, is presented in your role package.

REQUIREMENTS FOR YOUR ROLE
(READ ONLY THE ONE SPECIFIED FOR YOUR PRE-SELECTED ROLE)

ASSURANCE REQUIREMENTS

You, CPA, are an audit senior at Rutherford and Singh LLP (Rutherford), IBL's external audit firm. You report to Kim Davies, the audit manager. Rutherford is preparing for the 2023 audit and has also been asked by the Board of Directors to provide additional advice to management. Kim recently met with Tina and Jeff to discuss several issues. Kim has asked you to ignore, for now, any independence and conflict-of-interest considerations, as she will discuss them with the audit partner before any deliverables are provided to the client.

Kim asks you to discuss the financial reporting for the acquisition of Bookmarks, a new Halifax lease, and a lawsuit related to a contract breach. Jeff provided Rutherford with a copy of IBL's draft 2024 cash budget, which was prepared by a co-op student. Kim asks you to review the cash budget and make any necessary revisions. She notes that you should ignore Bookmarks' cash flows, since it will continue to operate independently for now.

IBL's balanced scorecard was implemented five years ago. During the meeting, Tina expressed a desire to update it. Kim asks you to assess the balanced scorecard and recommend improvements.

In 2023, IBL operated a café at its Toronto store as part of a pilot project. Tina wants to assess whether the pilot was a success, and what improvements could be made. Kim asks you to perform this analysis.

A few days after the meeting, Jeff informed Rutherford that IBL implemented a new share-based compensation plan. Kim asks you to discuss the financial reporting implications of the new plan.

Kim would also like you to assess the risks of material misstatement at the overall financial statement level and determine materiality for the 2023 audit. In addition, Kim asks you to prepare a year-over-year variance analysis of the statement of financial position and statement of earnings, excluding income tax accounts, and discuss any risks to consider when planning the audit. Kim also asks that you describe the audit procedures to be performed on the financial reporting issues noted by Kim, including the share-based compensation plan.

REQUIREMENTS FOR YOUR ROLE
(READ ONLY THE ONE SPECIFIED FOR YOUR PRE-SELECTED ROLE)

ASSURANCE REQUIREMENTS (continued)

Kim would like to rely on payroll controls for the 2023 year-end audit, and asks you to design procedures to establish whether IBL's payroll controls are operating effectively. IBL's audit committee raised some concerns regarding the control environment in IBL's retail operations. Kim asks you to discuss any internal control weaknesses you identify in the bookstore operations and recommend ways to address them, to present to the audit committee.

IBL has also provided a draft of its Management Discussion and Analysis that will accompany the financial statements in the annual report. Kim asks you to comment on the excerpts provided to date, and explain Rutherford's responsibilities regarding the business risks section, which Tina does not expect to be ready before the audit report is issued.

In addition to the common appendices (I to VII), information provided in Appendix VIII (Assurance) is relevant for your analysis.

REQUIREMENTS FOR YOUR ROLE
(READ ONLY THE ONE SPECIFIED FOR YOUR PRE-SELECTED ROLE)

FINANCE REQUIREMENTS

You, CPA, work at Westwood & Co., and provide consulting services to IBL. You recently met with Tina and Jeff to discuss some of IBL's present challenges.

Tina asks you to discuss the financial reporting for the acquisition of Bookmarks, a new Halifax lease, and a lawsuit related to a contract breach. Jeff provided you with a copy of IBL's draft 2024 cash budget, which was prepared by a co-op student. He asks you to review the cash budget and make any necessary revisions. He notes that you should ignore Bookmarks' cash flows, since it will continue to operate independently for now.

IBL's balanced scorecard was implemented five years ago. During the meeting, Tina expressed a desire to update it. She asks you to assess the balanced scorecard and recommend improvements.

In 2023, IBL operated a café at its Toronto store as part of a pilot project. Tina wants to assess whether the pilot was a success, and what improvements could be made. She asks you to perform this analysis.

IBL wants to acquire all of the outstanding shares of an owner-managed bookstore, Dominion Books Inc. (Dominion). Tina asks you to value Dominion using a capitalized earnings methodology that considers both years of available data. The appropriate earnings multiple for Dominion is 13 times.

Tina has received two proposals to replace IBL's existing long-term debt at a lower interest rate, to reduce IBL's borrowing cost. IBL can repay its existing long-term debt at any time with no penalty. Tina would like you to calculate the proposed covenants, based on the draft 2023 financial statements. She also wants you to assess the proposals and recommend which one to accept.

REQUIREMENTS FOR YOUR ROLE
(READ ONLY THE ONE SPECIFIED FOR YOUR PRE-SELECTED ROLE)

FINANCE REQUIREMENTS (continued)

Tina is unsure if IBL is using best practices with respect to its accounts payable process, and asks you to assess its days payable outstanding and whether IBL should be settling payables on a timelier basis. IBL is also concerned about its days in inventory, and has received a proposal for a new inventory management system that Tina would like you to evaluate.

Tina has summarized three financing proposals that are being considered, to provide IBL with additional comfort in meeting its working capital needs. She asks you to evaluate the proposals and recommend which, if any, IBL should accept.

IBL is expanding in Calgary, and can choose to either lease or purchase a property. Tina would like you to advise on which option is best suited to IBL.

Tina is considering introducing a share-based compensation plan for IBL's store managers and assistant managers. She would like you to calculate the impact of each of the two proposed plans on IBL's 2023 quick ratio, debt-to-equity ratio, and the long-term debt covenant ratios you previously calculated.

Some of IBL's shareholder groups are becoming increasingly vocal about their desire for distributions. Tina thinks a \$2 million cash dividend or share repurchase may satisfy them, but wonders if a 2:1 stock split or a 10% stock dividend are also viable alternatives.

In addition to the common appendices (I to VII), information provided in Appendix VIII (Finance) is relevant for your analysis.

**REQUIREMENTS FOR YOUR ROLE
(READ ONLY THE ONE SPECIFIED FOR YOUR PRE-SELECTED ROLE)**

PERFORMANCE MANAGEMENT REQUIREMENTS

You, CPA, work at Findlay & Butterfield LLP, and provide consulting services to IBL. You recently met with Tina and Jeff to discuss some of IBL's present challenges.

Tina asks you to discuss the financial reporting for the acquisition of Bookmarks, a new Halifax lease, and a lawsuit related to a contract breach. Jeff provided you with a copy of IBL's draft 2024 cash budget, which was prepared by a co-op student. He asks you to review the cash budget and make any necessary revisions. He notes that you should ignore Bookmarks' cash flows, since it will continue to operate independently for now.

IBL's balanced scorecard was implemented five years ago. During the meeting, Tina expressed a desire to update it. She asks you to assess the balanced scorecard and recommend improvements.

In 2023, IBL operated a café at its Toronto store as part of a pilot project. Tina wants to assess whether the pilot was a success, and what improvements could be made. She asks you to perform this analysis.

IBL is considering focusing more of its efforts on the online portion of the business. Jeff has summarized the cost allocation model between the online and in-store segments, and would like you to prepare a divisional income statement based on the current allocation model, as well as one based on any revisions you would propose. In addition, Tina would like you to discuss the advantages and disadvantages of increasing the focus on the online segment, and to consider whether it is aligned with IBL's mission and vision.

IBL's executive team wants to analyze whether they should introduce a home decor segment to their business. Tina would like you to calculate the potential operating income of this new product line.

In addition, Tina would like you to discuss the advantages and disadvantages of this project, consider whether it is a good strategic fit for IBL, and provide a recommendation.

REQUIREMENTS FOR YOUR ROLE
(READ ONLY THE ONE SPECIFIED FOR YOUR PRE-SELECTED ROLE)

PERFORMANCE MANAGEMENT REQUIREMENTS (continued)

The executive team wants to introduce a membership program. Tina would like you to assess the advantages and disadvantages of the proposed program and the financial impact it would have on IBL, excluding any impact the introduction of the home decor segment would have.

Tina wants you to review, and suggest improvements to, the incentive compensation plan for the online segment, which consists of bonuses for the vice president, managers, and staff. As part of your analysis, she would like you to estimate the vice president's bonus, based on the draft 2023 financial statements.

Tina surveyed some of IBL's store managers and corporate managers, and summarized their concerns about IBL's inventory management system, which has been in use for nearly 20 years. She would like you to discuss the weaknesses of the system and recommend improvements for a potential new system.

In addition to the common appendices (I to VII), information provided in Appendix VIII (Performance Management) is relevant for your analysis.

REQUIREMENTS FOR YOUR ROLE
(READ ONLY THE ONE SPECIFIED FOR YOUR PRE-SELECTED ROLE)

TAXATION REQUIREMENTS

You, CPA, work at Lloyd & Patel LLP (L&P), and provide consulting services to IBL, which has asked L&P for assistance with tax issues and to provide advice to management. You recently met with Tina and Jeff to discuss some of IBL's present challenges.

Tina asks you to discuss the financial reporting for the acquisition of Bookmarks, a new Halifax lease, and a lawsuit related to a contract breach. Jeff provided you with a copy of IBL's draft 2024 cash budget, which was prepared by a co-op student. He asks you to review the cash budget and make any necessary revisions. He notes that you should ignore Bookmarks' cash flows, since it will continue to operate independently for now.

IBL's balanced scorecard was implemented five years ago. During the meeting, Tina expressed a desire to update it. She asks you to assess the balanced scorecard and recommend improvements.

In 2023, IBL operated a café at its Toronto store as part of a pilot project. Tina wants to assess whether the pilot was a success, and what improvements could be made. She asks you to perform this analysis.

Tina asks you to determine IBL's net income (loss) for income tax purposes and taxable income for the year ended December 31, 2023, including an explanation of the adjustments made in the calculation. She also asks you to prepare a summary of the income tax implications of the share acquisition of Bookmarks.

IBL provided a leased vehicle to a new employee during the year. It also introduced new employee benefits during the year, including a merchandise discount for retail employees and a recognition and rewards program. Tina asks for L&P's assistance in determining the income tax implications of these benefits, for both the employees and IBL.

REQUIREMENTS FOR YOUR ROLE
(READ ONLY THE ONE SPECIFIED FOR YOUR PRE-SELECTED ROLE)

TAXATION REQUIREMENTS (continued)

IBL began offering loans to senior executives as an additional benefit in 2023. Tina provided a summary of the loans made during the year, and wants to know if there are any income tax implications for the executives and IBL as a result.

Lastly, Jeff has some GST/HST questions related to the events that took place during the year. He has shared them by email.

In addition to the common appendices (I to VII), information provided in Appendix VIII (Taxation) is relevant for your analysis.

**APPENDIX I – COMMON
EXCERPTS FROM DRAFT FINANCIAL STATEMENTS**

Inspired Books Ltd.
Statement of Financial Position
(Unconsolidated, in thousands of Canadian dollars)
As at December 31

	2023	2022
	Draft	Audited
Assets		
Current assets:		
Cash and cash equivalents	\$ 10,700	\$ 17,600
Inventory	84,113	76,517
Prepaid expenses	1,903	1,952
Income tax recoverable	1,284	1,581
Total current assets	<u>98,000</u>	<u>97,650</u>
Deferred tax asset	600	500
Property, plant, and equipment (PP&E) - net	15,627	16,409
Right-of-use assets	77,874	82,043
Investment in Bookmarks Inc.	5,000	0
Total assets	<u>\$ 197,101</u>	<u>\$ 196,602</u>
Liabilities		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 29,109	\$ 30,289
Current portion of lease liabilities	15,134	13,013
Interest payable	1,157	389
Total current liabilities	<u>45,400</u>	<u>43,691</u>
Lease liabilities	67,500	73,247
Long-term debt	15,000	5,000
Total liabilities	<u>127,900</u>	<u>121,938</u>
Shareholders' equity		
Common shares	65,000	65,000
Retained earnings	4,201	9,664
Total shareholders' equity	<u>69,201</u>	<u>74,664</u>
Total liabilities and shareholders' equity	<u>\$ 197,101</u>	<u>\$ 196,602</u>

APPENDIX I – COMMON (CONTINUED)
EXCERPTS FROM DRAFT FINANCIAL STATEMENTS

Inspired Books Ltd.
Statement of Earnings
(Unconsolidated, in thousands of Canadian dollars)
For the years ended December 31

	2023	2022
	Draft	Audited
Sales	\$ 74,500	\$ 70,775
Cost of sales	(33,525)	(31,924)
Gross profit	<u>40,975</u>	<u>38,851</u>
Operating expenses		
General and administrative	22,600	21,233
Marketing and sales	8,690	8,493
Depreciation	8,388	7,425
Total operating expenses	<u>39,678</u>	<u>37,151</u>
Operating income	1,297	1,700
Loss on disposal of PP&E	(160)	0
Gain on disposal of PP&E	35	0
Interest expense – lease liabilities	(7,649)	(9,599)
Interest expense – long-term debt	(906)	(250)
Loss before income taxes	<u>(7,383)</u>	<u>(8,149)</u>
Income tax recovery	1,920	2,119
Net loss	<u>\$ (5,463)</u>	<u>\$ (6,030)</u>

**APPENDIX II – COMMON
ACQUISITION OF SHARES OF BOOKMARKS INC.**

On December 31, 2023, IBL purchased 100% of the issued and outstanding shares of Bookmarks from its previous owner, a Canadian resident, for \$5 million cash pursuant to a share purchase agreement.

The following is an excerpt from an independent appraisal of Bookmarks (*in thousands of Canadian dollars*):

	Dec. 31, 2023 Carrying Amount (IFRS)	Dec. 31, 2023 Appraised Fair Value
Assets		
Current assets:		
Cash and cash equivalents	\$ 700	\$ 700
Inventory	2,500	3,500
Prepaid expenses	100	100
Total current assets	3,300	4,300
Property, plant, and equipment – net (Note 1)	750	850
Right-of-use assets	600	600
Deferred tax asset (Note 2)	52	52
Total assets	\$ 4,702	\$ 5,802
Liabilities		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,500	\$ 1,500
Current portion of lease liabilities	60	60
Total current liabilities	1,560	1,560
Lease liabilities	750	750
Total liabilities	\$ 2,310	\$ 2,310

APPENDIX II – COMMON (CONTINUED)
ACQUISITION OF SHARES OF BOOKMARKS INC.

Note 1

Property, plant, and equipment is broken down as follows (*in thousands of Canadian dollars*):

Item	Carrying Amount (\$)	Fair Value (\$)
Furniture and fixtures	500	550
Leasehold improvements	175	250
Computer systems	75	50
Total	750	850

Note 2

Bookmarks noted that the tax values of all of its assets and liabilities were equal to their carrying amounts on the acquisition date, except for the right-of-use asset and lease liability.

APPENDIX III – COMMON LEASE OF HALIFAX STORE

On October 1, 2023, IBL entered into a contract to lease a retail space in Halifax from Atlantic Leasing Corp. (ALC), with the intention of opening a Halifax location in early 2025.

The lease agreement provided the following terms:

- The lease commences on November 1, 2023, for a period of 62 months.
- The months of November and December 2023 are rent-free. Starting on January 1, 2024, IBL is required to make monthly payments of \$9,000.
- Following the 62-month term, IBL has the option to extend the lease for an additional 60 months, with the same monthly lease payments.

IBL incurred \$5,000 in legal costs and \$20,000 in commissions paid to a commercial real estate agent for this lease, which have been expensed as incurred. For the year ended December 31, 2023, IBL has not recorded any journal entries for the Halifax lease, other than for the legal fees and commissions. IBL plans on making leasehold improvements estimated at \$400,000 in August 2024. IBL intends to take the extension option when it comes up.

**APPENDIX IV – COMMON
LAWSUIT**

To: CPA
From: Jeff, acting controller
Date: January 11, 2024
Subject: FW: Breach of Contract

Hi CPA, as discussed, we recently settled a lawsuit relating to a contract breach that occurred during the summer. We recorded the expense today, in the 2024 fiscal year, for the final settlement. I've attached two relevant emails below.

Email 1

To: Jeff, acting controller
From: Alyssa, senior legal counsel, IBL
Date: August 9, 2023
Subject: Breach of Contract

Hi Jeff,

Further to our discussion, the following is a summary of the facts:

- Last month, the Toronto store released, one week early, the sixth instalment in a critically acclaimed young adult sci-fi series. Numerous copies were sold, and news of these early sales spread rapidly online.
- The publisher was upset and has brought a lawsuit against us for breaching our distribution agreement with them, specifically the clause surrounding release dates. Given the widespread reporting of our mistake, they feel we negatively impacted sales of the novel and caused damage to them and their author.
- The lawsuit is asking for \$250,000 in damages, which seems exorbitant. I think they would be entitled to \$100,000 at most.
- That said, I've reviewed our agreement with the publisher, and I think we can present a few arguments in our defence. Frankly, I don't think we will have to pay them anything.

Regards,

Alyssa

APPENDIX IV – COMMON (CONTINUED)
LAWSUIT

Email 2

To: Jeff, acting controller
From: Alyssa, senior legal counsel, IBL
Date: January 8, 2024
Subject: Re: Breach of Contract

Hi Jeff, disappointing result in court today. The judge dismissed my arguments and awarded the publisher \$125,000 in damages. I spoke with our outside counsel, and they agreed with the decision. Therefore, we will not be appealing the judgment.

Regards,

Alyssa

APPENDIX V – COMMON DRAFT CASH BUDGET

Below is the draft 2024 cash budget. Here are some notes that Jeff provided to the co-op student:

- We forecast an increase in sales of 3% from 2023.
- Sales occur from Quarter 1 to 4 (Q1 to Q4) in the following pattern: 15%, 20%, 25%, and 40%. The related marketing and sales expenditures occur in the following pattern: 15%, 15%, 35%, and 35%.
- Financing is available to cover any cash shortfalls for 2024.

	Note	Q1 (\$)	Q2 (\$)	Q3 (\$)	Q4 (\$)	Total (\$)
Cash balance, beginning		10,700,000	8,917,210	7,134,420	5,351,630	
Add: sales	1	18,625,000	18,625,000	18,625,000	18,625,000	74,500,000
Add: debt financing	1	2,500,000	2,500,000	2,500,000	2,500,000	10,000,000
Less: inventory purchases	2	(8,381,250)	(8,381,250)	(8,381,250)	(8,381,250)	(33,525,000)
Less: general and administrative	1	(5,650,000)	(5,650,000)	(5,650,000)	(5,650,000)	(22,600,000)
Less: marketing and sales	1	(2,172,500)	(2,172,500)	(2,172,500)	(2,172,500)	(8,690,000)
Less: depreciation	1	(2,097,040)	(2,097,040)	(2,097,040)	(2,097,040)	(8,388,160)
Less: lease payments	3	(4,132,000)	(4,132,000)	(4,132,000)	(4,132,000)	(16,528,000)
Less: purchase of PP&E	1	(475,000)	(475,000)	(475,000)	(475,000)	(1,900,000)
Cash balance, ending		8,917,210	7,134,420	5,351,630	3,568,840	

Notes:

1. These forecasted items are based on the draft 2023 statement of earnings and statement of cash flows.
2. The forecasted purchases are based on the draft 2023 cost of sales.
3. The forecasted lease payments are based on the lease payments made in 2023.

**APPENDIX VI – COMMON
BALANCED SCORECARD (LAST REVISED IN 2018)**

Financial Perspective

Goals	Measures
Promote financial growth of the business	Profit growth rate (%)
Improve cash flow relating to inventory	Gross margin (%)

Customer Perspective

Goals	Measures
Retain existing customers	Customer retention rate (%) (estimated through informal interactions between cashiers and customers)
Attract new customers	Overall sales volume

Learning and Growth Perspective

Goals	Measures
Promote continuing education	Number of employee voluntary learnings completed
Improve employee morale	Employee satisfaction rate (%) (anonymous survey administered by a third party)

Internal Operations Perspective

Goals	Measures
Improve order handling	Time from order to shipment
Improve systems capability	Number of new system features added

APPENDIX VII – COMMON CAFÉ PILOT PROJECT

On January 1, 2023, IBL launched a café within the Toronto store in an effort to rival competitors with similar offerings in their stores. IBL hoped that a successful pilot would lead to widespread rollout in 2024 and beyond, with each café contributing to growth in the core business and earning a small profit itself.

While the café has brought an increase in foot traffic to the store, and an increase in book and magazine sales volume of 8%, Tina is concerned because the café operation was unprofitable during 2023. She is considering closing it. The store manager provided a financial summary and comments on the pilot:

		Note
Sales	\$ 225,000	1
Cost of sales	(135,000)	1, 2
Gross profit	90,000	
Salaries and wages	120,000	3
Marketing and other	6,000	
Rent	3,150	4
Utilities	4,054	5
Loss	\$ (43,204)	

Notes:

1. Relates to café sales and cost of sales only.
2. Cost of sales includes inventory write-offs for food wastage. For example, we stock a variety of dairy alternative products, and while customers appreciate the offerings, we have had to dispose of near-full containers on multiple occasions.
3. We had trouble finding baristas to work in the café, and often had to ask our reluctant retail staff to provide coverage. About one-third of the salaries and wages are related to these retail employees, who would otherwise have been working elsewhere on the floor.
4. The café takes up 15% of the store's floor space, so we have allocated 15% of the annual lease payments of \$21,000 to the café. We had previously used this space as a lounge area, without any food or beverage offerings.
5. We also allocated 15% of the store's utilities to the café. Given the increased electricity and water required for the café, the bookstore's overall utilities increased by 17% from 2022.

APPENDIX VII – COMMON (CONTINUED)
CAFÉ PILOT PROJECT

Comments from the store manager:

- Our district manager asked me to oversee the café operations. Unfortunately, I've worked in retail my entire career. I don't even drink coffee! A supervisor performs most of the management duties for the café, but I make myself available if they need help.
- We've noticed damage to books and furniture near the café. As a result, we've had to replace some of our furniture, and mark books to clearance, due to spills.

***ASSURANCE ROLE
ADDITIONAL INFORMATION***

APPENDIX VIII – ASSURANCE ADDITIONAL INFORMATION

Restricted Stock Unit (RSU) Plan

On January 1, 2023, when IBL's common shares were trading at \$7, the company implemented an RSU plan for its senior leadership, which includes 25 eligible employees. On December 31, 2023, IBL's share price was \$7.50.

The plan sets out the following for eligible employees:

- Employees were each granted 1,000 RSUs on January 1, 2023.
- The RSUs vest according to the following schedule:
 - 40% on the first anniversary of the grant date; and
 - 20% on each anniversary thereafter.
- IBL will cash-settle vested RSUs at IBL's share price on the vesting date.
- Employees must be employed by IBL on the vesting date, to be entitled to the cash settlement.

IBL worked with a compensation consultant in creating the RSU plan. The consultant estimated that 90% of the eligible employees will be employed by IBL on the second anniversary date, 80% on the third anniversary date, and 70% on the fourth anniversary date. On December 31, 2023, all 25 eligible employees remained employed at IBL.

APPENDIX VIII – ASSURANCE (CONTINUED)

ADDITIONAL INFORMATION

Excerpts from IBL’s Process Descriptions Regarding Payroll

Timekeeping

Retail employees are responsible for checking in and checking out for each shift, using a point-of-sale (POS) system terminal located in the staff room. At the end of each pay period, the assistant manager and manager of each store review and approve their store’s time summary, and send it to the payroll clerk for processing.

Every six months, the assistant controller selects a random sample of time records and checks the master employee file from human resources, to ensure that each record is related to an active employee.

Payment of payroll

The payroll clerk prepares the payroll report in IBL’s internal payroll system, based on the approved time records and each employee’s wage rate, as defined in the employee’s master file. The payroll manager reviews the payroll report, including the inputs, prior to approving the amounts for payment. Employees are paid by direct deposit from IBL’s payroll-specific bank account to each employee’s bank account. In rare instances where an employee is not registered for direct deposit, a pre-numbered cheque is written and is signed by the payroll manager and the controller. Cheques, when required, are issued in sequential order. A treasury clerk prepares the monthly payroll bank account reconciliation, which is reviewed by the treasury manager.

Recording payroll transactions

The payroll clerk prepares the payroll journal entry for each pay period, based on the payroll report, and the entry is reviewed by the payroll manager. The payroll manager ensures that the entry ties to the payroll report generated by the payroll system, and further ensures that the appropriate general ledger accounts are being used for the journal entry before approving. The payroll clerk records the approved journal entry on the pay date.

APPENDIX VIII – ASSURANCE (CONTINUED)

ADDITIONAL INFORMATION

Bookstore Operations

A typical IBL store includes up to five checkout counters, staffed by cashiers. Cashiers process sales by scanning the bar code on the product, and the customer's subtotal, sales tax, and final total are tallied using the POS system, which is connected to a payment terminal. Each checkout counter has a cash register that maintains a cash float. Daily, one cashier is responsible for closing the store, and their tasks include summarizing sales transactions and providing the cash from the registers to the store manager. The store manager performs the cash reconciliation nightly, resets the floats to the appropriate levels, and deposits the excess cash at a local bank branch.

Store managers and assistant managers are permitted to order new furniture and fixtures, provided that they order from pre-approved vendors. They do not need approval from head office for these purchases, and there is no limit on the amount they may spend. They send the purchase orders to head office, which orders the requested items. Vendors send invoices to head office, and once the stores receive the items, they provide proof of receipt to head office so that payment can be arranged. Upon receipt of furniture and fixtures, retail staff are responsible for assembly and display. Since some of the items are interchangeable, IBL does not assign asset numbers to its furniture and fixtures.

IBL performs store and warehouse inventory counts annually, which are attended by Rutherford. A list of discrepancies is provided to the accounting department, which adjusts the inventory levels in the accounting system. The warehouse manager takes discrepancies seriously, and investigates any identified. Store managers, who view discrepancies as a cost of doing business, often ignore them.

IBL has had issues with employee retention over the last year. In multiple cases, store managers have had problems recovering company assets from departing employees, including store keys. IBL maintains a virtual private network (VPN), so that managers can access company systems from home when necessary. Recently, it was discovered that a former manager retained their VPN and systems access for five months following their termination.

APPENDIX VIII – ASSURANCE (CONTINUED)
ADDITIONAL INFORMATION

Excerpts from IBL’s Draft Management Discussion and Analysis

Operational results: EBITDA

IBL’s EBITDA from its physical stores and online business lines, for the year ended December 31, 2023, was as follows (*in thousands of Canadian dollars*):

Item	Stores (\$)	Online (\$)	Total (\$)
Revenue	65,000	15,000	80,000
Cost of sales	(29,250)	(4,275)	(33,525)
General and administrative	(18,363)	(4,237)	(22,600)
Marketing and sales	(7,061)	(1,629)	(8,690)
Depreciation	(8,388)	0	(8,388)
Loss on disposal of PP&E	(160)	0	(160)
Gain on disposal of PP&E	35	0	35
EBITDA	1,813	4,859	6,672

Balance sheet performance

IBL has strong liquidity, having a current ratio of 2.16, and a quick ratio of 0.31.

The company greatly improved inventory controls during the year, and this continues to be an area of focus.

Employee retention

IBL continued to experience high levels of turnover at the retail level, consistent with competitors in the immediate industry. However, IBL undertook efforts to improve retention at the senior leadership level by implementing a stock option plan, which provides some employees with the option to acquire IBL stock at certain grant prices.

Business outlook

On December 15, 2023, IBL closed on the acquisition of Bookmarks, which expands IBL’s footprint across the country.

In 2025, IBL will be opening a new retail store in Halifax, which will generate revenues of \$5 million annually over the 10-year lease.

***FINANCE ROLE
ADDITIONAL INFORMATION***

APPENDIX VIII – FINANCE
ADDITIONAL INFORMATION

Dominion Books Inc.
Statement of Earnings
For the years ended December 31

	2023	2022	Note
	Unaudited	Audited	
Sales	\$ 2,000,000	\$ 1,750,000	
Cost of sales	(940,000)	(840,000)	
Gross profit	<u>1,060,000</u>	<u>910,000</u>	
Operating expenses			
General and administrative	725,000	625,000	1
Management fees	100,000	100,000	2
Marketing	45,000	65,000	
Depreciation	65,000	68,000	
Total operating expenses	<u>935,000</u>	<u>858,000</u>	
Operating income	125,000	52,000	
Dividend income	10,000	9,500	3
Interest income	15,000	12,000	3
Loss on inventory revaluation	0	(25,000)	
Gain on disposal of PP&E	15,000	5,000	4
Income before income taxes	<u>165,000</u>	<u>53,500</u>	
Income tax expense	<u>35,723</u>	<u>25,427</u>	5
Net income	<u>\$ 129,277</u>	<u>\$ 28,073</u>	

Notes:

- General and administrative expenses include salaries of \$150,000 paid to the owner in each year, and \$45,000 paid to her husband only in 2023. IBL expects to replace them with regular full-time employees for total wages of \$100,000.
- Dominion paid a management fee to the owner's management company for various administrative services that could be performed by either IBL or Dominion without incurring additional costs.

APPENDIX VIII – FINANCE (CONTINUED)
ADDITIONAL INFORMATION

Notes (continued):

3. Dominion maintains an investment portfolio using excess cash. At December 31, 2023, the portfolio was valued at \$400,000, with an adjusted cost base of \$300,000. All dividend and interest income relates to this portfolio.
4. Dominion has a small portfolio of vacant land that it is in the process of liquidating. At December 31, 2023, the company owned vacant land with a fair market value of \$75,000, and an adjusted cost base of \$40,000.
5. Dominion's income from active operations is taxed at a combined small business rate of 12.2%, and investment income is taxed at a rate of 50.17%.

APPENDIX VIII – FINANCE (CONTINUED)
ADDITIONAL INFORMATION

Long-Term Debt Replacement

Commerce Plaza Bank

- Principal: \$15 million, with blended annual repayments of \$1,173,000 due on December 31 of each year.
- Interest rate: 6% fixed.
- Term: 5 years.
- Amortization period: 25 years.
- Covenants:
 - Debt-to-EBITDA ratio of 2.5 or lower. Debt includes all long-term debt and excludes lease liabilities.
 - Interest-coverage ratio (EBIT / interest on interest-bearing debt) of 1.05 or greater. EBIT is prior to all interest expenses, and interest on interest-bearing debt excludes interest on lease liabilities.
 - IBL may not make any investments (including, but not limited to, acquisitions, store renovations, store expansions, and significant furniture and fixture purchases) greater than \$1 million without the express consent of the lender.
- Securitization: General security agreement over IBL's inventory, investments, and property, plant, and equipment.
- Early repayment: An additional \$1 million may be repaid annually without incurring a penalty. Any excess repayment is subject to a penalty equal to the interest rate differential if the stated interest rate is greater than the posted rate on similar loans.

First Canadian Credit Union

- Principal: \$15 million, with blended monthly repayments of \$124,500 due on the first day of each month.
- Interest rate: 5.74% variable.
- Term: 5 years.
- Amortization period: 15 years.
- Covenants:
 - Debt-to-EBITDA ratio of 2.2 or lower.
 - IBL may not incur additional debt without the express consent of the lender.
- Securitization: General security agreement over IBL's inventory, investments, and property, plant, and equipment.
- Early repayment: No early repayment is permitted.

APPENDIX VIII – FINANCE (CONTINUED)

ADDITIONAL INFORMATION

Working Capital Management

Accounts payable

IBL's statement of financial position reflects accounts payable and accrued liabilities as at December 31, 2023, of \$29,109,000 (2022 – \$30,289,000). Of these amounts, accounts payable owing to inventory suppliers as of December 31, 2023, was \$2.5 million (2022 – \$2.75 million), and the remainder relates to salaries and wages, bonus accruals, amounts owing for PP&E, GST/HST payable, and other accruals.

IBL strives to be a courteous customer of the publishers from which it sources inventory, and aims to settle its inventory payables every 25 to 30 days. The following is an excerpt from IBL's primary supplier agreement:

Payment terms:

- Customer shall pay a supplier within 30 days of the date specified on the commercial invoice (net 30).
- Payments received on days 31 to 60 shall be assessed a one-time fee of 0.5%, and payments received on day 61 or later shall be assessed a one-time fee of 15%.
- A discount of 2.0% shall be applied to payments received on or before day 10.

Inventory

Each IBL store controls its inventory orders. Typically, store managers replenish inventory throughout the year as it depletes, and when new titles are released. IBL's inventory management system is quite old, and provides only simple information about the quantity of inventory in a specific store, the Stock Keeping Unit (SKU) number, and the cost. IBL stores do not share inventory.

IBL received a proposal to implement a new inventory management system. This system is expected to bring IBL's inventory turnover to the industry average of 1.15 through centralization of inventory orders and inventory management efficiencies (such as reducing orders for slow-moving and obsolete books, and sharing of inventory between stores). The cost of the system is \$2.5 million.

APPENDIX VIII – FINANCE (CONTINUED)

ADDITIONAL INFORMATION

Financing Proposals to Meet Working Capital Needs

Canadian Learning Program

The Canadian Learning Program is a new educational initiative launched by the federal government, with the mission of increasing youth literacy rates and engaging the next generation of readers. The program provides loans on a case-by-case basis. It proposed the following to IBL:

- \$10 million loan at a 4% annual rate, interest payable monthly, and principal payable at the end of the 2-year term.
- The government will forgive 25% of the principal at maturity if certain conditions are met. IBL must:
 - dedicate a minimum of 15% of each store’s floor space to books and magazines for children and young adults.
 - host a monthly reading session at each store.

Rights offering

Tina recently learned about a rights offering from a CFO peer in another industry. She wonders if IBL could use a rights offering to existing shareholders, to avoid increasing its debt level in 2024. She thinks IBL could raise additional funds as follows:

- Rights will be offered to existing shareholders, providing them with one right per common share held (10 million common shares of IBL are issued and outstanding).
- For every 7 rights, a holder can acquire a common share within the next 12 months for \$6.50. The new common share will be issued from treasury.
- IBL’s current share price is \$7.50.

Inventory financing

Timely Factoring Company (Timely) has offered to provide IBL with a line of credit collateralized by IBL’s inventory, under the following terms:

- Timely will advance up to 75% (at IBL’s option) of the appraised market value of IBL’s inventory, less any outstanding debt secured by the inventory. This value is estimated to be 60% of carrying value.
- The line of credit will bear interest at 12% annually.
- IBL must maintain a perpetual inventory process free from material weaknesses, and provide Timely with its audited annual financial statements.
- Timely will conduct quarterly inspections of IBL’s stores and warehouse, to assess inventory activity.

APPENDIX VIII – FINANCE (CONTINUED)
ADDITIONAL INFORMATION

Property Acquisition

IBL wants to open a new store in Calgary. The owner has historically leased the property but is open to selling it. IBL's commercial real estate agent has summarized the options as follows:

Purchase

- The purchase price is \$500,000, of which 20% would be allocated to land.
- The building has a remaining useful life of 10 years, at which point its residual value is expected to be \$125,000.
- IBL expects to place the building in Class 1, and to make the required election for an additional 2% CCA.
- Annual property taxes are estimated to be \$10,000, paid at the end of each year.
- Annual insurance premiums are estimated to be 1% of the building's acquisition value, paid at the start of each coverage period.

Lease

- Payments of \$7,000 are due on the first of each month for the duration of the lease.
- The lease term is set at 10 years, with no renewal option.
- Insurance is estimated to be \$2,000 annually, paid at the start of each coverage period.

APPENDIX VIII – FINANCE (CONTINUED)
ADDITIONAL INFORMATION

Share-Based Compensation Plan

Each of IBL's 45 stores has one store manager and one assistant manager, all of whom would be eligible for the bonus plan. Tina is concerned about the impact of each of the proposed plans on IBL's quick ratio, debt-to-equity ratio, and the ratios included in the long-term debt covenants.

Proposed plan #1 – Employee stock option plan (ESOP)

- Store managers and assistant managers will be provided with an annual grant of 100 options at an exercise price of \$8 on the first day of each year, which vest immediately and expire on the last day of the year.
- Exercised options will be settled via the issuance of new shares from treasury.
- At the time of grant, IBL would record an expense of \$14,400 and an increase in equity of the same amount, based on the fair value of the options at the grant date.
- IBL expects 7,200 of the stock options to be exercised within 12 months; at the time of exercise, IBL will receive cash of \$57,600 and record an increase in equity of the same amount.

Proposed plan #2 – Restricted stock unit (RSU) plan

- Store managers and assistant managers will be provided with an annual grant of 50 RSUs on the first day of each year.
- All RSUs will vest on the last day of the year; it is expected that 70% of the managers and assistant managers will still be employees of IBL at that time.
- Vested RSUs will be settled via the issuance of new shares from treasury.
- IBL expects to recognize an expense of \$23,625, and an increase in equity of the same amount on the vesting date of the RSUs.

***PERFORMANCE MANAGEMENT ROLE
ADDITIONAL INFORMATION***

APPENDIX VIII – PERFORMANCE MANAGEMENT ADDITIONAL INFORMATION

IBL’s Mission

To create a comfortable environment, and provide exceptional service and a wide variety of printed books and magazines, so our customers can experience the joy of reading.

IBL’s Vision

To contribute to a better society through the development of literacy and lifelong learning.

Company and Industry Background

IBL sells a wide range of books and magazines to readers of all ages, backgrounds, and reading abilities. IBL’s expertise has always been narrow, focusing on printed books, which has allowed it to provide a comfortable shopping environment.

The executive team is made up of individuals experienced in the industry, who have worked at IBL’s competitors and at publishing firms. Each IBL bookstore has one manager and one assistant manager, supported by a small staff of hourly retail employees and a corporate function that provides accounting, human resources, legal, marketing, and other related services. The senior leadership team does not conduct reviews of the IT systems.

IBL has noted some decline in the industry, with global book sales peaking in the early 2000s, but it has maintained stable-to-low growth since then.

Historically made up of small brick and mortar stores, IBL has grown into larger stores and introduced an online store. Online shopping has grown significantly in the last decade, with younger generations more willing to shop online. More broadly, e-businesses have an easier time scaling than traditional businesses. IBL outsources the delivery process but is responsible for packaging and handling at its warehouse. Customers must go to a store to complete a return or exchange.

APPENDIX VIII – PERFORMANCE MANAGEMENT (CONTINUED)
ADDITIONAL INFORMATION

To: CPA
From: Jeff Lincoln, acting controller
Subject: Cost Allocation Model

Hi CPA,

Our existing cost allocation model for the online and in-store segments is as follows:

- Cost of sales, general and administrative, interest expenses, and accounting gains or losses, if any, are allocated according to the revenue-split percentage.
- Marketing and sales and depreciation expenses are allocated equally between the segments.

In addition:

- The online-segment vice president says that their gross margin was 52% during the year.
- Based on my general and administrative cost allocation model, 40% of these costs are for duties that are related to the general administration of the business. The remaining expenses are the following:

Expense	Amount (\$)
Costs related to the IT department	2,030,000
Maintenance and repairs	1,540,000
Utilities	1,490,000
Store managers' wages and benefits	8,500,000
Total	13,560,000

- The marketing manager estimates that only 10% of the marketing costs are related to the online store, including the online-segment manager's salary and benefits.
- The only fixed assets used by the online store are the furniture and fixtures in the leased warehouse devoted to that store. Depreciation expense on these items totalled \$275,000 for the year. Interest expense on the lease was \$130,000 for the year, and actual cash payments were \$240,000.
- Utility costs related to the operation of the online store are variable costs, which generally represent 2% of sales. All the other utility costs are fixed.
- In my opinion, the IT department spends 80% of its time on managing the online store.
- All property, plant, and equipment disposals during the year occurred at retail stores.

Regards,
Jeff

APPENDIX VIII – PERFORMANCE MANAGEMENT (CONTINUED) ADDITIONAL INFORMATION

Home Decor Forecast

- Tina estimates that sales revenue will be \$13 million, plus or minus 10%.
- Gross margin is expected to be between 48% and 60% for the new products, although IBL has yet to form relationships with new suppliers for these products.
- IBL will use existing space in its stores, and will not incur incremental leasing costs. Management expects that stores will sacrifice between 12% and 16% of existing floor space in favour of the new products, thus negatively impacting sales of the current products proportionally.
- IBL anticipates that it will require new corporate employees to oversee the new product line, with an expected annual cost of \$600,000, plus or minus 5%.
- As the home decor products are significantly larger in size than books, IBL expects its warehousing costs will increase by \$800,000 annually, less a recovery of \$250,000 for savings related to books.
- IBL plans to spend \$300,000 on marketing annually, to develop its customer base.
- IBL expects to purchase \$1 million of new furniture, with a useful life of 10 years, to display the new products.

Home Decor Industry Trends

The home decor industry sells a wide range of products for all areas of the home. Specific product lines include artwork, organizational solutions, accents, textiles, and candles.

Some of IBL's competitors have adopted such offerings in their stores, with varying degrees of success, as they work to understand a new segment and new target markets, and to stock products whose demand is more elastic than books. These products are most successful in-store rather than online, and have been credited with encouraging shoppers to visit the stores, even if they are not interested in books.

APPENDIX VIII – PERFORMANCE MANAGEMENT (CONTINUED) ADDITIONAL INFORMATION

Proposed Membership Program

Overview

- The customer may purchase either a monthly (\$3 per month) or annual (\$20 per year) membership card. Both cards will be paid for upfront.
- The card will allow for a 10% discount on all merchandise.
- The physical card must be presented, for the discount to apply.
- The discount is only available in-store (the online store is not currently designed to allow for such a program).
- Customers must provide their email address to sign up, and will receive targeted advertising from IBL (with opt-out and unsubscribe options available).
- The program applies only to products currently sold by IBL (books, magazines, etc.).

Projections and additional information

- Estimated sign-ups are as follows:
 - Monthly card: 4% of the in-store customer base.
 - Annual card: 2% of the in-store customer base.
- IBL expects to incur \$100,000 in one-time costs related to the program, and an additional \$500,000 in annual operating costs.
- IBL's customers spend \$40 per purchase, on average. If they become members, customers are expected to spend 15% more per visit.
- The average in-store customer currently makes 1.65 purchases per year, although many customers are more frequent visitors. Customers who become members are expected to increase their number of annual visits to the stores by 50%.
- The current in-store customer base is 959,470 clients.

**APPENDIX VIII – PERFORMANCE MANAGEMENT (CONTINUED)
ADDITIONAL INFORMATION**

Online Segment – Bonus Plans

IBL employees within the online segment are included in one of the following two bonus plans:

Element	Plan 1 Vice President	Plan 2 Managers and Staff
Salary	\$150,000	Average of \$60,000
Target bonus % (of salary)	10%	10%
Weighting – Individual performance	0%	60%
Weighting – Organizational performance	100%	40%

All employees receive a minimum bonus of 5%, regardless of performance.

Targets for organizational performance

Metric	Weighting	Thresholds	Bonus Impact
Operating income of online segment	50% of target bonus	\$750,000 – \$1,600,000	50%
		More than \$1,600,000	100%
EBITDA of in-store segment	50% of target bonus	\$8,000,000 – \$16,000,000	50%
		More than \$16,000,000	100%

Operating income is revenue less the following: marketing and sales, cost of sales, general and administrative, warehouse lease costs, and depreciation.

APPENDIX VIII – PERFORMANCE MANAGEMENT (CONTINUED)
ADDITIONAL INFORMATION

Online Segment – Bonus Plans (continued)

Individual performance

All employees, including the vice president (reporting to the chief operating officer), are automatically included in IBL's performance management process. Staff and management are required to develop and submit annual goals, have quarterly check-ins with their direct superior, and self-assess their performance against those goals at the end of the year.

The vice president is responsible for oversight of the entire online segment, and for delegating projects to appropriate managers and staff. She has the discretion to hire an appropriate mix of experienced managers and staff, and to set salaries/wages within the ranges provided by human resources. She is ultimately responsible for the design and maintenance of the online store, and for negotiating leases for warehouse space from a pre-approved short list determined by the finance department. She also supervises the process for ordering inventory, which is stored at the warehouse until sold. Certain activities are carried out by the finance department, including the setting of prices to ensure the online store and retail stores align, and the allocation of head office overhead. Marketing activities are determined by the marketing department.

At the end of each year, direct superiors review the individual self-assessments of their employees, and have sole discretion for rating their direct reports, as follows:

Rating	Bonus Impact
Needs improvement	50%
Meeting expectations	100%
Exceeding expectations	100%

APPENDIX VIII – PERFORMANCE MANAGEMENT (CONTINUED)
ADDITIONAL INFORMATION

Inventory Management System

The inventory management system is a legacy IT solution that was custom built for IBL nearly 20 years ago. The system lacks current capabilities, such as notifications of stockouts, or a search function. Employees can only filter data using the columns listed below:

Quantity	Description	Stock Keeping Unit # (SKU)	Avg. Cost	Price	Last Sold

The corporate finance and operations departments often require inventory reports for financial planning and analysis. The inventory management system can only be viewed at each store; therefore, every store must export PDF reports (the system does not export in spreadsheet form), to send to corporate, as corporate does not have the ability to monitor inventory otherwise.

IBL employees must manually key in new inventory when it arrives, which involves entering data in each of the above fields. The descriptions are limited to 15 characters, so staff must be creative when naming a product, for it to be identifiable by description. The system refreshes at the end of each day, at which point the new products will show up and any sales or refunds made in the point-of-sale (POS) system will also be reflected.

Numerous store managers and corporate finance and operations managers have asked that IBL adopt a new inventory system. Senior leadership has not been receptive to these requests because they consider replacement to be a costly project, and because the legacy system is familiar to employees and easy to use.

***TAXATION ROLE
ADDITIONAL INFORMATION***

**APPENDIX VIII – TAXATION
ADDITIONAL INFORMATION**

Capital Items

Class	UCC as at Dec. 31, 2022 (\$)
Class 1 – Non-residential building	800,000
Class 8	7,500,000
Class 10	45,000
Class 12	125,000
Class 13	5,475,000
Class 46	50,000

The following transactions occurred during the year:

- IBL disposed of its remaining Class 10 computer systems for nil proceeds, and replaced them with new computer systems costing \$700,000. The computer systems disposed of had a net book value of \$160,000, and an original cost of \$900,000.
- IBL also disposed of some Class 46 (30%) data infrastructure systems for proceeds of \$75,000. The systems disposed of had a net book value of \$40,000, and an original cost of \$65,000.
- IBL acquired new furniture and fixtures for \$850,000 during the year.
- IBL renovated one of its buildings and capitalized \$100,000 for accounting purposes, including \$2,000 paid for landscaping.
- IBL has accurately determined its CCA for 2023 on the opening Class 13 UCC balance to be \$650,000, and it made an additional \$250,000 of leasehold improvements during the year on a five-year lease, with three renewal options for an additional five years each.

APPENDIX VIII – TAXATION (CONTINUED)
ADDITIONAL INFORMATION

Financial Statement Details

General and administrative expenses include the following:

- \$3,500 of penalties relating to late payroll remittances
- \$1,500 of interest relating to late-paid supplier invoices
- \$65,000 of donations made to registered Canadian charities
- \$250,000 of financing fees incurred to increase IBL's long-term debt
- \$36,000 of meals and entertainment

Accrued liabilities include accrued performance bonuses. The opening balance of accrued bonuses was \$525,000. This amount was added back on IBL's December 31, 2022, tax return as an accounting reserve. Cash payments of \$525,000 in respect of prior year bonuses were made in August 2023, and new bonuses of \$600,000 were accrued relating to 2023. Tina anticipates that 50% of the new accrued bonuses will be paid in April 2024, and the remaining 50% in July 2024.

Tax Return Details

The December 31, 2022, tax returns for IBL and Bookmarks showed the following:

Ending Loss Balance	IBL (\$)	Bookmarks (\$)
Non-capital losses	0	85,000
Net capital losses	30,000	200,000

APPENDIX VIII – TAXATION (CONTINUED)
ADDITIONAL INFORMATION

Vehicle Lease

During 2023, IBL hired a district manager, Janet, to oversee its Ontario stores, and provided Janet with a leased vehicle as she is frequently required to travel across the province to the various stores. The following relates to the leased vehicle, which is not a zero-emission vehicle, for 2023:

Manufacturer's suggested retail price: \$28,000

Lease start date: February 1, 2023

Monthly lease payments: \$950 + 13% HST

Personal kilometres: 15,000

Business kilometres: 35,000

Operating costs: \$10,000, of which Janet is required to reimburse 10% by January 30, 2024

Employee Discount Program

Retail employees are entitled to purchase merchandise at a price of cost + 10%. Corporate employees are not entitled to the discount program.

Recognition and Rewards (R&R)

Corporate managers have the discretion to provide their staff with the following gifts:

- Gift of a \$600 value, to celebrate a wedding or birth of a child
- Gift of a \$400 value, for long-term service, available every five years

Store managers have the discretion to provide their staff with the following gifts at any time:

- \$300 food delivery service gift card, usable only at one retailer and not convertible to cash
- IBL-branded coffee mugs

APPENDIX VIII – TAXATION (CONTINUED)
ADDITIONAL INFORMATION

Executive Loan Program

- Available to senior vice presidents and corporate officers (CEO, CFO, etc.).
- Executives can take loans up to \$100,000. The loans bear interest at 3%, have a five-year term, and have interest payable annually and principal repayable upon maturity.

The following loans were still outstanding at December 31, 2023.

Kayla Hengten, CEO

- Kayla borrowed \$10,000 on September 1, 2023, to fund her son's university tuition for the fall 2023 semester.
- Kayla is a long-time shareholder of IBL, and owns 8% of the common shares of the company.
- Kayla's brother, Lucas, is another long-time shareholder, and owns 4% of the common shares of IBL.

Tina Parker, CFO

- Tina borrowed \$80,000 on September 1, 2023, to assist with the down payment on a new home.
- Tina and her spouse, Paul, are long-time shareholders, and each own 7% of the common shares of IBL.

James Timmins, senior VP of human resources

- James borrowed \$50,000 on July 1, 2023, to renovate his cottage.
- James owns 0.25% of the common shares of IBL.

APPENDIX VIII – TAXATION (CONTINUED)
ADDITIONAL INFORMATION

To: CPA
From: Jeff Lincoln, acting controller
Date: January 11, 2024
Subject: GST/HST Questions

Hi CPA,

Further to our meeting, I wanted to follow up with some concerns regarding GST/HST:

1. Are the new benefits we are providing to our employees (discounts, leased car, and R&R program) subject to GST/HST?
2. Do we have any GST/HST considerations on the acquisition of Bookmarks?
3. We are contemplating an asset acquisition of another bookstore in 2024. Would that have the same outcome as the share acquisition, from a GST/HST perspective?
4. We are planning on selling some of IBL's furniture and fixtures to Bookmarks in early 2024. Are we required to charge GST/HST on this?

Thanks,
Jeff

**DAY 2 – MARKING GUIDE – COMMON
INSPIRED BOOKS LTD. (IBL)**

To: Tina Parker, CFO
From: CPA
Subject: Financial reporting and management accounting requests

Assessment Opportunity #1 (Common) (Depth and Breadth Opportunity)

The candidate discusses the financial reporting for the acquisition of Bookmarks.

The candidate demonstrates competence in Financial Reporting.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core
1.2.3	Evaluates treatment for non-routine transactions	B

CPA Map Enabling Competencies:

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Acquisition of Shares of Bookmarks Inc. (Bookmarks)

IBL acquired 100% of the issued and outstanding shares of Bookmarks immediately before the end of the year, and the impact must be reflected in IBL's financial statements.

Identifying a business combination

IFRS 3 – Business Combinations applies where the assets acquired, and liabilities assumed, in a transaction constitute a business, as described by IFRS 3.3:

“An entity shall determine whether a transaction or other event is a business combination by applying the definition in this IFRS, which requires that the assets acquired and liabilities assumed constitute a business. If the assets acquired are not a business, the reporting entity shall account for the transaction or other event as an asset acquisition. Paragraphs B5–B12D provide guidance on identifying a business combination and the definition of a business.”

Accordingly, to understand whether a business was acquired, the acquisition of Bookmarks' shares by IBL must be assessed by the criteria in IFRS 3, Appendix B.

First, IFRS 3, Appendix A should be considered, as it provides a definition of “business”:

“An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.”

The activities carried out by Bookmarks in operating as a book retailer meet this definition, as it is an integrated operation of providing goods, and generates income from that ordinary operation.

IFRS 3.B5 provides the definition of a business combination as the following:

“This IFRS defines a business combination as a transaction or other event in which an acquirer obtains control of one or more businesses. An acquirer might obtain control of an acquiree in a variety of ways, for example:

- (a) by transferring cash, cash equivalents or other assets (including net assets that constitute a business);*
- (b) by incurring liabilities;*
- (c) by issuing equity interests;*
- (d) by providing more than one type of consideration; or*
- (e) without transferring consideration, including by contract alone (see paragraph 43).”*

Based on the above, an acquirer must acquire control of an acquiree. IBL acquired control of Bookmarks through the purchase of 100% of its issued and outstanding shares. This was evidenced by the transfer of cash proceeds to the shareholder of Bookmarks, meeting criterion (a) above.

With respect to structuring, IFRS 3.B6 provides:

“A business combination may be structured in a variety of ways for legal, taxation or other reasons, which include but are not limited to:

- (a) one or more businesses become subsidiaries of an acquirer or the net assets of one or more businesses are legally merged into the acquirer;*
- (b) one combining entity transfers its net assets, or its owners transfer their equity interests, to another combining entity or its owners;*
- (c) all of the combining entities transfer their net assets, or the owners of those entities transfer their equity interests, to a newly formed entity (sometimes referred to as a roll-up or put-together transaction); or*
- (d) a group of former owners of one of the combining entities obtains control of the combined entity.”*

Bookmarks has become a wholly-owned subsidiary of IBL following the acquisition of 100% of its shares by IBL, thereby meeting criterion (a) above.

Based on the application guidance in IFRS 3.B5 and B6, this transaction constitutes a business combination, and should therefore be accounted for under IFRS 3.

The acquisition method

IFRS 3 requires that the acquisition method be used for all business combinations, which involves identifying the acquirer, determining the acquisition date, recognizing and measuring identifiable assets acquired and liabilities assumed, and recognizing and measuring goodwill.

IBL acquired control of Bookmarks through its acquisition of 100% of Bookmarks' shares, and is therefore the acquirer. The share purchase agreement had a closing date of December 31, 2023; therefore, this is the acquisition date.

IFRS 3.10 states that, on the acquisition date (December 31, 2023), the acquirer (IBL) shall recognize the identifiable assets acquired and liabilities assumed. These are to be measured at their acquisition-date fair values, as per IFRS 3.18.

Lastly, IFRS 3.32 states that goodwill shall be recognized and measured as follows:

“The acquirer shall recognise goodwill as of the acquisition date measured as the excess of (a) over (b) below:

(a) the aggregate of:

- (i) the consideration transferred measured in accordance with this IFRS, which generally requires acquisition-date fair value (see paragraph 37);*
 - (ii) the amount of any non-controlling interest in the acquiree measured in accordance with this IFRS; and*
 - (iii) in a business combination achieved in stages (see paragraphs 41 and 42), the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree.*
- (b) the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with this IFRS.”*

Accordingly, the calculation of goodwill for IBL's acquisition of Bookmarks is as follows:

Purchase price		\$ 5,000,000
Carrying amount of Bookmarks' net assets:		
Assets	4,702,000	
Liabilities	2,310,000	
		<u>2,392,000</u>
Acquisition differential		2,608,000
Allocated as follows: (Note 1)		
Fair value excess – Inventory	1,000,000	
Fair value excess – Furniture	50,000	
Fair value excess – Leasehold improvements	75,000	
Fair value excess – Computer systems	(25,000)	
		<u>1,100,000</u>
Deferred tax liability on acquisition differential (Note 2)		<u>(286,000)</u>
Goodwill		<u>\$ 1,794,000</u>

Notes:

1. The acquisition differential arising from the difference between the purchase price and the carrying value of Bookmarks' net assets should be first allocated by adjusting the fair value of the assets acquired and liabilities assumed:

Inventory:	$\$3,500,000 - \$2,500,000 = \$1,000,000$
Furniture:	$\$550,000 - \$500,000 = \$50,000$
Leasehold improvements:	$\$250,000 - \$175,000 = \$75,000$
Computer systems:	$\$50,000 - \$75,000 = (\$25,000)$

2. Accordingly, IBL will increase the value of inventory by \$1 million, and property, plant, and equipment acquired by \$100,000.

IFRS 3.24 outlines that, to determine goodwill, IBL must also recognize and measure deferred taxes arising from the assets acquired, and liabilities assumed, in a business combination.

Specifically, IAS 12.19 and 12.66 provide that:

“19. With limited exceptions, the identifiable assets acquired and liabilities assumed in a business combination are recognised at their fair values at the acquisition date. Temporary differences arise when the tax bases of the identifiable assets acquired and liabilities assumed are not affected by the business combination or are affected differently. For example, when the carrying amount of an asset is increased to fair value but the tax base of the asset remains at cost to the previous owner, a taxable temporary difference arises which results in a deferred tax liability. The resulting deferred tax liability affects goodwill (see paragraph 66).

66. As explained in paragraphs 19 and 26(c), temporary differences may arise in a business combination. In accordance with IFRS 3, an entity recognises any resulting deferred tax assets (to the extent that they meet the recognition criteria in paragraph 24) or deferred tax liabilities as identifiable assets and liabilities at the acquisition date. Consequently, those deferred tax assets and deferred tax liabilities affect the amount of goodwill or the bargain purchase gain the entity recognises. However, in accordance with paragraph 15(a), an entity does not recognise deferred tax liabilities arising from the initial recognition of goodwill.”

Due to the increase in the carrying value of property, plant, and equipment, temporary taxable differences arise that should be recognized. Note that no temporary difference arises on goodwill itself.

The timing differences will eventually reverse when the inventory is sold, or in the case of the PP&E, as CCA is claimed. Therefore, assuming Bookmarks’ income tax rate after acquisition will be similar to IBL’s income tax rate of 26%, a deferred tax liability arises on acquisition:

Increase in book basis, PP&E, and inventory	1,100,000
Income tax rate	<u>26%</u>
Deferred tax liability	286,000

At year end, after IBL adds Bookmarks’ trial balance to its own to consolidate the two, the following adjustment must be made to the book values of Bookmarks’ assets and liabilities at the acquisition date, and posted on IBL’s consolidation spreadsheet. This will ensure that the acquisition differentials and goodwill are reflected in the consolidated financial statements, in addition to eliminating the investment and equity accounts.

Dr. Inventory	1,000,000
Dr. PP&E – Furniture	50,000
Dr. PP&E – Leasehold improvements	75,000
Dr. Goodwill	1,794,000
Dr. Shareholder's equity (Bookmarks)	2,392,000
Cr. PP&E – Computer systems	25,000
Cr. Deferred tax liability	286,000
Cr. Investment in Bookmarks	5,000,000

An alternative approach would be to consider the accounting on the consolidated financial statements at the time of acquisition, since it is also the year-end date. Such an approach would record the following worksheet entry at the time of acquisition:

Dr. Cash (held in Bookmarks)	700,000
Dr. Inventory	3,500,000
Dr. Prepaid expenses	100,000
Dr. Furniture	550,000
Dr. Leasehold improvements	250,000
Dr. Computer systems	50,000
Dr. Right-of-use asset	600,000
Dr. Deferred tax asset (existing at Bookmarks)	52,000
Cr. Cash (paid by IBL to seller)	(5,000,000)
Cr. Accounts payable	(1,500,000)
Cr. Current portion of lease liability	(60,000)
Cr. Lease liability	(750,000)
Cr. Deferred tax liability (on acquisition differential)	(286,000)
Dr. Goodwill (to balance)	1,794,000

[Note: Business combinations are a proficiency level B topic, so candidates were not expected to perform the level of detailed analysis included in the guide.]

For Assessment Opportunity #1, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Nominal competence – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to discuss the financial reporting for the acquisition of Bookmarks.

Competent – The candidate discusses the financial reporting for the acquisition of Bookmarks.

Competent with distinction – The candidate thoroughly discusses the financial reporting for the acquisition of Bookmarks.

Assessment Opportunity #2 (Common) (Depth and Breadth Opportunity)

The candidate discusses the financial reporting for the new lease.

The candidate demonstrates competence in Financial Reporting.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core
1.2.2	Evaluates treatment for routine transactions	A

CPA Map Enabling Competencies:

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

6.3.3 Applies decision criteria to choose among viable alternatives

Lease of Halifax Store

Scope and recognition exemptions

The lease of the Halifax location is subject to *IFRS 16 – Leases*, which covers most leases. Note that IFRS 16.5 provides two elective exemptions to its application in respect to short-term leases, and leases for which the underlying asset is of low value:

“A lessee may elect not to apply the requirements in paragraphs 22–49 to:
(a) short-term leases; and
(b) leases for which the underlying asset is of low value (as described in paragraphs B3–B8).”

A short-term lease is defined in IFRS 16, Appendix A, as a lease with a term of 12 months or less; therefore, this exemption is not met.

IFRS 16.B6 specifies that *“A lease of an underlying asset does not qualify as a lease of a low-value asset if the nature of the asset is such that, when new, the asset is typically not of low value. For example, leases of cars would not qualify as leases of low-value assets because a new car would typically not be of low value.”* In this case, since IBL is leasing a building, there is no evidence to suggest it is a low-value asset.

Therefore, neither recognition exemption applies to the Halifax lease.

Identifying a lease

IFRS 16.9 outlines the identification of a lease as follows:

“At inception of a contract, an entity shall assess whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. Paragraphs B9–B31 set out guidance on the assessment of whether a contract is, or contains, a lease.”

IBL entered into a contract with ALC for the lease of a retail space for a period of 62 months, plus an optional renewal, for set monthly payments. Although further information has not been provided with respect to the use of the retail space, the contract clearly represents a lease, based on the identified asset (leased space), period of time (62 months plus renewal), and consideration (monthly payments).

Lease term

IFRS 16.18-19 discusses the determination of the lease term:

“An entity shall determine the lease term as the non-cancellable period of a lease, together with both:

- (a) periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and*
- (b) periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.*

In assessing whether a lessee is reasonably certain to exercise an option to extend a lease, or not to exercise an option to terminate a lease, an entity shall consider all relevant facts and circumstances that create an economic incentive for the lessee to exercise the option to extend the lease, or not to exercise the option to terminate the lease, as described in paragraphs B37–B40.”

The lease agreement provides for a 62-month lease term plus an option to extend the lease for an additional 60 months, which IBL intends to exercise. IBL should include the extension in its determination of the lease term, as it meets criterion (a) above. Therefore, the lease term is determined to be 122 months (the initial 62 months plus the 60-month optional extension).

Recognition

Per IFRS 16.22, lessees must recognize a right-of-use asset and a lease liability on the commencement date. Therefore, although IBL is not required to make its first monthly payment until January 1, 2024, the lease should be recognized on the commencement date of November 1, 2023, and capture the two rent-free periods.

Measurement

On the commencement date of November 1, 2023, the right-of-use (ROU) asset should be measured at cost, comprised of the following components, as per IFRS 16.24:

- “(a) the amount of the initial measurement of the lease liability, as described in paragraph 26;*
- (b) any lease payments made at or before the commencement date, less any lease incentives received;*
- (c) any initial direct costs incurred by the lessee; and*
- (d) an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories. The lessee incurs the obligation for those costs either at the commencement date or as a consequence of having used the underlying asset during a particular period.”*

To determine the initial cost of the ROU asset, the first step is to determine the initial measurement of the lease liability.

Per IFRS 16.26, the lease liability should be measured at the present value of the lease payments not paid as of the commencement date, and discounted using either the implicit rate in the lease, or if not readily determinable, the lessee’s incremental borrowing rate.

The interest rate implicit in the lease is not readily determinable as there is insufficient information with respect to the lessor, ALC. Accordingly, IBL’s incremental borrowing rate of 7.5% shall be used as the discount rate.

As outlined in the lease agreement, the monthly lease payment is \$9,000, starting on January 1, 2024. Therefore, to determine the present value at January 1, 2024, a PV formula can be used with the following inputs:

Rate = $7.5\% \div 12 = 0.625\%$
 Number of periods: 120
 Payment = \$9,000
 Type: Beginning of the period

The PV returns a present value of lease payments of \$762,941 on January 1, 2024. This amount must be further discounted for the two rent-free months, to determine the lease liability at the commencement of the lease on November 1, 2023: $\$762,941 \div (1 + 0.00625)^2 = \$753,493$.

Therefore, the lease liability on the commencement date is \$753,493, which is the starting point for the cost of the ROU asset. Returning to IFRS 16.24, initial direct costs incurred in relation to the lease should also be capitalized to the ROU asset.

IBL incurred \$5,000 of legal fees and \$20,000 of realtor commissions in securing the lease from ALC. These fees should be considered initial direct costs, as outlined in the measurement criteria above (IFRS 16.24(c)), which increases the ROU asset to \$778,493 ($\$753,493 + \$25,000$).

Therefore, the journal entry to set up the lease on November 1, 2023, would be as follows:

Dr. ROU asset	\$778,493	
Cr. Lease liability		\$753,493
Cr. General and administrative expenses	\$25,000	(amount previously expensed)

In addition, the interest expense should be accrued at December 31, 2023, as outlined by IFRS 16.36:

“After the commencement date, a lessee shall measure the lease liability by:
(a) increasing the carrying amount to reflect interest on the lease liability;
(b) reducing the carrying amount to reflect the lease payments made; and
(c) remeasuring the carrying amount to reflect any reassessment or lease modifications specified in paragraphs 39–46, or to reflect revised in-substance fixed lease payments (see paragraph B42).”

As calculated above, on December 31, 2023, the present value of the lease liability will be \$762,941. As no cash payments have been made, the interest expense to recognize up to December 31, 2023, is \$9,448 (\$762,941- \$753,493).

Dr. Interest expense	\$9,448
Cr. Lease liabilities	\$9,448

The lease liability will also have to be split between current and non-current portions. The present value of the lease payments as at January 1, 2024 is \$762,941 (as noted above) and as at December 31, 2024 (one year from the balance sheet date) is \$709,681. Therefore, the current portion is \$53,260, and the journal entry to record is:

Dr. Lease liabilities (non-current portion)	\$53,260
Cr. Current portion of lease liabilities	\$53,260

Finally, depreciation expense should be recorded on the ROU asset. IFRS 16.29 notes that the cost model should be used unless another measurement model applies, as described in IFRS 16.34 and 35:

“If a lessee applies the fair value model in IAS 40 Investment Property to its investment property, the lessee shall also apply that fair value model to right-of-use assets that meet the definition of investment property in IAS 40.

If right-of-use assets relate to a class of property, plant and equipment to which the lessee applies the revaluation model in IAS 16, a lessee may elect to apply that revaluation model to all of the right-of-use assets that relate to that class of property, plant and equipment.”

These measurement models are not applicable to IBL, as it does not maintain any investment property, and we can assume that it is not applying the revaluation model to any similar properties accounted for under IAS 16. Therefore, under the cost model, the depreciation requirements set out by IAS 16 are applied, and the ROU asset should be amortized on a straight-line basis over the life of the lease, with 2023 depreciation of \$12,762 ($\$778,493 \div 122 \text{ months} \times 2 \text{ months}$).

Dr. Depreciation expense	\$12,762
Cr. Accumulated depreciation – ROU asset	\$12,762

For Assessment Opportunity #2, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Nominal competence – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to discuss the financial reporting for the lease.

Competent – The candidate discusses the financial reporting for the lease.

Competent with distinction – The candidate thoroughly discusses the financial reporting for the lease.

Assessment Opportunity #3 (Common) (Depth and Breadth Opportunity)

The candidate discusses the financial reporting for the lawsuit.

The candidate demonstrates competence in Financial Reporting.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core
1.2.2	Evaluates treatment for routine transactions	A

CPA Map Enabling Competencies:

- 6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems
- 6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
- 6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
- 6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions
- 6.3.3 Applies decision criteria to choose among viable alternatives

Breach of Contract Lawsuit

In July 2023, the Toronto store accidentally released the sixth instalment of a critically acclaimed series one week ahead of the official release date set by the publisher, which violated its distribution agreement with the publisher, who brought a lawsuit against IBL.

Accounting guidance for lawsuits is found in *IAS 37 – Provisions, Contingent Liabilities and Contingent Assets*. IAS 37.14 outlines that a provision should be recognized when:

- “(a) an entity has a present obligation (legal or constructive) as a result of a past event;*
- (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and*
- (c) a reliable estimate can be made of the amount of the obligation.”*

IBL did not recognize a provision in July 2023, as it did not meet the recognition criteria. Although an estimate of \$100,000 had been determined, which would meet criterion (c), on the advice of internal legal counsel, there was no probable outflow under criterion (b). Accordingly, no amount was required to be provided for at the time.

Subsequent to year end, the lawsuit was settled, and we must therefore assess the guidance under *IAS 10 – Events After the Reporting Period*. The standard applies because the settlement occurred after the end of the reporting period but before the financial statements have been authorized for issuance, as outlined in IAS 10.3:

- “The following terms are used in this Standard with the meanings specified:
Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are authorised for issue. Two types of events can be identified:*
- (a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and*
 - (b) those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period).”*

The settlement was an event that provided evidence of a condition that existed as at December 31, 2023, being the liability for amounts owing to the publishing company. Therefore, this should be considered an adjusting event after the reporting period. Specifically, IAS 10.9(a) says:

- “The following are examples of adjusting events after the reporting period that require an entity to adjust the amounts recognised in its financial statements, or to recognise items that were not previously recognised:*

(a) the settlement after the reporting period of a court case that confirms that the entity had a present obligation at the end of the reporting period. The entity adjusts any previously recognised provision related to this court case in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets or recognises a new provision. The entity does not merely disclose a contingent liability because the settlement provides additional evidence that would be considered in accordance with paragraph 16 of IAS 37.”

Therefore, IBL should recognize a new provision with respect to the court case, in accordance with IAS 37.

Each of the three criteria in IAS 37.14 should be separately assessed, to determine if it is appropriate to recognize a provision.

Under criterion (a), a present obligation must exist resulting from a past event. It is evident that the past event in this instance refers to the accidental release of the sci-fi novel one week early, and that, in accordance with IAS 37.17(a), the settlement of any obligation (discussed below) would be enforceable by law.

IAS 37.16 provides additional guidance on present obligations:

“In almost all cases it will be clear whether a past event has given rise to a present obligation. In rare cases, for example in a lawsuit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation. In such a case, an entity determines whether a present obligation exists at the end of the reporting period by taking account of all available evidence, including, for example, the opinion of experts. The evidence considered includes any additional evidence provided by events after the reporting period. On the basis of such evidence:

- (a) where it is more likely than not that a present obligation exists at the end of the reporting period, the entity recognises a provision (if the recognition criteria are met); and*
- (b) where it is more likely that no present obligation exists at the end of the reporting period, the entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 86).”*

As provided, where a lawsuit is disputed and it is unclear whether a present obligation exists, the evidence will also include events after the reporting period. IBL’s senior legal counsel, Alyssa, did not believe that IBL had a present obligation, as of August 9, 2023, as they were confident in their defensive arguments. However, the lawsuit settled in favour of the publisher; therefore, a present obligation would have existed at the end of the reporting period on December 31, 2023.

Criterion (b) requires a probable outflow to settle the obligation. This criterion is met because the court has awarded the publisher \$125,000, which IBL will be required to pay in 2024.

Criterion (c) is also met, as the awarded value of \$125,000 is the appropriate amount to provide for. IAS 37.38, outlined below, specifically identifies that the estimate should include any additional evidence provided by events after the reporting period:

“The estimates of outcome and financial effect are determined by the judgement of the management of the entity, supplemented by experience of similar transactions and, in some cases, reports from independent experts. The evidence considered includes any additional evidence provided by events after the reporting period.”

Therefore, the \$100,000 previously estimated by Alyssa is disregarded as it does not reflect the additional evidence provided by events after the reporting period. That is, the final award of \$125,000 from January 2024 represents the best estimate.

Therefore, IBL has met the recognition criteria for a provision in respect of the lawsuit, which should be measured at \$125,000, as at December 31, 2023.

Dr. General and administrative expense	\$125,000
Cr. Accrued liabilities	\$125,000

For Assessment Opportunity #3, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Nominal competence – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to discuss the financial reporting for the lawsuit.

Competent – The candidate discusses the financial reporting for the lawsuit.

Competent with distinction – The candidate thoroughly discusses the financial reporting for the lawsuit.

Assessment Opportunity #4 (Common) (Depth and Breadth Opportunity)

The candidate reviews and revises the draft cash budget.

The candidate demonstrates competence in Management Accounting.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core
3.2.1	Develops or evaluates data and information inputs for operational plans, budgets, and forecasts	A
3.2.2	Prepares, analyzes, or evaluates operational plans, budgets, and forecasts	A

CPA Map Enabling Competencies:

5.1.3 Develops and uses knowledge of the organization, industry and stakeholders

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.2.3 Questions the relevance and tests the quality of information and assumptions in own analyses

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

Cash Budget

I have reviewed and updated the 2024 cash budget for IBL's stand-alone operations:

	Note	Q1 (\$)	Q2 (\$)	Q3 (\$)	Q4 (\$)	Total
Cash balance, beginning		10,700,000	3,863,305	70,629	58,972	
Add: Sales	1	11,510,250	15,347,000	19,183,750	30,694,000	76,735,000
Less: Inventory purchases	2	(6,353,195)	(8,470,926)	(10,588,657)	(16,941,852)	(42,354,630)
Less: General and administrative	3	(5,650,000)	(5,650,000)	(5,650,000)	(5,650,000)	(22,600,000)
Less: Marketing and sales	4	(1,303,500)	(1,303,500)	(3,041,500)	(3,041,500)	(8,690,000)
Less: Depreciation	5	0	0	0	0	0
Less: Lease payments	6	(4,159,000)	(4,159,000)	(4,159,000)	(4,159,000)	(16,636,000)
Less: Purchase of PP&E	7	(475,000)	(475,000)	(875,000)	(475,000)	(2,300,000)
Less: Lawsuit settlement	8	(125,000)	0	0	0	(125,000)
Less: Interest on long-term debt	9	(281,250)	(281,250)	(281,250)	(281,250)	(1,125,000)
Cash balance, ending (subtotal)		3,863,305	(1,129,371)	(5,341,028)	204,370	
Add: Financing	10	0	1,200,000	5,400,000	0	6,600,000
Cash balance, ending (after financing)		3,863,305	70,629	58,972	204,370	

Notes:

1. The draft 2024 cash budget is based on the draft 2023 income statement but does not include the 3% growth that Jeff is expecting:

Total 2023 sales	\$74,500,000
Growth	<u>3%</u>
Forecasted 2024 sales	<u>\$76,735,000</u>

Further, the draft cash budget assumes that sales occur evenly throughout the year. As provided in Appendix V, the historical quarterly sales levels are as follows, and it is expected that 2024 will continue that cyclical trend:

Period	Historical Rate	2024 Sales (\$)
Q1: January – March	15%	11,510,250
Q2: April – June	20%	15,347,000
Q3: July – September	25%	19,183,750
Q4: October – December	40%	30,694,000
Total	100%	76,735,000

2. The draft 2024 cash budget assumes purchases equivalent to cost of sales for each calendar month. However, this does not accurately track cash outlays, because it assumes that the cash outlay is tied to the sale of the good rather than to the purchase of the good. A better indicator would be to determine cash paid to suppliers, and then estimate when those purchases are occurring. It is assumed that the payments to suppliers for the purchase of goods occur cyclically in line with sales.

Further, the draft budget ignores the causation between the increase in sales volume and the increase in cost of sales.

Payments to suppliers:

2023 Cost of sales	\$ 33,525,000
2023 Increase in inventory	<u>7,596,000</u>
2023 Cash paid to suppliers	41,121,000
Growth	<u>3%</u>
Forecasted cash paid to suppliers	<u>\$ 42,354,630</u>

We have assumed that inventory will continue to increase similar to 2023 in order to determine the worst-case scenario, for the purpose of determining IBL's forecasted cash position; however, inventory management may be improved, so these amounts may be lower.

No adjustment was made to take into account the increase or decrease in accounts payable, since no information was provided to specify what portion of accounts payable related to inventory purchases.

Period	Historical Rate	2024 Purchases (\$)
Q1: January – March	15%	6,353,195
Q2: April – June	20%	8,470,926
Q3: July – September	25%	10,588,657
Q4: October – December	40%	16,941,852
Total	100%	42,354,630

- It appears reasonable that general and administrative costs will occur evenly throughout the year. This amount has not been adjusted for the lawsuit, despite the financial reporting adjustment made earlier, as it is a non-recurring expense (see Note 8).
- Similar to the analysis of cost of sales, the draft cash budget relies on 2023 marketing and sales expenses rather than on cash outlays, which were noted to occur in the following pattern: 15%, 15%, 35%, and 35%.

Period	Historical Rate	Marketing and Sales (\$)
Q1: January – March	15%	1,303,500
Q2: April – June	15%	1,303,500
Q3: July – September	35%	3,041,500
Q4: October – December	35%	3,041,500
Total	100%	8,690,000

- Depreciation is a non-cash expense, and should therefore be excluded from the cash budget.
- The lease payments are based on 2023 lease payments, and accordingly, do not include the new Halifax lease.

2023 Lease payments	\$ 16,528,000
Halifax lease payments	<u>108,000</u> (\$9,000 × 12 months)
Total estimated 2024 payments	<u>16,636,000</u>
Quarterly payments	<u>\$ 4,159,000</u>

It is assumed that the monthly lease payments are incurred evenly throughout the year, and that there are no lease terminations or additions planned for 2024 that would alter the monthly payments.

7. The draft calculation assumed that IBL would make purchases of property, plant, and equipment equal to 2023. However, additional analysis and confirmation of planned capital expenditure should be done and obtained before finalizing the budget. The budget also includes the projected leasehold improvements planned for August 2024 at the Halifax location.
8. Based on AO#3, IBL will have an additional cash outlay of \$125,000 during Q1, in settlement of the lawsuit.
9. The annual interest on the long-term debt of \$15 million, at a rate of 7.5%, is \$1,125,000, which would be \$281,250 per quarter, if paid quarterly or monthly. This amount excludes any potential interest on the additional financing required in Q2 and Q3, since the form of the financing has yet to be determined.
10. Cash shortages are forecasted for the second and third quarters. Additional financing will have to be raised during each quarter, and the additional financing was rounded to the next \$100,000.

After considering the above revisions, IBL will experience a cash shortage in both Q2 and Q3, and will require financing of \$1,200,000 in Q2 and \$ 5,400,000 in Q3.

For Assessment Opportunity #4, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Nominal competence – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to review and revise the cash budget.

Competent – The candidate reviews and revises the cash budget.

Competent with distinction – The candidate thoroughly reviews and revises the cash budget.

Assessment Opportunity #5 (Common) (Depth and Breadth Opportunity)

The candidate assesses the company's balanced scorecard and recommends improvements.

The candidate demonstrates competence in Management Accounting.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core
3.6.1	Evaluates performance using accepted frameworks	B
3.6.3	Evaluate root causes of performance issues	B

CPA Map Enabling Competencies:

5.1.1 Applies general business knowledge to enhance work performed

5.1.3 Develops and uses knowledge of the organization, industry and stakeholders

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.2.1 Maintains an objective and questioning mindset to avoid biased analyses

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Balanced Scorecard

IBL's balanced scorecard is outdated, having last been updated in 2018. Tina has asked us to assess the scorecard and recommend improvements.

Financial perspective

Profit growth % is an indication of whether IBL is improving its profitability and growing the business, which is a key metric for the executive team. However, "profit" can be defined in many ways. The recommended measure will use operating income (which is readily available from the statement of profit and loss) as being the definition of "profit."

Gross margin % is not the best indicator for cash flow relating to inventory, and IBL should consider a more appropriate measure. While it does inform on cash flow, it does not account for purchases of inventory. A more appropriate measure is inventory turnover. For 2023, IBL's inventory turnover was 0.42, indicating that it is not turning over its inventory annually, which is likely a major contributing factor to the cash flow concerns.

Customer perspective

The existing customer goals are relevant for achieving a successful business. While it is likely they were designed with the brick-and-mortar stores in mind, they can also be applied to the online stores. However, overall sales volume is not the best measure for attracting new customers, because sales volume could be skewed by an increase or decrease in sales volume from existing customers. Accordingly, a better measure could be tracking the number of new customers, which could be implemented at checkout. Specifically, a customer-facing POS system (such as on a tablet) can be used to collect information from customers at the time of purchase, while the cashier is scanning their purchases. The POS system could ask the customers to confirm whether this is their first purchase from IBL, or to provide their email address, to determine if the email address is linked to a previous purchase. This system would also allow for more accurate tracking than the existing, informal process at checkout.

Additionally, to focus on the online store specifically, IBL should add a goal of increasing online sales, and measure customer conversion online, because IBL has difficulty converting website traffic to actual sales. Online sales can be measured in terms of year-over-year online revenue growth, and customer conversion can be determined using e-commerce software, calculated as the percentage of website visits that lead to a completed purchase.

Learning and growth perspective

The first learning and growth goal does not appear to be appropriate, given that it only considers voluntary learnings completed by employees. The current measure does not capture any mandatory learnings offered by IBL, which would also align with the goal of promoting continuing education. A better measure would be to track the number of mandatory and voluntary learnings completed by employees.

However, given the employee turnover issues that IBL is presently facing, the goal to promote learning opportunities for employees may not be the most pressing matter to IBL. Given the difficulties with the “revolving door” of employees, a revised goal should be retaining current employees, and the associated measure should be employee retention %.

The second learning and growth goal appears to be appropriate, as employees with high morale are less likely to leave, and it fosters a healthier and more productive working environment overall.

Internal operations perspective

It appears that IBL has had success in its order handling from a timeliness perspective (orders are filled and dispatched on a timely basis); however, there have been some quality-control issues stemming from rough handling of products in the warehouse, such as wrinkled pages and scratched covers. Accordingly, a new goal of reducing product damage should be introduced, with a related measure of number of damaged products. The existing handling goal should be retained, with an update to the wording from “improved” to “maintained.” This will allow IBL to track the speed and quality of the warehouse operations, and ensure that neither speed nor quality are being sacrificed in favour of each other.

Given the renewed focus on the online store, it is appropriate that systems capability continue to be improved; therefore, this goal is still relevant. However, the goal could be more specific to the website for the online store. The measure could also be more specific to the various capabilities of the website. The number of improvement requests processed would be an example of a metric for monitoring the achievement of this goal, as improvements could address both website capabilities and reliability.

It would be important to consider data privacy and security in IBL’s balanced scorecard, given the rise in consumer concern about these matters. Accordingly, a new goal of ensuring the privacy and security of customers’ information should be added. The company could measure this by tracking the number of data breaches, phishing attempts, known weaknesses in IBL’s IT infrastructure, or amounts spent training employees in data security.

Also, the balanced scorecard should include, for each of the measures identified, a realistic target as a way to determine whether or not each of the goals was achieved during the year. This will need to be further analyzed by IBL, to determine appropriate targets for each measure.

Revised scorecard:*Financial perspective*

Goals	Measures
Promote financial growth of the business	Operating income growth %
Improve cash flow relating to inventory	Inventory turnover

Customer perspective

Goals	Measures
Retain existing customers	Customer retention %
Attract new customers	# of new customers
Increase online sales	Revenue growth % in online sales Online conversion %

Learning and growth perspective

Goals	Measures
Retain existing employees	Employee retention %
Improve employee morale	Employee satisfaction %

Internal operations perspective

Goals	Measures
Maintain order handling	Time from order to shipment
Reduce product damage	# of damaged products
Improve website capability	# of improvement requests processed

For Assessment Opportunity #5, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Nominal competence – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to assess the balanced scorecard and recommend improvements.

Competent – The candidate assesses the balanced scorecard and recommends improvements.

Competent with distinction – The candidate thoroughly assesses the balanced scorecard and recommends improvements.

Assessment Opportunity #6 (Common) (Depth and Breadth Opportunity)

The candidate assesses whether the café pilot was a success, and suggests improvements.

The candidate demonstrates competence in Management Accounting.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core
3.3.2	Evaluates and applies cost management techniques appropriate for specific costing decisions	B
3.4.1	Evaluates sources and drivers of revenue growth	B

CPA Map Enabling Competencies:

5.1.3 Develops and uses knowledge of the organization, industry and stakeholders

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Café Trial

IBL piloted a café at one of its Toronto stores during the year, and has provided financial results and additional notes on the impact of the café. In order to advise Tina on the best course of action with respect to the café, it is important to assess the quantitative performance and qualitative factors.

Financial performance

Tina is concerned about the loss incurred by the café operation during 2023. However, the results should be adjusted to provide a more accurate reflection of the café's operation. Specifically, IBL should be concerned with the relevant costs of operating the café.

Incremental operating income generated by the café:

	(\$)	Note
Sales – café	225,000	
Cost of sales – café	(135,000)	
Additional sales – retail	112,578	1
Additional cost of sales – retail	(50,660)	1
Salaries specific to café	(80,000)	2
Marketing expenses specific to café	(6,000)	3
Rent specific to café	0	4
Utilities specific to café	(3,927)	5
Incremental income generated by the café	61,991	

Notes:

- The general manager has not factored in the incremental sales of the retail store, driven by the increased foot traffic arising from the café. Although we do not have details of this individual store's performance, we can estimate, based on the average values known:

Revenue	\$ 74,500,000
In-store rate	<u>85%</u>
In-store revenue	63,325,000
Stores	<u>45</u>
Average store revenue	1,407,222
Increased sales volume	<u>8%</u>
Incremental sales	<u>112,578</u>
2023 COGS %	<u>45%</u>
Incremental COGS	\$ <u><u>50,660</u></u>

- The general manager noted that the café was staffed one-third of the time by retail employees who would otherwise be fulfilling other duties.

If the café is closed, the salaries and wages associated with the retail employees would continue. The only costs specific to the café would be two-thirds of the amount of \$120,000, or \$80,000. This assumes that the retail employees working at the café would return to working at the store. Therefore, in assessing the incremental operating income of the café for the past year, \$80,000 has been included related to salaries and wages.

Alternatively, it could be argued that the café would require the full \$120,000 in order to operate properly, and that new employees would be hired to replace the retail employees currently working at the store.

3. It is assumed that all marketing costs were specific to the café operation, and would cease if the café were closed.
4. The store would still be subject to the same amount of rent if it were to close the café. Accordingly, this cost is not relevant to the analysis.
5. Based on the general manager's notes, 15% of the utilities should be allocated to the café. Similar to rent, these costs would continue irrespective of whether the café were closed. However, the general manager also explained that the utility costs had increased by 17% due to the café operation. Accordingly, there should be a reduction in the utility costs, back to the store's pre-café standard.

Utilities allocated of \$4,054 ÷ 15% allocation = total utilities of \$27,027

Accordingly, pre-café utilities = \$23,100 ($\$27,027 \div 1.17$), and the entirety of the 17% increase can be attributable to the café, an amount of \$3,927. The remainder of the utility costs would have been spent regardless, café or not.

Therefore, by adjusting the avoidable and unavoidable expenses, IBL is better off by continuing to maintain the café, assuming that it forecasts similar activity for 2024.

Qualitative performance

While the figures above demonstrate a small financial benefit to maintaining the café, IBL should also consider the additional impacts.

The general manager noted that they had little experience in the food service field. The performance of the café could be better if a manager with exposure to food service were involved, to allow the general manager to focus on the retail side and the overall store workings. However, the addition of a manager would come with incremental salary costs, and IBL would need to weigh the benefits of that manager against the costs of employing them. One could expect that a dedicated and experienced manager could increase the gross margin, and tackle issues such as the food wastage identified by the general manager.

Further, the general manager noted that retail employees often needed to assist in the café operation due to staffing issues. This should be rectified as soon as possible, as it has multiple negative effects:

- Retail employees are likely poorly trained in the café, if at all, which diminishes customer experience, and could present a health and safety concern.
- It is likely that retail employees are unhappy with the arrangement, as the general manager said they were reluctant to help. This exacerbates issues that IBL is already facing in staffing.
- By taking retail employees away from their standard duties to assist in the café, there are likely corresponding deficiencies in the retail side of the operation.

There has been some damage to the fixtures and inventory near the café, which is causing problems for the retail store. IBL should consider what is causing this damage and find ways to manage it. For example, if the drinkware is leaking, IBL could purchase higher-quality items. Alternatively, IBL may have to accept this as an incremental cost of the café operation, and factor it into the financial analysis by estimating annual damage. Higher-value books could also be located further away from the café to minimize the costs.

In assessing the performance of the café, it appears that it provides a net benefit to IBL, and IBL should consider making the improvements discussed above, and continue the trial.

For Assessment Opportunity #6, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Nominal competence – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate assesses whether the café pilot was a success, or suggests improvements.

Competent – The candidate assesses whether the café pilot was a success, and suggests improvements.

Competent with distinction – The candidate thoroughly assesses whether the café pilot was a success, and suggests improvements.

**DAY 2 – MARKING GUIDE – ASSURANCE ROLE
INSPIRED BOOKS LTD. (IBL)**

To: Kim Davies, Audit Manager
From: CPA
Subject: IBL audit issues

See Common Marking Guide for the Common Assessment Opportunities #1 to #6.

Assessment Opportunity #7 (Depth Opportunity)

The candidate discusses the financial reporting implications of the RSU plan.

The candidate demonstrates competence in the Assurance role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
1.2.3	Evaluates treatment for non-routine transactions	B	A

CPA Map Enabling Competencies:

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgement to recommend and justify solutions or conclusions

6.3.3 Applies decision criteria to choose among viable alternatives

Restricted Stock Unit (RSU) Plan

The RSU plan implemented by IBL is to be accounted for under *IFRS 2 – Share-Based Payment*.

Recognition

IFRS 2.7 provides the following:

“An entity shall recognise the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received. The entity shall recognise a corresponding increase in equity if the goods or services were received in an equity-settled share-based payment transaction, or a liability if the goods or services were acquired in a cash-settled share-based payment transaction.”

The RSU plan provided by IBL is a cash-settled, share-based payment, as the plan stipulates that IBL will settle the units in cash as they vest. Accordingly, IFRS 2.32 outlines that IBL should recognize the services received (i.e., employee compensation expense), and a liability to pay for those services, over the vesting period:

“The entity shall recognise the services received, and a liability to pay for those services, as the employees render service. For example, some share appreciation rights vest immediately, and the employees are therefore not required to complete a specified period of service to become entitled to the cash payment. In the absence of evidence to the contrary, the entity shall presume that the services rendered by the employees in exchange for the share appreciation rights have been received. Thus, the entity shall recognise immediately the services received and a liability to pay for them. If the share appreciation rights do not vest until the employees have completed a specified period of service, the entity shall recognise the services received, and a liability to pay for them, as the employees render service during that period.”

Note that, while the above excerpt references share appreciation rights, IFRS 2.31 clarifies that they are used for illustration purposes, and the requirements are equally applicable to other plans:

“Share appreciation rights are used to illustrate some of the requirements in paragraphs 32–33D; however, the requirements in those paragraphs apply to all cash-settled share-based payment transactions.”

Therefore, IBL does not record an entry on the grant date because no services have been rendered by employees. Rather, IBL will initially measure the RSU plan at the end of its first reporting period, i.e., December 31, 2023, and remeasure annually thereafter.

Measurement

IFRS 2.30 and 2.33 provide the following with respect to measurement:

“For cash-settled share-based payment transactions, the entity shall measure the goods or services acquired and the liability incurred at the fair value of the liability, subject to the requirements of paragraphs 31–33D. Until the liability is settled, the entity shall remeasure the fair value of the liability at the end of each reporting period and at the date of settlement, with any changes in fair value recognised in profit or loss for the period.”

The liability shall be measured, initially and at the end of each reporting period until settled, at the fair value of the share appreciation rights, by applying an option pricing model, taking into account the terms and conditions on which the share appreciation rights were granted, and the extent to which the employees have rendered service to date subject to the requirements of paragraphs 33A–33D. An entity might modify the terms and conditions on which a cash-settled share-based payment is granted. Guidance for a modification of a share-based payment transaction that changes its classification from cash-settled to equity-settled is given in paragraphs B44A–B44C in Appendix B.”

As discussed above, IBL should measure the RSU plan at the end of its reporting period and recognize a liability at the fair market value.

In addition, IFRS 2.33A and 2.33B discuss the impact of vesting and non-vesting conditions:

“A cash-settled share-based payment transaction might be conditional upon satisfying specified vesting conditions. There might be performance conditions that must be satisfied, such as the entity achieving a specified growth in profit or a specified increase in the entity's share price. Vesting conditions, other than market conditions, shall not be taken into account when estimating the fair value of the cash-settled share-based payment at the measurement date. Instead, vesting conditions, other than market conditions, shall be taken into account by adjusting the number of awards included in the measurement of the liability arising from the transaction.

To apply the requirements in paragraph 33A, the entity shall recognise an amount for the goods or services received during the vesting period. That amount shall be based on the best available estimate of the number of awards that are expected to vest. The entity shall revise that estimate, if necessary, if subsequent information indicates that the number of awards that are expected to vest differs from previous estimates. On the vesting date, the entity shall revise the estimate to equal the number of awards that ultimately vested.”

The continuous employment clause in the RSU plan represents a vesting condition that is not a market condition, and accordingly, IBL should adjust the number of RSUs that it factors into the measurement of the liability as at December 31, 2023.

As the RSUs have multiple vesting dates, they should be divided into separate (four) tranches. The first tranche is represented by the 40% of the RSUs that vest on January 1, 2024. As all 25 eligible employees remained employed at IBL on December 31, 2023, 10,000 RSUs will vest on the first anniversary:

$$25 \text{ employees} \times 1,000 \text{ RSUs} \times 40\% \text{ vesting} = 10,000 \text{ RSUs}$$

The successive tranches are represented by the remaining 60% of the RSUs that vest evenly on each successive anniversary date. The vesting RSUs are estimated as follows:

$$\text{Tranche 2: } 25 \text{ employees} \times 1,000 \text{ RSUs} \times 20\% \text{ vesting} \times 90\% \text{ retention} = 4,500 \text{ RSUs}$$

$$\text{Tranche 3: } 25 \text{ employees} \times 1,000 \text{ RSUs} \times 20\% \text{ vesting} \times 80\% \text{ retention} = 4,000 \text{ RSUs}$$

$$\text{Tranche 4: } 25 \text{ employees} \times 1,000 \text{ RSUs} \times 20\% \text{ vesting} \times 70\% \text{ retention} = 3,500 \text{ RSUs}$$

Therefore, in aggregate, IBL anticipates that 22,000 of its RSUs will meet the vesting conditions, and that the fair market value of the RSUs on December 31, 2023, is estimated to be $22,000 \times \$7.50 = \$165,000$.

As each RSU tranche vests on a certain date, each tranche should be amortized over its own specific vesting period. The vesting period for Tranche 1 is therefore 12 months, Tranche 2 is 24 months, etc. As at December 31, 2023, 12 months have elapsed, and a pro-rata portion of the total fair market value of each tranche should therefore be recognized as a liability:

Tranche	Quantity	Share Price (\$)	FMV @ Dec. 31, 2023 (\$)	Vesting Completion	Liability (\$)
Tranche 1	10,000	7.50	75,000	100%	75,000
Tranche 2	4,500	7.50	33,750	50%	16,875
Tranche 3	4,000	7.50	30,000	33%	10,000
Tranche 4	3,500	7.50	26,250	25%	6,563
Total	22,000		165,000		108,438

$$\text{Tranche 1: Vesting completion} = 12 \text{ months} \div 12 \text{ months} = 100\%$$

$$\text{Tranche 2: Vesting completion} = 12 \text{ months} \div 24 \text{ months} = 50\%$$

$$\text{Tranche 3: Vesting completion} = 12 \text{ months} \div 36 \text{ months} = 33.33\%$$

$$\text{Tranche 4: Vesting completion} = 12 \text{ months} \div 48 \text{ months} = 25\%$$

The liability is determined as the vesting completion percentage multiplied by the FMV.

IBL should record the following as at December 31, 2023:

Dr. Compensation expense	\$108,438	
Cr. RSU liability		\$108,438

When the first tranche of RSUs vests on January 1, 2024, IBL will record the cash settlement:

Dr. RSU liability	\$75,000	
Cr. Cash		\$75,000

At the end of each subsequent reporting period, IBL should remeasure the liability, based on the share price on the year-end date, and any revisions to the forfeiture estimates. Any remeasurement expense or recovery is recognized in profit or loss.

For Assessment Opportunity #7, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to discuss the financial reporting implications of the RSU plan.

Competent – The candidate discusses the financial reporting implications of the RSU plan.

Competent with distinction – The candidate thoroughly discusses the financial reporting implications of the RSU plan.

Assessment Opportunity #8 (Depth Opportunity)

The candidate discusses the risks of material misstatement at the overall financial statement level, and determines materiality for the 2023 audit.

The candidate demonstrates competence in the Assurance role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
4.3.4	Assesses materiality for the assurance engagement or project	B	A
4.3.5	Assesses the risks of the project, or, for audit engagements, assesses the risks of material misstatement at the financial statement level and at the assertion level for classes of transactions, account balances, and disclosures	B	A

CPA Map Enabling Competencies:

2.2.1 Assists in identifying and monitoring risks within areas of work responsibility

5.1.1 Applies general business knowledge to enhance work performed

5.1.3 Develops and uses knowledge of the organization, industry and stakeholders

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Risk of Material Misstatement at the Financial Statement Level

In planning the audit, the following risks were identified:

- In May, the controller left the company, and Jeff was promoted to the role of acting controller. This increases risk, because Jeff would have needed to get up-to-speed on transactions he was not previously involved in, and has had to take on increased responsibility without a reprieve from his existing duties. Therefore, he may not have the time to prevent and detect errors in the financial statements.
- IBL has a history of accounting errors, punctuated by a revolving door of controllers, which indicates that the technical accounting knowledge at IBL is likely low. The CFO has been with the company for 15 years, providing stability; however, the history of accounting errors present at IBL suggests that the CFO may not be providing sufficient supervision to prevent and detect errors. This increases the risk of additional errors being present in the financial statements.
- The new RSU plan is tied to share price, which incentivizes management to present the financial statements in a favourable manner. This may lead to management fraudulently manipulating the financial statements.

- IBL has continued to draw on its long-term debt facility during the year, and is currently not servicing the debt, as noted in the increase in interest payable. This may create an incentive for management to manipulate the financial statements, to present a better financial outlook for IBL's debtors.
- IBL is a publicly-traded company, which means that the financial statements are relied upon by a broad group of users who are generally interested in profitability. There may be incentive for management to manipulate profits, to meet shareholder expectations, particularly as the draft financial statements for 2023 are showing a loss for the year.
- There were new transactions during the year (e.g., acquisition of Bookmarks, Halifax lease, lawsuit) that IBL has not been able to address on its own, indicating that the accounting team is lacking the technical knowledge and/or capacity to address these, or other new, transactions. Therefore, there may be additional errors in the financial statements that have not yet been identified.
- Control processes within payroll appear to be sufficient, as we are planning to rely on the controls in our audit approach over payroll. However, control weaknesses have been identified at the individual store level, which indicates that the control environment is not operating effectively. Therefore, the control environment may not be able to prevent and detect errors in all areas of the financial statements.

As a result of the risks of material misstatements identified, it will be important to have experienced staff assigned to the audit team, and we should increase supervision of the audit, to address the risks identified. Another response to these overall risks is to assign a suitably experienced engagement quality reviewer to this engagement; such an appointment is also a requirement under CSQM 1, paragraph 34 (f)(i), because IBL is a listed entity.

Materiality

In accordance with CAS 320, materiality should be based on the users of the financial statements. The following stakeholders have been identified as users of IBL's statements:

- As a public company, IBL's shareholders are users of the financial statements; they are concerned with the profitability of the company, so that they may earn a return on their investment.
- IBL's lenders are users of the financial statements, and are concerned with IBL's ability to service its long-term debt.
- Some eligible employees are included in the RSU plan, and are therefore concerned with IBL's stock price.

Given the users and their needs, profitability is the appropriate benchmark to use in setting materiality. However, as IBL is in a loss position for both 2023 and 2022, net income before income taxes is not a suitable basis.

As net income before income taxes is not suitable, materiality may be derived based on revenue, as it provides a proxy for financial performance. The range used for materiality based on revenue is typically 1% to 3%. Since IBL is in a loss position, lenders and shareholders will be more sensitive to misstatements in financial statements. Therefore, we will set materiality at the lower end of the range, at 1% of revenue. After reviewing the previous financial reporting discussions, it is noted that none of the adjustments identified have an impact on revenue.

Therefore, materiality will be set at: $\$74,500,000 \times 1\% = \$745,000$.

CAS 320 also states that performance materiality must be determined. Performance materiality is set to reduce the probability that the aggregate of uncorrected and undetected misstatements exceeds the materiality of the financial statements as a whole, and is generally set between 50% and 90% of materiality.

Based on the risks identified above and the accounting errors discussed previously, we will set performance materiality at the lower end of the range, at 60% of planning materiality.

Therefore, performance materiality will be set at: $\$745,000 \times 60\% = \$447,000$.

For Assessment Opportunity #8, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to discuss the risks of material misstatement at the overall financial statement level, and attempts to determine materiality, for the 2023 audit.

Competent – The candidate discusses some risks of material misstatement at the overall financial statement level, and determines materiality, for the 2023 audit.

Competent with distinction – The candidate discusses several risks of material misstatement at the overall financial statement level, and thoroughly determines materiality, for the 2023 audit.

Assessment Opportunity #9 (Depth Opportunity)

The candidate prepares a year-over-year variance analysis of the draft financial statements, and discusses risks to consider when planning the audit.

The candidate demonstrates competence in the Assurance role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
4.3.5	Assesses the risks of the project, or, for audit engagements, assesses the risks of material misstatement at the financial statement level and at the assertion level for classes of transactions, account balances, and disclosures	B	A

CPA Map Enabling Competencies:

- 2.2.1 Assists in identifying and monitoring risks within areas of work responsibility*
- 5.1.1 Applies general business knowledge to enhance work performed*
- 5.1.3 Develops and uses knowledge of the organization, industry and stakeholders*
- 6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives*
- 6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions*

Analytical Procedures

Analytical procedures are an important part of assessing the risks of material misstatement, as they can identify unusual or unexpected movements in balances, or in some instances, can help to explain relationships between different items. In addition, as per CAS 315.14(b), they are a required component of risk assessment for an audit engagement:

- “The risk assessment procedures shall include the following: (Ref: Para. A19-A21)*
- (a) Inquiries of management and of other appropriate individuals within the entity, including individuals within the internal audit function (if the function exists). (Ref: Para. A22-A26)*
 - (b) Analytical procedures. (Ref: Para. A27-A31)*
 - (c) Observation and inspection. (Ref: Para. A32-A36)”*

Note that the variance analysis below has been presented considering the adjustments identified in the financial reporting issues previously discussed. This variance analysis could also be performed using unadjusted numbers, but the financial reporting issues would still need to be considered in planning the audit.

**INSPIRED BOOKS LTD.
ANALYTICAL PROCEDURES MERGED**

	2023		Note	2023		2022		Variance	
	Draft	Adjustments		Adjusted	Audited	\$	%		
Assets									
Current assets									
Cash and cash equivalents	\$ 10,700	\$ 0		\$ 10,700	\$ 17,600	\$ (6,900)	-39.20%		
Inventory	84,113	0		84,113	76,517	7,596	9.93%		
Prepaid expenses	1,903	0		1,903	1,952	(49)	-2.51%		
Income tax recoverable	1,284	0		1,284	1,581	(297)	N/A		
Total current assets	<u>98,000</u>	<u>0</u>		<u>98,000</u>	<u>97,650</u>	<u>350</u>			
Deferred tax asset	600	0		600	500	100	N/A		
Property, plant, and equipment – net	15,627	0		15,627	16,409	(782)	-4.77%		
Right-of-use assets	77,874	766	1	78,640	82,043	(3,403)	-4.15%		
Investment in Bookmarks	5,000	0	5	5,000	0	5,000	New		
Total assets	<u>\$ 197,101</u>	<u>766</u>		<u>\$ 197,867</u>	<u>\$ 196,602</u>	<u>\$ 1,265</u>			
Liabilities									
Current liabilities									
Accounts payable and accrued liabilities	\$ 29,109	\$ 233	2	\$ 29,342	\$ 30,289	\$ (947)	-3.13%		
Current portion of lease liabilities	15,134	53	3	15,187	13,013	2,174	16.71%		
Interest payable	1,157	0		1,157	389	768	197.43%		
Total current liabilities	<u>45,400</u>	<u>286</u>		<u>45,633</u>	<u>43,691</u>	<u>1,995</u>			
Lease liabilities	67,500	710	3	68,210	73,247	(5,037)	-6.88%		
Long-term debt	15,000	0		15,000	5,000	10,000	200.00%		
Total liabilities	<u>\$ 127,900</u>	<u>\$ 996</u>		<u>\$ 128,896</u>	<u>\$ 121,938</u>	<u>\$ 6,958</u>			

	2023		Note	2023		2022		Variance	
	Draft	Adjustments		Adjusted	Audited	\$	%		
Shareholders' equity									
Common shares	\$ 65,000	\$ 0		\$ 65,000	\$ 65,000				
Retained earnings	4,201	(230)	4, 5	3,971	9,664				
Total shareholders' equity	69,201	(230)		68,971	74,664				
Total liabilities and shareholders' equity	197,101	766		197,867	196,602				
CHECK	0	0		0	0				

Notes:

- \$778,493 (increase in right-of-use asset) - \$12,762 (amortization of right-of-use asset) = \$765,731.
- \$125,000 (recognition of the provision for the lawsuit) + \$108,438 (RSU liability) = \$233,438.
- Current portion: \$53,260 (reclassification from non-current portion)
Non-current portion: \$753,493 (increase in lease liabilities) + \$9,448 (increase in lease liabilities from interest expense) – \$53,260 (reclassification to current portion) = \$709,681.
- Impact on retained earnings from adjustments to income are: \$125,000 (provision for lawsuit) + \$108,438 (compensation expense from RSU) + \$12,762 (amortization of right-of-use asset) + \$9,448 (interest on lease liabilities) - \$25,000 (reversal of general and administrative expenses in setting up the right-of-use asset) = \$230,648.

5. The investment in Bookmarks occurred on December 31, 2023. Adjustments related to the accounting for this acquisition have not been included in this analytical review so that the comparison of balances from 2022 to 2023 reflect unconsolidated numbers for IBL only. Additional risks of material misstatement related to Bookmarks' balances are identified separately below.

	2023		Note	2023		Variance	
	Draft	Adjustments		Adjusted	Audited	\$	%
Revenue							
Sales	\$ 74,500	\$ 0		\$ 74,500	\$ 70,775	\$ 3,725	5.26%
Cost of sales	(33,525)	(108)	6	(33,633)	(31,924)	(1,709)	5.35%
Gross profit	40,975	(108)		40,867	38,851	2,016	
Operating expenses							
General and administrative	22,600	100	7	22,700	21,233	1,467	6.91%
Marketing and sales	8,690	0		8,690	8,493	197	2.32%
Depreciation	8,388	13	8	8,401	7,425	976	13.14%
Total operating expenses	39,678	113		39,791	37,151	2,640	
Operating income	1,297	(221)		1,076	1,700	(624)	
Loss on disposal of PP&E	160	0		160	0	160	New
Gain on disposal of PP&E	(35)	0		(35)	0	(35)	New
Interest expense – lease liabilities	7,649	9	9	7,658	9,599	(1,941)	-20.22%
Interest expense – long-term debt	906	0		906	250	656	262.40%
Loss before income taxes	(7,383)	(230)		(7,613)	(8,149)	536	
Income tax recovery	1,920	0		1,920	2,119	(199)	N/A
Net loss	\$ (5,463)	\$ (230)		\$ (5,693)	\$ (6,030)	\$ 337	
Opening retained earnings	\$ 9,664	\$ 0		\$ 9,664	\$ 15,694		
Closing retained earnings	\$ 4,201	\$ (230)		\$ 3,971	\$ 9,664		

Notes (continued):

6. Increase in compensation expense to recognize the RSU liability = \$108,438.
7. \$125,000 (provision for lawsuit) - \$25,000 (reclass of G&A expenses to right-of-use asset) = \$100,000.
8. Increase in depreciation expense of right-of-use assets = \$12,762.
9. Increase in interest expense relating to lease liabilities = \$9,448.

Based on the year-over-year dollar and percentage variances in the financial statements, the following observations are noted.

Statement of financial position:

- Cash decreased by \$6.9 million, or 39.20%, from 2022, representing a significant change. \$5 million of this decrease can be accounted for by the investment in Bookmarks, but the company also received \$10 million in long-term debt proceeds. Significant changes in other accounts also affect cash (e.g., \$7,596,000 increase in inventory, \$3,725,000 increase in sales, etc.). Given the risks in other accounts that affect cash, and the fraud risk around cash, there is a potential completeness risk around cash.
- Inventory increased by \$7,596,000, or 9.93%, over 2022. The large increase implies that there was an increase in purchasing activity, which may relate to the decrease in cash discussed above. Inventory is expected to increase with increased sales activity; however, the increase in inventory is much higher than the increase in sales during the year (9.93% increase in inventory; 5.26% increase in sales). We are aware of issues in the retail operations, which could mean that the inventory does not exist.
- Prepaid expenses decreased by \$49,000, or 2.51%, from 2022. This year-over-year change is immaterial, and is likely attributable to changes in the timing of expenses. As the change is within expectations, it is not necessary to raise a risk of material misstatement relating to prepaid expenses.
- Property, plant, and equipment decreased by \$782,000, or 4.77%, from 2022. We know that some PP&E was disposed of during 2023, given the loss and gain on disposal recorded in the income statement, and we also know that the depreciation increase for the year was \$963,000. Therefore, a PP&E decrease of only \$782,000 indicates that there may have been some PP&E additions. As discussed below, there was a large increase in depreciation expense during the year; therefore, we would have expected additions to PP&E to support the increase in depreciation. There is a risk that purchases were not capital in nature, but were recorded as such in order to improve the financial position of the entity, resulting in an existence risk for PP&E.
- Right-of-use (ROU) assets decreased by \$3,403,000, or 4.15%, from 2022. While a decrease in ROU assets is expected, due to depreciation of those assets, we are also aware that the Halifax lease was new in 2023. Therefore, there is a potential completeness risk related to ROU assets, as well as an accuracy, valuation, and allocation risk related to the setup of the new ROU assets, and the calculation of the depreciation for the year.

- Accounts payable and accrued liabilities decreased by \$947,000, or 3.13%, from 2022. The 2023 adjusted balance includes \$233,000 related to the lawsuit and the RSU liability, so the decrease in recurring accounts payable from 2022 is \$1.18 million, or 3.90%. This change appears to be consistent with the changes in the cash balance, but not with the significant increase in the inventory balance. Therefore, there is a potential risk that accounts payable and accrued liabilities are incomplete.
- Interest payable increased by \$768,000, or 197.43%, from 2022. This year-over-year change appears to be in line with the increase in the long-term debt (200%). In addition, the interest payable represented 7.78% of the long-term debt balance in 2022 ($\$389 \div \$5,000 = 7.78\%$), and 7.71% in 2023 ($\$1,157 \div \$15,000 = 7.71\%$). Therefore, this year-over-year change appears to be in line with our expectations, as it changed relative to the corresponding level of long-term debt. Accordingly, it is not necessary to raise a risk of material misstatement for the interest payable.
- Long-term debt increased by \$10 million, or 200%, over 2022. This is a material increase, so there is an existence risk related to long-term debt. As the entire debt matures on March 31, 2025, it is appropriate to classify the entire balance as long-term. Therefore, this does not represent a presentation risk.
- The current and long-term portions of the lease liabilities changed by 16.71% and (6.88%), respectively. In total, the lease liabilities decreased from \$86,260,000 to \$83,397,000. We would generally expect the total lease liabilities to decrease annually, as lease payments are being made (part of the payments represent interest but part also decrease the lease liabilities); however, the new Halifax lease increased the aggregate balance by \$763,000, so the change in the recurring leases was a decrease of \$3,626,000. This may be a reasonable decrease year-over-year as it represents a decrease of 4.2%. Given the issues identified in the accounting for the new Halifax lease, there is a risk that the accounting for the lease liabilities is incomplete or inaccurate. The variance between the short- and long-term portions may represent a presentation risk.

Statement of profit or loss:

- Revenue and cost of sales have increased by 5.26% and 5.35%, respectively, over 2022. This change appears in line with management's expectation of future growth. In addition, the gross profit was 54.89% in 2022, and 54.86% in 2023, indicating that the relation between cost of sales and revenue appears appropriate, if the increases were driven by sales volume. However, given that both sales and cost of sales are very material, there are still risks of material misstatement in both balances. We know that management may be motivated to misstate the financial position and operating results, to meet shareholder expectations, so we should raise risks of material misstatement related to sales occurrence, and cost of sales completeness and classification. In particular, cost of sales completeness risk ties in with the inventory existence risk, and the accounts payable completeness risk.

- General and administrative expenses have increased by \$1,467,000, or 6.91%. This is a material change, even after removing the lawsuit settlement amount of \$125,000. This increase is not expected, and we should therefore raise risks related to occurrence and classification of general and administrative expenses. The lawsuit settlement is a separate risk of material misstatement, as it is a contingent liability. There is risk in the completeness and accuracy of the provision, and the presentation of the contingent liability in the financial statements, including the notes to the financial statements.
- Marketing and sales expenses have increased by \$197,000, or 2.32%. This increase is not material, and accordingly, we will not raise a risk of material misstatement for marketing and sales expenses.
- Depreciation expense has increased by \$976,000, or 13.14%, over 2022. If IBL uses straight-line depreciation, we would generally expect depreciation expense to be relatively stable, year over year. However, the increase may be explained by purchases of property, plant, and equipment and new right-of-use assets (such as the Halifax lease), but we do not have enough information to determine whether this amount of increase is expected. Since the \$976,000 increase is material, it may represent a risk in occurrence and accuracy of depreciation expense.
- The loss on disposal of property, plant, and equipment of \$160,000, and gain on disposal of property, plant, and equipment of \$35,000, are non-recurring items and are not material, so we do not need to raise risks of material misstatement for these items. However, in auditing PP&E, we may end up reviewing documentation of these disposals; therefore, we may verify that they have been recorded appropriately.
- Interest expense on lease liabilities decreased by \$1,941,000, or 20.22%, from 2022. We would generally expect that interest expense relating to leases decreases annually, if there are no new leases entered into, as a greater portion of the lease payment satisfies the principal portion of the corresponding lease liability. However, the Halifax lease was added in 2023, so we will need to obtain a further breakdown from management, to assess the completeness and accuracy of the balance.
- Interest expense on long-term debt increased by \$656,000, or 262.40%, over 2022. This increase is in line with the 200% increase in long-term debt, as per the balance sheet. Therefore, as this increase does not appear to be out of the ordinary, we will not raise a risk of material misstatement for this balance.

Note: As requested by Kim, income tax accounts (income tax recoverable, deferred tax asset, and income tax recovery) were excluded from this analysis.

For Assessment Opportunity #9, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to prepare a variance analysis of the draft financial statements, and to discuss risks identified.

Competent – The candidate prepares a variance analysis of the draft financial statements, and discusses some risks identified.

Competent with distinction – The candidate prepares a thorough variance analysis of the draft financial statements, and discusses several risks identified.

Assessment Opportunity #10 (Depth Opportunity)

The candidate recommends audit procedures to be performed on the financial reporting issues discussed, including the share compensation plan.

The candidate demonstrates competence in the Assurance role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
4.3.6	Develops appropriate procedures, including Audit Data Analytics (ADA), based on the identified risk of material misstatement	B	A

CPA Map Enabling Competencies:

5.1.3 Develops and uses knowledge of the organization, industry and stakeholders

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

We will perform the following audit procedures on the financial reporting issues that were identified.

Acquisition of Bookmarks:

- Review the executed share purchase agreement, and verify that IBL acquired control by obtaining 100% of the issued and outstanding shares, that the purchase price was \$5 million, and that the closing date was December 31, 2023, to confirm that the acquisition happened before year end.

- Review the appraisal report prepared by the independent valuator, and agree the amounts within the report, primarily the fair values, to the amounts provided by IBL (as per CAS paragraph 500.8, on using the work of management's expert). Make inquiries of the valuator about the nature and scope of their work, the methods and assumptions used to determine fair values, and the data used in their calculations. Assess the relevance and reasonableness of their methods, assumptions, data, and conclusions, using available industry information.
 - Further, verify the valuator's competence, capabilities, and objectivity by validating their credentials/membership with the relevant professional body, confirming that they have sufficient experience and competence for the work performed, and that they have no relationships with the entity that could impair their objectivity.
- Consider the need to use an auditor's expert, to verify the valuation of Bookmarks.
- Obtain a sample of subsequent payments after the acquisition date, to ensure that all liabilities in existence at the closing date were disclosed and appropriately recorded.
- Recalculate the acquisition differential, allocation of the fair value excess to specific items, and the goodwill arising from the acquisition. In addition, we should recalculate Bookmarks' effective tax rate, to ensure that the appropriate rate is being used in setting up the deferred tax liability.

Halifax lease:

- Recalculate the present value of the lease liability, using the inputs corroborated as follows:
 - Review the full lease agreement, and ensure that the terms specified (lease term, extension option, rent-free period, payment amounts, and timing) agree to the information previously provided by IBL.
 - Confirm, through supporting evidence (meeting minutes, budgets, communication with Halifax employees, etc.), IBL's intention to exercise the extension option.
 - In addition, we should obtain a copy of IBL's credit facility, to ensure the accuracy of the borrowing rate used in calculating the lease liability.
- Obtain invoices from the real estate agent and lawyer that assisted on the lease, and review that their fees were \$20,000 and \$5,000, respectively.
- Recalculate the short- and long-term portions of the lease liability, to verify that they have been classified appropriately, by determining the portion of the lease liability to be settled in the entity's normal operating cycle (i.e., 12 months), and the portion to be settled thereafter, based on the terms of the lease agreement.
- Recalculate the interest expense and the depreciation of the right-of-use asset for the period from lease inception to year end, and compare that to the amount recorded in the general ledger.

Lawsuit:

- Review the correspondence of the lawsuit that was received from the publisher, to confirm the date that this lawsuit was received by the company.
- Review the final documents of the court proceedings regarding the lawsuit, and verify their conclusion that IBL owes the publisher \$125,000. If available at the time of testing, inspect the relevant bank statement, to determine that the payment has subsequently been made.
- Verify that this amount relating to the lawsuit has been included in the accrued liabilities at December 31, 2023.
- Review the note disclosure, to ensure that the disclosure details the nature of the lawsuit and other required disclosures in IAS 37, and that an accrual has been made, based on what is payable.

RSU plan:

- Verify that the share compensation plan was created:
 - Obtain the board meeting minutes discussing the compensation plan, and review the minutes for details of the plan and evidence of board approval.
 - Obtain the list of the 25 eligible employees, and compare their names and/or positions to the board approval, to ensure that they are eligible for the plan.
 - Review the individual compensation plan contracts provided to each employee, to confirm the number of RSUs granted and the vesting dates and amounts.
 - Verify that the contracts specify that IBL will cash-settle the vested RSUs.
- Verify the valuation of the RSU liability as at December 31, 2023:
 - Obtain IBL's share price at close of market on December 31, 2023, through a reliable third-party market reporting tool such as Bloomberg.
 - Obtain a copy of the consultant's report, and assess the relevance and reasonableness of their methods, assumptions, data, and conclusions with respect to estimated forfeitures. Agree the percentages of eligible employees still estimated to be employed for Years 2, 3, and 4 (90%, 80%, 70%) to the consultant's report, to ensure accuracy.
 - Verify the consultant's competence, capabilities, and objectivity by validating their credentials/membership with the relevant professional body, confirming through inquiries that they have sufficient experience and competence for the work performed, and that they have no relationships with the entity that could impair their objectivity.
 - Obtain a copy of the December 31, 2023, payroll report, and verify that all 25 of the eligible employees were employed by IBL on December 31, to support the 100% inclusion on the first anniversary date.
 - Recalculate the RSU liability and compensation expense, based on the share price, RSUs granted, and the vesting period, each corroborated as outlined above.

For Assessment Opportunity #10, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate discusses some audit procedures to be performed on the financial reporting issues discussed, including the share compensation plan.

Competent – The candidate discusses several audit procedures to be performed on the financial reporting issues discussed, including the share compensation plan.

Competent with distinction – The candidate discusses many audit procedures to be performed on the financial reporting issues discussed, including the share compensation plan.

Assessment Opportunity #11 (Depth Opportunity)

The candidate recommends audit procedures for testing the key payroll controls.

The candidate demonstrates competence in the Assurance role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
4.3.6	Develops appropriate procedures, including Audit Data Analytics (ADA), based on the identified risk of material misstatement	B	A

CPA Map Enabling Competencies:

5.1.1 Applies general business knowledge to enhance work performed

5.1.3 Develops and uses knowledge of the organization, industry and stakeholders

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Key Payroll Controls

Rutherford is looking to rely on payroll controls for the 2023 year-end audit. Accordingly, the audit team should undertake the following general procedures, and specific procedures thereafter.

- To gain an understanding of the payroll process and related internal-control activities and accounting records, the payroll process documentation should be obtained and reviewed.
- A walkthrough of the payroll process and related internal-control activities should be given by the process owner who, for IBL, is the payroll manager. As well, a walkthrough should be given of the processes performed by each of the other individuals (the managers and assistant managers of the retail stores, the payroll clerk, treasury clerk, etc.), so that we understand who performs various processes and control activities, and what documentation exists regarding those processes and control activities.
- The walkthrough should be documented in a memo, and include discussion with the process owner(s) and other pertinent individuals, and evidence of sample transactions (such as screenshots of a time report, payroll calculation, employment contract, and direct deposit, for a randomly selected employee, in a randomly chosen pay period).
- It is noted that IBL utilizes payroll software internally to support its payroll processes. In addition to the key control activities identified in its payroll process, we will need to design appropriate procedures for understanding and evaluating the IT risks arising from the use of IT, and the entity's general IT controls for addressing those risks.
- For each relevant payroll control activity and each general IT control, we need to evaluate whether the control is designed effectively for addressing the risk of material misstatement at the assertion level or for supporting the operation of other controls; we would also determine whether the control has been implemented, by performing procedures and making inquiries of the entity's personnel (CAS 315.26).
- If the payroll control activities and related general IT controls appear to be effectively designed and properly implemented, we would proceed with testing the operating effectiveness of those controls, which is done by using tests of controls.

With respect to the specific key controls that IBL has in place, we should perform the following tests of controls, based on an appropriate sampling methodology.

Time records are reviewed and approved by supervisors

Control: At the end of each pay period, the assistant manager and manager of each store review and approve their store's time summary, and send it to the payroll clerk for processing.

Procedure: For a sample of pay periods, inspect a sample of retail employee time records, for evidence of review and approval by the store's manager and assistant manager.

Independent comparison of employee records to ensure that individuals are active employees

Control: Every six months, the assistant controller selects a random sample of time records and checks the master employee file from human resources, to ensure that each record is related to an active employee.

Procedure: Obtain documentation of the assistant controller's inspection of employee master files from human resources. For the sample of employees selected, inspect the documentation for evidence of the assistant controller's review of the employee master file; reperform the review of those employees' contracts and time sheets, to ensure that the selected employees were active during the payroll period.

Payroll report inputs are reviewed for accuracy

Control: The payroll manager reviews the payroll report, including the inputs, prior to approving the amounts for payment.

Procedure: For a sample of pay periods, obtain evidence of the payroll manager's review of the payroll report for those pay periods. Reperform the review, to ensure that the inputs (hours and wage rates) agree to their respective sources (time sheets and employment contracts).

Payroll cheques are pre-numbered

Control: In rare instances where an employee is not registered for direct deposit, a pre-numbered cheque is written and is signed by the payroll manager and the controller. Cheques, when required, are issued in sequential order.

Procedure: For a sample of payroll cheques issued to employees, inspect the issued cheques and ensure that they are signed by both the payroll manager and the controller. In addition, review cheque logs, to ensure that pre-numbered cheques are being issued sequentially and for payroll purposes only.

Preparation of payroll bank account reconciliation

Control: A treasury clerk prepares the monthly payroll bank account reconciliation.

Procedure: Obtain a sample of monthly reconciliations of the payroll bank account. Inspect the sample, to ensure that they were performed by the treasury clerk, and reperform the process by agreeing information to supporting documents (i.e., payroll reports, direct deposit lists, payroll cheques, etc.).

Payroll bank account reconciliation is reviewed for accuracy

Control: The monthly payroll bank account reconciliation is reviewed by the treasury manager.

Procedure: For the sample of monthly payroll bank reconciliations selected above, inspect them for evidence of the treasury manager's review.

Payroll journal entries are reviewed and approved

Control: The payroll manager ensures that the entry ties to the payroll report generated by the payroll system, and further ensures that the appropriate general ledger accounts are being used for the journal entry before approving.

Procedure: Inspect a sample of journal entries for evidence of the payroll manager's review, and agree the totals and account coding back to the payroll reports, to ensure that the control was performed effectively.

Payroll journal entries are up-to-date with pay periods

Control: The payroll clerk records the approved journal entry on the pay date.

Procedure: For pay periods sampled above, check that the corresponding journal entry is posted on a timely basis to the payroll report date.

For Assessment Opportunity #11, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate recommends some procedures for testing the key payroll controls.

Competent – The candidate recommends several procedures for testing the key payroll controls.

Competent with distinction – The candidate recommends many procedures for testing the key payroll controls.

Assessment Opportunity #12 (Depth Opportunity)

The candidate discusses internal control weaknesses in IBL’s retail operations, and provides recommendations to address them.

The candidate demonstrates competence in the Assurance role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
4.1.1	Assesses the entity’s risk assessment processes	A	A
4.1.2	Evaluates the information system, including the related processes, using knowledge of data requirements and risk exposures	B	A

CPA Map Enabling Competencies:

- 2.2.2 Recognizes the importance of internal controls within areas of work responsibility
- 5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
- 6.1.1 Identifies and articulates issues within areas of work responsibility
- 6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions
- 6.3.2 Articulates limitations to recommendations

The following weaknesses were identified in the control environment at IBL’s retail stores.

Cash reconciliation

Weakness: Store managers have access to the cash from the cash registers, perform the nightly cash reconciliation, and deposit excess cash in the bank.

Implication: There is a significant fraud risk by having only one employee responsible for reconciling the cash, handling the cash from the registers, and depositing the excess cash in the bank. This is because the employee could take some of the cash and change the amounts in the reconciliation, and the amount ultimately deposited, to cover the theft.

Recommendation: Cash-handling responsibilities should be segregated, to reduce fraud risk. For example, the store manager could perform the cash reconciliation, and an assistant store manager could receive the cash from the cashier, reset the floats, and make the deposit in the bank.

New furniture and fixtures

Weakness: Store managers are permitted to order new furniture and fixtures without approval or limit.

Implication: Individual stores may be spending excessive amounts on unnecessary furniture and fixtures, decreasing IBL's net income.

Recommendation: To ensure that cash spending is reasonable, a company-wide policy should be implemented, establishing the maximum spending power at each employee level, above which, additional approval is required. Further, stores should be assigned an annual budget that store managers must abide by; any purchases in excess of their budget must get pre-approval.

Furniture and fixture labelling

Weakness: Furniture and fixtures are not individually labelled.

Implication: This represents a risk of asset misappropriation; furniture and fixtures could be stolen, and it would be very difficult to reconcile. Further, it complicates the process for disposal of old furniture, as it may be unclear when assets were acquired, or which piece of furniture is which.

Recommendation: Individual asset numbers should be assigned to each separate piece of property, plant, and equipment. This information should be kept in a capital asset subledger.

Annual inventory counts

Weakness: Inventory counts are only performed annually.

Implication: Discrepancies could be occurring throughout the year and going unnoticed, which increases the risk of theft. Also, financial indicators relating to inventory may be inaccurate, leading to management making inappropriate decisions.

Recommendation: Inventory counts should be performed more frequently, at least quarterly, to better inform on discrepancies and inventory performance.

Inventory count discrepancies

Weakness: Inventory count discrepancies are not further investigated by retail staff.

Implication: If the source of the difference is not determined, discrepancies may reoccur, and there is an increased fraud risk if theft is one of the causes.

Recommendation: Inventory count discrepancies should be formally tracked and investigated, and conclusions should be provided to head office for follow up. IBL may also consider including the inventory discrepancies in the stores' performance assessment, or as part of the store managers' bonus..

Lack of access removal – physical

Weakness: Company property, including store keys, is not being fully recovered from departing employees.

Implication: The retail stores may be improperly accessed by former employees or other individuals by using store keys, which presents a risk of theft and property damage.

Recommendation: To mitigate the risks identified, departing employees should be provided with a checklist, indicating all items that must be returned to IBL. IBL may also consider asking for a deposit, to be reimbursed when the keys are returned. To the extent that keys are not returned, additional mitigation responses may be warranted, such as changing the locks to digital ones and removing the codes of terminated employees upon termination.

Lack of access removal

Weakness: VPN and systems access for managers are not suspended when managers depart from the company.

Implication: Former managers may improperly access company systems, which poses a data security risk. For example, managers could create minor nuisances, such as changing inventory amounts or placing improper orders. Further, depending on level of access, certain managers may be privy to birthdates, pay rates, addresses, social insurance numbers, bank account numbers, and other sensitive data, that may be improperly used or further disseminated.

Recommendation: When they become aware of a manager's departure, human resources should communicate with the IT department immediately, and all systems access, including VPN, should be suspended at the time of departure.

For Assessment Opportunity #12, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate discusses some of the internal control weaknesses in IBL’s retail operations, and provides recommendations to address them.

Competent – The candidate discusses several internal control weaknesses in IBL’s retail operations, and provides recommendations to address them.

Competent with distinction – The candidate discusses many internal control weaknesses in IBL’s retail operations, and provides recommendations to address them.

Assessment Opportunity #13 (Depth Opportunity)

The candidate comments on the excerpts from the draft Management Discussion & Analysis, and discusses Rutherford’s responsibilities for the section that is not expected to be ready before the audit report is issued.

The candidate demonstrates competence in the Assurance role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
4.3.6	Develops appropriate procedures, including Audit Data Analytics (ADA), based on the identified risk of material misstatement	B	A
4.3.7	Performs the work plan	B	A
4.3.8	Evaluates the evidence and results of analysis	B	A

CPA Map Enabling Competencies:

- 1.3.1 Maintains a skeptical mindset when performing assigned work
- 5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
- 6.1.1 Identifies and articulates issues within areas of work responsibility
- 6.1.3 Demonstrates skepticism, objectivity, due care and persistence when identifying issues
- 6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Management Discussion and Analysis (MD&A)

Under CAS 720 – *The Auditor’s Responsibilities Relating to Other Information*, Rutherford is required to consider whether material inconsistencies exist between other information and the financial statements and/or the auditor’s knowledge of the business. The draft MD&A prepared by IBL is intended to be included in its annual report, and accordingly, CAS 720 applies:

“This Canadian Auditing Standard (CAS) deals with the auditor’s responsibilities relating to other information, whether financial or non-financial information (other than financial statements and the auditor’s report thereon), included in an entity’s annual report. An entity’s annual report may be a single document or a combination of documents that serve the same purpose.”

Rutherford was informed that IBL intends to include a section on business risk in the MD&A; however, Tina indicated that she does not expect to have the section ready until after the audit report is issued. We are required to obtain written representation from management indicating that the final version of the MD&A, including the business risks section, will be provided to us when available, and before it is included in the publicized annual report, as outlined in CAS 720.13(c):

“When some or all of the document(s) determined in (a) will not be available until after the date of the auditor’s report, request management to provide a written representation that the final version of the document(s) will be provided to the auditor when available, and prior to its issuance by the entity, such that the auditor can complete the procedures required by this CAS. (Ref: Para. A22)”

With respect to the draft MD&A provided to us, we are required to read the information and consider whether material inconsistencies exist, as set out by CAS 720.14-15:

“The auditor shall read the other information and, in doing so shall: (Ref: Para. A23-A24)

- (a) Consider whether there is a material inconsistency between the other information and the financial statements. As the basis for this consideration, the auditor shall, to evaluate their consistency, compare selected amounts or other items in the other information (that are intended to be the same as, to summarize, or to provide greater detail about, the amounts or other items in the financial statements) with such amounts or other items in the financial statements; and (Ref: Para. A25-A29)*
- (b) Consider whether there is a material inconsistency between the other information and the auditor’s knowledge obtained in the audit, in the context of audit evidence obtained and conclusions reached in the audit. (Ref: Para. A30-A36)*

While reading the other information in accordance with paragraph 14, the auditor shall remain alert for indications that the other information not related to the financial statements or the auditor's knowledge obtained in the audit appears to be materially misstated. (Ref: Para. A24, A37-CA38)”

Based on the draft MD&A, we noticed the following inconsistencies relating to the draft financial statements:

- Total revenue in the operational results table is \$80,000; however, as per the draft financial statements, it is only \$74,500—this is a difference of \$5.5 million, which is material.
- The EBITDA calculation includes depreciation expense, which is a key item that should be excluded from the calculation.
- The EBITDA calculation includes the loss and gain on disposal of PP&E. Traditional EBITDA calculations would not include this type of item. IBL may want to relabel the line to “Adjusted EBITDA,” and provide a definition of this calculation, to alert readers of the MD&A to the amounts included or excluded from the adjusted EBITDA.
- The EBITDA calculation appears to be using unadjusted amounts. Therefore, the balances will need to be adjusted to consider the impact of the new Halifax lease, the lawsuit, and the RSU liability.
- The current ratio of 2.16 and quick ratio of 0.31 appear to be using unadjusted, unconsolidated balance sheet figures:

Current ratio = current assets ÷ current liabilities

Current ratio = \$98,000 ÷ \$45,400

Current ratio = 2.16

Quick ratio = (current assets - inventory) ÷ current liabilities

Quick ratio = (\$98,000 - \$84,113) ÷ \$45,400

Quick ratio = 0.31

Based on the accounting adjustments in respect to the new lease, the lawsuit and the RSUs, totalling approximately \$286,000, we would expect changes to the denominator of these ratios. In addition, the MD&A should clearly state whether the financial information includes Bookmarks or is for the unconsolidated IBL.

The quick ratio appears to include prepaid expenses, which are not highly liquid assets. In addition, IBL comments that it has a “strong liquidity.” Although the current ratio supports this statement, the quick ratio does not, as IBL can only cover 31% of its current liabilities with its highly liquid assets. The ratios do vary once adjusted, but the overall result is similar.

- The RSU plan has been misrepresented as a stock option plan, and further indicates that it is an equity-settled plan rather than a cash-settled plan.

Furthermore, we noticed the following inconsistencies relating to our understanding of the business:

- The acquisition date of Bookmarks is incorrectly listed as December 15 instead of December 31. Also, as Bookmarks is a small chain of retail bookstores, stating that it will expand IBL's footprint across the country may be an overstatement (to assess this properly, we would need more information on Bookmark's operations.).
- The MD&A suggests that the new Halifax store will earn revenue of \$5 million annually. IBL presently operates 45 stores and earns revenue of \$74.5 million, or an average of \$1.6 million per store. Based on this knowledge, it appears unreasonable that the Halifax store is expected to operate at this level of projected revenue. It is possible that the Halifax store will be a flagship location; therefore, we should discuss with management to determine if IBL has a fully-developed earnings forecast that supports the revenue levels described in the MD&A.
- In addition to the above, management should clarify that the Halifax lease is for five years (plus two months), with an option to extend for an additional five years.
- IBL suggests that it has "greatly improved" its inventory controls during the year, which is inconsistent with the control weaknesses identified in its inventory processes at retail locations, for which we have provided recommendations to management.

As we have identified inconsistencies in the draft MD&A, we are required to discuss these inconsistencies with management, to determine whether they are, in fact, material inconsistencies, whether the draft financial statements may have material misstatements, and whether our understanding of the business should be updated. Some items, such as the discrepancies in revenue and the adjustments required for the new Halifax lease, the lawsuit, and the RSU liability, should be aligned with the financial statements. Items such as the incorrect date of the Bookmarks acquisition, incorrect description of the RSU plan, and the other misleading statements related to ratios and inventory controls should be corrected in the MD&A.

For Assessment Opportunity #13, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to discuss the draft Management Discussion and Analysis.

Competent – The candidate discusses the draft Management Discussion and Analysis.

Competent with distinction – The candidate thoroughly discusses the draft Management Discussion and Analysis.

**DAY 2 – MARKING GUIDE – FINANCE ROLE
INSPIRED BOOKS LTD. (IBL)**

To: Tina Parker, CFO
 From: CPA
 Subject: IBL finance considerations

See Common Marking Guide for the Common Assessment Opportunities #1 to #6.

Assessment Opportunity #7 (Depth Opportunity)

The candidate prepares a capitalized earnings valuation of Dominion Books Inc. (Dominion).

The candidate demonstrates competence in the Finance role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
5.4.2	Applies appropriate methods to estimate the value of a business	B	A

CPA Map Enabling Competencies:

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Business Valuation

	2023 (\$)	2022 (\$)	Note
Pre-tax earnings	165,000	53,500	
Non-recurring items:			
(Gain)/loss on disposal of PP&E	(15,000)	(5,000)	1
Loss on inventory revaluation	0	25,000	2
Management fees	100,000	100,000	3
Owner's compensation	150,000	150,000	4
Owner's husband's compensation	45,000	0	4
New full-time wages required	(100,000)	(100,000)	4
Dividend income	(10,000)	(9,500)	5
Interest income	(15,000)	(12,000)	6
Maintainable pre-tax earnings	320,000	202,000	
Tax rate	26%	26%	7
Tax	83,200	52,520	7
Maintainable after-tax earnings	236,800	149,480	
Average maintainable earnings	193,140		
Capitalization multiple	13x		
	2,510,820		
Redundant assets:			
Vacant land	66,220		8
Investment portfolio	374,915		9
Valuation	2,951,955		

Notes:

1. Gains and losses are non-recurring items and should be excluded from maintainable earnings.
2. The major inventory loss is a non-recurring item and should be excluded from maintainable earnings.
3. The management fees should be excluded, as these are paid to the existing owner's management company and could be performed by either IBL or Dominion without incurring additional costs.
4. The owner's compensation and her husband's compensation should be reversed, as it is not expected that IBL will continue to employ them after an acquisition. However, IBL estimates that it will need to spend an additional \$100,000 on full-time equivalent wages to satisfy the day-to-day work that the owner and her husband performed.

5. The dividend income relates to the redundant marketable security portfolio, and should therefore be excluded from maintainable earnings.
6. The interest income relates to the redundant marketable security portfolio, and should therefore be excluded from maintainable earnings.
7. Dominion currently pays tax at low rates on its active business income. After an acquisition by a public company, it will no longer qualify for those rates; therefore, an estimate of 26% is more appropriate on future maintainable earnings.
8. The vacant land is a redundant asset and should therefore be added to the valuation. Assuming that the land is sold after acquisition by IBL, Dominion will realize a capital gain of \$35,000 (\$75,000 - \$40,000), which is subject to tax as follows:

$\$35,000 \times 50\%$ (inclusion rate) $\times 50.17\%$ (investment income tax rate) = \$8,780; therefore, after-tax proceeds are $\$75,000 - \$8,780 = \$66,220$.

9. The marketable security portfolio is a redundant asset and should therefore be added to the valuation. Assuming that the portfolio is sold after acquisition by IBL, Dominion will realize a capital gain of \$100,000 (\$400,000 - \$300,000), which is subject to tax as follows:

$\$100,000 \times 50\%$ (inclusion rate) $\times 50.17\%$ (tax rate) = \$25,085; therefore, after-tax proceeds are $\$400,000 - \$25,085 = \$374,915$.

Using a capitalized earnings approach, based on average earnings of the last two years and a 13x capitalization rate, Dominion is valued at \$2,951,955. Given the financing concerns discussed elsewhere in this memo, IBL should use this valuation to consider whether such an investment is appropriate at this time, and how best to fund the purchase if it proceeds. Note that, if the long-term debt offered by Commerce Plaza is taken, pre-approval for such an acquisition will have to be obtained due to the covenants imposed, which will impact IBL's ability to take on additional debt. Further, before proceeding with any acquisition, it will be important for IBL to assess Dominion's fit with the existing company, based on qualitative factors.

For Assessment Opportunity #7, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to prepare a capitalized earnings valuation of Dominion Books.

Competent – The candidate prepares a capitalized earnings valuation of Dominion Books.

Competent with distinction – The candidate thoroughly prepares a capitalized earnings valuation of Dominion Books, and considers IBL’s financial outlook.

Assessment Opportunity #8 (Depth Opportunity)

The candidate calculates the proposed debt covenants under the two proposals for replacing IBL’s existing long-term debt, assesses the proposals, and provides a recommendation.

The candidate demonstrates competence in the Finance role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
5.1.2	Develops or evaluates financial proposals and financing plans	B	A
5.2.3	Evaluates sources of financing	B	A

CPA Map Enabling Competencies:

- 5.1.1 Applies general business knowledge to enhance work performed*
- 5.1.3 Develops and uses knowledge of the organization, industry and stakeholders*
- 6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems*
- 6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions*

IBL is considering two proposals for replacing its existing long-term debt of \$15 million, which bears interest at 7.5% annually and matures on March 31, 2025.

Commerce Plaza BankCovenant analysis

The loan from Commerce Plaza requires IBL to maintain the following covenants:

- Debt-to-EBITDA ratio of 2.5 or lower
- Interest-coverage ratio of 1.05 or greater

Debt-to-EBITDA ratio

Debt:	\$15,000
EBITDA calculation:	
Income before income taxes	(7,383)
Add: Interest expense	8,555
Add: Depreciation expense	8,388
Add: Halifax lease – G&A expenses	25
Less: Lawsuit	(125)
Adjusted EBITDA	<u>\$ 9,460</u>
Debt-to-EBITDA ratio	<u>1.59</u>

IBL should meet its debt-to-EBITDA ratio covenant if it is able to maintain or improve upon its current EBITDA. In addition, this calculation does not yet consider the impact of Bookmarks, which does not have any external debt; therefore, if Bookmarks is earning positive EBITDA, it will improve IBL's debt-to-EBITDA ratio.

Assuming that the Commerce Plaza loan is the only outstanding debt, IBL's EBITDA could decrease to \$6 million and still meet the covenant (ignoring the impact of principal repayments) ($\$15,000 \div 2.50 = \$6,000$). Accordingly, IBL should have minimal risk of failing this covenant.

Interest-coverage ratio

EBIT calculation:

EBITDA	9,460
Less: Reported depreciation expense	(8,388)
Less: Depreciation on Halifax lease	(13)
EBIT	<u>1,059</u>

Interest on long-term debt:

Long-term debt	15,000
Interest rate	6%
Interest expense	<u>900</u>

Interest-coverage ratio: 1.18

IBL would meet the interest-coverage covenant; however, it could be easily jeopardized by a downturn in EBIT. Further, it will impact IBL's short-term financing options, as an increase in interest expense would put IBL at risk of not meeting the covenant.

Advantages:

- The payments are due annually, which provides IBL with more flexibility in saving for the payment.
- The debt-to-EBITDA ratio of 2.5 or lower required by the loan provides IBL with some capacity, to the extent that it realizes a decrease in EBITDA or is required to take on additional debt, such as the short-term options being considered, and is less restrictive than First Canadian's ratio; however, this advantage is mainly offset by the interest-coverage ratio discussed below.
- Early repayment is possible, which could reduce the interest cost over the life of the loan. However, this may not be realized given IBL's cash constraints.

Disadvantages:

- Commerce Plaza will have the authority to interfere with IBL's investment strategy, due to the \$1 million limitation.
- The interest-coverage ratio is materially sensitive to changes in either EBIT or interest expense.

- The loan is secured by IBL's inventory, which presents a risk of loss if the company is unable to make payments, and further requires coordination with the inventory financing option presented by Timely Factoring Company (Timely) on a short-term basis.
- The interest rate of 6%, while lower than the existing debt at 7.5%, is higher than the alternative credit union offer.

First Canadian Credit Union

Covenant analysis

The loan from First Canadian requires IBL to maintain a debt-to-EBITDA ratio of 2.2 or lower.

As previously calculated, IBL's debt-to-EBITDA ratio, based on the adjusted December 31, 2023, financial statements, is 1.59. Accordingly, IBL's risk of failing this covenant is remote. Similar to the discussion of Commerce Plaza, IBL's ratio is likely to be positively impacted by Bookmarks, and IBL could realize a significant decrease in EBITDA before the ratio is jeopardized.

Advantages:

- The interest rate is currently lower than that of Commerce Plaza's, which will result in a lower relative outflow for interest if rates remain steady; however, this may be negated by rising rates.
- The covenants are less restrictive than that of Commerce Plaza's, providing IBL with more control over the operations, and no limitations tied to interest expense.

Disadvantages:

- IBL is subject to interest-rate risk due to the variable rate, which could result in an increase in interest expense and, by extension, the monthly payment.
- No early repayment of the loan is permitted, which reduces the flexibility of this loan.
- Like the Commerce Plaza loan, this offering is collateralized by IBL's inventory, which presents loss risk, and potential coordination issues if the Timely offer is taken.
- The debt-to-EBITDA ratio of 2.2 is more restrictive than that of Commerce Plaza.
- Monthly repayments will require IBL to have strong cash flow budgeting in order to service the debt, which could be problematic, based on IBL's current internal process for cash budgeting.
- First Canadian has discretion over IBL's ability to incur additional debt, which could limit the availability of the Canadian Learning Program and inventory financing options.

Recommendation

We recommend that IBL proceed with Commerce Plaza because it is evident that IBL requires short-term financing; the terms of the First Canadian loan are less flexible and may limit IBL's ability to take on short-term financing.

As previously discussed, there is some risk that IBL will not be able to meet the interest-coverage ratio in a downturn. As such, IBL should consider negotiating with Commerce Plaza to utilize an EBITDA interest-coverage ratio, as it has significant depreciation expense that negatively impacts its EBIT. Under an EBITDA approach, IBL would have an interest-coverage ratio of 10.51 ($\$9,460,000 \div \$900,000 = 10.51$), which should provide Commerce Plaza with additional comfort in IBL's ability to service the debt, and maintain the availability of the short-term financing options.

Further, the terms of the Commerce Plaza debt require the consent of the lender if IBL makes investments greater than \$1 million, which gives Commerce Plaza some degree of operational control. IBL should consider whether the monetary threshold could be raised, to allow for easier operations without the interruption of gaining outside approvals.

For Assessment Opportunity #8, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to calculate the debt covenants, and assess the proposals for replacing IBL's existing long-term debt.

Competent – The candidate calculates the debt covenants, assesses the proposals for replacing IBL's existing long-term debt, and provides a recommendation.

Competent with distinction – The candidate accurately calculates the debt covenants, thoroughly assesses the proposals for replacing IBL's existing long-term debt, and provides a recommendation.

Assessment Opportunity #9 (Depth Opportunity)

The candidate assesses IBL's days payable outstanding, discusses whether IBL should be settling payables on a more timely basis, and evaluates a proposal for a new inventory management system.

The candidate demonstrates competence in the Finance role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
5.2.1	Evaluates the entity's cash flow and working capital	A	A

CPA Map Enabling Competencies:

5.1.1 Applies general business knowledge to enhance work performed

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Inventory and Accounts Payable ManagementAccounts payable / trade credit

Presently, IBL has a days payable outstanding of 29 days for its inventory, determined as:

$$\frac{[(\text{Opening A/P} + \text{closing A/P}) \div 2] \div \text{cost of sales} \times 365}{[(\$2,500,000 + \$2,750,000) \div 2] \div \$33,525,000 \times 365} = 29$$

This is consistent with management's description of IBL's cash disbursement process, in which it settles its inventory invoices within 25–30 days of issuance. However, by making payments at this frequency, IBL is neither taking advantage of the cash discount offered by paying within 10 days, nor leveraging the minimal interest charge on the extended timeline.

When purchasing on trade credit and not using the discount, IBL is effectively bearing the cost of the trade credit through an effective annual rate (EAR). During 2023, IBL made purchases of \$41,121,000:

$$\begin{aligned} \text{Closing inventory} - \text{opening inventory} + \text{cost of sales} &= \text{purchases} \\ \$84,113,000 - \$76,517,000 + \$33,525,000 &= \$41,121,000 \end{aligned}$$

If IBL had made early payments on each of these purchases, it could have realized a cash discount of \$822,420 ($\$41,121,000 \times 2\%$). Accordingly, the inventory cost is effectively \$40,298,580 if settled within 10 days, and the cost of 19 days of trade credit is \$822,420. The ordinary discount interest rate is $\$822,420 \div \$40,298,580 = 2.04\%$ per each 19-day trade credit period. The EAR of this is 47.42%, which is extremely high:

$$\begin{aligned} (1 + \text{ordinary interest rate})^{\# \text{ of trade credit periods}} - 1 &= \text{EAR} \\ (1 + 0.0204)^{(365 \div 19)} - 1 &= 47.42\% \end{aligned}$$

Therefore, by not taking advantage of the early settlement discount, IBL is effectively financing its purchases at an annual rate of 47.42%.

Given the concerns that IBL has with working capital management and its cash flow budget, it may not be possible to take advantage of the discount and thereby avoid this EAR. If possible, IBL should aim to make the early payment date, to realize cash savings.

Alternatively, IBL could stretch its payments, to reduce the EAR and provide more time internally to organize working capital for each payment. By stretching to pay on the 60th day, the EAR is as follows:

$$\text{Arrears ordinary interest} = \$41,121,000 \times 0.5\% = \$205,605$$

$$\text{Total interest paid (including discount lost)} = \$822,420 + 205,605 = \$1,028,025$$

$$\text{Total ordinary interest rate} = \$1,028,025 \div \$40,298,580 = 2.55\%$$

$$\text{EAR} = (1 + 0.0255)^{(365 \div 50)} - 1 = 20.19\%$$

By stretching the payment to Day 60, IBL can more than halve the EAR on its trade credit. However, IBL should be mindful that stretching payments is likely to worsen its relationships with suppliers, which could lead to negative consequences beyond a 0.5% interest charge, such as their refusal to do business with IBL.

The high interest rate of 15% on payments received on Day 61 or later makes it financially expensive to stretch payments beyond 60 days. Further, the high interest rate suggests that the vendor would view stretching payments beyond 60 days negatively.

Inventory system

Currently, IBL's inventory turnover is a poor 0.42, or 874 days, which is significantly lower than the industry benchmark of 1.15:

$$\text{Inventory turnover} = \text{cost of sales} \div \text{average inventory}$$

$$\text{Inventory turnover} = \$33,525,000 \div [(\$76,517,000 + 84,113,000) \div 2]$$

$$\text{Inventory turnover} = 0.42$$

$$\text{Days in inventory} = 365 \div \text{inventory turnover}$$

$$\text{Days in inventory} = 365 \div 0.42$$

$$\text{Days in inventory} = 874$$

If IBL's inventory turnover was to reach the industry standard of 1.15, that would result in a reduction of \$54,960,830 in working capital:

$$\text{Revised inventory} = \$33,525,000 \div 1.15 = \$29,152,170$$

$$\text{Working capital benefit} = \$84,113,000 - \$29,152,170 = \$54,960,830$$

Based on IBL's current long-term interest rate of 7.5%, this would result in annual financing savings of \$4,122,060:

$$\$54,960,830 \times 7.5\% = \$4,122,060$$

This indicates that one year of financing savings realized from the reduction in working capital is sufficient to support paying \$2.5 million for the inventory management system. The savings would likely be realized over many years, which would create an even stronger case for acquiring the inventory management system.

There are additional qualitative factors to consider:

- Given that IBL's current days in inventory is 874 days, it may take three years to get its inventory to the targeted state. IBL could perhaps accelerate this process through a clearance sale, which could negatively impact its profit margins in the short term. A longer time frame in which to achieve inventory efficiencies reduces IBL's savings in the initial years, and increases the payback time on the investment.
- The proposal provides few details on how it achieves inventory efficiencies—is it using IBL's past sales data and industry data, and how does it optimize ordering? IBL should undertake procedures to verify the benefits of the system, by trialling the features, and reviewing data and/or testimonials from other users of the system.
- It is unclear what other financial inputs may be required in order to use the system; IBL may incur additional time and money, to train staff on the system and ensure that the system operates smoothly. IBL may also incur additional annual costs (such as IT staff, etc.), to run the system. Sharing of inventory between stores could also result in IBL incurring additional costs, for shipping inventory from store to store; this is also inefficient, as it will take time for the inventory to arrive at a store where the item may be sold out (and that store may have missed out of sales in the meantime).
- IBL's inventory ordering is controlled by individual stores; centralization of inventory orders could upset staff at individual stores, who may feel strongly about the individualism of each store.

Based on the above, it is recommended that IBL obtain a stronger understanding of the inventory system, and of precisely how it will integrate with its existing business processes, to ensure that it can deliver on the working capital reduction within a reasonable time.

For Assessment Opportunity #9, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to assess IBL’s accounts payable settlement or the proposed inventory management system.

Competent – The candidate assesses IBL’s accounts payable settlement and the proposed inventory management system.

Competent with distinction – The candidate thoroughly assesses IBL’s accounts payable settlement and the proposed inventory management system.

Assessment Opportunity #10 (Depth Opportunity)

The candidate evaluates the financing proposals to meet IBL’s working capital needs, and provides a recommendation.

The candidate demonstrates competence in the Finance role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
5.1.2	Develops or evaluates financial proposals and financing plans	B	A
5.2.3	Evaluates sources of financing	B	A

CPA Map Enabling Competencies:

5.1.3 Develops and uses knowledge of the organization, industry and stakeholders

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

6.3.2 Articulates limitations to recommendations

IBL has asked for an evaluation of three proposals that it may require for its working capital needs. Based on the revised cash budget, it is expected that IBL will need to rely on a cash infusion in the short-term; therefore, it is necessary to consider at least one of the available proposals.

Canadian Learning Program

- The loan is at a generous rate of 4%, which is significantly lower than IBL's existing debt, and than the two proposals to replace the long-term debt.
- Due to the short term and principal payment at maturity, IBL will need to be cognizant of the large cash outlay required in two years' time, and ensure that the company has generated sufficient earnings to cover repayment; otherwise, IBL will need to seek further financing, to assist with repayment.
- Provided that IBL meets the requirements of the program, \$2.5 million of the principal may be forgiven, which would be extremely beneficial.
- IBL will need to consider the existing floorspace allocation at its store, and ensure that any necessary changes are made, to meet the 15% minimum. IBL should also consider whether an increase in floorspace for these target markets will lead to any negative consequences in relative contribution margin.
- IBL should estimate the cost of holding the monthly reading sessions, as well as the profit from any incremental sales that may be made from the audiences.
- It is unclear how the Program intends to evaluate compliance with the forgiveness conditions. IBL should clarify the details, as there may be additional matters that IBL is not considering (e.g., the need for external audit procedures or for additional internal time, or site visits by Program staff).

Rights Offering

The rights offering to current shareholders provides an opportunity to raise capital without taking on additional debt, making it an attractive proposal. However, it is important to note that this alternative is fundamentally different from the Canadian Learning Program or the inventory financing, as it represents a permanent issuance of shares (unless the shares are subsequently reacquired) rather than a temporary increase in the level of debt carried by IBL.

The following should also be considered:

- As common shares will be issued, there will be no ongoing interest to pay, nor any repayment required, which is favourable to IBL.
- The funds will be used toward IBL's working capital needs, which could be viewed as a short-term cash requirement; utilizing equity that is a permanent form of financing may not be aligned with the use of the proceeds.
- Depending on which shareholders choose to use their rights to purchase shares, and whether there are shareholders who sell their rights, there could be unintended changes in the voting structure of IBL, which could lead to unintended governance and/or ownership consequences.
- There are costs associated with issuing common shares that have not yet been identified, and IBL should be cognizant of the work involved, from both a regulatory perspective and an internal, legal, and finance perspective.

- The rights offering will allow IBL to raise up to \$9.3 million (10 million common shares ÷ 7 rights to purchase a share × \$6.50 = \$9,285,714).
- A direct rights offering does not obligate shareholders to purchase additional shares, and there is no backstop or standby purchaser for the issued rights. Therefore, to the extent that shareholders do not exercise their rights, IBL will not raise the maximum amount, and proceeds might be insufficient to support IBL's working capital needs. An insured rights offering could be considered, but that would lead to additional costs for IBL.
- The rights have an implied value of \$0.12 per right; this represents incremental value being distributed to existing shareholders, which may be viewed favourably by existing shareholders and may motivate them to exercise on the rights:
 - Current value of IBL = $10,000,000 \times \$7.50 = \$75,000,000$
 - Post-money value of IBL = $\$75,000,000 + \$9,285,714 = \$84,285,714$
 - New shares issued = $10,000,000 \div 7 = 1,428,571$
 - Post-issuance share price = $\$80,000,000 \div (10,000,000 + 1,428,571) = \7.38
 - Implied value of rights = $\$7.50 - \$7.38 = \$0.12$
- The issuance should lead to a decline in share price (due to the implied value outlined above); however, due to imperfect markets, the decline could be steeper than \$0.12, which may be viewed unfavourably by the broader market.

Inventory Financing

- Both long-term debt proposals include a general security agreement that includes IBL's inventory as collateral, which will limit the amount of financing that Timely would be willing to provide.
- Based on IBL's inventory at December 31, 2023, it would be able to finance up to \$22,850,000 through Timely. As this is more than the amount that IBL requires from short-term financing, it provides additional flexibility to IBL:
 - Appraised value = $\$84,113,000 \times 60\% = \$50,467,800$
 - Financing available from Timely = $\$50,467,800 \times 75\% - \$15,000,000 = \$22,850,000$
- However, if IBL moves forward with the inventory management system, IBL's inventory balance would decrease. Based on the outstanding long-term debt, Timely would not be willing to extend additional short-term financing to IBL, which may not meet IBL's objectives (although the reduction in IBL's working capital may reduce its need for short-term financing):
 1. Appraised value = $\$29,152,170 \times 60\% = \$17,491,300$
 2. Financing available from Timely = $\$17,491,300 \times 75\% - \$15,000,000 = \$0$
- The interest rate is 12%, which is significantly higher than the existing debt, and would lead to large interest payments, if utilized.
- The line of credit gives IBL the flexibility to draw on it as needed, which could be useful for short-term requirements.

- Additional costs may be incurred by IBL, in due diligence and ongoing maintenance of the inventory process, to meet Timely's requirements. For example, IBL may need to invest in the inventory management system, which will cost \$2.5 million upfront, with additional, potential run-rate costs.

Recommendation

It is recommended that IBL utilize the flexibility of the inventory financing, provided that the cost of implementing a new inventory system is not prohibitively expensive. Although the inventory financing bears the highest interest, it can be used for short lengths of time, allowing IBL to draw on the line as needed, and make repayments to reduce the interest burden.

The learning program provides a low-interest debt opportunity that may be considered if IBL has a further need for immediate cash, but is less advantageous, due to its term length and the operational requirements set out by the Program. It would also be predicated on Commerce Plaza changing the ratio definition, or of First Canadian allowing the Program to be taken on.

The rights offering is a more permanent injection of equity, and may not align with IBL's short-term needs for cash to maintain its working capital; therefore, it may not be the most appropriate mechanism for this purpose.

For Assessment Opportunity #10, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to evaluate the financing proposals.

Competent – The candidate evaluates the financing proposals, and provides a recommendation.

Competent with distinction – The candidate thoroughly evaluates the financing proposals, and provides a recommendation.

Assessment Opportunity #11 (Depth Opportunity)

The candidate calculates the cost of leasing and purchasing, discusses qualitative factors, and recommends whether the Calgary property should be leased or purchased.

The candidate demonstrates competence in the Finance role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
5.1.2	Develops or evaluates financial proposals and financing plans	B	A

CPA Map Enabling Competencies:

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Borrowing Rate

IBL's current cost of borrowing is 7.5%; however, based on the financing offers, it may consider an alternative rate (such as 6%, offered by Commerce Plaza).

Accordingly, IBL's after-tax cost of borrowing is estimated to be $7.5\% \times (1 - 26\%) = 5.55\%$.

Cost of Leasing

The cost of leasing is determined as follows:

Lease payments

BGN

$I/Y = 5.55\%$

$N = 12 \times 10 = 120$ months

$PMT = \$7,000 \times (1 - 26\%)$

$PV = (\$478,418)$

Insurance

BGN

$I/Y = 5.55\%$

$N = 10$

$PMT = \$2,000 \times (1 - 26\%) = \$1,480$

$PV = (\$11,746)$

Total cost of leasing

$$(\$478,418) + (\$11,746) = (\$490,164)$$

Cost of Purchasing

$$\text{Initial investment} = (\$500,000)$$

Tax shield

$$\text{PVCCATS} = [(C \times d \times T) \div (d + k)], \text{ where:}$$

$$C = \$400,000$$

$$d = 6\%$$

$$T = 26\%$$

$$k = 7.5\%$$

$$\text{PVCCATS} = \$46,222$$

Residual value

$$I/Y = 5.55\%$$

$$N = 10$$

$$FV = \$125,000$$

$$PV = \$72,833$$

PVCCATS relating to residual

$$\text{PVCCATS on residual} = - [(S \times d \times T) \div (d + k)] \times [1 \div (1 + k)^n], \text{ where:}$$

$$S = \$125,000$$

$$d = 6\%$$

$$T = 26\%$$

$$k = 7.5\%$$

$$n = 10$$

$$\text{PVCCATS on residual} = (\$7,008)$$

Insurance

BGN

$$I/Y = 5.55\%$$

$$N = 10$$

$$\text{PMT} = \$400,000 \times 1\% \times (1 - 26\%) = \$2,960$$

$$PV = (\$23,493)$$

Property taxes

$$I/Y = 5.55\%$$

$$N = 10$$

$$PMT = \$10,000 \times (1 - 26\%) = \$7,400$$

$$PV = (\$55,645)$$

Total cost of purchasing

$$(\$500,000) + \$46,222 + \$72,833 + (\$7,008) + (\$23,493) + (\$55,645) = (\$467,091)$$

Accordingly, based on the inputs available, the cost of purchasing is favourable to the cost of leasing by \$23, 073.

Other Considerations

Consideration should also be given to the following:

- No estimate has been made for the cost of repairs and maintenance on the property, which will reduce the benefit of purchasing.
- Based on IBL's cash flow outlook, it will likely need to utilize one of the available financing sources in order to fund the purchase, as it expects to lose cash in the coming year; therefore, IBL may not want to use its current reserves on an investment.
- With a lease, such financing may not be required, and IBL could absorb the incremental lease cost into its existing operations.
- The remaining useful life of the building is quite low for buildings; however, there is a possibility that the actual useful life could be longer, in which case there may be additional benefit to purchasing (depending on the incremental repairs and maintenance cost to extend the life).
- The above analysis assumes that the property purchase will be in cash. However, if debt financing were utilized for the purchase, the debt covenants would be impacted, which could make the purchase unrealistic.

Recommendation

It is recommended that IBL lease the property. The cost of leasing is immaterial in view of the total cost of the property, there are likely unidentified repairs and maintenance costs that would increase the cost of purchasing, and the lease does not require an upfront cash outlay.

For Assessment Opportunity #11, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to calculate the cost of leasing compared to purchasing, and attempts to discuss some qualitative factors.

Competent – The candidate calculates the cost of leasing compared to purchasing, discusses some qualitative factors, and provides a recommendation.

Competent with distinction – The candidate thoroughly calculates the cost of leasing compared to purchasing, discusses several qualitative factors, and provides a recommendation.

Assessment Opportunity #12 (Depth Opportunity)

The candidate evaluates the impact of the proposed share-based compensation programs for store managers on IBL’s financial ratios and debt covenants.

The candidate demonstrates competence in the Finance role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
5.1.1	Evaluates the entity’s financial state	A	A

CPA Map Enabling Competencies:

5.1.1 Applies general business knowledge to enhance work performed

5.1.3 Develops and uses knowledge of the organization, industry and stakeholders

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Tina has asked us to evaluate the impact of the proposed share-based compensation programs on various financial ratios, and on the proposed long-term debt covenants.

Impact on Key Financial Ratios

Before considering the impact of introducing an ESOP or RSU plan, we first need to establish IBL’s baseline financial ratios.

	2023 Actual	Plan #1 (ESOP)	Plan #2 (RSU)
Quick ratio	0.3050	0.3063	0.3050
Debt-to-equity ratio	0.2168	0.2166	0.2167
Debt-to-EBITDA ratio	1.5856	1.5868	1.5896
Interest-coverage ratio	1.1769	1.1689	1.1507

Implementing an ESOP improves IBL's quick ratio and debt-to-equity ratio slightly, but makes both the debt-to-EBITDA ratio and interest-coverage ratio worse.

Implementing an RSU plan allows IBL to maintain its quick ratio, with a slight improvement in its debt-to-equity ratio. However, it negatively impacts both the debt-to-EBITDA and interest-coverage ratios, although both ratios are still within the bank covenants.

Based on the above, we recommend implementing the ESOP, as it is less likely to result in IBL breaching its interest-coverage ratio covenant, which would cause issues with the long-term debt.

Calculations

	2023 Actual	Plan #1 (ESOP)	Plan #2 (RSU)
<u>Quick ratio:</u>			
Current assets	98,000,000	98,000,000	98,000,000
Add: Cash from exercised options	0	57,600	0
Less: Inventory	(84,113,000)	(84,113,000)	(84,113,000)
Less: Prepaid expenses	(1,903,000)	(1,903,000)	(1,903,000)
Adjusted current assets	11,984,000	12,041,600	11,984,000
Current liabilities	45,400,000	45,400,000	45,400,000
Add: AO#2 lease	53,260	53,260	53,260
Add: AO#3 lawsuit	125,000	125,000	125,000
Adjusted current liabilities	45,578,260	45,578,260	45,578,260
Quick ratio	0.2629	0.2642	0.2629

	2023 Actual	Plan #1 (ESOP)	Plan #2 (RSU)
<u>Debt-to-equity ratio:</u>			
Debt	15,000,000	15,000,000	15,000,000
Equity	69,201,000	69,201,000	69,201,000
Add: Income impact of adjustments (Note 1)	(90,435)	(90,435)	(90,435)
Less: FV of options at grant	0	(14,400)	0
Add: Exercised options	0	57,600	0
Add: RSU grant	0	0	23,625
	69,110,565	69,153,765	69,134,190
Debt-to-equity ratio	0.2170	0.2169	0.2170
<u>Debt-to-EBITDA ratio:</u>			
Debt	15,000,000	15,000,000	15,000,000
EBITDA (from AO#8)	9,460,000	9,460,000	9,460,000
Less: ESOP/RSU expense	0	(14,400)	(23,625)
Revised EBITDA	9,460,000	9,445,600	9,436,375
Debt-to-EBITDA ratio	1.5856	1.5880	1.5896
<u>Interest-coverage ratio:</u>			
EBIT (from AO#8)	1,059,238	1,059,238	1,059,238
Less: ESOP/RSU expense	0	(14,400)	(23,625)
Revised EBIT	1,059,238	1,044,838	1,035,613
Interest	900,000	900,000	900,000
Interest-coverage ratio	1.1769	1.1609	1.1507

Note 1: Income impact of adjustments calculated as:

G&A capitalized to ROU assets (AO#2)	(25,000)
Interest expense on lease liability (AO#2)	9,448
Depreciation on ROU asset (AO#2)	12,762
Breach of contract lawsuit (AO#3)	125,000
Total pre-tax adjustments	122,210
Tax rate	26%
After-tax adjustments	90,435

For Assessment Opportunity #12, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to evaluate the impact of the share-based compensation plans on IBL’s financial ratios or debt covenants.

Competent – The candidate evaluates the impact of the share-based compensation plans on IBL’s financial ratios and debt covenants.

Competent with distinction – The candidate thoroughly evaluates the impact of the share-based compensation plans on IBL’s financial ratios and debt covenants, and recommends which plan IBL should pursue.

Assessment Opportunity #13 (Depth Opportunity)

The candidate evaluates IBL’s distribution alternatives.

The candidate demonstrates competence in the Finance role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
5.2.6	Evaluates decisions related to distribution of profits	B	A

CPA Map Enabling Competencies:

5.1.1 Applies general business knowledge to enhance work performed

5.1.3 Develops and uses knowledge of the organization, industry and stakeholders

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

6.3.2 Articulates limitations to recommendations

Distribution Alternatives

We have been asked to evaluate alternatives with respect to a distribution to shareholders.

Cash dividend

A one-time cash dividend of \$2 million will provide \$0.20 per share, and be taxable in the hands of the shareholders. Generally, a cash dividend is viewed as a positive signal, which would lead to an increase in the share price. For IBL, that may not be the outcome, given the broader understanding that the dividend is not recurring at this time, and the cash may be better used in its operations.

Further, based on the cash budget (AO#4), IBL will require short-term financing in the next 12 months. Accordingly, as a one-time cash dividend would result in an additional shortfall that would have to be made up, this is not a good use of the existing cash balance.

Share repurchase

Based on the current share price of \$7.50 per share, a \$2 million share repurchase would result in a buyback of 266,666 shares (rounded down), representing 2.67% of all outstanding shares. As the share repurchase is a taxable event, shareholders would realize capital gains (or losses) on a repurchase by IBL. Given that capital gains are subject to a 50% inclusion rate, the corresponding tax burden on shareholders will be less than that of an eligible dividend. A share repurchase is generally a positive signal that the FMV of the shares is below the intrinsic value, leading to a rise in share price. Similar to the cash dividend, the circumstances surrounding a proposed repurchase may indicate that the repurchase is a poor use of existing cash, with the understanding that IBL is appeasing shareholders rather than believing in the intrinsic value of the stock. Further, as IBL is only proposing to repurchase 2.67% of the outstanding shares, this may not be enough to materially impact the share price.

Like the cash dividend, a \$2 million outflow does not appear to be a good use of IBL's existing cash balance, based on the cash budget for 2024, which will result in an incremental cash shortfall.

Stock split

A 2:1 stock split would double the outstanding common shares from 10 million to 20 million, and reduce the current FMV of IBL's share price from \$7.50 to \$3.75. The proposed stock split would not be taxable to shareholders; however, there is no benefit to the split unless the reduced share price causes an increase in demand for IBL's shares, and consequently increases the share price.

Stock dividend

Similar to a stock split, a stock dividend would involve increasing the number of shares owned by each common shareholder. The proposed stock dividend would increase the outstanding common shares to 11 million, which will cause the market value to reduce in the same proportion, from \$7.50 to \$6.82 (rounded). The proposed stock dividend is taxable to shareholders, and may therefore be viewed less favourably than a stock split. Also, similar to a stock split, there is no immediate value to shareholders from such a mechanism; rather, a subsequent increase in the share price and dividend entitlement would provide the value to shareholders. However, given IBL's cash issues, a stock dividend may be a useful short-term tool for satisfying shareholders' expectations without an actual cash outlay.

The stock dividend also represents a change in the makeup of shareholders' equity. The dividend of 1 million shares \times \$7.50 will result in an increase of \$7.5 million to the book value of common shares, with a corresponding decrease in retained earnings, or deficit.

Additional considerations

IBL should also consider the following:

- Despite the intended one-time nature of the current proposals, shareholders may expect IBL to make consistent distributions in future periods.
- There may be legal restrictions with respect to the proposed distributions, notably:
 - IBL's long-term debt should be reviewed, to ensure that a distribution is permitted, and that any existing covenants would not be negatively impacted.
 - Depending on corporate law, IBL may not be permitted to make a distribution out of a deficit position on its balance sheet.
- As evidenced in the revised cash budget, IBL is expected to realize a net decrease in cash over the next 12 months. Therefore, it may not be advisable to pay a cash dividend or make share repurchases in the short-term; such an outflow may result in IBL having to draw additional funds on its existing long-term debt, and/or make use of multiple short-term financing alternatives.
- Further, other than the immediate working capital concerns of a cash outlay of \$2 million, such an outlay would limit IBL's ability to invest in new opportunities, and similarly, would require financing for any new projects.

Recommendation

Given the cash constraints facing IBL in the short term, it is recommended that IBL appease the dividend demands by paying a stock dividend to its shareholders, provided that it is permitted to make such a distribution.

For Assessment Opportunity #13, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to evaluate IBL's distribution alternatives.

Competent – The candidate evaluates IBL's distribution alternatives, and provides a recommendation.

Competent with distinction – The candidate thoroughly evaluates IBL's distribution alternatives, and provides a recommendation.

**DAY 2 – MARKING GUIDE – PERFORMANCE MANAGEMENT ROLE
INSPIRED BOOKS LTD. (IBL)**

To: Tina Parker, CFO
 From: CPA
 Subject: Items requested

See Common Marking Guide for the Common Assessment Opportunities #1 to #6.

Assessment Opportunity #7 (Depth Opportunity)

The candidate prepares a divisional income statement, based on IBL’s current cost allocation model, and makes appropriate revisions.

The candidate demonstrates competence in the Performance Management role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
3.3.1	Evaluates cost classifications and costing methods for management of ongoing operations	A	

CPA Map Enabling Competencies:

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Cost Allocation

Existing cost allocation model

Based on the existing model, as outlined by Jeff, the online segment performs poorly and the in-store segment nearly breaks even. However, based on Jeff’s notes, it appears that numerous costs are misallocated; therefore, to better understand each segment’s performance, a revised model should be calculated (in thousands of dollars).

Item	Online (\$)	In-store (\$)	Total (\$)	Note
Revenue	11,175	63,325	74,500	1
Cost:				
Cost of sales	(5,029)	(28,496)	(33,525)	2
General and administrative	(3,390)	(19,210)	(22,600)	2
Marketing and sales	(4,345)	(4,345)	(8,690)	3
Depreciation	(4,194)	(4,194)	(8,388)	3
Loss on disposal of PP&E	(24)	(136)	(160)	2
Gain on disposal of PP&E	5	30	35	2
Interest expense	(1,283)	(7,272)	(8,555)	2
Loss before income taxes	(7,085)	(298)	(7,383)	
Income %	-63.40%	-0.47%		

Notes:

1. Given that 15% of revenue is from online sales.
2. Computed as the total balance, as per the income statement, multiplied by the revenue split (15/85).
3. Computed as the total balance, as per the income statement, split equally (50/50).

Revised cost allocation model

A revised cost model results in significantly different results for the online and in-store segments, and suggests that the online segment is profitable whereas the in-store segment is performing at a loss. Based on this analysis, it is evident that IBL had a major issue in its allocation; in future periods, IBL might want to consider a more granular analysis, to determine if the general and administrative, and marketing and sales portions could be further broken down in order for the cost drivers to be analyzed in greater detail.

Item	Online (\$)	In-Store (\$)	Total	Note
Revenue	11,175	63,325	74,500	4
Cost:				
Cost of sales	(5,364)	(28,161)	(33,525)	5
General and administrative	(1,847)	(11,713)	(13,560)	6
Marketing and sales	(869)	(7,821)	(8,690)	7
Depreciation	(275)	(8,113)	(8,388)	8
Loss on disposal of PP&E	0	0	0	9
Gain on disposal of PP&E	0	0	0	9
Interest expense	(130)	(8,425)	(8,555)	10
Income/(loss) before income taxes	2,690	(908)	1,782	

Notes (continued):

4. Given that 15% of revenue is from online sales.
5. Based on the vice-president's statement, the gross margin on online sales is 52%; therefore, the cost of sales should be 48%, or $\$11,175,000 \times 48\% = \$5,364,000$. Accordingly, of the total cost of sales of $\$33,525,000$, the remaining $\$28,161,000$ should be allocated to the in-store segment.
6. Based on Jeff's G&A cost allocation model, 40% of the general and administrative expenses relate to neither department, but are related to the general administration of the company as a whole. This amount of $\$9,040$ ($\$22,600 \times 40\%$) was allocated to neither of the two segments, for segmental reporting purposes. The remaining $\$13,560$ was allocated as follows:
 - As 80% of the time spent by the IT department related to the online segment, this fraction of the cost of that department was allocated to this segment.
 - As the IT department generally handles the troubleshooting duties linked with the online stores, the maintenance and repairs are likely incurred in the physical stores. The entirety of the maintenance and repair costs was therefore allocated to the in-store segment.
 - As the utilities expense related to the online store is a variable cost, it has been estimated at 2% of online sales, an amount of $\$223$ ($\$11,175 \times 2\%$). The remainder of the utilities expense has been allocated to the in-store segment.
 - The store managers' salaries and benefits have been entirely allocated to the in-store segment.

The following table summarizes the allocation of the general and administrative expenses:

	Online (\$)	In-Store (\$)	Head Office (\$)	Total (\$)
Administration of entire business			9,040	9,040
Costs related to the IT department	1,624	406		2,030
Maintenance and repairs		1,540		1,540
Utilities	223	1,267		1,490
Store managers' salaries and benefits		8,500		8,500
Total	1,847	11,713	9,040	22,600

7. Based on the manager's statement, marketing costs should be revised to $\$8,690,000 \times 10\% = \$869,000$, and $\$8,690,000 \times 90\% = \$7,821,000$.
8. As described by Jeff, the online segment only maintains a warehouse and related fixtures, which gave rise to depreciation of \$275,000 during the year. Therefore, the remaining \$8,113,000 ($\$8,388,000 - \$275,000$) should be allocated to the in-store segment.
9. Both the gain and loss were identified as being on property relating to the retail stores, and accordingly, 100% of their impact should be allocated to the in-store segment. However, these items are extraordinary and non-recurring; therefore, to provide a more representative picture of the performance of the segments on a recurring basis, they have been excluded from the cost allocation model.
10. As described by Jeff, the online segment only maintains a warehouse, giving rise to interest of \$130,000; therefore, the remaining \$8,425,000 should be allocated to the in-store segment. The actual cash payments are excluded.

For Assessment Opportunity #7, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to prepare a divisional income statement, based on IBL’s current cost allocation model, and attempts to make appropriate revisions.

Competent – The candidate prepares a divisional income statement, based on IBL’s current cost allocation model, and makes appropriate revisions.

Competent with distinction – The candidate prepares a divisional income statement, based on IBL’s current cost allocation model, and thoroughly makes appropriate revisions.

Assessment Opportunity #8 (Depth Opportunity)

The candidate discusses the advantages and disadvantages of increasing the focus on the online business, and assesses the alignment with IBL’s mission and vision.

The candidate demonstrates competence in the Performance Management role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
2.3.3	Evaluates strategic alternatives	B	A

CPA Map Enabling Competencies:

- 5.1.1 Applies general business knowledge to enhance work performed*
- 5.1.3 Develops and uses knowledge of the organization, industry and stakeholders*
- 6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems*
- 6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives*
- 6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions*
- 6.3.3 Applies decision criteria to choose among viable alternatives*

Online versus In-Store – Qualitative Analysis

Increased focus on online

Advantages:

- Younger generations are more likely to shop online, which represents a fundamental shift away from in-store shopping, leading to increased sales.
- Online stores allow customers to shop from anywhere, leading to more opportunities for customers to purchase IBL’s products.
- Investment in search engine optimization and targeted online advertising may lead to new customers, and increased sales from existing customers.
- New product lines can be easily added without sacrificing existing offerings, which leads to added opportunities for increasing sales through product diversification.
- There will be reduced overhead costs, as IBL only has to maintain a warehouse and website in order to operate its online business. This translates to higher profits. It also reduces break-even points, and therefore reduced variability of profits.
- Online businesses are more likely to realize rapid growth, outpacing traditional in-store businesses.
- Online stores can leverage the proposed membership program to tailor specific offerings to customers. The modifications can be done faster online, and consumers can be made aware of them in a timelier fashion.

Disadvantages:

- Data privacy and security risk are growing concerns for consumers, and additional efforts may be required by IBL, to mitigate such risks.
- Browsing for products is more difficult, and requires clicking through multiple webpages and/or filters to narrow down selections, which can make the shopping experience more burdensome for customers.
- Customers do not receive their purchases immediately, and IBL will become reliant on a delivery company for executing its sales, which carries additional risks of damage and delays.

Increased focus on in-store

Advantages:

- This builds on IBL’s history and expertise in offering in-store shopping to its customers.
- In-store shopping allows for a more personal experience for customers, which is a key feature of bookstores.
- Customers can preview books and other products before committing to their purchase.
- This integrates well with IBL’s café pilot project, and its intention to offer a wide range of bookstore products.

- In-store staff can provide faster and friendlier customer service, and ease of returns or exchanges.
- Stores can be highly visible, and may reach consumers going about their daily lives.
- IBL can set up stores in a manner that promotes incremental sales by browsing. The stores can therefore serve as an additional promotional tool for increasing sales.
- Physical stores provide legitimacy to a brand, which increases customer trust.
- Customers receive their purchases instantly, without waiting for delivery.

Disadvantages:

- Reach is limited to the geographical regions in which IBL has stores, which limits sales growth.
- A large staff of entry-level workers is required, for which a recognized shortage exists in the broader labour market.
- Further, even when it has been able to make hires, IBL has had trouble maintaining its entry-level workforce.
- There are increased fixed and variable costs over the online store, which simply consists of a warehouse and website.
- Brick-and-mortar stores are limited by their existing square footage, and it is often difficult to move or expand.

Alignment with mission and vision

IBL's current mission and vision do not make a distinction between online and in-store offerings.

It may be more difficult for IBL to foster a comfortable environment and exceptional service in an online store, as the personal connection to customers is lost. The mission may require a small modification, to ensure that online sales are fully supported by IBL, given that they form 15% of IBL's existing business and may grow in the future. Product variety will be easily met through an online offering, and the ultimate vision of IBL can be realized through the online store.

Accordingly, provided that IBL is able to provide its customers with a comfortable environment (ease of use/navigation, quelling data-security concerns), exceptional service (live support, feedback portals), and product variety through its online offerings, an increased focus on online sales will also meet IBL's mission and vision. Therefore, IBL's mission and vision support either approach.

Recommendation

Based on the revised quantitative analysis, which provides a more favourable outlook for the online segment, the advantages identified above, and the alignment with the mission and vision, it is recommended that IBL put additional focus on its online sales, thereby improving the overall profitability of the company.

For Assessment Opportunity #8, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to discuss the advantages and disadvantages of increasing the focus on the online business.

Competent – The candidate discusses the advantages and disadvantages of increasing the focus on the online business, and assesses the alignment with IBL’s mission and vision.

Competent with distinction – The candidate thoroughly discusses the advantages and disadvantages of increasing the focus on the online business, and assesses the alignment with IBL’s mission and vision.

Assessment Opportunity #9 (Depth Opportunity)

The candidate calculates the forecasted operating income for the proposed home-decor segment, using a sensitivity analysis.

The candidate demonstrates competence in the Performance Management role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
3.4.1	Evaluates sources and drivers of revenue growth	B	A
3.5.1	Performs sensitivity analysis	A	A

CPA Map Enabling Competencies:

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.2 Articulates limitations to recommendations

Home-Decor Segment – Quantitative Analysis

To assess the operating income of the proposed new segment, we have performed a sensitivity analysis, based on the inputs provided by IBL.

	Home Decor			Note
	Base	Pessimistic	Optimistic	
Revenue	13,000	11,700	14,300	1
Cost of goods sold	5,980	6,084	5,720	1
Gross profit	7,020	5,616	8,580	
Operating costs:				
Warehousing	550	495	605	2
Marketing	300	300	300	3
Depreciation	100	100	100	4
Salaries	600	630	570	5
	1,550	1,525	1,575	
Operating income	5,470	4,091	7,005	
Opportunity cost	4,923	5,626	4,220	6
Total benefit /(cost)	547	(1,535)	2,785	

Notes:

1. Based on the rates provided by IBL, revenue is estimated at \$13 million in the base scenario, rising to \$14.3 million (110%) in an optimistic scenario, and declining to \$11.7 million (90%) in a pessimistic scenario.

Gross margin for the new products is expected to be 48%–60%. Accordingly, cost of goods sold will be 40%–52%. Using the average of 46% for the base scenario, cost of goods sold will be \$5,980,000, rising to \$6,084,000 (52%) in the pessimistic scenario, and declining to \$5,720,000 (40%) in the optimistic scenario.

2. Warehousing costs are expected to increase by a net amount of \$550,000 (\$800,000 - \$250,000) annually. Although a range has not been provided for this amount, for sensitivity purposes, it is assumed that, as warehousing costs are likely somewhat linked to the sales volume, they may increase by 10% to \$605,000, or decrease by 10% to \$495,000.

3. Marketing costs are estimated to be \$300,000 annually. They appear to be fixed costs, so would remain the same under all scenarios.
4. IBL expects to acquire \$1 million of new furniture, with a 10-year life. Assuming straight-line depreciation and no residual value, this will generate \$100,000 of incremental depreciation expense for the company. As depreciation is a fixed cost, it is deemed to be the same under all scenarios.
5. Salaries are estimated to increase by \$600,000 in the base scenario, rising to \$630,000 (105%) in the pessimistic scenario, and declining to \$570,000 (95%) in the optimistic scenario.
6. IBL anticipates that it will allocate 12%–16% of its existing floor space to the new segment, which will result in a loss of in-store sales on the existing products. IBL must therefore include the opportunity cost of these sales in its analysis of the income derived from the home-decor segment:

	Base	Pessimistic	Optimistic
Existing gross profit (Note 7)	35,164	35,164	35,164
Reduction	14%	16%	12%
Foregone gross profit	4,923	5,626	4,220

7. Based on the gross profit generated by the in-store sales, calculated earlier:

Sales from the in-store segment	\$ 63,325
Cost of sales – in-store	<u>28,161</u>
Gross profit – in-store segment	<u>\$ 35,164</u>

Therefore, IBL can expect to achieve an operating income /(loss) from the new segment of \$(1,535,000) to \$2,785,000, with a base scenario of \$547,000. Although the base scenario is positive, introduction of the new segment could result in an operating loss if the pessimistic scenario occurs.

Further, there are important qualitative factors to consider, which are discussed below.

For Assessment Opportunity #9, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to calculate the forecasted operating income for the proposed home-decor segment, using a sensitivity analysis.

Competent – The candidate calculates the forecasted operating income for the proposed home-decor segment, using a sensitivity analysis.

Competent with distinction – The candidate thoroughly calculates the forecasted operating income for the proposed home-decor segment, using a sensitivity analysis.

Assessment Opportunity #10 (Depth Opportunity)

The candidate discusses the advantages and disadvantages of introducing a home-decor segment, and assesses whether it is a good strategic fit for IBL.

The candidate demonstrates competence in the Performance Management role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
2.3.1	Evaluates the entity's strategic objectives and related performance measures	B	A

CPA Map Enabling Competencies:

5.1.1 Applies general business knowledge to enhance work performed

5.1.3 Develops and uses knowledge of the organization, industry and stakeholders

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

6.3.3 Applies decision criteria to choose among viable alternatives

Home-Decor Segment – Qualitative Analysis

Introduce new product line

Advantages:

- Global book sales peaked in the early 2000s, and sales have been relatively stagnant since; therefore, exploring new product lines could provide an opportunity to promote growth.
- Younger generations have displayed a strong interest in trendy, affordable home-decor products, providing a good growth opportunity.
- The breadth and depth of new products is significant; if IBL is successful, it can easily continue to build on this with additional products in a specific line, or by widening to more lines.
- This provides an opportunity for increasing overall profitability by sacrificing low-margin offerings in favour of new, higher-margin lines.
- As a second-mover, IBL can reflect on the successes and failures of competitors that have branched out of books, to realize similar successes and avoid similar failures.

Disadvantages:

- IBL does not have existing expertise or history in home decor and furnishings at its senior leadership level, which could jeopardize the success of the new offerings.
- Consumers may not perceive IBL as a reliable retailer for these products, and may continue to shop at more familiar competitors.
- A shift toward home decor could cause a loss of loyal customers, as it signals an abandonment of IBL's historical focus on books.
- The demand for home-decor products is more elastic than the demand for books; in tougher economic times, when consumer spending on discretionary items decreases, home decor will be sacrificed before books.
- If IBL shifts its focus to online offerings, it may be difficult to integrate home-decor offerings, which typically demand an in-store presence, so customers can interact directly with decor products; this could jeopardize the success of the new offering.
- IBL will need to form relationships with new suppliers, and assess which inventory to stock.
- Home decor has many formidable competitors who have been operating in this market for a considerable period, which makes their sales assumptions more reliable.
- IBL may lose its competitive advantage in books by following the moves of its competitors toward a broader range of products, and its current customer base could potentially erode.
- If IBL chooses to implement a customer membership program, it may be difficult to accurately provide tailored offerings in home decor, as IBL does not have historical sales data to utilize.

Fit with mission and vision

The home-decor product differentiation does not align well with IBL's existing mission and vision.

IBL's mission is focused on the "joy of reading," which is lost in this strategic decision. However, IBL could continue to provide a comfortable environment and exceptional service if it differentiated its products.

With that in mind, IBL may consider an update to its mission, to expand upon its product offerings; however, in the current state, the mission statement would not support the introduction of home-decor product lines.

Further, IBL's vision is predicated on lifelong learning and literacy, neither of which are present in the introduction of these new product lines. Therefore, IBL's mission and vision do not support the product differentiation proposed by the company, and may have to be reworked if IBL intends to pursue this strategic alternative.

Recommendation

The quantitative analysis shows a situation that could lead to a significant reduction in operating income, if the unfavourable scenario materializes. Further, IBL should be aware of the initial investment in fixed assets and inventory that would be required, which may be difficult, given the impending cash shortage concerns that were outlined in the cash budget (Common AO#4).

Although there are some advantages to the new product lines, they are not a fit with the current mission and vision of the company, and there are significant disadvantages with respect to expertise, elasticity, and potential loss of competitive advantage.

Therefore, it is recommended that IBL not pursue the new home-decor segment at this time; rather, it should continue to focus on its traditional business, which is earning positive operating income.

For Assessment Opportunity #10, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to discuss the advantages and disadvantages of introducing a home-decor segment.

Competent – The candidate discusses the advantages and disadvantages of introducing a home-decor segment, and assesses whether it is a good strategic fit for IBL.

Competent with distinction – The candidate thoroughly discusses the advantages and disadvantages of introducing a home-decor segment, and assesses whether it is a good strategic fit for IBL.

Assessment Opportunity #11 (Depth Opportunity)

The candidate assesses the advantages and disadvantages of the proposed customer membership program, and the financial impact it would have on IBL.

The candidate demonstrates competence in the Performance Management role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
2.3.1	Evaluates the entity’s strategic objectives and related performance measures	B	A
3.4.1	Evaluates sources and drivers of revenue growth	B	A

CPA Map Enabling Competencies:

5.1.1 Applies general business knowledge to enhance work performed

5.1.3 Develops and uses knowledge of the organization, industry and stakeholders

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

6.3.3 Applies decision criteria to choose among viable alternatives

Membership Program

Quantitative

The membership program will generate two types of incremental annual inflows, and two types of annual incremental costs. First, it will generate membership revenues from the two types of members (annual and monthly). It will also generate an additional gross margin, in the increased sales to members generated by the program. It will generate a cost related to the 10% discount given to the members on their current sales, as well as the ongoing costs of managing the program.

The following table summarizes the impact of these four factors:

Monthly members ($959,470 \times 4\%$) - rounded		38,379	A
Monthly fee		3	
Monthly revenue	\$	1,381,644	
Annual members ($959,470 \times 2\%$) - rounded		19,189	B
Annual fee		20	
Annual revenue	\$	383,780	
Total revenue from membership fees	\$	1,765,424	C
Number of members - rounded:		57,568	A+B
Current sales to members ($57,568 \times 1.65 \times \40)	\$	3,799,488	
Projected sales to members ($57,568 \times 1.65 \times 1.5 \times \40×1.15)	\$	6,554,117	
Increase in sales generated by the program	\$	2,754,629	
Gross margin on the additional sales (55.53% – Note 1)	\$	1,529,645	
Less: Discounts given to members on additional sales (10%)	\$	(275,463)	
Additional profit earned on increase in sales	\$	1,254,182	D
Expected discount cost on current sales (Note 2)	\$	(379,949)	E
Ongoing costs of the program	\$	(500,000)	F
Overall benefit of the program	\$	2,139,657	C+D+E+F

Note 1:

Sales from in-store segment (see AO#7)	63,325
Cost of sales from in-store segment (see AO#7)	28,161
Gross margin on in-store sales (\$)	35,164
Gross margin on in-store sales (%)	55.53%

Note 2:

Number of members	57,568
Number of visits by members	1.65
Total current purchases by members	94,988
Average basket	\$ 40
Total current sales to members	\$ 3,799,488
Discounts on current sales to members (10%)	\$ 379,949

Note that the financial analysis focuses on recurring revenues and costs, and therefore excludes the upfront cost of the program. Further, the analysis assumes neutral sales-volume growth, and does not estimate for any attrition in the membership base.

Qualitative

Advantages:

- This allows IBL to remain competitive with other bookstores and retailers, who have their own membership programs.
- IBL can use customer data and spending habits to better inform inventory selection and timing.
- Customer data can be used to target customers with personalized marketing materials.
- A popular membership program can attract new customers, and therefore be a source of further profit not yet modelled.
- It improves the retention of existing customers, as they are incentivized to continue shopping at IBL over its competitors.
- The quantitative analysis suggests that the program will provide a net benefit in operating income.

Disadvantages:

- There are increased data-security risks, depending on the nature of customer data stored in IBL's databases.
- An oversaturation of membership programs in all areas of retail may reduce customer sign-ups.
- IBL's program is only for in-store sales, which limits its attractiveness as a membership program. IBL should consider upgrading its systems so that customers can also benefit from the discount in the online store, especially if IBL intends to focus more on its online presence.
- IBL's program requires the physical card to be presented, which may frustrate customers who forget, or lose, their card.

Fit with mission and vision

The proposed customer membership program will assist IBL in achieving its mission and vision by incentivizing customers to purchase a book, thereby retaining customers, and solidifying not only their joy of reading but the commitment to lifelong learning. IBL should consider updates to the design of the program, to address the physical card and in-store policies noted in the disadvantages above, as these are incongruent with IBL's mission of exceptional service. Overall, the proposed program is a good fit for IBL.

Conclusion

As it offers an increase to operating income, has several key advantages, and generally fits with its mission and vision, IBL should implement the customer membership program.

For Assessment Opportunity #11, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to assess the advantages and disadvantages of the proposed customer loyalty program, and the financial impact it would have on IBL.

Competent – The candidate assesses the advantages and disadvantages of the proposed customer loyalty program, and the financial impact it would have on IBL.

Competent with distinction – The candidate thoroughly assesses the advantages and disadvantages of the proposed customer loyalty program, and the financial impact it would have on IBL.

Assessment Opportunity #12 (Depth Opportunity)

The candidate calculates the VP's bonus, analyzes the incentive compensation plan for the online segment of the business, and suggests improvements.

The candidate demonstrates competence in the Performance Management role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
3.6.2	Evaluates performance of responsibility centres	B	A
3.7.1	Analyzes the implications of management incentive schemes and employee compensation methods	B	A

CPA Map Enabling Competencies:

5.1.2 Recognizes the interrelationships among departmental and functional areas within the organization

5.1.3 Develops and uses knowledge of the organization, industry and stakeholders

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

6.3.2 Articulates limitations to recommendations

Management Incentive Plans2023 VP bonus calculation

Tina has asked us to estimate the VP's bonus for 2023. The VP is assessed solely on organizational performance, with 50% attributable to the online store's operating income and 50% attributable to in-store EBITDA.

It is assumed that the cost allocation performed in AO#7 is a sufficient proxy for the online store's operating income :

Revenue	\$11,175,000
Cost of sales	(5,364,000)
General and administrative	(1,847,000)
Marketing and sales	(869,000)
Depreciation	(275,000)
Warehouse lease interest	(130,000)
Operating income (online)	<u>\$ 2,690,000</u>

As the actual operating income of \$2,690,000 is above \$1,600,000, the performance is 100%.

Similarly, we can estimate the in-store EBITDA, using the cost allocation from AO#7:

Revenue	\$ 63,325,000
Cost of sales	(28,161,000)
General and administrative	(11,713,000)
Marketing and sales	(7,821,000)
In-store EBITDA	\$ 15,630,000

As the actual EBITDA of the in-store segment of \$15,630,000 falls between \$8,000,000 and \$16,000,000, the performance is 50%.

Therefore, as these two metrics are equally weighted, the VP's bonus is \$11,250, determined as:

$$(50\% \times 100\%) + (50\% \times 50\%) = 75\%$$

$$\text{Base salary} \times \text{bonus rate} \times \text{performance} = \text{bonus}$$

$$\$150,000 \times 10\% \times 75\% = \$11,250$$

VP bonus plan

As noted, the VP's plan is based 100% on organizational performance, which devalues the performance management process. Although the VP is in a senior-management position, they report to the chief operating officer and are expected to develop goals and assess their annual progress. As their bonus calculation ignores individual performance, the goals (whether met or not), and assessment from the chief operating officer (whether positive or negative), are excluded, and the performance process is therefore irrelevant to the VP. Going forward, the weighting should be shifted to allocate a reasonable portion to individual performance.

In terms of the organizational performance, incentive plans are most successful when the inputs are controllable. The following items form part of the organizational performance calculation:

Revenue	Partially controllable, as the online segment can determine inventory selection, but prices are controlled by the finance department
Cost of goods sold	Controllable, as the VP has ultimate discretion over which inventory to stock

Salaries and wages	Partially controllable, as the VP can set head count for their segment, but the salary/wage must be within a range determined by HR
Warehouse lease costs	Partially controllable, as the VP can negotiate the warehouse lease details, but must select from a short list determined by the finance department
Marketing costs	Not controllable, as all marketing costs are at the discretion of the marketing department
General and administrative	Partially controllable, as some expenses are under their control, while others are allocations of corporate company-wide costs that are under the control of the finance department
EBITDA of the in-store segment	Not controllable, as it is outside the scope of the online segment

Based on the above, the VP is assessed based on numerous non-controllable and partially-controllable metrics.

For the incentive plan to operate more effectively, the non-controllable metrics should be removed, and the partially-controllable metrics limited, or redefined, to the extent possible.

Manager and staff bonus plan

The manager and staff plan is based 60% on individual performance and 40% on organizational performance. There are a few issues with the individual performance component:

- Direct superiors have sole discretion over the rating, without oversight from another superior or from the HR department, and may give undeserved ratings.
- As the bonus impact is the same for both meeting and exceeding expectations, there is no incentive for employees to exceed expectations.
- There is a steep decline from “meeting expectations” to “needs improvement,” which may cause undue anxiety for employees.
- Whether or not employees achieve their goals does not appear to be considered; therefore, it is unclear whether these are valuable to the organization.

To make the individual component more attractive, goals should be agreed upon with direct superiors and designed in a SMART format, and employee ratings should be assessed against the execution of those goals. Further, an additional superior or HR personnel should be involved in the annual review process, to avoid undeserved ratings. Lastly, the bonus impact should be redesigned with less of a reduction, to 75%, and with a small premium for exceeding expectations, to 110%.

Similar to that of the VP, it is important for the organizational portion to be controllable. The discussion for the managers and staff is broadly the same; however, a key difference is that managers and staff have less influence over these factors than the VP. The VP maintains ultimate responsibility for their segment; however, it is likely that the individual managers and staff may only be involved in certain areas of the online business. For example, one manager and their staff may be focused on website design and maintenance, whereas another may be focused on the day-to-day operations at the warehouses.

Accordingly, the conclusions from the VP's plan should be considered, but with the bonus plans for the managers and staff further customized to their direct areas of responsibility, rather than to the areas of responsibility for the entire department.

For Assessment Opportunity #12, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to calculate the VP's bonus and analyze the incentive compensation plan.

Competent – The candidate calculates the VP's bonus, analyzes the incentive compensation plan, and suggests some improvements.

Competent with distinction – The candidate calculates the VP's bonus, thoroughly analyzes the incentive compensation plan, and suggests several improvements.

Assessment Opportunity #13 (Depth Opportunity)

The candidate discusses the weaknesses of the legacy inventory management system, and recommends improvements for a potential new system.

The candidate demonstrates competence in the Performance Management role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
3.1.2	Documents and assesses business processes, systems and data requirements and recommends improvements to meet information needs	B	A

CPA Map Enabling Competencies:

5.1.1 Applies general business knowledge to enhance work performed

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Inventory Management

Legacy inventory management system

Based on the survey responses from IBL’s store and corporate managers, multiple weaknesses were identified in the legacy inventory system that IBL is currently using. These issues appear to be pervasive, and bear significant consequences, both in terms of the micro-level implications outlined below and in other areas of the organization. As IBL is contemplating the introduction of new inventory lines (home decor), key concerns should be addressed, to allow for a smooth introduction, if pursued. Further, it is possible that ineffective systems are having a negative impact on employees, contributing to the employee turnover issues noted by management. IBL should therefore consider implementing the recommendations identified below, to eliminate the weaknesses and the negative consequences they give rise to.

Limited filtering abilities

Weakness: The legacy system is limited to filtering by specific categories, and is unable to filter by author, or book category, or subcategory.

Implication: This limits the amount of inventory analysis that may be performed by stores and corporate, and does not allow them to have accurate information in order to manage their inventory, resulting in potential inventory shortages of certain books, or in an inability

to adequately respond to customer inquiries on the availability of the books they are seeking to purchase.

Recommendation: The new system should have additional filter and data-tagging options, to allow for easier data analysis. For example, the store managers should be able to query the system on the availability of books from a specific author, and obtain live information on the quantity in stock of all the books from this author.

Lack of searching abilities

Weakness: Store employees are unable to search the inventory database.

Implication: Without the ability to search, the store employees are unable to adequately inform the in-store customers on the availability of their preferred authors or books, and this could result in dissatisfied customers, who would ultimately purchase the book at a competing bookstore.

Recommendation: The new system should have a comprehensive search engine built in.

PDF format

Weakness: The legacy system will only export reports in a PDF format.

Implication: It is more difficult to manipulate and analyze data, as it must be first converted to a spreadsheet, either with an additional tool or manually. This results in an inefficient process, and wastes employee time.

Recommendation: The new system should be able to export reports in spreadsheet format, for ease of data manipulation.

Manual entry

Weakness: Store employees have to manually enter new units of inventory.

Implication: This is time-consuming for store employees, and is at risk for user input error, causing discrepancies in the system versus actuals.

Recommendation: The new system should allow inventory to be scanned in, and the system updated accordingly.

Daily refresh

Weakness: The legacy system refreshes only at the end of the day.

Implication: Store employees cannot provide customers with up-to-date data on whether certain inventory is in stock, which will lead to unsatisfied customers.

Recommendation: The new system should refresh instantly, or as close to instantly as possible, to allow for more accurate data, for store employees to help customers.

Inventory descriptions

Weakness: The legacy system limits descriptions to 15 characters. As a result of the character limit, staff have had to be creative when naming a product.

Implication: Both in-store and corporate employees may have difficulty understanding what products are being referred to, and inconsistent naming conventions may make product analysis difficult.

Recommendation: The new system should not have a character limit for product descriptions, to allow for more accurate and descriptive data to be inputted into the system. In addition, a standard method of naming inventory, or of what to put in the description field, should be created. For example, the title and the author's name should be entered in their entirety, and the book's genre could be assigned to the book using a drop-down menu containing all the possible options (fiction, self-help, children's, etc.).

Limited ability to access the system

Weakness: The legacy inventory system can only be viewed at each store.

Implication: Corporate must receive and compile reports from each individual store, to analyze company inventory, and individual stores are unable to provide customers with alternative inventory locations. This causes inefficiencies in analysis as well as customer dissatisfaction.

Recommendation: The new system should allow users to view other locations in read-only capacity, so that employees can direct customers to other locations, and it is easier for corporate to obtain the data they require.

Lack of notifications of stockouts

Weakness: The legacy system has no notifications for stockouts.

Implication: Store managers may not notice that certain inventory is out of stock, which could cause delays in restocking.

Recommendation: The new system should have notifications for stock outages, to prompt store managers to reorder on a timely basis.

IT environment

Separate from the specific issues identified in the legacy inventory system, the notes from IBL's store managers and corporate managers highlight a broader concern within IBL's

information technology environment. IBL does not maintain an IT plan, nor does it undertake reviews of the various systems in use across the organization.

Numerous store managers and corporate finance and operations managers have asked that IBL adopt a new inventory system. Senior leadership has not been receptive to these requests, as they consider replacement to be a costly project. IBL has demonstrated a lack of oversight and concern for its IT environment, which should be rectified. While the cost of replacement systems is a valid concern in the short term, at minimum, IBL should create an IT plan. The plan should define a periodic review of existing systems and department needs, and a member of the senior leadership team should be tasked with maintaining oversight of the systems, and acting as the IT voice amongst the rest of the team.

For Assessment Opportunity #13, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate discusses some weaknesses of the legacy inventory management system, and recommends improvements.

Competent – The candidate discusses several weaknesses of the legacy inventory management system, and recommends improvements.

Competent with distinction – The candidate discusses many weaknesses of the legacy inventory management system, and recommends improvements, including a discussion of IBL's broader IT environment.

**DAY 2 – MARKING GUIDE – TAXATION ROLE
INSPIRED BOOKS LTD. (IBL)**

To: Tina Parker, CFO
 From: CPA
 Subject: Items requested

See Common Marking Guide for the Common Assessment Opportunities #1 to #6.

Assessment Opportunity #7 (Depth Opportunity)

The candidate calculates the tax implications of the capital items.

The candidate demonstrates competence in the Taxation role.

CPA Map Technical Competencies:		Core	Elective
6.2.2	Advises on taxes payable for a corporation	B	A

CPA Map Enabling Competencies:

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Capital Cost Allowance (CCA)

	6%	20%	30%	100%	S/L	30%	55%	
	Class 1 NRB	Class 8	Class 10	Class 12	Class 13	Class 46	Class 50	Total
Note:	1	2	3	4	5	6	7	
Opening UCC	\$ 800,000	\$ 7,500,000	\$ 45,000	\$ 125,000	\$5,475,000	\$ 50,000	\$ 0	\$ 13,995,000
Additions	98,000	850,000			250,000		700,000	1,898,000
Disposals						(65,000)		(65,000)
AIIP adjustment	49,000	425,000					350,000	824,000
Basis for CCA	947,000	8,775,000	45,000	125,000	5,725,000	(15,000)	1,050,000	16,652,000
CCA	(56,820)	(1,755,000)		(125,000)	(687,500)		(577,500)	(3,201,820)
Reverse AIIP	(49,000)	(425,000)	0	0	0	0	(350,000)	(824,000)
Recapture						15,000		15,000
Terminal loss			(45,000)					(45,000)
Ending UCC	\$ 841,180	\$ 6,595,000	\$ 0	\$ 0	\$5,037,500	\$ 0	\$ 122,500	\$ 12,596,180

Notes:

- The building additions should be capitalized to Class 1, and IBL may elect, under income tax regulation 1101(5b.1), to include the additions in the existing separate Class 1 in order to be eligible for an additional 2% of CCA annually, or 6% in total. This election should be filed at the same time as IBL's corporate income tax return.

The \$100,000 additions have been reduced by the \$2,000 of landscaping that IBL may deduct on a current basis. Refer to AO #8.

The accelerated investment incentive applies, providing an additional $1.5 \times$ CCA for current-year additions.

2. The furniture and fixture additions should be capitalized to Class 8, and the additions are eligible for the accelerated investment incentive.
3. The computer systems in Class 10 were completely disposed of during the year for nil proceeds. For CCA purposes, the adjustment to the class is to reduce it by the lesser of cost and proceeds; therefore, the nil proceeds have no impact. As all property has been disposed of from Class 10, the remaining UCC of \$45,000 is considered a terminal loss and may be deducted from net income (loss) for income tax purposes.
4. There was no activity in Class 12 during the year; accordingly, the opening UCC is fully deductible, as $\$125,000 \times 100\% = \$125,000$.
5. The leasehold improvement additions should be capitalized to Class 13, and CCA has been determined as:

$$\$650,000 \text{ [given]} + (\$250,000 \div (5 + 5) \times 1.5) = \$687,500$$

The CCA on existing leaseholds was given as \$650,000. For the new leaseholds, IBL is entitled to straight-line CCA, calculated as the cost divided by the lease term, plus one renewal period, multiplied by 1.5 for the accelerated investment incentive.

6. IBL disposed of data infrastructure systems for \$75,000 during the year. The proceeds are greater than the original cost, and accordingly, the original cost of \$65,000 is deducted from the pool. The excess \$15,000 over the opening UCC is considered recapture, and will be included in IBL's net income (loss) for income tax purposes.

Further, the disposal also gives rise to a taxable capital gain, which should be included in net income (loss) for income tax purposes:

Proceeds of disposition	\$ 75,000
Adjusted cost base	<u>65,000</u>
Capital gain	\$ 10,000
Taxable capital gain (50%)	\$ 5,000

7. The new computer systems should be capitalized as Class 50 property, even though they were to replace Class 10 property, as the class is determined based on the relevant class at the time the assets are acquired.

For Assessment Opportunity #7, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to calculate the tax implications of the capital items.

Competent – The candidate calculates the tax implications of the capital items.

Competent with distinction – The candidate thoroughly calculates the tax implications of the capital items.

Assessment Opportunity #8 (Depth Opportunity)

The candidate calculates IBL’s net income (loss) for income tax purposes and taxable income.

The candidate demonstrates competence in the Taxation role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
6.2.2	Advises on taxes payable for a corporation	B	A

CPA Map Enabling Competencies:

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Net Income (Loss) for Income Tax Purposes and Taxable Income

	(\$)	Note
Loss before income taxes, before revisions	(7,383,000)	
Revisions from Common assessment opportunities:		
Increase depreciation expense	(12,762)	AO #2
Increase interest expense	(9,448)	AO #2
Reduce G&A expense	25,000	AO #2
Increase G&A expense	(125,000)	AO #3
Adjusted loss before income taxes	(7,505,210)	
Book to tax adjustments:		
Interest expense on ROU assets, from financial statements	7,649,000	1
Additional interest on ROU assets	9,448	1
Cash payments for ROU assets	(16,528,000)	1
Depreciation expense, from financial statements	8,388,000	2
Additional depreciation – ROU assets	12,762	1, 2
Contingent liability	125,000	3
Loss on disposal of PP&E	160,000	4
Gain on disposal of PP&E	(35,000)	4
Taxable capital gain	5,000	5
Capital cost allowance	(3,201,820)	3
Recapture	15,000	6
Terminal loss	(45,000)	7
Landscaping costs	(2,000)	8
Accrued bonuses	(225,000)	9
Interest and penalties	3,500	10
Donations	65,000	11
Financing costs	250,000	12
Financing fees for tax	(50,000)	12
Meals and entertainment	18,000	13
Net income (loss) for income tax purposes	(10,891,320)	
Donations	0	14
Capital loss carryforward	0	15
Taxable income	0	

For Assessment Opportunity #8, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to calculate net income (loss) for income tax purposes and taxable income.

Competent – The candidate calculates net income (loss) for income tax purposes and taxable income.

Competent with distinction – The candidate thoroughly calculates net income (loss) for income tax purposes and taxable income.

Assessment Opportunity #9 (Depth Opportunity)

The candidate discusses the adjustments required in the calculation of net income (loss) for income tax purposes and taxable income.

The candidate demonstrates competence in the Taxation role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
6.2.2	Advises on taxes payable for a corporation	B	A

CPA Map Enabling Competencies:

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Notes:

- There are three components to the right-of-use assets and corresponding lease liability that must be considered:
 - The amortization of right-of-use assets is not deductible because it is on account of capital. The amortization has been included in depreciation expense, and is discussed in Note 2.

- The interest expense on the lease obligations is not deductible because it is imputed interest, and does not represent an actual cash outlay by IBL. The amount from the financial statements is added back, along with the additional expense deducted in AO#2, for the new Halifax right-of-use asset.
 - The actual cash payments made to service the lease obligations are deductible.
2. Depreciation expense is not deductible because it is on account of capital. Capital cost allowance, calculated earlier, is allowed instead. Depreciation expense has been adjusted in AO#2 to include the depreciation expense on the new Halifax right-of-use asset, so an additional adjustment is made to reverse that expense.
 3. Contingent losses are generally not deductible for income tax purposes until the amount is paid, or where there is a legal or contractual liability to pay the damages, and the amount thereof has been quantified. A review of the contract should be performed, to determine if the contract specifies the amount of liability for such a violation. Given that the amount of liability was disputed by the lawyer until a judgment was made by the court in January of 2024, we have assumed that the contract does not specify the amount, and the amount will therefore only be deductible in 2024, when the amount was quantified.
 4. The book gain and loss on the disposal of assets are fully reversed because these are separately addressed for tax purposes as capital gains/losses (if applicable), and adjustments to the capital cost allowance of the impacted classes.
 5. As determined in AO#7, IBL realized a taxable capital gain on the disposal of its data infrastructure systems.
 6. The recaptured CCA determined in AO#7 is included in income, pursuant to subsection 13(1) of the Income Tax Act (ITA).
 7. The terminal loss determined in AO#7 is deductible from income, pursuant to ITA subsection 20(16).
 8. IBL incurred \$2,000 of landscaping fees that were capitalized for accounting purposes. These are deductible on a current basis, under ITA paragraph 20(1)(aa).
 9. Under ITA subsection 78(4), accrued remuneration must be paid before 180 days after the year end in which the remuneration was accrued, for it to be deductible in that year. IBL had an opening reserve for unpaid bonuses; therefore, it may deduct actual cash payments of \$525,000 made on this reserve in August of 2023. However, it has also accrued an additional \$600,000 of bonuses, of which it anticipates that \$300,000 will not be paid within 180 days. Accordingly, this amount should be added back, for a net deduction of \$225,000:

Opening accrued bonus reserve	\$ 525,000
Bonuses paid	(525,000)
Bonuses accrued	300,000
Closing accrued bonus reserve	<u>300,000</u>
Decrease in bonus reserve	<u>\$ (225,000)</u>

[Note: Alternatively, candidates may simply say that unpaid bonuses from 2022, that were paid in 2023, are deductible in 2023 (\$525,000), and that unpaid bonuses from 2023 are not deductible (\$300,000), which would yield the same result.]

10. IBL incurred \$3,500 of penalties relating to late payroll remittances during the year, which are not deductible for tax purposes. The interest on late-paid supplier invoices is considered a reasonable cost of carrying on a business, and is not precluded from being deducted.
11. Charitable contributions are not deductible in computing net income (loss) for income tax purposes, but provide a Division C deduction in determining taxable income, provided that the contributions do not exceed 75% of net income for income tax purposes.
12. IBL incurred \$250,000 of financing fees that have been expensed on a current basis for accounting purposes. As these are considered on account of capital, they are generally denied by ITA paragraph 18(1)(b). However, financing fees are specifically deductible under ITA paragraph 20(1)(e) over a five-year period; therefore, IBL may deduct \$50,000 per year for the next five years.
13. IBL expensed \$36,000 for meals and entertainment during the year. The meals and entertainment do not appear to qualify for any of the exceptions in ITA section 67.1, and accordingly, the entire balance should be subject to the 50% limitation.
14. As outlined in Note 11, donations may be deductible in computing taxable income. However, as per ITA paragraph 110.1(1)(a), donations are limited to 75% of net income for income tax purposes. Therefore, as IBL is in a loss position, it is not entitled to deduct donations in the current year. The donations may be carried forward for a period of five tax years, and may not be carried back.
15. IBL has net capital losses carried forward of \$30,000 from prior years, and it realized a taxable capital gain of \$5,000 during the year. However, as IBL is in a loss position, the net capital loss carryforward may not be utilized in the reconciliation of taxable income, and taxable income remains at nil.

The net capital loss carryforward may be applied against the taxable capital gain when reconciling the non-capital loss carryover for the year, so the non-capital loss carryover available for 2023 will be \$5,000 higher than the net loss for income tax purposes.

In other words, the non-capital loss carryforward becomes \$10,896,320 (\$10,891,320 + \$5,000), and the net capital loss carryforward becomes \$25,000 (\$30,000 - \$5,000).

No adjustments are recorded for the acquisition of Bookmarks, as it is a separate legal entity from IBL. The entry made by IBL at the time of acquisition (DR Investment in Bookmarks Corporation, CR Cash) is consistent with the tax treatment of the acquisition, and does not impact IBL's income for 2023. The entries proposed in AO#1, as well as the consolidation entries, would not be required for income tax purposes; non-consolidated financial statements are used for preparation of the income tax return, and for calculation of net income (loss) for tax purposes and taxable income. Accordingly, no adjustment has been made in the calculation for the consolidation or acquisition entries related to Bookmarks.

As there is a net loss for tax purposes, that amount (plus the \$5,000 adjustment for the net capital loss applied against the taxable capital gain, as mentioned in Note 15) may be carried forward up to 20 years, for use against any income, or may be carried back up to three years, if there is income to apply it against. There appears to have been a substantial loss in 2022, so we should check to see if there was any income in 2020 or 2021 that has not already been eliminated by the loss carryback from 2022.

For Assessment Opportunity #9, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate discusses some of the adjustments to net income (loss) for tax purposes.

Competent – The candidate discusses several of the adjustments to net income (loss) for tax purposes, including some of the more in-depth discussions.

Competent with distinction – The candidate discusses most of the adjustments to net income (loss) for tax purposes, including several of the more in-depth discussions.

Assessment Opportunity #10 (Depth Opportunity)

The candidate analyzes the income tax implications of the share acquisition of Bookmarks.

The candidate demonstrates competence in the Taxation role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
6.2.1	Evaluates general tax issues for a corporate entity	B	A
6.6.3	Analyzes income tax implications of the purchase and sale of a CCPC	B	B

CPA Map Enabling Competencies:

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Acquisition of Control

IBL acquired 100% of Bookmarks' shares on December 31, 2023, giving IBL control over Bookmarks. Since IBL was not related to the previous owner, and did not previously have control over Bookmarks, an acquisition of control took place on this date.

Deemed year end

Under ITA subsection 249(4), a year end is deemed to occur for a taxpayer that is subject to a loss restriction event. Per paragraph 251.2(2)(a), a loss restriction event includes an acquisition of control of a corporation by a person or group of persons. Further, ITA subsection 256(9) provides that, where control is acquired, it is deemed to be acquired at the beginning of the day (unless an election is filed). Accordingly, as IBL acquired control of Bookmarks on December 31, 2023, Bookmarks should have a deemed year end immediately before, on December 30, 2023.

Bookmarks will have to file an income tax return for its short year from January 1, 2023, to December 30, 2023. Bookmarks' capital cost allowance and business limit will both be pro-rated for the short year.

Following the acquisition of control, Bookmarks may select any new taxation year end date that is within 53 weeks of December 31, 2023. To align with IBL's year end, it would be possible to select December 31, 2024, as Bookmarks' first year end after the acquisition, and to use December 31 as the year end going forward.

Change in status

Prior to the acquisition, Bookmarks was a Canadian-controlled private corporation (CCPC), as its previous owner was a Canadian resident. Accordingly, upon acquisition by a public company, it ceased to be a CCPC. As a result, in its first tax year following the change in status, Bookmarks must determine an adjustment to its low-rate income pool (LRIP). In the future, as Bookmarks pays dividends to IBL, these dividends must be designated as other-than-eligible dividends in order to clear the LRIP balance (or be subject to Part III.1 tax), after which time the dividends may be designated as eligible. Bookmarks will also no longer have access to the small business deduction, or to any other benefits of being a CCPC, starting with the first taxation year after its deemed year end.

Non-capital losses

Bookmarks had non-capital losses of \$85,000 on hand at the end of 2022. Non-capital losses may survive an acquisition of control, provided that the business that gave rise to the losses continues to be carried on with a reasonable expectation of profit, and that the losses are deducted from profits from the same or similar business. Bookmarks intends to carry on its same business as a retail bookstore, with a reasonable expectation of profit; accordingly, its losses will survive the acquisition of control, and may be used to reduce future profits, if they are not otherwise exhausted by taxable income in the pre-acquisition tax year.

Note that the deemed year end will reduce the number of years remaining for use of the non-capital losses. However, assuming that Bookmarks selects December 31, 2024, as its first year end following the acquisition, due to the timing of the acquisition, this should not be a concern; Bookmarks would otherwise have had a year end on the following day and, as such, there is no acceleration of years.

Accrued losses

Accrued losses on non-depreciable property, depreciable property, doubtful accounts, and inventory are deemed to be recognized immediately before the acquisition. Based on Bookmarks' appraised balance sheet, Bookmarks does not have accrued losses on its inventory or non-depreciable assets, and it does not have accounts receivable.

In determining whether an accrued loss exists on depreciable property, the UCC of a class is measured against the fair market value of all property in that class. The appraisal noted that the tax values (i.e., UCC) of all of Bookmarks' assets were equal to their carrying amounts. Therefore, an accrued loss of \$25,000 exists on the computer systems owned by Bookmarks. As a result, the excess \$25,000 is deemed to be claimed as CCA in the short period immediately before acquisition, which will reduce net income (loss) for income tax purposes, or increase the non-capital loss balance available. The opening UCC following acquisition will therefore be \$50,000.

Capital losses

The net capital losses of \$200,000 carried forward by Bookmarks will expire on acquisition of control, pursuant to ITA subsection 111(4). Therefore, it may be advantageous for Bookmarks to make an election under paragraph 111(4)(e), to realize accrued gains on its capital property, which will "bump" the cost basis of the property. The adjusted cost base of the existing property, plant, and equipment is unknown; however, based on the purchase price allocation, Bookmarks has internally-generated goodwill, with a fair market value of \$1,794,000, and an adjusted cost base of nil.

To make use of the expiring capital losses, Bookmarks should elect for proceeds equal to \$400,000, thereby creating a capital gain of $\$400,000 - \$0 = \$400,000$, or a taxable capital gain of \$200,000. This will be fully sheltered by the net capital losses of \$200,000.

The result to Bookmarks is that they will be deemed to dispose of, and reacquire, the internally-generated goodwill for \$400,000. Under ITA subparagraph 13(7)(e)(ii), the capital cost added to Class 14.1 will only be half of this amount, so \$200,000 will be added to Class 14.1, and CCA can be claimed on this amount.

For Assessment Opportunity #10, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to analyze the income tax implications of the share acquisition of Bookmarks.

Competent – The candidate analyzes the income tax implications of the share acquisition of Bookmarks.

Competent with distinction – The candidate thoroughly analyzes the income tax implications of the share acquisition of Bookmarks.

Assessment Opportunity #11 (Depth Opportunity)

The candidate analyzes the income tax implications of the employee benefits.

The candidate demonstrates competence in the Taxation role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
6.2.2	Advises on taxes payable for a corporation	B	A
6.3.2	Evaluates income taxes payable for an individual	B	A

CPA Map Enabling Competencies:

6.1.1 Identifies and articulates issues within areas of work responsibility

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Leased VehicleEmployee

Janet receives two benefits from the vehicle provided by IBL, namely the standby charge under ITA paragraph 6(1)(e) (having use of the vehicle), and the operating benefit under ITA paragraph 6(1)(k) (IBL covering the cost of operating the vehicle).

For employer-leased vehicles, the standby charge is determined under ITA subsection 6(2) as the following:

$A/B \times [2/3 \times (E - F)]$, where:

A* = Lesser of:

- total personal-use kilometres
- value determined for B

B = 1,667 km \times (total days available \div 30)

E = Lease payments, including GST/HST

F = Portion of lease payments relating to insurance

* A is deemed equal to B unless the individual is required by their employer to use the automobile for employment, and the automobile is used primarily (more than 50%) for employment purposes.

As Janet is required to use the vehicle in her role as a district manager, and her employment use of the vehicle was greater than 50%, she is entitled to determine the value for A, as outlined above.

$$A = 15,000$$

$$B = 1,667 \text{ km} \times (334 \text{ days} \div 30) = 18,559$$

$$E = \$950 \times 11 \text{ months} \times 1.13 = \$11,809$$

$$F = \$0$$

$$= 15,000 \div 18,559 \times [2/3 \times (\$11,809 - \$0)]$$

$$= \$6,363$$

The default calculation of the operating charge benefit is the number of personal kilometres driven \times the prescribed rate (which was 33¢ for 2023). However, as Janet used the vehicle primarily for work, she is entitled to use the lesser of the default, or 50% of the standby charge. Further, her reimbursements to IBL will reduce the benefit if she makes the reimbursement within 45 days of year end (which she is expected to do):

Personal km \times prescribed rate

$$= 15,000 \times \$0.33 = \$4,950$$

50% of standby charge

$$= \$6,363 \times 50\%$$

$$= \$3,182$$

The lesser of these two amounts is \$3,182, which should be selected as the operating cost benefit. After deducting reimbursements of \$1,000, Janet's operating cost benefit will be \$2,182.

IBL

ITA section 67.3 outlines a limitation on the leasing costs that may be deducted from IBL's income as not exceeding the lesser of paragraph (c):

(A \times B) - C - D - E, where:

30

A = Prescribed amount for the year in which the lease was entered (\$950 for 2023)

B = Number of days leased in the year

C = Amounts deducted in prior periods

D = Interest that would be earned on the part of all refundable amounts in respect of the lease

E = Reimbursements that became receivable by the taxpayer in respect of the lease

$$= [(\$950 \times 1.13 \times 334) \div 30] - \$0 - \$0 - \$0$$

$$= \$11,952$$

and paragraph (d):

$(A \times B) - D - E$, where:
0.85C

A = Actual lease charges

B = Prescribed amount (\$36,000)

C = Greater of prescribed amount (100/85ths of \$36,000, being \$42,353) and MSRP

D = Interest that would be earned on the part of all refundable amounts in respect of the lease

E = Reimbursements that became receivable by the taxpayer in respect of the lease

$$= [(\$950 \times 11 \times 1.13 \times \$36,000) \div (0.85 \times \$42,353)] - \$0 - \$0$$

$$= \$11,808$$

The actual leasing costs were \$10,450, and are therefore fully deductible.

[Note: Candidates may identify that, because MSRP and lease payments are both less than the prescribed amounts, IBL can simply deduct the actual leasing costs.]

Employee Discount Program

Employee

Employee discounts are not specifically identified in the ITA, and are therefore governed by the general employee benefit provisions in ITA subsection 6(1).

The CRA maintains an administrative view that, where a discount is provided to all employees, that discount will not give rise to a taxable benefit. However, where a special arrangement has been made with an employee, or a group of employees, to buy merchandise at a discount, the benefit will be considered taxable.

As IBL only offers the discount to its retail employees, the program should be considered a special arrangement with a group, and the discount should therefore be a taxable benefit to the retail employees who take advantage of the discount, calculated as the difference between the fair market value of the goods and the actual price paid by the employee.

IBL

The merchandise sold at a discount to employees will be treated as a regular sale for income tax purposes, with the (lower) proceeds considered revenue included in income, and the cost expensed as deductible cost of goods sold.

Recognition and Rewards

Employee

The \$600 non-cash gift in respect of a marriage or childbirth is partially taxable. Although the gift is marking a special occasion, the CRA imposes a \$500 annual limit on non-cash gifts; therefore, the excess \$100 is considered a taxable benefit to the employee.

The \$400 non-cash gift in respect of long service is permitted under the CRA's administrative policy, and is therefore not a taxable benefit to the employee. Specifically, this award must be for a minimum of five years of service, and five years must elapse between awards. Further, the CRA imposes a \$500 limit on service awards that is separate from the limit discussed above in respect of special occasions.

The \$300 gift cards for retail employees are also considered non-cash, since they are usable only at one retailer and are not convertible to cash. In order to maintain their "non-cash" status, IBL should keep a log containing the name of the employee, the date the gift card was provided to them, the reason for providing the gift card, the type of gift card, the amount of the gift card, and the name of the retailer.

The \$300 gift cards are being provided at any time, at the manager's discretion, so they would only be non-taxable if they were a recognition award for the employee's overall contributions to the workplace; these gift cards would count toward the \$500 annual limit mentioned earlier. If, instead, they are used as a gift or an award related to the employee's job performance, such as meeting or exceeding sales targets, or the completion of a project, they are considered rewards, and the benefit is taxable.

Lastly, the IBL-branded mugs are considered to have trivial value, and may therefore be provided to employees without giving rise to a taxable benefit, under the CRA's administrative policy.

IBL

Each of the gifts is considered remuneration paid to employees, and is therefore deductible to IBL on a current basis.

Overall (IBL)

For all the benefits discussed here that are taxable to the employees, IBL will be obligated to include the value of the benefit in the employee’s income (to be reported on their T4), and to withhold and remit income taxes, CPP, and EI.

For Assessment Opportunity #11, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to analyze the income tax implications of the employee benefits.

Competent – The candidate discusses the income tax implications of the employee benefits.

Competent with distinction – The candidate thoroughly discusses the income tax implications of the employee benefits.

Assessment Opportunity #12 (Depth Opportunity)

The candidate discusses the tax implications of the senior executive loans.

The candidate demonstrates DEPTH in the Taxation role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
6.6.2	Analyzes income tax implications of compensation planning between a shareholder and a closely-held corporation	C	B

CPA Map Enabling Competencies:

6.1.1 Identifies and articulates issues within areas of work responsibility

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Loans

Under ITA subsection 15(2), the principal amount of loans made to individual shareholders is to be included in the individual's income in the year received, unless certain exceptions are met.

Loan to Kayla

Kayla is a shareholder of the corporation, and is therefore subject to the shareholder loan rules.

ITA subsection 15(2.4) outlines exceptions to the application of ITA subsection 15(2), where the shareholder is also an employee of the corporation and receives the loan by virtue of their employment.

Under ITA paragraph 15(2.4)(a), the loan may be excluded from income if the individual is an employee, but not a specified employee. A specified employee is defined in ITA subsection 248(1) as an employee who is a specified shareholder, and a specified shareholder is a taxpayer who owns at least 10% of the issued shares of any class of capital stock of the corporation. Further, paragraph (a) of the definition of a specified shareholder outlines that the taxpayer will be deemed to own each share that is owned by a person with whom the taxpayer does not deal at arm's length.

Under ITA paragraph 251(1)(a), related persons are deemed to not deal at arm's length, and under ITA paragraph 251(2)(a), individuals connected by a blood relationship are related. Therefore, as Kayla is a blood relation of her brother Lucas, she does not deal at arm's length with him. For the purposes of the definition of a specified shareholder, Kayla is deemed to own her 8% plus Lucas's 4%, for a total of 12%; accordingly, she is both a specified shareholder and a specified employee, and therefore does not meet the first exception.

The remaining exceptions in ITA paragraphs 15(2.4)(b) to (d) are for home purchases, share purchases (of IBL), and motor vehicles, respectively. As Kayla intends to use the loan to pay for her son's tuition, it does not meet any of these exceptions.

As a result, the entire amount of the loan will be included in Kayla's income for 2023 unless, pursuant to ITA subsection 15(2.6), Kayla repays the loan within one year after the end of IBL's taxation year. Since the loan terms specify that principal will only be paid at the end of the five-year term, it is unlikely that this exception will be available to Kayla.

When Kayla repays the loan in five years' time, the payment will be deductible from her income, as per ITA paragraph 20(1)(j).

ITA subsection 80.4(1) imputes interest on employee loans; however, Kayla should meet the exception in paragraph 80.4(3)(b) for the imputed interest not to apply, because the principal amount of the loan has been included in her income.

Loan to Tina

Similar to Kayla, Tina should be considered a specified employee of IBL, and therefore does not meet the exception in ITA paragraph 15(2.4)(a), as her spouse is related to her and does not deal at arm's length with her. Tina and her spouse each own 7% of the shares, for a combined total of 14%, which is greater than the 10% threshold.

However, Tina meets the second exception in ITA paragraph 15(2.4)(b), because she is an employee who is using the loan to acquire a dwelling for her habitation.

In order to rely on the home purchase exception, Tina must also meet ITA paragraphs 15(2.4)(e) and (f), which state that the loan must be received by virtue of employment rather than shareholdings, and that bona fide arrangements were made for repayment of the loan within a reasonable time.

In the CRA's view (IT-119R4), where other employees are entitled to receive loans with the same terms and conditions as the shareholder loan, the shareholder loan is deemed to be received by virtue of employment. As IBL provides the loan program to all senior leadership, irrespective of shareholdings and with the same terms and conditions, the loan made to Tina should be viewed as being on account of her employment; therefore, paragraph (e) is met.

Lastly, the loan is repayable in five years' time, which appears to be reasonable, and would be considered a bona fide arrangement. Therefore, the loan principal is excluded from Tina's income.

As Tina's loan is excluded from her income, the imputed interest exception relied on by Kayla is not available. Particular to loans for home purchases or relocations, ITA subsection 80.4(4) outlines that the imputed interest for each quarter is to be calculated using the lesser of: the prescribed rate in effect at the time the loan was received; and the prescribed rate in effect during that quarter.

Accordingly, Tina will be deemed to have received a benefit to the extent that the prescribed rate (5%) exceeds the 3% interest on the loan (provided that she pays the interest within 30 days of the end of the year); however, the prescribed rate will be the lesser of the rate in effect when the loan was made, and the rate in effect for the quarter in question. For 2023, that rate is 5% for the entire time that the loan was outstanding, so her taxable benefit would be approximately $\$80,000 \times (5 - 3)\% \times 4/12 \text{ months} = \533.33 . Starting in Q1 of 2024, the prescribed rate is 6%, but since the prescribed rate at the time the loan was made was lower, the lower rate of 5% will continue to be used.

Note that, even though the loan is received because of employment, this loan does not qualify for the CRA's new administrative policy on deemed interest benefits, as the term of the loan is for more than 60 days.

Loan to James

James only owns 0.25% of the shares of IBL, and is at arm's length from the corporation; therefore, he is not considered a specified employee. As a result, James meets the exception in ITA paragraph 15(2.4)(a), and the use of the loaned funds is irrelevant.

Like Tina, James should meet the requirement to have received the loan by virtue of employment, and the bona fide repayment requirement, based on the design of the loan program; therefore, the loan principal will be excluded from his income.

Similar to Tina, James is subject to an imputed interest benefit; however, he is not entitled to the favourable "lesser of" calculation that Tina is, as James utilized the loan for cottage renovations.

Accordingly, James will be deemed to have received a benefit to the extent that the prescribed rate (5%) exceeds the 3% interest on the loan (provided that he pays the interest within 30 days of the end of the year). For 2023, that rate is 5% for the entire time that the loan was outstanding, so his taxable benefit would be approximately $\$50,000 \times (5 - 3)\% \times 6/12 \text{ months} = \500.00 . Starting in Q1 of 2024, the prescribed rate used will be 6%.

Similar to Tina's situation, despite the fact that James's loan is received because of employment, this loan does not qualify for the CRA's new administrative policy on deemed interest benefits, as the term of the loan is for more than 60 days.

IBL impact

Any interest received by IBL on the employee loans will be included in its income for the year. IBL will be required to report any taxable interest benefits on the T4s of its employees.

For Assessment Opportunity #12, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to discuss the senior executive loans.

Competent – The candidate discusses the senior executive loans.

Competent with distinction – The candidate thoroughly discusses the senior executive loans.

Assessment Opportunity #13 (Depth Opportunity)

The candidate analyzes the GST/HST consequences of the employee benefits, the acquisition of control, and a proposed transfer of fixed assets.

The candidate demonstrates competence in the Taxation role.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core	Elective
6.7.2	Analyzes GST obligations of a person	C	B
6.7.5	Analyzes GST implications from tax planning for shareholders and a closely held corporation	C	B

CPA Map Enabling Competencies:

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Taxable Benefits

It is IBL’s responsibility to self-assess, and remit, GST/HST on taxable benefits in the course of its ordinary GST/HST filings. The employees of IBL do not remit GST/HST, nor claim input tax credits.

Standby Charge and Operating Cost

IBL is deemed to have collected GST/HST on the standby charge benefit, at a rate of 12/112 (the vehicle is in Ontario and was subject to HST at 13%) of the value of the benefit:

$$\$6,363 \times 12/112 = \$682$$

In accordance with clause 173(1)(d)(vi)(A) of the Excise Tax Act and paragraph 2(a) of the Automobile Operating Expense Benefit (GST/HST) Regulations, IBL is also deemed to have collected GST/HST on the operating cost benefit, at a rate of 9% of the value of the benefit (before taking into account any reimbursements paid by the employee):

$$\$3,182 \times 9\% = \$286$$

Discounts

The discount program represented a taxable benefit; therefore, GST/HST should be assessed by IBL, at a rate of 4/104 of the value of the benefit in non-participating provinces, such as its head office in BC. In participating provinces, the rate is increased to match the rate of HST minus 1, in both the numerator and denominator (for example, 12/112 in 13% provinces). Note that GST/HST only applies to supplies taxable at a rate other than zero; therefore, if any of the products are exempt or zero-rated supplies (such as certain baked goods at the café), IBL would not be required to assess GST/HST.

Gifts

To the extent that an employee realizes a taxable benefit under the R&R program, GST/HST is payable on the benefit, at a rate of 4/104 (in non-participating provinces) of the value of the benefit. Again, GST/HST only applies to taxable supplies; therefore, if said gift was a product or service that is an exempt or zero-rated supply (such as a gift card), IBL would not be required to self-assess GST/HST.

Acquisitions

Financial services are exempt for GST/HST purposes. Specifically, financial services include the transfer of ownership of a financial instrument, which includes an equity interest (i.e., shares of a corporation). Accordingly, the acquisition of the shares of Bookmarks would not give rise to GST/HST.

In future, if IBL were to acquire the assets of a target business, as suggested, GST/HST would have to be considered; the vendor would be required to assess which of their assets were taxable supplies, and charge GST/HST accordingly. For example, financial assets like cash would not be taxable supplies, but tangible property like inventory or property, plant, and equipment would be taxable supplies, and the target business would be required to charge GST/HST on those assets. In turn, IBL would be permitted to claim an ITC for any GST/HST paid. The result in this situation is that IBL is in the same position, as it would pay and then claim an ITC for the GST/HST paid; however, it causes a cash flow issue as it must pay the GST/HST initially and then claim a refund (or reduction in net tax owing) on its GST/HST Return.

Given that IBL is presently facing cash flow concerns, such timing issues are undesirable. Accordingly, if IBL pursues such an acquisition, it should consider making a joint election under subsection 167(1) of the Excise Tax Act (ETA). This election is available where a business, or part of a business, is being carried on by the supplier, and is sold pursuant to a written agreement. The recipient must acquire all, or substantially all (i.e., 90% or more), of the business from the supplier, and if the supplier is registered for GST/HST, IBL must be also (which would not be a concern, as IBL is registered). The result under the joint election is that no GST/HST is collected or remitted, thereby negating the cash flow timing issue.

Sale of Equipment from IBL to Bookmarks

IBL intends to sell certain furniture and fixtures to Bookmarks. Fixed assets are taxable supplies; therefore, GST/HST will arise on the transfer. Accordingly, IBL will be required to charge, collect, and remit GST/HST on the sale, and Bookmarks will be entitled to claim an input tax credit for the GST/HST paid.

Similar to the discussion for an asset acquisition of a business, the net effect of GST/HST is nil; however, it may also cause cash flow issues. An election is available under ETA section 156(2), to deem the taxable supply to have been made for no consideration where the transaction occurs between closely-related Canadian corporations (and/or partnerships). IBL and Bookmarks should be considered closely related under ETA subparagraph 128(1)(a)(i), as IBL owns not less than 90% of the value and number of issued and outstanding voting shares of the other corporation (Bookmarks) with whom the election is being made.

The election is available, provided that the corporations are engaged exclusively in commercial activities for GST/HST purposes, and hold property for use in those activities. A commercial activity is defined as a business (other than a business making exempt supplies), and each of IBL and Bookmarks is carrying on a business, as they are undertaking activities for profit.

Therefore, IBL and Bookmarks should jointly elect under ETA subsection 156(2), to avoid the cash flow concerns of their proposed transaction. The election should be made prior to the transaction being completed.

For Assessment Opportunity #13, the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Not competent – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to discuss the GST/HST consequences.

Competent – The candidate discusses the GST/HST consequences.

Competent with distinction – The candidate thoroughly discusses the GST/HST consequences.

APPENDIX D

**SEPTEMBER 12, 2024 – DAY 3
SIMULATIONS AND MARKING GUIDES**

**COMMON FINAL EXAMINATION
SEPTEMBER 12, 2024 – DAY 3**

Case #1

(Suggested time: 90 minutes)

Fresh Fashion Inc. (Fresh) is a company that was started by Alyssa Hamilton in 2013, which offers online, subscription-based clothing rental services. Alyssa, a Canadian resident, is the CEO and owner of all of the company's 1,500 common shares. Fresh offers mid-tier and designer-brand clothing for rent, as renting clothes has become a popular alternative to buying them. Customers pay either \$225 monthly for a regular subscription, which allows them to rent five mid-tier items a month, or \$300 monthly for a premium subscription, which allows them to rent five designer items a month. No unused rentals can be carried forward from month to month.

It is January 15, 2024, and you, CPA, an external consultant, are meeting with Griffin Anderson, CFO of Fresh. Griffin tells you, "As described in my business update, 2023 was an eventful year (Appendix I). There are several differences between our actual year-end numbers and the budget we prepared at the beginning of 2023. We need you to analyze the causes, and how much each contributed to the differences (Appendix II).

"Also, please calculate our 2023 federal corporate income taxes payable. We remitted income tax instalments totalling \$80,000 for 2023.

"We are currently building an algorithm to suggest clothing brands, styles, and colours to customers, based on their rental history. We will also license this algorithm, which we are calling "BestFit," to retailers looking to improve their sales and customer service. Here are the draft terms of our licensing agreement with retailers (Appendix III). Please explain any risks with these terms, and provide suggestions to mitigate them. We have interest from several retailers and expect this will grow into a significant revenue stream in the future; however, we still want our business strategy to focus on our core rental business as the driver of Fresh's growth going forward.

"To date, we have financed the algorithm project through operating cash flows; however, to complete the project, we will need external financing. We have narrowed it down to two options (Appendix IV). Please analyze them and make a recommendation.

"To help us prepare for our annual audit, please describe what audit procedures the auditor will likely perform over the algorithm expenditures (Appendix V), as well as revenue and salaries and wages.

“Lastly, Alyssa is planning to retire. She has worked hard to foster a close, cohesive workplace, and employees will be sad to see her go. We are looking to hire a new CEO, and have two candidates (Appendix VI). We would like your advice on which candidate will be the best strategic fit for Fresh.”

APPENDIX I 2023 BUSINESS UPDATE

Due to increased designer brand recognition from social media, customers are renting designer clothing more frequently. Throughout 2023, 720 customers switched their subscriptions from regular to premium.

In July 2023, we decided to start using social media influencers to promote Fresh. We provided them with a code, valid only in the month of July, to give to their followers. The code gave the customer the first month free when signing up for six months. A total of 150 new premium subscriptions were sold, using the discount code. Given the success of this campaign, we were able to cut \$30,000 from our originally planned print advertising.

We also sell fully depreciated clothing in bulk to discount chains. Our brands retained their value better than expected in 2023, and sold for \$80,000 as opposed to the anticipated \$12,000 salvage value.

APPENDIX II
DRAFT INCOME STATEMENT

Fresh Fashion Inc.
Draft Income Statement
For the year ended December 31, 2023
(in thousands of Canadian dollars)

	<u>Budget</u>	<u>Actual</u>	<u>Difference</u>	<u>Note</u>
Revenue				
Sales from subscriptions	\$ 3,096	\$ 3,735	\$ 639	
Sales discounts	(124)	(166)	(42)	
Gain on sale of clothing	0	68	68	
Net revenue	<u>2,972</u>	<u>3,637</u>	<u>665</u>	
Expenses				
Rental clothing depreciation	1,875	1,875	0	1
Salaries and wages	420	420	0	2
Shipping	155	187	32	3
General and administrative	120	119	(1)	4
Marketing	85	111	26	5
Rent	72	72	0	
Research and development (other than salaries and wages)	40	40	0	
Other depreciation	8	8	0	6
	<u>2,775</u>	<u>2,832</u>	<u>57</u>	
Income before taxes	<u>197</u>	<u>805</u>	<u>608</u>	
Income tax expense	<u>80</u>	<u>80</u>	<u>0</u>	
Net income	<u>\$ 117</u>	<u>\$ 725</u>	<u>\$ 608</u>	

APPENDIX II (CONTINUED)
DRAFT INCOME STATEMENT

Notes:

1. Rental clothing (apparel) has a useful life of two years. The opening UCC balance was nil, and additions during the year totalled \$1.5 million.
2. Salaries and wages include bonuses of \$30,000 for 2023 that will be paid in July 2024.
3. As Fresh pays for the return of the clothes at the end of the rental period, shipping expenses include a provision of \$12,500 for the return of items currently out for rent. This provision was \$7,500 at the end of 2022.
4. General and administrative expense includes \$12,000 for meals and entertainment, and \$5,000 for our annual, all-employee party.
5. The influencer advertising campaign cost \$50,000.
6. Other depreciation is on office furniture, which had an opening UCC balance of \$24,000. No new furniture was purchased during the year.

APPENDIX III
DRAFT TERMS OF ALGORITHM LICENSING AGREEMENT

- The retailer provides Fresh with historical customer purchase data and information on upcoming product launches, so Fresh can design a customized algorithm.
- The amount of historical data provided is at the discretion of each retailer, and they can provide the data in whatever format they wish.
- All data provided by the retailer, including customer personal information, is stored by Fresh on a secure, cloud-based server. All retailers have a common link to a shared folder on this server, where they can upload their customer and product data.
- The retailer can access the algorithm's source code upon request.
- Fresh guarantees improved customer satisfaction. The retailer agrees to send its customers a feedback form to complete after each purchase, and to report results to Fresh each month. The monthly service fee charged by Fresh to the retailer will be reduced if customer feedback for purchases made, based on a BestFit style suggestion, is less favourable than feedback from customers who purchased without using BestFit.

APPENDIX IV FINANCING ALTERNATIVES

Based on our forecast, we will need \$350,000 in 2024 to cover the remaining BestFit development expenditures, and \$150,000 for BestFit operational expenses in 2025 while we are building our customer base.

Option #1

\$500,000 bank loan, received in eight equal quarterly instalments, beginning on March 1, 2024.

- Principal repayments begin one year after the final instalment is received by Fresh.
- Interest is payable monthly, starting on April 1, 2024.
- The annual interest rate is 8%.
- The bank is open to changing the timing of the funding in exchange for a slightly higher interest rate.

Option #2

Loans from several friends and family members.

- Individual loans will range from \$25,000 to \$100,000, to get the \$500,000 needed.
- Once annual BestFit sales reach \$1.5 million, lenders each have the option to be repaid or to convert their loans to common shares. Each \$500 of debt is convertible into one common share.
- Interest is equal to the prime rate plus 2%. The current prime rate is 5%. Interest accrues monthly, and is paid out at the time of principal repayment, or the principal's conversion to common shares.

APPENDIX V BESTFIT EXPENDITURES

In March 2023, we spent \$15,000 for an external consultant, to determine whether there is a market for BestFit. The consultant found that, by using BestFit, retailers would see increased sales and customer satisfaction, and lower costs associated with returned goods.

In early July 2023, we hired a team of three software developers—at an annual salary of \$110,000 each—to build the algorithm. The team has extensive experience in developing similar technologies.

On October 1, 2023, the developers produced a preliminary working version of the algorithm; shortly thereafter, we incurred \$25,000 in legal fees to register a copyright on the BestFit source code. We anticipate completing the project by August 2024.

Please explain the best way to account for the BestFit costs under ASPE. All BestFit expenditures to date have been expensed.

APPENDIX VI CEO CANDIDATES

Candidate #1 – Genevieve

Genevieve, currently VP of operations at a department store, is a fashion industry veteran who has good relationships with executives at major retailers. The fashion retail industry has been slow to adopt new technology, so Genevieve does not have experience in this area.

She has been successful in growing companies by promoting individuals to leadership positions internally. Genevieve believes there is huge potential in clothing rentals as a sustainable alternative to conventional retail. She prefers to receive salary-based compensation.

Candidate #2 – Shane

Shane is the chief technology officer at a social media start-up. He has developed a very popular app, despite concerns with its privacy policies. Although he has no experience in fashion, Shane is interested in bringing high-tech solutions to the industry and he sees BestFit's potential. He envisions Fresh growing quickly by significantly increasing the number of software developers and salespeople, and hiring remote workers. Shane prefers stock compensation over a higher salary, so he can benefit from the growth of the company.

**MARKING GUIDE 3-1
FRESH FASHION INC. (FRESH)
ASSESSMENT OPPORTUNITIES**

To: Griffin Anderson
From: CPA
Subject: Consulting advice

Assessment Opportunity #1 (Depth and Breadth Opportunity)

The candidate analyzes the causes of the differences between the budgeted and actual income statement figures for 2023, and how much each contributed to the differences.

The candidate demonstrates competence in Management Accounting.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core
3.2.3	Computes, analyzes, or assesses implications of variances	A

CPA Map Enabling Competencies:

5.1.1 Applies general business knowledge to enhance work performed

5.1.3 Develops and uses knowledge of the organization, industry and stakeholders

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

As requested, I have identified the causes of the differences between the actuals and the budget, for the year ended December 31, 2023, and have analyzed how much these causes contributed to the calculated variances.

Sales from Subscriptions

Fresh's subscription sales were \$639,000 higher than budgeted. This could be due to a couple of different factors.

First, you mentioned that customers were renting designer clothing more frequently this year. As customers need to get the premium subscription in order to access this clothing, it has a higher rental price. This would result in higher revenue than anticipated. As the regular subscription generates revenues of \$225 per month, the switch to the \$30

0-per-month premium subscription would result in an increase of \$75 per month for every customer that switched. With 720 customers switching, and assuming that these customers joined evenly from January to December, we would expect an increase in revenues of \$324,000 ($720 \times \$75 \times 12 \text{ months} \div 2$).

The increase in sales may also be due to the new influencer marketing campaign that was started in July, and was not originally part of the business plan for 2023. You mentioned that 150 new customers joined in July 2023 because of this marketing strategy. Since all these customers joined in July, we would expect an increase in revenues (before discount) of \$270,000 ($150 \times \$300 \times 6 \text{ months}$).

Between those two drivers of revenue growth, the total expected increase in revenues is \$594,000 ($\$324,000 + \$270,000$), which explains most of the \$639,000 increase in revenue, suggesting that the increase is reasonable. Further investigation would be required, to determine what drove the remaining revenue increase, but it could be related to the actual timing of new premium subscriptions (with more users switching earlier, rather than later, in the year), or to influencer activity resulting in new regular subscriptions as well.

Sales Discounts

Sales discounts were \$42,000 higher than budgeted, suggesting that more sales discounts were given to customers than was originally planned. This is likely due to the discount code that you gave the social media influencers that you hired to market Fresh—to provide their followers with a first free month when signing up for six months. Since this marketing initiative was not originally budgeted for, sales discounts are higher than anticipated.

As 150 new customers joined in July and were given the first month free, at a rate of \$300 per month, this amounts to \$45,000 for all 150 customers ($\$300 \times 150 \text{ customers}$). The actual increase in sales discounts was just slightly less than this, at \$42,000, which could be due to some customers joining later in the month of July, and therefore seeing a portion of their discount accounted for in 2024 rather than in 2023, or due to slightly lower sales discounts in other areas.

Gain on Sale of Clothing

No gain on sale of clothing was budgeted for, but an actual amount of \$68,000 was recognized. This relates to the fully depreciated clothing that was sold for \$80,000, and that was expected to sell for its salvage value of \$12,000. Since depreciation would have been taken to the point of this expected salvage value, the net book value of the clothing would have been \$12,000 at the time of sale. That is why the budgeted gain on sale was nil (proceeds of \$12,000 less net book value of \$12,000 results in no gain). However, since actual proceeds were greater than net book value, a \$68,000 gain resulted (\$80,000 - \$12,000).

Shipping

Shipping costs increased by \$32,000 compared to budget; however, this change is in line with the increase in sales from subscriptions, as the percentage stayed consistent at 5% ($\$187,000 \div \$3,735,000$), compared to a budgeted percentage of 5% ($\$155,000 \div \$3,096,000$).

Marketing

Your marketing expenses were \$26,000 higher than you had anticipated in your budget, which is likely due to your decision to use influencer marketing during the year, whereas you had budgeted for print advertising. As you stated that you decreased your spending on print advertising by \$30,000, once you saw that this new social media marketing strategy was working, and spent \$50,000 on influencer marketing instead, I would therefore expect an increase of \$20,000. Based on the results, marketing increased by \$26,000. The remaining \$6,000 variance is minimal and likely suggests that the print advertising used, before you switched to influencer marketing, cost marginally more than expected.

For Assessment Opportunity #1 (Management Accounting), the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Nominal competence – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to analyze the causes of the differences between budgeted and actual income statement figures for 2023, and how much each contributed to the differences.

Competent – The candidate analyzes the causes of the differences between budgeted and actual income statement figures for 2023, and how much each contributed to the differences.

Competent with distinction – The candidate thoroughly analyzes the causes of the differences between budgeted and actual income statement figures for 2023, and how much each contributed to the differences.

Assessment Opportunity #2 (Breadth Opportunity)

The candidate calculates federal corporate income taxes payable.

The candidate demonstrates competence in Taxation.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core
6.2.2	Advises on taxes payable for a corporation	B

CPA Map Enabling Competencies:

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

As requested, here is a calculation of the 2023 federal corporate taxes payable.

Item	Amount (\$)	Note
Income before tax	805,000	
Accounting adjustments	107,500	1
Add back:		
Rental clothing depreciation	1,875,000	2
Return shipping provision at end of year	12,500	3
Meals and entertainment	6,000	4
Other depreciation	8,000	5
Bonus	30,000	6
Deduct:		
CCA on rental clothing	(1,420,000)	2
CCA on furniture	(4,800)	5
Gain on sale of clothing	(68,000)	7
Return shipping provision at beginning of year	(7,500)	3
Taxable income	1,343,700	
Federal small business rate at 9% (first \$500,000)	45,000	
Federal general rate at 15% (remainder)	126,555	
Federal taxes payable	171,555	
Less: Instalment payments	80,000	
Federal taxes owing	91,555	

Notes:

- As discussed later, some of the expenses related to the development of the BestFit algorithm should be capitalized for accounting purposes. For tax purposes, you will be able to claim capital cost allowance (CCA) on the limited-life intangible, as it is a capital expenditure; however, as the asset is not yet in use, no CCA deduction is therefore permitted in the year.
- Depreciation is not deductible in determining taxable income; however, you are allowed to claim CCA. The rental clothing (apparel) would be considered a Class 12 asset, and apparel is not subject to the half-year rule. As such, Fresh can deduct the full amount of Class 12 additions in 2023. Even if Fresh held items in Class 12 that were subject to the half-year rule, these could still be fully deducted in 2023 under the accelerated investment incentive, or alternatively, using the immediate expensing provisions. See below for the calculation of Class 12 CCA.

Item	Amount	Note
Opening UCC balance	0	
Additions (no half-year rule)	1,500,000	Purchases in 2023
Dispositions	(80,000)	Clothing was sold during the year for proceeds of \$80,000. When a capital asset is sold, the lower of cost and proceeds must be subtracted from the relevant CCA class. In this case, it is assumed that the proceeds are much lower than cost, given that used clothing would not sell for more than what it cost to buy new. The disposition would also create a capital loss, but capital losses on depreciable property are denied for tax purposes.
Net additions	1,420,000	
CCA at 100%	(1,420,000)	
Closing UCC balance	0	

- Paragraph 18(1)(e) limits the deductibility of general reserves. The return shipping provision is recorded in anticipation of expected, not actual, return shipping costs, so is not deductible. However, amounts actually paid for shipping during the year are deductible. The ending balance of the provision was \$12,500, and the beginning balance was \$7,500, so we add back and deduct those two amounts, respectively. This adjusts the provision on the income statement from an accrual to a cash basis for tax purposes.
- Paragraph 67.1(1) limits deductions on meals and entertainment expenses to 50% of the incurred cost. This general limitation has an exception in paragraph 67.1(2)(f) for up to six events per year, where the amounts paid are related to a special event provided to all employees, which allows 100% of the cost of the event to be deducted. The expense related to the annual all-employee party is deductible; however, general meals and entertainment expenses are only 50% deductible ($\$12,000 \times 50\% = \$6,000$).
- Depreciation is not deductible in determining taxable income; however, you are allowed to claim CCA. Class 8 is the appropriate class for office furniture, which is calculated using a 20% declining balance rate. Therefore, as there was an opening UCC balance of \$24,000, CCA is calculated as: $\$24,000 \times 20\% = \$4,800$.

6. Bonuses are deductible in determining taxable income if they are paid by the corporation within 180 days of the end of the taxation year. As you intend to pay the bonus to employees in July, this would exceed 180 days after year end, and the bonus would instead be deductible in the year in which the payment is made (2024). If you can pay the bonuses before June 28, you would be able to deduct them in 2023, to reduce your taxable income.
7. Accounting gains are not included in the calculation of taxable income. Instead, the original cost of the asset is compared to its proceeds, to determine if any capital gains or losses must be reported for tax purposes. In this case, we do not know the original cost of the clothing, but it is reasonable to assume that the cost exceeds the proceeds, thereby creating a capital loss that would be denied for tax purposes because clothing is depreciable property.

For Assessment Opportunity #2 (Taxation), the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Nominal competence – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to calculate federal corporate income taxes payable.

Competent – The candidate calculates federal corporate income taxes payable.

Competent with distinction – The candidate thoroughly calculates federal corporate income taxes payable.

Assessment Opportunity #3 (Breadth Opportunity)

The candidate discusses the risks associated with the draft terms of the algorithm licensing agreement, and provides suggestions to mitigate them.

The candidate demonstrates competence in Strategy and Governance.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core
2.5.1	Designs an effective risk management program and evaluates its impact on shareholder value	B
2.5.2	Assesses the impact of IT/IS risks on enterprise risk and recommends appropriate risk management strategies	B

CPA Map Enabling Competencies:

5.1.1 Applies general business knowledge to enhance work performed

5.1.3 Develops and uses knowledge of the organization, industry and stakeholders

6.2.1 Maintains an objective and questioning mindset to avoid biased analyses

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

I have noted some concerns regarding some of the items you intend to include in the agreement with the retailers who use BestFit. Please note that, once all terms are updated and finalized, the licensing agreement should be reviewed by legal counsel. This will ensure that the contract provides Fresh with full legal protection before being distributed to licensees. Fresh could further consider setting up a separate corporation to carry out the licensing activities. In this way, Fresh would be protected from all risks associated with the use of its algorithm by others.

Data Quality

According to the draft terms, retailers can provide whatever amount of historical customer data they want, in any format they choose. Both of these variables create risk for the quality of the resulting algorithm developed by Fresh. First, by allowing retailers to provide the information in whatever format they wish, there is a risk that the data will not be easy to use in building a functioning algorithm. Fresh may then have to clean the data in order to use it, but this process of data manipulation could introduce errors. The retailer, as the owner of the data, should be responsible for ensuring its accuracy, integrity, and usability for the intended purposes. Fresh should develop a template that retailers need to use in submitting their data. The template should be designed to collect the information in a format that is usable by the software developers, without modification by Fresh. Second, allowing retailers to determine the volume of information to provide could result in too little data, or too much outdated data, meaning that the algorithm will not have enough information for refining its recommendations. This in turn could lead to poor recommendations, which would leave Fresh exposed, under the terms of its “customer satisfaction guarantee.” To ensure optimum algorithm performance, Fresh should specify the minimum threshold of data required. Fresh should also specify the degree of recency required in the collected data points, as very old customer data may not be useful in predicting current buying trends.

Retention of Customer Personal Information

Currently, the agreement states that customers’ personal information will be stored by Fresh. This increases the risk of more severe consequences, such as identity theft, if anyone were to gain unauthorized access to the customer database. Depending on the nature of the data stored, Fresh may be required to disclose any breaches to the public, and could face reputational damage. Management should determine what customer information is required for the algorithm customizations, and obtain only what is needed from the retailers. If that information can be anonymized—by removing names and contact information, so that there is no personally identifiable information—Fresh should do so, to reduce risk.

Server Access

In the draft terms, you stated that you intend to store retailer data on a cloud-based server, with a common link to a shared folder for all retailers. This suggests that all retailers will have access to other retailers' information that has been uploaded to the server for Fresh. As this data includes upcoming product launches that are likely to be highly sensitive, storing the information in a shared folder may expose Fresh to a risk of litigation and loss of reputation if, for example, the data is used by other retailers to produce similar clothing. It is also not clear in the current draft terms whether authorization is required, to access the shared folder through this link. If there is no password protection or other authentication, anyone who obtains the link will also have access to this information. To mitigate these risks, Fresh should provide each retailer with a unique, encrypted, password-protected, link to a folder that only they have access to, for them to upload their data. Fresh could also consider other secure data transfer methods for collecting information from the retailers, such as Secure File Transfer Protocol (SFTP) or Application Programming Interface (API).

Source Code

Retailers will be provided with the algorithm's source code if they request it. While there may be valid reasons for a retailer to request access to the source code (e.g., to ensure that it does not contain any malicious code), providing the code to retailers without restrictions could result in the intellectual property being stolen. This would remove the competitive advantage that Fresh has gained by developing this copyrighted algorithm. Further, if retailers have full access to the code, they may be able to make changes to the source code, which could cause issues with the algorithm. To protect Fresh's intellectual property, I recommend removing this clause from the agreement, and restricting all retailer access to the source code.

Improved Customer Satisfaction Guarantee

Fresh will be relying on retailers to report the results of the customer surveys, which determines whether the retailers will be provided with a reduction of their monthly service fee. As these results are self-reported by the retailers, they may be incentivized to report only unfavourable feedback from customers who made purchases using BestFit, and favourable feedback from customers who did not purchase using BestFit, so they can receive a reduced monthly fee. To validate the results of the feedback, and to avoid any manipulation by the retailer, Fresh should be provided access to the original customer feedback data, or the feedback should be sent directly to Fresh.

In addition, in the current draft, there are few details about the amount of the potential fee reduction, or how that will be determined. This may result in retailers and Fresh having different expectations about the size of the reduction, and could lead to unhappy retailers who may choose to discontinue use of the service. The agreement should clearly state how much of a discount the retailer will receive. I suggest that you implement a sliding scale, whereby the discount amount is correlated with the difference in feedback from purchases made using the BestFit style suggestions, compared to customers who did not use the service.

Alternatively, Fresh may want to reconsider providing a reduced fee altogether. Instead, the terms of the guarantee could simply require Fresh to adjust the algorithm in response to any customer concerns that arise via the feedback forms. This would protect Fresh from lost revenue, reduce any vendor incentive to manipulate the feedback results, and eliminate the need to clarify or negotiate the size of the discount.

For Assessment Opportunity #3 (Strategy and Governance), the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Nominal competence – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate discusses some of the risks associated with the draft terms of the algorithm licensing agreement, or provides suggestions to mitigate them.

Competent – The candidate discusses some of the risks associated with the draft terms of the algorithm licensing agreement, and provides suggestions to mitigate them.

Competent with distinction - The candidate discusses several of the risks associated with the draft terms of the algorithm licensing agreement, and provides suggestions to mitigate them.

Assessment Opportunity #4 (Breadth Opportunity)

The candidate analyzes the financing options and makes a recommendation.

The candidate demonstrates competence in Finance.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core
5.2.3	Evaluates sources of financing	B

CPA Map Enabling Competencies:

5.1.1 Applies general business knowledge to enhance work performed

5.1.3 Develops and uses knowledge of the organization, industry and stakeholders

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.1.3 Demonstrates skepticism, objectivity, due care and persistence when identifying issues

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Fresh needs \$500,000 in funding to complete the BestFit project and is considering two potential financing options, a traditional bank loan versus a series of loans from friends and family. I have analyzed the key decision variables below.

Funding Certainty

- The bank loan is more favourable in terms of funding certainty because it is a very reliable funding source. Over the course of the disbursement period, the bank loan will provide the full amount of financing required for completing the development of BestFit. Conversely, friends and family are not in the business of providing loans, so there is some risk that they will not be able to provide the full \$500,000 needed.

Timing of Loan Proceeds

- The bank loan is disbursed quarterly until December 2025, which does not align with the cash flow needs of the project; you indicated that you need \$350,000 in the first year, but you will only have received \$250,000 by December 31, 2024. Since the loan disbursement amounts, as planned, are not sufficient for 2024, you may have to find additional funding elsewhere, or you may not have enough cash for other operating expenses. However, the bank is open to revising the timing of funding, but it will charge a higher, undefined interest rate to do so.
- The friends-and-family option involves establishing a series of loans and, at present, the loan timing is not defined. The bulk of the funding will be required between now and August 2024; assuming friends and family can advance the funds as needed, Fresh could align the start dates of the loans with the timing of future BestFit expenditures. This would ensure that funds are available as required and could have the added benefit of lowering interest expenses, since Fresh would only be taking on debt when absolutely needed. Overall, with respect to timing of proceeds, the friends-and-family option is more advantageous.

Principal and Interest Repayments

- Under the bank loan, the principal repayment does not begin until one year after the final instalment is received, which will be on December 1, 2025. Given that you plan to complete the project by August 2024, and you have potential customers, this could be enough time to start generating cash flows, to make the repayments.
- Conversely, if the algorithm is slow to generate the revenue expected, the required repayments could put a strain on cash flow.
- With the bank loan, interest is payable at the end of the first month, before the principal repayments begin and before the project is complete. It may be difficult to make these payments while you have significant cash outflows related to this project; however, as the funds are provided over a period of two years, the interest payments will also be smaller earlier on. You will need to determine whether you have sufficient cash flows to support these interest payments.
- In contrast, the timing of principal and interest repayment with the friends-and-family loans is tied to the performance of the new algorithm revenue stream. This means that Fresh will be more likely to have the needed cash to make payments, since they will only be required when the new algorithm has generated significant cash inflows of its own. This is favourable when compared to the bank loan, which requires repayment to start at a specific point in time, regardless of whether the algorithm is generating significant cash inflows.

Interest Rate

- The bank is offering an interest rate of 8%, which is higher than the current rate of 7% being offered by friends and family, and could be higher still, since you will likely have to ask the bank to change the timing of the cash disbursements to meet your needs. That said, the bank's interest rate is fixed, meaning it will not change over the term of the loan, and this predictability will make it easier to budget costs. In contrast, the interest on the friends-and-family loans is variable, based on the market rate. If rates drop or do not fluctuate, there will be interest savings under this option. However, as interest is tied to the prime rate, there is volatility associated with the cost of financing. If the prime rate increases by more than 1%, this option will become more expensive than the bank loan.

Conversion Feature

- The friends-and-family loans contain a conversion feature while the bank loan does not. This feature will allow friends and family to convert their loans to common shares, at their discretion, once BestFit sales reach \$1.5 million. If the lenders choose to convert their loans into common shares, one benefit is that you will not have to make any repayments beyond the interest accrued.

- However, converting the loans to common shares will reduce Alyssa’s ownership of Fresh. Currently, she is the sole shareholder and is used to having final decision-making authority. At the high end, if all loan holders convert their investment to common shares, 1,000 new shares will be issued ($\$500,000 \div \500). As Alyssa has 1,500 shares, this would not result in her losing control of the company; with 1,500 of 2,500 shares, she would own 60% of Fresh, with minority shareholders owning 40% ($1,000 \div 2,500$). While Alyssa would still retain control, the 40% interest to minority shareholders will create obligations that do not currently exist. For example, the new owners may expect regular reporting or representation on the Board of Directors, which could interfere with how Alyssa would choose to operate the business.
- Upon conversion, Fresh will basically be selling its common shares for \$500 each. It is unclear whether this reflects a fair valuation of Fresh. If this price is too low relative to the fair value of the shares, Alyssa will be giving up more ownership than would otherwise be required.
- With minority shareholders in the mix, Alyssa will not gain the full benefits of future growth in Fresh, as she will have a smaller ownership percentage. This increases the overall cost of borrowing, which may end up being higher than the bank loan alternative, once we factor in the lost growth opportunity.

Administrative Burden

- There will be several lenders with the friends-and-family option. With more lenders, there may be a higher administrative burden, to manage all the loans, and more time required to manage lender expectations. As both the repayment and conversion features rely on Fresh’s performance, to determine the timing of when these options become available, lenders will likely require frequent updates on financial results. The bank loan will be easier to manage, since only one lender is involved.

Recommendation

While both options have advantages and disadvantages, I recommend the loan from the bank; it is more predictable and therefore has far less risk, and Alyssa’s ownership interest in the company will not be diluted. The timing of funds, as proposed, does not meet Fresh’s needs, but the bank is willing to change this in exchange for a slightly higher interest rate. While the interest costs will be higher than the friends-and-family option, other costs will be avoided—such as a higher administrative burden or the lost future growth opportunities—so over the long term, it will likely result in lower financing costs.

For Assessment Opportunity #4 (Finance), the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Nominal competence – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to analyze the financing options.

Competent – The candidate analyzes the financing options and makes a recommendation.

Competent with distinction – The candidate thoroughly analyzes the financing options and makes a recommendation.

Assessment Opportunity #5 (Depth and Breadth Opportunity)

The candidate discusses the accounting treatment for the BestFit algorithm expenditures.

The candidate demonstrates competence in Financial Reporting.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core
1.2.1	Develops or evaluates appropriate accounting policies and procedures	A
1.2.2	Evaluates treatment for routine transactions	A

CPA Map Enabling Competencies:

6.2.1 Maintains an objective and questioning mindset to avoid biased analyses

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

6.3.3 Applies decision criteria to choose among viable alternatives

The first step is to assess whether the algorithm qualifies as an intangible asset. Under ASPE 3064 – *Goodwill and Intangible Assets*, intangible assets must be identifiable, the entity must have control over the resource, and there must be the expectation of future economic benefits.

Identifiability

As per paragraph 12:

“An asset meets the identifiability criterion in the definition of an intangible asset when it:

- (a) is separable (i.e., is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability); or*
- (b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.”*

As the costs incurred will give rise to a licensable product, criterion (a) is satisfied. Further, criterion (b) is satisfied because the costs incurred give rise to legal rights via the copyright. Given this, the intangible asset is identifiable.

Control

As per paragraph 13:

“An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits.”

As the BestFit algorithm will be protected by a copyright, Fresh will have control over the use of the software, and therefore has the power to obtain any future economic benefits and restrict others' access to the benefits.

Future Economic Benefits

As per paragraph 17:

“The future economic benefits flowing from an intangible asset may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the entity.”

Fresh plans to earn revenues from selling the use of the algorithm as a service; therefore, this criterion is satisfied. Fresh also plans to use the algorithm in its own business, to improve customer offerings and increase sales. This would also suggest that the criterion for future economic benefits is satisfied.

As all of the criteria above are met, the algorithm meets the definition of an intangible asset, and the next step is to determine whether the intangible asset can be recognized.

Per ASPE 3064, paragraph 21:

“An intangible asset shall be recognized if, and only if:

- (a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and*
- (b) the cost of the asset can be measured reliably.”*

Fresh has a plan to both use the algorithm in-house and to earn revenues from licensing the algorithm, and you had noted that there is a market for this type of product; therefore, criterion (a) is met. It seems that you have been tracking costs related to the development of BestFit; therefore, criterion (b) is also met.

ASPE 3064 has specific criteria related to internally-developed intangible assets, such as BestFit, and separates the research phase from the development phase. ASPE 3064, paragraphs 37 and 38, discuss the research phase:

“No intangible asset arising from research (or from the research phase of an internal project) shall be recognized. Expenditure on research (or on the research phase of an internal project) shall be recognized as an expense when it is incurred.

In the research phase of an internal project, an entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits. Therefore, this expenditure is recognized as an expense when it is incurred.”

Based on that guidance, the \$15,000 in costs, incurred for the consultant to determine whether there was a market, is not eligible to be capitalized as an intangible asset; rather, it is expensed as incurred, as this activity would be considered part of the research phase.

Paragraph 41 of ASPE 3064 provides the criteria that need to be met in order to recognize an internally-generated intangible asset:

“An intangible asset arising from development (or from the development phase of an internal project) is recognized if, and only if, an entity can demonstrate all the following:

- (a) the technical feasibility of completing the intangible asset so that it will be available for use or sale;*
- (b) its intention to complete the intangible asset and use or sell it;*
- (c) its ability to use or sell the intangible asset;*
- (d) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset;*

- (e) its ability to measure reliably the expenditure attributable to the intangible asset during its development; and*
- (f) how the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset.”*

Based on this guidance, for expenditures to be capitalized as development costs, all six criteria outlined, from (a) to (f), must be met. All criteria have been met:

- (a) Technical feasibility is met, as the developers produced a preliminary working version of the algorithm by early October 1, 2023, and they have significant experience in developing similar technologies.
- (b) Fresh intends to complete the development of the algorithm, has a target completion date in 2024, and intends to use the algorithm in its new revenue stream and to increase internal sales.
- (c) Fresh has already had interest from several large retailers, and intends to sell the use of the algorithm. Considering the strong interest in the service, it seems that Fresh will be able to sell the use of the algorithm to several large retailers.
- (d) Fresh has adequate technical, financial, and other resources to complete the development. You mentioned that you have hired three developers to complete development of the algorithm, and that they have the experience necessary for building the software. You are also looking to obtain financing, and since you have options for funding, it is likely that you have the financial means to complete the development.
- (e) Fresh can reliably measure expenditures related to the development of BestFit. Based on your notes, the developers are working exclusively on this project, so all their time would be allocated to the project. It appears that you have also been tracking other legal and administrative costs related to development of the algorithm.
- (f) Based on the market research completed by the consultant, there is a market for use of the algorithm by several retailers.

Capitalization can only begin when all six criteria have been met. On October 1, 2023, the developers produced a preliminary working version of the algorithm. At that point, technical feasibility was established, research supported the existence of a market for the algorithm, key resources (developers) were on staff, and a plan to complete the project by August 2024 was in place. October 1 appears to be the date when the capitalization criteria were met, so expenditures incurred from that point forward can be capitalized. Software developer salaries of \$82,500 ($\$110,000 \times 3 \times \frac{1}{4}$ year), incurred prior to this date (from July to September), would be expensed as part of the research phase.

ASPE 3064, paragraph 40, discusses the accounting treatment for the development costs that meet the above criteria:

“In accounting for expenditures on internally generated intangible assets during the development phase, an entity shall make an accounting policy choice to either:

- (a) expense such expenditures as incurred; or*
- (b) capitalize such expenditures as an intangible asset (provided the criteria in paragraph 3064.41 are met).”*

Currently, all expenditures have been expensed as incurred, which is an acceptable accounting policy choice under ASPE 3064; however, the costs could be capitalized and amortized over the life of the asset rather than all upfront. This would make the financial statements more relevant to users, such as banks or investors, as the value of the algorithm will be captured on the balance sheet and net income would be more reflective of operating costs in the period.

Under ASPE 3064, paragraph 50:

“The cost of an internally generated intangible asset comprises all directly attributable costs necessary to create, produce and prepare the asset to be capable of operating in the manner intended by management.”

All costs that meet the development criteria above would meet this criterion, as the costs of employee salaries (from October to December), totalling \$82,500 ($\$110,000 \times 3 \times \frac{1}{4}$ year), and fees of \$25,000, to register the source code copyright, are both required in order to use and obtain economic benefits from the algorithm.

Adjusting journal entry:

DR Capitalized development costs	\$107,500	
CR Expenses		\$107,500

For Assessment Opportunity #5 (Financial Reporting), the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Nominal competence – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to discuss the accounting treatment for the research and development costs of the BestFit algorithm.

Competent – The candidate discusses the accounting treatment for the research and development costs of the BestFit algorithm.

Competent with distinction – The candidate thoroughly discusses the accounting treatment for the research and development costs of the BestFit algorithm.

Assessment Opportunity #6 (Breadth Opportunity)

The candidate provides audit procedures that the auditor will likely perform over the algorithm expenditures, revenue, and salaries and wages.

The candidate demonstrates competence in Audit and Assurance.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core
4.3.5	Assesses the risks of the project, or, for audit engagements, assesses the risks of material misstatement at the financial statement level and at the assertion level for classes of transactions, account balances, and disclosures	B
4.3.6	Develops appropriate procedures, including Audit Data Analytics (ADA), based on the identified risk of material misstatement	B

CPA Map Enabling Competencies:

6.1.3 Demonstrates skepticism, objectivity, due care and persistence when identifying issues

6.2.1 Maintains an objective and questioning mindset to avoid biased analyses

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

The auditor will likely perform the following procedures related to the algorithm costs, revenues, and salaries and wages.

Algorithm Costs

- To ensure that capitalization criteria are met, meet with management to discuss their plans to sell and use the BestFit algorithm, the existence of a market, the technical feasibility of completing the algorithm, and the availability of resources for completing the development. Corroborate these discussions by:
 - reviewing the consultant’s market study and correspondence with potential retailers, to confirm the existence of a market.
 - observing the function of the working version of the algorithm, to verify the technical feasibility of completion.
 - reviewing credentials of the developers, along with draft financing agreements or correspondence with potential lenders, to verify that adequate technical and financing resources are available to develop and operate BestFit.
- To ensure that capitalization is appropriate for the BestFit costs, obtain a schedule of costs incurred for the project that are planned to be capitalized.
 - For legal and other administrative costs, verify the amount by tracing to a purchase invoice, and verify that the expense is related to development of the algorithm, or registration of the copyright.
 - For salary expenses, obtain payroll records, to verify the amount capitalized to the project. Ensure that any salaries or wages from other employees (besides the software developers) were directly related to the development of BestFit, through review of timesheets or other documentation. Have discussions with software developers and other relevant employees, to verify whether their time was exclusive to the algorithm. Ensure that salaries paid prior to October 1 have been expensed as part of the research phase.
 - Review the cost descriptions within the schedule of costs, to determine if any are ineligible to be capitalized.
- Verify the date that other costs were incurred by inspecting purchase records, to determine if any were before October 1, during the research phase, and are therefore ineligible for capitalization.
- To ensure the accuracy of market research costs incurred in the research phase, obtain the purchase invoice and proof of payment, and agree the invoiced amount to the general ledger.

Revenue

- Obtain a listing of active subscriptions per month, sorted into regular and premium subscriptions. Perform a predictive analytic by multiplying the number of active subscriptions in each month by the relevant monthly rate (\$225 for regular, \$300 for premium). Compare this to the amount of revenue recorded in the GL, to test for reasonableness. Investigate any significant deviations from the expected amount.

- To verify the subscription listing above, select a sample of active subscriptions from the listing and trace to the related sales invoices / subscription agreements, and associated proof of customer payment (i.e., receipt of credit card payment). Trace the payment to the bank statement, to verify the accuracy of the amount.
- Obtain a listing of all subscription customers that includes the start date of their subscription. To verify this list, select a sample of customers, obtain their subscription agreement, and verify that the start date, as per the agreement, agrees to the date on the customer list. For customers with active subscriptions in the month of December 2023 that do not begin on the first of the month, inspect their rental order history for December, and recalculate how many of the five allowed rentals are unused as at December 31, 2023, to determine the amount of revenue that should be deferred. Compare this calculated amount to the amount of deferred revenue, as per the financial statements.
- Obtain a listing of revenue transactions for rental orders placed in December. Select a sample and vouch to shipping documents, to ensure that the goods were shipped to the customer. Recalculate the amount of revenue recorded, using the monthly subscription price, number of rental items available for the month, and number of rental items in the selected shipment, and compare this to the amount recorded in revenue, as per the general ledger.
- To verify the sales discounts related to subscription sales from the influencer campaign, examine a sample of discounts given, and trace back to the related new subscription agreement, to ensure that the sale happened in July and the recorded discount amount was accurate.
- To verify the gain on fully depreciated clothing, select a sample of sales invoices to discount chains, and vouch the sales amount. For the clothing sold in those invoices, trace to the rental clothing ledger, to determine the net book value. Recalculate the gain on sale.

Salaries and Wages

- To confirm that amounts are paid to existing employees at the correct amount, select a random sample of payroll payments recorded in the general ledger and trace to the payroll register. Select a sample of employees from the payroll register. Determine whether the selected employees are paid by the hour or on a salaried basis.
 - For salaried employees, review their employment contract to confirm their salary amount. Agree the payment amount on the payroll register to the gross salary earned in a given pay period (i.e., annual salary ÷ number of pay periods in the year).
 - For hourly employees, agree the hours worked to their timesheets, to validate that the employees were paid for work performed. Agree the pay rate, as per the payroll register, to personnel files, to verify that the employees are paid at the correct rate.

- Recalculate the employee’s and employer’s portion of payroll source deductions included in the payroll register, such as CPP/QPP and EI, using the federal and provincial rates, to validate the net pay to the employee and the completeness of the payroll deductions payable.
- To ensure that all payroll expenses are recorded, select a sample of payroll registers. Agree the net pay, as per the payroll register, to the bank statements, to verify the total payroll amount, and agree this amount to the general ledger.
- Alternatively, perform a substantive analytic using actual salaries and average wages and hourly employee head count, to calculate the expected salary and wage expense, and compare to the amount recorded in the general ledger. Investigate any significant deviations from the expected amount.
- Obtain the payroll register around year end, and recalculate the portion relating to 2023, based on the number of working days that occurred during 2023 out of the total working days in the pay period. Compare to the payroll accrual, to validate appropriate cut-off.

For Assessment Opportunity #6 (Audit and Assurance), the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Nominal competence – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate provides a few audit procedures that would likely be performed over the algorithm expenditures, revenue, and salaries and wages.

Competent – The candidate provides some audit procedures that would likely be performed over the algorithm expenditures, revenue, and salaries and wages.

Competent with distinction – The candidate provides several audit procedures that would likely be performed over the algorithm expenditures, revenue, and salaries and wages.

Assessment Opportunity #7 (Breadth Opportunity)

The candidate discusses the strategic fit of each CEO candidate.

The candidate demonstrates competence in Strategy and Governance.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core
2.4.1	Analyzes key operational issues including the use of information assets and their alignment with strategy	B

CPA Map Enabling Competencies:

2.1.1 Applies knowledge of the organization's competitive environment and strategic direction when performing assigned work

2.1.3 Identifies the strategic impact of internal decisions and external influences on project plans and initiatives

5.1.1 Applies general business knowledge to enhance work performed

5.1.3 Develops and uses knowledge of the organization, industry and stakeholders

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Fashion Industry Experience

You mentioned that Genevieve is an industry veteran, which means she is likely very familiar with the fashion and retail industry, and would have the background required to steer the company in the right direction as the industry evolves. Her connections would also be a good way to introduce BestFit to even more retailers, and increase sales from the new algorithm revenue stream.

Shane's background is in technology, and you stated that he does not have any experience in fashion; therefore, he may not have a strong understanding of the market. This could lead to poor decision-making and decreased sales or market share. To know what improvements need to be made, it would likely be beneficial for him to have a good understanding of the fashion industry.

Business Model

Fresh operates in the e-commerce space, which is based heavily on technology. Genevieve's lack of experience in this area could leave her unprepared to capitalize on the competitive advantages, or to identify and mitigate the risks inherent in this type of business model.

Conversely, Shane, as the current chief technology officer at a social media start-up, has a very strong background in technology. E-commerce and social media business models are not identical, but would share a number of similarities when it comes to managing cyber-security and other technology-driven risks. Fresh has recently started using social media influencers to promote its clothing rental service, and Shane is likely well positioned to help the company expand its consumer reach even further, through other social media marketing efforts.

Cultural Fit

Fresh is a close and cohesive company, so Shane's plans to hire a significant number of remote workers may not fit well with the current company culture, and existing employees will likely see this as an extreme departure from how the company has been run by Alyssa so far. When the company is already facing new challenges by introducing a new revenue stream, this may add unnecessary disruption.

Genevieve, on the other hand, prioritizes promoting from within, which would likely serve to retain strong talent that already exists within the company, and be beneficial for the culture at Fresh while the company is undergoing changes in its business.

Growth

While Genevieve does not have a strong background in new technologies, she seems to understand the potential of the core rental business, and how it should be marketed as a sustainable option for customers. Clothing rental can be seen to reduce consumer waste because it keeps clothes in use longer, which is particularly beneficial for items that are usually worn only a few times. This type of sustainability is an increasingly important business imperative for socially-responsible corporations, and Genevieve's insight and focus on this potential competitive advantage will be helpful in continuing to grow and evolve the rental business.

Shane's experience and understanding of technology would benefit continued improvement and innovation of the BestFit algorithm; however, you noted that you want the rental business to be the core driver of Fresh's growth going forward. It appears that Shane is most interested in BestFit, so your rental business may suffer if he is prioritizing the algorithm sales rather than the rental business.

Compensation

The two candidates have different preferences for compensation, with Genevieve preferring salary-based compensation and Shane favouring stock-based compensation. Genevieve's preference would be straightforward and predictable; however, it would require more recurring cash outflows compared to stock options, as compensating partially through stock options would allow Fresh to offer Shane lower base compensation. Stock-based compensation also has the benefit of aligning the executive's interests with those of the shareholders, as well as creating an incentive for Shane to stay at Fresh longer, to ensure that the options vest. Shane may therefore have more motivation to ensure that Fresh's share price, and the value of the business, rises—to increase the value of his compensation. The downside to this type of compensation is that it would dilute Alyssa's ownership in the business.

Other

It appears that the app that Shane developed is known to have privacy concerns, which should be a red flag for Fresh if you are considering bringing him on. With the customer data you will be collecting from the retailers, and from the customer feedback surveys, customer data privacy should be a priority; based on the issues with the social media app, it may not be a high priority for Shane.

Recommendation

Overall, it appears that Genevieve's background and preferences are more aligned with the existing Fresh operations and future plans, as she is looking to maintain the rental business as the focus of the company, promote from within employees who understand the business and its customers, and has the industry background and connections to help ensure that BestFit has a good customer base. Although Genevieve lacks experience in technology, Fresh appears to have a robust IT team that she can lean on, at least initially, until she has gained a better understanding of Fresh's e-commerce business model.

For Assessment Opportunity #7 (Strategy and Governance), the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Nominal competence – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to discuss which CEO candidate is the best strategic fit for Fresh.

Competent – The candidate discusses which CEO candidate is the best strategic fit for Fresh, and makes a recommendation.

Competent with distinction – The candidate thoroughly discusses which CEO candidate is the best strategic fit for Fresh, and makes a recommendation.

**COMMON FINAL EXAMINATION
SEPTEMBER 12, 2024 – DAY 3**

Case #2

(Suggested time: 80 minutes)

It is April 2, 2024. You, CPA, meet with your new client, Kristel Percy, CEO of Percy & Thrower Inc. (PT), an online-based company that provides legal services. Kristel needs advice on several issues.

“Thank you for meeting with us, CPA. We have been operating for a few years, and business is booming! We are preparing our financial statements for the year ended March 31, 2024, in accordance with IFRS. Our controller, Brigit, needs help accounting for the first sale of our new legal services package (Appendix I).

“Business is so good that Rashad, one of my business partners in PT, has made two investments for PT with our excess funds (Appendix II). Please explain the impact of these investments on the corporate taxable income for the year ended March 31, 2024. Also, explain the impact on corporate taxable income if we were to sell them today. Please also answer Brigit’s questions regarding the accounting treatment of the real estate investment.

“Brigit has also expressed frustration with the investment process, so can you discuss the control weaknesses you identify, and recommend improvements (Appendix III)?

“Also, Rashad has new investment ideas (Appendix IV). We want our new investments to be of low-to-moderate risk, meet our expected rate of return, and support initiatives that align with our strategy. Our strategy is to optimize performance through the use of technologies, and promote and enable flexible work arrangements. Could you assess whether each of Rashad’s ideas meet our objectives?

“Lastly, we are considering buying a small firm, Westley Legal (Westley). I have sent you a summary of the potential deal and Westley’s financial information (Appendix V). Please calculate the value of this firm.”

APPENDIX I
NEW LEGAL SERVICES PACKAGE

We started offering a new legal services package, where customers can access all of the following services for \$4,500:

Service	Stand-Alone Price
Home purchase agreement	\$ 2,500
Pre-nuptial agreement	\$ 2,000
Will	\$ 1,500

Eveline, one of Rashad's old friends, is our first client to purchase this package. They discussed the idea over dinner, where Eveline verbally agreed to purchase the package. Eveline is waiting to free up some cash, so Rashad told her she could pay later this year. Rashad completed the legal work for Eveline's home purchase on March 31. Eveline is also getting married; Rashad started drafting the pre-nuptial agreement on March 1, 2024, but it will take about three more months to complete. No work has been done on the will so far. We have not yet recorded anything related to this package sold to Eveline.

APPENDIX II CURRENT INVESTMENTS

Real Estate

PT purchased real estate for \$2 million in early April 2023. The property includes two adjacent commercial buildings currently leased to tenants. PT has no other buildings. The land is worth 30% of the total value of the property, and the buildings have a remaining useful life of 30 years. If PT keeps growing, this could be a good place for an office; we currently do not have an office because we all work from home. PT could occupy one building and continue to lease the other one. We recorded the purchase as property, plant, and equipment (PP&E) on our balance sheet—is that correct? How would we account for this property if we end up moving in?

The real estate market is very strong, so we are also considering selling the property; it was recently appraised at \$2.3 million.

Shares

PT purchased 1,000 shares of You-Tok, a publicly traded company operating a social media video-sharing platform, on January 1, 2024, for \$20 each. These are now trading at \$15, compared to \$5 last summer. At least we receive a quarterly dividend of \$0.05 per share. You-Tok is a taxable Canadian corporation.

APPENDIX III INVESTMENT PROCESS

When Rashad comes up with an investment idea, he tells Kristel over coffee, or in an email or text message, and Kristel provides some feedback. Rashad then decides where and when to invest, and usually checks whether PT has the funds needed. Rashad makes most investments using PT's online broker, who withdraws funds directly from PT's bank account. Rashad also has the ability to send electronic transfers, if necessary.

Rashad monitors results, and makes the decision to sell investments when the time feels right.

Brigit is informed of the investments either incidentally, via email, or sometimes when completing the bank reconciliation, when trying to determine what withdrawals, transfers, or deposits are for. She once found out about an investment when she got a call from the broker, because the direct withdrawal could not go through due to insufficient funds. Both Rashad and Kristel have access to the accounting system.

Brigit asks Rashad to provide the financial information for the investments, as he is the one receiving the broker statements. However, he is very busy, and it sometimes takes weeks for her to get the statements, which results in delays finalizing the financial statements. Partners in the company have expressed frustration over having to wait for the financial information.

Some of the investments were not great. Rashad once invested in an ice cream company because it was a hot day! This investment did not meet the 6% annual return that the partners hope to get from investments.

APPENDIX IV NEW INVESTMENT IDEAS

Rashad thinks cryptocurrencies are the way of the future, and wants to invest in a new cryptocurrency called Costume. He also thinks the value of this cryptocurrency will appreciate.

Virtual Vagabond is a travel agency that helps businesses find short-term office accommodations for individuals who work remotely while travelling. The company would like to go public, has a strong earnings history, and discussed paying dividends. Rashad wants to make a \$60,000 equity investment in the company. Both Kristel and Rashad enjoy working remotely.

Rashad was asked to provide a \$50,000, three-year loan to a consulting company led by his long-time friend, Sid Morton, CPA. This small company has stable annual revenue and, using web-based tools, offers bookkeeping and financial statement preparation services to small businesses in remote farming communities. They will pay \$8,000 of interest at the end of the loan term.

APPENDIX V
INFORMATION ABOUT WESTLEY

Description	Amount
Net book value of PP&E	\$ 55,000
Fair market value of PP&E	\$ 60,000
Total liabilities (all short-term)	\$ 156,000
Revenue	\$ 1,500,000
Income before tax	\$ 450,000
Interest expense	\$ 3,600
Amortization	\$ 70,000

Notes:

- The above information is based on Westley's latest annual financial statements.
- It was an unusual year, as Westley had an insurance claim, and recorded a gain of \$10,000.
- Westley does not have bank debt. Interest expense is related to credit card interest paid.
- Revenue is down from the prior year by 3%. Adam, the owner, told us that this was due to a since-resolved personal health issue, but we noticed that he lost a long-time client around the same time. Adam has had many of the same clients for over 15 years.
- Adam is taking an annual salary of \$100,000, which is lower than the average lawyer's annual salary of \$250,000. Westley pays Adam's son \$50,000 per year for administrative duties. Adam is ready to retire this year, already spending several months a year in Florida, even though all his clients are in Canada.
- Westley has two annual office leases, and the monthly payments of both are expensed for accounting purposes: one in Markham, Ontario (\$3,500 per month), and one in Florida (\$2,000 per month).
- Law firms are typically valued using a two-to-three times EBITDA earnings multiplier.

MARKING GUIDE 3-2
PERCY & THROWER INC. (PT)
ASSESSMENT OPPORTUNITIES

To: Kristel Percy, CEO
 From: CPA
 Subject: Advice on several issues

Assessment Opportunity #1 (Depth and Breadth Opportunity)

The candidate discusses the accounting treatment for the first sale of the legal services package.

The candidate demonstrates competence in Financial Reporting.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core
1.2.2	Evaluates treatment for routine transactions	A

CPA Map Enabling Competencies:

6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Brigit has asked us to explain how to account for the new package of legal services with your client, Eveline.

Revenue is addressed in *IFRS 15 – Revenue from Contracts with Customers*. To assess revenue, there are five steps to follow.

Step 1: Identifying the Contract

Per paragraph 9:

“An entity shall account for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met:

(a) the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;”

There is no written agreement between Rashad and Eveline; however, Eveline and Rashad agreed verbally over dinner to the contract terms. Rashad is also committed to performing the obligations, as he has completed the work on the home purchase agreement and is in the process of drafting the pre-nuptial agreement. Eveline has agreed to pay for the services, even if she has yet to pay.

(b) *“the entity can identify each party's rights regarding the goods or services to be transferred;”*

The package of services clearly outlines the three services included: A home purchase agreement, a pre-nuptial agreement, and a will.

(c) *“the entity can identify the payment terms for the goods or services to be transferred;”*

The payment terms are vague; however, Rashad did explain that Eveline could pay “later this year.” We should obtain clarification from Rashad about what time frame he communicated as “later this year.” There is some uncertainty about this criterion; however, for now we will assume the payment term is within the year 2024.

(d) *“the contract has commercial substance (i.e., the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and”*

It is expected that \$4,500 will be received from this contract; therefore, PT’s future cash flows are expected to change as a result of this contract.

(e) *“it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession (see paragraph 52).”*

Eveline is experiencing some cash issues now, so we need to question whether collectability could be an issue. Eveline and Rashad are old friends and Eveline has agreed to pay, so funds are expected to be received from the agreement. Therefore, collection should not be an issue.

Conclusion: All of the criteria are met; therefore, it is reasonable to conclude that there is an agreement.

Step 2: Identifying Performance Obligations

As per paragraph 22 of IFRS 15:

“At contract inception, an entity shall assess the goods or services promised in a contract with a customer and shall identify as a performance obligation each promise to transfer to the customer either:

- (a) a good or service (or a bundle of goods or services) that is distinct; or*
- (b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer (see paragraph 23).”*

At the inception of the agreement, Rashad and Eveline agreed to the following services: a home purchase agreement, a pre-nuptial agreement, and a will. This is a bundle of services that are distinct, since Eveline can benefit from each service as a stand-alone service. Each of the services can be identified separately from the others.

Conclusion: The performance of each service represents a distinct performance obligation.

Step 3: Satisfaction of Performance Obligations

As per paragraph 31 of IFRS 15:

“An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (i.e., an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset.”

To determine the satisfaction of the performance obligation, we must ascertain if the services are transferred over time, or at a point in time. Each service can take time to complete; for example, Rashad has been working on the pre-nuptial agreement and will be working on it for another three months. We need to assess the following criteria, from paragraph 35:

“An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met:

- (a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs (see paragraphs B3–B4);”*

Eveline will not receive any benefits from each legal service until it is complete. For example, as Rashad works on the pre-nuptial agreement, Eveline cannot use it and has to wait until the agreement is completed, to be able to use it; therefore, this criterion is not met.

(b) “the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced (see paragraph B5); or”

As Rashad works on each service, he is creating an asset (for example, work in progress on the pre-nuptial agreement). However, we need to determine whether Eveline has control over the asset as it is being created. Paragraph 33 states: *“Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset.”* If Eveline was to take part of the pre-nuptial agreement to another firm, they would arguably not have to start from scratch in order to complete the agreement; they would likely be able to use what has been worked on so far, to create a full agreement. However, professional services do not usually allow for incomplete work to be taken to another professional to finish. We should get more information on what the understanding is between Rashad and Eveline. Until we get further information, we can assume that this criterion is not met.

(c) “the entity's performance does not create an asset with an alternative use to the entity (see paragraph 36) and the entity has an enforceable right to payment for performance completed to date (see paragraph 37).”

The work that Rashad is putting in is creating an asset that is specific to Eveline (pre-nuptial agreement, etc.). Therefore, the asset would not have an alternative use for PT, which would suggest that the first element of this criterion is met. However, it is unclear whether PT has an enforceable right to payment for performance completed to date, as this does not seem to have been discussed between Rashad and Eveline. More information on the discussion that happened between Rashad and Eveline would be needed, to establish whether this criterion is met, but it would be reasonable to assume that Eveline would be able to access the work done to date on the agreements and pay for the services if the contract were to be terminated. Therefore, it is likely that this criterion is met.

Conclusion: Since criterion (c) is met, each performance obligation is satisfied over time, and revenue will be recognized over time.

Measurement of the Obligations

We have to determine a reasonable system with which to measure the performance obligations. Firms typically bill for hours spent; we can determine an overall time estimate, and then recognize revenue according to the percentage of actual hours over the overall time estimate.

Step 4: Determining the Transaction Price

According to paragraph 47:

“An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.”

We are aware of the total price of the transaction: \$4,500. There is no variability in the price paid by the customers.

Step 5: Allocating the Transaction Price to Performance Obligations

As per paragraph 73:

“The objective when allocating the transaction price is for an entity to allocate the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.”

We have been provided with the stand-alone selling prices of each item in the package:

Service	Stand- Alone Price
Home purchase agreement	\$ 2,500
Pre-nuptial agreement	\$ 2,000
Will	\$ 1,500

According to paragraph 81, the discount that is provided on the package price needs to be allocated to the different components of the package:

“A customer receives a discount for purchasing a bundle of goods or services if the sum of the stand-alone selling prices of those promised goods or services in the contract exceeds the promised consideration in a contract. Except when an entity has observable evidence in accordance with paragraph 82 that the entire discount relates to only one or more, but not all, performance obligations in a contract, the entity shall allocate a discount proportionately to all performance obligations in the contract. The proportionate allocation of the discount in those circumstances is a consequence of the entity allocating the transaction price to each performance obligation on the basis of the relative stand-alone selling prices of the underlying distinct goods or services.”

We have no indication that the discount should be provided to only one component; therefore, we will allocate the discount equally to all items.

Service	Stand-Alone Price	Allocation	Calculation
Home purchase agreement	\$ 2,500	\$ 1,875	$\$2,500 \div \$6,000 \times \$4,500$
Pre-nuptial agreement	\$ 2,000	\$ 1,500	$\$2,000 \div \$6,000 \times \$4,500$
Will	\$ 1,500	\$ 1,125	$\$1,500 \div \$6,000 \times \$4,500$
Total	\$ 6,000	\$ 4,500	
Selling price	\$ 4,500		

Conclusion

As Rashad has stated that the home purchase had been completed as at March 31, we should therefore recognize the full \$1,875.

Rashad stated that he began work on the pre-nuptial agreement on March 1, 2024, and that it would take another three months to complete. As we do not have an hourly time estimate and actual hours, we will assume that the pre-nuptial agreement is 25% complete (one month out of four). We should therefore recognize $\$1,500 \times 25\% = \375 .

As no work has been done on the will, no revenue can be recognized.

Total revenue recognized should be \$2,250 ($\$1,875 + \375).

For Assessment Opportunity #1 (Financial Reporting), the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Nominal competence – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to discuss the accounting treatment for the first sale of the legal services package.

Competent – The candidate discusses the accounting treatment for the first sale of the legal services package.

Competent with distinction – The candidate thoroughly discusses the accounting treatment for the first sale of the legal services package.

Assessment Opportunity #2 (Breadth Opportunity)

The candidate explains the impact on the corporate taxable income of the current investments.

The candidate demonstrates competence in Taxation.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core
6.2.2	Advises on taxes payable for a corporation	B

CPA Map Enabling Competencies:

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

You have asked me to advise you on the impact on corporate taxable income of the two current investments.

Commercial Property

Purchase: The commercial buildings would originally be recorded in Class 1. The cost of the buildings (not including the land) would be added into the class in 2023. You will then calculate CCA on the buildings at a rate of 6%, or 4% if the buildings were first used before March 18, 2007, and the CCA would be deducted in the calculation of taxable income. Lastly, any financing costs incurred to purchase the property will be able to be deducted over five years.

Rental income: Any rental income received in the period would be included in the company's taxable income, net of any expenses. The amount of the CCA claim would be limited to the amount of net rental income.

Sale: If you decided to sell the property, you would need to remove it from the CCA class. Each building would be in its own Class 1, and the value of the buildings has increased, so the company would incur a capital gain, and you would have to calculate recapture of any CCA claimed in the first year. There would also be a capital gain on the land, as that value also increased. Only 50% of the capital gains are taxed.

I have included relevant calculations for you.

Year 1 – Ending March 31, 2024

Buildings

Total purchase price: \$2,000,000

Land value: $\$2,000,000 \times 30\% = \$600,000$

Buildings value: $\$1,400,000 (\$2,000,000 - \$600,000)$

CCA: $\$126,000 (\$1,400,000 \times 150\% \times 6\%)$

Ending UCC for March 31, 2024, year end: \$1,274,000

Land

The \$600,000 land has no tax implications for the 2024 year end.

Year 2 – Ending March 31, 2025

Buildings

If you sell the property, assuming that you get \$2,300,000, as expected:

Portion of sale price related to buildings: $\$2,300,000 \times 70\% = \$1,610,000$

Value of land: $\$690,000 (\$2,300,000 - \$1,610,000)$

Opening UCC: $\$1,274,000$ (from Year 1 calculation)

Less: Lower of cost and proceeds: $\$1,400,000$

Recapture of CCA: $\$126,000$ (full amount of CCA claimed in prior year)

Capital gain: $\$1,610,000 - \$1,400,000 = \$210,000$ (amount of sale price allocated to buildings, less original buildings value)

Taxable capital gain on buildings: $\$210,000 \times 50\% = \$105,000$ (Capital gain from above \times 50% inclusion rate)

Land

Capital gain: $\$690,000 - \$600,000 = \$90,000$ (selling price allocated to land, less original cost of land)

Taxable capital gain: $\$90,000 \times 50\% = \$45,000$ (capital gain from above \times 50% inclusion rate)

Note that this analysis assumes that the disposition would be treated as a capital gain, and not as being on account of income. The short time horizon for the sale (roughly one year from when the property was purchased) suggests that there may have always been an intention to sell the property from the time it was purchased; in that case, it would be treated as inventory, and any gain (proceeds, less disposition costs, less original cost) would be included fully in income.

You-Tok Shares

Purchase: Upon purchase of the shares, there are no immediate tax implications.

Dividends: Dividends received are included in net income for tax purposes. The amount is equivalent to the actual amount received. PT will then be entitled to deduct the full amount of qualifying dividends, in arriving at taxable income. As You-Tok is a taxable Canadian corporation, the You-Tok dividends would be considered qualifying dividends. The net impact of the dividends on PT taxable income is nil; this is to prevent double taxation, as a dividend received from a taxable Canadian corporation would be paid from retained earnings (i.e., from earnings that have already been subject to tax).

Sale: When you sell the shares, you need to calculate a capital gain or capital loss. I have included the calculations below:

Purchase price: $1,000 \text{ shares} \times \$20 = \$20,000$

Sale price: $1,000 \text{ shares} \times \$15 = \$15,000$

Capital loss: $\$15,000 - \$20,000 = \$5,000$

Net capital loss: $\$5,000 \times 50\% = \$2,500$

However, depending on the facts and circumstances, stock trading might be considered business income instead of capital gains or losses. This is something to keep in mind going forward.

The total taxable capital gain, assuming that you sell the property and shares in the same tax year, would be: $\$105,000 + \$45,000 - \$2,500 = \$147,500$.

For Assessment Opportunity #2 (Taxation), the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Nominal competence – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to explain the impact on the corporate taxable income of the current investments.

Competent – The candidate explains the impact on the corporate taxable income of the current investments.

Competent with distinction – The candidate thoroughly explains the impact on the corporate taxable income of the current investments.

Assessment Opportunity #3 (Depth and Breadth Opportunity)

The candidate discusses the accounting treatment for the real estate investment.

The candidate demonstrates competence in Financial Reporting.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core
1.2.1	Develops or evaluates appropriate accounting policies and procedures	A
1.2.2	Evaluates treatment for routine transactions	A

CPA Map Enabling Competencies:

6.2.1 Maintains an objective and questioning mindset to avoid biased analyses

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

6.3.3 Applies decision criteria to choose among viable alternatives

PT purchased a property for \$2 million, is using it as an investment for now, and is considering the option of moving into one of the two buildings purchased. PT is also considering selling the property.

Initial Recognition

You initially recorded this purchase as PP&E. You are not currently occupying the property; therefore, we need to account for this under *IAS 40 – Investment Property*.

IAS 40.05 defines an investment property as a “*property (land or a building — or part of a building — or both) held (by the owner or by the lessee as a right-of-use asset) to earn rentals or for capital appreciation or both, rather than for:*

- (a) use in the production or supply of goods or services or for administrative purposes; or*
- (b) sale in the ordinary course of business.”*

Since the two buildings are leased to tenants and PT earns rental income, they meet the definition of an investment property.

IAS 40.08 lists examples of investment property, specifically:

- (c) (c) “a building owned by the entity (or a right-of-use asset relating to a building held by the entity) and leased out under one or more operating leases.”*

Paragraph 16 states:

“An owned investment property shall be recognised as an asset when, and only when:

- (a) it is probable that the future economic benefits that are associated with the investment property will flow to the entity; and*
- (b) the cost of the investment property can be measured reliably.”*

PT is collecting rental income; therefore, criterion (a) is met, and we can reliably measure the cost, as PT just completed the purchase for \$2 million. Paragraph 20 states:

“An owned investment property shall be measured initially at its cost. Transaction costs shall be included in the initial measurement.”

Therefore, the initial accounting as an asset recorded at \$2 million is accurate. However, it should be presented as an investment property rather than as PP&E.

Subsequent Measurement

Paragraph 30 states:

“With the exception noted in paragraph 32A, an entity shall choose as its accounting policy either the fair value model in paragraphs 33–55 or the cost model in paragraph 56 and shall apply that policy to all of its investment property.”

Fair Value Model

Under this model, after initial recognition, the property would need to be accounted for at fair value. Assuming that the purchase was made at arm's length, it is likely that the \$2 million cost is also the fair value.

At each reporting date, we need to record a gain or loss resulting from the change in the fair value of the property. For example, if the current value is \$2.3 million at the next reporting date, we would increase the balance sheet value of the investment to \$2.3 million, and record a gain on the income statement of \$300,000 (\$2,300,000 - \$2,000,000).

Real estate properties are typically easy to value; you have already obtained a new appraisal of the property. The market is strong, so it is likely easy to obtain comparable sales, to support the fair value. However, the accounting is more complex with the fair value model than with the other option.

We also have to consider that, once you have elected to use the fair value model, you must continue to measure at fair value until disposal, or until there is a change in use. This is the case, even if the market is less strong and it becomes harder or more costly to value. You also need to use the same method for all of the investment properties that you might purchase in the future.

Cost Model

Under the cost model, you would record the property at cost, as you have done, and the cost model would continue to be used until the property is sold. You would follow the requirements in *IAS 16 – Property, Plant and Equipment* concerning the cost model.

Recommendation

Considering your small user base (just the partners), the uncertainty with the future use of the property, and the complexity of the fair value model, we recommend that you account for the property using the cost model. Note that under the cost model, the fair value will still need to be determined for disclosure purposes.

Depreciation

Under the fair value model, you would not depreciate the buildings; however, under the cost model, you would depreciate the cost of the buildings over their remaining estimated useful lives of 30 years. This is because, using the cost model, you follow IAS 16, and paragraph 30 states:

“After recognition as an asset, an item of property, plant and equipment shall be carried at its cost less any accumulated depreciation and any accumulated impairment losses.”

Therefore, under the cost method, depreciation of \$46,667 ($\$2,000,000 \times 70\%$ for buildings value \div 30 years) would be taken as of March 31, 2024. You do not depreciate the portion of the cost related to land under either method, as land is not a depreciable asset.

Change in Use

You have also asked for an explanation of how the property would be accounted for if you moved in. This would be considered a change in use, under paragraph 57 of IAS 40:

“An entity shall transfer a property to, or from, investment property when, and only when, there is a change in use. A change in use occurs when the property meets, or ceases to meet, the definition of investment property and there is evidence of the change in use. In isolation, a change in management's intentions for the use of a property does not provide evidence of a change in use. Examples of evidence of a change in use include:

(a) commencement of owner-occupation, or of development with a view to owner-occupation, for a transfer from investment property to owner-occupied property;”

Since you would only be using one of the buildings, we need to determine if this is considered a change in use. Paragraph 10 of IAS 40 states:

“Some properties comprise a portion that is held to earn rentals or for capital appreciation and another portion that is held for use in the production or supply of goods or services or for administrative purposes. If these portions could be sold separately (or leased out separately under a finance lease), an entity accounts for the portions separately. If the portions could not be sold separately, the property is investment property only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes.”

As the plan would be for PT to occupy one of the buildings, it seems that each building could be leased out separately under a finance lease, or perhaps even sold separately. It also seems that occupying one of the two buildings would be a significant portion of the property; therefore, occupying half of the property would be considered a change in use.

The portion that PT would occupy would now need to be accounted for under IAS 16, as property, plant, and equipment. The new cost of that half would be the fair value of that half of the property at the time that you move into it, if you choose to use the fair value model. As per paragraph 60 of IAS 40:

“For a transfer from investment property carried at fair value to owner-occupied property or inventories, the property's deemed cost for subsequent accounting in accordance with IAS 16, IFRS 16 or IAS 2 shall be its fair value at the date of change in use.”

However, if you choose to use the cost model, the new cost of that half would be the carrying amount of the property, as per paragraph 59 of IAS 40:

“When an entity uses the cost model, transfers between investment property, owner-occupied property and inventories do not change the carrying amount of the property transferred and they do not change the cost of that property for measurement or disclosure purposes.”

Lastly, we would also need to consider whether this would create deferred taxes.

For Assessment Opportunity #3 (Financial Reporting), the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Nominal competence – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to discuss the accounting treatment for the real estate investment.

Competent – The candidate discusses the accounting treatment for the real estate investment.

Competent with distinction – The candidate thoroughly discusses the accounting treatment for the real estate investment.

Assessment Opportunity #4 (Breadth Opportunity)

The candidate discusses the control weaknesses identified within the investment process, and provides recommendations.

The candidate demonstrates competence in Audit and Assurance.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core
4.1.1	Assesses the entity’s risk assessment processes	A
4.1.2	Evaluates the information system, including the related processes, using knowledge of data requirements and risk exposures	B

CPA Map Enabling Competencies:

2.2.2 Recognizes the importance of internal controls within areas of work responsibility

5.1.3 Develops and uses knowledge of the organization, industry and stakeholders

5.3.1 Assists in identifying opportunities for process, product and service improvements related to work functions

6.1.1 Identifies and articulates issues within areas of work responsibility

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

6.3.2 Articulates limitations to recommendations

You have asked for help with improving the controls in the investment process.

Investment Decisions

Weakness: The decision-making process is arbitrary; Rashad comes up with investment ideas, and there are only informal discussions or communications. Rashad once invested in an ice cream business because it was a hot day.

Implication: Investments may be made that are inconsistent with the company's objectives and are not meeting the expected rate of return, resulting in financial loss.

Recommendation: There should be a more formal process for evaluating and approving the investments, which should include more regular and formal meetings. Due diligence should be performed on the investments before any decision is made. At least two members of management should approve any investment decisions. They should also make sure that the investments are meeting the objectives stated. If there is a Board of Directors, significant investments should also be approved by the board. Documentation, such as minutes or emails, should be retained in order to support the decision-making process. A formal policy that outlines risk tolerances and formalizes the targeted expected rate of return should also be created and followed.

Investment Account Access

Weakness: Rashad can make investment decisions and execute the investments via an online broker, who has the ability to withdraw funds directly from PT's bank account. Rashad also has the ability to send electronic transfers on his own.

Implication: This results in a lack of segregation of duties in the investment process and a failure to safeguard the entity's assets. Rashad can execute the investment decisions, and even make payments, without another individual's involvement. This could result in financial loss to the company if Rashad chooses to invest in a business he owns personally, or just moves money directly into his own bank account. Also, as the broker can withdraw funds directly from the entity's bank account, the broker could also misappropriate entity assets.

Recommendation: Consider adding the requirement that only investments approved by two members of management can be made. Another alternative would be to determine if there is an option that would require two members of management to log into the brokerage account. If possible, deactivate the broker's ability to withdraw funds from PT's account, and see if you can add the requirement for two members of management to approve online payments. There should also be two members of management needed to issue electronic transfers. This would necessitate having another person involved in order to gain access to funds.

Divestment Decisions

Weakness: Rashad makes unilateral decisions to sell investments “when the time feels right.”

Implication: Divestments may not be optimized, resulting in the sale of investments that should be maintained, to help meet internal objectives. These decisions could result in financial loss.

Recommendation: The formalized investment policy should also address the disposal of investments. It should require two members of management to approve the divestitures.

Access to Investment Information

Weakness: The accounting department is informed of the investment decisions either incidentally, via email, or sometimes when completing the bank reconciliation (when trying to determine what withdrawals, transfers, or deposits are for). They also sometimes do not receive the broker statements in a timely manner.

Implication: This could result in missed information, causing inaccurate or incomplete initial recording of the investments and subsequent measurement, as the team in charge of producing the financial information is not informed of the investment decisions. Being informed of the decisions late in the process can also rush the accounting of the transactions, resulting in inaccurate or incomplete information in the financial statements. This has also resulted in the delayed release of the financial statements, causing frustration for the firm partners.

Recommendation: Someone from accounting should be included in the investment decisions communication, so that they are able to assess the accounting, and record transactions in an accurate and timely manner. Also, the accounting department should receive the broker statements directly, to increase segregation of duties and timeliness of information.

Cash Flow Management

Weakness: Rashad decides when to invest, and although he usually checks to see if PT has the funds needed for the investment, it appears that he does not always do this. Brigit once found out about an investment when the broker called, because his direct withdrawal could not go through due to insufficient funds.

Implication: There could be instances where the funds are not available for the investment, or where the funds taken for the investment were planned for something else, causing another payment to not go through due to insufficient funds. This could be costly for PT as there are usually fees for insufficient funds on payments, and it could also hurt PT's reputation with its vendors or its broker, or its employees, if payroll could not go through.

Recommendation: Before approving investment proposals, management should confirm that sufficient funds exist. In addition to checking the accounting records, management should always check with Brigit before making an investment, to ensure that sufficient funds are available, and that it can be integrated into the cash flow plan.

Segregation of Duties

Weakness: Rashad has access to issue funds from online banking and has access to the accounting system.

Implication: This provides an opportunity to issue funds and record related transactions, which are two incompatible functions. Rashad could issue funds for any reason (including personal reasons), and then record the transaction. This could go undetected by accounting or other partners in the firm.

Recommendation: The above recommendations regarding issuing funds (through the broker or via electronic transfer) will address this segregation-of-duties issue, and limit Rashad's ability to commit fraud. Requiring at least two members of management to authorize all banking disbursements will prevent Rashad's ability to issue funds for personal reasons.

For Assessment Opportunity #4 (Audit and Assurance), the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Nominal competence – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate identifies some of the control weaknesses and provides some recommendations for improvements.

Competent – The candidate discusses some of the control weaknesses and provides recommendations for improvements.

Competent with distinction – The candidate discusses several of the control weaknesses and provides recommendations for improvements.

Assessment Opportunity #5 (Breadth Opportunity)

The candidate assesses whether the potential investments meet PT's objectives.

The candidate demonstrates competence in Finance.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core
5.2.2	Evaluates the entity's investment portfolio	B

CPA Map Enabling Competencies:

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.2.1 Maintains an objective and questioning mindset to avoid biased analyses

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

You stated that you have the following objectives for the investment portfolio:

- Support initiatives that align with your strategy to optimize performance through the use of technologies and promote and enable flexible work arrangements;
- Low-to-moderate risk; and
- Meet the expected rate of return. It was noted that you hope to get a 6% annual return from your investments.

Costume Cryptocurrency

Strategy: Cryptocurrencies are tech-related, as they use technology as a method of payment. This is somewhat related to your strategy to optimize performance through the use of technologies. Although there is a link between your strategy and this investment, it is not a strong link. The use of cryptocurrencies will most likely not have an impact on optimizing the performance, as they cannot be integrated with the operations.

Risk level: Cryptocurrencies are highly volatile, and high-risk. Costume is a new coin, which increases the risk, as there is likely no established market at this time. Even if there were a market, there is no guarantee that this market will exist in the future, as coins sometimes get delisted. This is not in alignment with your risk objective. In addition, this would be a complex investment in an area where regulation is still being developed, which makes potential fraud more prevalent in this asset class.

Rate of return: While Rashad thinks the value will appreciate, considering that Costume is a new cryptocurrency with no history, we do not currently have sufficient information to assess the potential rate of return of this investment.

Conclusion: We do not recommend proceeding with this investment, as there is not a strong link to your strategy, and the risk level is higher than your target of low-to-moderate risk.

Virtual Vagabond

Strategy: Both you and Rashad like to work remotely as part of your business model. This company supports many workers who travel and require short-term office accommodations. This investment fits very well with your goal to support initiatives that align with your strategy to promote and enable flexible work arrangements.

Risk level: This business is in a different industry than you are used to (travel versus professional services), which can be risky as you are not as familiar with the business drivers and you might not be able to assess whether the business is doing well; however, they do have a strong earning history, and they would like to go public. The fact that they want to go public increases the risk, since there would be a strong motivation for misstatements in the financial information provided. In addition, if they do not go public, liquidity could be an issue, if things are not going as planned, or if PT wants to cash in on its investment. This is therefore a moderate-to-high risk investment, and would not meet the objective in terms of risk level.

Rate of return: At this time, we do not have enough information to calculate the rate of return. As the company is private, it would be harder to value if we did make the investment. However, if they go public, this would be easier to calculate. They are also planning to pay dividends, which could lead to a positive return.

Conclusion: Although this company aligns well with your objectives, at this point, we cannot be sure that it will generate a 6% return. If you do decide to invest, I would recommend you do so with caution.

Loan

Strategy: This company uses web-based tools to help their clients, which fits well with your strategy to optimize performance through the use of technologies.

Risk level: Bookkeeping and financial statement preparation are all fairly stable industries. Farming could be a little riskier, and collectability could be an issue for the consulting company. This would meet the risk level target of low-to-moderate risk.

Rate of return:

Item	Value	Calculation
Initial investment	\$50,000	
Term	3 years	
Future value	\$58,000	(\$50,000 repayment + \$8,000 in interest at the end of Year 3)
Rate of return	5.1%	= RATE (NPER=3, PMT=0, PV=\$50,000, FV=(\$58,000), TYPE=0)

This is less than the annual rate-of-return objective of 6%.

Conclusion

Since none of these options are suitable, as none meet all of your objectives, you should be looking for different investment options. However, if you really want to go with one of these options, the loan is the most suitable of the three options presented. Although there is a lower rate of return, the company's business model fits with your investment strategy, making this an attractive investment that meets your strategic objectives.

For Assessment Opportunity #5 (Finance), the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Nominal competence – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to assess whether the investments meet PT's objectives.

Competent – The candidate assesses whether the investments meet PT's objectives.

Competent with distinction – The candidate thoroughly assesses whether the investments meet PT's objectives.

Assessment Opportunity #6 (Breadth Opportunity)

The candidate prepares a business valuation of Westley.

The candidate demonstrates competence in Finance.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core
5.4.2	Applies appropriate methods to estimate the value of a business	B

CPA Map Enabling Competencies:

5.1.1 Applies general business knowledge to enhance work performed

6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

6.1.3 Demonstrates skepticism, objectivity, due care and persistence when identifying issues

6.2.1 Maintains an objective and questioning mindset to avoid biased analyses

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

You have asked me to calculate the value of Westley Legal (Westley). You mentioned that law firms are typically valued using a 2 to 3 times EBITDA earnings multiplier.

The first step would be to calculate EBITDA:

Income before tax:	\$450,000
Add: Interest expense	3,600
Add: Amortization	<u>70,000</u>
EBITDA:	\$523,600

We then need to consider if there are any adjustments required that would not be representative of continuing operations, in order to normalize the EBITDA.

Last year was unusual, as there was an insurance claim; therefore, there is a gain of \$10,000 included in income. This should be deducted from EBITDA, as it is not representative of a normal year's revenue.

Adam also noted that revenue was down from the prior year by 3%, due to a personal health issue. There could be an argument for increasing EBITDA by 3%, or revenue by 3%, if we think that the expenses would remain the same, even if the revenue was lost, as that would be a better representation of actual earnings. However, Westley also lost a major client around the same time, which might explain the income drop. As the client moved on, future income related to this client should likely not be included in the EBITDA; therefore, I have not adjusted for the 3% drop in income, as the current figure is probably more representative of future earnings.

In addition, Adam is taking a lower-than-average salary (\$100,000 versus \$250,000). This means that EBITDA should actually be lower by \$150,000. I have normalized EBITDA to include a salary of \$250,000 rather than \$100,000, so that the business value is more indicative and comparable.

Westley also pays Adam's son a salary of \$50,000 for administrative duties. We should consider whether this is a reasonable salary for the work provided. I will leave it in the initial calculation at this time, but this may be an area for negotiation.

Included in expenses are payments for two office leases. Adam stated that he is ready to retire and spends time in Florida, although Westley's clients are in Canada; therefore, it is unlikely that the Florida rental space is required, as this was probably an office only for him. I suggest that we normalize EBITDA for this amount: $\$2,000 \times 12 \text{ months} = \$24,000$.

Here is the normalized EBITDA calculation:

EBITDA	\$523,600
Normalization items:	
Less: Insurance claim	(10,000)
Add: Revenue loss due to illness	nil
Less: Additional salary	(150,000)
Add: Son's salary	nil
Add: Florida office	<u>24,000</u>
Normalized EBITDA	\$387,600

Earnings multipliers: 2 to 3 times EBITDA

Price range: \$775,200 to \$1,162,800

Average: \$969,000

Conclusion

Westley's enterprise value ranges between \$775,200 and \$1,162,800. As there are no long-term debts or redundant assets, this enterprise value is also the equity value. Since Adam has had many of the same clients for over 15 years, some of these clients might leave Westley once Adam retires, as they will no longer be able to deal with Adam. Therefore, although the average of the range calculated is \$969,000, the actual value might be closer to the lower end of the range.

For Assessment Opportunity #6 (Finance), the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Nominal competence – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to prepare a business valuation of Westley.

Competent – The candidate prepares a business valuation of Westley.

Competent with distinction – The candidate prepares a thorough business valuation of Westley.

**COMMON FINAL EXAMINATION
SEPTEMBER 12, 2024 – DAY 3**

Case #3

(Suggested time: 70 minutes)

It is February 8, 2024. You, CPA, are the new controller of Prairies Wheel Company (Prairies), and are meeting with Marta Licht, the new CFO. Prairies is a bicycle manufacturing company renowned for its high-quality products, and is located in a remote industrial area near Calgary, Alberta. Prairies was acquired by Tulip Pedals Inc. (Tulip), a public Dutch company in the bicycle industry, on January 1, 2024. Marta has just arrived in Canada from the Netherlands, and is still getting familiar with Canadian tax laws and accounting standards.

“Nice to meet you, CPA. I used to work at Tulip’s corporate office, and am here to increase Prairies’ profits, now that it makes up nearly 40% of Tulip’s consolidated sales. Prairies has not been operating at full capacity, and we have opportunities to expand our product offerings (Appendix I). Please analyze the opportunities and recommend one.

“Tulip has its own vision, mission, and objectives statements (Appendix II). Please compare them to Prairies’ business practices and the way it currently manages its operations, and identify areas where Prairies is aligned with Tulip, areas where it is not, and what might need to change at Prairies in order to fit with Tulip. I gathered some social media comments provided by Prairies’ employees (Appendix III).

“Tulip has a very competitive compensation plan that we are eager to provide to Prairies’ employees (Appendix IV). Please review the plan, explain whether each feature will be effective in incentivizing Prairies’ employees, and provide recommendations for improvement.

“Being from the Netherlands, I do not understand the Canadian GST/HST system. Please provide me with an overview. Also, when do we need to file our GST/HST return and make our payments? Are we on track with deadlines? What are the consequences if we are late? Can you also explain the corporate income tax filing and payment deadlines, as well as instalment requirements? I prepared some related financial information (Appendix V).

“Our bank now requires Prairies to submit audited financial statements as part of our loan agreement, so the audit of the December 31, 2023, financial statements will be Prairies’ first audit. Please provide me with a report that includes an assessment of risks of material misstatement at the overall financial statement level, an explanation of what the auditor’s materiality assessment will likely be, and a discussion of the expected audit approach. As we say, “Time is money, so let’s get to work—a little overtime never hurt anybody.”

APPENDIX I PRODUCT OFFERING OPPORTUNITIES

By adding shifts (paid at the regular rate), Prairies has up to 800 additional labour hours available per month, and we are considering two options for using them. Tulip has perfected the Cit-E-Bike, a commuting-style electric bike, and could manufacture and sell this bike here in Canada. Alternatively, we could manufacture SnoTrax, which are snow tracks that you can swap for regular tires, to use your bike in the snow.

Nowadays, it is difficult to find general labourers, and it is even harder to find specialized technicians. We pay our general labourers \$35 per hour. Utility charges are \$5 per labour hour. We will allocate approximately \$40,000 of annual overhead costs to whichever product we decide to manufacture.

Cit-E-Bike

Based on our European sales and manufacturing data, we estimate that we could sell all bikes produced, at \$2,000 each. The electrical components will require an inspection by a specialized electrical technician, which will cost us \$100 per bike. Parts for the bike are shipped from China; estimated shipping costs to Canada are \$4 per bike.

SnoTrax

SnoTrax would be a new product for both Prairies and Tulip. Prairies started working on this project prior to being acquired by Tulip, based on an idea from an employee. We previously spent \$50,000 on design and prototyping. We estimate that we can sell all of the SnoTrax produced, at \$900 for each set of two tracks. We have received interest from Canadian ski resorts. No specialized technicians are required in the manufacturing process. All materials would be sourced from Canada, with a shipping cost of \$3 per set.

Additional Information

Description	Cit-E-Bike	SnoTrax
Parts cost	\$1,200 per unit	\$450 per set
General labour hours required	5 hours per unit	3 hours per set
Estimated monthly demand	1,000 units	2,000 sets

APPENDIX II TULIP'S STATEMENTS

Vision

To be a growth-focused, global bicycle business that provides innovative and sustainable mobility solutions in order to create a world where cycling is the preferred mode of transportation.

Mission

To design, manufacture, and distribute high-quality products with cycling technology that is efficient, reliable, and sustainable, and to exceed customer expectations by delivering exceptional products while promoting the values of hard work, direct feedback, and innovation with our employees.

Corporate Objectives

- Expand to new countries: Leverage hard work, expertise, and resources, to identify new market opportunities.
- Foster green business practices: Promote sustainable business practices that reduce waste, conserve energy, and use eco-friendly materials and processes.
- Innovate through efficiency: Continuously improve the efficiency and performance of our cycling technology by investing in research and development, and adopting cutting-edge technologies.

APPENDIX III SOCIAL MEDIA COMMENTS FROM PRAIRIES' EMPLOYEES

The following comments are a good summary of the comments we have seen online, and are reflective of what we have observed at Prairies.

“Prairies was named the top employer in Alberta because of its *people-first* culture. They encourage work-life balance, making sure working conditions exceed regulations, even if it means less production.”

“At Prairies, we have strategy sessions, where we ask questions like, “Should we even stay in the bicycle market?” It is great to explore other ideas—it’s not all about bikes.”

“I was on the sustainability committee at Prairies. We came up with great ideas for reducing our carbon footprint, but it is really too bad that every employee still drives to work.”

“Prairies is a great local company, filling local needs. We only sell in Alberta, and pride ourselves on understanding the Calgary market.”

“I was fired from Prairies but never had a performance review or feedback, which is too bad, as I loved the high, stable salary. I do not miss month-end though—I worked in the accounting department, and we were always rushed to make correcting entries, sometimes having to correct entries from previous months or years.”

**APPENDIX IV
TULIP'S COMPENSATION PLAN FOR PRAIRIES**

Base salaries would be slightly below market rates; however, employees would get a generous bonus if certain objectives are met. For each objective achieved, employees would obtain a specified percentage of the maximum bonus.

Prairies' Objective	Target Measure	% of Bonus
Expand to new countries	10% increase in sales to new countries	20%
Foster green business practices	20% reduction in carbon footprint	30%
Innovate through efficiency	10% improvement in labour efficiency variance	25%
Increase overall profitability	5% increase in net income	25%

In addition:

- Employees who bike to work would receive an extra \$100 per month.
- Every employee could get reimbursed up to \$2,000 per year for health and wellness expenses.

APPENDIX V
PRAIRIES' 2023 FINANCIAL INFORMATION

Description	Amount	Note
Total assets	\$ 7,215,000	1
Net assets	\$ 3,250,000	
Estimated taxes payable	\$ 43,000	2
Sales	\$ 4,350,000	
Expenses	\$ 3,958,500	
Income before tax	\$ 391,500	

Notes:

1. Inventory and PP&E make up most of the asset balance.
2. We estimate taxes payable to be \$43,000, which is the same as it was last year. Prairies' last income tax instalment payment of \$10,750 was made on September 30, 2023. The last GST/HST filing was done for the quarter that ended on September 30, 2023.

Alberta charges only GST, at 5%.

MARKING GUIDE 3-3
PRAIRIES WHEEL COMPANY (PRAIRIES)
ASSESSMENT OPPORTUNITIES

To: Marta Licht, CFO
 From: CPA
 Subject: Advice on several issues

Assessment Opportunity #1 (Depth and Breadth Opportunity)

The candidate analyzes the expansion opportunities and provides a recommendation.

The candidate demonstrates competence in Management Accounting.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core
3.5.2	Evaluates sustainable profit maximization and capacity management performance	A

CPA Map Enabling Competencies:

6.1.2 Uses quantitative and qualitative techniques to clarify the nature of problems

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Quantitative Analysis

To determine which option is the most profitable, we first need to compute the contribution margin (CM) per unit.

Item	Cit-E-Bike (\$)	SnoTrax (\$)	Note
Selling price per unit	2,000	900	
Variable costs per unit:			
Parts	1,200	450	
Labour – general	175	105	1
Labour – specialized	100	0	
Utilities	25	15	2
Parts shipping	4	3	
Total variable costs	1,504	573	
Contribution margin per unit	496	327	

Notes:

1. Cit-E-Bike: 5 hours × \$35 per hour
SnoTrax: 3 hours × \$35 per hour
2. Cit-E-Bike: 5 hours × \$5 per hour
SnoTrax: 3 hours × \$5 per hour

The design and initial prototype costs for SnoTrax are considered a sunk cost, and are not included in the analysis.

The overhead costs of \$40,000 are irrelevant to this analysis, as these are an allocation of general costs that would have been incurred anyway. They have not been taken into account in the analysis.

This analysis shows that the Cit-E-Bike is more profitable per unit. However, we have been informed of a resource constraint: there are only 800 labour hours available per month. To determine which is the best product to manufacture, Prairies will need to maximize the contribution margin per labour hour.

Cit-E-Bike: $\$496 \div 5 \text{ labour hours} = \99.20

SnoTrax: $\$327 \div 3 \text{ labour hours} = \109.00

From a quantitative perspective, the SnoTrax is the most profitable option. SnoTrax has the higher contribution margin per hour, and will therefore make the best use of the constrained labour hours.

Qualitative Analysis

The following qualitative factors should be considered:

- The Cit-E-Bike sales volume and price information is based on European data. Canada is a much larger country with a lower population density; we might not be able to sell the same volume in Canada as would be sold in the Netherlands. We should complete additional research to ensure that our estimates are appropriately supported, as it could change the results of our analysis.
- Canada has a more extreme climate than the Netherlands. We should ensure that the sales estimates will translate to Canada, since e-bikes cannot be used all year round in some parts of Canada, which might translate to fewer sales.
- All SnoTrax parts come from Canada, as opposed to China. As the shipping distance will be reduced, this is in line with your objective to promote sustainable business practices that reduce the environmental impact.
- SnoTrax is a new product; therefore, the estimates are not supported by any actual sales. We should ensure that the estimates are as accurate as possible, as they could affect the results.

- If SnoTrax is successful, there might be the potential to sell it in Tulip's market in the future. Tulip's corporate objective includes expanding to new countries and regions. There are many snow-covered regions; therefore, SnoTrax could help with expansion into other cold climates.
- Although we are currently limited by capacity, it seems that the SnoTrax market is bigger than the Cit-E-Bike market, since we think that we could sell twice as many units of SnoTrax (2,000 versus 1,000). If we eventually decide to acquire more capacity, the SnoTrax is still the best option in an environment where capacity is no longer a constraint.
- The Cit-E-Bikes require specialized labour, and as it is difficult to find specialized technicians these days, this might be an issue compared to manufacturing SnoTrax, which do not require specialized labour.

Recommendation

Based on the quantitative and qualitative factors, we recommend pursuing SnoTrax, as it maximizes profit per labour hour and aligns with the corporate objectives.

For Assessment Opportunity #1 (Management Accounting), the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Nominal competence – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to analyze the expansion opportunities.

Competent – The candidate analyzes the expansion opportunities and provides a recommendation.

Competent with distinction – The candidate thoroughly analyzes the expansion opportunities and provides a recommendation.

Assessment Opportunity #2 (Breadth Opportunity)

The candidate discusses the strategic fit of Prairies' business practices, and the way it currently manages its operations, with Tulip's vision, mission, and objective statements.

The candidate demonstrates competence in Strategy and Governance.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core
2.2.1	Assesses whether management decisions align with the entity's mission, vision, and values	B
2.4.1	Analyzes key operational issues including the use of information assets and their alignment with strategy	B

CPA Map Enabling Competencies:

5.1.1 Applies general business knowledge to enhance work performed

5.1.2 Recognizes the interrelationships among departmental and functional areas within the organization

5.1.3 Develops and uses knowledge of the organization, industry and stakeholders

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

I have assessed Tulip's vision, mission, and objective statements in terms of their fit with Prairies. Throughout the statements, I noted the following key themes.

Global Business / Expand to New Countries

Prairies is a local company, filling local needs, and prides itself on understanding the Calgary market. Prairies employees are not used to dealing with companies outside of Prairies' geographical region. While acquiring Prairies was a good strategic fit for Tulip, it might be difficult for Prairies' employees to adapt to dealing with an international owner. This is an area that will need to be worked on internally at Prairies, to foster a sense of global interest. We could do this by showing employees the benefits of a wider reach, such as the opportunity to work in different countries, and to learn how work practices and technology in other countries could benefit Prairies.

Sustainable/Green Business Practices

Like Tulip, Prairies prioritizes environmental sustainability and green business practices; it has a sustainability committee. This is not an area that will have to change, but we have opportunities to maintain this, such as by selecting SnoTrax for the expansion opportunity due to the lower shipping distances for materials.

Innovation

A Prairies employee had the idea for SnoTrax, which was innovative; Prairies was going to pursue this opportunity prior to the acquisition. This shows that it fosters an innovative culture, which is a fit with Tulip. By pursuing SnoTrax, Prairies can show that it appreciates innovation. Prairies should continue to listen to ideas from employees, and consider them for future business opportunities.

Cycling Focus / Preferred Mode of Transportation

While Prairies is a bicycle company, an employee stated that it is not just all about bikes. They stated that Prairies has a people-first culture, and holds strategy sessions, where they ask questions such as whether they should even stay in the bicycle market. Tulip's vision is to create a world where cycling is the preferred mode of transportation, and offers additional compensation to employees who ride their bikes to work. We have noted that every Prairies employee still chooses to drive their vehicles to work. There is some cultural training that may need to occur, such as explaining the benefits of the use of bicycles, and how they can tie in with innovation and sustainability.

High Quality

Prairies is renowned for its high-quality products, which is in line with Tulip's mission statement: to distribute high-quality products with cycling technology. There is likely no cultural training required in this area; however, we should ensure that quality standards are maintained during the transition and in the future.

Hard Work and Efficiency

Prairies has been described as a people-first company, fostering people, even at the expense of production. There may be a cultural difference in this area, as Tulip's mission statement noted the value of hard work, and you seem to encourage working overtime, with your statement that a little overtime never hurt anybody. It is not clear if this would be at the cost of workers. It might be difficult to find and retain employees if too much emphasis is put on production at the expense of the employees' well-being and work-life balance. We should ensure that Prairies workers understand the importance of production and efficiency metrics, but that their work-life balance and well-being are still important. It is important to maintain employee engagement, as happy workers are likely to continue making high-quality products and sharing ideas for innovation, which are other key attributes in Tulip's vision, mission, and objective statements.

Direct Feedback

One Prairies employee stated that they had not obtained feedback prior to being terminated, and that seems to be representative of the comments you have observed. This appears to be a departure from the direct feedback that is part of Tulip's mission statement. We should provide training to leaders at Prairies, explaining the value of providing direct and accurate feedback to employees. This can lead to more efficient work practices and high-quality products. This will also contribute to happier employees, which could contribute to employees working harder, as per the above paragraph.

Continuous Improvement

Prairies hosts strategy sessions, where they explore new ideas. This would indicate that continuous change and improvement are also important to Prairies. We also discovered that Prairies is not the best at providing feedback to workers. Although not a total mismatch, there is likely some additional training that will be required, such as explaining the benefits of feedback in the context of continuous improvement, and exploring some other methods for identifying process inefficiencies in order to improve quality and efficiency, which are also both important.

For Assessment Opportunity #2 (Strategy and Governance), the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Nominal competence – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to discuss the strategic fit of Prairies' business practices, and the way it currently manages its operations, with Tulip's vision, mission, and objective statements.

Competent – The candidate discusses the strategic fit of Prairies' business practices, and the way it currently manages its operations, with Tulip's vision, mission, and objective statements.

Competent with distinction – The candidate thoroughly discusses the strategic fit of Prairies' business practices, and the way it currently manages its operations, with Tulip's vision, mission, and objective statements.

Assessment Opportunity #3 (Depth and Breadth Opportunity)

The candidate explains whether Tulip’s compensation plan will be effective in incentivizing Prairies’ employees, and provides recommendations for improvement.

The candidate demonstrates competence in Management Accounting.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core
3.7.1	Analyzes the implications of management incentive schemes and employee compensation methods	A

CPA Map Enabling Competencies:

- 5.1.1 Applies general business knowledge to enhance work performed*
- 5.1.2 Recognizes the interrelationships among departmental and functional areas within the organization*
- 5.1.3 Develops and uses knowledge of the organization, industry and stakeholders*
- 6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions*

You have requested that I review Tulip’s compensation plan, explain whether it will be effective in incentivizing Prairies' employees, and provide recommendations for improvement.

Below-Market Salary

Tulip’s compensation plan puts more focus on the bonus, which is linked to performance, and less on the salary. This can motivate employees to achieve corporate objectives. However, employees have noted that they appreciate working at Prairies because of their high, stable salaries. This may not be a fit for some existing employees, who rely on the stability of their income, and may not appreciate receiving a lower salary in exchange for a variable bonus scheme. There may also be employment agreements in place at Prairies, and it may not be possible to lower salaries.

Until we have the opportunity to assess how that will impact Prairies' employees, we should not rush into a salary cut. There is a labour shortage, and if we want to expand, we should ensure that we can at least retain the current employees.

Objectives and Target Measures

While achieving the objectives stated in the bonus structure will incentivize employees to work towards those objectives, some of the target measures may not be appropriate for Prairies.

Expand to new countries

The target to increase sales internationally may not be within Prairies' ability. Prairies is a popular local brand, and the expansion opportunity for SnoTrax would help it grow within Canada (based on the initial interest from Canadian ski resorts), not internationally. However, if SnoTrax proves profitable, there are many other cold-climate countries that may be interested in the product; this could help Prairies' role in international growth, perhaps using Tulip's contracts and distribution channels in other countries. It is unclear if Prairies has the authority to expand the business through foreign acquisitions, which is another way to expand sales. Perhaps the target should be to expand sales to new geographical areas outside of Calgary. This will encourage growth, but also be more achievable for Prairies.

Foster green business practices

The metrics that are used to calculate the carbon footprint should be clarified, since it is a generic term. This part of the bonus is likely to resonate well with Prairies' staff. They have a sustainability committee, so are also interested in reducing the carbon footprint. However, for Prairies, this objective might contradict with the objective to expand to new countries. While Tulip can acquire subsidiaries and produce the bicycles locally in new countries, Prairies, as a subsidiary, might not be able to expand through acquisitions. This means that Prairies would have to produce locally and ship internationally, which would make it difficult to reduce the shipping distance, given the size of Canada. Even within Canada, it could be difficult to reduce the shipping distance, given the long distance between Calgary and Newfoundland, for example. It might therefore be difficult for the staff at Prairies to understand how they can help reduce the carbon footprint. If we decide to move ahead with SnoTrax, this would be a good opportunity to help lower the carbon footprint, as there are no international shipping needs on the production side.

Innovate through efficiency

This objective addresses two items: innovation and efficiency.

Innovation:

There are currently no metrics that deal specifically with innovation. While the labour efficiency variances could improve with innovation, we also want to reward big ideas that help achieve other objectives, such as profitability, green business practices, and market expansions. We could add additional metrics to this objective, such as the number of new ideas implemented, as the idea for SnoTrax came from a Prairies employee.

Efficiency:

Labour efficiency variances are a good measure for efficiency; however, there may be some issues with applying this to Prairies. Prairies is known for its people-first value, even at the expense of production. This could be a difficult cultural shift.

Increase overall profitability

Net income is a figure that can include items that are not directly related to actual employee performance, such as impairments, taxes, customer write-offs, etc. Perhaps a better measure of profitability could be used, such as gross margin, or a combination of the components of the gross margin, such as sales units, sales price, and reduced costs, where there is less influence from financial reporting and more focus on actual results. A measure such as gross margin can also balance increases in sales with decreases in costs, which makes it harder to manipulate. If we use the components of the gross margin, each component can be tied to an individual's roles, such as salespeople being linked to units or pricing, and manufacturing linked to reduced costs. As the employee's ability to impact the overall goal increases, each employee's buy-in will increase.

In addition, all employees have the same targets, regardless of their role in the company. This reduces employees' incentive to improve on those elements that they can control or influence. It also increases the possibility of an employee being blamed for something outside of their control. Therefore, the targets should be tailored to the role of each category of employee.

Bike Transit Allowance

As Prairies is a bicycle company, and as bike transit would burn fewer fossil fuels and help reduce the carbon footprint, this perk would likely prove popular. However, we should consider that:

- Prairies is located in a remote industrial area in the city, and may not have the most efficient bike infrastructure.
- Calgary has a cold climate, and snow, in the winter, so commuting by bike in the snow and ice could be dangerous. However, the SnoTrax could make it possible, if you go ahead with that option.

An alternative to this could be to offer a carpool incentive for the winter, or to pay for bus passes, or provide free or discounted bikes, which would achieve the same goal but could be more regionally appropriate.

Additionally, this measure could be hard to quantify—how would we know that people are riding their bike to work, and how many bike trips per month would be required, to qualify for the allowance?

However, if we proceed with the SnoTrax option, we could give employees access to SnoTrax at a discount, which could incentivize them to bike to work, even when there is snow on the ground.

Health and Wellness Expense Reimbursement

This is a good fit for Prairies; work-life balance is important, and reimbursing employees for up to \$2,000 per year for health and wellness expenses supports employees' well-being.

Additional Recommendations

All of the target measures are currently related to the performance of Prairies. It could be worthwhile having a portion of the bonus that is only related to each individual's performance, so that there is a more direct incentive to perform well at their job. High-performing individuals in the company may do outstanding work; however, if the company does not perform well as a whole, they could end up with no bonus and lower-than-market compensation. By having a personal performance section, employees will still be incentivized to do their best at work.

For Assessment Opportunity #3 (Management Accounting), the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Nominal competence – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to explain whether Tulip's compensation plan will be effective in incentivizing Prairies' employees.

Competent – The candidate explains whether Tulip's compensation plan will be effective in incentivizing Prairies' employees, and provides recommendations for improvement.

Competent with distinction – The candidate thoroughly explains whether Tulip's compensation plan will be effective in incentivizing Prairies' employees, and provides recommendations for improvement.

Assessment Opportunity #4 (Breadth Opportunity)

The candidate provides an overview of the Canadian GST/HST system, and provides information on GST/HST and income tax compliance.

The candidate demonstrates competence in Taxation.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core
6.4.1	Evaluates adherence to compliance requirements	B
6.7.1	Discusses the GST system in Canada	C
6.7.4	Discusses GST compliance requirements	B

CPA Map Enabling Competencies:

6.1.1 Identifies and articulates issues within areas of work responsibility

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

6.3.2 Articulates limitations to recommendations

You have asked several questions about GST/HST and corporate tax compliance. I have provided the answers below.

Overview of the Canadian GST/HST System

In Canada, GST stands for Goods and Services Tax, which is a 5% federal tax charged on most goods and services sold or provided in Canada. In participating provinces, of which Alberta is not one, HST is Harmonized Sales Tax, which includes a provincial component in addition to the 5% GST.

GST/HST is a value-added tax, similar to other value-added taxes around the world. Prairies has to collect the GST/HST on sales and is responsible for remitting it to the Canada Revenue Agency (CRA). However, Prairies can also claim input tax credits (ITCs) for GST/HST paid on purchases. The net of the GST/HST collected, less ITCs, is remitted periodically, and the remittance frequency is based on the amount of revenue for the period.

GST Filing and Payment Timing

Businesses that make more than \$1.5 million and less than \$6 million in annual revenue must file and pay GST/HST quarterly. Therefore, since Prairies' 2023 sales were \$4.35 million, we needed to file and pay on a quarterly basis. Quarterly filers must file and pay one month after the reporting period. The last GST/HST filing was done for the period that ended on September 30, 2023. Therefore, we need to file the return and remit GST/HST for the period that ended on December 31, 2023. As it is early February, the return for the period that ended on December 31, 2023, is late.

GST/HST Late Filing Consequences

The penalty for late filing of a GST/HST return is 1% of the amount owing plus $0.25\% \times$ the number of complete months that the return is late. For example, if we file the December 31, 2023, return immediately, the late-filing penalty will be only 1%, but if we file it in March, it will be 1.25%.

In addition, as we owe GST/HST and are late, we will have to pay interest at the prescribed rate.

Corporate Income Tax Filing and Payment Deadlines

Corporate tax returns must be filed within six months of year end. As we have a December 31 year end, we must therefore file our tax return by June 30 of the following year. If we owe corporate income taxes, we must remit them within three months of our year end, assuming that Prairies is a qualifying CCPC for the year ended 2023. This means that, even if we do not have our 2023 tax return done by the end of March 2024, we will still need to compute our taxes payable so that we can pay on time. It is early February, so we will have adequate time before the deadline to calculate whether we owe any taxes.

Starting in 2024, Prairies will not be a CCPC because it is controlled by a Dutch public company; therefore, Prairies will need to make its final payment within two months of its year end, that being February 28, 2025, for the December 31, 2024, taxation year.

Corporate Income Tax Instalment Requirements

Generally, corporations must pay their taxes in monthly or quarterly instalments, but only eligible CCPCs can pay quarterly, so Prairies will now have to pay monthly.

There are three options we can use in order to calculate the least amount of tax you have to pay in instalments for the current tax year. We can base the instalments on one of:

- the current year
- the previous year
- a combination of the previous year and the year before the previous year

The CRA does not issue instalment payment reminder notices. We are responsible for calculating and remitting our own instalment payments.

Since we are no longer a CCPC, we will more than likely have more taxes to pay at the end of 2024 than we did for 2023. As the estimated taxes payable for 2023 and the taxes payable for 2022 are both \$43,000, it seems that \$43,000 will be the amount we will use as a base for calculating the instalments. The amount of \$43,000 exceeds the \$3,000 threshold, for which no instalments would be required. For 2024, we should make instalment payments of \$3,583 per month ($\$43,000 \div 12$).

For 2023, as Prairies was still a CCPC, it had the option to pay quarterly, and would have been required to make instalment payments of \$10,750 per quarter ($\$43,000 \div 4$). It appears that these quarterly payments were made up to and including September 30, 2023. However, a final instalment payment would have been due on December 31, 2023.

As we have not made the December 31, 2023, instalment payment at this time, we should make it as soon as possible, to mitigate interest. Interest on the outstanding instalment will be charged at the prescribed rate, and can be reduced by making the payment as soon as possible. As of today, February 8, 2024, interest has been accruing for 38 days. At a prescribed rate of 10% (4% + 6%) for late payments, compounding daily, the current interest owing is \$126.53.

If the interest owing on the late instalment exceeds \$1,000, late-instalment penalties may also apply, but given the short amount of time that the instalment has been outstanding, this is not the case.

For Assessment Opportunity #4 (Taxation), the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Nominal competence – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to provide an overview of the Canadian GST/HST system, and information on GST/HST or income tax compliance.

Competent – The candidate provides an overview of the Canadian GST/HST system, and information on GST/HST or income tax compliance.

Competent with distinction – The candidate provides an overview of the Canadian GST/HST system, and information on GST/HST and income tax compliance.

Assessment Opportunity #5 (Breadth Opportunity)

The candidate discusses the components of an audit plan.

The candidate demonstrates competence in Audit and Assurance.

CPA Map Technical Competencies (based on the 2022 CPA Competency Map):		Core
4.3.4	Assesses materiality for the assurance engagement or project	B
4.3.5	Assesses the risks of the project, or, for audit engagements, assesses the risks of material misstatement at the financial statement level and at the assertion level for classes of transactions, account balances, and disclosures	B
4.3.6	Develops appropriate procedures, including Audit Data Analytics (ADA), based on the identified risk of material misstatement	B

CPA Map Enabling Competencies:

6.1.3 Demonstrates skepticism, objectivity, due care and persistence when identifying issues

6.2.1 Maintains an objective and questioning mindset to avoid biased analyses

6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

You have asked for an assessment of the risks of material misstatement at the overall financial statement level, an explanation of what the auditor's materiality assessment will likely be, and a discussion of the expected audit approach.

Risks of Material Misstatement at the Overall Financial Statement Level

To assess the risks of material misstatement at the overall financial statement level, the auditors will consider some of the following items.

- You are new to the business and to Canada, and are still getting familiar with Canadian tax laws, accounting standards, and the GST/HST system. This means that you are less likely to identify accounting errors in the financial statements during your review. As the new controller, the business is also new to me. This increases risk.
- This is a first-time audit for Prairies. This means that opening balances, such as PP&E and inventory, which are more than likely significant portions of total assets, could contain errors. This increases risk.
- You have a goal of increasing profits, so there might be a risk of financial statement manipulation, to show higher profits and prove that you are doing a good job.
- From the reviews we read, it looks like the accounting department is always in a rush to make correcting entries at the end of the month. This is indicative of a weak control environment, which increases risk.

The auditors will be required to respond to the above risks during the audit by performing audit procedures that address those risks. The auditors will also be required to identify risks at the assertion level for classes of transactions, account balances, and disclosures, and they will perform audit procedures that address those risks as well.

Materiality

The primary users of the statements are as follows:

- Tulip is a public company; Tulip's shareholders will be interested in Prairies' net income, as Prairies is a significant portion of Tulip's consolidated financial statements.
- Prairies has a loan with a bank, who is another user of the financial statements. They will be concerned with Prairies' cash flow, to assess its ability to repay the loan; net income is a good starting point for assessing cash flows.

Prairies is a profit-oriented business, and all of the users above would be interested in its ability to generate profit. Accordingly, net income is an appropriate basis for materiality.

CAS 320.A8 states that:

“Determining a percentage to be applied to a chosen benchmark involves the exercise of professional judgment... For example, the auditor may consider five percent of profit before tax from continuing operations to be appropriate for a profit-oriented entity in a manufacturing industry, while the auditor may consider one percent of total revenue or total expenses to be appropriate for a not-for-profit entity. Higher or lower percentages, however, may be deemed appropriate in the circumstances.”

Calculating materiality is a matter of professional judgement. The auditor may consider that 5% is recommended for profit-oriented entities, and because there are no other factors to suggest that the users of the financial statements are extremely sensitive to errors, the auditors will likely use 5% of net income.

Net income before tax is $\$391,500 \times 5\% = \$19,575$.

Materiality is likely to be around \$19,000.

Performance materiality is calculated at an amount lower than materiality, to ensure that aggregated misstatements do not exceed overall materiality. According to CAS 320, performance materiality means *“the amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce aggregation risk to an appropriately low level.”* Aggregation risk is further defined in CAS 600 as *“the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole.”* Although it is also a matter of professional judgment, the acceptable range for performance materiality is 50% to 90% of overall materiality. Given that this is a first-year audit (so there may be significant misstatements in opening balances), it is expected that the auditors will select a percentage at the lower end of the range (65%), resulting in performance materiality of \$12,350 ($\$19,000 \times 0.65$).

Audit Approach

The auditors will want to understand our business and control environment. There are some indications that Prairies does not have established, functioning controls:

- We have had staff turnover in the group, as you are the new CFO and I am the new controller.
- The review states that there is a history of errors and that they “were always rushed to make correcting entries, sometimes having to correct entries from previous months or years.”

- We are also late in remitting GST/HST, which is a sign that controls for following tax regulations were not in place.

Based on these factors, it is likely that the auditors will take a substantive approach to the audit.

For Assessment Opportunity #5 (Audit and Assurance), the candidate must be ranked in one of the following five categories:

Not addressed – The candidate does not address this assessment opportunity.

Nominal competence – The candidate does not attain the standard of reaching competence.

Reaching competence – The candidate attempts to discuss the components of an audit plan.

Competent – The candidate discusses the components of an audit plan.

Competent with distinction – The candidate thoroughly discusses the components of an audit plan.

APPENDIX E

**RESULTS BY ASSESSMENT OPPORTUNITIES FOR DAY 2 AND DAY 3
(FOR ALL WRITERS)**

**THE LEVEL 2 DEPTH TEST
(DAY 2 AND DAY 3-ALL WRITERS)**

Financial Reporting:		NA	NC	RC	C	CD	C+CD
Day 2 Common							
AO1	Business acquisition	2%	13%	38%	43%	4%	47%
AO2	Lease	1%	6%	43%	42%	8%	50%
AO3	Lawsuit	0%	2%	48%	48%	2%	50%
Day 3 – Q1 Fresh							
AO5	Intangible asset	9%	10%	15%	59%	7%	66%
Day 3 – Q2 PT							
AO1	Revenue recognition	1%	6%	29%	54%	10%	64%
AO3	Investment property	4%	18%	32%	36%	10%	46%

Management Accounting:		NA	NC	RC	C	CD	C+CD
Day 2 Common							
AO4	Cash budget	2%	9%	30%	50%	9%	59%
AO5	Balanced scorecard	2%	21%	28%	45%	4%	49%
AO6	Café pilot	3%	9%	26%	55%	7%	62%
Day 3 – Q1 Fresh							
AO1	Budget variances	2%	14%	49%	19%	16%	35%
Day 3 – Q3 Prairies							
AO1	Expansion opportunities	3%	13%	39%	40%	5%	45%
AO3	Compensation program	5%	22%	31%	39%	3%	42%

**THE LEVEL 3 DEPTH TEST - ROLE
(DAY 2-ALL WRITERS)**

Audit and Assurance		Papers	NA	NC	RC	C	CD	C+CD
AO7	RSU plan	4472	4%	22%	30%	42%	2%	44%
AO8	Audit plan	4472	0%	7%	41%	48%	4%	52%
AO9	Planning analytic	4472	2%	44%	25%	28%	1%	29%
AO10	Procedures, acctg issues	4472	1%	24%	21%	50%	4%	54%
AO11	Procedures, payroll controls	4472	1%	29%	17%	50%	3%	53%
AO12	Internal control weaknesses	4472	0%	20%	32%	46%	2%	48%
AO13	MD&A	4472	3%	31%	24%	38%	4%	42%

Finance		Papers	NA	NC	RC	C	CD	C+CD
AO7	Capitalized earnings valuation	173	1%	2%	30%	51%	16%	67%
AO8	Financing	173	1%	9%	27%	49%	14%	63%
AO9	Working capital improvements	173	5%	15%	43%	37%	0%	37%
AO10	Short term financing	173	7%	13%	31%	43%	6%	49%
AO11	Lease vs buy	173	3%	15%	23%	56%	3%	59%
AO12	Share based compensation - ratio analysis	173	10%	41%	19%	28%	2%	30%
AO13	Distribution alternatives	173	12%	25%	36%	24%	3%	27%

**THE LEVEL 3 DEPTH TEST - ROLE
(DAY 2-ALL WRITERS)**

Performance Management		Papers	NA	NC	RC	C	CD	C+CD
AO7	Divisional allocations	602	3%	31%	31%	34%	1%	35%
AO8	Focus on on-line segment	602	4%	10%	28%	56%	2%	58%
AO9	Home décor - quantitative	602	3%	7%	32%	56%	2%	58%
AO10	Home décor - qualitative	602	2%	16%	41%	41%	0%	41%
AO11	Membership program	602	3%	16%	53%	28%	0%	28%
AO12	On-line segment performance evaluation	602	8%	25%	40%	26%	1%	27%
AO13	Inventory management system	602	4%	10%	34%	50%	2%	52%

Taxation		Papers	NA	NC	RC	C	CD	C+CD
AO7	CCA	225	0%	13%	33%	50%	4%	54%
AO8	Taxable income - quantitative	225	0%	12%	19%	47%	22%	69%
AO9	Taxable income - qualitative	225	0%	13%	29%	46%	12%	58%
AO10	Acquisition of control	225	3%	23%	25%	40%	9%	49%
AO11	Employee benefits	225	0%	14%	22%	49%	15%	64%
AO12	Shareholder loans	225	0%	33%	36%	24%	7%	31%
AO13	GST/HST	225	2%	16%	46%	34%	2%	36%

**THE LEVEL 4 BREADTH TEST
(DAY 2 AND DAY 3, BY COMPETENCY AREA, ALL WRITERS)**

Financial Reporting:		NA	NC	RC	C	CD	RC+C+CD
Day 2 Common							
AO1	Business acquisition	2%	13%	38%	43%	4%	85%
AO2	Lease	1%	6%	43%	42%	8%	93%
AO3	Lawsuit	0%	2%	48%	48%	2%	98%
Day 3 – Q1 Fresh							
AO5	Intangible asset	9%	10%	15%	59%	7%	81%
Day 3 – Q2 PT							
AO1	Revenue recognition	1%	6%	29%	54%	10%	93%
AO3	Investment property	4%	18%	32%	36%	10%	78%

Management Accounting:		NA	NC	RC	C	CD	RC+C+CD
Day 2 Common							
AO4	Cash budget	2%	9%	30%	50%	9%	89%
AO5	Balanced scorecard	2%	21%	28%	45%	4%	77%
AO6	Café pilot	3%	9%	26%	55%	7%	88%
Day 3 – Q1 Fresh							
AO1	Budget variances	2%	14%	49%	19%	16%	84%
Day 3 – Q3 Prairies							
AO1	Expansion opportunities	3%	13%	39%	40%	5%	84%
AO3	Compensation program	5%	22%	31%	39%	3%	73%

**THE LEVEL 4 BREADTH TEST
(DAY 2 AND DAY 3, BY COMPETENCY AREA, ALL WRITERS)**

Strategy and Governance		NA	NC	RC	C	CD	RC+C+CD
III1- AO3	Licensing agreement risks	2%	6%	32%	44%	16%	92%
III1- AO7	CEO strategic fit	2%	9%	27%	47%	15%	89%
III3- AO2	Strategic fit of current operations	2%	8%	20%	57%	13%	90%

Audit and Assurance		NA	NC	RC	C	CD	RC+C+CD
III-1 AO6	Audit procedures	4%	12%	31%	39%	14%	84%
III-2 AO4	Control weaknesses	2%	8%	44%	40%	6%	90%
III-3 AO5	Audit plan	4%	11%	23%	54%	8%	85%

Finance		NA	NC	RC	C	CD	RC+C+CD
III-1 AO4	Financing options	2%	6%	22%	59%	11%	92%
III-2 AO5	Investment options	2%	10%	27%	49%	12%	88%
III-2 AO6	Business valuation	2%	8%	44%	39%	7%	90%

Taxation		NA	NC	RC	C	CD	RC+C+CD
III-1 AO2	Corporate taxes payable	1%	6%	24%	51%	18%	93%
III-2 AO2	Tax on current investments	3%	14%	34%	37%	12%	83%
III-3 AO4	GST system and compliance	2%	20%	22%	48%	8%	78%

APPENDIX F

BOARD OF EXAMINERS' COMMENTS ON DAY 2 AND DAY 3 SIMULATIONS

BOARD OF EXAMINERS' COMMENTS ON DAY 2 SIMULATION

Paper/Simulation:	Day 2, Common Role (IBL)
Estimated time to complete:	300 minutes
Simulation difficulty:	Easy to Average
Competency Map coverage:	Management Accounting (3); Financial Reporting (3)

Evaluators' comments by Assessment Opportunity (AO)

AO#1 (Business combination)

Candidates were asked to assess the financial reporting for the acquisition of Bookmarks Inc. Information regarding the purchase of shares of Bookmarks was provided in Appendix II (Common), which included an independent appraisal of the fair value of Bookmarks' assets and liabilities as of the purchase date. To demonstrate competence, candidates were expected to apply case facts to *IFRS 3 – Business Combinations*, to determine that a business was acquired. Candidates were then expected to use the acquisition method listed in IFRS 3 to determine an appropriate amount of goodwill to record, and conclude consistently with their analysis.

Candidate performance on this AO was mixed. While most candidates were able to determine that IBL had acquired control of Bookmarks, candidates often struggled to provide depth in their analysis. For example, while many candidates correctly identified the acquirer (IBL), few candidates went further to discuss whether a business had been acquired. Candidates typically used the purchase of 100% of the shares of Bookmarks to discuss each point, neglecting other facts, such as that the operations of Bookmarks as a book retailer supported the fact that a business had been acquired. Most candidates recognized that the acquisition method under IFRS 3 should be used, and determined that the goodwill resulting from the transaction would need to be recorded. However, not all candidates were able to calculate a reasonable amount for goodwill. In general, candidates concluded consistently with their analysis.

Strong candidates were more likely to discuss whether a business was acquired, and to address the various steps present under the acquisition method of IFRS 3. These candidates were able to provide additional depth in their analysis by discussing whether IBL would represent a non-controlling interest, and discussing how goodwill would be calculated under the acquisition method. Strong candidates typically used the purchase price of the transaction to subtract the fair value of Bookmarks' net assets, to determine a reasonable amount of goodwill. Strong candidates were also more likely to comment on the deferred tax impact of the transaction, although such discussions were relatively rare.

Weak candidates were more likely to start their analysis in an incorrect Handbook section, such as *IAS 28 – Investments in Associates or Joint Ventures*, or *IFRS 10 – Consolidated Financial Statements*. While candidates using IFRS 10 were able to provide some value by correctly concluding that Bookmarks' financial statements would need to be consolidated with IBL's, candidates using IAS 28 seem to have missed the primary case fact that 100% of Bookmarks' shares had been acquired. Weak candidates often discussed the transaction with little depth, either bringing in few case facts or repeating the same case fact multiple times. Weak candidates struggled to determine a reasonable amount of goodwill, demonstrating conceptual errors such as: subtracting carrying value from the transaction price; using assets minus liabilities, total assets, or total liabilities instead of net assets; calculating only the acquisition differential; or taking the fair value of the net assets less the purchase price, resulting in a negative goodwill balance.

AO#2 (Lease)

Candidates were asked to address the financial reporting for IBL's new lease. Information regarding the lease of the retail space in Halifax was provided in Appendix III (Common). To demonstrate competence, candidates were expected to use Handbook guidance and case facts to provide a reasonable analysis of the accounting treatment of the initial recognition of the lease and its subsequent measurement. Candidates were expected to calculate a reasonable present value of the lease as at December 31, 2023, and conclude on both the asset and the liability to be recorded.

Candidates performed reasonably well on this AO. Most candidates were able to use *IFRS 16 – Leases* to correctly discuss how to record the lease as at IBL's year end. While not all candidates used case facts to discuss each step in IFRS 16, most were able to use sufficient case facts to support that a lease was present, and describe its key terms. Most candidates provided a reasonable present value calculation of the lease, using the initial term plus the extension period and IBL's incremental borrowing rate of 7.5%. While not all candidates were able to appropriately discuss the subsequent measurement of the interest portion of the lease, the majority of candidates provided a reasonable explanation or calculation of how future depreciation would be calculated and recorded. Most candidates correctly assessed how the direct legal and commission costs would affect the lease by adding them to the right-of-use asset balance.

Strong candidates discussed the lease term in depth, most often by concluding that the term should include the 60-month extension, due to IBL's intention to exercise it. Other strong candidates discussed the right-of-use asset and lease liability recognition exemptions, and assessed whether the Halifax lease would meet either exemption. Strong candidates were more likely to attempt to incorporate the two rent-free months into their analysis, although candidates who performed such an analysis often did so in their calculations, and were relatively rare. Strong candidates provided additional depth in their lease analysis by discussing the treatment of the future leasehold improvements that IBL planned to make in 2024.

Weak candidates appeared to think that IBL was the lessor, or used ASPE criteria to assess whether the lease would be considered capital or operating in nature. Weak candidates who used the correct Handbook section struggled to support their analysis of the issue, often simply concluding that the lease met the definition of a lease without using case facts to discuss the lease term that should be used, what interest rate should be used in the present value calculation, or which costs should be added to the lease asset. Weak candidates were more likely to use the initial term of 62 months in their present value calculations without supporting their decision. Weak candidates were also more likely to suggest measuring the lease by multiplying the payment amount by the total number of months in the contract, rather than by present valuing the lease payments.

AO#3 (Lawsuit)

Candidates were asked to discuss the financial reporting for the lawsuit relating to a contract breach that occurred in the summer of 2023. Details relating to the lawsuit, including an initial summary of the facts by IBL's senior legal counsel and a post-settlement email after year end, were provided in Appendix IV (Common). To demonstrate competence, candidates were expected to recognize and discuss that the lawsuit would constitute a provision as well as an adjusting event, under *IAS 10 – Events after the reporting period*. Candidates were expected to identify the fact that, although the settlement occurred in 2024, the settlement provided evidence of conditions that existed prior to the December 31, 2023, year end, which was that there was a liability for amounts owing to the publishing company.

Candidate performance on this AO was mixed. Many candidates recognized that the settlement in January 2024 related to conditions existing prior to year end, although not all candidates used IAS 10 to frame their discussions. A significant number of candidates simply discussed the lawsuit as a provision, using *IAS 37 – Contingencies*, as of December 31, 2023, ignoring the settlement that occurred in January 2024. Other candidates reached a conclusion about recording the amount of the settlement without providing a supporting analysis.

Strong candidates were more likely to frame their analysis using IAS 10, which led them to recognize that, since the events leading to the lawsuit originated in 2023, there were conditions that existed prior to year end. These candidates correctly concluded that the settlement would provide evidence of these conditions, and therefore constitute an adjusting event under IAS 10. Strong candidates concluded consistently with their analysis by determining that the amount of the settlement of \$125,000 should be recorded at December 31, 2023.

Weak candidates did not recognize the difference in timing between the conditions leading to the lawsuit and the settlement itself. These candidates were more likely to attempt to analyze the issue under IAS 37, and to conclude that a provision is not required or that a provision of \$100,000 should be recognized, despite the amount of the settlement being known. Other weak candidates were more likely to conclude that \$125,000 should be recorded because IBL's financial statements had not yet been prepared, instead of focusing on whether the settlement provided evidence of conditions that existed prior to year end. Weak candidates were also more likely to conclude inconsistently with their analysis, for example, by concluding that only disclosure was required for the provision, despite determining that a present obligation existed under IAS 37, or concluding that \$100,000 should be recorded, despite assessing the settlement as an adjusting event. Other weak candidates simply concluded that \$125,000 should be recorded because this amount had been paid.

AO#4 (Cash budget)

Candidates were asked to review and revise the draft 2024 cash budget that was prepared by a co-op student. A copy of the draft 2024 cash budget was provided in Appendix V (Common), along with some notes provided by Jeff, IBL's acting controller. To demonstrate competence, candidates were expected to make adjustments to the draft cash budget and conclude on the company's financing needs.

Candidates performed well on this AO. Most candidates provided a reasonable number of adjustments to the draft cash budget, and determined whether the company would be in a cash shortfall position during 2024. The most common adjustments made by candidates were adjusting the cash budget for the 3% sales growth expected by Jeff in 2024, adjusting sales volumes per quarter to match the cyclical trend of historical sales, and adjusting the marketing and sales expenses to match the spending pattern provided by Jeff. Most candidates were able to indicate, either in their qualitative discussion or their calculation, whether IBL would experience a cash shortfall in 2024.

Strong candidates were more likely to make a greater number of adjustments to the cash budget, such as identifying the fact that payments to suppliers would occur cyclically in line with sales. Strong candidates were more likely to integrate case facts from other Common AOs into their revised budget, such as incorporating the lease payments and planned leasehold improvement expenditures from AO#2, or the lawsuit settlement from AO#3. Strong candidates were also more likely to explicitly conclude on IBL's cash flow needs. These candidates often commented on whether IBL would experience a cash shortfall during 2024, discussed whether additional financing was required, or suggested repayment of IBL's existing long-term debt.

Weak candidates made fewer adjustments to the cash budget, often failing to recognize that inventory purchases would be impacted by the cyclical nature of sales, or that depreciation is a non-cash item. Weak candidates were also less likely to integrate information from other Common AOs, and very rarely adjusted for the interest on the long-term debt. Finally, weak candidates struggled to correctly calculate the opening and closing balances of the budget each quarter, and often did not attempt to interpret the results of the budget they prepared.

AO#5 (Balanced scorecard)

Candidates were asked to assess the company's balanced scorecard, last revised in 2018, and to recommend improvements. A summary of the existing balanced scorecard was provided in Appendix VI (Common), which listed goals and measures under four different areas of the business. Additional information relevant to the balanced scorecard, such as IBL's recent focus on its online business and reports of damaged products, was provided in the Background section. To demonstrate competence, candidates were expected to discuss several issues with the current scorecard and recommend improvements.

Candidates performed adequately on this AO. While most candidates were able to identify several weaknesses with the current scorecard, not all candidates were able to explain why the weakness was relevant to IBL. Similarly, while most candidates offered improvements to the balanced scorecard, not all candidates were able to discuss what issue the improvement would fix, or why it would be relevant to IBL. Candidates were most comfortable discussing the financial and customer perspectives of the balanced scorecard, such as the customer retention or cash flow from inventory measures, and less comfortable discussing goals and measures from the learning and growth and internal operations perspectives.

Strong candidates were more likely to demonstrate greater depth in their discussions of the balanced scorecard by explaining the weaknesses identified and the improvements suggested. For example, after identifying overall sales volume as an inappropriate measure for the goal of attracting new customers, strong candidates would explain that this was due to the fact that overall sales volume could be skewed by the sales volume from existing customers. These candidates would then provide a more suitable measure and describe how the measure could be tracked, for example, by suggesting that the number of new customers could be tracked by information obtained during the checkout process. Strong candidates were also more likely to support their discussions of why particular existing goals or measures were adequate, such as noting that the second learning and growth goal was appropriate, given the importance of employee morale in maintaining employee satisfaction and retention. Finally, strong candidates were more likely to discuss additional relevant measures, such as tracking online sales, as well as to assign specific targets to the measures discussed.

Weak candidates struggled to assess the current balanced scorecard in depth, as they were less likely to support their discussions of the goals and measures with case facts. These candidates often simply listed new goals or measures that IBL should use, without explaining why they would be relevant to the business. Other weak candidates framed their discussions from an operational perspective, for example, by recommending that IBL provide discount offers to attract new customers, or that IBL require employees to attend mandatory training. The recommendations of weak candidates often did not address the issue identified, or were highly impractical, such as recommending that IBL replace the anonymous, employee survey conducted by a third-party with one-on-one discussions with managers in order to improve employee morale. Other recommendations by weak candidates were aimed at improving the balanced scorecard process rather than the scorecard itself, such as suggesting that IBL update the scorecard, despite this being Tina's initial request.

AO#6 (Café pilot project)

Candidates were asked to assess whether a café pilot project was a success, and suggest improvements. Information regarding the café pilot project, including a financial summary and associated information, was provided in Appendix VII (Common). To demonstrate competence, candidates were expected to make several adjustments to the financial summary in order to quantitatively determine whether the café was profitable, conclude consistently with their analysis, and recommend improvements for the project moving forward.

Candidates performed well on this AO. Most candidates were able to make several adjustments to the pilot's financial summary, typically by adjusting for the non-incremental rent and salaries of the retail employees, to quantitatively determine the success of the project. The majority of candidates concluded consistently with their analysis about whether the project was a success; however, most candidates simply concluded based on the results of their quantitative analysis rather than discussing additional relevant qualitative points. In general, candidates provided several supported recommendations that addressed the issues experienced by the café, such as hiring an experienced manager to address the current manager's lack of experience in the food service industry.

Strong candidates included a greater number of adjustments in their analysis, such as attributing 17% of the bookstore's utility expense to the café in addition to adjusting for the salaries and wages and rent. Strong candidates were also more likely to acknowledge the incremental sales in the retail store and the costs of damaged inventory and furniture. Some strong candidates attempted to quantify the 8% of incremental retail sales, and in rare cases, the associated cost of goods sold, using IBL's gross margin. Strong candidates typically incorporated qualitative points when assessing the success of the pilot, for example, by discussing the potential negative impact on employee morale or the increased foot traffic to the retail store. Strong candidates were also more likely to tailor their suggested improvements to the specific issues experienced by the café.

Weak candidates often did not provide any adjustments to the financial summary provided by the store manager, or qualitatively discussed the adjustments without quantifying their impact on the café's profitability. Other weak candidates did not conclude on whether the café was a success, despite Tina's request that they assess the success of the project. Some weak candidates appeared confused about how to adjust for certain costs, for example, by removing salaries and wages altogether or multiplying the café's existing share of utilities by 15%. Weak candidates were more likely to ignore both the quantitative and qualitative impact of the incremental retail sales on the overall success of the project. Finally, weak candidates often provided recommendations that were either generic or impractical, such as suggesting that IBL hire security guards to protect the furniture from coffee spills, or recommending that employees volunteer at the café in order to increase profitability.

Paper/Simulation: Day 2, Assurance Role (IBL)

Estimated time to complete: 300 minutes

Simulation difficulty: Average

Competency Map coverage: Financial Reporting (1);
Audit and Assurance (6)

Evaluators' comments by Assessment Opportunity (AO)

AO#7 (RSU plan)

Candidates were asked to discuss the financial reporting implications of the new share-based compensation plan, which granted restricted stock units (RSUs). Details of the plan were provided in Appendix VIII (Assurance). To demonstrate competence, candidates were expected to identify relevant IFRS guidance on share-based payments, discuss it in light of the case facts, and provide a supported conclusion on how to account for the plan.

Candidates struggled with this AO. Most candidates identified the correct Handbook guidance to use (*IFRS 2 – Share-Based Payment*), and attempted to apply it to the case facts provided. However, while most candidates were able to identify that a liability needed to be recorded at fair value, they struggled to apply the Handbook guidance to IBL's situation and to propose a reasonable accounting treatment. For example, most candidates did not recognize that nothing needed to be recorded at the initiation of the plan. Although most candidates attempted a calculation of the amount to recognize, there was often a disconnect between the guidance they included from the Handbook and the amount they concluded should be recognized. For example, many candidates recommended recognizing the entire liability related to the plan, although only one year of the plan had passed. Candidates also demonstrated a technical weakness in their ability to consider the impact of the future vesting dates (Years 2 to 4), as they often ignored those future years in their analysis.

Strong candidates were able to focus on the relevant portion of the Handbook guidance that related to cash-settled, share-based compensation. They were able to interpret the Handbook, and provided clear links between the guidance and the accounting treatment they recommended. For example, strong candidates recognized that a liability had to be recorded as the services were received from the employees, and translated this into a calculation of the liability that should be recognized at year end related to the RSUs that were vesting on January 1, 2024. Although some strong candidates were able to provide calculations that incorporated the estimated percentage of retention of employees at the future anniversary dates, very few explained the accounting treatment for the RSUs that vested in future years.

Weak candidates often confused share-based compensation with equity-settled, share-based payments, incorrectly increasing equity instead of recognizing a liability. Some weak candidates provided unclear recommendations, for example, proposing to record a liability and increase equity in the same discussion or journal entry, therefore demonstrating that they did not understand the difference between a cash-settled plan and an equity-settled plan, and which one applied to IBL. Many weak candidates provided Handbook guidance but proved unable to apply it to IBL's RSU plan. These candidates copied and pasted the Handbook section without analysis, and either did not attempt a calculation of the amount to be recognized at year end, or provided a calculation that was not reasonable. For example, many weak candidates recognized the full amount of the plan's liability at the beginning of the plan, not understanding that it should be recognized as the services are received from the employees. Other weak candidates did not refer to the appropriate Handbook guidance, often referring to *IFRS 9 – Financial Instruments*, or *IAS 19 – Employee Benefits*, and provided a calculation without understanding the purpose of it.

AO#8 (Audit plan)

Candidates were asked to assess the risks of material misstatement at the overall financial statement level, and determine materiality for the 2023 audit. Information relevant to the audit plan, such as risk factors and users, was provided throughout the case, both in the Common and Assurance sections. To demonstrate competence, candidates were expected to provide a reasonable discussion of risks of material misstatement at the financial statement level, and a reasonable materiality analysis.

Candidates performed adequately on this AO. Most candidates attempted to discuss both risks and materiality. The most commonly discussed risks factors were the new controller, the history of accounting errors at IBL, and the bias for management to manipulate the financial statements, given that IBL is a publicly-traded company. Most candidates also provided a reasonable materiality analysis by discussing multiple users of the financial statements, choosing an appropriate basis that would address their needs, taking into account that IBL had incurred a net loss, and calculating a planning materiality using an appropriate percentage, given their selected basis.

Strong candidates addressed several of the risk factors, and clearly explained how each factor affected the risk of material misstatement, using the case facts provided. They also provided a discussion of multiple users, clearly explaining how each would use the financial statements, and a discussion of the basis that would be the most appropriate. Strong candidates usually concluded that, although net income would be the preferred basis for the materiality calculation, IBL was in a net loss position, and a different basis needed to be used. They picked another basis that was relevant and explained why it was the best choice in the circumstances, often picking revenue. Strong candidates also adjusted the basis they used with the financial statement adjustments they had recommended in their accounting discussions, or specified that none of the adjustments affected revenue, when that basis was picked. Strong candidates also discussed and calculated performance materiality for the engagement.

Weak candidates often identified multiple risk factors, but struggled to support their discussions, using the case facts available. For example, they would state that having a new controller or having a history of errors in the financial statements increased the risk of material misstatements, without explaining why. Weak candidates struggled to deal with the net loss when choosing a basis for materiality. Although most candidates identified the net loss, and the need to find another basis, some weak candidates recommended using the net loss as a basis for materiality. Those who recommended another basis struggled to identify a relevant one, and often did not explain the reasoning behind their choice, for example, recommending the use of assets without explaining how this would suit the users' needs.

AO#9 (Planning analytic)

Candidates were asked to prepare a year-over-year variance analysis of the statement of financial position and statement of earnings, and discuss any risks to consider when planning the audit. The statement of financial position and the statement of earnings were presented in Appendix I (Common), and information relevant to the variances was provided throughout the case, both in the Common and Assurance sections. To demonstrate competence, candidates were expected to calculate and discuss some of the variances in both statements.

Candidates struggled with this AO. Most candidates calculated the variances for both the statement of financial position and the statement of earnings, and attempted to discuss some of the variances. However, candidates struggled to use case facts in their analysis of the variances identified, or struggled to explain why the variance represented an audit risk. For example, many candidates identified a decrease in cash, but failed to explain what could have caused it, or what the audit risk would be related to the variance of the cash account.

Strong candidates demonstrated that they understood the interrelation between the financial statement accounts, for example, explaining that the increase in cost of sales was reasonable since it was proportionate to the increase in sales, analyzing gross profit rather than cost of sales on its own, or explaining that the increase in inventory is disproportionate when compared to the increase in sales. Strong candidates were also able to demonstrate good integration of case facts from their other analyses in their explanation of the variances. For example, some strong candidates integrated the adjustments from their accounting discussions into their variance calculations, or used case facts, such as the new loan or the new lease, to set their expectations on the financial statement balances. Strong candidates were also more inclined to explain the impact on the audit risk of the variances they calculated, which they supported with case facts, for example, explaining that the increase in inventory represents a risk, given the known control issues within the retail operations.

Weak candidates often calculated the variances and simply indicated whether there was an increase or a decrease since the prior year, sometimes adding that the variance increased the audit risk, or that testing will need to be done on that account, without further explanation. When they attempted to explain the variances, their explanation was often unreasonable, for example, explaining that the cost of sales increase was due to the disposal of near-full containers of milk in multiple occasions in the café, when this would not have had a significant impact on the overall cost of sales.

AO#10 (Procedures – accounting issues)

Candidates were asked to describe the audit procedures to be performed on the financial reporting issues noted by Kim, including the share-based compensation plan. Information on the financial reporting issues was provided throughout the case, both in the Common and Assurance sections. To demonstrate competence, candidates were expected to discuss several procedures that would address the specific risks related to the financial reporting issues identified.

Candidates performed well on what was expected to be a straightforward AO. Most candidates demonstrated sufficient breadth by providing multiple procedures for each of the financial reporting issues, and most candidates addressed all of the issues. Most candidates were also able to adequately explain their procedures by discussing what audit evidence they would obtain, and what they would do with that audit evidence. The procedures that were most often adequately discussed were related to the Bookmarks acquisition, the Halifax lease, and the lawsuit.

Strong candidates provided more fulsome procedures that focused on the significant audit risk of each financial reporting issue, and went beyond confirming amounts to agreements. For example, for the Bookmarks acquisition, strong candidates would not only obtain the appraisal report to confirm the fair values of the assets purchased, but also recalculate the goodwill and ensure that the correct amount was recorded in the financial statements. Strong candidates also provided a clear description of the evidence that needed to be obtained, and focused on third-party evidence. For example, for the lawsuit, they were more likely to review the court documents to confirm information, rather than the emails that were exchanged between IBL and the lawyers. Strong candidates were also clear when describing the information they were looking for when obtaining a piece of evidence, for example, describing exactly which terms of the lease agreement they would be looking for (duration of 62 months, two free months, option to extend for 60 months).

Weak candidates identified a fewer number of procedures to be performed, but the main weakness was the quality of the procedures provided. Weak candidates were not specific enough in the description of the information they would be looking for on each piece of evidence. For example, many weak candidates proposed a review of the lease agreement to verify the terms, without specifying which terms they would look for and why. Weak candidates provided incomplete procedures, often confirming some of the information without explaining what they would do with that information. For example, they would suggest obtaining the appraisal report related to the Bookmarks acquisition and looking for the fair values, without explaining what they would do with those fair values. Weak candidates also tended to provide generic procedures, such as sending a legal confirmation to see if there were any outstanding lawsuits, instead of being specific about the lawsuit related to the contract breach they were asked to discuss.

AO#11 (Procedures – payroll controls)

Candidates were asked to design procedures to establish whether IBL's payroll controls are operating effectively. Excerpts from IBL's process descriptions regarding payroll were provided in Appendix VIII (Assurance). To demonstrate competence, candidates were expected to discuss several procedures that would test the key payroll controls.

Candidates performed adequately on this AO. Most candidates were able to provide sufficient breadth of procedures as they covered several of the controls included in the payroll process. Candidates most commonly suggested procedures to test the controls around the review of the store time summary and the review of the journal entry. Some candidates focused on reperforming the controls, but sometimes struggled to demonstrate that they understood the difference between a test of details and a test of controls. For example, for the control performed by the assistant controller to check the master file from human resources, to ensure that each record is related to an active employee, many candidates selected their own sample instead of using the sample selected by the assistant controller as the start of their procedure. These candidates failed to demonstrate that they understood the nature of test of controls.

Strong candidates were able to suggest a variety of procedures, ranging from looking for evidence of review or approval from the IBL employee performing the control, to reperforming the control with a clear description of how they would perform the procedure and what they would be looking for. Strong candidates understood their sample needed to include a sufficient number of items, and also demonstrated they knew to start from the sample already reviewed by the person in charge of the control when the initial control only included a sample.

Weak candidates often provided test of details rather than procedures to test controls. For example, they would select a sample of time records and obtain the master employee file, to ensure that the employees on the records were active employees. Many weak candidates demonstrated a lack of technical knowledge in sampling. For example, they would only select one occurrence of the control to test instead of sampling a few to look at, not understanding that a sample size of one is insufficient for a manual control. Some weak candidates did not provide any test of controls, and instead analyzed the strengths and weaknesses of the existing controls, and provided recommendations for how to improve them.

AO#12 (Internal control weaknesses)

Candidates were asked to discuss any internal control weaknesses in IBL's bookstore operations, and recommend ways to address them. A process description was provided in Appendix VIII (Assurance). To demonstrate competence, candidates were expected to identify several weaknesses, explain the implication of each weakness, and provide a reasonable recommendation for addressing each weakness.

Candidates performed adequately on this AO. Most candidates identified many of the weaknesses and discussed them in sufficient depth. The most commonly identified weaknesses were the lack of approval for the furniture and fixture purchases, the lack of segregation of duties in the cash reconciliation process, and the lack of access removal for departing employees.

Strong candidates often provided more practical and effective recommendations. For example, relating to the discrepancies in the inventory counts, strong candidates recognized that asking the store managers to investigate the discrepancies would not be sufficient, since the store managers saw the discrepancies as a cost of doing business without willingness to investigate them, and therefore proposed further actions to solve the issue. Strong candidates also provided good explanations of the implications of the control weaknesses they identified. For example, they were able to explain how cash could be misappropriated due to a lack of segregation of duties, by explaining that the cashier or store manager could pocket the cash and change the amount in the reconciliation so that no one would notice the missing cash.

Weak candidates often did not explain how the internal control weaknesses could cause fraud or errors to occur. For example, weak candidates often explained that theft could occur due to the lack of segregation of duties, but did not explain how the fraud could be perpetuated. Some weak candidates also ignored case facts in their discussion of the implication of the weaknesses and did not focus on the right aspect of the weakness. For example, some candidates explained that the lack of follow-up in the inventory count discrepancies would result in misstatement in the financial statements, which would not be the case, since a list of discrepancies was provided to the accounting department following the inventory count, and the inventory levels were adjusted in the accounting system. In addition, the recommendations that weak candidates provided were often not sufficiently specific or practical. For example, some weak candidates recommended having all of the physical locks changed every time an employee departed, or having the manager request the keys back from the departing employees, despite being told that the managers were already having problems recovering the company assets from the departing employees.

AO#13 (MD&A)

Candidates were asked to comment on the excerpts provided from the Management Discussion and Analysis (MD&A), and explain Rutherford's responsibilities regarding the business risks section, which is not expected to be ready before the audit report is issued. Excerpts from the draft MD&A were provided in Appendix VIII (Assurance). To demonstrate competence, candidates were expected to demonstrate their understanding of Rutherford's responsibilities, and identify some of the inconsistencies in the draft MD&A.

Candidates struggled with this AO. Most candidates recognized the need to comment on the information provided in the appendix, but struggled to provide commentary that aligned with the auditor's role and responsibilities in relation to the MD&A. While most candidates were able to identify a few inconsistencies in the MD&A, most commonly pointing out the discrepancies with the revenue figure, the Bookmarks acquisition date, or the statement about the company having greatly improved the inventory controls, they were not able to explain what Rutherford's responsibility was regarding those inconsistencies or the business risks section. While some candidates explained Rutherford's responsibility toward the inconsistencies found, very few candidates addressed the business risks section. Those who did often discussed the business risks themselves instead of discussing Rutherford's responsibility.

Strong candidates seemed to have a better knowledge of what Rutherford's responsibilities were, and were able to explain what to do about the inconsistencies found. For example, they noted that the inconsistencies needed to be discussed with management, and that any material inconsistency would need to be corrected. Strong candidates also demonstrated greater breadth, as they identified multiple inconsistencies included in the MD&A and addressed some that were less obvious, such as the fact that the EBITDA calculation included depreciation expense, issues in the calculation of ratios, and the statement about efforts deployed by the company to improve employee retention.

Weak candidates often did not understand what their role was, sometimes offering advice on how to improve the MD&A, or how to improve operations. For example, some candidates proposed to add information to the MD&A that they thought users would like, or suggested offering the new RSU compensation plan to all employees instead of restricting it to senior leadership. Weak candidates did not understand Rutherford's responsibility regarding the MD&A or the business risks section, and when they identified inconsistencies, they identified very few of them and only pointed out the obvious ones, such as the incorrect revenue figure and the incorrect Bookmarks acquisition date.

Paper/Simulation: Day 2, Finance Role (IBL)

Estimated time to complete: 300 minutes

Simulation difficulty: Average

Competency Map coverage: Finance (7)

**Evaluators' comments by Assessment Opportunity (AO)
AO#7 (Capitalized earnings valuation)**

Candidates were asked to prepare a capitalized earnings valuation of Dominion Books Inc. (Dominion). Information relating to Dominion, including its statement of earnings and relevant notes, was provided in Appendix VIII (Finance). To demonstrate competence, candidates were expected to value Dominion using the capitalized earnings approach, starting with 2022 and 2023 pre-tax earnings, make several appropriate normalization adjustments, apply a reasonable multiple, and adjust for redundant assets.

Candidates performed well on this AO. Candidates generally demonstrated an understanding of the capitalized earnings methodology. Most candidates started with 2022 and 2023 pre-tax earnings and adjusted for various normalizations (typically, the management fees, compensation, gain/loss on PP&E, and inventory revaluation). Most candidates applied a reasonable multiple to the resultant normalized earnings. Many candidates recognized that the resultant value needed to be adjusted for redundant assets (vacant land, investments), and attempted to make an adjustment based on the fair value of these assets.

Strong candidates adjusted for most normalizations, including income taxes, and applied a reasonable multiple to the resultant normalized earnings. Strong candidates also accurately determined the fair value of the redundant assets, incorporating latent taxes into the value of the vacant land and/or investments.

Weak candidates sometimes did not start with pre-tax earnings, attempting to adjust to EBITDA or starting with after-tax earnings without subsequently adjusting for income taxes, or only considered one year of earnings, although the case explicitly indicated that candidates should consider two years of earnings. Weak candidates often did not make a sufficient number of adjustments or demonstrated technical weaknesses in their adjustments (for example, adjustments in the wrong direction). Weak candidates often did not attempt to incorporate adjustments for the fair value of the redundant assets.

AO#8 (Financing)

Candidates were asked to calculate the proposed covenants (debt-to-EBITDA ratio and interest coverage ratio) for two proposals to replace IBL's existing long-term debt, assess the proposals, and provide a recommendation. Information relating to the two debt proposals was provided in Appendix VIII (Finance). To demonstrate competence, candidates were expected to calculate some debt covenants, discuss the financing options, and provide a supported conclusion.

Candidates performed well on this AO. Financing options are a frequently tested topic, and the debt financing options presented are relatively straightforward. Most candidates attempted to calculate both debt covenants. Most candidates attempted to discuss several elements of the financing options, most often the interest rate, early repayment, security, and covenants. Most candidates also provided a supported conclusion.

Strong candidates correctly calculated the debt covenants, including correctly excluding the lease liabilities in their analysis. They also discussed more elements of the financing options, incorporating more complex considerations, such as the flexibility and limitations, or integrating their analysis by discussing the covenants, using their calculations.

Weak candidates made errors in their calculation of both debt covenants (for example, using total debt or incorporating lease liabilities or interest, even though it was an explicit exclusion in the formulas provided in the case). Weak candidates also provided a discussion that lacked depth, repeating case facts without explaining why they supported selecting one of the financing options. Weak candidates often focused on either the calculation or the qualitative analysis without attempting, or providing only a brief attempt of, the other piece, and were therefore unable to provide a complete analysis.

AO#9 (Working capital improvements)

Candidates were asked to assess IBL's days payable outstanding and whether IBL should be settling payables on a timelier basis, and evaluate a proposal for a new inventory management system. Information relating to the accounts payable process and inventory management proposal was provided in Appendix VIII (Finance). To demonstrate competence, candidates were expected to provide a quantitative and qualitative analysis of the accounts payable settlement and inventory management system proposal.

Candidates performed adequately on what was expected to be a difficult AO, since candidates generally find working capital analysis to be challenging. Most candidates attempted a days-in-payables and days-in-inventory calculation, taking into consideration the relevant components. Most candidates considered whether the company is settling its payables by their due date, but often did not interpret the implications (for example, whether they were close to being late and owing interest). Many candidates attempted to discuss the inventory management system, but most did not go beyond restating case facts.

Strong candidates attempted to assess both the payables settlement and inventory management system proposal, and often attempted more complex calculations, such as the savings or effective interest rate from paying early, or the working capital reduction from the new inventory management system. Strong candidates also better discussed the inventory management system, identifying and discussing benefits or considerations, and demonstrating depth by explaining how these factors would support their recommendation.

Weak candidates often attempted the days-in-payables and days-in-inventory calculations, but made technical errors by applying incorrect formulas (for example, calculating days in payables using total payables rather than trade payables, or using sales to calculate days in inventory). Weak candidates often did not go further than the days-in-payables and days-in-inventory calculations, and did not attempt to calculate other components of the analysis. Weak candidates also often provided no qualitative discussion of the inventory management system to support their analysis.

AO#10 (Short-term financing)

Candidates were asked to evaluate three financing proposals, to provide IBL with additional comfort in meeting its working capital needs, and provide a recommendation. Information related to these financing proposals was provided in Appendix VIII (Finance). To demonstrate competence, candidates were expected to discuss some of the short-term financing options, and provide a supported conclusion.

Candidates performed adequately on this AO. Most candidates discussed a number of elements, typically the interest rate, forgiveness, and requirements of the CLP loan, the amount raised and lack of shareholder obligation to exercise on the rights offering, and the interest rate and total available financing on the inventory financing. Most candidates also provided a supported conclusion.

Strong candidates discussed more relevant elements, including more complex items, such as the appropriateness of using a rights offering as short-term financing (recognizing that a rights offering is equity, and is therefore not typically used as short-term financing), and linking the inventory management system from the previous AO to the inventory financing (recognizing that the inventory management system is critical to being able to finance the inventory).

Weak candidates listed the terms of each short-term financing option, but did not discuss them in depth or attempt to compare the options, or did not discuss all of the options, choosing instead to focus on one or two without demonstrating sufficient breadth (i.e., not discussing a sufficient number of relevant considerations). Weak candidates sometimes demonstrated weak technical knowledge; for example, related to the rights offering, they did not recognize the timing of cash inflows, or looked at it as pure equity rather than as a rights offering, which is not an obligation to purchase.

AO#11 (Lease versus buy NPV)

Candidates were asked to advise IBL on whether it should lease or purchase a property in Calgary. Information on the purchase or lease of this property was provided in Appendix VIII (Finance). To demonstrate competence, candidates were expected to prepare a net present value analysis, incorporating various relevant components, provide a qualitative analysis, and make a supported recommendation.

Performance was mixed on what was expected to be a straightforward AO. A number of candidates did not incorporate a net present value analysis, instead looking at total costs or only first-year costs. Most candidates incorporated a number of relevant costs (including the upfront purchase price, residual value, and annual expenses). Many candidates also attempted a qualitative discussion, which typically included a couple of: the useful life of the building; capital appreciation; and control over the property. Most candidates also provided a supported recommendation.

Strong candidates prepared a net present value analysis that considered upfront and annual costs, as well as the residual value of the property and the impact of taxes. Strong candidates also considered the impact of timing, as some of the cost items occur at the beginning, versus the end, of the year. Strong candidates also often discussed more qualitative considerations, although they still tended to focus on the useful life of the building, capital appreciation, and control over the property.

Weak candidates typically did not attempt a net present value analysis, instead looking at total costs or only first-year costs. Weak candidates also often did not incorporate all relevant costs, focusing on upfront and annual payments only, without taking into consideration the residual value of the property or the impact of taxes. Weak candidates did not provide a qualitative discussion, or listed case facts without explaining their impact on the decision.

AO#12 (Share-based compensation – ratio analysis)

Candidates were asked to calculate the impact of two proposed share-based compensation plans on IBL's quick ratio, debt-to-equity ratio, and the long-term debt covenant ratios. Information on the share-based compensation plans was provided in Appendix VIII (Finance). To demonstrate competence, candidates were expected to calculate some ratios for both share-based compensation plans.

Candidates performed adequately on what was expected to be a harder AO. Most candidates attempted to calculate some of the ratios, often with minor errors (such as excluding prepaid expenses from the quick ratio). Most candidates attempted to incorporate adjustments for the two proposed share-based compensation plans in recalculating the ratios, sometimes with minor errors (such as adjustments in the wrong direction, or only making adjustments for one of the two plans).

Strong candidates calculated the actual 2023 ratios, and compared the ratios under the proposed share-based compensation plans to these actuals, which provided IBL with a better understanding of how the proposed plans would impact IBL's ratios. Strong candidates also calculated all of the ratios correctly, incorporating the adjustments for the two proposed share-based compensation plans.

Weak candidates did not attempt to calculate all of the ratios, or made significant errors in their calculations (such as calculating the current ratio as opposed to the quick ratio, or calculating a debt-to-total capital ratio rather than the debt-to-equity ratio). Weak candidates also made incorrect adjustments for the two proposed share-based compensation plans (for example, adjustments in the wrong direction, not adjusting equity for the share-based compensation plans, or not recognizing the impact on EBITDA), or used incorrect figures in their calculations, although the adjustments were provided in the narrative. Some weak candidates did not attempt to calculate the ratios, but discussed them at a high level, sometimes indicating the directional impact but without explaining what that means for IBL.

AO#13 (Distribution alternatives)

Candidates were asked to assess alternatives for shareholder distributions, including a cash dividend, share repurchase, 2:1 stock split, or 10% stock dividend. Information that could be used to support the discussion of these options was found throughout the Common and Finance sections of the case. To demonstrate competence, candidates were expected to discuss some of the distribution alternatives.

Candidates struggled with this AO. Most candidates attempted to discuss some of the distribution alternatives, typically the cash and stock dividend (which are more traditional distribution options). Candidates often focused on the tax treatment for shareholders (generally correctly recognizing that most options are taxable), the market signals (for example, markets tend to expect ongoing cash dividends), and the directional share price impact.

Strong candidates clearly distinguished between the distribution alternatives, discussing various factors and making it clear which factors would be beneficial for the company versus the shareholders (for example, recognizing that the taxability of the different distributions is important to the shareholders but not necessarily to the company, or recognizing that the market signals would impact the company's future behaviour rather than just stating the market expectation). Strong candidates also considered more complex considerations, and looked at the bigger picture issues, such as the availability of cash (for example, considering whether IBL has cash to distribute, given that it is currently looking for short-term financing), and/or alternative options (for example, investing in return-generating projects rather than distributing cash).

Weak candidates often did not clearly distinguish between the distribution alternatives, providing generic discussions, and focusing on single issues (such as the form of distribution) without fully considering the differences between the options, or did not consider the impact of each distribution alternative on the company and/or shareholders. Weak candidates often were very brief, repeated their discussion points, made technical errors (for example, incorrectly identifying the tax impact or indicating that the stock split would increase share price), or were unclear in their discussion, often ascribing certain considerations to multiple distribution alternatives even if they did not apply (for example, stating that all of the options provided shareholders with cash distributions).

Paper/Simulation: Day 2, Performance Management Role (IBL)

Estimated time to complete: 300 minutes

Simulation difficulty: Easy to Average

Competency Map coverage: Performance Management (7)

Evaluators' comments by Assessment Opportunity (AO)

AO#7 (Divisional income statement)

Candidates were asked to prepare a divisional income statement for IBL, based on the company's current allocation model, as well as one based on the candidates' proposed revisions to the model. Information related to IBL's current model for allocating expenses to its two segments (online and in-store) was provided in Appendix VIII (Performance Management). Additional information on the company's expenses was also provided in this appendix, which should have allowed candidates to realize that some elements of the current allocation model needed improvement. To demonstrate competence, candidates were expected to provide reasonable divisional income statements, based on the current allocation policy and the candidates' revised policy.

Candidates struggled on what was expected to be a straightforward assessment opportunity. Many candidates made mistakes in allocating the revenues and expenses between IBL's two segments under the company's current model. For example, many candidates forgot that the allocation of expenses between the two segments simply broke down the total of each of the expenses' total amounts into two segments, and therefore, allocation to the two segments cannot be more than the total amount. In addition, for many candidates, the total of the expenses they allocated to both segments did not match the total amount for that expense for the entire company. In preparing the divisional income statement based on the current model, many candidates also incorporated adjustments based on proposed revisions to the model, not recognizing that the first component of the required was to prepare a divisional income statement based on the current model, without any adjustments to the model.

Strong candidates were able to provide a perfect calculation of the revenues and expenses presented in the divisional income statement based on IBL's current allocation policy, and a divisional income statement based on any revisions proposed, containing very few errors, if any. They correctly proposed revisions for the elements of IBL's current allocation policy that generated misleading segmented financial information, such as the segment-specific gross profit, the proportion of general and administrative expenses that was common for both segments, the arbitrary allocation of salaries and marketing expenses that were, in fact, specific to the in-store segment, and the arbitrary allocation of interest and depreciation expenses.

Weak candidates often only responded to one of the two components of the required, omitting either the divisional income statement based on IBL's current allocation model, or the divisional income statement based on a revised model. Some weak candidates attempted both, but made numerous mistakes in both statements. For example, in their revised version of the divisional income statements, they allocated the general and administrative expenses in aggregate, even though there were case facts addressing each component of general and administrative expenses individually (IT department, utilities, maintenance and repairs, store managers' wages, and benefits), which would have enabled candidates to present a more precise allocation of those expenses.

In general, weak candidates did a poor job of incorporating case facts in their revisions. For example, they would allocate the bookstore salary expenses to the two segments based on revenue, not realizing that these costs were specific to the in-store segment. Similarly, they would do the same with the depreciation expense, despite a case fact indicating that the only fixed assets used in the online segment had a depreciation expense of \$275,000.

AO#8 (Focus on online segment)

Candidates were asked to discuss the advantages and disadvantages of increasing the focus on the online segment, and to consider whether it is aligned with IBL's vision and mission. IBL's mission and vision statements, as well as general information related to the company and its industry, were provided in Appendix VIII (Performance Management). Other relevant information was provided to the candidates in the background section of the case. To demonstrate competence, candidates were expected to present a balanced qualitative analysis of the advantages and disadvantages of increasing the focus on the online segment, and to provide a reasonable discussion of the fit of this proposed strategy with IBL's mission and vision.

Candidates performed well on this relatively easy assessment opportunity. Most candidates provided a qualitative analysis that included several relevant discussions that were linked to the case facts, showing a good understanding of the issues. The most commonly addressed elements included the appeal to a new generation of readers, the lower fixed costs associated with the online segment compared to running physical stores, the additional risks linked with the data security surrounding the customers' personal information, and the loss in personal and friendly service that can be obtained in the stores.

In addition to the commonly addressed elements noted above, strong candidates would provide additional elements. For example, strong candidates discussed the fact that the trend of declining book sales could be offset by the easier growth that can be obtained online, as well as the additional sales that can be generated by attracting customers who prefer shopping from home. They also addressed the potential geographical expansion that can easily be obtained online, and identified the potential issues linked to the home delivery of the products, as well as the logistics associated with returns. In addition, strong candidates were more likely to discuss all elements identified in depth, by explaining in more detail the consequences for IBL of the elements noted as advantages or disadvantages, rather than simply presenting a list of case facts as being pros and cons of the initiative. Strong candidates also made compelling links between this decision and the overall strategic direction that IBL had indicated through its mission and vision statements. For example, they would argue that the increased focus on the online segment was in line with IBL's vision to "contribute to a better society through the development of literacy and life-long learning," since it would allow IBL to reach customers that would not have purchased books in-store, but can now purchase them more conveniently online. Strong candidates generally provided a recommendation consistent with the analysis they had provided.

Weak candidates generally only repeated several case facts in the form of a list of pros and cons, without explaining why or how the case facts listed were actually arguments for or against the increased focus on the online segment. Other weak candidates were able to show some depth in the discussion of some points by explaining why the points identified would impact the decision, but the breadth of their analysis was generally lacking. Many weak candidates also failed to attempt to link their discussion to IBL's mission and vision statements, even though they were specifically directed to do so. Some weak candidates attempted to make such links, but they were either generic, or did not sufficiently explain why the increased focus on the online segment was a good fit with the element of the mission or vision statement quoted. For example, they would argue that the focus on the online segment would be a good fit with the vision statement that indicated the desire to promote the development of literacy and life-long learning, without explaining how this would be the case.

AO#9 (Home décor – quantitative)

Candidates were asked to analyze whether IBL should introduce a home décor segment to their business by calculating the potential operating income of this new product line. Information on the projected sales and costs related to the introduction of the new products was provided in Appendix VIII (Performance Management). To demonstrate competence, candidates were expected to provide a reasonable calculation of the incremental operating income (or loss) generated by the introduction of the home décor products, taking into consideration the fact that some of the square footage of the stores would otherwise have been used for books and magazines, and that sales of these products would be reduced proportionally. Candidates were also expected to perform a sensitivity analysis on the additional operating income generated, since all the information provided was a range of possible values.

Candidates performed adequately on this relatively easy assessment opportunity. Candidates were generally able to calculate the incremental operating income generated by the sale of the new products. Most candidates saw the need to include in their analysis an opportunity cost related to the cannibalization of book and magazines sales that would otherwise have occurred for the square footage used to sell the home décor products. However, the calculation of this impact generally contained one of the following two errors: 1) basing the calculation on the selling price of the books and magazines rather than on their gross profit; or 2) basing the calculation on the overall sales of IBL rather than on the in-store sales only. Despite this, most candidates made a reasonable attempt to adjust for the cannibalization of book and magazine sales. The quality of the sensitivity analysis presented varied. Many candidates made the mistake of considering all high numbers in the optimistic scenario and all low numbers in the pessimistic scenario, not realizing that high expenses should instead be associated with a pessimistic scenario. This error prevented candidates from providing a useful analysis of the variability of the incremental operating income projections.

Strong candidates performed better in all three aspects of this AO. They correctly calculated the contribution margin of the new products, had reasonable calculations of the impact of the sales cannibalization, and provided a coherent sensitivity analysis that correctly showed the potential variability of the bottom line.

Weak candidates generally made a poor attempt at quantifying the effect of the cannibalization of sales, or omitted it altogether. Weak candidates also provided a poor sensitivity analysis. They either inverted the scenarios when it came to expenses, or simply did not incorporate the variability of certain expenses, such as salaries, in their calculations. Many weak candidates struggled to transform assumptions on potential gross margins into accurate calculations of sales and cost of goods sold, making various mistakes in the process. For example, several weak candidates used the gross margin percentages provided in the case (a range of 48% to 60%) directly, to quantify the cost of goods sold of the optimistic and pessimistic scenarios, not realizing that if the gross margin is 48% of sales, then cost of goods sold is 52% of sales.

AO#10 (Home décor – qualitative)

Candidates were asked to discuss the advantages and disadvantages of introducing a new home décor segment, and to consider whether it is a good strategic fit for IBL. IBL's mission and vision statements, general information related to the company and its industry, and qualitative information related to the new segment were provided in Appendix VIII (Performance Management). To demonstrate competence, candidates were expected to present a balanced qualitative analysis of the advantages and disadvantages of introducing the new products, and to provide a reasonable discussion of the strategic fit of this proposed addition, including the fit with IBL's mission and vision.

Candidates performed adequately on this assessment opportunity. Most candidates provided a qualitative analysis that included some relevant discussions that were linked to the case facts, displaying a good understanding of the issues. However, the number of valid elements discussed was often lacking, and the breadth of the average discussion was generally disappointing. Most candidates were able to address the most obvious elements, such as the appeal to a new generation, the lack of experience of IBL in that field, and the additional foot traffic in the stores generated by the new products that could wind up increasing book sales as well. However, they often limited their analysis to these elements, and were often unable to provide adequate links to IBL's mission and vision statements.

Strong candidates discussed more valid elements, and in more depth. For example, in addition to what was noted above, strong candidates raised additional elements, such as the issues related to the selection of suppliers, the difficulty of selling these products online, the public perception associated with the change in the type of products, the price sensitivity associated with home décor products, as well as the fact that IBL's competitors have had a head start in introducing these products. Strong candidates also made better links between this decision and the mission and vision statements. Strong candidates generally provided a supported recommendation based on the analysis they had provided.

Similar to AO#8, most weak candidates generally only repeated several case facts in the form of a list of pros and cons, without explaining why or how the case facts listed were actually arguments for or against the new segment. Other weak candidates were able to show some depth in the discussion of some points by explaining why the points identified would impact the decision, but the breadth of their analysis was generally lacking. Many weak candidates seemed to believe that AOs #9 and #10 were a single assessment opportunity, and did not give the qualitative component of the analysis the importance it deserved. Again, many weak candidates also failed to attempt to discuss the strategic fit, even though specifically directed to do so. Some weak candidates attempted to discuss the fit, but they either did not sufficiently explain why the new product line was a good fit with the element of the mission or vision statement quoted, or made interpretation mistakes when they attempted to discuss these items. For example, some weak candidates argued that these home décor products would be a good fit with the part of the mission statement that promoted the creation of a comfortable environment, mistakenly thinking that the home décor products were for redecorating the bookstores themselves, to create an improved customer experience, rather than additional products being sold in the bookstores.

AO#11 (Membership program)

Candidates were asked to discuss the advantages and disadvantages of introducing a new membership program, and to assess its financial impact on IBL. Information related to this proposed program was provided in Appendix VIII (Performance Management). Candidates could have also used other information provided in the Common section of the case to enhance their analysis, such as the mission and vision statements, and general industry and company information. To demonstrate competence, candidates were expected to calculate the incremental operating income generated by the introduction of the membership program, and to present a reasonable qualitative analysis, highlighting the advantages and disadvantages of introducing it.

Candidates struggled with this assessment opportunity, which was expected to be more difficult. They especially struggled with the quantitative component of the required. Candidates were expected to calculate several specific financial impacts of introducing the program: 1) the revenue generated by the fees charged to the members (annual or monthly); 2) the gross margin on the additional sales of books and magazines to the members, as they are expected to visit the stores more often and spend more on each visit; 3) the 10% discounts given to the members; and 4) the costs associated with running the program. Most candidates successfully quantified the first impact (fees) and the third impact (discounts), but struggled with the other two. For the additional sales to the members, they generally calculated the total sales to the members rather than the increase in sales generated by the program. They also generally did not calculate the gross margin on these sales, and mistakenly assumed that additional sales equated to incremental profits. For the costs of running the program, many candidates were unable to differentiate between the ongoing annual costs of running the program (\$500,000 per year) and the one-time initial costs of setting up the program (\$100,000), and treated them as if they were both ongoing costs. Candidates generally did much better on the qualitative portion of this assessment opportunity, and were generally able to provide a reasonable and balanced analysis of the advantages and disadvantages of introducing the program. For example, many candidates discussed the fact that the membership program only provided discounts on in-store sales, which went against IBL's potential willingness to grow its online presence. They also noted that customers would probably be reluctant to provide personal confidential information, given the data security risks involved.

Strong candidates were able to identify the four components of the financial impact of the program, and made a reasonable attempt at quantifying each of them. They understood that only incremental sales to members mattered, and were able to adequately incorporate the discounts and the fees into their calculation. They were also able to clearly differentiate the impact of ongoing costs from the one-time, set-up costs within their quantitative analysis. Strong candidates provided a reasonable qualitative analysis of the program, containing several valid elements.

Weak candidates provided a very poor quantitative analysis, generally making several mistakes in all components of the calculations, except for the annual or monthly fees. Their calculation was often presented in an unstructured way, where many components of the calculation were attempted together, and their logic was therefore very difficult to follow. They often omitted the additional sales and the discount components altogether, and were unable to differentiate upfront costs from ongoing costs. Weak candidates generally provided fewer valid qualitative elements, and their explanations generally lacked depth.

AO#12 (Online segment incentive compensation plan)

Candidates were asked to review, and suggest improvements to, the incentive compensation plan for the online segment, which consists of bonuses for the vice-president, managers, and staff of the segment. Candidates were specifically asked to estimate the vice-president's bonus based on the draft 2023 financial statements. Information on both components of the incentive plan (one for the vice-president, and one for managers and staff) was provided in Appendix VIII (Performance Management). The information provided also contained the job descriptions of the vice-president and managers, and highlighted the elements they could control or influence. IBL's financial statements were provided in Appendix I (Common). To demonstrate competence, candidates were expected to use the results from their AO#7 analysis when calculating the operating income for both segments, to quantify the vice-president's bonus. They were also expected to provide a reasonable analysis of the weaknesses of the current incentive plan, and provide recommendations to improve them.

Candidate performance on this assessment opportunity was disappointing. Although most candidates attempted to calculate the vice-president's bonus and provide the qualitative analysis requested, their performance was generally poor. Candidates made several mistakes in calculating the vice-president's bonus, either because they were unable to apply the bonus formula provided in the case, or because they were unable to quantify the operating income of the online segment, or the EBITDA of the in-store segment, which were the main inputs of the bonus calculation. Candidates generally did better on the qualitative component of the AO, for example, identifying that the vice-president's bonus was in part driven by the performance of the in-store segment, over which she has no control or influence. They also noted that the vice-president's bonus was solely based on the organizational performance, which did not give her an incentive to improve her personal performance.

Strong candidates were able to use the calculations from their AO#7 analysis to quantify the operating income of the online segment, and the EBITDA of the in-store segment, and made a reasonable attempt at quantifying the vice-president's bonus. They also identified additional weaknesses of the current incentive plan, such as, for example, that the managers and staff were being evaluated on elements they did not control, and that they were not encouraged to exceed expectations, since the impact on their bonus was the same, whether they met or exceeded expectations.

Weak candidates often provided a very short response, barely attempting to quantify the vice-president's bonus, and providing a list of very generic attributes of a good incentive plan without addressing the specific components of IBL's incentive plan for its online segment. Many weak candidates skipped over this assessment opportunity, and came back to it at the very end of the exam, and their responses were often rushed and unstructured.

AO#13 (Inventory management system)

Candidates were asked to discuss the weaknesses of IBL's current inventory management system, which has been in use for nearly 20 years. They were also asked to recommend improvements for a potential new system. A description of the features of the current system was provided in Appendix VIII (Performance Management). To demonstrate competence, candidates were expected to identify a reasonable number of weaknesses of the current system, explain the repercussions of these weaknesses on IBL, and provide a recommendation for improvement for each of them.

Candidates performed well on this assessment opportunity. They generally appeared comfortable with this type of required, and the weakness, implication, recommendation approach used by the majority of candidates was an effective way to respond to this required. Candidates were generally able to identify a sufficient number of weaknesses, provide an adequate explanation of the potential adverse consequences of those weaknesses for IBL, and provide a recommendation for improvement for each one. The main differentiator in the quality of the responses was the candidate's ability to explain the impact of the weaknesses identified.

Strong candidates were able to identify many weaknesses, explain their impact clearly, and provide a recommendation that was specific to the weakness addressed. Strong candidates were able to take the description of the features of the current system and pinpoint the specific problems within those features. The impacts of the weaknesses were articulated clearly, and they were specific to the weakness identified, and the recommendations provided were also precise and specific. For example, when using the case fact that "the system lacks current capabilities, such as notifications of stockouts, or a search function. Employees can only filter data using the columns listed below," they segregated this fact into its three components (stockouts, search function, and the limited description of the new inventoried items), and addressed them individually, providing an explanation of the impact, and a distinct recommendation for each one.

Some weak candidates provided a short response, which did not allow them to achieve enough breadth in their analysis. Often, these weak candidates also struggled to articulate the impact of the weaknesses identified clearly enough to display depth in their analysis. For example, when analyzing the lack of notification for stock outages in the current system, they would only identify the problem, and suggest that notifications for stock outages be incorporated in the new system without clearly explaining the unfavourable consequences of stock outages for IBL's operations. Other weak candidates identified what they thought was one weakness of the system that, in fact, included two or three weaknesses. They were then unable to segregate those weaknesses clearly enough when they discussed the impact of those weaknesses. Often, the impact explained by weak candidates was only linked to a single component of the weakness identified, and as a result, the remaining weaknesses were left unexplained.

For example, weak candidates would argue that a weakness of the current system was that the system lacks current capabilities, such as notifications of stockouts, or a search function. Employees can only filter data using the columns listed below. This sentence, taken directly from the case, addresses three different topics (stockouts not notified, impossible to query the system, and the limited descriptions of new inventory items). By lumping them together in their discussions, weak candidates could not demonstrate that the impact of each of the three components is potentially different, and that multiple solutions are required, to alleviate these issues.

Paper/Simulation: Day 2, Taxation Role (IBL)

Estimated time to complete: 300 minutes

Simulation difficulty: Average

Competency Map coverage: Taxation (7)

Evaluators' comments by Assessment Opportunity (AO)

AO#7 (CCA)

Candidates were asked to determine IBL's net income (loss) for income tax purposes and taxable income for the year ended December 31, 2023. The first page of Appendix VIII (Taxation) was entirely about depreciable assets, and candidates had to calculate CCA, to be able to calculate taxable income. To demonstrate competence, candidates were expected to calculate CCA on the opening UCC balances and to incorporate many of the elements related to the current-year additions/dispositions.

Candidates performed well on this AO. Most candidates calculated CCA, providing a clearly laid out table in Excel, showing the different CCA classes and the various items being added or adjusted. They included brief notes for the items that required explanation (such as the landscaping or the Class 13 calculations), and came to a reasonable CCA figure for the year. Typically, they had many of the calculations correct, but made some errors, such as including the new computer purchases in Class 10 instead of Class 50.

Strong candidates calculated CCA, again providing a clearly laid out table in Excel, showing the different CCA classes and the various items being added or adjusted. Strong candidates included brief notes explaining all the items, and came to a reasonable CCA figure for the year. Strong candidates usually made few or no technical errors, often having nearly perfect responses.

Weak candidates attempted to calculate CCA, but often made technical errors while doing so. In addition to including computer additions in Class 10, weak candidates often used immediate expensing and/or did not use the accelerated investment incentive, made errors on the Class 13 additions (such as using only one lease term or all of them), deducted something other than the lesser of cost and proceeds from Class 46, and did not attempt to calculate the capital gain on the Class 46 disposition.

AO#8 (Taxable income – quantitative)

Candidates were asked to determine IBL's net income (loss) for income tax purposes and taxable income for the year ended December 31, 2023. This AO assessed the quantitative component of this request. Information was provided throughout the Common portion of the case about IBL's income for the year, particularly in the financial statements in Appendix I (Common). Additional information about some of the items that were included in income, along with information about transactions affecting CCA, was provided in Appendix VIII (Taxation), and candidates could have also integrated the results of their financial reporting analyses from the Common section into their calculations. To demonstrate competence, candidates were expected to calculate taxable income, incorporating many valid adjustments.

Candidates performed well on this AO. Most candidates provided detailed calculations of net income (loss) for income tax purposes and taxable income, incorporating many adjustments from throughout the case. Most commonly, adjustments were made to integrate the financial reporting changes from the Common AOs, to add back depreciation and deduct CCA, to add back 50% of meals and entertainment, to replace the financial statement gain/loss with recapture and/or terminal loss, to add back non-deductible penalties, and to add back donations.

Strong candidates also provided detailed calculations of net income (loss) for income tax purposes and taxable income. Strong candidates typically included nearly all of the available adjustments in their calculations.

Weak candidates often struggled to make even the simplest adjustments to net income, and rarely integrated the results of their financial reporting discussions into the calculation. They often provided very few adjustments at all, and often made erroneous adjustments, such as deducting donations against a loss for income tax purposes, or including loss carry-overs from Bookmarks, which was a separate legal entity.

AO#9 (Taxable income – qualitative)

Candidates were asked to determine IBL's net income (loss) for income tax purposes and taxable income for the year ended December 31, 2023, including an explanation of the adjustments made in the calculation. This AO assessed the qualitative component of this request. As with AO#8, information was provided throughout the Common portion of the case about IBL's income for the year, particularly in the financial statements in Appendix I (Common). Additional information about some of the items that were included in income was provided in Appendix VIII (Taxation), and candidates could have also integrated the results of their financial reporting analyses from the Common section into their discussions. To demonstrate competence, candidates were expected to discuss several of the adjustments.

Candidates performed adequately on this AO. Most candidates provided explanations for each adjustment, either immediately beside the number in Excel, or in numbered “footnotes” that they provided in Excel or in their Word document. Their explanations were generally satisfactory, addressing the major items and why they needed to be adjusted. Most candidates provided only brief explanations of the financial reporting issues, if they addressed them at all.

Strong candidates also provided explanations for each adjustment, often in more detail than most candidates. For example, they not only stated that bonuses were deductible if paid within 180 days of the end of the year, but also explained that, if paid after that time, they were deductible when paid, and then explained how that applied to each of the three payments (2022 bonuses paid in 2023, and the two 2023 bonus payments). Strong candidates also discussed the items they were not adjusting for, such as the deductible interest paid to suppliers, the income and losses incurred by Bookmarks, and the carry-over of losses and donations.

Weak candidates either provided no explanations at all for their adjustments, or only provided very brief ones, such as “deductible” or “not deductible,” which did not explain why those items were or were not deductible. Even when they made appropriate adjustments in their calculations for AO#8, weak candidates often provided inaccurate explanations for why they were making the adjustments, such as using incorrect timelines for when bonuses must be paid in order to be deductible.

AO#10 (Acquisition of control)

Candidates were asked to prepare a summary of the income tax implications of the share acquisition of Bookmarks. Information was provided about the acquisition of Bookmarks in Appendix II (Common), including the tax values and fair values of its assets and liabilities. Additional information was provided in Appendix VIII (Taxation) about its loss carryforward balances. To demonstrate competence, candidates were expected to identify that there was an acquisition of control and discuss some of the implications, incorporating some specific case facts (such as the specifics around the deemed year end or the case facts supporting the same or similar business criterion).

Candidates performed adequately on this AO. Most candidates identified that there was an acquisition of control, and provided a summary of the significant consequences of this, such as the deemed taxation year end, the rules regarding expiry of non-capital and net capital losses, and the potential for a “bump” on assets whose fair values were higher than their tax values. Most candidates attempted to apply these concepts to case facts, although some struggled to provide relevant case facts to support their discussion.

Strong candidates explained why there was an acquisition of control and provided most of the significant consequences of this—in addition to the concepts discussed by most candidates, strong candidates also identified the requirement to recognize accrued losses, and to choose a new taxation year end. Strong candidates consistently applied the concepts to case facts, for example, explaining that Bookmarks would continue operating its bookstore business with a reasonable expectation of profit and would therefore be eligible to use its non-capital loss carryforwards, or recognizing that, while the deemed taxation year end would be December 30, 2023, Bookmarks could choose a December 31, 2024, end date for its next taxation year, to bring it back in line with IBL.

Weak candidates, if they identified an acquisition of control at all, often focused on minor technical points such as a deemed taxation year end, and rarely applied the concepts to the case facts. Those who attempted to apply the concepts to the case facts often made errors, for example, saying that the deemed taxation year end would be on December 31, 2023, the same day as the acquisition. Those who did not identify the acquisition of control provided generic discussions that were not relevant to the situation at all.

AO#11 (Employee benefits)

Candidates were asked for assistance in determining the income tax implications of automobile and other benefits, for both the employees and IBL. In Appendix VIII (Taxation), candidates were provided with details of the car that had been leased for an executive, as well as information about employee discounts and several non-cash gifts that could be given to employees by managers. To demonstrate competence, candidates were expected to discuss or calculate several of the items relevant to the employee benefits.

Candidates performed well on this AO. Most candidates addressed the personal tax, and some of the corporate tax, implications of the vehicle benefits, consistently attempting (usually correctly) a calculation of the standby charge and operating cost benefit, adjusting both benefits to reflect the reductions available for the low personal use. Most candidates attempted to discuss the other benefits (employee discounts, and several small employee gifts), although they did not always have strong discussions—often, they would discuss some benefits correctly and some incorrectly.

Strong candidates consistently addressed both the personal and corporate tax implications of the vehicle benefits, calculating correctly both the standby charge and operating cost benefit, adjusted to reflect the reductions available for the low personal use. Strong candidates also discussed all the other benefits, correctly identifying the rules around non-cash gifts, and explaining clearly which benefits would or would not be taxable.

Weak candidates, if they attempted the standby charge or operating cost benefit calculations at all, frequently made errors in their calculations, usually by using incorrect formulae or by confusing the formula for a leased vehicle with the one for a purchased vehicle. They rarely explained why the reductions for low personal use would be available, although some did attempt to calculate these reductions. Weak candidates often made many errors in discussing the other benefits, for example, saying that the mugs would be non-taxable if they were under \$500, rather than because they were of trivial value, or saying that the full amount of the non-cash gift over \$500 was taxable, even though only the excess would be.

AO#12 (Shareholder loans)

Candidates were asked if there are any income tax implications for the executives and IBL as a result of some loans that had been advanced to three executives, all of whom owned at least some shares in IBL. Details of the executive loan program, and of the three specific loans, were provided in Appendix VIII (Taxation). To demonstrate competence, candidates were expected to discuss the income tax treatment of some of the loans.

Candidates struggled on this AO. Most candidates attempted to discuss all three loans, and generally understood that the principal on a shareholder loan needs to be included in the shareholder's income unless certain exceptions are met, although they did not always address the specific case facts for these loans, often focusing instead on the two-taxation-year-end rule, which would only be available if the terms of the loans were changed (they were all due to be repaid at the end of five years). Most candidates attempted to address the deemed interest benefits, although their conclusions were not always consistent with their conclusions on the principal (that is, they sometimes taxed both principal and interest, or neither).

Strong candidates discussed the principal inclusion or exclusion for all three loans, clearly identifying the specific rules at play for each (the specified employee/shareholder rules, including the shares of non-arm's length persons, and the home purchase exception). Strong candidates also recognized that the Section 80.4 interest benefit only applies when the principal has not been included in income, and performed calculations of the amounts to be included for each shareholder.

Weak candidates often focused entirely on the Section 80.4 interest benefit, and ignored the Section 15 principal inclusion altogether. Those who did attempt to discuss the principal generally made significant errors, such as excluding the shares held by non-arm's length persons from the specified employee/shareholder calculations, or focusing entirely on the two-taxation-year-end rules, even when both Tina and James met other exceptions, which would not require them to repay their loans before the existing term. This often led to responses in which the explanation for all three shareholders was identical but with changed names and amounts, ignoring the significant differences in the case facts for each loan.

AO#13 (GST/HST)

Candidates were asked some GST/HST questions by Jeff, the acting controller. In Appendix VIII (Taxation), candidates were posed four specific questions about the GST/HST implications of employee benefits, the Bookmarks acquisition, and two proposed transactions. Additional information about the benefits was provided earlier in Appendix VIII (Taxation). To demonstrate competence, candidates were expected to discuss the employee benefits and the transactions in some depth.

Candidates struggled with this AO, which was expected to be difficult. Most candidates generally understood some of the more difficult technical concepts around the purchase of assets of a business and intercompany transactions, including the availability of an election in both situations that could relieve the cash flow issues of paying GST/HST and then claiming an input tax credit (ITC). However, they struggled significantly when it came to discussing the employee benefits—very few candidates identified the rules that deem GST/HST to have been collected on employee benefits, and most candidates usually focused instead on the availability of an ITC on purchases, which was often discussed incorrectly.

Strong candidates had more robust discussions of the technical concepts around the purchase of assets of a business and intercompany transactions, not only identifying that these were taxable transactions and that an election might be available, but that the availability of an ITC leads to the same result, with or without the election, therefore saving only an unnecessary cash outflow. Strong candidates identified that there would be some GST/HST implications to the taxable benefits, often addressing the general concept that GST/HST must be assessed on employee benefits, although they still struggled to identify how they would be determined for the specific benefits.

Weak candidates identified that the asset purchase and intercompany transaction would be taxable transactions, but rarely identified the availability of an election to mitigate the cash flow impacts. If they attempted the GST/HST impact of the benefits at all, they generally focused on the potential for an ITC on some of the costs but drew incorrect conclusions, for example, that all costs spent on vehicle leases would be eligible for an ITC (without identifying that there were limits), or that an ITC would be available for the gift cards purchased (even though gift cards are deemed not to be supplies).

BOARD OF EXAMINERS' COMMENTS ON DAY 3 SIMULATIONS

Paper/Simulation: Day 3, Case 1 (Fresh)

Estimated time to complete: 90 minutes

Simulation difficulty: Average

Competency Map coverage: Management Accounting (1);
Taxation (1);
Strategy and Governance (2)
Finance (1);
Financial Reporting (1);
Assurance (1)

Evaluators' comments by Assessment Opportunity (AO)

AO#1 (Budget variances) (Mgmt Acct)

Candidates were told that Fresh has several differences between its budget and actual 2023 year-end numbers and were asked to analyze the causes, and how much each contributed to the differences. Information regarding new events and initiatives in 2023 was provided in Appendix I, and a draft 2023 income statement, including calculated differences between actual and budget amounts for the year, and notes, was provided in Appendix II. To demonstrate competence, candidates were expected to explain the cause of several budget-to-actual differences, using case facts, and calculate how much the cause contributed to the overall variance in the relevant account.

Candidates struggled with this AO. While most were able to qualitatively explain the reason for several budget-to-actual differences, they had difficulty supporting their explanations with valid calculations. Those who did provide quantitative support for their explanations usually focused on the more obvious variances, such as the \$68,000 gain on the sale of clothing or the \$26,000 increase in marketing expenses. Candidates struggled to provide quantitative support for the largest variance, the \$639,000 increase in subscription sales. While most recognized that it was the result of the change from regular to premium subscriptions, and the new premium subscriptions obtained via the social medial influencer campaign, they were unable to provide reasonable estimates of how much these events would have contributed to the revenue increase. Instead, they would provide no quantitative support at all, or would calculate only how much revenue would have increased in one month rather than across the entire year.

Strong candidates qualitatively and quantitatively analyzed many budget-to-actual differences. They clearly recognized the need to estimate how much an item would have contributed to Fresh's financial results, and to reconcile that estimate to the calculated difference on the draft income statement. Strong candidates were better at integrating information from throughout the case, for example, combining the subscription pricing on the first page with the information on new customers from the social media campaign in Appendix I, to calculate the new revenue that was generated by influencer advertising. Strong candidates were also able to provide useful information in the face of uncertainty by making reasonable assumptions in their calculations. For example, these candidates assumed that the switch from regular to premium subscriptions occurred evenly across the year. As a result, they were able to provide a useful estimate of how much total new revenue was generated by the switch, even though the case said only that the switch happened throughout 2023. While rare, some strong candidates were able to explain less obvious differences by applying a general understanding of Fresh's business model, for example, concluding that shipping expense had gone up due to, and in the same proportion as, the growth in revenue.

Weak candidates explained only a few of the budget-to-actual differences, and their explanations were often incorrect or only partially correct. For example, some weak candidates concluded that shipping expense had increased solely because of the increased shipping provision, or that marketing expense had gone down because of the cut to print advertising, when in fact, marketing expense had gone up overall. Weak candidates generally did not provide any supporting calculations. Weak candidates who did attempt to quantify focused on calculating the percentage change in the various accounts, or the percentage that each account contributed to the overall change in net income. These candidates seemed to recognize that some type of calculation was required for this AO, but ultimately provided analyses that were of no value in explaining the underlying causes of the individual line-item variances.

AO#2 (Federal corporate taxes payable) (Tax)

Candidates were asked to calculate Fresh's federal corporate taxes payable for 2023. Appendix II contained information relevant to the request, including an income statement showing an accounting gain on sale, and notes with details on opening UCC balances, clothing additions, unpaid bonuses, a shipping provision, meals and entertainment, and an annual staff party. To demonstrate competence, candidates were expected to make several adjustments to the net income for accounting purposes in order to arrive at taxable income, and apply a reasonable tax rate, to calculate taxes payable.

Candidates performed well on this AO. Most candidates attempted to calculate taxable income, and commonly provided adjustments for depreciation, meals and entertainment, and CCA on the furniture. Many also attempted to address the unpaid bonuses, staff party, and the CCA on rental clothing. However, candidates struggled with some of the more complex adjustments, such as those related to the shipping provision, and the accounting gain on the sale of clothing. Candidates who did address the shipping provision frequently included only one side of the adjustment, or incorrectly deducted the current-year provision while adding back the provision amount from the prior year. Candidates who addressed the gain on sale of the clothing frequently assumed that the amount resulted in a taxable capital gain, failing to recognize that the proceeds on disposition were unlikely to exceed the cost of the clothing. Most candidates used a reasonable rate for calculating taxes payable, although many assumed that only one rate, either the small business rate or the general rate, would apply to all of Fresh's taxable income. Most candidates reduced their final taxes payable amount by the instalments remitted by Fresh during the year.

Strong candidates incorporated more elements into their taxable income calculation, and accurately explained the reasons for their adjustments. For example, they explained that bonuses had to be added back, since they were not paid within 180 days of year end, or that the staff party was an allowable deduction, since it was within the limit of six parties per year and was provided to all employees. Strong candidates also demonstrated better technical knowledge with respect to CCA by accurately placing the clothing additions in Class 12, and explaining either the ability to claim a 100% CCA allowance, or to immediately expense these items. Strong candidates demonstrated a solid understanding of corporate taxes payable by splitting Fresh's taxable income into the portion that was eligible for the small business deduction and the portion that was not, and then applying an accurate small business rate and general rate to these amounts, respectively. Finally, strong candidates were more likely to appropriately integrate information from other areas of their response, for example, adjusting income to reflect the recommendation they had made regarding accounting for the algorithm costs.

Weak candidates limited their analysis to only a few adjustments, and many lacked the technical knowledge required for calculating taxable income. For example, weak candidates did not add back the rental clothing depreciation, and either did not attempt to calculate CCA or did not identify appropriate CCA classes for Fresh's capital assets. Other weak candidates treated the instalment payments as an adjustment to taxable income rather than an adjustment to taxes payable. Finally, weak candidates frequently mixed up the direction of their adjustments, adding back items that should have been deducted, or deducting items that should have been added back. When weak candidates did provide correct adjustments, they often did not support the treatment they suggested, or provided incorrect technical guidance, for example, stating that bonuses could not be deducted because they were not paid in 2023. Weak candidates either did not attempt to calculate taxes payable, or did not use a reasonable rate in their calculation. For example, many weak candidates applied the full basic federal tax rate of 38%, or assumed that the appropriate rate was equal to the instalment amount of \$80,000 divided by Fresh's accounting income before taxes.

AO#3 (Algorithm licensing agreement risks) (Strat & Gov)

Candidates were asked to explain the risks of a draft licensing agreement for Fresh's algorithm, BestFit, and to provide suggestions for mitigating the risks. Appendix III outlined the draft licensing agreement, with five draft terms for consideration. To demonstrate competence, candidates were expected to discuss some of the risks associated with the agreement, and recommend appropriate revisions or risk mitigation strategies.

Candidates performed well on this AO. They were able to provide a reasonable coverage of the risk areas, most commonly addressing the collection of retailer data, the use of a shared folder for data storage, and retailer access to the algorithm's source code. Most candidates attempted to address the impact these risks would have on Fresh, and provided effective recommendations for mitigating the risk, such as providing a standard data collection template for all retailers to use, having separate, password-protected folders for each retailer, and prohibiting access to the algorithm's source code in order to protect Fresh's intellectual property. Candidates typically addressed the risks using a weakness, implication, recommendation approach that proved to be effective.

Strong candidates discussed most of the risks and provided more depth in their discussions. For example, they would go beyond noting that shared file access would give retailers unauthorized access to each other's confidential information, explaining the legal consequences or reputational damage that Fresh might incur as a result. Other strong candidates commented, not only on the need for a consistent data collection format, but also for standardization of the amount and type of data provided by retailers, to optimize BestFit's performance. Strong candidates provided practical recommendations that were simple to implement but respected the initial intent of the draft terms. For example, regarding the customer-satisfaction guarantee, strong candidates recommended practical ways to ensure the validity of the customer feedback received, or discussed how the satisfaction guarantee could be modified to limit lost revenue.

Weak candidates discussed only a few risks, or suggested revisions to the agreement without first explaining the impact of the risk identified. For example, weak candidates would conclude that retailer data should not be stored on the cloud without explaining why cloud storage was an issue. Weak candidates who did attempt to address the implications of the risks did not explain them in enough depth, for example, stating simply that retailers would be able to see each other's data in the shared folder, without explaining why that was problematic or how it could ultimately create consequences for Fresh. Other weak candidates provided invalid implications, for example, concluding that, if allowed to use whatever format they wished, retailers would intentionally provide misleading data, so the algorithm would fail. Weak candidates also provided impractical or ineffective recommendations, for example, having customers submit signed paper versions of their feedback forms, or requiring retailers to ask permission before disclosing or selling the algorithm source code to others. In other cases, rather than providing valid revisions to the terms, weak candidates would simply recommend that the terms be removed from the agreement altogether. Finally, some weak candidates would provide generic IT control discussions regarding the prevention of hacking or the need for regular backups, that did not clearly tie to the terms in the draft licensing agreement.

AO#4 (Financing options) (Fin)

Candidates were asked to analyze two financing options for completing the development of Fresh's algorithm, BestFit, and recommend one. Appendix IV introduced two debt options that could be used to obtain the needed \$500,000: a traditional bank loan, or a series of loans from friends and family. To demonstrate competence, candidates were expected to discuss some of the factors to consider in the two financing options, and provide a recommendation.

Candidates performed well on this AO. Most candidates discussed relevant decision factors for both options and provided a recommendation. Candidates seemed particularly comfortable addressing the timing of interest and principal repayments, the fact that the bank disbursement schedule did not align with the timing of when the funds were needed for the project, and the potential dilution of Alyssa's share ownership percentage under the convertible loans from friends and family. Most candidates also compared the interest rate of each option, but these comparisons lacked depth, generally stating simply that the interest rate on the bank loan was higher than the interest rate on the loans from friends and family.

Strong candidates discussed more relevant factors for each option and provided more depth in their discussion. For example, strong candidates not only recognized that Alyssa's shareholdings could be diluted under the convertible debt option, but also calculated the maximum 40% equity stake that would be given up upon conversion. Strong candidates addressed not only the current cost of both options, but compared the volatility associated with the variable rate on the loans from friends and family to the stability of the fixed rate on the bank loan. Finally, strong candidates not only recognized that the bank loan disbursement schedule did not meet Fresh's needs, but supported this observation by calculating the \$250,000 that would be received in 2024 and comparing it to the \$350,000 needed for BestFit expenditures. Many strong candidates also had greater breadth in their discussions, addressing not only the common decision variables above, but also the administrative burden involved in a series of loans, and the fact that the bank is a more reliable funding source for securing the full \$500,000 needed. While rare, some strong candidates discussed that, since the conversion of the loans to common equity was at a fixed amount, depending on the value of Fresh at the time of conversion, Alyssa might be forced to give up equity for less than it is worth.

Weak candidates lacked depth and breadth in their discussions, typically discussing only a few valid decision factors, or simply listing the case facts as pros or cons without explaining why they were viewed as such. For example, weak candidates would label the fact that the bank is open to changing the timing of funding in exchange for a slightly higher interest rate as a pro, but would not explain why this timing flexibility would be beneficial to Fresh. Other weak candidates would build discussions around variables that did not differ between the two options, for example, stating that the lack of collateral on the bank loan was a benefit; however, there was no mention of collateral on the loans from friends and family either, so this was not a valid area of difference between the two options. Finally, weak candidates frequently performed unnecessary calculations in an attempt to compare the two options, for example, using a net present value analysis to determine which of the two options was most expensive, when a simple comparison of the provided interest rates would have been sufficient. These candidates seemed unable to adapt to a different scenario that emphasized qualitative over quantitative analysis in the assessment of financing options.

AO#5 (Intangible assets – algorithm) (Fin Rep)

In Appendix V, candidates were provided with a list of expenditures incurred by Fresh for the development of its BestFit algorithm, and asked to explain the best way to account for the BestFit costs under ASPE. They were told that all costs to date have been expensed. To demonstrate competence, candidates were expected to analyze the accounting treatment of the BestFit costs, using *ASPE 3064 – Goodwill and intangible assets*, and to conclude on whether the specific costs must remain expensed or if some could be capitalized as development costs.

Candidates performed well on this AO. Most candidates were familiar with either the general definition and recognition criteria for intangible assets, or the specific criteria applicable to internally-generated intangible assets, and consistently used relevant case facts to assess whether the relevant criteria had been met. Almost all candidates provided a conclusion on whether the developer salaries or copyright-related legal fees could be capitalized. Most also seemed aware of the distinction between research costs and development costs, and explained the need to expense the consultant fees, since these were incurred during the research phase of the project.

Strong candidates provided a discussion of most of the applicable sections of ASPE 3064 before concluding on the costs that had been incurred. For example, most strong candidates first analyzed the definition of an intangible asset, as well as the general intangible asset recognition criteria, before moving on to discuss the internally-generated intangible asset recognition criteria. Strong candidates consistently applied case facts to all the criteria before concluding on whether the costs for the internally-developed algorithm could be capitalized. Many strong candidates also demonstrated a clear understanding of the distinction between the research phase and the development phase, and used events and dates provided in the case to determine when the development phase began. These candidates then clearly concluded that only costs incurred after that date were eligible for capitalization. Finally, strong candidates recognized that, even when the criteria are met, it is still a choice to capitalize development costs, and provided a supported recommendation on whether to capitalize or expense the salaries and legal fees.

Weak candidates either attempted to discuss fewer of the applicable sections of the Handbook, or their discussion did not address all of the relevant criteria. Many weak candidates did not discuss the criteria in enough depth, lacking the integration of case facts to support their analysis, and often stating only whether or not the criterion was met. Weak candidates often allocated the specific costs to the research and development phases, without first analyzing whether the criteria were met in order to be able to capitalize the costs. Other weak candidates discussed only the consultant fees and the need to expense these as research costs. Some weak candidates did not address this client request at all, despite it being explicitly asked for in Appendix V.

AO#6 (Audit procedures) (Assu)

Candidates were asked to help Fresh prepare for its annual audit by describing what audit procedures the auditor will likely perform over the algorithm expenditures, revenue, and salaries and wages. Appendix V provided details on the algorithm expenditures, and the first page of the case described Fresh's subscription revenue model. Additional information on revenue was provided in Appendices I and II. Appendix II also provided information on salaries and wages. To demonstrate competence, candidates were expected to provide some valid procedures in these areas.

Candidates performed adequately on this AO. Most candidates provided a sufficient number of procedures, and most attempted to provide procedures in the three identified areas of the required. Candidates most commonly provided procedures over the algorithm expenditures and the subscription revenue, and did better with simple procedures that tested accuracy, for example, vouching to third-party documents, such as the consultant's invoice, to verify the amount of the research expense. Most candidates provided several procedures; however, not all of them were complete, precise, and useful. For example, some candidates proposed inquiring with management, to ensure that the algorithm costs met the capitalization criteria, but did not specify what types of questions would be asked.

Strong candidates provided precise procedures that included specific and clear audit evidence, such as invoices, customer subscription agreements, and payroll reports. They were also able to clearly explain how the work would be performed. Strong candidates offered multiple procedures per area, for example, providing procedures on both research costs and development costs. Their procedures also addressed multiple assertions, such as occurrence, cut-off, and completeness, rather than just accuracy, and were more complete, providing a better coverage of the risk. Strong candidates attempted procedures that went beyond the simple ones, and clearly incorporated an understanding of Fresh's business model, for example, explaining that they would test whether revenue performance had been achieved by looking at shipping documents, to ensure that clothing had been delivered.

Weak candidates provided procedures that were vague and not well explained. These candidates were unable to suggest clear audit evidence. For example, they would recommend reviewing the costs for the algorithm to see if they meet the capitalization criteria, without explaining where the cost information would come from, or would suggest looking at source documents without identifying the specific document that would be viewed (e.g., invoices, time sheets, etc.). Other weak candidates provided incomplete procedures, often only providing the purpose of the procedure they were suggesting, rather than explaining how to perform the procedure. For example, they would recommend obtaining the customer agreement and verifying that revenue is recorded properly, but did not specify what information from the contract would be used in making this determination. Weak candidates also attempted fewer procedures overall, and did not cover all three areas included in the required. Many weak candidates failed to provide any kind of audit evidence at all, suggesting only that the auditors would look at the GL to ensure that amounts were recorded properly.

AO#7 (CEO strategic fit) (Strat & Gov)

Candidates were asked to advise on which of two potential CEO candidates would be the best strategic fit for Fresh. Appendix VI presented information on both candidates. To demonstrate competence, candidates were expected to discuss some of the strategic decision factors to consider, and provide a recommendation on which candidate to select.

Candidates performed well on this AO. Most candidates discussed a reasonable number of decision variables, the most frequent being the more obvious items, such as the benefit of Genevieve's fashion experience for a clothing rental company versus the benefit of Shane's technology experience for the development of BestFit. Most candidates also discussed the pros and cons of Shane's desire for stock-based compensation, and many highlighted the alignment between Genevieve's belief in the potential of clothing rental with Fresh's core business strategy. Candidates generally went beyond case facts to explain why a given factor was strategically important to Fresh, but did not always clearly contrast the two CEO candidates. For example, many candidates would discuss the impact of Shane's preference for stock-based compensation without addressing the impact of Genevieve's preference for salary-based compensation. Almost all candidates provided a recommendation on which CEO candidate to select.

Strong candidates discussed most of the important decision variables and provided more depth in their discussion. Most strong candidates clearly contrasted Shane and Genevieve, explaining the strengths and weaknesses of each in terms of fashion experience, technology experience, and alignment with Fresh's core business strategy. Strong candidates recognized multiple ways in which a candidate's past experience could benefit Fresh, for example, stating that Shane's technology experience would be useful, not only for BestFit but also for marketing through social media and optimizing Fresh's e-commerce business model. Strong candidates were also more likely to discuss the cultural fit of the two candidates, recognizing that Shane's plans to hire more software developers, salespeople, and remote workers would not align with Fresh's current close and cohesive workplace. Finally, although rare, a few strong candidates made recommendations to help address any weaknesses in the selected candidate, for example, suggesting that IT professionals be hired, as needed, to supplement Genevieve's lack of knowledge in technology.

Weak candidates lacked depth and breadth in their discussions, typically discussing only a few valid decision variables. Weak candidates tended to focus on the more obvious factors related to each candidate's past work experience but often ignored the more strategic issues in the case. For example, weak candidates generally did not discuss how each candidate aligned with Fresh's desire to focus on clothing rental as the driver of its future growth, or how their plans for the future would fit in with the current workplace culture. Other weak candidates would simply list the case facts pertaining to Shane and Genevieve as pros or cons, without explaining why they were viewed as such. For example, weak candidates would state that Shane's technology experience was beneficial to Fresh without explaining why. Weak candidates who did attempt to explain why an issue was important to Fresh would often lack a strategic focus, for example, discussing that Genevieve's preference for salary was beneficial because it was tax deductible. In general, weak candidates provided brief discussions that arrived at a recommendation without a useful analysis to support that recommendation.

Paper/Simulation: Day 3, Case 2 (PT)

Estimated time to complete: 80 minutes

Simulation difficulty: Average

Competency Map coverage: Financial Reporting (2);
Taxation (1);
Assurance (1);
Finance (2)

Evaluators' comments by Assessment Opportunity (AO)

AO#1 (Revenue recognition) (Fin Rep)

Candidates were told that PT's controller needed help with accounting for the first sale of its new legal-services package. Appendix I provided information on the new legal-services package. To demonstrate competence, candidates were expected to discuss, in reasonable depth, the performance obligations of the contract and the amount of revenue to recognize, using the guidance from *IFRS 15 – Revenue from contracts with customers*.

Candidates performed well on this AO. Most candidates identified the five steps for revenue recognition under IFRS 15, and were able to integrate relevant case facts into their analyses, under each of these steps. Most candidates recognized that, although there was no written agreement, the fact that there was a verbal agreement between Rashad and Eveline still met the contract criterion under IFRS 15. Most candidates were able to identify the three performance obligations in the contract, but had more difficulty explaining why each service represented a distinct performance obligation. Most candidates also discussed the satisfaction of performance obligations criteria; however, they did not always adequately address all three performance obligations in their analyses. Most candidates also attempted an allocation of the transaction price, using stand-alone prices provided in the case and the total transaction price.

Strong candidates were able to provide depth in their analyses of the five steps for revenue recognition under IFRS 15. For example, for the first step (identifying the contract), they would go beyond recognizing that there was a verbal agreement between Rashad and Eveline, identifying that the transaction had commercial substance, discussing the vague payment terms, as Rashad explained that Eveline could pay “later this year,” or discussing the collectability of the contract, as Eveline was experiencing cash flow issues. Strong candidates were also able to better support why the three performance obligations in the contract were distinct from each other, explaining how Eveline could benefit from each service as a stand-alone service. Strong candidates also addressed all three services regarding the satisfaction of performance obligations criterion, and provided a clear conclusion on the amount of revenue that could be recorded at year end.

Weak candidates usually provided a superficial analysis of the accounting treatment for the new package of legal services, often incorporating little to no case facts. They were more likely to reach a conclusion, for example, that there was a contract in place without providing any support for their conclusion, or that there were three performance obligations included in the contract without any explanation. Weak candidates were also likely to discuss the satisfaction of performance obligations for only one of the three services, the most common being the home purchase agreement that was completed by the year end. For the allocation of the transaction price step in IFRS 15, weak candidates often took the stand-alone price for each service provided in the case as the transaction price for each service individually, not realizing that the total transaction price of \$4,500 was lower than the total stand-alone price for the bundle of three services (\$6,000), and that this lower price needed to be allocated to each service. Weak candidates also provided conclusions that were not adequately supported. For example, they would conclude that one-quarter of the pre-nuptial agreement revenue should be recognized, but did not explain why the revenue should be recorded over time.

AO#2 (Impact on the corporate taxable income of the current investments) (Tax)

Candidates were told that Rashad, one of the business partners in PT, made two investments with excess funds. They were asked to explain the impact of these investments on the corporate taxable income for the March 31, 2024, year end. They were also asked to explain the impact on corporate taxable income if PT were to sell the investments today. Appendix II provided information on the two investments (a real estate investment of two commercial buildings currently rented, and an investment in 1,000 shares of You-Tok, a publicly-traded company). To demonstrate competence, candidates were expected to address several of the taxation issues related to these transactions, such as the original recording of the buildings in Class 1 for capital cost allowance (CCA) purposes, the potential taxable capital gain on the buildings if they were to be sold, or the inclusion in net income and following deduction for the full amount of qualifying dividends for the You-Tok shares, a taxable Canadian corporation.

Candidates performed adequately on this AO. Most candidates were able to discuss a reasonable number of taxation issues in the case, but they often focused their discussions on the simpler taxation issues, such as the initial recording of the buildings in Class 1 for CCA purposes, the potential taxable capital gain on the buildings, or the potential net capital loss on the You-Tok shares. For the taxable capital gain and the net capital loss discussions, candidates often did not take into consideration the inclusion rate of 1/2 (or the 2/3 inclusion rate that applies for dispositions after June 24, 2024). When they tried to discuss other taxation issues, their discussions often lacked support or contained technical errors. For example, regarding the impact of receiving dividends from the You-Tok shares, candidates would conclude that the dividends had to be included in taxable income, not realizing that the impact on taxable income was nil, as You-Tok was a taxable Canadian corporation, so PT would benefit from a deduction of the full amount of qualifying dividends received.

Strong candidates were able to provide greater coverage of the different taxation issues in this case, and their discussions were technically accurate. In addition to the most common taxation issues discussed, strong candidates would also discuss other issues, such as calculating the potential CCA recapture if PT were to sell the buildings today, integrating the Class 1 undepreciated capital cost (UCC) they previously calculated and comparing it to the potential disposal proceeds of \$2.3 million in order to determine the recapture amount.

Weak candidates often did not provide PT with enough information on the tax implications of the investments, or their discussions contained technical errors. For example, they would simply conclude that the dividends from You-Tok would have to be included in income, or that the disposition of the buildings and shares would generate a capital gain and loss, and potentially some CCA recapture to be included in taxable income. Many weak candidates confused the personal taxation of investment income with the corporate taxation of investment income, for example, concluding that the dividends received from You-Tok, a taxable Canadian corporation, would have to be grossed-up as eligible dividends, and that PT would receive a corresponding eligible dividend tax credit on this amount. Other weak candidates did not take into consideration the capital gain or loss inclusion rate, concluding, for example, that PT would have to include a \$300,000 capital gain in taxable income if it were to sell the property now.

AO#3 (Investment property) (Fin Rep)

Candidates were asked to answer the controller's questions regarding the accounting treatment of the real estate investment. Appendix II provided information on the property, which includes two adjacent commercial buildings currently leased to tenants. Candidates were told that the purchase was recorded in property, plant, and equipment (PP&E) on the balance sheet, and were asked if that was correct. They were also asked how to account for this property if PT ends up moving in. To demonstrate competence, candidates were expected to recognize that the property needed to be accounted for as an investment property, and to discuss the accounting policy choices available to PT under *IAS 40 – Investment property* for its measurement (i.e., cost model or fair value model). They were also expected to discuss the impact of a change in use, if PT ended up moving in.

Candidates performed adequately on this AO. Most candidates recognized that they needed to use the guidance in IAS 40 to determine how to account for this property. Most candidates were able to properly use the definition and recognition criteria of IAS 40, and concluded that the property should be presented as an investment property rather than as PP&E. Most candidates also recognized that PT would have a choice of accounting policy available for the measurement of the investment property—either the cost model or the fair value model. However, candidates had more difficulty properly explaining how these two models worked, and their potential impact on PT's financial statements. A significant proportion of candidates completely ignored the last part of the requirement (i.e., how to account for this property if PT ends up moving in). When they tried to answer that question, most candidates simply concluded that there would be a change in use, without properly explaining the impact of this change in use on PT's financial statements.

Strong candidates provided more depth in their analysis of the investment. They used case facts to properly support why the property met the definition and recognition criteria as an investment property. They were also able to discuss the two models in greater depth, explaining the difference between the two, and using case facts to demonstrate what the impact of both models would be on PT's financial statements. Strong candidates also discussed the impact of a change in use, and the related reclassification as PP&E. They would take into consideration the model they recommended to use for the measurement (fair value model or cost model), to establish the new cost under IAS 16 after the change in use.

Weak candidates either did not identify the two options available for the measurement of the investment property, or provided a weak analysis of the options, simply concluding that there would be a choice between two models. Some weak candidates incorrectly assumed that the investment property was properly recorded as PP&E, using *IAS 16 – Property, plant and equipment* criteria, and incorrectly concluded that PT could choose between the cost model or the revaluation model.

AO#4 (Control weaknesses) (Assu)

Candidates were asked to discuss the control weaknesses in the investment process, and to recommend improvements. Appendix III provided information regarding PT's investment process. To demonstrate competence, candidates were expected to identify some of the investment process control weaknesses, explain their implications, and provide practical recommendations for addressing the control weaknesses identified.

Candidates struggled with this AO. Most candidates attempted to discuss a reasonable number of control weaknesses, but struggled to clearly identify the underlying control weakness in PT's investment process. They would often focus their discussion on the form of communication regarding the investment decision (for example, "when Rashad comes up with an investment idea, he tells Kristel over coffee"), or they would simply restate case facts as a weakness (for example, "Rashad once invested in an ice cream company because it was a hot day"), not realizing that these were case facts they could use, to discuss the greater control weakness issue regarding the arbitrary investment decision-making process. By not understanding what the real issues in the investment process were, candidates often had several discussions revolving around the same control weakness.

Strong candidates discussed more control weaknesses and showed a greater understanding of the underlying control issues, providing complete discussions that included a clear identification of the weakness and implication to PT, and a reasonable recommendation. Strong candidates were also able to provide precise and practical recommendations, for example, suggesting that at least two members of management should approve any investment decisions, rather than just proposing that PT have a formal approval process for the investment decision.

Weak candidates attempted to discuss fewer of the control weaknesses. Weak candidates also provided recommendations that were too vague or not practical, for example, suggesting that PT hire more employees and better segregate the duties around the investment process. Many weak candidates clearly struggled to identify the underlying control weakness in the investment process. For example, these candidates would often have more than one separate discussion around the arbitrary investment decision-making process. They would provide a discussion based on the form of communication for new investment ideas (over coffee, or in an email or text message), the fact that there is no approval for the new investment, and the fact that Rashad once invested in an ice cream company because it was a hot day, without realizing that all of these had the same root cause (the arbitrary investment decision-making process).

AO#5 (Investment options) (Fin)

Candidates were asked to assess whether each one of Rashad's investment ideas meets PT's objectives. The first page of the case provided information about the objectives (PT's low-to-moderate risk tolerance, and its strategy to optimize performance through the use of technologies, and promote and enable flexible work arrangements). Appendix III provided PT's 6% expected rate of return. Appendix IV provided information on Rashad's new investment ideas (a new cryptocurrency, an equity investment in a travel agency, and a loan to a consulting company). To demonstrate competence, candidates were expected to provide a reasonable analysis of the investment options, taking into consideration PT's objectives.

Candidates performed well on this AO. They were usually able to discuss the risk level associated with each of the three investment options, and to tie it back to PT's low-to-moderate risk tolerance. Candidates had more difficulty explaining why the investment options met, or did not meet, the expected 6% rate of return. For the loan to the consulting company, although they had all the information needed to calculate the exact rate of return, most candidates did not provide a calculation, and when they did, their calculation often contained technical errors, with the most frequent error being not taking into consideration the time value of money (as the loan was for a three-year period). Candidates were generally able to explain why some investments were in line with PT's strategy, most commonly regarding the equity investment in Virtual Vagabond, a travel agency that helps businesses find short-term office accommodations for individuals who work remotely while travelling.

Strong candidates provided a thorough analysis across the three investment options and all three of PT's objectives. These candidates provided good depth in their analysis of the options, and demonstrated a clear understanding of these investment vehicles. Strong candidates were able to better support why the investment met, or did not meet, PT's objectives. Regarding the loan to the consulting company, strong candidates were able to provide an accurate calculation of the rate of return, and to compare it with the expected 6% rate of return.

Weak candidates generally provided very superficial analyses around the three investment options. Some weak candidates would simply conclude on whether the objectives were met, or were not met, for the three options, with little to no support. Some other weak candidates did not seem to clearly understand all the investment vehicles presented, especially the cryptocurrencies. They would often have vague statements, such as "cryptocurrencies are risky," but were unable to explain how this fact related to PT's objective, for example, by explaining that Costume was a new cryptocurrency with no history, which could be highly volatile, and would therefore most likely exceed the low-to-moderate risk tolerance of PT. Other weak candidates did not clearly link their analysis to PT's objectives. For example, they would discuss how the value of the cryptocurrency could fluctuate significantly, but did not relate this back to PT's risk tolerance or expected rate-of-return objectives.

AO#6 (Business valuation) (Fin)

Candidates were told that PT was considering buying a small firm (Westley), and were asked to calculate the value of the firm. Appendix V provided a summary of the potential deal, and Westley's financial information. To demonstrate competence, candidates were expected to provide a calculation of PT's normalized EBITDA that included a sufficient number of adjustments, and to use the two-to-three times EBITDA earnings multiplier, to provide a valuation of Westley.

Candidates performed adequately on this AO. All the information they needed for calculating the normalized EBITDA was clearly laid out in Appendix V, and most candidates appropriately adjusted net income, using some of the information provided. The most common adjustments were the more obvious ones, such as removing the recorded gain for the unusual insurance claim, or adjusting for the salary of the owner, which was \$150,000 lower than the average lawyer's annual salary. However, candidates usually had more difficulty integrating other adjustments, such as the salary for the owner's son or the cost of the two offices, and when they did, they struggled to explain the rationale behind those adjustments. Most candidates were able to use an appropriate multiplier to calculate the value of Westley, often providing a range of value (using the two-to-three times EBITDA multiplier).

Strong candidates were able to integrate more EBITDA normalizing adjustments, and to clearly explain the rationale behind those adjustments. For example, they would add back the monthly rent of \$2,000 for the Florida office, explaining that this office was used by the owner to work from Florida but, as most of Westley's clients are in Canada, it would therefore not be needed going forward. Strong candidates also provided a recommended value in the price range they calculated, that was supported by case facts. For example, some strong candidates recommended a price based on two times EBITDA, since the owner had many of the same clients for over 15 years, but as they will not be dealing with him anymore, some of these clients might leave Westley once the owner retires.

Weak candidates struggled to correctly incorporate the EBITDA normalization adjustments, usually having difficulty determining which direction to make the adjustment, for example, adding back \$10,000 for the unusual insurance gain instead of removing it, as it was already recorded. Weak candidates also did not incorporate a sufficient number of adjustments into their calculation, usually only adjusting for one or two items noted in Appendix V. Some weak candidates also used the wrong basis for their calculation of the firm's value, for example, using income before tax instead of EBITDA.

Paper/Simulation: Day 3, Case 3 (Prairies)

Estimated time to complete: 70 minutes

Simulation difficulty: Average

Competency Map coverage: Management Accounting (2);
Strategy and Governance (1);
Taxation (1);
Assurance (1)

Evaluators' comments by Assessment Opportunity (AO)

AO#1 (Expansion opportunities) (Mgmt Acct)

Candidates were asked to analyze two product expansion opportunities, Cit-E-Bike and SnoTrax, and recommend one. In Appendix I, candidates were provided with sales and variable cost figures, estimated monthly demand for each product, and the additional labour hours available per month. To demonstrate competence, candidates were expected to provide a reasonable calculation of the contribution margin of each product and recommend which product to produce, considering the constraint on available labour hours. Candidates could have also provided qualitative considerations to support their recommendation.

Candidates performed adequately on this AO. Most candidates were able to provide a reasonable calculation of the contribution margin for the two products, correctly incorporating the variable costs, and ignoring the sunk costs for design and prototyping. Candidates were generally comfortable converting the general labour and utility charges to a per-unit basis for each product, and incorporated the specialized labour in the Cit-E-Bike product. Many candidates who calculated the contribution margin on a per-unit basis were able to recognize that there were not enough available labour hours to meet the demand for each product, and were able to perform a second calculation, to determine the contribution margin per direct labour hour by product in order to provide a reasonable conclusion of which product was more profitable on a per-hour basis. Some candidates calculated a full net profit by product, based on the demand that could be fulfilled using constrained labour hours, and concluded, based on which product produced the higher net profit, which was also acceptable. Candidates were not as comfortable addressing the qualitative considerations of the decision, with many not addressing any qualitative considerations. Most candidates provided a recommendation based on their quantitative analysis only.

Strong candidates prepared a contribution margin calculation for both products, often with no errors. They correctly calculated the variable costs associated with parts, labour, utilities, and shipping, and included the specialized labour associated with the Cit-E-Bike product. Strong candidates correctly excluded the overhead costs that were applicable to both products, or the design and prototyping costs associated with the SnoTrax product. Strong candidates recognized the capacity constraint on available labour hours, and determined which product was more profitable, considering that the production capacity was less than the demand for each product. Strong candidates also incorporated some qualitative considerations into their analysis, the most common being the logistical and sustainability considerations of Cit-E-Bike parts coming from China, the implications to Prairies of having to find specialized labour for the Cit-E-Bike, or that the data for Cit-E-Bike estimates was based on European information, and is not yet supported with actual sales data. Strong candidates added depth to their qualitative discussions by explaining how or why the consideration was important to Prairies. Strong candidates often addressed the qualitative considerations related to how the product offerings fit with Prairies' business practices, or Tulip's vision, mission, and corporate objectives. For example, they would address the sustainability impact and reduced carbon footprint of purchasing products locally, or how SnoTrax allowed the company to be innovative. Strong candidates provided a recommendation based on both their quantitative and qualitative analyses.

Weak candidates provided quantitative analyses that included significant conceptual errors. For example, many weak candidates incorporated the design and prototype costs in their calculation for SnoTrax, failing to recognize that these costs are considered a sunk cost and should not be part of the analysis. Weak candidates often omitted multiple variable costs from their calculations, the most common being the general labour and utility charges. Some weak candidates were unable to express the inputs to their calculations on a consistent basis. These candidates did not recognize that the variable costs were provided on a different basis, with the general labour and utilities being provided on a per-hour basis, and the specialized technician and shipping costs provided on a per-unit basis. Weak candidates did not recognize the labour constraint, or were unsure how to incorporate it into their analysis. For example, many weak candidates tried to allocate the available hours between the two products so that both could be produced, rather than determining which one was the best to produce with the available hours. Weak candidates did not attempt a qualitative discussion, and based their recommendation solely on their calculations.

AO#2 (Strategic fit of current operations) (Strat & Gov)

Candidates were asked to compare the vision, mission, and objectives of Tulip with Prairies' business practices and address areas where they are aligned, areas where they are not, and recommend changes to Prairies in order to fit with Tulip. Candidates were provided with Tulip's vision, mission, and objectives in Appendix II, and with some social media comments from Prairies employees in Appendix III. To demonstrate competence, candidates were expected to discuss several areas where Tulip and Prairies may or may not be aligned.

Candidates performed well on this AO. Most candidates were able to identify the vision, mission, and corporate objectives of Tulip, and analyze whether the business practices of Prairies aligned. Candidates were generally able to identify relevant information from the social media comments from Prairies' employees to support their conclusion on whether Prairies was in alignment with Tulip. Candidates were most comfortable identifying that Prairies' business practice of focusing on the local Calgary market was not aligned with Tulip's vision to be a global bicycle business, with an objective to expand to new countries. Candidates were also comfortable recognizing that Prairies' sustainability committee suggested they promote sustainable business practices, which was in alignment with the corporate objective to foster green business practices. Further, candidates often adequately discussed that Prairies' employees never had a performance review, which was not in alignment with Tulip's mission to promote direct feedback to employees. Candidates had more difficulty with providing improvements in areas where they did not align, and often provided an overall recommendation for Tulip to change its vision, mission, and corporate objectives, rather than recommending individual changes to Prairies' business practices.

Strong candidates were able to address, in more depth, whether the vision, mission, and corporate objectives of Tulip aligned with the current business practices of Prairies. Strong candidates provided a balanced analysis, addressing areas where Prairies and Tulip did not align, as well as areas where they did. Strong candidates clearly identified which components of the vision, mission, and corporate objectives aligned, or did not align, with Tulip, and integrated the relevant case facts to support their conclusion. Strong candidates also provided recommendations on steps that Prairies could take to become more aligned with Tulip, such as suggesting that Prairies train employees to be able to grow sales in markets outside of Calgary, and incorporating performance reviews and regular employee communications to better align with Tulip's mission to promote hard work, direct feedback, and innovation with employees.

Weak candidates struggled in all areas. They usually listed business practices of Prairies without identifying whether they aligned or did not align with Tulip, often in bullet format, restating information provided in the case. For example, they would state that Prairies had a sustainability committee or that Prairies fired an employee without providing a performance review, but did not address whether that meant they were aligned or not aligned with Tulip's vision, mission, and corporate objectives. Some weak candidates thought that Prairies was well aligned with Tulip, and these candidates failed to see the significant areas where Prairies' business practices did not align with Tulip. Most weak candidates ignored the request to address what might need to change at Prairies, to fit **with Tulip**.

AO#3 (Compensation program) (Mgmt Acct)

Candidates were asked to review Tulip's compensation plan, explain whether each feature of the plan will be effective in incentivizing Prairies' employees, and provide recommendations for improvement. Information on Tulip's compensation plan was provided in Appendix IV. To demonstrate competence, candidates were expected to discuss several features of the compensation plan and provide recommendations for improvement.

Candidates struggled with this AO. Candidates often addressed whether the compensation plan met Tulip's vision, mission, and objectives, rather than addressing whether the compensation plan would be incentivizing for Prairies' employees. For example, candidates would discuss that the bike allowance would be incentivizing to employees because Tulip's vision was for cycling to be the preferred mode of transportation. Candidates also often focused their discussion solely on the company's perspective. For example, they were concerned that the quality of production might go down if employees attempted to improve labour efficiency by reducing their hours to manufacture a product, or they would discuss the high cost of offering a health and wellness plan, or the difficulty in tracking employees biking to work. Candidates who did address the plan from the employee's perspective often felt the compensation plan would be incentivizing to employees because it was a means to earn additional income, or because the employee would want to meet the vision, mission, and objectives of Tulip. These candidates failed to recognize that there were weaknesses in Tulip's compensation plan, such as the impact of introducing below-market salaries to employees who were used to high, stable salaries. Candidates who addressed whether the compensation plan would incentivize employees were most comfortable identifying that employees would likely not be motivated to meet the measure of increasing sales to new countries, as they were unlikely to be able to control the ability to meet the target. Often, candidates did not provide improvements, and those who did often recommended that the company remove the measure entirely rather than provide an improved measure. The few candidates who did address recommendations provided vague or impractical suggestions for improvement. For example, to incentivize employees to bike to work, candidates would

suggest that the company check the parking lot throughout the day for signs of cars, or remove the parking lot entirely so that employees had to bike to work.

Strong candidates analyzed several of the compensation plan objectives and provided explanations, addressing whether they would be incentivizing to the employees. Strong candidates were comfortable addressing the more straightforward objectives, such as the bike allowance and expanding to new countries, as well as the more challenging objectives, such as increasing overall profitability. Some strong candidates recognized that the objectives were not likely to incentivize employees, as they were only within the control of senior management staff rather than all employees. These candidates often provided additional depth in their analysis by explaining why that would not incentivize an employee. For example, they would identify that employees likely did not have direct control over an increase in net income because they had no direct involvement in managing depreciation and income tax amounts, or would identify how it was likely only the sales department that had any influence over sales to new countries. Strong candidates were able to address ways to improve the measures, to motivate employees. For example, some strong candidates would address that the bike allowance did not consider the climate in Calgary, or the geographic distance to work for all employees, and would recommend that the compensation plan offer bus passes, or support carpooling for all employees of Prairies.

Weak candidates were unable to address the compensation plan from the perspective of whether it would incentivize employees. For example, weak candidates would state that the measure to increase sales to new countries was effective in incentivizing employees because employees would want to meet Tulip's vision for cycling to be the preferred mode of transportation, failing to recognize that all of Prairies' employees did not currently bike to work. These candidates could not support why an employee would be incentivized to meet the vision, mission, and corporate objectives, and failed to recognize that an employee was unlikely to want their compensation tied to something they had no control in achieving, or did not personally value. Most weak candidates did not attempt to provide recommendations to address the measures; those who did often recommended that the company remove the measure entirely, or reallocate the percentage of bonus over the other measures.

AO#4 (GST system and compliance) (Tax)

Candidates were asked to provide the new controller with an overview of the Canadian GST/HST system, and to explain the GST/HST return filing and payment deadlines, whether the company was on track to meet its deadlines, the consequences of being late, the corporate income tax filing and payment deadlines, and the instalment requirements. The first page of the case provided candidates with the current date, the second page provided the year-end date, and Appendix V provided information relating to the estimated taxes payable, details regarding an income tax instalment payment, and the date the last GST/HST return was filed. To demonstrate competence, candidates were expected to discuss several tax concepts, considering both GST/HST and corporate income tax.

Candidates performed well on this AO. Most candidates were comfortable addressing the filing and payment deadlines associated with corporate income tax returns, and were able to provide a general understanding of the Canadian GST/HST system, often addressing the company's responsibility to charge and remit HST on revenues, and explaining how input tax credits could be claimed, to reduce the amount owing. Candidates demonstrated technical knowledge in GST/HST by identifying the rules around filing frequency, and often provided the technical rules for monthly, quarterly, and annual filers. However, candidates often failed to use the revenue amount provided in Appendix V to determine how frequently Prairies needed to file its GST/HST return, based on the filing frequency rules in the Income Tax Act. Candidates often ignored the request to address the consequences to the company of being late on their filing and payment deadlines, and when they did address the request, showed technical weakness in explaining how interest and penalties are calculated, with many candidates assuming it was a single rate applied to both. Candidates also often ignored the request to address instalment requirements, but when they did attempt a discussion, they generally only mentioned that instalments are required when the corporate tax payable in the current or previous year exceeds \$3,000.

Strong candidates provided an in-depth discussion of the Canadian GST/HST system, explaining how the value-added tax works, addressing both the responsibility to collect as well as the ability to offset the amount owing with input tax credits. Many candidates also discussed considerations for when a company would need to initially register for GST/HST. Strong candidates could identify what the revenue thresholds were, to determine the GST/HST filing requirements, and were able to integrate case facts to identify that, based on Prairies' revenue, it was required to file quarterly returns. Strong candidates could identify when the GST/HST return was due, based on the quarterly filing requirement, and advised whether the return and payment were late. Strong candidates explained how interest and penalties would apply to the late filing, and recognized that they are calculated separately by the Canada Revenue Agency, with interest being based on the prescribed rate, and penalties being a formula based on the amount owing and the number of months the return is late. Strong candidates correctly identified the filing and payment deadlines for the corporate tax return, and noted that neither the payment nor the return was late. Some strong candidates were able to recognize that Prairies' CCPC status ended because of the acquisition by Tulip, and explained the impact of this on the payment frequency of the corporate tax instalments or on the corporate tax filing deadline.

Weak candidates struggled to identify the GST/HST filing and payment deadlines for Prairies. These candidates often demonstrated technical weakness in the application of filing and payment deadlines, with many weak candidates stating that the company had to file and pay GST/HST three months after the quarter ended. Weak candidates often addressed the interest and penalties associated with late-filed GST/HST returns as one combined amount, not recognizing the different calculations each required. Weak candidates often provided a conclusion on whether Prairies was late that was not supported by an application of case facts, to determine the specific filing and payment deadlines. For example, they struggled to identify that the company's year end was December 31, and to correctly apply the filing rules to a calendar. They would identify that the corporate tax return was due within six months of year end, but would then conclude that it was due in March or September. Weak candidates also demonstrated technical weakness in the application of corporate tax filing and payment rules, with some incorrectly concluding that the company had to file its return and pay its taxes at the same time, or by referencing deadlines for personal tax (April 30) or self-employed individuals (June 15).

AO#5 (Audit plan) (Assu)

Candidates were asked to provide a report that included an assessment of the risk of material misstatement at the overall financial statement level, an explanation of what the auditor's materiality assessment would likely be, and a discussion of the expected audit approach. Information relevant to the audit plan was provided throughout the case. To demonstrate competence, candidates were expected to provide a reasonable discussion of the risk assessment at the overall financial statement level, what the auditor's materiality assessment would likely be, and discuss the audit approach.

Candidates performed well on this AO. Candidates were generally comfortable addressing risks, with many explaining that both the fact that it is a first-time audit, and the new staff, increased risk at the financial statement level. Candidates were most comfortable discussing materiality, and discussed the users, basis, percentage, and performance materiality, demonstrating a strong understanding of assurance concepts applied to the case. Most candidates recognized that the basis for determining materiality was the needs of the users of the audited financial statements. When discussing the users of the financial statements, candidates usually identified the bank and Tulip (or its shareholders) as users. Candidates were generally able to provide a calculation of materiality using a reasonable basis, and some were able to address performance materiality, recognizing that it is based on the risk assessment, and not the sensitivity of the users. Candidates were less comfortable discussing the overall approach to the audit, with many candidates not integrating case facts into their analysis, and providing a generic response on a combined-versus-substantive audit approach that could apply to any entity. Candidates often incorrectly concluded that a substantive approach was the only approach that could be used in a first-time audit, failing to recognize that it is possible to use a combined approach in a first-time audit if controls are strong, and can be adequately tested and relied upon.

Strong candidates identified more risks when addressing the risk of material misstatement at the overall financial statement level. For example, in addition to the commonly addressed risks, many strong candidates were able to identify that Prairies has a bias of increasing profits to make the financial statements look stronger to the bank, or that errors in the accounting department suggested a lack of controls in place, which could increase the risk of further errors. Strong candidates were able to adequately discuss the users' needs in using the financial statements, and to identify a relevant basis and percentage to use, by using professional judgment and a consideration of the users' needs and sensitivity to error. Most were also able to calculate a reasonable materiality and performance materiality figure. Strong candidates were also able to provide a supported conclusion on the audit approach by applying specific case facts. These candidates often noted that the auditor would likely use a substantive approach, since there were signs of a weak control environment at Prairies, and supported this with examples of control weaknesses from the case, such as identifying the history of errors, and the accounting department always being rushed to make correcting entries. Some strong candidates would address first-year audit considerations on the approach, since Prairies had not been previously audited. For example, they would discuss the need to audit the opening balances and prior-year comparative information. They also identified that inventory made up most of Prairies' asset balance, and discussed that roll-back procedures would be necessary for auditing inventory, since it was now past the year end.

Weak candidates struggled to use case facts in discussing the risks, and demonstrated a misunderstanding of the timing of the audit. Weak candidates often noted that the acquisition of Prairies by Tulip would increase the risk of material misstatement, as it was a complex transaction; however, the acquisition occurred after the audit year. Similarly, the compensation plan was often discussed as a risk area, even though it had not yet been implemented. Many weak candidates also demonstrated technical weakness when explaining materiality concepts. For example, many confused materiality and performance materiality, often explaining that materiality is based on risk rather than on user needs, and performance materiality is based on user needs rather than risk. Some weak candidates simply provided a materiality calculation of income before tax multiplied by 5%, with no justification of why this basis or percentage would be appropriate for the users. Weak candidates often concluded that the auditors would take a substantive approach, solely because it was after year end, and incorrectly noted that controls could not be tested.

APPENDIX G

CPA COMMON FINAL EXAMINATION REFERENCE SCHEDULE

CPA COMMON FINAL EXAMINATION REFERENCE SCHEDULE

Present Value of Tax Shield for Amortizable Assets

Present value of total tax shield from CCA for a new asset acquired after January 1, 2024, and before January 1, 2028, other than those eligible for immediate expensing, which would normally be subject to the half-year rule.

$$= \frac{CdT}{(d+k)}$$

Present value of total tax shield from CCA for a new asset acquired after January 1, 2024, and before January 1, 2028, other than those eligible for immediate expensing, which would not normally be subject to the half-year rule.

$$= \frac{CdT}{(d+k)} \left(\frac{1+1.25k}{1+k} \right)$$

Present value of total tax shield from CCA for a new asset acquired after November 20, 2018, and before January 1, 2024, other than those eligible for immediate expensing.

$$= \frac{CdT}{(d+k)} \left(\frac{1+1.5k}{1+k} \right)$$

Notation for above formula:

C = net initial investment

T = corporate tax rate

k = discount rate or time value of money

d = maximum rate of capital cost allowance

Selected Prescribed Automobile Amounts

Item	2023	2024
Maximum depreciable cost — Class 10.1	\$36,000 + sales tax	\$37,000 + sales tax
Maximum depreciable cost — Class 54	\$61,000 + sales tax	\$61,000 + sales tax
Maximum monthly deductible lease cost	\$950 + sales tax	\$1,050 + sales tax
Maximum monthly deductible interest cost	\$300	\$350
Operating cost benefit — employee	33¢ per km of personal use	33¢ per km of personal use
Non-taxable automobile allowance rates		
— first 5,000 kilometres	68¢ per km	70¢ per km
— balance	62¢ per km	64¢ per km

Individual Federal Income Tax Rates

For 2023:

If taxable income is between	Tax on base amount	Tax on excess
\$0 and \$53,359	\$0	15%
\$53,360 and \$106,717	\$8,004	20.5%
\$106,718 and \$165,430	\$18,942	26%
\$165,431 and \$235,675	\$34,208	29%
\$235,676 and any amount	\$54,579	33%

For 2024:

If taxable income is between	Tax on base amount	Tax on excess
\$0 and \$55,867	\$0	15%
\$55,868 and \$111,733	\$8,380	20.5%
\$111,734 and \$173,205	\$19,833	26%
\$173,206 and \$246,752	\$35,815	29%
\$246,753 and any amount	\$57,144	33%

Selected indexed amounts for purposes of computing income tax

Personal tax credits are a maximum of 15% of the following amounts:

Item	2023	2024
Basic personal amount, and spouse, common-law partner, or eligible dependant amount for individuals whose net income for the year is greater than or equal to the amount at which the 33% tax bracket begins	\$13,520	\$14,156
Basic personal amount, and spouse, common-law partner, or eligible dependant amount for individuals whose net income for the year is less than or equal to the amount at which the 29% tax bracket begins	15,000	15,705
Age amount if 65 or over in the year	8,396	8,790
Net income threshold for age amount	42,335	44,325
Canada employment amount	1,368	1,433
Disability amount	9,428	9,872
Canada caregiver amount for children under age 18, and addition to spouse, common-law partner, or eligible dependant amount with respect to the Canada caregiver amount	2,499	2,616
Canada caregiver amount for other infirm dependants age 18 or older (maximum amount)	7,999	8,375
Net income threshold for Canada caregiver amount	18,783	19,666
Adoption expense credit limit	18,210	19,066

Other indexed amounts are as follows:

Item	2023	2024
Medical expense tax credit — 3% of net income ceiling	\$2,635	\$2,759
Old age security repayment threshold	86,912	90,997
Annual TFSA dollar limit	6,500	7,000
RRSP dollar limit	30,780	31,560
Lifetime capital gains exemption on qualified small business corporation shares	971,190	
Lifetime capital gains exemption for dispositions before June 25		1,016,836
Lifetime capital gains exemption for dispositions on or after June 25		1,250,000

Prescribed interest rates (base rates)

Year	Jan. 1 – Mar. 31	Apr. 1 – June 30	July 1 – Sep. 30	Oct. 1 – Dec. 31
2024	6	6	5	
2023	4	5	5	5
2022	1	1	2	3

This is the rate used for taxable benefits for employees and shareholders, low-interest loans, and other related-party transactions. The rate is 4 percentage points higher for late or deficient income tax payments and unremitted withholdings. The rate is 2 percentage points higher for tax refunds to taxpayers, with the exception of corporations, for which the base rate is used.

Maximum capital cost allowance rates for selected classes

Class	Rate	Additional information
Class 1	4%	For all buildings except those below
Class 1	6%	For buildings acquired for first use after March 18, 2007, and \geq 90% of the square footage is used for non-residential activities
Class 1	10%	For buildings acquired for first use after March 18, 2007, and \geq 90% of the square footage is used for manufacturing and processing activities
Class 8	20%	
Class 10	30%	
Class 10.1	30%	
Class 12	100%	
Class 13	N/A	Straight line over original lease period plus one renewal period (minimum 5 years and maximum 40 years)
Class 14	N/A	Straight line over length of life of property
Class 14.1	5%	For property acquired after December 31, 2016
Class 17	8%	
Class 29	50%	Straight-line
Class 43	30%	
Class 44	25%	
Class 45	45%	
Class 50	55%	
Class 53	50%	
Class 54	30%	

The CPA certification program prepares future CPAs to meet the challenges that await them. For more information on the qualification process, the common final examination (CFE), and the specific education requirements for your jurisdiction, contact your provincial/regional CPA body.

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