CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

CFE CANDIDATE NUMBER:

Common Final Examination
September 14, 2021 – Day 2
(Booklet #1 – Case)

Total examination time: 5 hours.
Further details on the examination can be found on the next page.

GENERAL INSTRUCTIONS BEFORE THE EXAMINATION

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

_____________________________ CANDIDATE NAME (Please print)

_____________________________ SIGNATURE

Examination Details

The examination consists of:

Booklet #1 – Case (this booklet)
Booklet #2 – Rough notes

Candidates are allowed **five (5) hours** to respond.

The case should be answered using the software provided, which includes a word processor and spreadsheet for inputting your response. The main body of your response should be in the word processor file. Only supporting calculations should appear in the spreadsheet file, in **Sheet 1**. You are responsible for clearly explaining all your calculations.

Answers or part answers will not be evaluated if they are recorded using anything other than the software provided.

Rough-note paper is available in a separate booklet. Rough notes, and any other notations made in the examination booklets, will not be evaluated.

The CPA Canada Handbooks and the *Income Tax Act* are available in *Folio Views* throughout the entire examination. *Folio Views* provides the standards in effect and tax laws substantively enacted as at December 31, 2020.

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

Candidates are instructed to consider and respond to the case as presented and ignore the potential impacts of COVID-19.

Common Final Examination, September 2021

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

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

(CONTINUED ON PAGE 3)

BACKGROUND
COMMON INFORMATION FOR ALL ROLES

Farm Fresh to You Inc. (FFTY), a Canadian-controlled private corporation founded in 2010 by Scott McMaster and Antonia Lee, is a grocery store chain specializing in locally-produced, farm fresh foods. Having both previously worked for a nationwide grocery chain, Scott and Antonia saw an unmet demand and opened their first FFTY location in Toronto in 2010. Currently, FFTY has nine corporate-owned stores in Ontario. It also has two franchised stores in Ontario, both opened in 2020. Both franchisees are former managers of FFTY stores.

Scott and Antonia each own 50,000 of FFTY's 100,000 outstanding common shares. Scott is the chief executive officer and Antonia is the vice-president, finance and real estate.

FFTY's Board of Directors (board), which met once last year to approve the audited financial statements, is comprised of three directors: Scott, Antonia, and Michelle Walker, FFTY's vice-president, franchising operations. The management committee, made up of the three directors plus Dennis Mitchell (vice-president, corporate-owned stores) and Laura Zhang (controller), meets regularly to review the actual and budgeted statements and make operational decisions.

FFTY plans to grow significantly through franchising. Michelle was hired in September 2020 to manage and expand the franchising operations. Michelle has extensive experience with grocery store franchises and has suggested several changes and hired additional accounting staff.

Today is February 19, 2021. FFTY reports under ASPE, and its December 31, 2020 financial statements have not yet been finalized.

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

(CONTINUED ON PAGE 4)

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

ASSURANCE REQUIREMENTS

You, CPA, work as an audit manager at Crawford & Powell LLP (Crawford), FFTY's external auditor, and report directly to Shelley Winters, the audit partner. Shelley recently met with Scott and Antonia to discuss several issues.

Shelley asks you to address the FFTY management committee's requests from their most recent meeting. Shelley has already dealt with any independence and conflict-of-interest considerations.

Also, Shelley asks you to prepare the audit plan for the 2020 year-end audit, and the audit procedures for any accounting issues you identify.

Antonia informed Shelley of payroll problems at one of the stores. Shelley asks you to review the store's summary wage report, and recommend audit procedures that should be performed on any significant changes during the year and any anomalies you identify.

In early 2020, FFTY signed a new lease agreement with SMT Enterprises Inc. (SMT), for three stores. The agreement requires independent verification of the annual statement of gross sales, which Antonia has asked Crawford to provide. Shelley asks you to discuss the various reporting options available for this engagement, and the procedures that would need to be performed for the recommended report.

In 2020, FFTY installed self-checkouts in three stores. As the systems are new, Shelley wants you to assess the related internal controls for weaknesses and recommend improvements.

FFTY has prepared a disclosure document for potential franchisees, which will include the audited financial statements. FFTY has asked for consent to include Crawford's audit report in the disclosure document. Given that Crawford will be associated with the disclosure document, Shelley asks you to perform the appropriate audit procedures on the document, and discuss what additional information may be needed to perform the procedures.

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

(CONTINUED ON PAGE 5)

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

FINANCE REQUIREMENTS

You, CPA, work as a financial analyst at Crawford & Powell LLP (Crawford) in the finance consulting division, and report directly to Hans Meindl, a partner. Hans recently met with Scott and Antonia to discuss several issues.

Hans asks you to address the FFTY management committee's requests from their most recent meeting.

Also, the MG Bank long-term debt comes due in June 2022. To eliminate their personal guarantees, Scott and Antonia plan for FFTY to repay the loan early and replace it with alternative financing. FFTY is therefore seeking $50 million in financing. There have been discussions with Kings Bank and a private investor. FFTY would like a comparison of the two financing alternatives, including the impact on annual cash flows, and a recommendation.

FFTY wants to pilot a project that will offer home delivery of freshly prepared meals, using its own vehicles and staff. Laura and Antonia have estimated the delivery service's costs and revenue. Hans asks you to prepare a quantitative analysis, and to recommend whether FFTY should proceed.

Antonia would like an estimate of FFTY's weighted average cost of capital. You are told to assume that FFTY's equity has a fair value of $30 million.

FFTY plans to purchase equipment from a U.S. supplier, for delivery in October 2021. Hans asks you to discuss the three proposed alternatives for hedging the equipment purchase, determine the final cost of the equipment under each alternative, and recommend the best option.

FFTY has excess funds available from a 2020 property sale, which will only be used in 12 to 15 months from now to fund the anticipated expansion costs. Scott and Antonia have different views on how to invest these funds in the interim. Hans asks you to discuss the company's investment objectives, review the current investment, and to recommend changes, if any, to the investment mix.

Antonia is concerned about the financial viability of Franchisee #1 because it is behind in its payments to FFTY. Antonia asks you to review their financial statements, assuming that there are no accounting issues, evaluate their financial health, and recommend ways that FFTY could avoid similar situations with future franchisees.

(CONTINUED ON PAGE 6)

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

FINANCE REQUIREMENTS (continued)

A warehouse manager received a proposal from Logistics Inc. (Logistics), a warehousing and distribution service provider. Hans wants to understand the impact of accepting the proposal on working capital and net warehouse costs, and asks you to recommend whether FFTY should accept the proposal.

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

(CONTINUED ON PAGE 7)

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

PERFORMANCE MANAGEMENT REQUIREMENTS

You, CPA, work at Crawford & Powell LLP (Crawford) in the management consulting division, and report to Larry Osbourne, a partner. Larry recently met with Antonia and Scott to discuss several issues.

Larry asks you to address the FFTY management committee's requests from their most recent meeting.

Also, both Scott and Antonia want to better understand FFTY's position in the industry. They would like you to perform a SWOT analysis, clearly explaining a few of the most relevant considerations for each element of the SWOT.

Antonia thinks FFTY's current vision and mission statements are outdated. With franchising in mind, Larry asks you to review them and suggest changes. He also asks you to prepare a list of core values, which FFTY has never had before.

FFTY is considering offering home delivery of freshly prepared meals to either seniors or millennials. Larry asks you to calculate the cash flows, perform a qualitative analysis of the proposal for each market segment, and provide a recommendation.

Antonia would like you to identify which type of responsibility centre each of the four specific departments is, and discuss how each department's performance should be evaluated. She would also like your opinion on how the performance bonuses are currently determined for Dennis and Michelle.

Scott needs assistance evaluating the performance of two of the corporate-owned stores that are underperforming. Larry asks you to identify the causes of each store's low operating income, and recommend ways to improve their performance.

Antonia has been working with Riverside Dairy Company (Riverside) to secure a long-term supply contract. Larry would like a quantitative and qualitative analysis of the proposed contract.

In her previous job, Michelle successfully implemented a customer loyalty program and has suggested that FFTY do the same. Larry would like a quantitative and qualitative analysis of the proposed program for the corporate-owned stores.

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

(CONTINUED ON PAGE 8)

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

TAXATION REQUIREMENTS

You, CPA, work at Crawford & Powell LLP (Crawford) in the tax group, and report to Thomas, a partner. Thomas recently met with Antonia and Scott to discuss several issues.

Thomas asks you to address the FFTY management committee's requests from their most recent meeting.

In addition to those requests, Antonia and Scott would like to better understand FFTY's taxes and have asked for a supported calculation of taxable income and taxes payable for 2020, based on the revised net earnings. Thomas asks you to prepare these calculations.

You do not need to prepare the financial reporting entries for current and future taxes payable, but Thomas wants to know the ending undepreciated capital cost balances so he can prepare the entries later.

Since FFTY may pay dividends in future, Thomas asks you to explain what the RDTOH and capital dividend accounts are, and calculate FFTY's balances at January 1, 2021.

In 2020, FFTY was assessed interest and penalties on income taxes for 2019. Antonia wants to know why. Recently, Laura informed Antonia that the company only made two instalments in 2020. Thomas asks you to calculate the corporation income tax instalments that should be paid for 2021. Antonia would also like guidance on how to ensure that tax payments are made on time from now on.

Antonia's husband Ross, as well as Scott, each want to borrow funds from FFTY, and some terms have been drafted. Thomas asks you to comment on the tax implications of these loans.

Some employees are suggesting that FFTY provide them with certain benefits. Thomas asks you to comment on the tax implications of these benefits, from both the employees' and FFTY's perspective.

Antonia just learned the GST/HST return for January 2021 has not yet been completed. Thomas asks you to estimate the GST/HST balance payable for January and explain how it was calculated. Thomas would also like an explanation of any GST/HST implications for FFTY for each of the suggested employee benefits.

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

(CONTINUED ON PAGE 9)

APPENDIX I – COMMON BACKGROUND INFORMATION

FFTY currently owns two warehouses and the buildings for two of its stores. It leases its other seven store locations. FFTY's stores are about 28,000 square feet each, which is smaller than many competitors' stores.

FFTY's success is attributed to having recognized early and capitalized on the emerging trend of healthy eating. FFTY also offers customers a unique experience by having friendly, knowledgeable staff and a variety of food-tasting stations. Because its stores have a reputation for superior freshness and cleanliness, FFTY's brand is well recognized in southern Ontario. Unlike some of its competitors, FFTY does not have a seating area for customers to consume food purchased in the store.

FFTY's focus is on whole (unprocessed or minimally refined) foods. The product mix in each store, on average, consists of: 75% perishable products, such as fruit and vegetables, dairy and meat; 15% non-perishable products, such as canned and dry goods; and 10% freshly prepared, hot and cold food.

FFTY differentiates itself by ensuring that at least 60% of all products are locally sourced. About 10% of all products are purchased from the U.S. The value of the Canadian dollar has been deteriorating relative to the U.S. dollar for the past six months, and this is expected to continue.

About 30% of FFTY's perishable products are organic. FFTY recently signed contracts with some of its key suppliers for one or more years, ensuring a reliable supply of whole and organic foods. Some of the contracts require minimum purchase volumes.

FFTY's prices are 5% higher than national chain prices; its customers are willing to pay a premium for locally produced, whole foods. Unless offering temporary discounts, which are usually on non-perishable products, FFTY tries to keep prices for most items stable throughout the year. To date, the company has no customer loyalty program and does not sell any items under an FFTY label.

(CONTINUED ON PAGE 10)

APPENDIX II – COMMON
EXCERPTS FROM DRAFT FINANCIAL STATEMENTS

Farm Fresh to You Inc.
Statement of Earnings
For the years ending December 31
(in thousands of Canadian dollars)

	2020 Draft	2019 Audited
Sales (net of returns and discounts)	$ 152,916	$ 142,148
Franchise fee revenue	598	0
Total revenue	153,514	142,148
Cost of goods sold	86,860	78,078
Direct store costs (Note 1)	7,284	6,907
Sales and marketing	3,240	3,145
Amortization	6,302	6,890
Employee wages and benefits	21,853	20,789
Occupancy costs, including rent	14,170	13,234
General and administration	4,678	4,547
Total operating expenses	144,387	133,590
Operating income	9,127	8,558
Dividend income	85	0
Interest income	10	0
Gain on sale of land and building	4,000	0
Loss on sale of delivery vehicles	(150)	0
Interest expense – long-term debt	(3,520)	(3,940)
Interest expense – line of credit	(42)	(50)
Income before taxes	9,510	4,568
Income taxes	(2,265)	(1,142)
Net earnings	$ 7,245	$ 3,426

(CONTINUED ON PAGE 11)

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

Farm Fresh to You Inc.
Balance Sheet
As at December 31
(in thousands of Canadian dollars)

	2020 Draft	2019 Audited
Assets		
Current assets		
Cash and cash equivalents	$ 3,899	$ 678
Accounts receivable (Note 2)	1,147	215
Inventories	6,178	5,735
Prepaid expenses	125	110
Total current assets	11,349	6,738
Property, plant and equipment (Note 3)	83,323	91,512
Investment in Leila's Organic Bakery	1,907	0
Total assets	$ 96,579	$ 98,250
Liabilities		
Current liabilities		
Line of credit (Note 4)	$ 1,480	$ 642
Trade payables and accrued liabilities	10,586	10,330
Income taxes payable	1,365	375
Current portion of long-term debt (Note 5)	3,000	3,000
Total current liabilities	16,431	14,347
Long-term debt (Note 5)	50,170	61,170
Total liabilities	66,601	75,517
Shareholders' equity		
Share capital	2,500	2,500
Retained earnings	27,478	20,233
Total shareholders' equity	29,978	22,733
Total liabilities and shareholders' equity	$ 96,579	$ 98,250

(CONTINUED ON PAGE 12)

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

Notes (*in thousands of Canadian dollars*):

1. Direct store costs include distribution, shipping, shelving and display, training and promotions. Promotions include weekly flyers, emails to customers, and weekly, in-store promotions.

2. Accounts receivable:

	2020	2019
Franchisees – monthly royalty fees	$ 150	$ 0
Franchisees – inventory sales	656	0
Vendor rebates	341	215
	$ 1,147	$ 215

3. Property, plant and equipment:

	Land	Buildings	Furniture and Fixtures	Delivery Vehicles	Leasehold Improvements	Total
Carrying amount Jan 1, 2020	$5,170	$39,390	$26,012	$250	$20,690	$91,512
Additions			4,063		5,300	9,363
Amortization		(2,980)	(1,542)		(1,780)	(6,302)
Disposals (Note a)	(1,400)	(9,600)		(250)		(11,250)
Carrying amount Dec 31, 2020	$3,770	$26,810	$28,533	$ 0	$24,210	$83,323

Note a – FFTY sold land and a building to Retail Properties REIT (REIT) for total proceeds of $15,000. The original cost of the land and building was $1,400 and $12,560, respectively. The gain on the sale was $4,000.

FFTY also sold all its delivery vehicles for $100. The net loss on the sale was $150.

FFTY amortizes assets on a straight-line basis over their useful lives, with monthly amortization beginning in the month of purchase.

(CONTINUED ON PAGE 13)

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

Notes (*in thousands of Canadian dollars*) (continued):

4. The line of credit with MG Bank is secured by inventory. Interest is at prime (currently 3%) plus 1%. Effective January 1, 2021, the bank increased the limit from $1,500 to $3,000.

5. The long-term debt with MG Bank is secured by land, buildings and equipment, and personal guarantees from the shareholders. The loan is repayable in annual principal payments of $3,000 and bears interest at 6%. Additional principal can be repaid without penalty. Using proceeds from the sale to REIT, FFTY paid off an additional $8,000 during the year.

(CONTINUED ON PAGE 14)

APPENDIX III – COMMON
EXCERPTS FROM MANAGEMENT COMMITTEE MEETING
FEBRUARY 17, 2021

Attendees: Scott McMaster, Antonia Lee, Michelle Walker, Laura Zhang, Dennis Mitchell

Scott: Before finalizing the draft 2020 financial statements, we need Crawford to review the accounting treatment for some transactions. Where possible, we want to maximize our net income. Let's start with the investment in Leila's Organic Bakery (LOB).

Antonia: Leila Qureshi, the sole shareholder, asked us to invest in LOB, one of our organic, fresh, and frozen bread suppliers. On September 1, 2020, FFTY invested $1,907,000 for 18% of the outstanding common shares. The agreement states that LOB will pay FFTY at least 5% in dividends annually, and grants me a seat on its board.

Scott: If I remember correctly, only Leila, one other person, and you sit on the board. How have we accounted for our ownership in LOB and how is its performance?

Laura: The $1,907,000 has been recorded on the balance sheet as an investment. The $85,000 in dividends that we received in 2020 has been recognized as income.

LOB's net income from September 1 to December 31, 2020, was $1.25 million. FFTY represents about 30% of LOB's annual revenues. At the end of December, there was no inventory from LOB on hand.

Michelle: We signed two franchise agreements in 2020 (Appendix IV). Laura, how have the revenues from these franchisees been recognized?

Laura: The initial fees, optional services fees, and monthly royalty fees are included in franchise fee revenues as they are received.

Scott: On September 1, 2020, FFTY sold the land and building from its head office to REIT for their fair market values of $1.5 million and $13.5 million, respectively. The building had an estimated remaining economic life of 25 years. On that same date, FFTY entered a 20-year lease arrangement with REIT. We got a great deal—the present value of the minimum lease payments is $13,958,077 using our incremental borrowing rate. Laura, how have you reported this sale and the total lease payments of $400,000 that we have paid up to year-end?

(CONTINUED ON PAGE 15)

APPENDIX III – COMMON (continued)
EXCERPTS FROM MANAGEMENT COMMITTEE MEETING
FEBRUARY 17, 2021

Laura: The lease payments made to REIT have been included in rent expense. The gain has been recognized as income.

Scott: How did you account for our exchange with Design Webmasters Corp. (DWC)?

Laura: We provided DWC with freshly prepared foods that we could normally sell to customers for $290,000. This was a great deal because DWC provided us with an estimated $310,000 in web design services. I therefore made an adjustment to increase sales, and sales and marketing expenses, by $310,000.

Scott: Let's discuss our proposal for selling organic wines.

Laura: I gathered information on selling prices and costs (Appendix V). Crawford will help us determine the breakeven number of bottles to be sold.

Michelle: How is the 2021 operational plan coming along?

Antonia: We had an employee, Jim, prepare some charts and graphs to help us identify relevant considerations for this year's plan (Appendix VI).

Michelle: Sounds like a good start. Let's ask Crawford to look at Jim's summary, analyze the data, and provide us with any recommendations they have for improving our operating profits.

(CONTINUED ON PAGE 16)

APPENDIX IV – COMMON FRANCHISE INFORMATION

The standard franchise agreement, which is not expected to change in the next few years, is for 10 years, with a renewal option for an additional 10 years. The franchisee is a distinct corporation, in which FFTY has no ownership, and that operates independently of FFTY.

Fees

Each franchisee pays a non-refundable, initial fee of $140,000, due on signing the agreement. This fee covers assistance with initial setup of the store, upfront training, and an operations' manual, all provided in the two-week period prior to the store opening date.

Optional services, including record keeping, administration, and IT support, commencing when the store opens, can also be obtained by the franchisee for the first six months, for a payment of $60,000.

The franchisee also pays monthly royalty fees of 5% of the franchise's gross sales to FFTY for the right to use the FFTY brand name. These royalties accrue when sales are recognized by the franchisee and are payable to FFTY within seven days following the month to which they relate.

Franchises Opened to Date

	Franchisee #1	**Franchisee #2**	**Total**
Date contract signed	July 1, 2020	August 1, 2020	
Date store opened	November 1, 2020	December 1, 2020	
Initial franchise fee collected	$140,000	$140,000	$280,000
Optional services fee collected	$60,000	$60,000	$120,000
Sales from store opening to December 31, 2020	$2,256,000	$1,700,000	$3,956,000
Monthly royalty fees (5%)	$112,800	$85,000	$197,800
Monthly royalty fees receivable as at December 31, 2020	$65,300	$85,000	$150,300

(CONTINUED ON PAGE 17)

APPENDIX V – COMMON
ORGANIC WINE PROPOSAL

FFTY conducted a survey, costing $23,000, to determine whether to sell organic wines in its stores. The survey results indicated that for every bottle of organic wine purchased, people will also purchase organic cheese, for an additional average contribution margin of $0.75.

FFTY would operate an organic wine boutique within each of its stores, and sell the producers' organic wines at two price points.

The expected sales mix is as follows:

Bottle Price	Percentage of Sales	Direct Cost of Wine
$15.00	40%	65%
$25.00	60%	60%

Shipping and distribution costs are $19.80 for a 12-bottle case. FFTY will purchase, for $3 million, shelving that is expected to last for 10 years.

The other annual costs are as follows:

Labour to operate and manage the boutique, including $40,000 for the current administrative staff's wages	$450,000
Marketing costs for print and electronic media	$280,000
Supplies	$180,000
Warehousing costs for volumes less than 200,000 bottles (Note 1)	$300,000
Occupancy costs (portion related to space occupied by the boutique)	$25,000

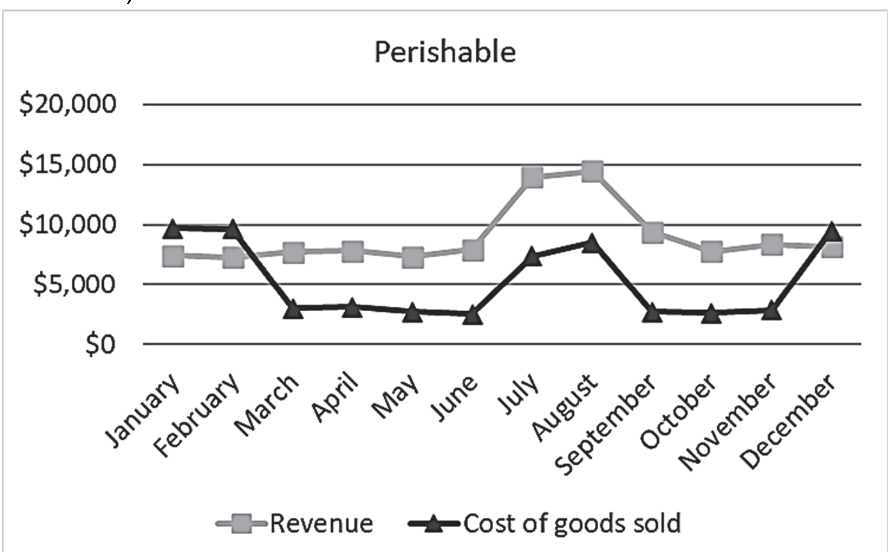
Note 1 – If volumes are greater than 200,000 bottles, the cost is $400,000.

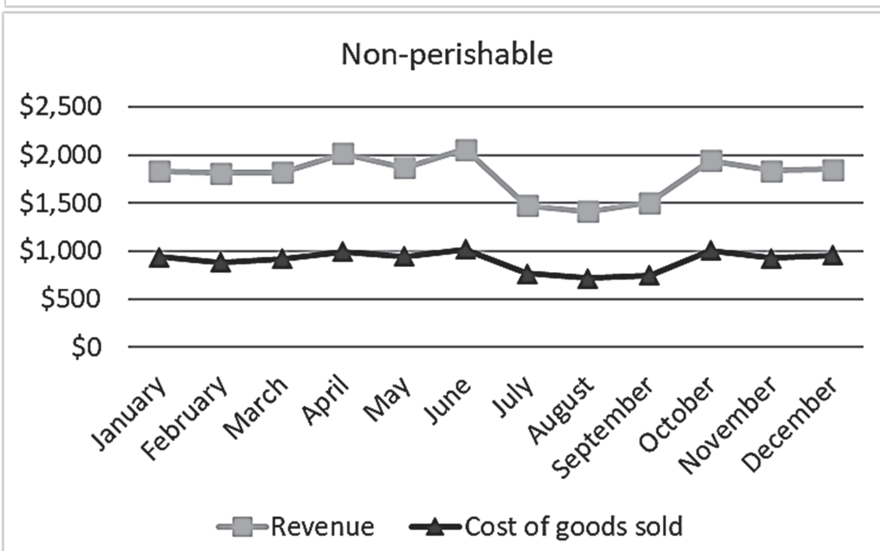
(CONTINUED ON PAGE 18)

APPENDIX VI – COMMON
2021 OPERATIONAL PLAN – RELEVANT INFORMATION

Being quite unique, FFTY cannot be compared to its competitors. Therefore, Jim only used internal data. Since the 2020 audit has yet to be completed, his main source of data was the 2019 accounting system records. To minimize the sources of data, the only other information Jim gathered was from a spreadsheet that tracks spoilage. Whenever employees throw out spoiled or expired items, they document on the spreadsheet, which is accessible by all stores, the date, item, product number and amount thrown away. Jim was surprised that this information was available; when he toured one store last month, he saw several employees throw items away and continue their work. He did not see them write anything down and there was no computer available for employees to record this information.

Jim prepared the following summary related to revenues, gross margins, and spoilage (*in thousands of dollars*):





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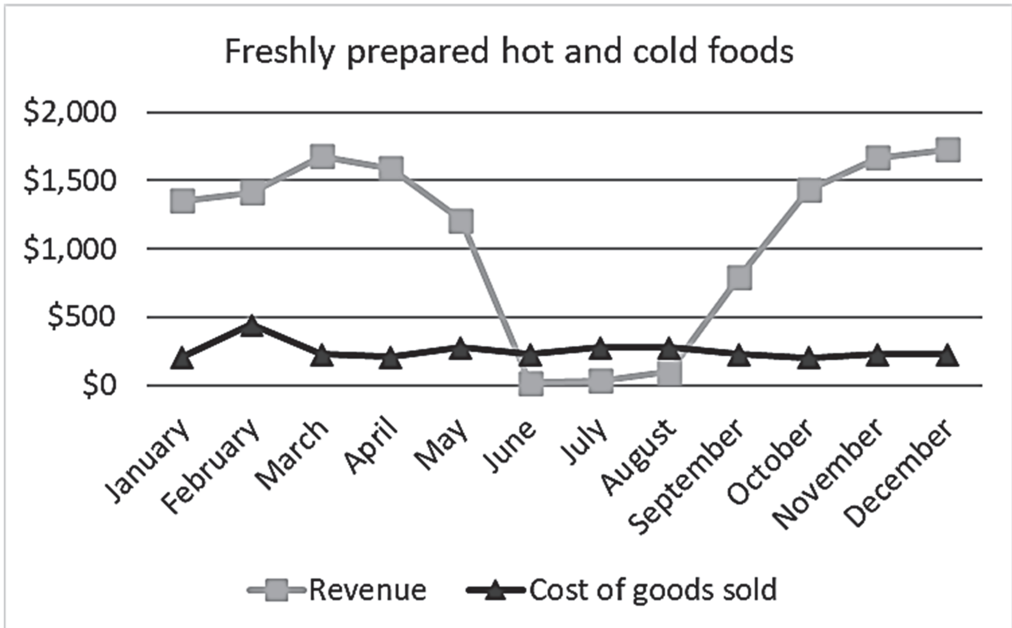
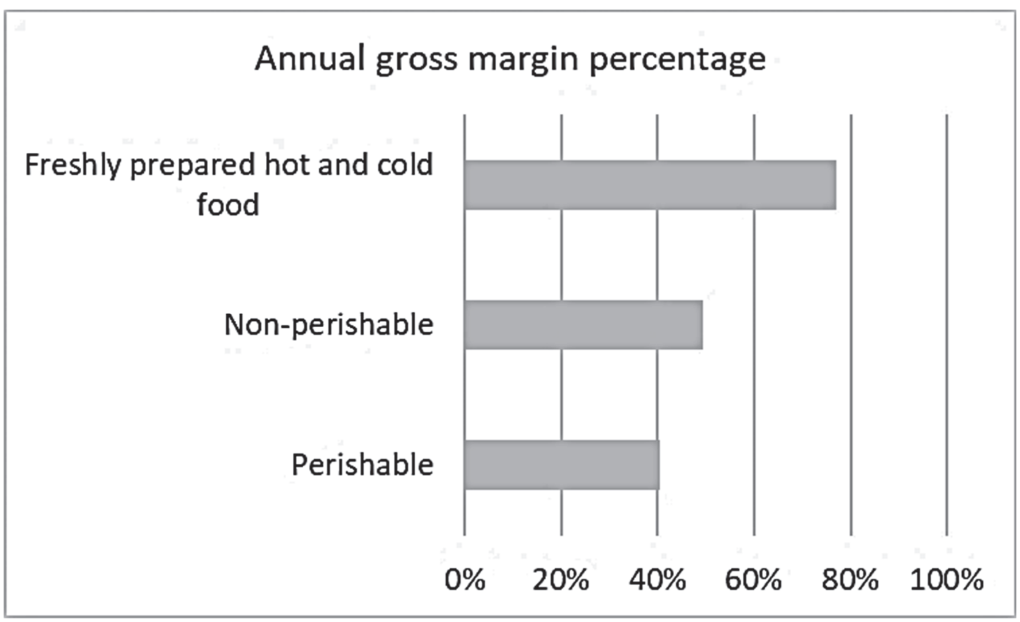
APPENDIX VI – COMMON (continued)
2021 OPERATIONAL PLAN – RELEVANT INFORMATION





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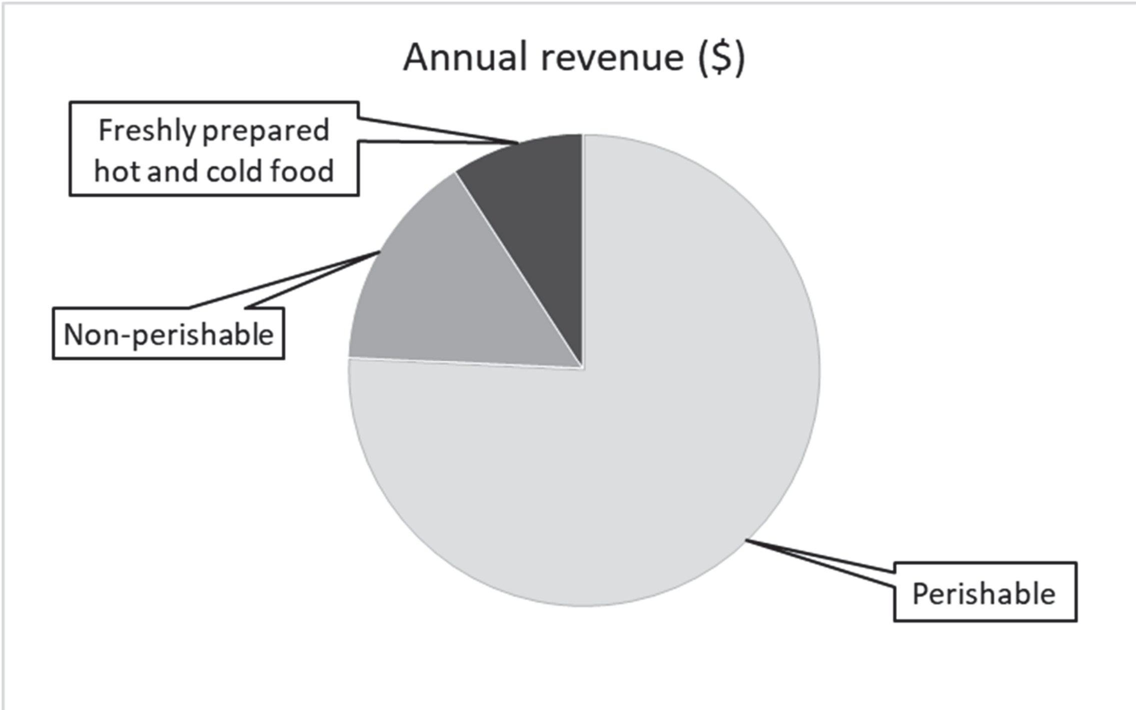
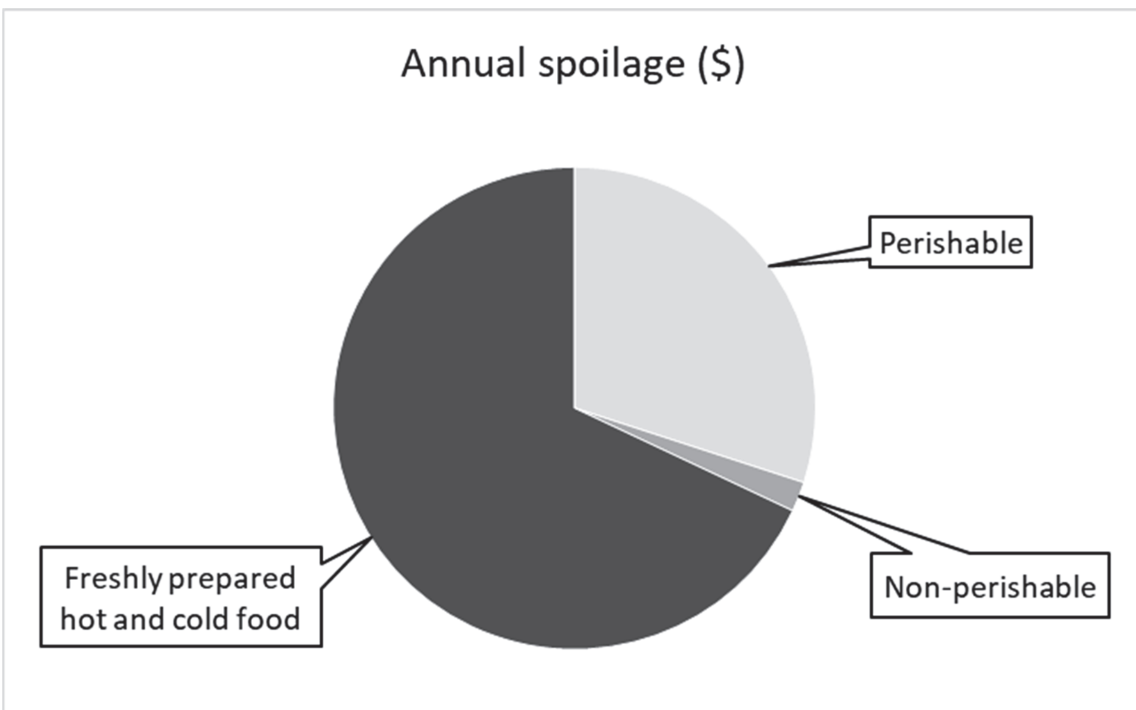
APPENDIX VI – COMMON (continued)
2021 OPERATIONAL PLAN – RELEVANT INFORMATION





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ASSURANCE ROLE
ADDITIONAL INFORMATION

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APPENDIX VII – ASSURANCE
ADDITIONAL INFORMATION

Wage Report for Store #3004

Employees fill out daily timesheets, which are approved by the store manager. The information is entered at the store and then electronically transferred to head office where the weekly payroll report for hourly employees is prepared. This report is also approved by the store manager.

The hourly pay for employees ranges from $15 to $20 and employees' weekly hours range from 20 to 25, with a maximum, as per FFTY policy, of 40 hours.

The summary wage report for Store #3004, which excludes management salaries, is as follows:

2020	Number of Hourly Employees Paid per Month	Average Number of Hours per Employee per Week	Average Hourly Pay per Employee	Total Gross Pay	Total Net Pay	% of Net to Gross Pay
Jan.	60	20	$17.00	$20,400	$17,340	85%
Feb.	60	22	$17.10	$22,572	$19,186	85%
Mar.	60	25	$17.30	$25,950	$22,058	85%
Apr.	60	45	$16.90	$45,630	$36,504	80%
May	63	20	$16.40	$20,664	$16,738	81%
June	63	22	$16.50	$22,869	$13,950	61%
July	63	11	$16.70	$11,573	$10,416	90%
Aug.	65	20	$14.65	$19,045	$15,998	84%
Sept.	65	22	$16.80	$24,024	$19,940	83%
Oct.	65	20	$16.90	$21,970	$18,675	85%
Nov.	63	21	$17.10	$22,623	$19,004	84%
Dec.	63	46	$17.00	$49,266	$40,891	83%

Lease Agreement

On March 1, 2020, FFTY signed a new lease agreement with SMT. In addition to a fixed payment, FFTY must pay a variable rent of 10% of gross monthly sales that are over a minimum amount. FFTY must provide SMT with a monthly unaudited statement of gross monthly sales, which will specify revenue for each of the three store locations being leased. FFTY will also provide annual statements showing gross sales by month, by store, prepared in accordance with ASPE and verified by an independent CPA. Returns and discounts (defined in the agreement) are to be shown separately.

(CONTINUED ON PAGE 24)

APPENDIX VII – ASSURANCE (continued)
ADDITIONAL INFORMATION

Self-checkout Process

In September 2020, FFTY started using four self-checkout systems in three of its corporate-owned stores. One attendant is assigned to all four checkouts, to assist with problems and ensure that customers are following the prompts correctly. The attendant has a personalized card that allows access to the system.

At the checkout:

- The customer scans an item, then puts it into a bag that sits on a weigh scale. The system reads the universal product code (UPC) and accesses the price and weight per unit from the database. If there is no UPC, a sticker on the item has the code to be entered by the customer. For items with a sticker (usually items charged by weight), the customer puts them on the scanner, which has a weigh scale, and the system calculates the price to be charged based on the weight and the price from the database. If there is no UPC or code sticker, the customer asks for assistance and the attendant inputs the product code.
- For items with UPC codes, the weight of the bag on the scale is compared to the weight as per the database, and the item description and the price are itemized on the screen. An alert sounds if the weight does not match, and the attendant checks the item and weight to ensure it is accurate. Often, the attendant is too busy and overrides the error without checking.
- If an item is scanned and not put in the bag, the machine prompts the customer to do so.
- The system then asks if the customer wants to scan another item or pay. If paying, the system asks for any coupons, which the customer inserts into the machine. The coupon has a barcode that indicates the item, coupon value and expiry date. If the coupon is valid and is for an item purchased, the coupon value is deducted from the amount owing.
- The customer is then prompted to choose the form of payment (cash, debit or credit card). If the customer removes the bags before paying, an alert sounds to notify the attendant, ensuring that the customer pays.
- Once payment is complete, a numbered sales receipt is printed that details the quantity and price of each item purchased, any coupons used and the total payment amount. The system automatically updates the perpetual inventory system. On exit, the attendant quickly reviews the sales receipt to ensure that the list of purchases is reasonable in comparison to the volume of items in the cart. However, given management has told attendants not to make people wait for this review, it only occurs when the attendant is immediately available.

(CONTINUED ON PAGE 25)

APPENDIX VII – ASSURANCE (continued)
ADDITIONAL INFORMATION

Self-checkout Process (continued)

At the end of each shift:

- The attendant takes the cash and coupons from the four self-checkouts to the back office.
- In the back office, the attendant counts the cash and prints off the sales report by checkout, which details each individual sale, payment amount and type, value of coupons and the total sales per shift. The total cash received is reconciled to the report. No other verification is performed.
- There is also an exception report produced by the system, which details attendant interventions and the nature of the intervention, such as whether it was a correction or an override; however, it is not reviewed.

Reports:

- A weekly spot check compares the perpetual inventory system report to the actual inventory in the stores, and any discrepancies are investigated. One store manager commented that some items seem to have more discrepancies than others, but could not remember which ones because there is no tracking.
- Pricing changes are made as required and input into the system by the pricing clerk. A price change report is printed weekly, and is reviewed and initialled by the pricing clerk as evidence that the change was made.

(CONTINUED ON PAGE 26)

APPENDIX VII – ASSURANCE (continued)
ADDITIONAL INFORMATION

Excerpts from Disclosure Document for Potential Franchisees

Disclaimer

The information provided in this report is for potential franchisees only. Crawford & Powell LLP has audited the information included in this report.

Company information

Farm Fresh to You Inc. (FFTY) is a grocery store chain specializing in locally supplied, farm fresh foods and freshly prepared, hot and cold foods. Currently, FFTY has two franchised stores in southern Ontario that began operations in January 2020. The company plans to grow significantly through franchising in the next several years.

FFTY's focus is on fresh, whole foods. The company differentiates itself from other competitors by ensuring that at least 60% of all products are locally sourced and that about 50% of the perishable products are organic.

FFTY's audited 2020 results, which are attached, indicate that total revenues were $153 million, representing a 10% increase from 2019 and a 15% increase from 2018. Net earnings also jumped up by 111% for 2020, mainly driven by an improvement in gross margins. FFTY has a long-term debt-to-asset ratio of 52%, which is in line with its competitors.

Franchise details

The franchise agreement is initially for 20 years. The franchisee will pay a non-refundable, initial fee of $140,000, due on signing the agreement. Ongoing, the franchisee will pay FFTY a monthly royalty fee of 3% of gross sales for the right to use the FFTY brand name.

In the first 12 months of operations, each franchisee averaged net earnings of $40,000, after deducting the owner's salary.

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FINANCE ROLE
ADDITIONAL INFORMATION

(CONTINUED ON PAGE 29)

APPENDIX VII – FINANCE
ADDITIONAL INFORMATION

Alternative Sources of Financing

1. Kings Bank will lend $50 million, with blended interest and principal repayments of $330,000 per month for 20 years. The annual interest rate is 5%. The loan is secured by the land, buildings and equipment. It cannot be repaid early without incurring significant penalties. FFTY must maintain a long-term debt-to-asset ratio of 0.60 or less. Any dividend payments, sale of assets or new loans must be approved by Kings Bank. If any covenant is breached, the outstanding balance becomes immediately repayable.

2. Jason Puneet is a private investor who recently sold his chain of Canadian franchised coffee shops to a large, public company. He recently met Scott through a mutual friend and became quite interested in FFTY. Jason believes that FFTY has the potential to become very successful and would like to be part of that success. He is willing to lend $50 million to FFTY under the following terms:
    - The interest rate is 3%, payable annually on the anniversary date of the loan.
    - The principal is due when the loan matures in 10 years.
    - The loan has 40,000 detachable warrants. Each warrant gives the holder the right to purchase a share in FFTY at a strike price to be negotiated. The warrants can be exercised at any time after two years, at the holder's option, and expire when the loan matures.
    - While the loan is outstanding, Jason Puneet will have a seat on FFTY's board. If Jason exercises the warrants and becomes a shareholder, only he can decide to end his term as a director.

    The yield on similar-risk unsecured loans, without warrants, is 6%.

(CONTINUED ON PAGE 30)

APPENDIX VII – FINANCE (continued)
ADDITIONAL INFORMATION

New Delivery Service

On January 1, 2022, a delivery service will be piloted at some of FFTY's corporate-owned stores. The project has a five-year life and needs to generate an 8% rate of return. FFTY's applicable tax rate is 26.5%.

Upfront costs:

- Delivery vehicles equipped with heated storage: $800,000
- Additional upfront costs: $400,000
- Working capital investment (additional food): $100,000

At the end of the project, the vehicles can be sold for $50,000.

Additional information:

- Average food selling price per delivery: $35
- Additional delivery fee charged to customer: 20% of the food selling price
- Average deliveries per week: 1,000 for the first year, increasing by 100 in each subsequent year
- Cost of food: 50% of the food selling price
- Annual labour costs: $450,000
- Annual website maintenance costs: $80,000
- Annual vehicle operating and maintenance costs: $100,000
- Marketing costs: $150,000 in the first year and $70,000 in each subsequent year

(CONTINUED ON PAGE 31)

APPENDIX VII – FINANCE (continued)
ADDITIONAL INFORMATION

Information on Public Companies

Company	Description	Number of Stores	Average Store Size (sq. ft.)	Beta
Brone's Inc.	Grocery retailer and gas stations	1,500	45,000	0.5
Best Foods Emporium	Organic and whole foods retailer	150	25,000	1.6
Himyl's Fresh Foods Inc.	Fresh foods and freshly prepared foods retailer	195	28,000	1.3
My Favorite Food Corp.	Grocery retailer and restaurants	450	35,000	0.9
Rosey's Sisters Food Corp.	Grocery retailer and freshly prepared foods	395	30,000	1.4
Worthy's Grocery Inc.	Grocery retailer and coffee shops	1,020	50,000	0.6

<u>Additional information:</u>

- Risk-free rate: 2.5%
- Market risk premium: 6%

(CONTINUED ON PAGE 32)

APPENDIX VII – FINANCE (continued)
ADDITIONAL INFORMATION

U.S. Equipment Purchase

FFTY plans to purchase equipment for U.S. $5 million that will be delivered on October 1, 2021, at which time the full amount is payable. FFTY currently purchases 10% of its products in U.S. dollars, but has no U.S. dollar cash inflows.

FFTY has the following options with respect to the equipment purchase:

1. The supplier offers a 2% discount if the full amount is paid when the order is placed on April 1, 2021. The exchange rate on April 1, 2021, is expected to be USD $1 = CAD $1.22. FFTY plans to borrow the full purchase price in Canadian dollars.
2. The bank has offered to sell a forward contract for U.S. $5 million, due on October 1, 2021, at a forward rate of USD $1 = CAD $1.28. FFTY would enter the contract on April 1, 2021.
3. On October 1, 2021, FFTY can borrow U.S. $5 million from a U.S. bank through a five-year term loan to pay for the equipment. The bank suggested the loan could be repaid through ongoing U.S. dollar transactions, which would reduce FFTY's exposure to exchange rate fluctuations during the term of the loan. Antonia isn't sure how this would work.

(CONTINUED ON PAGE 33)

APPENDIX VII – FINANCE (continued)
ADDITIONAL INFORMATION

Investment Options

As a result of its 2020 property sale, FFTY has funds available to invest for the next 12 to 15 months.

Scott's preference is to have all the funds remain in the savings account so they are easily available for the expansion whereas Antonia wants investments that will generate high returns.

Currently, the $3 million is invested in a savings account. The following investments are available to FFTY.

Investment	Annual Return
Savings account	0.5% (minimum balance of $100,000)
Three-year, non-redeemable Guaranteed Investment Certificate (GIC)	2.0%
S&P 500 Index Exchange Traded Fund (ETF)	2020: 29%
Five-year private loan (Note 1)	10%
Money market funds	2020 return: 1.4% The annual return has only fallen below 0.75% once in the past ten years
Publicly traded preferred shares	5.5%

Note 1 – A loan would be made to an established local business with 20 years of operating history; their financial forecasts indicate good debt coverage.

(CONTINUED ON PAGE 34)

APPENDIX VII – FINANCE (continued)
ADDITIONAL INFORMATION

Financial Statements of Franchisee #1
Income Statement – Internally Prepared
For the period from November 1, 2020, to January 31, 2021

	3 Months
Sales	$ 3,384,000
Cost of goods sold	2,064,200
Monthly royalty fee	169,200
Amortization of furniture and fixtures	84,000
Amortization of intangible assets	10,000
Startup costs	140,000
Store operating costs	605,800
General and administration	285,300
	3,358,500
Operating income	25,500
Interest expense	(32,600)
Earnings (loss) before income taxes	(7,100)
Income taxes	0
Net earnings (loss) for the period	$ (7,100)

(CONTINUED ON PAGE 35)

APPENDIX VII – FINANCE (continued)
ADDITIONAL INFORMATION

Financial Statements of Franchisee #1 (continued)
Balance Sheet – Internally Prepared
As at January 31, 2021

Assets	
Cash	$ 500
Inventory	376,800
Prepaid expenses	600
Furniture and fixtures	2,281,000
Intangible assets	295,000
Total assets	$ 2,953,900
Liabilities	
Bank indebtedness	$ 99,600
Accounts payable and accrued liabilities	611,400
Current portion of long-term debt	150,000
Long-term debt	1,700,000
Total liabilities	2,561,000
Shareholder's equity	
Common shares	400,000
Retained earnings (deficit)	(7,100)
Total shareholder's equity	392,900
Total liabilities and shareholder's equity	$ 2,953,900

(CONTINUED ON PAGE 36)

APPENDIX VII – FINANCE (continued)
ADDITIONAL INFORMATION

Benchmarks for Franchisees

Ratios	Benchmark
Cost of goods sold as a percentage of sales	60%
Operating margin	5%
Times interest earned (EBIT/interest)	4.0
Days in inventory	22
Current ratio	0.70
Debt ratio (total liabilities / total assets)	0.60
Minimum average sales per month in first year of operations for the franchise to be viable	$1,500,000

(CONTINUED ON PAGE 37)

APPENDIX VII – FINANCE (continued)
ADDITIONAL INFORMATION

Logistics Proposal

Currently, FFTY owns two warehouses. Total monthly costs for both warehouses are as follows:

Wages and benefits – paid on 30th day of the month	$84,350
Delivery vehicle leases – paid on 30th day of the month	$16,700
Operating costs – paid on 30th day of the month	$38,000

The proposed contract with Logistics requires a monthly payment of $135,000, payable on the first day of the month.

Logistics has promised faster delivery times, reduced spoilage and better inventory management, which will reduce stock-outs. Logistics estimates that FFTY can reduce its inventory by 25%.

(CONTINUED ON PAGE 38)

PERFORMANCE MANAGEMENT ROLE ADDITIONAL INFORMATION

(CONTINUED ON PAGE 39)

APPENDIX VII – PERFORMANCE MANAGEMENT ADDITIONAL INFORMATION

Vision and Mission

Vision: To be the largest Canadian-owned retailer of fresh, whole foods.

Mission: To support our local producer partners, and be the fastest growing retailer of whole foods by ensuring that customers are offered a unique experience.

Industry Information

The Canadian food retail industry has three segments: grocery stores, specialty food stores and warehouses. Specialty stores sell whole and organic foods. FFTY is in the specialty food segment.

The entire industry grew less than 1% in 2020 and is expected to continue to grow at this rate; however, the specialty food segment grew by 5% in 2020 and is expected to grow by 7% in 2021 and 2022.

The four largest players in the grocery store segment have 70% of the total industry market, although the warehouse segment has been steadily increasing its share. Many large grocery store chains have also entered the warehouse segment and increased their market share. Because margins are small, consolidation has been occurring in the industry as a way of achieving economies of scale.

Although some customers are willing to pay a premium for specialty foods, the industry still competes on price. Most customers tend to visit multiple stores looking for the best prices. Large grocery store chains can negotiate lower costs due to their high volumes, and pass these savings on to consumers. Many retailers have customer loyalty programs which they use to gather customer data, perform target marketing on specific products and increase traffic.

Since margins are low, product and labour costs must be constantly monitored. This is a labour-intensive industry, using low-skilled labour. However, wages that are too low can hinder service and increase employee turnover.

Inventory management is critical to controlling costs, and any disruption in distribution impacts profits. Data captured by the point-of-sale system helps determine which products are selling well and when inventory needs to be replenished in order to ensure availability.

Specialty food stores appeal to consumers who are particular about their food choices. Customers tend to shop at these types of stores less often. To stabilize costs and ensure that high-quality products are consistently available, retailers enter long-term supplier contracts.

(CONTINUED ON PAGE 40)

APPENDIX VII – PERFORMANCE MANAGEMENT (continued)
ADDITIONAL INFORMATION

A successful franchisor needs to attract franchisees who share goals, beliefs, and values, while still allowing their entrepreneurial spirit to flourish. Franchisees look for companies that demonstrate leadership, integrity and have a well-defined vision, mission, and a strong support system. The brand must be well recognized and respected, and the business model must be easily replicated so that every store is similar. Franchisees like being consulted on important business decisions.

Trends in the industry include:

- implementing loyalty programs that result in increased sales and customer loyalty.
- performing analytics on the data collected by the point-of-sale system. The data can also be used to personalize the customer's shopping experience and provide discounts on their favourite items. Some customers are concerned with their privacy and object to the tracking of their purchases and receiving targeted marketing.
- introduction of new products, including wine, beer and liquor, freshly prepared foods and health and wellness products.
- delivery of groceries to homes or to other convenient locations.
- increasing the percentage of private-label products offered, to reduce costs and increase margins.

In Ontario, disposable income per capita is forecast to increase over the next five years. In the past, as disposable income has increased, consumers spent more on specialty foods. Customers in their forties are now tending toward healthier living, consuming fresh, whole products. Higher income retired seniors are less interested in cooking and are looking for delivery of healthy, freshly prepared foods. Millennials who are busy building their careers are also interested in delivery of freshly prepared foods.

(CONTINUED ON PAGE 41)

APPENDIX VII – PERFORMANCE MANAGEMENT (continued)
ADDITIONAL INFORMATION

Food Delivery Service Proposal

Starting on January 1, 2022, a few of the corporate-owned stores plan to pilot a delivery service.

	Seniors Market	**Millennials Market**
Average sale per delivery	$35	$75
Number of deliveries per year	60,000 to 68,000	28,000 to 45,000
Fee charged by FFTY per delivery	$8	$8
Cost of food as a percentage of selling price	50%	50%
Labour costs – for cooks and drivers	$740,000	$560,000
Labour costs – for telephone support	$40,000	0
Costs for app development	$350,000	$520,000
Amortization	$270,000	$270,000
Brand loyalty	High, but values price over quality; less spending power	Lower, but values quality over price; more spending power

Additional information:

- Only one competitor currently delivers prepared foods made with whole and organic ingredients specifically targeted to seniors.
- Millennials spend up to 8% of their food budget on prepared foods whereas seniors spend only 2%.
- Millennials tend to live in the downtown core while seniors tend to live in the suburbs. Due to downtown traffic congestion, delivery to millennials takes longer.
- Grocery stores and restaurants are also competing for the millennials' prepared-food delivery market.
- Expectations are that, by 2030, 60% of meals will be delivered rather than cooked at home.

(CONTINUED ON PAGE 42)

APPENDIX VII – PERFORMANCE MANAGEMENT (continued)
ADDITIONAL INFORMATION

FFTY's Departments

Four of FFTY's departments are managed as follows:

Manager, Marketing	• Responsible for all marketing activities, including brand marketing and local marketing for individual stores
Manager, Product Purchasing	• Responsible for product purchasing and negotiation of supplier contracts and shipping requirements • Manages store inventory levels
VP, Franchising Operations (Michelle)	• Responsible for selecting franchisees, training and onsite support, and monitoring franchisee sales and purchases • Receives a performance bonus based on a percentage of franchise fees
VP, Corporate-owned Stores (Dennis)	• Involved in investment decisions for the equipment and leasehold improvements for each corporate-owned store • Oversees the corporate-owned store managers' work • Sets selling prices and employee wages and oversees all store operating costs • Receives a performance bonus based on a percentage of total net profit of all corporate-owned stores (see calculation below)

Net profit is calculated as follows:

Total revenue of all corporate-owned stores
Less costs:
Cost of goods sold
Distribution and shipping
Marketing and advertising
Wages
Electricity
Property taxes
Allocated costs of overhead for finance, human resources, and information technology
Interest cost on capital invested in property, plant and equipment

(CONTINUED ON PAGE 43)

APPENDIX VII – PERFORMANCE MANAGEMENT (continued)
ADDITIONAL INFORMATION

Information on Two Corporate-owned Stores (CO)

2020	CO #1002	CO #1009
Sales	$ 16,350,000	$ 14,780,000
Cost of goods sold	(11,718,000)	(9,459,000)
Direct store costs	(664,000)	(680,000)
Wages	(1,435,000)	(2,032,000)
Amortization	(302,000)	(314,000)
Occupancy costs	(1,487,000)	(1,595,000)
Allocated head office costs based on sales	(255,000)	(230,000)
Operating income	$ 489,000	$ 470,000

Key performance measures:

		Target	CO #1002	CO #1009
Financials	Annual increase in sales	3%	5%	-10%
	Gross margin percentage	35%	28%	36%
	Inventory turnover	20 times	21 times	19 times
	Percentage of sales of high-margin items	15%	4%	18%
	Wages as a percentage of sales	10%	9%	14%
	Operating margin	5%	3%	3%
Customers	Product returns as a percentage of sales	2%	2%	1%
	Number of customer complaints per week	10	8	4
Internal Business Processes	Percentage of sales of new products	10%	6%	12%
	Employee turnover	5%	25%	1%
	Average weekly hours for each employee	30	19	31
	Average hourly rate for employees (minimum for new employees is $15; maximum for full-time, experienced employees is $20)	$16.50	$15.20	$17.00
	Food and safety inspection failures	0	2	0

(CONTINUED ON PAGE 44)

APPENDIX VII – PERFORMANCE MANAGEMENT (continued)
ADDITIONAL INFORMATION

Information on Two Corporate-owned Stores (CO) (continued)

Additional information:

- CO #1002 – During the year, the store manager lowered the prices of commonly sold items to less than a local competitor's prices. He also reduced the average weekly hours worked for each employee to less than 20 hours, to save on benefits.
- CO #1009 – During the year, the store was closed for six weeks due to a sewer backup caused by the municipality; lost sales totalled $2,235,000. However, the employees helped with the cleanup and, in addition to working the regular number of hours during this period, were paid overtime totalling $340,000.

(CONTINUED ON PAGE 45)

APPENDIX VII – PERFORMANCE MANAGEMENT (continued)
ADDITIONAL INFORMATION

Riverside Contract Proposal

Dairy sales for 2021 are forecast to be $16 million. Selling prices and unit costs are expected to increase by 2% annually, due to inflation. Dairy prices are kept low to attract customers. FFTY currently uses four local suppliers as each one has a variety of products, giving customers more choice. All suppliers are paid within 30 days.

Under existing contracts, the 2020 purchases for the four suppliers are as follows:

Supplier	Products	Purchases	Minimum Order Period Prior to Delivery	Point of Delivery
Riverside	Milk, butter, cheese, and yogurt	$ 5,000,000	15 days	To the stores
Supplier #2	Cheese	1,700,000	7 days	FFTY does pickup and distribution
Supplier #3	Milk and yogurt	2,400,000	8 days	To the warehouse
Supplier #4	Butter and cheese	2,900,000	12 days	FFTY does pickup and distribution
		$12,000,000		

If FFTY does not sign the proposed contract with Riverside, the cost of goods sold for the dairy products is expected to be $12 million in 2021, and the quantities purchased are expected to remain stable.

(CONTINUED ON PAGE 46)

APPENDIX VII – PERFORMANCE MANAGEMENT (continued)
ADDITIONAL INFORMATION

Riverside Contract Proposal (continued)

The proposed contract has the following terms:

- The contract is for six years, starting on January 1, 2022.
- The minimum annual purchases are $10 million. If the minimum is not reached in any year, FFTY will either purchase enough product to reach the minimum or pay a penalty equal to 50% of the shortfall.
- Prices will be fixed for the first three years, and will increase by 2% a year thereafter.
- At the beginning of each year, FFTY is to provide a forecast of annual purchases, by quarter.
- Orders must be placed by FFTY no less than 15 days before delivery.
- Payment terms are 25 days.
- Deliveries will be made directly to the stores at no cost to FFTY.
- Riverside will be responsible for any products returned by customers.
- FFTY's stores will receive one type of each product rather than three to four types.

Note: FFTY would continue to purchase the remainder of its required dairy products from the three existing suppliers; due to reduced volumes, their prices will increase by 8%.

Customer Loyalty Program

Customers in the corporate-owned stores will be awarded one point for each dollar spent; each point will be worth $0.02 and will expire at the end of the following calendar year. The points can be redeemed for any products sold in the store.

Sales in 2021 are forecast at $158 million for the corporate-owned stores. The program should increase sales by at least 5% in all corporate-owned stores. Head office will incur annual costs of $250,000 to manage the program. Michelle estimates that customers will eventually redeem 55% of the points awarded.

On average, the corporate-owned stores currently have gross margins of 43%.

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TAXATION ROLE
ADDITIONAL INFORMATION

(CONTINUED ON PAGE 49)

APPENDIX VII – TAXATION
ADDITIONAL INFORMATION

Capital Cost Allowance

Undepreciated capital cost (UCC) balances at January 1, 2020, are as follows:

Class	Description	UCC Balance
1	Buildings (all at 4%)	$45,790,200
8	Furniture and equipment	$16,754,300
10	Delivery vehicles	$180,000
12	Computer software	$56,890
13	Leasehold improvements	$17,360,000
50	Computer hardware	$75,300

The original capital cost of the leasehold improvements included in Class 13 totalled $22,679,000. The length of all store leases is 10 years, and the leasehold improvements in 2020 were made at the commencement of new leases.

After the sale of delivery vehicles during 2020, there are no remaining items in Class 10.

Information for the Calculation of Net Income for Tax Purposes and Taxable Income

General and administrative expenses are comprised of the following:

Wages and benefits	$ 2,780,000
Travel	570,000
Computer application software purchases	120,000
Mileage (at the per-kilometre rates allowed by the CRA)	230,000
Meals	130,000
Donations to registered charities	112,000
Membership dues for social club	20,000
Automobile leasing costs for Dennis (Note 1)	16,800
Life insurance on shareholders	40,000
Interest and penalties on late payments of income taxes	35,000
Other operating expenses	624,200
	$ 4,678,000

Note 1 – The automobile lease is for 24 months and began on October 1, 2019. The retail price of the automobile on that date was $65,000. Monthly lease payments are $1,700 plus 13% HST. Dennis reimburses the company $300 per month for personal use of the vehicle, and the $16,800 expense is net of this reimbursement. A refundable deposit of $15,000 was made at the start of the lease. The amount deducted for tax purposes in 2019 was $1,483.

(CONTINUED ON PAGE 50)

APPENDIX VII – TAXATION (continued)
ADDITIONAL INFORMATION

Information for the Calculation of Taxes Payable

During 2020, LOB paid $472,220 in dividends and received a dividend refund of $118,055 from its eligible RDTOH balance. FFTY received $85,000 of those dividends.

FFTY's provincial tax rate on income eligible for the small business deduction is 3%, and on all other income is 11.5%.

FFTY's Non-Eligible RDTOH balance at December 31, 2019, was $0. Its Eligible RDTOH balance at December 31, 2019, was $60,000, and FFTY did not receive any dividend refund for 2019. The balance in the general rate income pool (GRIP) at January 1, 2020, was $10 million.

FFTY's taxes payable for the 2019 taxation year was $1,142,000, and FFTY paid $1 million of this in May of 2020. The income tax return for 2019 was filed on August 17, 2020, and the remaining amount was paid on that date.

Capital Dividend Account

Prior to 2019, capital transactions were as follows:

Year	Asset Sold	Proceeds	Adjusted Cost Base
2013	Land and building	$8,630,000	$7,850,000
2016	Investment securities	$730,000	$960,000
2018	Investment securities	$567,000	$432,000

There have been no capital dividends paid in prior years.

Eligible dividends, received on short-term investments in public companies, were:

Year	Amount
2016	$150,000
2017	$225,000
2018	$215,000

(CONTINUED ON PAGE 51)

APPENDIX VII – TAXATION (continued)
ADDITIONAL INFORMATION

Proposed Loans

Ross Lee, Antonia's husband, has no ownership in FFTY. FFTY will lend Ross $300,000 to invest in his own business, Next Opportunity Inc. The loan will be for five years and will bear interest at 0.5% annually. Interest is payable annually and the principal is due only on the maturity date of the loan. The loan will be advanced on April 1, 2021.

FFTY will lend Scott $500,000 to help him purchase a new home. The loan will be advanced on May 1, 2021. Principal in the amount of $50,000 is repayable annually on May 1 until the loan matures in 2031. The loan bears interest at an annual rate of 0.5%, which is payable monthly.

Proposed Employee Benefits

- All employees would receive a 10% discount on all products sold in FFTY stores.
- FFTY would issue non-cash awards for every fifth anniversary at FFTY, starting at a value of $500 and increasing by $500 on each subsequent fifth anniversary date. For example, a non-cash award of $1,000 and $1,500 would be paid to employees achieving their tenth and fifteenth anniversaries, respectively. Employees would select their non-cash award from a list of ten items, such as a watch, tablet, or barbecue.
- All employees would be eligible to have FFTY annually contribute an amount equal to 5% of their wages to their tax-free savings account.
- FFTY would create a group disability insurance plan that could be funded in one of three ways: FFTY would pay all the premiums; the employee would pay all the premiums; or FFTY and the employee would share the premium payments.

(CONTINUED ON PAGE 52)

APPENDIX VII – TAXATION (continued)
ADDITIONAL INFORMATION

GST/HST

FFTY is required to file monthly GST/HST returns. All transactions take place in Ontario, where the HST rate is 13%.

In January 2021, FFTY had the following transactions (all figures are net of GST/HST):

Sales	$14,700,000
Franchise fees received	$180,000
Cost of goods sold	$8,400,000
Rent	$1,568,000
Salaries and wages	$2,670,000
Financing costs (interest)	$300,000
Other operating costs	$1,753,000
New furniture and fixtures	$10,400,000

Notes:

- Of the total sales, $7.2 million was for zero-rated items and the remaining amount was for taxable supplies.
- Purchases were $10.7 million, of which $4.2 million was for zero-rated items and the remaining amount was for taxable supplies.
- In other operating costs, 100% were for taxable supplies and include the following items:
  - Lease costs for Dennis's vehicle
  - Social club membership of $1,800
  - Meals of $25,000
- The furniture and fixtures have a useful life of eight years. At the end of the month, there was $3.2 million in accounts payable related to this purchase.

(CONTINUED ON PAGE 53)

End of Examination

(CONTINUED ON PAGE 54)

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

	2020	**2021**
Maximum depreciable cost — Class 10.1	\$30,000 + sales tax	\$30,000 + sales tax
Maximum depreciable cost — Class 54	\$55,000 + sales tax	\$55,000 + sales tax
Maximum monthly deductible lease cost	\$800 + sales tax	\$800 + sales tax
Maximum monthly deductible interest cost	\$300	\$300
Operating cost benefit — employee	28¢ per km of personal use	27¢ per km of personal use
Non-taxable automobile allowance rates		
— first 5,000 kilometres	59¢ per km	59¢ per km
— balance	53¢ per km	53¢ per km

3. INDIVIDUAL FEDERAL INCOME TAX RATES

For 2020

If taxable income is between			Tax on base amount	Tax on excess
\$0	and	\$48,535	\$0	15%
\$48,536	and	\$97,069	\$7,280	20.5%
\$97,070	and	\$150,473	\$17,230	26%
\$150,474	and	\$214,368	\$31,115	29%
\$214,369	and	any amount	\$49,644	33%

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%

(CONTINUED ON PAGE 55)

4. SELECTED INDEXED AMOUNTS FOR PURPOSES OF COMPUTING INCOME TAX

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

	2020	2021
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	$12,298	$12,421
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	13,229	13,808
Age amount if 65 or over in the year	7,637	7,713
Net income threshold for age amount	38,508	38,893
Canada employment amount	1,245	1,257
Disability amount	8,576	8,662
Canada caregiver amount for children under age 18	2,273	2,295
Canada caregiver amount for other infirm dependants age 18 or older (maximum amount)	7,276	7,348
Net income threshold for Canada caregiver amount	17,085	17,256
Adoption expense credit limit	16,563	16,729

Other indexed amounts are as follows:

	2020	2021
Medical expense tax credit — 3% of net income ceiling	$2,397	$2,421
Annual TFSA dollar limit	6,000	6,000
RRSP dollar limit	27,230	27,830
Lifetime capital gains exemption on qualified small business corporation shares	883,384	892,218

5. PRESCRIBED INTEREST RATES (base rates)

Year	Jan. 1 – Mar. 31	Apr. 1 – June 30	July 1 – Sep. 30	Oct. 1 – Dec. 31
2021	1	1		
2020	2	2	1	1
2019	2	2	2	2

This is the rate used for taxable benefits for employees and shareholders, low-interest loans, and other related-party transactions. The rate is 4 percentage points higher for late or deficient income tax payments and unremitted withholdings. The rate is 2 percentage points higher for tax refunds to taxpayers, with the exception of corporations, for which the base rate is used.

(CONCLUDED ON PAGE 56)

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%	

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