CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

CFE CANDIDATE NUMBER:

Common Final Examination
September 13, 2017 – Day 1
(Booklet #1 – FVT Version 1)

Total examination time: 4 hours.
Further details on the examination can be found on the next page.

GENERAL INSTRUCTIONS BEFORE THE EXAMINATION

1. Fill in your 7-digit candidate number on the booklets and the USB key. The exam booklets and the USB key (or paper response, as instructed) must be submitted before leaving the writing centre. They must NOT BE REMOVED from the writing centre. If these items are not received, the response may not be accepted.
2. Sign the Policy Statement and Agreement Regarding Exam Confidentiality below.
3. Follow the Securexam instructions provided. Instructions must not be removed from the examination centre.

<u>Policy Statement and Agreement Regarding Exam Confidentiality</u>

I understand that all examination materials are the property of CPA Canada and are under the exclusive custody and control of CPA Canada. CPA Canada has the exclusive authority over examination materials to determine the contents, use, retention, disposition and disclosure of this material. Candidates do not have access to the examination questions, examination marking keys or any other marking materials for a non-disclosed examination. For disclosed examination questions, access to questions, marking keys and other marking materials is only available when published by CPA Canada.

I hereby agree that I will not:

- Obtain or use answers or information from, or give answers or information to, another candidate or person during the sitting of the examination;
- Refer to unauthorized material or use unauthorized equipment during testing; or
- Remove or attempt to remove any CPA Canada Examination materials, notes, or any other items from the examination room.

I further agree to report to CPA Canada any situations where there is a material risk of compromising the integrity of the examination.

I affirm that I have had the opportunity to read the Writing Centre Rules and I agree to all of its terms and conditions.

In addition, I understand that failure to comply with this Policy Statement and Agreement may result in the invalidation of my results, disqualification from future examinations, expulsion from the profession, and possible legal action.

______________________________ __________________________
CANDIDATE NAME (Please print) SIGNATURE

(CONTINUED ON PAGE 2)

Examination Details

The examination consists of:

Booklet #1 – Linked Case (240 minutes) (this booklet)
Booklet #2 – Capstone 1 case and rough notes

The case should be answered in Securexam. Securexam has an answer tab and a spreadsheet tab to input your response. The main body of your response should be in the answer tab. Only supporting calculations should appear in the spreadsheet tab, **under Sheet 1**. You are responsible for clearly explaining all your calculations, as outlined in the Securexam tutorial.

Answers or part answers will not be evaluated if they are recorded on anything other than Securexam or the CPA Canada writing paper provided. Rough-note paper is available in the second booklet, which also includes a copy of the Capstone 1 case. Rough notes, and any other notations made in the exam booklet(s) will not be evaluated.

The CPA Canada Handbooks and the Income Tax Act, in the form of searchable PDF files, are available within Securexam throughout the entire examination. Securexam provides the standards in effect and tax laws substantively enacted as at December 31, 2016.

A tax shield formula and other relevant tax information are available at the end of this booklet.

Common Final Examination, September 2017

Chartered Professional Accountants of Canada
277 Wellington Street West
Toronto, Ontario M5V 3H2

Case **(Suggested time: 240 minutes)**

It is May 5, 2020, and Chris Renker, your boss at Renker and Curtis Co Management Consultants (RCC) tells you that you will be working with the original consulting team on another consulting engagement with First View Theatres Inc. (FVT).

Chris recently met with Stephanie, Viktor, and Lanny Lightfoot and Zobair Terdel to discuss the events that occurred between 2017 and 2020 (Appendix I). Industry growth rates for regular box office revenue have been nil and are predicted to decline as entertainment substitutes gain popularity. Many smaller companies have been forced out of the industry, and the larger nation-wide companies have gained more negotiation power with film distributors. This change has increased film costs and decreased margins for FVT's film exhibition business.

During 2017, FVT invested in the Premium Plus Viewing (PPV) technology in two auditoriums in London and two auditoriums in Leamington. Due to these successful investments, FVT has remained profitable, despite the increased film costs. The proposed investments in CLR, the Quebec-based company, and The Games Place were not pursued. The sale leaseback of the head office building was not pursued either.

Updated statistics on 2019 attendance numbers by theatre locations and industry benchmarks are in Appendix II and III. Financial statements for the year ended 2019 are included in Appendix IV.

To better compete for qualified staff, FVT increased its hourly part-time rate and changed some part-time positions to full-time. Interest rates have increased, and the Canadian dollar is expected to remain stable against the U.S. dollar. Consumers appear willing to spend more of their discretionary income than in the recent past.

Changes, including luxury seating and service, along with four-dimensional (4D) technology, have made film watching very different from home viewing. As attendees are willing to pay a premium for enhanced viewing experiences, an increasing number of theatres are upgrading their technology. The latest technology is virtual reality (VR). Although no feature-length VR movies have yet been released, industry experts believe the technology will be perfected within the next two years.

Change is so rapid that it is increasingly expensive to stay informed of, and implement, the changes. Some of FVT's competitors have gained significant financial benefit by investing in new technology at the developmental stage, resulting in lower implementation costs and increased profits on sale of the technology to competitors.

(CONTINUED ON PAGE 3)

At FVT's most recent board meeting, the mission and vision statements were changed, after much heated discussion, with Stephanie being the only dissenting shareholder. The company is still committed to providing a premier entertainment experience. However, the board supported more aggressive investment in new technology.

Vision statement: *Our vision is to be at the forefront of providing premier and, state-of-the-art entertainment to our guests.*

Mission statement: *Our mission is to provide a premier and state-of-the-art entertainment experience tailored to the local community. We accomplish this by investing in leading-edge film projection technology in order to be the first company to implement this technology for our customers' viewing experience. We also strive to train employees to be respectful, attentive, and friendly, select films that best appeal to the local community, ensure clean and safe venues for employees and attendees, and support entertainment and arts in the local community.*

The board also modified some of FVT's objectives. The board wants to ensure that operating cash flow and net income increase by at least 5% in 2020. In addition, shareholders want to improve FVT's solvency ratios by continuing to pay off the term loan, and they want to reach a return on equity of 10% by 2021. FVT is less focused on revenue per attendee and more focused on growing profits.

FVT needs to make some decisions quickly. Chris assigns you the following tasks: "Please prepare a report for the board of FVT. Taking into account what you learned about FVT in the previous engagement, please recap the important decision factors for FVT's board to consider, focusing on significant changes from our previous situational analysis that will impact FVT. Further, provide your assessment of the major issues currently facing FVT. For each of the major issues, identify for the board any significant considerations they may not have taken into account and any additional information they must obtain before making their decisions. FVT's board wants us to focus on the strategic decisions but to also address any operational issues that need to be considered first. Finally, where there is sufficient information, you are to suggest a course of action."

(CONTINUED ON PAGE 4)

INDEX TO APPENDICES

(CONTINUED ON PAGE 5)

APPENDIX I
BOARD MEETING WITH CHRIS RENKER IN ATTENDANCE

Stephanie: Thank you, Chris, for attending our special board meeting. For your information, since our last engagement, the management positions have not changed. The board has decided to limit FVT's total spending on investments at this time to $2.5 million.

Here is a summary of major events since the last engagement.

2017	May 16	FVT sold its head office land and building, but there was no leaseback. Consequently, FVT moved its head office to a new location and entered into a 10-year operating lease.
2017	June 1	FVT invested $0.5 million in Connery's Bar and Grill (CBG) for a 75% ownership in the joint arrangement.
2018	January 1	Stephanie invested $3 million for 5,000 common shares of FVT.
2018	February 17	Cost-cutting measures were implemented at the Sarnia locations, and the number of auditoriums showing films at Sarnia #1 was reduced to six.
2018	August 27	Suisui Yang left and was replaced by Caterina Lavine.
2018	October 15	FVT implemented the FLIXREWARDS program.
2018	December 31	The remaining preferred shares were redeemed. Kent and Sheila Lightfoot officially retired from FVT and FLL and are no longer involved in either business.
2019	February 19	FVT invested another $0.5 million in CBG for a second location in London. Fred invested a proportionate amount; FVT's ownership remained at 75%.
2019	April 22	The bank approved a new line of credit, to a maximum amount of $5 million, which expires in 2025. It has the same covenant as the bank loan and is secured by selected equipment and the personal guarantees of Viktor, Lanny, and Stephanie Lightfoot. The interest rate is prime plus 1% (prime is currently 2.8%).
2020	January 1	Zobair Terdel was given the opportunity to buy into FVT and invested $0.6 million for 1,000 common shares.

(CONTINUED ON PAGE 6)

APPENDIX I (continued)
BOARD MEETING WITH CHRIS RENKER IN ATTENDANCE

Viktor: I believe that VR technology is the next big step. Virtual Reality Tech Inc. (VRT) is a private Canadian company that currently uses this technology to produce five-to-ten-minute promotional videos. Yuxuan Zhang, the owner of VRT, asked me if FVT would consider investing to further develop this leading-edge technology. Yuxuan conducts research and development in the use of VR technology for producing and viewing feature films. Yuxuan has been unable to raise funds through traditional sources and has had limited success raising funds through crowd sourcing. I am surprised, as I think this capability will be another "landmark" in film technology. Investing in VRT would help us diversify.

Stephanie: I am concerned that we will be asked to make more than one cash investment before a product is available for commercialization. R&D is expensive. This direction is very different from the vision of our parents, who would want us to upgrade our theatres.

Lanny: We cannot live in the past. Viktor is the only one of us who understands new technologies and who has experience in this area. If Viktor believes our future profits will benefit from this investment, I am supportive of investing. Viktor, what kind of return do you think we might see from this investment?

Viktor: Due to its unique nature, we will want an annualized return of 30%. We would get this return by selling this investment to a major strategic buyer in five years. I have had the accounting department prepare some preliminary numbers (Appendix V).

Lanny: As there is little growth potential, we have to move away from our heavy reliance on general box office admission fees. But I still need to better understand how we will make a return from this investment. It looks like we would recognize this investment at cost and would receive no income, and the only return will be on the eventual sale to a strategic investor.

Chris: Do any of you know anything about Yuxuan's past successes?

Zobair**:** Yuxuan has both technical expertise and the experience of bringing two other technological advances to market. I am confident that, with Yuxuan's involvement, this investment could be the first step in gaining experience in investing in the earlier stage of new technology development. I really like the idea of working with an experienced partner. I also see it as a way to diversify our income streams.

(CONTINUED ON PAGE 7)

APPENDIX I (continued)
BOARD MEETING WITH CHRIS RENKER IN ATTENDANCE

Stephanie: Chris, we need an assessment of this investment opportunity. What is up next for discussion?

Zobair: The Sarnia locations continue to underperform. As you know, we closed six of the twelve auditoriums in the Sarnia #1 location during 2018, and we cut costs by reducing staff and limiting the hours of operation at both Sarnia locations. As we still have a loyal, although shrinking, customer base, I vote to keep these locations open. My research on the Sarnia competitor that is taking away our customers indicates that they are charging the same admission price as us. In addition, if we want to keep our staff, we probably have to further increase our wages as other companies are offering higher hourly rates to attract part-time staff.

Viktor: Both Sarnia locations were last upgraded nine years ago. This is most likely the cause of the attendance decline. For the same admission price, the competitor offers newer projection technology and an ambience far superior to FVT's. It would cost us at least $2 million to upgrade the two theatres, and I am not sure this is the wisest use of our cash.

Stephanie: If we close these locations, it will look like we have abandoned our customers. Kent and Sheila would be completely against closures. FVT has always been about the community, and closures, or even lowering our admission prices, could have a detrimental impact on FVT's reputation. If customers outside Sarnia hear of this, it could negatively impact our other locations. I also do not want to lay off staff, some of whom have been with us for a long time.

Lanny: With the loss of both Sheila and Suisui, FVT has lost many of its film distribution contacts, and we are now having difficulty negotiating favourable film costs. I think we should close the theatres. Realistically, we have already made as many cost cuts as possible. Attendance numbers are falling, and the losses from both Sarnia locations have been hurting FVT for years now. Keeping Sarnia open will only continue to negatively affect us.

Zobair: I asked the accounting department to look at different options (Appendix VI).

Stephanie: I think we need to better understand the impact. Let's get Chris to look at it.

Let's discuss CBG. Fred has recently developed serious health issues and needs to sell. As Fred is the head chef and manages both restaurants, we have had little involvement with the daily operations and have relied heavily on Fred. In fact, Fred only sought our input when he wanted to invest in another location. We received an offer from George McCain yesterday to purchase all outstanding shares of CBG – both Fred's and FVT's.

(CONTINUED ON PAGE 8)

APPENDIX I (continued)
BOARD MEETING WITH CHRIS RENKER IN ATTENDANCE

Zobair: A few weeks ago, I personally offered Fred $700,000 for his shares. As you know, my wife is a chef who wants to open her own restaurant, and we both thought this might be great for her. Fred has not yet gotten back to me but is considering my offer.

Stephanie: I am surprised! Why didn't you tell us?

Zobair: When I learned that McCain was considering making an offer, I needed to act quickly, for my wife's sake.

Lanny: Zobair, I cannot believe that you did not let us know right away that McCain was considering making an offer, and that you acted on this information by making your own offer!

Zobair: The restaurant has proven to be very profitable and I did not want McCain to get it. I think CBG will continue to be successful, which is why I want to invest. I just assumed FVT would not be interested in buying out Fred.

Stephanie: Well, we now need to consider what to do. We could sell out entirely to McCain, or hope that Fred accepts Zobair's offer and continue in a JV arrangement with Zobair as our new partner. Or, maybe FVT should buy out Fred?

Lanny: I believe that CBG will continue to be successful. The JV arrangement outlines how a buyout price would be determined. We need an idea of the value of CBG in order to make a decision. I do not think there has been any change in the rate of return of 17% in the restaurant business since 2017.

Viktor: I think we should sell CBG to McCain and invest the proceeds in technology. With Fred no longer involved, the restaurant may not continue to be as successful. I think it is far too risky to go forward with a new chef and managers in the highly competitive restaurant business.

Stephanie**:** But, due to the crossover benefits of discounts for movie goers and diners, the investment in CBG has helped to increase revenues at the London theatre locations. CBG also prepares our light lunches for our PPV experience and charges FVT cost, without any markup. CBG's cost is substantially lower than we would normally have to pay, which has helped reduce our overall costs, and the revenue value of those light lunches is three times what was originally estimated.

(CONTINUED ON PAGE 9)

APPENDIX I (continued)
BOARD MEETING WITH CHRIS RENKER IN ATTENDANCE

Zobair: If my wife takes over as chef, FVT won't have to worry about who will make the day-to-day decisions. Fred and I started looking for a location in Tillsonburg (near London) for a third restaurant to open in 2021, and I want to continue pursuing this expansion. However, since Fred was completely dedicated to CBG, it will require a chef and two managers to replace him, just to run the existing restaurants, at an annual total cost of $350,000.

Stephanie: Chris, here are excerpts from the proposed purchase offer from McCain, and a copy of the JV arrangement (Appendix VII). Can you give us the value of CBG?

Chris: Anything else?

Viktor: I want to continue our PPV upgrades in one auditorium in each of three more locations – Tillsonburg, St. Thomas, and Chatham. We already know they have been successful at the other locations, and our St. Thomas and Chatham customers are asking for these improvements. The accounting department says the capital budget would be similar to the one in 2017, which was $2 million for each location. This project has a positive NPV. We expect annual operating cash flows before tax to increase by $1.15 million in total. I would like to start these upgrades immediately.

Zobair: Good idea. I am confident these new investment projects will proceed more quickly, with less revenue lost due to the closures during renovations.

Lanny: Where is all this cash coming from? We have to place orders for the equipment, screens, and seats very soon. I think we can better use this money on some of the other investments we have discussed and put off the upgrades until we have at least $6 million built up in the bank.

Viktor: Why can't we borrow on our new line of credit? The return on this project will be far greater than the interest we have to pay on the loan. Also, equipment costs are going up. In January 2021, a totally new and advanced system is expected to be launched. The supplier is predicting that prices will increase by 8%. They are selling off their current equipment at reduced prices, which is great for us. That is why we want to upgrade all three locations now and not wait.

Stephanie: I have a bigger concern. How will closing Sarnia look to the Sarnia customers and employees? People will wonder why we made major upgrades in some locations, but not in Sarnia. This might have a negative impact on FVT's reputation and employee morale.

(CONTINUED ON PAGE 10)

APPENDIX I (continued)
BOARD MEETING WITH CHRIS RENKER IN ATTENDANCE

Lanny: Chris, what do you think about this potential investment? Could you also suggest how the company could finance the upgrades?

Stephanie: Our last issue is the customer loyalty program. In October 2018, we implemented our FLIXREWARDS program. We now have a strong web presence, and more customers signed up than originally projected. In June 2019, we made a program change, and last week we discovered that, since then, our customers have been earning one-tenth the number of points they should have been. Our IT department has fixed the program error, but we have not yet adjusted the accumulated points balances. The number of accumulated points in the customer accounts is not right. IT staff are asking what we want them to do.

Zobair: We have fixed it going forward and we have had no complaints from customers. The total amount is likely not material to FVT's financials. Why tell them or adjust?

Viktor: We owe those points to our customers, and we probably owe FLIXREWARDS something too. We can't just ignore that.

Zobair: FLIXREWARDS provides us with reports each month. I am surprised that they did not notice that reward points numbers dropped dramatically after June. Maybe we should get FLIXREWARDS to pay us what we owe our customers. We could argue that FLIXREWARDS missed this change and should have been monitoring it.

Stephanie: It is time to wrap up this meeting. Chris, can you identify what we need to consider based on what you learned at this meeting?

(CONTINUED ON PAGE 11)

APPENDIX II
THEATRE STATISTICS

For the year ended December 31, 2019

1. Statistics for 2019

	Number of auditoriums	With digital 3D screens	PPV auditoriums	Attendance, excluding PPV	PPV attendance	Total attendance
London #1	12	6	2	518,935	105,060	623,995
London #2	9	3		456,300		456,300
London #3	12	5		472,500		472,500
London #4	7	4		295,800		295,800
Sarnia #1	6	5		254,250		254,250
Sarnia #2	6	4		215,780		215,780
Chatham	9	4		442,130		442,130
Leamington	10	6	2	406,649	87,140	493,789
St. Thomas	12	5		481,900		481,900
Tillsonburg	9	4		346,980		346,980
Woodstock	8	4		425,110		425,110
Total	100	50	4	4,316,334	192,200	4,508,534

2. Average revenues per attendee

	2019
Average box office revenue – regular	$ 8.75
Average box office revenue – PPV	$19.70

(CONTINUED ON PAGE 12)

APPENDIX III
INDUSTRY BENCHMARKS

	2016 Benchmark	2019 Benchmark	2016 Actual	2019 Actual
Ratios				
Box office revenue per attendee	$9.10	unchanged	$8.67	$9.22
Concession revenue per attendee	$5.25	unchanged	$4.95	$5.25
Box office revenue per theatre (in thousands of dollars)	$3,948	unchanged	$3,732	$3,778
Liquidity				
Current ratio	0.67	unchanged	0.30	0.49
Quick ratio	0.64	unchanged	0.22	0.39
Solvency ratios				
Long-term debt to equity	0.47	unchanged	1.39	0.47
Total debt to equity	1.20	unchanged	1.69	0.64
Total debt to assets	0.54	unchanged	0.63	0.39
Activity ratios				
Days in concession inventory	21	unchanged	23	21
Days in film costs payable	35	unchanged	33	35
Profitability				
Film costs to box office revenue	52%	unchanged	58.8%	57%
Concession costs to concession revenue	23%	unchanged	25%	23%
Advertising as percentage of revenues	2%	unchanged	1.1%	1.3%
Employee wages and benefits as percentage of revenues	19%	unchanged	18.1%	17.3%
Theatre costs as percentage of total revenues	12%	unchanged	12.2%	14.3%
General and administrative as percentage of total revenues	6%	unchanged	2.3%	2.6%
Operating margin	9%	5%	5.4%	4.4%
Net profit margin	6%	4%	3%	3%
Return on assets	4.7%	5%	4%	4.5%
Return on equity	10.4%	7.5%	10.8%	7.4%

(CONTINUED ON PAGE 13)

APPENDIX IV
INTERNALLY PREPARED FINANCIAL STATEMENTS

First View Theatres Inc.
Statement of Earnings
For the year ended December 31, 2019
(in thousands of dollars)

Revenues		
Box office revenue – regular	$	37,768
Box office revenue – PPV		3,786
Concession revenue		23,670
Other income – arcade games		657
Other income – party room rentals		375
		66,256
Expenses		
Film costs		23,700
Concession costs		5,444
Advertising and promotion		831
Amortization		5,525
Employee wages and benefits		11,450
Employee bonuses		400
Rent		4,786
Theatre operating costs		9,480
General and administrative		1,710
		63,326
Operating income		2,930
Equity income from Connery's Bar and Grill		310
Finance costs – net interest expense and foreign exchange gains and losses		(558)
Income before taxes		2,682
Income taxes		(671)
Net earnings	$	2,011
Statement of retained earnings		
Balance – beginning of year	$	18,336
Net earnings		2,011
Dividends		(600)
Balance – end of year	$	19,747

(CONTINUED ON PAGE 14)

APPENDIX IV (continued)
INTERNALLY PREPARED FINANCIAL STATEMENTS

First View Theatres Inc.
Balance Sheet
As at December 31, 2019
(in thousands of dollars)

Assets		
Current assets		
Cash and cash equivalents	$	2,362
Concession inventories		313
Prepaid expenses		285
Total current assets		2,960
Investment in Connery's Bar and Grill (equity method)		2,193
Property, plant and equipment (net)		38,648
Intangible assets		890
Goodwill		145
Total assets	$	44,836
Liabilities		
Current liabilities		
Trade payables and accrued liabilities	$	1,705
Film costs payable		2,273
Income taxes payable		350
Employee bonuses payable		400
Current portion of long-term debt		1,275
Total current liabilities		6,003
Long-term debt – term loan		11,486
Total liabilities		17,489
Shareholders' equity		
Share capital		7,600
Retained earnings		19,747
Total shareholders' equity		27,347
Total liabilities and shareholders' equity	$	44,836

(CONTINUED ON PAGE 15)

APPENDIX V
INFORMATION ON INVESTMENT IN VRT

Virtual Reality Tech Inc. (VRT) Investment Proposal

- Investment in common shares – $2 million is required for a 10% ownership. Yuxuan would own 85%, with 5% widely held. Currently, VRT has no debt.
- VRT is expected to have losses totalling $1.5 million over the next five years, mainly due to the research and development costs. Yuxuan estimates that the technology could be sold for $100 million in five years' time. He has already had lower offers from three potential buyers.
- Any future sale negotiation will include the right of FVT to purchase the technology at a 20% reduction from the normal selling price, giving FVT a competitive advantage when upgrading its theatres.

(CONTINUED ON PAGE 16)

APPENDIX VI
INFORMATION ON SARNIA LOCATIONS

Forecasted 2020 revenues per attendee are based on 2019 actuals and the proposed changes being considered.

	Option 1	**Option 2**	**Option 3**
	Keep open with current prices	**Lower price by 15%**	**Renovate**
Forecast box office revenue	$7.88	$6.70	$7.88
Film costs (at 57%)	(4.49)	(3.82)	(4.49)
Admission contribution margin	3.39	2.88	3.39
Plus concession contribution margin	2.88	2.88	2.88
Total contribution margin per attendee	**$6.27**	**$5.76**	**$6.27**
Expected number of attendees	470,030	517,033	525,000
Total contribution margin	$2,947,088	$2,978,110	$3,291,750
Operating loss before taxes	$(404,612)	$(373,590)	$(329,950)
Total annual cash flows before taxes	$175,788	$186,810	$500,450
Breakeven attendance (calculated)	**534,561**	**585,365**	**577,624**

Option 4 – Close Sarnia locations

Listing of net assets at the Sarnia locations:

Carrying value of net assets:	
Inventories	$ 23,000
Leasehold improvements and equipment	2,451,500
Goodwill	145,000
Net carrying value	**$ 2,619,500**

(CONTINUED ON PAGE 17)

APPENDIX VI (continued)
INFORMATION ON SARNIA LOCATIONS

Option 4 – Close Sarnia locations (continued)

Add additional cash outflows to close:	
Total costs to close and terminate leases (before taxes)	$ 609,031
Severance payments for both locations	50,000
Total cash outflows required to close	**$ 659,031**

Notes:

- The operating loss before taxes includes the allocation of overhead costs. Fixed costs include an overhead allocation of $310,900 from head office. Closure of the locations would reduce overhead costs by only $95,000.

- Costs of $609,031 to close and terminate leases consist of lease cancellation penalties for the remaining 38 months of the leases, plus an estimated cost of $160,000 to remove the leasehold improvements, equipment, and games.

(CONTINUED ON PAGE 18)

APPENDIX VII
INFORMATION ON CONNERY'S BAR AND GRILL

1. The most recent joint venture income statements is as follows (*in thousands of dollars*):

Summarized Income Statement

	2019
Revenues	$ 5,141
Expenses	
Operating costs	4,140
Fred's salary	450
Income before taxes	551
Income taxes (25%)	(138)
Net earnings	$ 413

2. Excerpts from the offer from George McCain, dated May 4, 2020, are as follows:

   - The price offered is $2.75 million.
   - The closing date will be June 30, 2020.
   - The full purchase price will be paid in cash on the closing date.
   - The offer includes all of the food and beverage inventory and equipment, tables and chairs, tableware, linens, kitchen equipment, and computer systems.

3. Excerpts from the JV arrangement are as follows:

- If one of the parties wants to sell their share, the other party has the right of first refusal.
- The price to buy out the other party's share will be determined as follows:
  Adjusted annual net earnings × Multiple, where:
  – Adjusted annual net earnings is equal to the net earnings as calculated using the most recent annual financial statements plus the after-tax cost of Fred's salary less a reasonable after-tax cost to replace Fred.
  – Multiple is equal to 1 divided by a discount rate, where the discount rate is the required rate of return for a privately held restaurant business at the date of the valuation.
- The purchase price will be payable in five equal annual instalments, with the first instalment due on closing of the sale.
- If the other party is not able to pay this purchase price, the seller has the right to find another buyer. If another offer is made, the other party has the right to match the terms of such an offer.

(CONTINUED ON PAGE 19)

End of Exam

(CONTINUED ON PAGE 20)

CPA COMMON FINAL EXAMINATION REFERENCE SCHEDULE

1. PRESENT VALUE OF TAX SHIELD FOR AMORTIZABLE ASSETS

Present Value of Total Tax Shield from CCA for a New Asset

$$= \frac{CTd}{(d+k)}\left(\frac{2+k}{2(1+k)}\right) = \frac{CdT}{(d+k)}\left(\frac{1+0.5k}{1+k}\right)$$

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

2. SELECTED PRESCRIBED AUTOMOBILE AMOUNTS

	2016	**2017**
Maximum depreciable cost — Class 10.1	$30,000 + sales tax	$30,000 + sales tax
Maximum monthly deductible lease cost	$800 + sales tax	$800 + sales tax
Maximum monthly deductible interest cost	$300	$300
Operating cost benefit — employee	26¢ per km of personal use	25¢ per km of personal use
Non-taxable automobile allowance rates		
— first 5,000 kilometres	54¢ per km	54¢ per km
— balance	48¢ per km	48¢ per km

3. INDIVIDUAL FEDERAL INCOME TAX RATES

For 2016

If taxable income is between			Tax on base amount	Tax on excess
$0	and	$45,282	$0	15%
$45,283	and	$90,563	$6,792	20.5%
$90,564	and	$140,388	$16,075	26%
$140,389	and	$200,000	$29,029	29%
$200,001	and	any amount	$46,316	33%

For 2017

If taxable income is between			Tax on base amount	Tax on excess
$0	and	$45,916	$0	15%
$45,917	and	$91,831	$6,887	20.5%
$91,832	and	$142,353	$16,300	26%
$142,354	and	$202,800	$29,436	29%
$202,801	and	any amount	$46,965	33%

(CONTINUED ON PAGE 21)

4. SELECTED INDEXED AMOUNTS FOR PURPOSES OF COMPUTING INCOME TAX

Personal tax credits are a maximum of 15% of the following amounts:

	2016	**2017**
Basic personal amount	$11,474	$11,635
Spouse, common-law partner, or eligible dependant amount	11,474	11,635
Age amount if 65 or over in the year	7,125	7,225
Net income threshold for age amount	35,927	36,430
Canada employment amount	1,161	1,178
Disability amount	8,001	8,113
Infirm dependants 18 & over	6,788	6,883
Net income threshold for infirm dependants 18 & over	6,807	6,902
Adoption expense credit limit	15,453	15,670

Other indexed amounts are as follows:

	2016	**2017**
Medical expense tax credit — 3% of net income ceiling	$2,237	$2,268
Annual TFSA dollar limit	5,500	5,500
RRSP dollar limit	25,370	26,010
Lifetime capital gains exemption on qualified small business corporation shares	824,176	835,716

5. PRESCRIBED INTEREST RATES (base rates)

Year	Jan. 1 – Mar. 31	Apr. 1 – June 30	July 1 – Sep. 30	Oct. 1 – Dec. 31
2017	1	1	1	
2016	1	1	1	1
2015	1	1	1	1

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.

(CONCLUDED ON PAGE 22)

6. MAXIMUM CAPITAL COST ALLOWANCE RATES FOR SELECTED CLASSES

Class 1…………………………………	4%	for all buildings except those below
Class 1…………………………………	6%	for non-residential buildings acquired for first use after March 18, 2007
Class 1…………………………………	10%	for manufacturing and processing buildings acquired for first use after March 18, 2007
Class 8…………………………………	20%	
Class 10……………………………..	30%	
Class 10.1…………………………...	30%	
Class 12……………………………..	100%	
Class 13……………………………..	Original lease period plus one renewal period (minimum 5 years and maximum 40 years)	
Class 14……………………………..	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%	

****