CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

CPA Common Final Examination

BOARD OF EXAMINERS' REPORT

PART A — The Day 2 and Day 3 Report

September 2022 Examination

CPA EVALUATIONS

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See Part B for full Day 1 report on Waste Disposal Inc. simulations and marking guides.

THE BOARD OF EXAMINERS' REPORT ON THE SEPTEMBER 2022 COMMON FINAL EXAMINATION

OBJECTIVES OF THE REPORT

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

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

The September 2022 CFE Report is presented in two parts: Part A is the Day 2 and Day 3 report and Part B is the Day 1 report.

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

RESPONSIBILITIES OF THE BOARD OF EXAMINERS

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

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

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

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

THE CFE

Preparation and Structure of the CFE

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

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

Nature of the Simulations

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

Day 1 – The first paper is a four-hour examination consisting of a single simulation that is linked to the Capstone 1 group case. There are two versions of the linked cases, unless special circumstances require that a third version be provided. Version 1 is linked to the most current Capstone case and is written by first time writers and by repeat writers who chose to attempt the new case rather than Version 2 of the previous Capstone case. Version 2 (and Version 3, if applicable) is written by repeat writers and candidates who deferred and are writing Version 2 (and Version 3, if applicable) as their first attempt. The versions of the exams are calibrated to ensure the difficulty of all versions is comparable. For the September 2022 CFE, a Version 1 and a Version 3 were offered. The Version 3 case relates to WDI, for which a Version 1 was offered in May 2021 and a Version 2 was offered in September 2021. Version 3 was required and offered on the September 2022 CFE as the May 2021 CFE was not able to be offered nationally.

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

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

Assessment Opportunities

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

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

Appendix A contains a comprehensive description of the evaluation process.

Marking Guides

Marking centre leaders and assistant leaders provide valuable input during the testing and setting of the marking guides, before live marking begins. The vice-chair, selected member(s) of the CFE subcommittee and senior evaluations staff hold meetings with the leaders and their assistants during both the guide-setting and the marking processes. See **Appendix B** for the Day 1 simulations that appeared on the September 2022 CFE and **Appendix C and D** for the Day 2 and Day 3 simulations and marking guides. The marking results for Day 2 and Day 3, by Assessment Opportunity, appear in the statistical reports found in **Appendix E** of this report. See Part B of the CFE Report for details on Day 1, Waste Disposal Inc. Version 1, Version 2 and Version 3.

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

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

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

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

Setting the Passing Standard

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

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

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

The Decision Model

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

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

➢ Day 2 is the **depth** test. It assesses technical **depth** in one of four unique roles (that reflect the four CPA elective choices) and provides **depth** opportunities in the common core competency areas of Financial Reporting and/or Management Accounting. Candidates pre-select one role and respond from that role's perspective.

➢ Day 3 supplements the **depth** test in the common core areas of Financial Reporting or Management Accounting. It is also the **breadth** test for all common core competency areas.

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

Day 1

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

Day 2 and Day 3

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

1. The response must be **sufficient**; i.e., the candidate must demonstrate competence in the Assessment Opportunities presented on Day 2 and Day 3 (Level 1).

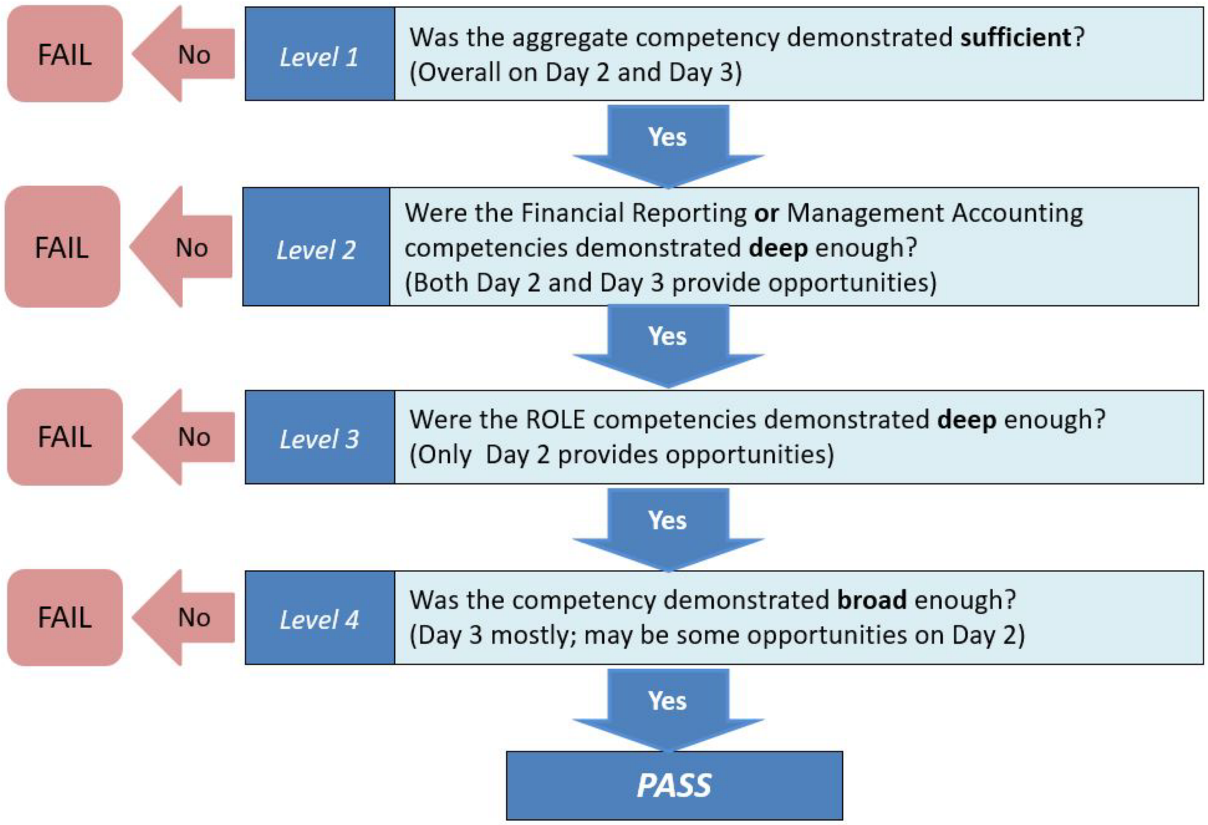
2. The response must demonstrate **depth** in the common core area of Financial Reporting or Management Accounting (Level 2).

3. The response must demonstrate **depth** in the pre-selected elective role (Level 3).

4. The response must demonstrate **breadth** across all competency areas of the *Map*, at a core level, by not having avoided a particular technical competency area (Level 4).

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

EXHIBIT I
DAY 2 AND 3 PASS/FAIL ASSESSMENT MODEL



Approving the Results

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

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

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

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

Reporting

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

The board reports the following information by candidate number:

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

Thank You

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

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

Jordan Oakley, CPA, CA
Chair
Board of Examiners

A MESSAGE TO CANDIDATES

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

Introduction

The September 2022 CFE Report, Part A and Part B combined, presents detailed information on all candidates' performance for all the examination cases, except for the Day 1 linked case, CFL Version 1. Detailed commentary on the performance of candidates on the CFL cases (Version 1 and Version 2) will only be available after CFL Version 2 is written in September 2023. The simulations, marking guides, marking results, and Board of Examiners' (BOE) comments on the Day 2/Day 3 portion of the examination are found in Part A of the CFE Report. Similar information on Day 1 WDI simulations (Version 1 to Version 3) can be found in Part B of the CFE Report.

The intent of this message from the BOE is to help candidates improve their performance on future CFEs by drawing their attention to the most common detracting characteristics observed in candidate responses to the September 2022 CFE. The BOE's comments are based on the feedback of the marking teams, who see the entire candidate population, and reflect the broad themes noted by the markers that apply to all candidates who wrote this sitting of the CFE. More detailed AO-by-AO commentary on candidates' performance can be found in the BOE's comments in Appendix F of Part A, or Appendix H of Part B, of the CFE Report.

Nature of the CFE

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

Strengths and Weaknesses

Time management

Overall, candidates demonstrated good time management skills. The Day 1 simulation was not time constrained in any way and, generally, the amount of time that candidates devoted to their situational analysis and their issue analysis was appropriate. Most candidates were able to address all the strategic alternatives presented, spending more time on the alternatives that required more analysis and discussion. The Day 2 simulation was also not time constrained, and most candidates managed their time appropriately on Day 2, attempting all the AOs and appropriately balancing their time between the common section and the role section. On Day 3, which is designed to be time constrained and required time management on the part of the candidates, to ensure that all three simulations were completed within the four hours allotted, candidates seemed to be able to plan their time accordingly. There was some evidence of slight time constraint, given the high percentage of NA (10%) on the last AO on Day 3, Simulation 3; however, this is expected, given the design of Day 3.

Unrelated discussions

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

Technical ability

The BOE has noted a trend of declining technical abilities. The pattern the BOE has seen for the past few CFEs has continued, with candidates generally avoiding the more complex topics. In addition, while candidates performed well on some of the common, straightforward topics, there were also common topics where candidates struggled.

Candidates generally performed well on: Day 2, Common, AO#3 (Financial Reporting – Renovation costs), AO#4 (Management Accounting – Variance analysis) and AO#5 (Management Accounting – Budget); Day 2, Assurance role, AO#11 (Internal controls); Day 2, Finance role, AO#7 (Packaging equipment NPV); Day 2, Performance Management role, AO#8 (Delivery pricing); Day 2, Taxation role, AO#8 (Taxable income and taxes payable); Day 3, Simulation 1, AO#5 (Finance – Bank covenants); Day 3, Simulation 2, AO#4 (Management Accounting – Divisional allocations) and AO#5 (Assurance – Internal controls); and Day 3, Simulation 3, AO#3 (Management Accounting – Minimum selling price).

However, on certain of the remaining AOs, there was more variability in the quality of the responses, with some candidates demonstrating a very poor understanding of the required technical knowledge.

In financial reporting, for example, on Day 2, Common, AO#1 (Financial Reporting – Revenue recognition), candidates performed worse on this AO when compared to similar AOs on past CFEs. Candidates struggled to apply the guidance in IFRS 15 to relevant case facts and to allocate the discount across the performance obligations. On Day 2, Assurance role, AO#7 (Operating segments), many candidates could not identify the relevant guidance for the issue, even though there is a specific Handbook section that is applicable, and the guidance is relatively straightforward to apply. On Day 3, Simulation 2, AO#6 (Financial Reporting – Inventory), the BOE was surprised at the performance on this relatively straightforward AO. Candidates did a poor job of discussing the issues related to the feed inventory in transit at year end and the additional storage costs incurred, or ignored these issues altogether.

Candidates also demonstrated poor technical knowledge in some of the Day 2 role AOs. On Day 2, Finance role, AO#10 (Financing options), candidates were unable to adequately analyze the two different options (a note payable and share exchange), not understanding how to compare two options that have different terms. On AO#12 (Dividend or buy back), candidates did not seem to understand the different options presented, and were unable to articulate the differences between the two options. On Day 2, Performance Management role, AO#9 (Outsourcing secret sauces), candidates generally struggled with how to incorporate the capacity constraint in their calculations. On Day 2, Taxation role, AO#11 (Shareholder loans), candidates struggled with providing the specific period for when loans would be included in income, and the calculation of the imputed tax benefit. Also, on Day 2, Taxation role, AO#13 (Estate planning), many candidates treated the RRSP as a capital gain upon death.

In addition, the BOE purposely included a newer auditing standard on the exam, and candidates struggled with addressing it. On Day 2, Assurance role, AO#13 (Key audit matters), many candidates did not identify the relevant guidance (CAS 701), and others did not address the issue in the right context, for example, focusing on assertion-level risks for specific accounts and the work that the external auditor would complete. While the BOE recognized that this is a harder topic, candidates were expected to be up-to-date on the newer standards.

Candidates should expect to see a variety of issues of varying difficulty. The BOE encourages candidates to be balanced in studying, and to ensure that they have a sufficient level of technical knowledge in all competency areas.

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

Consistent with previous CFEs, candidates on the September 2022 exam seemed to struggle with applying the specific context of the simulation to their response. For example, on Day 2, Performance Management role, AO#7 (Recipe development), candidates struggled with applying the percentage of customers who would have bought meals anyway, or incorporating development and graphic design costs of the new recipes. Also on Day 2, Performance Management role, AO#10 (Chef Dashim sales data), candidates struggled to give useful advice, based on their findings from the analysis of the charts and graphs provided to them. They were mostly able to make valid interpretations of the graphs, but seemed unable to integrate those findings with the remaining case facts in order to provide useful advice. On Day 2, Taxation role, AO#11 (Shareholder loans) and #12 (Shareholder remuneration), many candidates failed to recognize that BDFH only had passive income so it could not have been Conrad's employer with respect to his shareholder loan, nor could it justify salaries to the children. On Day 3, Simulation 1, AO#1 (Financial Reporting – Investment property), candidates did not apply the case facts presented to support their choice of the accounting policy option for subsequent measurement (fair value model or cost model), instead simply suggesting one model without support. Also on Day 3, Simulation 1, AO#3 (Management Accounting – Operational weaknesses), candidates struggled to identify the root cause of the problem, failing to understand the specific context provided. As a result, candidates' discussions lacked depth and did not address the most significant issues. On Day 3, Simulation 2, AO#1 (Taxation – LCGD and QSBC), most candidates were able to explain what the LCGD is, but struggled to apply the QSBC criteria, given the specific case facts provided.

The BOE emphasizes that the ability to adapt to unique scenarios and integrate information from various parts of the case are important skills for an entry-level CPA. In addition, the role of the CPA is often to advise clients, either on the application of standards and tax rules or on why, and how, to proceed with certain business and financial decisions. Without a clear explanation, a client would have incomplete information. In the case of responses to CFE simulations, the BOE is interested in understanding the logic used and is looking for evidence of the analysis and professional judgment that was applied in reaching a conclusion. Therefore, it is important for candidates to answer the questions "Why?" or "So what?", using case facts, when making any point, and to include the answer in the response. Jumping to the conclusion without first presenting the analysis supporting that conclusion is insufficient. The BOE is looking for a clearly articulated response.

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

Additional Comments Specific to Day 1 – CFL (Version 1)

Most candidates dedicated the first section of their response to a relevant situational analysis. Most used this information later in their response, making relevant links back to the company's global situation when analyzing the specific strategic issues that were presented, and within their conclusions. However, the links that weak candidates made were typically to the more obvious case facts that related to CFL's key success factors, mission, and vision, rather than being tied to the more important factors, which generally varied for each strategic issue.

Beyond the specific objective to improve EBITDA in the coming years, CFL's board wanted advice on which age demographic to target in order to improve the performance of the company's fitness gyms. Internally, CFL had only $2 million of cash available for strategic investment, a limitation that was made worse by the fact that CFL did not have access to any further debt. Candidates were expected to integrate the crucial elements of the company's broader situation, including CFL's cash constraint, within their qualitative and quantitative analyses of each strategic alternative. They were also expected to explain how each available alternative aligned with the company's overall choice of which age demographic to target.

For each of the strategic options available to CFL, candidates were expected to conclude and recommend a course of action that was consistent with their analyses. Within their conclusions, candidates were expected to address how the company's constrained cash position would impact which strategic options could be chosen, recognizing that there was an opportunity to sell two of its business units, the Zenfit distribution/video production agreement and/or the company's climbing wall facilities, which would provide additional cash. They were also expected to provide an overall conclusion that was consistent with whichever age demographic they recommended that CFL target.

There were four strategic options to be analyzed in this case: which age demographic CFL should target for its fitness gyms; whether CFL should become Zenfit's national distributor; whether CFL should open new climbing facilities; and whether CFL should acquire RJ's Health Clubs Limited. In addition, candidates were expected to discuss, given the departure of Rosa, whether Louisa Rice or Albert Fong would be a suitable replacement as a CFL board member.

Within the analysis of the major issues, three main factors differentiated strong responses from weak responses. First, a strong response identified and provided an in-depth discussion on the most important decision factors for each issue. Weak candidates tended to list case facts, often failing to explain why those elements were important and how they affected the decision-making process. Second, strong candidates provided valuable quantitative analyses to help support their recommendations (such as by linking their calculations to the stated objectives of CFL). On the other hand, weak candidates' quantitative analyses were often unstructured and unclear and, therefore, challenging to follow. Many failed to perform the correct calculation to assess the decision. These candidates often struggled to explain how the results of their quantitative analyses affected the decision at hand. Third, strong candidates routinely linked their analysis of each option to the two prevalent entity-level issues presented in the case: the targeted age demographic and the cash constraint. Strong candidates incorporated these aspects into their discussion of each strategic option, whereas weak candidates either missed making these links altogether or provided a superficial discussion by listing pros or cons, sometimes in contradictory ways from option to option, and failing to adequately highlight the importance of these aspects to the decision. Strong candidates typically incorporated both entity-level issues to some extent and usually prioritized their strategic recommendations, explaining why one option should be pursued over another, drawing on the entity-level decision factors.

Weak candidates tended to only perform an issue-by-issue analysis without stepping back to consider the broader perspective and without integrating the key entity-level issues into their conclusions. As a result, they failed to make important links between the various aspects of each alternative. For example, weak candidates typically did not incorporate the preferences of each age demographic within their analysis of any of the other strategic options, beyond the analysis of the age demographic decision itself.

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

Additional Comments Specific to Day 1 – WDI (Version 3)

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

In addition to considering the company's objective of a first-year return of at least 10% for any investments that were made, candidates should have highlighted the major issue relative to WDI's external environment in their situational analysis: there was an opportunity for Jack to sell WDI to SDL in the near term, or to take a chance and hope to receive a higher offer in the future. Candidates should have also highlighted the increased importance of sustainability that had occurred within the industry, and to incorporate the implications of that shift within their analysis of each strategic option that was available to the company. Candidates were expected to integrate the crucial elements of the company's broader situation into their analysis.

There were five strategic options that candidates were expected to analyze both qualitatively and quantitatively: whether Jack should accept SDL's offer and sell WDI now; whether it was still possible for WDI to achieve the company's GHG emission reduction target, and whether WDI should commit to future incentive programs; whether WDI should pursue the open bid for a ten-year waste management contract with the municipality of Truro; whether WDI should acquire the Halifax-based PET plastic recycling plant; and whether WDI should collaborate with FFC for the ecodiesel project.

Similar to CFL Version 1, strong candidates recognized and discussed the most important decision factors for each issue, provided valuable quantitative analysis, and linked their analysis to the significant entity-level issues presented in the case. Strong candidates tended to incorporate Jack's intention to sell within a two-year time frame, as well as the increased focus on sustainability in the industry, throughout each of their issue-by-issue discussions and within their conclusions and overall recommendations. Strong candidates recognized that each strategic option would have an impact on WDI's GHG emissions, and whether WDI could have still met its reduction target by 2025.

One of the main differentiating factors between strong and weak candidates was the ability to identify and discuss in depth the most relevant aspects of each strategic option presented as part of their analysis. Rather than discuss the more pertinent implications, weak candidates' analyses tended to focus on the minor considerations. For example, for the ecodiesel project, weak candidates tended to focus their analysis on the operational aspects of the proposal (such as the complexity involved in unloading the waste oil into FFC's storage tanks), rather than on how the collaboration would impact the broader strategic elements of WDI's business. Weak candidates also often did not step back and consider the entity-level issues within their analysis of the options. For example, weak candidates analyzed the purchase of the PET plastic recycling plant to WDI's assets in isolation, without making broader links to the two key entity-level issues.

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

APPENDIX A

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

CFE Design

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

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

Day 3 is a four-hour examination containing a mix of small cases (75 to 90 minutes each[1]) that evaluate the common core competencies only. The Day 3 cases provide additional opportunities for **depth** in Financial Reporting and Management Accounting and all the **breadth** opportunities for all the technical competency areas. Cases are time constrained, and they are designed to cover different competency areas within each case. A higher level of integration and judgment is required on Day 3 of the CFE than in the core modules, although the technical competencies are tested at the common core level of expectation.

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

The Development of Marking Guides and the Provincial Review Centre

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

[1] The CFE Blueprint allows anywhere between 45 to 90 minutes. The September 2022 CFE ranged from 75 to 90 minutes.

The September 2022 CFE Marking Centre

The September 2022 CFE Evaluation Centre was run with both in-person and remote components. From the marker applications received, approximately 230 individuals were chosen to participate in the September 2022 CFE marking centre. The criteria for selection included marking experience, motivation, academic achievement, work experience, personal references, and regional representation. The marking was supervised by the CPA Canada CFE full-time board staff.

The Day 1 Version 1 linked case (CFL V1) was marked by a team of 27 people from October 1 to 15, 2022. The Day 1 Version 3 linked case (WDI V3) was marked by a team of six people from September 16 to 22, 2022.

The Day 2 Common assessment opportunities were marked separately from the role assessment opportunities by a team of 40 people from September 30 to October 15, 2022. Day 2 Assurance was marked by a team of 44 people from September 30 to October 15, 2022. Day 2 Performance Management was marked by a team of 16 people from September 28 to October 11, 2022. Day 2 Finance was marked by a team of five people from October 2 to 10, 2022. Day 2 Taxation was marked by a team of six people from September 26 to October 5, 2022. All three Day 3 cases were marked from October 4 to 20, 2022. The Day 3 simulations were marked by a total of 89 people.

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

All teams, with the exception of Day 1 Version 3, followed a set marking centre schedule, which included a start-up phase to train the markers. During the start-up phase, the leaders and assistant leaders presented the marking guides to their teams, while staff and the BOE vice-chair monitored the discussions. The teams undertook a two-phase test-marking procedure prior to actual marking. Phase one consisted of marking guide familiarization, during which markers applied the marking guide to copies of candidates’ responses and collectively reviewed their results. Phase one thus ensured that all markers understood the issues in the marking guide and the basis on which to apply each expectation level. Phase two consisted of an expanded test marking of several responses to establish marker congruence.

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

For the Day 1 Version 3 team, all markers attended PEC due to their small size, and moved directly from PEC into live marking; therefore no separate marker training was required.

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

Borderline Marking (Day 1)

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

Double Marking (Day 2)

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

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

Borderline Marking (Day 3)

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

Subsequent Request for Remark of Results and Request for Performance Analysis

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

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

<u>Review and Remarking Approach</u>

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

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

The results are tabulated, and a decision made regarding whether any candidates have been treated unfairly and should be granted a pass on the examination.

The results are then forwarded to the provincial bodies for notification of the candidates.

APPENDIX B

SEPTEMBER 7, 2022 – DAY 1 SIMULATIONS

COMMON FINAL EXAMINATION
SEPTEMBER 7, 2022 – DAY 1

Case (CFL-Version 1) **(Suggested time: 240 minutes)**

It is July 4, 2025, and your boss at Serringers Consulting Group LLP (SCG) has assigned you to another engagement with CanDo Fitness Ltd. (CFL).

Since SCG's last engagement with CFL in 2022, the number of members at CFL's traditional fitness gyms has continually declined. This is largely due to an increase in competition from new companies that have entered the fitness market, which continues to grow rapidly.

Over the past three years, CFL made two major investment decisions. First, CFL entered into a five-year agreement with Zenfit to become the Western Canadian distributor of Zenfit products and to livestream videos for Zenfit's online exercise platform, Zenfit Live. Second, CFL converted eight of its fitness gyms to climbing facilities. So far, both investments have been successful. CFL declined the option to acquire Mighty Fitness Inc. (MFI), as well as the proposal to develop PurCafés at five of CFL's fitness gyms. At the company's 32 remaining fitness gyms, CFL has maintained its approach of offering the same consistent format at all locations.

CFL successfully resolved the dispute with its fitness instructors by increasing their compensation rates, and now pays them slightly above the industry average. CFL let go the personal trainers who were caught selling supplements. Also, late in 2024, Rosa resigned as a CFL board member and as the company's CFO, and wants to sell her 1,000 Class B common shares in CFL as soon as possible.

To finance the climbing-facility conversions and the ongoing need to purchase new equipment, CFL accepted the sale-leaseback option that Hume Properties REIT (HPR) offered in 2022. As of today, CFL has $2 million of cash available for strategic investment. As most creditors have restricted lending to smaller fitness companies, the company does not have access to any new debt facilities.

The company's mission, vision, and core values have not changed.

CFL's Board of Directors has asked you, CPA, to review the information that has been provided and draft a report that analyzes and makes a recommendation for each proposal that has been presented. The board would also like you to comment on CFL's overall strategic direction, and on how each proposal might affect that direction. For this engagement, please ignore any tax implications within your analysis and recommendations.

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APPENDIX I
BOARD MEETING WITH CPA IN ATTENDANCE

Phillip: Thank you for joining us today, CPA. As you know, our 32 fitness gyms are struggling. Without a major change, I am not sure whether we can keep them open for business.

Brian: In 2021, we had over 50,000 annual members at our fitness gyms. Today, we have closer to 35,000. We lowered the cost of our annual memberships, but that tactic has not worked. When you consider the cost to purchase new equipment each year, our fitness gyms are no longer profitable.

Phillip: Our competitors have invested a lot of money into both new and existing gyms, making it almost impossible for us to compete while remaining profitable. I agree with Brian—the current format of our fitness gyms is no longer working. If we want our fitness gyms to survive, we need to determine how to specialize them. It appears we have two options: target either the under-40 market or the over-55 market.

Sandra: That is right, Phillip. Our market research shows a clear distinction between these two age demographic groups. We can no longer cater to everyone.

Frank: Let's have CPA help us make that decision.

Phillip: Excellent. CPA, an objective for CFL in the coming years is to improve its EBITDA. As you analyze each proposal, please pay particular attention to that figure.

I have compiled select data from our recent member survey, which details the different preferences of our two potential target demographics (Appendix III). As you can see, it would be hard to please both groups within the same gym.

Sandra: Our market research suggests that the under-40 market is growing significantly faster than the older demographic. In fact, the under-40 group has never been so focused on their health and fitness. We could take advantage of this growth by modernizing our gyms with all the latest equipment, which is what the younger demographic clearly wants.

Brian: However, the over-55 group is willing to pay a bit more for a gym membership that suits their preferences. Also, our wage expense would decrease with the over-55 group because this demographic is satisfied with fewer fitness classes relative to the younger group.

APPENDIX I (continued)
BOARD MEETING WITH CPA IN ATTENDANCE

Sandra: That may be true, but more of our current members are in the under-40 group. A switch in our focus to the over-55 group would be a significant change to our fitness gyms. If we focus on the older demographic, many of our current members would be pushed away.

Another reason to focus on the under-40 market is CFL's current synergy with Zenfit. Our agreement with Zenfit has worked well, and our Zenfit product sales are highest with the under-40 demographic. And we now have the opportunity to become Zenfit's exclusive national distributor in Canada.

Frank: I think we should be careful, Sandra. I reviewed our original projection for Zenfit sales and it may be overly optimistic (Appendix V). In the first six months of this year, we have seen a 20% drop in unit sales from the same period in 2024, and because of increased competition for streaming fitness videos, we also project the number of Zenfit Live subscribers will drop by 10% annually when compared to 2024. As it currently stands, I expect these trends to continue.

Sandra: That is something to consider. However, Zenfit just announced the launch of a new Zentracker machine for next year. It is technologically advanced, integrates well with almost all wearable fitness devices, and has received great reviews by early users. This upgraded machine should help boost Zenfit sales.

Brian: Becoming the national distributor of Zenfit products would help CFL's brand gain more exposure and would not require an upfront cash investment. However, there are many other new fitness machines that are expected to enter the market in the next few months and years, and many of these machines have impressive built-in technology.

Sandra: That's right, Brian. Zenfit also mentioned that, if we do not agree to extend our contract now and become their national distributor, Zenfit will not renew our contract when it expires in two years. They already have several companies interested in becoming their national distributor, one of which has offered CFL $9 million to buy our current distributor and video production rights.

Brian: Next, I have identified six suitable locations where CFL could open new climbing facilities. So far, the performance of our existing eight climbing facilities has surpassed expectations. One reason for this success is the growing popularity of climbing, which is expected to continue to grow for the foreseeable future.

APPENDIX I (continued)
BOARD MEETING WITH CPA IN ATTENDANCE

Frank: Another big reason for their success has been your contribution, Brian. Your climbing expertise has been a big advantage for us, and our members are very satisfied with the climbing facilities. Across all age demographics, our membership numbers at the climbing facilities continue to increase each year. As such, we do not need to specialize this aspect of our business for any particular age demographic.

Brian: Thanks, Frank. If we open new climbing facilities, I am confident that they will be even more successful, as we have learned a lot from opening our first eight facilities. However, once we have over 10 climbing facilities, we will have to hire a senior manager to assist me, as there is a limit to the number of locations I can effectively manage by myself. But I am not sure that will be necessary; Phillip mentioned to me before the meeting that we received an offer to purchase our climbing facilities.

Phillip: Yes. We received a generous $12 million offer for all eight of our existing climbing facilities. This is something we should seriously consider.

Brian: It would be tough to let the climbing facilities go, especially because we do not have much competition in this area of our business; most new entrants to the industry seem focused on the fitness gym market.

Phillip: Another opportunity we should consider relates to RJ's Health Clubs Limited (RJ). RJ owns 25 gyms in Eastern Canada, which share a very similar format to CFL's current fitness gyms. Unfortunately, the company is going out of business.

Sandra: Why would we want to purchase a company that is going out of business?

Phillip: Good question, Sandra. I am not sure that we do. However, at $7.5 million, the asking price for RJ is very low—it was purchased for almost three times that amount just a few years ago! If we could put RJ back on track, we would significantly expand our fitness gym operations. CFL would then become a national brand.

Frank: Each RJ location has a yoga and meditation studio. This unique feature would help CFL take advantage of the growth in popularity of those two activities.

Sandra: Okay, but RJ is still going out of business. Do we know why it struggled so much?

APPENDIX I (continued)
BOARD MEETING WITH CPA IN ATTENDANCE

Phillip: For the same reason that we are—RJ has lost a significant number of its members to the new competition within the industry. It tried a few tactics to boost sales, such as increasing the number and variety of fitness classes offered, and increasing its marketing, but that only increased costs and had little effect on improving member satisfaction. Like CFL, RJ is currently trying to accommodate members from all age demographics. If we acquire RJ and target a specific age group, I think that the research and analysis we have done for our existing fitness gyms would apply to the RJ locations as well.

Finally, we need to find a replacement for Rosa. In addition to needing a new director, we need to find someone to purchase Rosa's shares of CFL.

Brian: I might have someone. Louisa Rice is a CrossFit competitor who gained a large following on social media after she won last year's world championship. She used to climb competitively, and I have known her for years. She lives in British Columbia and is very interested in becoming a shareholder of CFL. She would use her winnings from the CrossFit championships to buy Rosa's shares. Her following on social media would provide CFL with instant exposure.

Phillip: Besides her social media following, what would Louisa provide as a board member?

Brian: Louisa is a professional athlete and has a passion for teaching. Her knowledge would undoubtedly help CFL create more unique fitness classes, which we could offer in our gyms. I know from experience that Louisa's workouts are always intense!

Frank: I have another potential new shareholder and board member that we should consider. His name is Albert Fong, and he lives in Quebec. We met many years ago when we were both on the professional boxing circuit. Albert sustained a shoulder injury that unfortunately ended his career. Since then, he has had a successful career in corporate finance, but now wishes to return to the fitness world.

Phillip: I like the fact that Louisa is still involved in the fitness world. Given his injury, is Albert still able to be active?

Frank: Yes, but his focus is on less intense exercise. After his injury, Albert became an expert on restorative styles of fitness, such as Pilates and yoga, and is now a certified trainer for both.

Phillip: That is very interesting.

APPENDIX I (continued)
BOARD MEETING WITH CPA IN ATTENDANCE

Phillip: Everyone, thank you so much for coming, and contributing your thoughts today. CPA, as you can see, we have some critical decisions to make. Your analysis and advice on these matters will be greatly appreciated.

CPA: I will start working on my report immediately.

APPENDIX II
INDUSTRY UPDATE

The increasing popularity of fitness among all age demographics has resulted in a large increase in the number of fitness gyms across the country, which has led many fitness companies to lower their annual membership fees in the hope of attracting more members—a trend that is expected to continue. Most of these new gyms are equipped with modern, high-tech equipment.

Wearable fitness devices that integrate with exercise machines have become particularly popular in the last two years. Most wearable fitness devices can connect directly with the new, high-tech exercise machines, to track the users' exercise output and biometric data. As a result, exercise machines that can connect to these devices are in demand; this increased demand has led to the development and release of many new, technologically advanced fitness machines.

Due to the increased number of loan defaults in the past two years among smaller fitness facility operators, lenders have become reluctant to finance gym companies with fewer than 50 locations. Also, recent sales within the industry indicate that fitness and recreation facilities are being sold for an average of six times annual EBITDA.

APPENDIX III
PREFERENCES BY AGE DEMOGRAPHIC
(Prepared by Phillip Rogers)

According to the member survey recently conducted at CFL's 32 fitness gyms, there is a clear distinction between the preferences of two age demographics: those under 40 years old, and those over 55 years old. For the 40-to-55 age demographic, no clear preference patterns were noted other than a slight preference for more modern machines.

	Under 40 Years	**Over 55 Years**
Requested activities	Varied widely, such as free weights, resistance machines, many different kinds of fitness classes, martial arts, climbing, swimming, and diving boards.	Limited to free weights, basic resistance machines, and fitness classes.
Equipment type	Modern, high-tech, able to integrate with fitness apps and wearable fitness devices.	Simple to use, and not constantly changing.
Fitness class instructors	Prefer a variety of classes and instructors with specialized expertise.	Prefer to have the same instructor from class to class.
Fitness class types	High-intensity interval training; specialized classes focusing on either cardio or strength training.	Lower-intensity aerobics and cardio classes, and yoga/meditation classes.
Most important aspect of fitness facility	Variety (of activities, classes, machines, etc.) and technologically-advanced machines.	Consistency of equipment and classes, and community (this group is reluctant to change gyms because of their connection to the gym's community).
Least important aspect of fitness facility	Community.	High-tech equipment.
Typical length of use of the same piece of workout equipment	Less than one year, and sometimes only briefly, such as for one week.	A long time, sometimes for years.
Use of the Zentracker machine by Zenfit	Used, as the equipment is good, but many stopped using it because it does not connect to wearable fitness devices.	Very rarely, as the machines are too complicated.

APPENDIX IV
FITNESS GYMS
(Prepared by Phillip Rogers)

A 12-month earnings report for CFL's 32 fitness gyms, which still operate under the company's "one-size-fits-all" approach, is as follows:

For the year ended December 31, 2024

Number of members by age	
Younger than 40	10,854
40 to 55	16,653
Older than 55	10,030
	37,537
Revenue	
Membership fees	$ 21,396,000
Personal training sessions	13,262,000
Total revenue	34,658,000
Operating expenses	
Purchases	1,191,000
Wages	19,065,000
Marketing and advertising	1,786,000
Occupancy costs	5,691,000
General and administrative	6,691,000
EBITDA	$ 234,000

APPENDIX IV (continued)
FITNESS GYMS
(Prepared by Phillip Rogers)

Option #1 – Modernizing Gyms

If CFL chooses to target the under-40 market, membership forecasts are as follows:

	2026		2027		2028	
Number of members by age						
Younger than 40	16,281	(+50%)	24,422	(+50%)	36,632	(+50%)
40 to 55	18,318	(+10%)	20,150	(+10%)	22,165	(+10%)
Older than 55	2,006	(-80%)	2,006	(0%)	2,006	(0%)

- Annual gym memberships will be priced at $550.
- As more members are expected to use online training applications instead of CFL's personal trainers, revenue from personal training sessions is expected to decline by 10% in each of the next three years.
- Given the need to hire additional fitness class instructors, an initial increase in wages of 5% is expected in 2026, but should remain stable after that.
- Annual equipment investment costs are expected to be $7 million.
- All other expenses are expected to remain the same as in 2024.

Option #2 – Specializing Gyms

If CFL chooses to target the over-55 market, membership forecasts are as follows:

	2026		2027		2028	
Number of members by age						
Younger than 40	2,171	(-80%)	2,171	(0%)	2,171	(0%)
40 to 55	14,988	(-10%)	13,489	(-10%)	12,140	(-10%)
Older than 55	12,036	(+20%)	14,443	(+20%)	17,332	(+20%)

- Annual gym memberships will be priced at $650.
- Given the over-55 age segment's demand for personal trainers, revenue from personal training sessions is expected to increase by 5% in each of the next three years.
- Given this age segment's fitness class preferences, an initial 25% decrease in wages is expected in 2026, but should remain stable after that.
- Annual equipment investment costs are expected to be $1 million.
- Annual marketing expense will increase to $2.5 million.
- All other expenses are expected to remain the same as in 2024.

APPENDIX V
INFORMATION ON ZENFIT PROPOSAL
(Prepared by Sandra MacCarthy)

Actual and projected earnings information from the current Zenfit agreement is as follows:

	Actual			Projected (Note 1)	
	2022	**2023**	**2024**	**2025**	**2026**
Distributor's fee					
Units sold	435	683	546	700	750
Annual sales (Zenfit products)	$ 4,350,000	$ 6,830,000	$ 5,460,000	$ 7,000,000	$ 7,500,000
Distributor's fee (15% of sales)	$ 652,500	$ 1,024,500	$ 819,000	$ 1,050,000	$ 1,125,000
Less related direct costs	$ 76,000	$ 84,350	$ 81,800	$ 50,000	$ 50,000
Annual distributor's fee (net)	$ 576,500	$ 940,150	$ 737,200	$ 1,000,000	$ 1,075,000
Video royalty fees					
Number of subscribers	100,000	225,000	202,500	255,000	350,000
Annual CFL viewed videos	1,560,000	3,510,000	3,159,000	3,978,000	5,460,000
Royalty rate per video viewed	$ 0.75	$ 0.75	$ 0.75	$ 0.75	$ 0.75
Annual video royalties (net)	$ 1,170,000	$ 2,632,500	$ 2,369,250	$ 2,983,500	$ 4,095,000
EBITDA to CFL	$ 1,746,500	$ 3,572,650	$ 3,106,450	$ 3,983,500	$ 5,170,000

Note 1 – These figures were projected by CFL in 2022 before the original Zenfit agreement was signed.

Additional Information:

- The proposed exclusive national distributor contract has a five-year term.
- In order to retain exclusivity over the sale of Zenfit products, CFL must achieve a minimum of $10 million in annual sales as Zenfit's national distributor.
- In addition to the Zenfit showrooms that CFL already has in Western Canada, the proposed contract specifies that CFL must provide at least 10 different showrooms throughout Eastern Canada, so that potential customers can try the equipment prior to purchase.
- The national distributor has the right to purchase Zenfit products for its own use at a discounted price of 15% off the normal retail price.
- With its advanced technology, Zenfit products retail at the high end of the price range of comparable products.
- Zenfit's livestreamed videos are most popular with the 25-to-39 age demographic.

APPENDIX VI
CLIMBING FACILITIES
(Prepared by Brian Mitchell)

Actual earnings information for CFL's eight existing climbing facilities is as follows:

	2023	2024
Number of members	3,500	3,920
Annual membership rate	$ 660	$ 660
Revenue		
Membership fees	$ 2,310,000	$ 2,587,200
Day passes	2,079,000	2,328,480
Special events	1,201,200	1,345,344
Other	1,339,800	1,500,576
Total revenue	6,930,000	7,761,600
Expenses		
Wages	1,455,300	1,629,936
Purchases	485,100	543,312
Marketing	207,900	232,848
Occupancy costs	1,400,000	1,400,000
Other	1,039,500	1,164,240
Amortization	622,222	622,222
Total expenses	5,210,022	5,592,558
Operating income	$ 1,719,978	$ 2,169,042

Additional Information:

- The eight existing climbing facilities were originally fitness gyms that were converted. Because the next six potential locations are not currently CFL locations, it will cost more to prepare and open these locations ($850,000 per location).
- There has been some brand confusion between CFL's fitness gyms and its climbing facilities. When the climbing gyms were initially opened, members of CFL's fitness gyms were angry that their fitness gym membership did not give them access to CFL's climbing facilities.
- CFL received many complaints from the members who lost access to the fitness gyms that were closed in order to be converted into climbing facilities; some cancelled their memberships entirely.
- Since opening, the climbing facilities have had two major injuries. In both cases, the climber was found to have used the equipment improperly, and because the climbers signed a waiver prior to using the facilities, CFL was not held liable.

APPENDIX VII
RJ'S HEALTH CLUBS LIMITED
(Prepared by Phillip Rogers)

RJ provided CFL with the following earnings information from RJ's 25 existing gyms:

	2022	2023	2024
Number of members by age			
Younger than 40	5,524	4,630	3,528
40 to 55	9,354	8,570	7,836
Older than 55	6,980	7,735	8,174
	21,858	20,935	19,538
Revenue			
Membership fees	$ 13,989,120	$ 12,561,000	$ 10,745,900
Personal training sessions	7,367,500	6,630,750	6,344,000
	21,356,620	19,191,750	17,089,900
Operating expenses			
Purchases	929,537	935,038	941,895
Wages	5,719,731	6,672,750	7,054,050
Marketing and advertising	361,587	724,230	1,207,050
Occupancy costs	3,453,500	3,453,500	3,453,500
General and administrative	4,267,625	4,272,250	4,277,021
EBITDA	$ 6,624,640	$ 3,133,982	$ 156,384

Additional Information:

- The number of members within both the under-40 and the 40-to-55 age demographics has been in decline. This is largely due to increased competition from gyms that offer modern facilities with high-tech equipment. Because RJ did not have sufficient cash to purchase modern equipment, its fitness machines have become outdated.
- If CFL agrees to the purchase agreement, all of RJ's current assets, lease agreements (all RJ locations are leased rather than owned), and staff members would be transferred to CFL; however, CFL would not be required to retain any of RJ's current board members.
- RJ has 10 locations in Ontario, 10 in Quebec, and 5 in Atlantic Canada.
- RJ has continually lowered its price for an annual membership, which is currently set at $550.
- RJ members say they are satisfied with the variety of fitness classes offered, but the attendance of individual classes declined as the number of available classes increased.

COMMON FINAL EXAMINATION
SEPTEMBER 7, 2022 – DAY 1

<u>Case</u> (WDI-Version 3) **(Suggested time: 240 minutes)**

It is November 2024, and Shawn Bryson, your boss at Stineman Consulting Group (SCG), informs you, CPA, that Kingsley Investment Inc. (Kingsley) has hired SCG for a consulting engagement related to Waste Disposal Inc. (WDI). He has forwarded you the following update from Brian Leung, WDI's CFO.

Soon after SCG issued its last report, Laura Simmons announced that she was unhappy with the direction of the company and decided to exit WDI. Kingsley purchased her common shares and now owns 100% of WDI.

After the last engagement, WDI decided to partner with the municipalities to build an organic-waste treatment facility. During its first year of operations, as many of WDI's existing customers signed up for this sustainability-focused addition to their contracts, the project generated a higher-than-expected profit margin. Given the increased priority that many organizations have placed on environmentally-responsible business practices, the addition of the organic-waste treatment facility has also helped WDI retain customers. While Jack and the Board of Directors still view WDI's strong customer relationships and traditional waste management service contracts as the most valuable part of the business, the organic-waste treatment facility's success has made them more receptive to investments in sustainable alternatives.

Over the past several years, due to a rapid increase in demand, the selling prices of recycled materials have increased. This has allowed WDI to reopen its recycling plants, and all collected OCC and glass can currently be recycled and sold at a profit. Because WDI decided the upfront cost of converting its fleet of vehicles to biogas was too high, its vehicles still rely exclusively on regular diesel fuel. The current price of diesel fuel is $1.25 per litre (L), but due to an increase in taxes and pressure on the diesel fuel supply chain, prices are rising rapidly.

With stricter regulations around less sustainable waste management methods, the cost to operate landfills continues to rise. Also, because of public opposition to converting additional land to landfills, it has become more difficult for companies within the industry to secure landfill space. There is growing awareness and societal demand for a higher commitment to sustainability in the industry. Recently, a potential new customer turned down WDI's services because too much of their waste would be directed to landfills.

In 2022, as part of a new government incentive program, WDI began producing an annual greenhouse gas (GHG) emission statement, and set an emission reduction target to be achieved by 2025. However, WDI does not currently expect to meet this target. Also, in an effort to achieve their own sustainability targets, some of WDI's customers have asked WDI about its sustainability efforts. This is because WDI's emissions are higher than the industry average. Most of WDI's competitors are implementing programs to reduce GHG emissions to satisfy their customers' demands and to qualify for the growing number of government incentives available for reducing emissions.

Shawn asks you to review the information provided and prepare a report for WDI's board that strategically analyzes and makes a recommendation for each proposal being discussed. You are also to advise the board of any significant factors that may not have been considered, identify information that should be obtained before making any decisions, and recommend an overall course of action that will best meet the objectives specified by WDI's board. For this engagement, please ignore any tax implications within your analysis and recommendations.

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APPENDIX I
BOARD MEETING WITH CPA IN ATTENDANCE

Marlene: Thank you, CPA, for attending our board meeting. Now that Kingsley has 100% control of WDI, we have very clear directives for the future. Jack has replaced Laura on the board as CEO; otherwise, the board composition remains the same.

Jack: Nice to meet you, CPA. WDI has performed well for the last two years, and Kingsley is on track to sell WDI within our expected timeframe. WDI has $5 million in cash available to use for investments, if required. However, any investments made should provide a first-year return of at least 10% and should align with our plan to sell WDI within the next two years.

Marlene: It's funny you should mention that, Jack. Yesterday, we received an offer to sell 100% of WDI's outstanding shares to Sustainable Disposal Ltd. (SDL). The offer price, which expires in two months, is $35 million. SDL has a great reputation, a lot of capital to invest, and is very familiar with the industry and WDI's operations.

Robert: I'm familiar with SDL. It is known for purchasing underperforming waste management businesses and modernizing them with operations that emphasize sustainability.

Jack: The offer is interesting. However, with the improvements we have made over the past few years, I do not consider WDI to be underperforming, especially given the strength of our long-term and loyal customer list. Either way, the offer is worth evaluating.

Marlene: Since most of the board is not familiar with selling a waste management company, I had Brian contact an experienced business broker. Brian has summarized the details of the offer and the broker's comments on the market.

Jack: I would like to maximize Kingsley's return on the sale of WDI, but I recognize that the market will limit the price we receive.

Robert: Next, we must develop a plan to tackle our GHG emission target. We are not currently forecast to meet our targeted reduction by 2025, which means we will not receive the significant federal incentive. In addition, if we miss the 2025 target, we also miss out on improving our relationship with customers who have committed themselves to sustainable practices.

APPENDIX I (continued)
BOARD MEETING WITH CPA IN ATTENDANCE

Jack: That is disappointing. We have already made some big sacrifices in our current operations to cut GHG emissions, and have spent extra money and time to train staff on how to compile our GHG emission statement. All this money and effort may not be worth it for one incentive program, especially when we might not even receive the incentive.

Robert: The target we set in 2022 was quite aggressive because, at that time, we were considering some significant upgrades to WDI's sustainable practices that we did not actually complete. If we had, the target would have been achievable. However, at this point, the target cannot be changed.

Marlene: Regardless, we need to determine whether it is still possible to qualify for the $500,000 incentive by next year. We must also decide whether WDI should commit to future incentive programs. As well, if there are any potential investments that would help us qualify for the incentive, it could influence our decisions on which strategic investment options to choose.

Jack: The $500,000 would be a significant contribution to our income for the year.

Brian: Whether we accept SDL's offer or not, there is currently an open bid for a ten-year waste management contract for the municipality of Truro, Nova Scotia (Truro). The municipality signed up for our new organic-waste program, and has invited WDI to bid on their waste management contract. They had to suddenly terminate their existing contract due to the contractor's non-compliance with dumping regulations. The bid is only open for two weeks, and Truro wants the contract to begin one month from now. As we are used to dealing with this kind of short timeline, I do not think it will pose a problem. We can use our standard process to calculate our bid price.

Marlene: Although it would be short notice, I am confident our suppliers can provide us with any new capital equipment needed to satisfy the contract. I wonder if adding this long-term contract would help attract a higher sale price for WDI, especially because the potential client is a municipality as big as Truro. I have also heard that the previous contractor's reputation has been tarnished. With an increased presence in the area, WDI might be able to attract other organizations that want to move away from this non-compliant contractor.

APPENDIX I (continued)
BOARD MEETING WITH CPA IN ATTENDANCE

Brian: Also, Truro has excess landfill capacity, and given how difficult it has become to obtain new landfill space, that is quite an advantage. They are also including an incentive for the successful bidder to use that excess capacity right away, and to potentially purchase an entire landfill if the relationship goes well. This would help us relieve some capacity pressure at our other landfills.

Jack: This contract aligns well with our operations and creates efficiencies. If the costs and profit margin of the contract are acceptable for us, there does not seem to be much risk in moving forward with it. We should look at the project's details more closely to see if we can come up with a competitive bid.

Brian: Next, my friend Lucy is selling her Halifax-based PET plastic recycling plant assets and operations. I know we opted out of building a similar plant in the past, due to how long construction would take, but operations would begin right away with this purchase. Based on the information Lucy has provided, we would be profitable from the first day after purchase.

Jack: If we can reach our targeted return on investment (ROI) in the first year, it may be worth it.

Brian: The recycling industry is on the rise right now, with both selling prices and demand for recycled materials trending upward. However, some analysts are concerned about the potential for significant short-term price volatility.

Robert: WDI should invest and further develop our recycling services purely to keep up with our competitors. The last time we took a risk was with the organic-waste treatment facility agreement, and it has outperformed expectations. Recycling PET plastics rather than dumping them into a landfill would allow us to reduce our GHG emissions while also reducing the environmental burden of landfills.

Jack: I wonder if investing in the recycling plant would be the right choice as we prepare to sell the business within the next two years, or even the next two months, if SDL's offer is attractive enough.

APPENDIX I (continued)
BOARD MEETING WITH CPA IN ATTENDANCE

Robert: There is one other investment we should consider. A new biodiesel company in our area, Fried Fuels Company (FFC), is looking for a partner who currently collects waste cooking oil from restaurants. The plan is to send the oil to FFC's new facility for conversion into what FFC calls "ecodiesel." FFC wants the partner to loan them $1 million for three years, and to guarantee to collect and deliver a minimum volume of waste cooking oil.

Marlene: Does redirecting waste cooking oil to this ecodiesel operation mean we will no longer incur disposal costs?

Robert: Correct. The waste cooking oil we already collect will be dropped off at this facility instead of having to incur the costs of dumping it in our landfills. Plus, FFC is giving us the opportunity to purchase, at a discounted price, the same volume of ecodiesel fuel that we drop off in waste cooking oil. We could use the ecodiesel to fuel our trucks. What a forward-thinking concept!

Jack: That may be, Robert, but loaning money to a start-up business is risky. As our disposal cost for waste cooking oil is minimal, I am not sure there is any financial benefit from this proposal. Also, ecodiesel is more expensive than the regular diesel fuel we typically use.

Robert: That is true, but alternative vehicle fuels are becoming the industry standard. We have fallen behind our competitors in this respect, and our customers have noticed. Although this arrangement would not allow WDI to replace all the diesel fuel we currently use, it would be a good start. It would be worth evaluating the proposal to quantify the net impact.

Jack: Lots to consider. If the offer from SDL is deemed reasonable, we will need some advice on whether we should sell the business now. Purchasing WDI was a departure from trucking, where my experience is, and I look forward to selling it and being free of the risks involved with this business.

Marlene: Hopefully, CPA's report helps us make well-informed decisions. Otherwise, are we finished for today?

Jack: Yes. Thank you all for your thoughtful contributions.

APPENDIX II
EXCERPT FROM WDI'S FINANCIAL STATEMENTS

Waste Disposal Inc.
Income Statement
(in thousands of Canadian dollars)

	2024	2023
	Forecast	Audited
Revenue	$ 96,641	$ 94,720
Direct costs	41,914	40,814
Gross margin	54,727	53,906
Expenses		
Amortization	11,800	12,200
Operating costs	27,440	26,700
Selling and administrative	8,500	8,400
Total expenses	47,740	47,300
Operating income	6,987	6,606
Interest expense	(2,583)	(2,875)
Income before taxes	4,404	3,731
Income taxes	(1,167)	(988)
Net income	$ 3,237	$ 2,743

APPENDIX III
INFORMATION ON THE PURCHASE OFFER
PRESENTED BY SUSTAINABLE DISPOSAL LTD.
(Prepared by Brian Leung)

Offer Details:

- SDL is offering $35 million for 100% of the outstanding shares of WDI.
- The offer expires in two months.
- To confirm that the business is performing as SDL expects, SDL requires a copy of the audited financial statements.
- There are no other conditions.
- SDL plans to retain all of WDI’s employees, honour all of WDI’s existing long-term customer contracts, and uphold WDI’s existing mission and vision statements.

Notes from Discussion with Business Broker

Comparable sales prices for waste management businesses have been established using a multiple of 1.85 to 2.30 times EBITDA. The main differentiating factor between businesses selling at the higher end of the range is the amount of investment in, and income generated from, sustainable operations such as recycling, composting, and alternative energy use. The lower end of the price range includes companies that are more focused on traditional landfill disposal.

The average number of days that waste management businesses are listed for sale before an offer is agreed upon varies from 46 days for businesses attracting sale prices at the higher range to 92 days for businesses valued at the lower range.

Due to the increase in the selling prices of recycled materials, there has been a recent increase in the valuation of waste management businesses that have recycling capacity for a diverse range of materials. Many of these higher-priced businesses have also been monitoring their GHG emissions for many years, and have been quite successful at reducing their GHG emissions.

Buyers also seem to place less value on long-term contracts than in the past. Recent industry growth has occurred due to the rapid rise in demand for sustainable waste management options, and buyers want to try and benefit from this trend.

APPENDIX IV
GHG EMISSIONS REDUCTION INCENTIVE PROGRAM
(Prepared by Robert Manning)

In 2022, WDI set a three-year target to reduce the company's GHG emissions by 30% from the 2022 baseline of 145 million kg of CO2e (carbon dioxide equivalents). This target was registered as part of a federal government incentive program. If the 2025 GHG emission statement demonstrates that WDI has met the target, the company will receive a $500,000 cash incentive.

Based on WDI's existing operations, it is currently forecast to emit 120 million kg of CO2e in 2025, which is only a reduction of 17.2%.

The following factors influence WDI's GHG emissions:

- Waste disposed of in a landfill increases GHG emissions by 2,000 kg of CO2e per tonne of waste dumped.
- PET recycling reduces GHG emissions by 224 kg of CO2e per tonne of plastic recycled.
- Adopting ecodiesel fuel reduces GHG emissions by 13.4 kg of CO2e for each litre of regular diesel fuel replaced.

Additional Notes

Participating in the program requires significant time and effort from WDI's operations staff, as they are required to track many additional metrics for GHG emissions. There are increased training costs, and time requirements beyond the staff's existing jobs. Some staff members have complained about the lack of compensation for the additional workload. In 2025, a new reduction target will need to be set for the next three years, and a plan developed for how to achieve it. As WDI does not have an internal engineer for this, it will need to incur significant consulting fees.

It is expected that there will be several new incentive programs proposed within the next federal budget that require a GHG emission statement in the same format as the one that WDI already produces. Also, with current political pressure to promote sustainable waste disposal practices, more incentives will likely be introduced in future years.

APPENDIX V
MUNICIPALITY OF TRURO CONTRACT BID INFORMATION
(Prepared by Brian Leung)

Truro requires a contractor to perform waste management services for the municipality. The municipality has set a maximum bid price of $900,000 per year. This is a 10-year contract, with an option for a 10-year renewal term. The contract involves the collection, transfer, and disposal of household, commercial, and construction waste. In total, 7,050 tonnes of waste will need to be transported and dumped in a landfill per year.

WDI's bid price should allow for a 25% profit margin. This will provide WDI with a 10% return on the upfront investment in the capital equipment that will need to be purchased in order to fulfill the contract.

Truro has provided the expected annual weight of each type of waste that will be collected. WDI estimates its contract costs based on the following average costs per tonne of waste collected:

		Cost per Tonne		
	Annual Weight Collected (tonnes)	**Labour**	**Tipping & Landfill**	**Collection & Transfer**
Household	3,300	$76	$28	$31
Commercial	2,580	$27	$35	$18
Construction	1,170	$28	$42	$17
Total annual waste	7,050			

If WDI wins the bid, Truro will provide the use of its excess landfill capacity at competitive rates, even for waste collected from other WDI contracts. As these landfills are much closer to WDI's northern operations, the logistics team has determined that their use will save WDI approximately 25,000 kilometres of trucking mileage annually. The current cost for trucking is $5.20 per kilometre. These efficiency savings are also forecast to reduce WDI's GHG emissions by 125,000 kg of CO_2e per year.

As the municipality has found the excess landfill capacity more difficult to manage due to increased regulations, Truro is also offering the contractor the right of first refusal to purchase one of their landfill sites after the first year of the contract.

APPENDIX VI
PET PLASTICS RECYCLING PLANT PURCHASE
(Prepared by Lucy Tong)

The PET recycling plant can be purchased for $2.4 million, and includes the assets, operations, and current employment contracts of all staff.

The plant is modern and well maintained, and is not scheduled for any technological updates within the next five years. The plant has a dedicated team who are well compensated and have a depth of experience in the field.

Currently, the plant processes 42,000 tonnes of recycling per year, which is its maximum capacity. Much of this PET plastic is collected from one-time contracts rather than long-term service contracts. However, there is the possibility for the purchaser of the plant to forgo these one-time contracts, and instead pursue long-term contracts. This would help secure the plant's future supply of PET plastic for recycling.

Revenue is forecast to grow between 4% and 12% annually. Costs have been rising steadily by 4% annually.

The plant's financial performance for 2024 is expected to be as follows *(in thousands of Canadian dollars):*

Revenue	$ 987
Direct costs	780
Gross margin (21%)	207
Overhead	39
Net income	$ 168

APPENDIX VII
FRIED FUELS COMPANY COLLABORATION PROPOSAL

(Prepared by Robert Manning)

FFC is a new business aimed at redirecting restaurants' waste cooking oil away from landfills. FFC's plan is to convert the waste cooking oil into an ecodiesel fuel that can be used in vehicles that currently use regular diesel fuel. FFC's ecodiesel can be used interchangeably with regular diesel fuel, with no need to incur any vehicle conversion costs.

FFC will require WDI to collect 736,000 L of waste cooking oil per year. In return, WDI will be able to purchase 736,000 L of ecodiesel fuel at a discounted price of $1.38/L (the price is fixed for the duration of the collaboration). To ensure that it can meet its other contract obligations, FFC cannot guarantee any excess ecodiesel for purchase above this volume. However, FFC plans to increase capacity in two years, at which time more ecodiesel would be available to WDI at the same discounted price. This ecodiesel would replace an equal volume of regular diesel fuel that WDI currently uses.

WDI's current cost to dispose of waste cooking oil in its landfills is $0.12/L of oil dumped.

To secure the collaboration, WDI would provide FFC with a three-year, $1 million loan with interest of $100,000 per year. FFC requires the funds to upgrade its plant's technology. If the upgrade is successful, FFC will be able to accept a wider variety of waste oils to recycle into various products that it can sell to industries currently reliant on fossil fuels. WDI will also have access to any new products developed by FFC within the contract period, at a discount.

The logistics of dropping waste cooking oil off at FFC instead of the landfill are more complex, and will require WDI's truck drivers to be properly trained in unloading the oil into FFC's storage vats. After it is converted, the ecodiesel purchased from FFC will need to be stored onsite at WDI's facilities. WDI's current onsite diesel storage tanks can be used to store ecodiesel, so there will be no additional storage costs.

APPENDIX C

SEPTEMBER 8, 2022 – DAY 2
SIMULATION AND MARKING GUIDES

COMMON FINAL EXAMINATION
SEPTEMBER 8, 2022 – DAY 2

Case

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

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

INDEX

BACKGROUND
COMMON INFORMATION FOR ALL ROLES

Tasty Meal Baskets Limited (TMB) was started in Montreal fifteen years ago by Chef Rita Bisset and her husband, Conrad Desjardins. Ever since TMB went public in 2018, Rita and Conrad have owned 40% of the 10 million common shares outstanding. The remainder are widely held.

TMB sells meal kits directly to consumers and holds about 21% of the Canadian meal-kit market. TMB also owns and operates eight restaurants.

In 2019, analysts reacted favourably when TMB announced its plans to grow over the next six years through acquisitions. In May 2020, TMB completed its first acquisition, purchasing the net assets of Paeks Vegetarian Meals Limited (PVM). PVM was owned by Chef Dashim Paek, who is well known for creating unique vegetarian dishes, and his wife Ara Paek, CPA. PVM owned four vegetarian restaurants in Vancouver and a vegetarian meal-kit business serving large urban centres in British Columbia and Alberta. TMB now sells under the Chef Dashim brand in Western Canada and the Chef Rita brand in Eastern Canada.

TMB's management team consists of the following:

- Rita Bisset, chief executive officer
- Conrad Desjardins, chief operating officer
- Ara Paek, chief financial officer
- Bradley Gosling (the former CEO of PVM), VP procurement and fulfillment
- Fatima Rabbani, VP marketing

It is now February 14, 2022, and the draft December 31, 2021, year-end financial statements have been prepared in accordance with IFRS. TMB's share price is currently $4.20 per share.

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

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

ASSURANCE REQUIREMENTS

You, CPA, work as a manager in TMB's internal audit department. Frances O'Brien, chief internal auditor, would like you to discuss the financial reporting issues associated with the new discount offer, the Chef Arlene contract, and the renovation of the fulfillment centre. Ara also wants assistance with the requests from Bradley and Fatima. Frances asks you to perform these additional tasks and has confirmed that internal audit will not be auditing Bradley's and Fatima's departments for the next 12 to 18 months.

TMB disclosed its operating segment information by line of business (restaurants and meal kits) in its 2020 financial statements. Given TMB's growth-by-acquisition strategy, Rita now thinks it is more beneficial to disclose information by geographic region, consistent with how she normally assesses financial performance. Frances asks you to discuss which geographic regions should be disclosed separately by TMB in 2021.

In preparation for TMB's external audit, Frances also asks you to recommend audit procedures to be performed for the financial reporting issues you have been asked to discuss, including the disclosure by geographic region.

TMB has recently converted PVM to TMB's sales system. Frances asks you to provide recommendations that can be implemented for similar system conversions in the future and to discuss any issues you identify in the converted sales system data.

As the next step in its acquisition plan, TMB plans to acquire Sweet Tooth Ltd. (STL). Frances asks you to recommend due diligence procedures to minimize the risks related to the proposed acquisition. Frances also asks that you review STL's production processes, discuss any weaknesses, and recommend any additional controls that TMB should implement to ensure that STL's nut-free products are nut-free.

Effective January 1, 2021, TMB has entered into a supplier contract with All Things Green Inc. (ATG). Frances asks you to recommend audit procedures to ensure compliance with the requirements set out in the contract.

Finally, in planning for TMB's year-end external audit, Frances asks you to identify which material account balances would likely be included in the key audit matters section of the auditor's report and to explain why.

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

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

FINANCE REQUIREMENTS

You, CPA, work as a financial analyst for TMB and report directly to Ara. Ara would like you to discuss the financial reporting issues associated with the new discount offer, the Chef Arlene contract, and the renovation of the fulfillment centre. Ara also wants assistance with the requests from Bradley and Fatima.

Management is considering acquiring new packaging equipment to replace existing equipment in the Montreal fulfillment centre. Ara asks you to provide an analysis of this project and make a recommendation.

Shelly Kopp, the sole shareholder of Desserts Inc. (DI), has approached TMB with a proposal to sell her shares in DI. DI bakes and sells vegan desserts to various customers. As TMB's customers have been asking for desserts as an add-on to the meal kits, TMB is excited about the opportunities DI could provide. Ara asks you to value DI on a standalone basis using the capitalized cash flow method. Next, based on the industry benchmark ratios provided, Ara asks that you assess DI's financial performance, discuss areas where DI could improve its operations, and describe synergies that TMB could generate from this acquisition. Separately, assuming that TMB will proceed with the acquisition, Ara asks you to analyze the financing options Shelly has offered.

Because of delays in receiving their cheques due to postal issues, TMB's suppliers have asked to be paid electronically. For example, cheques were sometimes lost in the postal system and needed to be replaced. Further, the accounting group has complained about the time required to complete monthly bank reconciliations. Ara has gathered information on an electronic payment system and wants you to recommend whether TMB should adopt it.

Many companies in this industry pay annual dividends, with an average dividend yield of 3%. TMB's current market capitalization is $42 million, and management believes that the shares are undervalued. Some of TMB's shareholders would like a dividend from TMB's excess cash. Management indicates that they could use up to $3 million in excess cash to pay shareholders a regular dividend, a special dividend, or to execute a share buy back. Ara asks you to discuss each option and provide a recommendation.

TMB's acquisition strategy is to acquire companies (generally through a share exchange) that improve its earnings per share and return-on-assets ratio and that increase net earnings by at least $800,000. TMB recently received a list of potential acquisition targets. Ara asks you to review the information provided and identify the companies that TMB should target.

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

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

PERFORMANCE MANAGEMENT REQUIREMENTS

You, CPA, work as a financial analyst for TMB and report directly to Ara. Ara would like you to discuss the financial reporting issues associated with the new discount offer, the Chef Arlene contract, and the renovation of the fulfillment centre. Ara also wants assistance with the requests from Bradley and Fatima.

Ara would like to know the impact of reducing the number of new recipes introduced per week for Chef Rita's casual meal kits from four to three, from both a quantitative and a qualitative perspective, and would like your recommendation.

Ara would also like a quantitative and qualitative analysis of three alternatives being considered for delivering meal kits, along with a recommendation on which one to pursue.

Customers often ask to purchase the secret sauces that TMB uses in its meals, and TMB has decided to sell bottles of the secret sauces separately. TMB can either continue to make the sauces in-house on a larger scale or use an outside supplier to produce and ship the bottled sauces to TMB, who will then resell them. Ara would like you to perform a quantitative and qualitative analysis of the two options and make a recommendation.

Ara is concerned with the significant decline of Chef Dashim's meal-kit sales in 2021. She has provided detailed information regarding pricing and customer orders. She asks that you analyze this information and provide her with advice on the best ways for TMB to differentiate itself in Western Canada, as well as any other advice on how to attract more customers.

Candy Circus Limited (CC) has made a preliminary offer to sell the assets of its division, Vegan Sweets Inc. (VS), to TMB. Ara wants to know how the cash flow forecast provided by VS would change if TMB became the owner. She would also like your views on the advantages and disadvantages of TMB acquiring VS and whether this acquisition is a good strategic fit.

In 2019, TMB had strategically prioritized growth through acquisitions. For the PVM acquisition, Ara asks you to comment on the relative success of the original objectives. She is wondering what could have been improved in implementing and integrating the newly acquired business. She also wants to know what avenues for growth other than acquisitions might be considered in the future.

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

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

TAXATION REQUIREMENTS

You, CPA, work as a tax consultant for Ellsworth and Company (EC) and report directly to Samra, CPA, a senior manager at EC. Samra would like you to discuss the financial reporting issues associated with the new discount offer, the Chef Arlene contract, and the renovation of the fulfillment centre. Samra also wants assistance with the requests from Bradley and Fatima.

Samra would also like you to discuss the tax treatment of the three financial reporting issues, as well as the disposition of the vacant land in Vancouver. Samra asks you to calculate federal taxes payable for 2021.

TMB is negotiating to purchase the assets or shares of Desserts Inc. (DI). DI produces vegan desserts for the restaurant industry, which aligns with TMB's strategy to grow through acquisitions, since the desserts could be sold with the meal kits. Samra asks you to analyze the income tax and GST/HST implications of the purchase of DI, from both an asset purchase and share purchase perspective.

TMB has asked Krzysztof Broughton, an employee, to move to Atlantic Canada for two to three years to conduct market research and identify possible acquisition targets. Krzysztof will be given several employee benefits related to the potential relocation, and Samra asks you to evaluate the income tax and GST/HST consequences for both Krzysztof and TMB.

EC is also engaged to assist Rita and Conrad (who are both 53) with their family's tax issues. BD Family Holdings Limited (BDFH) is owned jointly by Rita and Conrad, and they want you to help them understand the implications of the shareholder loans.

Rita and Conrad also want your advice on how to structure future cash distributions from BDFH. If they made their children (Justine, age 21; Jules, age 18; and Brice, age 15) shareholders of BDFH, they wonder whether dividends or salaries could be paid to them. They would like to distribute $2 million from BDFH over the next three years.

Rita and Conrad are considering gifting shares of TMB to their children. They are also leaving shares of TMB, and other assets, to their children in their wills. They would like a summary of the tax consequences of their proposed plans.

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

APPENDIX I – COMMON
EXCERPTS FROM DRAFT FINANCIAL STATEMENTS

Tasty Meal Baskets Limited
Statement of Comprehensive Income
For the years ended December 31
(in thousands of Canadian dollars)

	2021	2020
	Draft	Audited
Revenue		
Meal kits	$ 84,716	$ 69,343
Restaurants	9,215	7,783
Total revenue	93,931	77,126
Expenses		
Cost of products sold	33,644	25,912
Salaries and wages	34,974	27,291
Advertising and promotion	4,800	5,760
Depreciation and amortization	3,017	2,383
Other expenses	10,786	8,208
Total expenses	87,221	69,554
Operating income	6,710	7,572
PVM integration costs	(1,400)	(3,500)
Financing costs	(750)	(612)
Income before taxes	4,560	3,460
Income taxes	(1,230)	(933)
Net and comprehensive income	$ 3,330	$ 2,527

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

Tasty Meal Baskets Limited
Statement of Financial Position
As at December 31
(in thousands of Canadian dollars)

	2021 Draft	2020 Audited
Assets		
Current assets		
Cash and cash equivalents	$ 4,996	$ 5,166
Inventories	1,180	980
Prepaid supplies and expenses	840	690
Total current assets	7,016	6,836
Property, plant, and equipment – net	18,330	15,296
Intangible assets (computer software, brand and customer lists, Chef Arlene contract)	2,651	2,482
Goodwill	580	580
Total assets	$ 28,577	$ 25,194
Liabilities		
Current liabilities		
Trade payables and accrued liabilities	$ 4,648	$ 4,263
Contract liabilities	410	350
Income taxes payable	481	150
Current portion – mortgage payable	500	500
Current portion – lease obligations	1,042	983
Total current liabilities	7,081	6,246
Mortgage payable	5,000	5,500
Lease obligations	1,462	2,504
Deferred tax liability	1,682	922
Total liabilities	15,225	15,172
Shareholders' equity		
Share capital – common shares	6,800	6,800
Retained earnings	6,552	3,222
Total shareholders' equity	13,352	10,022
Total liabilities and shareholders' equity	$ 28,577	$ 25,194

APPENDIX II – COMMON INDUSTRY AND TMB INFORMATION

Meal-Kit Industry

Meal kits are a form of food delivery where customers are provided with recipes and all the ingredients to make meals at home. Competition is from other meal-kit delivery services, supermarkets, and restaurants, and it is expected to increase. While competition is primarily based on price, other considerations include product quality, unique flavours and ingredients, flexibility of product offerings, and reliable delivery. The industry growth rate is 10% annually.

A key success factor is customer retention. Because higher discounts are being given to attract new customers and more dollars are being spent on marketing, customer acquisition costs are increasing. A new global competitor entered the Vancouver and Calgary markets in the third quarter of 2021, enticing new customers with large discounts on initial orders.

The industry's annual subscription cancellation rate is very high because the cost of switching providers is minimal: of the customers who cancel, 30% do so in the first month; 30% between two and three months; and 25% between four and six months.

TMB Meal-Kit Product Lines

TMB uses a subscription model to sell two lines of meal kits, which contain ingredients for four meals: a gourmet line and a casual line. The subscription plan is flexible, allowing customers to skip deliveries or cancel their subscription at any time. In line with industry practice, customers' credit cards are charged the same day as delivery. The day before delivery is the last day a customer can modify or skip their order for that week.

In addition to the recipes and ingredients, the gourmet kits include access to videos showing the chef preparing the meals. The gourmet kits are more expensive than the casual kits because they include high-cost ingredients and teach different cooking techniques.

The casual kits are competitively priced, and TMB offers two price levels: basic and organic. The organic meals contain certified organic products, which are more expensive and are, therefore, priced higher.

Customers can also pay more to add extra protein (e.g., fish, poultry, tofu) to their meal kit, even to vegetarian kits. Although this requires more preparation and packaging, such as ice packs, extra protein sales provide a higher markup than other sales. Starting in the third quarter of 2021, more orders of Chef Dashim's meal-kits included extra protein purchases.

APPENDIX II – COMMON (continued)
INDUSTRY AND TMB INFORMATION

TMB Meal-Kit Production

Within one day of receiving the ingredients, TMB prepares, packages, and ships the meal kits. TMB's production workforce is composed of full-time (salary or hourly) employees and part-time, hourly employees who work when there is increased volume. TMB has two fulfillment centres: one in Vancouver and one in Montreal, which has just been renovated. Although the meal-kit preparation process is largely automated, some manual preparation is required. This is especially true for protein ingredients.

More maintenance work was completed at both locations in the third quarter than normal. In addition, some of the automated equipment in Vancouver was out of operation for three weeks during the fourth quarter while waiting for a replacement part. This resulted in more manual labour to prepare ingredients, and less equipment usage.

TMB uses sustainable packaging materials where possible, which are more expensive.

New recipe development is overseen by Rita and Dashim. To remain competitive, TMB must constantly develop new and creative recipes.

TMB Strategy

TMB has differentiated itself by developing recipes with unique ingredients and spices. In June 2021, TMB developed secret sauces in house and includes them in its meal kits. During 2021, TMB also launched Celebrity Chef meal kits within the gourmet line, featuring recipes purchased from well-known chefs.

APPENDIX III – COMMON
NEW DISCOUNT OFFER

The following new offer was on TMB's website for the month of December 2021:

> *Special deal for new customers! Order two meal kits now to be delivered on separate weeks, pay full price on your first meal kit, and save $31.68 on your next meal kit!!! Your credit card will only be charged for each meal kit on the day it is delivered. The delivery date for the second meal kit must be no later than 30 days following the first. No cancellations are allowed.*

	Meal Kit #1	***Meal Kit #2***
Regular price	*$ 62.80*	*$ 62.80*
You pay only	*$ 62.80*	*$ 31.12*
Your savings		*$ 31.68*

A total of 10,000 new customers placed orders in December under this offer. At the end of December, all first meal kits had been delivered and 3,000 of the second meal kits had been delivered. The remaining 7,000 second meal kits has been delivered and charged to customers in January 2022.

TMB has recognized revenue of $721,360 in December 2021 based on the following:

Delivery	**Quantity**	**Price**	**Revenue Recognized**
Meal Kit #1	10,000	$ 62.80	$ 628,000
Meal Kit #2	3,000	$ 31.12	$ 93,360
Total			$ 721,360

APPENDIX IV – COMMON
CHEF ARLENE CONTRACT

TMB entered into a contract with Chef Arlene, a well-known chef in Toronto, for the rights to use her brand name and her recipes for TMB's new Celebrity Chef meal kits. Recipes cannot be patented and are not protected by copyright laws. The payment to Chef Arlene has been capitalized as an intangible asset.

Excerpts from the contract between Arlene and TMB

Dated: June 1, 2021

For $400,000, Arlene agrees to the following for a five-year period:

1. TMB has the right to use the "Chef Arlene" brand name to market and promote TMB meal kits. Arlene agrees not to sell the right to use her brand name to any other meal-kit company.

2. TMB has the right to use all of Arlene's recipes, subject to the following conditions:
   a) Arlene retains ownership of the recipes, which she can continue to use in her restaurant.
   b) Neither TMB nor Arlene may sell the rights to the recipes to any other party.
   c) TMB agrees not to alter the recipes in any way without the express consent of Arlene.
   d) TMB must credit the recipes as "created by Chef Arlene."

APPENDIX V – COMMON
RENOVATION OF THE FULFILLMENT CENTRE

The building and equipment at the fulfillment centre in Montreal were outdated and have been upgraded. With these renovations, utility costs and ongoing maintenance costs are expected to decline. Construction started in February 2021 and finished on November 1, 2021. During this time, TMB continued to use the parts of the building that were not under renovation.

The following 2021 additions have been capitalized:

	Carrying Amount at Dec. 31, 2020	2021 Additions	Note
Outside structure of the building	$ 2,271,000	$ 250,000	Replaced missing or damaged bricks
Heating and cooling system, and roof	120,000	1,300,000	Complete replacement
Air filtration system	0	240,000	New system added to the building
Internal walls and floors	340,000	2,010,000	Complete replacement with environmentally friendly materials
Total	$ 2,731,000	$ 3,800,000	

After the new internal walls and floors were installed, a flood occurred that damaged the new flooring. TMB incurred $350,000 to replace the floor that had just been installed. This cost is included in internal walls and floors listed above. Insurance proceeds received of $120,000 are netted against other expenses.

In addition, the following costs were included in other expenses, along with other repairs and maintenance costs:

- For six months, some employees worked on the construction of the internal walls and floors, and their wages and benefits for that period totalled $600,000.
- TMB incurred $60,000 to relocate equipment during the renovation process to the parts of the building that were not under construction.
- Costs to dispose of the old wall and floor materials totalled $150,000.

APPENDIX VI – COMMON
EMAIL FROM BRADLEY

From: Bradley
To: Ara and CPA
Subject: Production costs and budgets

We have calculated the cost variances for the Chef Dashim meal kits.

The flexible budget is based on the original budget, adjusted for the actual volumes of all meal kits. Extra protein is considered an addition to existing meal kits, and not an additional product line.

Please explain the possible causes for these significant flexible budget variances for the fourth quarter of 2021 for the Chef Dashim meal kits:

	Flexible Budget	**Actual**	**Variance Favourable/ (Unfavourable)**	**Variance (% of Budget)**
Food costs	$ 2,778,564	$ 2,897,472	$ (118,908)	-4.3%
Packaging costs	$ 905,460	$ 985,140	$ (79,680)	-8.8%
Direct labour	$ 543,276	$ 693,120	$ (149,844)	-27.6%
Maintenance and repairs	$ 319,560	$ 202,150	$ 117,410	36.7%
Marketing costs	$ 532,600	$ 470,000	$ 62,600	11.8%

APPENDIX VI – COMMON (continued)
EMAIL FROM BRADLEY

Next, I would like you to finalize the spending budgets for April, May, and June 2022 for the Chef Rita meals. I am hopeful that, once the budgets have been updated, we will be in line with our production-related spending target of $1.8 million per month. Please explain what factors impact whether we are likely to meet our target.

The ingredient budget has been prepared, but I still need the packaging purchases, direct labour, and overhead amounts. With increased volumes resulting from the PVM acquisition, we finally renegotiated some supplier contracts to lower our costs.

	April	May	June	July	August
Number of sales of Chef Rita meals (based on four meals per kit) – as projected by marketing	260,000	270,000	250,000	210,000	190,000
Monthly ingredient budget	$1,339,974	$1,463,843	$1,410,860		
Beginning inventory – packaging, in kilograms (kg)	240,000				

During 2021, the Vancouver fulfillment centre used a U.S.-based packaging supplier, whereas Montreal used a local supplier. During the fourth quarter of 2021, the USD to CAD exchange rate worsened, causing higher packaging costs for the Vancouver fulfillment centre. Effective January 1, 2022, we negotiated a new contract with a Canadian supplier to supply both fulfillment centres at a price of $2.78 per kilogram of packaging materials. However, at that price, they will only ship monthly and suggested that we keep a two-month supply of packaging inventory.

Fixed costs related to fulfillment overhead are $400,000 per month.

Our estimates, per meal, are as follows:

Amount of packaging materials	0.46 kg
Direct labour cost	$0.80
Variable overhead cost	$1.19

APPENDIX VII – COMMON
EMAIL FROM FATIMA

From: Fatima
To: CPA
Subject: Marketing information

I would like you to comment on the sales per customer, customer retention, and the marketing initiatives that have been used.

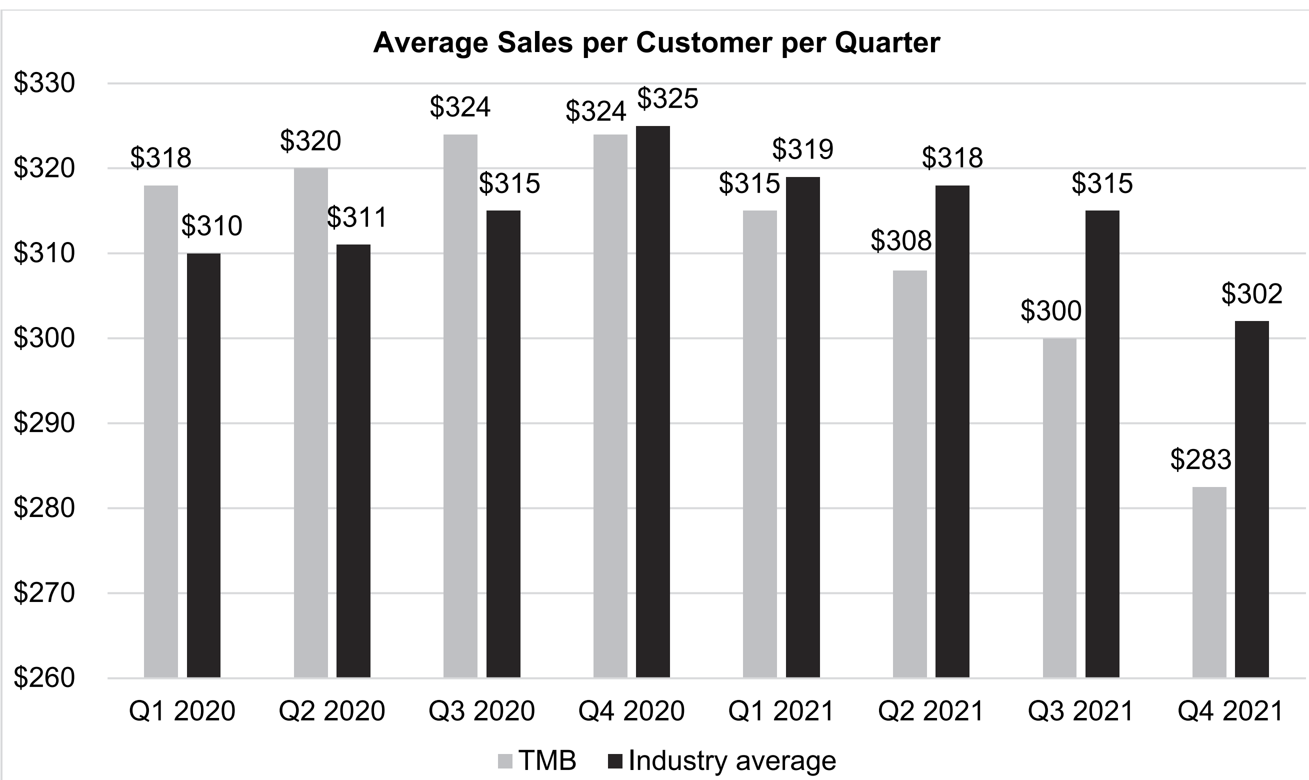
During 2021, we incurred the following amounts for marketing initiatives:

- $2.3 million on television ads
- $1.5 million on podcast ads
- $650,000 on social media
- $350,000 on a referral program for new customers

We also provided $1.5 million in discounts to new customers during 2021.

During the first three quarters of 2021, TMB spent the same amount on television advertising as in the past. In the fourth quarter of 2021, these costs were cut by 50%, and TMB focused on promoting the new discount program to attract new customers. All other marketing costs remained the same as in previous quarters.

Some quarterly information from our marketing dashboard is as follows:



APPENDIX VII – COMMON (continued)
EMAIL FROM FATIMA

TMB Data

	Q1 2021	**Q2 2021**	**Q3 2021**	**Q4 2021**
Active customers – beginning	65,000	68,400	70,800	69,400
New customers	9,400	10,400	10,600	20,700
Lost customers (Note 1)	(6,000)	(8,000)	(12,000)	(16,000)
Active customers – ending	68,400	70,800	69,400	74,100
Orders per customer	4.6	5.1	5.3	5.7
Trend for sales of casual meal kits – basic	↓	↑	↑	↑
Trend for sales of casual meal kits – organic	↑	↓	↓	↓
Trend for sales of gourmet meal kits, including Celebrity Chef	↓	↓	↑	↑

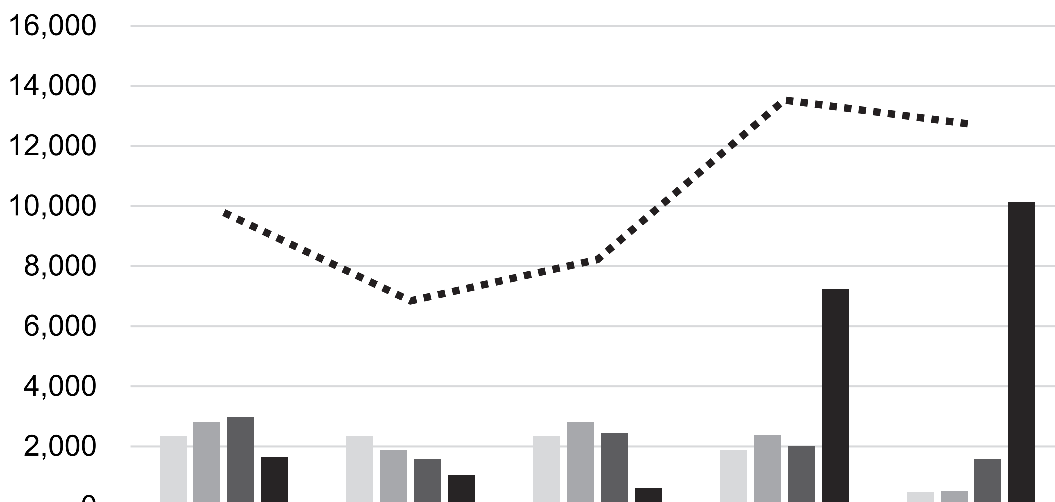
Note 1 – The following table shows the percentage of customers lost for each quarter based on the number of months they were clients before cancelling their subscription:

Number of Months	**Q1 2021**	**Q2 2021**	**Q3 2021**	**Q4 2021**
1 or less	15%	25%	30%	35%
2 to 3	30%	32%	35%	40%
4 to 5	30%	25%	23%	15%
6 or more	25%	18%	12%	10%

APPENDIX VII – COMMON (continued)
EMAIL FROM FATIMA

TMB Data (continued)

Number of New Customers by Marketing Initiative



	Television	Podcasts	Social media	Referrals	Discounts to new customers
Q1 2021	2,350	2,350	2,350	1,880	470
Q2 2021	2,808	1,872	2,808	2,392	520
Q3 2021	2,968	1,590	2,438	2,014	1,590
Q4 2021	1,656	1,035	621	7,245	10,143
Total	9,782	6,847	8,217	13,531	12,723

Q1 2021 Q2 2021 Q3 2021 Q4 2021 Total

ASSURANCE ROLE ADDITIONAL INFORMATION

APPENDIX VIII – ASSURANCE
ADDITIONAL INFORMATION

Geographical Regions

The following summary is available from TMB's accounting software for 2021 (*in thousands of Canadian dollars*):

	BC	**AB**	**SK and MB**	**ON**	**QC**	**Atlantic**	**Total**
Assets	$ 13,700	$ 1,536	$ 430	$ 2,225	$ 10,185	$ 501	$ 28,577
Liabilities	$ 4,553	$ 2,897	$ 828	$ 2,735	$ 3,760	$ 545	$ 15,318
Revenue	$ 28,294	$ 18,006	$ 5,144	$ 16,995	$ 23,368	$ 2,124	$ 93,931
Expenses	$ 25,695	$ 16,988	$ 4,554	$ 16,034	$ 22,047	$ 1,903	$ 87,221
Net and comprehensive income (loss)	$ 2,386	$ (668)	$ 191	$ 631	$ 1,025	$ (235)	$ 3,330

There are no inter-regional sales or transfers.

APPENDIX VIII – ASSURANCE (continued)
ADDITIONAL INFORMATION

PVM Sales System Conversion

Following the acquisition, TMB continued to use PVM's sales system for PVM's customers until 12:00 am on December 25, 2021, when it was converted to TMB's sales system. Rather than transferring only summary data, TMB also transferred PVM's historical transaction data, to facilitate historical comparisons for future decision-making. TMB agreed the total number of customer accounts and sales transferred into its system to PVM's former system. Since no exceptions were noted, the PVM system was shut down immediately, and any new transactions were then processed by TMB's system. TMB's IT manager was relieved, as he was too busy to complete additional detailed testing.

Since the conversion, TMB has received many complaints from customers experiencing issues with the system. Therefore, Frances has requested a daily sales report for December 24, 2021, from TMB's system for Nanaimo, BC, as a starting point, to further investigate the converted historical data. An excerpt from the report is below:

Daily Sales Report
Location: Nanaimo
Date: 12/24/2021

Surname	First Name	Address 1	City & Province	Credit Card	Expiry	Status	Sale
Barnes	Jillian	920 Tamama Drive	Nanaimo, BC	****1488	08/2024	Active	79.20
Chen	Yazhu	110-751 Ptarmigan Way	Nanaimo, BC	****5267	10/2021	Active	79.20
Denver	Chris	7879 Coal Place	Nanaimo, BC	****6798	01/2025	Active	79.20
Denver	Chris	7879 Coal Place	Nanaimo, BC	****6798	01/2025	Active	(79.20)
Ellison	Fred	6048 Departure Bay	Nanaimo, BC	****6681	01/2023	Active	79.20
Fujiwara	Yoko	14 Brechin Place	Nanaimo, BC	****3816	11/2024	Active	105.60
Hodges	Rebecca	3306 Black Bear Ridge	Nanaimo, BC	****7552	07/2025	Active	79.20
Hodges	Rebecca	25-221 Commercial St	Nanaimo, BC	****7552	07/2025	Active	79.20
Izumi	Tohru	110-751 Ptarmigan Way	Nanaimo, BC	****5403	06/2024	Active	79.20
Jain	Deepa	555 Bobolink Way	Nanaimo, BC	****4371		Active	79.20
Jeong	Sung	2040 Arnhem Terrace	Nanaimo, BC	****6639	06/2023	Inactive	79.20
Kwok	Ling	804-351 Arnhem Place	Salmon Arm, BC	****8624	01/2023	Active	105.60
Misra	Anup		Nanaimo, BC	****1223	07/2024	Active	79.20
Patal	Darshana	908-2340 Albatross Way	Nanaimo, BC	****4422	09/2023	Active	105.60
Simons	Drew	776 Blue Jay Trail	Nanaimo, BC	****1997	03/2024	Active	105.60
Yang	Jung	511 Harbour Road	Kelowna, BC	****8850	12/2023	Active	79.20

APPENDIX VIII – ASSURANCE (continued)
ADDITIONAL INFORMATION

Sweet Tooth Ltd.

Background

Sweet Tooth Ltd. (STL), a privately owned corporation, bakes and sells desserts to restaurants. TMB has agreed to purchase 100% of the common shares of STL effective March 15, 2022, subject to due diligence procedures being performed. STL's CFO has provided the following unaudited condensed financial statements, which will determine the basis for the purchase price. There is no plan to audit these financial statements.

Sweet Tooth Ltd.
Balance Sheet
As at December 31, 2021
(Unaudited – in thousands of Canadian dollars)

Cash	$	360
Accounts receivable		910
Inventories		1,590
Property, plant, and equipment – net		4,250
	$	7,110
Accounts payable	$	2,770
Income taxes payable		110
Bank loan payable, due December 31, 2026		4,040
Common shares		100
Retained earnings		90
	$	7,110

APPENDIX VIII – ASSURANCE (continued)
ADDITIONAL INFORMATION

Sweet Tooth Ltd. (continued)

Sweet Tooth Ltd.
Income Statement
For the year ended December 31, 2021
(Unaudited – in thousands of Canadian dollars)

Revenue	$ 29,650
Cost of goods sold	23,720
Gross profit	5,930
Operating expenses	
Amortization	320
Other	3,070
Selling and administration	1,480
	4,870
Income before taxes	1,060
Income tax expense	210
Net income	$ 850

APPENDIX VIII - ASSURANCE (continued)
ADDITIONAL INFORMATION

Sweet Tooth Ltd. (continued)

Production process

Rita met with STL's head baker, who informed her that they will soon introduce a new production line. The existing production line will be used to bake desserts that include nuts, and the new one will be for desserts that are nut-free. The head baker was pleased with how STL arranged for the lines to be beside each other, to minimize the space used. As STL expects the volume of desserts that include nuts to be approximately double that of desserts that are nut-free, baking staff will move back and forth between the production lines as needed. The same thing will be done for baking equipment and utensils.

The head baker explained the processes he has planned to ensure that the nut-free desserts are, in fact, nut-free, as he understands the significant impact an error in this area can have on the company:

- New suppliers of nut-free ingredients will be required to provide written confirmation to STL that their products are nut-free before their first delivery. No additional verification will be performed.
- As ingredients are received from suppliers, they will be placed into STL's ingredient storage room and walk-in refrigerator. The packaging minimizes the risk of cross contamination; therefore, ingredients containing nuts and ingredients that are nut-free will be grouped together for storage. Other than a symbol denoting "nut-free," the packaging used for nut-free ingredients and those that contain nuts is identical.
- The desserts will be labelled as containing nuts or being nut-free after they have cooled down and are packaged.
- Baking staff will work 7.5-hour shifts, with a 30-minute break between shifts; during that break, the production lines will be cleaned, using high-pressure spray washers.
- At their employee orientation, baking staff will be educated about the seriousness of the reactions that people with nut allergies can have (anaphylactic shock that could cause death) and the importance of keeping ingredients and desserts containing nuts separate from those that are nut-free.

APPENDIX VIII - ASSURANCE (continued)
ADDITIONAL INFORMATION

Supplier Contract

All Things Green Inc. (ATG) is TMB's major supplier of leafy greens, such as kale and spinach, that are used in its meal kits. According to the contract, ATG must comply with the following requirements:

- Greens must be grown on ATG's farm and cannot be purchased from other farms.
- Universal bar codes must be attached to packaged greens. When scanned, the bar code must indicate that the greens were grown by ATG and provide the date and time harvested and best-before date.
- Greens must be certified to Canadian Organic Standards by a verification body designated by the Canadian Food Inspection Agency.
- To remove contaminants and insects after harvest, greens must be pre-washed in chlorinated water.
- Bar-coded greens must be placed into temperature-controlled storage until they are shipped to TMB. The storage must be equipped with a system that maintains a record of any instances of temperatures that fall outside the range of 1°C to 4°C.

To demonstrate compliance with these requirements, ATG agrees to maintain detailed records, grants TMB the right to have its internal auditor assess compliance, and agrees to provide TMB with unrestricted access to its farm, records, management, and staff.

FINANCE ROLE ADDITIONAL INFORMATION

APPENDIX VIII – FINANCE
ADDITIONAL INFORMATION

General Information

Ara likes to maintain a cash balance of at least $2 million. TMB has a $5 million line of credit, which bears interest at prime (currently 2.17%) plus 2.5%. TMB is not currently using this line of credit but, during 2021, TMB used the maximum amount for nine months. TMB has a mortgage on the Montreal property, which bears interest at 7% and has a maximum debt-to-equity covenant of 2.5.

New Packaging Equipment

A manufacturer has offered TMB new packaging equipment, which will speed up packaging of meal kits, reduce paper and plastic consumption, and generate labour savings. With a better sealed package, there will be improved freshness benefits to the customer.

TMB would be the manufacturer's first customer in the meal-kit industry. The manufacturer has offered TMB a promotion, in which the manufacturer will pay for all customization, setup, and training costs. The manufacturer has also offered TMB a referral bonus of $30,000 for every successful referral. To date, TMB has spent $11,200 on travel to meet with the manufacturer.

The total cost of the equipment (Class 53) is $1,312,000, including customization, setup, and training costs. The manufacturer estimates a five-year useful life, at which time the equipment could be sold for $250,000 net of selling costs. TMB's existing equipment can be sold immediately for $42,000 net of selling costs.

The government has proposed a carbon emissions reduction incentive that will be voted on in four months' time. The manufacturer believes this equipment will qualify for this rebate, equal to 4% of the acquisition cost.

Based on current volumes, the equipment will generate the following annual cost savings:

- Plastic and paper materials: $260,000
- Labour: $ 50,000
- Maintenance: $ 70,000

There will be an initial inventory reduction of $75,000 related to packaging materials. The new machine will use $15,000 of additional electricity per year. Overhead of $85,300 will continue to be allocated to this cost centre.

TMB's after-tax cost of capital for this project is 15% and its income tax rate is 27%.

APPENDIX VIII – FINANCE (continued)
ADDITIONAL INFORMATION

Acquisition of Desserts Inc.

Dear Rita,

I am looking to sell my shares of Desserts Inc. (DI) for $18 million, and then retire. In exchange, I would consider either a note payable or TMB shares.

Key terms for the note payable:

- TMB would make a 5% cash down-payment, with the remainder being financed through the note payable
- Security on all property, plant, and equipment of DI
- Annual interest of 5% on the outstanding balance, payable quarterly
- Equal annual principal payments for ten years, payable on the anniversary date of the purchase
- Events of default that would require full and immediate repayment of the outstanding amount:
  - filing for bankruptcy; or
  - forced or voluntary de-listing of TMB from the Toronto Stock Exchange.

Key terms for share exchange:

- I will have one seat on TMB's Board of Directors, to be filled by me or my designate, provided that I continue to own at least 5% of TMB's outstanding shares.
- For each of the next two years, 2022 and 2023, TMB will pay me a cash earnout calculated as: 3% × (DI's fiscal year EBIT - $2.7 million). If negative, no amount will be paid by either me or TMB.
- There will be no restrictions on the sale of my TMB shares.

Yours sincerely,
Shelly Kopp

APPENDIX VIII – FINANCE (continued)
ADDITIONAL INFORMATION

Desserts Inc.
Balance Sheet
As at December 31, 2021
(Prepared under ASPE – in thousands of Canadian dollars)

Assets		
Current assets		
Cash	$	2,844
Accounts receivable		1,072
Inventory		995
Prepaids		52
Total current assets		4,963
Property, plant, and equipment		2,322
Total assets	$	7,285
Liabilities		
Current liabilities		
Trade payables and accrued liabilities	$	1,190
Income taxes payable		21
Current portion – long-term debt		195
Total current liabilities		1,406
Long-term debt		802
Total liabilities		2,208
Shareholder's equity		
Common shares		1,000
Retained earnings		4,077
Total shareholder's equity		5,077
Total liabilities and shareholder's equity	$	7,285

APPENDIX VIII – FINANCE (continued)
ADDITIONAL INFORMATION

Desserts Inc.
Income Statement
For the year ended December 31, 2021
(Prepared under ASPE – in thousands of Canadian dollars)

Revenue	$ 12,010
Cost of goods sold	6,870
Gross profit	5,140
Marketing	1,210
General and administration	1,002
Interest	42
Amortization	128
Total expenses	2,382
Income before taxes	2,758
Income taxes	(509)
Net income	2,249
Retained earnings – opening	7,769
Dividends	(1,941)
Retained earnings – closing	$ 8,077

APPENDIX VIII – FINANCE (continued)
ADDITIONAL INFORMATION

Key Information about DI

- DI was founded by Shelly 18 years ago; its customers include restaurants, bakeries, supermarkets, and other commercial establishments.
- DI's headquarters and sole production facility is in Montreal, about 20 kilometres from TMB's Montreal facility. Long-term debt was used to finance the purchase of DI's production facility. The current market value of this debt is $1,030,000. In 2021, DI paid $42,000 of interest on this debt.
- Shelly's annual compensation is $380,000; her son is paid $80,000 per year but is not involved in DI's operations. Shelly could be replaced with an executive at an annual cost of $250,000.
- In summer 2021, DI speculated on some foreign exchange options that resulted in a net realized gain of $113,444 (which is netted against general and administration costs).
- Shelly is a generous philanthropist; 2% of cost of goods sold represents desserts given to kids' camps and charity events.
- DI has historically underinvested in equipment; Shelly estimates that a one-time capital expenditure of $350,000 (net of tax benefits) is required to bring its equipment up to industry standards. DI requires annual capital investments of $110,000 (net of tax benefits) to sustain its operations.
- DI requires $2 million in cash on hand to support its operations.
- DI's expected long-term growth rate is 3%.
- DI's income tax rate is 18%.

TMB evaluates acquisitions using a discount rate of 17%.

Specialty Food Manufacturing Industry Benchmarks

Average annual revenue of a company in this industry	$100 million
Gross profit margin	50%
Marketing expenses as a percentage of revenues	14%
General & administration expenses as a percentage of revenues	6%
EBITDA as a percentage of revenues	30%

APPENDIX VIII – FINANCE (continued)
ADDITIONAL INFORMATION

Electronic Payment System

TMB pays its suppliers using cheques, which cost $1 per cheque (excluding postage and handling fees). All cheques are hand signed by two of TMB's six signing officers. During 2021, TMB issued 5,100 cheques. As it takes up to five days for cheques to clear the banking systems, suppliers want cheques issued at least ten days prior to the due date, to ensure that funds are available to them by the due date.

For an initial fee of $2,000, the bank will set up an automatic clearing house electronic funds transfer system. The bank charges a monthly fee of $600 to process up to 500 payments per month. The bank obtains and stores suppliers' banking information through secure portals. Transfers are initiated through the bank's secure website. Any number of approvers can be configured through the website, and payment authorizations can be provided electronically.

Once the transfer has been authorized, the amount is withdrawn immediately from TMB's account and deposited in the supplier's account. TMB expects to authorize payments as they come due.

Acquisition Targets

The following potential acquisition targets have been identified:

Company	Type	Sales	Net Earnings	TMB Shares (Note 1)	Return on Assets
Home Food	Meal-kit	$ 3,500,000	$ 175,000	530,000	4.8%
Easy Meals	Meal-kit	$ 46,000,000	$ 2,622,000	7,300,000	16.9%
Chef Home Meals	Meal-kit	$ 21,500,000	$ 1,333,000	4,200,000	12.8%
Food2Home	Meal-kit	$ 8,800,000	$ 378,400	900,000	14.3%
Nutri Food	Meal-kit	$ 11,600,000	$ 1,055,600	2,700,000	18.2%
Sweets Galore	Dessert	$ 12,400,000	$ 892,800	2,300,000	10.4%
Pie Experts	Dessert	$ 16,300,000	$ 1,401,800	3,600,000	12.1%
Desserts@Home	Dessert	$ 2,300,000	$ 133,400	540,000	7.0%

Note 1 – Represents number of shares that would be issued by TMB in exchange for shares of the target. TMB currently has 10 million shares outstanding.

PERFORMANCE MANAGEMENT ROLE ADDITIONAL INFORMATION

APPENDIX VIII – PERFORMANCE MANAGEMENT ADDITIONAL INFORMATION

Recipe Development for Casual Meal Kits

Eastern Canada customers opting for Chef Rita’s casual meal kits select from a list of 20 recipes each week.

In 2021, the research and development costs incurred to develop four new casual recipes per week totalled $2.6 million. In addition, there is a one-time, upfront cost of $3,000 for the graphic design and pictures of each new recipe created. On average, a new recipe is offered for six consecutive weeks. Afterwards, there is no discernible pattern to a recipe being subsequently offered; recipes will periodically be put in rotation based on customer requests or historical order rates. Recipes may also be slightly modified and reintroduced at a later date at little additional cost.

The total number of Chef Rita meals sold, related to the new recipes introduced over the six-week period, is as follows:

	Week 1	Week 2	Week 3	Week 4	Week 5	Week 6
Total number of new-recipe meals sold (with four new recipes)	10,800	8,200	1,800	1,200	800	540
Total number of new-recipe meals sold (with three new recipes)	8,208	6,232	1,368	912	608	410

During 2021, the average contribution margin per meal was $8.50.

If no new recipes were available, 40% of the number of meals shown in the table above would still have been purchased from existing recipes instead.

Customers in the West are offered new recipes less frequently, since it was decided that Chef Dashim’s efforts would be directed towards reducing recipe costs, to be more price competitive.

APPENDIX VIII – PERFORMANCE MANAGEMENT (continued)
ADDITIONAL INFORMATION

Delivery Costs

A third party delivers TMB's meal kits on its behalf. Consistent with its competitors, TMB charges its customers a flat rate of $10.00 per delivery, regardless of the actual delivery costs incurred. In 2021, the total number of deliveries was 1,361,600. TMB is charged an average fee of $8.25 for a delivery within city limits. For deliveries outside city limits, the fee charged to TMB varies depending on the destination but averages $21.50 per delivery, as it might include air shipment and/or long-distance trucking. In 2021, TMB deliveries within and outside city limits were 83% and 17%, respectively. It is anticipated that the percentage of shipments outside city limits will continue to increase. Therefore, Ara is considering three alternatives: keep the current delivery charge, increase it to $11.00 per delivery, or charge the actual delivery cost to those customers outside city limits.

Secret Sauces

Annual projections indicate that TMB's existing meal-kit customers would purchase 161,000 bottles of the secret sauces. An additional 200,000 bottles could be sold to local pubs.

Based on competitors' comparable sauces and the planned bottle size, TMB will sell its sauces for $16.00 per bottle. If the sauces are made in-house, the following costs are projected per bottle:

Food ingredients	$ 10.87
Labour	$ 1.50
Packaging	$ 0.60
Variable overhead	$ 0.75

If the sauces are made in-house, TMB's existing puree machine will be used. It is currently used to puree ingredients required for all of TMB's meal kits. In 2022, TMB expects to puree 2.2 million kilograms of ingredients for its meal kits. A bottle of sauce will require 1.5 kilograms of ingredients to be pureed.

The machine purees a maximum of 550 kilograms of ingredients per hour and operates a maximum of 13 hours per day, 365 days a year. TMB will also have to spend $125,000 on a bottling machine, which is expected to last five years. Maintenance and utilities for the bottling machine will cost approximately $55,000 per year.

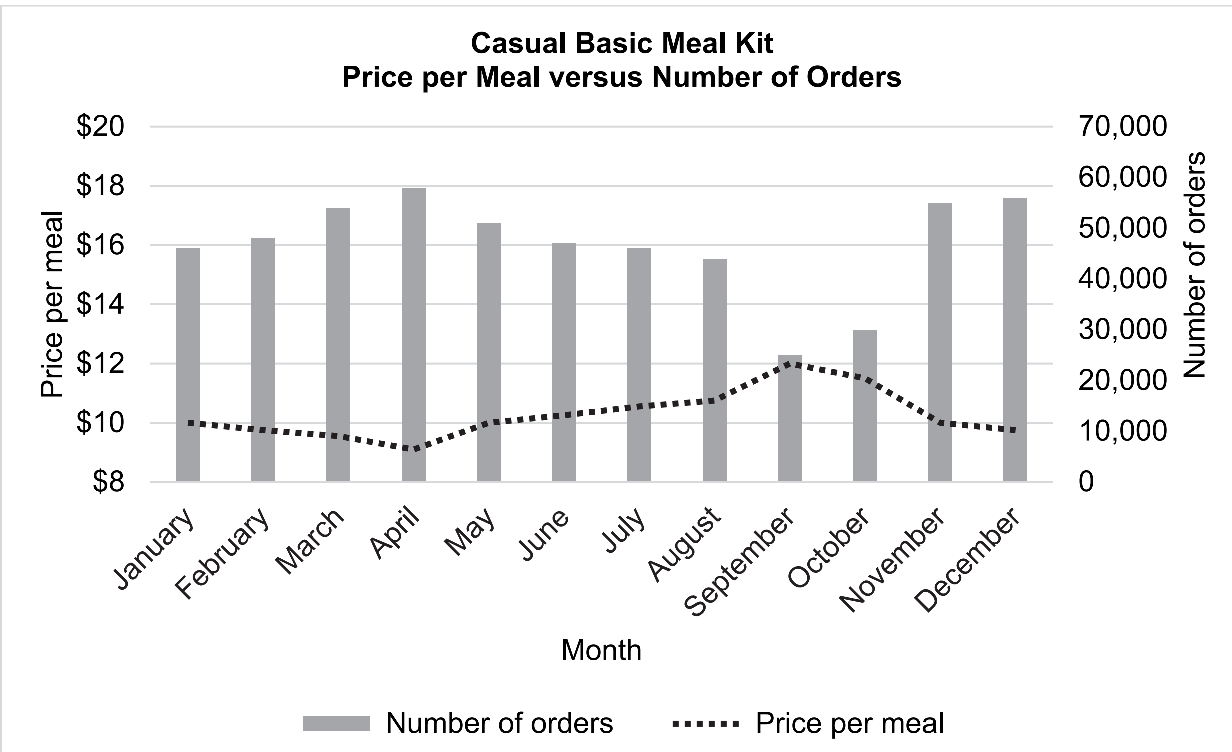
Delicious Sauces Inc. (DS) is a potential supplier that specializes in sauces and could produce and bottle the sauces for TMB. DS would ship the finished, bottled products in cases of 1,000 bottles for a total price of $14,000, plus a delivery charge of $250 per case.

To ensure consistent quality, TMB does not want to divide production between in-house and DS.

APPENDIX VIII – PERFORMANCE MANAGEMENT (continued)
ADDITIONAL INFORMATION

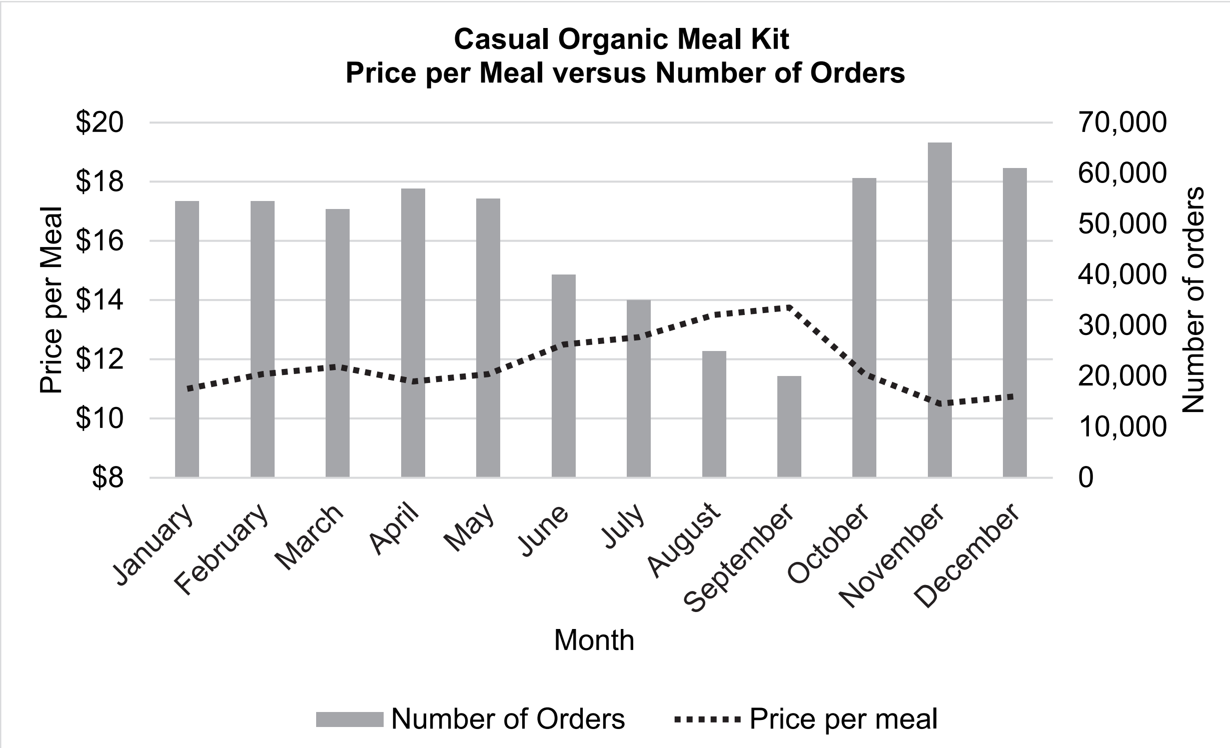
Chef Dashim Sales Data

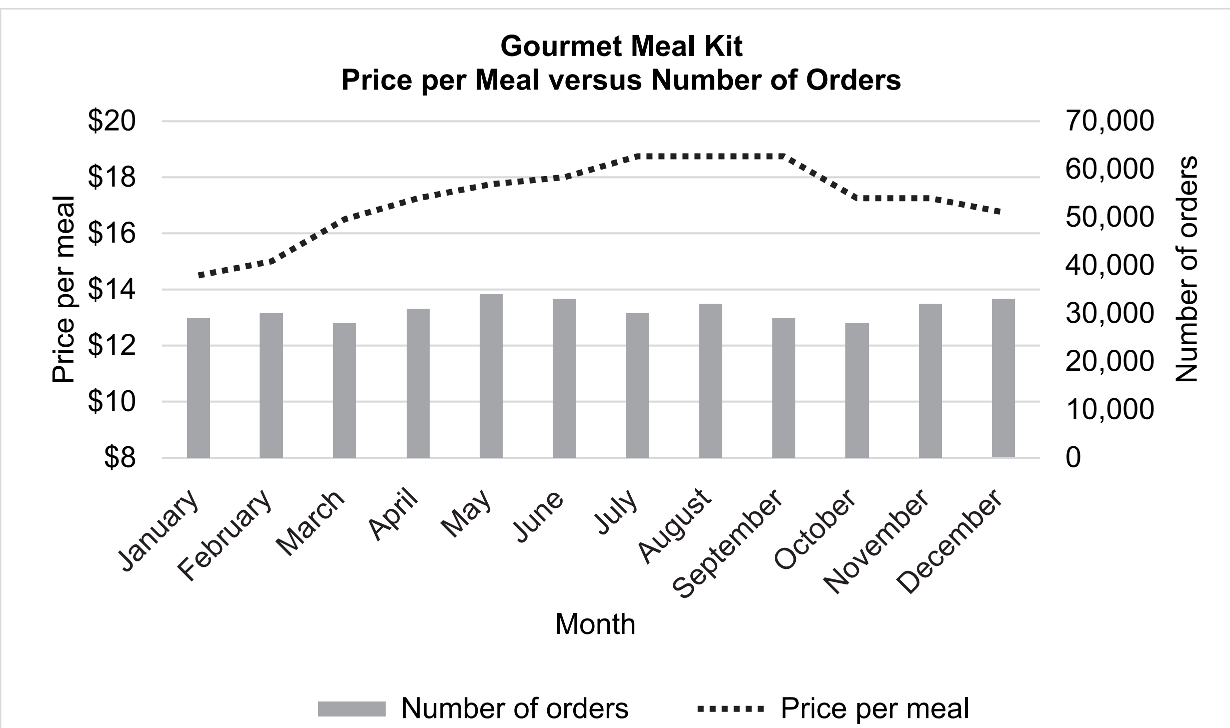
Below is a detailed breakdown of the 2021 sales data for the vegetarian-only, Chef Dashim meal kits, which had a significant drop in sales from prior years. All meal kits within each product line (casual basic, casual organic, and gourmet) have the same selling price, but TMB can change these prices during the year, depending on the meals being offered. The data presented is the meal-kit revenue prior to personalization or any protein add-ons purchased by the customer. Starting with the casual basic, then casual organic, and finally gourmet product lines, the quality and uniqueness of the ingredients increase as the price of the meal kits increases.



APPENDIX VIII – PERFORMANCE MANAGEMENT (continued)
ADDITIONAL INFORMATION

Chef Dashim Sales Data (continued)





APPENDIX VIII – PERFORMANCE MANAGEMENT (continued)
ADDITIONAL INFORMATION

Candy Circus Limited's (CC) Offer to Sell Vegan Sweets Inc.'s (VS) Assets

VS is a small company that sells vegan desserts, including cakes and pies, to supermarkets and restaurants in Western Canada. Each product comes in various flavours, but the base recipe for each product line is the same. TMB is considering the benefits of the acquisition, including selling desserts to VS's existing customers (supermarkets and restaurants) and the potential to sell ready-to-eat desserts as an add-on to its meal kits.

To help TMB estimate the impact on its cash flows from operations once VS is acquired, VS has provided the following cash flow forecast:

	2021 Actual	2022 Forecast	2023 Forecast	2024 Forecast	2025 Forecast
Units sold	1,050,000	1,071,000	1,124,550	1,180,778	1,239,816
Cash collections from sales	$8,400,000	$8,568,000	$8,996,400	$9,446,220	$9,918,531
Cash outflows from product costs:					
Direct materials	3,500,000	3,570,000	3,748,500	3,935,925	4,132,721
Direct labour	1,250,000	1,275,000	1,338,750	1,405,688	1,475,972
Variable overhead	550,000	561,000	589,050	618,503	649,428
	5,300,000	5,406,000	5,676,300	5,960,116	6,258,121
Contribution margin	3,100,000	3,162,000	3,320,100	3,486,104	3,660,410
Fixed costs	895,000	895,000	895,000	895,000	895,000
Total net cash flow	$2,205,000	$2,267,000	$2,425,100	$2,591,104	$2,765,410

APPENDIX VIII – PERFORMANCE MANAGEMENT (continued)
ADDITIONAL INFORMATION

Candy Circus Limited's (CC) Offer to Sell Vegan Sweets Inc.'s (VS) Assets (continued)

Notes from VS are as follows:

- The contribution margin is for all products combined.
- We have taken the cash flow from 2021 and projected forward using a 2% annual growth rate for 2022, and 5% per year thereafter.
- During 2021, we had an abnormal amount of spoilage. We were unable to get the gelatin substitute in some of our products to react correctly, but the issue was resolved in November 2021. Included in direct materials is an additional cost of $225,000 due to this abnormal spoilage.
- Flour, sugar, and substitute butter comprise approximately 75% of our normal direct material costs. As the combined annual orders from CC and its divisions are over $50 million, VS receives the same volume discount that CC gets from shared suppliers. Without this discount, the cost for these three ingredients would be 40% higher.
- Included in direct labour is an allocation of $35,000 for a portion of the salary of CC's master candy maker. As it is a shared cost, each of CC's five divisions absorbs one-fifth of this salary. The master candy maker spends only about 18% of their time making garnishes for VS's desserts.
- The fixed costs represent other manufacturing, selling, and administrative expenses.
- The machinery used in production was purchased five years ago at the inception of VS and has a remaining useful life of 10 years.

TMB has noted the following:

- CC's procurement manager fulfilled procurement duties for VS, but the cost was not allocated to VS. TMB expects to hire a procurement manager at an annual cost of $60,000.
- As TMB believes it can achieve some synergies with its existing workforce, it plans to lay off 5% of VS's direct labour workforce.
- Due to its lack of experience in desserts, TMB will need to hire a manager who specializes in dessert baking and new recipe development, at an expected annual cost of $130,000.
- Similar to CC's master candy maker, TMB will need to hire a part-time candy maker for VS at an annual salary of $25,000.

APPENDIX VIII – PERFORMANCE MANAGEMENT (continued)
ADDITIONAL INFORMATION

PVM Acquisition

TMB had three objectives:

1. To access the Western Canadian market to achieve economies of scale on procurement costs and increase revenues that were stagnating in Eastern Canada.

2. To reduce costs by duplicating PVM's state-of-the-art Vancouver fulfillment centre in its existing Montreal facility.

3. To obtain Chef Dashim's culinary expertise for product development.

Chef Dashim believes his creative culinary skills are not being used to their full potential. To him, TMB seems to be duplicating the model used in Eastern Canada with Chef Rita's meal kits in the West, and he is surprised by this approach.

The performance of the four high-end restaurants acquired has been declining. Many customers have complained about the reduced number of new dishes offered and the lower quality of the offerings. Customers who were polled said the reduction in prices over the past year seems to have reduced the gastronomic vegetarian experience and the reputation of the restaurants. Chef Dashim thought TMB would have consulted with him before making changes.

He senses that the higher-than-expected integration costs of the PVM acquisition and the lower-than-expected sales volume for his meal kits are being attributed to him.

TAXATION ROLE
ADDITIONAL INFORMATION

APPENDIX VIII – TAXATION
ADDITIONAL INFORMATION

Ending Balances from TMB's 2020 Corporate Tax Return

At December 31, 2020, the undepreciated capital cost balances are as follows:

Class 1 (all at 6%)	$ 6,826,000
Class 8	$ 1,015,000
Class 14.1	$ 1,258,000
Class 50	$ 102,000

Additional Information from the 2021 Financial Statements

In addition to the Montreal renovations and the Chef Arlene contract, the following capital items were acquired during 2021:

Manufacturing equipment	$ 2,850,000
Office equipment	$ 60,000
Computer application software	$ 260,000
Computer hardware	$ 350,000

Other expenses in the income statement include meals and entertainment of $50,000 and donations of $30,000 to registered charities.

Land Sale

In 2018, TMB purchased vacant land in an industrial area of Vancouver with the intention of building a fulfillment centre as part of expansion plans for Western Canada. After the acquisition of PVM, the land was no longer needed. TMB sold it in February 2021. No development activities had been started. The adjusted cost base of the land was $1.5 million, and it was sold for $2.2 million. Disposition costs were $150,000. The accounting gain was netted against PVM integration costs in the financial statements.

APPENDIX VIII – TAXATION (continued)
ADDITIONAL INFORMATION

Proposed Acquisition of Desserts Inc. (DI)

DI is a Canadian-controlled private corporation and a GST/HST registrant, with the following tax balances at its most recent taxation year end:

Class 8	$ 600,000
Class 50	$ 400,000
Unused charitable donations	$ 50,000
Non-capital losses	$ 300,000

The preliminary purchase price of substantially all of DI's net assets is $10 million, allocated as follows:

Office equipment	$ 250,000
Computer hardware	450,000
Dessert-making equipment	1,500,000
Liabilities to be assumed by TMB	(300,000)
Goodwill	8,100,000
	$ 10,000,000

If TMB agrees to purchase the shares of DI instead of net assets, DI's owner would be willing to discount the price to $8.6 million.

APPENDIX VIII – TAXATION (continued)
ADDITIONAL INFORMATION

Krzysztof Broughton Relocation Benefits

Krzysztof owns his home in Vancouver and is married with two children. To entice Krzysztof to move 5,800 kilometres from Vancouver to Halifax, TMB will reimburse house-hunting costs, to a maximum of $5,000.

Estimated house-hunting costs are as follows:

Airfare	$ 1,500
Hotels	2,100
Childcare	2,000
Car rental	300
	$ 5,900

TMB will also reimburse expenses for moving Krzysztof, his family, and their possessions to Halifax, to a maximum of $25,000. When they move, Krzysztof and his family expect to spend one day travelling by plane and five nights in a hotel in Halifax while waiting for the moving company to deliver their possessions.

Estimated moving costs are as follows:

Moving company	$ 20,000
Airfare	3,000
Mail forwarding	100
Two hotel rooms in Halifax for five nights	3,000
Utility connection fees	150
Damage deposit on leased house	1,000
	$ 27,250

Housing

The value of their Vancouver home has appreciated and will continue to appreciate, so Krzysztof and his spouse do not want to sell it yet. While they reside in Halifax, they will rent the Vancouver home to a third party and would like advice on the tax implications of doing so.

Since TMB has no office in Atlantic Canada, Krzysztof will be required to work from his Halifax home as a condition of his employment. TMB will pay him a monthly housing allowance of $1,000 in addition to his regular salary.

APPENDIX VIII – TAXATION (continued)
ADDITIONAL INFORMATION

BD Family Holdings Limited (BDFH)

BDFH holds residual funds from previous business ventures of both Rita and Conrad and has a December 31 taxation year end. It does not own any shares of TMB. Currently, all the funds are invested in securities. Annually, BDFH earns approximately $50,000 in eligible dividends, $20,000 in taxable capital gains, and $60,000 in interest income.

Rita and Conrad each take an annual salary of $300,000 from TMB and no salary from BDFH. They withdraw funds from BDFH annually for personal use, but they have not given much thought to how to structure these draws. So far, BDFH has only paid them with dividends other than eligible dividends.

On December 31, 2021, there were two loans receivable in BDFH, neither of which bears interest:

- Due from Conrad for $50,000, which he used to purchase a car. The loan was made on September 30, 2020.
- Due from Justine for $10,000, which she used to pay for university tuition and living expenses. The loan was made on August 1, 2021.

In addition, Rita borrowed $100,000 from BDFH on February 1, 2021, and repaid the full amount on October 31, 2021. Rita did not pay any interest to BDFH for this loan.

At the end of 2021, BDFH had the following tax balances:

Paid-up capital	$	100,000
Capital dividend account	$	325,000
General rate income pool	$	200,000
Eligible refundable dividend tax on hand	$	100,000
Non-eligible refundable dividend tax on hand	$	125,000

In addition to federal taxes, the highest marginal provincial individual tax rate is 20%. The provincial dividend tax credit is 16% of the gross-up for all dividends.

APPENDIX VIII – TAXATION (continued)
ADDITIONAL INFORMATION

Information on Personal Assets

Rita and Conrad jointly own 4 million shares of TMB, with an adjusted cost base of $1.08 per share.

Rita and Conrad want to gift shares of TMB to their children before their death. They want to know the tax implications of doing so. They plan to gift at least 50,000 shares of TMB to each of their children annually. Ultimately, they plan to gift 3.5 million of their shares over 20 years, starting next year.

Rita's and Conrad's wills provide for each other to be the beneficiary upon each other's death. When the second spouse dies, their wills specify that 500,000 shares of TMB will be donated to a specific registered charity before the remainder of their estate is distributed equally among their children. They would like an explanation of the tax implications of this plan.

In addition to their shares of TMB and BDFH, Rita and Conrad have RRSPs worth $600,000 and $550,000, respectively. They expect to have significant value remaining in their RRSPs at death. They also jointly own their family home in Montreal, the only real estate they own, which is worth approximately $1.5 million. They expect that BDFH will be wound up before they retire.

DAY 2 – MARKING GUIDE – COMMON
TASTY MEAL BASKETS LIMITED (TMB)

To: TMB
From: CPA
Re: Financial reporting and management accounting requests

Assessment Opportunity #1 (Common) (Depth and Breadth Opportunity)
The candidate discusses the accounting treatment for the new discount offer.
The candidate demonstrates competence in Financial Reporting.

CPA Map Technical Competencies:		**Core**
1.2.2	Evaluates treatment for routine transactions	A

CPA Map Enabling Competencies:
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions
6.3.3 Applies decision criteria to choose among viable alternatives

TMB has entered into sales arrangements with 10,000 new customers in the last month of 2021, which might need correcting journal entries.

Customers pay full price on their first delivery of a meal kit and save $31.68 on their next order, which they must order in advance and cannot cancel. They can select delivery dates for the second meal kit up to 30 days following the initial order date, which for 70% of customers was after the December 31, 2021, fiscal year end. Both meal kits would normally sell for the regular price of $62.80.

Under IFRS 15, *Revenue from Customer Contracts*, there are five steps for revenue recognition:

1. Identify the contract with the customer
2. Identify separate performance obligations, if they exist
3. Determine the overall transaction price
4. Allocate the transaction price to the separate performance obligations
5. Determine when the performance obligation is complete, and revenue can be recognized

Step 1: Identify the contract with the customer

For a revenue contract to exist, it must be written or oral, rights regarding the transfer of goods and services are identified, payment terms are specified, and collection of consideration is probable.

Given that there is documentation of the terms on the website and there is documentation of the orders that were placed online, the revenue contracts are all valid in that they are written, outline the rights regarding the transfer of the product from TMB to the customer, and specify the transaction price and payment terms.

Collection is probable as the amount for each delivery is charged to customers' credit cards on the delivery date. There is a small collection risk if, for example, customers' credit card payments are declined at the time of delivery, but this would already be known for meal kits delivered by year end, and will not be relevant until the second meal kit is delivered for those that have not yet been delivered.

Step 2: Identify separate performance obligations, if they exist

IFRS 15.22 indicates:

> *"At contract inception, an entity shall assess the goods or services promised in a contract with a customer and shall identify as a performance obligation each promise to transfer to the customer either:*
> *(a) a good or service (or a bundle of goods or services) that is distinct; or*
> *(b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer (see paragraph 23)."*

The two meal kits appear to be distinct goods, as there would be two individual deliveries of different meal kits on different dates. Specifically, IFRS15.27 says that:

> *"A good or service that is promised to a customer is distinct if both of the following criteria are met:*
> *(a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (i.e., the good or service is capable of being distinct); and*
> *(b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (i.e., the promise to transfer the good or service is distinct within the context of the contract)."*

TMB's customers can benefit from each meal kit on its own (each meal kit contains the ingredients and recipes for specific recipes and for four meals, and is not intended to be mixed, since they are not part of same kit), and it is easy to identify each promise to transfer the meal kit from the other (the customer chooses specific dates to receive each meal kit, and each meal kit is in a separate box, which clearly identifies it as separate).

Step 3: Determine the overall transaction price

The total overall transaction price for the series is $62.80 + $31.12 = $93.92.

Step 4: Allocate the transaction price to the separate performance obligations

IFRS 15.73 states that:

> *"the objective when allocating the transaction price is for an entity to allocate the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer."*

Therefore, TMB must allocate the transaction price to each performance obligation (each meal kit).

IFRS 15.76 adds:

> *"To allocate the transaction price to each performance obligation on a relative stand-alone selling price basis, an entity shall determine the stand-alone selling price at contract inception of the distinct good or service underlying each performance obligation in the contract and allocate the transaction price in proportion to those stand-alone selling prices."*

Further guidance about allocation of a discount is provided in IFRS 15:

> *"81 A customer receives a discount for purchasing a bundle of goods or services if the sum of the stand-alone selling prices of those promised goods or services in the contract exceeds the promised consideration in a contract. Except when an entity has observable evidence in accordance with paragraph 82 that the entire discount relates to only one or more, but not all, performance obligations in a contract, the entity shall allocate a discount proportionately to all performance obligations in the contract. The proportionate allocation of the discount in those circumstances is a consequence of the entity allocating the transaction price to each performance obligation on the basis of the relative stand-alone selling prices of the underlying distinct goods or services.*
>
> *82 An entity shall allocate a discount entirely to one or more, but not all, performance obligations in the contract if all of the following criteria are met:*
>
> *(a) the entity regularly sells each distinct good or service (or each bundle of distinct goods or services) in the contract on a stand-alone basis;*
>
> *(b) the entity also regularly sells on a stand-alone basis a bundle (or bundles) of some of those distinct goods or services at a discount to the stand-alone selling prices of the goods or services in each bundle; and*

> (c) *the discount attributable to each bundle of goods or services described in paragraph 82(b) is substantially the same as the discount in the contract and an analysis of the goods or services in each bundle provides observable evidence of the performance obligation (or performance obligations) to which the entire discount in the contract belongs."*

In this case, the offer requires customers to buy both meal kits, so there is no evidence that the discount applies to only one of them, even though the actual discount is applied only to the second meal kit. The discount on the second meal kit is not available without buying the first meal kit and committing to buy the second one. TMB does not regularly sell bundles (this is a new offer), so paragraph 82 does not apply.

Accordingly, the overall transaction price should be allocated evenly to the two meal kits, as they have identical stand-alone prices. This means that $46.96 ($93.92 ÷ 2) should be allocated to each meal kit.

<u>Step 5: Determine when the performance obligation is complete, and revenue can be recognized</u>

The performance obligation for each meal kit, under paragraph 31, would be met when the asset (the meal kit) is transferred to the customer, which would be at the time of delivery.

> *"An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (i.e., an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset."*

In this case, the performance obligation is achieved at each delivery, and there are two deliveries to take place.

Each performance obligation cannot be recognized until the meal kit has been delivered. Since purchases are paid for at the same time as delivery, when the first meal kit is ordered and delivered, TMB will receive payment of $62.80, of which $46.96 represents revenue on the first meal kit and the balance ($15.84) represents a prepayment for the second meal kit. The correct entry should be to increase revenue by $46.96, increase deferred revenue by $15.84, and increase cash by $62.80.

After the second meal kit is delivered and paid for (which again takes place simultaneously), the entry required would be to record the receipt of the $31.12 received (increase cash), increase revenue by another $46.96 for the second meal kit, and decrease the deferred revenue set up previously of $15.84.

For the 3,000 customers whose second meal kit has already been delivered and paid for, the revenue has been accounted for correctly (TMB would have recorded a total of $93.92 of revenue for each of these customers).

For the remaining 7,000 customers, revenue is overstated by the $15.84 per meal kit that should have been deferred until delivery of the second meal kit. Thus, to correct this error, an entry needs to be recorded to increase deferred revenue, and decrease revenue, by $110,880 ($15.84 × 7,000):

DR Revenue	$110,880	
CR Deferred revenue		$110,880

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

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

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

Reaching competence – The candidate attempts to discuss the accounting treatment for the new discount offer.

Competent – The candidate discusses the accounting treatment for the new discount offer.

Competent with distinction – The candidate thoroughly discusses the accounting treatment for the new discount offer.

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

The candidate discusses the accounting treatment for the agreement with Chef Arlene.

The candidate demonstrates competence in Financial Reporting.

CPA Map Technical Competencies:		Core
1.2.2	Evaluates treatment for routine transactions	A

CPA Map Enabling Competencies:
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
5.2.2 Uses brainstorming or other techniques to generate ideas
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions
6.3.3 Applies decision criteria to choose among viable alternatives

TMB has entered into an agreement with Chef Arlene for the right to use her brand name and her recipes for five years. The total cost of these rights is $400,000.

The first question is, what has been acquired for the $400,000? TMB has acquired: 1) rights to the use of Chef Arlene's brand name; and 2) rights to the recipes. Therefore, there are two intangible assets that have been acquired. Each of these intangible assets will be assessed separately.

Before we assess each of these intangible costs, we need to determine how much of the cost of the contract ($400,000) is allocable to each. IAS 38 (Intangible assets) does not provide guidance on allocating a bundled cost, other than to indicate that the entity should disclose intangible asset information separately for each class. Paragraph 119 lists several different classes, which include brand names and recipes as different classes.

Absent any specific guidance, it would be appropriate to allocate the costs of each of these two components of the contract based on their fair market values. Since these are not known, we will assume for now that 50% of the cost relates to each of the two components (since they are enumerated separately), but more work will need to be performed, including obtaining a valuation of each item, to determine a more appropriate allocation of the $400,000.

Definitions

IAS 38.10 states that:

> *"not all the items … meet the definition of an intangible asset, i.e., identifiability, control over a resource and existence of future economic benefits."*

IAS 38.11 states that:

> *"the definition of an intangible asset requires an intangible asset to be identifiable to distinguish it from goodwill."*

IAS 38.12 indicates that:

> *"An asset is identifiable if it either:*
> *(a) is separable, i.e., is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or*
> *(b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations*."

In addition, IAS 38.13 states:

> *"An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits. The capacity of an entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control because an entity may be able to control the future economic benefits in some other way."*

Therefore, to be capitalized as an asset, the asset must be a resource: (a) that can be identifiable; (b) that can be controlled by TMB because of past events; and (c) from which future economic benefits are expected to flow to the entity.

Rights to the Recipes

<u>Identifiable</u>

In this case, TMB does not have the ability to sell or transfer these rights to another party; therefore, they do not meet the separable criterion. However, TMB does have a legal right by the contractual agreement with Chef Arlene to use these recipes. Therefore, they meet the requirement to be identifiable.

<u>Control</u>

TMB must demonstrate that it has the power to obtain future economic benefits from the recipes, and restrict access to these benefits from others. This control is demonstrated by legal rights, but under IAS 38.13, "legal enforceability of a right is not a necessary condition for control because an entity may be able to control the future economic benefits in some other way." As discussed later, TMB will benefit from future sales, but also from saving costs as it will not have to incur costs it would otherwise have incurred to develop new meal kit recipes.

On the one hand, recipes cannot be patented or protected by copyright laws. TMB will distribute the recipe with each meal kit when it is delivered, so at that point in time, the recipes are available for anyone to copy. After that time, the control of the recipe itself cannot be restricted, and others using the recipe could gain benefits from it, since it will be public knowledge and there is no legal right to prevent its distribution. There is no way to prevent customers or others from using these recipes for their own purposes, some of which may be to generate revenues. In addition, TMB cannot resell the rights to any other party.

On the other hand, the contract with Chef Arlene specifies that she cannot sell the rights to the recipes to any other party, which suggests that TMB has some amount of control over this asset. Presumably, until the recipes are distributed by TMB to its customers, no one else would be able to take advantage of the recipes.

While there are arguments supporting both sides of whether the control criterion is met, we conclude that, until the recipes are distributed to customers (and thus publicly available), TMB has control over the future economic benefits of the recipes. Therefore, at the time the contract is signed, we believe this criterion is met.

Future economic benefits

IAS 38, paragraph 17, specifies that "future economic benefits flowing from an intangible asset may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the entity. For example, the use of intellectual property in a production process may reduce future production costs rather than increase future revenues."

Certainly, selling the meal kits with these recipes will generate revenues, so there is some future benefit. Chef Arlene makes recipes that are desirable, and when customers like the recipes and meal kits they receive, they are more likely to continue ordering new ones (and to tell their friends to sign up).

In addition, the acquisition of these recipes will save TMB money on future costs—TMB is constantly refreshing its recipes, so acquiring these ones from Chef Arlene means that TMB will not have to incur costs to internally develop as many gourmet line recipes in future. Even if Chef Arlene does something to diminish the quality of her brand name (discussed later), TMB could still benefit from the recipes themselves due to the quality of the chosen ingredients and instructions.

Conclusion

Since the rights to recipes meet the definition of an intangible asset, their cost can be capitalized and recognized as an asset.

Rights to use Chef Arlene's Brand Name

Identifiable

In this case, TMB does not have the ability to separately sell or transfer these rights (i.e., they are not separable); however, by contractual agreement, it has the right to use Chef Arlene's brand name. Therefore, these rights meet one of the criteria to be identifiable.

Control

TMB has been given the right to use Chef Arlene's brand name to promote a line of products. Chef Arlene has agreed not to sell the rights to use her brand name to any other meal-kit company, so TMB controls the use of the Chef Arlene brand name within the meal-kit industry. Also, TMB does have control over the use of the Chef Arlene brand name as it can choose to use the brand name or not, and no other meal-kit company can use it.

On the other hand, Chef Arlene continues to be allowed to use her own name at her restaurants, and could presumably do so for other purposes as well (e.g., her own brand of cookware). She or her business could at any time make the name less valuable (for example, by decreasing the quality of her restaurant meals or by engaging in offensive behaviour), which suggests that TMB may not have a meaningful amount of control over the use of the Chef Arlene brand name.

Although there are arguments for both sides, there seems to be a stronger argument for TMB having control, since the economic benefits from using the name in the meal-kit industry are exclusive to TMB, and they will fully control it. We conclude that TMB does have control over the brand name rights.

Future economic benefits

Future economic benefits could arise because TMB believes that promoting the recipes as being created by Chef Arlene will help in marketing these kits, resulting in increased sales.

Conclusion

Since the brand name meets the definition of an intangible asset, its cost can also be capitalized and recognized as an asset.

Recognition and Initial Measurement

Since both the recipes and the brand name can be recognized as an intangible asset, the next issue is the amount at which TMB should initially recognize them.

IAS 38.21 states that:

> "*an intangible asset shall be recognised if, and only if:*
> *(a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and*
> *(b) the cost of the asset can be measured reliably.*"

In addition, IAS 38.25 states:

> *"Normally, the price an entity pays to acquire separately an intangible asset will reflect expectations about the probability that the expected future economic benefits embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits, even if there is uncertainty about the timing or the amount of the inflow. Therefore, the probability recognition criterion in paragraph 21(a) is always considered to be satisfied for separately acquired intangible assets*."

IAS 38.26 goes on to state:

> "*In addition, the cost of a separately acquired intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.*"

In this case, the fact that TMB was willing to pay $400,000 for the agreement indicates that TMB believes it is probable that future benefits will flow to the company, so paragraph 25 suggests this automatically means that this criterion is met.

As discussed earlier, we do not have enough information to know precisely what portion of the $400,000 relates to the brand name versus the recipes—further analysis will be required, to determine how much of the total relates to each portion. However, both meet the criteria for capitalization as intangible assets, so the full $400,000 will be recorded to intangible assets.

Subsequent Measurement

Under IAS 38.88:

> "*An entity shall assess whether the useful life of an intangible asset is finite or indefinite and, if finite, the length of, or number of production or similar units constituting, that useful life. An intangible asset shall be regarded by the entity as having an indefinite useful life when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity*."

There is a five-year limit on these rights; therefore, there is a finite life. However, we should also consider if the useful life should be less than five years. In considering the length of the finite life, the following should be considered (per IAS 38.90):

- Expected usage of the asset – This asset will be used up as recipes are distributed or until the end of five years, when the contract expires.
- Typical product life of the asset for similar assets – TMB needs to "constantly" refresh and develop new recipes, so the product life is likely relatively short. However, since the recipes will likely be distributed over time rather than all at once, we can probably assume that there are sufficient recipes to last for the five-year period.
- Expected actions by competitors – Although competitors may follow the idea of having celebrity chefs, no competitor will be able to get the same recipes that TMB has from Chef Arlene, since she has agreed to not sell to any other meal-kit companies during the five years of the agreement.
- Level of maintenance required – There is a need to refresh and update recipes so that the meal kits continue to be sought after. However, as mentioned, we can assume that the recipes will not all be disclosed at once, and will therefore not need to be updated very frequently.

Based on this analysis, the rights to the recipes should likely be amortized as each recipe is used in a meal kit, to reflect that its future benefits are mostly used up at that point. TMB may still benefit from reusing unmodified recipes, but once they are distributed, TMB no longer has any ability to keep competitors from simply duplicating their recipes, so the only benefit to TMB is not having to develop more new recipes. While we do not have details of the rate at which the recipes will be used, we will assume for now that they will be used evenly over the five years. Since the contract commenced on June 1, 2021, the estimated amortization for 2021 would be $23,333 ($200,000 × 7/60 months).

As the brand name has value separately from the recipes, we need to consider how the brand name amount should be amortized. The benefit of the brand name will likely be used evenly over the five years, assuming the brand name will be used to promote products equally over the period. It should therefore be amortized evenly over the five-year period, not based on recipe usage. Given this, the estimated amortization for 2021 for the brand name would be $23,333 ($200,000 × 7/60 months). The total amortization for 2021 would be $46,666.

Amortization on these intangible assets will have to be reviewed and reassessed annually. In addition, as required by IAS 38.110, the rights will have to be tested for an indication of impairment at each reporting period.

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

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

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

Reaching competence – The candidate attempts to discuss the accounting treatment for the Chef Arlene agreement.

Competent – The candidate discusses the accounting treatment for the Chef Arlene agreement.

Competent with distinction – The candidate thoroughly discusses the accounting treatment for the Chef Arlene agreement.

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

The candidate discusses the accounting treatment for the costs related to the renovation of the fulfillment centre in Montreal.

The candidate demonstrates competence in Financial Reporting.

CPA Map Technical Competencies:		**Core**
1.2.2	Evaluates treatment for routine transactions	**A**

CPA Map Enabling Competencies:
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions
6.3.3 Applies decision criteria to choose among viable alternatives

TMB renovated its fulfillment centre in Montreal, and incurred a variety of construction costs for the building and equipment. Some of these costs can be capitalized and others must be expensed.

Under IAS 16, paragraph 7, the cost of an item of property, plant, and equipment shall be recognized as an asset if: “(a) *it is probable that future economic benefits associated with the item will flow to the entity*; and (b) *the cost of the item can be measured reliably*.” Since we have cost information for the renovation work performed, we will assume that criteria (b) has been met for all items. Thus, we will determine the correct amount of costs to be capitalized using criteria (a), or other paragraphs in IAS 16, as necessary.

The following schedule details the renovation costs, and explanations for each adjustment are provided below.

	Outside Structure	**Heating and Cooling System and Roof**	**New Air Filtration System**	**Internal Walls and Floors**
Balance Dec 31, 2020	$2,271,000	$120,000	$0	$340,000
2021 Additions:				
Replaced bricks (Note 1)	0			
Heating and cooling system, roof replacement (Note 2)		1,300,000		
Air filtration system (Note 2)			240,000	
Replacement of internal walls and floors (Note 3)				2,010,000
Assets that have been fully replaced (Note 4)		(120,000)		(340,000)
Employee costs (Note 5)				600,000
Relocation costs (Note 6)				
Disposal costs (Note 7)				150,000
Replace new floors (Note 8)				(350,000)
Balance Dec 31, 2021	$2,271,000	$1,300,000	$240,000	$2,410,000

Total amount to be capitalized = $2,271,000 + $1,300,000 + $240,000 + $2,410,000 = $6,221,000.

Notes:

1. If the replacement of these bricks is related to the structural integrity of the building, and enhances the life of the building or represents a betterment, these costs may be capitalized. However, we have assumed the replacement of the missing or damaged bricks is related to regular maintenance on the building. As such, these costs should be expensed as per IAS 16.12, which notes that the day-to-day servicing of property, plant, and equipment should be recognized in profit or loss as incurred.

2. The replaced heating and cooling system, roof, and air filtration system will result in improvements to the building from higher air quality and lower maintenance and utility costs. As such, these additions will result in a future economic benefit to TMB and should be capitalized.

3. The replacement of internal walls and floors will result in improvements to the building from ensuring structural integrity, preparing the space for its intended use, and potentially lowering utility costs through the use of more environmentally-friendly materials. As such, these additions will result in a future economic benefit to TMB and should be capitalized.

4. The carrying values of the former assets that are replaced and discarded need to be removed, which has not been done, so these adjustments correct for that error.

5. Employee wages and benefits related to the construction of the internal walls and floors can be capitalized as a cost under IAS 16.17, as these are directly attributable costs. IAS 16.17 states:

   "*Examples of directly attributable costs are: (a) costs of employee benefits (as defined in IAS 19 Employee Benefits) arising directly from the construction or acquisition of the item of property, plant and equipment*."

6. \$60,000 of costs were incurred to relocate equipment during construction. IAS 16.20 states:

   "*Recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management. Therefore, costs incurred in using or redeploying an item are not included in the carrying amount of that item. For example, the following costs are not included in the carrying amount of an item of property, plant and equipment: …*
   c) costs of relocating or reorganising part or all of an entity's operations."

   Therefore, these costs cannot be capitalized, as they are not directly related to the construction of the building, but instead are related to the use of the equipment within the building. It is clear that relocation does not increase the economic benefits associated with the equipment itself. As a result, no adjustment is required.

   We have assumed the relocation of the equipment was a temporary move during the construction phase. However, if the relocation was a permanent move and required structural changes to the building, there could be a case for capitalizing these costs as part of the building costs. More information would be required, to determine if this was the case.

7. IAS 16.17 (b) states that:

   "*Examples of directly attributable costs are: …*
   (b) costs of site preparation."

   Therefore, the costs to dispose of the old walls and floors are part of the construction costs, as they would qualify as costs related to the site preparation. The new walls and floors cannot be constructed or laid until the old materials have been removed.

8. Included in the above amounts is \$350,000 for additional costs to replace the floor that was damaged. By adding these costs, a portion of the cost of the floor has been recorded twice, and therefore includes items that were wasted. IAS 16.22 states that:

> "*The cost of a self-constructed asset is determined using the same principles as for an acquired asset. If an entity makes similar assets for sale in the normal course of business, the cost of the asset is usually the same as the cost of constructing an asset for sale (see IAS 2). Therefore, any internal profits are eliminated in arriving at such costs. Similarly, the cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset is not included in the cost of the asset.*"

These costs of abnormal amount of wasted material cannot be included; this amount needs to be expensed to other expenses, and effectively netted against the insurance proceeds of $120,000, which is already included in this expense account.

The total carrying amount of the Montreal fulfillment centre is $6,531,000 ($2,731,000 + $3,800,000) before adjustments or depreciation, and the amount that should have been capitalized is $6,221,000. The difference of $310,000 should be expensed.

In addition, it is unclear whether 2021 depreciation has been taken. If no depreciation has been recorded for 2021, that amount will have to be calculated, and if depreciation has been recognized on this asset, the amount will need to be adjusted for these changes.

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

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

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

Reaching competence – The candidate attempts to discuss the additions that were capitalized.

Competent – The candidate discusses the additions that were capitalized.

Competent with distinction – The candidate thoroughly discusses the additions that were capitalized.

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

The candidate discusses the possible causes for the significant variances.

The candidate demonstrates competence in Management Accounting.

CPA Map Technical Competencies:		**Core**
3.2.2	Prepares, analyzes, or evaluates operational plans, budgets, and forecasts	**A**
3.2.3	Computes, analyzes or assesses implications of variances	**A**

CPA Map Enabling Competencies:
5.1.1 Applies general business knowledge to enhance work performed
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.2 Identifies patterns from data analysis
6.2.3 Questions the relevance and tests the quality of information and assumptions in own analyses

We are asked to discuss the possible causes for the significant variances for Q4 of 2021 for Chef Dashim's meal kits. As the flexible budget was provided, the budget has already been adjusted for any changes in costs solely due to a change in volume of sales. Therefore, this discussion addresses the remaining variances that arise due to other factors.

	Flexible Budget	**Actual**	**Variance ($)**	**Variance (% of budget)**
Food costs	2,778,564	2,897,472	(118,908)	(4.3%)
Packaging costs	905,460	985,140	(79,680)	(8.8%)
Direct labour	543,276	693,120	(149,844)	(27.6%)
Maintenance and repairs	319,560	202,150	117,410	36.7%
Marketing costs	532,600	470,000	62,600	11.8%

Causes of the Significant Flexible Budget Variances

Food costs

There is an unfavourable variance of $118,908 due to factors other than sales volume. We are told that the meal kits sold in the last quarter contained more protein add-ons than usual, and more than what would have been budgeted. Proteins include fish, poultry, and tofu, which have higher costs per meal than other ingredients; the additional unfavourable variance is likely due to the higher unit food costs on meal kits containing a protein supplement.

Another contributing factor could be the introduction of the new secret sauces to the meal kits in June 2021. Depending on the timing of the Q4 budget, the introduction of the new ingredient may not have been incorporated in the original budget, and would increase the unfavourable food cost variance.

Packaging costs

There is an unfavourable variance of $79,680. There are two other factors that have been identified that could cause this unfavourable difference. The first factor is that shipping of proteins requires more refrigerated packaging, using ice packs. This is more expensive than the packaging of vegetables, which do not require refrigeration. Secondly, the packaging used in Vancouver came from the United States, and during the last quarter of 2021, the USD to CAD dollar exchange rate worsened, causing the price of this packaging to increase.

Direct labour

TMB's production workforce is composed of both full-time (salary or hourly) employees, and part-time (hourly) employees, who are only used when there is increased volume. There is an unfavourable variance of $149,844, which has been likely caused by two factors. First, the added proteins to the meal kits increase the direct labour costs per meal kit as they require more preparation, so this will increase the direct labour used. In addition, we are told that the automated line was down for three weeks waiting for parts, during which time more manual labour had to be used to complete the orders. This would also have increased the direct labour costs.

Maintenance and repairs

There is a significant favourable variance in the maintenance and repairs costs. Since the automated equipment was down for three weeks waiting for a part to be received and installed, there was no maintenance required on this equipment, which would reasonably account for part of the variance. In addition, we are told that there was more maintenance and repair performed in Q3 than originally budgeted, which may also partially explain the reduction in costs for Q4.

Marketing costs

The marketing costs are also less than budgeted, by $62,600. However, we are told that the company cut back on television advertising by 50% in Q4. Assuming that marketing expenses were budgeted to be spent evenly throughout the year, this would account for a 12.5% decrease of costs. Instead, TMB started offering new customer discounts and customer referrals, which have less direct marketing costs. The costs of these customer offers are reflected in revenue and margins instead.

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

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

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

Reaching competence – The candidate discusses some of the significant variances.

Competent – The candidate discusses several of the significant variances.

Competent with distinction – The candidate discusses most of the significant variances.

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

The candidate prepares the spending budgets, explains whether the Chef Rita meal kits are expected to exceed the spending target, and explains the factors that impact meeting the target.

The candidate demonstrates competence in Management Accounting.

CPA Map Technical Competencies:		Core
3.2.2	Prepares, analyzes, or evaluates operational plans, budgets, and forecasts	A

CPA Map Enabling Competencies:
5.1.1 Applies general business knowledge to enhance work performed
5.1.2 Recognizes the interrelationships among departmental and functional areas within the organization
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems
6.2.2 Identifies patterns from data analysis
6.2.3 Questions the relevance and tests the quality of information and assumptions in own analyses
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Spending Budget

We have revised the spending budgets for Chef Rita’s meal kits.

	April	May	June	July	Aug
Budgeted sales of meals	260,000	270,000	250,000	210,000	190,000
No beginning or ending inventory of finished goods					
Required production	260,000	270,000	250,000	210,000	190,000
Ingredients:					
Total ingredients to purchase – given	**$1,339,974**	**$1,463,843**	**$1,410,860**		
Packaging:					
Required production (no. of meals)	260,000	270,000	250,000	210,000	190,000
Materials per unit (in kg)	0.46	0.46	0.46	0.46	0.46
Production needs (in kg)	119,600	124,200	115,000	96,600	87,400
Desired ending inventory – sum of production needs of next two months	239,200	211,600	184,000		
Total packaging needed	358,800	335,800	299,000		
Less beginning inventory	(240,000)	(239,200)	(211,600)		
Packaging to be purchased	118,800	96,600	87,400		
Cost per kilogram	$2.78	$2.78	$2.78		
Total packaging to purchase	**$330,264**	**$268,548**	**$242,972**		
Direct labour:					
Required production	260,000	270,000	250,000		
Direct labour cost per meal	$0.80	$0.80	$0.80		
Total costs for direct labour	**$208,000**	**$216,000**	**$200,000**		
Overhead:					
Required production	260,000	270,000	250,000		
Variable overhead cost per meal	$1.19	$1.19	$1.19		
Total costs for variable overhead	$309,400	$321,300	$297,500		
Fixed overhead per month	$400,000	$400,000	$400,000		
Total overhead costs per month	**$709,400**	**$721,300**	**$697,500**		
Total budgeted	**$2,587,638**	**$2,669,691**	**$2,551,332**		

As can be seen, each month has monthly expenditures higher than the target amount of $1.8 million. Whether this is expected to continue depends on several factors:

- Volume of sales – It is noted that July and August have lower sales volume estimates, compared to April to June. It is unclear whether April to June were unusually high, or if it is the typical volume going forward. July indicates a 16% decrease in sales volume compared to June; as a significant portion of costs appear to be variable, the decrease in July sales could easily reduce spending to less than the target.
- Ingredient costs – These costs appear to be on the rise, as the cost per meal is increasing with each month (April = $5.15 ($1,339,974/260,000); May = $5.42 ($1,463,843/270,000); and June = $5.64 ($1,410,860/250,000)). Because the spending target was set in February, it may not reflect the trend of rising food costs that appears to be significant in 2022. If this trend continues, the spending target may continue to be missed.
- Packaging costs – The target did not consider the new contract for packaging costs, which was only obtained in 2022. On the one hand, the cost is likely less than what was experienced by TMB at the end of 2021, given that the USD to CAD exchange rate was poor at that time. On the other hand, TMB must keep extra packaging inventory on hand (two months' worth), which increases the packaging cost. These have likely not been considered in the target. These two factors offset each other in terms of direction. Therefore, depending on which factor is stronger, there will be either a positive or negative impact on TMB's ability to meet the target.
- Overhead costs – The target would not have considered the cost savings that could be realized due to the newly renovated Montreal fulfillment centre (finished in November 2021). With these upgrades, utility costs are expected to decline, as well as ongoing maintenance costs. This would make TMB more likely to meet the spending target.

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

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

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

Reaching competence – The candidate attempts to prepare the spending budget, and attempts to explain whether the spending target will likely be exceeded or the factors that impact whether the target will be met.

Competent – The candidate prepares the spending budget and explains whether the spending target will likely be exceeded, and the factors that impact whether the target will be met.

Competent with distinction – The candidate prepares the spending budget, and thoroughly explains whether the spending target will likely be met.

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

The candidate provides comments on the sales per customer, customer retention, and the marketing initiatives used.

The candidate demonstrates competence in Management Accounting.

CPA Map Technical Competencies:		**Core**
3.2.1	Develops or evaluates data and information inputs for operational plans, budgets, and forecasts	A
3.4.1	Evaluates sources and drivers of revenue growth	B

CPA Map Enabling Competencies:
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.1.1 Identifies and articulates issues within areas of work responsibility
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.2 Identifies patterns from data analysis
6.2.3 Questions the relevance and tests the quality of information and assumptions in own analyses
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

We have been asked to provide comments on TMB's sales trends by analyzing the data provided, including commenting on the sales per customer, customer retention, and the various marketing initiatives that have been used.

<u>Average sales per customer per quarter</u>

As seen in the graph, during the first three quarters of 2020, TMB's average sales per customer was higher than the industry average, reaching its peak of $324 in Q3. From this point on, sales per customer started to fall significantly, reaching $283 by Q4 of 2021. Over 2021, the average sales per customer fell by 12.7% (($324 - $283)/$324), compared to the industry average decline of 7.1% over 2021 (($325 - $302)/$325).

We also see that, during 2021, the number of orders per customer increased from 4.6 to 5.7 per quarter. This, combined with the fact that there is a drop in average sales per customer, indicates that the sales per order has declined over 2021. We can also see that the mix of product sales has changed. Early in 2021, the less expensive, casual meal kits were trending downward, while the high-priced, organic meal kits were trending upward. But for Q2, Q3, and Q4, the less expensive casual meals were trending upward, while the highest priced casual meals trended downward.

These factors indicate that the declining sales per customer per quarter is being impacted by the choice of the less expensive meal kits, even though the number of orders per customer has increased. In addition, a global competitor entered the Canadian market in Q3 of 2021. As pricing is the key competitive driver, there is immense pressure to reduce prices in order to maintain customers, and the decline in average sales per customer starting at that point indicates that the new competitor likely had a significant impact on sales.

During Q3 and Q4, the sales of the gourmet meals and the Celebrity Chef kits showed upward trends. This is a potential area of opportunity for TMB to explore further.

Cancellation rates

Overall, the number of active customers per quarter has been increasing each quarter. In Q1 and Q2, the company was gaining new customers faster than it was losing customers. In Q3, the number of lost customers outpaced the number of new customers. In Q4, likely due to the new marketing initiatives for the discount program, new customers outnumbered lost customers. However, the trend is alarming; although TMB gained a net new 9,100 (65,000 - 74,100) customers over the year, 51,100 (9,400 + 10,400 + 10,600 + 20,700) new customers were needed to achieve this, which represents 79% of TMB's opening number of customers.

In addition, the percentage of customers leaving after just one month has increased from 15% in Q1 to 35% in Q4, which is higher than the industry average of 30%. Even more alarming is the percentage of customers leaving after two months, which represents the highest percentage of lost customers, at 40% by Q4, which is higher than the 30% industry average. The percentage of customers that remain beyond six months is also significantly declining.

In comparison to the industry cancellation rates, the stats for December 2021 indicate that the TMB customers who cancel their subscription do it earlier than other meal-kit companies in the industry; a larger proportion of TMB customers who cancel their subscription do it in the first month, and in the second or third month (35% and 40%, respectively), compared to 30% for the industry. However, TMB's cancellation rate for its customers who stay for four to five months, or for more than six months before leaving (15% and 10%, respectively), are below the industry rates of 25%. This suggests that, if TMB is successful in keeping customers for more than three months, they are more likely to be longer-term customers, compared to the industry.

Success of marketing initiatives

New customer acquisitions from television marketing have remained consistent for the first three quarters, ranging from 2,350 to 2,968 customers, but then significantly decline to 1,656 customers in Q4, which is reasonable, as the spending was cut by 50%. For the podcasts, even though the expense is incurred evenly throughout the year, the new customers from this source declined steadily over the year, indicating that this initiative may no longer be as effective. The new customers attracted by social media had also been consistent, ranging from 2,350 to 2,808 customers between Q1 and Q3, but declined sharply to 621 in Q4, even though there was no change in effort or monies spent in this area. The number of customers attracted due to discounts given to new customers increased significantly in Q4, to 10,143. It is obvious that the new marketing initiative in Q4 was very successful in attracting customers, using heavily discounted meal kits. Finally, the number of new customers from referrals was consistent between Q1 and Q3, ranging from 1,880 to 2,392 customers, and then increased to 7,245 in Q4, which is a significant increase.

When we examine the acquisition cost per customer, we calculate the following:

	Television	**Podcasts**	**Social Media**	**Discounts to New Customers**	**Referrals**
Total new customers	9,782	6,847	8,217	12,723	13,531
Total annual spend	$2,300,000	$1,500,000	$650,000	$1,500,000	$350,000
Acquisition cost per customer	$235.13	$219.07	$79.10	$117.90	$25.87

Referral programs are one of the least expensive ways to acquire a new customer, and are very effective, accounting for the largest increase in new customers during 2021. Conversely, podcast ads are the second most expensive way to acquire customers, and are not attracting very many customers.

Conclusion

TMB has had to continuously spend to attract new customers, to replace the customers that are leaving at an alarming rate. Its rate of losing customers may be too high to be able to sustain this approach. The company may be better off trying to retain its customers rather than spending money to continually attract new customers that will leave within a few months.

Based on the above analysis, television is the most expensive, but the most reliable, quarter over quarter. On a per-customer basis, television has the highest acquisition cost, but this media seems to be very effective in attracting new customers. Spending on podcasts should be eliminated, since this is a marketing channel that does not appear to attract new customers. The social media channel is an inexpensive method, as are the customer referrals, and should be kept. The discounts are expensive and, although they worked for December, these should be monitored to see how sustainable these growth rates have been in 2022, and how long these new customers stay. If these new customers were only attracted by the low price, and then leave after their two deliveries, another marketing initiative that will attract and retain target customers could be more cost effective.

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

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

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

Reaching competence – The candidate attempts to comment on sales per customer, customer retention, or the marketing initiatives used.

Competent – The candidate comments on some of sales per customer, customer retention, and the marketing initiatives used.

Competent with distinction – The candidate provides insightful comments on the sales per customer, customer retention, and the marketing initiatives used.

DAY 2 – MARKING GUIDE – ASSURANCE ROLE
TASTY MEAL BASKETS LIMITED (TMB)

To: Frances
From: CPA
Subject: Various matters

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

Assessment Opportunity #7 (Depth Opportunity)
The candidate discusses which geographic regions should be disclosed separately by TMB.
The candidate demonstrates competence in the Assurance role.

CPA Map Technical Competencies:		**Core**	**E3 AS**
1.4.2	Evaluates financial statements including note disclosures	A	A

CPA Map Enabling Competencies:
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Guidance regarding segmented reporting is provided in *IFRS 8 Operating Segments*. According to paragraph 5:

> "*An operating segment is a component of an entity:*
> *(a) that engages in business activities from which it may earn revenues and incur expenses (including revenue and expenses relating to transactions with other components of the same entity),*
> *(b) whose operating results are regularly reviewed by entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and*
> *(c) for which discrete financial information is available.*"

In reviewing the summary available from TMB's accounting software, it is clear that the different regions earn revenues and incur expenses, and it is possible to obtain discrete financial information by region. Additionally, Rita thinks it is now more beneficial to disclose information by region as this is how she normally assesses TMB's financial performance. Therefore, TMB has operating segments.

To determine which operating segments TMB should report information for separately, it is necessary to consider the relevant paragraphs from IFRS 8:

"*11 An entity shall report separately information about each operating segment that:*
(a) has been identified in accordance with paragraphs 5–10 or results from aggregating two or more of those segments in accordance with paragraph 12, and
(b) exceeds the quantitative thresholds in paragraph 13."

Paragraphs 14 to 19 specify other situations in which separate information about an operating segment shall be reported.

Aggregation criteria

"12 Operating segments often exhibit similar long-term financial performance if they have similar economic characteristics. For example, similar long-term average gross margins for two operating segments would be expected if their economic characteristics were similar. Two or more operating segments may be aggregated into a single operating segment if aggregation is consistent with the core principle of this IFRS, the segments have similar economic characteristics, and the segments are similar in each of the following respects:
(a) the nature of the products and services;
(b) the nature of the production processes;
(c) the type or class of customer for their products and services;
(d) the methods used to distribute their products or provide their services; and
(e) if applicable, the nature of the regulatory environment, for example, banking, insurance or public utilities.

13 An entity shall report separately information about an operating segment that meets any of the following quantitative thresholds:
(a) Its reported revenue, including both sales to external customers and intersegment sales or transfers, is 10 per cent or more of the combined revenue, internal and external, of all operating segments.
(b) The absolute amount of its reported profit or loss is 10 per cent or more of the greater, in absolute amount, of (i) the combined reported profit or all operating segments that did not report a loss and (ii) the combined reported loss of all operating segments that reported a loss.
(c) Its assets are 10 per cent or more of the combined assets of all operating segments."

As TMB has operating segments identified in accordance with paragraphs 5 to 10, we therefore go to paragraph 13 to determine if quantitative thresholds are met.

Beginning with revenue, TMB reported total revenue for the year ended December 31, 2021, of $93,931, so the revenue threshold would be $9,393 ($93,931 × 0.1). Based on this threshold, TMB would be required to report separate information regarding the British Columbia, Alberta, Ontario, and Quebec segments.

Before applying the reported profit (loss) threshold, it is necessary to determine 10% of each of the total reported comprehensive incomes and total reported comprehensive losses. The regions that were profitable during the year ended December 31, 2021, reported a total net income of $4,233 ($2,386 + $191 + $631 + $1,025). The regions that suffered losses during the year ended December 31, 2021, reported a total net loss of $903 ($668 + $235). As the total comprehensive income is larger than the total comprehensive loss, the 10% threshold should be calculated, based on the total net income of $4,233, resulting in a threshold of $423 ($4,233 × 0.1). Therefore, based on this threshold, TMB would be required to report separate information regarding British Columbia, Alberta, Ontario, and Quebec.

TMB reported total assets of $28,577 as at December 31, 2021, resulting in a threshold of $2,858 ($28,577 × 0.1). Based on the total assets threshold, TMB would be required to report separate information regarding only British Columbia and Quebec.

As the guidance provided requires that a segment that meets or exceeds any one or more of the thresholds be reported separately, the following summary can be used to make the final determination about the regions for which separate reporting must be provided:

Threshold	**BC**	**AB**	**SK & MB**	**ON**	**QC**	**Atlantic**
Revenue	√	√	X	√	√	X
Reported profit (loss)	√	√	X	√	√	X
Assets	√	X	X	X	√	X

√ Indicates a region for which separate reporting is required
X Indicates a region for which separate reporting is not required

Therefore, TMB should report information separately for British Columbia, Alberta, Ontario, and Quebec. However, before concluding definitively, it is necessary to also consider paragraph 15, which states:

> *"If the total external revenue reported by operating segments constitutes less than 75 per cent of the entity's revenue, additional operating segments shall be identified as reportable segments (even if they do not meet the criteria in paragraph 13) until at least 75 per cent of the entity's revenue is included in reportable segments."*

British Columbia, Alberta, Ontario, and Quebec reported revenue totalling $86,663 ($28,294 + $18,006 + $16,995 + $23,368), or approximately 92% ($86,663/$93,931) of all revenue, which more than satisfies this requirement. Therefore, no additional regions are required to be reported. The regions of Saskatchewan and Manitoba and Atlantic would be reported together as "other," as they do not satisfy any of the thresholds for separate reporting.

Paragraphs 20 to 22 provide additional guidance regarding the information to be disclosed for each reportable segment, as follows:

"*20 An entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates.*

21 To give effect to the principle in paragraph 20, an entity shall disclose the following for each period for which a statement of comprehensive income is presented:

(a) general information as described in paragraph 22;

(b) information about reported segment profit or loss, including specified revenues and expenses included in reported segment profit or loss, segment assets, segment liabilities and the basis of measurement, as described in paragraphs 23-27; and

(c) reconciliations of the totals of segment revenues, reported segment profit or loss, segment assets, segment liabilities and other material segment items to corresponding entity amounts as described in paragraph 28.

22 An entity shall disclose the following general information:

(a) factors used to identify the entity's reportable segments, including the basis of organisation (for example, whether management has chosen to organize the entity around differences in products and services, geographic areas, regulatory environments, or a combination of factors and whether operating segments have been aggregated);

(aa) the judgements made by management in applying the aggregation criteria in paragraph 12. This includes a brief description of the operating segments that have been aggregated in this way and the economic indicators that have been assessed in determining that the aggregated operating segments share similar economic characteristics; and

(b) types of products and services from which each reportable segment derives its revenues."

Further details, including specific line items and other amounts that are to be disclosed for each segment, are provided in paragraph 23.

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

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

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

Reaching competence – The candidate attempts to discuss which geographic regions should be disclosed separately by TMB.

Competent – The candidate discusses which geographic regions should be disclosed separately by TMB.

Competent with distinction – The candidate thoroughly discusses which geographic regions should be disclosed separately by TMB.

Assessment Opportunity #8 (Depth Opportunity)

The candidate recommends audit procedures to be performed for the financial reporting issues, including the disclosure by geographic region.

The candidate demonstrates competence in the Assurance role.

CPA Map Technical Competencies:		**Core**	**E3 AS**
4.3.6	Develops appropriate procedures, including Audit Data Analytics (ADA), based on the identified risk of material misstatement	B	A

CPA Map Enabling Competencies:
6.1.3 Demonstrates skepticism, objectivity, due care and persistence when identifying issues
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

The following audit procedures should be performed for each financial reporting issue, including the disclosure by geographic region.

New Discount Offer

- To develop an understanding of the offer as it relates to revenue recognition, we will need to obtain and read the new marketing offer posted to TMB's website in December. In particular, we should ensure that the requirements for a contract, as described in *IFRS 15 Revenue from Contracts with Customers,* are satisfied (contract has commercial substance, parties have approved the contract, each party's rights can be identified, payment terms have been specified, and collection of the consideration by TMB is probable). We will need to pay particular attention to the selling price of the first meal kit, and the discount to be offered on the subsequent meal kit. Based on our understanding of the offer, we should satisfy ourselves that the first meal kit and subsequent discounted meal kit to be provided in the next 30 days represent separate performance obligations. We should then reperform the allocation of the total transaction price to the separate performance obligations, to verify the accuracy of the revenue to be recognized.
- For a sample of the 10,000 meal kit sales, we should agree the sale to supporting documentation that the customer has entered into the transaction, such as an email confirmation sent to TMB's customers, and check the date to confirm that it was during the offer period. Additionally, we should vouch the customer payments to TMB's bank account or bank statements.
- We should request confirmation from TMB's shipping company of a sample of deliveries made in December, covering both the 10,000 first meal kits and 3,000 second meal kits. Given that the control of the meal kit passes to the customer at the time of delivery, we can then recalculate the revenue to be recognized, based on the meal kits delivered and the prices of the two kits, to verify the occurrence and accuracy of the reported revenue.

Chef Arlene Contract

- To determine whether the contract contains elements that meet the definition of an intangible asset:
  - We should obtain and read the full, signed agreement between Chef Arlene and TMB to obtain an understanding of the terms. In particular, we will need to confirm that Chef Arlene has agreed to not sell the rights to her recipes to other meal kit companies, to demonstrate that there is an intangible asset that is identifiable, and that TMB has control over the future benefits associated with Chef Arlene's recipes.
  - To determine whether there is future economic benefit, we should request from management a listing of the sales of meal kits that include Chef Arlene's recipes to date. We should select a sample of these meal kit sales and vouch back to supporting documentation, such as proof of payment. In addition, we should obtain management's future sales forecast, to establish the future benefits. The assumptions used to build the forecast will need to be corroborated by agreeing amounts to supporting documentation. For example, for future sales growth, we can examine industry trends, and historical growth of TMB sales.
- We should also confirm that, according to the agreement, TMB paid $400,000 to Chef Arlene, to verify the accuracy of the amount of the intangible asset and vouch the payment made to the bank statement.

- We should obtain evidence to support the value of the two components of the Chef Arlene contract (brand name and recipes). This could be a valuation report obtained from a qualified expert, for example, or industry reports available to support the value of recipes from a chef with similar status.
- We should discuss with management the length of time over which it expects to sell meal kits that include Chef Arlene's original recipes and are branded with her name, to assess the reasonability of the five-year useful life of the intangible asset. We should corroborate this assertion with evidence, such as management meeting minutes regarding future plans, etc. We should then recalculate the amortization of the intangible asset to verify the accuracy of accumulated amortization as at December 31, 2021, and amortization expense for the year ended December 31, 2021.

Renovation of Fulfillment Centre

- We should tour TMB's renovated fulfillment centre to confirm the existence of the centre itself and the renovations performed. We should also observe the individual parts of the building at the Montreal fulfillment centre, to satisfy ourselves as to the allocation of the total cost of the various components, particularly for the air filtration system, which is new in 2021.
- For the amounts spent that qualify for recognition as an asset or component thereof, we should vouch the additions to the building and its various components to the supporting documentation and bank statements, to verify the existence of the asset and accuracy of the amount. For example:
  - For amounts paid to external parties for heating and cooling system, roof, internal walls and floors, we should agree the amounts to invoices and review the description of the item, to ensure that it is capital in nature.
  - For employee wages and benefits, we should agree the employees' hourly wage rates to their employment contracts, hours worked on the internal walls to the employee time cards or other payroll records, and employee benefits as a percentage of wages to prior periods. Also, we should discuss with the project manager to ensure that these employees did in fact work on the fulfillment centre. We should then recalculate the employment wages and benefits, to assess the accuracy of the $600,000.
  - For the disposal costs, we should vouch the amounts to the related invoices.
- For the amounts spent that should instead be recognized as expenses, we should vouch the expenses to the supporting documentation and bank statements, to verify the accuracy of the amounts. For example:
  - For the amount spent on brick replacements, we should vouch the amount to supporting documentation, such as an invoice.
  - For the cost of relocating the equipment, if the relocation was performed by TMB's own employees, we would perform procedures similar to those performed for the work that employees did on the internal walls. If the work was contracted out, we should vouch the costs to the invoice received from the contractor.
  - For the additional cost to replace the damaged floor, we should vouch the cost to the contract with the supplier.

- For the insurance proceeds received, we should request any communications TMB has received from the insurer, and examine these communications, to verify the accuracy of the amount.

Reporting of Operating Segments

- We should discuss with Rita how she makes decisions regarding allocating resources and assessing TMB's performance, to satisfy ourselves that operating segments should be based on geographic regions rather than by line of business. Additionally, we should examine the management reports produced in 2021 for evidence that they are based on regions rather than on lines of business.
- We should verify that the amount of the revenues, expenses, and assets by region according to TMB's accounting system is correct. For example, for revenues and expenses, we could select a sample of meal kit sales to customers and, using the delivery address in the customers' profiles and/or proof of delivery from the delivery company, verify that the amount has been recorded in the correct region. We can then reperform the calculations of the quantitative thresholds, to ensure their accuracy, as well as the determination of regions for which information should be separately reported according to each threshold and on an overall basis, to ensure that the note disclosures are properly classified and presented. For assets, we could select a sample of assets and vouch to supporting invoices to see where the assets were delivered, or visit the offices in the regions to physically observe that the assets are there.

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

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

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

Reaching competence – The candidate recommends some audit procedures for the financial reporting issues.

Competent – The candidate recommends several audit procedures for the financial reporting issues.

Competent with distinction – The candidate recommends many audit procedures for the financial reporting issues.

Assessment Opportunity #9 (Depth Opportunity)

The candidate provides recommendations that can be implemented for similar system conversions in the future, and discusses issues identified in the converted sales system data.

The candidate demonstrates competence in the Assurance role.

CPA Map Technical Competencies:		Core	E3 AS
4.1.2	Evaluates the information system, including the related processes, using knowledge of data requirements and risk exposures	B	A
4.3.7	Performs the work plan	B	A
4.3.8	Evaluates the evidence and results of analysis	B	A

CPA Map Enabling Competencies:
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems
6.1.3 Demonstrates skepticism, objectivity, due care and persistence when identifying issues
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Recommendations for Future System Conversions

The following are recommended for any future system conversions.

Reconciliations performed after conversion

While it was appropriate to agree the total customer accounts and sales in PVM's system to those in TMB's system following the conversion, the work performed was insufficient for ensuring the accuracy of customer profiles and historical sales data. Based on an examination of the daily sales report for Nanaimo, there were several instances in which the customer profiles appeared to be inaccurate and/or incomplete (see below). It is reasonable to assume that TMB's system is functioning properly, since it has been used and the data issues identified in the sales report for Nanaimo were from before the conversion date. Therefore, it is likely that the conversion has not transferred the data properly. For future system conversions, we recommend that not only the total sales amount should be agreed, but TMB should also agree the details in individual customer accounts from the old system to the new system, post conversion. For example, a hash total could be calculated for customer credit card numbers, to verify the accuracy of the conversion of the information in the customer profiles. Ideally, this process would be automated, such that 100% of the details could be verified, but this could be done on a sample basis, should TMB not have the tools to automate the comparison. All details should be compared between the two systems (customer address, status, credit card number and expiry date, etc.). This would also enable TMB to ensure that there were no offsetting errors in the data converted.

Running of parallel systems

The conversion of PVM's sales system was completed on December 25, with the system shut down immediately thereafter. While TMB's system is likely reliable, as it is currently being used, this is not always the case, and running systems in parallel helps to ensure that the new system is working appropriately, by reconciling information between the old and new systems. It is also helpful to maintain the old system for some time so that employees can look back at historical information, should the new system contain inaccurate data. Therefore, should TMB perform future system conversions, we recommend that the systems be run in parallel for a reasonable period of time post conversion. This would allow TMB to compare the data produced by both systems and investigate any discrepancies prior to shutting down the system of the acquired company. For example, for a future conversion of sales data, it would be important to run the system in parallel and then compare sales by customer as they are occurring (to ensure that there are no offsetting errors), so that any discrepancies are resolved without negatively impacting the customer experience.

Increased IT resources

Based on the comments made by TMB's IT manager, it appears that the conversion of the PVM system was under-resourced, given that he did not have time to complete additional testing. The concerns noted, based on the examination of the daily sales report for Nanaimo, could result in an inability to take orders from customers post conversion, customer dissatisfaction, etc. Therefore, given TMB's plans to grow by acquisition, we recommend that the IT manager be placed in charge of the future conversions, with sufficient human resources to backfill his other job responsibilities. Doing so would make it possible to use test data in order to perform user acceptance testing in advance, so that any errors can be addressed prior to the conversion of actual data.

Timing

The conversion of PVM's sales system was completed on December 25, at 12:00 am. With December 25 being a statutory holiday, there is a chance that this date was selected because the sales volume was expected to be lower on that date. However, the risk with this timing is that TMB likely had very few employees working on December 25; therefore, staff would not be available to address any issues that might arise during the conversion process. For future conversions, TMB should select a date when support staff will be available to address any concerns, while also considering a time that will not cause significant interruption to customers and operations.

Issues in the Converted Sales System Data

Based on my examination of the daily sales report for Nanaimo, I noted the following issues in the sales system data:

- Although the sales report is clearly labelled as being related only to sales of meal kits to customers located in Nanaimo, BC, the report includes customers living in Salmon Arm, BC (Ling Kwok), and Kelowna, BC (Jung Yang). These are different cities, so it appears that there are errors in the customer account profiles or in the settings for the report. Alternatively, as it is not clear from the sales data report whether the address represents the address associated with the credit card or the delivery address, it is possible that a customer ordered a meal kit for someone located in another city.
- There is an instance (Anup Misra) in which the customer address information is incomplete (missing street addresses). These omissions could be problematic if, in future, the delivery company cannot locate the customer's home, which could result in spoiled meal kits and/or dissatisfied customers.
- There is one instance (Deepa Jain) in which the credit card expiry date is missing, and another (Yazhu Chen) for which the credit card had already expired at the date of the sale. Either these orders went through and the credit cards were valid at that time, in which case the conversion likely did not capture the correct data for these customers, or the old system had a glitch whereby expired/missing credit cards still allowed for a sale to be made and TMB would not be paid for the orders.

- A review of the status column in the sales report revealed that meal kits were sold to a customer (Sung Jeong) with an “inactive” account. There was a credit card number on file and the transaction date was December 24, 2021, so the customer would have been charged for the meal kit. If the customer is, in fact, active, as ordering meal kits would suggest, there are further concerns about the accuracy of the daily sales report.
  According to the daily sales report, there was both a sale and a reversal of a meal kit for one customer (Chris Denver) on December 24, 2021. While this could be legitimate if an order was placed and subsequently cancelled, the negative amount could also indicate errors in the daily sales report.
- There was one customer (Rebecca Hodges) for which there were two meal kits sold on the same day. It is not impossible (for example, a customer could have a larger-than-average family), but unlikely that a customer would order two meal kits at the same time, suggesting that the report produced by TMB’s system may be inaccurate. There are also different addresses for these meal kit sales. While the different addresses may be correct, if Rebecca sometimes accepts deliveries of meal kits at home and other times at work, or if she has ordered for her own family and others at the same time, the different addresses make it less likely that she ordered two meal kits delivered to different addresses on the same day. Therefore, we will need to investigate further, to determine whether the duplicate transactions are correct or in error.
- There are two customers (Yazhu Chen and Tohru Izumi) who have the same address. While it is plausible that they live together and the daily sales report is accurate, it is also possible that the duplicate addresses suggest that the report is in error.

These concerns should be investigated immediately, so that any errors can be corrected before the customer experience is negatively impacted.

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

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

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

Reaching competence – The candidate provides some recommendations that can be implemented for similar system conversions in the future, or discusses some issues identified in the converted sales system data.

Competent – The candidate provides some recommendations that can be implemented for similar system conversions in the future, and discusses some issues identified in the converted sales system data.

Competent with distinction – The candidate provides several recommendations that can be implemented for similar system conversions in the future, and discusses several issues identified in the converted sales system data.

Assessment Opportunity #10 (Depth Opportunity) The candidate recommends due diligence procedures to minimize the risks related to the proposed acquisition of Sweet Tooth Ltd. *The candidate demonstrates competence in the Assurance role.*

CPA Map Technical Competencies:		**Core**	**E3 AS**
4.3.5	Assesses the risks of the project, or, for audit engagements, assesses the risks of material misstatement at the financial statement level and at the assertion level for classes of transactions, account balances, and disclosures	B	A
4.3.6	Develops appropriate procedures, including Audit Data Analytics (ADA), based on the identified risk of material misstatement	B	A

CPA Map Enabling Competencies: *6.1.3 Demonstrates skepticism, objectivity, due care and persistence when identifying issues* *6.2.1 Maintains an objective and questioning mindset to avoid biased analyses* *6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives* *6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions*

Due diligence involves going beyond the summary financial statements provided by the CFO of Sweet Tooth Ltd. (STL), prior to entering into an agreement to purchase 100% of STL's common shares. Although there are some similarities between the procedures that would be performed in a financial statement audit and a due diligence engagement, there are also differences. For a due diligence engagement, the focus of the procedures should be on the following:

- Ownership of the assets recognized on the balance sheet
- Completeness of STL's liabilities, both recognized and unrecognized
- Valuation of STL's assets and liabilities at fair values rather than carrying amounts, which are not relevant to TMB
- Sustainability of STL's financial performance post acquisition

To minimize the risks related to the proposed acquisition, I recommend performing the following due diligence procedures:

- A bank confirmation should be sent, to establish the existence of the cash balance, completeness of the bank loan payable, and accuracy of both accounts. In addition, the bank confirmation will also provide other details that may be relevant to TMB's decision about the proposed acquisition, including any assets pledged as security for the bank loan and the related interest rate, covenants, and repayment terms.

- Similarly, accounts receivable confirmations should be sent to a sample of STL's customers, to verify the existence and accuracy of the customer accounts. Valuation should be tested by examining receipts subsequent to December 31, 2021. We should obtain the January and February bank statements to see if the accounts receivable as at December 31 have been settled, by comparing them to deposits received. This would assess the collectability of outstanding accounts as at the date of the summary financial statements, to ensure that they are not valued at more than their fair value.
- We should perform an inventory count, with both sheet to floor and floor to sheet counts conducted, to establish that the inventories (raw materials, work in process, and finished goods) are complete and exist. Roll-back procedures will also be needed, to determine the inventory balance at December 31, 2021, as it is now after year-end. When counting the inventory, we should take note of the expiry dates for ingredients, and dates on which the desserts were prepared and/or best-before dates, to ensure that the inventories remain usable/salable, to support the valuation on the balance sheet. Additionally, the cost of completed desserts should be compared to recent selling prices, to ensure that the inventory is valued at its fair value for the purposes of assessing the proposed acquisition.
- We should tour STL's facilities, to establish the existence of property, plant, and equipment included on STL's property, plant, and equipment schedule. We should look for specific evidence of the age and condition of these assets, such as whether the assets have information about date of assembly, etc. An expert may have to be engaged to help assess this. Further, we should request a copy of STL's insurance policy, including the schedule of property, plant, and equipment assets insured, to establish ownership, given that STL is unlikely to incur premiums for insuring assets that it does not own. We should also request any recent appraisals that have been performed on STL's property, plant, and equipment, or if appraisals have not been performed recently, we should arrange to have appraisals performed, to establish their fair value and expected remaining useful life, especially for significant assets.
- Although STL has not recognized any intangible assets on its balance sheet, it is possible that there are unrecognized intangible assets, including customer lists, supplier contracts, and dessert recipes. Therefore, we should discuss with management whether these items exist, to establish the existence of any intangible assets. We should then request forward-looking financial information prepared by STL, and audit the information, so that we can establish the fair values of any unrecognized assets, using a technique such as discounted cash flow analysis or a market-based approach.
- Accounts payable confirmations should be sent to STL's suppliers, including those with \$0 balances, to verify the completeness and accuracy of its accounts payable. Additionally, we should perform a search for unrecorded liabilities, to gain further comfort as to the completeness of liabilities. This would involve selecting a sample of payment transactions after December 31, 2021, and comparing the payments to supporting documentation, such as the supplier invoices, to determine whether they were accounted for in the correct period and if there were additional liabilities that should have been recognized as at December 31, 2021. This would also involve looking for any unrecorded invoices.
- We should request access to, and examine, STL's corporate income tax and GST/HST returns and related notices of assessment/reassessment, to verify the completeness and accuracy of any tax-related liabilities.

- We should request and review the bank loan agreement. We should also calculate the present value of the future cash flows associated with the bank loan payable, based on a current market rate of interest, to establish the fair value of this liability, given that it is not due until December 31, 2026.
- We should request and examine recent legal invoices, for evidence of any unrecognized contingent liabilities and their amounts. Additionally, we should contact STL's legal counsel, to request information about any legal actions against STL.
- For a sample of sales, we should agree the sale to the invoice and shipping documents to confirm the amount of the sale and that the customer received the goods.
- The second largest expense on STL's income statement is "other," after cost of goods sold. Therefore, TMB should request a breakdown of the "other" expense account and review the description of items, to assess whether the expenses are valid business expenses or are personal expenses of the owners.
- We should review a sample of employee contracts, to ensure that there are no unrecorded liabilities, such as pension plan costs or vacation pay.
- We should request a list of customers from STL. Based on that customer list, STL should confirm the terms of any contracts directly with major customers, to establish the sustainability of its revenue and gain an awareness of the terms, including any refund provisions. Similarly, we should request a list of STL's suppliers and confirm the terms of any contracts directly with its major suppliers, to gain an understanding of its cost structure and the impacts on profitability. This would also provide evidence of any significant future commitments that would impact STL's financial position and performance on a go forward basis.
- Given that STL is a privately-owned corporation, we should examine the accounting records for evidence of any personal expenses that have been included in the accounts in error, and that will not represent future expenses. Similarly, we should assess whether the total management compensation (salary, dividends, etc.) is consistent with expected salaries and wages on a go forward basis, as any differences would affect the sustainability of STL's financial performance.

It is also important to note that the financial statements include only current-year balances. TMB should therefore request a full set of financial statements (income statement, statement of retained earnings, balance sheet, and cash flow statement), that includes comparative numbers for at least the 2020 year end, in order to identify trends and risks that should be investigated further. In addition, there are procedures that will have to be performed for the period between December 31, 2021, and March 15, 2022, as that is the effective date of the purchase, in case there are significant changes in financial position during that time.

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

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

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

Reaching competence – The candidate recommends some due diligence procedures.

Competent – The candidate recommends several due diligence procedures.

Competent with distinction – The candidate recommends many due diligences procedures.

Assessment Opportunity #11 (Depth Opportunity)

The candidate discusses weaknesses in STL's production processes, and recommends additional controls that TMB should implement, to ensure that STL's nut-free products are nut-free.

The candidate demonstrates competence in the Assurance role.

CPA Map Technical Competencies:		Core	E3 AS
4.1.1	Assesses the entity's risk assessment processes	A	A

CPA Map Enabling Competencies:
6.1.3 Demonstrates skepticism, objectivity, due care and persistence when identifying issues
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Based on Rita's meeting with STL's head baker, there are several internal controls that TMB should implement if it proceeds with the nut-free desserts.

Production Line Proximity

Weakness: Once the new production line is introduced, STL's two production lines will be located in the same bakery environment and in close proximity to one another.

Implication: Given the proximity of the production lines, it is possible for cross contamination to occur, particularly when high-pressure spray washing is used to clean the lines between shifts. The spraying could cause nut particles to become airborne and affect the nut-free production line. At a minimum, this would require a further shutdown, and costs to deep clean the line prior to reopening it for nut-free production.

Recommendation: If possible, STL should reconfigure its bakery in order to separate the production lines. If this is not possible, it should install barriers between the production lines, to minimize the risk of cross contamination. Further, it should investigate cleaning techniques other than high-pressure spraying.

Sharing of Staff and Equipment/Utensils

Weakness: Baking staff are expected to move back and forth between the production lines, baking desserts that include nuts and desserts that are nut-free. Similarly, baking equipment and utensils will also be alternated between production lines, based on product volumes.

Implication: As baking staff move back and forth between production lines, it is possible for cross contamination of lines to occur, should nut particles be transported on a uniform or the hands of baking staff. The same is true for any baking equipment and utensils that are moved between production lines. This could result in the need to discard desserts that are contaminated, so that individuals consuming the desserts do not suffer allergic reactions.

Recommendation: STL should plan for fluctuating production volumes when scheduling its baking staff, so that it is not necessary to move these individuals back and forth between production lines. When doing so is not possible, or there are unexpected changes in volumes, baking staff should be required to practice proper hand hygiene prior to moving from the production line where nuts are being used to the nut-free production line, to minimize the risk of cross contamination. At a minimum, baking equipment and utensils should be cleaned thoroughly before they are shifted between production lines. Preferably (given the relatively low cost associated with doing so), STL should purchase sufficient baking equipment and utensils for each production line, with these items colour coded, so there is never any crossover between production lines.

Written Confirmations

Weakness: STL plans to accept written confirmation from new suppliers that ingredients are nut-free; however, it does not appear that this confirmation is verified.

Implication: As there is no verification, new suppliers could provide written confirmation regarding the nut-free status of their ingredients even if that is not really the case. This could result in STL purchasing ingredients that contain nuts and unknowingly incorporating those ingredients into its desserts. Should individuals who consume STL's desserts suffer from serious health consequences, including anaphylaxis and death, this could negatively impact STL's reputation and the viability of the business, as customers are unlikely to order from STL following such an incident.

Recommendation: STL should implement additional processes to ensure that the ingredients purchased from suppliers are nut-free. This could include verifying with any industry associations whether the supplier has been certified as nut-free. Alternatively, when ingredients are received at STL, they could be tested to ensure that they are nut-free, and placed on hold until confirmation of their nut-free status is received. Finally, STL should require these verifications from suppliers on at least an annual basis, not only before the first delivery, as supplier processes may change over time.

Ingredient Storage

Weakness: When received from suppliers, STL will place ingredients that contain nuts, and nut-free ingredients, in the same ingredient storage room and walk-in refrigerator, even though, other than a notation that certain ingredients are nut-free, the packaging for nut-free ingredients and ingredients containing nuts is identical.

Implication: By placing ingredients in the same ingredient storage area and walk-in refrigerator, when the packaging is identical other than the notation that certain ingredients are nut-free, it is possible that ingredients could be used in the wrong production line. For example, the baking staff could intend to source nut-free ingredients, but instead select ingredients containing nuts, since the packaging is similar. This would result in the contamination of desserts, that would then either need to be sold as containing nuts or discarded. In addition, if packaging gets damaged or bags of ingredients are left open in the same storage area, there is a risk of particles from the ingredients containing nuts contaminating the nut-free ingredients.

Recommendation: STL should construct separate ingredient storage areas for ingredients that contain nuts and those that are nut-free, to reduce the risk of cross-contamination and reduce the risk that baking staff bring incorrect ingredients into a production line. Similarly, STL should acquire an additional walk-in refrigerator that can be dedicated to nut-free ingredients, with the original refrigerator dedicated to ingredients that contain nuts. Alternatively, STL could request that ingredient suppliers modify their packaging so that it differs between ingredients containing nuts and those that are nut-free.

Dessert Cooling

Weakness: Desserts are not labelled as containing nuts or being nut-free until after they have cooled and are packaged.

Implication: Without immediately labelling desserts as containing nuts or being nut-free after they come off the production line, there is a risk that the desserts will be comingled without detection. This could result in customers with nut allergies consuming desserts containing nuts and suffering adverse health consequences.

Recommendation: If not already part of its plans, STL should ensure that there is an area linked to each of its two production lines, where desserts can be cooled prior to being packaged and labelled as containing nuts or being nut-free. An alternative solution would be to have different coloured baking pans or equipment, to visually identify desserts containing nuts or being nut-free. Additionally, the head baker should perform a visual inspection of all desserts for evidence of nuts and, for a sample of desserts ready to be packaged and labelled, the head baker should test to ensure that desserts to be labelled as nut-free are, in fact, nut-free.

Staff Training

Weakness: STL intends to educate its baking staff about the seriousness of the reactions for those suffering from nut allergies, and the importance of keeping ingredients and desserts containing nuts separate from those that are nut-free, only as part of employee orientation at their initial hiring.

Implication: The longer that baking staff work with STL, the more likely it is that they will forget some of what they learned about nut allergies during their employee orientation, or will become complacent with respect to following safety measures that are in place in the bakery. This could result in desserts that are supposed to be nut-free reaching consumers, who then suffer allergic reactions.

Recommendation: STL should require its baking staff to attend safety training on at least an annual basis. Further, as part of its performance evaluation process, STL should consider the extent to which baking staff comply with safety protocols, and any violations should be treated seriously.

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

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

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

Reaching competence – The candidate discusses some weaknesses and recommends additional controls TMB should implement, to ensure that STL's nut-free products are nut-free.

Competent – The candidate discusses several weaknesses and recommends additional controls TMB should implement, to ensure that STL's nut-free products are nut-free.

Competent with distinction – The candidate discusses most of the weaknesses and recommends additional controls TMB should implement, to ensure that STL's nut-free products are nut-free.

Assessment Opportunity #12 (Depth Opportunity)

The candidate recommends audit procedures to ensure compliance with the requirements set out in the supplier contract.

The candidate demonstrates competence in the Assurance role.

CPA Map Technical Competencies:		**Core**	**E3 AS**
4.3.6	Develops appropriate procedures, including Audit Data Analytics (ADA), based on the identified risk of material misstatement	B	A

CPA Map Enabling Competencies:
6.1.3 Demonstrates skepticism, objectivity, due care and persistence when identifying issues
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

For each of the requirements included in the supplier contract with All Things Green Inc. (ATG), I recommend performing the following procedures:

- To ensure that greens were grown on ATG's farm and were not purchased from other farms, we should inquire of ATG's management and staff about whether all greens were grown on the farm, and about any exceptions (such as in the case of a crop failure). We should also examine ATG's accounting records to ensure that there is no evidence that purchases of greens were made from other farms, and for any purchases from farms, obtain and inspect the invoice, to ensure that the purchase was not for greens.
- To ensure that universal bar codes have been attached to packaged greens, which, when scanned, indicate that the greens were grown by ATG and provide the date and time harvested and best-before date, we should discuss the bar-coding process with management and staff. We should attend the farm when greens are being harvested, pre-washed, packaged, and bar coded. We should select a sample of packaged greens and scan the bar codes, to ensure that the details are correct, including that the date harvested is the current date.
- To ensure that greens have been certified to Canadian Organic Standards by a verification body designated by the Canadian Food Inspection Agency, we should examine the certification documents provided to ATG. In doing so, we should take note of the verification body, to ensure that it has been designated by the Canadian Food Inspection Agency on its website, and that the date of certification was recent. Alternatively, we could request confirmation of ATG's certification directly from the verification body.

- To ensure that greens have been pre-washed in chlorinated water to remove contaminants and insects after harvest, we should make inquiries of ATG's management and staff regarding pre-washing procedures. We should also tour the farm, to confirm the presence of a wash station, and test the water to ensure that there is chlorine in it. Other procedures we could perform include examining records that ATG maintains regarding pre-washing, to ensure that this occurs every time greens are harvested, or testing packaged greens for traces of chlorine.
- To ensure that bar-coded greens are placed in a temperature-controlled storage facility until they are shipped to TMB, we should visit the farm and tour the storage facility. We should request access to the temperature reports and examine the reports for any automated alerts, for any exceptions to the temperature range of 1°C to 4°C. We should then discuss those exceptions with ATG's management and staff. Also, we should use our own thermometer to take the temperature of the storage facility and compare this to the current reading of the system, to verify that the temperature per the system is accurate.

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

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

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

Reaching competence – The candidate recommends some audit procedures to ensure compliance with the requirements set out in the supplier contract.

Competent – The candidate recommends several audit procedures to ensure compliance with the requirements set out in the supplier contract.

Competent with distinction – The candidate recommends many audit procedures to ensure compliance with the requirements set out in the supplier contract.

Assessment Opportunity #13 (Depth Opportunity)

The candidate identifies which material account balances would likely be included in the key audit matters section of the auditors' report, and explains why.

The candidate demonstrates competence in the Assurance role.

CPA Map Technical Competencies:		**Core**	**E3 AS**
4.3.4	Assesses materiality for the assurance engagement or project	B	A
4.3.10	Draws conclusions and communicates results	B	A

CPA Map Enabling Competencies:
6.1.1 Identifies and articulates issues within areas of work responsibility
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.3 Applies decision criteria to choose among viable alternatives

CAS 701 Communicating Key Audit Matters in the Independent Auditor's Report provides guidance regarding inclusion of key audit matters in the auditor's report.

According to paragraph 2:

> "*The purpose of communicating key audit matters is to enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed. Communicating key audit matters provides additional information to intended users of the financial statements ("intended users") to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Communicating key audit matters may also assist intended users in understanding the entity and areas of significant management judgment in the audited financial statements.*"

Given that TMB is listed on the TSX, paragraph C6 (a) requires that the external auditor include key audit matters in the auditor's report for periods ending on or after December 15, 2020, so this requirement would apply to the 2021 year-end financial statements.

Paragraph 9 provides the following guidance regarding determining key audit matters:

> "*The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:*
> *(a) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with CAS 315.*
> *(b) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that are subject to a high degree of estimation uncertainty.*
> *(c) The effect on the audit of significant events or transactions that occurred during the period.*"

In addition, per paragraph A29:

> *"A29 Other considerations that may be relevant to determining the relative significance of a matter communicated with those charged with governance and whether such a matter is a key audit matter include:*
> - *The importance of the matter to intended users' understanding of the financial statements as a whole, in particular, its materiality to the financial statements.*

- *The nature of the underlying accounting policy relating to the matter or the complexity or subjectivity involved in management's selection of an appropriate policy compared to other entities within its industry.*
- *The nature and materiality, quantitatively or qualitatively, of corrected and accumulated uncorrected misstatements due to fraud or error related to the matter, if any.*
- *The nature and extent of audit effort needed to address the matter, including:*
  - o *The extent of specialized skill or knowledge needed to apply audit procedures to address the matter or evaluate the results of those procedures, if any.*
  - o *The nature of consultations outside the engagement team regarding the matter.*
- *The nature and severity of difficulties in applying audit procedures, evaluating the results of those procedures, and obtaining relevant and reliable evidence on which to base the auditor's opinion, in particular as the auditor's judgments become more subjective.*
- *The severity of any control deficiencies identified relevant to the matter.*
- *Whether the matter involved a number of separate, but related, auditing considerations. For example, long-term contracts may involve significant auditor attention with respect to revenue recognition, litigation or other contingencies, and may have an effect on other accounting estimates."*

Based on the guidance provided in CAS 320 Materiality in Planning and Performing an Audit, paragraph A5:

> *"Examples of benchmarks that may be appropriate, depending on the circumstances of the entity, include categories of reported income such as profit before tax, total revenue, gross profit and total expenses, total equity or net asset value. Profit before tax from continuing operations is often used for profit-oriented entities…."*

As a profit-oriented entity, materiality for TMB would normally be equal to 5% of its income before income taxes. This calculation is as follows:

Income before taxes	$ 4,560,000
Adjustments for accounting errors:	
Reduction in revenue related to new discount offer	(110,880)
Amortization of rights of Chef Arlene's recipes	(46,666)
Costs related to fulfillment centre capitalized in error	(310,000)
Potential 2021 depreciation not taken	????
Corrected income before taxes	4,092,454
	× 5%
Materiality	$ 204,623

Therefore, the following are the material account balances for which a key audit matter could be included in the auditor's report, and why.

Revenue Recognition

Revenue from the sale of meal kits is material to the financial statements. According to *CAS 240 The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements,* paragraph 27:

> *"When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks."*

Even before considering the unique aspects of TMB's business, revenue recognition would normally have a higher assessed risk of material misstatement due to the presumption of fraud, which would require a higher level of audit effort. In the case of TMB, revenue recognition for the sale of restaurant meals is straightforward, since control of the meals passes to the customer at the time of dining. However, due to the discounts that are prevalent in the meal-kit industry and the new discount offer available on TMB's website in December, the determination as to when to recognize revenue from the sale of meal kits has a higher risk of material misstatement. Also, the error identified previously in the recognition of revenue associated with the new discount offer further supports the increased risk of material misstatement.

The external auditor is therefore likely to include a key audit matter in the auditor's report regarding the recognition of revenue from the sale of meal kits.

Intangible Assets and Goodwill

Other material account balances that should be considered for inclusion as key audit matters are TMB's intangible assets and goodwill.

During the year ended December 31, 2021, there was an increase in intangible assets of approximately $169,000, which is close to materiality. This balance consists of computer software, brand and customer lists, and the Chef Arlene contract. Since, as a publicly-traded company, TMB may have an incentive to capitalize amounts that should instead be expensed, to meet analyst expectations and attract the investors that will be necessary to fund its strategy to grow by acquisition, there is a higher risk of material misstatement regarding these amounts. Therefore, management and the external auditor must exercise significant judgment, to determine whether the criteria for the recognition of purchased intangible assets have been satisfied.

Regarding both the intangible assets and goodwill, there is also a higher risk of material misstatement related to valuation, which again would require more audit effort. The determination of whether these assets have indefinite or finite useful lives may not be straightforward. Similarly, there is a high degree of estimation uncertainty regarding the useful lives of those assets that have finite useful lives. Lastly, intangible assets and goodwill may be more subject to impairment losses than other assets. Developing the estimates of the value in use, and fair value less selling costs, for these assets will again require considerable judgment on the part of management and the external auditor, and involve estimation uncertainty.

Due to the factors above, the external auditors are likely to include this as a key audit matter in the auditor’s report.

Property, Plant, and Equipment

Property, plant, and equipment (PP&E) would also be considered for inclusion as a key audit matter.

During the year ended December 31, 2021, the fulfillment centre in Montreal was renovated to upgrade the building and equipment. The renovations resulted in net additions to PP&E of $3,490,000, which is greater than materiality. Since, as a publicly-traded company, TMB may have an incentive to capitalize amounts that should instead be expensed, to meet analyst expectations and attract the investors that will be necessary to fund its strategy to grow by acquisition, there is a higher risk of material misstatement regarding these amounts. Also, there was a material error of $310,000 identified in the capitalization of the renovation costs. Therefore, management and the external auditor must exercise significant judgment to determine whether the criteria for the recognition of capital assets have been satisfied.

Furthermore, the renovation of the fulfillment centre would likely meet the definition of a key audit matter, per CAS 701, paragraph 9(c). Given that TMB only has two fulfillment centres, the renovation of one would likely be deemed a significant event.

Due to the factors above, the external auditors are likely to include this as a key audit matter in the auditor’s report.

Income Taxes

Income taxes are commonly included as a key audit matter in an entity's auditor's report, given that accounting estimates are required to determine deferred tax balances, and audit teams often require the assistance of an income tax expert to obtain sufficient, appropriate audit evidence. Therefore, TMB's external auditor should also consider the balances related to income taxes (income tax expense, current income taxes payable, and deferred income tax liability) for inclusion as a key audit matter, given that they are material. However, the risk of material misstatement related to these balances would likely be assessed as low to moderate for TMB. For example, the deferred income tax liability is likely the result of temporary differences between the carrying amounts of TMB's property, plant, and equipment and intangible assets for accounting purposes, and the undepreciated capital cost balances for income tax purposes. This is routine and would not require significant judgment. Therefore, it is unlikely that the external auditors would include a key audit matter in the auditor's report related to TMB's income tax balances.

Other

Although there are numerous other material account balances, there is no information to suggest a higher risk of material misstatement or significant judgment or estimation uncertainty that would warrant the inclusion of a key audit matter in the auditor's report.

For Assessment Opportunity #13 (Assurance), the candidate must be ranked in one of the following five categories:

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

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

Reaching competence – The candidate attempts to discuss which material account balances would likely be included in the key audit matters section of the auditor's report.

Competent – The candidate discusses which material account balances would likely be included in the key audit matters section of the auditor's report.

Competent with distinction – The candidate thoroughly discusses which material account balances would likely be included in the key audit matters section of the auditor's report.

DAY 2 – MARKING GUIDE – FINANCE ROLE
TASTY MEAL BASKETS LIMITED (TMB)

To: Ara
From: CPA
Subject: Various matters

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

Assessment Opportunity #7(Depth Opportunity)
The candidate analyzes the capital budgeting decision about purchasing the new packaging equipment for the Montreal fulfillment centre.
The candidate demonstrates competence in the Finance role.

CPA Map Technical Competencies:		**Core**	**E2 FIN**
5.3.1	Develops or evaluates capital budgeting processes and decisions	B	A

CPA Map Enabling Competencies:
5.1.1 Applies general business knowledge to enhance work performed
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.3 Questions the relevance and tests the quality of information and assumptions in own analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

The company needs to decide whether to order new packaging equipment at the Montreal fulfillment centre.

Below is a capital budgeting analysis using the net present value (NPV) method. A qualitative discussion of the decision follows.

The $11,200 spent in travel costs to meet with the manufacturer is a sunk cost and has therefore been ignored in the analysis.

I have not considered the manufacturer's referral bonus as its realization is uncertain, although it represents potential upside. The government rebate for the carbon incentive has also been excluded as it has not yet passed, which indicates that its receipt is uncertain.

The $85,300 of allocated plant overhead is not an incremental cash flow and is therefore excluded from the NPV calculation.

Purpose: To determine whether to purchase packaging equipment

Tax rate	27%	
Discount rate	15%	
Project time frame	5	
Initial investment	(1,312,000)	
Referrals fees earned		These are contingent and therefore excluded from the analysis
Proceeds on salvage value of old equipment now	42,000	
Present value of CCA tax shield on initial investment	280,972	= (1,312,000 - 42,000) × 27% × 50%/(15% + 50%) × ((1 + 15% × 1.5)/(1 + 15%)) (Note 2)
Reduction of inventory	75,000	Reduction of inventory for packaging materials
Recovery of reduction of inventory at end of Year 5	(37,288)	= 75,000 × [1/(1.15)^5]
Present value of after-tax annual net operating savings	893,182	Note 1
In five years – PV of salvage proceeds on new equipment	124,294	= 250,000 × [1/(1.15)^5]
Recaptured tax on salvage proceeds of new equipment	(33,560)	= 250,000 × 27% × [1/(1.15)^5] (excludes impact of remaining UCC)
NPV	32,600	

Note 1 – Annual operating savings:

Paper and plastic materials	260,000
Labour	50,000
Maintenance	70,000
Electricity consumed	(15,000)
Pre-tax savings	365,000
After-tax	266,450
Present value for five years	893,182

Note 2 – Equipment in Class 53 can also be fully expensed in the year acquired.

Note that this analysis is based on current volumes. Further increases in volumes, or acquisitions driving higher volume, could make the NPV higher, provided that the equipment can handle the increased volumes. Lower volumes would likely reduce the savings and the NPV.

Qualitative factors to also consider in this decision are as follows.

Pros:

- Using the equipment will reduce TMB's carbon footprint via reduced use of paper and plastic. TMB could be eligible for a government carbon incentive of a 4% rebate equal to $52,480 ($1,312,000 × 4%).
- TMB will be the first in the industry to install this equipment, which appears to create savings and reduced costs, which will improve margins. In a competitive environment where prices are constantly declining, any cost reduction will help the company to compete and retain its operating margins.
- There will be some impact on freshness via kit sealing, which customers should see as a benefit.
- There is a possible upside via the referral bonus for third-party referrals, although we would want to refer non-competitors. For each referral, TMB could earn $30,000 in referral fees.
- If the equipment lives up to expectations, it could be considered for implementation at the Vancouver fulfillment centre, or at other future meal kit companies acquired.
- There are benefits related to speed of packaging that have not been quantified but that will ensure that meal kits are packaged more quickly, increasing the quantity of meal kits that can be packaged at the Montreal fulfillment centre, and maintaining the freshness of these meal kits.
- If less paper and plastic is used, packages should be lighter; therefore, there may be possible delivery savings.
- Free training and setup costs may only be available at the outset, as it appears to be an early adoption incentive from the manufacturer.

Cons:

- As this is newly customized equipment without a track record, there may be operational issues that occur, causing the machine to be down for a period of time, which will impact TMB's costs as it will have to manually prepare the meal kits.
- As this equipment is new to the meal-kit industry, the cost savings may be less than anticipated.
- The manufacturer appears to be offering substantial incentives (free training and setup costs) to incentivize TMB; if the equipment generates substantial savings, why have they not been able to attract other acquirers?
- As there are labour cost savings of $50,000, staff will lose a few working hours, which will be less popular. As such, there may be a negative reaction from the affected employees.

Overall Conclusion

As the NPV is positive $32,600, from a strictly quantitative standpoint, the project would be accepted.

In addition, if the carbon incentive is passed by the government, the project will have an even higher NPV. If speed, courier, or freshness benefits could be quantified, this would also add to the project NPV. TMB should purchase the asset subject to the supplier providing some assurances from the manufacturer that any operational issues will be fixed at their expense and as quickly as possible.

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

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

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

Reaching competence – The candidate attempts to calculate the NPV of the packaging equipment.

Competent – The candidate calculates the NPV of the packaging equipment, discusses some qualitative factors, and provides a supported conclusion.

Competent with distinction – The candidate accurately calculates the NPV of the packaging equipment, discusses several qualitative factors, and provides a supported conclusion.

Assessment Opportunity #8 (Depth Opportunity)

The candidate performs a valuation of DI, using the capitalized cash flow method.

The candidate demonstrates competence in the Finance role.

CPA Map Technical Competencies:		**Core**	**E2 FIN**
5.4.2	Applies appropriate methods to estimate the value of a business	B	A
5.6.1	Evaluates the purchase, expansion, or sale of a business	B	A

CPA Map Enabling Competencies:
5.1.1 Applies general business knowledge to enhance work performed
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

You have asked for a capitalized cash flow valuation of DI, and a financial assessment of the purchase.

In order to value a company using the capitalized cash flow approach, the normalized annualized cash flows must first be determined, and then the capitalization rate is applied, based on the discount rate and growth rate.

DI income before taxes – 2021	$ 2,758,000	
Amortization	128,000	
Interest	42,000	
Adjustments to normalize the income:		
Kopp's remuneration to market	130,000	= $380,000 - $250,000
Kopp's son's remuneration	80,000	No work done, so not necessary
Cost of desserts given away	137,400	= 2% × $6,870,000
Foreign exchange gain – speculation	(113,444)	Speculation gain removed, as not normal business
Operating cash flows before taxes	3,161,956	
Income taxes at 18%	(569,152)	
Operating cash flow after tax	2,592,804	
Annual capital acquisitions	(110,000)	Given
Maintainable annual cash flow	$ 2,482,804	
Discount rate	17%	
Perpetual growth rate	3%	
Multiplier	7.1	
Total firm value	17,734,314	
Less: debt at market value	(1,030,000)	Given
Add: redundant cash	844,000	= $2,844,000 - $2,000,000
Catch up capital at beginning	(350,000)	
Value of equity	$ 17,198,314	

Note that the cost of desserts given to kids' camps and charity events has been adjusted for on an initial opinion that they do not generate additional revenues.

The resulting valuation of the company is $17.2 million, which is less than the $18 million that Shelly has asked for.

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

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

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

Reaching competence – The candidate attempts to calculate a valuation of DI.

Competent – The candidate uses the capitalized cash flow method to calculate a reasonable value for DI, and compares it to Shelly's requested price.

Competent with distinction – The candidate uses the capitalized cash flow method to calculate an accurate value for DI, and compares it to Shelly's requested price.

Assessment Opportunity #9 (Depth Opportunity)

The candidate calculates some financial ratios for DI, and discusses areas where DI's operations could be improved, and synergies that TMB could generate from this acquisition.

The candidate demonstrates competence in the Finance role.

CPA Map Technical Competencies:		**Core**	**E2 FIN**
5.1.1	Evaluate the entity's financial state	A	A
5.6.1	Evaluates the purchase, expansion, or sale of a business	B	A

CPA Map Enabling Competencies:
5.1.1 Applies general business knowledge to enhance work performed
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

The chart below summarizes DI's financial ratios compared to the industry.

	DI	Industry
Average annual revenue	$12 million	$100 million
Gross profit margin	43%	50%
Marketing expenses as a percentage of revenues	10%	14%
General and administration expenses as a percentage of revenues	8%	6%
EBITDA as a percentage of revenues	24%	30%
Adjusted EBITDA as a percentage of revenues	26%	30%

Based on the above analysis, it appears that DI is substantially smaller ($12 million in revenues versus $100 million in revenues) than the average company in the specialized food manufacturing industry, which could contribute to its lower gross profit margins, higher G&A costs, and lower EBITDA margins, as DI would not have sufficient scale.

Areas where DI could improve its operations are as follows:

- Increasing its gross profit margins, by renegotiating its food contracts to reduce food costs, or considering whether there is a high degree of food waste, which is driving down its gross profit margins.
- Increasing the amount that DI spends on marketing, and growing its revenues at a faster pace, resulting in a larger revenue base, since DI currently spends a lower percentage of its annual revenues on marketing than the average company in the industry.
- Assessing DI's G&A expenses for redundancies that, if removed, could reduce its G&A expenses; DI's G&A expenses as a percentage of revenue are higher than the industry average.
- Assessing whether DI may be able to generate additional cost savings, either through renegotiating contracts (i.e., food contracts) or becoming more efficient at administrative items. Based on its adjusted EBITDA, DI's EBITDA margin is 26%, which is lower than the industry average of 30%. (This could be related to the industry being, on average, larger than DI, and should be investigated further.)

Based on the above analysis, and our understanding of TMB, various synergies that could be achieved on the acquisition of DI are as follows:

- Greater volume purchases of some ingredients, such as flour, sugar, or other supplies that would be used in meal-kit preparation and desserts, could result in volume discounts. This would improve DI's gross profit margin, potentially bringing it in line with the industry.
- Cross-marketing between TMB's and DI's existing customer bases could increase sales volumes of all of its products.
- There are competitors in the industry that are differentiating themselves by selling add-ons to their meal kits. TMB could include DI's products in its meal kits, and market it as a premium add-on product. This is especially true for gourmet kits, where customers might like to have a dessert also provided. This would allow TMB to differentiate itself from the industry, and increase its revenues through the add-on product.

- Select DI recipes (but without the ingredients) could be added as a bonus to TMB's meal kits; this initiative is low cost but could generate promotion for DI's products, and also differentiate TMB from its competitors.
- DI and TMB both operate out of production facilities in Montreal, which are about 20 kilometres apart. TMB should consider if the facilities could be merged (perhaps DI could operate out of TMB's facilities), which could result in cost savings. If so, the facilities owned by DI could be sold, which would generate additional value.
- DI likely has duplicate back-office functions, such as accounting and IT, which could be combined with TMB's back-office functions. This would lower DI's G&A expenses, potentially bringing it in line with the industry.

The synergies available to TMB could impact the price that TMB is willing to pay. However, there is execution risk associated with realizing synergies; therefore, as they are higher risk than DI's core operations, TMB may not be willing to pay for synergies on a dollar-for-dollar basis.

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

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

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

Reaching competence – The candidate attempts to calculate some financial ratios, and attempts to discuss how DI could improve its operations, and/or synergies that TMB could realize on the acquisition.

Competent – The candidate calculates some financial ratios, and discusses how DI could improve its operations, and/or synergies that TMB could realize on the acquisition.

Competent with distinction – The candidate accurately calculates the financial ratios, and thoroughly discusses how DI could improve its operations, and synergies that TMB could realize on the acquisition.

Assessment Opportunity #10 (Depth Opportunity)

The candidate discusses the two options proposed for financing the acquisition of DI, and makes a recommendation.

The candidate demonstrates competence in the Finance role.

CPA Map Technical Competencies:		**Core**	**E2 FIN**
5.2.3	Evaluates sources of financing	B	A

CPA Map Enabling Competencies:
5.1.1 Applies general business knowledge to enhance work performed
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems
6.1.3 Demonstrates skepticism, objectivity, due care and persistence when identifying issues
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

You have asked for a discussion of the two options offered by Shelly for financing the purchase of DI. For the purposes of this analysis, I have assumed that the purchase price paid will be $18 million. However, if a lower price can be negotiated, the issues discussed are still relevant.

Note Payable Option

Below is a calculation of the down payment required and annual interest, which will decline by 10% per year, as the annual payments are made.

Asking price for acquisition	$	18,000,000	
Cash required	$	900,000	5%
Vendor take-back amount	$	17,100,000	
Interest expense, Year 1	$	855,000	5%
Equal annual payments	$	1,710,000	1/10 of VTB

As at December 31, 2021, TMB has cash on hand of $4,996,000, which would be sufficient to make the down payment of $900,000. DI generates sustainable free cash flows of $2,482,804 annually, which is less than the amount required in the first year for interest and principal, which totals $2,565,000 ($855,000 + $1,710,000). Therefore, TMB will have to utilize its own cash flows to support the loan payments. TMB appears to have sufficient earnings to bridge the gap between the loan payment and DI's cash flows.

<u>Pros:</u>

- The simple interest at 5% is very reasonable, compared to TMB's line of credit (currently 4.67%) and mortgage (7%). This is equivalent to borrowing $15.6 million at a 7% rate, instead of the $17.1 million that will be funded through the debt from Shelly.
- Accepting the note payable avoids the earnout required for the share exchange financing option.

Cons:

- The issuance of the note payable will worsen the company's debt-to-equity ratio. If this debt is added, the revised debt-to-equity ratio will be 2.4 (15,318 + 17,100/13,259), which is just below the maximum debt-to-equity covenant of 2.5. TMB needs to be confident that it will not require additional debt in the near future, which could put it over its covenant. TMB could also consider having a conversation with the bank to discuss their debt-to-equity covenant; the bank may be open to increasing the threshold if they understand the benefits of acquiring DI (i.e., the acquisition results in an increase in cash flows available to service the debt).
- Using cash on hand for the down payment will reduce the company's overall cash position; at various points in the past year, TMB needed to fully draw down on its line of credit. This could cause a cash flow issue for TMB in the upcoming year.
- The event of default requiring immediate full repayment of the loan may be problematic. The first issue is that it restricts the company from going private in the next 10 years, with respect to the de-listing clause. TMB might consider going private if management continues to believe that its shares are undervalued for a long time in the public markets.

Overall, the note payable offer requires substantial annual cash flows to support, particularly in the initial years. However, it generally appears as though TMB and DI have sufficient earnings and cash flows to repay the note, although DI on its own does not.

Share Exchange Option

Below is an analysis of the shares to be issued to Shelly and the dilution that would occur, assuming that the share price on the date of acquisition is still $4.20 per share.

TMB – current shares outstanding		10,000,000	
TMB' s current share price	$4.20		
Asking price for acquisition	$18,000,000		
Share to be issued		4,285,714	
Revised shares outstanding		14,285,714	
S. Kopp ownership			30%
Rita and Conrad's shares:			
Shares outstanding		4,000,000	
Ownership before acquisition			40%
Ownership after acquisition			28%

Pros:

- This will use minimal cash in the near term, compared with the note payable option (no down payment, or interest and principal payments), and leave TMB with more cash to spend on other priorities.
- The issuance of equity will improve the company's debt-to-equity ratio, which is beneficial from the bank's viewpoint.

- This allows the company to obtain additional debt financing via the unsecured assets of DI, and balance sheet debt capacity.
- Shelly would be joining TMB's Board of Directors; given the success of DI, she could provide advice on improving TMB's and DI's profits.

Cons:

- The issue of shares will dilute current shareholders' proportionate ownership and give Shelly 30% ownership, making her the largest shareholder of the group and giving her the greatest proportion of voting power over the board decisions. This amount is now higher than the proportion owned by Rita and Conrad, which would fall to 28%.
- If the company is able to pay dividends in the future, this will mean fewer dividends for current shareholders.
- Management believes the shares are currently undervalued; therefore, as this would dilute value for the existing shareholders, it is not a good time to use shares for a business purchase.
- There may be regulatory approvals required to issue these shares, which could complicate, and increase the cost of, this option.
- With the earnout, there is a risk that TMB will have to pay a higher acquisition price than $18 million. If DI has an EBIT greater than $2.7 million for 2023 and 2024, TMB will be required to pay in cash 3% of this difference, although this is not likely to be a significant amount.
- Without escrow/ restrictive sale clauses (e.g., setting a maximum percentage of TMB's shares that can be sold in a given period), Shelly could liquidate her shares quickly and drive TMB's stock price down even further.
- Having Shelly on the board could be disruptive and create conflicts, resulting in a delay in decisions. Shelly can also designate a board member; her designate may not have the best interests of TMB in mind, given that they do not own the shares of TMB, and may not add value to the board. Further, having Shelley on the board might not appeal to other shareholders, as she would have influence over TMB's operations.

Recommendation

It is recommended that the note payable option be used. Although this requires significant cash outflows over the next ten years, there is sufficient cash flow generated by DI to pay for most of the obligations. Also, the interest rate is very favourable in comparison to the rates that TMB is currently paying. The share exchange option is very expensive from a dilution perspective, particularly if TMB is thought to be undervalued. Although it has no cash requirements, there are substantial risks in having Shelly on the board and owning 30% of the voting power, being the highest of all shareholders.

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

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

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

Reaching competence – The candidate attempts to discuss the two financing options.

Competent – The candidate discusses the two financing options, and makes a recommendation.

Competent with distinction – The candidate thoroughly discusses the two financing options, and makes a recommendation.

Assessment Opportunity #11 (Depth Opportunity)

The candidate analyzes the adoption of an electronic payment system, and provides a recommendation.

The candidate demonstrates competence in the Finance role.

CPA Map Technical Competencies:		**Core**	**E2 FIN**
5.2.1	Evaluates the entity's cash flow and working capital.	**A**	**A**

CPA Map Enabling Competencies:
5.1.1 Applies general business knowledge to enhance work performed
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.2 Identifies patterns from data analysis
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Some major suppliers have reported delays in receiving their payment cheques due to postal issues, and have asked that TMB start to pay electronically. You have gathered cost information related to implementing electronic payments, and would like me to assess the impact of the company adopting this method for all of its suppliers.

Here is my analysis of moving to Automatic Clearing House (ACH) electronic payments of suppliers, instead of cheques. Quantitatively, the ACH system would be more expensive, but there are substantial qualitative benefits, which are discussed later.

<u>Implementation of ACH transfers:</u>

Setup cost	$	2,000	
Monthly fee	$	7,200	$600 × 12
Annualized cost	$	9,200	

<u>Current cheque process:</u>

Cheque printing		?
Envelopes		?
Postage		?
Per-cheque fee	$	1
Volume		5,100
Total	$	5,100

As shown above, ACH will cost approximately $4,000 more per year. However, we should also consider qualitative factors in assessing this option.

<u>Pros:</u>

- TMB will be better able to manage its cash flows, as it will know exactly when payments will come out of the bank account. Currently, the cheques are mailed by TMB, deposited by the supplier, and finally clear TMB's account. This could take up to ten days, given that the suppliers have requested that cheques be issued ten days earlier. Adopting electronic payment will allow the company to keep the cash as long as possible in its account, with no delay in it being deposited in the suppliers' accounts. This will result in the company having more cash available for its own use, as payments will be made later than if TMB continues to use cheques, reducing the likelihood of the line of credit being drawn upon.
- There will be no late cheques due to mail delays, and suppliers will always be paid on time. Further, suppliers will save time and resources related to processing and depositing the cheques. This ensures that good relationships with suppliers are maintained.
- There will be no lost cheques that require time (and likely cost) to cancel and replace.
- As authorizations can be done electronically under the new system, it will save the time of organizing cheque signers to come to the office to sign the cheques. It will also save staff the time to print cheques, find officers to sign cheques, etc.
- The bank will gather and store the suppliers' banking information so that it is secure, and not part of TMB's database or responsibility. Given that banks likely have a high level of security built into their systems, likely higher than something TMB could put into place on its own, this is advantageous to TMB.

- The accounting group has complained about the length of time needed to complete their bank reconciliations, which is likely as a result of the large number of cheques issued and the time required for a cheque to be cashed and cleared. Switching to the new system would reduce the time required to complete bank reconciliations, as payments would clear immediately.
- The ACH has a one-time fee of $2,000, which will not be charged in the future. Therefore, although the ACH is still more expensive, the gap between the ACH and the cheque system will decrease in the future.
- The cost per cheque is $1, which excludes postage and handling fees. These fees can be substantial, depending on where the suppliers are located. Incorporating these fees could result in the cheques being more expensive, which decreases the price gap between the ACH and cheques.

<u>Cons:</u>

- There might be a few suppliers who will not want to use the electronic payment system, and having to sign up to use it if they want to be paid by TMB could make them unhappy.
- This system provided by the bank may not work for international transfers, so the company will have to follow its existing practices for those payments.
- TMB wants to authorize payments as they come due; if the approvers are not available on the due date, this could result in payments being made late. TMB should implement a policy to pay bills on specific days, to ensure that the approvers have notice, and are available on a periodic basis to approve payments.

Conclusion

The advantages for enhanced security, better management of cash outflows, and maintaining good supplier relationships outweigh the disadvantages; therefore, we recommend that TMB implement electronic payments as soon as possible.

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

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

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

Reaching competence – The candidate attempts to analyze adopting the electronic payment system.

Competent – The candidate analyzes adopting the electronic payment system, and makes a recommendation.

Competent with distinction – The candidate thoroughly analyzes adopting the electronic payment system, and makes a recommendation.

Assessment Opportunity #12 (Depth Opportunity)
The candidate assesses whether the company should pay a dividend or buy back shares, and makes a recommendation.
The candidate demonstrates competence in the Finance role.

CPA Map Technical Competencies:		Core	E2 FIN
5.2.6	Evaluates decisions related to distribution of profits	B	A

CPA Map Enabling Competencies:
5.1.1 Applies general business knowledge to enhance work performed
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Some of the shareholders have started to become vocal about wanting TMB to pay a dividend with its excess cash. I have provided an analysis of the three possible options: the company paying out a regular dividend; paying the funds as a special dividend; or using the funds to buy back shares.

In the discussion, we must first determine if there are any restrictions on the amount being paid, and then discuss which type of payment should be made.

Restrictions

The first concern is that the company has a debt-to-equity covenant that cannot go above 2.5. Currently, the debt-to-equity ratio is 1.15 ($15,318/$13,259). If a dividend or share repurchase is completed for $3 million, this will increase the ratio to 1.49 ($15,318/($13,259 - $3,000)), which is still below the 2.5 maximum. Therefore, the full $3 million could be paid out and TMB would remain within its debt-to-equity covenant.

Regular Dividend

If the company decides to pay a regular dividend, this implies that the company is committing to paying this dividend on a regular (at least annual) basis, and this will be the first of a stream of regular dividend payments.

Other companies in the industry have an average dividend yield of 3%. At a $42 million market capitalization, this implies that TMB would only need to pay $1.3 million in order to have a dividend yield comparable with other companies in the industry, which is less than the $3 million of excess cash that management indicates they could pay.

If TMB decides to pay a regular dividend, it will need to pay a consistent dividend in the future; investors have an expectation that a regular dividend will be paid, typically at the same rate per share, or same dividend yield. By paying less than the $3 million of cash available, the remainder could be reinvested in the company (for example, investing in the packaging equipment and/or DI), and the increased profits (or remainder of the amount) used to pay future dividends.

Pros:

- Payment of a regular dividend will appease current shareholders, who want the cash paid out.
- Companies that pay out regular dividends demonstrate strong earnings capabilities, which may increase the share price. This does depend on the industry; if other companies in the industry are paying dividends but TMB is not, TMB's trading multiples will likely be lower than that of its peers.

Cons:

- All shareholders will receive the $0.30 per share, regardless of their preferences.
- As with all dividends, there will be a decline in the price of the share on the ex-dividend date, such that the price will fall to $3.90 per share, given the current share price of $4.20. (Note that this would cause an increase in the number of shares to be issued for DI's acquisition.)
- Shareholders will expect a regular dividend in the future, typically the same dividend per share or the same dividend yield. Given that TMB wants to grow by acquisition, it may not have the cash available for future dividend payments if it makes an acquisition. Not continually paying dividends will result in unhappy shareholders, and potentially a decrease in the share price.
- If TMB has to reduce or stop the dividend in a future year (for example, due to operating challenges), this is usually interpreted negatively by investors, and the share price will fall.

Special Dividend

Paying out a special dividend of $3 million will result in a dividend of $0.30 being paid per share ($3,000,000/10,000,000 shares).

Pros:

- Payment of a special dividend will appease current shareholders, who want the cash paid out.
- As this is a special dividend and will be announced as such, investors will have no expectation that this amount will be paid in future years—it is a one-time payment.

Cons:

- All shareholders will receive the $0.30 per share, regardless of whether they have been vocal about wanting TMB to make a dividend payment, or believe that TMB should reinvest these funds in order to generate higher future returns (for example, by expanding or acquiring another company).
- As with all dividends, there will be a decline in the price of the share on the ex-dividend date, such that the price will fall to $3.90 per share, given the current share price of $4.20.
- Generally, special dividends do not result in an increase in share price as they are viewed by shareholders as a one-time payout, and therefore do not necessarily demonstrate continued company strength.
- The payout will reduce cash and reduce equity, which worsens the debt-to-equity ratio.
- If the company is considering using a share exchange for the purchase of DI, paying the special dividend will reduce the share price, increasing the number of shares that must be issued.
- Alternatively, if the company is considering acquiring DI by paying cash of $900,000 with a note payable for the difference, payout of the special dividend will reduce the cash available to make this payment.

Share Repurchase

The third alternative is to use the $3 million to buy back shares. When a company announces a buyback of its shares, this is usually interpreted by investors that management thinks its shares are undervalued. Currently, TMB's management believes its shares are undervalued and are trading below their intrinsic value in the market. Therefore, this is the right time to buy back shares, as the company can repurchase at a price that is below their true fair value.

Assuming that the shares can be repurchased for $4.20, this will result in 714,285 shares ($3,000,000/$4.20) being repurchased.

Pros:

- Each shareholder can decide whether to sell their shares or not. If they want to sell their shares, they will receive a portion of the $3 million; if they decide not to sell their shares, they will not receive any of this cash. This addresses the concerns of any shareholders who are not looking to reduce their shareholding.
- The EPS will improve with fewer shares outstanding. If we use 2021 as an example, the EPS was $0.333 ($3,330,000/10,000,000); if the shares are repurchased, the EPS would have been $0.35 ($3,330,000/(10,000,000 - 714,285)). A higher EPS can drive higher per-share value.
- Often, an announcement of a share repurchase results in investors bidding the share price up. If TMB decides to use $3 million to buy back the shares, this will cause the share price to rise.
- There are no future expectations that a share repurchase will recur; this is in contrast to a regular dividend payment, where investors expect that payment to continue annually.

- If the company decides to purchase DI using the share exchange, the higher price will result in fewer shares being issued, less dilution of current owners' proportionate share, and less voting ownership by Shelly.

Cons:

- Using the cash of $3 million means that it is not available for other investments.
- Investors may interpret this announcement that TMB has limited investment opportunities, as it is willing to pay this amount out, which could negatively impact investors' outlook on TMB.

Conclusion

Ideally, the company should keep its excess cash, given its acquisition strategy. In addition, because there are too many unknowns for the future and given the strategy to grow by acquisition, TMB should not pay out the $3 million as a regular dividend.

If TMB decides to proceed with paying out $3 million, due to the current low share price and the positive reaction of the market with a share buyback compared to a special dividend, the recommendation is that the company use the $3 million to buy back shares.

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

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

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

Reaching competence – The candidate attempts to assess the alternatives for paying out the $3 million.

Competent – The candidate assesses the impact of the three alternatives for paying out the $3 million, and provides a recommendation.

Competent with distinction – The candidate thoroughly assesses the three alternatives for paying out the $3 million, and provides a recommendation.

Assessment Opportunity #13 (Depth Opportunity)

The candidate analyzes which companies best meet the acquisition criteria, and recommends which company to complete further due diligence on.

The candidate demonstrates competence in the Finance role.

CPA Map Technical Competencies:		Core	E2 FIN
5.1.3	Assesses reporting systems, data quality and the analytical models used to support financial analysis and decision-making	B	A
5.6.1	Evaluates the purchase, expansion, or sale of a business	B	A

CPA Map Enabling Competencies:
5.1.1 Applies general business knowledge to enhance work performed
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

TMB's acquisition strategy is to acquire companies that will be accretive to its earnings per share, improve its return-on-assets ratio, and increase net earnings by at least $800,000. Using these criteria for the initial selection process, we have identified the companies that meet all three of these criteria, as discussed below.

To be accretive to EPS, the acquisition has to improve TMB's EPS and be favourable for its share price. For this to occur, TMB has to look for targets where the price paid is lower than the increase to EPS. In order to be accretive, TMB wants to target companies that have a P/E ratio that is lower than its own. It also wants to target companies that have a better ROA than it currently does, as this will improve the company's overall ROA. The last criterion is that the target will increase net earnings by at least $800,000.

Currently, TMB's P/E ratio and ROA are as follows:

EPS	$	0.333
Current share price	$	4.20
Net earnings	$	3,330,000
Total assets	$	28,577,000
ROA		11.7%

Based on the above, target companies that meet all three criteria will have: earnings per share of TMB issued greater than $0.333; an ROA that is greater than 11.7%; and net earnings higher than $800,000.

Company	Type	Revenue	Net Earnings	TMB Shares Issued
Home Food	Meal-kit	3,500,000	175,000	530,000
Easy Meals	Meal-kit	46,000,000	2,622,000	7,300,000
Chef Home Meals	Meal-kit	21,500,000	1,333,000	4,200,000
Food2Home	Meal-kit	8,800,000	378,400	900,000
Nutri Food	Meal-kit	11,600,000	1,055,600	2,700,000
Sweets Galore	Dessert	12,400,000	892,800	2,300,000
Pie Experts	Dessert	16,300,000	1,401,800	3,600,000
Desserts @ Home	Dessert	2,300,000	133,400	540,000

Company	ROA	Earnings/ TMB Share	ROA > 11.7%	Earnings Accretive?	Net Earnings > $800,000
Home Food	4.8%	0.330	NO	NO	NO
Easy Meals	16.9%	0.359	YES	YES	YES
Chef Home Meals	12.8%	0.317	YES	NO	YES
Food2Home	14.3%	0.420	YES	YES	NO
Nutri Food	18.2%	0.391	YES	YES	YES
Sweets Galore	10.4%	0.388	NO	YES	YES
Pie Experts	12.1%	0.389	YES	YES	YES
Desserts @ Home	7.0%	0.247	NO	NO	NO

Based on the above analysis, there are three companies that meet all three criteria:

Company	Type	Net Earnings	Earnings per TMB Share	ROA
Easy Meals	Meal kit	$2,622,000	0.359	16.9%
Nutri Food	Meal kit	$1,055,600	0.391	18.2%
Pie Experts	Dessert	$1,401,800	0.389	12.1%

The company that has the highest earnings per share of TMB issued (0.391), and the highest ROA (18.2%), is Nutri Food. Further, it is a meal-kit company, which is beneficial, since TMB is already considering the acquisition of a dessert company, DI. Therefore, it is recommended that TMB first pursues, and gathers more information about, Nutri Food.

For Assessment Opportunity #13 (Finance), the candidate must be ranked in one of the following five categories:

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

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

Reaching competence – The candidate attempts some analysis of the data that has been provided.

Competent – The candidate analyzes the data with respect to the three criteria, and provides a conclusion.

Competent with distinction – The candidate analyzes the data with respect to the three criteria, and provides a well-supported conclusion.

DAY 2 – MARKING GUIDE – PERFORMANCE MANAGEMENT ROLE
TASTY MEAL BASKETS LIMITED (TMB)

To: Ara
From: CPA
Subject: Various matters

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

Assessment Opportunity #7 (Depth Opportunity)

The candidate performs a quantitative and qualitative assessment of the impact of reducing the number of new recipes for Chef Rita's casual meal kits from four to three, and makes a recommendation.

The candidate demonstrates competence in the Performance Management role.

CPA Map Technical Competencies :		**Core**	**E1 PM**
3.3.4	Recommends cost management improvements across the entity	B	A

CPA Map Enabling Competencies:
5.1.1 Applies general business knowledge to enhance work performed
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions
6.3.3 Applies decision criteria to choose among viable alternatives

Recipe Development

The analysis below shows the contribution per week, based on introducing four new recipes, and compares it to introducing three new recipes per week.

Development costs per FS	$2,600,000
New recipes per week	4
New recipes per year	208
Cost per new recipe	$12,500
Average contribution margin per meal	$8.50
Percentage of sales that would be lost if four new recipes not introduced	60%

<u>If four new recipes are introduced per week:</u>

	Week 1	Week 2	Week 3	Week 4	Week 5	Week 6
Total sales of new recipe meals for four new recipes	10,800	8,200	1,800	1,200	800	540
Percentage of sales lost if recipes were not new	60%	60%	60%	60%	60%	60%
Portion of incremental sales only due to new recipes	6,480	4,920	1,080	720	480	324
Contribution margin per meal	$8.50	$8.50	$8.50	$8.50	$8.50	$8.50
Incremental contribution from four new recipe sales	$55,080	$41,820	$9,180	$6,120	$4,080	$2,754
Total incremental contribution	$119,034					
Less development costs	(50,000)					
One-time graphic design costs	(12,000)					
Net contribution (loss), before other costs	$ 57,034					

The annual cost incurred during 2021 by TMB to develop four new recipes per week is $2.6 million. There are 208 (4 × 52 weeks) recipes developed each year, resulting in an average per-recipe development cost of $12,500 ($2,600,000/208), for a total of $50,000 for four recipes.

The average contribution margin per meal during 2021 was $8.50. The incremental costs to introduce a new recipe include a one-time, upfront cost of $3,000 for the initial design of graphics and pictures, for a total of $12,000 for four recipes.

In addition, if new recipes are not offered, 60% of the new recipe sales would not be made; 40% of the sales would occur anyway, as those customers would purchase some other recipe (from the available list) for that week.

<u>If three new recipes are introduced per week:</u>

	Week 1	Week 2	Week 3	Week 4	Week 5	Week 6
Total sales of new recipe meals for three new recipes	8,208	6,232	1,368	912	608	410
Percentage of sales lost if recipes were not new	60%	60%	60%	60%	60%	60%
Incremental sales only due to three new recipes introduced	4,925	3,739	821	547	365	246
Contribution margin for each meal	$8.50	$8.50	$8.50	$8.50	$8.50	$8.50
Incremental contribution from three new recipe sales	$41,863	$31,782	$6,979	$4,650	$3,103	$2,091
Total incremental contribution	$90,468					
Less development costs (12,500 × 3)	(37,500)					
One-time graphic design costs (3,000 × 3)	(9,000)					
Net contribution (loss), before other costs	$43,968					

As can be seen from the above analysis, both scenarios provide positive net contribution, but the net contribution is higher for the introduction of four, rather than three, new recipes per week, by $13,066 per week ($57,034 - $43,968).

However, there are other factors that should be considered before the company decides to reduce the number of new recipes down to three from four, as outlined below.

Advantages of reducing to three new recipes per week:

- The resources currently used to develop the fourth recipe, including both the time and money spent on development, could be devoted to other areas that might benefit the company more if they were used elsewhere.
- Rather than having the chefs spend time developing new recipes, they could work on ways to change the recipes, which would allow TMB to compete on factors other than price. It could be as simple as changing a spice or adding another ingredient, which does not require a lot of development costs.

- With high customer turnover and a significant number of new weekly customers, the 20 weekly recipes offered will be new to a lot of the customer base, regardless of whether the recipe was introduced that week. As TMB has been operating for 15 years, there is presumably an inventory of thousands of recipes. TMB could cycle through the existing inventory without repeating the same recipe twice in one year.
- Customers may already be overwhelmed by the number of weekly choices offered, and find it less time consuming, or easier, to find a meal they want with less selection.
- If TMB continues to compete on price, the gross margin of each recipe will decrease, and it will take longer to recover the development costs.

Disadvantages of reducing to three new recipes per week:

- TMB needs to determine if offering four new weekly recipes is a differentiating feature that is attracting customers. Other meal-kit companies may be offering the same, or a greater, number of new recipes per week, and loyal customers may appreciate being able to select from a greater number of new recipes.
- The estimates show that 76% of new recipe sales will still occur if only three new recipes are introduced versus four. This actual percentage may be lower than the estimate. In addition, there may be a loss of existing customers, who like to choose from four recipes and will go elsewhere if they cannot find a suitable selection from the weekly offerings.
- What has not been included in the quantitative analysis is the reintroduction of recipes later, which would increase sales and require little additional cost to modify. This would increase the profits contributed by a single recipe. If the number of recipes is maintained at four per week, there is a better chance that, out of four recipes, at least one may become a favourite and be continuously offered.

Overall

In either case, TMB has been successful in recovering the development costs and marketing costs for each new recipe. However, if the sales prices of the meal kits decline, resulting in a falling contribution margin, or the popularity of new recipes declines, the contribution of each new recipe will need to be reassessed. In addition, as there are no material incremental costs, the recipe will continue to generate profit as long as the direct costs do not exceed the sales price.

The bigger issue is determining whether the inclusion of the new weekly recipes is helping to drive customer retention, which is where the company's efforts should be focused. TMB needs to question whether the proportion of new recipes ordered over the course of the first month is really due to the recipes being new, or if the customer would simply select another available meal.

Having a large inventory of recipes allows TMB to rotate recipes without having the same recipe appear twice in one year, and therefore moving from four to three new recipes is likely feasible. I recommend that TMB test, for a few weeks, the introduction of only three new recipes, and observe what happens to new recipe sales, and total sales, to determine whether the assumptions for three recipes per week are valid. If the sales data indicates that customer retention becomes an issue, and it is clearly linked to the lack of new recipes, TMB can quickly return to introducing four new recipes per week.

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

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

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

Reaching competence – The candidate attempts to calculate the difference between introducing four recipes per week and three recipes per week, or discusses some of the qualitative considerations.

Competent – The candidate calculates the difference between introducing four recipes per week and three recipes per week, discusses some of the qualitative considerations, and makes a recommendation.

Competent with distinction – The candidate accurately calculates the difference between introducing four recipes per week and three recipes per week, discusses several of the qualitative considerations, and makes a recommendation.

Assessment Opportunity #8 (Depth Opportunity)

The candidate performs a quantitative and qualitative analysis of the three alternatives being considered for delivering meal kits, and recommends which one to pursue.

The candidate demonstrates competence in the Performance Management role.

CPA Map Technical Competencies:		**Core**	**E1 PM**
3.3.4	Recommends cost management improvements across the entity	B	A

CPA Map Enabling Competencies:
5.1.1 Applies general business knowledge to enhance work performed
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems
6.1.3 Demonstrates skepticism, objectivity, due care and persistence when identifying issues
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions
6.3.3 Applies decision criteria to choose among viable alternatives

Delivery

TMB charges a $10 fee for delivery, regardless of where the meal kits are delivered. TMB's actual delivery cost within city limits is $8.25 per delivery, and therefore generates revenue of $1.75 for each of those deliveries. For customers outside the city, the actual average cost per delivery is $21.50, which is $11.50 higher than the $10 fee charged.

To determine the impact on TMB, we need to look at the total delivery charges collected on deliveries, both inside and outside the city limits, and compare that to the total delivery costs incurred. 83% of all meal kits are delivered inside, and 17% are delivered outside, the city limits.

During 2021, 1,361,600 meal kits were delivered. The analysis below calculates the net profit (loss) from delivery.

Delivery charges collected	1,361,600 × $10	$ 13,616,000
Actual costs for in-city deliveries	83% × 1,361,600 × $8.25	$ 9,323,556
Actual costs for outside-city deliveries	17% × 1,361,600 × $21.50	4,976,648
Total actual delivery costs		$ 14,300,204
Net profit (loss) from delivery		$ (684,204)

Based on the above mix of meal-kit deliveries, there is currently a net loss on delivery charges. Although the delivery charges within the city are covering most of the losses on deliveries to the outside-city customers, there is still a net loss.

Given that TMB anticipates that the percentage of deliveries outside the city will continue to increase, discontinuing to sell to the outside-city customers is not an option.

TMB is considering three options for its delivery fees.

Option 1: Retain the $10 flat rate and incur the net loss on delivery charges

Under this option, TMB will continue to charge the same $10 rate, to remain competitive and in line with industry practice. Unless the mix of customers changes so that there are more in-city customers, and fewer outside-city customers, the company will continue to incur net delivery losses under this option.

However, given that TMB expects deliveries to outside-city customers to increase, there will have to be increases in the in-city customers in order to ensure that the 83%-17% split of in-city to outside-city is maintained, at a minimum. Under this option, the delivery loss will be absorbed by the contribution margin that is earned on the sales.

Option 2: Increase flat rate to $11 and continue shipping to outside-city customers

At the $11 charge, TMB generates a net profit from delivery, as shown below, using the 2021 deliveries. However, this is $1 higher than the current competitors, and TMB may lose some customers as a result of the increase; the loss of these customers has not been factored into the analysis.

Delivery charges collected	1,361,600 × $11	$ 14,977,600
Actual costs for in-city deliveries	83% × 1,361,600 × $8.25	$ 9,323,556
Actual costs for outside-city deliveries	17% × 1,361,600 × $21.50	4,976,648
Total actual delivery costs		$ 14,300,204
Net profit (loss) from delivery		$ 677,396

Option 3: Increase the shipping charge to customers outside the city to cover the actual costs

Under this option, the outside-city customers would pay their actual costs, and there would be net profit.

Delivery fees collected from in-city customers	83% × 1,361,600 × $10	$ 11,301,280
Delivery fees collected from outside-city customers	17% × 1,361,600 × $21.50	4,976,648
Total delivery charges collected		$ 16,277,928
Actual costs for in-city deliveries	83% × 1,361,600 × $8.25	$ 9,323,556
Actual costs for outside-city deliveries	17% × 1,361,600 × $21.50	4,976,648
Total actual delivery costs		$ 14,300,204
Net profit (loss) from delivery		$ 1,977,724

If TMB increases the shipping costs to outside-city customers, it would need to assess whether the profit of $1,977,725 is enough to offset the risk of losing this market.

Recommendation

If TMB increases the delivery price, it may lose some of its remote customers, as other meal-kit companies may continue to offer a flat rate. However, if TMB is able to differentiate itself on other factors, these customers may be willing to pay the additional delivery cost. This being uncertain, the best solution would be to increase the flat fee slightly, so that the delivery service is done at no net cost for TMB without taking the risk of losing a market that is expected to grow. I recommend increasing the flat rate to $11 per delivery.

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

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

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

Reaching competence – The candidate attempts to calculate the current delivery loss and the profit generated by the two options, and attempts to discuss some of the qualitative considerations.

Competent – The candidate calculates the current delivery loss, assesses the profit generated by the two options, discusses some of the qualitative considerations, and makes a recommendation..

Competent with distinction – The candidate calculates the current delivery loss, accurately assesses the profit generated by the two options, discusses several of the qualitative considerations, and makes a recommendation.

Assessment Opportunity #9 (Depth Opportunity)

The candidate performs a quantitative and qualitative analysis of the two options being considered for manufacturing the bottles of secret sauces, and provides a recommendation.

The candidate demonstrates competence in the Performance Management role.

CPA Map Technical Competencies:		**Core**	**E1 PM**
3.5.2	Evaluates sustainable profit maximization and capacity management performance	A	-

CPA Map Enabling Competencies:
5.1.1 Applies general business knowledge to enhance work performed
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems
6.2.3 Questions the relevance and tests the quality of information and assumptions in own analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions
6.3.3 Applies decision criteria to choose among viable alternatives

The analysis below assesses the costs and profits of producing the bottles in-house versus outsourcing to DS. The analysis also includes a discussion of the capacity constraints related to the pureeing machine.

The total number of bottles to produce annually is 361,000; 161,000 are to be sold to TMB's existing meal-kit customers, and 200,000 are to be sold to local pubs.

Capacity Constraint

The puree machine can puree a maximum of 550 kilograms of ingredients per hour for 13 hours per day. This allows a maximum annual output of pureed ingredients of 2,609,750 kilograms (550 kilograms/hour × 13 hours/day × 365 days).

The 2022 annual requirement of the puree machine is 2.2 million kilograms. Therefore, there is capacity to puree an additional 409,750 kilograms of ingredients (2,609,750 - 2,200,000). As the expected demand is 361,000 bottles (161,000 + 200,000), and each bottle requires 1.5 kilograms of pureed ingredients, the total requirement for the bottled sauces is 541,500 kilograms, which is more than the available capacity by 131,750 (541,500 - 409,750) kilograms. Production would be limited to 273,167 bottles (409,750 kilograms/1.5 kilograms per bottle).

In order to produce more bottles, TMB would need to consider the cost of installing a second puree machine. More information is required to assess the cost; therefore, this has not been included in the analysis.

Option 1 – Manufacture Bottled Sauces In-house

Based on the analysis above, TMB could only manufacture 273,167 bottles of sauce

The contribution margin per bottle and overall profit, if produced in-house, is as follows:

Selling price per bottle	$	16.00
Food ingredients	$	10.87
Labour		1.50
Packaging		0.60
Variable overhead		0.75
Total variable cost	$	13.72
Contribution margin	$	2.28

The fixed cost to run the bottling machine is expected to be $55,000 annually. In addition, there is annual depreciation of $25,000 ($125,000/5).

Therefore, the total profits, if the maximum number of bottles is produced in-house, are $542.821:

Total contribution margin for 273,167 bottles (273,167 × $2.28)	$	622,821
Less: fixed annual costs		80,000
Net profit contributed, before selling and other costs	$	542,821

Option 2 – Outsource the Manufacturing and Bottling of Sauces

The contribution margin per bottle, if outsourced, is as follows:

Sales price per bottle		$	16.00
Cost per case	$14,000		
Shipping cost per case	$250		
Bottles per case	1,000		
Cost per bottle		$	14.25
Contribution margin per bottle		$	1.75
Total net profit for 361,000 bottles (361,000 × $1.75), before selling and other costs		$	631,750

Based on the above analysis, and production of the 361,000 bottles required, the more profitable option is to outsource the production and bottling of the secret sauces. Under this option, profits are higher by $88,929 ($631,750 - $542,821), due to the greater number of bottles that can be sold.

Qualitative Analysis

Advantages of outsourcing / Disadvantages of manufacturing in-house:

- TMB specializes in meal-kit preparation, not manufacturing of sauces, and will need to consider that it is dealing with different types of customers, who would likely want different payment terms, etc.
- How reliable are the sales and cost estimates? The decision to proceed is based on rough estimates. Further work should be done to substantiate the amounts.
- In-house, the company can only produce 273,167 bottles of sauce, which would leave an unmet demand of $87,833 bottles (361,000 - 273,167), which would likely reduce the number of bottles sold to pubs. Pubs have expressed interest in purchasing the sauces, which could expand TMB's customer base. If the pubs' customers associate the sauce with the meal-kit business, they could potentially become new meal-kit customers in the future.
- TMB can continue to focus on producing meals.
- DS has expertise in sauce making that TMB may lack for large scale production.
- This allows the company to meet the total demand of 361,000 bottles, therefore meeting the demand of existing customers and the pubs.
- TMB does not have to outlay $125,000 for a new bottling machine.

Disadvantages of out-sourcing / Advantages of manufacturing in-house:

- TMB will have to give the sauce recipes to the manufacturer; therefore, there is the risk that they might be copied.
- TMB is not able to directly control the quality of the sauces produced, or the quality of the ingredients used. DS may not have the same standards for the quality of ingredients, or they might not be sustainably sourced.
- There is a risk that sales demand is not there; if there are manufacturing order commitments with DS, TMB could be stuck with the inventory. (TMB should consider what contract terms it is willing to accept.)

Recommendation

If TMB wants to pursue bottling the secret sauces, it should outsource to DS. DS would be able to fill the total demand, resulting in a higher profit. It would also negate TMB's need to invest $125,000 in a bottling machine. DS is experienced in sauce making and has the necessary equipment to make the sauces. If TMB is concerned about the recipes being revealed to outsiders, it can establish proprietary agreements, to ensure that the recipes remain confidential. Perhaps in the future, if the anticipated demand is realized and TMB is prepared to make the required capital investment, TMB could choose to bring the operation in-house. The capital investment would include the $125,000 investment in the bottling machine and an additional puree machine in order to continue filling both the meal-kit demand and sauce demand.

Selling sauces to new and different customers could result in TMB reaching more customers, which could translate into more meal-kit revenue from customers who like the sauces, and want to try TMB's other products.

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

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

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

Reaching competence – The candidate attempts to perform a quantitative and qualitative analysis of the two options being considered for manufacturing the bottles of secret sauces.

Competent – The candidate performs a quantitative and qualitative analysis of the two options being considered for manufacturing the bottles of secret sauces, and provides a recommendation.

Competent with distinction – The candidate thoroughly performs a quantitative and qualitative analysis of the two options being considered for manufacturing the bottles of secret sauces, and provides a recommendation.

Assessment Opportunity #10 (Depth Opportunity)

The candidate analyzes the Chef Dashim data on pricing and customer orders, and provides advice on the best ways for TMB to differentiate itself in Western Canada, and how to attract more customers.

The candidate demonstrates competence in the Performance Management role.

CPA Map Technical Competencies:		**Core**	**E1 PM**
2.2.1	Assesses whether management decisions align with the entity's mission, vision, and values	B	A
3.6.3	Evaluates root causes of performance issues	B	A

CPA Map Enabling Competencies:
5.1.1 Applies general business knowledge to enhance work performed
5.1.2 Recognizes the interrelationships among departmental and functional areas within the organization
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.1.3 Demonstrates skepticism, objectivity, due care and persistence when identifying issues
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.2 Identifies patterns from data analysis
6.2.3 Questions the relevance and tests the quality of information and assumptions in own analyses
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Currently, the Chef Dashim brand offers vegetarian meal kits at three different price levels. With each increase in price, higher quality and more unique ingredients are introduced. As the level moves up, the recipes also become more intricate.

Sales Data Analysis

Based on the monthly sales data provided, which shows the number of meal orders versus the price of the meal, there are several interesting observations.

The casual basic meal kits are not unique in the market, nor do they have anything that specifically differentiates the Chef Dashim brand from other brands in the market. The graph indicates that, as prices decrease, more meals are ordered, and as prices increase, fewer meals are ordered. There is a price point ($12 per meal for basic kits, and $14 per meal for organic kits) where the price is prohibitive. In other words, customers are not willing to pay more than $12 or $14 per meal for these two product lines, respectively. This suggests that customers will search for the lowest price available for meals at the casual level. The customers purchasing these casual meal kits appear to be price sensitive, as the number of orders increases as the price falls, and vice versa. The increase in TMB's total units sold, when discounts were given to customers, supports the conclusion that customers purchasing these product lines are price sensitive.

The data for the gourmet meals indicates that customers are not as price sensitive. In fact, during some months, as the price per meal increased, the number of meals ordered increased. Customers appear to be finding something in the gourmet meals worth paying for, and seem more likely to continue to purchase the Chef Dashim brand regardless of price.

Overall, it is fair to assume that the revenue from Chef Dashim meal kits will continue to decline if price incentives are the only basis of differentiation. When customers cannot identify obvious differentiating factors, they look for the company offering the lowest price. If TMB wants to compete on something other than price, it should promote the gourmet products, since it appears that, in the market segment, the product is differentiated for which customers are willing to pay a premium price. In order to build brand loyalty, rather than continuously trying to attract new customers, the Chef Dashim brand needs to differentiate itself on factors other than price.

Target Market

Based on data, the Chef Dashim brand should not compete based on price for sales of the casual basic meals, as this is not a sustainable strategy. Instead, the data suggests focusing on the other two meal kit options: gourmet meal kits, and casual organic meal kits.

Gourmet meal kits

Customers often purchase meal kits for convenience. However, if it were only about convenience, ordering take-out or delivery would be the more likely option. Consumers are also looking for the experience of creating a new meal but without the pressure of sourcing the unique ingredients and recipes. The gourmet meal kit takes this one step further and gives consumers the feeling of having a gourmet chef cooking alongside them. As the data suggests, customers do not seem to be sensitive to the price of these meals. They are ordering the meals for the quality, uniqueness, and experience of creating the meals alongside Chef Dashim. TMB should focus on marketing its product lines for organic and gourmet meal kits, as these customers value uniqueness and quality, and are not price sensitive. This will allow TMB to develop a loyal customer base in a niche market, and hopefully draw on customers who will continuously return to TMB for the type of meal kits that are not available elsewhere or from competitors.

Casual organic meal kits

These meals contain organic or unique ingredients, which come with a higher price, but the customers seem to accept this. This aspect of the Chef Dashim brand should be clearly communicated to consumers, as it will attract those with similar values.

Recommendation

Based on the above analysis, I recommend that TMB focus its marketing on the casual organic and gourmet meal kits, while de-emphasizing the casual basic line. The casual basic meal kits should still be offered, but a focus on generating sales of the casual organic and gourmet meal kits will result in a more sustainable revenue level that will not be as sensitive to price fluctuations. TMB should focus on marketing the Chef Dashim brand on platforms that attract the type of customers who are more likely to be drawn to high-quality, vegetarian meals. A focus on maintaining customers needs to be made. De-emphasizing the casual basic meal kits within the Chef Dashim brand will shift the brand away from competing on price and towards more sustainable factors. TMB needs to clearly communicate to consumers that these product lines are the foundation of the Chef Dashim brand, and that customers can expect high-quality meal kits. In this way, TMB can focus its product development on these two product levels, rather than spreading its resources across three product levels.

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

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

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

Reaching competence – The candidate attempts to analyze some of the pricing and customer orders data.

Competent – The candidate analyzes the pricing and customer orders data and provides some recommendations on the customers that should be targeted, making linkages between the information provided.

Competent with distinction – The candidate analyzes the pricing and customer orders data and provides several supported recommendations on the customers that should be targeted, making linkages between the information provided.

Assessment Opportunity #11 (Depth Opportunity)

The candidate determines how the cash flow projections provided by VS would change if TMB became the owner of VS.

The candidate demonstrates competence in the Performance Management role.

CPA Map Technical Competencies:		**Core**	**E1 PM**
3.3.2	Evaluates and applies cost management techniques appropriate for specific costing decisions	B	A

CPA Map Enabling Competencies:
5.1.1 Applies general business knowledge to enhance work performed
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems
6.2.3 Questions the relevance and tests the quality of information and assumptions in own analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

After reviewing the cash flow forecast provided by VS, the following issues/questions have been noted:

- Abnormal spoilage costs of $225,000 are included in the 2021 direct materials, and projected into the cash flow forecast. To forecast more accurately the "normal state," these unusual costs need to be removed from the 2021 direct materials expense.

VS 2021 direct materials	$ 3,500,000
Less: VS spoilage of gelatin	(225,000)
Normalized direct materials	$ 3,275,000

- VS receives volume discounts on its three primary ingredients. These materials make up 75% of the normal direct materials balance. Without the volume discount, VS would pay the regular price, which is 40% higher than it currently pays. TMB would not benefit from these volume discounts from suppliers, because total annual orders would not be over $50 million. The direct material costs need to be adjusted for this lack of a discount.

2021 normalized direct materials	$ 3,275,000
75% of direct materials receive volume discount	2,456,250
Market cost – 40% increase ($2,456,250 × 140%)	3,438,750
TMB's additional expected direct material costs	$ 982,500

- The allocation for the master candy maker can be removed and replaced by our anticipated cost for a part-time candy maker.

VS master candy maker allocated cost (portion of salary)	$ 35,000
TMB anticipated cost (part-time candy maker)	25,000
Adjusted to direct labour	$ (10,000)

- VS did not have costs of procurement allocated to the subsidiary. TMB expects to incur $60,000 per year; therefore, this needs to be adjusted.

- A dessert manager would have to be hired. TMB expects this cost to be $130,000 per year, which therefore needs to be adjusted.

- TMB expects to lay off 5% of the direct labour costs due to the hiring of new employees. This needs to be adjusted in the cash flow.

VS direct labour costs	$ 1,250,000
Add: reduction in candy maker salary	(10,000)
Less: 5% reduction wage savings due to layoffs	(60,750)
Total direct labour costs	$ 1,179,250

Taking into account these pro forma adjustments to the 2021 information, and assuming an increase of 2% in 2022, and 5% per year thereafter, the cash flow projection becomes the following.

	2021 Actual – Pro Forma	**2022 Forecast**	**2023 Forecast**	**2024 Forecast**	**2025 Forecast**
Units sold	1,050,000	1,071,000	1,124,550	1,180,778	1,239,816
Revenue	$8,400,000	$8,568,000	$8,996,400	$9,446,220	$9,918,531
Product costs:					
Direct materials (Note 1)	4,257,500	4,342,650	4,559,783	4,787,772	5,027,160
Direct labour (Note 2)	1,179,250	1,202,835	1,262,977	1,326,126	1,392,432
Variable overhead	550,000	561,000	589,050	618,503	649,428
	5,986,750	6,106,485	6,411,810	6,732,400	7,069,020
Contribution margin	2,413,250	2,461,515	2,584,590	2,713,820	2,849,511
Fixed costs (Note 3)	1,085,000	1,106,700	1,162,035	1,220,137	1,281,144
Total cash flow	$1,328,250	$1,354,815	$1,422,555	$1,493,683	$1,568,367

Notes:

1.

Original projection	$ 3,500,000
Additional cost of flour, sugar, and substitute butter	982,500
Reduction in spoilage	(225,000)
	$ 4,257,500

2.

Original projection	$ 1,250,000
Reduction in candy maker salary	(10,000)
Wage savings caused by layoffs	(60,750)
	$ 1,179,250

3.	Original projection	$	895,000
	Salary of procurement manager		60,000
	Salary of dessert manager		130,000
		$	1,085,000

Additional comments:

- The forecast does not account for inflation of actual costs over the forecast period. Currently, any increases are a result of increases in sales volumes. Presumably, over the years presented in the forecast, there will be an increase in the cost of materials and labour, overheads, and other fixed costs. Perhaps those would be offset by an annual inflation in sales price, which has also not been forecast. This information needs to be assessed, to ensure that direct cost increases are not outpacing the ability to increase the sales prices. In addition, given the competitive market in the meal-kit business and consumers' price sensitivity, TMB may not be able to increase selling prices for the desserts sold in the meal kits to compensate for higher input costs.
- TMB will have another revenue stream of selling to a new customer base: supermarkets and restaurants. TMB may be able to cross-sell its meal kits to the supermarket customers, since supermarkets are also getting into the meal-kit market. This would further increase the sales from this acquisition, and increase the annual cash flows forecast.
- The forecast is driven off unit growth. TMB needs to understand how the 2% and 5% annual growth rate in unit sales is determined. Is it based on historical sales, market research, or some other factor? This will impact the accuracy of the forecast.
- The additional sales of dessert add-ons for the meal kits have not been incorporated into the forecasts. As is currently being done in the industry, competitors are providing add-ons to the meal kits in order to differentiate themselves. Selling vegan add-on desserts in smaller portions will provide another revenue stream for TMB. There will be additional costs to TMB to re-portion and package the dessert recipes into smaller servings to accommodate meal kits, or to deliver the desserts to the fulfillment centres. Provided that TMB can charge an appropriate price for these add-ons, the contribution margins should be maintained. Alternatively, if the total costs cannot be covered with the add-on selling price, this may reduce the contribution margin provided by the desserts' add-on sales.

Conclusion

Based on the above, the projected cash flow of VS will be lower under TMB's ownership. VS was able to benefit from significant cost savings as a result of being a subsidiary of CC. TMB will not have access to volume discounts from the supplier, and it can expect a lease cost increase, beginning on January 1, 2023. In addition, as TMB does not have experience in making desserts, it will need to hire a baking manager to oversee the operation, to ensure that it is functioning as intended. However, there are possible additional profits that could be generated from this acquisition if TMB sells these desserts as add-ons to its meal kits. Being vertically integrated with a bakery would allow TMB's costs for these add-ons to be lower than for many competitors.

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

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

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

Reaching competence – The candidate attempts to make appropriate adjustments to the cash flows under TMB's ownership.

Competent – The candidate makes appropriate adjustments to the cash flows under TMB's ownership.

Competent with distinction – The candidate makes appropriate adjustments to the cash flows under TMB's ownership, and provides relevant qualitative analysis.

Assessment Opportunity #12 (Depth Opportunity)

The candidate discusses the advantages and disadvantages of TMB acquiring VS, and whether this acquisition is a good strategic fit.

The candidate demonstrates competence in the Performance Management role.

CPA Map Technical Competencies:		**Core**	**E1 PM**
2.3.3	Evaluates strategic alternatives	B	A

CPA Map Enabling Competencies:
5.1.1 Applies general business knowledge to enhance work performed
5.1.2 Recognizes the interrelationships among departmental and functional areas within the organization
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.1.3 Demonstrates skepticism, objectivity, due care and persistence when identifying issues
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions
6.3.3 Applies decision criteria to choose among viable alternatives

The following qualitative factors should also be considered with respect to adding ready-to-eat desserts through the VS asset acquisition.

Advantages:

- This acquisition would complement Chef Dashim's expertise in the vegetarian meal niche of TMB. Adding vegan desserts to the existing meal kits would enhance TMB's position in the vegetarian market.
- VS operates in Western Canada, and is therefore geographically located in a strategically sound location, considering the Western Canadian market targeted by the Chef Dashim branded vegetarian meal kits.
- Including ready-made desserts as an add-on to the existing meal kits might become a new trend, and could help differentiate TMB.
- The ready-made desserts provide customers with the opportunity to create a complete meal. Customers may see value in this option, and may order their meal kits from TMB simply to take advantage of the dessert add-on.
- Offering ready-made desserts fits extremely well with the gourmet product line, as a gourmet meal is typically a complete meal, including a fancy dessert.
- Leasing a fulfillment centre that is already operating efficiently eliminates the need to build one, or to expand TMB's existing centres if it chose to start including desserts in its meal kits.
- Chef Dashim and Chef Rita could expand on, or improve, the dessert recipes that have been acquired from VS, to appeal to more customers.
- The sale of vegan desserts with quality ingredients further establishes TMB as a quality and health-oriented company.
- Having the supermarkets and restaurants as customers will expand TMB's market, and provide diversification of its customer base and revenue streams.
- There may be some opportunity to approach the supermarkets about their purchasing meal kits, to be sold in the supermarkets, allowing for some cross-selling opportunities.

Disadvantages:

- Although the desserts will be sold as an add-on to meal kits, customers may not be interested in adding any more to their meal-kit orders, and may not be interested in purchasing the desserts.
- TMB will need to determine the appropriate pricing of the dessert add-on, that accounts for price sensitivity. TMB may not be able to charge what VS charged when the dessert was a stand-alone item.
- Baking desserts requires a different skill set, and TMB may not have the experience or knowledge necessary. Therefore, it will need to hire a baking manager, to ensure that the operation functions optimally.
- TMB is not experienced when dealing with supermarkets and restaurants. There may be a learning curve to this operation, which may result in extra use of resources, or a loss in the existing revenue from supermarkets/restaurants, if they become frustrated with disruptions.
- If TMB wants to expand on the recipe inventory purchased from VS, it will incur development costs, which will reduce the financial benefits of the acquisition.
- As it is an emerging trend, market data on how consumers would view the ability to add dessert to their meal kit is limited.

- Although the acquisition includes a customer list, as VS customers are bakeries and supermarkets, TMB may not be able to take advantage of this list in order to expand its meal-kit customer list.

Recommendation

There are several benefits to the acquisition, such as diversification of revenue stream (supermarkets and restaurants), the dessert recipes (thus eliminating development costs in the near term), a functioning fulfillment centre, and the customer lists (which may not translate into additional meal-kit customers, given that VS's market was restaurants and supermarkets). Based on the above quantitative and qualitative analysis, it does not appear that acquiring VS is in TMB's best interests. VS receives several significant cost savings that would not apply to TMB. In addition, given that there is already so much price sensitivity, it may be difficult for customers to justify an extra charge for the dessert add-ons, and TMB may not be able to charge enough per dessert to generate an acceptable margin.

If TMB is interested in ready-made desserts to sell as add-ons to its meal kits, it could begin with purchasing ready-made desserts from VS, to see how the customer base reacts. TMB can then assess whether there is sufficient traction before further exploring how to develop this line of business.

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

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

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

Reaching competence – The candidate attempts to discuss some of the qualitative issues around the acquisition of VS.

Competent – The candidate discusses some of the qualitative issues around the acquisition of VS.

Competent with distinction – The candidate discusses several of the qualitative issues around the acquisition of VS, providing a well-balanced analysis.

Assessment Opportunity #13 (Depth Opportunity)

The candidate discusses the relative success of the original objectives, what could have been improved in implementing and integrating the newly acquired business, and what avenues for growth other than acquisitions might be considered in the future.

The candidate demonstrates competence in the Performance Management role.

CPA Map Technical Competencies:		Core	E1 PM
2.3.3	Evaluates strategic alternatives	B	A
2.4.1	Analyses key operational issues including the use of information assets and their alignment with strategy	B	A

CPA Map Enabling Competencies:
5.1.1 Applies general business knowledge to enhance work performed
5.1.2 Recognizes the interrelationships among departmental and functional areas within the organization
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.1.3 Demonstrates skepticism, objectivity, due care and persistence when identifying issues
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions
6.3.3 Applies decision criteria to choose among viable alternatives

With the acquisition of only PVM in the past three years, TMB has been slow to implement its strategy of growth through acquisition. The integration of PVM has been challenging, with higher integration costs than anticipated, and large reductions to expected revenues. TMB has been occupied with trying to realize the cost savings and revenue growth that PVM was thought to provide.

TMB Objectives and What Could Have Been Improved

TMB acquired PVM with three objectives:

- **To access the Western Canadian market to achieve economies of scale on procurement costs and increase revenues that were stagnating in Eastern Canada**. Before an acquisition was made to address this issue, TMB should have determined why revenues in the east were stagnating, and how an acquisition would alleviate this. It seems that the eastern location of TMB was attempting to compete based only on price. If the eastern location was offering a very similar product to its eastern competitors, consumers will always purchase the lowest price option. The stagnating revenues in the east demonstrate why competing on price is not sustainable. Unless costs are decreasing proportionately, the profits will quickly erode. If TMB does not intend to differentiate (and then market that feature) from other meal-kit companies on factors other than price, it should expect the same results in the west. If TMB wanted access to the western market, it needed to clearly understand how PVM was different from the existing meal-kit companies in the west, and how it was going to market those differences. This objective was therefore only partially met; the economies of scale on procurement costs are ongoing and will likely materialize going forward, but the increase in revenues has not materialized, due to the causes mentioned above.

- **To reduce costs by duplicating PVM's state-of-the-art Vancouver fulfillment centre in its existing Montreal facility**. Instead of doing this, TMB should have had an in-depth look at the Montreal operations, figure out what is driving the high costs, and see if it was something within its control. The duplication of the fulfillment centres does not take into account the differences in the two markets and the two product lines, which makes meeting this objective more difficult.
- **To obtain Chef Dashim's culinary expertise for product development**. This is what TMB should have focused on, once the acquisition was complete. Rather than limiting the creation and development of new recipes by Chef Dashim, and continuing to offer products similar to others in the meal-kit industry (resulting in price competition), TMB needed to emphasize Chef Dashim's unique vegetarian offerings, and communicate what consumers can expect with the Chef Dashim brand, and how that makes TMB different from the existing meal-kit companies. Although TMB offered gourmet and casual organic meal kits that showcase his experience, these were not emphasized. Instead, too much focus remained on the casual basic meal kits, whose customers are very price sensitive. This objective was probably the most significant one, and TMB's actions since the acquisition made it very difficult to meet it.

In addition, Chef Dashim had four high-end restaurants that were acquired, but the implementation and integration of their acquisition by TMB did not seem to take this strategic positioning into account. Instead of trying to replicate the model used by its existing activities, which focused on competing on price, TMB should have integrated the restaurant acquisition with the strategic objective that motivated the acquisition—access to the culinary expertise of Chef Dashim. For example, the high-end restaurants could have been used to test the popularity of new recipes developed by Chef Dashim, which could then be eventually included in gourmet meal kits. Instead, TMB ignored the high-end strategic positioning of the four restaurants, and instructed Chef Dashim to reduce prices, which has had a detrimental impact on the customer experience, as evidenced by the negative comments made by the customers polled.

Although TMB wants a strategy of growth through acquisition, it may not have spent enough time considering the direction it wanted to take, and why that direction would add value to consumers. Before making any further acquisitions, TMB probably needs to take the time to do that.

If TMB plans to continue to grow through acquisition, the acquired company must have an existing, or potential, differentiating feature. Revenue growth is too simple a reason for acquiring a company. There needs to be a clear sense of why/how the revenue would grow, and a specific, realistic way of achieving the growth. Ideally, TMB would identify a gap in the meal-kit market and acquire a company that can fill that gap, thus attracting customers for reasons other than price. If TMB cannot identify this, the acquisition is a poor idea, as TMB would continue to compete based on price. There are too many meal-kit companies offering similar products, leaving price as the only factor to compete on. In addition, supermarkets are entering the meal-kit market. With access to a large customer base and cheaper ingredients through discounts, it will be very difficult for any meal-kit company to compete on price.

Other Avenues for Growth

TMB needs to consider where it wants to position itself in the meal-kit market, and how it plans to compete. TMB may want to consider internal growth. It also needs to get its operations in order before acquiring, to drive revenues. By looking at what makes TMB unique, it can find a way to compete. Price is one way to compete. Competing solely on price means consistently underpricing competitors for a similar product. The number of companies in the meal-kit market is significant and increasing. There is always pressure to price meal kits lower than the next company in order to attract customers. This strategy is only sustainable if the company has lower total costs than its competitors. The right type of acquisition can achieve economies of scale, reducing total costs. We saw this with TMB's ability to renegotiate its supplier contracts, now that its annual purchase volumes are substantially higher.

As we have seen throughout my report, there are other ways that TMB can differentiate itself beyond price, some that may not require the acquisition of another meal-kit company:

- TMB should begin emphasizing and marketing the high-quality, unique vegetarian meals and gourmet meals, which is where Chef Dashim excels. It is evident from the pricing-versus-orders data within the Chef Dashim brand that customers who order the organic and gourmet meal kits are not price sensitive.
- TMB could consider adding additional products that are not typical of a meal-kit company, either through an acquisition or organic growth. We have received the offer to purchase Vegan Sweets. While an acquisition of this nature may not be immediately advisable, adding desserts is an example of how TMB can further differentiate itself. Including the option for a ready-made dessert may appeal to customers who are looking for a complete meal, especially among the gourmet meal customers. It might also be a way for TMB to differentiate itself from its competitors.
- Adding new product lines that are outside of meal kits is a way to differentiate and grow the company. TMB's secret sauces are very popular among customers. There is an opportunity to develop this into another product line. This would diversify TMB and provide some protection against the market changes within the meal-kit market.
- Environmental sustainability is becoming important to consumers. For example, I would suggest that TMB differentiate itself through moving towards reusable plastic, but as a pilot program, and then begin using it with repeat customers. TMB may become known as the meal-kit company that values environmental sustainability, and might attract like-minded consumers.

Overall

Before any further acquisitions, TMB needs to develop a differentiation strategy that moves away from price competition, and the integration of PVM needs to be completed. TMB needs to find ways to develop a loyal customer base that recognizes TMB for qualities beyond simply price, as competing on price is not sustainable. Consumers will continuously look for the meal-kit company with the best pricing incentives. TMB needs to differentiate itself with something that appeals enough to customers to bring in repeat business. The messaging to the external shareholders needs to be updated. It may be appropriate to provide more information on what the company is trying to achieve with its acquisitions; this could communicate that TMB will pick its targets to achieve growth by acquisition through differentiation. In the near term, TMB will be focusing on streamlining the current operations to emphasize its current strengths, and then perhaps move toward acquisitions that will fill a gap in the meal-kit market.

For Assessment Opportunity #13 (Performance Management), the candidate must be ranked in one of the following five categories:

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

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

Reaching competence – The candidate attempts to discuss the relative success of the objectives related to the acquisition of PVM, what could have been improved in the integration and implementation of the new acquisition, or suggests ways to improve the strategy of growth by acquisition going forward.

Competent – The candidate discusses the relative success of the objectives related to the acquisition of PVM, what could have been improved in the integration and implementation of the new acquisition, and suggests ways to improve the strategy of growth by acquisition going forward.

Competent with distinction – The candidate thoroughly discusses the relative success of the objectives related to the acquisition of PVM, what could have been improved in the integration and implementation of the new acquisition, and suggests ways to improve the strategy of growth by acquisition going forward.

DAY 2 – MARKING GUIDE – TAXATION ROLE
TASTY MEAL BASKETS LIMITED (TMB)

To: Samra, CPA
From: CPA
Re: TMB taxation issues

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

Assessment Opportunity #7 (Depth Opportunity)

The candidate discusses the tax treatment of the financial reporting issues and the land sale.

The candidate demonstrates competence in the Taxation role.

CPA Map Technical Competencies:		**Core**	**E4 TAX**
6.2.2	Advises on taxes payable for a corporation	B	A

CPA Map Enabling Competencies:
5.1.1 Applies general business knowledge to enhance work performed
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.1.1 Identifies and articulates issues within areas of work responsibility
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

Tax Treatment of Financial Reporting Issues

Under subsection 9(1) of the Income Tax Act*,* net income for tax purposes is determined by starting with profit. Profit would be determined using normal accounting practices, in this case, IFRS. Any adjustments are then made that are specifically required for tax.

Discounts

Subsection 12(1) requires that all amounts received, or receivable, are included in net income for tax purposes. Therefore, this would suggest that the entire $62.80 for the first meal kit and $31.12 for the second meal kit be included in income for tax purposes at the time each of those payments is received. This means that the amount moved to deferred revenue should be added back into income for tax purposes.

Paragraph 20(1)(m) permits a reserve with respect to undelivered goods and services, so this reserve can be claimed in the same amount as was brought to deferred revenue, as the amount deferred relates to the meal kits that have not yet been delivered. Ultimately, this yields the same result as for financial reporting purposes, but it is important to claim the reserve for tax purposes on the tax return.

<u>Contract with Chef Arlene</u>

TMB purchased a right to use Chef Arlene's recipes and brand name. We should consider the alternative treatments for tax purposes.

Class 44

We are told that recipes cannot be patented; as Class 44 is only for patents, these cannot be Class 44 assets. Similarly, the brand names are not patents and therefore would not belong in Class 44.

Class 14.1

Class 14.1 is used for goodwill and certain other capital costs with respect to a business, including unlimited life intangibles. The contract clearly indicates that there is a limited life to the property (five years), and there is no mention of a renewal term. It is therefore unlikely that the property would be added to Class 14.1, as that class is typically reserved for property with an unlimited life, which is not the case here.

Also, for property to be added to Class 14.1, there would have to be enduring benefit (this is not the same concept as future economic benefits used for financial reporting purposes). Given that the recipes are publicly available when meal kits are sent to customers, it is difficult to say that there is any enduring benefit. There may be some enduring benefit to the Chef Arlene brand name, but that is time limited to the five years, as TMB will not be able to use it after the end of the contract without an extension. Thus, Class 14.1 is not available for these costs.

Class 14

Class 14 includes property that is a patent, franchise, concession, or licence, for a limited time. There is a limited time that TMB can use the recipes and brand name, being five years, so Class 14 should be considered. There is no patent or franchise involved, but it could be a concession or licence. These terms are not defined in the Income Tax Act, so we must refer to the normal definition of those words. A concession would generally involve the conceding or granting of something for a specific purpose, and a licence would generally be a form of permission to do (or not do) something. Since Chef Arlene is granting permission to use her recipes and brand name for five years, there is an argument that this is a concession or licence.

In this case, TMB would claim CCA over the useful life of the asset (five years, or 1,826 days). Class 14 does not have a half-year rule, but the accelerated investment incentive rules provide for a 50% increase in the CCA deduction for the year of acquisition because the property was acquired before 2024. Therefore, CCA for 2021 would be $70,318 ($400,000 × 214/1,826 × 1.5).

Period costs

Alternatively, concessions and licences would not include a contract under which a person is paid for the performance of specified services, nor a covenant not to compete for a limited period. (This wording is used in archived IT bulletin IT-477 (Consolidated), but also follows the normal use of these words.) Some amount of the portion paid is related to Chef Arlene's agreement not to provide the brand name to other meal-kit companies and not to provide the recipes to any other party.

It can also be argued that the recipes are a sort of "prepaid expense" or "inventory" that is used up as each one is used for the first time (since the cost is, in a way, incurred so that TMB does not have to incur costs to develop as many new recipes internally). Similarly, there is an argument that the brand name rights are a form of prepaid compensation for five years of advertising.

Thus, following the underlying concept in subsection 9(1) of determining net income for tax purposes by starting with "profit," the costs would be treated for tax purposes in the same way that they are treated for accounting; that is, capitalized and amortized over five years (as an approximate estimate of the costs being used up—again, we would need more information to determine the actual rate of use). The expenses are deductible as they are laid out for the purpose of earning business income, but given the length of the contract, it is reasonable to expense them over the five years rather than as an immediate deduction.

Since all of accounting depreciation and amortization is added back, TMB would deduct $46,666 (the same amount as for accounting purposes) in 2021 for tax purposes.

Conclusion

Treatment of the contract, both the brand name and recipe costs, as a prepaid expense would be most appropriate, following the principle that net income for tax purposes should start with accounting profits. Accordingly, there is no additional adjustment required to net income for tax purposes once the financial reporting adjustment made earlier is reflected.

Purchase of property and equipment

Accounting write-off of building components fully replaced

The write-off of the net carrying value of the old heating and cooling system, roof, flooring, and walls of $460,000 ($120,000 + $340,000) is not deductible for tax purposes, and must be reversed when reconciling from net income for accounting purposes to net income for tax purposes. These assets are essentially disposed of for zero proceeds. For tax purposes, the lesser of cost or proceeds of disposition is removed from UCC. The lesser would be the nil proceeds, and these are not the only assets in the class, so there is neither a terminal loss nor any impact on the calculation of CCA.

Whether an item is a betterment or a period expense for tax purposes follows similar concepts used for IFRS, but there can be differences.

Costs to replace missing or damaged bricks on outside of building of $250,000

This is a current expense, as it is clearly a repair.

Total replacement of heating and cooling system and roof of $1.3 million

It could be argued that this is a current expense, as it is an integral part of the building, but given the life of such systems, the fact that a new system is likely more efficient than the old one creates enduring benefits. Thus, this is a capital cost and should be added to Class 1.

New air filtration system of $240,000

Since this is a “new system added to the building,” this is clearly an addition to the Class 1 building.

Replacement of floors and walls for $2,010,000

This is a substantial cost compared to the value of the asset as a whole, is an improvement in technology, and has enduring value. Thus, this is a capital cost and is added to Class 1.

Employee wages and benefits of $600,000

This cost relates to the replacement of the floors and walls, and thus should be capitalized as well. Direct costs required for making an asset available for use are included in the capital cost for tax purposes.

Costs of relocating the equipment of $60,000

These costs should be expensed, as there is no improvement to the underlying equipment, and the equipment was already available for use at the time it was moved.

Costs of disposing of the old floor and wall material of $150,000

These costs are part of the betterment, and thus should be capitalized with the other capital expenses.

Costs to repair new floor due to flood

The cost of $230,000 (costs of $350,000 less insurance proceeds of $120,000) to repair the new floor due to the flood is repairs and maintenance, as it was incurred to maintain the asset in its present state, despite being a relatively new item. The insurance proceeds are netted against the cost of the repair as a cost recovery. Since the $350,000 cost is included in the $2,010,000 above, it needs to be deducted from the addition to Class 1, though no adjustment is required to income as the amount was recommended earlier to be expensed in the financial statements.

Summary

Unadjusted additions to building, from draft financial statements	$ 3,800,000
Expense brick repair	(250,000)
Capital wages (walls and floors)	600,000
Capitalize disposal cost – wall and floor material	150,000
Expense flood repairs	(350,000)
Addition to Class 1	$ 3,950,000

<u>Disposition of vacant land</u>

In addition to the financial reporting issues, one additional issue needs to be discussed, which is the tax treatment of the disposition of vacant land in Vancouver. Whether the disposition of vacant land is a capital gain or business income is a question of fact. In this case, we know the original intent was to build a fulfillment centre, which supports that TMB purchased it as capital property. If some costs had been incurred toward this purpose, that would have made even more clear that this was the intended purpose. The lack of any such activities might indicate that the land was purchased to merely hold and sell later, which would point to the purchase of inventory.

In addition, TMB announced in 2019 that it planned to grow through acquisition, so if these plans were already in the works in 2018 when the land was acquired, and the acquisition plans might have included the acquisition of PVM (or a similar acquisition that would negate the need for the Vancouver land), there may be an argument that the land was in fact inventory for resale.

However, it does seem that the land was initially purchased specifically for the construction of a fulfillment centre. Given that TMB purchased PVM, there was no longer a need to build its own fulfillment centre. In this case, the original intent was "frustrated," and the land was no longer needed for its original purpose. It is possible that the Canada Revenue Agency (CRA) might say that the use is a mix of capital and inventory, but the property was sold in a reasonable length of time after the acquisition of PVM (less than one year).

Therefore, TMB should file on the basis that the gain is a capital gain. The accounting gain is deducted from income for tax purposes, and the taxable capital gain (50% of the gain) is added.

Note that subsection 18(2) limits the deduction of property taxes and interest on vacant land, other than to the extent that land produces income or is used in the ordinary course of the taxpayer's business. Since TMB was not using the land in its business or producing income from the land, it should have capitalized these expenses. Accordingly, before finalizing the tax return, we should confirm how these items were treated in the past, and whether all relevant amounts have been added to the land's adjusted cost base.

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

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

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

Reaching competence – The candidate discusses the tax treatment of some of the significant issues.

Competent – The candidate discusses the tax treatment of several of the significant issues.

Competent with distinction – The candidate discusses the tax treatment of most of the significant issues.

Assessment Opportunity #8 (Depth Opportunity)

The candidate calculates taxes payable, providing supporting explanations.

The candidate demonstrates competence in the Taxation role.

CPA Map Technical Competencies:		**Core**	**E4 TAX**
6.2.2	Advises on taxes payable for a corporation	B	A

CPA Map Enabling Competencies:
5.1.1 Applies general business knowledge to enhance work performed
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

Preparation of Income Tax Return

Capital cost allowance (CCA)

Class	Opening UCC	Additions	Disposals (none)	Accelerated Investment Incentive Adjustment	Base for CCA	Rate	CCA
1	$ 6,826,000	$3,950,000		$ 1,975,000	$12,751,000	6%	($765,060)
8	1,015,000	60,000		30,000	1,105,000	20%	(221,000)
12	0	260,000		0	260,000	100%	(260,000)
14.1	1,258,000	0		0	1,258,000	5%	(62,900)
50	102,000	350,000		175,000	627,000	55%	(344,850)
53	0	2,850,000		0	2,850,000	50%	(2,850,000)
							($4,503,810)

I have assumed that additions to the Class 1 building will also be eligible for the 6% CCA rate, as they are being made to the same building. Due to the accelerated investment incentive, Class 53 has a 100% deduction in the year of acquisition rather than 50%.

Other adjustments to taxable income

Accounting depreciation and amortization

Amortization is added back for income tax purposes as an amount on account of capital. CCA is deducted instead.

Capital lease payments

Leases are treated as a current expense for income tax purposes. The accounting depreciation of the capitalized lease asset would be added back (which is already done through adding back depreciation from the financial statements).

The entire lease payment should be deducted for income tax purposes. The interest portion of the lease payment would already be deducted in accounting income. Therefore, the principal portion of the lease payment needs to be deducted for tax purposes. Assuming there are no new leases for 2021, the 2021 principal portion is the change (reduction) in the lease liability from 2020 to 2021.

Meals and entertainment

Only 50% of meals and entertainment is deductible for income tax purposes, thus 50% is added back.

Charitable donations

Charitable donations are not considered to be incurred for the purposes of earning income from business, and are added back in determining net income for tax purposes. There is a deduction available for charitable donations made by a corporation by virtue of subsection 110.1(1), thus the donations are deducted in Division C in the determination of taxable income. The amount of the deduction is limited to 75% of the corporation's net income for tax purposes, which is easily met here.

Calculation of taxable income

Income before taxes, per financial statements	$	4,560,000
Financial statement adjustments:		
Discount website offer (AO#1)		(110,880)
Chef Arlene contract – brand name (AO#2)		(23,333)
Chef Arlene contract – recipes (AO#2)		(23,333)
Net costs expensed (AO#3)		(310,000)
Revised income before taxes, per financial statements		4,092,454
Reverse IFRS contract liability – accounting reserve		110,880
Claim tax reserve for undelivered goods on website discount		(110,880)
Chef Arlene contract – no tax adjustment required		0
Heating and cooling system and roof accounting write-off		120,000
Floors and walls accounting write-off		340,000
Accounting amortization		3,017,000
Capital lease principal payments		(983,000)
Capital cost allowance		(4,503,810)
Charitable donations		30,000
Meals and entertainment		25,000
Accounting gain on land sale		(550,000)
Taxable capital gain on land sale		275,000
Net income for tax purposes		1,862,644
Division C deductions – charitable donations		(30,000)
Taxable income	$	1,832,644

Federal taxes payable:

Taxable income		$	1,832,644
Basic corporate rate	38%		696,405
Federal abatement	10%		(183,264)
General rate reduction	13%		(238,244)
Federal taxes payable		$	274,897

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

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

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

Reaching competence – The candidate attempts to calculate taxes payable.

Competent – The candidate provides a reasonable calculation of taxes payable.

Competent with distinction – The candidate provides a thorough calculation of taxes payable.

Assessment Opportunity #9 (Depth Opportunity)

The candidate analyzes the income tax and GST/HST implications of the purchase of DI.

The candidate demonstrates competence in the Taxation role.

CPA Map Technical Competencies:		**Core**	**E4 TAX**
6.2.2	Advises on taxes payable for a corporation	B	A
6.6.3	Analyzes income tax implications of the purchase and sale of a CCPC	B	B
6.7.5	Analyzes GST implications from tax planning for shareholders and a closely held corporation	C	B

CPA Map Enabling Competencies:
2.1.1 Applies knowledge of the organization's competitive environment and strategic direction when performing assigned work
2.2.1 Assists in identifying and monitoring risks within areas of work responsibility
5.1.1 Applies general business knowledge to enhance work performed
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.1.1 Identifies and articulates issues within areas of work responsibility
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

Purchase of Desserts Inc. (DI)

Purchase of assets

If the assets are purchased, TMB would have additions to several CCA pools, based on the fair market value (FMV) of the assets acquired. CCA in the first year would be calculated as follows:

Class 8	$250,000 × 20% × 1.5	=	$ 75,000
Class 50	$450,000 × 55% × 1.5	=	371,250
Class 53	$1,500,000 × 50% × 2.0	=	1,500,000
Class 14.1	$8,100,000 × 5% × 1.5	=	607,500
Total			$ 2,553,750

GST/HST would have to be paid on the Class 8, 50, and 53 assets, and then TMB would claim an input tax credit (ITC) for the GST/HST paid. Goodwill is not a taxable supply.

Alternatively, the seller and the purchaser could jointly elect to have GST/HST not apply, using Form GST44 "GST/HST Election Concerning the Acquisition of a Business or Part of a Business." Both parties are GST/HST registrants, and the transaction is for substantially all of the assets of the business, so this transaction will qualify for this election.

Purchase of shares

If TMB purchases the shares of DI, there would be an acquisition of control, and a deemed taxation year end for DI immediately before the acquisition.

The acquisition of control requires DI to recognize all accrued losses. Based on this rule, the Class 8 assets would have to be written down to their fair market value of $250,000. This would result in deemed CCA taken of $350,000 (UCC $600,000 - $250,000 FMV). The new UCC balance after the acquisition of control would be $250,000. There would be no adjustment to Class 50 or Class 53, as the FMV of each is greater than the UCC balances for both pools. Note that this is to be determined on an asset-by-asset basis, not on the entire pool, so this is an assumption that would need to be confirmed at the time of acquisition.

CCA available in the year after acquisition would be calculated as follows:

Class 8	$250,000 × 20% =	$ 50,000
Class 50	$400,000 × 55% =	220,000
Total		$ 270,000

The charitable donations of $50,000 expire at the acquisition of control.

Non-capital losses can survive an acquisition of control, but they can only be claimed against income from the same or a similar business that generated the non-capital losses, which is carried on with a reasonable expectation of profit (paragraph 111(5)(a)).

DI meets these conditions. DI would continue to operate the same business, as TMB intends to offer DI's desserts as part of its meal kits. Given the value of goodwill, it seems likely that there was a reasonable expectation of profit.

It could be possible to elect to realize unrealized gains, under paragraph 111(4)(e), which would be applicable to Classes 14.1, 50, and 53. The maximum elected value would be FMV, which would result in a higher UCC balance and higher CCA after the acquisition. This would result in both a capital gain and recapture in the deemed taxation year end before the acquisition. This election is usually done to realize capital gains to offset any capital losses that expire at acquisition of control. There is no indication that there are any capital losses that would expire, but it may still be useful to recognize some income in order to absorb the charitable donation carryforward that would otherwise expire.

Since DI is a CCPC being acquired by a non-CCPC, it will need to compute its low-rate income pool (LRIP) at the time of the change in status, which should align with the time of the acquisition of control. Since DI will no longer be a CCPC, if it was previously eligible for the small business deduction, it will lose this deduction going forward.

There would be no GST/HST implications because shares are not a taxable supply.

Comparison

Clearly, the purchase of assets is more beneficial from the perspective of CCA, as the deductions are based on the FMV of the assets rather than on the old UCC balances.

Purchase of assets versus purchase of shares

The purchase of shares offers a significant discount, which may be a result of the seller hoping to use the lifetime capital gains deduction. While the seller's tax implications are beyond the scope of this report, the savings for TMB are $1.4 million ($10 million - $8.6 million).

At an assumed federal and provincial combined tax rate of 27%, the tax savings from the larger CCA in Year 1 after an asset purchase is approximately $610,538 (($2,531,250 - $270,000) × 27%). CCA in the year of acquisition is a large deduction presently, due to the accelerated investment incentive. However, CCA is greatly reduced after the year of acquisition. Therefore, the reduced purchase price of a share purchase is still beneficial by $789,462 ($1,400,000 - $610,583).

Other qualitative factors of a share purchase should also be considered. A share purchase results in a simpler transaction, as TMB would be purchasing one asset (shares of DI) rather than multiple assets (equipment and goodwill). However, with a share purchase, there is a risk of undisclosed liabilities that come with the legal entity. These could include lawsuits and tax liabilities. Finally, acquiring shares and maintaining a separate corporation would result in more complex financial reporting (consolidation of controlled entity) and taxation (multiple entities to file tax returns for), which could only be resolved by a subsequent amalgamation or wind-up, which may be complicated or costly.

Conclusion

From a tax perspective, purchasing shares appears to be a better option. However, a proper due diligence process should be performed to help identify risks of undisclosed liabilities and, given TMB's size, the additional financial reporting and taxation requirements.

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

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

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

Reaching competence – The candidate attempts an analysis of the income tax and GST/HST implications of the purchase of DI.

Competent – The candidate provides an analysis of the income tax and GST/HST implications of the purchase of DI.

Competent with distinction – The candidate provides an in-depth analysis of the income tax and GST/HST implications of the purchase of DI.

Assessment Opportunity #10 (Depth Opportunity)

The candidate discusses the income tax and GST/HST consequences related to Krzysztof's potential relocation.

The candidate demonstrates competence in the Taxation role.

CPA Map Technical Competencies:		**Core**	**E4 TAX**
6.2.2	Advises on taxes payable for a corporation	B	A
6.3.2	Evaluates income taxes payable for an individual *(change in use is Level B in the Knowledge List)*	B	A
6.7.2	Analyzes GST obligations of a person	C	B
6.7.3	Calculates net tax for a person	C	B

CPA Map Enabling Competencies:
2.1.1 Applies knowledge of the organization's competitive environment and strategic direction when performing assigned work
5.1.1 Applies general business knowledge to enhance work performed
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.1.1 Identifies and articulates issues within areas of work responsibility
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

Benefits Offered to Krzysztof

Moving expenses

This move would be considered an eligible relocation as the distance from Vancouver to Halifax (5,800 kilometres) is greater than 40 kilometres. It does not matter that the move is temporary, because it is still a new work location, and the move does not have to be for a new job.

Since not all moving expenses are deductible by him, Krzysztof should first have TMB reimburse the non-deductible costs, then assign reimbursement to deductible costs, and finally deduct (on his personal tax return) eligible moving expenses that exceed the available reimbursement. Subsection 62(3) defines deductible eligible moving expenses. CRA policy does provide for no taxable benefit on some expenses that are not included in subsection 62(3); however, there are several examples of CRA providing administrative application of paragraphs 6(1)(a) and (b), which generally require all benefits to be included in an employee’s income, which is the case here.

Costs of house-hunting trips are not a deductible moving expense, but can be reimbursed without giving rise to a taxable benefit. Airfare, hotels, and car rental are clearly eligible travel costs. Childcare expenses for this purpose can also be reimbursed with no taxable benefit. Meals would be eligible as well. Therefore, since TMB will cover up to $5,000 of house-hunting costs, Krzysztof can be reimbursed for $5,000 of house-hunting costs without having to include that payment in income.

That would leave him to pay $900 ($5,900 - $5,000) of house-hunting expenses, plus any meal costs, out of pocket. If possible, the portion that is not reimbursed should be for childcare costs, as Krzysztof or his spouse could then deduct these as childcare expenses on their personal tax returns (subject to the rules and limits for the childcare expenses deduction).

Of the actual moving costs, the mail forwarding and damage deposit are not reimbursable without giving rise to a taxable benefit, nor are they deductible. Krzysztof would have to pay for this $1,100 ($100 + $1,000) out of pocket.

Meals can be claimed using the simplified method for the six days spent travelling and waiting for the moving truck. The allowable rate for 2021 is $23/meal or $69/day per person (the 2022 figure is not made available until the end of the year). Therefore, there is $1,656 ($69 × 4 persons × 6 days) of deductible meal allowance. No receipts are necessary. Alternatively, actual expenses could be claimed using receipts.

The remaining costs are all eligible moving expenses of $27,806 ($27,250 - $1,100 + $1,656) that can be reimbursed or deducted. TMB will cover $25,000, so that leaves $2,806 ($27,806 - $25,000) that Krzysztof can deduct from his income on his personal tax return.

All moving expenses paid for by TMB are deductible by TMB for tax purposes, as they are costs laid out for the purpose of earning business income. TMB can claim an input tax credit for any GST/HST paid for the specific expenses it reimburses.

Change in use of Vancouver home

If Krzysztof changes the use of his principal residence in Vancouver to a rental property, there is a deemed disposition at FMV at the time of the change in use, by virtue of subsection 45(1). This would result in a capital gain, which would be included in Krzysztof's and his spouse's incomes. While the principal residence exemption (PRE) could be applied to the deemed disposition that could reduce the capital gain to nil, there is an election available that is likely more appropriate in this situation.

Subsection 45(2) provides for an election on the change in use of a principal residence to a rental property. The election has the following effects:

1. The deemed disposition is deemed not to occur, and the property retains its status as personal use property, and
2. Four additional years can be designated as the property being ordinarily inhabited for the purposes of the PRE, even if this is not in fact the case.

The result is that Krzysztof and his spouse would still be able to shelter a future sale of the Vancouver home with the PRE, given that they only expect to be in Halifax for two to three years. The four "bonus" years from the subsection 45(2) election will cover the time he is away from Vancouver, even if the property is rented out.

If more years are required, Krzysztof may be able to use section 54.1 to extend the principal residence treatment to an unlimited number of years. This is available when the taxpayer stopped residing at the former residence "as a consequence of the relocation of the place of employment of the taxpayer … while the taxpayer … is employed by an employer who is not a person to whom the taxpayer or the taxpayer's spouse or common-law partner is related," and eventually either moves back into the property or dies during the temporary relocation. As Krzysztof is not related to TMB, if he moves back into the Vancouver home at the end of the relocation, he will be able to designate it as a principal residence for longer than four years.

Krzysztof and his spouse would still have to report any rental income on their personal tax returns. It is important to note that, for the election to be valid, they must not claim CCA on the property.

Housing allowance

The monthly housing allowance would have to be included in Krzysztof's income by virtue of paragraph 6(1)(b), as it is to pay for personal and living expenses.

However, Krzysztof may be able to deduct home office and travel expenses.

Since Krzysztof is an employee, TMB should be required to provide a signed Form T2200, “Declaration of Conditions of Employment,” for each taxation year. This form would outline the requirements of working from home and what specific costs Krzysztof would be required to incur.

Home office expenses are deductible if Krzysztof’s home is the place where he principally (more than 50% of the time) performs his duties of employment. As TMB does not yet have an office in Atlantic Canada, this would appear to be the case.

The amount of the deduction would be based on the percentage of his home that is used to perform his duties of employment.

Deductible home office expenses would include utilities (including home internet access fees), maintenance (including light bulbs, cleaning materials and fees, and minor repairs), and rent.

Home insurance is only deductible by commissioned salespersons, which might apply if Krzysztof is paid a commission for attracting new clients, for example.

Candidates are not responsible for the COVID-19-specific temporary flat-rate deduction rules.

If Krzysztof is required to travel for the purposes of employment, he can also deduct the costs of travel, including automobile costs, assuming they are not reimbursed or paid for directly by TMB.

Krzysztof would also be eligible for a rebate of GST/HST paid on employment expenses. These can be claimed by filing Form GST370, “Employee and Partner GST/HST Rebate Application,” with his personal income tax return.

The housing allowance would be deductible to TMB, again as a cost incurred for the purpose of earning business income. If Krzysztof’s employment results in a permanent establishment for TMB in Nova Scotia, this may affect TMB’s provincial allocation for income tax purposes—further review would be required, to determine whether this would be the case.

TMB would not be eligible for any GST/HST input tax credit for the allowance, as it is a reimbursement related to a residential home, which is an exempt supply.

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

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

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

Reaching competence – The candidate attempts to discuss the income tax and GST/HST consequences related to Krzysztof's potential relocation.

Competent – The candidate discusses the income tax and GST/HST consequences related to Krzysztof's potential relocation.

Competent with distinction – The candidate thoroughly discusses the income tax and GST/HST consequences related to Krzysztof's potential relocation.

Assessment Opportunity #11 (Depth Opportunity)

The candidate discusses the shareholder loans.

The candidate demonstrates competence in the Taxation role.

CPA Map Technical Competencies:		**Core**	**E4 TAX**
6.3.2	Evaluates income taxes payable for an individual *(Tax on Split Income is Level B in the Knowledge List)*	B	A
6.3.3	Analyzes specific tax-planning opportunities for individuals	B	B
6.6.2	Analyzes income tax implications of compensation planning between a shareholder and a closely-held corporation	C	B

CPA Map Enabling Competencies:
2.1.1 Applies knowledge of the organization's competitive environment and strategic direction when performing assigned work
5.1.1 Applies general business knowledge to enhance work performed
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.1.1 Identifies and articulates issues within areas of work responsibility
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

BDFH Tax Issues

<u>Shareholder loans</u>

Due from Conrad

This loan has been outstanding past the second taxation period end of BDFH. This loan (the entire amount loaned) must be included in Conrad's income in 2020, since the repayment conditions in subsection 15(2.6) have not been satisfied. However, it is worth looking to see if another exemption applies.

Paragraph 15(2.4)(d) provides for an exemption where an employee is given a loan to purchase an automobile for use in duties of employment. Conrad likely does not qualify under this exemption for several reasons, as follows:

- Conrad is not an employee of BDFH as he does not draw a salary. Because dividends are his only form of remuneration, that is a shareholder relationship only.
- Even if there were an employee/employer relationship, it is doubtful that the test in paragraph 15(2.4)(e) would be satisfied, as it is difficult to establish that the loan is by virtue of employment when there is only one possible employee.
- Also, paragraph 15(2.4)(f) would likely not be satisfied, as there do not appear to be repayment terms, since the loan has been outstanding for some time.

Also, the exception related to a vehicle does not extend to shareholders who are employees of a related corporation; that rule only applies to the paragraph 15(2.4)(c) exception relating to loans to purchase shares. TMB and BDFH may or may not be related for tax purposes, but that is irrelevant since the loan was not for the purchase of shares of either company.

Since Conrad has probably already filed his income tax return for 2020, it should be amended to report this additional income, if it was not already reported.

Due from Justine

Even though Justine is not a shareholder of BDFH, she is related to a shareholder (both Rita and Conrad) by blood, and thus the shareholder loan rules apply equally to her by virtue of paragraph 15(2)(b) and subsection 15(2.1).

There are no exceptions available in subsection 15(2.4). Therefore, to avoid the income inclusion, the loan must be repaid in full before December 31, 2022.

Even if the loan is repaid, there would be a deemed interest benefit at the prescribed rate for the time the loan is outstanding, under section 80.4. For the 2021 taxation year, the interest benefit that Justine would have to include on her tax return is $41.92 ($10,000 × 1% × 153/365). Thus, this appears to be an effective way to use corporate funds at a low tax cost.

Because this is a shareholder benefit derived from a private corporation, the loan also falls under rules relating to tax on split income (TOSI), by virtue of section 120.4. The effect would be that, if the loan is not repaid by December 31, 2022, the income inclusion on Justine's 2021 tax return would be considered "split income," and taxed at the highest federal marginal rate of 33%. Therefore, it is imperative that the loan be repaid in time. However, given that Rita and Conrad would likely have to withdraw excess funds from BDFH in order to repay the amount on behalf of Justine, such an extra dividend would be taxed at the highest marginal rate anyway, so having the $10,000 subject to TOSI may not be a great concern.

The interest benefit is not subject to TOSI because it is by virtue of section 80.4 rather than section 15.

Due from Rita

Rita borrowed $100,000 from BDFH on February 1, 2021, and repaid the full amount on October 31, 2021. No interest was paid on this amount. This loan would meet the exception in subsection 15(2.6), since the loan was "repaid within one year after the end of the taxation year of the lender;" in fact, it was repaid within the taxation year.

However, under section 80.4, Rita will be treated as receiving an interest benefit for the unpaid interest. Like Justine's loan, this is calculated using the prescribed rate. The benefit for Rita will be $748 ($100,000 × 1% × 273/365).

As above, the interest benefit is not subject to TOSI because it is by virtue of section 80.4 rather than section 15.

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

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

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

Reaching competence – The candidate attempts to discuss the shareholder loans.

Competent – The candidate discusses the shareholder loans.

Competent with distinction – The candidate discusses in depth the shareholder loans.

Assessment Opportunity #12 (Depth Opportunity) The candidate discusses the shareholder remuneration for BDFH. *The candidate demonstrates competence in the Taxation role.*

CPA Map Technical Competencies:		**Core**	**E4 TAX**
6.2.2	Advises on taxes payable for a corporation	B	A
6.3.2	Evaluates income taxes payable for an individual *(Tax on Split Income is Level B in the Knowledge List)*	B	A
6.3.3	Analyzes specific tax-planning opportunities for individuals	B	B
6.6.2	Analyzes income tax implications of compensation planning between a shareholder and a closely-held corporation	C	B

Remunerate children from BDFH

Making the children shareholders

To make the children shareholders of BDFH, there would have to be some sort of “freeze” performed so that the children could purchase new shares at a nominal value. The process of a freeze is beyond the scope of this report.

It should also be noted that, as we discuss later, attribution may apply to income received by Brice until he turns 18, depending on how he acquires the shares.

Tax on split income (TOSI)

Even if the children are shareholders, any dividends would likely be subject to TOSI. The most common exceptions to the TOSI rules are unlikely to be met:

- Excluded business – This exception would not be satisfied, as the children would not be involved on a “regular, continuous and substantial basis,” as the corporation is only earning investment income.
- Excluded shares – Even if voting shares were issued on the freeze, the children would never meet the excluded shares test, as the parents would always have too much value in any freeze shares for the 10% of votes *and* value test to be met for the children.
- Reasonable return – If the children subscribe to new shares for a nominal value, any return would likely be considered unreasonable for the purposes of this test.

Therefore, there is little benefit to having the children become shareholders of BDFH from a tax perspective.

Paying salaries

As far as paying the children a salary, the amount would have to be reasonable, to comply with section 67, for the corporation to be able to deduct the salary. Given the nature of the operations (investment holdings), almost any salary would be considered unreasonable. The deduction would then be denied to the corporation, but the amounts would still be included in the children's income, resulting in double taxation.

<u>Renumeration from BDFH</u>

There are some tax-free methods of distribution for Rita and Conrad to receive funds from BDFH, and they should also consider the recovery of the prepayment of tax on corporate investment income that is tracked in the ERDTOH and NERDTOH accounts. I will discuss the options below.

Capital dividends

Capital dividends are primarily the non-taxable portion of capital gains, net of the unallowable portion of capital losses. BDFH has a capital dividend balance of $325,000. This amount can be distributed tax-free. As the company realizes additional net capital gains in future years, the CDA balance will increase, and additional capital dividends can be paid. An election in prescribed form must be filed prior to paying the capital dividends.

Paid-up capital (PUC)

The next most efficient item is through a reduction of PUC. PUC reductions are also distributed tax-free, and BDFH has access to $100,000 of PUC for this purpose. This will affect the amount of income that is taxed on an eventual wind-up, however, so the timing of any future wind-up should be considered, to ensure that this does not result in a larger income inclusion in that year than is anticipated.

Eligible dividends

Other distributions from BDFH that are not from CDA or PUC would be taxable. The most efficient taxable distribution is through the payment of eligible dividends. Eligible dividends can only be paid up to the general rate income pool (GRIP) balance, and require notification to the dividend recipients at the time of payment, in accordance with subsection 89(14). GRIP tracks the amount of eligible dividends received from other corporations, plus business income taxed at the general corporate rate. Currently, BDFH's only source of GRIP is eligible dividends. Therefore, eligible dividends can essentially be flowed through to Rita and Conrad, on a tax-free basis to the corporation. This is because the temporary Part IV tax on eligible dividends of 38 1/3% is fully recovered from the ERDTOH pool when eligible dividends are paid by BDFH.

BDFH currently has a GRIP balance of $200,000, so eligible dividends of $200,000 could be declared. This would recover $76,666 of the ERDTOH, being the lesser of $100,000 and $200,000 × 38 1/3%. The $76,666 is refunded to the corporation. The remaining $23,333 of ERDTOH can be recovered by paying eligible dividends (after more GRIP is accumulated), or dividends other than eligible dividends.

The incremental tax rate on eligible dividends is approximately 46.33%, calculated as follows:

Eligible dividends		100.00
Gross-up	38%	38.00
Gross-up dividend		138.00
Federal tax	33%	45.54
Provincial tax	20%	27.60
Federal dividend tax credit	6/11	(20.73)
Provincial dividend tax credit	16%	(6.08)
		46.33

Dividends other than eligible dividends

The last type of dividends that should be paid are taxable dividends other than eligible dividends (non-eligible dividends), which are only limited by the earnings and cash retained in the corporation. Non-eligible dividends first recover NERDTOH, and then any remaining ERDTOH. To recover the entire $125,000 of NERDTOH balance, $326,115 of non-eligible dividends would have to be paid ($125,000 ÷ 38 1/3%).

To recover the remaining $23,333 of ERDTOH, additional non-eligible dividends of $60,870 would have to be paid ($23,333 ÷ 38 1/3%). Alternatively, Rita and Conrad could wait until additional GRIP is generated to recover the ERDTOH. Note that it is generally not tax-efficient to use non-eligible dividends to recover ERDTOH, because dividends with a higher marginal personal tax rate are used to recover prepaid tax that is determined based on lower-rate dividends.

BDFH generates approximately $24,533 ($80,000 × 30 2/3%) of NERDTOH annually by virtue of the refundable portion of Part I tax on the $80,000 of capital gains and other investment income. To fully recover this amount annually, non-eligible dividends of $64,006 would have to be paid ($24,533 ÷ 38 1/3%).

The incremental tax rate on taxable dividends other than eligible dividends is approximately 48.17%, calculated as follows:

Non-eligible dividends		100.00
Gross-up	15%	15.00
Gross-up dividend		115.00
Federal tax	33%	37.95
Provincial tax	20%	23.00
Federal dividend tax credit	9/13	(10.38)
Provincial dividend tax credit	16%	(2.40)
		48.17

Recommendation

The most tax-effective strategy for drawing funds from BDFH is to draw funds in the following order:

1. Capital dividends (up to $325,000, plus any subsequent additions to CDA)
2. Paid-up capital reductions (up to $100,000)
3. Eligible dividends (up to $200,000, plus any subsequent additions to GRIP)
4. Dividends other than eligible dividends (any remaining amount)

Tax-free and tax-preferred amounts currently total $625,000, and should be paid out first, leaving $1,375,000. Of this, paying $386,985 ($326,115 + $60,870) of dividends other than eligible dividends would still be beneficial, because this would yield refunds from the RDTOH balances.

This leaves a little less than $1 million, which could be paid out over time, as capital dividends or eligible dividends when the CDA and GRIP accounts, respectively, are replenished through BDFH earning capital gains or eligible dividend income from its investments. Any amounts remaining would have to be paid as dividends other than eligible dividends.

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

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

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

Reaching competence – The candidate attempts to discuss the shareholder remuneration for BDFH.

Competent – The candidate discusses the shareholder remuneration for BDFH.

Competent with distinction – The candidate discusses in depth the shareholder remuneration for BDFH.

Assessment Opportunity #13 (Depth Opportunity)

The candidate discusses the transfer of shares to Rita and Conrad's children, and the tax consequences at death.

The candidate demonstrates competence in the Taxation role.

CPA Map Technical Competencies:		**Core**	**E4 TAX**
6.3.2	Evaluates income taxes payable for an individual *(Non-arm's-length transfers are Level B in the Knowledge List)*	B	A
6.3.3	Analyzes specific tax-planning opportunities for individuals	B	B
6.6.1	Analyzes income tax implications of death	C	B

CPA Map Enabling Competencies:
2.1.1 Applies knowledge of the organization's competitive environment and strategic direction when performing assigned work
2.2.1 Assists in identifying and monitoring risks within areas of work responsibility
5.1.1 Applies general business knowledge to enhance work performed
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.1.1 Identifies and articulates issues within areas of work responsibility
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses

Gifting and Tax Planning for Assets Held at Death

There are several proposed transactions with respect to Rita and Conrad's assets. It is important to note that they each earn $300,000 of salaries currently, and therefore are already in the highest tax bracket.

Gifting of shares to children

Deemed disposition at FMV

If Rita and Conrad gift shares of TMB to their children, they will have a deemed disposition at FMV. This will result in a capital gain of $468,000 (($4.20 - $1.08) × 150,000) per year, assuming the current share price and only 50,000 shares per child per year, at first. Since the shares are jointly held, Rita and Conrad will each have a capital gain of $234,000, 50% of which is taxable, so a $117,000 increase to taxable income. This will not be beneficial right now, as they are paying tax in the top tax bracket. However, since they plan to continue this after retirement, this may be an effective way of using the lower tax brackets before their deaths so that less tax is paid on the gains over time. I recommend that Rita and Conrad not increase the number of shares above 50,000 per year until such time as they are in lower tax brackets and can take advantage of them.

Each of the children will receive the shares at FMV, and that becomes their cost of the shares, which is $210,000 ($4.20 × 50,000) each.

Attribution

As the shares are to be gifted (no consideration is to be exchanged), attribution might apply to future dividends or capital gains.

For Justine and Jules, since both are 18 years old or older, neither of them is captured by any of the attribution rules.

For Brice, attribution rules apply because he is a related person under 18 years of age. In his case, dividends paid by TMB to Brice will attribute back to Rita and Conrad. However, once Brice turns 18, attribution of dividends will stop, and they will be taxed in the hands of Brice. Since Brice is a related person under 18 years of age, there is never attribution of capital gains, thus any capital gains from the subsequent sale of the shares will be taxed in Brice's hands.

There is little that can be done in this scenario to reduce the impact of attribution. Attribution could be avoided if Brice pays FMV for the shares, which does not seem practical as Brice likely would not have the financial resources to pay $210,000 for the shares. This might be achieved by using a note payable, but this would only benefit the family for a few years of attributed dividends.

Regardless, it appears that TMB does not pay any dividends now (based on the financial statements), so there may be no point to doing this. Therefore, the proposal to begin to gift shares next year is a reasonable one, but only if TMB is not expected to start paying dividends. It may be better to wait a few years to begin this plan, after Brice has turned 18.

Tax on split income (TOSI)

Fortunately, since TMB is a public company, TOSI would not apply to dividends or capital gains earned from TMB. TOSI only applies to private corporations.

Deemed disposition at death

Any property left to a surviving spouse is transferred at cost by virtue of subsection 70(6). Therefore, there will be no immediate tax consequences when the first of Rita or Conrad dies and property is transferred to the surviving spouse.

When the second spouse dies, all property is deemed to be disposed of at FMV. The estate/beneficiary would receive the property at the FMV at the time of the deemed disposition.

The specific impact is as follows:

- For the shares of TMB, given 500,000 shares remaining and FMV similar to today (in the absence of any other information), there would be a deemed disposition resulting in a taxable capital gain of $780,000 (($4.20 - $1.08) × 500,000 × 50%). Note that the deemed capital gain of nil does not apply to shares donated by virtue of a deceased's will.
- RRSPs are deemed to be redeemed at their FMV. Based on the values today, there would be $1,150,000 ($600,000 + $550,000) included in taxable income.
- The family home is deemed to be disposed of at FMV, but the entire capital gain would be offset by the PRE, so ultimately there would be no inclusion in taxable income.

The above results in taxable income in the final tax return of the second spouse of $1,930,000 ($780,000 + $1,150,000). At the highest marginal tax rate (assuming other income that year exceeded the highest tax bracket), income tax payable would be $1,022,900 ($1,930,000 × (33% + 20%)). After-tax cash in the estate (before gifting of shares) would be as follows:

Shares ($4.20 × 500,000)	$ 2,100,000
RRSPs	1,150,000
Family home	1,500,000
Income tax	(1,022,900)
	$ 3,727,100

Charitable donations and losses in estate

The estate would receive the property at the values above. Once converted to cash, the estate would realize any remaining capital gain or loss.

The estate would sell the family home, and the proceeds would be distributed to the children on a tax-free basis. If there is any capital loss incurred on the sale (that is, if the FMV of the property has decreased since the date of death), the loss can be carried back to the final return of the second spouse to offset any capital gains on the deemed disposition of the shares of TMB. Any income tax refund received from the loss carried back can be distributed to the children tax-free.

When publicly-traded shares are donated to charity, any capital gain in the estate is deemed nil by virtue of paragraph 38(a.1). In any case, if the donation is made soon after the date of death, there would be little change in FMV from the date of death, and thus little gain or loss, if any.

There would be a large donation tax credit created in the estate because of this donation. However, there would be little to no income tax in the estate, and the credit could be wasted. However, if the estate is a graduated rate estate (GRE), which would likely be the case, then the donation credit can be carried back to the last two taxation years of the deceased individual (the final return and the preceding year), or an earlier year of the estate, should there be one.

Recommendation for improvement

Assuming that Rita and Conrad will still be in the highest tax bracket until death (which is likely, given the plan to continue gifting shares to their children), there is little advantage to advancing income to be taxed earlier. A typical recommendation of redeeming RRSPs and gifting to children earlier does not save any tax, but just results in tax being paid earlier.

One possible improvement is with respect to the donation of the shares of TMB. Before 2016, the donation of securities of an estate were deemed to be made by the deceased individual, resulting in a nil capital gain in the final return of the deceased individual. This was advantageous as there would be no deemed disposition of the shares at FMV, thus saving tax on that amount in addition to the value of the donation tax credit. To mitigate these new rules, in this situation, the shares should be donated *before* death so that the nil capital gain is not in the estate, where it is essentially wasted. The donation tax credit can be used by the individual to reduce income tax in the year of the donation, or in any of the five following taxation years.

For Assessment Opportunity #13 (Taxation), the candidate must be ranked in one of the following five categories:

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

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

Reaching competence – The candidate attempts to discuss the transfer of shares to the children, and the tax consequences at death.

Competent – The candidate discusses the transfer of shares to the children, and the tax consequences at death.

Competent with distinction – The candidate discusses in depth the transfer of shares to the children, and the tax consequences at death.

APPENDIX D

SEPTEMBER 9, 2022 – DAY 3
SIMULATIONS AND MARKING GUIDES

COMMON FINAL EXAMINATION
SEPTEMBER 9, 2022 – DAY 3

Case #1 **(Suggested time: 90 minutes)**

Claudia Garcia is a carpenter, and her husband, Rafael, is an architect. Together, they own STH Inc. (STH), a custom staircase manufacturing company. It is July 2, 2022, and you, STH's new controller, are in your first meeting.

Claudia: These past two years have been great. Our business is growing rapidly. We are now working with Canal Venture Capitalists (CVC), who is going to help take STH to the next level, and eventually an IPO.

Rafael: We recently purchased a commercial property and need your help accounting for it under IFRS (Appendix I). We can look into any other accounting issues later.

Claudia: We also need help with the costing of our orders. Here are the details of our manufacturing process, and our costing reports (Appendix II). For a start, please calculate the full absorption cost and the gross margin that we earned on order #178. This client will place 10 additional orders identical to order #178 if we reduce our selling price. Should we use the full absorption cost of order #178 to establish the lowest selling price that will allow us to recover our costs for the additional 10 orders? If not, what would be the minimum acceptable price in order to not lose money on these 10 orders?

Rafael: Also, CVC said our ordering and delivery processes need to be stronger in order to keep growing STH. We have had issues recently. We started offering a wider selection of products, but our suppliers can't keep up with the higher volume. We hired new people on our packaging team, but it has been hard to get them trained quickly. We have also received some bad online reviews. As you look through the information provided, please discuss any operational weaknesses you identify in our processes, and recommend improvements (Appendix III).

CVC said we need a strong audit committee. Please review the current audit committee composition and the appropriateness of its current mandate, and provide recommendations (Appendix IV).

Also, CVC is concerned with the new covenants the bank requires us to meet (Appendix V). We would like to know whether we would have been in compliance as at December 31, 2021. Please note any areas of concern, so we can adjust as necessary, to comply going forward.

Claudia: Lastly, STH will be audited for the first time for the December 31, 2022, year end. For the areas of revenue, inventory (i.e. raw materials, work-in-progress, and finished goods), and the bank loan, what procedures will the auditors likely perform? We are late with our 2021 tax return. Can you calculate STH's taxable income? I have sent you some information (Appendix VI).

APPENDIX I
INVESTMENT PROPERTY

In January 2022, we purchased a commercial property in an area of town that is gaining popularity. We paid $100,000 for the land, $350,000 for the building, $5,000 in building inspection fees, and $2,000 in lawyer fees, and the building should last 30 years. The building is currently vacant but we intend to start renting it out soon to earn some revenue, until its value is high enough for us to sell it.

To help us decide when to sell, our real estate agent sends us monthly reports on the estimated value of the building. For example, the June 30, 2022, report said that the property is worth $465,000. The values in the reports are based on recent sales of similar properties in the area.

As this is our first time buying a property that we are not using for our regular business, we are unsure how to account for it currently, and going forward, given the accounting choices available. For now, we have recorded the property in property, plant, and equipment, and have not depreciated it.

APPENDIX II
MANUFACTURING PROCESS

Once a contract is signed, we input details in the costing software. As the employees work on an order, they record the materials used and the hours worked in the software.

Below are the costing reports for the month of June 2022, as well as some additional information.

Direct Materials List Report

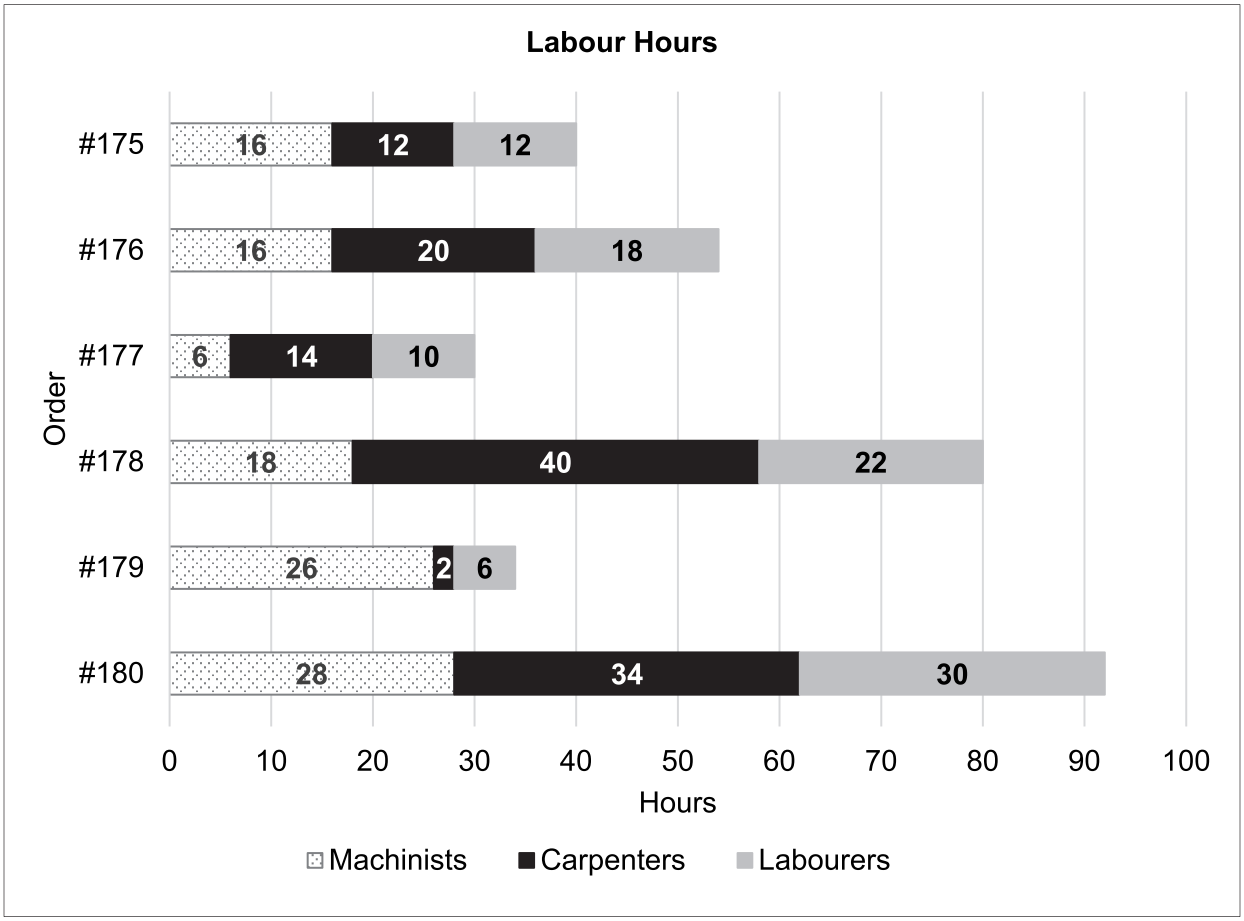
Order #	Contract Sales Value ($)	Wood (square feet)	Glass (panels)	Steel (feet)	Other Materials (feet)
175	30,000	180	20	60	120
176	11,000	190	12	0	0
177	8,000	170	0	50	0
178	16,000	140	12	44	0
179	38,000	200	22	0	160
180	42,000	220	24	70	120
Totals	145,000	1,100	90	224	400

Direct Materials Costing Report

- Wood (per square foot): $10
- Glass (per panel): $100
- Steel (per foot): $35
- Other materials (per foot): $80

APPENDIX II (continued)
MANUFACTURING PROCESS

Direct Labour Hours Report

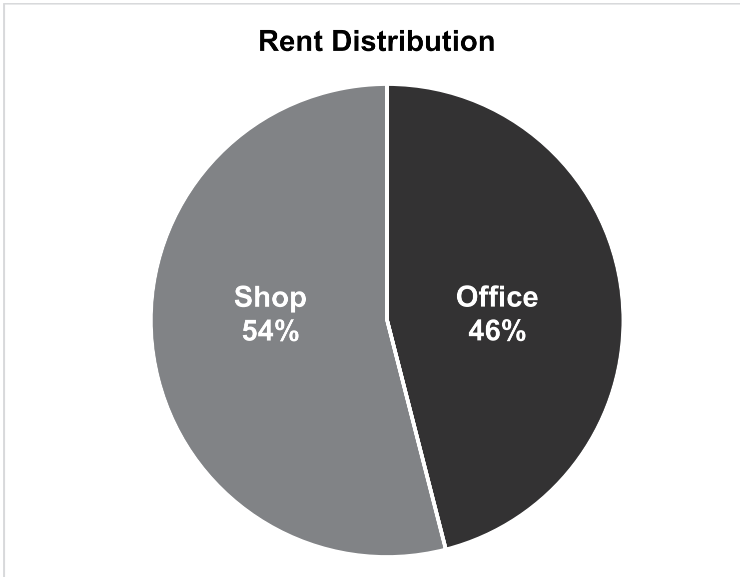


Additional information:

- Average hourly rates:
  - Machinists: $35
  - Carpenters: $40
  - Labourers: $20

APPENDIX II (continued)
MANUFACTURING PROCESS

Rent Distribution Report



Additional Information:

- Total rent is $13,000 per month.
- In June 2022, depreciation of manufacturing equipment of $1,000 was included in cost of goods sold.
- All work is completed in the shop, and the square footage of the wood used in an order is a good indication of the space and equipment used for that order.
- Sales commissions are 5% of the contract value.
- Website hosting costs are $50 per month. Website traffic is growing rapidly. Our provider only offers basic services but has great customer service.
- Utilities are closely correlated to machinist hours: for each machinist hour, we incur $25 of utilities.
- STH has no capacity constraints.

APPENDIX III
OTHER INFORMATION

Website Excerpt on Steps for Customers to Follow

The process is simple:

1. Select product on the website.
2. Input the approximate measurements, for an automated quote. In one click, your quote and personal information is sent directly to our team.
3. Our sales team emails you to confirm the order details.
4. We send you a contract.
5. We come and take measurements.
6. Wait four to six weeks.
7. Your stairs arrive.
8. Follow our easy installation instructions.
9. Use your new staircase!

Online User Reviews

"Simple process? No way. I went through the process several times just to receive an email each time saying the products I selected on the website were not in stock. Good thing the stairs look great."
– Pier, April 30, 2022

"The quality is great, but client service is not. They didn't tell me when they would come to deliver. Luckily, I was home that day!"
– Anthony, May 25, 2022

"Something is not right here. I requested a quote and the next day received spam and phishing emails from other parties! Not to mention how slow their website is to load!"
– Jordan, June 12, 2022

"What a joke. They sent me the wrong order, and then expected me to repack and return the large boxes to them."
– Monique, June 22, 2022

APPENDIX IV
AUDIT COMMITTEE

Members

- Chair, Renata Garcia, CPA. Renata is Rafael's sister, and works for an accounting firm that specializes in taxation and owner-managed businesses.
- Member, Rafael Garcia. As the board chairman, chief executive officer (CEO), and owner of STH, Rafael is intimate with details of the company's financial statements and operations.
- Member, Lilian Phan, is a chartered financial analyst (CFA). As a senior executive at CVC, Lilian has helped many companies grow into prosperous public entities.

Mandate

- Annually approve the financial statements
- Appoint external auditors
- Periodically review whistleblower complaints submitted to the CEO

APPENDIX V
LOAN COVENANTS AND FINANCIAL INFORMATION

Covenants Effective July 1, 2022

- Working capital ratio of no less than 0.5
- Debt to equity not exceeding 2:1
- Bank loan to EBITDA not exceeding 4:1
- Unmodified audit report within 90 days of year end
- Report cybersecurity breaches within 30 days of identification

Key Balance Sheet Amounts at December 31, 2021

Current assets	$	165,000
Total assets	$	2,250,000
Current liabilities	$	225,000
Bank loan	$	600,000
Total liabilities	$	1,300,000
Total equity	$	950,000

APPENDIX VI
TAX INFORMATION

STH Inc.
Income Statement
For the year ended December 31, 2021
(Unaudited)

Revenue	$	2,040,000
Cost of goods sold		1,325,000
Gross margin		715,000
Marketing		112,000
Delivery		40,000
Insurance		20,000
Administrative wages		205,000
Office expenses		35,000
Meals and entertainment		14,000
Depreciation		25,000
Interest		24,000
Net income before taxes	$	240,000

Notes:

- Marketing expense includes a $5,000 golf membership.
- Cost of goods sold includes $10,000 of depreciation for manufacturing equipment.
- UCC ending balances from our 2020 return are as follows:

Class 8	$	165,000
Class 10	$	145,000
Class 10.1	$	22,000
Class 50	$	25,000

- In 2021, we sold all our vehicles and outsourced all deliveries. The delivery trucks sold for $100,000 and the only passenger vehicle sold for $15,000, which were their carrying amounts at that time. During the year, we purchased $120,000 of manufacturing equipment, $16,000 of computers, and $5,000 of furniture.

MARKING GUIDE 3-1
STH INC. (STH)
ASSESSMENT OPPORTUNITIES

To: Claudia and Rafael
From: CPA (controller)
Subject: Various matters

Assessment Opportunity #1 (Breadth and Depth Opportunity)
The candidate discusses the accounting treatment for the investment property.
The candidate demonstrates competence in Financial Reporting.

CPA Map Technical Competencies:		**Core**
1.2.2	Evaluates treatment for routine transactions	A

CPA Map Enabling Competencies:
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions
6.3.3 Applies decision criteria to choose among viable alternatives

Investment Property

You have asked for my help with the accounting treatment for the land and building you purchased for this year, and going forward. As you purchased the property to earn rental revenues while waiting for the value to be high enough to sell, it meets the definition of an investment property, as per IAS 40 – Investment Property: *"Investment property is held to earn rentals or for capital appreciation or both."*

As per paragraph 16 of IAS 40:

"16 An owned investment property shall be recognised as an asset when, and only when:

(a) it is probable that the future economic benefits that are associated with the investment property will flow to the entity; and

(b) the cost of the investment property can be measured reliably."

In this case, as you purchased an asset that has the potential to be rented (as you expect to have the property rented out soon), and has potential for capital appreciation (as it is situated in an area of town that is gaining in popularity), it is probable that there will be future economic benefits flowing to STH. The cost of the investment can also be measured reliably, as you know you paid $450,000 for the property.

Measurement at Recognition

As per paragraph 20: *"An owned investment property shall be measured initially at its cost. Transaction costs shall be included in the initial measurement."*

The cost in this case is $457,000 ($100,000 for the land + $350,000 for the building + $7,000 for transaction costs ($5,000 for the building inspection + $2,000 for the lawyer fees)).

IAS 1 Presentation of financial statement, paragraph 54, states that: "*The statement of financial position shall include line items that present the following amounts: […] (b) investment property; […].*" Therefore, the property will have to be removed from PP&E and be presented separately as investment property in the financial statements:

DR Investment property	$457,000	
CR PP&E		$457,000

According to paragraph 30, there is a choice in accounting policy to be made: *"With the exception noted in paragraph 32A, an entity shall choose as its accounting policy either the fair value model in paragraphs 33–55 or the cost model in paragraph 56 and shall apply that policy to all of its investment property."*

Whichever model is chosen, the fair value will need to be determined, as per paragraph 32: *"This Standard requires all entities to measure the fair value of investment property, for the purpose of either measurement (if the entity uses the fair value model) or disclosure (if it uses the cost model). An entity is encouraged, but not required, to measure the fair value of investment property on the basis of a valuation by an independent valuer who holds a recognised and relevant professional qualification and has recent experience in the location and category of the investment property being valued."*

Although you are getting estimated fair values on a monthly basis from your real estate agent, the relevant standard encourages you to use an independent valuator to determine the value of the property investment.

<u>Fair value model</u>

According to paragraph 35: *"A gain or loss arising from a change in the fair value of investment property shall be recognised in profit or loss for the period in which it arises."*

Under this model, there is no depreciation recognized, and the investment property is adjusted to fair value at each reporting period. The change in the fair value is immediately recognized in the current year's income statement. For example, if the value stayed at $465,000 at year end, the following entry would be required to account for the increase in value of $8,000 ($465,000 - $457,000):

DR Investment property	$8,000	
CR Fair value gain – investment property		$8,000

<u>Cost model</u>

According to paragraph 56: *"After initial recognition, an entity that chooses the cost model shall measure investment property:*

(a) in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations if it meets the criteria to be classified as held for sale (or is included in a disposal group that is classified as held for sale);
(b) in accordance with IFRS 16 if it is held by a lessee as a right-of-use asset and is not held for sale in accordance with IFRS 5; and
(c) in accordance with the requirements in IAS 16 for the cost model in all other cases."

In this case, if you choose the cost model, the investment property will be measured following IAS 16 – Property, plant and equipment. IAS 16, paragraph 50 states: "*The depreciable amount of an asset shall be allocated on a systematic basis over its useful life*." In addition, paragraph 55 states: "*Depreciation of an asset begins when it is available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.*"

This means that depreciation should have started when STH purchased the land and building in January 2022 as it was available for use, and the building would have to be depreciated over its useful life, which is 30 years. Assuming that the lawyer fees are related to the building (we would have to see which part of the fees are related to the land and which part are related to the building), the depreciation for the first six months of the year would be $5,950 (($350,000 + $5,000 + $2,000) ÷ 30 years × 6/12 months). This would reduce your earnings and would also affect the ratios linked to your debt covenant, for 2022 and going forward. The following entry would be required for the first six months:

DR Depreciation expense	$5,950	
CR Accumulated depreciation - Investment property		$5,950

Going forward, the property would also need to be tested for impairment. Given that the book value of the property is $451,050 ($457,000 - $5,950) as at June 30, 2022, and the property has been assessed at $465,000, there is currently no indicator of impairment. This assessment would have to be made again at year end.

Recommendation

As STH intends to sell the property in the future, presenting the fair value of the asset would be more reflective of the economic reality of STH's intention. In addition, since you are thinking of an IPO, the users of the financial statements would likely find the fair value of the property more useful than the cost. Therefore, we recommend using the fair value model. The cost of choosing this model would not be significantly different from the cost model, as fair value information would have to be obtained for disclosure purposes under the cost model as well.

The cost model provides a more stable net income year to year, since the depreciation is spread over the 30 years of useful life. On the other hand, the fair value model will have a less predictable impact on the net income, as it will depend on how volatile the real estate market is. Therefore, you can expect your net income to fluctuate more under this model. Assuming that the value of the property will increase, it would have a positive impact for the ratios that are calculated as part of your debt covenants.

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

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

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

Reaching competence – The candidate attempts to discuss the accounting treatment for the investment property.

Competent – The candidate discusses the accounting treatment for the investment property and provides a recommendation.

Competent with distinction – The candidate thoroughly discusses the accounting treatment for the investment property and provides a recommendation.

Assessment Opportunity #2 (Breadth and Depth Opportunity)

The candidate provides a quantitative analysis of order #178 and the 10 additional orders.

The candidate demonstrates competence in Management Accounting.

CPA Map Technical Competencies:		**Core**
3.3.1	Evaluates cost classifications and costing methods for management of ongoing operations	**A**

CPA Map Enabling Competencies:
5.1.1 Applies general business knowledge to enhance work performed
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

For the purpose of calculating the gross margin of the order, the cost of the order will be its full absorption cost, which consists of direct labour, direct materials, and manufacturing overhead. Based on the information you provided, the full absorption cost of order #178 is as follows.

Direct Materials

Direct materials are costs that are easily traced and become a physical part of the final staircase produced. These are provided in the direct materials list report.

	Wood (square feet)	**Glass (# of panels)**	**Steel (feet)**	**Other Materials (feet)**
#178	140	12	44	0
Price per unit	$10	$100	$35	$80
Cost (rate × price)	$1,400	$1,200	$1,540	$0

Total direct materials costs are $4,140.

Direct Labour

Direct labour is the labour costs that are directly traced to the staircases. These are provided in the direct labour hours report.

	Machinist Hours	**Carpenter Hours**	**Labourer Hours**
#178	18	40	22
Average hourly rate	$35	$40	$20
Cost (rate × price)	$630	$1,600	$440

Total direct labour costs are $2,670.

Manufacturing Overhead

Rent: Only rent costs directly attributable to the manufacturing process should be included in the cost. The shop is used entirely for the production process; therefore, it is reasonable to allocate part of this rent to the order. We would want to allocate a portion to each order, and you have stated that the best allocation basis is the square footage of the wood used.

Based on the rent distribution report, the amount of rent applicable to the shop is as follows:

$13,000 × 54% = $7,020
Total monthly square footage of wood used: 1,100 square feet
Portion of square footage related to #178: 140 square feet

140 ÷ 1,100 × $7,020 = $893

Depreciation: The portion of depreciation that is related to manufacturing equipment is attributable to the manufacturing process and should also be included in the cost of the order: 140 ÷ 1,100 × $1,000 = $127

Utilities: Utilities directly attributable to the shop and orders should also be included: $25 × 18 machinist hours = $450

Sales commissions and website hosting: These are not directly attributable to the manufacturing process and should not be included.

Total manufacturing overhead is therefore: $893 + $127 + $450 = $1,470.

Total order cost:

Direct materials	$ 4,140
Direct labour	2,670
Manufacturing overhead	1,470
Total order cost	$ 8,280

Gross Margin

As the contract sales value for #178 was $16,000, the gross margin for this order is $7,720 ($16,000 - $8,280).

Additional Orders

To determine the minimum acceptable price in order to not lose money on the 10 additional orders, the full absorption cost of $8,280 would not be the most relevant cost to use, as the calculation includes fixed costs that would remain the same regardless of whether the order is placed. Allocated rent and depreciation (respectively $893 and $127, as calculated above) would be incurred regardless of the new order, and should be removed from the calculation for the purpose of deciding a selling price for the additional orders. However, utilities ($450, as calculated above) are closely correlated to machinist hours and are variable in nature, so should be included. Also, variable selling costs (such as the 5% commission) would be added to the cost used to calculate the minimum price acceptable, as they would be incurred because of the order. The full absorption manufacturing cost would therefore be replaced with the variable cost of the order for that purpose. To help you with your decision, I have calculated the variable cost for each order identical to order #178, if sold at cost.

Direct materials	$ 4,140
Direct labour	2,670
Variable overhead costs (utilities)	450
Variable selling costs (Note)	382
Total order cost	$ 7,642

Note: If sold at cost, the selling price would be $7,642 (($4,140 + $2,670 + $450) ÷ 0.95) which means a commission of $382 ($7,642 - $4,140 - $2,670 - $450).

Therefore, any order sold below $7,642 would be sold at a loss, and the minimum acceptable price for the 10 orders would be $76,420 ($7,642 × 10). Any profit margin would have to be added to this price. As seen in the calculation, the minimum acceptable price ignores fixed costs, so while it is acceptable to use it for a decision on these additional orders, it would not be acceptable to use it for pricing of regular orders, since fixed costs need to be recovered in the long term.

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

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

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

Reaching competence – The candidate attempts to provide a quantitative analysis of order #178 or the 10 additional orders.

Competent – The candidate provides a quantitative analysis of order #178 and the 10 additional orders.

Competent with distinction – The candidate provides a thorough quantitative analysis of order #178 and the 10 additional orders.

Assessment Opportunity #3 (Breadth and Depth Opportunity)

The candidate discusses the operational weaknesses in the ordering and delivery processes and provides recommendations.

The candidate demonstrates competence in Management Accounting.

CPA Map Technical Competencies:		**Core**
3.1.2	Documents and assesses business processes, systems and data requirements and recommends improvements to meet information needs	B

CPA Map Enabling Competencies:
2.2.1 Assists in identifying and monitoring risks within areas of work responsibility
2.2.2 Recognizes the importance of internal controls within areas of work responsibility
5.1.2 Recognizes the interrelationships among departmental and functional areas within the organization
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
5.3.1 Assists in identifying opportunities for process, product and service improvements related to work functions
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

I have identified the following operational weaknesses in your ordering and delivery processes.

Product Availability

Weakness: As per Pier's review, customers must go through the process several times if the product they select is not in stock. This is supported by your comment that you started offering a wider selection of products and some suppliers cannot keep up with the demand.

Implication: You may start to lose customers if they become frustrated with a slower, and more complicated, process than advertised. The quality of the end product could also suffer if you cannot source the quality materials that you ordinarily use.

Recommendation: Consider linking the inventory availability to your project management system, as well as to your website. Customers will get real-time information about product availability and your sales team will have a smoother ordering process. This will enable you to work proactively with suppliers, to ensure that you have the products you need as you grow.

Internet Security

Weakness: A customer complained about receiving spam and phishing emails from other parties after submitting personal information via the website.

Implication: The provider offers very basic services. It would be useful to know what security measures they have in place. Security breaches can undermine customer confidence in your business and hurt your reputation. Customers may think that, if personal information is insecure, their financial information provided for payments may also be at risk. Your bank covenants also require you to report cybersecurity breaches. An unreported security breach could result in the bank calling your debt or changing terms.

Recommendation: Consider upgrading your website hosting to one that offers more than basic services. You would likely need to obtain an audit report on controls at a service organization.

Website Performance

Weakness: A customer complained about the speed of the website. This may be due to the increased traffic on the website, and the website hosting service provider.

Implication: The website reflects your business. If customers believe the website is slow and of poor quality, they may also make these assumptions about your business. You could lose customers. This will be important if you integrate the website with your inventory availability.

Recommendation: Consider upgrading your website hosting to a provider that can provide faster speeds and uptime guarantees.

Delivery Accuracy and Timing

Weakness: Delivery concerns have been noted. One reviewer noted that they received the wrong order, and were then asked to re-pack and ship the products. Another noted that the delivery team did not contact them before shipping the product.

Implication: This is likely due to the new hires in the packaging team, with reduced training, or due to the outsourcing of shipments. You could lose customers or incur additional delivery costs that result from missed deliveries or poor customer service.
Recommendation: You should prioritize the training of your packaging team and your new contracted delivery companies, to ensure that they meet STH's standards.

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

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

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

Reaching competence – The candidate attempts to discuss some of the operational weaknesses in the ordering and delivery processes.

Competent – The candidate discusses some of the operational weaknesses in the ordering and delivery processes, and provides recommendations.

Competent with distinction – The candidate discusses several of the operational weaknesses in the ordering and delivery processes, and provides recommendations.

Assessment Opportunity #4 (Breadth Opportunity)

The candidate discusses the current audit committee composition and the appropriateness of its current mandate, and provides recommendations.

The candidate demonstrates competence in Strategy and Governance.

CPA Map Technical Competencies:		Core
2.1.2	Evaluates the specific role of the audit committee in governance	B

CPA Map Enabling Competencies:
5.1.2 Recognizes the interrelationships among departmental and functional areas within the organization
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

While there are no specific rules that apply to audit committees of private companies, there are specific rules that apply to public companies. Since you are planning for an IPO in the future, CVC says you need a strong audit committee, so the following governance practices should be implemented to improve the audit committee composition and mandate, and to prepare for when the company becomes public.

Audit Committee Composition

Audit committees should be independent of management, and consist of individuals with financial literacy. You also want individuals who will provide value to STH, to help it pursue its vision and strategic plan. Using these criteria, I have evaluated the current board composition.

<u>Renata Garcia</u>

- Independence: Renata is Rafael's sister. While she is independent of the company (not an employee), she would potentially be biased in her support of her brother's activities and decisions.
- Financial literacy: Renata is a CPA. She is financially literate, with a basic understanding of audit and financial reporting.
- Strategic fit: Renata's background is in tax and owner-managed businesses. Her tax expertise is relevant to STH, especially in the context of the upcoming IPO. However, while her
owner-manager expertise is currently a good fit with STH, as STH moves to a publicly accountable enterprise, with an IPO or wider share ownership, an individual who has expertise with public companies would be a better fit.

Conclusion: Renata should at least be replaced as the chair of the audit committee. Since her tax expertise complements the audit committee and will be helpful in preparing for an IPO, she could remain for now as a member of the committee, but it would be preferable to have another person act as chairperson. It would also be advisable to have additional independent members on the committee, to ensure that Renata does not act in a biased manner.

<u>Rafael Garcia</u>

- Independence: As the CEO and owner, Rafael is not independent of management; he is part of the management team. This creates a risk, as he would be responsible for oversight of his own work.
- Financial literacy: Rafael is an architect. While not an accountant or finance professional, Rafael would be financially literate as he is the CEO and in charge of overall operations.
- Strategic fit: Rafael would certainly be aware of the detailed activities of the company, based on the intimate knowledge he has of the business, but as an architect would not have the necessary experience to operate a publicly accountable company.

Conclusion: Rafael should be replaced as a member of the audit committee.

<u>Lilian Phan</u>

- Independence: There is no indication that Lilian owns shares in the company or that she gets remuneration related to the success of STH. Therefore, she is independent of management and is in a good position to oversee their decisions. However, if the IPO occurs, and if CVC retains some ownership, or if Lilian's remuneration is linked to the success of her work with STH, her independence would have to be reviewed.
- Financial literacy: As a chartered financial analyst (CFA), Lilian is financially literate.
- Strategic fit: As a venture capitalist working with STH, Lilian is a good strategic fit for the company's growth and for knowledge of its operations.

Conclusion: Lilian should remain as a member of the audit committee.

Although having all independent members on the audit committee is not a requirement for private companies, I recommend that we start recruiting new, independent members now, so that all of the audit committee members are independent if we decide to proceed with the IPO.

Audit Committee Mandate

The mandate provided includes some appropriate tasks:

- Annually approve the financial statements: This should remain, but should be performed quarterly if the company goes public, as public companies report quarterly. The audit committee should also review the Management Discussion and Analysis (MD&A), once public. The MD&A is an important additional document that explains the financial results, and is required for public companies.
- Appoint external auditors: This should remain, but should be clarified that it will be performed annually if the company goes public; it is a public company requirement that the audit committee recommend an auditor, to be appointed by the shareholders at each annual general meeting.
- Review whistleblower complaints: This is also important; however:
    a) complaints are submitted to the CEO. As the CEO is not independent, this is not ideal. STH should consider having an independent company administer the complaints, or have them submitted to an independent audit committee member, who would then report to the audit committee.
    b) the mandate states that this review should be done periodically. I recommend clarifying this to be performed at least quarterly.

In addition, the audit committee should:

- be involved in approving significant changes to accounting policies, such as when new policies are implemented or changed. This applies, for example, to the accounting policy for the commercial property that was acquired.
- oversee management's assessment of internal controls over financial reporting.
- oversee any internal audit department that STH will have.
- ensure that they are meeting in camera (i.e., without management present) with the external auditors on a regular basis.

For Assessment Opportunity #4 (Strategy and Governance), the candidate must be ranked in one of the following five categories:

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

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

Reaching competence – The candidate attempts to discuss the audit committee composition or mandate.

Competent – The candidate discusses the audit committee composition or mandate.

Competent with distinction – The candidate thoroughly discusses the audit committee composition and mandate.

Assessment Opportunity #5 (Breadth Opportunity)

The candidate discusses compliance with the new bank covenants.

The candidate demonstrates competence in Finance.

CPA Map Technical Competencies:		**Core**
5.1.1	Evaluates the entity's financial state	A

CPA Map Enabling Competencies:
5.1.1 Applies general business knowledge to enhance work performed
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses

Compliance with Bank Covenants

I have analyzed each covenant to determine whether STH is in compliance as at December 31, 2021. Note that the ratios calculated below will change according to which model you choose in order to account for the investment property, when the calculation is done as of December 31, 2022.

<u>Working capital ratio of no less than 0.5</u>

The working capital ratio is the same as the current ratio: current assets ÷ current liabilities:

$165,000 ÷ $225,000 = 0.73

The covenant is met; however, it is under 1.0, which is not ideal. So that we do not breach this covenant, we should work toward improving our working capital by reducing current liabilities or increasing current assets.

Debt to equity not exceeding 2:1

Debt to equity is calculated as total liabilities / total equity:

$1,300,000 ÷ $950,000 = 1.37

This covenant is met, and we are in a healthy position compared to the 2:1 ratio limit.

Bank loan to EBITDA not exceeding 4:1

EBITDA calculation:

Net income before tax	$ 240,000
Interest	24,000
Depreciation ($25,000 + $10,000)	35,000
EBITDA	$ 299,000

The ratio is calculated as bank loan /EBITDA:

$600,000 ÷ $299,000 = 2.01

This covenant is met, and STH is in a healthy position.

Unmodified audit report within 90 days of year end

There are two aspects to this covenant:

- Unmodified audit report – Because of our opening balances, we may have trouble meeting this covenant. They have not been audited, which means there could be a scope limitation qualification in our audit report. We should:
  - contact the auditors. We are six months into the year. Perhaps they can perform rollback procedures, to gain comfort over the balance.
  - contact the bank and let them know. Perhaps we can negotiate the covenant for the first year.
- Within 90 days of year end – We will likely be able to comply. Our year end is December 31, 2022, which is in six months, and should be sufficient time to prepare for and plan the audit.

<u>Report cybersecurity breaches within 30 days</u>

- This could be a risk area for us. Based on our reviews, we may have had a cybersecurity breach, as someone received spam and phishing emails from other parties after sending us information. We should perform an investigation into the potential leak. The user review is dated June 12, 2022, which does not allow much time to complete the investigation within the 30-day requirement. We should contact our web-hosting service provider (or our internal IT support, if we have one) immediately, to begin this investigation.
- We should also assess our cybersecurity controls, to ensure that we can identify future breaches in a timely manner.

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

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

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

Reaching competence – The candidate attempts to discuss some of the bank covenants, or provides calculations of some of the ratios.

Competent – The candidate discusses some of the bank covenants, providing supporting ratio calculations when needed.

Competent with distinction – The candidate discusses several of the bank covenants, providing supporting ratio calculations when needed.

Assessment Opportunity #6 (Breadth Opportunity)

The candidate provides audit procedures for the revenue, inventory (i.e., raw materials, work-in-progress, and finished goods), and the bank loan.

The candidate demonstrates competence in Assurance.

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

CPA Map Enabling Competencies:
6.1.3 Demonstrates skepticism, objectivity, due care and persistence when identifying issues
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

In each of the areas detailed below, the auditors will want to assess controls and determine whether they can be relied upon. If so, a mixed approach will be taken instead of a substantive approach.

Revenue

- The auditors will select a sample of revenue transactions from the GL and request the associated contracts, to confirm the terms, including the specific performance obligations, date of delivery of the performance obligations, and the purchase price of the contract. They will then calculate the amount of revenue and compare it to what we have recorded, to ensure that it is appropriate.
- They will trace the cash receipts noted in the contracts to the bank statement, to ensure that the amounts were received for the sales that were collected, and to the proof of shipping for sales that have not yet been collected.
- To ensure that revenue is recorded in the proper period, they will select additional revenue transactions around year end. This will be those recorded in the GL before and after year end (e.g., last five transactions of 2022 and first five transactions of 2023). They will request the contracts related to those transactions, to ensure that the terms have been met and that the revenue has been accounted for in the right year.

Raw Materials, Work-in-Progress, and Finished Goods Inventory

- The auditors will want to attend our year-end inventory count. They will want to get an understanding of the procedures performed and controls in place for the count. Typically, they will also perform test counts. These counts will be from the count sheets to the floor, to test that all inventory on record exists, and from the floor to the count sheets, to ensure that the records are complete.
- They will also select transfers from inventory to COGS and trace this to supporting documentation, such as work orders and shipping documents. This will ensure completeness of inventory.
- They may also select a sample of raw material purchases and trace them to invoices, to ensure that they exist.
- As this is the first audit, the auditors will want to obtain assurance over the opening balances. They will first have to assess whether this is possible, given that we are already six months past December 31, 2021. If possible, they may perform roll-back procedures. This includes the following:
  - Inspecting the inventory GL to see transactions (additions and removals) from December 31, 2021, to the current date.
  - Selecting a sample of significant transactions and tracing them to supporting documents. For inventory additions, they will inspect invoices, looking at the dates, value, and contents, to ensure that they were accurately recorded.

- For transfers of finished goods to COGS, they will inspect sales contracts to ensure that the details of the transferred inventories agree with the details on the sales agreement. They will also trace the contracts to cash payment, to ensure that they relate to sales that occurred.
- For transfers of raw materials to work-in-progress, they will select a sample of those transfers and trace the quantities of raw materials transferred back to the reports provided by the costing software, to ensure that the quantities transferred tie in with the projects worked on during that roll-back period.
- For transfers of work-in-progress to finished goods, they will select a sample of those transfers and ensure that they correspond to the quantities used in the projects completed, as per the costing software.

- The auditors will want to verify our cost calculations for work-in-progress inventory. This could include tracing direct labour to time sheets, direct materials to work orders and contract details or supplier invoices, and overhead allocations and rates to supporting data. They could also request floor plans, to validate our allocation for the shop rent. They will want to confirm the costs of the direct labour, which means they might trace rates to employment agreements or pay stubs. They will also make sure that the costs included in the calculation do not include things such as abnormal waste.
- They will audit normal production capacity to ensure that the allocation of overhead costs is appropriate. They might do this by looking at production reports and recalculating the total production for the last few years, and comparing it to the normal capacity used in the calculation of the overhead allocation.
- They will look at the selling price from a recent sale of the staircases and compare that to the value of the inventory. This will give an indication of whether the inventory value is less than the selling price, which could mean that the inventory is impaired.
- They will also compare the cost of recent purchases, per raw material invoices, and compare that to the value on the books, to ensure that we have recorded it as an accurate value.
- During the inventory count, they will look for items that look damaged or are dusty or old, which could also mean that they are impaired.

Bank Loan

- The auditors will likely send a confirmation to the bank, to confirm the amount and key terms (e.g., interest rate) of the loan, and agree the balance to the GL.
- They will also confirm with the bank whether there are any other loans, to ensure that they have all been recorded.
- They will inspect the agreement with the bank, to make sure that payment terms are accurately disclosed. They will recalculate the value of the current portion of our loan and compare this with the amount on the financial statements.
- They will look at the covenants listed in the agreement, re-perform ratio calculations, and review other covenants, to ensure that we are in compliance. If we are not, the auditor will perform additional procedures, to determine whether the entire loan should be presented as current, such as asking management whether a waiver of the debt covenants could be obtained.

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

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

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

Reaching competence – The candidate provides a few procedures over revenue, inventory, and the bank loan.

Competent – The candidate provides some procedures over revenue, inventory, and the bank loan.

Competent with distinction – The candidate provides several procedures over revenue, inventory, and the bank loan.

Assessment Opportunity #7 (Breadth Opportunity)

The candidate calculates STH's taxable income.

The candidate demonstrates competence in Taxation.

CPA Map Technical Competencies:		**Core**
6.2.2	Advises on taxes payable for a corporation	B
6.4.1	Evaluates adherence to compliance requirements	B

CPA Map Enabling Competencies:
6.1.1 Identifies and articulates issues within areas of work responsibility
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

You have asked that I calculate taxable income for 2021.

Net income before tax		$240,000	Per income statement
Add back:			
Golf membership	5,000		Golf membership is non-deductible
50% of meals and entertainment	7,000		Per income statement. Meals and entertainment are 50% deductible
Depreciation	35,000		$25,000 per income statement + $10,000 included in COGS
		47,000	
Deduct:			
CCA	184,750		Note 1
Terminal loss	45,000		Note 1
		(229,750)	
Taxable income		$ 57,250	

Note 1:

CCA Class	UCC	Additions	Dispositions	Subtotal	All	UCC for CCA	CCA	Rate
Class 8	165,000	5,000		170,000	2,500	172,500	34,500	20%
Class 10 (Note A)	145,000		100,000	45,000				
Class 10.1 (Note B)	22,000		15,000	7,000			3,300	30%
Class 50	25,000	16,000	0	41,000	8,000	49,000	26,950	55%
Class 53 (Note C)		120,000		120,000			120,000	
Total	357,000	141,000	115,000	383,000			184,750	

Notes:

A. STH sold all vehicles; these were the last assets in the class. This leaves UCC of $45,000, which is claimed as a terminal loss.

B. While the selling price is also less than the ACB, Class 10.1 is not subject to recapture or terminal loss. CCA is allowed in the final year of disposition, on the UCC before reducing for the disposition, but the half-year rule applies in the year of disposition.

C. Under the Accelerated Investment Incentive, Class 53 is allowed a full deduction in the year of acquisition.

Finally, it should be noted that the corporation income tax return is due six months after the end of the taxation year, which means that it was due on June 30, 2022. Since today is July 2, 2022, we should file the tax return as soon as possible, to minimize any penalties. Late-filing penalties will be 5% + 1% for each full month that the return is overdue, so if we file by the end of July, we can avoid any further penalties.

Interest will also apply on unpaid balances as at March 31, 2022, and the instalment schedule for 2022 should be updated to reflect the 2021 actual taxes payable, once determined.

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

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

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

Reaching competence – The candidate attempts to calculate STH's taxable income.

Competent – The candidate calculates STH's taxable income.

Competent with distinction – The candidate thoroughly calculates STH's taxable income.

COMMON FINAL EXAMINATION
SEPTEMBER 9, 2022 – DAY 3

Case #2 **(Suggested time: 75 minutes)**

TFS Ltd. (TFS) is a farm-supply retailer located in Ontario, incorporated in 1985 by Tamara Hynes. TFS has three divisions: Feed, Seed, and Farm Supplies. Tamara explains that all three divisions are important, as they complement each other. TFS's clientele ranges from small farmers to large corporate farms. TFS's success is largely due to providing exceptional customer service, including Tamara's countless hours of work and her frequent visits to customers' farms. TFS also offers generous credit terms to its customers, which the small farmers take advantage of, resulting in a very large accounts receivable balance aged 90 days and over. These farmers have always paid, in cash, at the end of the season.

Gary is the business manager who usually handles the accounting, with the help of Paul, the bookkeeper. TFS's financial statements are prepared in accordance with ASPE. However, Gary has taken a leave of absence due to illness. You, CPA, have been engaged by Tamara as a consultant, to perform Gary's duties.

It is November 15, 2022, and you meet with Tamara, who begins: "I am considering selling a portion of my shares to John and Scott, two long-time employees, making the three of us equal owners. Before Gary went on leave, he said we should see if I could use the lifetime capital gains deduction (LCGD) when I sell my shares. Please explain to me what the LCGD is, whether I could use it, and what could be done to ensure that my shares are qualified small business corporation (QSBC) shares when the time comes to sell. Here is TFS's draft balance sheet at October 31, 2022 (Appendix I).

"I have been operating my business by myself all these years. John, Scott, and I will now be operating the business together. Are there any broader considerations that I should factor in, when deciding whether to sell shares to John and Scott?

"The three of us have agreed upon a selling price for the shares, and I am considering personally loaning each of them a portion of the selling price. Can you suggest any improvements to the financing proposal (Appendix II)?"

After making notes on the financing proposal, you meet with John and Scott (Appendix II).

Tamara later asks you to finalize the divisional allocations of revenues and costs that Gary did not complete, for the year ended October 31, 2022. Based on preliminary numbers, Tamara thinks the Farm Supplies division is not as profitable as the other two divisions, and would like your opinion. She provides a draft divisional income statement and Gary's notes on the required adjustments (Appendix III).

Tamara has become concerned that there may be several weaknesses in TFS's accounting processes. She would like you to discuss the control weaknesses you identify, and recommend improvements (Appendix IV).

Lastly, Tamara tells you about some inventory issues, and asks whether the inventory balance needs to be adjusted in the October 31, 2022, financial statements (Appendix V).

APPENDIX I
DRAFT BALANCE SHEET

TFS Ltd.
Draft Balance Sheet
As at October 31

	2022	2021
Assets		
Current assets		
Cash (Note 1)	$ 1,418,000	$ 1,653,000
Short-term investments	399,000	321,000
Accounts receivable	1,439,000	1,250,000
Inventory	1,011,000	989,000
Income taxes receivable	100,000	0
	4,367,000	4,213,000
Property, plant, and equipment	2,915,000	2,016,000
	$ 7,282,000	$ 6,229,000
Liabilities		
Current liabilities		
Accounts payable	$ 673,000	$ 556,000
Income taxes payable	0	21,000
Shareholder loan	521,000	612,000
	1,194,000	1,189,000
Shareholder's equity		
Share capital	100	100
Retained earnings	6,087,900	5,039,900
	6,088,000	5,040,000
	$ 7,282,000	$ 6,229,000

Note 1 – TFS carries a significant cash balance in order to finance big inventory purchases. To receive higher discounts on its spring inventory, it makes large down payments to its suppliers in November and December.

APPENDIX II
SALE OF SHARES TO JOHN AND SCOTT

Financing Proposal

Amount to finance:	20% of the selling price for John and for Scott
Interest rate:	2%
Security:	None
Term and payment:	20 years, blended monthly payments

The repayment term is long because John and Scott will finance the remainder of the selling price through a bank loan, bearing interest at 5% per annum. Tamara hopes they will pay her loan back faster using the substantial yearly dividends and divisional net-income-based bonuses that owners and managers receive, per TFS's policy. Because she has known John and Scott for so long, Tamara does not believe security is necessary.

Discussion with John and Scott

John and Scott are in their late thirties, highly energetic, and have many ideas for modernizing the company.

John: Tamara wastes so much time visiting farmers. We want to start using online ordering and maybe even use self-checkouts, to save on salaries.

Scott: Some farmers take forever to pay, and the accounts receivable balance is always high. We think it would be a great idea to switch to electronic payments only, just like the big retail stores.

John: Perhaps we should just shut the Feed division down. It takes so much of our time that there is little left to spend with our families.

APPENDIX III
DRAFT DIVISIONAL INCOME STATEMENT

For the year ended October 31, 2022

	Seed	Feed	Farm Supplies
Sales	$ 4,105,000	$ 3,795,000	$ 4,230,000
Cost of sales	2,595,000	2,295,000	3,250,000
Gross margin	1,510,000	1,500,000	980,000
Operating expenses			
Insurance	15,500	13,200	11,400
General and administration	25,400	26,700	25,900
Professional fees	7,100	6,500	14,900
Repairs and maintenance	11,100	12,300	10,900
Vehicle expense	98,500	89,000	151,900
Wages and benefits	220,300	245,100	368,400
Total operating expenses	377,900	392,800	583,400
Net income	$ 1,132,100	$ 1,107,200	$ 396,600

Additional Information:

- Paul posted all the entries related to the sale of 3,170 bags of seeds to the Feed division, rather than the Seed division. These bags were delivered mid-October and all of our deliveries are FOB destination. These bags cost $12 each, and are marked up by 33%.
- Some allocations were not yet performed when Gary left. The purchases of the bags of seeds in the table below were recorded entirely to the Farm Supplies division. Gary initially recorded annual fuel costs, and Tamara's and Paul's annual compensation, entirely in the Farm Supplies division. Fuel was purchased at an average price of $1.10 per litre, and the trucks consume, on average, 30 litres for every 100 kilometres driven.

APPENDIX III (continued)
DRAFT DIVISIONAL INCOME STATEMENT

The information Gary intended to use for the allocations is as follows:

	Seed	Feed	Farm Supplies
Delivery trucks mileage in kilometres	105,500	95,200	108,300
Tamara's hours	790	1,290	840
Bags of seed purchased	16,250	24,375	0
Paul's hours	410	590	440

- Total cost of Tamara's and Paul's annual compensation: $156,000
- Tamara receives an annual salary and Paul earns $25/hour
- Tamara's total hours worked: 2,920
- Paul's total hours worked: 1,440

APPENDIX IV
ACCOUNTING SYSTEM AND PROCESSES

TFS's point-of-sale system is used to track inventory, sales, and receivables, and cannot be integrated with the accounting software. Every morning, Paul manually enters the previous day's summary sales/inventory information into TFS's "off-the-shelf" accounting software.

Paul does not use the payables module of the accounting software. He keeps all invoices in a filing cabinet, goes through them once a month, selects the ones that are due, and prepares the cheques for payment. Rather than enter individual invoices, he records the total payment in the system.

All cheques are signed by Tamara or Gary; whomever signs the cheques reviews the supporting documents.

Paul performs the bank reconciliations monthly using a spreadsheet, which takes a long time due to the large number of transactions in a month. As Tamara does not understand bank reconciliations, she does not review them.

Gary records the allocation entries to the divisions once a year. There are many entries, and he manually tracks the amounts in a spreadsheet. Because he has been with the company for so long, no one reviews Gary's entries.

APPENDIX V
INVENTORY ISSUES

During our inventory count, we discovered that some seed inventory was damaged by a leak in the warehouse. We left it in inventory because one of our customers can use it as a by-product. The normal selling price of these seeds is $60,000, and the customer will buy them next week for 25% of this price. The cost of these seeds is $42,000.

On October 30, one of our trucks, which was taking feed with a cost of goods sold of $17,000 to a customer, broke down on the way, causing the delivery to be delayed. We stored the feed in a temperature-controlled warehouse that we found on the way, at a cost of $1,000. The goods arrived at the client's premises on November 2, 2022.

MARKING GUIDE 3-2
TFS LTD. (TFS)
ASSESSMENT OPPORTUNITIES

To: Tamara
From: CPA
Subject: Advice on pending share sale and other issues

Assessment Opportunity #1 (Breadth Opportunity)

The candidate explains the lifetime capital gains deduction (LCGD), whether it could be used, and what could be done to ensure that Tamara's shares are qualified small business corporation (QSBC) shares.

The candidate demonstrates competence in Taxation.

CPA Map Technical Competencies:		**Core**
6.6.3	Analyzes income tax implications of the purchase and sale of a CCPC	B

CPA Map Enabling Competencies:
2.1.1 Applies knowledge of the organization's competitive environment and strategic direction when performing assigned work
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.1.1 Identifies and articulates issues within areas of work responsibility
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

The lifetime capital gains deduction (LCGD) may be claimed by an individual resident in Canada against taxable capital gains arising on the disposition of qualified small business corporation (QSBC) shares, and qualified farm or fishing property.

The lifetime capital gains exemption (LCGE) for 2022 is $913,630, assuming you have not used any of this balance before. This is the amount of capital gain on the disposition of eligible assets that you can incur without incurring tax on the sale, assuming you have no cumulative net investment loss (CNIL) balance. Only 50% of capital gains is taxable, so the LCGD is claimed at 50% of this limit (i.e., $456,815), up to the amount of taxable capital gain. This would greatly reduce the amount of taxes you will pay on the sale of your shares.

We need to determine if your shares in TFS would be considered QSBC shares. To qualify, they must meet three criteria.

Small Business Corporation

The shares must be in a corporation that is a small business corporation (SBC). This has two criteria:

1. The corporation must be a Canadian-controlled private corporation (CCPC).

   As you are a resident of Canada, and you control TFS, this is met.

2. All or substantially all (90%) of the fair market value of the assets of the corporation, including unrecorded assets such as internally-generated goodwill, must be used primarily (at least 50%) in an active business carried on in Canada.

All of TFS's assets are used in the active business except for the short-term investments. It may also be questionable to have such a large cash balance at year end. If the cash was considered inactive, TFS would not meet the 90% test. However, the large cash balance is required at year end to pay for large supplier deposits in November and December.

While the short-term investments would not be considered used in active business, they are not large enough as of October 31, 2022, to keep TFS from meeting this criterion. Assuming that the entire cash balance is considered to be used in an active business, 94.5% [($7,282,000 - $399,000) ÷ $7,282,000] of TFS's assets are used in an active business, thus meeting the 90% threshold.

Note that there is likely internally-generated goodwill, which would increase both the numerator and denominator in this calculation by the same amount, which would likely increase the percentage of active business assets to a level higher than the 94.5% calculated. However, given that much of the goodwill relates to your personal actions, Tamara, there may not be a significant amount—we should determine this, based on the purchase price, once it is known.

Ownership Period

The shares must not have been owned by anyone other than the individual or a related person during the 24 months before the shares are disposed of. As you have been the only shareholder and have held all the shares since the company's inception, this criterion is met.

Asset Test

Throughout the 24-month holding period, more than 50% of the fair value of the assets must have been used primarily in an active business carried on in Canada. Based on the two balance sheets you have provided, and the fact that a large cash balance is required for operations, this criterion is met, as the only asset that is not used in active business is the short-term investments, and that balance is small.

Conclusion

Based on the above, TFS's shares would meet the criteria as QSBC shares and you would be eligible to claim the LCGD. An analysis of alternative minimum tax is outside the scope of this report, but it may apply when an individual claims the lifetime capital gains deduction, so we should review your personal tax situation before the sale.

You also asked for advice on how to ensure that you meet the criteria. Given how close the short-term investments are to putting TFS offside of the SBC test, there may be a need to sell these before selling the company. You have a large shareholder loan balance; to ensure that you always meet the 90% and 50% tests above, I recommend that you sell the short-term investments and transfer the proceeds to yourself in order to reduce the amount owing to you.

Also, if you do decide to provide financing to John and Scott, you may be able to take advantage of the capital gains reserve, which will defer the taxation of the portion of the gain for which you have not been paid until a later year. Deferring some of the gain to later years will have the advantage of that income being taxed in a year in which you may be in a lower tax bracket. It will also give you the opportunity to use more of the LCGD; the limit is indexed to inflation annually, so any additional limit would become available to you in subsequent years.

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

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

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

Reaching competence – The candidate attempts to discuss the LCGD, whether the capital gain from the sale of Tamara's shares will qualify for the LCGD, and ways for the company to ensure that the shares qualify for the LCGD.

Competent – The candidate discusses the LCGD, whether the capital gain from the sale of Tamara's shares will qualify for the LCGD, and ways for the company to ensure that the shares qualify for the LCGD.

Competent with distinction – The candidate thoroughly discusses the LCGD, whether the capital gain from the sale of Tamara's shares will qualify for the LCGD, and ways for the company to ensure that the shares qualify for the LCGD.

Assessment Opportunity #2 (Breadth Opportunity)

The candidate discusses the broader considerations that Tamara should factor in, when deciding whether to sell shares to John and Scott.

The candidate demonstrates competence in Strategy and Governance.

CPA Map Technical Competencies:		**Core**
2.2.1	Assess whether management decisions align with the entity's mission, vision, and values	B

CPA Map Enabling Competencies:
5.1.2 Recognizes the interrelationships among departmental and functional areas within the organization
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.3.1 Uses evidence and judgement to recommend and justify solutions or conclusions

You have built a successful business and pride yourself on exceptional customer service, including in-person interactions with customers. A large part of your success relates to providing very generous credit terms to your customers, who seem to have cash flow timing issues. John and Scott seem to have views on running the company that might clash with your way of operating. They do not believe that face-to-face interaction is necessary, and want to make the company more automated in terms of online ordering and self-checkouts.

They also think it would be best to switch to electronic payments only, to decrease or eliminate accounts receivable altogether. For many of those customers that pay at the end of the season, this might not be feasible.

Part of your business's success is due to the countless hours you have invested in it. John and Scott do not seem ready to invest as much time in the business; they think the Feed division is taking too much of their time, and they don't have enough left to devote to their families. It appears that they wish to be less involved than you have been.

John and Scott are considering getting rid of the Feed division. You mentioned that all three divisions are important, as they complement each other. John and Scott are heading in a very different direction than you have been in the past.

While your visions may differ in terms of the company's direction, the company could benefit from having them as shareholders. As mentioned later in this memo, there are many inefficiencies in your accounting systems and processes. John and Scott seem to keep abreast of the latest technology, and these skills will be very useful when you look at replacing your systems and streamlining some of your processes.

Since founding the company, you have been the only owner, and therefore the sole decision maker. Going from making all decisions yourself to sharing this responsibility with the two other shareholders will require some adjustment. Given the difference between your vision and theirs, this is especially important. You may find yourself outnumbered on many issues. I recommend that you clearly establish your roles before the share sale takes place. You should have a shareholder agreement drafted that outlines each of your roles and responsibilities; if you wish, this agreement could also give you more control over the operations than the other two shareholders. You could also accomplish this through multiple voting shares. You should also clearly define what happens when one shareholder wishes to sell their shares.

Overall, I recommend that you only proceed with the sale once you have better financing terms for John and Scott, and have addressed the issues above. I also recommend that you have a shareholder agreement in place before you sell your shares, especially because you, John, and Scott have a different vision for TFS. This agreement should cover what happens in case of disagreements, or if a shareholder wants to sell their shares, for example.

For Assessment Opportunity #2 (Strategy and Governance), the candidate must be ranked in one of the following five categories:

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

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

Reaching competence – The candidate attempts to discuss the broader considerations to factor in, when deciding whether to sell shares to John and Scott..

Competent – The candidate discusses the broader considerations to factor in, when deciding whether to sell shares to John and Scott.

Competent with distinction – The candidate thoroughly discusses the broader considerations to factor in, when deciding whether to sell shares to John and Scott.

Assessment Opportunity #3 (Breadth Opportunity)

The candidate recommends improvements to the financing proposal.

The candidate demonstrates competence in Finance.

CPA Map Technical Competencies:		**Core**
5.1.2	Develops or evaluates financial proposals and financing plans	B
5.2.6	Evaluates decisions related to distribution of profits	B

CPA Map Enabling Competencies:
5.1.1 Applies general business knowledge to enhance work performed
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems
6.1.3 Demonstrates skepticism, objectivity, due care and persistence when identifying issues
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

To improve your financing proposal, you should consider the following factors.

Interest Rate

Your interest rate of 2% is very low compared to the 5% rate that John and Scott will have on their bank loan; your loan will be ranking lower than the bank loan, and this is typically compensated by a higher interest rate. Over a 20-year period, the difference in rate would have a significant financial impact for you. Also, since the bank loan has a higher interest rate than your loan, John and Scott might put priority on paying back their bank loan to save on interest, and delay the repayment of your loan. You should increase your rate to the same rate as the bank, or at least to a rate closer to the bank's rate, such as 4%. Also, you will have to claim this as interest income on your personal tax return; therefore, a rate of 2% would not yield you a large return after tax.

Term

Twenty years is a very long term for the loan. It seems that you set up this longer term, hoping that John and Scott would make additional payments and repay the loan faster than scheduled. If you want to have access to your funds more quickly, a shorter-term loan may be more appropriate, to ensure that you actually collect the payments sooner.

Security

While it is good that you trust John and Scott, it is always risky to have a loan with no security. Given the large amounts you are funding for them and their overall debt load (as they will be funding the remainder of the purchase through a bank loan), this is especially true. Although you hope that John and Scott will make additional payments using their dividends and bonuses, there is no guarantee that this will happen. It would therefore be in your best interest to require some sort of security from John and Scott, such as claims on these shares or on some of their personal assets.

Dividends/Bonus

You noted that the company pays substantial dividends and bonuses to its owners and managers. As there will now be two more shareholders, you should ensure that the policy is updated with any changes you would like to make. Since TFS has a large cash balance and strong earnings, you should have a clause in the financing agreement that some or all of John's and Scott's dividends go to you to pay down their loan balances, to protect yourself. The same should be done for any management bonuses they would receive.

Risk

On the date of the share sale, two-thirds of your current shares will now legally be John's and Scott's shares. There is nothing to prevent them from selling their shares at any point during the term of your loan to them. You should ask your lawyer to put a clause in their agreements that prevents them from selling their shares until the loan is repaid in full. On a similar note, to protect all three shareholders, you should consider having a right of first refusal if one of the shareholders decides to sell in the future, or a clause allowing you to sell your shares at the same price if both shareholders sold to the same third party.

Overall Recommendation

Instead of personally lending money to John and Scott, it would be better to lend to the company and have the company lend funds to John and Scott. This may require the use of a holding company to minimize the tax implications, but further consultation with a tax advisor would be required, regardless of the financing option chosen. This would allow you to have security over the company's assets and for your loan payments to come out before John and Scott get paid any dividends or bonuses (i.e., have it as a covenant). If you decide to lend the funds personally, it would be advisable to increase the interest rate to at least the bank's lending rate. You should also shorten the term to a more reasonable length, such as five or ten years. In lieu of security, you should have a formal dividend policy, and consider receiving automatic payments of some or all of their dividends or salary.

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

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

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

Reaching competence – The candidate attempts to provide some recommendations for improvements to the financing proposal.

Competent – The candidate provides some recommendations for improvements to the financing proposal.

Competent with distinction – The candidate provides several recommendations for improvements to the financing proposal.

Assessment Opportunity #4 (Breadth and Depth Opportunity)

The candidate prepares revised divisional income statements and advises Tamara on the profitability of the Farm Supplies division.

The candidate demonstrates competence in Management Accounting.

CPA Map Technical Competencies:		**Core**
3.5.2	Evaluates sustainable profit maximization and capacity management performance	A

CPA Map Enabling Competencies:
5.1.2 Recognizes the interrelationships among departmental and functional areas within the organization
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

When Gary left, the divisional allocations of revenues and costs had not been completed, and some costs had been entirely accounted for in the Farm Supplies division, which makes it seem less profitable. We have performed the required adjustments to the draft divisional income statements, as shown in the table below. Note that the inventory adjustments discussed further in this report will need to be made, but we do not have sufficient information on the allocation of these adjustments to incorporate them into our divisional income statement.

Revised Divisional Income Statement

	Seed	Feed	Farm Supplies	Note
Sales as presented	4,105,000	3,795,000	4,230,000	
Seed posting error	50,593	(50,593)	0	1
Revised sales	4,155,593	3,744,407	4,230,000	
Cost of sales as presented	2,595,000	2,295,000	3,250,000	
Seed posting error	38,040	(38,040)	0	1
Seed purchases	195,000	292,500	(487,500)	2
Revised cost of sales	2,828,040	2,549,460	2,762,500	
Revised gross margin	1,327,553	1,194,947	1,467,500	
Operating expenses as presented	377,900	392,800	583,400	
Fuel cost	34,815	31,416	(66,231)	3
Paul's compensation	10,250	14,750	(25,000)	4
Tamara's compensation	32,466	53,014	(85,480)	5
Total additional operating expenses	77,531	99,180	(176,711)	
Revised operating expenses	455,431	491,980	406,689	
Revised net income	872,122	702,967	1,060,811	
Revised gross margin percentage	32%	32%	35%	

Notes:

1. Sales adjustment: \$12 per bag × 3,170 bags × 1.33 for the markup = \$50,593
   Cost of sales adjustment: \$12 per bag × 3,170 bags = \$38,040

2. Seed: \$12 × 16,250 bags = \$195,000
   Feed: \$12 × 24,375 bags = \$292,500

3. Seed: \$1.10 per litre × 105,500 kms ÷ 100 kms × 30 litres = \$34,815
   Feed: \$1.10 per litre × 95,200 kms ÷ 100 kms × 30 litres = \$31,416
   Farm Supplies: \$1.10 per litre × 108,300 kms ÷ 100 kms × 30 litres = \$35,739; Total to reallocate: \$34,815 + \$31,416

4. Seed: \$25 × 410 hours = \$10,250
   Feed: \$25 × 590 hours = \$14,750

Farm Supplies: \$25 × 440 hours = \$11,000; Total to reallocate: \$10,250 + \$14,750 = \$25,000

5. Tamara's salary: \$156,000 - \$10,250 - \$14,750 - \$11,000 = \$120,000
   Seed: \$120,000 × 790 hours ÷ 2,920 hours = \$32,466
   Feed: \$120,000 × 1,290 hours ÷ 2,920 hours = \$53,014
   Farm Supplies: \$120,000 × 840 hours ÷ 2,920 hours = \$34,520; Total to reallocate: \$32,466 + \$53,014 = \$85,480

As can be seen in the revised divisional income statement, the Farm Supplies division is the most profitable division, with a slightly higher gross margin of 35%.

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

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

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

Reaching competence – The candidate attempts to provide revised divisional income statements for the three divisions.

Competent – The candidate provides revised divisional income statements for the three divisions.

Competent with distinction – The candidate provides revised divisional income statements for the three divisions and concludes that the Farm Supplies division is the most profitable.

Assessment Opportunity #5 (Breadth Opportunity)

The candidate discusses the control weaknesses identified, and provides recommendations.

The candidate demonstrates competence in Assurance.

CPA Map Technical Competencies:		**Core**
4.1.1	Assesses the entity's risk assessment processes	A
4.1.2	Evaluates the information system, including the related processes, using knowledge of data requirements and risk exposures	B

CPA Map Enabling Competencies:
6.1.3 Demonstrates skepticism, objectivity, due care and persistence when identifying issues
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Multiple Accounting Systems

Weakness: TFS is currently using two systems for its accounting needs: the point-of-sale system for sales, inventory, and accounts receivable; and an accounting software.

Implication: Having the detailed information in two systems causes time inefficiencies for yourself and Paul. You constantly have to switch between different systems, depending on what information you need. It also presents opportunities for errors, as Paul manually enters the summary information of one system into the other system.

Recommendation: You need to upgrade either the current point-of-sale system or the accounting system so that the two can be integrated. TFS would benefit from a fully integrated accounting package that meets all your accounting needs. Alternatively, if this is not feasible, at a minimum, the manual entries should be reviewed by another individual.

Accounts Payable

Weakness: Paul does not use the accounts payable module of the accounting software, and records invoices on a cash basis. Instead of entering the details of each invoice, he only records the total of the payments.

Implication: You never know the accounts payable balance of any of your suppliers without having to manually pull the vendor file from the cabinet. In addition, this could lead to late payments to suppliers, as Paul could miss a due date when manually going through the invoices to pay them, which is only done once a month, or duplicate payments, if he forgets to note them as paid. It would also lead to cut-off issues, as expenses are recorded at the date of payment. This is mostly concerning at year end, when you would have to estimate payables based on the outstanding-cheque list. Finally, if an invoice gets lost, there would be no record of it, leading to potentially missed payments.

Recommendation: Paul should start using the accounts payable module of the accounting software. Invoices should be entered individually, and on a regular basis, shortly after they arrive. This will ensure timely and accurate accounts payable and income statements for you and the upcoming new shareholders. This will also help ensure that all expenses are recorded in the correct period, and provide more accurate and detailed information on each vendor in the system, at any point in time.

Signing Authority

Weakness: You currently only need one person to sign the cheques, which can be you or Gary.

Implication: This increases the risk that fraud or errors could occur and not be detected.

Recommendation: With the new shareholders potentially coming on board, this could be a good time to implement dual signatures. All three could have signing authority but only two of the three signatures would be required. In the meantime, your monthly review of the bank reconciliation will help mitigate the risk of fraud and error. As you review the monthly reconciliation, you can see copies of all cheques that cleared the bank, and will spot anything unusual, such as an inappropriate payment.

Bank Reconciliations

Weakness: Paul currently performs bank reconciliations monthly on a spreadsheet, which is not reviewed.

Implication: Paul is spending time on the monthly bank reconciliations that he could be spending on other tasks. In addition, because they are not reviewed, there could be errors or fraud that you would not know about.

Recommendation: To save time and reduce chances of errors, Paul should see if there is a bank reconciliation option in the accounting software. Using this function would provide real-time access to information for you and the future shareholders. The bank reconciliation process should be explained to you, so you are able to identify any potential issues. In addition, the monthly bank reconciliation should be reviewed and initialled by you. This way, you can see the types of transactions going through the bank, and ensure that you are comfortable with any outstanding items, such as deposits and cheques.

Timely Reporting/Entries

Weakness: Many expenses, such as fuel, seed purchases, and Tamara's and Paul's compensation, are recorded in the Farm Supplies division, and Gary only makes the relevant allocations to the other divisions once a year.

Implication: You never truly know how the divisions are doing until after year end. Problems or errors in divisions could go undetected for a long time.

Recommendation: Gary should properly allocate all costs to each division on a timelier basis. For example, fuel costs and seed costs can be allocated as the invoices are entered (or at the very least, monthly). Any payroll costs, such as yours, can be allocated to the divisions every payroll. As you look to upgrade to a more integrated system, this entry can likely be automated, to record all payroll allocations to the appropriate divisions.

Segregation of Duties

Weakness: Gary has signing authority, and records entries, such as the entries for the fuel cost, seed purchases, Tamara's and Paul's compensation, and the allocation entries. Gary receives a generous annual bonus based on the net income of the divisions.

Implication: This provides opportunities, not only for errors but also for misappropriation of assets. Gary could easily redirect money to himself, either through a fictitious vendor or by manipulating the divisional allocations in order to affect his year-end bonus.

Recommendation: The recommendation of having dual signatures on cheques would also solve this weakness. You would be able to review all of the cheques, as well as the documentation that supports the payments and the allocations.

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

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

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

Reaching competence – The candidate identifies some of the control weaknesses at TFS and provides some recommendations for improvements.

Competent – The candidate discusses some of the control weaknesses at TFS and provides recommendations for improvements.

Competent with distinction – The candidate discusses several of the control weaknesses at TFS and provides recommendations for improvements.

Assessment Opportunity #6 (Breadth and Depth Opportunity)

The candidate discusses the inventory issues and recommends the appropriate accounting treatment.

The candidate demonstrates competence in Financial Reporting.

CPA Map Technical Competencies:		**Core**
1.2.2	Evaluates treatment for routine transactions	A

CPA Map Enabling Competencies:
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions
6.3.3 Applies decision criteria to choose among viable alternatives

You had a few issues with inventory that we need to consider, to determine whether any adjustments should be made. Inventory must be measured at the lower of cost and net realizable value, as summarised below.

As per ASPE 3031 Inventories:

"Measurement of Inventories

.10 Inventories shall be measured at the lower of cost and net realizable value.

Cost of inventories

.11 The cost of inventories shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Net realizable value

.27 The cost of inventories may not be recoverable if those inventories are damaged, if they have become wholly or partially obsolete, or if their selling prices have declined. The cost of inventories may also not be recoverable if the estimated costs of completion or the estimated costs to be incurred to make the sale have increased. The practice of writing inventories down below cost to net realizable value is consistent with the view that assets are not carried in excess of amounts expected to be realized from their sale or use.

.28 Inventories are usually written down to net realizable value item by item. However, in some circumstances, it may be appropriate to group similar or related items. This may be the case with items of inventory relating to the same product line that have similar purposes or end uses, are produced and marketed in the same geographical area, and cannot be practicably evaluated separately from other items in that product line. It is not appropriate to write inventories down on the basis of a classification of inventory (for example, finished goods, or all the inventories in a particular industry or geographical segment).

.29 Estimates of net realizable value are based on the most reliable evidence available, at the time the estimates are made, of the amount the inventories are expected to realize. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the end of the period to the extent that such events confirm conditions existing at the end of the period."

Seed Inventory

During the year, you had water damage to your seed inventory. According to ASPE 3031.27, because the amount you can sell this inventory for is below what you paid for it, you need to write down the value of the seed inventory to the net realizable value of $15,000 ($60,000 × 25%). Since its current book value is $42,000, the write-down required is $27,000.

Feed Inventory

Since the feed inventory was in transit on October 31 and the shipment terms are FOB destination, it would not have been counted during the inventory count, which was appropriate, as it was supposed to get delivered that same day.

However, we need to determine if the feed should be included in inventory while it is in transit. Per ASPE 1000 Financial statement concepts, paragraph 24: *"Assets are economic resources controlled by an entity as a result of past transactions or events and from which future economic benefits may be obtained."* Since TFS still had control of the feed on October 31 and was responsible for it, as they had to pay $1,000 for in-transit storage, it is still an asset of TFS and should be included in inventory at year end.

However, the cost for the storage of $1,000 cannot be included in the cost of the inventory, as per ASPE 3031, paragraph 17:

> *"Examples of costs excluded from the cost of inventories and recognized as expenses in the period in which they are incurred are:*
> *(a) abnormal amounts of wasted materials, labour or other production costs;*
> *(b) storage costs, unless those costs are necessary in the production process before a further production stage;*
> *(c) administrative overheads that do not contribute to bringing inventories to their present location and condition; and*
> *(d) selling costs."*

Therefore, the inventory balance should increase by $17,000. The journal entries related to the sale and the cost of goods sold should also be reversed.

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

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

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

Reaching competence – The candidate attempts to discuss the accounting treatment for the inventory issues.

Competent – The candidate discusses the accounting treatment for the inventory issues.

Competent with distinction – The candidate thoroughly discusses the accounting treatment for the inventory issues.

COMMON FINAL EXAMINATION
SEPTEMBER 9, 2022 – DAY 3

Case #3 **(Suggested time: 75 minutes)**

It is April 15, 2022, and you, CPA, work at McDonald & Tilley. You have been asked by the partner, Grace, to help with Brokers Inc. (Brokers), a new client. Brokers will operate a bar, which will open on June 1, 2022.

Grace begins: “Brokers is owned by Janine, who has a background in human resources, and Ann, who has bookkeeping and retail experience. They have spent months working on their business plan for a unique bar idea on George Street in St. John’s, Newfoundland. George Street is a famous downtown pedestrian street that has approximately 40 restaurants and bars within a few city blocks. Over the years, some bars have thrived while others were only open for a short time. Due to their successful careers, Janine and Ann have funds readily available, and initial cash projections look positive.

“Brokers’ business concept, which is in line with provincial regulations, is that its selling prices will vary throughout the day and night, similar to the way the stock market fluctuates. Several times during operating hours, the virtual stock market will “crash” and drink prices will drop, similar to a happy hour but without a fixed time. Clips of the actual stock market crash of 1929 will play on big screens, along with music, to notify customers of the temporary price drop, after which time prices will gradually return to normal. At all other times, the prices will be comparable to the standard prices charged in the local area. The owners spent extensive time conducting customer surveys and doing market research. The response was overwhelmingly positive, and people are looking forward to this new, and different, bar. Brokers was incorporated on January 1, 2022, and prepares its financial statements in accordance with ASPE.

“Brokers had custom software developed. Ann needs advice on how to account for the costs related to this software (Appendix I).

“Also, Brokers has the option to purchase equipment and finance it with a bank loan, or to opt for a capital lease from the vendor. Janine and Ann would like your advice as to which financing option is preferable (Appendix II).

“They also need help determining what the selling price for a pint of beer should be during the “stock market crash.” Brokers will brew and only sell its own beer and does not want to sell at a price lower than its full production cost at any time. Janine and Ann have provided information on beer production (Appendix III).

“Audited financial statements will be required. Ann wants to be as prepared as possible for the auditors, and asked us to discuss procedures that the auditors will likely perform on the software, new equipment, and capital lease in case this option is chosen.

“Once the bar is successful and showing positive cash flows, Janine and Ann want to withdraw some funds from the company for personal use. They want to know their options, and the impact of each option from a personal and corporate tax perspective. They also want to know how the various components of the software, and upcoming equipment purchase or capital lease, will be treated for tax purposes.

“When they prepared their business plan, Janine and Ann considered the opportunities and risks related to their business venture. However, they have been so focused on getting things ready that they think they may have omitted some factors in their assessment. They would like us to provide our own objective assessment.”

APPENDIX I
SOFTWARE COSTS

Brokers needed software that would change drink prices without dropping prices too low, or too often. It also needed to be able to integrate with the point-of-sale system, to accurately report and record daily sales. Brokers contracted Roy, a retired software engineer who worked on large projects for big companies, to create software that would meet these needs.

In January 2022, Brokers incurred the following costs related to the software:

- Market research, to determine whether there was interest in this business idea: $3,000
- IT consulting, to determine the type of system that Brokers would need: $4,000

Roy invoiced for his time, based on the following phases of the project:

February 2022	Design	$ 5,600
February 2022	Software implementation	$ 24,300
March 2022	Documentation	$ 5,800
March 2022	Testing	$ 2,500
June 2022 to May 2023	IT support (Note 1)	$ 24,000

Note 1 – Roy has agreed to be on call for one year for any technical issues, at a cost of $2,000 per month. This service will start on June 1, 2022, but he has billed Brokers in advance.

All invoices submitted by Roy have been paid by Brokers.

APPENDIX II
EQUIPMENT FINANCING OPTIONS

Breakdown of $45,000 of Equipment Costs

- Six point-of-sale systems (computer hardware, screens, cash drawers): $13,500
- Office computer: $4,500
- Ten large screens for the bar and seating area: $8,000
- Surround-sound system: $19,000

Financing Options

<u>Option 1 – bank loan</u>

The bank requires security over all of Brokers' assets and a $5,000 down payment, and will finance the balance at 5% annual interest over five years. Monthly blended payments will be $755.

<u>Option 2 – capital lease</u>

The vendor is offering a capital lease over five years, with payments of $900 per month. This amount also includes routine maintenance by the vendor, and lease payments are to be made at the end of each month. At the end of the lease, Brokers will have the option to buy the equipment at its estimated fair value of $5,000.

<u>Additional information</u>

Brokers intends to use this equipment for its first seven to eight years of operation. Under Option 1, maintenance will be provided by a different vendor at a cost of $100 per month.

APPENDIX III
BEER PRODUCTION

Based on market research, bars on George Street sell, on average, 68 kegs of beer per week. One keg contains 124 pints. The average selling price per pint of beer in downtown St. John's is $11.

Production will be 10 kegs per day, seven days a week, which is the most we can produce. Production and sales costs are as follows:

Item	Amount	Unit
Ingredients, including fermentable sugar and hops	$ 345	per keg
Direct labour (includes benefits)	$ 18	per hour
Utilities	$ 36,000	per year
Rent	$ 7,000	per month
Marketing	$ 27,000	per year
General and administrative	$ 34,000	per year
Indirect brewing labour	$ 41,000	per year
Insurance	$ 1,500	per month
Depreciation of brewing equipment	$ 200	per month
Maintenance of brewing equipment	$ 500	per month

Each keg will require 12 hours of direct labour. The brewery will use 30% of utilities, and 40% of the rented space. Also, 15% of the insurance cost is related to the brewery. Thankfully, the price of ingredients is guaranteed by our supplier for the next six months, because we think we might need more as we encounter some spoilage in our first few months of operations, trying to perfect our recipe.

MARKING GUIDE 3-3
BROKERS INC. (BROKERS)
ASSESSMENT OPPORTUNITIES

To: Janine and Ann
From: CPA
Subject: Advice regarding Brokers

Assessment Opportunity #1 (Breadth and Depth Opportunity)

The candidate discusses the accounting treatment for the costs related to the software.

The candidate demonstrates competence in Financial Reporting.

CPA Map Technical Competencies:		**Core**
1.2.2	Evaluates treatment for routine transactions	A

CPA Map Enabling Competencies:
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions
6.3.3 Applies decision criteria to choose among viable alternatives

Intangible Asset

The software costs represent an intangible asset because they meet the identifiability criterion in the definition of an intangible asset, as per paragraph 12 of ASPE 3064 Goodwill and intangible assets:

> "*An asset meets the identifiability criterion in the definition of an intangible asset when it:*
> *(a) is separable (i.e., is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability); or*
> *(b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.*"

Because the software that Roy created could be sold to another entity, it is separable.

Further, the software costs meet the control and existence of future economic benefits criteria of the definition, as per paragraphs 13 and 17:

> *"An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits. The capacity of an entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control because an entity may be able to control the future economic benefits in some other way."*

Because Brokers paid for the software and can use it, it controls the future economic benefit of the software.

> *"The future economic benefits flowing from an intangible asset may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the entity."*

The software is a key component of Brokers' business model, and will be used to determine the price of the beer during the "stock market crash"; therefore, future economic benefits will be flowing from the software.

The software also meets the criteria to be recognized, which are stated in paragraph 21 of ASPE 3064:

> "*An intangible asset shall be recognized if, and only if:*
> *(a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and*
> *(b) the cost of the asset can be measured reliably."*

The software's intended use is for Brokers' business concept and, according to surveys performed, is expected to generate revenue in the future when Brokers opens, so criterion (a) is met. We have the list of costs incurred so far, so criterion (b) is also met.

Internally Generated Intangible Asset

Because the software is an internally generated intangible asset, additional criteria need to be met for recognition, according to paragraph 35:

> *"To assess whether an internally generated intangible asset meets the criteria for recognition, an entity classifies the generation of the asset into:*
> *(a) a research phase; and*
> *(b) a development phase."*

Brokers incurred various costs related to the software. The following table classifies the various costs into research, development, or other.

Description	Amount	Note
Market research	$ 3,000	1
IT consulting for the type of system	$ 4,000	1
Design	$ 5,600	2
Software implementation	$ 24,300	2
Documentation	$ 5,800	2
Testing	$ 2,500	2
IT support	$ 24,000	3

Notes:

1. As these costs were incurred to obtain new knowledge, that of determining if the concept was a good idea, and the type of software needed, they are research costs. They were not directly related to the actual design of the software. The total of the research costs is $7,000 ($3,000 + $4,000).

2. These costs are development costs, as they were incurred to develop the actual software that will be used. The total of the development costs is $38,200 ($5,600 + $24,300 + $5,800 + $2,500).

3. The cost of the one-year contract for IT support is not considered research or development. This cost needs to be recorded as a prepaid expense, as this represents Roy's support time from June 1, 2022, to May 31, 2023. When the actual support begins, Brokers can expense this monthly.

Research Costs

As per paragraph 37, *"No intangible asset arising from research (or from the research phase of an internal project) shall be recognized. Expenditure on research (or on the research phase of an internal project) shall be recognized as an expense when it is incurred."*

Therefore, the $7,000 of research costs needs to be expensed as incurred.

Development Costs

As per paragraph 40:

> *"In accounting for expenditures on internally generated intangible assets during the development phase, an entity shall make an accounting policy choice to either:*
> *(a) expense such expenditures as incurred; or*
> *(b) capitalize such expenditures as an intangible asset (provided the criteria in paragraph 3064.41 are met)."*

As per paragraph 41, development costs are capitalized if Brokers 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;"*

This was met by the end of January 2022, as IT consulting had been performed by that point, and if it was not technically feasible, Brokers would have been aware.

> (b) *"its intention to complete the intangible asset and use or sell it;"*

This was met by the end of January 2022, as Brokers advertised to recruit an IT expert, demonstrating its intent to complete the intangible asset. Brokers clearly intends to use the intangible asset, as the software will be an integral part of its pricing system. The asset will be used in daily operations as soon as the business opens.

> (c) *"its ability to use or sell the intangible asset*;"

This was met by the end of January 2022, as market research was performed by that date, which demonstrated sufficient interest in the business idea and therefore the ability to use the asset.

> (d) *"the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset*;"

This was met by the end of January 2022. Given that an IT expert was recruited, there was a technical resource available to complete the development. You have adequate financial resources, as you noted that you have funds readily available.

> (e) *"its ability to measure reliably the expenditure attributable to the intangible asset during its development; and"*

This was met by the end of January 2022. Roy was to bill for his time, and therefore the costs related to the intangible asset are expected to be reliably measurable from that date onward.

> (f) *"how the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset*."

This was met by the end of January 2022. The asset will be used internally in the pricing system to create the changing drink prices, and is key to Brokers' daily business. Therefore, it has future economic benefits to the company, as it is not only useful but necessary.

As the software development meets all of the above criteria by the end of January 2022, eligible development costs can be capitalized starting at that date. Brokers can choose to capitalize these costs as an intangible asset and amortize them over the useful life of the software, or to expense them in the current year. The policy choice has to be applied consistently to all internal projects. As this is the first year of operation and Brokers will want to show positive results on its financial statements (for the bank financing), I recommend that you capitalize the development costs. All of the development costs noted above can be capitalized as they were all incurred subsequent to January 2022. Amortization of the software starts when the software was available for use, and should be spread over the useful life of the software. As per paragraph 57 of Section 3064, *“The amortization method and estimate of the useful life of an intangible asset shall be reviewed annually.”*

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

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

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

Reaching competence – The candidate attempts to discuss the accounting treatment for the costs related to the software.

Competent – The candidate discusses the accounting treatment for the costs related to the software.

Competent with distinction – The candidate thoroughly discusses the accounting treatment for the costs related to the software.

Assessment Opportunity #2 (Breadth Opportunity)

The candidate performs a quantitative and qualitative analysis of the financing options for the equipment, and provides a recommendation.

The candidate demonstrates competence in Finance.

CPA Map Technical Competencies:		**Core**
5.3.1	Develops or evaluates capital budgeting processes and decisions	B

CPA Map Enabling Competencies:
5.1.1 Applies general business knowledge to enhance work performed
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems
6.1.3 Demonstrates skepticism, objectivity, due care and persistence when identifying issues
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions

Quantitative Analysis

Option 1 – Bank loan

The annual interest rate charged by the bank is 5%. Under this option, as discussed later in this report, the assets will be capitalized for tax purposes and CCA will be deducted each year.

To compare this option to the capital lease option, we can calculate the annual implicit interest rate:

Interest rate: 5.00% ÷ 12 = 0.42% per month = 5.12% per year ($(1 + 0.42\%)^{(12)} - 1$)

Option 2 – Capital lease

In order to compare the lease rate to the bank rate, we need to exclude the maintenance from the calculation of the annual implicit interest rate.

Annual implicit interest rate:

Number of months: 60 (12 months × 5 years)
Payment (excluding maintenance): $900 - $100 = $800
Present value: $45,000 ($13,500 + $4,500 + $8,000 + $19,000)
Future value: $5,000

Interest rate: 0.51% per month = 6.25% per year ($(1 + 0.51\%)^{(12)} - 1$)

As you have mentioned needing the equipment for seven to eight years, and being able to compare this option to the bank loan, it was assumed that the option to purchase the equipment at the end of the lease at a price of $5,000 would be exercised, and it was incorporated in the calculation.

Under this option, as discussed later in this report, Brokers will be able to deduct the lease payments for tax purposes as they occur.

Qualitative Analysis

While the implicit interest rate of the lease is higher than the bank's interest rate, there are other factors to consider.

While the bank loan has a more favourable interest rate, it requires a down payment of $5,000. As you will not commence operations until June 1, 2022, this will have to be paid by you in advance. Since you have readily available funds, this down payment should not be an issue for you.

The bank also requires security over all of Brokers' assets, which could cause issues if Brokers needs more financing in the future.

The lease provides for routine maintenance costs, which Brokers will require in either case. It is probably an advantage to have this maintenance provided by the vendor itself, as they will know their equipment better than another vendor.

Recommendation

While the capital lease has a higher implicit interest rate, it is the best financing option for Brokers. The lease option allows for the maintenance to be performed by the vendor from whom the equipment was leased, which is an advantage. In addition, Brokers will not have to pay an upfront payment, and this option provides an additional flexibility: at the end of the lease term, the equipment can be either purchased for $5,000 or Brokers could upgrade the system to the latest technology to suit its business requirements. We would also need to consider whether one option is more advantageous than the other from the tax perspective.

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

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

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

Reaching competence – The candidate attempts to provide a quantitative and qualitative comparison of the financing options.

Competent – The candidate provides a quantitative and qualitative comparison of the financing options, and provides a recommendation.

Competent with distinction – The candidate provides a thorough quantitative and qualitative comparison of the financing options, and provides a recommendation.

Assessment Opportunity #3 (Breadth and Depth Opportunity)

The candidate determines the selling price for Brokers' beer during the "stock market crash."

The candidate demonstrates competence in Management Accounting.

CPA Map Technical Competencies:		Core
3.5.1	Performs sensitivity analysis	A

CPA Map Enabling Competencies:

5.1.1 Applies general business knowledge to enhance work performed
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems

To cover all the production costs of its beer, Brokers should sell it for $4.74 per pint. This is calculated as follows.

Fixed Production Costs

	Per Year	
Utilities	$ 10,800	$36,000 × 30%
Rent	$ 33,600	$7,000 × 12 months × 40%
Indirect brewing labour	$ 41,000	
Insurance	$ 2,700	$1,500 × 12 months × 15%
Equipment depreciation	$ 2,400	$200 × 12 months
Equipment maintenance	$ 6,000	$500 × 12 months
Total	$ 96,500	

As they are not incurred as part of the beer manufacturing process, marketing and administrative costs have been excluded.

Variable Production Costs

	Per Keg	
Direct materials	$ 345	
Direct labour	$ 216	12 hours × $18/hour
Cost per keg	$ 561	

Number of kegs produced per year: 3,650 (10 kegs per day × 365 days)
Total variable production costs per year: $2,047,650 (3,650 × $561)
Total production costs to cover: $2,144,150 ($96,500 + $2,047,650)
Number of pints produced: 452,600 (3,650 kegs × 124 pints per keg)
Minimum price per pint: $4.74 ($2,144,150 ÷ 452,600)

Other Factors to Consider

The current plan is to produce 10 kegs per day, which is the most that Brokers can produce, which means 3,650 kegs per year, as calculated above. If you sell the same amount as the average bar on George Street sells, you will sell 3,536 kegs annually (68 kegs per week × 52 weeks), which is 97% of production. This does not leave a big margin for error. If Brokers sells more than planned, it might run out of beer, which could hurt its reputation. Also, this production level does not leave much room for the spoilage you think you might encounter while perfecting your recipe. You should estimate the number of kegs you think you will sell in one year, and think of ways to increase production on short notice, if needed.

Spoilage does not seem to have been considered in the above production cost calculation. Spoilage might increase the production cost in the first few months of production, and therefore should likely be taken into account when setting the selling price for the beer, so that it is not being sold at a loss in the first few months.

Lastly, the price of the ingredients has been set for six months, but it is not known if the price is expected to remain the same or to increase after the six-month period. If the price of ingredients increases, Brokers might have to increase its beer prices in the future. Alternatively, you could decide to start with a higher price, to protect you from the risk of an ingredient price increase. The average selling price for a pint of beer in St. John's is $11. The minimum price per pint calculated above is much lower, at $4.74. To mitigate the risk of an increase in ingredients prices, and an increase in production costs due to spoilage, Brokers could set a price higher than the minimum price calculated above.

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

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

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

Reaching competence – The candidate attempts to determine the selling price for Brokers' beer during the "stock market crash."

Competent – The candidate determines the selling price for Brokers' beer during the "stock market crash."

Competent with distinction – The candidate determines the selling price for Brokers' beer during the "stock market crash," and provides additional considerations.

Assessment Opportunity #4 (Breadth Opportunity) The candidate discusses audit procedures that the auditors will likely perform on the software, new equipment, and capital lease. *The candidate demonstrates competence in Audit and Assurance.*

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

CPA Map Enabling Competencies: *6.1.3 Demonstrates skepticism, objectivity, due care and persistence when identifying issues* *6.2.1 Maintains an objective and questioning mindset to avoid biased analyses* *6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives* *6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions*

Software Costs

- If Brokers chose to capitalize the costs, the auditors will ensure that the costs incurred meet the recognition criteria by, for example, looking at your market research studies to determine Brokers' ability to use the software system, the fact that this was performed before January 31, 2022, and inspecting Roy's invoices in detail to ensure that each invoice is related to the development phase of the process.
- The auditors will obtain the general ledger amounts for software additions during the year. They will vouch the additions to the related supporting invoices to ensure that the amounts recorded are accurate, and were incurred subsequent to January 31, 2022 (when Brokers entered the development phase). They will also look at the details of the invoices to ensure that the nature of the expenditure relates to the software system.
- They may ask to speak to Roy (the contractor) to get an understanding of the system and its useful life. This will help them understand if the amortization rates applied to the system are reasonable. They will recalculate any related amortization amount based on the company policy, to ensure that it is reasonable.

New Equipment Costs

- The auditors will select a sample of equipment purchases from the general ledger account and vouch these to supporting documents, such as invoices and cancelled cheques or EFTs.
- They will also do a reasonableness test of the amortization expense related to the equipment purchased by first discussing with management the expected useful life of the assets and whether there have been any changes, and then recalculating the expected

expense based on the balances in the capital asset accounts, and comparing this to the amount expensed in the income statement.

- They may also request to physically inspect the asset during their site visit, to ensure that it exists.

Capital Lease

Based on how you decide to finance your equipment, the auditors will want to ensure that it was recorded correctly.

- The auditors will request a copy of the lease agreement. They will inspect the terms of the lease and compare it to the capital lease criteria, to ensure that it has been recorded appropriately in the financial statements as a capital lease.
- As the option notes that it is a capital lease, the auditors will look for the duration of the lease, the lease payments, and the implicit rate of the lease, if available, to recalculate the useful life and the present value of the minimum lease payments, to help determine whether it is in fact a capital lease.
- They will not only want to ensure that the lease liability has been recorded, but that it has been recorded at the correct amount. In doing this, they will corroborate certain key calculation inputs, such as the discount rate by vouching the amount to a recent debt agreement, the market value of the assets leased by comparing it to market research (e.g., online) of comparable assets for sale, etc., and recalculating the loan balance and interest expense, to ensure that it is correctly reflected in the amount reported.
- They may also ask to send a confirmation to the vendor, and compare the result with the amount recorded in the general ledger.

For Assessment Opportunity #4 (Audit and Assurance), the candidate must be ranked in one of the following five categories:

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

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

Reaching competence – The candidate attempts to discuss some of the audit procedures the auditors will likely perform on the software, new equipment, and capital lease.

Competent – The candidate discusses some of the audit procedures the auditors will likely perform on the software, new equipment, and capital lease.

Competent with distinction – The candidate discusses several audit procedures the auditors will likely perform on the software, new equipment, and capital lease.

Assessment Opportunity #5 (Breadth Opportunity)

The candidate discusses ways to get cash out of the company from a tax perspective, and discusses the tax treatment for the software components and equipment (whether it is either purchased or leased).

The candidate demonstrates competence in Taxation.

CPA Map Technical Competencies:		**Core**
6.2.2	Advises on taxes payable for a corporation	B
6.6.2	Analyzes income tax implications of compensation planning between a shareholder and a closely-held corporation	C

CPA Map Enabling Competencies:
6.1.1 Identifies and articulates issues within areas of work responsibility
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives
6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions
6.3.3 Applies decision criteria to choose among viable alternatives

Owner Compensation Options

Salaries

You have the option of paying yourselves salaries. This will require Brokers to withhold income taxes and Canada Pension Plan (CPP) contributions from your pay (the same as for any other employee), and Brokers would claim an expense (deduction) for the salary paid, as well as for its share of any payroll taxes. As owners of the company, you are exempt from EI on your employment income from Brokers. You would be personally taxed on your salary at your marginal personal tax rate. Paying yourselves salaries has several benefits, including creating RRSP room for yourselves and contributing to CPP in order to build your future benefits from this program. You will also gain access to the Canada employment amount credit for employment income.

Bonuses

Bonuses are treated in the same way as a salary for the company and the employees. However, a corporation can record a bonus expense and a corresponding liability, and pay the bonus out later. The only requirement is that the actual bonus must be paid within 179 days of Brokers' taxation year end. This provides a potential tax deferral opportunity, as Brokers could deduct the bonus as an expense in the year in which the bonus is declared, but you would only include the bonus in your income when you receive it. If this bonus is not paid out within 179 days of the end of the taxation year, it will be added back to the corporation's income in the year in which it was declared.

Dividends

Owners of a company can also take dividends. Dividends are not a deductible expense to the company, as they are paid out of equity/ retained earnings. As a result, they should only be declared when there is a sufficient balance in your retained earnings account. From a personal perspective, dividends have a lower effective tax rate for the owners. They are grossed up when included in the individual's net income for tax purposes, but they generate a tax credit that more than makes up for the tax effect of the gross-up; this is intended to reflect the fact that the corporation has already paid income tax on the income earned inside the corporation. However, dividends do not generate RRSP room.

Dividends also do not require source deductions to be withheld or matched by the company, so there is no CPP cost to the company of paying dividends; however, they also do not provide an increase to CPP contributions for the recipient. If dividends are paid regularly, the shareholders may have a requirement to remit income tax instalments because no income taxes are withheld from those payments. The payment of compensation solely through dividends could create alternative minimum tax implications, which are beyond the scope of this report.

Other considerations

Overall, the total tax paid (adding together corporate tax and personal tax) will theoretically be about the same, regardless of whether distributions are made to the owners using employment income or dividends. However, the qualitative considerations noted here may have an impact on your decision, as well as factors such as which tax bracket you are in, which may make integration imperfect.

Each of you likely has different needs and preferences, so it may be possible to have a different strategy for each shareholder. A detailed calculation should be performed, considering your personal income tax situations, and a tax specialist engaged to determine the best course of action.

Tax Treatment of the Software and Equipment

Software – research costs

The costs related to market research and other costs leading up to actual development of the program will be expensed consistent with their accounting treatment, as they are costs laid out for the purpose of earning business income.

<u>Software – development costs</u>

The internally-generated software costs that are considered development costs are costs incurred for application software, and thus would be included in Class 12. With the Accelerated Investment Incentive, this would allow for a 100% deduction from income in the year in which the costs are incurred.

<u>Equipment – if purchased</u>

If the equipment is purchased rather than leased, the assets will go into various CCA pools, depending on the nature of the equipment, and would all qualify for the Accelerated Investment Incentive of 150% of the normal CCA in the first year. All computer hardware purchases will go in Class 50, at a rate of 55%. This will include your POS system ($13,500), office computer ($4,500), and the large screens ($8,000), for a total of $26,000. I have assumed for this purpose that the large screens are effectively computer monitors, but if they are merely televisions, they may belong in Class 8; more information would be required in order to confirm this. The CCA deduction in the first year will be $26,000 × 55% × 150% = $21,450.

The surround-sound system purchased would be considered a Class 8 asset, which has a CCA rate of 20%. The CCA deduction in the first year will be $19,000 × 20% × 150% = $5,700.

<u>Loan</u>

If a bank loan is taken to fund this purchase, the interest paid on the loan will be deductible from income, as the assets purchased were used for income-earning purposes.

<u>Capital lease</u>

If the equipment is leased, the lease payments will be deducted when they are paid, regardless of how the lease is accounted for under financial reporting standards. If the equipment is bought out at the end of the lease, it would then be added to CCA classes, similar to the initial purchase alternative.

The immediate expensing provision was announced in 2021 but was not substantively enacted by December 31, 2021, so was not examinable. Candidates who use this provision, however, will receive credit accordingly.

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

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

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

Reaching competence – The candidate attempts to discuss ways to get cash out of the company from a tax perspective, or attempts to discuss the tax treatment for the software and equipment.

Competent – The candidate discusses ways to get cash out of the company from a tax perspective, and discusses the tax treatment for the software and equipment.

Competent with distinction – The candidate thoroughly discusses ways to get cash out of the company from a tax perspective, and thoroughly discusses the tax treatment for the software and equipment.

Assessment Opportunity #6 (Breadth Opportunity)

The candidate evaluates the opportunities and risks related to this new business venture.

The candidate demonstrates competence in Strategy and Governance.

CPA Map Technical Competencies:		**Core**
2.3.2	Evaluates the entity’s internal and external environment and its impact on strategy development	B

CPA Map Enabling Competencies:
5.1.2 Recognizes the interrelationships among departmental and functional areas within the organization
5.1.3 Develops and uses knowledge of the organization, industry and stakeholders
6.3.1 Uses evidence and judgement to recommend and justify solutions or conclusions

Opportunities

- There is a readily available market for what Brokers will be offering. The location is on George Street, which is home to approximately 40 restaurants and bars. This is a high-traffic area, so there should be a readily available customer base.

- The initial market research is positive. This is a unique business idea, and bar-goers will likely be receptive to a unique idea that offers something different from the other, traditional bars.
- Ann has a background in retail and bookkeeping. This skillset will be useful at Brokers for monitoring the books and making basic business decisions.
- Janine has a background in human resources and can handle the personnel side of the business, which includes hiring, scheduling, compensation, etc.

Risks

- Although your background could be useful in some aspects of the business, you have no experience in the nightclub industry, which could be a challenge as it is a very specific market, and very different from what you have done in the past.
- While it is a unique idea, the nightclub industry is competitive, and not all businesses survive. Many bars have opened and closed on George Street over the years. There is a risk that profits will not be as high as you predicted in your business plan. Sales could be lower and there could be additional expenses.
- There may be customers who only buy drinks when the "stock market crashes." If most customers are only buying at the low bar price, this will make it difficult to be profitable on any given night.
- As there will be a surge in demand once the "stock market crashes," there is a risk that the staff will not be able to serve all the customers in a timely manner, which could create customer dissatisfaction. As the business model revolves around the possibility of price reductions, this could jeopardize Brokers' ability to retain clients.
- You are already planning to produce at maximum capacity, which appears to be close to what the demand will be. There is a chance that you cannot produce enough beer to meet demand.
- The software is unique and custom designed, and only Roy knows how it works. While Roy is very talented and will be available for support, you run the risk of software problems that could shut down your system completely. All your sales data and sales prices are reliant on this program, making it critical for business operations. Roy is going to be on call for technical issues, but it is possible that you may not always be able to reach him. In addition, the POS system is linked to the software, and sales are recorded through this program. You need to be able to sell to customers while you troubleshoot the issue with Roy. To mitigate this risk, in the event of downtime, you could have cash registers ready as a backup. Also, you could ensure that all staff are adequately trained in the process to follow in the event of system problems.
- There is a lot of competition in Brokers' current location on George Street. As George Street is home to many bars, customers have many options to choose from, so they can easily visit your bar for the low prices and then go to another bar offering different specials or music. There are low barriers to entry, as you noted that many bars have opened and closed over the years, so there is always the risk of new competitors arriving.
- There is nothing preventing an existing or new bar owner from mimicking your idea of low drink prices, and Roy could also develop the software he developed for you, for another bar.

- There is the risk that you will be busy at first while this “stock market” idea is new and different, but that customers may lose interest after the initial opening, and sales could drop as a result.
- Due to the nature of the bar industry, it could be difficult to find and retain good quality staff. This relates to staff working long and late hours and dealing with customers that potentially had too much to drink. Janine’s background in human resources could help with this, and you could consider offering wages a little higher than minimum wage, and motivate staff in other ways, such as by offering benefits or team building activities.
- Any industry dealing with a lot of cash is susceptible to theft. Most people pay by debit or credit, which helps reduce the amount of cash on hand. The bar area would be less risky as there would normally be more than one person working behind the bar. Having adequate security cameras around the building will help prevent theft. If a cover charge is charged at the door, you could encourage customers to pay by debit or credit, and have security cameras in the entranceway. This would also prevent the person collecting cover charges from letting friends or family in for free. It is also recommended that all paid customers are given a wrist band, to prove they have paid their cover charge.
- In addition to your regular insurance policy, ensure that you have adequate liability insurance to cover events such as injuries due to falls, altercations under the influence, etc. In addition, business interruption insurance is a good idea; if you ever need to close for extended periods due to circumstances outside your control, this will provide you with some compensation for lost sales.

For Assessment Opportunity #6 (Strategy and Governance), the candidate must be ranked in one of the following five categories:

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

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

Reaching competence – The candidate attempts to provide an analysis of the opportunities and risks to Brokers.

Competent – The candidate provides a balanced analysis of the opportunities and risks to Brokers.

Competent with distinction – The candidate provides a thorough, balanced analysis of the opportunities and risks to Brokers.

APPENDIX E

RESULTS BY ASSESSMENT OPPORTUNITIES FOR DAY 2 AND DAY 3
(FOR ALL WRITERS)

THE LEVEL 2 DEPTH TEST (DAY 2 and DAY 3)

Financial Reporting:

		NA	NC	RC	C	CD	C+CD
Day 2 Common							
AO1	**Revenue recognition**	0%	6%	50%	43%	1%	**44%**
AO2	**Intangible assets – recipes/name**	0%	5%	48%	46%	1%	**47%**
AO3	**Renovation costs**	1%	6%	26%	65%	2%	**67%**
Day 3 – Q1 STH							
AO1	**Investment property**	1%	18%	45%	31%	5%	**36%**
Day 3 – Q2 TFS							
AO6	**Inventory**	3%	13%	49%	30%	5%	**35%**
Day 3 – Q3 Brokers							
AO1	**Intangible assets - software**	1%	9%	31%	51%	8%	**59%**

Management Accounting:

		NA	NC	RC	C	CD	C+CD
Day 2 Common							
AO4	**Variance analysis**	1%	9%	30%	57%	3%	**60%**
AO5	**Budget**	4%	12%	25%	58%	1%	**59%**
AO6	**Data analysis**	5%	9%	32%	53%	1%	**54%**
Day 3 – Q1 STH							
AO2	**Costing methods**	2%	14%	56%	24%	4%	**28%**
AO3	**Operational weaknesses**	1%	12%	42%	38%	7%	**45%**
Day 3 – Q2 TFS							
AO4	**Divisional allocations**	2%	15%	24%	52%	7%	**59%**
Day 3 – Q3 Brokers							
AO3	**Minimum selling price**	6%	10%	24%	56%	4%	**60%**

THE LEVEL 3 DEPTH TEST ROLES (DAY 2)

Audit and Assurance		Papers	NA	NC	RC	C	CD	C+CD
AO7	**Operating segments**	4447	1%	43%	11%	41%	4%	**45%**
AO8	**Procedures - actg issues**	4447	1%	14%	26%	55%	4%	**59%**
AO9	**System conversion**	4447	0%	8%	39%	48%	5%	**53%**
AO10	**Procedures - due diligence**	4447	1%	32%	25%	40%	2%	**42%**
AO11	**Internal controls**	4447	0%	8%	26%	62%	4%	**66%**
AO12	**Procedures - contract compliance**	4447	0%	7%	35%	55%	3%	**58%**
AO13	**Key audit matters**	4447	2%	36%	22%	37%	3%	**40%**

Finance		Papers	NA	NC	RC	C	CD	C+CD
AO7	**Packaging equipment NPV**	160	1%	8%	26%	58%	7%	**65%**
AO8	**DI valuation**	160	1%	6%	44%	35%	14%	**49%**
AO9	**Ratio analysis**	160	1%	18%	25%	48%	8%	**56%**
AO10	**Financing options**	160	3%	18%	31%	45%	3%	**48%**
AO11	**Electronic payments**	160	3%	14%	28%	53%	2%	**55%**
AO12	**Dividend or buy back**	160	6%	21%	30%	38%	5%	**43%**
AO13	**Acquisition criteria**	160	2%	12%	31%	45%	10%	**55%**

THE LEVEL 3 DEPTH TEST ROLES (DAY 2)

Performance Management		Papers	NA	NC	RC	C	CD	C+CD
AO7	**Recipe development**	604	1%	5%	42%	52%	0%	**52%**
AO8	**Delivery pricing**	604	1%	5%	29%	64%	1%	**65%**
AO9	**Outsourcing secret sauce**	604	1%	1%	41%	52%	5%	**57%**
AO10	**Chef Dashim sales data**	604	4%	22%	35%	39%	0%	**39%**
AO11	**VS acquisition - cash flow**	604	8%	10%	22%	58%	2%	**60%**
AO12	**VS acquisition - qualitative**	604	3%	15%	29%	52%	1%	**53%**
AO13	**PVM implementation and growth strategy**	604	3%	25%	36%	35%	1%	**36%**

Taxation		Papers	NA	NC	RC	C	CD	C+CD
AO7	**Accounting issues / land sale**	248	0%	16%	45%	37%	2%	**39%**
AO8	**Taxable income and taxes payable**	248	0%	2%	40%	51%	7%	**58%**
AO9	**Purchase of DI**	248	2%	18%	32%	45%	3%	**48%**
AO10	**Employee relocation**	248	1%	4%	49%	43%	3%	**46%**
AO11	**Shareholder loans**	248	1%	18%	34%	42%	5%	**47%**
AO12	**Shareholder remuneration - BDFH**	248	2%	19%	23%	52%	4%	**56%**
AO13	**Estate planning**	248	2%	15%	31%	48%	4%	**52%**

THE LEVEL 4 BREADTH TEST (DAY 2 AND DAY 3, BY COMPETENCY AREA)

Financial Reporting:

		NA	NC	RC	C	CD	RC+C+CD
Day 2 Common							
AO1	**Revenue recognition**	0%	5%	48%	46%	1%	**95%**
AO2	**Intangible assets - recipes/name**	0%	5%	44%	50%	1%	**95%**
AO3	**Renovation costs**	1%	5%	24%	68%	2%	**94%**
Day 3 – Q1 STH							
AO1	**Investment property**	1%	15%	43%	35%	6%	**84%**
Day 3 – Q2 TFS87							
AO6	**Inventory**	2%	11%	49%	32%	6%	**87%**
Day 3 – Q3 Brokers							
AO1	**Intangible assets - software**	1%	7%	29%	53%	10%	**92%**

Management Accounting:

		NA	NC	RC	C	CD	RC+C+CD
Day 2 Common							
AO4	**Variance analysis**	1%	8%	28%	60%	3%	**91%**
AO5	**Budget**	4%	10%	23%	61%	2%	**86%**
AO6	**Data analysis**	4%	7%	29%	59%	1%	**89%**
Day 3 – Q1 STH							
AO2	**Costing methods**	2%	12%	56%	26%	4%	**86%**
AO3	**Operational weaknesses**	1%	11%	41%	39%	8%	**88%**
Day 3 – Q2 TFS							
AO4	**Divisional allocations**	1%	14%	23%	54%	8%	**85%**
Day 3 – Q3 Brokers							
AO3	**Minimum selling price**	5%	9%	23%	58%	5%	**86%**

THE LEVEL 4 BREADTH TEST (DAY 2 AND DAY 3, BY COMPETENCY AREA)

Strategy and Governance		**NA**	**NC**	**RC**	**C**	**CD**	**RC+C+CD**
III-1 AO4	**Audit committee**	1%	6%	25%	61%	7%	**93%**
III-2 AO2	**Broader considerations**	2%	17%	28%	49%	4%	**81%**
III-3 AO6	**Opportunities & risks**	7%	18%	32%	36%	7%	**75%**

Audit and Assurance		**NA**	**NC**	**RC**	**C**	**CD**	**RC+C+CD**
III-1 AO6	**Audit procedures**	3%	16%	30%	45%	6%	**81%**
III-2 AO5	**Control weaknesses**	1%	4%	30%	55%	10%	**95%**
III-3 AO4	**Audit procedures**	3%	15%	33%	41%	8%	**82%**

Finance		**NA**	**NC**	**RC**	**C**	**CD**	**RC+C+CD**
III-1 AO5	**Bank covenants**	1%	6%	29%	55%	9%	**93%**
III-2 AO3	**Financing proposal**	2%	14%	27%	52%	5%	**84%**
III-3 AO2	**Financing options**	1%	20%	56%	19%	4%	**79%**

Taxation		**NA**	**NC**	**RC**	**C**	**CD**	**RC+C+CD**
III-1 AO7	**Taxable income**	1%	9%	33%	51%	6%	**90%**
III-2 AO1	**QSBC**	1%	30%	32%	35%	2%	**69%**
III-3 AO5	**Tax on funds withdrawal, software & equipment**	2%	14%	32%	40%	12%	**84%**

APPENDIX F

BOARD OF EXAMINERS' COMMENTS ON DAY 2 AND DAY 3 SIMULATIONS

BOARD OF EXAMINERS' COMMENTS ON DAY 2 SIMULATION

Paper/Simulation:	**Day 2, Common Role (TMB)**
Estimated time to complete:	300 minutes
Simulation difficulty:	Easy to Average
Competency Map coverage:	Management Accounting (3); Financial Reporting (3)

Evaluators' comments by Assessment Opportunity (AO)

AO#1 (Revenue recognition)

Candidates were asked to discuss the accounting treatment for the new discount offer. Details relating to the new discount offer were provided in Appendix III (Common). To demonstrate competence, candidates had to analyze the offer using *IFRS 15 – Revenue from contracts with customers,* using case facts, and allocate the discount appropriately across the two meal kits.

Candidate performance on this AO was mixed. While most candidates were able to identify the correct Handbook section with which to assess the discount offer, some candidates did not discuss each of the steps under IFRS 15 in reasonable depth. For example, most candidates recognized that the two meal kits represented separate performance obligations, but some struggled to apply case facts to the Handbook criteria in order to support their conclusions. Candidates often jumped to a conclusion that there were two performance obligations present in the offer without providing any case facts to support their conclusion, or simply restated guidance from the Handbook with no further analysis. Similarly, while most candidates attempted to allocate the discount across the performance obligations, not all candidates performed the allocation correctly using the stand-alone selling prices of each kit.

Strong candidates were more likely to discuss the accounting treatment for the new discount offer in depth by listing IFRS 15 guidance, and including appropriate case facts to support their analysis. For example, strong candidates were more likely to support their conclusion that the meal kits represented two performance obligations by pointing out that the customers can benefit from the meal kits on their own, or that they were delivered on different dates. Strong candidates were also more likely to recognize that the stand-alone selling prices of the meal kits were the same, and to therefore correctly allocate the discount evenly across the two performance obligations.

Weak candidates were more likely to jump to a conclusion about the number of performance obligations present in the new discount offer, and did not explain their thought process for arriving at that conclusion. Weak candidates were also more likely to demonstrate inconsistencies in their analysis, for example, by concluding that there was only one performance obligation but later allocating the discount as if there were two. Further, weak candidates were more likely to allocate the discount based on the discounted selling prices of each meal kit, which led them to incorrectly conclude that no adjustment to revenue was necessary.

AO#2 (Intangible assets)

Candidates were asked to discuss the accounting treatment for the intangible assets purchased from Chef Arlene. Details relating to the contract with Chef Arlene were provided in Appendix IV (Common). To demonstrate competence, candidates were expected to assess the transaction using the criteria for definition of an intangible asset under *IAS 38 – Intangible assets*, and apply case facts to each criterion in order to reach a supported conclusion.

Candidate performance on this AO was mixed. Most candidates identified the correct Handbook section with which to assess the transaction, and identified case facts relevant to the issue. However, many candidates were unable to clearly explain the link between the details of the contract and the definition criteria, thus forming an unsupported conclusion about whether the contract should be capitalized as an intangible asset. Relatively few candidates recognized that there were multiple assets involved in the transaction, and instead assessed the purchase of the brand name and recipes as a single asset.

Strong candidates were more likely to discuss the accounting treatment for the contract in depth by using the excerpts of the contract to support whether the three criteria of IAS 38 were met. For example, strong candidates were more likely to support their conclusion that the transaction either met, or did not meet, the control criterion. These candidates appropriately used case facts, such as TMB's ability to use the Chef Arlene brand name to promote and market TMB meal kits to generate revenue, or Chef Arlene's ability to continue to use the recipes in her restaurant, when assessing TMB's ability to obtain future economic benefits from the asset or their ability to restrict others' access to those benefits. Strong candidates were also more likely to explain, using case facts, why the identifiable and future economic benefit criteria of IAS 38 were met, or not met.

Weak candidates were more likely to form an unsupported conclusion about whether the Chef Arlene contract met the three definition criteria under IAS 38. For example, these candidates did not explicitly make the link between the case facts and the Handbook criteria, often simply listing case facts after the Handbook criteria without adding further analysis. Other weak candidates did not clearly demonstrate that they understood the Handbook guidance they were using, or were more likely to misinterpret the meaning of the various IAS 38 concepts. For example, some weak candidates interpreted the control criterion to be focused on whether TMB could control the physical recipes, rather than on the future economic benefits associated with the right to use those recipes. Finally, weak candidates were more likely to attempt to apply an incorrect section of the Handbook in their analysis, such as *IFRS 16 - Leases*.

AO#3 (Renovation costs)

Candidates were asked to discuss the accounting treatment of the renovation costs related to the upgrades at TMB's fulfillment centre in Montreal. Details regarding the renovation of the fulfillment centre were provided in Appendix V (Common). To demonstrate competence, candidates were expected to discuss in depth several of the renovation costs, using guidance from *IAS 16 – Property, plant and equipment* to support their conclusion of how to account for the costs.

Candidates performed reasonably well on this AO. Most candidates discussed the accounting treatment of several of the renovation costs in some depth, supporting their discussions using guidance from IAS 16, and demonstrating an understanding of the case facts presented. Candidates typically did not address the renovation costs in any particular order; however, they showed a preference for discussing the costs related to employee wages and the outside structure of the building. Many candidates attempted to discuss most of the costs presented, although candidates did not discuss all costs to the same level of depth.

Strong candidates were more likely to discuss several of the renovation costs in depth. These candidates often used a specific section of IAS 16 relevant to each cost to frame their discussions, for example, using IAS 16.17 to discuss how the employee wages would qualify as directly attributable costs and should thus be capitalized. Strong candidates were also more likely to use a systematic approach by discussing the costs as they were listed in Appendix V, and were also more likely to address each cost individually, rather than using Handbook guidance to address multiple items at once. Stronger candidates were therefore more likely to achieve both breadth and depth on this AO.

Weak candidates were more likely to address the costs of the renovation en masse, for example, by using the recognition criteria of IAS 16 to address all of the renovation costs at once. Other weak candidates attempted to discuss fewer of the renovation costs, and were less likely to discuss each of the costs in depth, often simply stating whether the cost should be capitalized without providing any justification. Other weak candidates appeared to assume that the accounting treatment of the major costs, such as the replacement of the heating and cooling system or the addition of the internal walls and floors, did not need to be discussed. These weak candidates tended to focus their attention on the treatment of less substantial issues, such as the insurance proceeds or the costs of disposal, which did not allow them to fully demonstrate their understanding of how property, plant, and equipment should be accounted for.

AO#4 (Variance analysis)

Candidates were asked to discuss the possible causes for the cost variances calculated for the Chef Dashim meal kits. The cost variances were provided in Appendix VI (Common), where candidates were asked to explain the possible causes for the significant flexible budget variances for the fourth quarter of 2021. The case facts relevant to explaining the variances were contained elsewhere in the simulation, such as the extra protein packaging and preparation, as noted in Appendix II (Common), or the 50% reduction in television spending in Q4, as noted in Appendix VII (Common). To demonstrate competence, candidates were expected to provide, using case facts, valid reasons for the variances noted in the cost categories.

Candidates performed well on this AO. Most candidates supported their analyses with case facts integrated from other parts of the simulation. Candidates typically attempted to discuss most or all of the budget variances presented, and discussed several in depth, most notably the variances identified in packaging and labour.

Strong candidates were more likely to discuss all of the variances in depth. These candidates were more likely to identify one or more case facts that were relevant to the variances calculated, and used them to support their analyses of why the variances had occurred. For example, strong candidates often listed both the additional packaging required for the protein add-ons, and the worsening USD to CAD exchange rate, as reasons for the unfavourable variance noted for packaging costs.

Weak candidates were more likely to focus their discussions on the quantitative aspect of the variances presented. For example, weak candidates often simply noted whether the variances calculated were favourable or unfavourable, which did not provide any additional value, since this information was already presented. Weak candidates were also more likely to provide generic explanations for the variances. For example, weak candidates would suggest the reason for the variance noted in packaging was the result of more packaging being used, which could apply to any situation and did not integrate specific case facts, such as the additional packaging required for protein add-ons or the change in the exchange rate.

AO#5 (Budget)

Candidates were asked to finalize the spending budget for April, May, and June 2022 for the Chef Rita meals. Candidates were also asked to explain which factors would impact whether TMB was likely to meet its spending target of $1.8 million per month. Information relevant to the budget was provided in Appendix VI (Common). To demonstrate competence, candidates were expected to prepare a reasonable budget for April to June, state whether the spending target would be met, and explain the factors that would influence it.

Candidates performed reasonably well on this AO. Most candidates correctly incorporated the packaging purchases, direct labour, and overhead amounts into the monthly budget. Most candidates also concluded appropriately on whether the spending target would be met, based on their revised budget. While some candidates struggled to incorporate the two-month supply of packaging inventory into their budget, or did not clearly explain the factors that would influence whether the spending target would be met, many candidates only had one such weakness. These candidates were often able to make up for weaknesses in their inventory calculation with a strong explanation of the factors that would influence the spending target being met, or vice versa.

Strong candidates were more likely to incorporate the costs of holding additional inventory into their budget, calculating the rolling inventory needs, using the opening inventory and sales forecasts provided. Strong candidates were also more likely to provide valid and specific explanations of the significant factors that would influence whether the spending target would be met, for example, by noting the impact on the budget of the new supplier’s suggestion of holding additional inventory.

Weak candidates were less likely to attempt to incorporate the costs associated with the additional packaging inventory into their analyses. Other weak candidates did not include the monthly ingredient budget into their finalized budgets. Some weak candidates did not conclude on whether TMB would meet its spending target of $1.8 million, or did not attempt explanations of the factors that would influence whether the target would be met. Finally, some weak candidates used only generic explanations when discussing the factors that influenced the budget, for example, by stating that higher packaging costs would influence the budget, without linking the variance of such costs to specific case facts (such as the possibility of a worsening USD to CAD rate on packaging costs).

AO#6 (Data analysis)

Candidates were asked to analyze information presented for TMB’s revenues per customer, customer retention, and marketing initiatives. Information regarding TMB’s marketing information was provided in Appendix VII (Common), including a chart indicating average sales per customer for the year, data on product sales and customer retention, and a graph presenting data on new customers by marketing initiative. To demonstrate competence, candidates were expected to provide supported interpretations of the information provided across the categories requested.

Candidates performed well on this AO. Most candidates provided supported comments, based on the information presented, for the categories of revenues per customer, customer retention, and marketing initiatives. Comments by the average candidate typically integrated information from multiple graphs, charts, or appendices, to provide some valid reasons for the trends identified, and the conclusions reached were reasonable, based on the data presented. For example, most candidates were able to link the increase in number of new customers and lost customers to the introduction of TMB’s new discount program.

Strong candidates were more likely to provide in-depth comments across all three categories by integrating information from the various charts, graphs, and data. For example, strong candidates used the costs of the marketing initiatives listed at the beginning of Appendix VII, and the number of new customers at the end of Appendix VII, to determine which marketing initiative was most cost effective for attracting new customers. Strong candidates were also more likely to use multiple case facts noted elsewhere in the simulation to provide explanations for the trends they identified. For example, in addition to integrating information about the new discount offer into their analysis, as noted above, strong candidates used the arrival of the new competitor in the Vancouver and Calgary markets noted in Appendix II as a potential reason for the increase in lost customers. Strong candidates were also more likely to provide TMB with valid recommendations for addressing the issues identified from the information presented.

Weak candidates often simply repeated the information presented in the various charts and graphs. For example, while weak candidates often noted the downward trend for sales of organic meal kits, they did not attempt to provide a reason for the trend or a recommendation for how to address it. Similarly, weak candidates often noted that the average sales per customer was decreasing compared to industry average, but did not suggest potential causes or solutions. Finally, rather than provide a balanced discussion of all three categories, weak candidates were more likely to focus their discussion on one category.

Paper/Simulation:	**Day 2, Assurance Role (TMB)**
Estimated time to complete:	300 minutes
Simulation difficulty:	Average
Competency Map coverage:	Financial Reporting (1); Audit and Assurance (6)

Evaluators' comments by Assessment Opportunity (AO)

AO#7 (Operating segments)

Candidates were asked to discuss which geographic regions should be disclosed separately by TMB in 2021. Additional details on the geographic regions were provided in Appendix VIII (Assurance). To demonstrate competence, candidates were expected to discuss the disclosure requirements for operating segments, and provide a supported conclusion on which geographic regions to disclose separately.

Candidates struggled with this AO. Many candidates demonstrated technical weaknesses in their analysis by not identifying the relevant guidance (*IFRS 8 – Operating segments*). Most candidates concluded that some regions should be disclosed separately; however, candidates were unable to adequately support their conclusion without the relevant Handbook guidance, and instead often made up their own criteria for why certain regions should be disclosed. Those who did identify the correct Handbook guidance generally were able to provide a reasonable discussion.

Strong candidates demonstrated the technical knowledge required to assess this issue by providing both a discussion of whether the geographic regions meet the definition of operating segments under IFRS 8, and a calculation of which regions meet the quantitative thresholds for disclosure based on the Handbook guidance. Strong candidates were also able to provide a conclusion that was consistent with their analysis.

Weak candidates did not identify the relevant Handbook section and were therefore limited in the depth of their analysis. Some weak candidates attempted to analyze the summary financial information provided for the geographic regions, but then applied incorrect quantitative thresholds or simply concluded that the largest regions should be disclosed, without any additional rationale. Some weak candidates did not identify that this was a financial reporting issue, and discussed the disclosures from a strategy or management accounting perspective.

AO#8 (Procedures – accounting issues)

Candidates were asked to recommend audit procedures for the financial reporting issues discussed (the new discount offer, the Chef Arlene contract, the renovation of the fulfillment centre, and the disclosure by geographic region). Information on the financial reporting issues was provided throughout the case, both in the Common and Assurance sections. To demonstrate competence, candidates were expected to discuss several procedures that would address the specific risks related to the financial reporting issues identified.

Candidates performed well on this relatively straightforward AO. Most candidates demonstrated sufficient breadth by providing one or two procedures for three or four of the financial reporting issues. Most candidates were also able to adequately explain their procedures by discussing what audit evidence they would obtain, and what they would do with that audit evidence. The procedures that were most often adequately explained, and that addressed the most significant risks, were related to the renovation of the fulfillment centre and the Chef Arlene contract, as these areas are more straightforward to audit.

Strong candidates clearly demonstrated that they understood the significant audit risks of each financial reporting issue. For example, for the renovation of the fulfillment centre, instead of simply verifying the amounts to related invoices, strong candidates focused their audit procedures on whether the costs were appropriate to be capitalized by obtaining the associated invoices and verifying that the descriptions supported that the items were capital in nature. Strong candidates also provided precise and well-described procedures, clearly noting what external evidence would be obtained and what the auditor should do with that evidence.

Weak candidates tended to provide vague procedures without suggesting what specific audit evidence needed to be obtained and what information needed to be verified, which made it difficult to determine exactly what they were proposing, and what risk they were trying to address. In addition, some weak candidates provided generic audit procedures for the relevant financial statement accounts (revenue, intangible assets, etc.), instead of focusing their procedures on the specific risks associated with the financial reporting issue. For example, some weak candidates recommended selecting a sample of sales and obtaining the delivery slip to confirm that the revenue had occurred; however, this procedure tested the occurrence of all revenue and did not address the risks specifically associated with the new discount offer.

AO#9 (System conversion)

Candidates were asked to provide recommendations that could be implemented for system conversions in the future, and to discuss any issues identified in the converted sales system data. Information on the PVM sales system conversion was provided in Appendix VIII (Assurance). To demonstrate competence, candidates were expected to provide some recommendations for future system conversions, and discuss some of the issues in the converted sales system data.

Candidates performed adequately on this AO. Most candidates provided sufficient breadth of coverage of the issues presented in the converted sales system data; however, candidates often struggled to adequately explain their recommendations for future system conversions. The recommendation that was most often adequately explained, and that addressed the issues with the PVM sales system conversion, was to run the two systems in parallel for a period of time or, at a minimum, to have the old system continue to be available, to refer back to in case any data issues are identified.

Strong candidates demonstrated an understanding of risks associated with system conversions and provided clear recommendations for future system conversions. For example, strong candidates identified that agreeing the total number of customer accounts and sales was not sufficient for verifying the completeness and accuracy of the data transferred. Strong candidates recommended that the underlying sales data (customer names, addresses, credit cards, etc.) be reconciled between the old and new system, to ensure the completeness and accuracy of the data conversion. They also addressed a significant number of the issues present in the converted sales system data.

Weak candidates identified issues in the converted sales system data but were not able to provide adequate recommendations for future system conversions. Some of these candidates identified weaknesses in the procedures performed during the PVM sales system conversion, but were not able to clearly explain what should be done differently in future conversions. For example, some weak candidates identified that the IT manager did not complete detailed testing, and simply recommended that detailed testing be completed for future system conversions without explaining what specific procedures should be performed.

AO#10 (Procedures – due diligence)

Candidates were asked to recommend due diligence procedures, to minimize the risks related to the proposed acquisition of Sweet Tooth Ltd. (STL). The unaudited financial statements of STL were provided in Appendix VIII (Assurance), along with other information about the business. To demonstrate competence, candidates were expected to recommend some due diligence procedures that would address the risks related to the proposed acquisition.

Candidates performed adequately on this AO. Most candidates provided sufficient breadth by providing multiple due diligence procedures. Most candidates were also able to adequately explain their procedures by discussing what audit evidence they would obtain, and what they would do with the audit evidence. The procedures that were most often adequately explained were related to property, plant, and equipment, STL's income statement, and sending confirmations to STL's bank, customers, and/or suppliers, as these areas are more straightforward to audit.

Strong candidates clearly demonstrated that they understood the key risks associated with due diligence. For example, strong candidates focused their procedures on unrecorded liabilities (including potential lawsuits) and the fair value of assets. Strong candidates also provided precise and well-described procedures, clearly noting what external evidence would be obtained and what the auditor should do with that evidence.

Weak candidates tended to provide vague procedures without suggesting what specific evidence needed to be obtained. For example, weak candidates often provided procedures that were only inquiry. In addition, some weak candidates provided the same procedure for multiple financial statement accounts, and were therefore unable to demonstrate their ability to address other risks associated with the acquisition. For example, some weak candidates recommended obtaining a bank confirmation to confirm both the cash and loan balances, and also recommended sending confirmations to customers and suppliers to verify the existence of accounts receivable and accounts payable balances.

AO#11 (Internal controls)

Candidates were asked to review STL's production processes, discuss any weaknesses, and recommend any additional controls that TMB should implement, to ensure that STL's nut-free products are nut-free. A process description was provided in Appendix VIII (Assurance). To demonstrate competence, candidates were expected to identify several internal control weaknesses, explain the implication of each weakness, and provide a reasonable recommendation for addressing each weakness.

Candidates performed well on this AO. Most candidates identified many of the weaknesses and discussed them in sufficient depth. The most commonly identified weaknesses were that baking staff and equipment/utensils will move back and forth between the production lines as needed, no additional verification will be performed for suppliers after their first delivery, and both nut-free ingredients and ingredients containing nuts will be grouped together for storage.

Strong candidates better explained the implications of each weakness identified. For example, instead of simply stating that there is a risk of contamination because the two lines are arranged beside each other, they explained that the high-pressure spray washers used during cleaning could cause nut particles to end up on the nut-free line. Strong candidates also often provided clearer and more practical recommendations. For example, relating to desserts being labelled as containing nuts or being nut-free after they are cooled and packaged, strong candidates recommended having different coloured baking trays for the two production lines, or separate cooling areas.

Weak candidates often did not explain how the internal control weakness could cause the nut-free products to become contaminated. In addition, the recommendations they provided were often not sufficiently specific or practical. For example, weak candidates often suggested that desserts be packaged and labelled immediately, which did not consider that the desserts would need to be cooled before being packaged in order to ensure the quality of the dessert. Some weak candidates also provided multiple discussions that addressed similar issues. For example, weak candidates often provided separate discussions of both the sharing of baking staff between the two production lines and the sharing of baking equipment and utensils. As the implication and recommendation for the two weaknesses are similar, these candidates were unable to demonstrate sufficient breadth in their discussion.

AO#12 (Procedures – contract compliance)

Candidates were asked to recommend audit procedures, to ensure compliance with the requirements set out in the contract with All Things Green Inc. (ATG). Information on the contract requirements was provided in Appendix VIII (Assurance). To demonstrate competence, candidates were expected to discuss several procedures that would ensure compliance with the requirements set out in the contract with ATG.

Candidates performed well on this AO. Most candidates demonstrated sufficient breadth by providing procedures for four or five of the contract requirements. Most candidates were also able to adequately explain their procedures by discussing what evidence they would obtain and what they would do with the evidence. The procedures that were most often adequately explained were related to the universal bar codes and the certification to Canadian Organic Standards, as these requirements are more straightforward to audit.

Strong candidates clearly demonstrated that they understood the risks of each requirement. For example, instead of simply obtaining the certificate directly from the verification body and validating that ATG's greens are certified organic, strong candidates further validated that the verification body was designated by the Canadian Food Inspection Agency (CFIA) by confirming directly with the CFIA, or searching on an external database. Strong candidates also provided precise and well-described procedures, clearly noting what external evidence would be obtained and what the auditor should do with that evidence.

Weak candidates tended to provide vague procedures without suggesting what specific evidence needed to be obtained, and what information needed to be verified in order to do so. Some weak candidates provided procedures that only involved inquiry or observation, with no further testing. For example, related to the requirement that greens must be pre-washed in chlorinated water, some weak candidates simply recommended that the auditor visit ATG and observe staff washing the greens. This was not a sufficient audit procedure as it did not verify that the greens were being washed in chlorinated water or that ATG is pre-washing all greens.

AO#13 (Key audit matters)

Candidates were asked to identify which material account balances would likely be included in the key audit matters section of the auditor's report, and to explain why. Information on TMB's financial statements and operations was provided throughout the case, both in the Common and Assurance sections. To demonstrate competence, candidates were expected to apply the concepts from *CAS 701 Communicating key audit matters in the independent auditor's report,* and support why some material account balances would likely be included in the key audit matters section of the auditor's report.

Candidates struggled with this AO. Many candidates demonstrated technical weaknesses in their analysis by not identifying the relevant guidance (CAS 701). Most candidates attempted to discuss specific account balances; however, there was a variety of approaches, and the discussions were not always in the correct context of key audit matters. Candidates most often adequately discussed that revenue would be included as a key audit matter, by explaining the risk of material misstatement, either due to the accounting error identified with the new discount offer or due to management’s bias to increase revenues. However, they often struggled to adequately discuss the other areas they identified.

Strong candidates identified the specific criteria noted in CAS 701 and discussed, using relevant case facts, which material account balances met the criteria. For example, strong candidates identified that the renovation to the fulfillment centre and/or the PVM system conversion were significant events that occurred during the 2021 year, and should therefore be included as a key audit matter.

Weak candidates often did not identify the guidance in CAS 701, and therefore struggled to explain why specific account balances should be included as key audit matters. In addition, some weak candidates’ discussions were not in the context of key audit matters. For example, some weak candidates focused on the assertion-level risks for specific account balances and discussed the work that the external auditor would complete. Other weak candidates copied the Handbook guidance from CAS 701 and concluded on specific account balances to be included as key audit matters, but provided little to no analysis of case facts to support how the account balances met the criteria of a key audit matter.

Paper/Simulation:	**Day 2, Finance Role (TMB)**
Estimated time to complete:	300 minutes
Simulation difficulty:	Average
Competency Map coverage:	Finance (7)

Evaluators' comments by Assessment Opportunity (AO)

AO#7 (Packaging equipment NPV)

Candidates were asked to analyze the capital budgeting decision on whether TMB should purchase new packaging equipment for the Montreal fulfillment centre. Information related to this decision, including information on the new equipment, assumptions on equipment costs, and the impact on TMB's annual costs, was provided in Appendix VIII (Finance). To demonstrate competence, candidates were expected to prepare a net present value analysis that incorporated a sufficient number of relevant cash flow items, provide an analysis of the qualitative considerations (discussing both pros and cons), and provide a conclusion on whether TMB should purchase the new equipment.

Candidates performed well on this AO. Most candidates applied the net present value technique, using an appropriate discount rate of 15% (as provided in the case), and included appropriate items in their analysis. This included one-time items such as the cost of the new equipment, tax shield, salvage value (on the old and new equipment), and after-tax annual operating cost savings. Most candidates attempted to discuss qualitative considerations, such as the freshness and speed improvements, environmental impact, potential referral fees, and the risk of being the first customer in this industry. Most candidates also provided a conclusion supported by their quantitative and qualitative analysis.

Strong candidates often incorporated an adjustment for the inventory reduction (sometimes including the return of working capital after five years), and considered a tax shield adjustment on both the new equipment as well as on the old equipment that would be sold. Strong candidates also provided a more in-depth, balanced qualitative response, discussing more relevant points in depth and considering both pros and cons of the new equipment.

Weak candidates did not provide a net present value analysis or made errors in applying the method, such as placing cash flows in the wrong years or discounting some, but not all, of the relevant future cash flows. Some weak candidates did not consider a sufficient number of items in their net present value analysis or made errors, such as making adjustments in the wrong direction, excluding significant items such as salvage values and taxes, or including overhead costs. Some weak candidates also did not discuss qualitative factors, or only identified or briefly discussed a few qualitative factors without explaining why they are important to the decision of whether TMB should purchase the new equipment.

AO#8 (Valuation – DI)

Candidates were asked to value Desserts Inc. (DI) using the capitalized cash flow method, and to compare their valuation to Shelly's requested price. Details of DI, including historical financial statements and other key information about DI, were provided in Appendix VIII (Finance). To demonstrate competence, candidates were expected to value DI using the capitalized cash flow method. They were expected to make appropriate adjustments to net income in order to arrive at cash flows, normalize cash flows to reflect DI's maintainable cash flows, apply an appropriate capitalization rate (using reasonable discount rate and growth rate assumptions), and make balance sheet adjustments, to arrive at the equity value of DI.

Candidates performed adequately on this AO. Most candidates attempted to value DI using the capitalized cash flow method, starting with pre-tax net income and making adjustments (most often, amortization and interest), to arrive at cash flows. Most candidates attempted to normalize the cash flows, typically incorporating normalizations for Shelly's and her son's salaries and for the foreign exchange gain. Candidates typically applied a capitalization rate (based on the discount rate and growth rate provided) to the maintainable cash flows. Many candidates attempted some balance sheet adjustments (typically, the outstanding debt and initial capital investment), to arrive at equity value. Most candidates concluded by comparing the valuation to the offer price.

Strong candidates correctly calculated DI's cash flows, taking into consideration amortization, interest, taxes, and sustaining capital investments. Strong candidates incorporated all relevant normalizations as well as balance sheet adjustments, including the fair value of the outstanding debt, redundant cash, and initial capital investment.

Weak candidates did not apply the capitalized cash flow method, and instead attempted to capitalize income or pre-tax earnings, or used the discounted cash flow method. In addition, weak candidates often made few normalizing adjustments, or made the adjustments incorrectly (for example, in the wrong direction). Weak candidates sometimes capitalized the cash flows using an incorrect capitalization rate, such as using an incorrect discount rate or not considering the impact of growth, or applying the capitalization rate to the cash flows incorrectly. Many weak candidates also did not make balance sheet adjustments or made them incorrectly (for example, in the wrong direction, or using total cash on hand without considering DI's operating cash flow needs).

AO#9 (Ratio analysis)

Candidates were asked to calculate some financial ratios for DI and discuss areas where DI's operations could be improved, and synergies that TMB could generate from acquiring DI. Financial benchmarks for the specialty food manufacturing industry, and background on DI, were provided in Appendix VIII (Finance). To demonstrate competence, candidates were expected to calculate most of the financial ratios and discuss some operational improvements and synergies, based on the financial ratios.

Candidates performed adequately on this AO. Most candidates calculated all of the financial ratios correctly. Most candidates attempted to discuss some operational improvements (such as increasing marketing spend and capital investment) and potential synergies (typically, the add-on products and sharing of production facilities), but sometimes did not provide sufficient depth by making only brief recommendations without tying back to case facts, or providing only a few recommendations.
Strong candidates discussed more operational improvements, such as improving the general and administrative spending, and potential synergies, such as back-office consolidation. Strong candidates also demonstrated stronger case fact integration by considering the normalization adjustments from the valuation, for example, the excess salaries being paid to Shelly and her son, the impact of donations on DI's expenses, and/or the underinvestment in capital expenditures.

Weak candidates sometimes only performed a ratio analysis and attempted to explain DI's ratios relative to the industry, but did not discuss operational improvements and/or synergies. Other weak candidates identified operational improvements and/or synergies, but did not explain how they could be achieved or how they would benefit TMB.

AO#10 (Financing options)

Candidates were asked to discuss two options proposed for financing the acquisition of DI, and to make a recommendation. Details on the two financing options, including key terms for the note payable and the share exchange, were provided in Appendix VIII (Finance). To demonstrate competence, candidates were expected to provide a discussion of both financing options, incorporating case facts and various terms of each financing option, and provide a recommendation on the financing option that TMB should pursue in order to acquire DI.

Candidates struggled with this AO. Most candidates attempted a discussion of the note payable but had difficulty comparing the terms to the share exchange, given that the financing options are different. Candidates typically focused on the cash flows (although they often did not consider whether TMB generated sufficient cash flows to service the debt), implications of defaulting, and the required security. Many candidates attempted a discussion of the share exchange, considering Shelly's ownership, dilution of existing shareholders, and the implication of Shelly being on TMB's board, but often did not attempt to calculate Shelly's ownership interest or the dilution on existing shareholders. Further, some candidates misunderstood the case facts and assumed that Shelly would receive only 5% of TMB's shares, or did not understand how the share exchange would work, for example, by not recognizing that new shares of TMB would need to be issued to Shelly. Most candidates provided a conclusion on the financing options supported by their analysis.

Strong candidates discussed more relevant considerations in assessing the note payable, tying their discussions for the note payable into case facts about both TMB and DI and their cash balances, cash flows, or operating strategies. Strong candidates also discussed more relevant considerations in assessing the share exchange, often calculating the ownership percentage and dilution on the share exchange option, calculating and/or discussing the earn out clause, and using these calculations and discussions to support their conclusion.

Weak candidates identified some terms of either the note payable or share exchange, such as the interest rate on the note payable, without explaining whether the terms were beneficial for TMB. Some weak candidates also calculated the annual cash flows (incorporating principal plus interest), but did not discuss the implications (such as whether TMB could afford to service the cash flows, or comparing to expected cash flows or cash balances).

AO#11 (Electronic payments)

Candidates were asked to analyze an electronic payment system and provide a recommendation on whether TMB should adopt it. Details of the electronic payment system, including the current cost to TMB of the cheques and the cost of the electronic payment system, were provided in Appendix VIII (Finance). To demonstrate competence, candidates were expected to prepare an analysis of the cost of the electronic payment system, discuss some qualitative factors associated with the system, and provide a supported recommendation.

Candidates struggled with this AO. Most candidates provided a cost analysis that incorporated the relevant costs. They also attempted to discuss some qualitative factors related to the electronic payment system, often considering the impact on timeliness of payments, lost cheques, electronic authorizations, and ease of bank reconciliations, but often repeated case facts without demonstrating depth by explaining the impact of these items on TMB. Most candidates provided a supported conclusion based on their qualitative and quantitative analyses.

Strong candidates provided a cost analysis, but discussed more relevant considerations, such as the impact of the electronic payment system on working capital, and attempted to balance their discussion by incorporating some cons, such as the transaction limit or data security risk. Strong candidates also generally better explained the impact of the qualitative factors on TMB.

Weak candidates sometimes did not provide a cost analysis, but when they did, the analysis was appropriate. They often did not provide a qualitative discussion or did not discuss a sufficient number of qualitative considerations, or identified and repeated relevant case facts but did not explain why they would be an advantage or disadvantage for TMB. Some weak candidates also did not provide a quantitative analysis of the costs.

AO#12 (Dividend or buy back)

Candidates were asked to assess whether TMB should pay a dividend or buy back shares. Information on TMB's cash balance was provided in Appendix VIII (Finance). To demonstrate competence, candidates were expected to discuss at least two of the three options (regular dividend, special dividend, and share buyback) in some depth, and provide a supported recommendation.

Candidates struggled with this AO. Most candidates attempted to discuss the three options by explaining how each option worked and their impact on TMB. In their discussion, most candidates considered some factors that differed between the three options, such as shareholders' future expectations or the impact on TMB's share price, but many candidates were unclear about the differences between the options, and therefore provided a discussion that was not technically correct. Most candidates also provided a supported conclusion on the option that would be most appropriate for TMB.

Strong candidates provided a technically correct analysis that considered the differences between the three options, considering factors such as shareholders' future expectations, market signaling on TMB's cash flows, and the impact on TMB's share price. Strong candidates also integrated case facts by considering TMB's desire to grow inorganically and its bank covenants.

Weak candidates did not understand the differences between the three options and provided a technically incorrect analysis. Some weak candidates focused on the tax consequences to the shareholders only, which are less important from TMB's perspective than the implications to TMB itself.

AO#13 (Acquisition criteria)

Candidates were asked to analyze which potential acquisition targets best meet TMB's acquisition criteria, and to recommend which company (or companies) TMB should complete further due diligence on. On the role requirement page, candidates were provided with the criteria they should use in order to assess the acquisition targets. Details of the potential acquisition targets, including key financial metrics, were provided in Appendix VIII (Finance). To demonstrate competence, candidates were expected to assess some of the acquisition targets using TMB's acquisition criteria, including TMB's benchmarks, and conclude on the targets that TMB should focus on.

Candidates performed adequately on this AO. Most candidates attempted to calculate the earnings per share of some or all of the potential acquisition targets. Most candidates also used the provided acquisition criteria, including the earnings threshold, earnings per share, and return on asset, to support their recommendation.

Strong candidates correctly calculated TMB's earnings per share and return on asset ratios, and compared TMB's ratios against the ratios for each of the acquisition targets to support their conclusion.

Weak candidates did not calculate, or incorrectly calculated, the acquisition targets' earnings per share ratio (by not considering the size of each target relative to TMB and other targets), and TMB's earnings per share and return on asset ratios (by selecting incorrect inputs). Also, weak candidates sometimes did not consider the criteria provided for selecting the acquisition targets, but used their own criteria (such as selecting the highest-ranking target or using metrics that were not part of the acquisition criteria, such as the line of business the target operates in), or made a recommendation without explaining what criteria they utilized.

Paper/Simulation: **Day 2, Performance Management Role (TMB)**

Estimated time to complete: 300 minutes

Simulation difficulty: Average

Competency Map coverage: Performance Management (7)

Evaluators' comments by Assessment Opportunity (AO)

AO#7 (Recipe development)

Candidates were asked to perform a quantitative and qualitative analysis of the impact of reducing the number of new recipes introduced weekly for Chef Rita's casual meal kits from four to three, and to provide a recommendation. Information related to the proposal, including total meals sold from new recipes under both scenarios and related costs, was presented in Appendix VIII (Performance Management). In addition, information provided throughout the Common section of the case could have been used to assess the proposal. To demonstrate competence, candidates were expected to calculate the incremental operating income generated by introducing new recipes under each of the two options considered, discuss relevant qualitative elements, and provide a recommendation.

Candidates struggled somewhat with the quantitative aspect of the required but did much better with their qualitative analysis. For the quantitative component of the required, candidates were generally able to calculate the contribution margin that would be lost on the sales related to the new recipes if the number of new recipes introduced was lowered, but the vast majority failed to incorporate into their calculation the percentage of customers buying meal kits from new recipes who would have bought meals anyway, even if the recipe was not new. In addition, many candidates were unable to incorporate the development and graphic design costs of new recipes in a useful and logical way in their calculation. They generally got mixed up in the timeframe considered (weekly versus annually), or failed to realize that these costs were proportional to the number of recipes developed. For the qualitative portion of the required, most candidates provided a reasonable analysis of the qualitative elements to consider, such as the new recipes being a differentiating factor that helps increase customer retention (a key success factor in the industry), the fact that the number of new recipes introduced is already lower in Western Canada, or that older recipes could be recycled and improved, rather than having to create new recipes from scratch. Most candidates also provided a recommendation that flowed from their quantitative and qualitative analyses.

Strong candidates not only calculated the contribution margin lost on the sales related to reducing the number of new recipes but also considered the development and graphic design costs saved, or correctly incorporated into their calculation the percentage of customers who would have bought meals anyway, even if the recipe was not new. This led them to accurately determine the overall difference in operating income for TMB under the two scenarios considered. They also provided a qualitative analysis that contained several valid elements described in sufficient depth.

Weak candidates struggled with the quantitative component of the analysis. They often failed to compare the two scenarios, and limited themselves to calculating the current contribution margin generated by the sale of new recipes. Most weak candidates attempted to present a comparison of the contribution margins generated under the two scenarios, but their analysis contained numerous errors. They also often mistakenly concluded that the development and graphic design costs were not relevant because they were sunk costs, or incorporated them in an inconsistent way, such as calculating an annual difference when the rest of the analysis was performed on a weekly basis. The qualitative analysis of weak candidates generally consisted of repeating some components of their quantitative analysis in a narrative format, rather than trying to identify additional, non-quantitative, elements that could influence the decision.

AO#8 (Delivery pricing)

Candidates were asked to provide a quantitative and qualitative analysis of a pricing decision concerning the delivery fees to be charged to customers, depending on whether they lived within, or outside of, the city limits. Candidates were specifically asked to review three alternatives: the status quo (charging a flat fee of $10 per delivery, which is generating a loss on the delivery service); a flat fee of $11 per delivery; and a hybrid approach consisting of charging the current fee of $10 for orders within city limits, and charging the actual cost borne by TMB for customers living outside city limits. Information related to the three alternatives, including the number of orders and the related costs, was provided in Appendix VIII (Performance Management). In addition, information provided throughout the Common section of the case could have been used to assess the alternatives. To demonstrate competence, candidates were expected to compare the profit/loss generated by the delivery fees under each of the three alternatives, discuss relevant qualitative elements, and provide a recommendation.

Candidates performed well on this relatively easy AO. Most candidates attempted to calculate the profit/loss generated by the delivery fees under all the alternatives, providing very good calculations for the first two alternatives, which were the easiest to analyze. In general, candidates struggled with the third option, with many candidates mistakenly concluding that the profit/loss was zero, since the actual costs were being charged to the customers, which was untrue as this only applied to one of the segments (customers living outside of city limits). For the qualitative portion of the required, most candidates provided a reasonable analysis of the qualitative elements to consider (such as price sensitivity, the growing trend in the proportion of orders from outside the city limits, the potential loss of customers, and the key success factor of customer retention), and provided a recommendation that flowed from their quantitative and qualitative analyses.

Strong candidates were generally able to provide a near-perfect calculation of the profit/loss generated by the delivery fees for all three alternatives. They also provided a qualitative analysis that contained several valid elements described in sufficient depth, and concluded with a recommendation consistent with their quantitative and qualitative analyses.

Weak candidates seemed to misunderstand the case facts about the delivery service. Some believed that TMB provided the delivery service itself, while others mistook the amount charged to the customer for the amount paid by TMB to a third-party supplier providing the delivery service. Those mistakes led to significant errors in the calculation of the profit/loss generated by each option. In addition, many weak candidates omitted the third option from their analysis altogether, seemingly being confused by the concept of recharging a cost to a customer. The qualitative analysis of the weak candidates generally consisted of a repetition of some components of their quantitative analysis in a narrative format, rather than trying to identify additional, non-quantitative, elements that could influence the decision. Other weak candidates failed to provide a recommendation to TMB on which option to choose.

AO#9 (Outsourcing – secret sauce)

Candidates were asked to provide a quantitative and qualitative analysis of a decision related to the manufacturing of a new product: bottles of a sauce currently used in the meal kits. TMB is considering two options: manufacturing the secret sauce in-house; or outsourcing the manufacturing activity to a third party, Delicious Sauces (DS). Information related to the two options was provided in Appendix VIII (Performance Management). In addition, information provided throughout the Common section of the case could have been used to assess the options. To demonstrate competence, candidates were expected to calculate the operating income generated by the sale of the bottled sauces under both options, taking into account the capacity constraint associated with the option of manufacturing the sauce in-house. They were also expected to discuss relevant qualitative elements, and provide a recommendation.

Candidate performance on this AO was mixed. Most candidates performed a reasonable calculation of the unit contribution margin of the bottled sauces under the in-house option, and a reasonable calculation of the operating income generated by the sale of the bottled sauces under the outsourcing option. However, many candidates struggled with the most challenging component of the quantitative analysis, the inclusion of the capacity constraint under the in-house option. Most candidates correctly calculated the capacity of the puree machine available to manufacture the secret sauce bottles, and were able to realize that there was a capacity shortfall preventing TMB from manufacturing the entire expected demand for the bottled sauces. However, most candidates were unable to use this to adjust the operating income from the in-house option. Many instead chose to mention the capacity shortfall issue within the qualitative portion of their analysis, not realizing that this was something that they could quantify. Most candidates provided a reasonable qualitative analysis of the two options considered. The most frequently mentioned qualitative elements to support in-house production were the added control on quality, the increased reliability of timely production, the added protection it provided for the confidentiality of the recipe, and the added flexibility with respect to modifications in the recipe or the addition of various types of sauces. The most frequently mentioned elements supporting outsourcing were the fact that DS specialized in manufacturing sauces, that it removed any capacity issues going forward, that it enabled TMB to focus on its core competencies, such as creating new recipes, and that it enabled TMB to avoid a significant initial cash outflow.

Strong candidates not only calculated the capacity shortfall but also understood that the calculation of the operating income from the in-house option would be based on a reduced number of bottles. Other strong candidates disregarded the shortfall in the first step of their calculation, but then proceeded to calculate an "opportunity cost" based on the lost contribution margin on the unsold bottles. These strong candidates made very few errors in the calculation of the operating income generated under both options, and then proceeded to compare the two amounts in a useful way. They also provided a qualitative analysis that contained several valid elements described in sufficient depth, and concluded with a recommendation consistent with their quantitative and qualitative analyses.

Weak candidates either missed the capacity issue altogether, or chose to ignore it in their quantitative analysis. Some weak candidates made errors in the calculation of the capacity available and/or the capacity needed, and mistakenly concluded that capacity was not an issue. Weak candidates often made the error of using the unit contribution margin as their starting point of the outsourcing option, not realizing that the unit variable costs of labour, materials, and variable overhead would not have to be incurred if the production were outsourced to a third party. Their qualitative analysis generally consisted of a list of case facts presented in a pros-and-cons format, with little or no explanation of how these facts could help TMB choose which option to prioritize.

AO#10 (Chef Dashim sales data)

Candidates were asked to analyze data related to the sale and the selling prices of the three types of Chef Dashim meal kits, and were asked for advice on how TMB could better differentiate itself in Western Canada, as well as for any other advice on how to attract more customers. Candidates were expected to realize that the three types of meal kits had a very different sensitivity to price, and were purchased by different types of customers. They were also expected to identify the seasonality of the data presented to them. They were then expected to provide useful advice on which market to prioritize, the pricing strategy specific to each type of meal kit, and to provide other advice on how to improve sales and differentiate TMB in Western Canada. Information related to pricing and customer orders for Chef Dashim's meal kits was provided in Appendix VIII (Performance Management). To enhance their analysis, candidates could also use information provided throughout the Common section of the case.

Candidates struggled with this assessment opportunity, which was the least directed of the seven AOs in the Performance Management role. Most candidates were able to identify, through their analysis of the graphs and charts presented to them, that the three types of meal kits (casual basic, casual organic, and gourmet) had different price sensitivity. However, few candidates were able to use this to provide meaningful and useful advice on how to differentiate TMB and increase its number of customers in Western Canada. Most candidates merely concluded that the meal kits most sensitive to price (casual basic) should have a low price, and that the ones least sensitive to price (gourmet) should be priced higher, without providing additional depth. Many candidates also noted the seasonality in the sales data presented, but were unable to go beyond that in their analysis.

Strong candidates correctly identified the difference in the level of price sensitivity between the three types of meal kits, and the seasonal nature of TMB meal-kit sales in Western Canada, and used this information to provide useful advice for TMB going forward. Some strong candidates attempted to identify the different types of customers purchasing the three types of meal kits, and made specific recommendations on how to differentiate TMB in the specific market niches, going beyond simply recommending whether to increase or reduce prices. Stronger candidates made links with the information presented in the case on the competition in the industry, based on price, and with Chef Dashim's reputation as a high-end chef, and suggested that TMB focus its market positioning on the higher-quality meals, such as gourmet or casual organic, since the Western Canada market was already saturated with the lower-end meal kits that do not fully utilize Chef Dashim's competence and expertise. Other strong candidates made insightful recommendations on how to improve TMB's sales in Western Canada during the months of the year when sales were at their lowest, adapting their recommendations to the three diverse types of meal kits. For example, some candidates recommended offering discounts in September for the casual basic meal kits, or introducing new innovative recipes in September for the gourmet meal kits. In general, strong candidates were better able to integrate the various facts presented throughout the case in order to provide useful advice for TMB.

Weak candidates seemed surprised by this unusual and less directed required, and had difficulty making any meaningful inferences from the information presented. They generally described what they saw in the graphs in words, without really attempting to give meaning to the information described. For example, they would remark that, when prices dropped, the sales volume increased for all types of meal kits, without attempting to assess which types of meals were more sensitive to price. They would comment on a seasonality in the sales volumes without attempting to explain why that might be the case, or without attempting to use it as the basis for a useful recommendation. In general, weak candidates focused only on descriptions, and provided little analysis of the data described.

AO#11 (Cash flow – VS acquisition)

Candidates were asked to determine how the forecasted cash flows generated by a vegan dessert business, Vegan Sweets (VS), that TMB is considering acquiring would change if the acquisition occurred and TMB became the new owner. Information related to VS's cash flow forecast for the next four years, provided by its current owners, was provided in Appendix VIII (Performance Management). To demonstrate competence, candidates were expected to use the additional detail provided to make appropriate adjustments to the forecast presented.

Candidates performed adequately on this AO. Most candidates understood the required and made a reasonable attempt at restating the cash flow forecast of the targeted business. Most candidates correctly adjusted the forecast for the abnormal spoilage, and for the added personnel (dessert manager and procurement manager) required in the event that the acquisition would go through, and provided a revised four-year forecast consistent with the growth rate assumptions. The most common mistakes made were to ignore the abnormal spoilage in the calculation of the reduction in volume discounts, to ignore the breakdown between the types of direct materials in the calculation of the lost discounts, to base the adjustment of the new candy-maker salary on his entire salary rather than on the difference in the salaries of the previous one and the new one, and to ignore the previous candy-maker's salary when quantifying the reduced cash outflows due to employee layoffs.

Strong candidates made fewer errors in their revised cash flow forecast. They generally correctly calculated the direct material purchases of flour, sugar, and substitute butter separately, since only these purchases were subject to the reduced discount. They correctly ignored the information provided on the allocation rate of the previous candy-maker, and only adjusted the forecast for the difference between the allocated salary of the previous candy-maker and the salary of the new candy-maker to be hired. Most of them also avoided the minor technical errors in the calculation of the direct labour and direct material adjustments.

Weak candidates made numerous errors in their calculation of the revised cash flow forecast. Some of them limited their analysis to one year, rather than attempting to revise the entire forecast provided by the previous owner. Some weak candidates also misunderstood the required, and described the adjustments to be made in a narrative form, rather than revising the forecast quantitatively. A surprising number of candidates did not attempt this assessment opportunity.

AO#12 (VS acquisition – qualitative)

Candidates were asked to perform a qualitative assessment of the advantages and disadvantages of TMB acquiring the vegan dessert business, and to recommend whether the acquisition would be a good strategic fit. Similar to the previous AO, information specific to VS was provided in Appendix VIII (Performance Management), and additional information was provided throughout the Common section of the case. To demonstrate competence, candidates were expected to provide a reasonable analysis of the strategic fit of this acquisition, as well as its advantages and disadvantages, making links to the information provided on TMB and its industry, and with information specific to the targeted business presented. They were expected to take into account that the new venture was an existing business in operation, as opposed to a projected business being started from scratch.

Candidates performed adequately on this AO. Most candidates identified a reasonable number of valid elements supporting, or not supporting, the proposed acquisition, or assessed the strategic fit with TMB's current activities and strategic direction. Most candidates noted the natural fit between the vegan dessert offering and the vegetarian meals offered in Western Canada by Chef Dashim, and the potential usage of VS's desserts as an add-on to the current meal kits provided by TMB. They also noted TMB's lack of expertise in the manufacturing and sale of desserts, the potential issues associated with the layoff of multiple VS employees, and the opportunity to sell TMB's meal kits in the restaurants and supermarkets currently selling VS desserts. However, many candidates failed to notice that VS was an existing business, and mentioned items that would only be valid if TMB wanted to set up a new business selling and manufacturing desserts rather than purchasing an existing one. For example, they would mention that TMB's employees had no experience in manufacturing desserts, not realizing that most of VS's employees would still be around after the acquisition, and could provide TMB with their own expertise.

Strong candidates discussed more valid advantages and disadvantages of the acquisition, stressing the ones that were strategic in nature, and explaining in depth why they were important or relevant. They avoided the more generic items that would apply to any acquisition, such as the large capital outlay, the potential culture clashes, and the impact of layoffs on employee morale, and rather focused their analysis on strategic items specific to the case, such as the possibility of accessing VS's customer base, the geographic proximity between VS and TMB in Western Canada, the complimentary nature of the products sold, and the potential pricing issues associated with the price sensitivity in TMB's market.

Weak candidates often listed their arguments in the form of a list of bullet points, mentioning pros and cons, and generally going into little depth beyond listing the case facts in question. Many of the elements were generic, and could apply to most acquisitions or start-ups of new ventures. Many weak candidates repeated in a narrative form some elements that they had incorporated in their quantitative reassessment of the cash flow projections of VS in the previous AO, rather than attempting to identify truly qualitative or strategic elements that would help justify the acquisition. Those candidates' responses were therefore overly focused on operational issues such as discounts, labour costs, and spoilage, as opposed to the more strategic elements that were expected in the current AO.

AO#13 (PVM implementation and growth strategy)

Candidates were asked to assess the acquisition of PVM, Chef Dashim's company that TMB acquired 18 months ago, by addressing three specific requireds: 1) assess whether the original objectives for the acquisition were met; 2) discuss what improvements could have been made in the implementation and integration of the PVM acquisition, or on future acquisitions going forward; and 3) suggest future growth opportunities for TMB other than acquisitions. Information related to the implementation of the PVM acquisition, including the original objectives, was presented in Appendix VIII (Performance Management). In addition, information provided throughout the Common section of the case could have been used to assess the acquisition and discuss potential growth strategies. To demonstrate competence, candidates were expected to provide a reasonable assessment of the original objectives for PVM's acquisition, integrating relevant case facts, and conclude that these objectives had generally not been met. They were also expected to discuss the flaws in the integration of PVM to TMB, and in the implementation of the acquisition. Finally, they were expected to suggest some ways to grow TMB in the future.

Candidates struggled with this assessment opportunity, which was expected to be the most difficult AO in the Performance Management role. Most candidates presented a reasonable attempt at the analysis of the original objectives for the PVM acquisition, but their assessment generally lacked depth. Most candidates jumped to the conclusion that the first two objectives were met (expansion and growth in Western Canada, and duplication of the Vancouver fulfillment centre in Montreal), without going further and considering the case facts that demonstrated how these objectives were only met in a limited way. Most candidates concluded that the third objective (use of Chef Dashim's culinary expertise) was not met, and provided a supported analysis to explain their assessment. Candidates performed very poorly on the second required of this AO. Most mistakenly thought that they were asked for recommendations on how to solve the current operational problems occurring in the Western Canada division of TMB (formerly PVM), rather than to identify the problems in the implementation and integration of the acquisition and provide suggestions for how to better implement and integrate future acquisitions. Most candidates understood the third required, and provided a reasonable attempt at discussing avenues of future growth for TMB other than by acquisitions, but their analysis often contained generic elements, such as suggesting that TMB enter into joint ventures, partnerships, or expand geographically, but without going into more depth or without linking the recommendations to case-specific elements.

Strong candidates realized that the three original objectives for the acquisition of PVM had not been achieved, and they supported their assessment with relevant case facts. They noted that the implementation could have been improved by involving Chef Dashim more in the process by asking for his ideas, and that, rather than attempt to duplicate the Montreal model in Western Canada, the implementation should have tried to understand the strengths and specificities of PVM and its Western Canada market, and implement and integrate the acquisition in such a way as to take advantage of them. The second required remained a challenge, however, even for strong candidates, although they had no trouble identifying avenues for future growth, adapted to the specific characteristics of PVM. For example, strong candidates suggested making alliances with specialized supermarkets, to use them as a selling vehicle for the meal kits, signing contracts with additional, highly reputable chefs, or entering into partnerships with local farmers, to supply high-quality local ingredients for the meal kits.

Weak candidates generally ignored the three requireds, and instead attempted to solve the operational problems at PVM, providing recommendations that, while often being valid thoughts in general, were not answering any specific component of the required. Other weak candidates understood the first and third requireds, but provided very shallow or simplistic responses to them. They jumped to the conclusion that objectives #1 and #2 were met and that objective #3 was not, providing little support for their assessments. Weak candidates generally gave little or no response to the second required in the context in which it was intended, instead providing operational improvements for the Western Canada division of TMB.

Paper/Simulation: **Day 2, Taxation Role (TMB)**

Estimated time to complete: 300 minutes

Simulation difficulty: Average

Competency Map coverage: Taxation (7)

Evaluators' comments by Assessment Opportunity (AO)

AO#7 (Accounting issues / land sale)

Candidates were asked to discuss the tax treatment of the three financial reporting issues, as well as the disposition of the vacant land in Vancouver. Information was provided throughout the Common portion of the case with respect to the three financial reporting issues (the discount offer, Chef Arlene contract, and renovations of the Montréal building). In Appendix VIII (Taxation), candidates were provided with information about the history of the land that was sold. To demonstrate competence, candidates were expected to discuss several of these items from an income tax perspective.

Candidates struggled on this AO. Most candidates discussed the income versus capital treatment of the disposition of land, typically including at least one or two case facts to support their conclusions. However, they often did not attempt to discuss the tax treatment of the financial reporting issues, or attempted to discuss them but provided very brief explanations.

Strong candidates discussed the income versus capital treatment of the disposition of land, using several facts to argue both sides before coming to a supported conclusion. They also addressed the tax implications of the financial reporting issues by discussing, specifically from a tax perspective, the nature of each of the three transactions.

Weak candidates often jumped to the conclusion that the land sale was a capital gain (without even identifying the possibility that it might not be) and, at most, explained the implications of that (that only 50% of the gain would be included in income). Weak candidates rarely attempted to discuss the tax treatment of the financial reporting issues, and those who did simply stated that the taxes would go up because financial statement income went up, or vice versa, without going into additional details.

AO#8 (Taxable income and taxes payable)

Candidates were asked to calculate federal taxes payable for 2021. They were provided with financial statements in Appendix I (Common) of the case, along with information about capital items and other tax-specific items in Appendix VII (Taxation). Candidates were also able to integrate the results of the work performed in AO#7 into their calculation. To demonstrate competence, candidates were expected to calculate taxable income, including a reasonable attempt at a CCA calculation, and provide a reasonable calculation of taxes payable.

Candidates performed adequately on this AO. Most candidates calculated net income for tax purposes and taxable income, starting with net income before tax and adjusting for the simpler tax adjustments (amortization, donations, meals and entertainment, the sale of land, and the integration of the accounting income adjustments), although they often did not adjust for the difference between the accounting treatment and tax treatment of the financial reporting issues. They usually calculated CCA appropriately on the opening balances and Classes 8 and 50, but often struggled to correctly reflect the additions to Classes 1, 12, and 53 (usually making errors on one or two of these). Most candidates also calculated taxes payable correctly by calculating the basic rate, provincial abatement, and general rate reduction.

Strong candidates calculated net income for tax purposes and taxable income, adjusting for most of the adjustments (including adjustments for the difference between the accounting treatment and tax treatment of the financial reporting issues), and calculating CCA correctly for most of the classes. Strong candidates also calculated taxes payable correctly by calculating the basic rate, provincial abatement, and general rate reduction, often adding some depth by explaining why other items were not included (such as explaining that there is no small business deduction because TMB is not a CCPC).

Weak candidates typically attempted a calculation of net income for tax purposes and taxable income, usually attempting most of the simpler tax adjustments but rarely attempting to adjust for the difference between the accounting treatment and tax treatment of the financial reporting issues. Weak candidates frequently made multiple errors on CCA, often putting additions into the wrong classes, and failing to apply the accelerated investment incentive. Weak candidates usually calculated taxes payable using an estimate based on the financials (27%), rather than showing the calculation of the appropriate rates to be used.

AO#9 (Purchase of DI)

Candidates were asked to analyze the income tax and GST/HST implications of the purchase of Desserts Inc. (DI), from both an asset purchase and share purchase perspective. Information about DI was provided in Appendix VIII (Taxation), including its ending balances from its most recent taxation year end, and the fair market value (FMV) of the assets to be acquired. To demonstrate competence, candidates were expected to attempt discussions of both the asset and share options, including an attempt at the GST/HST implications, providing depth on some of the specific issues (such as the impacts on CCA, the GST/HST election, or the non-capital loss carryforwards).

Candidates performed adequately on this AO. Most candidates attempted to discuss the purchase of both assets and shares, although, as there was no clear quantitative component to this AO, a wide variety of approaches was taken. Most commonly addressed were CCA being available on the FMV of assets acquired in an asset purchase, the availability of an election to avoid paying GST/HST on the asset purchase, and the restrictions on losses after an acquisition of control. Most candidates also addressed qualitative issues, such as the potential for hidden liabilities in a share purchase and the ability to "pick and choose" which assets TMB would like to acquire in an asset purchase.

Strong candidates typically addressed the same concepts (CCA on FMV, GST/HST election, and loss restrictions), but had better discussions of the loss restrictions, clearly understanding that the losses could be claimed by DI because it plans to continue its existing business with a reasonable expectation of profit. Strong candidates also usually considered the GST/HST impacts on both alternatives, and often identified that there would be goodwill acquired, which would be eligible for CCA in Class 14.1.

Weak candidates often approached this AO from the incorrect perspective (that of the seller rather than the buyer), and those who had the correct perspective still struggled to identify the difference between asset and share purchases, and often demonstrated significant technical errors while attempting to do so. Weak candidates frequently stated that losses and donations would transfer to the acquirer in an asset purchase, or suggested that DI's non-capital losses could be used by TMB (without providing any planning suggestions, which would be necessary in order to achieve such a result).

AO#10 (Employee relocation)

Candidates were told that an employee, Krzysztof, will be given several employee benefits related to a potential relocation, and were asked to evaluate the income tax and GST/HST consequences for both Krzysztof and TMB. In Appendix VIII (Taxation), candidates were provided with additional information about Krzysztof's expenses, and were told that, while residing in Halifax, Krzysztof and his spouse will rent their Vancouver home to a third party, and would like advice on the tax implications of doing so. To demonstrate competence, candidates were expected to discuss in some depth the issues associated with Krzysztof's move (moving expense benefit/deduction, change-in-use from principal residence to rental property, and housing allowance / workspace-in-the-home expenses).

Candidates performed adequately on this AO. Most candidates discussed the moving expenses, usually explaining that, since the move was greater than 40 kilometres and required for work, Krzysztof would be able to deduct moving expenses in excess of the reimbursement paid, and that the reimbursement would not be taxable. They often made errors on the house-hunting expenses (either saying that the reimbursement would be taxable, which is incorrect, or that the remaining expenses could be deducted by Krzysztof, which is also incorrect). Most candidates attempted to discuss either the change-in-use rules or the housing allowance, but often did not provide much depth in either (for example, only identifying that the housing allowance would be taxable without identifying the ability to deduct work-from-home expenses). Most candidates discussed the deductibility of expenses by TMB or the GST/HST implications.

Strong candidates usually discussed the moving expenses correctly, addressing not only the eligible move criteria and the moving expenses generally, but also the house-hunting expenses and other items, such as meals and the damage deposit. They identified that there would be a change in use, which would lead to a deemed disposition of the home at FMV, which would be eligible for the principal residence exemption, and that an election was available to defer the deemed disposition. Strong candidates also explained that the housing allowance would be taxable, and could be offset by claiming home office expenses. They also discussed the deductibility of expenses by TMB and the GST/HST implications.

Weak candidates discussed the moving expenses, often stating that the reimbursements would be taxable to Krzysztof (which is incorrect), and identifying that he would be able to deduct moving expenses against this. Weak candidates often did not address the change in use or the housing allowance, or at most only identified that the rental income Krzysztof earned would be taxable. They rarely attempted to discuss the implications of these benefits for TMB.

AO#11 (Shareholder loans – BDFH)

Candidates were asked to help Rita and Conrad understand the implications of the shareholder loans issued to several family members from BDFH, a private, family holding company. In Appendix VIII (Taxation), candidates were provided with the dates, amounts, and purpose of three different shareholder loans. To demonstrate competence, candidates were expected to correctly discuss the tax treatment of the principal of a shareholder loan, and to discuss some of the other issues that were specific to the loans (such as the automobile exception, the timing of inclusion, the impact of the tax on split income (TOSI), or the deemed interest benefit).

Candidates performed adequately on this AO. Most candidates attempted to discuss the loans, although they often skipped one (not any one in particular) and only addressed two. They usually understood that there was generally an income inclusion required for loans taken by shareholders, and that there was an exception for when the loan is paid back within specific time periods, although many struggled to correctly identify those time periods. Most candidates attempted a discussion of the imputed interest benefit, although many struggled to apply the rules correctly.

Strong candidates discussed all three loans, and clearly identified the time required to repay the loan in order to avoid income inclusion, concluding correctly that Conrad had missed that window of opportunity. They also looked for other exclusions for Conrad (such as the employee automobile exception), explaining why they would not be available. Strong candidates also considered the impact of the deemed interest benefit for each of the three loans.

Weak candidates often only discussed shareholder loans in general (not the specific loans presented to them). Those who did attempt to discuss the specific loans often only addressed one or two, and usually made technical errors (such as using the wrong timing for the exception for repayment). They also often misapplied case facts, for example, failing to realize that Conrad is not an employee of BDFH and is therefore not eligible for the employee exception. Weak candidates often got the deemed interest benefit rules backwards, by stating that there would be an interest inclusion for the loans where the principal was included, and no interest inclusion if the loan principal was excluded.

AO#12 (Shareholder remuneration – BDFH)

Candidates were asked for advice on how to structure future cash distributions from BDFH. Rita and Conrad further asked whether dividends or salaries could be paid to their children (aged 21, 18, and 15) if they were made shareholders. Candidates were also told that the couple would like to distribute $2 million from BDFH over the next three years. Additional information about BDFH, including many of its tax balances, was provided in Appendix VIII (Taxation). To demonstrate competence, candidates were expected to address the tax treatment of some of the forms of distribution (such as CDA, PUC, eligible dividends, and other-than-eligible dividends), and to provide additional value by discussing the TOSI, using the case facts to recommend a strategy, or calculating the impact of the distributions.

Candidates performed adequately on this AO. Most candidates provided explanations of the basic concepts of dividend taxation, often focusing on the capital dividend account and the eligible dividends, skipping over the paid-up capital account and other-than-eligible dividends. Some attempted to provide a prioritized list of what to pay to Rita and Conrad, in what order, but many did not. Most candidates also attempted a discussion of payments to the children, but struggled to apply these concepts to the specific situation in the case (for example, failing to understand that BDFH did not have an active business and therefore could not justify salaries to the children, or meet any of the excluded business exceptions to TOSI).

Strong candidates generally discussed several of the potential forms of distribution to Rita and Conrad. They often focused on the capital dividend account, eligible dividends, and other-than-eligible dividends, and linked the latter two to the RDTOH and GRIP accounts. Strong candidates provided a clear recommendation for how to distribute the $2 million that the client asked about. They also usually discussed TOSI in the context of the children, concluding correctly that it would likely apply to any dividends paid to them, and rejected the possibility of salaries due to BDFH being a passive holding company.

Weak candidates often simply provided a generic discussion of the technical treatment of salaries versus dividends, completely ignoring the nature of BDFH and concluding, for example, that salaries would be deductible against the income earned by the corporation. If they attempted to discuss payments to the children at all, weak candidates generally did not consider the nature of BDFH's income, and made inappropriate recommendations (such as hiring the children to work for BDFH and deducting their salaries from BDFH's income).

AO#13 (Estate planning)

Candidates were asked for a summary of the tax consequences of Rita and Conrad's proposed plans to gift shares of TMB to their children, and to leave shares of TMB, and other assets, to their children in their wills. In Appendix VIII (Taxation), candidates were provided with details of the three assets in question (TMB shares, RRSPs, and a family home). To demonstrate competence, candidates were expected to discuss the deemed disposition at FMV of the gifted shares, along with some of the other issues (including at least an attempt at the implications of death).

Candidates performed adequately on this AO. Most candidates identified that there would be a deemed disposition of TMB shares at FMV at the time of gifting, although they usually did not go very far beyond this to discuss the implications of the gifting to the children after receiving the shares. Most candidates attempted to discuss the rules applicable at the time of death of Rita and Conrad, although many struggled to deal with the implications of holding RRSPs and a principal residence at the date of death (often making technical errors, such as suggesting that there would be a capital gain on the RRSP).

Strong candidates identified that there would be a deemed disposition of TMB shares at FMV at the time of gifting, and that the FMV would also be used by the children as their adjusted cost base. They also identified the implications for attribution of future dividends or capital gains from TMB. Strong candidates discussed the basic principles of what happens at the time of death, usually clearly indicating that the full RRSP is included in income at the death of the second spouse, and that the principal residence exemption would be available on the family home.

Weak candidates often only attempted one of the two areas in this AO (gifting or death). Those who addressed gifting often made technical errors, suggesting that there would be double taxation, or mixing up the attribution rules with the TOSI rules by suggesting that the children could work for TMB in order to avoid attribution. Those who addressed the death of the taxpayers generally made multiple technical errors, stating that the RRSPs would give rise to capital gains, the family home would be taxable at the time of death (without identifying the principal residence exemption), or that the children (who were the beneficiaries) would be personally taxable on the various assets they received.

BOARD OF EXAMINERS' COMMENTS ON DAY 3 SIMULATIONS

Paper/Simulation:	**Day 3, Case 1 (STH)**
Estimated time to complete:	90 minutes
Simulation difficulty:	Average
Competency Map coverage:	Financial Reporting (1); Management Accounting (2); Strategy and Governance (1); Finance (1); Audit and Assurance (1); Taxation (1)

Evaluators' comments by Assessment Opportunity (AO)

AO#1 (Investment property) (Fin Rep)

Candidates were asked to account for a recently purchased commercial property under IFRS. Information regarding this property was provided in Appendix I, including how the company planned to use the property, the original purchase price, and its value as at June 30, 2022. To demonstrate competence, candidates were expected to recognize that the property needed to be accounted for as an investment property, and to discuss the accounting policy choices available to STH under *IAS 40 – Investment property* (i.e., cost model or fair value model). Using the case facts provided, candidates were expected to make a supported conclusion as to which subsequent measurement option to choose.

Candidates struggled on this AO. The majority of candidates recognized that IAS 40 was the correct Handbook section to apply, and identified the two options available for subsequent measurement. However, candidates struggled to incorporate case facts into their recommendation of which model to adopt going forward. Many candidates concluded on which model to choose without much explanation, for example, concluding that the fair value model would be better without explaining what impact this choice would have on the financial statements or the users. Many candidates also recommended using the fair value model, simply because the information on fair value was already available, which was not strong enough support for justifying the use of that model. Some candidates appeared confused as to which Handbook section to apply and attempted to apply *IAS 16 – Property, plant and equipment* instead of *IAS 40 – Investment property*, often leading them to conclude that the property should be recorded as PP&E at cost and amortized over its useful life, without further analysis.

Strong candidates discussed the models in greater depth, clearly explaining the difference between the two, and often identifying the adjustments necessary for valuing the property at fair value as at June 30, 2022. Many strong candidates correctly calculated the amount of depreciation that would need to be taken under the cost model. Strong candidates also concluded on which option made the most sense in the context of the scenario by referring to the users' needs, often considering the potential IPO, or the bank covenants that STH will be subjected to.

Weak candidates either did not identify the two options available for the subsequent measurement of the property or provided a weak analysis of the options. Some of them incorrectly assumed that the investment property was to be assessed using *IAS 16 Property, plant and equipment*, while others attempted to discuss the accounting treatment of the property using *IFRS 5 – Non-current assets held for sale*, neither of which were appropriate in the scenario presented. Some weak candidates mistakenly used ASPE instead of IFRS.

AO#2 (Costing methods) (Mgmt Acct)

Candidates were asked to calculate the full absorption cost and gross margin of order #178 and, for an additional 10 identical orders that the client is willing to place if the selling price is reduced, to establish the lowest selling price that will allow STH to recover its costs and not lose money. Information necessary for calculating the cost and lowest selling price was presented in Appendix II, which contained tables and graphs showing the materials and labour used in the orders, as well as information on the different production overhead components. To demonstrate competence, candidates were expected to perform a reasonable calculation of the absorption cost of order #178, and of the lowest selling price for the additional orders, considering that there was no capacity constraint.

Candidates performed poorly on this AO. While most candidates were able to incorporate the simpler costs (direct materials, labour, and utilities) into their calculation, they struggled to incorporate costs such as the rent and depreciation, which needed to be prorated using different bases. In addition, many candidates came up with their own basis for allocating these costs, such as the contract value or the number of orders, which were weaker bases to use in this case, whereas other candidates simply did not prorate the amounts for depreciation and rent. Most candidates failed to identify how the lowest selling price would differ from the absorption cost for the order, and simply recommended using the absorption cost for the additional orders. Most candidates also did not understand that the lowest selling price should not consider the fixed costs, as they will be incurred regardless of whether the additional orders were obtained, since no capacity constraint existed.

Strong candidates calculated the full absorption cost of order #178 and incorporated most of the relevant costs provided in the case. In addition to the common adjustments attempted (direct material, labour, and utilities), they incorporated the different overhead costs (rent and depreciation) using an appropriate basis, such as the square footage of the wood used, or the space used by the shop, depending on the specific cost that they were allocating. Strong candidates also performed a calculation of the lowest selling price, which included relevant variable costs and excluded fixed costs. Strong candidates concluded on a lowest selling price that was lower than the absorption cost. These candidates clearly demonstrated their understanding of the difference between the absorption cost and the lowest selling price in their calculations, and many of them were able to provide an explanation for why fixed costs were excluded from the lowest selling price calculation.

Weak candidates either only included direct materials and direct labour in their calculation of the full absorption cost, or simply included all the numbers provided in the case without any proration or consideration of whether these costs should be included. Weak candidates concluded that the full absorption cost should be used as the lowest selling price for the additional orders, which demonstrated that they did not understand the difference between the two.

AO#3 (Operational weaknesses) (Mgmt Acct)

Candidates were asked to discuss any operational weaknesses identified in the company's processes, and recommend improvements. In Appendix III, candidates were provided with a website excerpt that included the steps customers had to take for ordering stairs, as well as online user reviews. In addition, information was provided on the first page of the case about issues that the company was having with its ordering and delivery processes. To demonstrate competence, candidates had to identify some of the weaknesses in the processes, and provide recommendations for improving them.

Candidates struggled on this AO. Many candidates identified some weaknesses in the ordering and delivery processes, discussed how they affected STH, and proposed recommendations to improve them, most often discussing the product availability, website security, and the timing of delivery. However, most candidates were unable to identify the root cause of the problem. For example, many candidates solved the issue of customers having to process their order multiple times because the products selected were not in stock by recommending that the website be frequently updated with quantities in inventory. Although this would solve the issue identified in the user reviews, the root cause of the issue was that suppliers were not able to keep up with the higher volume. Therefore, a better recommendation would have proposed ways to solve that issue. Many candidates also tried to solve the issue of customers having to repack large boxes instead of addressing the lack of training of the packaging team, which would avoid incorrect orders being shipped in the first place.

Strong candidates clearly understood the root causes of the operational weaknesses, and were able to identify the issue at hand and provide a more meaningful recommendation. For example, strong candidates identified that the suppliers' difficulty in keeping up with STH's expansion was the root cause of the product availability problem, and recommended finding new vendors or negotiating new terms, to ensure product availability. Many strong candidates also addressed the lack of training of the new employees in the warehouse, and suggested that the company concentrate its efforts on training in order to avoid mistakes in the order deliveries.

Weak candidates focused on improving customer satisfaction, and as a result, their recommendations only resolved part of the issue. For instance, many weak candidates proposed hiring a customer service team to appease customers and provide better service, instead of fixing the operational problem that caused the issue in the first place (basic Internet service, supplier issues, lack of employee training). Many weak candidates provided a list of recommendations without first analyzing the cause of the issues, and their implications to STH. Weak candidates also offered recommendations that were not efficient or practical, such as manually updating the inventory available a few times a day in order to be able to display it on the website.

AO#4 (Audit committee) (Strat and Gov)

Candidates were asked to review the current audit committee composition and the appropriateness of its current mandate, and provide recommendations. The first page of the case mentioned that the company is now working with Canal Venture Capitalists (CVC), who are going to help take the company to the next level, and eventually take it public. Information about the current composition of the audit committee and its mandate was provided in Appendix IV. To demonstrate competence, candidates were expected to discuss some of the issues with STH's current audit committee composition and mandate.

Candidates performed adequately on this AO. Most candidates were able to provide some valid discussions; however, a surprising number of candidates chose to provide a general (and often generic) description of the ideal composition of an audit committee in terms of independence, rather than focusing on the case facts presented with regards to the current members of the audit committee. Candidates were most comfortable identifying the lack of independence of Renata and Rafael, but they often did not go beyond saying that there was a conflict of interest for Renata, or risk of self-review for Rafael, to explain why this would be the case. Many candidates appropriately recognized that it was the role of the audit committee to provide oversight, and provided examples of how that could be done, such as a frequent review of the financial statements or review of the internal control function. Many candidates missed the opportunity to recognize the fact that CVC would require a stronger audit committee for the upcoming IPO.

Strong candidates provided a more thorough analysis of the current members of the committee by explaining why there was a lack of independence and assessing their financial literacy, often addressing Renata's lack of independence because she is Rafael's sister, and addressing her financial literacy as a CPA. Strong candidates identified the tasks in the current mandate that were not appropriate for an audit committee to perform, and provided recommendations for how to improve the mandate in the event that the company proceeded with an IPO, such as providing an oversight of controls or performing a quarterly review of the financial statements. Strong candidates suggested having whistleblower complaints reviewed by an impartial third party that is not the CEO, and having those complaints reviewed when they are submitted rather than only periodically, explaining why this was important. As a result, strong candidates demonstrated their understanding of the appropriate composition of an audit committee, and addressed the tasks that it should perform.

Weak candidates only provided generic discussions of the composition of an audit committee without addressing any concerns related to STH's current audit committee composition. For example, many weak candidates mentioned that the audit committee should have all independent members, but did not address whether the current members were independent. Weak candidates also did not provide good coverage of the issues to be addressed, many of them only addressing one of the issues. Weak candidates struggled with the audit committee mandate, as many claimed that the audit committee should be involved in day-to-day operations in order to implement controls, which indicated that they misunderstood the role of an audit committee, perhaps mistaking it for an internal audit department. Many candidates had generic discussions about the mandate of the committee, stating that they should review financial statements more frequently, without explaining why. In addition, weak candidates did not identify how unethical it was for the whistleblower complaints to be reported to the CEO, and simply suggested having the complaints sent to the human resources department, without explanation. Finally, many weak candidates got confused, and discussed the ideal composition of a board of directors rather than an audit committee.

AO#5 (Bank covenants) (Fin)

Candidates were told that CVC had concerns about the new covenants that the bank required the company to meet. They were asked whether the company would have been in compliance as at December 31, 2021, and to note any areas of concern that STH could adjust going forward, to comply with the covenants. The covenants, along with a table with the relevant financial information, were provided in Appendix V. To demonstrate competence, candidates had to perform a reasonable analysis of the covenants, covering both financial and non-financial aspects, to assess whether they were met.

Candidates performed adequately on this AO. Most candidates calculated the financial covenants with only minor errors, and provided a conclusion on the compliance with the covenants. Most candidates attempted a qualitative discussion on the non-financial covenants related to the cybersecurity breaches or the unmodified audit report within 90 days, but their analysis was not supported by case facts. For example, these candidates simply mentioned that 90 days was a short length of time for providing an audit report, without mentioning that this would be STH's first audit, and an unmodified audit report might be an issue with opening balances that had never been audited before. Candidates more frequently attempted to calculate the working capital ratio and the debt-to-equity ratio than the bank loan to EBITDA ratio, with this last ratio requiring a more complex calculation than the first two.

Strong candidates calculated all three financial covenants correctly, and provided a conclusion on whether each covenant was met that was consistent with their calculation. Strong candidates also addressed the non-financial covenants by using case facts to support their discussion, such as referring to the phishing emails incident that occurred in June when discussing the covenant related to the cybersecurity breaches, and explaining how the unmodified report might be difficult to obtain since STH's opening balances had never been audited before. Many strong candidates provided advice on how to improve the covenants in the future.

Weak candidates attempted to calculate the covenants but made significant errors in their calculations, such as not incorporating the correct components, inversing the nominator and the denominator in the ratio, or not properly adjusting the EBIDTA for interest and depreciation. Weak candidates did not conclude on their analysis, or provided a conclusion that was inconsistent with the ratio calculated, for example, calculating a debt-to-equity ratio of 1.37 and incorrectly concluding that it was not met because it is under 2.1. These candidates were unable to interpret the results of the ratios. Weak candidates also provided generic comments about the non-financial covenants related to the cybersecurity and the unmodified audit report, for example, mentioning that an audit report will have to be issued quickly, without explaining how this could be an issue for STH.

AO#6 (Audit procedures) (Assu)

Candidates were told by Claudia that STH will be audited for the first time for the December 31, 2022, year end and were asked what procedures the auditors are likely to perform on revenue, inventory (i.e., raw materials, work-in-progress, and finished goods), and the bank loan. To demonstrate competence, candidates were expected to provide some procedures that would address the specific risks related to the areas mentioned.

Candidates performed adequately on this AO. Most candidates provided a sufficient number of procedures that appropriately addressed the risks in the areas mentioned. The most commonly addressed procedures were the simpler ones, such as testing revenue through examining shipping documents, performing an inventory count, and sending out a bank loan confirmation.

Strong candidates provided precise procedures that included specific and clear audit evidence, demonstrating that they knew what documentation was needed, to get comfort on the balance being audited. They provided enough details in their procedure to demonstrate exactly how they would perform the work. Strong candidates offered multiple procedures per area, for example, providing procedures for raw materials, work-in-progress, and finished goods. They also attempted more complicated procedures, such as the rollback on inventory, allocation of direct material and labour to work-in-progress, or the net realizable value of finished goods. Strong candidates provided procedures that not only tested the amount of the transaction, but also addressed cut-off, depreciation, and other aspects of the balance being audited. Strong candidates suggested procedures that were efficient, i.e., that gathered the highest level of evidence, such as vouching to documents from external sources.

Weak candidates provided procedures that were vague, for instance, reviewing invoices to check revenue, without explaining how they would select the invoices, or what they would trace them to. Weak candidates attempted fewer procedures overall, and as a result, fell short in terms of the breadth of their response. Weak candidates also provided procedures that did not include valid source documents that were external to the company, for example, often referring to internal invoices to assess occurrence.

AO#7 (Taxable income) (Tax)

Candidates were told that the company was late with its 2021 tax return, and were asked to calculate the company's taxable income. The company's income statement for the year ended December 31, 2021, was provided in Appendix VI. Additional details about STH's expenses, capital assets for the period, and ending undepreciated capital cost (UCC) balances as at December 31, 2020, were also provided. To demonstrate competence, candidates were expected to perform a calculation of taxable income, including a calculation of the capital cost allowance (CCA).

Candidates performed adequately on this AO. Most candidates calculated taxable income, considering most of the easier adjustments, such as depreciation, meals and entertainment, and golf dues. Most candidates also incorporated a CCA calculation into their taxable income. Most candidates were able to sort the addition of furniture and computers, and the disposals of the vehicle and delivery trucks, into the right CCA class; however, most candidates struggled with applying the terminal loss rules to the delivery trucks sold. Some candidates chose to apply the half-year rule to the additions instead of the accelerated investment incentive, which showed that they were not as comfortable with this CCA concept.

Strong candidates calculated CCA and taxable income, including most of the easier adjustments as well as some of the more difficult CCA concepts, such as the accelerated investment incentive and the sale of the assets in Classes 10 and 10.1 in the final year of disposition, and demonstrated that they understood the difference between the two classes. Strong candidates were also able to correctly classify the addition of manufacturing equipment in Class 53, which is more difficult as it was not provided in the opening UCC balance table provided, and were therefore able to demonstrate more breadth of knowledge.

Weak candidates attempted to calculate taxable income and CCA, and most of them correctly treated the easier income adjustments, such as golf dues and meals and entertainment. However, they often made errors in their CCA calculations, commonly placing additions and disposals in the wrong CCA classes, or misapplying the accelerated investment incentive. Weak candidates often omitted calculating CCA on the opening UCC balances, and instead only calculated CCA on the additions in the year. Other weak candidates applied the accelerated investment incentive to the opening UCC balances in addition to, or instead of, applying it to the additions for the year.

Paper/Simulation:	**Day 3, Case 2 (TFS)**
Estimated time to complete:	75 minutes
Simulation difficulty:	Average
Competency Map coverage:	Taxation (1); Strategy and Governance (1); Finance (1); Management Accounting (1); Audit and Assurance (1); Financial Reporting (1)

Evaluators' comments by Assessment Opportunity (AO)

AO#1 (LCGD and QSBC share criteria) (Tax)

Candidates were asked to explain to Tamara what the lifetime capital gains deduction (LCGD) is, whether Tamara could use it on the sale of shares of TFS to John and Scott, and what could be done to ensure that her shares are qualified small business corporation (QSBC) shares when the time comes to sell. In Appendix I, candidates were provided with TFS's balance sheet, with a note that explained the reason for the significant cash balance. To demonstrate competence, candidates were expected to demonstrate sufficient knowledge in discussing the lifetime capital gains exemption, analyzing the QSBC criteria, and providing advice on how to ensure that Tamara's shares are QSBC shares in the future.

Candidates struggled with this AO. Most candidates were able to explain what the LCGD is; however, they struggled with the identification of the QSBC criteria, and application of the criteria to TFS's specific situation. When candidates identified some of the QSBC share criteria, they most commonly discussed the 24-month ownership period. Many candidates discussed incorrect criteria, such as the criteria to qualify for the small business deduction instead of the criteria to qualify as a small business corporation. Candidates rarely attempted a calculation to assess whether TFS's assets met the 90% fair market value test, and rather stated the criteria without much analysis. Many candidates ignored the request to provide advice on how TFS could continue to qualify as a QSBC, and when advice was given, it was often not well explained and/or generic. For example, some candidates mentioned that TFS should purify its assets, without explaining what that meant or how to do it.

Strong candidates provided a more in-depth explanation of what the LCGD is; for example, many explained that it can be deducted from taxable capital gains, and that the LCGD is claimed at 50% of the lifetime capital gains exemption limit. Strong candidates identified all of the QSBC share criteria, and most of them applied relevant case facts to many of the criteria. These candidates usually provided a calculation of the fair market value of the assets used in active business, and a supported discussion of whether the cash held by TFS could be considered active. Many strong candidates provided advice on how Tamara's shares could continue to qualify as QSBC shares; however, the advice was sometimes incomplete. For example, some candidates mentioned that the short-term investments should be sold, without realizing that this would create inactive cash in the company and would therefore not reduce the amount of inactive assets held by TFS, and that subsequent steps had to be taken to purify TFS's assets.

Weak candidates provided a definition of what the LCGD is by stating that the limit is $913,630, with no further explanation. Many weak candidates did not include any case facts in their analysis of the QSBC criteria, simply stating the criteria and mentioning that TFS should follow them. Many weak candidates applied incorrect criteria, for instance, using the small business deduction criteria and incorrectly explaining that TFS needs to have income of less than $500,000 and taxable capital of less than $10 million. Many weak candidates focused on the criteria requiring Tamara to be a resident of Canada, and that operations need to be in Canada, and skipped the discussion of the other QSBC criteria, which required more analysis.

AO#2 (Broader considerations on the sale of shares) (Strat & Gov)

Candidates were asked whether there were any broader considerations that Tamara should factor in when deciding whether to sell shares to John and Scott. Candidates were expected to draw on the general information provided regarding how Tamara runs her business, and compare it to information provided in Appendix II on John and Scott's ideas for TFS. They were expected to discuss considerations such as customer interaction, automation, time invested, and closing of the Feed division. To demonstrate competence, candidates were expected to identify the conflict between Tamara's way of doing business and John and Scott's ideas, and discuss some of the specific considerations.

Candidates performed adequately on this AO. Most candidates discussed several of the issues related to John and Scott's vision for the business, explained how they did not align with Tamara's current way of operating, and analyzed the impact that these misalignments could have for Tamara. Many candidates also discussed the fact that Tamara was going to lose control of her business, or provided a discussion about the challenges of moving from being a sole shareholder to working with two other shareholders. However, most candidates did not link these two issues together, and therefore did not realize that, because Tamara was losing control of TFS, John and Scott were going to be able to implement any new ideas that they agreed upon, regardless of whether they aligned with Tamara's vision.

Strong candidates discussed multiple issues, supporting their analysis with case facts. These candidates explained the impact of the changes that John and Scott were planning to make, and how these changes differed from the way that Tamara was used to running her business. Some strong candidates recognized the conflict between Tamara's vision and John and Scott's vision, and linked it to her losing control of TFS and being unable to influence the direction in which the new owners would take the company. These candidates were able to see the big picture, and bring the potential conflicts and challenges to Tamara's attention.

Weak candidates provided a generic discussion of the misalignment of John and Scott's ideas with Tamara's ideas, without explaining the impact of this misalignment, or using case facts to support their discussion. Some weak candidates focused on the issue of voting control and ignored the misalignment of visions, while others focused on the more operational issues, such as the fact that Tamara would need to share her income with John and Scott, or whether to pay salaries or dividends to John and Scott. While these were valid considerations, there were bigger, more important, issues to address before Tamara could decide whether to sell shares to John and Scott.

AO#3 (Comments on financing proposal) (Fin)

Candidates were told that Tamara is considering personally loaning John and Scott a portion of the selling price. Candidates were then asked to suggest any improvements to the financing proposal. Information on the terms of Tamara's financing proposal was provided in Appendix II. To demonstrate competence, candidates were expected to analyze some of the terms of the proposal, and provide recommendations on how the proposal could be improved.

Candidates performed adequately on this AO. Most candidates identified and discussed a sufficient number of issues with the proposal, and provided relevant, supported recommendations on how to improve the proposal, most often discussing the lack of security and the 20-year term of the proposal. Candidates were not as comfortable discussing the interest rate in relation to the market rate, or the priority of payments between Tamara's loan and the bank loan.

Strong candidates discussed many areas of the proposal and provided an in-depth analysis of the issues. In their explanation of the issues with the proposal, strong candidates brought in more insightful factors to consider. For example, when discussing the term length, some strong candidates pointed out that Tamara was hoping to be paid back sooner than the term indicated in the proposal, or when discussing the interest rate being lower than the bank rate, they explained the consequences to Tamara of providing a lower rate. In addition to explaining how the issues would impact Tamara, strong candidates also provided clear recommendations on how to improve the proposal.

Weak candidates usually only discussed one issue with the proposal, often the fact that no security was required in the current proposal. Many weak candidates did not understand some of the case facts, such as what a blended monthly payment is. Some weak candidates provided a list of recommendations without any explanation of what the issues were with the current financing proposal. For example, these candidates recommended having a higher interest rate and a shorter term, without providing any rationale for their recommendation. Some weak candidates discussed irrelevant topics, for example, incorrectly noting that John and Scott would have an imputed interest benefit because the interest rate was lower than the market rate, which was not relevant to Tamara. Weak candidates focused on the wording of the proposal, rather than on its content, which demonstrated a lack of technical knowledge. For example, some candidates suggested indicating the actual payment amount, instead of stating that they were blended monthly payments. Other weak candidates confused the case facts and analyzed the proposal as if TFS was lending the funds to John and Scott, rather than Tamara.

AO#4 (Divisional allocation) (Mgmt Acct)

Candidates were asked to finalize the divisional allocations of revenues and costs that Gary did not complete. In addition, candidates were asked to provide their opinion on whether the Farm Supplies division was as profitable as the other two divisions. The draft divisional income statement, along with Gary's notes on the required adjustments, was provided in Appendix III. To demonstrate competence, candidates were expected to revise the divisional income statement, allocating some of the items noted across the relevant divisions.

Candidates performed well on this AO. Most candidates were able to revise the divisional income statement, performing a sufficient number of correct adjustments. Most candidates correctly allocated the sales and cost of sales of the seeds to the relevant divisions. Most candidates attempted to calculate the adjustments related to the salaries and fuel, but many of them either had errors in their calculations, or only allocated the expense without first removing it from the Farm Supplies division. Many candidates struggled to calculate the allocation of Tamara's salary and the fuel.

Strong candidates clearly understood how to approach this calculation by correctly removing the expense from the Farm Supplies division before allocating it to the other divisions. Strong candidates provided more correct adjustments to the divisional income statement. These candidates provided better calculations, most of them being able to correctly calculate either the fuel or the salary adjustments.

Weak candidates made many errors in both the calculation of the adjustments, and in the technical understanding of how to approach a calculation that was already partially complete. Many weak candidates calculated the expense for each division and proceeded with the allocation to all three divisions, not understanding that those expenses were already included in the Farm Supplies division. Weak candidates lacked an understanding of how to use the information provided to allocate the costs. For example, many candidates allocated the total vehicle expense that was included in the Farm Supplies division across all of the divisions based on a percentage of kilometres, not understanding that they were expected to allocate the fuel expense only. Other weak candidates allocated Tamara's salary evenly to all three divisions, ignoring the case fact regarding the number of hours worked, which was meant to be used to determine the allocation of her salary to each division.

AO#5 (Control weaknesses) (Assu)

Candidates were told that Tamara had become concerned that there may be several weaknesses in TFS's accounting processes. Candidates were asked to discuss the control weaknesses identified and recommend improvements. Information regarding TFS's control environment was provided in Appendix IV. To demonstrate competence, candidates were required to identify some of the control weaknesses, explain their implications, and provide recommendations.

Candidates performed well on this AO. They were able to demonstrate breadth by identifying a sufficient number of control weaknesses, recognizing the implication of those weaknesses to TFS, and discussing improvements that TFS could implement. Candidates typically addressed several control weaknesses, often choosing to apply a weakness, implication, recommendation structure, which was effective in this case. Candidates were most comfortable discussing the use of multiple systems, the issues with the accounts payable process, and the lack of review of the bank reconciliations.

Strong candidates discussed more control weaknesses, explained their implication to TFS in greater depth, and provided a recommendation for addressing each control weakness. Strong candidates provided complete explanations of the implications; for example, instead of just noting that a manual bank reconciliation could lead to errors, they explained that, because there are many transactions to enter, there is a greater chance of error when completing the reconciliation. In addition, strong candidates made specific, practical recommendations, and provided a broad coverage of areas of the accounting process.

Weak candidates often did not explain the implication of the control weaknesses identified, or did so in very vague terms. For example, many weak candidates noted that an implication of many of the weaknesses would be fraud, without explaining how fraud could occur. Weak candidates also spent time discussing processes that were not problematic, and as a result, provided discussions that were of limited use to Tamara. For example, many weak candidates recommended that the person who signs a cheque should not be the same person who reviews the supporting documentation. These candidates failed to realize that it would actually be an issue if the person who signs the cheque did not also review the cheque's supporting documentation. Many weak candidates provided recommendations that were not always practical, such as integrating the point-of-sale system to the accounting system, even though the case clearly stated that this was not possible.

AO#6 (Inventory) (Fin Rep)

Candidates were asked whether the inventory balance needed to be adjusted in the October 31, 2022, financial statements. Information regarding the inventory issues was found in Appendix V, and information regarding the shipping terms (FOB destination) was found in the additional information section of Appendix III. To demonstrate competence, candidates were required to discuss some of the inventory issues in sufficient depth.

Candidates performed poorly on this AO. Most candidates provided a good discussion of the issue related to the damaged seed inventory, referring to the guidance in *ASPE 3031 - Inventories*, supporting their discussion with relevant case facts, and concluding that the inventory needed to be written down to the lower of cost and net realizable value. However, candidates either did a poor job of discussing the issue related to the feed inventory in transit at year end and the additional storage costs incurred, or ignored these issues altogether. When the feed inventory was discussed, many candidates approached the issue from a revenue recognition perspective and did not conclude on whether the inventory should be removed from the balance sheet at year end, although Tamara had specifically asked whether the inventory balance needed to be adjusted in the October 31, 2022, financial statements. When discussing the feed inventory in transit at year end, few candidates integrated the information provided earlier in the case, that the company ships all its products FOB destination, which limited the depth of their analysis. When discussing the storage costs, many candidates provided a conclusion without any Handbook support or analysis. On both the feed inventory issue and the storage cost issue, candidates demonstrated a lack of technical understanding of financial reporting concepts tested.

Strong candidates discussed all of the inventory issues, appropriately supporting their analysis with case facts applied to the Handbook guidance. Most strong candidates provided an in-depth analysis of both the feed inventory in transit at year end and the storage costs. For example, instead of just noting that the inventory was not delivered, strong candidates explained that, when a company ships FOB destination, risks and rewards of the inventory do not transfer until they reach the client, and therefore, because of the delay in delivery, TFS still had control over the inventory at year end. In addition, strong candidates explained that, because the storage costs incurred were not part of the production process, and were rather a cost after production was complete, they could not be added to inventory and should be expensed, as stated in the Handbook.

Weak candidates only attempted to discuss the issue related to the damaged seed inventory. Many weak candidates had errors in their understanding of cost and net realizable value, and suggested that a write-down needed to be done from the $60,000 previous selling price to the cost of $42,000, rather than suggesting to write down the cost of $42,000 to the net realizable value of $15,000 ($60,000 × 25%). Other weak candidates misunderstood the case facts and calculated the recoverable amount as 25% of the original cost, rather than 25% of the original selling price. When attempted, the discussion of the accounting treatment of the feed inventory in transit at year end was generally poorly done, as many weak candidates provided a conclusion without any technical analysis or case facts to support their discussion. For example, many weak candidates concluded that, because delivery had not occurred, revenue could not be recorded, without any analysis or Handbook support. Many weak candidates addressed the issue with the $1,000 of storage costs, and missed the underlying issue of whether the feed inventory should be included in the year-end balance. Many weak candidates incorrectly concluded that the storage costs were incurred to bring the inventory to its present location and condition, and therefore, should be included in the cost of inventory, demonstrating a technical weakness in their understanding of inventory costing.

Paper/Simulation: **Day 3, Case 3 (Brokers)**

Estimated time to complete: 75 minutes

Simulation difficulty: Average

Competency Map coverage: Financial Reporting (1);
Finance (1);
Management Accounting (1);
Audit and Assurance (1);
Taxation (1);
Strategy and Governance (1)

Evaluators’ comments by Assessment Opportunity (AO)

AO#1 (Software costs) (Fin Rep)

Candidates were asked to provide advice on how to account for the costs related to the custom software that Brokers had developed. Appendix I presented information on the phases of the project, including dates and details of the costs incurred. To demonstrate competence, candidates were expected to analyze the accounting treatment of the software costs using *ASPE 3064 - Goodwill and intangible assets*, and allocate the specific costs provided in the case to the research and development phases.

Candidates performed well on this AO. They appeared familiar with the guidance on intangible assets, and the criteria for internally-generated intangible assets. Most candidates demonstrated that they knew the difference between the research phase and the development phase, and what the accounting treatment was for the costs incurred in each phase. Most candidates were also familiar with the criteria for internally-generated intangible assets, and provided an analysis that was supported by case facts to explain whether each criterion was met. Of the possible areas of discussion, candidates performed best on allocating the specific costs presented in the case between the research and development phases.

Strong candidates provided a discussion of most of the applicable sections of ASPE 3064 before allocating the costs that had been incurred. For example, most strong candidates first analyzed the definition of an intangible asset, as well as the general intangible asset recognition criteria, before moving on to discuss the internally-generated intangible asset recognition criteria. Strong candidates used case facts to support whether the definition and/or the recognition criteria were met. Many strong candidates also explained the difference between the research and development costs, as well as their respective accounting treatment. Strong candidates used their internally-generated intangible asset analysis to classify each cost incurred to either the research or development phase, and most of them recognized that the $24,000 paid for IT support was not part of either of those phases and must be expensed as incurred. Some strong candidates mentioned that, even when the criteria are met, it is still a choice to capitalize development costs.

Weak candidates either attempted to discuss fewer of the applicable sections of the Handbook or their discussion did not address all of the relevant criteria. Many weak candidates did not discuss the criteria in enough depth, lacking the integration of case facts to support their analysis, and often only stating whether the criterion was met or not. Weak candidates often jumped to a conclusion and allocated the specific costs to the research and development phases, without first analyzing whether the criteria were met in order to be able to capitalize the costs. Some weak candidates attempted to apply Handbook standards that were not relevant in this case, such as *ASPE 3061 - Property, plant and equipment*.

AO#2 (Financing options) (Fin)

Candidates were told that Brokers has the option to purchase equipment and finance it with a bank loan, or to opt for a capital lease from the vendor. Candidates were asked for their advice as to which financing option is preferable. Appendix II provided candidates with the breakdown of the equipment costs and details on the two financing options: a bank loan, and a capital lease. To demonstrate competence, candidates were expected to provide a reasonable quantitative analysis of the financing options, putting them on a comparable basis, address some qualitative considerations, and recommend an option.

Candidates performed poorly on this AO. Most candidates performed more calculations than needed, attempting to perform a present value calculation for each financing option, even though the best tool to use in this case was an internal rate of return of the capital lease, to compare it to the bank rate provided. Most candidates also did not realize that the present value of the bank loan, using the bank rate, was the value of the loan itself, which led them to perform an unnecessary calculation. When candidates chose to perform a present value calculation, their calculation was often incomplete, leaving out the down payment on the bank loan option, or the buyout amount on the capital lease. Many candidates also did not present value all the appropriate components of their calculation. For example, they would present value the monthly payments, but not the buyout at the end of the lease. In addition, most candidates ignored the fact that the lease option provided for maintenance at no additional cost, whereas the bank loan required an incremental cost for maintenance. Therefore, these candidates did not put the two options on a comparable basis, as they did not quantitatively consider the maintenance by either including the cost of maintenance in the bank loan calculation or removing it from the capital lease calculation. Some candidates did not perform a quantitative analysis at all, and instead listed the terms for the two financing options without explaining why, or how, they should be considered. Candidates also struggled to discuss qualitative factors in their analysis, choosing instead to conclude based solely on their quantitative analysis.

Strong candidates considered the maintenance cost in their quantitative analysis, usually by incorporating it into the bank loan calculation. Some strong candidates recognized that the most appropriate and efficient tool to use was a calculation of the internal rate of return of the capital lease, and compared it to the bank loan rate. These candidates saved valuable time by not performing two calculations (net present value of each option). Strong candidates provided qualitative considerations, such as the implications of the collateral or down payment, and used case facts to support their analysis, for example, pointing out that Janine and Ann had funds readily available.

Weak candidates struggled to put the two options on a comparable basis, as they did not recognize that the maintenance costs needed to be either included or excluded from both options. Weak candidates often made conceptual errors in their calculations, resulting in options that were not comparable, for example, ignoring the time value of money by simply adding up all of the costs. Many candidates provided limited qualitative analysis, often only repeating case facts without adding value. These candidates were unable to evaluate the options in a way that would be useful to Janine and Ann. Some weak candidates attempted to analyze the lease from a financial reporting perspective, trying to assess whether the lease was a capital lease, as mentioned in the case, although they were not asked to provide financial reporting advice on the lease.

AO#3 (Minimum selling price) (Mgmt Acct)

Candidates were asked to determine what the selling price for a pint of beer should be during the "stock market crash," based on Brokers' goal of never selling at a price lower than the full production cost. In Appendix III, candidates were provided with the information needed to calculate various fixed and variable costs. Candidates were also provided with the average selling price and demand for beer in downtown St. John's. To demonstrate competence, candidates were expected to calculate the minimum selling price for a pint of beer, incorporating some of the relevant variable and fixed costs.

Candidates performed well on this AO. Most candidates were able to correctly calculate several of the fixed and variable costs, to arrive at the full production cost that the minimum selling price per pint of beer during the "stock market crash" would be based on. The most common components incorporated were direct labour, direct materials, utilities, and indirect labour. Most candidates were also able to calculate the insurance and depreciation expenses to include in their calculation. Few candidates realized that the marketing and general and administrative costs needed to be excluded from their calculation. Candidates struggled the most with converting the costs provided in the case to a common basis before including them in their calculation.

Strong candidates calculated most of the variable and fixed costs from the information provided, and completed their calculations by incorporating the expected number of units produced, to arrive at a production cost per pint as their minimum selling price. Strong candidates often considered more components in their calculation, including depreciation and insurance, and some strong candidates also correctly recognized that the marketing and general and administrative expenses were to be omitted from the calculation of the full production cost. Strong candidates provided a more accurate calculation of the minimum price, considering case facts regarding the brewery's usage of the different cost components, and bringing all of the financial information on the same basis before using it in their analysis.

Weak candidates were not able to accurately integrate the case facts into their calculations, making errors such as calculating the utilities, rent, and insurance without considering their usage by the brewery, and failing to recognize that the various components of their calculation were not on the same basis, mixing up monthly costs with annual costs, costs per pint, and costs per keg. Weak candidates also failed to exclude non-production costs from their calculation, such as marketing and general and administrative costs. Many weak candidates failed to answer the required, and instead calculated a break-even price or a contribution margin, using the demand and selling price from the existing bars, rather than providing what was requested, which was a price that would cover Brokers' full production cost.

AO#4 (Audit procedures) (Assu)

Candidates were asked to discuss audit procedures that the auditors will likely perform on the software, new equipment, and capital lease. Information on the software was provided in Appendix I, and information on the new equipment and capital lease was provided in Appendix II. To demonstrate competence, candidates were expected to provide some valid procedures in these areas.

Candidates performed adequately on this AO. Most candidates provided a sufficient number of valid procedures, and were able to cover enough of the areas requested. Candidates most commonly provided procedures over the software and the new equipment, and did better with simple procedures, such as vouching to third-party documents to verify the equipment cost. Most candidates provided several procedures; however, not all of them were complete, precise, and useful. For example, some candidates proposed checking the amounts to make sure they are correct, without providing details on how to check them or what audit evidence to gather.

Strong candidates suggested several procedures that were specific, complete, and clear as to their purpose. Strong candidates focused on the specific risks relevant to the account, given the case facts presented, and their procedures were clear, explaining how to perform the procedure and what evidence would need to be gathered. Strong candidates attempted procedures beyond the simple ones, for example, explaining how they would verify whether the capitalization criteria were met for the development costs.

Weak candidates provided few procedures. They also suggested procedures that were generic and not specific to the case presented, such as recalculating depreciation based on the useful life of the equipment, which could apply to any situation. Other weak candidates provided incomplete procedures, often by only providing the purpose of the procedure they were suggesting, rather than explaining how to perform the procedure. For example, some weak candidates suggested ensuring that the lease was a capital lease, without explaining how they would do that.

AO#5 (Withdrawal of funds and tax treatment of other issues) (Tax)

Candidates were advised that the clients wanted to withdraw some funds from the company for personal use, and were asked to provide the options, and the impact of each option from a personal and corporate tax perspective. The clients also wanted to know how the various components of the software, and upcoming equipment purchase or capital lease, will be treated for tax purposes. To demonstrate competence, candidates were expected to draw on their tax knowledge in order to discuss the withdrawal options, and the tax treatment of the software and equipment purchase or capital lease.

Candidates performed adequately on this AO. They more frequently discussed the withdrawal options than the tax treatment of the software and equipment purchase or capital lease. Most candidates were able to discuss salaries and dividends as withdrawal options, but very few candidates addressed other withdrawal options, such as shareholder loans or bonuses. When discussing the salaries option, candidates most often addressed the deductibility of salaries for Brokers, and CPP and RRSP implications. When discussing the dividends option, candidates most often addressed the dividend gross up and the corresponding dividend tax credit. When candidates discussed the tax treatment of the software and equipment purchase or capital lease, they mostly addressed the lease payments and the development costs, and focused on the CCA classes that the development costs would be classified under, and how the accelerated investment incentive would affect Brokers. Few candidates were able to provide a specific analysis of the CCA classes for the equipment, or discuss the tax treatment of the research costs.

Strong candidates discussed many of the tax considerations when withdrawing funds from Brokers, providing good coverage of considerations that the clients should be aware of before deciding. Some strong candidates discussed the broader implications and recognized that, regardless of the method of withdrawal chosen between salaries and dividends, the overall tax between the individual and the corporation would be roughly equivalent, due to the concept of tax integration. Most strong candidates who addressed tax integration were able to clearly explain it. Many strong candidates provided complete discussions regarding the tax treatment of the software, and equipment purchase or capital lease, using specific information from the case. For example, they classified the equipment into the specific CCA classes they belonged to, instead of just mentioning that the equipment would be put into a CCA class, without providing details.

Weak candidates did not address a sufficient number of considerations for withdrawing funds from the company, often only mentioning that salaries would be deductible for Brokers, or performed only a superficial analysis, such as mentioning that there would be an impact on the RRSP contribution room, without explaining why. Many weak candidates ignored the required to discuss the tax treatment of the software and equipment purchase or capital lease. Weak candidates also displayed a lack of technical knowledge, for example, applying the dividend tax credit at the corporate level, or mentioning that the interest on the capital lease would be deductible, when the whole lease payment would be deductible. Weak candidates often discussed tax concepts that were of little relevance to Janine and Ann's request, such as the capital dividend account, RDTOH, and TFSAs. These candidates did not consider Brokers' specific situation, being primarily an active business with no capital gains or any other investment income to trigger CDA or RDTOH, and did not realize that TFSAs were not a relevant item to consider when deciding how to withdraw funds from Brokers.

AO#6 (Opportunities and risks) (Strat & Gov)

Candidates were asked to provide an objective assessment of the opportunities and risks related to Janine and Ann's business venture. Information that was relevant to the analysis, including Brokers' location, Janine's and Ann's backgrounds, and the industry environment of the surrounding area, was provided throughout the case. To demonstrate competence, candidates were expected to integrate information from various parts of the case in order to discuss some of the opportunities and risks related to the business venture.

Candidates struggled with this AO. They were able to draw on the information about Brokers provided throughout the case and use it to analyze the various risks, with the most frequently discussed risks being the business model, Janine and Ann's lack of experience, and the competitive environment. However, many candidates only focused their analysis on the risks related to the business venture and did not also analyze the opportunities. As a result, many candidates did not provide a balanced discussion.

Strong candidates provided a balanced assessment, acknowledging that the business venture provided many risks but also many opportunities. They incorporated case facts into their analysis, and explained why each factor was an opportunity or a risk. In addition to the most commonly addressed risks and opportunities, many strong candidates also addressed the risks related to the use of custom software, or the opportunity related to Janine's and Ann's skill sets.

Weak candidates did not provide good breadth of discussion, only addressing a few of the risks and opportunities. Many weak candidates did not go beyond repeating the case facts, for example, stating that many bars were only open for a short time, without explaining what this meant for the business venture. Some weak candidates provided a list of case facts, sorted between risks and opportunities, without further explanation. As this was information that Janine and Ann already had, merely restating case facts did not provide any additional value to them. Other weak candidates provided general opportunities and risks that could be applied to any bar or restaurant, such as the risk of customers getting sick from consuming Brokers' products. While this is a risk, there were many case facts to draw on that would have provided an analysis that was more relevant to Brokers' specific situation. Some weak candidates got confused in their role, and provided an analysis of the audit risks instead of what was asked of them.

APPENDIX G

CPA COMMON FINAL EXAMINATION REFERENCE SCHEDULE

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 acquired after November 20, 2018

$$= \frac{CdT}{(d+k)}\left(\frac{1+1.5k}{1+k}\right)$$

Notation for above formula:
C = net initial investment
T = corporate tax rate
k = discount rate or time value of money
d = maximum rate of capital cost allowance

2. SELECTED PRESCRIBED AUTOMOBILE AMOUNTS

	2021	**2022**
Maximum depreciable cost — Class 10.1	\$30,000 + sales tax	\$34,000 + sales tax
Maximum depreciable cost — Class 54	\$55,000 + sales tax	\$59,000 + sales tax
Maximum monthly deductible lease cost	\$800 + sales tax	\$900 + sales tax
Maximum monthly deductible interest cost	\$300	\$300
Operating cost benefit — employee	27¢ per km of personal use	29¢ per km of personal use
Non-taxable automobile allowance rates		
— first 5,000 kilometres	59¢ per km	61¢ per km
— balance	53¢ per km	55¢ per km

3. INDIVIDUAL FEDERAL INCOME TAX RATES

For 2021

If taxable income is between			Tax on base amount	Tax on excess
\$0	and	\$49,020	\$0	15%
\$49,021	and	\$98,040	\$7,353	20.5%
\$98,041	and	\$151,978	\$17,402	26%
\$151,979	and	\$216,511	\$31,426	29%
\$216,512	and	any amount	\$50,141	33%

For 2022

If taxable income is between			Tax on base amount	Tax on excess
\$0	and	\$50,197	\$0	15%
\$50,198	and	\$100,392	\$7,530	20.5%
\$100,393	and	\$155,625	\$17,820	26%
\$155,626	and	\$221,708	\$32,180	29%
\$221,709	and	any amount	\$51,344	33%

4. SELECTED INDEXED AMOUNTS FOR PURPOSES OF COMPUTING INCOME TAX

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

	2021	**2022**
Basic personal amount, and spouse, common-law partner, or eligible dependant amount for individuals whose net income for the year is greater than or equal to the amount at which the 33% tax bracket begins	$12,421	$12,719
Basic personal amount, and spouse, common-law partner, or eligible dependant amount for individuals whose net income for the year is less than or equal to the amount at which the 29% tax bracket begins	13,808	14,398
Age amount if 65 or over in the year	7,713	7,898
Net income threshold for age amount	38,893	39,826
Canada employment amount	1,257	1,287
Disability amount	8,662	8,870
Canada caregiver amount for children under age 18, and addition to spouse, common-law partner, or eligible dependant amount with respect to the Canada caregiver amount	2,295	2,350
Canada caregiver amount for other infirm dependants age 18 or older (maximum amount)	7,348	7,525
Net income threshold for Canada caregiver amount	17,256	17,670
Adoption expense credit limit	16,729	17,131

Other indexed amounts are as follows:

	2021	**2022**
Medical expense tax credit — 3% of net income ceiling	$2,421	$2,479
Old age security repayment threshold	79,845	81,761
Annual TFSA dollar limit	6,000	6,000
RRSP dollar limit	27,830	29,210
Lifetime capital gains exemption on qualified small business corporation shares	892,218	913,630

5. PRESCRIBED INTEREST RATES (base rates)

Year	Jan. 1 – Mar. 31	Apr. 1 – June 30	July 1 – Sep. 30	Oct. 1 – Dec. 31
2022	1	1	2	
2021	1	1	1	1
2020	2	2	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.

6. MAXIMUM CAPITAL COST ALLOWANCE RATES FOR SELECTED CLASSES

Class 1………………………….	4%	for all buildings except those below
Class 1………………………….	6%	for buildings acquired for first use after March 18, 2007 and ≥ 90% of the square footage is used for non-residential activities
Class 1………………………….	10%	for buildings acquired for first use after March 18, 2007 and ≥ 90% of the square footage is used for manufacturing and processing activities
Class 8………………………….	20%	
Class 10……………………….	30%	
Class 10.1…………………….	30%	
Class 12……………………….	100%	
Class 13……………………….	n/a	Straight line over original lease period plus one renewal period (minimum 5 years and maximum 40 years)
Class 14……………………….	n/a	Straight line over length of life of property
Class 14.1…………………….	5%	For property acquired after December 31, 2016
Class 17……………………….	8%	
Class 29……………………….	50%	Straight-line
Class 43……………………….	30%	
Class 44……………………….	25%	
Class 45……………………….	45%	
Class 50……………………….	55%	
Class 53……………………….	50%	
Class 54……………………….	30%	

The CPA certification program prepares future CPAs to meet the challenges that await them. For more information on the qualification process, the common final examination (CFE), and the specific education requirements for your jurisdiction, contact your provincial/regional CPA body.

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