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## Summary

Day 1 of the Common Final Examination is focused on assessing the candidate's problem solving abilities by drawing on the group work participation in Capstone 1. Candidates are expected to have done extensive evaluation of the organization at hand and its industry. Regardless of the strategy recommended by the candidate's group, each candidate will come into a new scenario which integrates the learnings and group work from Capstone 1.

## Timing

The case facts are set approximately two years subsequent from the original case facts.

## Issues

In this particular case:

- bank covenants are not being met, and
- a major decision that was made (in Cap 1 case) is in question as a result of the joint venture partner being in financial difficulty.

These issues directly test the higher-level problem solving aspect and integrate earlier analysis, such as:

- the Board's request for receiving information on other forms of ownership/financing
- Joint venture issues related to an alternative analyzed in the original Cap 1 case
- understanding of the stakeholders in the Cap 1 case
- bringing the performance measurement/incentive and transfer pricing issue to the forefront by integrating a business level alternative

## Assessment Opportunities

The assessment is focused on the problem solving and decision-making professional enabling skills and candidates are expected to apply these skills at the highest level for certification as defined in the CPA Competency Map; however, candidates are expected to draw on the Core 1 and 2 common base of competencies in formulating the technical elements of their response.

A sample technical response is shown separately.

Some of the enabling skills as well as a summary of some of the technical competencies assessed are summarized below (or, “tools” that could be applied within the analysis).

## 2. Problem Solving and Decision Making

### 2.1 Demonstrates a cohesive process for using professional judgment to solve problems and make decisions.

2.1.1 Defines the scope of the problem.

2.1.1.1 Obtains an initial understanding of the problem and its context.

The main issues are:

- Not meeting bank covenants (current ratio and return on assets) and the bank will call some financing at the end of the year without a solid business plan
- The joint venture partner has gone bankrupt and a competitor has offered to purchase this company
  - Arndt can either counter the offer and obtain a new facility for production;
  - allow the purchase and renegotiate the Joint Venture into a 50/50 split;
  - sell the Joint Venture
- Internal performance measurement and transfer pricing policies (companies are outsourcing rather than purchasing internally, in order to meet metrics)
- Arndt still wants to break \$500 million in sales by 2019

2.1.1.2 Divides larger problems into appropriate sub-problems to facilitate analysis.

- Evaluation of the Joint Venture from the perspective of keep or sell
  - Keep means an IPO/Private Equity alternative
    - Diversion of production to newly acquired facility
  - Selling means loss of this product and loss of revenue (jeopardizing the revenue goal)
- Evaluation of decreasing operating results and performance measurement

2.1.1.3 Exercises judgment in determining whether an issue requires attention.

- Issues should be prioritized. For example, emphasis should be placed on the major issues (meeting bank covenants and decision to keep or sell Joint Venture)

**2.1.1.4 Differentiates problems having a single viable solution/conclusion from problems having multiple potentially viable solutions/conclusions.**

- Major issues have different viable solutions/conclusions; setting an internal transfer pricing policy (integrated with performance metrics/bonus evaluation) is more suited to one recommendation.

2.1.2 Collects and verifies relevant information.  
 2.1.2.1 Identifies the purpose and type(s) of information to be gathered.  
 2.1.2.2 Uses appropriate methods to gather or develop relevant information.  
 2.1.2.3 Verifies/corroborates/tests information and evaluates the quality of information sources, as needed, to satisfy the purpose of the analysis.

- Evaluation of ratios (gross margin, operating ratios and bank covenants)
- Determines shortfall and forecasts if the organization can resolve the issues internally or not
- Summarizes current goals, targets, objectives, constraints for the purpose of performing analysis

**Technical Competency Areas**

Analysis of the current situation	Core – Fin Actg	Core– Mgmt Actg	P M	FI N	AS	TX
1.4.4 Interprets financial reporting results for stakeholders (external or internal)- <i>Analyzes, interprets, and explains financial statement information to or for stakeholders</i>	A					
2.3.2 Evaluates the entity’s internal and external environment and its impact on strategy development		B	A			
5.1.1 Evaluates the entity’s financial state ( <i>Performs financial analysis, including ratio analysis, industry benchmarking, trend analysis, and cash flow analysis</i> )		A		A	A	
5.2.1 Evaluates the entity’s cash flow and working capital		A				

### 2.1.3 Performs appropriate analyses.

2.1.3.1 Identifies the purpose of computations and analyses, and considers qualitative factors.

2.1.3.2 Determines whether precise calculations, estimates, forecasts, or projections are required.

2.1.3.4 Chooses and applies appropriate analysis techniques.

#### EL Buy/Sell/50-50 Joint Venture (JV) option

- Assesses company financials (risk/goodwill/new facility)
- Assesses impact to locomotive option (COGS, time of delivery)
- Assesses risk in sharing 50/50 JV
- Assesses value of the JV (in terms of asking price)
- Assesses impact on revenue goal by selling the JV
- Assesses impact on current ratio and return on assets

#### Private Equity Option

- Assesses risks (loss of control)
- Assesses impact on current ratio

#### IPO

- Assesses risks and regulatory creep
- Assesses impact on current ratio

#### Performance measurement/transfer pricing

- Suggests an improvement to measurement and transfer pricing policies

*Note: Candidate Groups should have evaluated overall performance measurement/incentive systems and general transfer pricing theory in the original Cap 1 case. In this additional piece, the issue comes to a more technical forefront by allowing candidates to calculate a transfer price given an investment opportunity. They can also use their group work discussions in suggesting a performance measurement/incentive structure so that the divisions are more willing to transfer goods between each other versus going out to the market. (Note: gross margins are decreasing, coupled with inter-company transfers – e.g. in 2007 intercompany transfers were \$17.7 million; in 2009 they were \$15.031 million and in 2012 they are only \$7.9 million and this is integrated with overall material costs being higher as a whole).*

#### Overall

- Assesses return on assets (given the forecasts), and evaluates how Arndt can meet this covenant

2.1.3.6 Performs and interprets sensitivity analysis.

- Directly through IPO alternative (i.e. number of shares to issue and related costs)
- Other (based on candidate assumptions)

*Technical Competency Areas*

Analysis options	Core – Fin Actg	Core– Mgmt Actg	P M	FN	AS	TX
<b>Analysis of strategic alternatives – General</b>						
1.4.5 Analyzes and predicts the impact of strategic and operational decisions on financial results	B	B	A			
3.2.1 Develops or evaluates information inputs for operational plans, budgets, and forecasts		A				
3.2.2 Prepares, analyzes, or evaluates operational plans, budgets, and forecasts		A				
3.6.2 Evaluates performance of responsibility centres		B	A			
3.6.3 Evaluates root causes of performance issues		B	A			
4.3.1 Assesses issues related to the project	B				A	
4.3.5 Assesses the risks of the project ( <i>i.e. internal and external risks related to the alternative</i> )	B				A	
5.2.3 Evaluates sources of financing		B		A		
5.2.4 Evaluates decisions affecting capital structure		B		A		
5.2.5 Evaluates the entity's cost of capital		B		A		
5.3.1 Develops or evaluates capital budgeting processes and decisions		B		A		
5.6.1 Evaluates the purchase, expansion, or sale of a business	B			A		
6.1.1 Assesses a corporate entity's general tax issues	B					A

**2.1.4 Integrates information to investigate each potentially viable solution or conclusion.**

- 2.1.4.1 Explores potentially viable solutions or conclusions.
- 2.1.4.2 Analyzes cause-and-effect relationships and makes logical inferences.
- 2.1.4.3 Considers alternative interpretations of quantitative and qualitative information.
- 2.1.4.5 Integrates information and the results of quantitative and qualitative analyses to evaluate alternative solutions/conclusions.
- 2.1.4.6 Extends analyses beyond immediate, short-term effects to evaluate longer-term, indirect implications.
- 2.1.4.7 Explicitly articulates and justifies assumptions.

- These attributes reiterate the analysis done above → the overall integrating issues are keep/sell the JV and longer-term impacts to goals and covenants

**2.1.5 Recommends and justifies a solution or conclusion based on an integrative view of information for the situation.**

- 2.1.5.1 Develops appropriate decision criteria and uses the criteria to select and justify a preferred solution/conclusion or to rank potential solutions.

Major decision criteria:

- Bank's covenants (current ratio and return on assets)
- Arndt goal (\$500 million in revenues by 2019)
- Stakeholder preferences (IPO versus private equity versus neither)

- 2.1.5.3 Develops implementation plans for recommendation(s).

- High-level implementation plan; mainly highlighting goals/targets/constraints can be met and addresses risks related to the recommendations

### Technical Competency Areas

Analysis options	Core – Fin Actg	Core– Mgmt Actg	P M	FN	AS	TX
<b>Implementation of strategic alternatives - General</b>						
1.3.1 Prepares financial statements	A					
3.2.1 Develops or evaluates information inputs for operational plans, budgets, and forecasts		A				
2.5.1 Designs an effective risk management program and evaluates its impact on shareholder value		B	A			
4.3.10 Draws conclusions and communicates results	B				A	

#### 2.1.6 Uses creativity and innovation to enhance problem solving and decision making.

2.1.6.1 Identifies and sets aside preconceived ideas that might bias or limit analyses and conclusions.

*Candidates have to put aside what they may have concluded/recommended earlier (in Cap 1) in order to address the current state/issues*

### 3. Communication

3.2 Writes and speaks to enhance work performed.  
 3.2.1 Communicates logically, clearly, and concisely in one of the two official Canadian languages (English and French).  
 3.2.3 Formats and organizes financial and non-financial information to enhance understandability and usefulness.  
 3.2.4 Exhibits professionalism in written and spoken communications.

### 4. Self-Management

4.1.4 Manages time effectively.

- Candidates must use their time effectively and prioritize the issues and analyses