PERFORMANCE MANAGEMENT –MARKING GUIDE
SABLETEL

You, CPA, work for StarNova and are asked to assess SableTel's current position and then to critique SableTel's strategic plan. To do so, the candidate is expected to first do an environmental scan which generally includes looking at where SableTel is positioned in the market, competition, financial position, doing a SWOT analysis, etc. Then using that information, the candidate needs to review Dan's strategic plan and identify the major flaws.

In addition, candidates need to consider the strategic options for StarNova—IPO for SableTel vs divest SableTel ($46 million purchase offer) or investing $22 million in Wireless and improving SableTel's current operations. Candidates need to suggest ways to turn around /fix SableTel's operations (sales levels, staffing, bonus, etc. and make recommendations, as part of StarNova's bigger decision to keep or divest SableTel.

Candidates would be expected to recommend a course of action to the extent it is possible and comment on where more information is needed to be able to make a recommendation.

(Note: Solutions have been created for illustration purposes only. The Board of Examiners will determine the actual number of opportunities and define the expectations that will be part of the assessment to ensure the four roles are equated.)

CORE Financial Reporting-Depth
(will be broken down into multiple assessment opportunities by the BOE)

As part of their analysis of SableTel, the candidate discusses the significant accounting issues related to the 2014 financial statements.

The candidate demonstrates competence in Financial Reporting.

Note: all CPA candidates are expected to achieve the same level of competence for Core Financial Reporting regardless of the role they choose. For purposes of illustration, the same information appears in each of the four Elective role solutions. However, it is possible that in a real case, that the ranking of the issues and the "slant" put on the discussion would be tailored to the role being assumed.

CPA	CPA Competency Statement	Core
1.1.1	Evaluates financial reporting needs	A
1.2.1	Develops or evaluates appropriate accounting policies and procedures	A
1.3.1	Prepares financial statements	A

In order to be able to assess Sable Tel's current financial position and evaluate the strategic alternatives, which include doing an IPO, accepting an offer for SableTel, or status quo with improvements to Wireless, first we need to fix the financial statements. I have identified several accounting issues with respect to the 2014 financial statements of SableTel. Where possible I have estimated the misstatement and I have then adjusted the financial statements as presented to better reflect the actual financial condition and financial results of SableTel for its 2014 fiscal year. This will allow for a better assessment of Sable Tel's current position.

Issue #1- Inventory – obsolescence provision

Guidance for accounting for inventory can be found in IAS 2 - Inventories

Inventory at SableTel consists of routers and modems that SableTel sells to its customers. Total inventory at August 31, 2014 had a book value of $3,219,431. The continuity of the inventory for the 2014 fiscal year can be presented as follows:

Inventory – Opening	$	883,318
Purchases – Discounted Product		2,500,000
Purchases – Other (Regular)		515,972
Cost of Sales – Routers and Modems		(679,859)
Inventory – Closing	$	3,219,431

The inventory level at year end would appear to be extremely high and may require write-down. The main reason for the substantial increase in inventory relates to the $2,500,000 of inventory which was purchased in September 2013. Given that the inventory tends to have a short life (typically 12 months), it is not clear why SableTel would purchase such a large quantity of inventory as its annual sales do not justify such a large purchase. It is now twelve months after this discounted product was purchased and therefore it is likely that much of this inventory can no longer be sold.

Sales of routers and modems for the 2014 fiscal year totaled $1,675,759. The costs associated with these sales totaled $679,859. Assuming similar sales in future years, SableTel has inventory on hand at August 31, 2014 which represents 4.74 years of sales ($3,219,431/$679,859). Given that these items have a short life (typically 12 months), a portion of the inventory is likely obsolete and requires write down. Further details would need to be gathered regarding the specific inventory items to determine an accurate obsolescence provision, but as an initial estimate, we could assume that items representing sales greater than one year will likely require a write down. Therefore the estimated obsolescence provision is $2,539,572 ($3,219,431 - $679,859). Therefore SableTel should reduce its inventory balance on the financial statements by $2,539,572 and increase its cost of sales by a similar amount (see the adjusted financial statements below).

Issue #2- Deferred Research and Development Costs

Guidance for research and development costs can be found in IAS 38 – Intangible Assets

Deferred research and development costs represents costs associated with the Wireless Technology Project from 2013 and 2014 that have been capitalized. The amounts have been capitalized as management has "declared its intention to carry this project to market". However, this is only one of the criteria that must be met in order for research and development costs to be capitalized.

IAS 38 paragraph 57 states:

"An intangible asset arising from development (or from the development phase of an internal project) shall be recognised if, and only if, an entity can demonstrate all of 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) 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.

(e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset.

(f) its ability to measure reliably the expenditure attributable to the intangible asset during its development."

SableTel clearly does not meet all of the criteria for recognition as an intangible asset.

The first criterion requires that the technical feasibility be assured. However, Dan has indicated that SableTel is currently awaiting a third party feasibility study for this project. Therefore it is unlikely that this criterion has been met at year end.

The second criterion requires an intention to complete the intangible asset. Management has indicated that they intend to complete the Wireless Technology Project so this criterion is likely met.

The next criterion requires SableTel to prove that it will use or sell the intangible asset. We can assume that this criterion is met and the Industry Canada grant may provide further evidence supporting this criterion as Industry Canada wants to use the technology (indicating that SableTel may be able to sell the technology as well.)

The fourth criterion requires management to demonstrate how the asset will generate probable future economic benefits. SableTel will utilize the wireless technology internally, presumably to decrease costs and increase margins. Therefore SableTel likely meets this criterion as the technology is supposed to increase margins by 5% across all of its product lines. This would provide substantial benefits (5% of $65 million is $3.25 million on an annual basis). SableTel would need to provide some evidence to support this assertion. This may be available once the third party feasibility assessment has been completed.

The fifth criterion requires adequate technical, financial and other resources to complete the project. Dan has indicated that SableTel does not currently have the financial resources to finish this project and requires funding from StarNova to complete the project. Therefore this criterion is likely not met currently as StarNova has not committed itself to the funding. However, should SableTel be able to provide support that StarNova or some other source will fund the remainder of the project then this criterion may be supportable.

Finally, SableTel must be able to demonstrate that it can measure reliably the expenditures attributable to the project. It is not clear if SableTel can do this. Dan has indicated that accounting came up with the $20 million necessary to complete the project but he is not sure how they came up with this number. As well, SableTel would also need to demonstrate that it had the necessary systems in place to track the costs associated with this project reliably. Therefore this criterion may be met but more information is required.

Since all six criteria must be met in order to capitalize the costs and at least two of the criteria are likely not met, the costs cannot be capitalized and must be expensed. As a result SableTel should reduce the deferred research and development costs from $9,160,250 to Nil and increase administration expenses by the same amount (see the adjusted financial statements below).

Even if SableTel met all of the criteria for capitalization of the development costs, it would not be able to go back to 2013 and capitalize those research and development costs in 2014. IAS 38 paragraph 71 states *"Expenditure on an intangible item that was initially recognised as an expense shall not be recognised as part of the cost of an intangible asset at a later date."*

From a presentation standpoint I would also recommend that consideration be given to separating the research and development costs from the administration expenses on the face of the statement of comprehensive income as it is a significant amount and is likely of interest to users of the financial statements.

Issue #3-Industry Canada Grant

Guidance for government assistance can be found in IAS 20 – Accounting for government assistance and disclosure of government assistance.

There are two issues associated with the government grant. The first issue is whether SableTel has met the criteria for recognition of the government grant. IAS 20 paragraph 7 states:

"Government grants, including non-monetary grants at fair value, shall not be recognised until there is reasonable assurance that:

(a) the entity will comply with the conditions attaching to them; and

(b) the grants will be received."

SableTel has received the $2,750,000 so we can safely state that the second criterion has been met. However, it is not clear if the first criterion, related to satisfying all of the conditions attached to the grant has been met. There is some evidence that the conditions have not been met as SableTel must share its technology with Industry Canada (IC) and IC must formally approve the technology. However, I would need to gather further details relating to the grant in order to determine if the first criterion has been met and as a result if the amount can be recognized.

Assuming that the above two criteria have been met then the second issue regarding the government grant relates to its presentation. IAS 20 paragraph 24 states:

"Government grants related to assets, including non-monetary grants at fair value, shall be presented in the statement of financial position either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset."

This government grant relates to the Wireless Technology Project. This project was initially recorded as an intangible asset. If the Wireless Technology Project was still recorded as an asset then SableTel would need to reverse the amount recorded as revenue and record the amount as either deferred income or by deducting the amount from the carrying value of the Wireless Technology Project.

However, due to the adjustment proposed above (see Deferred Research and Development Costs), the Wireless Technology Project is now expensed as administration on the statement of comprehensive income. The presentation of grants related to income is discussed in IAS 20 paragraph 29 which states:

"Grants related to income are presented as part of profit or loss, either separately or under a general heading such as 'Other income'; alternatively, they are deducted in reporting the related expense."

I would recommend that the amount be recorded as a reduction of the related expense as it is clearly attributable to these expenditures. Therefore, the amount should be removed from revenue and recorded as a reduction of the research and development expenses (administration expenses) on the statement of comprehensive income (see the adjusted financial statements below). Note that the adjustment will have no net effect on the profit (loss) of SableTel.

Issue #4- Impairment of Mobile Network

Guidance for the impairment of assets can be found in IAS 36 – Impairment of assets.

In August 2014, Hurricane Baylee damaged several of the communication towers associated with SableTel's mobile network disabling the entire network. In total 60 of the 340 towers were damaged. Each tower has a carrying value of $35,000.

SableTel must determine if the communication towers require a write down at year end.

IAS 36 paragraph 9 states:

"An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset."

Clearly there is an indication that the assets may be impaired as the towers have been damaged. Therefore SableTel should estimate the recoverable amount.

IAS 36 paragraph 18 states:

"This Standard defines recoverable amount as the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use."

IAS 36 paragraph 22 states:

"Recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. If this is the case, recoverable amount is determined for the cash-generating unit to which the asset belongs (see paragraphs 65–103), unless either:

(a) the asset's fair value less costs to sell is higher than its carrying amount; or

(b) the asset's value in use can be estimated to be close to its fair value less costs to sell and fair value less costs to sell can be determined."

It would appear from the facts of the case that the towers, as a whole, make up a cash-generating unit as the entire mobile network has been disabled by the damage to 60 of the towers. Therefore it may be necessary to estimate the recoverable amount for the entire mobile network (i.e. the 340 communication towers) and not just the 60 towers that have been damaged.

IAS 36 paragraphs 66 and 67 state:

Paragraph 66 – *"If there is any indication that an asset may be impaired, recoverable amount shall be estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, an entity shall determine the recoverable amount of the cash-generating unit to which the asset belongs (the asset's cash-generating unit)."*

Paragraph 67 – "The recoverable amount of an individual asset cannot be determined if:

> *(a) the asset's value in use cannot be estimated to be close to its fair value less costs to sell (for example, when the future cash flows from continuing use of the asset cannot be estimated to be negligible); and*
>
> *(b) the asset does not generate cash inflows that are largely independent of those from other assets.*

In such cases, value in use and, therefore, recoverable amount, can be determined only for the asset's cash-generating unit."

As stated above, there are two possible ways to determine an assets (or group of assets) recoverable amount. The first is to determine the assets fair value less costs to sell. We do not have a lot of information to determine this amount but it is unlikely that SableTel could sell the damaged towers for any significant amount. As well there is no indication that SableTel could sell its entire mobile network but it is possible that another telecom company may want this network. The mobile network, in its current state has no value as the entire mobile network has been disabled. It is important to note that the value in use is generally determined by its estimated future cash flows in its *current condition*. IAS 36 paragraph 44 states:

"Future cash flows shall be estimated for the asset in its current condition. Estimates of future cash flows shall not include estimated future cash inflows or outflows that are expected to arise from:

(a) a future restructuring to which an entity is not yet committed; or

(b) improving or enhancing the asset's performance."

SableTel has indicated that it is unclear if the mobile network can be fixed. It is also contemplating replacing the entire tower system with a new faster system. Therefore it is unclear what the recoverable amount of the towers, or the entire system, (the cash-generating unit) is at year-end.

I believe that there is likely some impairment within the mobile network. Further information would need to be gathered to determine the exact amount of the impairment but as an estimate we could approximate that the recoverable amount of the 60 damaged towers is likely NIL. SableTel should therefore write-down the asset to this amount. The total for these six towers would be $2,100,000 (60 X $35,000) (see the adjusted financial statements below).

Note that it is possible that all 340 towers and the entire mobile system (the cash-generating unit) would need to be written down to NIL or the estimated recoverable amount (fair value less costs to sell) as the mobile network has no value in use based on its current condition. It is also not clear if the network can be fixed, or even if it can be fixed, if SableTel plans to repair the network. If the mobile network cannot be sold (i.e. the fair value less costs to sell is minimal) and SableTel does not plan to fix the network, then the entire network should be written down to NIL. At a minimum this amounts to $11,900,000 (340 towers X $35,000 per tower) for the towers and may need to be higher if there are additional capital assets associated with the mobile network. At this point we will assume that the 280 towers that were not damaged would not require a write-down as they may have a fair value in the open market or may be able to generate positive cash flows in the future.

The write-down should be recorded as an impairment loss as stated in IAS 36 paragraph 59:

"If, and only if, the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset shall be reduced to its recoverable amount. That reduction is an impairment loss."

If there are any insurance proceeds that are likely to be received as a result of the damaged tower it would reduce the loss.

As well, given that SableTel is contemplating replacing the entire system, it would be prudent to analyze the estimated useful lives of the assets in question and/or the residual values.

Deferred Revenues (minor issue)

There are no deferred revenues on the face of the statement of financial position. Given the nature of the company, a telecommunications company, I would expect that certain of its revenues would be billed in advance (i.e. it is typical for companies in this industry to bill a month of service in advance and some also require substantial deposits). This should be investigated further. It is possible that this amount is buried in the Trade and other payables line item on the statement of financial position. It is also possible that these amounts have been incorrectly recorded as revenues. Further information would need to be gathered to determine any error that exists.

Issue #5- CRTC Fee

I have recalculated the estimated misstatement in the 2013 and 2014 CRTC Fees. The total estimated misstatement is $1,193,619. Of this amount $672,218 relates to 2013 and $521,401 relates to 2014. The amount relating to 2013 ($672,218) is an accounting error and as such the amount should be added to accrued liabilities and should reduce the 2014 opening retained earnings. The amount for 2014 ($521,401) should be added to cost of sales (CRTC Fee) and be added to accrued liabilities at August 31, 2014 as this amount relates to the 2014 fiscal year.

This calculation is based on preliminary information.

Description of Input	2014 Calculation	2013 Calculation
Revenues from long-distance, local and mobile services (see Note 1 to the financial statements)	$ 56,857,395	$ 60,712,173
Less: Related Party Revenues (assume = $0)	0	0
Less: Qualifying Costs (see Note 2 to the financial statements)	(25,215,367)	(25,333,908)
Add: Fees paid to non-Canadian entities (see Note 2 to the financial statements)	897,500	788,000
Add: 200% of negative margin customers (assume that the finance database is correct and assume 2013 = $0)	2,260,000	0
Add: Related Party Costs (see Note 2 to the financial statements)	1,357,850	1,458,760
Fee Base	36,157,378	37,625,025
Contribution Rate	12%	12%
Preliminary Fee Calculation	4,338,885	4,515,003
Fee as Calculated	3,817,484	3,842,785
Adjustment Required	$ 521,401	$ 672,218

Issue #6- Adjusted Financial Statements

The financial statements for 2014 will require adjustment due to the cumulative material effect of the misstatements noted above. The following schedule adjusts the financial statements:

Item Description	2014 Actual F/S's (unadjusted)	Required IFRS adjustments	JEs	2014 Actual F/S's (adjusted)
Current assets				
Cash	$ 351,018			$ 351,018
Accounts receivable	15,864,501			15,864,501
Inventory	3,219,431	(2,539,572)	**1**	679,859
Total Current Assets	19,434,950	(2,539,572)		16,895,378
Property, plant and equipment	62,532,502	(2,100,000)	**4**	60,432,502
Deferred taxes	35,629			35,629
Intangible assets	10,753,709	(9,160,250)	**2**	1,593,459
Total Assets	$ 92,756,790	(13,799,822)		$ 78,956,968
Current liabilities	$ 22,265,938	1,193,619	**5**	$ 23,459,557
Long-term debt	44,152,572			44,152,572
Total Liabilities	66,418,510	1,193,619		67,612,129
Total Shareholders' Equity	26,338,280	(14,993,441)	**(A),5**	11,344,839
Total Liabilities and Shareholders' Equity	$ 92,756,790	(13,799,822)		$ 78,956,968
Revenue	$ 65,072,224	(2,750,000)	**3**	$ 62,322,224
Cost of sales	30,714,869	3,060,973	**1,5**	33,775,842
Gross profit	34,357,355	(5,810,973)		28,546,382
Expenses:				
Selling and marketing	16,875,413			16,875,413
Administration	13,336,292	8,510,250	**2,3,4**	21,846,542
Interest expense	2,967,650			2,967,650
Total Expenses	33,179,355	8,510,250		41,689,605
Profit (loss)	$ 1,178,000	14,321,223	**(A)**	$ (13,143,223)

The adjusted financial statements present a much different financial picture for SableTel for its 2014 fiscal year.

Journal Entries (JEs) (Candidates are not expected to present these entries)

JE #	Account Description	Debit	Credit
1	Cost of sales (routers and modems)	$ 2,539,572	
1	Inventory		$ 2,539,572
	To set-up a provision for inventory obsolescence		
2	Administration (R&D expenses)	$ 9,160,250	
2	Intangible assets		$ 9,160,250
	To reverse expenditures associated with the Wireless Technology Project that were capitalized		
3	Revenue (Government Grant)	$ 2,750,000	
3	Administration (R&D expenses)		$ 2,750,000
	To reclassify the Industry Canada grant received during the year		
4	Administration (Impairment charge)	$ 2,100,000	
4	Property, plant and equipment (Mobile Network Towers)		$ 2,100,000
	To record an impairment charge on the mobile network towers		
5	Cost of sales (2014 CRTC Fee adjustment)	$ 521,401	
5	Retained earnings (opening – 2013 CRTC Fee adjustment)	672,218	
5	Current liabilities (accrued liabilities)		$ 1,193,619
	To record the estimated misstatement in the CRTC Fee for 2013 and 2014		

Performance Management
(will be broken down into multiple assessment opportunities by the BOE)
The candidate provides a qualitative analysis of SableTel's environment.
The candidate demonstrates competence in Performance Management.

CPA Competency Statement	**CORE**	**PM Elective**
2.3.2 Evaluates the entity's internal and external environment and its impact on strategy development.- subsection a) evaluates the external part of competitive position (e.g. using analysis of value proposition, customer/target markets, and competitive offerings).	B	A
2.4.1 Analyzes the key operational issues and alignment with strategy…subsection c) Analyzes the effectiveness of initiatives in addressing key human resource management issues. Subsection e) evaluates the advantages and disadvantages of various reward and recognition systems and their effect on the entity's decision making policies and/or practices	B	A
3.6.1 Evaluates performance using accepted frameworks, subsection b) distinguishes theoretical and realistic expectations of performance	B	A

Analysis of SableTel's strategic plan would begin with an analysis of the internal and external environment and will likely need to include a combination of the parent requirements as well as some elements of SableTel's own strategy.

Current Situation Analysis:

Mission: The overall mission of SableTel, notwithstanding the autonomy afforded it, is to align with the direction of the parent company, StarNova. In so doing, Sable Tel provides customers across Canada with the delivery of high-quality service in meeting their telecommunication needs, utilizing the latest in technology and customer support systems.

Vision: SableTel aligns to the StarNova's vision by creating value through its people, technology and exceptional service. As a leading Canadian telecommunications company, SableTel is committed to using leading edge technology, to meet the telecommunication and other needs of its customers.

SableTel aspires to being the nation's pre-eminent source for telecommunications services.

CPA commentary on current situation: exceptional service would imply a customer intimacy value proposition whereas leading the industry with technology would imply a product innovation value proposition. The two value propositions are competing with one another. The combination of this internal competitive environment with the CEO's focus on cost minimization due to the long distance segment evolving into a low-cost, low margin segment (i.e. operational excellence value proposition) sets up diametrically opposed focus leaving the process of strategic decision-making at best confused, at worst non-effective or incorrect, which results in elevating strategic risk.

Specific Goal: Provide 25% year over year growth in net income within the planning cycle.

Industry Key Success Factors:

- Network service up time is 100%.
- Newest technology used to support all product sales
- Leading technology used to provide all services
- Product quality is high
- Product variety essential to ensure single source billing

Key Risks:

Substantial adjustment to the financial statements for 2014 resulting in a loss of $13,143,223 instead of a profit of $1,178,000.

Possibly having the CRTC revoke SableTel's operating licence.

Substantial risks were highlighted with Hurricane Baylee. This shows the need for contingency planning to minimize downtime of SableTel's mobile network.

If project is approved by Industry Canada (IC), it makes what would normally be a competitive advantage technology that could be made available to others depending on what IC does in 2017. Therefore once the project is completed, SableTel must use the Wireless Technology quickly to achieve success before the risk of market saturation. SableTel needs to apply a first-to-market strategy.

SableTel is exposed to some foreign exchange risk with over $1.6 million paid to a US supplier over the last two years.

Inventory risk given the short shelf life of the technology that SableTel holds in its inventory. The fact that there is no provision for inventory becoming obsolete could be an issue for financial reporting.

Internal Environmental Analysis:

Strengths:

- Operates autonomously as a profit centre separate from the parent company, StarNova.
- Company possesses proprietary technology that allows it to enjoy a competitive advantage in the wireless and long distance industry, resulting in being a major contributor to corporate profits from 2008 through 2011.
- Grants available to SableTel, given that they received $2,750,000 from Industry Canada (IC))

- Even with loss of two major customers, margins are stable (however, loss was in June)

Weaknesses:
- Loss of a long-time salesperson, therefore continuity, through retirement
- EC meets only once per year
- Inadequate internal controls (CRTC payment inaccurate; financial statements require re-statement for major and significant adjustments; capital being expended without prior or thorough investigation, etc.)
- For past three years company has experienced a decline in profitability.
- Providing access to what could potentially become an additional competitive advantage to Industry Canada based on the grant
- Procurement procedures – purchase of large quantities of inventoried equipment with little probability of selling
- Inventory hyper-sensitive to obsolescence
- Asset protection limited via insurance
- The delivery system (the mobile network tower system) has limited protection and no secondary delivery avenues are evident (this is a strategic issue because the primary method of delivery is the only method of delivery; when the system is down revenue ceases)
- No secondary relationship established with a major infrastructure owner
- Current trending indicates that business is shrinking
- IT and Marketing reporting systems do not align
- Decisions being driven by inaccurate reporting
- CEO appears unaware of specific details related to major capital expenditures or may not be getting the proper data from Accounting (i.e. not able to answer question on $20 million for Wireless spending)
- Sales team unable to meet or not meeting quotas
- High sales staff turnover
- Loss of two large customers (estimate: 2 x $25,000 x12 = $600,000 revenue); have not been replaced (will need to adjust forward estimates)
- The reason for loss of customers is still unknown
- Reasons for variances in financials is not clearly understood by management
- IT is under-utilized (if they can be re-allocated to undertake the Wireless Project with no impact to current operations – something is amiss)
- Dependent on StarNova for financing
- Compensation plan does not address the area where the turnover is creating the greatest risk
- CEO is using related party for corporate tax planning issues (ethical issue)

<u>External Environmental Analysis:</u>
Opportunities:
- Larger corporations, with existing infrastructure, provide potential for stop gap corrections of lost towers on south shore of Nova Scotia
- Analysts are expecting revenues to grow by 1.5% in 2015
- Growth trend expected in the mobile segment
- Growth in mobile users - expected to grow by 2.9% in 2015
- Growing trend for HD3D technology (different from wireless project)

- Industry pundits are predicting growth in Internet consumption

Threats:

- Licence at risk of being revoked
- Telecomm industry is highly regulated
- Potential for legal lawsuits (noted in Executive Reporting document there are none right now)
- Once technology proven will be made available nationally by IC (in 2017)
- Inventory has short life cycle, given rapid technological change
- Subject to the outcomes of severe weather conditions
- Many regional competitors
- Marketplace is dominated by three large operators
- Mobile competition expected to be fierce – resulting in lower prices and margins
- An unsolicited offer to buy SableTel may be indicative of a hostile takeover
- Long distance segment continues to decline rapidly
- Major owners of infrastructure are not investing in the infrastructure
- Feasibility of Wireless project is dependent on a third party

Performance Management
(will be broken down into multiple assessment opportunities by the BOE)

The candidate provides a quantitative analysis of SableTel's environment.

The candidate demonstrates competence in Performance Management.

CPA Competency Statement	CORE	PM
2.3.1 Evaluates the entity's strategic objectives and related performance measures. In particular: b) Analyzes the nature of the entity and identifies key financial and non-financial performance indicators (KPIs) that are in-line with the entity's strategies, including industry- or sector-specific tracking needs c) identifies the leading and lagging KPIs that might be suitable for evaluating the entity's effectiveness d) uses accepted best practices in providing input on the formulation of KPI's that fit with the long-term strategies	B	A
3.2.3 Computes, analyzes, or assesses implications of variances. In particular a) analyzes actual performance against budget or another relevant benchmark b) explains results of variance analysis to appropriate levels of management c) provides insights based on findings and recommends courses of action	A	A
3.4.1 Evaluates sources and drivers of revenue growth	B	A
3.6.3 Evaluates root causes of performance issues, subsection a) analyzes the possible impact of unusual circumstances on performance	B	A
Also draws upon Core (Finance), however, is done in the context of strategy so the "slant" of the discussion differs from Finance i.e. draw risk and strategic conclusions from analysis of ratios, etc.:		
5.1.1 Evaluates the entity's financial state; subsection a) performs financial analysis including ratio analysis, industry benchmarking, trend analysis and	A	NA

cash flow analysis; subsection c) draws conclusions as to the entity's financial state		

Current Financial Assessment

Ratio Analysis

Financial Ratio	SableTel 2014 Actual (unadjusted)	SableTel 2014 Actual (adjusted)	SableTel 2013 Actual (unadjusted)	SableTel 2012 Actual (unadjusted)	Industry Ratios (2014)	Industry Ratios (2012)
Profitability Ratios						
Return on Equity	4.5%	(115.9%)	(5.1%)	0.4%	9.6%	10.2%
Margin Analysis						
Gross Profit %	52.8%	45.8%	53.1%	52.3%	52.2%	52.8%
Selling, marketing and administration %	46.4%	62.1%	50.6%	47.8%	40.5%	40.4%
Operating Profit %	6.4%	(16.3%)	2.4%	4.5%	11.7%	12.9%
Turnover						
A/ R Turnover	4.1x	3.9x	9.6x	12.7x	6.7x	6.9x
Days Collection	89days	93	38	29		
Inventory Turnover	38.3	7.4	10.5	34.6		
Inventory Turns	9.5x	50	34.6	10.6		
Short Term Liquidity						
Current Ratio	0.9x	0.6x	1.0x	0.9x	0.8x	0.8x
Long Term Solvency						
Operating Profit/Interest Expense	1.4x	(3.4x)	0.6x	1.0x	8.1x	8.0x
Growth Over Prior Year						
Revenue Growth	(0.2%)	(4.4%)	1.1%	N/A	(2.6%)	0.5%

The above ratio analysis indicates that SableTel is not performing as well as its peers, both when looking at the statement of comprehensive income and the statement of financial position. The analysis also indicates that SableTel's financial condition has deteriorated over the past year.

Coverage Ratios:

- Long Term Solvency: Times Interest earned– Its interest coverage ratio is worse than the industry average and has deteriorated further in 2014 meaning that it may have trouble meeting its interest payments in the future. This is very troubling and indicates that, without some form of financial assistance, SableTel may not be able to meet its financing obligations in the near term.

Liquidity Ratios:

- Short-Term Liquidity: Current ratio – SableTel appears to meet the industry norms with respect to its current ratio. This is in part due to the high accounts receivable balance at year end. The ratio is slightly worse than the prior year but above the industry norms and are acceptable (before adjustments). After the adjustment to write-off a portion of the inventory at year end, the current ratio is worse than the industry average. Reviewing this in conjunction with the A/R turnover raises cause for concern, as the rapid accumulation of receivables with an extended collection period is indicative of SableTel further exposing itself to risk of collection, especially considering the number of smaller, residential customers that may be undergoing current economic hardships resulting in the shift in the payments cycle.

Activity ratios:

- A/R Turnover – SableTel is not "turning" its accounts receivable over fast enough. This is particularly true with respect to its accounts receivable in 2014 which appear to be abnormally high at August 31, 2014. This has also resulted in a turnover that is considerably worse than the prior year. SableTel appears to be tying up a significant amount of cash in its accounts receivable. If SableTel were able to increase its accounts receivable turnover to the average turnover in the industry it would generate significant additional cash and therefore it would need to borrow less money from StarNova in order to meet the needs identified in its strategic plan. This low accounts receivable turnover may be an indication that SableTel has uncollectible accounts receivable. Further information needs to be obtained to assess the amount for reasonableness and to determine if additional write-offs are required. Detailed ageing schedules would be beneficial.

Profitability Ratios:

- Return on Equity ratio- this ratio is below the industry average and after adjustments it is negative. This indicates that SableTel is not earning an adequate return for its shareholder (StarNova). StarNova has indicated that it typically expects all of its investments to surpass WACC as a rate of return. After the 2014 adjustments, SableTel's ratios have deteriorated significantly from 2013 due to the large loss in 2014. The major driver is the pre-initiation of investment into the Wireless Project, which should not have occurred without prior authorization.

- Gross Margin Analysis – SableTel's margin analysis indicates that it is earning a gross margin which is slightly higher than its competitors (before adjustments). The margin (before adjustments) is also similar to the prior year. However, the SM&A percentage appears high. This is causing SableTel to have a lower operating profit relative to the industry. SM&A expenses are 6% higher at SableTel (before adjustments) and after adjustments, almost 22% higher. Some of this is due to the impairment charge and to the R&D related to the Wireless Technology Project. Once the capitalized R&D expenditures are adjusted for, the SM&A percentage is significantly higher in 2014 than in 2013. Further investigation is required to identify the root cause, though with the decline in sales in the long distance segment continuing and replacement business not keeping pace, the decline will likely continue (See market Analysis below).
- Growth Ratios – The industry has contracted over the past year and SableTel has contracted with the industry. Sales at SableTel have decreased by more than the industry (after adjustments) indicating a loss of market share. Note that the 2012 actual sales figures were not available. These growth ratios should be computed over several years and trends identified and compared with the industry, for better information.

Product/ Market Analysis:

2015F	chg	2014	chg	2013	chg	2012
$23,793,743	-$4,256,885	$28,050,628	-$5,018,475	$33,069,103	-$1,806,563	$34,875,666
25,489,025	$921,225	24,567,800	$887,930	23,679,870	$603,315	23,076,555
4,533,922	$294,955	4,238,967	$275,767	3,963,200	$886,325	3,076,875
4,956,281	$1,167,211	3,789,070	$892,331	2,896,739	$1,599,987	1,296,752
1,791,118	$115,359	1,675,759	$107,929	1,567,830	$80,221	1,487,609
				–		
$60,564,089	-$1,758,135	$62,322,224	-$2,854,518	$65,176,742	$1,363,285	$63,813,457
	% Chg		% Chg		% Chg	
	-15%		-15%		-5%	
	4%		4%		3%	
	7%		7%		29%	
	31%		31%		123%	
	7%		7%		5%	

The decline in long-distance sales is not being offset by growth in other areas. If this situation continues, it will result in further deterioration of both profits and margins. The fixed costs will likely not be decreasing in the future, as long as there are no further write-downs of assets. If these trends continue into 2015, an additional $1.7 million in revenues will be lost. A constant and concerted effort on sales of existing products is required, or new products or services must be brought to market to replace the declining business. Alternatively, considering that long distance is fast becoming a commodity, a review of the price to quantity relationship may provide some opportunity for pricing reductions to increase volumes then provide other services in a cross-selling initiative.

Horizontal Analysis

Aside from the financial statement line items that require adjustment, there are several other statement of financial position items which require further investigation. This includes:

Cash decrease of 96%, A/R increase of 134%, current liabilities increasing 42% and inventory increasing 254%.

This situation could be closely related to the pre-investment in the Wireless Technology Project and an inability to convert sales to cash as shown by the extended length of time to collect, although this is offset by the payables accumulation. This situation, however, is not sustainable in the longer term as suppliers will soon tire of their having to wait for their payments. Controls need to be improved to accelerate the cash cycle.

Gross Margin Analysis

	2014	2013	2012	Average
Long-distance	57.4%	62.0%	60.2%	60%
Local access	54.9%	54.9%	55.8%	55%
Mobile	48.0%	47.3%	47.5%	48%
Internet and data services	73.6%	72.6%	72.5%	73%
Internet and data services – routers and modems	59.4%	60.5%	61.8%	61%

The decrease in gross margin from long-distance is a concern and specific reasons should be identified, especially since long-distance is the largest source of revenue.

With the adjustment to cost of goods for obsolete routers and modems, this segment of SableTel lost $1,543,672.

Dan's comments and the ratios presented to the StarNova Executive Committee are at the very least not informative and may even be misleading. The three ratios provided to the Executive Committee in Dan's presentation all essentially report the same information. All compare the net income of SableTel to some other balance and therefore, since SableTel initially reported an increase in net income, appear to be better in 2014 than in 2013. However, none of the ratios presented explain the financial condition of SableTel or how SableTel compares to the industry.

Performance Management
(will be broken down into multiple assessment opportunities by the BOE)

The candidate provides an analysis of SableTel's current strategic plan.

The candidate demonstrates competence in Performance Management.

CPA Competency Statement	**CORE**	**PM**
1.4.5 Analyzes and predicts the impact of strategic and operational decisions on financial results. In particular, a) analyzes and predicts the impact of strategic and operational decisions on the entity's performance, financial position, and cash flows b) explains the financial impact of strategic and operational decisions	**B**	**A**
2.2.1 Assesses whether management decisions align with the entity's mission, vision, and values. In particular, b) assesses the alignment of the entity's mission, vision, values, and mandate with the overall objective defined c) critiques the alignment of specific decisions and strategies with the entity's mission, vision, values, and mandate	B	A
2.3.3 Evaluates strategic alternatives. In particular a) analyzes the strategic alternatives presented using a set of qualitative and quantitative criteria.	B	A
Also draws upon Core Management Accounting and Finance:		
3.5.1 Performs sensitivity analysis, in particular subsection a) calculates CVP, undertakes a sensitivity analysis for a given entity and assesses the implication for profitability	A	NA
5.1.2 Develops or evaluates financial proposals and financing plans. In particular c) identifies the strengths and weaknesses of the financial proposal or financial plans d) reviews the alignment of the proposal or plan with strategic objectives	B	NA

The candidate assesses the components of the strategic plan as presented and integrates their prior qualitative and quantitative analysis into their assessment of the plan.

<u>Current Plan</u>:
The current plan includes goals related to StarNova's higher goals, and SableTel's internal metrics, namely: Customer Service, Sales, Information Technology, Human Resources, and Marketing.

Current CEO Presentation Commentary:
Based on an initial review of presentation content, it is not abundantly clear whether the value proposition being executed is actually what SableTel's mission implies. With the overarching directive of "value through its people, technology, and exceptional service", there is an explicit indication of a customer intimacy value proposition. This, however, is clearly not the case given the loss of two major clients, the high turnover of sales staff, and the current pricing as though it were a commodity item. A customer- intimacy value proposition in general implies premium product or service accompanied by premium pricing because the target customer values that level of service. SableTel is clearly not in a position, at this time, to be a provider of such a value proposition. Operational excellence may need to be more highly focused on to get margins in line with targets. However, when the ongoing delivery of new cutting edge technology is a mainstay, focusing on costs may not be the right approach, considering that margins should be rich enough to support the ongoing R&D required to continue to bring to market new product on an ongoing basis.

SableTel's current strategic objectives are not aligned with the overall corporate goals of StarNova. It is not clearly focused on a single value proposition. Continuing this pattern will likely continue to erode the financial underpinnings of SableTel's existence, while also harming StarNova. SableTel likely needs to re-organize itself.

It must align itself with one value proposition and drive growth taking a more narrow focus. A review of the organizations value curve against the market/industry would assist in this "soul-searching". The HD3D technology represents a unique and engaging technology that could provide SableTel with first-to-market new technology and the benefits that come along with being first. However, the life cycle is short as industry competition will enter the market quickly. This does not allow SableTel the luxury of delivering to market and then rethinking the approach, thus making an ongoing product innovation value proposition one with little longevity. SableTel has been in the telecommunication delivery industry since inception, and based on its experience should have more effectiveness and efficiency in the management and delivery of these sought-after services. SableTel has the opportunity to introduce a new product ahead of the market. The decision to put more focus on the Wireless Project, at the expense of other options, warrants further consideration. SableTel needs to specifically assess the feasibility of execution, and alignment with Star Nova's corporate goals, namely the delivery of telecommunications services, with a year over year improvement in profitability.

The goals presented for SableTel were reviewed and my comments follow:

Information Technology: aligns insofar as it is an opportunity that will bring both sales growth in a new market, and improvements within internal processes through reduced costs, resulting in an overall improvement in margins across all product lines, moving SableTel toward an "operational excellence" value proposition. This is a valid and applicable goal.

Human Resources: It is not clear how a compensation plan for the senior executive team will forestall the high rate of employee turnover in a crucial area within the organization, namely the sales division. Continued turnover will result in margins declining further as the sales will not continue to cover the fixed costs in the long run without compensatory growth in other markets. The goal of a better compensation plan to help staff retention is a valid goal. A new compensation plan is SableTel's way of increasing motivation to generate increased sales. This only works if increased sales are possible. Considering that SableTel is operating in what is already a saturated market for the local, mobile and internet segments, this may not be achievable.

Customer Service: Aligns with what was originally thought to be the value proposition for SableTel. However, with shrinking margins, the service levels have not retained customer business. The shrinking margins, the declining demand, and the saturation of the market would imply that customer intimacy being taken for granted. But, it appears that customers are shopping for price, which forces the industry to become more efficient. Increasing the number of staff to better serve existing customers to avoid their jumping to a competitor could be seen as alignment. However, holding off on this decision until the strategic direction is finalized would be more prudent.

Sales: To increase sales is in alignment with the Star Nova's growth in net income goal, as without sales there is no growth. The means by which sales are increased is unclear. Current quotas are not being met, so increasing them will not result in anything greater and could possibly worsen the staff turnover as the increase would be seen as making the bonus something that is harder to get. A rethinking of the quota plan, along with the development of a recruitment plan would be far more beneficial.

Marketing: Increasing margins and increasing cross-selling both align with StarNova's goal of increased profitability. As indicated by the customer mix, the greatest reach for volume price points would be within the larger customer groups and the opportunity for greatest reach in cross selling would be in the lower revenue customers where there are several potential customers to target. Targeting these different customers with specific strategies would require a review of the Price to Quantity relationship and the ability to offset any discounts that might be offered at each price level with some other pricing strategy.

To be able to assess Dan's strategic plans for SableTel, the targets set need to be analyzed:

Customer Service – Goal: increase customer satisfaction

The goal to increase customer satisfaction is being supported by requiring customer service to visit 20% of all customers (5,000 customers) and increasing the customer service staff by 27% (55 to 70 employees).

Commentary: The logistics of this are not clear. Requiring the visitation of 5,000 customers annually, which is less than two per person per week, does not require an additional 15 staff to lower the call rate. The expense of the salaries of 15 additional staff might be better spent on retaining and motivating current staff members to increase productivity, and thereby reduce staff turnover. Customer service is probably more of a motivation issue. Customer satisfaction is not a measurable that can be used to indicate success, so providing additional staff to visit customers will not lead to better customer service. It is only in the use and effectiveness of the product and service that good customer service can be measured, over time. Ideally, a customer intimacy value proposition is focused primarily on the customers and their needs, regardless of how it is provided to them. The focus on customer service may help mitigate the loss of further customers. However, the focus of the visits should be on the larger customers instead of the geographically closest customers. A better approach would be to re-allocate the customer list based on revenue volumes and manage the list based on customer portfolio profitability rather than geographically.

There is already a problem with staff retention and hiring additional staff may exaggerate the issue. As well, one of the strengths of SableTel has been to restrain costs and one of Dan Wilson's goals is to reduce future costs. Increasing staff by 27% seems contrary.

Sales - Goal is to increase sales by 15% in 2015 and 10% in 2016.

The industry is expecting a 1.5% increase overall, so an increase of 2.3 to 2.5% on existing local, mobile, and internet business should be an achievable target. Note that with the restated financials, the goal of $75,400,000 translates into a sales increase of 21%.

Commentary: Hiring additional sales staff should help achieve the $75,400,000 revenue target. However, when the hiring occurs would be dependent upon the required learning curve and the onset of the new technology.

Similar to the hiring of more customer service staff, the additional sales staff will put a burden on cost reduction and further highlight the retention problems SableTel is currently facing.

Information Technology

- Primary goal: with new technology, introduce a new product to market in support of the product innovation value proposition and downplay the mainstay service delivery of the long-distance service. The long-distance service in becoming a highly competitive market that has transitioned from a new innovative service plan to becoming a crowded market space requiring a diametrically opposed value proposition – one of operational excellence and lowest cost provider.
- Secondary goal: to reduce cost of sales with new technology. Assuming funding is granted to complete the Wireless Technology Project, this goal should be achievable and supports the intent to provide long distance at the lowest possible cost and remain competitive. Unfortunately, the savings will not be fully realized until the after 2015 when the project is complete.

Commentary: Focusing all IT resources on the Wireless Technology Project will ensure it is complete. However, current operations and IT needs cannot be ignored. There needs to be IT resources committed to support not only the existing staff but also the substantial number of new staff that will be hired in 2015. This may present itself as an issue moving forward.

Human Resources - The goal is to improve staff retention.

Commentary: Introducing an executive bonus program may help retain the executives of SableTel. However, this program could have a negative impact on achieving the 2015 financial targets because of the increased expense. Moreover, the retention issue is not so much an issue at the executive level. Rather the problem is at the more operational levels of the organization. Therefore the program should be reviewed and a plan developed to address all levels of the organization with the focus at the top relating the bonus to align with the strategic goals and the operational level goals targeting the business level metrics that translate into specific goal achievement.

Marketing - The goal of 60% gross margin in all categories.

Commentary: It is possible, but could have significant implications in most of the categories. Long distance, local access and routers would have moderate price increases. But in a competitive, price-sensitive market this could have a substantial impact on gross revenues. Margins, in comparison to industry averages, indicate that SableTel, in a steady state, is average. But, with the new wireless project could achieve a 5% improvement which would allow it to become more competitive.

A 60% gross margin in the internet and data services would result in a substantial price decrease which should lead to more revenue. However, if revenue levels remain unchanged, this price change would result in a gross margin decrease. Also, given that the equipment in inventory may be obsolete, a gross margin of 60% is likely not a realistic goal.

Suggested revisions to marketing goals include: refocus of goals on ensuring the successful launch and application of the Wireless Project once it is approved.

Also consider the introduction of a new product. Internal marketing research indicates that initial sales might reflect volumes that would generate 75% of current mobile and internet sales volumes in 2015.

A gross revenue goal is suggested. The above amount could be set as the starting goal to provide direction and focus to SableTel. As well, so as to not sacrifice current market positions in other segments, industry growth expectations would be suitable targets to set for the other streams.

Constraints:
Wireless Technology Project requires Industry Canada approval. If approval of the project is not granted, there could be significant impact on SableTel's future financial results.

The feasibility of IT having the necessary technology to complete this project is still being assessed.

Insufficient cash to operate SableTel and invest without support from StarNova.

Analysis of Wireless Project Alternative:

Pros: (*expect candidates to align the analysis with the overarching parameters within the case facts, namely: mission/vision, goals, constraints, preferences, KSFs, and points from SWOT*)

- Introduction of new technology aligns well with the overall focus of StarNova's mission to provide customers with high-quality service utilizing new technology
- With projections of sales into 2017 resulting income meets StarNova 25% growth goal. (*See calculations below -SableTel forecast sales if include HD3D*)
- A NPV of the Wireless Project needs to be obtained from Finance (Preliminary calculations included here; Finance will provide a more detailed analysis).
- SableTel has a clear choice of project champion through current CEO as there is clear indication of commitment to see this project end successfully.
- The current industry KSFs will be sustained by SableTel i.e. Leading technology providing service, and product variety to allow single source billings
- A current major market segment (i.e. long distance) is declining rapidly causing cash flow pressures to increase
- Allows SableTel to increase its competitive advantage by being first to market with proprietary software
- Can continue to leverage government grants if available
- Wireless infrastructure not dependent on current land-line or mobile networks
- Improve utilization rate of internal fixed cost service provider (i.e. IT)
- Large growth expectations related to new technology HD3D
- Internet growth continues
- Margins in a second segment expected to be under increased pressure from competition – i.e. mobile service; SableTel's product mix is diversified, which tempers any of these effects.
- Major market players are not reinvesting in delivery infrastructure, eventually all delivery will be wireless requiring transition or exit
- Potential to recapture two lost customers with new product

Cons:

- Requires the full attention of the current IT staff – leaving the operation of SableTel's under resourced leading to potential unidentified cost overruns
- The Industry Canada involvement means SableTel has earlier and more exposure to market competition reducing the longevity of any competitive advantage
- A project of this stature would require more frequent meetings with EC because of its prominence and potential impact on SableTel's success
- Current sales team unable to meet current sales targets with a known product mix, introduction of a new product could create greater gaps in meeting targets rather than help

- Currently high turnover within the sales team; not a solid base from which to launch a new product
- Feasibility of project is still pending and dependent up in a third party evaluation.

Cash Flow Estimate and NPV—ESTIMATE ONLY *(FOR PURPOSES OF ILLUSTRATION THE SAME QUANTS ARE SHOWN FOR FINANCE AND PM-- a "lighter" version with less adjustments would be expected for PM based on the required.)*

	2015adj	5%	no chg	2016	2017	2018	2019	2020	2021
rev	$66,050	$75,400	$75,400	$75,590	$82,708	$82,708	$82,708	$82,708	$82,708
cos	$31,704	$32,422	$36,192	$32,504	$35,564	$35,564	$35,564	$35,564	$35,564
margin	$34,346	$42,978	$39,208	$43,086	$47,143	$47,143	$47,143	$47,143	$47,143
	52%	57%	52%	57%	57%	57%	57%	57%	57%
SM&A	$36,500	$36,500	$36,500	$37,230	$37,975	$38,734	$39,509	$40,299	$41,105
Dep&Cap	-$24,500	-$24,500	-$24,500	$7,500	$7,500	$7,500	$7,500	$7,500	$7,500
ttl	-$61,000	-$61,000	-$61,000	-$29,730	-$30,475	-$31,234	-$32,009	-$32,799	-$33,605
CF	-$26,654	-$18,022	-$21,792	$13,356	$16,669	$15,909	$15,135	$14,344	$13,538
proj Net \inc	-$2,154	$6,478	$2,708	$5,856	$9,169	$8,409	$7,635	$6,844	$6,038
depn	$7,500	$7,500	$7,500	$7,500	$7,500	$7,500	$7,500	$7,500	$7,500
cash flow	$5,346	$13,978	$10,208	$13,356	$16,669	$15,909	$15,135	$14,344	$13,538
recurring Cap	$4,000	$4,000	$4,000	$4,000	$4,000	$4,000	$4,000	$4,000	$4,000
project CF	$1,346	$9,978	$6,208	$9,356	$12,669	$11,909	$11,135	$10,344	$9,538
			0.8696	0.7561	0.6575	0.5718	0.4972	0.4323	0.3759
project worth	PVCF		$5,398	$7,075	$8,330	$6,809	$5,536	$4,472	$3,586
	$41,206		1	2	3	4	5	6	7
	30%		15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%
	$12,362								

In reference to next page: The last thing that Oldmun did before he retired was compile a high level customer demographic in the hopes of doing one last good thing and help focus efforts in the future. Little did he know that this may have saved the need to hire so many more customer service staff.

Comment re calculation below

C = net initial investment;
k = discount rate or time value of money;
T = corporate tax rate;
d = maximum rate of capital cost allowance;
(could be class 50 and 46, for an average CCA rate of 49%)

C= $20m
T = 30%
d = 40%
k = 10.71%

CCA = $4,503,871

SableTel Forecasted Sales HD3D

avg rev for group	customer in group	avg total revenues	Long Distance	Local	Mobile	Internet	Hardware	Mobile and Internet Tech volumes	Mobine and Internet HardWare volumes	Check
$ 275,000	7	$ 1,925,000	$866,420	$758,843	$130,932	$117,036	$51,760	$0	$0	$1,924,991
$ 175,000	30	$ 5,250,000	$2,362,964	$2,069,573	$357,087	$319,188	$141,165	$0	$0	$5,249,977
$ 75,000	46	$ 3,450,000	$1,552,805	$1,360,005	$234,657	$209,752	$92,765	$0	$0	$3,449,985
$ 32,500	54	$ 1,755,000	$789,905	$691,829	$119,369	$106,700	$47,189	$0	$0	$1,754,992
$ 15,000	937	$ 14,055,000	$6,325,991	$5,540,542	$955,974	$854,513	$377,918	$0	$0	$14,054,938
$ 1,500	23925	$ 35,887,500	$16,152,544	$14,147,008	$2,440,947	$2,181,881	$964,961	$0	$0	$35,887,341
	24999	$ 62,322,500								
			$28,050,628	24,567,800	4,238,967	3,789,070	1,675,759	0	0	$62,322,224
			$28,050,628	$24,567,800	$4,238,967	$3,789,070	$1,675,759	$0	$0	$62,322,224
		Change	50.0%	101.6%	101.6%	101.6%	101.6%	75%	75%	
		YEAR ONE	$14,025,314	$24,967,118	$4,307,866	$3,850,656	$1,702,996	$25,248,042	$1,298,007	**$75,400,000**
		Change	50%	101.6%	101.6%	101.6%	101.6%	125%	125%	
		YEAR TWO	$7,012,657	$25,372,927	$4,377,885	$3,913,244	$1,730,676	$31,560,052	$1,622,509	**$75,589,950**
		Change	75%	101.6%	101.6%	101.6%	101.6%	125%	125%	
		YEAR THREE	$5,259,493	$25,785,331	$4,449,042	$3,976,849	$1,758,806	$39,450,065	$2,028,136	**$82,707,722**

	margin benefits: from existing	margin benefits: new business	Gross profit	Net Inc	YoY change	%CHG	Comments
YEAR ONE	**$ 3,770,000**	**$ 13,803,945**	$ 39,208,000	$ 2,708,000			75% of combine local, mobile and internet users
	0.52	0.52					75% of current hardware sales
							50% drop in long distance
							1.6% growth in main line business
YEAR TWO	**$ 3,779,498**	**$ 4,446,463**	$ 41,574,473	$ 5,074,473	$2,366,473	87%	25% gowth in MTVI
	0.55	0.55					50% drop in long distance
							1.6% growth in main line business
YEAR THREE	**$ 4,135,386**	**$ 4,562,602**	$ 45,489,247	$ 8,989,247	$3,914,775	77%	25% gowth in MTVI last year of growth
	0.55	0.55					20% drop-long distance then stable thereafter
							1.6% growth in main line business

PV- after tx CF	$ 43,678,883
CCA	$ 4,503,871
Investment	-$ 21,000,000 StarNova Investment
NPV	$ 27,182,754

$$PVIFA = \frac{1-(1+r)^{-n}}{r}$$

n	5
r	10.71%
PVIFA	3.7230

Years	margin(exst)	margin(new)	factors		Taxrate	ATax PVmargin(old)	ATax PVmargin(new)
year1	$3,770,000	$ 13,803,945	0.9033		30%	$2,383,809	$8,728,373
year2	$3,779,498	$ 4,446,463	1.7191		30%	$4,548,134	$5,350,740
year3	$4,135,386	$ 4,562,602	3.7230	0.7370	30%	$10,777,230	$11,890,598
						$17,709,172	$25,969,711
							$ 43,678,883

* Present value of CCA tax shield:

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

Comment:

Performance Management

(will be broken down into multiple assessment opportunities by the BOE)

The candidate provides an analysis of the financing alternatives from a strategic perspective.

The candidate demonstrates competence in Performance Management and Finance.

CPA Competency Statement	**CORE**	**PM**
1.4.5 Analyzes and predicts the impact of strategic and operational decisions on financial results	**B**	**A**
2.3.2 Evaluates the entity's internal and external environment and its impact on strategy development. In particular, b) evaluates the implications of the entity's ownership structure : legal form (e.g., corporation versus partnership, public versus private sector) and types of ownership	**B**	**A**
Also draws upon Core Finance :		
5.1.2 Develops or evaluates financial proposals and financing plans. In particular, c) identifies the strengths and weaknesses of the financial proposal or financing plans; d) reviews the alignment of the proposal or plan with strategic objectives	B	NA

The finance group will do the detailed analysis of the options to cost them out. However, there are other considerations we have identified. The three financing alternatives for SableTel: StarNova provides $22 million in funding; SableTel IPO for 30% of shares or sell SableTel's assets for $46 million, need to be considered from a strategic perspective, based on some preliminary finance analysis.

(For this illustration, the quants have not been included. They would be a "light" version of the quantitative analysis found in the Finance Section.)

1. Provide $22 million in funding

   Pros
   - ensure completion of the Wireless Technology Project
   - retain 100% ownership of SableTel in view of potential large near-term market position gains

   Cons
   - SableTel is in a bad financial position and losing money, cash flow is tied up in receivables, and in light of the decline in operations is not generating sufficient cash flow to support ongoing operations

2. SableTel IPO

   Pros

- do not have to deplete StarNova funds
- diversify the risk exposure – only occurs if the feasibility study indicates a positive contribution can be generated from the Wireless Project

Cons
- will require a full financial audit (this may uncover additional accounting issues)
- poor financial results = may not generate enough buyer interest to raise the amount
- existing management is poor (deters prospective buyers as strong management is an important factor for investors)
- give up ownership and some control

3. Sale of SableTel for $46 million

Pros
- sell a money-losing subsidiary that has declining revenues and increasing losses
- exit a highly competitive, saturated market

Cons
- offer price is below book value (see quantitative analysis)
- relinquish any position in the telecommunications industry
- lose proprietary software
- lose out on the growth opportunity in the mobile segment
- loss of first to market position with new Wireless Technology

StarNova's decision is also affected by the financing options and on the outcome of the third party review of the Wireless Project's feasibility.

There would be two options in the corporate funding alternative:
1) provide the funding and have SableTel continue to work on the Wireless Project and consider the costs if the investment does not improve overall results;
2) wait until the Wireless Project is proven, in which case there could be increased potential for beating the competition to market.

In both cases, StarNova will want to determine if IC piggy-backing on the development is absolutely necessary as it can severely limit the length of time SableTel remains the market leader.

If the intent were to sell SableTel, the company would need to be brought back up to efficient operating levels and could possibly require a replacement CEO with the skills to do so. That would be a major strategic decision on StarNova's part that is not discussed here.

The recommendation for financing would be to pursue the $22 million funding option (based on a preliminary cash flow – Finance will do the more detailed analysis).

Performance Management **(will be broken down into multiple assessment opportunities by the BOE)** The candidate provides recommendations to the strategic plan. *The candidate demonstrates competence in Performance Management.*

CPA Competency Statement	**CORE**	**PM Elective**
1.4.5 Analyzes and predicts the impact of strategic and operational decisions on financial results. In particular a) analyzes and predicts the impact of strategic and operational decisions on the entity's performance, financial position, and cash flows;	**B**	**A**
2.4.1 Analyzes the key operational issues and alignment with strategy. In particular a) investigates the effectiveness of control systems and accountability structures in aligning resources with strategy; c) analyzes the effectiveness of initiatives in addressing key human resource management issues	**B**	**A**
2.5.1 Designs an effective risk management program and evaluates its impact on shareholder value. In particular b) discusses the potential impact of significant changes in the entity's environment on the entity's risk profile; c) analyzes risks; risk tolerance and exposure; risk mitigation responses; and the risk monitoring process; e) identifies and suggests courses of action to help manage risks	**B**	**A**

Recommendations

	2014 ADJ	changes	2014	changes	2013	changes	2012
revenue	$62,322,224	-$2,854,518	$65,072,224	-$104,518	$65,176,742	$1,363,285	$63,813,457
COS	$33,775,842	-$3,184,160	$30,714,869	-$123,187	$30,591,682	-$164,937	$30,426,745
Gross profit	$28,546,382	-$6,038,678	$34,357,355	-$227,705	$34,585,060	$1,198,348	$33,386,712
Expenses							
Sell & Admin	$16,875,413	-$291,588	$16,875,413	-$291,588	$16,583,825	-$1,488,939	$15,094,886
Administration	$21,846,542	-$5,435,297	$13,336,292	$3,074,953	$16,411,245	-$993,913	$15,417,332
	$38,721,955	-$5,726,885	$30,211,705	$2,783,365	$32,995,070	-$2,482,852	$30,512,218
opg profit	-$10,175,573	-$11,765,563	$4,145,650	$2,555,660	$1,589,990	-$1,284,504	$2,874,494
interest	$2,967,650	-$89,800	$2,967,650	-$89,800	$2,877,850	-$101,950	$2,775,900
profit	-$13,143,223	-$11,855,363	$1,178,000	$2,465,860	-$1,287,860	-$1,386,454	$98,594

After the adjustments to the 2014 financial statements, SableTel appears to be in a precarious financial situation. With restated financials that show revenue at $62.3 million and a net loss of $13.1 million, the 2015 targets need to be achieved to remain a viable going concern. There is no other viable option but the status quo. In view of the market that SableTel currently is involved in, the company is faced with a choice: the displacement, replacement, improvement or protection of market position or product sales. SableTel is being faced with a rapid decline in the long-distance market and if it is not replaced quickly will find that the incremental improvements provided through “displacing, improving, or protecting” will not protect SableTel from eventual bankruptcy.

The Wireless Project, when approved, will provide substantial sales volumes to not only grow the base of business that SableTel currently has, but also replace some of the lost business in the long distance segment that is recurring annually (See Project Forecast above). The alignment to the mission is evidenced through the Project’s ability to improve the profitability year over year and provide product variety within the telecommunications venue. Dan Wilson will have to champion the Project to its successful completion and its implementation will improve margins such that either greater return or lower pricing will result, the latter closing the gap between where SableTel is in the market and reaching the key success factor of value for cost. The downside risk for SableTel is emphasized only if the Wireless Project is non-viable and SableTel is left with nothing to replace the lost long distance business. In this case SableTel must undergo dramatic internal improvement initiatives to optimize revenues and minimize internal costs. Some of these recommendations should be undertaken regardless of the outcome associated with the Wireless Project.

To remain aligned with the mission of SableTel and ultimately the corporate mission of StarNova, the Wireless Project must be pursued.

Summary of Adjusted Budget and Capital Requirements

Are the Plans Likely to be Achieved?

The budget as set out by Dan is potentially achievable and SableTel could return to profitability in 2015. However, this is not as yet guaranteed as the feasibility study on the Wireless technology is yet to be received. Other significant changes should be made in order for SableTel to become profitable in the event that the project is not feasible. SableTel should take immediate actions to improve revenues and/or to decrease expenses in order to become profitable.

There are no indications that there is a retention issue with the executives at SableTel, however, there are issues with retention of sales people. The introduction of a bonus plan should be focused on the sales people and the Board should determine, if and when, a bonus plan for the executives is required at a later date.

Introducing a bonus plan for the sales people will help alleviate the salary difference between SableTel and the industry benchmarks. In an effort to improve operations to support the ongoing drive toward operational excellence certain other recommendations are necessary.

Operational Issues Evaluations:

1. Internal Controls:

There are several issues related to internal controls, these have been identified and corrective actions are in order. These include:

i) EC meets only once per year:

During the development and execution phases of the Wireless Project it would be highly recommended that the EC meet more regularly with SableTel to ensure the projects related to continuous improvement and the new Wireless Project remain on time, on budget, and within scope.. Ongoing margins depend on it.

ii) Procurement procedures:

Given that inventory mix and ageing schedules are not available, the determined limit is not readily available. The purchase of equipment and hardware should be managed in a fashion that does not restrict front line empowerment, but does protect the financial exposure. Spending limits should be implemented such that any purchase of consumables that have a risk of aging be approved when a specific limit has been reached. Likewise, any general purchase that exceeds a specific limit would need a more senior level approval.

Inventory hyper-sensitivity to obsolescence

The hyper-sensitivity of the hardware in this industry warrants a closer scrutiny of the Economic Order Quantity processes within Purchasing. inventory schedules prepared using the ABC method would provide insight into specific order quantity/value relationships to facilitate more efficient order practices and approval processes.

Asset protection limited insurance coverage

A review of capital assets (i.e. strategic assets – towers for delivery of service) must be undertaken to fully assess the risk of prolonged outage, and the estimated revenue lost and/or customer loss due to the outage. When the risk has been established the actuarial estimate can be used to determine the amount of insurance SableTel should acquire. The high-level risk arises from the fact that the infrastructure is at its peak and will only deteriorate because the major players are no longer investing in this technology and will allow it to fully depreciate without reinvestment.

No secondary plan for service delivery

SableTel and its parent StarNova should immediately enter into negotiations with a major national supplier of service to purchase line capacity in the event of another catastrophic failure such as has been experienced recently. To not have a secondary routing method exposes SableTel to extensive losses in revenue streams, that once lost may not be recovered, especially those that may have renewals occurring during an outage period. Risk management procedures must be drawn up.

IT and Marketing reporting systems do not align

An immediate task force should be charged with the duty of reconciling the two systems. Until further notice however, the system that is the most accurate must be the only system reporting information. This is to avoid situations such as that with the CRTC. The fact that the IT system does not reconcile to the marketing system raises another issue related to the Wireless project. There may not be adequate IT resources to support the Wireless Project and SableTel operations.

Decisions cannot be made while there are two different reporting systems which do not reconcile. It is imperative that one be defined as the single source of record and any other reporting source ensure reconciliation to the main source, run in parallel or the original source be redesigned to respond to the same questions that the alternative source is being designed to respond to. There is no logical reason to have multiple information sources. Internal audit of information systems is a necessary requirement in this regard.

IT under-utilized

The fact that IT is under-utilized is puzzling insofar as there appears to be an abundance of IT readily available to be redeployed to the Wireless Project. However, the reconciliation of the two information systems is still unresolved and perhaps requires the IT staff's time.

Unable to meet sales quotas/high turnover

This operational problem is a circular condition wherein the sales are falling and quotas are not being met so people are resigning, leaving large staff shortfalls, which create pressure for even higher quotas. There is a combination of problems resulting in the spiralling effect being seen. The sales force is being rewarded for making sales, but demand is falling and competition is increasing. The performance measure for sales should ensure sales people are not penalized because of setting quotas that are not achievable. Rather, the quotas should relate to the market trends such that in a downward trend the metric for that market could be set to 5% higher than the market trend. .This does not solve the problem of needing to grow sales, but could help reduce the exodus of sales people.

Lost two large customers

A reason for the lost customers must be found. The situation is serious enough that Dan Wilson should make a personal call to the person in charge of sales. It takes several times more money and effort to recapture a lost customer than it takes to keep one. The fact that two unhappy customers have abruptly left the company is unacceptable. There needs to be more controls in place with respect to customer retention programs. If they were not happy there should have been a process for their concerns to be heard, recorded and rectified.

Use of non-arm's length relation for tax-planning issues

This is a breach of two if not more controls. On the face of it, the CEO has enlisted the aid of an unqualified student for tax planning purposes which exhibits poor judgement. To add to the severity of the issue, the student is a relative, which breaches certain pecuniary and conflict of interest guidelines. In addition, the advice has not been beneficial. The more insidious issue relates to how this could even occur unless there are no internal controls in place to prevent it.

Potential risk of CRTC licence being revoked

This is another internal control issue whereby a government body has not had their inquiries addressed and SableTel is now facing revocation of its license. Controls should be in place to flag such occurrences so that something as strategic as an operating license never gets to the point of a notice of revocation. The full fee payment should be executed and reparations made after the root errors have been identified.

Account Receivables collections

The recent accumulation of receivables year over year is indicative of some underlying fundamental issue that requires investigation. The root cause to this growth must be determined so that controls can be designed and put in place so that receivables do not envelope such a large portion of cash in working capital.

Dependence on parent company for financing

Until SableTel is able to generate excess operating cash flows at levels that allow repayment of loans and re-investment in capital, dependence on StarNova will be an issue. The key concern that should remain in focus is the outstanding unsolicited bid to buy SableTel. If SableTel continues along its current trajectory, buyers will become more interested, especially if they have the type of leadership required to undergo an effective turnaround. StarNova at that point might want to consider a strategic alliance rather than sell-off to leverage other expertise that is not currently present within SableTel.