CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

CFE CANDIDATE NUMBER:

Common Final Examination
May 26, 2016 – Day 2
(Booklet #1 – Case)

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

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1. Fill in your 7-digit candidate number on the booklets and the USB key. The exam booklets and the USB key (or paper response, as instructed) must be submitted before leaving the writing centre. They must NOT BE REMOVED from the writing centre. If these items are not received, the response may not be accepted.
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(CONTINUED ON PAGE 2)

Examination Details

The examination consists of:

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

The case is developed to be four (4) hours. Candidates are allowed **five (5) hours** to respond.

The case should be answered in Securexam. Securexam has an answer tab and a spreadsheet tab to input your response. The main body of your response should be in the answer tab. Only supporting calculations should appear in the spreadsheet tab, **under Sheet 1**. A copy of the financial statements (balance sheet and income statement) from the case have been preloaded into the spreadsheet tab, **after Sheet 1.** The cells in this section are locked. You must copy and paste the financial statements into your **Sheet 1**, where you can then do all your calculations. You are responsible for clearly explaining all your calculations, as outlined in the Securexam tutorial.

Answers or part answers will not be evaluated if they are recorded on anything other than Securexam or the CPA Canada writing paper provided.

The CPA Canada Handbooks and the Income Tax Act, in the form of searchable PDF files, are available within Securexam throughout the entire examination. Securexam provides the standards in effect and tax laws enacted at December 31, 2015.

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

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

Common Final Examination, May 2016

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 common to 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)

COMMON – BACKGROUND

Atlantic Shellfish Inc. (ASI) is a privately-held company operating since 1992 and located in Prince Edward Island. ASI harvests, processes, distributes and markets lobsters and red sand clams (clams) to Canada and the United States. It sells primarily to large grocery retailers and restaurant chains that specialize in seafood. ASI's objective is to be a leading supplier of clams and lobsters with a well-known and respected brand name.

ASI is owned 60% by Darrell McDermott and 40% by a group of 50 ASI employees. Seven years ago, in 2010, the group of employees invested $20,000 each and received a total of 10,000 Class B common shares, allowing ASI to raise $1 million in equity. Darrell currently owns 15,000 Class A common shares. Having continuously reinvested its profits, ASI has not paid any dividends in over a decade.

When first approached about becoming Class B shareholders, the employee group was promised a return on investment of at least 10% annually in the form of dividends, commencing no later than 2014. The Class B shareholders have recently voiced concerns about the return on their shares. In lieu of the original contract terms, the Class B shareholders are proposing an exchange of their Class B common shares for retractable preferred shares.

The Board of Directors consists of Darrell, who is the CEO and chairman of the board, and seven representatives from the Class B shareholders. The board meets quarterly to review strategy and financial reports.

Today is February 7, 2017. On January 14, 2017, the CFO for the past 20 years passed away. ASI is in the process of hiring a new CFO. For the last four months of the 2016 fiscal year, the CFO had not been well, and was not able to perform his duties. His work was delegated to the accounting staff, including the preparation of the 2016 draft financial statements. ASI reports under IFRS. The draft financial statements are provided in Appendix I.

The board has one committee, an Audit Committee, which meets quarterly to review the statements. The committee met yesterday to review the draft 2016 financial statements before submitting them to the auditors. Extracts from the meeting minutes are in Appendix II.

Government regulations and industry information

The Canadian Federal Department of Fisheries and Oceans (DFO) regulates the amount of harvest by issuing licences for specific species. A licence has an indefinite life. A nominal fee is paid each year to maintain each licence. The DFO sets the annual "total allowable catch" by species and by region for: 1) inshore fishing; and 2) offshore fishing. These quotas, designated to a particular enterprise, may be transferred, traded or sold.

Offshore fishing is dominated by a few, large integrated companies that, similar to ASI, own large vessels and hold significant quotas. Smaller companies and individuals tend to hold the inshore fishing licenses and utilize smaller boats with less complex equipment. It is industry practice to determine volumes in pounds rather than kilograms.

(CONTINUED ON PAGE 4)

COMMON – BACKGROUND (continued)

ASI owns one Canadian offshore licence for clams, which allows it an annual quota of 10.8 million pounds of clams; this amount represents 23% of the total allowable offshore catch designated by the DFO. ASI has three Canadian offshore lobster licences, with a total allowable annual quota of 600,000 pounds; this amount represents 28% of the total allowable offshore catch designated by the DFO.

ASI holds no inshore licences, but purchases additional lobsters from suppliers who have inshore licences. In 2016, this totalled a further 1.2 million pounds.

Red sand clams

ASI's sales of clams totalled $20.5 million in 2016. Clam fishing is not seasonal. During 2016, ASI harvested four million pounds of clams. ASI owns one vessel that is used exclusively for harvesting clams. The clams are taken to the plant to be shelled, blanched, frozen and then shipped.

ASI has been planning to purchase one more vessel that would allow it to harvest its remaining annual offshore clam quota; an additional six million pounds. A German supplier has tentatively been selected to manufacture the vessel at an estimated cost of $45 million (32 million euros). The processing plant currently has excess capacity available that could be used to process this additional catch.

Darrell recently informed the board that he would be meeting with the bank soon to review the year-end results. Darrell stated that he will ask the bank manager to increase the line of credit in order to help finance the purchase of the new vessel.

Lobsters

ASI's sales of lobsters totalled $18.5 million in 2016. ASI has two vessels for lobster fishing. Lobster fishing is seasonal, with the peak periods being early spring and late fall. Once the lobsters are caught, they are taken to the plant where they are sized, graded, sorted and inventoried. Some are kept alive in the storage facility for up to three months, allowing ASI to sell live lobsters after the season has ended. This is unique in the industry, as no competitor has similar storage facilities. As customers' orders are filled, the live lobsters are packaged and shipped by overnight courier to ensure that delivery is within one to two days.

Supplier bonus arrangement

In addition to being paid for their catch, inshore lobster suppliers who have been supplying ASI for five years or more qualify for a bonus. Currently, 20 suppliers qualify for the bonus, which is calculated based on a percentage of ASI's lobster profits. The 2016 bonus is substantially less than the 2015 and 2014 bonuses.

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

(CONTINUED ON PAGE 5)

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

ASSURANCE REQUIREMENTS

You, CPA, work as an employee of CPA LLP. Recently, you met with Sarah Chin, who is a partner with the firm. CPA LLP will again perform ASI's year-end audit. Although the 2016 year-end audit plan was completed in early September, some additional issues have arisen that may require changes to the plan. This morning, Darrell contacted Sarah to discuss the audit of the draft 2016 financial statements.

Darrell is meeting with ASI's bank manager next week to review the draft 2016 financial statements and covenant compliance. He would like to promise the bank that the final audited statements will be available three weeks from today. ASI's audit committee has expressed some concerns about the initial draft, and Darrell has asked CPA LLP to review the draft financial statements, discuss any accounting issues and identify any accounting adjustments required. Sarah asks you to complete this work.

Sarah says: "I would also like you to assess the risk factors of this engagement, given the current circumstances at ASI, and provide me with your recommended materiality and performance materiality. Be sure to also discuss any changes required to our audit approach. I would like to know whether we will be able to rely on controls again this year, and if not, what procedures we will have to perform."

Sarah is also concerned about the acquisition of Freeze the Shell Co., and would like you to recommend substantive procedures related to the balances at the acquisition date and at year-end as part of your audit plan.

In addition, ASI implemented a new ordering and invoicing system in 2016. Based on discussions with Darrell, there have been many customer complaints regarding incorrect invoice amounts. Dealing with these complaints has added to the accounting staff's workload. ASI would like help in evaluating the system. Sarah asks you to identify any control weaknesses, and to suggest improvements.

Finally, the suppliers are concerned that the amount they are receiving as a bonus is not fair, and feel they are being undercompensated. As such, Sarah has asked you to verify the calculation of the 2016 bonus and to highlight any concerns you have with regards to fairness. The suppliers have also requested that a special report be prepared, asserting that the amount is calculated in accordance with the formula. ASI has consented to CPA LLP taking on the engagement. Therefore, Sarah has asked you to identify potential special reports, discuss their respective advantages and disadvantages, and recommend the option that best meets the needs of the suppliers. She would also like you to design appropriate procedures, based on the special report you recommend.

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

(CONTINUED ON PAGE 6)

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

FINANCE REQUIREMENTS

You, CPA, work as a financial analyst for Clarence & Co. (C&C), a consulting firm providing finance and accounting-related services on an as-needed basis to clients. You work closely with Brian Clarence, a partner with C&C, who has recently met with Darrell.

Darrell is meeting with ASI's bank manager next week to review the draft 2016 financial statements and covenant compliance. ASI's audit committee has expressed some concerns about the initial draft, and Brian has asked you to review the draft financial statements, discuss any accounting issues and identify any accounting adjustments required.

Brian would also like you to provide him with an analysis of ASI's financial performance and financial condition for 2016, relative to its competitors.

You are also to look at the recent proposal by the Class B shareholders to exchange their shares. He asks you to assess the impact on the covenants and ASI's cash flows if this proposal is accepted. Additionally, you are asked to outline the advantages and disadvantages of the proposal, from ASI's and the Class B shareholders' perspectives noting any issues you see with the proposal, or modifications that you believe should be made.

Part of the discussion with the bank is arising because ASI is considering an investment in a new vessel to harvest the remaining amount of its clam quota. You are to prepare an analysis of this investment, assuming that the funds are available for this new vessel. ASI uses an after-tax weighted average cost of capital of 12%. The company's corporate tax rate is 25%.

Recently, ASI was approached by a competitor to see if there was interest in ASI purchasing lobster licences for an asking price of $7.5 million. You are to prepare a valuation to assess whether $7.5 million is a reasonable price, and if not, to suggest what would be an appropriate counter-offer.

Finally, ASI has a potential new Chinese customer and wants to know what impact this contract will have on ASI if accepted. Specifically:

- The impact on ASI's receivables, inventory and cash flows
- The advantages and disadvantages of accepting the contract

Additionally, since this contract is in U.S. dollars, you are to prepare a brief discussion of how to manage the foreign exchange risks. Options to be considered include forward contracts, futures contracts and purchase options to sell U.S. dollars at a certain price.

In addition to the common appendices (I to V), information provided in Appendix VI (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 as a financial analyst for Clarence & Co. (C&C), a consulting firm providing services on an as-needed basis to clients. You work closely with Brian Clarence, a partner with C&C, who has recently met with Darrell.

Darrell is meeting with ASI's bank manager next week to review the draft 2016 financial statements and covenant compliance. ASI's audit committee has expressed some concerns about the initial draft, and Brian has asked you to review the draft financial statements, discuss any accounting issues and identify any accounting adjustments required.

Brian has also asked you to assess several issues at ASI but first he would like you to complete a situational analysis. Furthermore, he would like you to discuss the risks ASI faces and propose a mitigation strategy.

Brian has requested that you then review and critique the existing suppliers' bonus agreement to assess whether this plan appropriately motivates suppliers to meet their targets, is fair and is sustainable. He would like you to outline any other issues or concerns you have regarding the existing agreement, and to make recommendations for changes. If you believe any adjustments to the bonus are required, you are asked to present a revised calculation.

Darrell is considering a bonus plan for key managers, specifically: the CEO, CFO, plant manager and VP of marketing and sales. Recently, ASI's board set new key performance indicators (KPIs) and Brian would like you to suggest appropriate performance measures and types of incentives for these managers keeping these KPIs in mind.

ASI is assessing a possible sales contract with a new Chinese customer. You are asked to evaluate and make a recommendation on the new contract, including a discussion of the benefits and risks of this contract as a new source of revenue.

Recently, ASI has been approached to store, process and package lobsters for a competitor. You are asked to assess the impact of this proposed contract on the current lobster operations. Specifically, Brian has asked you to calculate the total profit earned from the lobster division if the contract is accepted. Finally, you are to discuss the advantages and risks related to this contract, and to make a final recommendation as to whether ASI should accept this agreement.

In addition to the common appendices (I to V), information provided in Appendix VI (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 as an employee of CPA LLP in the tax group. You work closely with Jim Allen, a partner with CPA LLP, who has recently met with Darrell. CPA LLP has been engaged to assist ASI with its financial reporting and taxation needs. Since you were recently transferred from the accounting group and have accounting and financial analysis experience, Jim has requested that you help him with ASI's requests.

Darrell is meeting with ASI's bank manager next week to review the draft 2016 financial statements and covenant compliance. ASI's audit committee has expressed some concerns about the initial draft, and Jim has asked you to review the draft financial statements, discuss any accounting issues and identify any accounting adjustments required.

Darrell also mentioned that ASI has recently been audited by CRA. First, Jim has asked that you recalculate the taxes payable for 2015, assuming that the CRA auditor adjustments are correct. Next, if you disagree with any of the proposed adjustments, you should explain your disagreements. You should also calculate revised taxes payable based on your disagreements, and indicate what ASI can do about them.

Jim has also asked you to calculate both the taxable income and income taxes payable for 2016. While he realizes these calculations will have an impact on the financial statements, Jim has asked you not to calculate the revised current or deferred income tax balances for now, as he will work on these after all the other issues are taken care of.

In late 2016, the board approved a stock option plan for the key managers. Before the new plan is announced to the managers, Darrell wants to be clear on the income tax implications for the participants. He also wants to understand the tax implications for ASI.

Darrell has also asked the board to consider a defined contribution plan (registered pension plan) or a matching RRSP contribution plan for all employees, and has asked for the tax considerations for this benefit, from both the company's and the employees' perspectives. Jim would like you to include this analysis in your report.

Finally, there is the proposed exchange of Class B common shares. Darrell would like to understand the tax implications of this proposal on ASI, and for the shareholders, not only for the initial exchange but also for the eventual redemption of the new shares. You are not being asked to discuss the financial reporting implications of this transaction. Assume the shares would be qualifying small business corporation (QSBC) shares at the time of the transaction.

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

(CONTINUED ON PAGE 9)

APPENDIX I (COMMON)
EXCERPTS FROM DRAFT FINANCIAL STATEMENTS

Atlantic Shellfish Inc.
Statement of Financial Position
As at December 31
(in thousands of Canadian dollars)

	2016 (Draft)	2015 (Audited)
Assets		
Current assets:		
Cash	$ 720	$ 1,678
Accounts receivable	3,742	3,581
Advances to suppliers (Note 1)	290	325
Inventory (Note 2)	4,923	4,881
Prepaid expenses	333	541
	10,008	11,006
Investment in Freeze (Note 3)	1,754	0
Property, plant and equipment (Note 4)	10,844	11,785
Licences	8,900	8,900
	$ 31,506	$ 31,691
Liabilities		
Current liabilities:		
Bank indebtedness (Note 5)	$ 2,128	$ 1,288
Trade payables and accrued liabilities	3,054	3,258
Provisions (Note 6)	430	230
Current portion of long-term debt	1,570	1,690
	7,182	6,466
Long-term debt (Note 7)	18,531	20,101
Provisions (Note 6)	970	850
Deferred tax liabilities	156	250
	26,839	27,667
Shareholders' equity		
Common shares	1,650	1,650
Retained earnings	3,017	2,374
Total shareholders' equity	4,667	4,024
	$ 31,506	$ 31,691

(CONTINUED ON PAGE 10)

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

Atlantic Shellfish Inc.
Statement of Comprehensive Income
For the year ended December 31
(in thousands of Canadian dollars)

	2016 (Draft)	2015 (Audited)
Sales	$ 39,025	$ 35,671
Harvesting and procurement (Note 8)	23,415	20,750
Processing (Note 8)	3,620	3,455
Freight and other transport	2,406	2,275
Depreciation	2,374	2,360
Cost of goods sold	31,815	28,840
Administrative and selling (Note 9)	4,390	3,510
Total expenses	36,205	32,350
Operating income	2,820	3,321
Finance costs — interest	(1,978)	(2,005)
Dividend income — Freeze	55	0
Foreign exchange gain (loss)	(40)	(57)
Income before taxes	857	1,259
Income taxes	(214)	(315)
Net earnings and comprehensive earnings	$ 643	$ 944

(CONTINUED ON PAGE 11)

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

Additional Information
(in thousands of Canadian dollars)

Note 1 – Advances to suppliers

These are non-interest bearing, due on demand and secured by the suppliers's catch.

Note 2 – Inventory

	2016	2015
Lobsters and clams	$ 4,023	$ 3,931
Supplies and other	900	950
	$ 4,923	$ 4,881

Note 3 – Investment in Freeze the Shell Co. (Freeze)

In August 2016, ASI purchased 18% of the outstanding shares of Freeze for a total cost of $1,754. This investment has been recorded at cost.

Note 4 – Property, plant and equipment

	Land	Building	Manufacturing equipment	Vessels	Total
Net book value					
Balance — Jan. 1, 2016	$ 170	$ 1,567	$ 830	$ 9,218	$ 11,785
Additions	0	75	300	1,058	1,433
Depreciation	0	(150)	(436)	(1,788)	(2,374)
Balance — Dec. 31, 2016	$ 170	$ 1,492	$ 694	$ 8,488	$ 10,844
Year-end balances					
Cost	170	5,980	6,240	53,940	66,330
Accumulated depreciation	0	4,488	5,546	45,452	55,486
Net book value	$ 170	$ 1,492	$ 694	$ 8,488	$ 10,844

(CONTINUED ON PAGE 12)

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

Additional Information (continued)
(in thousands of Canadian dollars)

Note 4 – Property, plant and equipment (continued)

Depreciation is recorded on a straight-line basis, as follows:

Building	40 years
Equipment	15 years
Vessels	30 years

Note 5 – Bank indebtedness

ASI has a line of credit, to a maximum of $3,000, bearing interest at prime + 2% (currently, prime is 3%). It is secured by accounts receivable and inventory.

Note 6 – Provisions

The provisions for asset decommissioning costs relate to retirement of vessels and plant facilities. The increase of $320 over the prior year represents unwinding of the discount, which is recognised over time in profit or loss as a finance cost.

Note 7 – Long-term debt

	2016	2015
Marine loan	$ 5,832	$ 6,792
Term loan	14,269	14,999
Total	20,101	21,791
Less current portion	(1,570)	(1,690)
Long-term portion	$ 18,531	$ 20,101

The marine loan, which is payable in euros, was advanced 10 years ago for the acquisition of the vessel, *Clam,* from a German supplier. The 8% loan is repayable in quarterly instalments of $210 (150 euros), and matures in 2023. The lender requires audited annual financial statements prepared in accordance with IFRS. The vessel, *Clam,* is security for this loan. Realized foreign exchange gains and losses are recorded through profit or loss, and unrealized foreign exchange gains and losses are insignificant.

(CONTINUED ON PAGE 13)

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

Additional Information (continued)
(in thousands of Canadian dollars)

Note 7 – Long-term debt (continued)

The unsecured term loan was advanced five years ago for plant facility and vessel upgrades. The 8.5% loan is repayable in annual instalments of $730, matures in 2020, and requires the following covenants be maintained:

- The current ratio must be a minimum of 1.0.
- Total debt to EBITDA must be a maximum of 5.0.
- EBITDA to interest must be a minimum of 2.0.
- No dividends are to be paid or new debt issued without prior approval.

Note 8 – Harvesting and procurement and processing

Harvesting and procurement includes labour, fuel and repair costs related to operating the vessels. Processing includes the costs of processing lobsters and clams into fresh or frozen packages. Both of these production costs include all direct and indirect materials and labour.

Note 9 – Administrative and selling costs

Administrative costs include salaries and benefits, professional fees, occupancy costs and other. Selling costs include advertising, marketing and bad debts.

(CONTINUED ON PAGE 14)

APPENDIX II (COMMON)
EXTRACTS OF THE MINUTES FROM THE AUDIT COMMITTEE MEETING – FEB 6, 2017

All members of the Audit Committee were present at the meeting:

- Dorees Finnigan — employee, Class B shareholder and committee chair
- Caren Jones — external advisor (retired CPA)
- Jacques LeMare — employee and Class B shareholder

The CEO, Darrell McDermott, was also present.

Dorees: Darrell, as a result of the illness and death of the CFO, we have some concerns about the 2016 draft statements and the work performed by the accounting staff for the past four months. In particular, I have questions about the new investment in Freeze. We paid $1,754,000 for this investment, correct?

Darrell: Yes. A valuation of the company is provided (Appendix III). We purchased 25,000 shares, which gave us 18%. The remaining shares are widely held. If you remember, we were also able to negotiate having two of the five director seats on their board and the ability to participate in policy decisions.

Jacques: I was recently on our oldest vessel, the *Lobster I*. It has deteriorated over the last year and I think this may impact the carrying value of the vessel. As a result, I requested some additional information (Appendix IV).

Caren: There were over $1 million in additions to the vessels this year. What do these additions represent?

Darrell: In late March, we purchased and installed a new high-tech crane on the *Lobster II*. The *Lobster II* was out of commission for about one week while the new crane was installed. There were also some other costs associated with the new crane (Appendix V).

Dorees: I remember we contracted some development work. Is there an update on this project?

Darrell: In June, ASI entered into an agreement with an independent contractor for some experimental development to improve the blanching process and reduce waste water. To date, the contractor has invoiced for labour, materials and laboratory costs of $300,000. We recorded these costs as additions to equipment since we will eventually have a new and more cost-efficient process. The contractor has produced a working prototype which has performed well during initial testing. Further testing will be performed this summer to help refine the process.

(CONTINUED ON PAGE 15)

APPENDIX II (COMMON) (continued)
EXTRACTS OF THE MINUTES FROM THE AUDIT COMMITTEE MEETING – FEB 6, 2017

Jacques: What is happening with the leased building that we moved out of in December? Have we been able to settle with the landlord with respect to the lease agreement?

Darrell: Not yet. The landlord is still sticking to the lease agreement, which requires us to pay $2,500 at the beginning of each month until March 2019. We are paid up until December 31, 2016, and are committed to pay until the lease expires. Unfortunately, this lease has provisions that disallow cancellation or subletting.

Jacques: Will this have an impact on our year-end financial statements?

Darrell: I'm not sure. To date we have just been expensing the amounts as paid.

(CONTINUED ON PAGE 16)

APPENDIX III (COMMON)
SUMMARY OF INVESTMENT IN FREEZE THE SHELL CO.

On August 16, 2016, ASI purchased 25,000 common shares of Freeze for cash consideration of $1,754,000.

The schedule below indicates the fair values of net assets on August 16, 2016, as prepared by an independent appraiser.

	Carrying value	Fair market value
Identifiable net assets		
Net working capital	$ 1,690,000	$ 1,690,000
Land	1,000,000	2,711,000
Plant and equipment	13,029,000	13,029,000
Customer relationships	0	2,500,000
Long-term debt	(11,147,250)	(11,147,250)
Total	$ 4,571,750	

Freeze has a December 31 year end and follows IFRS. For the period from August 16 to December 31, Freeze reported a net profit after tax of $750,000. ASI received $55,000 of cash dividends from Freeze in December 2016, and Freeze was not eligible for a dividend refund on this payment.

The customer relationships will be useful over the next fifteen years.

(CONTINUED ON PAGE 17)

APPENDIX IV (COMMON)
DETAILS REGARDING *LOBSTER I*

Original cost	$10,000,000
Accumulated depreciation to December 31, 2016	$ 8,333,350

Remaining useful life is estimated to be four years, with no residual value.

Annual pre-tax cash flows to be generated by the vessel's use for the next four years are estimated to be $335,000. ASI's pre-tax weighted average cost of capital (WACC) is 14% and its after-tax WACC is 12%.

An appraisal from a local dealer estimated proceeds of $1.7 million on the sale of the vessel, if sold on December 31, 2016.

The dealer would charge 5% for sales commission on the gross proceeds of the sale, and ASI would be responsible for legal costs of $1,500 to transfer title.

(CONTINUED ON PAGE 18)

APPENDIX V (COMMON)
NEW CRANE PURCHASE

Vessels, such as the *Lobster II*, each have three major components: the crane, the engine and the vessel structure. When the *Lobster II* was purchased in late 1998, each of these components had a useful life of approximately 30 years. At December 31, 2016, the engine and the vessel structure on the *Lobster II* each had a remaining useful life of 12 years.

In March 2016, ASI purchased a new, technologically-advanced, crane for its *Lobster II* vessel. The new crane allows for more efficient lobster fishing, reducing costs and enhancing productivity. Costs were capitalized as follows (in thousands of Canadian dollars):

Cost of new crane	$ 845
Financing costs paid to supplier	14
Removal of old crane from *Lobster II*	34
Installation of new crane on *Lobster II*	56
Training of employees on crane operation	109
	$ 1,058

The new crane has a useful life of at least 20 years. Training was provided by the crane supplier at an additional fee.

The removal of the old crane and the installation of the new crane were both performed by employees of ASI. The old crane is still sitting on ASI's dock. Due to its age and uniqueness, there is no market for the old crane.

(CONTINUED ON PAGE 19)

ASSURANCE ROLE
ADDITIONAL INFORMATION

(CONTINUED ON PAGE 20)

APPENDIX VI
ASSURANCE – ADDITIONAL INFORMATION

Preliminary Audit Planning Excerpts

The following planning information was documented based on CPA LLP's existing knowledge of ASI, along with the preliminary planning completed in September 2016.

- ASI has been a client of CPA LLP for the past eight years.
- During previous years' audits, no errors were identified.
- ASI has strong corporate governance, with both an audit committee (meeting quarterly and including an external advisor who is a retired auditor) and a board of directors (meeting quarterly), who exercise oversight for the company.
- There have been no known changes in accounting policies applied by ASI.

Materiality

- Previous year's materiality had been set using a benchmark of income before taxes and CPA LLP's acceptable range of 5% to 7%.
- Materiality and performance materiality were not calculated at planning time, as internal financial statements were not available. Instead, the previous year's materiality of $75,000 was used.

Test of controls

The following controls have been identified as key controls for ASI, and have been tested and relied upon for audit purposes in the past.

<u>Revenue</u>

- The CFO reviews and approves weekly sales listings, which lists all sales order numbers that were generated during the week, as well as their status.
- As part of his review, he looks at the supporting documentation to validate which sales belong in revenue. To facilitate his review, he receives the sales order, packing slip and customer invoice for completed sales (orders where goods have been shipped and delivered). For incomplete sales, he receives all supporting documentation that is available (packing slip or cancellation of sales order).
- The CFO manually marks his review of each sales order number and signs off each weekly sales listing.
- For sales orders that do not have appropriate supporting documentation, the CFO removes the sale from the listing and ensures that it is not recorded in revenue.
- The test of this process provides assurance over completeness, existence, cutoff and accuracy of revenue.

(CONTINUED ON PAGE 21)

APPENDIX VI (continued)
ASSURANCE – ADDITIONAL INFORMATION

Preliminary Audit Planning Excerpts (continued)

Purchases

- The CFO reviews and approves all expenditures by signing the physical cheque or by using his personal sign-in banking code to authorize the electronic funds transfer (EFT).
- The CFO must receive a signed purchase order, as well as the final invoice, in order to approve the payment.
- For expenses greater than $10,000, sign-off from Darrell must also be obtained. Evidence of sign-off can be seen by viewing the signature on the cheque or by verifying the EFT authorization on the banking website.
- The test of this process provides assurance over the existence/occurrence and accuracy of purchases.

Payroll

- The accounting assistant processes the payroll on a bi-weekly basis.
- The CFO reviews and approves the payroll reports.
- The CFO also performs a reconciliation on a monthly basis, which accounts for any differences in payroll as a result of new hires or terminations during that time frame.
- The test of this process provides assurance over the completeness, existence/occurrence and accuracy of payroll.

(CONTINUED ON PAGE 22)

APPENDIX VI (continued)
ASSURANCE – ADDITIONAL INFORMATION

New Order and Invoicing System

In late October, ASI implemented a new order and invoicing system, Fast Fish (FF). ASI is leasing the software for an annual fee and ASI has the ability to request simple modifications. The system works as follows:

- Customers place their orders online and are asked to input their name as well as their billing and shipping address. FF automatically accepts the order, creates a customer account using the information inputted by the customer and assigns a sequential sales number to the order, such as S00001.
- Pricing depends on volumes. FF automatically determines prices for each order by accessing an electronic file with the prices by volume. All accounting staff have access to the master pricing file but no one has updated it since the system was implemented. Shipping charges are automatically calculated, based on the address entered by the customer, and added to the sales order.
- Sales staff can grant a discount up to 50% of the sales price at their discretion in order to close the sale.
- Once the sales order is finalized, the details are sent to the accounting department where the order is printed and reviewed to ensure that it is complete and that the pricing is accurate. The hard copy of the sales order is then initialled. An accounting department member must then open the sales order in FF and click “Accept” to move to the next step. With the absence of the CFO, the accounting department is sometimes backlogged. Therefore in order to avoid upsetting customers, they simply enter the system and click “Accept” without completing their review and sign-off.
- Upon acceptance, FF sends the sales order to the shipping department, and a packing slip is generated. The packing slips are numbered to match the sales order (P00001).
- The shipping department uses the packing slip to fill the order, and the goods are shipped.
- The shipping department then opens the order in FF using the packing slip number, and clicks “Complete”. Upon completion, the invoice is generated and the customer is billed. The invoice numbers are aligned with the sales order and packing slip numbers (IN00001).
- Before the invoice is sent to the customer, the accounting department manually verifies the accuracy of the information. When they are satisfied, they open FF and click “Send”. This triggers the invoice to be posted to the general ledger, and inventory is automatically reduced. Once again, due to the additional responsibilities the accounting department is experiencing, they sometimes just enter the system and click “Send” on all outstanding invoices, to get the general ledger up-to-date.

(CONTINUED ON PAGE 23)

APPENDIX VI (continued)
ASSURANCE – ADDITIONAL INFORMATION

Suppliers' Bonus Arrangement

At the end of each year, each supplier who has sold lobsters to ASI for five years or more is paid a bonus based on operating profit earned from lobster sales, calculated as follows:

Sales of lobsters
Less harvesting costs of lobsters
Less processing costs of lobsters
Less freight, customs and transport related to sale of lobsters
Less an allocation of administration and selling costs based on time spent only on the lobster division
Equals operating profit earned from lobster sales

Note: depreciation is excluded from the calculation.

As a group, the suppliers receive a bonus of 20% of this operating profit. The amount to be paid to each individual supplier is based on their proportion of lobsters sold to ASI during the fiscal year.

For 2016, the calculation is as follows:

Lobster sales	$ 18,500,000
Harvesting costs (excluding the bonus)	(12,025,000)
Processing costs	(1,320,000)
Freight, customs and transport related to lobster sales	(924,000)
Administration and selling costs allocated to lobster division	(2,856,000)
Operating profit from lobster sales	$ 1,375,000
Profit-sharing bonus — 20%	$ 275,000
Pounds of lobster purchased from suppliers eligible for the bonus	800,000
Bonus per pound	$ 0.344

In 2016, 20 suppliers earned the bonus, so the average bonus per supplier was: $275,000 / 20 = $13,750.

The profit-sharing bonus is included in harvesting costs and accounts payable on the draft 2016 financial statements.

(CONTINUED ON PAGE 24)

APPENDIX VI (continued)
ASSURANCE – ADDITIONAL INFORMATION

Suppliers' Bonus Arrangement (continued)

Recently, some information has surfaced about the allocation of the administration and selling costs. In the past, this allocation was based on time spent, but this year, due to insufficient records being kept, the allocation was simply based on last year's time, which was 68.65% for the lobster business. However, in 2016, there were the following significant differences in expenses in comparison to 2015:

- The company paid for a marketing study on clams that cost $50,000.
- A new sales agent was hired specifically to market clams in Asia. The additional costs of this agent totalled $420,000.
- A new lobster-packaging design was created by an advertising consultant, along with new advertising material, totalling $270,000.
- ASI made donations totalling $170,000 that had not been made in previous years.

Finally, there was a major repair performed on the lobster-packaging machinery. An operator had inadvertently jammed the equipment, causing damage of $400,000. This cost has been included in processing costs, but the suppliers feel that this is not a "normal expense," and should be excluded from the bonus calculation.

(CONTINUED ON PAGE 25)

FINANCE ROLE

ADDITIONAL INFORMATION

(CONTINUED ON PAGE 26)

APPENDIX VI
FINANCE – ADDITIONAL INFORMATION

Industry Benchmarks

The following information relates to large, integrated seafood companies that harvest, process and deliver seafood within North America.

	2016	2015
Profitability		
Return on equity	14.0%	13.8%
Margin analysis		
Operating profit as % of sales	12.4%	11.4%
Turnover		
Days in receivables	41.0	45.1
Days in inventory	39.6	40.1
New capital investment/depreciation	150%	220%
Short-term liquidity		
Current ratio	2.3	2.3
Long-term solvency		
Total debt/Total assets	0.8	0.7
EBITDA/Interest	3.0	3.2

(CONTINUED ON PAGE 27)

APPENDIX VI (continued)
FINANCE – ADDITIONAL INFORMATION

Retractable Preferred Share Proposal

Currently, there are 10,000 Class B common shares outstanding. Each share was issued for $100. Each of the 50 employees invested $20,000, and in return, received 200 common shares.

The proposal is to exchange the 10,000 Class B common shares on a one-to-one basis for new, Class D preferred shares.

The Class D preferred shares will have the following terms and conditions:

- There will be one vote per share.
- A quarterly cumulative dividend will be payable on the 16th day of March, June, September and December. The quarterly dividend will be equal to the higher of:
  - $2.50 per share; or
  - 10% of earnings per share (calculated by including Class D preferred shares in the number of shares outstanding).
- The shares are retractable any time after January 1, 2020, for a price of $100.
- ASI can also redeem the shares at $100 any time after January 1, 2022.
- All dividends in arrears must be paid prior to redemption of the shares.
- On dissolution, the Class D preferred shareholders will participate fully along with the common shareholders.

As there is a contractual obligation to deliver cash when the holder surrenders his shares, these preferred shares will be reported as a liability at the amount that ASI will be obligated to pay, being $100 each.

(CONTINUED ON PAGE 28)

APPENDIX VI (continued)
FINANCE – ADDITIONAL INFORMATION

New Vessel Investment Proposal

ASI is considering the purchase of a new vessel for harvesting clams. The vessel will cost $45 million and will allow the company to harvest an additional six million pounds of clams annually. This vessel will have state-of-the-art technology, allowing the company to process the clams to frozen state directly on board, keeping the food fresher and ensuring a better taste. ASI estimates that this product could be sold for $6.00 per pound in 2018.

The vessel will take 12 months to complete and will be put into service at the beginning of 2018. The supplier will be paid $30 million immediately and $15 million in January 2018. This new vessel will have a useful life of 25 years, and qualifies for the CCA Class 7 special rate of 16 2/3% in the first year and 33 1/3% for each year thereafter.

The harvesting costs, representing all vessel operating costs (fuel, labour and fishing gear) required to harvest and process six million pounds of clams, will total $26 million in 2018. Selling costs, including delivery, are estimated to be 5% of sales. Annual maintenance and repairs will be $2 million. Annual administrative costs of $1.5 million will be allocated to this project, although annual incremental costs will only be $0.8 million. As any increase in costs should be offset by increased revenue, inflation should be ignored.

An initial investment in working capital of $2.5 million in 2018 will be required, and will stay at this level until the end of the vessel's life. At the end of the vessel's useful life, it is estimated that decommissioning costs of $5 million will be required.

The German supplier will finance a portion of the costs associated with the new vessel, at an interest rate of LIBOR plus 6%. LIBOR is currently at 4%. Darrel is nervous about this variable rate loan, and wonders if there is any way to mitigate the risks associated with fluctuations in interest rates.

(CONTINUED ON PAGE 29)

APPENDIX VI (continued)
FINANCE – ADDITIONAL INFORMATION

Intangible Asset Purchase

Recently, a competitor that is closing its business approached ASI to ask if ASI would be interested in acquiring the rights to its ten offshore lobster licences. The ten licences would allow ASI to harvest an additional 500,000 pounds of offshore lobster annually. The asking price is $7.5 million for the ten licences. The licences have indefinite lives and only require a nominal annual fee.

ASI has been able to gather the following information with respect to historical lobster licence transactions in the open market. ASI believes that some of these lease transactions should be useful to assist in the valuation of the ten licenses that have been offered to ASI and to help determine if the asking price is reasonable.

Company	Total annual pounds available under the leased license	Terms and conditions of lease
Tiger Limited	250,000	Offshore lobster — Six-year lease fee of $100,000 annually plus $1.50 per pound with no minimum guaranteed volume. This agreement is renewable every six years.
Shore to Shore Inc.	500,000	Inshore lobster — Two-year lease fee of $50,000 annually plus $2.45 per pound, with a minimum guaranteed volume of 400,000 pounds annually. Not renewable.
Coldwater Seafood Inc.	250,000	Inshore lobster — Three-year lease fee of $25,000 annually plus $2.80 per pound, with a minimum guaranteed volume of 100,000 pounds annually. Not renewable.
Shellfish Harvester Ltd.	400,000	Offshore lobster — Five-year lease fee of $200,000 annually plus $1.75 per pound, with a minimum guaranteed volume of 300,000 pounds annually. Renewable every five years.

The appropriate discount rate for this analysis is ASI’s WACC of 12%.

(CONTINUED ON PAGE 30)

APPENDIX VI (continued)
FINANCE – ADDITIONAL INFORMATION

Contract with New Chinese Customer

A restaurant chain in China, called Dragon Delights (DD), is interested in contracting for a three-year supply of red sand clams at a fixed price in U.S. dollars. They will commit to a minimum and maximum volume to be purchased each year. Currently, ASI does not have enough product to support this agreement, and will have to outsource to another company to harvest and procure the additional required clams at C$3.50 per pound.

The proposed terms and conditions of the sales contract to DD include the following:

- The contract is for three years, from March 1, 2017, to February 28, 2020.
- DD agrees to purchase a minimum of two million pounds and a maximum of three million pounds of frozen clams annually, at a price of US$5.10 per pound.
- The two million pounds will be ordered evenly over the year, estimated at between 160,000 and 170,000 pounds per month.
- Orders will be made every two weeks, with shipment following within one day of the order.
- DD will be responsible for all shipping and related costs.
- DD will have credit terms of 60 days.
- The contract may be renewed in 2020 if both parties are in agreement.
- The contract may be terminated without penalty by either party with sixty days' notice.

Currently, the clams are selling for US$4.40 per pound (the current exchange rate is US$1 = C$1.17).

ASI's 2016 production and selling costs for the clams are detailed below:

Harvesting and procurement:	
Variable costs	$2.23 per pound
Fixed costs	$2,500,000
Processing and manufacturing:	
Variable costs	$0.39 per pound
Fixed costs	$760,000
Freight costs — variable	$0.38 per pound (from the processing plant to the customer)
Selling costs — variable	$0.21 per pound (there would be no selling costs for the DD contract)

ASI expects that it will hold, on average, two weeks' worth of sales in inventory in order to meet the delivery requirements of this contract.

(CONTINUED ON PAGE 31)

PERFORMANCE MANAGEMENT ROLE
ADDITIONAL INFORMATION

(CONTINUED ON PAGE 32)

APPENDIX VI
PERFORMANCE MANAGEMENT – ADDITIONAL INFORMATION

Information about the Industry

Harvesting seafood

ASI operates two distinct segments for seafood fishing — seasonal fishery for lobsters, and year-round offshore fishery for clams.

Offshore fishing is dominated by a few, large, integrated companies that, similar to ASI, own large vessels and have licences to harvest large proportions of the annual total allowable catch stipulated by the government. These companies harvest, process and distribute seafood. There are economies of scale that can be obtained with integration and size, and as a result, consolidation has been predominant in the industry. The high costs of vessels and the limited number of licences create significant barriers to entry.

As health-conscious consumers demand premium, sustainable products that taste good, demand for seafood has been increasing. Since supply is fixed by government quotas, prices are increasing as demand outstrips supply.

Prices for clams are expected to increase by 26% over the next six years. Demand from Asia, and particularly China, is expected to double by 2020.

Clams

Red sand clams are the species most often preferred in the preparation of sushi, resulting in high demand in Japan and China, in addition to North America. Global growth of the clam supply is expected to increase by 15% annually for the next three years. ASI estimates that, by 2018, clams could be sold for $6.00 per pound.

Lobsters

Global growth rates for lobster sales are expected to increase by 5% annually for the next 10 years. However, the lobster population has been declining and the Department of Fisheries and Oceans has reduced the allowable annual harvest quota for the inshore fishing licences. Many inshore lobster fishermen have complained that their annual quotas have been reduced by up to 80%. To date, offshore lobster quotas have not been impacted.

(CONTINUED ON PAGE 33)

APPENDIX VI (continued)
PERFORMANCE MANAGEMENT – ADDITIONAL INFORMATION

Industry Benchmarks

The following information relates to large, integrated seafood companies that harvest, process and deliver seafood within North America.

	2016	2015
Profitability		
Return on equity	14.0%	13.8%
Margin analysis		
Operating profit margin as % of sales	12.4%	11.4%
Turnover		
Days in receivable	41.0	45.1
Days in inventory	39.6	40.1
New capital investment/depreciation	150%	220%
Short-term liquidity		
Current ratio	2.3	2.3
Long-term solvency		
Total debt/Total assets	0.8	0.7
EBITDA/Interest	3.0	3.2

For 2017, the board has identified three key performance indicators:

- return on equity of at least 14%;
- operating profit margin of at least 10% of sales; and
- a total debt/total asset ratio of no more than 0.8.

(CONTINUED ON PAGE 34)

APPENDIX VI (continued)
PERFORMANCE MANAGEMENT – ADDITIONAL INFORMATION

Suppliers' Bonus Arrangement

At the end of each year, each supplier who has sold lobsters to ASI for five years or more is paid a bonus. As a group, these suppliers receive a bonus of 20% of operating profit earned from lobster sales. The amount to be paid to each individual supplier is based on their proportion of lobsters sold to ASI during the fiscal year.

For 2016, the calculation is as follows:

Lobster sales	$ 18,500,000
Harvesting costs (excluding the bonus)	(12,025,000)
Processing costs	(1,320,000)
Freight, customs and transport related to lobster sales	(924,000)
Administration and selling costs allocated to lobster division	(2,856,000)
Operating profit from lobster sales	$ 1,375,000
Profit-sharing bonus — 20%	$ 275,000
Pounds of lobster harvested by suppliers eligible for the bonus	800,000
Bonus per pound	$ 0.344

Note: depreciation is excluded from the calculation.

In 2016, 20 suppliers earned the bonus, so the average bonus per supplier was: $275,000 / 20 = $13,750.

The profit-sharing bonus is included in harvesting costs and accounts payable on the draft 2016 financial statements.

(CONTINUED ON PAGE 35)

APPENDIX VI (continued)
PERFORMANCE MANAGEMENT – ADDITIONAL INFORMATION

Suppliers' Bonus Arrangement (continued)

Recently, some information has surfaced about the allocation of the administration and selling costs. In the past, this allocation was based on time spent, but this year, due to insufficient records being kept, the allocation was simply based on last year's time, which was 68.65% for the lobster business. However, in 2016, there were the following significant differences in expenses in comparison to 2015:

- The company paid for a marketing study on clams that cost $50,000.
- A new sales agent was hired specifically to market clams in Asia. The additional costs of this agent totalled $420,000.
- A new lobster-packaging design was created by an advertising consultant, along with new advertising material, totalling $270,000.
- ASI made donations totalling $170,000 that had not been made in previous years.

Finally, there was a major repair performed on the lobster-packaging machinery. An operator had inadvertently jammed the equipment, causing damage of $400,000. This cost has been included in the manufacturing costs related to lobster processing.

(CONTINUED ON PAGE 36)

APPENDIX VI (continued)
PERFORMANCE MANAGEMENT – ADDITIONAL INFORMATION

Contract with New Chinese Customer

A restaurant chain in China, called Dragon Delights (DD), is interested in contracting for a three-year supply of red sand clams at a fixed price in U.S. dollars. They will commit to a minimum and maximum volume to be purchased each year. Currently, ASI does not have enough product to support this agreement, and will outsource to another company to harvest and procure the additional required clams at C$3.50 per pound. This will result in a contribution margin of C$2.08 per pound. ASI has not yet investigated whether or not this contract would incur any additional fixed administration costs.

The proposed terms and conditions of the sales contract to DD include the following:

- The contract is for three years, from March 1, 2017, to February 28, 2020.
- DD agrees to purchase a minimum of two million pounds and a maximum of three million pounds of frozen clams annually, at a price of US$5.10 per pound.
- The two million pounds will be ordered evenly over the year, estimated at between 160,000 and 170,000 pounds per month.
- Orders will be made every two weeks, with shipment following within one day of the order.
- DD will be responsible for all shipping and related costs.
- DD will have credit terms of 60 days.
- The contract may be renewed in 2020 if both parties are in agreement.
- The contract may be terminated without penalty by either party with sixty days' notice.

Currently, the clams are selling for US$4.40 per pound (the current exchange rate is US$1 = C$1.17).

(CONTINUED ON PAGE 37)

APPENDIX VI (continued)
PERFORMANCE MANAGEMENT – ADDITIONAL INFORMATION

Proposed Contract with Royal Lobster Co.

ASI has been approached by a competitor, Royal Lobster Co. (RLC). RLC wants ASI to process and package 2.5 million pounds of lobster annually on behalf of RLC. RLC will harvest and deliver the lobsters to ASI for storage in the lobster ponds and for processing and packaging. ASI will then ship directly to RLC's customers, but shipping costs will be paid by RLC. The contract will initially be for four years.

RLC will pay ASI $0.85 per pound for storage, processing and packaging. Any cost overruns, wastage or other costs will be ASI's responsibility. ASI will also be responsible for ensuring that the packaged lobsters comply with all food safety regulations and ASI will be held responsible for any liabilities arising from any food contamination or failure to pass inspection. ASI will also be responsible for any penalties incurred due to late delivery caused by processing problems. Annual wastage and overrun costs are estimated to be 3.5% of the total contract price.

ASI's plant has the capacity to process and package a total of four million pounds of lobster annually. In 2016, ASI processed 1.8 million pounds of lobster.

The current selling price per pound of lobster is $10.27.

Below are the variable and fixed costs for the lobster division:

Harvesting and procurement:	
Variable costs for own catch	$3.71 per pound
Variable costs for catch from inshore lobster suppliers	$5.66 per pound
Fixed costs	$3,000,000
Processing and packaging:	
Variable costs	$0.20 per pound
Fixed costs	$960,000
Freight costs — variable	$0.51 per pound
Selling costs — variable	$0.26 per pound
Administration and selling costs — fixed	$2,388,000

Note: these figures do not include the suppliers' bonus that is calculated annually.

Ignore the suppliers' bonus and tax implications in your calculations.

RLC has stipulated that the contract is to process and package all 2.5 million pounds and is not interested in doing the contract for less.

(CONTINUED ON PAGE 38)

TAXATION ROLE

ADDITIONAL INFORMATION

(CONTINUED ON PAGE 39)

APPENDIX VI
TAXATION – ADDITIONAL INFORMATION

Income Tax Details

Provincial corporate tax rates in Prince Edward Island (PEI) for both 2015 and 2016 are as follows:

Active business income up to the small business limit	4.5%
All other income	16%
Investment tax credit on qualifying SR&ED expenditures	15%

ASI uses the accrual method of accounting for its fishing income.

Income tax data for 2015

ASI's 2015 T2 Corporation Income Tax Return as filed included the following:

Costs deducted related to upgrading *Clam*	$	750,000
Total allowable SR&ED expenditures	$	325,000
Taxable income	$	1,350,000
Taxes payable	$	178,500

All instalments and the final balance owing were paid on time. The CRA performed an audit of certain items after ASI filed its 2015 tax return. The auditor is proposing the following adjustments to taxable income:

- Total meals and entertainment expenses were $48,000. Included in this amount was $10,000 relating to the annual summer and December holiday parties. ASI deducted 100% of $10,000, and added back 50% of the remainder ($19,000), but CRA also denied 50% of the deduction for the parties.
- $15,000 was paid to obtain updated appraisals for the vessels. The deduction claimed by ASI was denied by the CRA as it was considered a cost of financing.
- Several small tools, each costing less than $500, were purchased for a total of $28,000 and placed by ASI in Class 12 without the half-year rule. CRA reallocated these tools to Class 8 and applied the half-year rule.
- The annual insurance payment of $180,000 was denied by CRA on the basis that it was a prepaid expense. The policy renews on January 1 annually and is paid all at once.
- The costs of the *Clam* upgrade were determined by CRA to be a betterment rather than repairs and maintenance. The costs had been correctly capitalized for financial reporting purposes in 2015. CRA added these costs to *Clam,* in Class 7.
- $225,000 of the SR&ED expenditures were found by CRA to be capital expenditures on manufacturing equipment. CRA denied the deduction and added the costs to Class 29.

(CONTINUED ON PAGE 40)

APPENDIX VI (continued)
TAXATION – ADDITIONAL INFORMATION

Income Tax Details (continued)

In addition to the above, the auditor is proposing the following adjustments to the calculation of taxes payable:

- The federal and PEI small business deductions were denied based on the amount of taxable capital in the prior year.
- The additional 20% federal investment tax credit on eligible SR&ED expenditures available to Canadian-controlled private corporations was denied.

UCC/CEC balances at December 31, 2015, prior to proposed audit adjustments:

Class	Description	CCA rate	UCC/CEC balance
Class 1	Buildings	4%	$ 1,354,000
Class 7	Vessel, *Clam*	15%	$ 2,142,000
Class 7	Vessel, *Lobster I*	33 1/3% straight-line	$ 28,000
Class 7	Vessel, *Lobster II*	33 1/3% straight-line	$ 544,000
Class 8	Furniture, equipment and tools	20%	$ 50,000
Class 12	Software and small tools	100%	$ 10,000
Class 29*	Manufacturing equipment	50% straight-line	$ 400,000
Class 50	Computer equipment	55%	$ 40,000
ECP	Licences	7% CECA	$ 6,200,000

* The balance in Class 29 consists of processing equipment purchased in 2014.

Vessels manufactured outside of Canada (such as *Clam)* are pooled in Class 7, with a declining-balance CCA rate of 15%, and the half-year rule applies in the year of acquisition. Vessels manufactured and operated in Canada (such as *Lobster I* and *Lobster II*) are eligible for a separate Class 7, with straight-line CCA at 33 1/3% of the capital cost and the rate in the year of acquisition being 16 2/3% of the capital cost. CCA of $28,000 may be claimed in 2016 on costs included in the 2015 ending UCC for *Lobster I*. CCA of $224,000 may be claimed in 2016 on costs included in the 2015 ending UCC for *Lobster II*.

Additional income tax data for 2016

Included in selling costs for 2016 are meals of $120,000 and donations of $170,000 ($75,000 to unregistered not-for-profit organizations and $95,000 to registered charities).

(CONTINUED ON PAGE 41)

APPENDIX VI (continued)
TAXATION – ADDITIONAL INFORMATION

Proposed Stock Option Plan

The average annual income of all employees is $150,000. ASI would like to provide some additional compensation in the form of stock options, to be granted annually to key managers. Options will be granted at the discretion of the board on an annual basis on January 1. Options will be for the purchase of new Class C common shares, which will participate in ownership in the same manner as Class A common shares.

The options will have an exercise price set at the date of grant equal to the fair market value of the shares plus $2. The fair market value will be determined using an agreed-upon valuation model.

The options will vest after two years, with 25% vesting after the first year and 75% vesting after the second year. The options will be exercisable for five years after the vesting date.

On exercise, the exercise price will be paid to the company, and the shares will be issued.

(CONTINUED ON PAGE 42)

APPENDIX VI (continued)
TAXATION – ADDITIONAL INFORMATION

Retractable Preferred Share Proposal

Currently, there are 10,000 Class B common shares issued and outstanding to a group of 50 employees. When issued seven years ago, each share was issued for the fair value of the shares, being $100. Each employee invested $20,000 and, in return, received 200 shares.

The proposal is to exchange the 10,000 Class B common shares, on a dollar-for-dollar basis, for new Class D preferred shares, using a fair value determined using an agreed-upon valuation model.

The Class D preferred shares will have the following terms and conditions:

- There is one vote per share.
- A quarterly, cumulative dividend will be payable on the 16th day of March, June, September and December. The quarterly dividend per share will be equal to the higher of:
  - $2.50; or
  - 10% of earnings per share (calculated by including Class D preferred shares in the number of shares outstanding).
- The shares are retractable any time after January 1, 2020, for a price of $100 paid in cash.
- ASI can also redeem the shares at $100 any time after January 1, 2022.
- All dividends in arrears must be paid prior to redemption of the shares.
- On dissolution, the Class D preferred shareholders will have preference over all classes of common shares, and will be entitled only to redemption at the retraction price.

Legal fees to ASI relating to the exchange are estimated to be $10,000.

(CONTINUED ON PAGE 43)

End of Exam

(CONTINUED ON PAGE 44)

CPA COMMON FINAL EXAMINATION REFERENCE SCHEDULE

1. PRESENT VALUE OF TAX SHIELD FOR AMORTIZABLE ASSETS

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

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

Notation for above formula:
C = net initial investment
T = corporate tax rate
k = discount rate or time value of money
d = maximum rate of capital cost allowance

2. SELECTED PRESCRIBED AUTOMOBILE AMOUNTS

	2015	**2016**
Maximum depreciable cost — Class 10.1	$30,000 + sales tax	$30,000 + sales tax
Maximum monthly deductible lease cost	$800 + sales tax	$800 + sales tax
Maximum monthly deductible interest cost	$300	$300
Operating cost benefit — employee	27¢ per km of personal use	26¢ per km of personal use
Non-taxable automobile allowance rates		
— first 5,000 kilometres	55¢ per km	54¢ per km
— balance	49¢ per km	48¢ per km

3. INDIVIDUAL FEDERAL INCOME TAX RATES

For 2015

If taxable income is between			Tax on base amount	Tax on excess
$0	and	$44,701	$0	15%
$44,702	and	$89,401	$6,705	22%
$89,402	and	$138,586	$16,539	26%
$138,587	and	any amount	$29,327	29%

For 2016

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

(CONTINUED ON PAGE 45)

4. SELECTED INDEXED AMOUNTS FOR PURPOSES OF COMPUTING INCOME TAX

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

	2015	**2016**
Basic personal amount	$11,327	$11,474
Spouse, common-law partner, or eligible dependant amount	11,327	11,474
Amount for children under 18	N/A	N/A
Age amount if 65 or over in the year	7,033	7,125
Net income threshold for age amount	35,466	35,927
Canada employment amount	1,146	1,161
Disability amount	7,899	8,001
Infirm dependants 18 & over	6,700	6,788
Net income threshold for infirm dependants 18 & over	6,720	6,807
Adoption expense credit limit	15,255	15,453

Other indexed amounts are as follows:

	2015	**2016**
Medical expense tax credit — 3% of net income ceiling	$2,208	$2,237
Annual TFSA dollar limit	10,000	5,500
RRSP dollar limit	24,930	25,370
Lifetime capital gains exemption on qualified small business corporation shares	813,600	824,176

5. PRESCRIBED INTEREST RATES (base rates)

Year	Jan. 1 – Mar. 31	Apr. 1 – June 30	July 1 – Sep. 30	Oct. 1 – Dec. 31
2016	1			
2015	1	1	1	1
2014	1	1	1	1

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

(CONCLUDED ON PAGE 46)

6. MAXIMUM CAPITAL COST ALLOWANCE RATES FOR SELECTED CLASSES

Class 1	4%	for all buildings, except those below
Class 1	6%	for new non-residential buildings acquired after March 18, 2007
Class 1	10%	for new manufacturing and processing buildings acquired after March 18, 2007
Class 8	20%	
Class 10	30%	
Class 10.1	30%	
Class 12	100%	
Class 13	Original lease period plus one renewal period (minimum 5 years and maximum 40 years)	
Class 14	Length of life of property	
Class 17	8%	
Class 29	50%	straight-line
Class 43	30%	
Class 44	25%	
Class 45	45%	
Class 50	55%	
Class 53	50%	

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