CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

CFE CANDIDATE NUMBER: | | | | | | | |

Common Final Examination
September 11, 2019 – Day 1
(Booklet #1 – Marmani Version 1)

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

GENERAL INSTRUCTIONS BEFORE THE EXAMINATION

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

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_____ _____

CANDIDATE NAME (Please print) SIGNATURE

Examination Details

The examination consists of:

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

The case should be answered in *SecureClient*, which has 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 on anything other than *SecureClient* or the CPA Canada writing paper provided. Rough-note paper is available in the second booklet, which also includes a copy of the Capstone 1 case. Rough notes, and any other notations made in the exam booklet(s), will not be evaluated.

The CPA Canada Handbooks and the *Income Tax Act* are available within *SecureClient* throughout the entire examination. *SecureClient* provides the standards in effect and tax laws substantively enacted as at December 31, 2018.

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

Common Final Examination, September 2019

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

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

It is now June 18, 2022, and you, CPA, continue to work as Marmani's corporate controller. Currently, Marmani is thriving. Roberto ultimately decided against the sale of the company and operations were instead expanded into the athleisure apparel industry. To accommodate the additional production demands of the new Athleisure product line, Marmani purchased a new production facility in Richmond, British Columbia. Marmani now operates with two divisions: Adaptive and Athleisure.

The introduction of a digital marketing campaign for Athleisure resulted in rapid growth in that division. The formation of a dedicated, in-house sales force for the Adaptive division has also proven successful.

Marmani secured a long-term debt agreement with Hurley Bank of Canada with the terms and covenant that were first discussed with them. Combined with Marmani's strong earnings and cashflows, Marmani is in a more secure financial position than it has ever been. Marmani's goal remains to increase annual revenues by between 8% and 10%. The management team remains the same.

Marmani revised both its vision and mission statements to emphasize its dedication to quality and environmental sustainability.

"Our vision is to be a leader in the apparel industry by creating products that, through sustainable business practices and a commitment to quality, perform beyond the expectations of our customers and make people's lives better."

"We accomplish our vision by designing and selling functional and attractive clothing with materials and production practices that adhere to the tenets of long-term sustainability and quality."

The athleisure industry segment has grown considerably in the past three years and industry experts are forecasting a high growth trend for at least the next five years. However, competition within the segment has become fierce. The popularity of online shopping has led many companies to offer an online marketplace in order to remain competitive. Based on industry research, the online market for athleisure clothing currently generates $800 million in annual revenue globally, having grown at an exceptionally rapid pace compared to other retail segments. The current growth rate of 15% per year for online sales is predicted to continue for the next five years.

With a large portion of the Canadian population being 65 or older, the adaptive clothing industry is also growing, and this is expected to continue. Only a few of Marmani's competitors have started to recognize this opportunity. As a result, competition within this market is slowly growing.

The Canadian economy is strong and consumer confidence is high.

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APPENDIX I
TRANSCRIPT OF MANAGEMENT MEETING – JUNE 18, 2022

Roberto: Thank you for joining me today. I called this meeting because, like most of you, I am overwhelmed. I just cannot believe the rapid growth we have experienced. Who would have thought that our athleisure products would be so popular? I am so proud of all of you and thank you for your hard work. However, we have some major decisions to make. First, what is our next step with the adaptive apparel line? Sonya, can you give us an update?

Sonya: Well, Roberto, to be honest, I have been spending so much time on the designs for Athleisure that I haven't had the opportunity to do much on Adaptive.

Wayne: I can attest to the same thing, Roberto. The Athleisure division has absorbed all our attention, and because of that, the Adaptive division is in a decline. Products are still selling but we are nowhere near our annual revenue growth target. This past month, adaptive apparel sales have decreased for the first time. I am starting to become concerned. We need to do something to reverse this trend.

Roberto: Witherspoon's is still interested in Adaptive and has again submitted an offer to purchase the division. They have increased the offer and I want to reconsider it . Their offer seems reasonable. When we were securing financing through Hurley in November 2020, Hurley's valuators assessed the value of Adaptive, as a stand-alone division, to be approximately $28.5 million.

Sonya: Roberto, you know my passion lies in adaptive apparel. If we were to sell Adaptive, I would reconsider my future with Marmani. I want to work on designs that make a difference in people's lives.

Roberto: We would hate to lose you, Sonya, as you are such an important part of our management team. And if we sell to Witherspoon's, most of our Adaptive employees may be terminated, which is hard for me to accept. But I am not sure there is another viable option.

Sonya: My preference is to stay. I believe adaptive apparel still presents an opportunity to increase Marmani's revenue. We could expand our adaptive apparel product line. We need to develop new designs and offer new products. If we refocus our attention on the Adaptive division, I have no doubt that we can turn it around while also making a real difference.

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APPENDIX I (continued)
TRANSCRIPT OF MANAGEMENT MEETING – JUNE 18, 2022

CPA: I will look at the options for the Adaptive division. By the way, what was done regarding the sales staff issue? While doing some analysis of Adaptive's sales, Ronald found a large increase in returns for one salesperson. He said he informed the sales manager, Rory, so that he could deal with it. I assume Rory told you, Karen, about the issue and how he resolved it.

Karen: He did, but he gave me the impression he took care of what he considered to be a minor issue, so I didn't investigate any further. CPA, could there be concerns of a broader nature here?

CPA: I'll review Rory's email more closely and let you know .

Roberto: Karen, prior to our meeting, you mentioned that you wanted to discuss something.

Karen: Yes. I want to explore the idea of offering our athleisure products online. We are overlooking a huge opportunity. Sonya, I'm sorry, but I think Marmani would be far better off directing more resources towards Athleisure than towards Adaptive. I would even suggest that we focus all our attention on Athleisure.

As the largest growth segment of the apparel industry, the athleisure segment is flourishing. If our objective is growth, why not focus on this segment? The research clearly supports higher growth in it than in the adaptive apparel segment.

In addition, Marmani's digital presence has expanded since we adopted a digital marketing strategy. Athleisure has become a recognized brand online. We could increase revenue even more with online sales, which our customers now expect. If we are to compete in today's world successfully, we need online sales!

Roberto: What kind of earnings do you expect from an online marketplace for our athleisure wear?

Karen: The potential is huge. According to the expert I have been working with, our market share could be anywhere between 1% and 4.5% of the global market. We could maybe get around 3% of the market share.

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APPENDIX I (continued)
TRANSCRIPT OF MANAGEMENT MEETING – JUNE 18, 2022

Roberto: Karen, you know I am conservative and 3% seems aggressive to me, especially since we would be competing with some of the biggest brands in the segment.

Karen: I am surprised that you would doubt the potential of our Athleisure brand, especially after the explosive growth we have been experiencing. Admittedly, there is risk because of how competitive the marketplace has become, making it impossible to be more definitive with our market share estimate.

Sonya: And what about our IT situation? We upgraded for digital marketing, but we lack the infrastructure to support online sales. I hear about disasters with online sales all the time on the news. We could be putting clients' confidential, personal information at risk, for example.

Roberto: CPA, please analyze Karen's proposal . Although it may be unrealistic, the ideal would be to both rejuvenate Adaptive and expand into online sales of athleisure wear.

Wayne: That would be difficult. We would risk overextending ourselves. Ever since the Athleisure division was created, we have been overworked. Personally, I am exhausted. I think we can all agree that we need to lighten our workload.

Sonya: I agree with you, Wayne. We cannot keep up this pace. Roberto, what was the name of the guy you met a couple of weeks ago at that business conference, the one you were so impressed by?

Roberto: His name is Matthew Mondoux. I was really impressed by his self-confidence and his interest in Marmani. He seemed willing to come work for us and even proposed bringing in a whole managerial team for the Athleisure division. He was confident that he could find the right people very quickly, using his many contacts in the industry. He promised to present some proposed plans for Athleisure. I just received them but haven't had a chance to consider them yet.

Sonya: I think expanding our management team could really help us.

Karen: I agree, and our earnings in Athleisure are fantastic, so we can certainly afford to hire additional staff.

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APPENDIX I (continued)
TRANSCRIPT OF MANAGEMENT MEETING – JUNE 18, 2022

Wayne: Just because we can afford it does not mean it is a good idea. The success of Marmani is a direct result of the decisions made by us. Bringing in a new team makes me nervous. If the new manager and the new team we hire do not perform to our expectations, it could undo Marmani's hard-earned success. What do we know about Matthew?

Roberto: Matthew's online profile speaks for itself. He has extensive experience and a proven record, which should reduce the risk. And the reality is that we need help now. The timing of his offer to help seems perfect. If we hire him, the current burden being placed on all of you would be lifted.

Karen: I agree that we need more help, but we should be cautious. Our Athleisure brand is built on quality and sustainability. I worry about Matthew maintaining our quality standards. I did an online search after you first mentioned his name, and I discovered a few things.

Roberto: Really? What did you find?

Karen: Well, does Matthew plan to expand Athleisure by outsourcing our production to Vietnam? If he uses the same overseas facility that he has in the past, we may have a problem. That facility has previously used questionable business practices.

Roberto: Matthew has been so successful! I can't believe he would jeopardize that in any way. CPA, please look at Matthew's profile and plans for Athleisure and at Karen's findings, and provide your opinion.

CPA: Of course.

Roberto: We have a lot more to consider than I thought and the decisions we make cannot be made in isolation. To ensure Marmani's future, we must have a coherent strategy. Let's reconvene next week. With CPA's input, we should be better able to make good decisions about the issues we are facing.

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APPENDIX II
NOTES ON WITHERSPOON'S OFFER

Prepared by Roberto Marmani

Witherspoon's has expressed renewed interest in acquiring the Adaptive division. The offer is for $30 million. The only other change to the offer is that my commitment to stay with the company after the sale has been reduced to three months.

Because Witherspoon's does not want a long, complex process, the deal is structured so that the sale of the Adaptive division would be simple and quick. The offer expires in two weeks.

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APPENDIX III
ADAPTIVE APPAREL EXPANSION

Prepared by Sonya Valencia

If we refocus our attention on it, the Adaptive division can be so much more successful than it is now. We have not released new designs or products in years. I have some new designs ready, and am working on other plans for new, innovative product designs that I am confident will revive Adaptive's sales.

Expanding our product line will most likely require our management team to be dedicated full-time to the project. The biggest obstacle at this point is the production facility in Toronto.

We can only expand our product line and continue to meet our high-quality standards efficiently if we put state-of-the-art equipment in Toronto, like we did in Richmond. I think that equipment is largely responsible for Athleisure's success. In order to produce and quickly change our designs, we will need to invest an estimated $5 million in specialized, advanced production equipment, a new design lab and a new IT system.

Realistically, it will take a year to make these changes. Once we introduce our new products, I expect annual revenue from them to be $9 million. Following that, I expect our total revenue will increase by at least 5% per year, which is a conservative estimate. I also have other design ideas, and after the upgrade to our production facility, Adaptive will produce some truly innovative products. Therefore, there is even greater growth potential!

With the upgrade to our production facility, our gross profit percentage should increase significantly.

After the upgrades are completed, my estimates translate into an after-tax operating cash flow of approximately $70 million in total for the Adaptive division for five years of operation, and a net present value of approximately $35 million for that period, net of the initial $5 million investment. I used the 15% discount rate that we typically apply.

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APPENDIX IV
EMAIL FROM SALES MANAGER (RORY)

June 10, 2022

To: Ronald
Re: Sales staff member
From: Rory

Thanks for making me aware of a potential issue with one of our new internal salespeople. I have since discovered that this salesperson has been artificially inflating their earned commission by making sales to retailers that they knew would be returned. I discovered three orders, coincidentally made with the same retailer, that came back shortly after the product was sold.

Our current compensation policy does not deduct returns from a salesperson's earned commission of 2% on the value of each contract that they conclude between Marmani and any retailer. Returns are common in this industry. I strongly believe it would be unreasonable to penalize our sales staff, who work very hard to secure business for us, each time a product is returned.

I don't think we should overreact to this isolated incident. At this point, it appears to be limited to one salesperson. I spoke to the person in question, which should suffice.

All my attention has been on supporting our new sales team, to ensure its success. Let's keep the focus on that, and consider this issue resolved.

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APPENDIX V
POTENTIAL ONLINE MARKETPLACE FOR ATHLEISURE WEAR

Prepared by Karen Zenkovic

Competition online is fierce. I know it is a risk, but based on the strength of our brand, I believe that we can successfully compete in the world of online sales. Marmani has never been in direct competition with the big, global brands, but Marmani's size could work to its advantage. Consumers are increasingly looking for unique styles, which we can provide. Our products are of higher quality and are more exclusive. This exclusivity allows us to target niche markets that the big brands, who mass produce their products, cannot reach effectively.

Because Athleisure's current production facility is nearing capacity, we will need an additional facility to service an online marketplace. I have assumed that we will lease and renovate that facility to meet our needs, at an estimated total cost of $4.25 million, including information technology development and infrastructure.

I have assumed that our margins will be lower; based on my research, variable costs of 60% should be achievable. We will make up the decline in margin with more volume in sales, resulting in higher profits. Our fixed costs should be about $750,000 per year.

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APPENDIX VI
SUMMARY ON MATTHEW AND HIS PLAN FOR ATHLEISURE

Prepared by Roberto Marmani

Matthew's online profile is impressive. Here are some highlights I noted:

- Matthew has managed three separate apparel brands, each time achieving financial success.
- In only three years, Matthew took a company from having virtually no sales or brand recognition to being valued at over $500 million. That company's success is attributed to its online sales.
- Matthew was able to take an unprofitable apparel company from losing market share to once again being a successful company. In this case, his strategy was to drastically reduce costs. He outsourced the brand's production to an overseas facility in Vietnam (Viet BDG) and was able to reduce the cost of materials by changing suppliers.

One of Matthew's references described him as a "natural born leader," "tenacious and confident" and "tech savvy."

Here are some of the key items from the plan that Matthew submitted:

- Given that the Richmond facility is nearing capacity, all new production demands will be outsourced to Asia. Matthew has suggested moving all Athleisure production to Asia. According to Matthew, the more that Athleisure utilizes his connections in Asia, the more that production costs will be reduced.
- Matthew suspects that Marmani is currently paying too much for the fabrics that it uses for Athleisure products. Matthew has contacts within the textile industry and would likely change suppliers.
- Matthew's plan includes the introduction of many new products that will appeal to a wider consumer market, thereby increasing sales.
- Matthew's colleagues include a designer who has extensive experience in the apparel industry. This designer's products are mass produced and sold all over the country. He expects this designer will join the Athleisure division.
- Based on outsourcing production and changing suppliers, total production costs should decrease by nearly 30%. At the same time, given an expanded product line and aggressive expansion into new markets, revenue is projected to increase by 40% annually.
- While he does not outline the details, Matthew recommends stock option plans for all senior managers, enabling them to purchase shares based on the increase in revenue.

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APPENDIX VII
KAREN'S FINDINGS

Prepared by Karen Zenkovic

Viet BDG has a very poor reputation and has been accused of serious violations. Two years ago, Viet BDG was reprimanded for its facility being an unhealthy workplace. Apparently, the facility has since improved, but I couldn't find anything to confirm or deny any improvements.

Although Matthew has indeed successfully managed several apparel companies, those companies all manufactured products that we would expect to see in department stores: low-quality, low-priced clothing.

One of the companies Matthew worked for is being sued by a designer for copyright violations.

It appears that Matthew has frequently changed employers, and that his colleagues often follow him.

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End of Exam

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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 before November 21, 2018

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

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

	2018	**2019**
Maximum depreciable cost — Class 10.1	$30,000 + sales tax	$30,000 + sales tax
Maximum monthly deductible lease cost	$800 + sales tax	$800 + sales tax
Maximum monthly deductible interest cost	$300	$300
Operating cost benefit — employee	26¢ per km of personal use	28¢ per km of personal use
Non-taxable automobile allowance rates		
— first 5,000 kilometres	55¢ per km	58¢ per km
— balance	49¢ per km	52¢ per km

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3. INDIVIDUAL FEDERAL INCOME TAX RATES

For 2018

If taxable income is between			Tax on base amount	Tax on excess
$0	and	$46,605	$0	15%
$46,606	and	$93,208	$6,991	20.5%
$93,209	and	$144,489	$16,544	26%
$144,490	and	$205,842	$29,877	29%
$205,843	and	any amount	$47,670	33%

For 2019

If taxable income is between			Tax on base amount	Tax on excess
$0	and	$47,630	$0	15%
$47,631	and	$95,259	$7,145	20.5%
$95,260	and	$147,667	$16,908	26%
$147,668	and	$210,371	$30,534	29%
$210,372	and	any amount	$48,718	33%

4. SELECTED INDEXED AMOUNTS FOR PURPOSES OF COMPUTING INCOME TAX

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

	2018	**2019**
Basic personal amount	$11,809	$12,069
Spouse, common-law partner, or eligible dependant amount	11,809	12,069
Age amount if 65 or over in the year	7,333	7,494
Net income threshold for age amount	36,976	37,790
Canada employment amount	1,195	1,222
Disability amount	8,235	8,416
Canada caregiver amount for children under age 18	2,182	2,230
Canada caregiver amount for other infirm dependants age 18 or older (maximum amount)	6,986	7,140
Net income threshold for Canada caregiver amount	16,405	16,766
Adoption expense credit limit	15,905	16,255

Other indexed amounts are as follows:

	2018	**2019**
Medical expense tax credit — 3% of net income ceiling	$2,302	$2,352
Annual TFSA dollar limit	5,500	6,000
RRSP dollar limit	26,230	26,500
Lifetime capital gains exemption on qualified small business corporation shares	848,252	866,912

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5. PRESCRIBED INTEREST RATES (base rates)

Year	Jan. 1 – Mar. 31	Apr. 1 – June 30	July 1 – Sep. 30	Oct. 1 – Dec. 31
2019	2	2	2	
2018	1	2	2	2
2017	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.

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……..	Original lease period plus one renewal period (minimum 5 years and maximum 40 years)	
Class 14……..	Length of life of property	
Class 14.1……...	5%	For property acquired after December 31, 2016
Class 17……..	8%	
Class 29……..	50%	Straight-line
Class 43……..	30%	
Class 44……..	25%	
Class 45……..	45%	
Class 50……..	55%	
Class 53……..	50%	

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