CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

CFE CANDIDATE NUMBER:

Common Final Examination
May 26, 2022 – Day 2
(Booklet #1 – Case)

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

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

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____________________________ ____________________________

CANDIDATE NAME (Please print) SIGNATURE

<u>Examination Details</u>

The examination consists of:

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

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

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

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

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

The CPA Canada Handbooks, the *Income Tax Act* and the *Excise Tax Act* are available in *Folio Views* throughout the entire examination. *Folio Views* provides the standards in effect and tax laws substantively enacted as at December 31, 2021.

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

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

Common Final Examination, May 2022

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

Case

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

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

INDEX

(CONTINUED ON PAGE 3)

BACKGROUND INFORMATION
COMMON INFORMATION FOR ALL ROLES

Solitary Publishing House Limited (SPH) is a book publisher whose revenues represent 5% of the Canadian book publishing industry. SPH's customers include schools, universities, bookstores, and online retailers. SPH does not sell directly to end consumers.

SPH is a mid-sized private company incorporated by Brian McGregor in 1990. It has a December 31 fiscal year end. SPH follows IFRS to allow for comparison with its competitors. All operations are in Toronto, Ontario.

On December 30, 2020, the vice presidents bought shares in the company. The entire executive team lives in Toronto. As of today, February 2, 2022, their roles and share ownership are as follows:

Name	Role at SPH	Percentage Ownership
Brian McGregor	CEO	40%
Doris Simmons	VP Finance	25%
Jonathan Fleming	VP Production	15%
Rodney Chan	VP Editorial	15%
Maria Olejnik	VP Marketing	5%

Brian is 68 years old and wants to sell his SPH shares to finance his retirement. In 2021, SPH issued bonds to a private investor, Jefferson Investments Inc. (Jefferson), a Canadian-controlled private corporation. Jefferson has expressed interest in purchasing shares in SPH and will use SPH's 2021 statements to determine an offer price.

In October 2021, Suzanne Pietrobon, the controller, resigned for personal reasons. Her role has not yet been filled, and the accounting department is currently short-staffed.

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

(CONTINUED ON PAGE 4)

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

ASSURANCE REQUIREMENTS

You, CPA, are a manager with Franklin & Elliot Chartered Professional Accountants (FE), SPH's auditor. Kaylee Verra is the audit engagement partner.

Jonathan asked for assistance with some tasks related to SPH's budget, costs, and prices. Kaylee advises you that the work you perform on these tasks will ultimately be reviewed and approved by management, and she has handled the independence and conflict-of-interest considerations. She also asks you to discuss the accounting treatment for the inventory, for the Kingston University contract, and for the joint arrangement with AppsWiz.

Kaylee asks you to prepare the audit plan for the December 31, 2021, year end, and to recommend audit procedures for the accounting issues you discuss, as well as for the newly constructed warehouse. She also wants you to explain any risks that you identify in the sales cycle, provide audit procedures for each of these risks, and describe any additional information required. Walkthroughs of the sales, purchases, and payroll cycles were completed as part of interim fieldwork. The internal controls were found to be operating effectively and were consistent with those relied upon during prior audits, except in the children's books division.

Kaylee would like you to discuss whether it would be appropriate to use the work of SPH's internal audit department and describe any procedures that will need to be performed to be able to use their work. The department was established in July 2020 and is led by chief audit executive Belvin Alexander, who is a CPA and a certified internal auditor (CIA). Belvin was an audit senior manager of an accounting firm before he joined SPH. Belvin reports functionally to the audit committee and administratively to the CEO.

As FE will provide a management letter to SPH, Kaylee asks you to discuss any weaknesses in internal controls that you identify in the children's books division and make recommendations for improvements.

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

(CONTINUED ON PAGE 5)

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

FINANCE REQUIREMENTS

You, CPA, work at Manchester Consultants LLP (MC) and report directly to Michel Hebert, CPA, a partner with the firm. Michel recently met with Doris and Jonathan to discuss some issues relating to the 2021 year-end financial statements, as well as other matters.

Jonathan asked for assistance with some tasks related to SPH's budget, costs, and prices. Michel asks you to perform these tasks and to discuss the accounting treatment for the inventory and for the Kingston University contract.

MC is being asked to determine whether SPH should accept Chantal Summer as a new author, using SPH's new author selection methodology. Michel also asks you to assess the sales data provided, the assumptions that SPH's editors made as part of this methodology, and their impact on the Chantal Summer decision.

In anticipation of future share transactions, Michel asks for a valuation of SPH's common shares. He tells you to use SPH's financial statements as presented, without adjusting for changes related to any accounting issues.

Recently, Jefferson proposed replacing its outstanding bonds with a convertible bond. Michel would like you to discuss Jefferson's likely motivation and whether SPH should accept the proposal, based on the risks and benefits to SPH.

A major supplier, W.B. Limited (WBL), is offering SPH a 5% discount for invoices paid within 10 days. Michel asks you to assess the impact of the discount on SPH's bank covenant and cash flow if SPH pays WBL's invoices within 10 days, as well as make a recommendation.

Michel asks you to recommend whether to acquire the intellectual property rights for a collection of children's books, based on an analysis of the proposed purchase price and the qualitative decision factors related to the acquisition.

SPH is considering investing its existing cash surplus and any cash surplus generated in the coming year. Its investment objectives are to generate capital growth and maintain liquidity. Michel wants you to assess the following investment options against SPH's investment objectives and to recommend one or more:

- HHI Series 2020 bonds
- an exchange-traded fund that reproduces the investment mix of the Toronto Stock Exchange (which has generated strong historical returns)
- money market investments
- bank term deposit
- bank savings account

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

(CONTINUED ON PAGE 6)

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

PERFORMANCE MANAGEMENT REQUIREMENTS

You, CPA, work at Manchester Consultants LLP (MC) and report directly to Michel Hebert, CPA, a partner with the firm. Michel recently met with Doris and Jonathan to discuss some issues relating to the 2021 year-end financial statements, as well as other matters.

Jonathan asked for assistance with some tasks related to SPH's budget, costs, and prices. Michel asks you to perform these tasks and to discuss the accounting treatment for the inventory and for the Kingston University contract.

Next, Michel asks you to review a proposal to produce e-books and determine which percentage price reduction would produce the highest profitability based on the estimated sales volumes.

In an effort to strengthen SPH's competitive position, Rodney proposes creating video lectures to accompany certain textbooks. Michel asks you to determine the incremental cost of producing videos for each course and to recommend whether the project should be pursued, considering the targeted cost.

Michel also asks you to assess the effectiveness of the ProofONE editing program recently tested on six books. Based on your findings, he also wants you to suggest key performance indicators (KPIs) that would enable SPH to assess the program's effectiveness if the program is adopted.

Michel also wants you to assess the performance of the autonomous editorial resource unit (AERU) pilot project compared to the levels of production and profitability under SPH's current structure.

Brian noted that the current incentive plan may not be well suited to the employees in the AERU. He asks MC to identify the concerns related to the current incentive plan for those in the AERU project and to suggest changes that would make it better suited to them. He wants to know what risks are associated with implementing this newly suggested plan.

Given SPH's success outsourcing its delivery function, Jonathan suggests outsourcing SPH's sales function. Michel asks you to provide a qualitative assessment of the benefits and risks of this outsourcing proposal.

Finally, Michel asks you to perform an overall assessment of the external risk factors affecting SPH's strategic direction and to explain the impact of these factors on each proposed initiative.

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

(CONTINUED ON PAGE 7)

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

TAXATION REQUIREMENTS

You, CPA, work at Manchester Consultants LLP (MC) and report directly to Michel Hebert, CPA, a partner with the firm. Michel recently met with Doris and Jonathan to discuss some issues relating to the 2021 year-end financial statements, as well as other matters.

Jonathan asked for assistance with some tasks related to SPH's budget, costs, and prices. Michel asks you to perform these tasks and to discuss the accounting treatment for the inventory and for the Kingston University contract.

MC provides tax planning to SPH's employees and shareholders. Brian has asked MC to analyze the tax consequences to him of selling his shares in SPH to Jefferson. Rodney is also considering selling his shares to Jefferson and wants to know his taxes payable if he does so.

Michel would also like you to outline the tax consequences to SPH of Jefferson acquiring all of Brian's and Rodney's shares.

Brian and his wife, Sarah, plan to retire on June 30, 2022. They would like an estimate of their taxes payable for 2022, which they want to minimize.

As demand has shifted from print to e-books, SPH is considering selling its Tilly Avenue warehouse and moving to a smaller one. SPH would like to know the tax consequences, for 2022 and subsequent taxation years, of the sale of the Tilly Avenue warehouse and the purchase of the Foster Avenue warehouse.

Michel asks you to calculate net income for tax purposes, taxable income, and federal taxes payable for SPH for its 2021 taxation year. The shareholders know that earning passive income in a CCPC can have tax implications and want you to explain what the implications would be if SPH earns $150,000 in dividend income from an investment in Canadian public companies. To help illustrate this, Michel asks you to recalculate taxes payable for 2021, as though SPH had earned that additional income.

Since Suzanne left, Doris asked Rhea, the accounting clerk, to ensure that SPH is up to date with its GST/HST obligations. The November return was filed on time by MC. Michel asks you to review what Rhea completed for December and perform any incomplete work. Doris is worried that there may be penalties to pay.

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

(CONTINUED ON PAGE 8)

APPENDIX I – COMMON INDUSTRY BACKGROUND

Publishers typically edit, design, print, digitally format (for e-books), and market a book before its distribution to wholesalers, to retailers, or directly to end consumers.

Publishers purchase the rights to the authors' works and agree to pay royalty fees on the books' sales. Up to one-third of projected royalties for the first print batch may be paid in advance.

Competition

The industry is consolidating and includes four large, well-established publishers who, combined, hold a high percentage of the market share. They have the resources to aggressively market their products and control the distribution channels.

Competition is based on price, brand recognition, and marketing. Some publishers have reduced costs and increased revenues by outsourcing their sales function. Some of the firms performing this sales function represent multiple publishers and have considerable bargaining power with retailers. However, some retailers have refused to work with these firms, citing aggressive sales tactics and declining service.

Profit Margins

A key success factor is the ability to predict which topics or authors will be top sellers. For both print and e-books, publishers aim for net profit margins of around 10%. Because e-books have lower selling prices, the weighted average selling price for a specific title decreases as the proportion of sales of e-books to printed books increases.

All books can be published as print-only, digital-only, or both. Historically, children's picture books and books for very young children have been predominantly sold as print copies due to parents' preferences.

Textbooks

Textbook sales volumes are expected to increase, with a growing percentage being sold as e-books. At the same time, publishers are bundling textbooks with a variety of online learning resources (OLRs) to differentiate their offerings. The OLRs, which include smart books (where pop-up explanations are available to students), exercises, and quizzes, are costly to produce and must be continuously updated.

Barriers to entry are high for textbooks due to the large upfront investment required (such as preparation of OLRs).

(CONTINUED ON PAGE 9)

APPENDIX II – COMMON
SPH'S OPERATIONS

Divisions

SPH has three divisions, each operating in one of the publishing industry's major segments:

- *Children's books* – This division is profitable because it has well-known authors' works. It primarily publishes books for early readers, as well as board books for very young children.
- *Textbooks* – In 2021, this division experienced a higher proportion of e-book sales compared to printed textbooks. Some of SPH's textbooks do not include OLRs, and only those with OLRs have remained competitive in price and sales volume.
- *Adult non-fiction* – This division produces only Canadian-authored books, including large coffee table books with photographs. Although certain products remain profitable, profits in this division have been declining.

Cost Structure and Sales

SPH pays its authors royalties ranging from 10% to 15% of the book's revenues. SPH has its own sales and marketing staff. Sales representatives are dedicated to specific customers and are paid a salary plus a 5% commission on sales.

SPH has some titles (representing about 45% of sales) that are widely used and for which there is little competition, ensuring stable sales year over year.

(CONTINUED ON PAGE 10)

APPENDIX III – COMMON
EXCERPTS FROM DRAFT FINANCIAL STATEMENTS

Solitary Publishing House Limited
Statement of Net Income and Comprehensive Income
For the years ended December 31
(in thousands of Canadian dollars)

	2021	2020
	Draft	Audited
Revenues		
Children's books	$ 22,520	$ 20,874
Textbooks	37,590	42,810
Adult non-fiction books	15,060	16,220
	75,170	79,904
Cost of goods sold		
Production and royalty costs	34,639	35,343
Amortization of pre-production costs	972	1,720
Depreciation and amortization related to production	850	875
	36,461	37,938
Gross profit	38,709	41,966
Operating Expenses		
Depreciation	2,203	2,315
Sales and marketing	12,401	12,136
General and administration	16,459	15,984
Total operating expenses	31,063	30,435
Operating income	7,646	11,531
Interest income – HHI bonds	23	0
Interest expense – Jefferson bonds	(354)	0
Interest expense – term loan	(598)	(643)
Income before taxes	6,717	10,888
Income taxes	(1,814)	(2,940)
Net income and comprehensive income	$ 4,903	$ 7,948

(CONTINUED ON PAGE 11)

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

Solitary Publishing House Limited
Statement of Financial Position
As at December 31
(in thousands of Canadian dollars)

	2021 Draft	2020 Audited
Assets		
Cash and cash equivalents	$ 1,529	$ 250
Accounts receivable (net of allowance 2021 – $256; 2020 – $236)	8,268	7,632
Inventories	6,450	6,514
Prepaid expenses	2,980	2,460
	19,227	16,856
Investment – HHI bonds	924	0
Property, plant and equipment, net	33,387	24,850
Pre-production costs	2,560	2,790
Royalty advances	2,040	1,910
Intangible assets	3,590	3,740
Total assets	$ 61,728	$ 50,146
Liabilities		
Accounts payable	$ 7,520	$ 7,490
Accrued liabilities	9,800	10,480
Contract liability – unearned revenue	1,109	1,350
Income taxes payable	140	240
Current portion of term loan	750	750
	19,319	20,310
Bonds payable – Jefferson	8,500	0
Term loan	9,090	9,840
Deferred tax liability	980	1,060
Total liabilities	37,889	31,210
Shareholders' equity		
Share capital – common shares	5,640	5,640
Retained earnings	18,199	13,296
Total shareholders' equity	23,839	18,936
Total liabilities and shareholders' equity	$ 61,728	$ 50,146

(CONTINUED ON PAGE 12)

APPENDIX IV – COMMON
BUDGET EMAIL FROM JONATHAN

From: Jonathan Fleming, VP Production
To: CPA
Date: February 1, 2022
Subject: Fiscal 2022 budget

We finished our 2022 budget for the adult non-fiction division in November 2021. It was based on our normal operating capacity:

Volume of sales	180,000	
Average selling price	$ 85	
Total revenues		$ 15,300,000
Variable costs		
Direct materials and direct labour	$ 4,536,000	
Royalty fees	1,836,000	
Commission	765,000	
Shipping and fulfillment costs	306,000	
Other production costs	432,000	
Selling and marketing costs	413,100	
Total variable costs		8,288,100
Total fixed costs		5,717,000
Operating income		$ 1,294,900

Assumptions:

1. Variable selling and marketing costs are generally based on revenue dollars.
2. The fixed costs are relevant for up to 200,000 books. For each additional print batch of 50,000 books or less, there is an additional fixed cost of $75,000.
3. The fixed costs include other fixed production costs, the fixed portion of selling and marketing costs, occupancy costs, as well as $440,000 of depreciation expense.

After the budget was prepared, marketing revised its strategy for our adult non-fiction division:

We have some brand-new titles this year. We plan to spend $300,000 more on advertising, and to sell an additional 30,000 of these new books at a price of $75 each. We also want the books published using the highest quality paper to differentiate them in the market. Because these are new, unknown authors, we have negotiated royalties of only 9% on sales. We will need one more salesperson to market these books.

Please revise the initial budget to reflect these changes.

(CONTINUED ON PAGE 13)

APPENDIX V – COMMON
OTHER REQUESTS FROM JONATHAN

From: Jonathan Fleming, VP Production
To: CPA
Date: February 2, 2022
Subject: 2021 fiscal year

We sell a three-book box set, as well as single books, of our “Hot Shot” children’s series. Here is a sales summary for 2021:

Sales Option	Actual Volume	Standard Volume	Actual Selling Price	Standard Selling Price	Actual Variable Cost per Unit	Standard Variable Cost per Unit
Three-book box set	25,000	20,000	$13.90	$15.10	$7.48	$7.39
Single books	11,000	15,000	$7.65	$6.85	$3.55	$3.64

At the beginning of 2021, because Maria’s research indicated an increase in sales of box sets for children, she suggested we spend more on marketing box sets and reduce our price on them to drive demand. However, it looks like this trend reversed for 2022, with customers preferring to purchase a single book so they don’t have to spend so much at once. Maria recommends changing our promotions for the coming months to reflect this. Please perform a sales price variance and sales volume variance analysis for each product to help me understand whether the strategy adopted in 2021 was effective in increasing profit.

(CONTINUED ON PAGE 14)

APPENDIX V – COMMON (continued)
OTHER REQUESTS FROM JONATHAN

Next, I need your assistance in setting a selling price for a new book in the adult non-fiction division to be released in 2023, *Forgotten Landscapes*. We'll select the best of two methods to price the book: 1) full absorption cost-based pricing, marking up total unit production costs by 50% (consistent across all books); or 2) demand-based pricing, looking at expected sales volumes at different price points based on market analysis. Please calculate a target price using these two methods and recommend a selling price for this book.

Please also qualitatively compare the benefits and drawbacks of each of the two methods.

We anticipate high demand for this book; however, given the printing costs for the high-quality photos, we expect the margin to be lower. Demand and pricing tend to increase over time for these books as the photographers become better known.

Our commitment is an initial print batch of 10,000 books, with the capacity to print additional batches.

A competitor's book showcasing a more famous photographer is priced at $70.

Fixed costs for volumes between 8,000 and 14,000 books will be $150,000 for production overhead and $130,000 for selling, general, and administration.

Per-book costs are as follows:

Direct materials	$ 24.30
Direct labour	$ 4.00
Variable production overhead	$ 3.00
Variable selling, general, and administration	$ 2.50

The marketing department estimated the number of books that could be sold at different prices:

Selling price	$ 60.00	$ 65.00	$ 70.00	$ 75.00
Number of books	14,000	12,500	9,500	8,500

(CONTINUED ON PAGE 15)

APPENDIX VI – COMMON INVENTORY INFORMATION

Doris provided an excerpt from the finished goods inventory listing at December 31, 2021:

Inventory List – Warehouse – December 31, 2021			
Inventory Item	**Inventory on Hand (books)**	**Cost per Book**	**Inventory Value**
Introduction to Ecology	10,000	$57.20	$572,000
Law: Ethics	15,000	$25.60	$384,000
Total			$6,450,000

Doris also provided a list of returned books that were in transit from customers to SPH as at December 31, 2021. SPH takes ownership of returns when the books leave the customer's premises. All books in transit were recorded in SPH's inventory at year end.

							Page 1 of 1 **December 31, 2021**
Inventory List – Books in Transit							
Inventory Item	**Books in Warehouse December 31**	**Shipped from**	**Date Shipped**	**Quantity in Transit (books)**	**Cost per Book**	**Inventory Value**	**Note**
Introductory Physics	0	Sheldon High School	Dec 28	3,200	$15.78	$50,496	1
Biochemistry – Advanced, Fifth Edition	0	Brookston University	Dec 22	4,700	$32.90	$154,630	2
Total						$205,126	
Note 1 – Received January 3, 2022 – 2,000 units were damaged and not saleable. Note 2 – Received January 2, 2022 – all were in good condition.							

(CONTINUED ON PAGE 16)

APPENDIX VII – COMMON
EMAIL FROM MARIA

From: Maria Olejnik, VP Marketing
To: Doris Simmons, VP Finance, and Jonathan Fleming, VP Production
Date: January 9, 2022
Subject: Price list

The prices of the following books were amended to reflect changes in demand:

Inventory Item	Sales Price Dec 2021	Note
Introduction to Ecology	$ 55.00	1
Introductory Physics	$ 25.30	
Biochemistry – Advanced, Fifth Edition	$ 28.60	2

Notes:

1. A contract commits the customer to purchase 20,000 books at a price of $75.00 each during the nine-month period ending April 30, 2022. By December 31, 2021, we had sold and shipped 13,000 units under this contract.
2. In February 2022, the fifth edition will be replaced by a sixth edition; we usually stop selling the old editions during the two months prior to a new edition being released.

We estimate that our variable costs to ship textbooks to retailers will average $1.50 per book.

(CONTINUED ON PAGE 17)

APPENDIX VIII – COMMON
KINGSTON UNIVERSITY CONTRACT

SPH signed a contract with Kingston University (Kingston) under terms that differ from SPH's typical contracts.

Excerpts from the contract and related information are provided below.

Customer:	Kingston
Re:	Contract #KU47-5
Date:	April 27, 2021
Subscription period:	Kingston's academic year, from September 1, 2021, to April 30, 2022

Kingston agrees to purchase 3,000 units of *Architecture 101* (first edition) at a total price of $360,000 ($120 per unit). Each unit consists of a printed textbook and OLRs. The course runs for eight months, and the OLRs will be accessible to the students for the entire subscription period. To complete the course, students must use the textbook to complete assignments in the OLRs. Kingston is prohibited from selling the textbook or OLRs separately.

Kingston agrees to pay in full within 40 days of receipt of the textbooks. SPH commits to ship the books by August 15, 2021.

We shipped on August 12. Kingston signed for receipt of all textbooks on August 14; revenue of $360,000 was recognized. Full payment was received on September 16.

SPH paid sales commissions of 5% on this contract and incurred travel costs of $4,800 to present the proposal to Kingston. There is sufficient profit from this contract to cover these costs, which have all been recognized as sales expenses.

(CONTINUED ON PAGE 18)

ASSURANCE ROLE
ADDITIONAL INFORMATION

(CONTINUED ON PAGE 19)

APPENDIX IX – ASSURANCE
ADDITIONAL INFORMATION

Joint Arrangement

On August 1, 2021, SPH entered into a joint arrangement with AppsWiz Inc. (AppsWiz), a company that specializes in creating mobile applications. Each company invested $500,000 in return for 50% of the shares in SmartKids, a newly created legal entity. SPH will provide its expertise for the design and printing of the books, and AppsWiz will provide the mobile application expertise.

SmartKids will produce and sell a new line of interactive books, featuring traditional fairy tales, such as *The Three Little Pigs*. When a mobile device is held over the printed page and the words on the page are read out loud, the application will animate the printed characters on the screen.

A contractual agreement specifying the rights and responsibilities of each party was signed by SPH and AppsWiz. It contains the following terms:

- If SmartKids requires additional funds, both parties will contribute equally to it by purchasing additional common shares.
- All assets purchased and liabilities incurred by SmartKids must be approved by both SPH and AppsWiz and will belong to SmartKids.
- SmartKids will be responsible for payroll and any other administrative functions.

At the end of 2021, no sales had been made yet by SmartKids, although there are many interested parties. Doris recorded the $500,000 as production expense for the year.

At December 31, 2021, SmartKids had the following balances:

Total assets	$ 850,000
Total liabilities	$ 50,000
Total equity	$ 800,000

In addition, SmartKids incurred a net loss of $200,000 in 2021.

(CONTINUED ON PAGE 20)

APPENDIX IX – ASSURANCE (continued)
ADDITIONAL INFORMATION

Additional Information on Fiscal 2021

SPH's information technology (IT) department delayed a planned upgrade of the accounting software until early 2022. For the last few weeks of 2021, the program would freeze up unexpectedly, but a reboot always resolved the issue. However, Doris wonders whether the accounting subledgers were impacted in any way by these incidents.

During the year, SPH hired Connor Smith, director of data analytics. Connor is responsible for the weekly dashboards provided to management. His team has performed extensive testing on the dashboards to ensure data integrity.

An audit junior attended the December 31, 2021, inventory count at SPH and was satisfied with the count procedures and accuracy.

In September 2021, SPH purchased land for $1 million and hired a company that started constructing an additional warehouse. As at December 31, 2021, the construction was complete and $2 million of construction costs were incurred.

Information Related to the Sales Cycle

- The trend in SPH's monthly sales as a percentage of annual sales is generally consistent throughout the year with those of other publishing houses.
- The allowance for doubtful accounts for 2021 was calculated as 3% of gross accounts receivable, consistent with prior years.
- The Canadian economy is struggling to recover from the recent recession; SPH has seen increases in accounts outstanding for longer than 60 days, plus related write-offs.
- SPH would not normally have any accounts in the "Over 90 days" category. The entire balance in this category relates to accounts with We Love Books.
- FE's estimates of uncollectible accounts range from 3% to 5% of gross accounts receivable.

A/R Subledger
As at December 31, 2021
(in thousands of Canadian dollars)

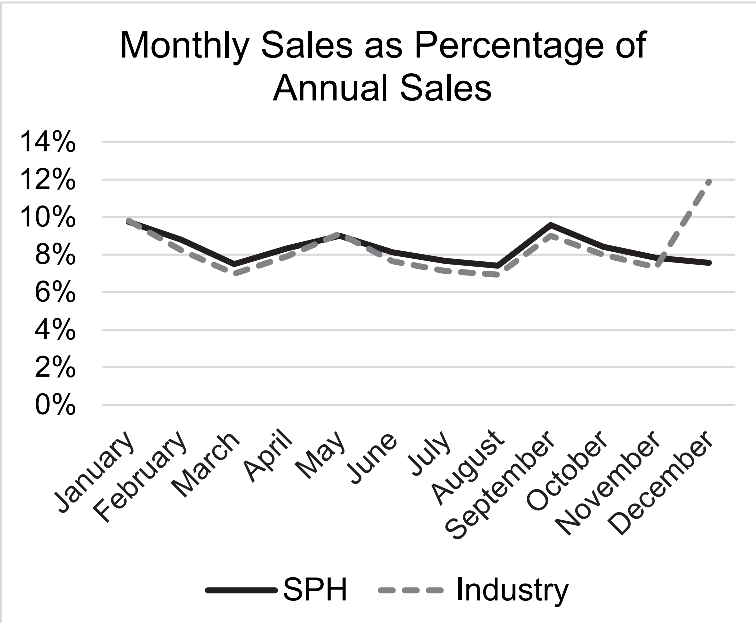
	0 to 30 Days	31 to 60 Days	61 to 90 Days	Over 90 Days	Total
Total	$6,320	$1,170	$213	$840	$8,543

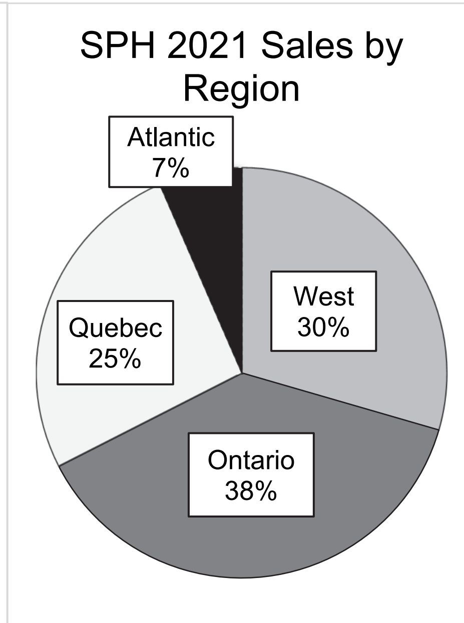
(CONTINUED ON PAGE 21)

APPENDIX IX – ASSURANCE (continued)
ADDITIONAL INFORMATION

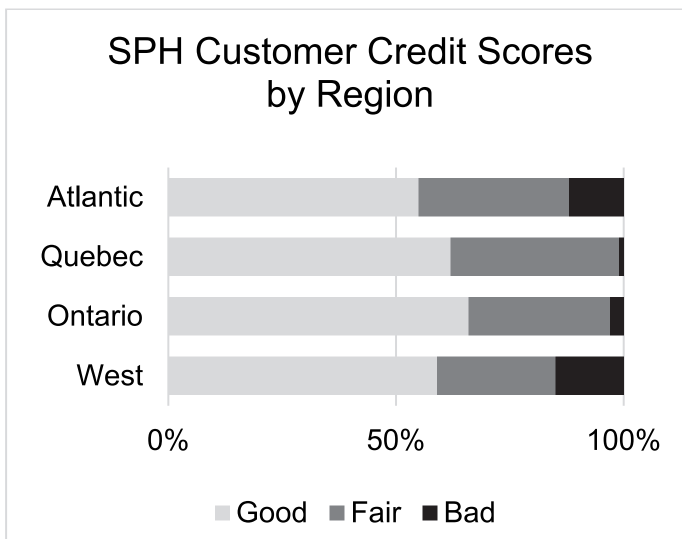
Information Related to the Sales Cycle (continued)

Weekly Management Dashboard
For the week of January 3, 2022





Latest Customer Updates
We Love Books filed for bankruptcy.



(CONTINUED ON PAGE 22)

APPENDIX IX – ASSURANCE (continued)
ADDITIONAL INFORMATION

Internal Audit Department

Internal audit loaned Louise Swanson, CPA, to the accounting department, starting December 15, 2021. Despite this, the accounting department is still understaffed, and Louise has struggled to review the staff's work in a timely manner.

Per the internal audit charter, Belvin's responsibilities include:
- confirming the independence of internal audit to the audit committee at least annually;
- submitting an annual risk-based internal audit plan for approval;
- ensuring that planned engagements are executed, work programs and testing are documented, and results are communicated; and
- following up on recommendations, and reporting to the audit committee any corrective measures not implemented.

Audit managers in internal audit are required to have both a CPA designation and either a CIA or certified information systems auditor (CISA) designation, plus a minimum of two years of internal audit experience. Each auditor is required to have a commerce degree and to complete the CIA or CISA program within two years of their start date. From January 1 to December 15, 2021, internal audit was fully staffed.

The audit managers are responsible for planning internal audits, which are then performed by the auditors. Audit managers review the work performed by the auditors and draft an audit report. Belvin also performs a review of all audit files and the audit reports prior to their issuance.

Internal audit performed numerous internal audits during the year ended December 31, 2021, including audits of sales, general and administrative costs, payroll, and sales and marketing costs. Some audit reports issued included findings. For example, internal audit determined that, although the costs incurred were reasonable, some sales representatives had stayed in unapproved hotels. However, no material weaknesses or significant deficiencies in internal controls were reported. By December 31, 2021, all recommendations made by internal audit had been implemented.

(CONTINUED ON PAGE 23)

APPENDIX IX – ASSURANCE (continued)
ADDITIONAL INFORMATION

Children's Books Division Changes

On August 31, 2021, internal audit issued a report regarding the children's books division's internal controls, noting no material weaknesses or significant deficiencies. On September 15, the sales manager responsible for the children's books division left. Brian was able to recruit Yolanda Vallis to replace him. She started with SPH on November 1, 2021.

When she started, Yolanda reviewed the monthly budget-to-actual sales reports of the division for 2021. Because she noted no significant issues, the sales representatives have been authorized since November 2021 to set up new customers and determine their credit limits.

Upgrades were made to the sales system in November, where certain information is now pre-populated in the system. For example, when sales representatives enter an order in the system, the system automatically populates certain fields such as the shipping address, telephone number, and email address once a customer is selected. In addition, when sales representatives select the items to be ordered from a drop-down list, the price related to the item is also automatically populated. If any pre-populated items are incorrect, the sales representatives change the information in the field before submitting the order in the system.

Discounts were rarely authorized before Yolanda joined, but she understands how important it is to give the sales representatives flexibility. Since Yolanda joined, sales representatives have therefore been authorized to offer a 10% volume discount to customers of the children's books division if they believe the customers are purchasing more than usual. Volume discounts of more than 10% must be approved by Yolanda.

When customers are delinquent in paying their invoices, the accounts receivable department asks the sales representatives to follow-up. If the sales representative thinks that collection is unlikely, they let the accounts receivable department know, and the amount is written off.

When Yolanda joined, she decided all sales representatives should have tablets, to stay connected. The tablets arrived in early December. When IT indicated that it would require five business days to set the tablets up with virtual private network access, encryption, and antivirus software, Yolanda decided not to delay their issuance. She instructed the sales staff to return the tablets between Christmas and New Year's so that IT could work on them.

(CONTINUED ON PAGE 24)

FINANCE ROLE
ADDITIONAL INFORMATION

(CONTINUED ON PAGE 25)

APPENDIX IX – FINANCE
ADDITIONAL INFORMATION

New Author Selection Methodology

SPH decides whether to accept a new author based on a net present value analysis, using a discount rate of 9%.

SPH incurs upfront editorial and design costs of $50,000 per title.

SPH applies the following assumptions for children's book sales:

	Hardcover	Paperback	E-book
Percentage of total sales volume	30%	60%	10%
Price per book	$9.50	$5.50	$4.10
Production and fulfillment costs as a percentage of revenue	35%	30%	5%

Each new book is assumed to have a five-year life. Regardless of the format, the total sales volume is expected to occur as follows:

Year	Sales Volume
1	40%
2	20%
3	15%
4	15%
5	10%

SPH pays a commission equal to 5% of revenues.

SPH incurs upfront fixed marketing costs of $275,000. In subsequent years, marketing costs represent 13% of sales.

Where it is considered relevant to the decision, SPH includes in its analysis a portion of its annual corporate overhead costs i.e., $5,000 in rent and $6,000 in technology costs. SPH also allocates printing machine amortization at $0.30 per hardcover and $0.20 per paperback.

SPH's tax rate is 27%.

(CONTINUED ON PAGE 26)

APPENDIX IX – FINANCE (continued)
ADDITIONAL INFORMATION

Information about Chantal Summer

Chantal Summer is an environmental activist in Canada and Latin America, where her evening talk show is extremely popular. Chantal has approached SPH to publish a children's book she wrote. Given her significant social media presence (598,200 Instagram followers), Chantal believes that a large percentage of the book's sales will be in e-book format.

SPH's editors met Chantal at a conference; they frequently attend these conferences because the guest speakers are often interested in becoming authors. SPH's editors incurred travel costs of $25,000 for this conference.

SPH's editors would launch Chantal's book in English on January 1, 2023. They expect to sell 400,000 books over a five-year period. This amount includes a Spanish version, which will require translation costs of $15,000 in 2024. SPH has sufficient printing capacity to publish Chantal's book without any upgrades to its facilities.

Chantal has asked for a royalty of 15% on book sales and an advance of $450,000. Royalty payments start once the royalties earned are greater than the advance. Royalties are only deductible for income tax purposes when SPH has incurred the cost and expensed it for accounting purposes.

(CONTINUED ON PAGE 27)

APPENDIX IX – FINANCE (continued)
ADDITIONAL INFORMATION

Sales Data

SPH management provided estimated first-book sales volumes for the 10 new authors that they most recently selected:

Launch Date	Genre	Additional Languages (beyond English)	Royalty Rate	Instagram Followers (prior to launch)	Total Sales Volume (Note 1)		Format (Note 2)		
					Years 1 to 5	Years 6+	Hard-cover	Paper-back	E-book
5-Oct-21	Children		9.25%	233,000	210,000	117,000	30%	30%	40%
15-Jan-21	Children	French	10.00%	1,089,000	403,000	298,000	20%	20%	60%
30-Aug-20	Children		11.00%	N/A	120,000	27,000	40%	50%	10%
5-Feb-20	Non-fiction		11.50%	11,000	95,000	9,000	30%	50%	20%
2-Dec-19	Children	Spanish	10.75%	175,000	230,000	65,000	20%	40%	40%
2-Jun-19	Textbook		14.00%	N/A	5,000	0	100%	0%	0%
10-Dec-18	Children	French	10.25%	N/A	168,000	71,000	30%	50%	20%
30-Aug-18	Non-fiction		11.50%	N/A	201,000	38,000	20%	70%	10%
10-Nov-17	Children		10.00%	N/A	108,000	10,000	50%	45%	5%
2-Aug-17	Non-fiction		10.50%	N/A	174,000	26,000	20%	80%	0%

Note 1 – Represents total sales estimated for the period. Sales volumes for recent releases are estimated based on retailer orders and feedback from current customers.

Note 2 – Sales formats are based on actual sales volume to date.

(CONTINUED ON PAGE 28)

APPENDIX IX – FINANCE (continued)
ADDITIONAL INFORMATION

Valuation of SPH

Management believes that SPH's financial results in the last two years are reflective of future earnings. Management further notes:

- Brian McGregor was paid $250,000 in 2020 and $350,000 in 2021. A replacement CEO could be hired for $200,000 per year.
- SPH uses office space owned by Jonathan Fleming. Until August 2021, SPH paid rent of $2,500 a month, which was below the market rate. In September 2021, rent increased to $3,500 a month, in line with the current market rate.
- In 2020, a new textbook edition was released ahead of schedule, which increased revenues by $980,000. This reduced 2021 sales by the same amount. The gross profit margin on these textbooks is 45%.
- As a token of goodwill to a long-time children's author, Brian agreed to pay a one-time bonus of $50,000 and a royalty of 20% (typically 10%) for books sold during 2021. In 2021, this author generated sales revenue of $600,000.
- At December 31, 2021, SPH owned a vacant warehouse that was appraised at $400,000.

MC's internal research group indicated that three privately owned publishing businesses sold in the last year at enterprise value to EBITDA multiples of 5.75 to 6.75 times.

At December 31, 2021, SPH's outstanding debt and equity was comprised of the following:

- A $2 million line of credit (currently unutilized). The annual interest rate is 3%.
- An outstanding term loan of $9.84 million. It has a covenant requiring a current ratio of at least 1.0.
- The Jefferson bonds payable for $8.5 million, issued on March 1, 2021. The annual interest rate is 5%; interest is payable annually, with the principal due on February 28, 2026.
- Two million common shares. Ownership of at least 100,000 shares entitles the holder to a seat on SPH's Board of Directors.

(CONTINUED ON PAGE 29)

APPENDIX IX – FINANCE (continued)
ADDITIONAL INFORMATION

Jefferson Proposal – Convertible Bond

Jefferson has proposed replacing its outstanding bonds with a convertible bond for $8.5 million, with a coupon rate of 2.5%; payment terms are otherwise the same as the existing bonds. The holder has until December 31, 2023 to exercise their right to convert the principal amount into 220,000 common shares.

Jefferson acquired two publishing businesses in the past and merged them, on the premise that the industry needs to consolidate to become more efficient.

(CONTINUED ON PAGE 30)

APPENDIX IX – FINANCE (continued)
ADDITIONAL INFORMATION

Working Capital

SPH has provided its quarterly net working capital forecast *(in thousands of Canadian dollars)*:

	31-Mar-22	30-Jun-22	30-Sep-22	31-Dec-22
Cash	$ 1,350	$ 1,150	$ 740	$ 1,480
Accounts receivable	6,308	3,964	10,665	8,968
Inventories	6,372	8,940	7,180	7,002
Prepaid expenses	3,156	2,950	2,644	3,120
	17,186	17,004	21,229	20,570
Accounts payable (Note 1)	7,373	9,153	9,452	8,130
Accrued liabilities	6,820	5,850	7,330	8,950
Contract liability – unearned revenue	1,360	1,075	1,265	1,210
Income taxes payable	140	140	140	240
Current portion of term loan	750	750	750	750
	$16,443	$16,968	$18,937	$19,280

Note 1 – SPH has forecast its quarterly accounts payable:

	31-Mar-22	30-Jun-22	30-Sep-22	31-Dec-22
Accounts payable – opening	$ 7,520	$ 7,373	$ 9,153	$ 9,452
Purchases:				
WBL	1,200	1,600	1,700	1,350
Other suppliers	7,648	9,384	9,643	8,406
	8,848	10,984	11,343	9,756
Payments:				
WBL	(1,400)	(1,200)	(1,600)	(1,700)
Other suppliers	(7,595)	(8,004)	(9,444)	(9,378)
	(8,995)	(9,204)	(11,044)	(11,078)
Accounts payable – closing	$ 7,373	$ 9,153	$ 9,452	$ 8,130

SPH currently pays WBL in the quarter after the purchases are made. If it commits to paying within 10 days, SPH will have to pay WBL in the quarter in which the purchases are made.

(CONTINUED ON PAGE 31)

APPENDIX IX – FINANCE (continued)
ADDITIONAL INFORMATION

Content Library Acquisition

Brian was approached by Don Garcia, the CEO of Legacy Publishing House (Legacy), which is in the process of winding up its operations. Legacy is offering SPH the intellectual property rights for its children's books (the Legacy Library) for $5 million.

The Legacy Library consists of copyrights on 1,374 children's book titles, most of which were first published 20 years ago. These copyrights give the holder the right to produce books, media, or other products based on the intellectual property.

The Legacy Library could be further monetized by licensing the media rights to content creators and collecting licensing fees from video streaming. However, Legacy never pursued this option. SPH could also consider licensing the content to another publisher and collect annual licensing income of $500,000.

SPH's management believes the content library could improve profitability since it avoids the upfront investment and risk of failure of a new book launch.

The MC research team has provided an analysis of recent sales of content libraries on the market:

Date	Content Library	Annual Licensing Income	Purchase Price	Licensing Income/ Purchase Price	Description
13-Nov-21	Mystery Novels Library	$2,020,000	$23,000,000	8.8%	Income derived from licensing current works and reprints of mystery novels from the past 30 years.
30-May-21	Vintage Comics	$2,350,000	$15,235,294	15.4%	Income derived from licensing for reprints, collections, and video streaming of classic comic books.
16-Jan-21	Classic Management Theory	$1,700,000	$23,333,333	7.3%	Income derived from licensing for reprints of well-known management literature.
24-Aug-20	Artwork Portfolio	$215,000	$23,125,000	0.9%	Income derived from licensing for printed materials such as physical paintings.
23-Feb-20	Modern Children's Stories IV	$1,100,000	$12,666,667	8.7%	Income derived from the 30-year fixed term copyrights for modern children's books.

(CONTINUED ON PAGE 32)

PERFORMANCE MANAGEMENT ROLE ADDITIONAL INFORMATION

(CONTINUED ON PAGE 33)

APPENDIX IX – PERFORMANCE MANAGEMENT ADDITIONAL INFORMATION

E-book Proposal

Maria noted that SPH's market share is being eroded in the e-book segment because SPH only publishes e-books in its textbook division. However, SPH's competition contains small publishers with little overhead that can churn out low-cost e-books and deliver a greater number of titles because they publish adult fiction e-books. In general, consumers who prefer e-books are less likely to purchase higher-priced items, like the textbooks currently produced by SPH, which contain denser content and require greater costs and lead times to produce.

This is the reason Maria is proposing a high-volume, low-cost strategy for selling adult fiction e-books directly to consumers. Since this would be a new market for SPH, Maria is confident these books will not cannibalize sales from SPH's other offerings. The projected average number of sales, per e-book, is 1,775. The average selling price for this type of e-book is $20. For every 10% reduction in price, the sales volume should increase by 30%. Maria suggests taking 20%, 30%, or anywhere up to 60% off this price. There would be no equivalent printed versions.

<u>Costs</u>

SPH's average costs for producing an e-book (i.e., one title) in the textbook division are as follows:

Royalty fees – as a percentage of the selling price	12%
Variable selling costs – as a percentage of the selling price	5%
Variable general and administration costs – per unit (i.e., each copy)	$ 2.50
Total editing costs	$ 6,000
Total design costs	$ 5,000
Total e-book formatting costs	$ 4,500
Total sales and marketing costs	$ 13,000

By reducing the editorial oversight and streamlining the design and production process for the projected adult fiction e-books, Maria believes the fixed costs will be reduced by 20%. Unit variable costs should remain the same.

(CONTINUED ON PAGE 34)

APPENDIX IX – PERFORMANCE MANAGEMENT (continued)
ADDITIONAL INFORMATION

Video Lecture Proposal

Several universities have expressed interest in purchasing pre-recorded online lectures of course material so their lecturers can focus on more value-added student engagement. Rodney has developed a proposal to produce high-quality videos to accompany SPH's undergraduate science textbooks.

SPH is willing to incur a maximum additional cost of $125 per student to create videos for each course. Each course reaches an average of 1,200 students.

Costs related to producing the videos are as follows:

Recording equipment	The videos need to be produced in high definition (HD). SPH has an existing HD camera that can be used but will need to purchase an additional camera. HD cameras cost $50,000 each, and have a useful life of 2,000 hours of film time. SPH currently owns approximately $70,000 of other recording equipment. An additional $150,000 of recording equipment will need to be purchased. This equipment will have the same useful life as the cameras. Each course will require approximately 200 hours of recording time.
Technical experts	Technical experts will be required for the entire recording time and will provide a total of 50 hours of preparation per course. The experts will be paid $200 per hour.
Web hosting	As each video is about 10 gigabytes (GB) in size, they will need to be hosted on a server with sufficient storage capacity. SPH currently has 15 GB of additional storage capacity. The server has a total storage capacity of 500 GB, which costs $40,000 per year. The current market rate for web-hosting large files is $150 per GB.
Labour	Labour costs for the film crew will be $80,000 per course. Approximately 20% of the crew's tasks will be performed by existing SPH staff; the other 80% of the work will need to be performed by an external crew.
Edition	The portion of SPH's editor's salary, for the time spent, is estimated to be $2,000 per course.
Rent – studio	Rental of a studio for editing the videos is $11,000 per course.
Rent – SPH boardroom	Rental of the boardroom, where the videos will be filmed, is estimated to be $10,000. This amount is based on the size of the boardroom, its share of the building costs, and the number of days used for each course.

(CONTINUED ON PAGE 35)

APPENDIX IX – PERFORMANCE MANAGEMENT (continued)
ADDITIONAL INFORMATION

ProofONE Test Results

SPH is known in the university sector for its accuracy when producing textbooks. SPH is experimenting with an artificial intelligence (AI) program, called ProofONE, to perform copyediting of textbooks. The program targets three key elements of the process:

1. The reduction of publication lead time, which is the time from the author handing over the manuscript to publishing the book. The current average lead time is 10 months.
2. The reduction of the editing time.
3. The increased accuracy of the editing. This is measured by the number of errors missed by the editor, as well as by the number of "false positives"; i.e., errors detected that are not actual errors.

ProofONE's main functions include fixing grammatical and formatting errors and cross-checking citations and references. This work currently takes SPH's editors an average of 60 seconds per page. The main purpose of using ProofONE would be to reduce this review time. Even if ProofONE is used, editors must still review the program edits to finalize the editing process.

Several algorithms, based on punctuation and other grammatical rules, were inputted into the program. These algorithms were tested on a sample of six textbook manuscripts. The program was updated after each book was completed, based on refinements to the algorithms that the editors suggested.

(CONTINUED ON PAGE 36)

APPENDIX IX – PERFORMANCE MANAGEMENT (continued)
ADDITIONAL INFORMATION

Editorial review by ProofONE test dataset:

Book	A	B	C	D	E	F
Number of pages	350	273	392	432	120	249
Time spent (in minutes)	14.1	17.7	27.3	67.8	14.5	39
Grammatical or formatting errors fixed	1,025	543	235	5,321	753	3,434
Citation errors fixed	131	71	31	1,943	54	532
Potential errors identified for further review	181	137	79	56	37	13

Additional work performed by the editors after the test run, plus other relevant information:

Book	A	B	C	D	E	F
Editor time to review and clear errors identified (in minutes)	131	97	93	128	28	36
Errors not found by ProofONE	61	58	27	70	34	19
False positives	23	12	48	41	21	17
Publication lead-time (in months)	8.32	7.9	6.21	11.32	3.6	8.5

The editors also noted the following:

- The program was fairly accurate detecting simple errors, but less accurate with the more complex decisions that contained technical language.
- Considerable time was spent refining the algorithms to ensure the program was not identifying and correcting false positives.
- Some editors found the process of teaching the program the algorithms and clearing the false positives tedious, and said it affected their job satisfaction. Others found that diverting their attention from routine mistakes to the more value-added edits empowered them.

(CONTINUED ON PAGE 37)

APPENDIX IX – PERFORMANCE MANAGEMENT (continued)
ADDITIONAL INFORMATION

AERU Pilot Project

The initiative is intended to give small teams the autonomy to develop a book from conception to publication. The AERU was piloted in the adult non-fiction division. The pilot project team included two lead editors, four support staff, and two publicists, who are all among the best in their field.

The expectation is that, due to their lean size, AERUs will react to market trends faster. SPH hopes this structure results in a 20% increase in the number of new book titles published per employee, and a 30% reduction in publication lead time. The average number of sales per book title should also increase by 15%. With more autonomy, the AERU employees should see their level of satisfaction increase.

Current adult non-fiction division information (excluding the pilot project)

Non-fiction sales for new books during the six months ending December 2021 were 52,200 books, from 54 new book titles. There are currently 78 employees in the division. The average lead time is currently 10.32 months, calculated as new titles published over a 12-month span. There were no reprints, which are generally required due to significant typographical errors.

AERU pilot project results

The pilot began in July 2020 and concluded at the end of June 2021.

Number of new book titles published	16
Average selling price	$74
Average lead time	9 months
Total sales (Note 1)	$1,294,704
Number of reprints	1

Note 1 – Sales figures are based on the six months following the end of the pilot project.

(CONTINUED ON PAGE 38)

APPENDIX IX – PERFORMANCE MANAGEMENT (continued)
ADDITIONAL INFORMATION

Current Performance Incentives

Editorial and support staff

For editors, a bonus pool is created, and it ranges from 5% to 10% of each division's net profit. The pool is allocated to the editors based on seniority within the organization.

All support staff get the same bonus at the end of the year, based on the net profit of their division.

Sales and marketing staff

Sales staff are incentivized on an individual basis using a commission of 5% of sales.

Publicists and other members of the marketing staff are incentivized using a bonus pool that is based on multiple targets, such as sales volumes and average selling price of books published.

AERU employees

The publicists in the AERU pilot did not receive a bonus for the year because the rest of the marketing staff in the adult non-fiction division did not meet their targets.

Brian stated that properly incentivizing the AERU members is a priority, as they are some of SPH's best and most highly regarded employees.

(CONTINUED ON PAGE 39)

APPENDIX IX – PERFORMANCE MANAGEMENT (continued)
ADDITIONAL INFORMATION

Outsourcing Sales Function

Email, forwarded from Jonathan to Michel (MC)

From: Roger Mahovlich, Big M Marketing Inc.
To: Jonathan Fleming, VP Production, SPH

Hi Jonathan!

Thanks for reaching out.

Big M Marketing Inc. is a team of professionals that specializes in the publishing business. Our clients include some of the “Big Four” publishers.

We would replace your sales process with our own Direct Marketing approach, which has proven to be highly effective for our clients. We combine your company data with our growing database to reach a broader market than any single publisher can achieve on its own!

With our approach, our clients can almost entirely eliminate their marketing costs. As our staff are paid 100% by commission, they are highly motivated to serve your needs. All our clients have experienced at least 20% sales growth year over year (adjusted for elements that are out of our control), which is why we guarantee that you will experience the same growth in the first year. We charge no upfront fee and require no fixed-length commitments or contracts.

(CONTINUED ON PAGE 40)

TAXATION ROLE
ADDITIONAL INFORMATION

(CONTINUED ON PAGE 41)

APPENDIX IX – TAXATION
ADDITIONAL INFORMATION

Opening Balances

At January 1, 2021, SPH has $100,000 of net capital losses carrying forward.

Undepreciated capital cost (UCC) balances (*in thousands of Canadian dollars*) were as follows:

Class	UCC
Class 1	$ 12,000
Class 8	$ 3,500
Class 10	$ 600
Class 50	$ 400

SPH has not placed its buildings into separate Class 1 pools; all are in a pooled 4% category.

2021 Activity

The following is cumulative information from the beginning of the fiscal year to the last quarter of 2021 from SPH's accounting system.

Asset purchases *(in thousands of Canadian dollars)*:

	January - September	October	November	December	Total 2021
Class 8 equipment	$ 8,312	$ 0	$ 588	$ 0	$ 8,900
Class 50 equipment	$ 2,421	$ 0	$ 0	$ 269	$ 2,690
Total additions	$ 10,733	$ 0	$ 588	$ 269	$ 11,590

(CONTINUED ON PAGE 42)

APPENDIX IX – TAXATION (continued)
ADDITIONAL INFORMATION

2021 Activity (continued)

Excerpts from the detailed income statement (*in thousands of Canadian dollars*):

	January - September	October	November	December	Total 2021
Revenues	$ 55,420	$ 6,350	$ 6,250	$ 7,150	$ 75,170
Cost of goods sold					
Production and royalty costs (Note 1)	25,988	3,155	2,846	2,650	34,639
Amortization of pre-production costs	729	81	81	81	972
Depreciation and amortization related to production	637	71	71	71	850
Gross profit	$ 28,066	$ 3,043	$ 3,252	$ 4,348	$ 38,709
Expenses					
Depreciation	$ 1,652	$ 184	$ 184	$ 183	$ 2,203
Sales and marketing	9,401	1,200	1,000	800	12,401
General and administration					
Meals and entertainment	1,450	50	50	50	1,600
Golf membership fees	520	0	0	100	620
Bad debt expense	0	0	0	1,000	1,000
Bank charges	800	50	75	75	1,000
Professional fees	1,250	150	250	50	1,700
Rent expense	4,800	533	533	534	6,400
Utilities	1,825	208	208	209	2,450
Office supplies	1,050	30	59	50	1,189
Telephone and internet	375	41	42	42	500
Total operating expenses	$ 23,123	$ 2,446	$ 2,401	$ 3,093	$ 31,063

Note 1 – Production and royalty costs approximates inventory purchases for the period.

(CONTINUED ON PAGE 43)

APPENDIX IX – TAXATION (continued)
ADDITIONAL INFORMATION

Brian and Sarah – Tax Information

Sarah is 66 years old and a retired teacher. She will have the following income in 2022:

Canada Pension Plan	$ 14,110
Pension income	40,000
RRIF income	15,000
	$ 69,110

Brian will have the following income in 2022:

Canada Pension Plan	$ 7,055
RRIF income	75,000
Employment income (January – June)	80,000
	$ 162,055

Brian and Sarah intend to sell their home in Toronto for $7 million. It is their main dwelling, which they acquired in 2010 for $2.5 million. They also own a cottage that they purchased in 2015 for $250,000, and that currently has a fair market value (FMV) of $1 million. Since they go there often for vacations during the summer, they have never rented it out.

Share Sale Information

Brian has used $175,000 of his lifetime capital gains deduction (LCGD) in the past on other investments. Brian paid $100 for his SPH shares at the time it was incorporated.

Rodney's adjusted cost base of his shares in SPH is $1.4 million. He has not used any of his LCGD. Rodney currently earns over $250,000 in annual salary from SPH and does not have any other income.

Jefferson has valued the equity of SPH at $60 million and has proposed to purchase Brian's and Rodney's respective shares on March 31, 2022, although the terms allow for flexibility, should any tax planning need to be performed. Jefferson's taxable capital is $12 million.

SPH's financial position on March 31, 2022, is expected to be similar to its financial position on December 31, 2021. The equipment in Class 8 has a total FMV of only $7.5 million. All other depreciable assets have FMVs higher than their UCC balances, and all of SPH's land has appreciated since it was acquired.

(CONTINUED ON PAGE 44)

APPENDIX IX – TAXATION (continued)
ADDITIONAL INFORMATION

Warehouse Move

The warehouse at 360 Tilly Avenue was purchased in 2014. A buyer is willing to purchase it on May 31, 2022, for $1.5 million, being $1.05 million for the land and $450,000 for the building. The land has an adjusted cost base (ACB) of $700,000, while the ACB of the building is $300,000.

SPH would purchase a warehouse located at 350 Foster Avenue for $1.6 million, of which $1.1 million is allocated to the land and $500,000 to the building. Construction of the warehouse started in 2019, and it was ready for use in 2021. The purchase of this warehouse is tentatively scheduled for June 30, 2022.

GST/HST Information

Rhea had never filed a GST/HST return before but realized that the December GST/HST needed to be paid.

Rather than prepare or file a GST/HST return for December, she reviewed what was remitted for November and simply paid the same amount ($146,000) for December by the filing deadlines.

In December, SPH's sales were divided evenly between sales to customers in Ontario (where there is 13% HST) and British Columbia (where there is only GST). All expenses and asset purchases take place in Ontario. New pre-production cost purchases were $100,000 in December.

(CONTINUED ON PAGE 45)

End of Examination

(CONTINUED ON PAGE 46)

CPA COMMON FINAL EXAMINATION REFERENCE SCHEDULE

1. PRESENT VALUE OF TAX SHIELD FOR AMORTIZABLE ASSETS

Present value of total tax shield from CCA for a new asset acquired after November 20, 2018

$$= \frac{CdT}{(d+k)}\left(\frac{1+1.5k}{1+k}\right)$$

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

2. SELECTED PRESCRIBED AUTOMOBILE AMOUNTS

	2021	2022
Maximum depreciable cost — Class 10.1	$30,000 + sales tax	$34,000 + sales tax
Maximum depreciable cost — Class 54	$55,000 + sales tax	$59,000 + sales tax
Maximum monthly deductible lease cost	$800 + sales tax	$900 + sales tax
Maximum monthly deductible interest cost	$300	$300
Operating cost benefit — employee	27¢ per km of personal use	29¢ per km of personal use
Non-taxable automobile allowance rates		
— first 5,000 kilometres	59¢ per km	61¢ per km
— balance	53¢ per km	55¢ per km

3. INDIVIDUAL FEDERAL INCOME TAX RATES

For 2021

If taxable income is between			Tax on base amount	Tax on excess
$0	and	$49,020	$0	15%
$49,021	and	$98,040	$7,353	20.5%
$98,041	and	$151,978	$17,402	26%
$151,979	and	$216,511	$31,426	29%
$216,512	and	any amount	$50,141	33%

For 2022

If taxable income is between			Tax on base amount	Tax on excess
$0	and	$50,197	$0	15%
$50,198	and	$100,392	$7,530	20.5%
$100,393	and	$155,625	$17,820	26%
$155,626	and	$221,708	$32,180	29%
$221,709	and	any amount	$51,344	33%

(CONTINUED ON PAGE 47)

4. SELECTED INDEXED AMOUNTS FOR PURPOSES OF COMPUTING INCOME TAX

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

	2021	2022
Basic personal amount, and spouse, common-law partner, or eligible dependant amount for individuals whose net income for the year is greater than or equal to the amount at which the 33% tax bracket begins	$12,421	$12,719
Basic personal amount, and spouse, common-law partner, or eligible dependant amount for individuals whose net income for the year is less than or equal to the amount at which the 29% tax bracket begins	13,808	14,398
Age amount if 65 or over in the year	7,713	7,898
Net income threshold for age amount	38,893	39,826
Canada employment amount	1,257	1,287
Disability amount	8,662	8,870
Canada caregiver amount for children under age 18, and addition to spouse, common-law partner, or eligible dependant amount with respect to the Canada caregiver amount	2,295	2,350
Canada caregiver amount for other infirm dependants age 18 or older (maximum amount)	7,348	7,525
Net income threshold for Canada caregiver amount	17,256	17,670
Adoption expense credit limit	16,729	17,131

Other indexed amounts are as follows:

	2021	2022
Medical expense tax credit — 3% of net income ceiling	$2,421	$2,479
Old age security repayment threshold	79,845	81,761
Annual TFSA dollar limit	6,000	6,000
RRSP dollar limit	27,830	29,210
Lifetime capital gains exemption on qualified small business corporation shares	892,218	913,630

5. PRESCRIBED INTEREST RATES (base rates)

Year	Jan. 1 – Mar. 31	Apr. 1 – June 30	July 1 – Sep. 30	Oct. 1 – Dec. 31
2022	1			
2021	1	1	1	1
2020	2	2	1	1

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

(CONCLUDED ON PAGE 48)

6. MAXIMUM CAPITAL COST ALLOWANCE RATES FOR SELECTED CLASSES

Class 1………………………	4%	for all buildings except those below
Class 1………………………	6%	for buildings acquired for first use after March 18, 2007 and ≥ 90% of the square footage is used for non-residential activities
Class 1………………………	10%	for buildings acquired for first use after March 18, 2007 and ≥ 90% of the square footage is used for manufacturing and processing activities
Class 8………………………	20%	
Class 10…………………….	30%	
Class 10.1…………………..	30%	
Class 12…………………….	100%	
Class 13…………………….	n/a	Straight line over original lease period plus one renewal period (minimum 5 years and maximum 40 years)
Class 14…………………….	n/a	Straight line over length of life of property
Class 14.1…………………..	5%	For property acquired after December 31, 2016
Class 17…………………….	8%	
Class 29…………………….	50%	Straight-line
Class 43…………………….	30%	
Class 44…………………….	25%	
Class 45…………………….	45%	
Class 50…………………….	55%	
Class 53…………………….	50%	
Class 54…………………….	30%	

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