CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

CPA Common Final Examination

BOARD OF EXAMINERS' REPORT

PART B — The Day 1 Report

September 2016 and September 2017 Examinations

CPA BOARD OF EXAMINERS COMMITTEE MEMBERS

Chair: Terry Booth, FCPA, FCA, CF
Collins Barrow Calgary LLP
Calgary, Alberta

Vice-Chair: Paul Van Bakel, CPA, CA
Musashi Auto Parts Canada Inc.
Waterloo, Ontario

Joan Davison Conrod, FCPA, FCA
Dalhousie University
Halifax, Nova Scotia

Monique Côté, CPA, CA
MNP LLP
Calgary, Alberta

Susan Deleau, FCPA, FCA
The Great-West Life Assurance Company
Winnipeg, Manitoba

Mohamed Drira, MSc, PhD, CPA, CGA
University of New Brunswick
Fredericton, New Brunswick

Naïma Hafidi, CPA, CGA, Msc Finance
Public Services and Procurement Canada
Gatineau, Québec

Réal Jacques, CPA, CMA, M.Sc.
HEC Montréal
Montréal, Québec

Gabriela Kegalj, CPA, CA
KPMG LLP
Toronto, Ontario

Tanya Kirsch, CPA, CA, CFA
University of Toronto
Mississauga, Ontario

David Legere, CPA, CA
Brantford, Ontario

Colin MacLean, FCPA, FCMA
Dalhousie University
Halifax, Nova Scotia

Pier-Olivier Migneault, CPA, CA
Business Development Bank of Canada
Montréal, Québec

David (Jordan) Oakley, CPA, CA
Deloitte
Winnipeg, Manitoba

Jonathan Vandal, CPA, CA, Fin Pl.
Groupe Lepore-Gosselin
Montréal, Québec

Bill Waterman, CPA, CMA
Aurora College
Yellowknife, North West Territories

Michael Wright, PhD, FCPA, FCGA
University of Calgary
Calgary, Alberta

TABLE OF CONTENTS

See Part A for full report on Day 2 and Day 3 simulations and marking guides.

THE BOARD OF EXAMINERS' REPORT ON THE COMMON FINAL EXAMINATION

OBJECTIVES OF THE REPORT

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

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

The September 2017 CFE Report is presented in two parts: Part A is the Day 2 and Day 3 Report and Part B is the Day 1 report.

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

RESPONSIBILITIES OF THE BOARD OF EXAMINERS

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

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

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

The chair is responsible for the supervision of the evaluation process. The entire board is actively involved in the preparation of the CFE simulations, the preliminary marking guides, and the setting of the initial passing profile. A CFE subcommittee, made up of five members, participates in the Preliminary Evaluation Centre where the marking guides are tested against candidate responses and finalized. The chair and vice-chair participate in the start-up of the marking centre and provide oversight throughout the marking process. The full board is responsible for determining the passing standard.

THE CFE

Preparation and Structure of the CFE

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

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

Nature of the Simulations

The CFE comprises a set of simulations that are both essential and effective in evaluating the candidates with regard to their readiness to be a CPA:

Day 1 – The first paper is a four-hour examination consisting of a single simulation that is linked to the Capstone 1 group case. There are two versions of the linked cases. Version 1 is linked to the most current Capstone case, and is written by either first time writers, or by repeat writers who chose to attempt the new case rather than version 2 of the previous Capstone case. Version 2 is written by repeaters and candidates who deferred and are writing version 2 as their first attempt.

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

Day 3 – The third paper consists of three multi-competency area simulations.

Assessment Opportunities

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

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

Appendix A contains a comprehensive description of the evaluation process.

Marking Guides

Marking centre leaders and assistant leaders provide valuable input during the testing and setting of the marking guides, before live marking begins. The board chair, vice-chair, selected board member(s) and senior evaluations staff hold meetings with the leaders and their assistants during both the guide-setting and the marking processes. See **Appendices B to F** for the PRI Day 1 simulations and related capstone case, PRI marking guides, and PRI sample responses.

Appendix G contains the marking results by assessment opportunity, and **Appendix H** contains the BOE comments. A copy of the Day 1 V1 (FVT), Day 2 and Day 3 simulations can be found in **Part A** of the CFE Report. The marking guide and detailed BOE commentary for the FVT Day 1 simulation will not published until version 2 is written on the September 2018 CFE.

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

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

Five categories of performance are given for each assessment opportunity (AO). The candidate's performance must be ranked in one of the five categories:

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

Setting the Passing Standard

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

In determining which candidates pass the CFE, a passing profile is developed by the CFE subcommittee of the board. A candidate is judged in relation to these pre-established expectations of an entry-level chartered professional accountant. The passing profile decisions are ratified by the full board. In setting the passing profile, the board considers the following:

- The competency area requirements described in the *Map*
- The level of difficulty of each simulation
- The level of difficulty of each assessment opportunity
- The design and application of the marking guides
- Comments from leaders and assistant leaders regarding any marking difficulties encountered or any time constraints noted
- Possible ambiguity of wording or of translation
- Input on critical decision factors from an independent board of three CPAs who review the fair pass package

The Decision Model

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

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

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

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

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

Day 1

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

Day 2 and Day 3

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

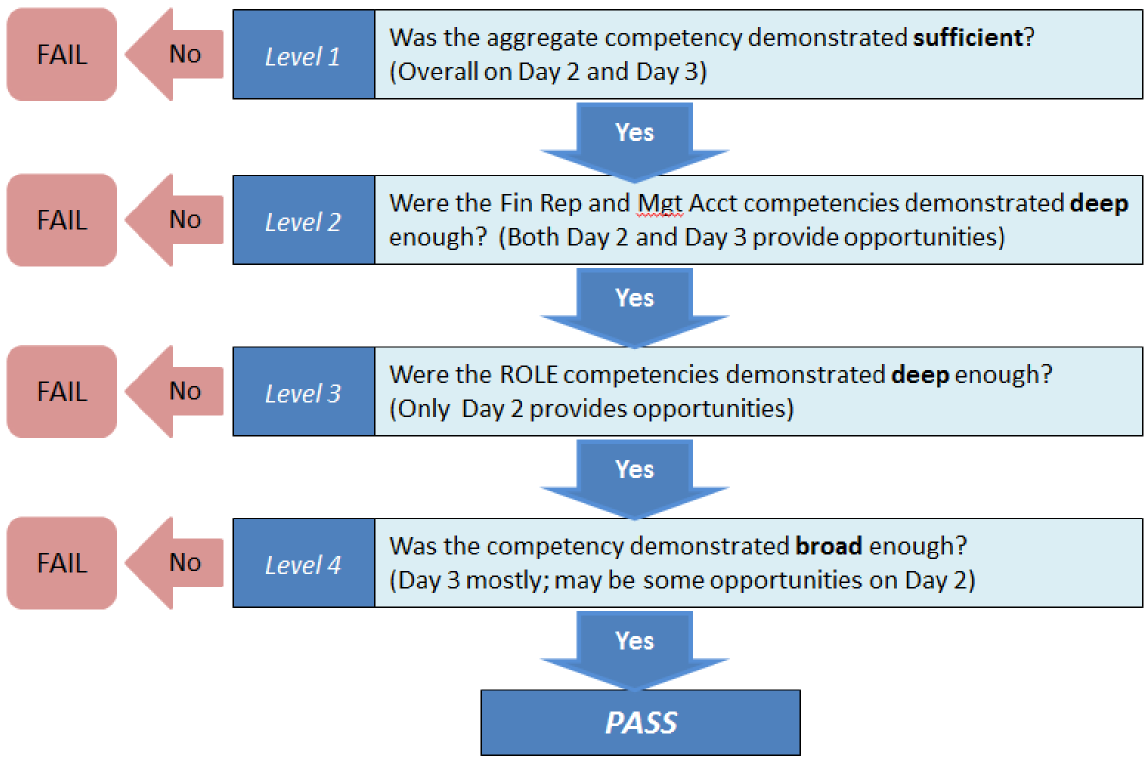
1. The response must be **sufficient**; i.e., the candidate must demonstrate competence in the Assessment Opportunities presented on Day 2 and Day 3 (Level 1).

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

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

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

EXHIBIT I
DAY 2 AND 3 PASS/FAIL ASSESSMENT MODEL



Approving the Results

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

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

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

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

Reporting

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

The board reports the following information by candidate number:

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

Thank You

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

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

Terry Booth

Terry Booth, FCPA, FCA, CF
Chair
Board of Examiners

A MESSAGE TO CANDIDATES

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

INTRODUCTION

The September 2017 CFE Report presents detailed information on candidates' performance for all the examination cases, except for FVT, the Day 1 linked case, Version 1. Commentary on the performance of candidates on Day 1 (FVT Version 1) is provided in a summary format only in this message to candidates, since detailed commentary on FVT will only be provided after Version 2 is written in September 2018. The simulations, marking guides, marking results, and Board of Examiners' comments on Day 2 and 3 of the examination are found in Part A of the CFE Report. Similar information on Day 1 (PRI version 1 and version 2) can be found in Part B of the CFE Report.

The intent of this message is to highlight common areas of deficiency and to offer advice from the BOE to help candidates understand how to improve their performance on the CFE.

Nature of the CFE

The design of the CFE is such that each day of the examination allows candidates to demonstrate a different skill set. Day 1 allows candidates to demonstrate their high-level professional skills, such as critical analysis, decision-making, and professional judgment, as well as communication. Day 2 allows candidates to demonstrate their technical competence in the common Financial Reporting and, or Management Accounting competencies and in their chosen role, which ties to one of the four elective areas. Day 2 clearly directs candidates to the work to be done and is not designed to be time-constrained, allowing candidates to demonstrate depth. Day 3 allows candidates to demonstrate depth in the common Financial Reporting and Management Accounting competencies and provides multiple opportunities to demonstrate breadth in all the core technical competency areas. Day 3 is less directive and more integrative than Day 2. It is also time-constrained, requiring candidates to prioritize their time per issue.

Specific Strengths and Weaknesses

<u>Enabling – Professional Skepticism</u>

For the first time this year, there was a common enabling AO on Day 2 (AO#7). Information was provided throughout the case that should have led candidates to question some of the actions of FRE's COO, Andy. Candidates were told that Andy maintains an active role on Halloran's board of directors, a company FRE has used for building several of its buildings. They were also told that a foundation crack in a property built by Halloran had resulted in FRE selling the property at a significant loss a few years ago. In addition, a large crack was recently found in the foundation of another building constructed by Halloran. Andy directed the VP Acquisitions, Construction & Maintenance not to investigate the crack. Candidates were expected to put together these case facts and explain the potential conflict of interest in Andy's different roles and the fact that he may not be acting in the best interests of FRE. While candidates were not explicitly directed to this assessment opportunity, the Board would have liked to see more candidates raise this issue.

The Board acknowledges that, because the issue was non-directed and required candidates to integrate case facts spread throughout Day 2, the issue was not easy. However, an important skill expected of a CPA is professional skepticism and being aware when information indicates that there may be an underlying problem. Therefore, despite the lack of direction, candidates should have recognized that Andy’s behaviour was questionable and that it was their duty as a CPA to bring this issue to Gloria’s attention.

Communication

A majority of candidates communicated clearly and professionally. For the most part, candidates’ responses were well organized, with a logical flow. However, the BOE still found that some responses were unclear, often due to the use of extreme point-form, which sometimes made it difficult to interpret the meaning and intention of what candidates had written. The BOE also noted there were candidates who merely repeated the case facts, with no further explanation as to why each fact was listed. This was typically done in point form. For example, on Day 2, Assurance role, candidates provided examples of case facts that affected the overall financial statement risk but did not explain why each fact increased or decreased the risk assessment. On Day 2, Performance Management role, many candidates listed case facts as either pros or cons without any further explanation. In addition, when discussing the board governance, candidates restated case facts but often did not explain whether each was a strength or weakness and why. On Day 2, Finance role, many candidates listed case facts as either a pro or con when analyzing the qualitative aspects of the townhouse project, without explaining why. On Day 3, Simulation 2, the Board saw a similar approach taken to the discussion of the e-book format versus the printed book. Some candidates simply listed case facts under either “pro” or “con” for each format, with no further explanation as to why each factor would be either an advantage or disadvantage of each option. Similarly, on Day 3, Simulation 3, some candidates listed case facts under each SWOT category without any further explanation.

Most candidates’ quantitative analyses were well organized, with a logical flow. However, as was mentioned for the prior examinations, some candidates still did not explain the details of their calculations, making it hard to know what assumptions they used or how they arrived at their figures. For example, on Day 3, Simulation 2, candidates did not always explain why they were making normalizing adjustments to the earnings. Candidates’ calculations were also lacking on Day 3, Simulation 1, where candidates provided a conclusion on whether or not the criteria for the grant claw-back were met without providing supporting calculations. Without seeing the underlying calculation, it was difficult to determine if the reasoning behind the comment made was valid.

Candidates are reminded that they need to clearly explain their train of thought to demonstrate competence. It is not sufficient to just state a correct conclusion. The Board is interested in understanding a candidate’s logic and wants to see evidence of the analysis and professional judgment that has been applied.

Time Management

An improvement in time management was noted on the September 2017 CFE, in particular with regards to Day 3. With a few exceptions described in this section, time was also well managed on the Day 1 and Day 2 simulations, which are not designed to be time-constrained.

Although neither of the Day 1 simulations on the September 2017 CFE were time-constrained in their design, some time management issues were still evident. Some candidates spent an inordinate amount of time preparing a full situational analysis, rather than simply addressing the changes that were relevant based on the case facts presented. Others spent too much time analyzing one of the issues presented, to the detriment of the others.

Some candidates in the Day 2 Taxation and the Day 2 Finance role spent too much time on the common management accounting AOs. In addition, a number of candidates chose to leave the more difficult taxation or finance requireds to the end. While candidates are free to address the requireds in the order they like, by focusing on easier issues or by spending too much time on the quantitative calculations, candidates run the risk of running out of time to address all of the requireds, as was seen frequently on both of these Day 2 roles.

Candidates are reminded that spending too much time on any one required can hurt performance on another required. Allocating sufficient time to cover all of the requireds, while still ranking the importance of the issues, is essential. Judgment is required in determining how much evidence to provide to demonstrate competence per AO. The BOE is looking for sufficient, but not excessive, depth to be demonstrated. Day 2 in particular is designed to allow time for filtering information and planning the response. Candidates are encouraged to use the time provided to plan sufficient time to address all the requireds.

The Board saw a marked improvement in candidates' time management on Day 3. There was much less evidence of candidates going over the suggested times on Simulation 1 and sometimes Simulation 2, to the detriment of their performance on Simulation 3. The Board was pleased to see candidates generally following the suggested times for each simulation on Day 3 to ensure they had the opportunity to answer all the requireds.

Despite an improvement from the prior year, there was still some evidence on Day 2 and Day 3 of candidates skipping issues (see the percentage of Not Addressed). For example, on Day 2, a greater number of candidates did not attempt to discuss the impairment issue at all. On Day 2, Finance role, some candidates skipped the most difficult required (AO#11 – tenant financing). Also, a greater number of candidates did not attempt AO#13 (Bates offer). This was not a difficult AO. It may be that candidates did not address the issue due to the time management issues discussed earlier. On Day 3, Simulation 1, a greater number of candidates did not address the clawback, procedures, and performance measures. Also, on Day 3, Simulation 3, more candidates avoided the responsibility centres and transfer pricing issue. All of these issues were directed to, but they were ones that candidates struggled with.

The Board is concerned that candidates may be intentionally not addressing the difficult issues in favour of the easier ones. The BOE reminds candidates that the CFE has not only depth and breadth tests, but also a sufficiency score. Skipping issues affects the sufficiency score. Candidates are encouraged to attempt all the requireds, managing their time carefully in doing so.

Day 1

Points have been excerpted from the September 2016 Board of Examiners' report on Day 1, Version 1 of PRI. Additional commentary based on candidates' performance on Version 2 has been added.

Comments Specific to Day 1 (PRI Version 1) [excerpted from September 2016 CFE Report]

The following paragraphs elaborate on the strengths noted and draw attention to the common weaknesses identified by the Board of Examiners on the September 2016 CFE, Day 1, Version 1 of PRI.

The PRI Day 1, Version 1 case presented less opportunity for financial assessments and calculations than previous cases (CHEI and RSI). It had more undirected issues, and candidates needed to be careful not to lose sight of the need to address not only the operational matters but also the high-level qualitative strategic analysis that was required for each major issue. Candidates struggled to identify the issue they were not directed to (governance and bonus). Candidates are reminded to step back and consider the broader problems, rather than taking an issue-by-issue, silo approach. It is important to integrate the case facts, particularly those important factors highlighted in the situational analysis, to identify the broader strategic issues.

Generally, candidates presented their responses in a well-structured format, beginning with the situational analysis and followed by an analysis of the issues they identified and a conclusion. The level of communication was generally good, with few exceptions.

All candidates started with a situational analysis. However, many simply restated case facts without putting those facts together to consider the implications to the situation presented. The BOE noted that many candidates appeared to go through a "checklist" that looked like a template approach, rather than logically addressing the matters that were relevant to the case being specifically presented. Candidates are reminded to think through the issues. There is no point presenting a situational analysis that is several pages long if that information is not going to be used as part of the analysis of the issues. Instead, the situational analysis should focus on the elements that have changed since Capstone 1 or those that will affect the decisions. These facts can then be linked to the later analysis.

Comments Specific to Day 1 (PRI Version 2)

Similar to Version 1, most candidates performed an appropriate situational analysis, identifying the important factors that had changed from the Capstone case or were new and relevant to PRI. Where many candidates fell short was in their failure to link their assessment of the situation within their analysis of the issues. For example, many candidates highlighted the mission and vision statements and PRI's values, but then failed to bring those elements into the discussion of which system is the better fit for PRI.

A number of candidates simply recapped the case facts, typically in extremely short bullet points, with no explanation as to why they were important enough to be listed. For example, candidates would simply state a case fact like, "Jeff wants to expand into the U.S.," but would not discuss the relevance of the point or use it in their analysis. As another example, candidates would identify the disagreement between Jeff and George in terms of future strategies but would not use that information in their analysis. This approach was not considered sufficient for a situational analysis.

At the other end of the spectrum were those candidates who went into too much depth in their situational analysis, redoing the entire analysis rather than focusing on the changes, which the case specifically directed them to do.

There were three major issues that candidates were expected to analyze from both an operational and a strategic perspective: the choice of e-commerce system, the shipping and distribution, and whether to increase real estate holdings. There were two additional issues that candidates could have discussed: the conflict between Jeff and George and the fact that, once again, Martina showed favouritism toward a family member in hiring. Some candidates chose to address the possible expansion to the U.S. as a separate issue. This was considered a valid discussion as well. Candidates were directed by the client to all the issues other than the governance issue. Candidates were expected to do both qualitative and quantitative analysis.

Most candidates identified the main issues and attempted a discussion of them. A surprising number of candidates failed to use the survey information that was provided in the case. This information could have been used in the analysis of the Alpha versus Express website decision or in the shipping and warehousing discussions. When the survey information was linked with the key success factors for the business, a supported recommendation was easily reached.

There was a lot of integration between the issues presented in the case. Better candidates saw the interrelationships and addressed them, whereas weak candidates tended to deal with each issue in a silo. For example, the shipping and warehousing issues and the real estate issues could all be linked and suggestions made to improve PRI's overall strategic position. The possible expansion into the United States could also play into several issues. Candidates are reminded to step back and consider the broader implications, rather than being too focused on an issue-by-issue, silo approach.

Unlike in past cases, most candidates performed calculations. However, the quality of their quantitative analysis was often poor. The calculations that were expected were minimal and quite straightforward, yet many candidates made mistakes like including the sunk costs in their system analysis or including a cost of shipping even though the heading was “100% billed to customers.”

Overall, strong candidates clearly understood that their role was to address Martina’s request to assess whether the company is moving in the right direction. They focused their analysis on the key risk areas to PRI from a strategic point of view, drawing in relevant case facts and elements of their situational analysis to present an overall conclusion on the direction PRI was heading and what should be done in the future to secure its positon in the marketplace. Weak candidates did not provide an overall conclusion and sometimes failed to conclude on the individual issues.

Candidates are reminded that concluding on their position is important, particularly when lists of pros and cons are presented for each alternative. When there are multiple issues, some of which are recommended to be pursued and others not, summing up is necessary to convey which courses of actions should be pursued first and why. In this case, since the issues were highly integrative, an overall conclusion helped demonstrate the candidate’s strategic thinking.

Many candidates used short point-form lists of pros and cons with little explanation in their responses. This was considered poor communication because it led to responses that were confusing, difficult to follow, and in many cases challenging to understand.

Comments Specific to Day 1 (FVT Version 1)

Most candidates dedicated the first section of their response to a situational analysis. Most used their situational analysis later in their response, making links back to the work they did while analyzing the specific issues. Most also used the information provided in the case (e.g., financial ratios and industry benchmark) to perform a general financial assessment of FVT. The most frequently used element of the situational analysis was the focus on new technology (e.g., the new mission and trends toward new technology). Some candidates calculated the covenant based on the internally prepared financial statements and recalculated it incorporating their recommendations for financing.

Weak candidates simply recapped case facts or went into too much depth in their situational analysis, redoing the entire analysis rather than focusing on the changes, which the case specifically directed them to do.

Candidates are reminded that the purpose of the situational analysis is to identify relevant changes in circumstances since the Capstone 1. It is not intended to be a full SWOT, nor is it intended to be a standalone analysis that is rewarded. Only when the information is integrated into the discussion of the specific issues is there value added.

There were five issues that candidates were expected to analyze both from a strategic perspective and an operational perspective. Four were investment opportunities that the candidates were specifically ask to analyze, and the fifth was an undirected requirement about the governance and ethical issues facing FVT. Candidates were expected to provide a qualitative and quantitative analysis for each of the four investment opportunities. Candidates were also expected to integrate the case information to recognize at least one of the ethics and governance issues and to recommend appropriate action.

Overall, most candidates provided a balanced response, with appropriate depth in the qualitative discussion on every issue, and they showed some numeracy skill in most of the major issues. Strong candidates tended to discuss the issues with the strategic implications at the forefront of their analysis. Weak candidates tended to list qualitative points that were mostly restated case facts, and they also tended to focus on the operational decision factors. Some weak candidates were not able to use the quantitative information in a useful way for FVT. Candidates are reminded that avoiding the numbers is a fatal flaw for the Day 1 case and are strongly advised to perform a balanced quantitative and qualitative analysis. Candidates are also reminded that it is important on Day 1 to discuss the strategic implications, not just identify the operational issues, keeping in mind that often the operational issues are presented in the case to raise broader strategic issues. Candidates are reminded to step back and think about the interrelationships between the issues. For example, candidates were expected to realize that FVT had financial constraints, such as the financial covenant and the limit on spending on investment ($2.5 million), that they should have considered when assessing the investment options. Weak candidates did not understand the constraints that FVT was facing.

Candidates were not specifically directed to the ethical and governance issues but were given multiple examples in the case of these issues. Many candidates recognized the unethical actions of Zobair and realized that the FLIXREWARDS points should be remitted to the clients in order to maintain FVT’s reputation. However, some did not see the issue at all, which was disconcerting to the Board. Candidates are expected to address ethical issues that could have an impact on the business, even though they are not directed directly to them. Candidates need to step back and integrate all the case facts to uncover those non-directed issues.

Candidates are expected to conclude on each analysis they complete, and their conclusions are expected to be consistent with the analysis they perform. There was no one correct solution to the FVT case. Strong candidates provided thorough conclusions for all the issues they analyzed. Most candidates took into account the constraints provided in the case by either comparing the investment needed for each project with the spending limit or attempting to recalculate the financial covenant based on the projects recommended.

Only a few candidates struggled with effective communication. The approach most candidates took was well structured and the language used was clear. However, the presentation of the exhibit in Excel by some candidates was hard to follow. The use of decision matrix and column format in Word (with pro/con listings) is also not an effective communication technique because it is difficult to clearly communicate the thought process in this format.

Additional Day 2 and Day 3 Comments

The following paragraphs elaborate on the strengths noted and draw attention to the common detracting characteristics identified by the Board of Examiners on Day 2 and Day 3.

Technical Knowledge

Most candidates were able to demonstrate the technical knowledge required throughout the CFE. In general, candidates performed well across most of the depth and breadth tests. The following are some examples of the technical weaknesses noted on the Day 2 and Day 3 simulations that contributed to the weaker results on those AOs.

Most candidates were able to provide a complete analysis of the basic accounting issues, but they struggled with the more difficult issues. On Day 2, Common AO#3 (BOT project), candidates did not always understand how to apply revenue recognition criteria to long-term contracts. Some candidates applied general revenue recognition criteria and concluded that, since performance of the contract had not been fully completed, no revenue could be recognized, without considering the fact that the *Handbook* guidance allows for the percentage-of-completion method to be used if certain criteria are met. Other candidates recognized that percentage-of-completion could be used to recognize revenue but demonstrated poor knowledge of how to apply the concept. On Day 2, Common AO#5 (impairment of buildings), many candidates struggled to explain the various steps required to assess the impairment of an asset. Candidates often confused the IFRS and ASPE *Handbook* guidance for impairment of assets and, as a result, provided incorrect discussions. For example, some suggested that the assets in question be written down to the higher of the asset's fair value less costs to sell or value-in-use (IFRS concepts), instead of considering ASPE's two-step approach of first determining whether the asset's carrying value exceeds its undiscounted future cash flows and, if so, then writing the carrying value down to the asset's fair value.

On Day 2, Assurance role, AO#8 (independence), many candidates struggled to apply the correct independence concepts, often applying concepts from CAS 200 that were not relevant, such as professional competence. Of those candidates who did discuss the correct concepts, many struggled to apply case facts to these concepts correctly. For example, many candidates concluded that there was a self-review threat, despite the fact that it is very unlikely the audit engagement would be relying on any of the work provided from the advisory engagements.

On Day 2, Performance Management role, AO#13 (mission), candidates struggled to provide a revised mission statement. Many candidates recommended surface-level improvements, such as adding the words "young individuals and families" or "Prince Joel and Bluebell" to the existing mission because a mission should include the "who" and "where." While those were valid points, they were the easiest ones to raise. Candidates should have also discussed the broader issues, like the macroeconomic factors facing FRE. Also, the reasons that Gloria created FRE and her desire to obtain more funds to provide more affordable housing could have been considered.

On Day 2, Taxation role, candidates were able to discuss the simpler issues with sufficient technical proficiency but struggled with more difficult concepts. For example, candidates had difficulty with the nature of de facto control (AO#9), where they often failed to recognize that de jure control was not the only form of control to be considered. They also struggled to identify the tax implications of a donation of private company shares to charity (AO#11), instead either treating them the same as public company shares or failing to use fair value for the resulting transactions. Finally, in candidates' discussions of the process for correcting prior year errors (AO#13), they consistently applied incorrect statute-barred dates or suggested that it was not possible to correct such errors.

Candidates struggled the most on Day 3 in Assurance and Finance. Candidates struggled with the review engagement context they were put in on Day 3, Simulation 1, AO#5 (review procedures), where they were asked to provide specific review procedures. Some candidates seemed to understand that review engagements focused on discussion, inquiry, and analytical procedures; however, they did not seem to know how to translate this into actual procedures.

Candidates also struggled on the Finance AOs on Day 3. On Day 3, Simulation 2, AO#3 (business valuation), candidates struggled to calculate EBITDA. Most candidates were not able to make a sufficient number of normalizing adjustments to earnings to be able to calculate EBITDA, which is a basic finance concept. Candidates also had difficulties with Day 3, Simulation 3, AO#5 (new equipment), where the majority of them were not able to differentiate between the go/no-go decision and the financing decision. Most candidates treated the two decisions at the same time and provided a calculation for each of the financing options, which resulted in calculations that were not comparable to each other. For example, candidates included the annual incremental net cash inflows in some of the options, but not all. The maintenance and repair costs were also included in the lease amount, but not in the other options, which some candidates ignored. This reduced the usefulness of their recommendation to the client.

Finally, candidates demonstrated a lack of knowledge on Day 3, Simulation 3, AO#3 (responsibility centres and transfer pricing). Many candidates were able to list the possible types of responsibility centres and explain what each type was about, as well as list the different types of transfer pricing that could be used. However, they had great difficulty when it came to the application of the theory to the scenario presented. Many candidates stated what the current situation was but then struggled to explain why they thought the responsibility centres or the transfer pricing policy were adequate (or not). Many candidates stopped short of providing an explanation, while others recommended policies that were not appropriate, such as recommending that the manufacturing division should be a profit centre in order to show a profit and improve the overall company's profitability. Candidates seemed to have enough technical knowledge to state what the theoretical options were, but not enough to apply the options to the client's situation and resolve the issues at stake.

Candidates are reminded that the CFE requires a strong foundation of technical knowledge in order for candidates to clearly demonstrate their professional skills, apply their judgment, and thereby demonstrate competence.

Lack of Support/Generic Discussions

A common theme across all the days was the fact that some candidates presented case facts without elaborating on why a fact was relevant to the discussion or position being argued. Also, some candidates made generic comments or drew conclusions without integrating the case facts into their analysis, making for a superficial analysis of the issues. The following are examples drawn from the BOE's commentary on the Day 2 and Day 3 simulations.

On Day 2, Assurance, AO#14 (special reports), candidates were able to provide several relevant reports that would meet the requirements of the Ministry. However, candidates typically discussed these options in a very generic manner, often without discussing why each report would be relevant in FRE's particular circumstances and would meet the users' needs.

On Day 2, Finance, AO#12 (financial position and return), some candidates performed a very generic ratio analysis, with explanations of the trends that were not tailored at all to FRE's rental property context. For example, some candidates referred to "sales" and "receivables" or "inventory," all concepts that do not really fully apply in a real estate context.

On Day 2, Performance Management, AO#14 (reports), many candidates just provided a theoretical discussion of financial statements without relating it back to FRE. For example, candidates would recommend a statement of cash flows and then discuss how it can tell a company how much cash they have to work with. However, there were specific case facts that supported why a cash flow statement would be useful for FRE, such as the fact that FRE's current ratio was below 1.0 and that FRE operates with a very low profit margin, meaning that it is important for the board to know FRE's cash position at all times.

Candidates struggled on the Assurance AOs on Day 3. Lack of support and generic discussions were seen. Candidates struggled to provide procedures that were relevant to the scenario presented, many providing very generic procedures that would apply to any engagement. On Day 3, Simulation 1, AO#4 (review planning memo), candidates had difficulty using case facts to describe the significant aspects of the business and areas to focus on. For example, some candidates suggested determining whether the accounting policies in place were appropriate or inquiring about unusual transactions, et cetera, without providing any procedures linked to the actual sources of revenue or expenses incurred by ECCS. Candidates' descriptions of the procedures were also vague, with many using wording such as "we should verify" or "we need to ensure." This also happened on Day 3, Simulation 2, AO#5 (CRA procedures), where candidates were asked to provide examples of procedures the CRA would be performing during the agency's review of Roxanne's 2015 income tax return. Many candidates told Roxanne to make sure she kept her receipts, without providing examples of actual procedures the CRA would be performing.

Candidates must ensure that they answer the questions "Why?" or "So what?" when they make any point using case facts. Candidates are reminded that all competent candidate profiles on the CFE require supported arguments and defensible positions that are case specific.

Irrelevant Discussions

The BOE noted that this issue was far less of a concern than on previous examinations. However, there were still a few incidents of candidates providing irrelevant discussions.

On Day 2, Common, some candidates discussed the BOT project as a government grant and tried to apply contingent gain criteria to the property tax assessment appeal, the operating portion of the BOT project, or the RTO forfeited credits. The application of these specific *Handbook* sections to the topics listed were not relevant and demonstrated an overall lack of understanding of the scenario presented.

Some Day 2, Performance Management role candidates spent time unnecessarily doing a situational analysis, which was simply a restatement of case facts and was not required of their role. Perhaps they were using last year's exam as a template, since a situational analysis was requested on last year's Day 2 Performance Management role.

On Day 3, Simulation 1, AO#7 (performance measures), some candidates misunderstood their role and, instead of providing measures to assess whether ECCS was meeting its mission, provided advice on how ECCS could achieve its mission. For example, instead of providing a way to measure the clients' satisfaction, some candidates suggested ways for ECCS to improve clients' satisfaction.

Candidates are reminded to use their judgment in deciding whether a discussion is pertinent to the issues at hand or the role. Where there are few case facts to work with, candidates should stop and question themselves about the appropriateness of the discussion. They should ask, "Is this helpful and relevant to the client/user of the report? Why?" Only if they can answer "yes" to these questions should they proceed with the discussion.

Contradicting Case Facts

The 2017 CFE saw an increase in the proportion of candidates directly contradicting case facts presented to them, even when the facts were presented by authoritative sources in the simulation.

For example, on Day 2, Common, AO#6 (lawsuit), some candidates ignored the case facts presented that stated the lawyer could not comment on the likely outcome of the lawsuit due to a lack of available information, and instead concluded that it was likely a future event would confirm that an asset had been impaired or a liability incurred at the date, which is in direct contradiction of what the case suggested.

On Day 2, Assurance, AO#8 (independence), many candidates explicitly ignored the partner's direction that the consulting engagements could be performed and concluded that the audit firm should withdraw from the consulting engagements.

On Day 2, Taxation role, candidates were explicitly told by the partner at FRE's CPA firm that the property would not qualify as a replacement property because it is rental property. Despite this, a significant number of candidates chose to analyze the replacement property rules.

In addition, on Day 2, Taxation, Finance, and Performance Management roles, candidates were told that FRE has accounted for the RTO program properly for external reporting purposes. Despite this, some candidates in these roles chose to analyze the financial reporting aspects of the RTO program.

On Day 3, Simulation 3, AO#5 (new equipment), some candidates incorporated taxes in their calculations, despite the fact that the required specifically said to ignore tax implications. The required also said to ignore any financial reporting implications for now, but some candidates still addressed the accounting treatment of the purchase of the new equipment by discussing whether the leasing option would result in a capital lease or an operational lease.

Candidates are reminded that, while they should remain skeptical of unreliable sources, they should not be suspicious of all the information presented to them. Candidates are expected to apply their judgment to determine what information can be relied upon and what information should be treated with skepticism.

APPENDIX A

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

CFE Design

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

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

Day 3 is a four-hour examination containing a mix of small cases (60 to 90 minutes each) that evaluate the common core competencies only. The Day 3 cases provide additional opportunities for **depth** in Financial Reporting and Management Accounting and all the **breadth** opportunities for all the technical competency areas. Cases are time constrained, and they are designed to cover different competency areas within each case. A higher level of integration and judgment is required on Day 3 of the CFE than in the core modules, although the technical competencies are tested at the common core level of expectation.

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

The Development of Marking Guides and the Provincial Review Centre

Approximately three months prior to the Common Final Examination booklets being finalized and printed provincial reviewers meet to examine the simulations and the preliminary marking guides. The provincial reviewers' comments are considered by the board when it finalizes the examination set and again when the senior markers review the marking guides in the context of actual responses.

The September 2017 CFE Marking Centre

From the marker applications received, approximately 225 individuals were chosen to participate in the September 2017 CFE marking centre. The criteria for selection included marking experience, motivation, academic achievement, work experience, personal references, and regional representation. The marking was supervised by the CPA Canada Evaluations and International Assessment full-time board staff (8 staff).

The Day 1 FVT Version 1 linked case was marked by a team of 33 markers in Montreal from October 13 to October 28, 2017. The Day 1 PRI Version 2 linked case was marked remotely by a team of four markers from October 13 to October 28th. [See the September 2016 Board of Examiners' Report for details on the Day 1 PRI Version 1 marking centre.]

Day 2 Assurance was marked by a team of 71 markers in Montreal from October 7 to October 20, 2017. Day 2 Performance Management was marked by a team of 18 markers from October 7 to October 21, 2017. The other two Day 2 roles (Taxation and Finance) were marked by 12 markers in Toronto over a 7-day period in early October, immediately following the preliminary evaluation centre.

Two of the three Day 3 cases were marked in Montreal from October 13 to October 28, 2017. The third case was marked remotely over the same time frame. The Day 3 simulations had a total of 89 markers.

Before the marking centre, some board members, leaders, and assistant leaders attended a five-day preliminary evaluation centre (PEC). Participants reviewed the marking guides, applied them to randomly selected candidate responses, and made necessary revisions to the marking guidelines. The written comments on the marking guides received from provincial reviewers were carefully considered.

At the beginning of the marking centre, the leaders and assistant leaders presented the marking guides to their teams. The teams undertook a two-phase test-marking procedure prior to actual marking. Phase one consisted of marking guide familiarization, during which markers applied the marking guide to copies of candidates' responses and collectively reviewed their results. Phase one thus ensured that all markers understood the issues in the marking guide and the basis on which to apply each expectation level. Phase two consisted of an expanded test marking of several responses to establish marker congruence.

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

The board strives for the highest possible marking consistency and quality control. Leaders and assistant leaders therefore devoted much of their time to cross-marking and other monitoring activities. Markers' statistics were reviewed to ensure that marking remained consistent throughout the centre. Based on analysis of the statistics, leaders reviewed and, if necessary, re-marked responses to ensure that the assessment opportunities were marked fairly for all candidates. Bilingual markers marked responses in both languages, and their results were compared to ensure that the marking was consistent in both languages.

Borderline Marking (Day 1, Version 1 and Version 2)

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

Double Marking (Day 2)

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

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

Borderline Marking (Day 3)

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

Subsequent Appeal of Results and Request for Performance Analysis

Failing candidates may apply for an appeal of their examination results and/or a performance analysis for either Day 1, Day 2 and Day 3, or for all three days.

Appeal Approach

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

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

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

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

APPENDIX B

CAPSTONE 1
PRI BACKGROUND CASE

Capstone 1

Phoenix Risen Incorporated (PRI) – Case

(All dollars are Canadian dollars unless specifically stated otherwise.)

It is May 12, 2016, and you, CPA, work for Phoenix Risen Incorporated (PRI) as a senior business analyst. You have been a go-to support for Martina Legault, the current CEO of PRI. She appreciates that you have a professional designation and asks you to work with the various teams at PRI to provide advice on a number of concerns to assist both PRI and the family in moving forward. Your primary focus will be on the Phoenix chain, but assistance may be required in other areas as well.

PRI has approached you with a request to assist it in strategic analysis and to help set a new direction for the company. PRI is concerned with its ability to stay current and continue to grow in the current retail environment. There are also several operational issues that it would like you to analyze and address.

You have been provided with the following information to review and analyze.

Phoenix Risen Incorporated (PRI)

Established in 1943, PRI is a Canadian privately held retailer, operating under a department store concept. The company was founded by two brothers, Pierre and Marcel Legault. The PRI family of stores continues to be owned and operated by the Legault family today. The Phoenix chain is the core of PRI. As a national department store chain, from the beginning Phoenix established itself as an icon in the Canadian retail sector and has high brand awareness.

Industry information

The department store concept

Department stores were once a staple of the Canadian shopping landscape. The concept emerged in the early 1900s when consumers began to share a culture of consumption. Fashions were changing and a rising middle class led to an increase in the number of people who shopped for pleasure as opposed to necessity. Additionally, at a time when women were expected to behave in particular ways, shopping was a pastime that was not only acceptable but could also be done without accompaniment. As a result, the department store became a social outing for the middle-class woman.[1]

Large-scale stores that allowed consumers to purchase all of the goods they needed in one location became cornerstones of the shopping world across Britain and North America. Department stores found success by luring customers into a store where everything could be found under one roof — large-size stores and wide selections catered to shoppers.

Today, department stores struggle to stay current. With the rise of specialty stores that focus on one area, such as large-scale stores that focus on electronics or business supplies, consumers are focusing on stores that can cater to their specific needs.

An age of convenience has also resulted in more and more consumers turning to online shopping as their new "one-stop shop." Where the department store used to house everything in one location, the Internet now houses everything at the click of a mouse. This creates challenges where customers have become more attuned to comparison shopping and purchasing products from whichever retailer is selling them at the lowest price.

Canadian shopping market

The latest generation of shopper belongs to the millennial group. Millennials[2] are people born roughly between 1980 and 2000. They are just entering a time of having disposable income and more spending power, and they shop differently from their parents. Millennials, who are often labelled as entitled, are actually — and surprisingly — careful with their money[3]. They spend significant time researching products before purchasing, with the majority of that research occurring online. They tend to focus on buying items that have staying power, with an interest in quality and goods that will endure. They also socialize differently. Where the mall was once a common hangout for young adults, today coffee shops and other social places are the go-to gathering places.

This younger generation also tends to multitask and shop via computer or smartphone, allowing them the ability to shop wherever they are. By 2018, online sales are expected to double their current levels, capturing more than 6% of the total market[4]. That number is only expected to continue to increase as the century goes on.

---

[1] http://www.hbcheritage.ca/hbcheritage/history/social/CustomerExperience/departmentstore. Accessed January 12, 2015.

[2] William Strauss, Neil Howe (2000). *Millennials Rising: The Next Great Generation*. p. 370. ISBN 0-375-70719-0. Accessed January 12, 2015.

[3] http://www.businessweek.com/articles/2014-04-25/millennials-are-careful-frugal-shoppers-who-buy-for-the-long-term. Accessed January 12, 2015.

[4] http://www.huffingtonpost.ca/2014/06/27/canadian-shopping-mall-retail-brands-dying_n_5534651.html. Accessed January 12, 2015.

In 2013, Industry Canada published a Consumer Trends Update on Canada's Changing Retail Market. Based on this report, a company like PRI has much to consider when it comes to its future, especially with the Millennials, followed by Generation Z.

Company background

Pierre and Marcel each invested $1,000 in shares to start PRI. The brothers also made an agreement which stipulated that future ownership of the company should include all descendants in a fair and equitable way (see Exhibit 1 for a summary of the family history).

When Marcel passed in 1970, his shares were redeemed by the company leaving 100% ownership with Pierre.

In 1972, an estate freeze was done, where Pierre froze the value of the company into Class A voting preferred shares. The shares were redeemed over a 10-year period allowing Pierre and Anne-Marie to live comfortably for the rest of their days.

James and Stephen then each acquired 50% of the common shares at a cost of $1,000 each.

Exhibit 2 contains the current organizational chart.

PRI's businesses

Phoenix

Phoenix was built on the belief that "strong values breed profits." The Legault brothers were advocates of stronger communities and they looked to provide a store that would unite people and generate goodwill.

Phoenix focuses on sourcing only the highest-quality products so that consumers will be satisfied with their purchases, believing this will build lifelong relationships and loyal customers. The majority of the products highlighted in the stores are Canadian made, not only because of their quality but also to promote Canadian entrepreneurs. Phoenix has earned the respect of other businesses and a reputation for being not only fair but also generous, with high morals and preference for ethically made products.

Cinder

Recognizing that department stores were becoming more of a niche market, Cinder was acquired with the view to expand PRI's customer base in the Canadian market. Cinder is a mass merchandiser that helps PRI to continue to be a go-to retailer for Canadians. It provides the option of a shopping experience that is different from Phoenix, but with the same level of trust that Phoenix has always provided.

Cinder focuses on supplying everyday consumer goods at an affordable price. With an aim to provide service to more Canadians, Cinder has stores across Canada primarily in small towns.

Corporate mission

PRI is a Canadian shopping experience that provides products for both the budget shopper and for those looking for superior products. Founded on the principles of treating customers, suppliers and employees with respect and integrity, PRI is a family-run business that treats its customers like family.

Vision: *"We make it easy for Canadians to shop with us*."

Mission: Our mission is to serve our customers through our stores by providing a high-quality home and fashion retail experience. The experience is tailored to meet the needs of Canadians by providing quality, choice and service that can be trusted.

Quality – Quality of service and excellent value. High end or mass market, PRI provides products to meet and exceed the expectations of our customers.
Choice – We aim to provide shopping alternatives to meet your various needs. The PRI family of stores offers a wide selection of products to satisfy Canadians.
Trust – PRI is a brand that can be trusted. We are committed to maintaining and strengthening the trust Canada has in us in our relationships with both our customers and our staff.

Phoenix	**Cinder**
From the beginning of PRI, the Phoenix brand of department stores across Canada offers a complete shopping experience with high-end products sure to meet the needs of even the most discerning shopper. Carrying a large selection of Canadian-made, high-quality products, Phoenix provides the experience your family has been accustomed to since the 1940s. There are 14 Phoenix stores.	Cinder is a budget shopping alternative for the consumer who demands competitive pricing and a large array of general merchandise. Low pricing and a selection of household brands are the cornerstone of the Cinder store. Cinder operates at a low price point while maintaining the corporate values of PRI and of the Legault family. There are 75 Cinder stores.

Corporate values

The Legault family places great emphasis on ensuring that their reputation with customers is high, by providing friendly service, easy returns and a general sense of doing their best for them at all their stores. PRI as a family of stores believes that the customer is always right and that keeping a customer happy means they will return.

PRI extends the same treatment to its staff. The business started out small and staff were family or close friends of the brothers. As it expands, PRI continues to treat staff with respect. The family believes that, for customers to be treated well, staff need to be treated well first. PRI has worked to retain its staff, offering industry-leading employment packages that allow staff the ability to work in retail as a career, not just a job. Staff are confident in their roles, as PRI provides stable work hours and considers their needs in planning operations.

Management team

Stephen and James Legault

PRI, and especially Phoenix, have been a core piece of James' life. Next to his children, it is the creation he values the most, and he is very proud to have been a part of the creation of a landmark in the Canadian market.

James has stepped away from the business now and he is happy to let the younger generation take over. He will leave the future decisions and profits to them. It is important to both Stephen and him that their families are cared for and that each of their offspring feel valued and appreciated. They have made allowances in their wills for the inheritance of their shares, but both Stephen and James would like to change this. They would like to pass on ownership of PRI now, rather than later. They would like to benefit from the growth in the company up until the end of fiscal 2016 in order to ensure that they have the means to live out the remainder of their lives as they have become accustomed to, but all future growth should accrue to the third generation of Legaults involved with PRI. James expects to stay out of the management of operations; however, together with Stephen, he would like to keep voting control of the company for a little while in order to help resolve any disputes that may arise as everyone settles into their new roles. They currently draw dividends from the company. This would cease upon the handover and no further dividends would be paid until their shares are redeemed.

They would like to minimize the taxes paid as much as possible and neither has used his lifetime capital gains exemption. Ideally they would like to redeem 25% of their shares evenly over the next five years, with the remaining 75% to be redeemed in the future as needed. The expectation is that the cash for the redemption will come equally from Phoenix and Cinder.

Both James and Stephen would like to address the need to honour Justine, who died very young. Her daughter, Maggie, is her legacy, and James and Stephen believe that one-third of the company their fathers built belongs to Justine. The only way to acknowledge this is to pass some ownership onto Maggie. However, they are not sure how to do this.

Martina Legault

Martina's focus is largely on Phoenix. She is proud of the store built by her father and grandfather. PRI has always put customers' needs first and provided them with a store that reflects the family values: quality, honesty and care. It is really important to her that the traditions of PRI and Phoenix are carried on in a way that is respectful to the legacy of her family.

Although George and Jennifer believe that significant changes must be made to meet the objective of regaining PRI's former glory, Martina does not. Martina struggles to stay true to her personal values, while her relatives attempt to change the business based on their previous experiences in younger markets. In her opinion, Phoenix has been making changes to address the needs that have been identified. In the past, the Phoenix stores have been predominately street-front stores in downtown locations, and she is happy that the family continues to maintain them today. She takes pride in the fact that PRI owns and cares for prominent buildings. To her, it is important that the goods carried are of a high-end quality and that PRI caters to a customer who cares to experience the store, not just obtain the lowest price. She believes they should continue to maintain these stores today.

Martina recognizes that the market and shoppers have changed over the last two decades. She is confident that, in keeping the Phoenix values, PRI has responded well by adding Cinder to the family of stores. Additionally, Phoenix has expanded geographically outside of the downtown core to both suburban malls and standalone locations in suburban shopping areas. PRI is trying to cater to the more budget-conscious but still high-end shopper, which is also an answer to the changing market. It is her belief that the downtown stores have maintained their high quality of product and higher margins, while more economical options, through a slightly different product mix, are available in the suburban areas. The economical options decreased the store margins; however, the expectation is that the volume sold would help to offset the lost margin. Phoenix's most recent financial results and information on store results are included in Exhibits 3 to 7.

Jennifer Legault

Jennifer believes that Phoenix requires a major overhaul. She disagrees with Martina's traditional objectives for PRI and believes there is more that could be done to make this company a success. It is time to move forward and update the company by infusing new methods of doing things. Jennifer is glad to have found an ally in George.

Based on her previous experience, Jennifer believes that you need to understand your market and focus on it, instead of trying to be everything to everyone. Jennifer disagrees with the approach Phoenix has taken of expanding stores to suburban areas with lower-quality products and lower margins. In her opinion, this confuses customers and is poor decision-making on the part of management.

Maggie Smith

Maggie is excited to be part of a vibrant family. She spends a lot of time on social media and the new job opportunity of VP of Social Media was a great fit for her. Her days are pretty relaxed. Phoenix doesn't have an audience that is into social media as most customers prefer an in-person experience. In her opinion, the Phoenix customer is keener on in-person experiences and she doesn't think a lot of her time should be spent trying to interact with them online. She has created a Facebook page and updates it with the latest flyer each week. Cinder does not currently have any online presence.

The majority of Maggie's time is spent networking with people on her own social media and making sure that the Phoenix name is out there. As an avid shopper who loves giving fashion advice to the world, she has started her own personal blog which earns approximately $80,000 a year from advertising revenue, and it continues to grow. She uses a lot of the time she spends in the corporate office to work on her blog and uses Phoenix's resources to pull together product information. Some of the marketing staff have helped her put together the website and work with advertisers. On her blog, Maggie provides advice on where to get the best deals on designer labels, as well as similar knock-off versions that can be found at cheaper retailers. She attempts to promote Phoenix whenever possible, but to be fair to her readers, if there are better deals or more fashionable items elsewhere, she discusses them instead.

Maggie would prefer to just work on her blog, as she has a busy social life and enjoys her free time. She simply needs enough money to live the lifestyle she is accustomed to and is not interested in running the business or making decisions.

George Legault

George's father was a great sculptor but was always totally hands off PRI. George has never really thought of it as his family's company; however, recognizing his grandfather's legacy, he is excited to get involved in the business.

Operations

Finance and accounting

Discontinued product line

In 2012, Phoenix created its own product line of pots and pans which was associated with a popular prime-time cooking challenge show seen on TV.

Phoenix purchased the rights to have the pots and pans produced through a high-end manufacturer with a prominent brand name. The rights cost $1.2 million and were capitalized as an intangible asset on the financial statements, and are being amortized over a 10-year period.

Sales of the pots began in 2013 with disappointing results. Unfortunately, at the same time as their release, a popular celebrity chef released his almost identical line of cookware produced by the same manufacturer. Phoenix believes it was deceived into purchasing rights that were of no value.

In 2013, the line of pots made a profit of $220,000. This slumped to losses in 2014 and 2015 of $75,000 and $325,000, respectively.

The remaining inventory of pots is currently being cleared out at a price of 50% below cost. Phoenix has taken action against the manufacturer and is suing it for misrepresentation.

Branding costs

Jennifer is keen to work on improving the Phoenix brand and thinks a new marketing approach is necessary in order to reach a wider audience. In July 2015 she signed a $1.5 million contract and paid a branding company a $500,000 deposit to undertake a study of the Phoenix brand and begin creating a marketing plan.

When Martina heard this she was shocked and immediately stopped the process. Although Jennifer did have the authority to sign the contract, traditionally an agreement of this magnitude would be approved by the board first. The $500,000 is non-refundable and no work has been completed to date.

Martina told Jennifer that the board will discuss whether a rebranding is necessary at a future date, after decisions are made on the other strategies that the company is currently considering. Martina is hoping the cost incurred to cancel the contract does not need to be expensed in the financial statements as potentially the rebranding may still occur.

Property, plant and equipment

Leasehold improvements

Phoenix owns four malls/shopping centres in addition to two stand-alone stores. These have had a successful history with high tenant occupancy and low turnover. This is primarily due to their locations and the success of the local markets.

In 2014, the Edmonton mall began to slump and Phoenix was finding it a challenge to keep all of its leases filled. This situation continued through 2015. Believing that the reason for the tenants leaving had much to do with refurbishments needed to the storefronts, Phoenix offered a promotion to tenants at the beginning of the current year. Tenants that sign a 10-year extension on their current lease term are provided with funds to complete leasehold improvements. Lease incentives are tailored to the nature and total sales revenue of the stores. Phoenix has never before provided a lease incentive to its tenants.

The Edmonton mall contains 71 stores. Sixteen stores agreed to extend their leases by 10 years and, in exchange, Phoenix issued a total of $700,000 in incentives for leasehold improvements. Approximately one-third of the funds will go towards improvements, such as lighting, which will remain Phoenix's property after the leases expire. The remainder is for shelving, signage, paint and items specific to the stores. This is expected to increase foot traffic to the mall by 20% and sales in Phoenix by the same amount.

George has done some estimations and believes that similar improvements are required in a number of Phoenix's properties in order to maintain them at the quality expected. The Legaults do not see this as an option but, with all of the demands on the company right now, they are unsure how they will come up with the cash since bank loans are coming due over the next few years. With the changes in the market since the last negotiation, any bank financing will come with a higher interest rate and stricter terms. George is not sure if that is the best option. To assess this, he would like to see what Phoenix's cash flow is anticipated to look like over the next five years. Financing options available are summarized in Exhibit 8.

Legault family and board meeting dialogue

The family and board met on March 14, 2016, to discuss PRI's future.

Excerpts from the discussion that took place at the meeting appear below.

Martina: At present I have been considering closing a number of stores. For example, some of the properties we own have significant value. Closing the store and selling the property or leasing the property to someone else may be more profitable. Many of our properties are valuable because of their location but could use some serious facelifts, so now would be the time to make a change if one is to be made.

I have even been considering closing our location in Vancouver. Maintaining it for our use would require significant additional capital investment to bring it back to its former glory. If we were to lease it to someone else, they would do much of the cosmetic work and we would only need to upgrade some minor structural items.

When the CEO of the retail space to which the flagship store is physically connected heard that we may close our store, he phoned me almost immediately. I was surprised! Apparently, he believes the prominence of our brand increases the foot traffic in his building and, therefore, the rents he earns from his tenants. He has made Phoenix an offer (**Exhibit 9**) that I would like to consider, in which they would buy our building from us and then lease it back to us at a reasonable rate. I admit the thought of selling the flagship does sadden me, so I am intrigued. An additional financing source is tempting, though I am a little unsure about giving up the title to the building.

George: Let's discuss the Real Estate Income Trust (REIT) idea I mentioned to you. Managing the real estate separately from the retail operations would help us.

Martina: Yes, another strategy I am open to considering is the spinoff of our real estate. We own six pieces of real estate across the country (Exhibit 7). I am not sure what that entails or if it is a good idea; however, it will be good to learn more about how it will impact our business and if it will be a good idea to implement.

George: We have a lot of value sitting in our real estate and I want to make sure we are managing this appropriately. I agree with Jennifer that we may need to assess closing down some of our Phoenix stores, but I also want to make sure that, if we were to choose to close our store and lease the space to someone else, it would not impact the rental income we earn from the tenants in the malls. I do not have information on how the store's foot traffic impacts the malls, but to me that seems like it would be important.

Martina: I like the idea of the sale and leaseback in that we can keep the store but can gain access to the capital tied up in the property. The sale and leaseback gives me what I want, but the lease rate seems a bit pricey. The CEO does seem eager to work with us, though.

Jennifer: Success in the industry depends on margin per square foot, and our current high and low margin approach is hurting PRI. We need to be clear on what we are and focus on ensuring that the market understands this. Cinder is the budget store — Phoenix should not be. Phoenix cannot continue to sustain 14 stores, and we need to be either suburbia or downtown — not both.

I think there may be a better way to hone in on the right clientele. I think the right way to do this is through acquiring another company. We need something to appeal to the younger market without being a bargain shop like Cinder. An opportunity has come up to discuss a potential acquisition of Sparky Limited. Sparky is a department store as well, but with a much smaller square footage per store — not the multi-floor palaces that Phoenix has. It targets a younger market, looking for quality products but on a lower budget. Acquiring the company would allow us to balance our need for growth, while also keeping with tradition with our other stores. I have included some preliminary information on the company (Exhibit 10) just to assess if it might be a fit.

George: I come to PRI with some different perspectives. To me, keeping things the way they have always been is not a great way to honour the past — it is a way to die out. I think we need to really look at our current strategy and consider where we want to be.

The acquisition of Sparky makes a lot of sense. I have always loved the way some companies have several stores that match different price points. The way I see it, with Cinder and Phoenix we have the means to cater to a wider array of Canadians. Sparky would get us that missing piece of the market we don't currently have — the young, trendy shopper who is likely to turn high end as their income increases. It may tap a market that can transition to Phoenix in later years. I am a little concerned, though, that

Sparky might be an easy way to go without actually being the right fit for us. I do, however, like its online presence, and wonder if this would be a good idea for Phoenix to adopt. I think we need to open up to the idea of attracting new types of customers, and online might be the way to do it. I am concerned, however, with the security breach that occurred at Sparky.

Martina: We should be more cautious with this type of store. We all know what happened to one of our competitors recently and the losses they suffered when they decided to leave the Canadian market. A higher rate of return of at least 6% should be expected for this type of investment. As well, I would like to ensure the valuation is reasonable based on several different valuation methods.

I know online shopping is a growing trend and, George, I can see why you would be pushing for it. I have heard of some stores being converted to warehouses for distribution. I guess that is an option too.

We’d need to make sure we can ship quickly and make sure the warehouses are set up in the right places. Being able to quickly respond and ship is the key to success in online sales. The demographic we currently serve, however, tends to be older and I just don’t know that they would shop online. Why implement something that doesn’t match our current customers?

Jennifer: That’s exactly why I would like to see Phoenix online! What better way to capture the younger demographic? I believe that moving towards an online presence for Phoenix is the way to go and bring the company into this century. I have gathered preliminary information on the idea (Exhibit 11). This is a great fit for us and will ensure our ability to attract the younger customer transitioning from being a Sparky customer to a Phoenix customer. Also, many of our customers would prefer the convenience of their purchases being delivered to them. This is the world we live in and PRI needs to start living in it as well.

Martina: I’d be willing to review this; however, I would like to see a minimum of 8% return on investment over the next five years. I would like to see us implement a performance measurement tool to better keep track of our performance.

Maggie: I love shopping online! I wait by the door until my mail arrives and it’s like Christmas almost every day!

Jennifer: There is a very strong shift in the way customers shop, young and old. We need to keep up with the customers.

Martina: We need to spend more time focusing on Cinder. Since we acquired it, it has been fairly stable. George took over the reins as COO when he joined PRI, but, as you know, we work closely as a team across the board. With recent changes in the market and the pressure of other large stores, Cinder has to figure out what its strategy is going forward to maintain market share. I know George has some information for you on this and I would like to get your preliminary thoughts.

George: Cinder has always been the dominant store where it is located. We have traditionally been in small towns with one main retailer where we were the place where customers purchased the majority of their household needs. We have not had to compete with specialty-focused stores, such as home office supplies, because the towns are simply not large enough to support such retailers. Obviously the towns also had a grocery store as Cinder does not deal in groceries. A major national chain owns the majority of the grocery stores in the towns we operate in. With their recent expansion into the general merchandise market as well, our stores have taken a significant hit. People have to buy groceries! Now, while they are doing that, they are able to pick up a lot of the general products they would have come to us for just a few years ago — like dishes, toys, books, etc.

I know we need to figure out a way to compete and draw people back to us. I have been struggling with what strategy to employ for the discount brand. I have put together information on the market outlook for Cinder and the possibility of adding groceries to our Cinder stores. Although this will not give us a competitive edge, at least we will be able to compete with our competition and bring back some of the traffic we have lost. (Exhibit 12.)

Perhaps one way to improve our margins in the downtown stores is to consider the option of replacing some of our more expensive suppliers with less costly options. We have always sold store-brand Canadian-made winter coats. They are a staple product that truly represents our brand. These coats have always been made by a supplier in Yellowknife. Recently we were approached by another manufacturer with a proposal. I have compiled some information on this for you to review and consider (Exhibit 13).

James: As you know, Stephen and I would like to retire. Before we do that, we would like to know that PRI's ownership structure reflects everyone appropriately. The only way to do this is to pass some ownership onto Maggie. However, I am not sure how to do this. I don't want Maggie to have more ownership of the company than the others, but I do want her to receive her mother's share of the present-day value. I will need a recommendation on how to accomplish this, as well as advice on any of the tax consequences. The current valuation of the company has been appraised at $6.2 billion.

Exhibit 1 – Family History
The Legault Family

First generation

Pierre Legault (married Anne-Marie 1931)
(1912-1991)

Marcel Legault (married Isabelle 1940)
(1914-1970)

Pierre and Marcel started the Phoenix general store together in 1941. The store was extremely successful and the brothers built on this, developing it into one of Canada's most iconic department stores by the late 1950s.

Second generation

James Legault (son of Pierre, married Erica 1961, divorced 1970, married Heather 1975)
(1933-)

Justine Legault (daughter of Pierre, married Ryan Smith 1968)
(1945-1970)

Stephen Legault (son of Marcel, married Stephanie 1970)
(1942-)

Pierre and Anne-Marie had two children, James and Justine. Justine tragically died at the age of 25 in a boating accident. She left behind her husband Ryan and their then-infant daughter. Justine never took an active role in the business while she was alive.

James took over the business from the brothers not long after Marcel's death in 1970. James worked at expanding across the country and ensuring the brand remained in the forefront of the Canadian market. He prided himself in procuring only high-quality products and promoting "Canadian made" whenever possible. Recognizing the need for a lower-cost alternative and wanting to maintain PRI as the preferred choice, James made the move to acquire Cinder. This was done with the intention of expanding PRI to serve more of the Canadian market while maintaining the same core values of the organization.

Marcel and Isabelle had one son, Stephen. Stephen has never had an interest in the business and turned down a seat on the board. He prefers to focus on his artwork. A talented sculptor, Stephen has appreciated the flexibility that belonging to an affluent family has allowed him so that he could develop his creative side. James was happy to run the show and did not encourage any involvement from Stephen — allowing him access to profits through his share ownership in exchange for Stephen's support of his decisions.

Third generation

Jennifer Legault (daughter of James and Erica, never married)
(1969)

Martina Legault (daughter of James and Heather, married Bob 2005)
(1975-)

Maggie Smith (daughter of Justine and Ryan Smith, married Mark 1990)
(1970-)

George Legault (son of Stephen and Stephanie, married Melissa 2006)
(1975-)

The third generation of the Legault family have all taken an active interest in the business.

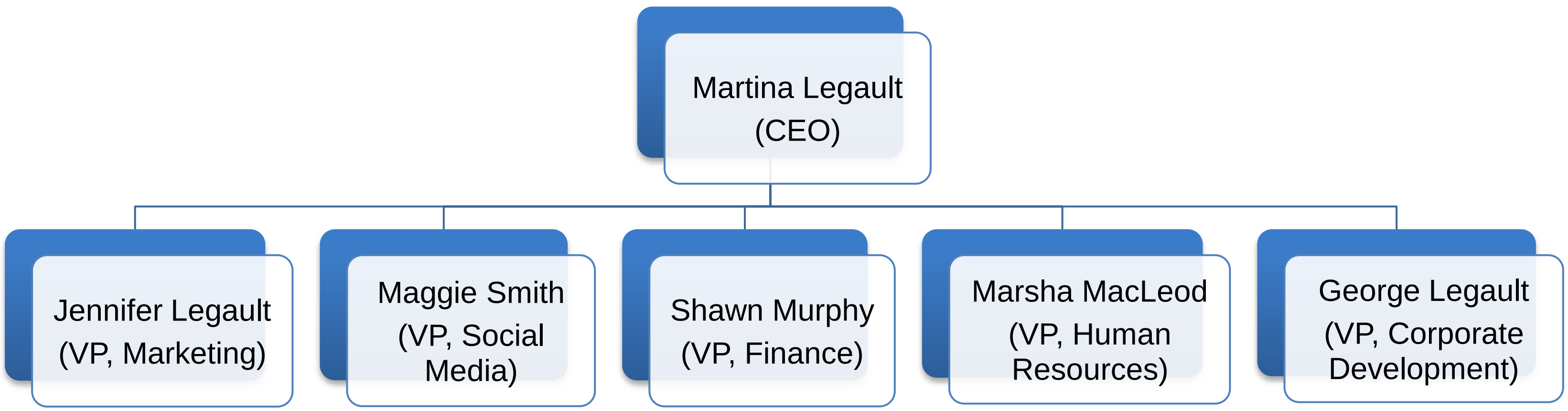
James and Heather's daughter, Martina, is the current CEO of PRI and the COO of Phoenix. James and Martina have a close relationship, and Martina respects the work her father has put into the company. She has worked with Phoenix her entire life and was groomed for running it by her father. While she oversees both Phoenix and Cinder, her primary focus is on the Phoenix brand.

James' daughter Jennifer, from his first marriage to Erica, is not as close with her father. She grew up at the other end of the country and, with the busy schedule of an entrepreneur, James saw little of her. Jennifer has just recently come on board with PRI as the VP of Marketing for Phoenix. Jennifer would like to shake things up at Phoenix and thinks the company needs to move into the new millennium. She has worked in marketing with a high-end yoga chain and a national juice franchise. Jennifer would like to target a younger crowd and believes she has the knowledge to do so.

After Justine's untimely death, Maggie Smith was raised by her father. She has always stayed close to the Legault family with her uncle James consistently watching out for her and ensuring she was a part of her mother's family. Maggie started working with PRI right out of high school. She wasn't interested in the work required to attend university. Maggie worked for many years on the front line of the retail business. Recently she moved into the head office and took over the newly created position of VP, Social Media. PRI does not really have a social media presence. Martina is being pressured by the board to create one, starting with Phoenix, and creating this new position relieves some of that pressure, while giving Maggie a more significant role in the organization.

Stephen and Stephanie's son, George, is the most recent member of the family to come on board. Stephen had never been active in the business, so George grew up aware of, but not involved in, PRI. George obtained a business degree in his early 20s and has been working for a number of retail outfits since then, including some mid-sized chains aimed at young adults with a strong online presence. After settling down in his early 30s George decided to return to his roots and take an interest in PRI. He has taken over as the VP of Corporate Development for PRI, while also operating as the COO of Cinder. His other experiences and removal from the core family running PRI give him a unique perspective.

Exhibit 2 – Organizational Chart
Executive Organization



PRI Board of Directors:

- Martina Legault, Chair
- George Legault, Deputy Chair
- Jennifer Legault, Director
- Maggie Smith, Director
- Connor MacMillan, LLB, Independent Director
- Isla MacDonald, CPA, Independent Director
- Cate Nugent, Independent Director
- Heather Sceles, Independent Director
- Katie Brine, Independent Director

Currently there are no subcommittees, such as an audit committee, as part of the Board of Directors team.

Exhibit 3
Extracts from Phoenix Financial Statements

Phoenix Incorporated
Statement of Comprehensive Income
For the Year Ending December 31
(millions of Canadian dollars)

	Note	2015	2014	2013	2012
Retail sales	1	$ 267.6	$ 276.1	$ 273.3	$ 278.8
Cost of sales		$ (158.8)	$ (159.1)	$ (158.2)	$ (158.4)
Margin		$ 108.8	$ 117.0	$ 115.1	$ 120.4
Other income (leases)	1	$ 201.2	$ 189.3	$ 187.4	$ 193.0
Selling, general and admin		$ (191.3)	$ (186.5)	$ (186.0)	$ (190.2)
Operating income		$ 118.7	$ 119.8	$ 116.5	$ 123.2
Finance costs		$ (17.7)	$ (18.5)	$ (19.0)	$ (19.4)
Earnings before income tax		$ 101.0	$ 101.3	$ 97.5	$ 103.8
Income tax expense		$ 20.2	$ 20.3	$ 19.5	$ 20.8
Net earnings for the year		$ 80.8	$ 81.0	$ 78.0	$ 83.1

Phoenix Risen Incorporated – PRI
PRI Consolidated Statement of Comprehensive Income – Excerpt

	2015	2014	2013	2012
Margin	$ 371.20	$ 371.60	$ 367.00	$ 374.60
Operating income	$ 241.28	$ 241.54	$ 238.55	$ 243.49
Earnings before income tax	$ 129.92	$ 130.06	$ 128.45	$ 131.11
Net earnings for the year	$ 103.94	$ 104.05	$ 102.76	$ 104.89

Notes

1 – Retail revenue is recognized upon delivery of goods to the customer.

Lease revenue is recognized over the course of the lease as earned. Commissions on lease revenues are estimated and included in revenues as earned, with any adjustments to actuals being recorded when known. No lease revenue is recognized for retail space occupied by Phoenix stores.

Exhibit 4
Extracts from Phoenix Financial Statements

Phoenix Incorporated
Balance Sheet
As at December 31
(millions of Canadian dollars)

Assets	**Note**	**2015**	**2014**	**2013**	**2012**
Cash		$ 3.3	$ 2.4	$ 2.5	$ 3.1
Trade and other receivables		$ 5.1	$ 4.7	$ 5.5	$ 4.6
Inventories	1	$ 67.6	$ 61.8	$ 64.5	$ 59.7
Other current assets		$ 2.3	$ 1.7	$ 3.5	$ 2.8
Total current assets		$ 78.3	$ 70.6	$ 76.0	$ 70.2
Property, plant and equipment	4	$ 852.3	$ 832.1	$ 825.7	$ 828.9
Intangible assets	1	$ 15.8	$ 15.3	$ 16.0	$ 16.5
Pensions and employee benefits		$ 2.6	$ 3.2	$ 4.1	$ 3.8
Deferred tax assets	3	$ 15.0	$ 15.0	$ 15.0	$ 15.0
Total assets		$ 964.0	$ 936.2	$ 936.8	$ 934.4
Liabilities and shareholders' equity					
Line of credit		$ 1.5	$ 2.1	$ 1.4	$ 1.9
Loans and borrowings	2	$ 14.0	$ 14.0	$ 14.0	$ 14.0
Trade payables		$ 51.8	$ 57.5	$ 49.8	$ 53.2
Other payables and accrued liabilities		$ 18.3	$ 27.6	$ 24.5	$ 23.9
Deferred revenue		$ 7.5	$ 9.0	$ 8.5	$ 7.8
Provisions		$ 5.9	$ 6.8	$ 6.4	$ 6.7
Income taxes payable	3	$ 0.8	$ 7.0	$ 9.5	$ 8.3
Total current liabilities		$ 99.8	$ 124.0	$ 114.1	$ 115.8
Loans and borrowings	2	$ 332.5	$ 346.5	$ 360.5	$ 374.5
Provisions		$ 0.9	$ 1.7	$ 2.3	$ 1.4
Employee benefits		$ 4.8	$ 5.1	$ 4.9	$ 5.2
Other liabilities		$ 6.0	$ 8.1	$ 7.5	$ 7.9
Total liabilities		$ 444.0	$ 485.4	$ 489.3	$ 504.8
Shareholders’ equity					
Share capital		$ -	$ -	$ -	$ -
Retained earnings		$ 520.0	$ 450.8	$ 447.5	$ 429.6
Total shareholders' equity	5	$ 520.0	$ 450.8	$ 447.5	$ 429.6
Total liabilities and shareholders' equity		$ 964.0	$ 936.2	$ 936.8	$ 934.4

Phoenix Risen Incorporated – PRI Consolidated
PRI Balance Sheet – Excerpt

Cash	$ 23.3	$ 21.4	$ 24.5	$ 21.1
Total assets	$ 1,631.6	$ 1,603.8	$ 1,604.8	$ 1,600.0
Total liabilities	$ 565.2	$ 628.8	$ 624.8	$ 650.1

Notes

Note 1:
Inventory: Inventories are valued at the lower of cost and net realizable value. Cost is determined, for the majority of inventory, using the weighted average cost method, based on individual items. Net realizable value is the estimated selling price determined at the item level using historical markdown rates for similar items in the ordinary course of business, less estimated costs required to sell.

Intangibles: Trade names with indefinite lives are measured at cost less any accumulated impairment losses and are not amortized.
Intangibles with definite lives are amortized straight-line over their useful life. Amortization taken in 2015 totals $1,300,000.

Note 2: Long-term loans and borrowings are mortgages on malls and retail locations. Interest is payable at the rate of prime minus 1%. Property, plant and equipment have been pledged as security and there are no covenants on the mortgages. Weighted average cost of borrowing is 5% per annum.

Note 3: Phoenix uses the deferred method of accounting for income taxes. Deferred tax asset includes $15 million in capital losses from prior years, with the remainder being made up of temporary differences between depreciation and capital cost allowance.

Note 4: Property, plant and equipment are stated at historic cost less accumulated depreciation.
See PPE detail.

Note 5: Retained earnings includes changes in net income and other appropriate adjustments.

Exhibit 5
Phoenix Sales Information by Store

Store	Sales ('000s of Canadian dollars)	COS	Margin	Margin prior year	Space owned/ leased	Square footage ('000s)	Lease rate	Location
1	$ 24,165	$ 13,530	$ 10,635	$ 11,485	Owned	179	$75/sq. ft.	Toronto; street front in downtown attached to a major retail centre also owned by Phoenix
2	$ 26,750	$ 14,890	$ 11,860	$ 12,920	Owned	214	$50/sq. ft.	Vancouver; flagship store; street front in downtown, attached to a major retail centre not owned by Phoenix
3	$ 38,500	$ 21,050	$ 17,450	$ 18,435	Owned	275	$40/sq. ft.	Calgary; street front in downtown attached to a major retail centre also owned by Phoenix
4	$ 15,400	$ 9,650	$ 5,750	$ 6,410	Leased	140	$20/sq. ft.	Halifax; stand-alone store in a suburban shopping area
5	$ 13,755	$ 8,600	$ 5,155	$ 5,675	Leased	131	$25/sq. ft.	Regina; stand-alone store in a suburban shopping area
6	$ 18,620	$ 11,720	$ 6,900	$ 7,500	Owned	190	$40/sq. ft.	Edmonton; in a suburban shopping centre
7	$ 11,760	$ 7,400	$ 4,360	$ 5,430	Leased	105	$30/sq. ft.	Quebec City; in a suburban shopping centre
8	$ 22,720	$ 12,800	$ 9,920	$ 10,750	Owned	160	$40/sq. ft.	Montreal; street front in downtown attached to mall network
9	$ 17,500	$ 9,700	$ 7,800	$ 8,300	Leased	125	$35/sq. ft.	Edmonton; street front in downtown, attached to a major retail centre not owned by Phoenix
10	$ 14,672	$ 9,300	$ 5,372	$ 5,225	Owned	131	$25/sq. ft.	Winnipeg; suburban shopping centre
11	$ 18,900	$ 12,000	$ 6,900	$ 7,150	Leased	140	$35/sq. ft.	Toronto; stand-alone store in a suburban shopping area
12	$ 15,015	$ 9,475	$ 5,540	$ 5,970	Leased	165	$25/sq. ft.	Montreal; stand-alone store in a suburban shopping area
13	$ 16,200	$ 10,200	$ 6,000	$ 6,450	Leased	150	$35/sq. ft.	Saskatoon; in a suburban shopping centre
14	$ 13,635	$ 8,455	$ 5,180	$ 5,300	Leased	135	$20/sq. ft.	Moncton; standalone store in a suburban shopping area

A lease rate is provided for leased and owned stores. For owned stores, Phoenix does not pay rent. This is the amount that would have to be paid if leased from a third party. Selling and operating costs, not shown here, approximate 20% of sales for leased stores and 40% for owned stores. The operating costs include items such as maintenance, property taxes and utilities.

Exhibit 6
Property, plant and equipment

	Cost	Accumulated depreciation	Net book value
Buildings	$ 931,450,000	$ 654,715,000	$ 276,735,000
Leasehold improvements	$ 542,536,000	$ 206,163,680	$ 336,372,320
Fixtures and fittings	$ 428,156,000	$ 235,485,800	$ 192,670,200
Other	$ 95,462,000	$ 48,939,520	$ 46,522,480
	$ 1,997,604,000	$ 1,145,304,000	$ 852,300,000

Buildings have a fair market value of $1,661 million. All other property, plant and equipment have a fair market value that approximates book value.

Exhibit 7
Real estate

Capital expenditures required	Planned improvements	Cost	Increase in sales
Toronto retail centre	2017	$ 27,000,000	25%
Vancouver building	2016	$ 2,400,000	20%
Calgary retail centre	2016	$ 13,000,000	25%
Montreal store	2018	$ 1,000,000	15%
Winnipeg mall	2019	$ 30,000,000	20%

*If lease and buyback utilized, capital expenditure required by Phoenix would be $1.2 million.

Remaining mortgage	Balance	Annual payment	Balloon payment due
Toronto retail centre	$ 100,000,000	$ 5,000,000	2017
Vancouver building	$ -	$ -	-
Calgary retail centre	$ 112,000,000	$ 4,000,000	2033
Montreal store	$ 530,000	$ 60,000	2018
Edmonton mall	$ 100,000,000	$ 5,000,000	2029
Winnipeg mall	$ 20,000,000	$ -	2016
Total	$ 332,530,000	$ 14,060,000	

Long-term loans and borrowings are mortgages on malls and retail locations. Interest is payable at the rate of prime minus 1%. Property, plant and equipment have been pledged as security, and there are no covenants on the mortgages. Weighted average cost of borrowing is 5% per annum.

Balloon payments are required to be paid at the end of the year in which they become due.

	Store makeup	Historic cost	Tenant commission rate*	Total tenant revenue
Toronto downtown building w/retail centre owned by Phoenix	Mixed retail centre with mid-high end shops	$ 120,000,000	1.0%	$ 900,000,000
Vancouver downtown building	N/A	$ 10,250,000	N/A	
Calgary downtown building w/retail centre owned by Phoenix	Mixed retail centre with mid-high end shops	$ 300,000,000	1.5%	$ 1,300,000,000
Montreal downtown building	N/A	$ 1,200,000	N/A	
Edmonton mall	Low-mid end shops	$ 375,000,000	0.5%	$ 1,400,000,000
Winnipeg mall	Mid range shops	$ 125,000,000	0.5%	$ 120,000,000

*Mall tenants pay a flat rate plus a percentage of revenues to Phoenix as part of their lease agreement.

Exhibit 7: Real Estate Addendum

Real Estate/ Mall/Retail Location	FMV	Balloon Payment For Mortgage
Toronto retail centre	$ 600,000,000	$ 95,000,000
Vancouver building	$ 157,500,000	$ -
Calgary retail centre	$ 500,000,000	$ 40,000,000
Montreal store	$ 3,500,000	$ 410,000
Edmonton mall	$ 300,000,000	$ 50,000,000
Winnipeg mall	$ 100,000,000	$ 20,000,000

Any increase in sales is 50% realized in Year 1, 80% in Year 2 and 100% in Year 3 and beyond.

Exhibit 8
Financing Options

	Term loan	Unsecured debenture
Amount	As needed	As needed
Loan period	10 years	10 years
Interest rate	6%	8% (Issue and YTM)
Payment requirement	Monthly - blended	Semi-annual coupon (June 30, Dec 31)
Collateral	PPE - buildings	None
Covenants	Current Ratio 1.00	None
	Debt-to-equity 1.20*	None

*Debt includes all liabilities.

Exhibit 9
Phoenix Flagship Store Lease Opportunity

Word of Phoenix considering closing its Vancouver flagship store spread recently, with Martina acknowledging the high cost of Vancouver real estate.

When this reached the ears of the CEO of the shopping centre Phoenix is physically connected to, alarm bells went off. While Phoenix is not a part of the mall, it does access it. Foot traffic from Phoenix therefore drives foot traffic in the mall itself. The possibility of the store being leased to another retailer could impact the mall's overall profitability if the new retailer did not align with the mall's clientele or did not draw foot traffic the way the current Phoenix store does.

The Vancouver Phoenix flagship store is a high-end shopping mecca. It was the first major department store in Vancouver and the primary store of Phoenix for many years. The store sees an average of 50,000 shoppers per week. Of these shoppers, approximately 50% continue on to the mall itself visiting on average three stores each. The conversion rate from foot traffic to sales in the mall is at approximately 20% with the average sale being $72.

The CEO of the shopping centre has proposed a solution to entice Phoenix to stay. He is willing to purchase the building from Phoenix and lease it back to them at an annual cost of $50/sq. ft. He would also cover 50% of the $2.4 million upgrade that Phoenix believes is needed for the store. The lease would have an initial term of 10 years and would be renegotiated after that. He is willing to offer fair market value to purchase the store.

Exhibit 10
Sparky Limited Acquisition Opportunity

Sparky Limited sells an assortment of general merchandise in its stores. Its goal is to provide trendy products to an ever-demanding consumer. Sparky recognizes the needs of young consumers who want to have all the latest fashion and home goods but who do not have the income to purchase high-end products. They fill the need of offering the same style of products but at a reduced cost.

Sparky is a privately held company founded and controlled by Charles Snookers. The company has 140 stores across Canada and the northeastern United States, largely in mid-priced shopping malls averaging 100,000 square feet per store. The shopping environment is very hip with the latest fashions displayed in eye-catching ways.

Sparky has a large online retail presence. All products can be purchased online and shipped to the consumer’s home address. Approximately one-third of its sales occur online, which has been a major reason for the prominence of the brand. Sparky was the first general merchandise store in Canada to launch online shopping and achieve the traction to make it a success. This made it extremely popular with people outside of urban centres who cannot access the retail locations as easily, as well as those who simply like the convenience of goods being delivered to their door. Standard shipping on orders over $25 is free to the consumer.

2014 was Sparky’s best year ever. It paired with a top celebrity designer and really tapped into the young professionals market — attracting consumers who are drawn to higher-end products but, at the beginning of their career, cannot yet afford them. It saw an increase in revenues in stores of 5% and online of 7% as a result of a major marketing push to this demographic. The cost of the campaign was $45,000.

In 2015, Sparky had a security glitch that allowed customer credit card information for online shoppers to be accessed by hackers. No actual fraud was committed by the hackers — they simply wanted to prove they could do it and they did! But this was extremely problematic and caused significant reputational damage to the store, with sales dropping initially by 23%, though they have since started to recover only moderately. To date, approximately 50% of the lost sales have been recovered. In addition, there was a class action suit filed against Sparky by irate consumers. The case is waiting to move forward and there is no indication yet as to how it will be settled.

The IT security breach has since been patched and the system is now secure. The costs of the patch were capitalized in the current year; however, the increase in technology costs on the income statement was a result of additional work performed in-house related to the breach. These costs will continue in the future to ensure that no further security issues occur.

Charles Snookers is a shrewd businessman. In starting Sparky his goal was to maximize profits. The products at Sparky are trendy and loved by consumers but, in order to achieve the look consumers desire at a price they can afford, most products are produced overseas. Sparky has many “exclusive to Sparky” labels, which are largely made in China and thus able to provide lower costs than what Canadian manufacturers can supply.

Sparky maintains a largely part-time employee base in order to limit the need to provide employee benefits. Charles has not been opposed to high employee turnover and finds it a good way to keep hourly wages low. Sparky’s employees have been trying to unionize for the past year. They argue that hours are very unstable and they need more job security and consistent full-time hours. At present, it is unclear if a union will form, but if Sparky wants to prevent this, it will need to look at how to improve employee satisfaction. Either way, i.e., the creation of a union or taking the steps necessary to avoid one, there would be an expected increase in employee wages and benefits of 20%.

Mr. Snookers has approached Phoenix with an offer to sell. Recent sales in the industry have been at 15 to 20 times EBITDA. Mr. Snookers believes this works for Sparky and would be willing to sell for a price of $1.8 billion. The price was set based on prior year earnings at the high end of the range due to the popularity of Sparky. Although 2015 was admittedly a much lower earning year, Mr. Snookers is adamant that it was a blip and Sparky will have no trouble returning to its previous earning levels; therefore, the purchase price should reflect as much.

If Phoenix were to acquire Sparky, Mr. Snookers would retire. He is very hands-on and is a senior person with significant retail experience. He would likely need to be replaced and currently draws a salary that reflects market rates.

Sparky’s IT system software was developed in-house. It has been used for Sparky’s online sales for five years. The website is extremely user friendly, allowing customers to easily find products and purchase them with little hassle and retyping of information. The IT system additionally links directly into Sparky’s inventory and accounting systems, reducing errors throughout.

Always looking to make money, Mr. Snookers has indicated that, in the event Phoenix is not interested in purchasing Sparky, he would be happy to allow for the purchase of a copy of Sparky’s software. However, Mr. Snookers is more interested in selling the company than in licensing the software.

Sparky Limited Acquisition Opportunity
Sparky Limited
Statement of Comprehensive Income
For the Year Ended December 31
(thousands of Canadian dollars)

		2015		2014
Retail sales	$	1,020,723	$	1,200,850
Online sales	$	394,748	$	563,925
Cost of merchandise	$	(1,026,216)	$	(1,263,579)
Margin	$	389,254	$	501,196
Fulfillment costs	$	31,580	$	45,114
Technology	$	40,697	$	37,668
Employee wages and benefits	$	89,009	$	90,432
Amortization	$	20,878	$	20,477
General*, administrative & other**	$	208,087	$	252,503
Earnings before income tax	$	(997)	$	55,002
Income tax expense	$	(279)	$	15,401
Net earnings	$	(718)	$	39,602

* Includes $45,000 of supplemental advertising in 2014
** Includes $15,000 of interest in 2015 and $18,000 of interest in 2014

Excerpts from notes to the financial statements

1. Sparky's financial statements are prepared in accordance with accounting standards for private enterprises (ASPE).

2. Revenues

Retail revenues are recognized at point of sale. Sales are made either on a cash basis or with a credit card, and there are no collection concerns. No allowance for returns is established. Returns are removed from sales in the period that they are returned.

Online sales are recognized at time of shipping. Shipments are normally made within one and two days of the online order.

Fulfillment costs

Fulfillment costs relate to the inventory storage costs for online orders, and the packing and shipping of these orders. All order fulfillment costs are expensed in the period incurred.

3. Technology

Significant technology costs include maintaining a team of IT personnel who perform regular maintenance as well as continuous security testing.

Other financial data

1. The capital expenditures related to maintenance of assets such as buildings and IT infrastructure are $20 million with a $2 million tax shield.
2. The present value of the tax shield on the existing assets is $15 million.
3. Total interest-bearing debt at the end of 2015 was $205 million.
4. The terminal growth rate is estimated at 2%.

Sparky's IT System

Sparky's online sales system allows customers to easily browse through a large selection of items. The system is linked to the perpetual inventory records, so customers are able to see if an item is in stock online and to check if it may be in stock at their local store. Sparky has found that many of its in-store customers have first looked at items online to assess features, compare to other products and check availability. This feature adds a lot of value for the customers.

The website allows customers to provide reviews on items by entering a name and filling out a comment box. Sparky has had some trouble with trolls, those who fill out reviews to advertise their own websites or to cause distractions from the other products. To address the issue, reviews can now only be provided by people who have created a customer profile on the site.

Customer profiles must also be completed to purchase items. Customers must provide their name, address and email address. Emails need to be confirmed, and the customer must receive the email in their inbox and click on a link to activate the account. Only active accounts can proceed through checkout. Customers have the option of including their credit card in their profile for ease of purchase, and many do since it facilitates future orders.

When an online sale occurs, customers must log in and confirm their billing address. The billing address postal code must match the postal code of the credit card used. This check is performed as part of the credit card authorization process. Customers enter the shipping address or select if it is the same as the billing address. They then select the preferred shipping method and enter their payment information. When the order is submitted, the credit card is cleared for authorization and the order is approved. At this time, a confirmation email is sent to the email account of the customer profile.

The system interfaces with Sparky's inventory and sales records. When an item is shipped, the transaction closes in the online sales system. The transaction is immediately recognized as revenue, the item is removed from inventory and COGS is recorded. Items purchased but not yet shipped are not removed from the accounting system but are marked as not available in the online system module. Since the system was custom designed for Sparky, this interface is seamless. Some work would need to occur to adapt the interface to a different system. Physical inventory counts are performed on a cyclical basis to confirm that the perpetual inventory is correct. Where the inventory is warehoused with tight controls, there is a low theft risk and inventory records are usually up to date with little adjustment required.

Security is an increasing risk for the system. Recently a security breach involved a hacker getting into Sparky's system. This allowed the hacker access to the stored credit card information. To prevent this access in the future, Sparky has installed extra security measures around the credit cards including additional firewalls on its system and improved encryption.

Sparky developed its IT software in-house over several years. It does not have a significant recorded value in the financial statements.

Exhibit 11
Phoenix E-Commerce

The following is information gathered by Jennifer.

The process of creating an e-commerce system for Phoenix is expected to take one year to implement until the website is live.

The online system will cost $10 million to set up with annual costs of $1 million to update and upgrade annually.

Initial net working capital investment required will be $19 million plus an additional $1 million annually.

Each store will require a section to be allocated for prepping and shipping products. The reorganizing and refurbishing of each store’s back-room storage area will cost $75,000 per store. This section will not impact the retail floor space; however, an improvement in inventory organization is expected.

In order to successfully bring awareness to the new e-commerce side of the business, Phoenix will have to launch an aggressive marketing campaign at a cost of $5 million and $1.5 million annually thereafter.

Phoenix will outsource the order processing, fulfillment and shipping to a third party. They will operate out of the assigned space within each store. The cost will be 10% of online sales and a $5 shipping charge per order. Phoenix will only ship to Canadian customers.

Average online weekly visits are expected to be 280,000 in year 1 and to grow at 5% annually. Conversion rate is expected to be 10% in year 1 of operations, 15% in year 2 and 20% thereafter. Average order is expected to be $65. Incremental operational costs are expected to be $200,000 annually; this will cover additional support functions such as accounting, marketing and legal.

Cost of goods sold will be consistent with current retail sales. Seventy per cent of the incremental margin will be due to new customer purchases, while 30% will be due to current in-store customers switching to online shopping. Annual IT maintenance is expected to be $500,000.

Due to increasing concerns regarding IT security, Phoenix will have an annual cost of $300,000 for security system audits.

Exhibit 12
Cinder’s Market Outlook

Cinder is a budget shopping alternative for the consumer who demands competitive pricing and a large array of general merchandise. A mass merchandise retailer, Cinder focuses on providing low-cost options to the Canadian market on a wide selection of household goods, while maintaining the same values as the entire PRI family.

The mass merchandise market has been dominated for quite some time by discount retailers competing on price. That competition has most recently been raised as a result of large grocery retailers expanding their product lines to include home goods, clothing, toys and other general merchandise. The large discount retailers have reacted by bringing groceries into their stores. Consumers are now able to choose whether to shop at a full-service grocery store with a wide range of general merchandise, or a full-service mass merchandiser with a wide range of everyday grocery items.

Cinder’s focus on small towns has meant that, historically, they have been the primary choice for general merchandise for Cinder’s market. Small towns tend to have one primary shopping area and, traditionally, have not had the capacity for numerous large retailers. The shift in the large grocery stores to carry general merchandise means that, for many of the locations where Cinder exists, one of the main grocery stores in town is now competing for the general merchandise market as well.

Cinder’s profile is as follows:

Number of stores:	75
Average town population:	10,000
Average consumer age:	53 years
Average store size:	120,000 sq. ft.

Standard departments: Clothing, Pharmacy, Bedding and Bath, Kitchen, Small Appliances, Outdoor/Seasonal, Baby, Toys, Electronics and Entertainment, Sports and Recreation, Home and Pets.

The Home section has always included a small grocery section that provided dry snacks and other prepackaged goods, such as candy and granola bars. Additionally, at the front of the store, convenience items like pop and small containers of milk are displayed in refrigerators.

Adding a grocery department

George has gathered the following data for adding a full grocery department to the Cinder chain:

1. The grocery department will utilize 15% of the total store square footage with a margin of 13% of sales.
2. The new department cannot cannibalize more than 25% of the square footage of any existing department.
3. Slow-moving products will be eliminated first; as a result, the lost margin on the cannibalized square footage will be 10%.
4. The new department will improve traffic resulting in a 20% expected overall increase in store sales.
5. The expected grocery department sales are projected to be $1.115 million annually per store.
6. Expected operating costs will increase by $350,000 annually per store.

Department	Allocated square footage (%)	Revenue ('000s)	Cost ('000s)	Margin ('000s)
Clothing	15%	1,467.00	885.00	582.00
Pharmacy	8%	1,093.00	685.00	408.00
Bedding and Bath	5%	889.00	699.00	190.00
Kitchen	10%	933.00	745.00	188.00
Small Appliances	15%	887.00	635.00	252.00
Outdoor/Seasonal	12%	1,095.00	745.00	350.00
Baby	7%	1,020.00	802.00	218.00
Toys	10%	1,324.00	945.00	379.00
Electronics and Entertainment	5%	1,214.00	892.00	322.00
Sports and Rec	7%	1,011.00	745.00	266.00
Home and Pets	6%	1,067.00	899.00	168.00
		12,000.00	**8,677.00**	**3,323.00**

Exhibit 13
Canadian Parka Supplier

Since the early days of operations, Phoenix has sold a “Canadian Parka” that is recognizable as belonging to the Phoenix brand. From inception, it has been manufactured by Polar Tradition Inc. It is now time to renew the manufacturing contract, and an alternative manufacturer is vying for Phoenix’s business. Winter Gear Ltd. has committed to providing the same quality of jacket at a much lower cost.

Polar Tradition Inc.

- Manufacturer of Phoenix’s Canadian Parka since inception.
- 95% of the products manufactured by Polar Tradition are for Phoenix.
- Located in Yellowknife, NWT.
- Polar Tradition supports 50 direct employees, excluding suppliers of its materials.
- Coats manufactured are of high-quality Canadian-sourced synthetic materials.
- Coats are designed to be extremely warm but breathable while maintaining a sense of fashion.

Polar Tradition Inc. is a small operation with limits on capacity due to its manufacturing approach, which sources local materials and employs traditional craftspeople. While it does sell some coats locally under its own brand, 90% of its revenue comes from Phoenix, and it depends on this. Local sales are also at a reduced margin to support the community in which Polar Tradition operates.

Winter Gear Ltd.

- Manufacturer of several significant brands of coats, similar in appearance to Phoenix’s Canadian Parka.
- Head office is located in Toronto, Ontario. Manufacturing would occur in China.
- Labour would not be dedicated specifically to Canadian Parka. Increased task specialization of employees working on multiple brands and increased automation would allow for reduced costs.
- The company will not disclose the sources for their materials.
- Coats would maintain the same design.

The rights to the design of the coat are held by Phoenix, and the change in manufacturer would not impact the appearance of the coat.

The Canadian Parka retails for $950. Polar Tradition Inc. supplies the parka at a wholesale cost of $600 and makes a profit of $200 per coat.

Winter Gear has put in a bid to provide the coats to Phoenix for $400 per coat.

APPENDIX C

THE COMMON FINAL EXAMINATION
DAY 1 PRI VERSION 1 BOOKLET – SEPTEMBER 21, 2016

COMMON FINAL EXAMINATION
SEPTEMBER 21, 2016 – Day 1 PRI Version 1

<u>Case</u> **(Suggested time 240 minutes)**

You, CPA, are enthusiastically greeted by Kieran Postmaa, the vice-president of Sparky's operations. It is October 14, 2017, and you are one week into your assignment to assess Sparky's performance from PRI's perspective (Appendix I).

Kieran ushers you into his office and launches into his plans for the week. "Jennifer told me that your visit is a formality. As you know, she couldn't be here to meet with you. I understand she sent you an email instead (Appendix II)."

During the past week, you gathered information from Kieran about Sparky's operations (Appendix III), visited stores, spoke with store managers and attended a staff meeting with management at one location (Appendix VII).

Kieran continues: "I thought we could have dinner with the executive team tonight. Tomorrow, you and I can talk further about our operations and then we can improvise for the rest of your visit. Do you like to golf?"

You are a little surprised by Kieran's welcome, having thought that this visit was more than just a formality.

INDEX TO APPENDICES

APPENDIX I
EMAIL FROM MARTINA

To: **CPA**
Re: **Sparky Ltd. visit**

As you know, we purchased Sparky Ltd. for $1.2 billion on January 1, 2017. The acquisition was hotly debated, and I hope we made the right decision. We want a brand that targets the young-professional market and is trendy and appealing. At the time of purchase, the fair value of Sparky's net assets, using an earnings-based valuation, was in the range of $1.1 to $1.5 billion. If profits remain at or above 2016 levels for the next three years, there is a contingency payment of an additional $500 million. Profits will be calculated using PRI's customary accounting policies.

Employees at Sparky unionized just prior to the acquisition. The minimum wage was increased by the government by 3%. The trend in the industry seems to be to offer some benefits to part-time employees. So far, the union has not raised significant issues, but we will be heading into our first round of collective bargaining with them next year, at which time potential wage issues and working conditions will be negotiated.

I wanted to provide you with a brief update on changes that have occurred since you last helped us.

Maggie no longer plays an active role in the company and is proceeding with her shopping blog, which has become quite successful.

George and I now have a good working relationship and share the same vision for PRI. I have stayed at the helm of Phoenix. As you may know, we agreed to keep our downtown department stores and to close our suburban locations. Sales of the two owned suburban stores and the cash flow savings from the closure of all the suburban locations allowed us to reinvest in our downtown core stores. The closings have been hard on our employees but we have accommodated them as much as possible by offering positions at other locations.

The Canadian dollar has lost value relative to the US dollar. The retail industry and the economy continue to struggle, but the reinvestment we made in our infrastructure has given us an advantage over our competitors and our sales have actually improved. A renewed support in the marketplace for Canadian businesses has also helped us.

Fortunately, the class action lawsuit related to the data breach was thrown out and small settlements were reached with only those customers who were impacted. Several IT experts have tested the software for potential data breaches and we are confident that the data is secure.

APPENDIX I (continued)
EMAIL FROM MARTINA

Drawing on Sparky's expertise in online sales, we have launched online shopping for Phoenix. Our strategy of expanding to a larger market seems to be bringing in younger shoppers, which is positively impacting both our online and in-store sales.

A significant competitor launched its own e-commerce site at the same time as us. Industry experts predict that this space will become more competitive in the next few years.

Phoenix is one of the few online retailers that serves the Canadian market exclusively. We are able to maintain our mission of being a hallmark retailer in the Canadian market with strong traditions and values, while becoming more accessible to a wider market. Our mission statement now reflects the online addition: "Our mission is to serve our customers through our stores by providing a high-quality home and fashion retail experience. The experience is tailored to meet the needs of Canadians by providing quality, choice and service that can be trusted. *From in-store to online, we make it easy for Canadians to shop with us*."

Activity at Cinder has remained stable. As we decided not to make any significant decisions until Sparky was more settled, we have made no major operational changes.

Sparky will serve its own unique market. We support its offering trendy, quality products at an affordable price to its niche market. However, like Phoenix and Cinder, Sparky is expected to adopt PRI's values and the principle of treating customers, suppliers and employees with respect and integrity.

I have been hearing some grumblings from Phoenix employees. I think it might be due to the changes we had to make recently. This concerns me, and I want you to look into this when you return from Sparky. Thankfully, Cinder seems quiet at the moment.

Jennifer is now president of Sparky. As a wholly-owned subsidiary of PRI, and consistent with the setup of Cinder and Phoenix, Sparky is a separately incorporated entity. Jennifer was unhappy with the decisions being made at Phoenix, and with the fact that George and I were agreeing with each other! While I have some qualms about Jennifer being president, it seemed easiest to let her work for Sparky, as it is the closest fit with her personal vision. I have emphasized that decisions must still be made in PRI's best interest. The board instructed Jennifer to operate Sparky just as it is for the current year, as we want to get a better feel for the company before making any significant changes. Jennifer is to make all operational decisions at Sparky but still reports to me. It is important to the board that Sparky be in line with PRI's vision, and we want Jennifer to set that tone with current management.

APPENDIX I (continued)
EMAIL FROM MARTINA

I asked Jennifer to investigate one possible operational change. In line with Sparky's desire to remain contemporary, I asked Jennifer to look into self-checkout systems. The industry has been moving towards more automated alternatives for customer service, which suits the younger, tech-savvy market. If this is considered the best way to provide customer service, perhaps we should implement it in all of our stores across PRI. I know she would appreciate your input. And I am curious to see the information she has gathered so far.

I haven't heard a lot from Jennifer. Now that we have had Sparky for almost one year, she will begin making formal quarterly reports to the board, starting this quarter. It will be important to bring PRI's board and audit committee up to date as we have not had a thorough look at Sparky's results since our due diligence was completed in October of 2016.

I would like you to give me a sense of how Sparky is performing in Jennifer's hands. Taking into account what you know about our family of stores from the previous engagement, I would like you to assess Sparky's current situation and operating environment. Provide your assessment of the challenges you see Sparky facing, or having to face in the near future. Please consider both strategic and operational challenges. Where you believe you have sufficient information to do so, please suggest a course of action, or indicate what further investigation is required.

Kind regards,
Martina

APPENDIX II
EMAIL FROM JENNIFER

To: **CPA**
Re: **Visit to Sparky Ltd.**

Thank you so much for coming to visit Sparky! I apologize for not being able to welcome you but I am in Taiwan.

As you may know, we are now generating profits because of the decision to manufacture many of our in-house-brand products in China, where labour costs are lower. After Kieran discovered a factory in Taiwan with the capacity to manufacture many of our remaining Canadian-made products at a significantly lower cost, we started having all of our in-house-brand linens, such as towels and curtains, manufactured there. As the goods have just recently started to be sold, we aren't seeing a huge financial statement impact yet, but Kieran is confident that we will. I am in meetings here to see what other manufacturing we can move to Taiwan, to further lower our inventory costs. And while I'm here, I will be formalizing the acquisition of one of those suppliers. I will bring a signed binding memorandum of understanding back with me, to present to Martina and the board.

I have also looked into two self-checkout systems (Appendix VI) and am about to decide which option to pursue. While I am interested in the cost savings this will generate, I also think it is critical that we provide our target market with the technology they expect. Busy young professionals don't like to waste time waiting, and self-checkouts meet that need. It will also bring us in line with many other retailers in the industry, several of which offer a mix of self-service and conventional checkout systems. A few have moved to 100% self-service, which is my preference. Self-checkouts tend to be preferred by shoppers in the 18 to 45 age range. Older, less tech-savvy shoppers don't like the impersonal nature as much. Self-checkout systems have an expected useful life of four years.

The biggest change I have planned is to increase our appeal to the young professional by developing an in-store café. Customers can take a break from shopping to have a coffee, or can sip on one while they stroll the aisles. I did my research before moving ahead. Our market studies indicated that in-store cafés were viewed favourably by 82% of customers surveyed in the 25 to 39 age range, and by 67% of those in the 40-55 age range. Our analysis of similar competitor stores in the US indicated that cafés create profits of their own while also increasing in-store traffic by 15%. This is exciting, and we expect to open the cafés in the next year. As I knew Martina would get all worked up about this, I have kept it quiet so far, and I ask you to do the same. I am positive the board will be thrilled when I present it to them next quarter. Martina thinks she knows what's best for all of PRI, but she needs to recognize that I know what's best for Sparky.

APPENDIX II (continued)
EMAIL FROM JENNIFER

Mr. Snookers was a visionary, and I am following his example by applying my own vision to this part of the family empire. I am lucky to have the freedom to do so. I am confident that Kieran can show you how we have achieved our recent successes at Sparky, and can answer any questions you might have. He has been very enterprising and I don't have to worry, knowing he is making great decisions for Sparky.

Cheers,
Jennifer

APPENDIX III
COMMENTS FROM KIERAN POSTMAA

"As you know," Kieran begins, "2015 was a rough year, but things returned to our normal levels in 2016, and we are confident we can continue at this level. We are on target for fiscal 2017 and expect things to look even better at year end, given that the holiday season, which is always our biggest quarter, is upon us.

"When Mr. Snookers retired on January 1, 2017, Jennifer took over as president. I continued as vice-president of operations, but have taken on several new responsibilities. As Mr. Snookers' second-in-command, I learned everything I know from him. Jennifer is following his example, although taking a more hands-off approach, which is great. She understands that making a profit is important and trusts me to make the right decisions. We both believe in being aggressive when it comes to Sparky's continued success. I make most of the decisions and then report to Jennifer, simply for confirmation to proceed. We have implemented a number of key strategies that I am excited to share with you.

"We are having a stellar year (Appendix IV), which is due to some of the new initiatives I have implemented. As a retailer, one of our largest controllable costs is labour, which is often as much as 20% of our margin. I have worked with our scheduling department to find ways to minimize labour costs while still providing the support we need for our customers.

"I realized that the daytime staff were not spending enough time restocking shelves. With customers in the store, it was hard to know whether items were sold out or were sitting in carts waiting to be put back on the shelves. Daytime staff also spent a lot of time tidying up after customers instead of restocking. I therefore moved the restocking to the night shift. We always had some restocking done then, with four staff on overnight. I put four more staff on the overnight shift and eliminated ten staff during the day. The result is great savings and a more efficient way of working! There have been no issues filling the night shifts — lots of employees are asking to work them.

"We are also working hard to find more ways to economize, such as manufacturing more goods overseas for cost-saving measures on many of our in-house brands. Jennifer should be signing a binding memorandum of understanding with one of our suppliers, for Sparky to buy them, which should allow us to expand and start being a supplier to others. There is money to be made.

"With respect to the in-store cafés, we have worked closely with design teams to develop both the brand and the interior atmosphere that the cafés will bring to our store. We used the results of our market studies to create a design that will appeal to our target market. This has been a massive undertaking, and it has cost quite a bit to finalize the designs. Our next step is to start construction. We capitalized everything as a branding intangible, so fortunately, nothing will show up on the income statement in the current year.

APPENDIX III (continued)
COMMENTS FROM KIERAN POSTMAA

These costs include:

Legal fees	$ 50,000
Preliminary market study	200,000
Design consulting fee and logo	275,000
Marketing staff salaries	75,000
Office overhead	50,000
Interior design fees	400,000
	$ 1,050,000

"Mr. Snookers, who was always focused on cutting costs, must have recognized that increased compensation would improve morale, since he implemented a new bonus plan just before he left (Appendix V). Mr. Snookers mentioned that this should motivate managers to achieve higher profits in the next three years, in line with what PRI would want, based on the purchase and sale agreement. I know that top management is happy with the new plan, and is working hard to earn it. Happier managers should translate into happier employees overall!

"Come to think of it, Jennifer has never asked me about the plan and how it is working, which is a bit odd. I'm assuming that Martina knew about the bonus plan at the time of the acquisition."

APPENDIX IV
SPARKY LTD. INCOME STATEMENT

Sparky Ltd.
(in thousands of dollars)

	9 months ended Sep. 30, 2017	12 months ended Dec. 31, 2016
Retail sales	$ 792,081	$ 1,025,347
Online sales	396,428	511,789
Cost of merchandise	(855,726)	(1,117,498)
Margin	332,783	419,638
Fulfillment costs	31,714	40,943
Technology	32,099	41,352
Employee wages and benefits	59,872	85,371
Amortization	15,789	19,747
General, administrative and other	152,897	204,589
Earnings before income tax	40,412	27,636
Income tax expense	11,315	7,738
Net earnings	$ 29,097	$ 19,898

APPENDIX V
MANAGEMENT BONUS STRUCTURE

In November of 2016, Mr. Snookers announced that, effective January 1, 2017, Sparky would be implementing a revised bonus structure for its senior management team. Whereas senior managers previously received a small annual bonus, Mr. Snookers introduced a structured bonus system, to provide incentive for improved profits and to motivate all Sparky employees to work as a team.

The revised management bonus structure is as follows:

- Bonuses are calculated as a percentage of each manager's base salary.
- The percentage of the base bonus is equal to the percentage change in profits in any given year; for example, a 5% increase in profits equals a 5% base bonus.
- Base bonuses will increase by one percentage point for every 10% decrease in expenses from the prior year.
- Base bonuses will increase by one percentage point for every 10% increase in total assets from the prior year.
- Bonuses will be paid out in February of the following fiscal year.

The senior management team consists of the four vice-presidents and the ten regional managers responsible for sales and finances.

APPENDIX VI
SELF-CHECKOUT SYSTEMS

Check-It-Out

Check-It-Out is the original self-checkout system, and is used by retailers worldwide.

The Check-It-Out process is as follows:

- The customer presses "Start" on the touchscreen.
- For every item scanned, the weight of that item is registered in the system, and the checkout expects the same weight to be added to the bagging area.
  - If the same weight is added, the customer may continue to scan and bag items.
  - If the same weight is not added, an error message such as, "Please rescan the item and place the item in the bag," will be displayed and the customer cannot proceed until this is corrected.
- If an item is bagged without being scanned, an error message such as, "Unexpected item in the bagging area – please scan item before placing in bag," will be displayed and the customer cannot proceed until this is corrected.
- Once all items are bagged, the customer selects their method of payment, pays and leaves.
- Acceptable methods of payment are by debit, credit and cash.

As it is familiar to most customers, the Check-It-Out system is popular. The scale is quite sensitive and can be problematic if a customer leans on it or if an item's weight does not exactly match the weight registered in the system. This often leads to cashiers clearing errors without knowing the actual reason for the error.

Read-It-All

Read-It-All is a new, high-tech system that eliminates some of the frustrations of the weight checks performed by previous versions of self-checkouts. It is brand new to the market and initial feedback has been positive.

The Read-It-All process is as follows:

- The customer places an item inside a large rectangular space. The machine finds and automatically reads the UPC code without the customer having to scan the product.
- At the same time, the machine weighs the product, so when moved to the bagging area, the weights are matched up. The scale is less sensitive, so inconsequential weight differences rarely cause an error message.

APPENDIX VI (continued)
SELF-CHECKOUT SYSTEMS

- When all items have been scanned, the customer pushes a button and proceeds to payment, similar to the Check-It-Out system.
- No cash is accepted — all payments must be with debit or credit cards.

Each self-checkout system requires a master terminal and annual maintenance. The estimated initial investment costs and annual operating expenses have been compiled below.

	Traditional	Check-It-Out	Read-It-All	Note
Number of registers	12	12	8	1
Cost per register	$ 0	$ 30,000	$ 80,000	2
	0	360,000	640,000	
Master terminal	0	150,000	200,000	
Installation cost	0	25,000	50,000	
Upfront investment	$ 0	$ 535,000	$ 890,000	
Annual maintenance	$ 500	$ 25,000	$ 40,000	
Staffing cost	546,000	162,500	65,000	3
Annual costs	$ 546,500	$ 187,500	$ 105,000	

Notes:

1. Due to its efficiency, Read-It-All can accommodate a quicker flow-through rate, so only eight registers are required.

2. There is no upfront cost for traditional equipment as it has already been purchased. If disposed of, the traditional equipment has no salvage value.

3. The cost of staffing one checkout person for all open hours is $65,000 per year.

Traditional:	Requires one staff per register for the average time each checkout register is open (70%) = (12 × $65,000 × 70%)
Check-It-Out:	Requires one staff per four registers during peak times (75%) and one staff for all twelve registers during slow times (25%) = (3 × $65,000 × 75%) + (1 × $65,000 × 25%)
Read-It-All:	Requires one staff per eight registers = (1 × $65,000)

APPENDIX VII
NOTES FROM A STAFF MEETING WITH MANAGEMENT AT A SPARKY LOCATION

- The results from the customer comment box that is maintained in the front of the store were presented. Some of the customer comments are as follows:

  - *Whenever I am in the store, I feel like it is in chaos. I check back every few days for curtains I see advertised online. I can never find them and the window treatment aisle always looks like a closing-out sale — bare and a mess!*

  - *I am excited about the rumours I am hearing of a café being added! As a young mom, I am always looking for an easy caffeine fix while I shop.*

  - *You can never find a staff person when you need one. I look for help and there is nobody around! I like a personal touch when I shop.*

  - *I like how bright and cheerful the store is, but it is frustrating that it is so behind on technology. It is more efficient to check prices and ring things up for myself. At least the addition of high-quality coffee in your rumoured café will help make my shopping more enjoyable while I am stuck waiting in lineups.*

  - *The staff is always flustered and the place is a mess. I cannot find anything and no one is around to find it for me. What a nightmare!*

  - *They need more staff on checkouts. The lineups are out of control. I am tired of waiting for the old lady in front of me to finish chitchatting with the one clerk that is on cash!*

  - *I just bought a set of sheets from you. They have always been of reasonable quality, but faded as soon as I washed them. When I tried to return them, the store clerk told me I couldn't because they had been washed. Well, I wouldn't know they were going to fade without washing them, would I?*

  - *Your store treats customers like an inconvenience. There is no respect! Your goods might be trendy, but your service sucks. Everything is impersonal. I was excited about visiting the new stores, but with what I've experienced, I will not be coming back.*

- The staff seemed unfazed by the comments. "Well, that's just how things are now," one stated. "It's not like we control any of that — there's not much we can do about it." "Customers think it is bad for them — they should try being us," groaned another. "The holiday season is only going to make it worse."

APPENDIX VII (continued)
NOTES FROM A STAFF MEETING WITH MANAGEMENT AT A SPARKY LOCATION

- The next week's schedule was presented, which prompted a staff person to complain. "I cannot believe I only have three shifts! That will make paying rent a challenge. When we unionized, we expected to see better control over our shifts, but management still isn't listening."

- The general consensus among staff is that they are frustrated with the hours of work. There are less regular day shifts and more staff are being asked to pick up night shifts. With less hours being given out in total, they take them because they need the money, but it is not ideal. Some also commented that, with their hours being reduced, many of them are at risk of losing full-time status and might therefore lose their rights to full benefits.

- The store manager attempted to keep the focus positive but eventually agreed with staff that the hours weren't working, adding that there is little to be done as their regional manager seems set on keeping costs down.

- Concerns related to restocking were discussed. A decision was made by the regional manager to place more out overnight so that enough products would be on the shelves for customers. Staff noted that this would cause shelf space shortages, and some products might need to be moved around. In terms of getting product onto the shelves during the day, the store manager's instruction was, "Just do your best."

As staff were leaving the meeting, you heard them discussing a union local being formed at Phoenix's flagship store in Vancouver. Phoenix employees are worried that the acquisition will result in employment changes similar to Sparky's experience. The feeling was that unionizing that store would show PRI how serious the employees are.

APPENDIX D

DAY 1 (PRI VERSION 1) – SEPTEMBER 21, 2016
MARKING GUIDE AND SAMPLE CANDIDATE RESPONSE

MARKING GUIDE
PHOENIX RISEN INCORPORATED (PRI)
VERSION 1

Summative Assessment #1 – Situational Analysis (Update)

Competencies
2.3.2 Evaluates the entity's internal and external environment and its impact on strategy development.
Enabling:
2.1.1 Defines the scope of the problem.
2.1.2 Collects and verifies relevant information.
2.1.3 Performs appropriate analyses.

For Summative Assessment #1, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate used a reasonable situational analysis when analyzing the major issues facing Sparky and PRI.

Unsure – The candidate attempted to use a reasonable situational analysis when analyzing the major issues facing Sparky and PRI.

No – The candidate clearly did not use a reasonable situational analysis when analyzing the major issues facing Sparky and PRI.

Competent candidates should complete a sufficient situational analysis. The candidate should focus on describing the factors that have changed that will affect the decisions to be made (e.g., Jennifer in charge of Sparky — new acquisition, new union, etc.) A recap of the mission and vision and relevant KSFs, as well relevant elements of the SWOT, is appropriate. It is not appropriate to repeat case facts without linking those facts to the issues that must be addressed. Candidates should draw upon their situational analysis when analyzing the issues facing Sparky and PRI (the fact that Jennifer's decisions and objectives are contradictory to PRI's objectives, as well as the bonus plan, checkout systems, cafés, potential purchase of supplier, and HR issues).

Mission and Vision Points

PRI's mission statement has been updated to include the online aspect of its retail business.

Key Objectives

From Capstone 1:

- To determine a strategic focus for PRI, and in particular Phoenix, going forward
- To maintain a high-end department store versus serving different segments by selling in suburban locations at a lower price point than in downtown stores
- For Martina, to see a minimum of 8% return on investment over the next five years

From Day 1:

- Since the focus of this case is on Sparky, to assess the state of Sparky since the acquisition, including how well it is aligning with PRI's values
- To gain an understanding of Jennifer's performance

KSFs for industry (from Cap 1)

- High margin per square foot in each store (this is also a performance measure)
- Reputation as a generous company, with high standards and strong moral values

External

- Expansion of retail online (from Cap 1)
- Renewed focus on buying Canadian goods
- Fact that competitor has moved into the online market and others are moving in that direction
- Devaluation of Canadian dollar relative to US dollar
- Increase of minimum wage by 3%
- New trend in industry to offer benefits to part-time (not just full-time) employees

Internal

- Customers unhappy with changes made
- Employees unhappy with operational changes
- Unionization of Sparky (from Cap 1)
- Threat of Phoenix (Vancouver office) unionizing
- Martina putting Jennifer in charge of Sparky
  - Personal conflicts between Jennifer and Martina (from Cap 1)
  - Jennifer and Kieran moving Sparky in a different direction
- New bonus plan in place (implemented by Snooker, not Martina or Jennifer)

Quantitative Analysis (based on Sparky's income statement)

Sparky has increased its net income by 50% from 2016 to 2017, with the fourth quarter of the year yet to occur (and 2015 was a very poor year). This is significant in a market that is said to be struggling.

Margins on products have increased, while at the same time wages have declined. This matches what we are told by management (i.e., efforts to cut costs in these areas, outsourcing in Asia).

Consider influence of new bonus plan on results.

Summative Assessment #2 – Analyzes the major issues

For Summative Assessment #2, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate completed a reasonable assessment of the major issues facing Sparky and PRI.

Unsure – The candidate attempted to complete a reasonable assessment of the major issues facing Sparky and PRI.

No – The candidate clearly did not complete a reasonable assessment of the major issues facing Sparky and PRI.

Competencies
2.3.3 Evaluates strategic alternatives.

Enabling:
2.1.3 Performs appropriate analyses.
2.1.4 Integrates information to investigate each potentially viable solution or conclusion.

This summative assessment is based on Assessment Opportunities #2 to #5.

Assessment Opportunity #2 (Strategic Issue #1 – Jennifer's decisions and objectives are contradictory to PRI's objectives.)

Candidates are expected to recognize the incongruences between Jennifer's decisions and objectives and PRI's objectives. They should recognize both that Sparky is required to be run in the best interests of PRI and that Jennifer's actions are not consistent and are reportable to Martina and the board. Candidates should identify examples in which Jennifer is intentionally contradicting PRI's and Martina's wishes and discuss the potential impact it has on Sparky and PRI. Candidates should discuss the significance of Jennifer's actions and recommend some actions (e.g., increase the communication between Martina and Jennifer, consider removal of Jennifer as the head of Sparky).

Candidates were asked to look at Sparky on behalf of PRI. Martina indicates, in Appendix I, that although Jennifer has taken over Sparky, it is to be run in the best interests of PRI, and that Jennifer is responsible for reporting to Martina and the board of directors. Jennifer is instructed to make no significant changes to the operations of Sparky, other than the self-checkout systems, until there is a good understanding of the company. Additionally, Jennifer is to be the final decision maker of any decisions made and is to clearly set a tone with the current management of Sparky in keeping with PRI's vision.

Key points from Cap 1 that could be integrated:

Candidates need to understand their role with PRI and the priorities of the Legault family. They must be conscious of how management's decisions are affecting the employees and operations of Sparky and of how the Legault family would view this.

Candidates must also recognize the family dynamics between Jennifer and Martina, that the prior disagreement of approach is still ongoing, and that, because it is a family business, some options, like firing Jennifer, are not feasible.

- Jennifer's decisions conflict with PRI's values (employees and customers not happy)

Key points from Day 1 that could be integrated:

- Poor communication between Jennifer and Martina (why did Martina not "check in" more often?). Board was not informed of the possible acquisition of the Taiwan supplier, the outsourcing in China, and the in-store café market research.
- Jennifer's decisions are not in line with PRI's mission and vision. Jennifer is cutting costs (restocking during night shifts) and risking quality (manufacturing in China).
- Decisions being made by Jennifer (and Kieran, approved by Jennifer) without Martina's and PRI's consent are in opposition to the directive given by Martina to Jennifer to "operate just as it is" (in-store café, possible acquisition of a Taiwan supplier, night restocking).
- Jennifer is not consulting Martina or the board (governance issues), which increases business risk.
- Jennifer is not overseeing Kieran and delegates a lot to him, so a similar pattern could be happening with Kieran, where he is making decisions that don't match PRI's objectives.

Assessment Opportunity #3 (Strategic Issue #2 – The candidate discusses how the bonus plan may be influencing Kieran's behaviour and considers the broader implications.)

Candidates should discuss how the bonus plan may be influencing Kieran's behaviour and provide examples of areas in which the decisions made by Kieran may not be in the best interests of Sparky and PRI and may be driven by bonus. Candidates should also consider the impact of the bonus on employees and recognize that it is not meeting the stated purpose of improving employee morale. Candidates are expected to recognize the potential link between the implementation of the bonus plan just before the sale by Charles Snookers and the contingency payment that may be due to him.

In November 2016, Charles Snookers announced that, effective January 1, 2017, Sparky would be implementing a revised bonus structure for its senior management team. Jennifer never asked Kieran about the plan, and Kieran assumes that Martina knew about it at the time of the acquisition.

Qualitative Analysis

<u>Key points from Day 1 that could be integrated:</u>

- The bonus plan may benefit Charles in reference to the contingency payment of $500 million
- The bonus plan may be motivating Kieran and other managers, but not employees (alignment with PRI goals, employee complain, scheduling)
- The bonus plan may influence the decision to increase profits and assets (lower costs with oversea supplier, cutting the number of hours worked)
- The bonus plan may bring bias to accounting treatments (café market research capitalized)
- Ethical issue of whether Charles informed Martina at the time of acquisition or governance issue of whether there was a lack of due diligence by PRI

Quantitative Analysis

- Analyze financial statement results and see if there is a link to the bonus (e.g., sales up and costs down)
- If an accounting treatment is incorrect, then expenses are understated or assets are overstated, which increases the bonus

Assessment Opportunity #4 (Strategic Issue #3 – The candidate discusses the implications of using automated self-checkout system and makes a recommendation.)

Candidates are expected to prepare a quantitative analysis of the self-checkout options. The analysis should also discuss the qualitative factors of each system, with links to the needs of Sparky's customer base. Candidates should make a recommendation specific to the needs of Sparky. Candidates should also address the potential expansion of self-checkouts to Cinder and Phoenix.

Quantitative Analysis

The majority of the quantitative analysis has been provided for candidates, with the upfront and annual costs of each system presented. Candidates can perform a quick pay-back calculation.

Check-It-Out:

Upfront investment ÷ annual savings = 535,000 ÷ (546,500 − 187,500) = 1.49 years

Read-It-All:

Upfront investment ÷ annual savings = 890,000 ÷ (546,500 − 105,000) = 2.02 years

Candidates should recognize that the cost recovery time is longer on the Read-It-All system.

Qualitative Analysis

Key points from Cap 1 that could be integrated:

- Need to assess suitability for Phoenix and Cinder (different markets) — it may be right for Cinder, but likely not for Phoenix

Key points from Day 1 that could be integrated:

- Discuss customers' reactions: familiarity with the products, assistance needed, payment options
- Discuss technology: error potential, checkout speed
- Discuss fit with mission and objectives: impact on employees, morale

Assessment Opportunity #5 (Strategic Issue #4 – The candidate considers whether the cafés and potential purchase of the supplier in Taiwan are a good strategic fit with Sparky's objectives. The candidate discusses the unionization threat at Phoenix and provides recommendations.)

Candidates are expected to separate their analysis of the cafés/possible acquisition of supplier in Taiwan from the fact that the decision was made contrary to Martina's directions.

Candidates should analyze the cafés in the context of their fit with Sparky's and PRI's objectives and with the current information on how the idea has been received by customers. Candidates should make a recommendation on a course of action.

Candidates should also discuss the acquisition of a supplier in Taiwan, with the idea of becoming a supplier to other companies, and whether the outsourcing to China is a good strategic fit.

Candidates are expected to recognize the potential threat of unionization at Phoenix as a result of the union establishing in Sparky and the uncertainty caused by change in the organization. Candidates should address the potential impact of unionization and make recommendations to improve employee satisfaction.

1. Cafés

Quantitative Analysis

- Significant dollar investment (over $1 million) is a sunk cost with regard to the decision to keep and proceed with cafés
- However, cafés could increase in-store foot traffic by 15%, but we don't know what 15% converts into in terms of dollars and should find out

Qualitative Analysis

Key points from Cap 1 that could be integrated:

- Consider the size of the Sparky store (smaller than Phoenix), and question how much space the café will take up
- Cafes are a new meeting place (rather than malls) for the younger generation — may draw in shoppers

Key points from Day 1 that could be integrated:

- Objective of Sparky, as defined by PRI, is to provide a trendy, appealing environment for young professionals

Additional considerations candidates could discuss:

- The market study supports that cafés meets the objective of Sparky, as defined by PRI, to provide a trendy, appealing environment for young professionals, as does the analysis of competitors
- Revenue increases are possible, since adding a café could increase in-store traffic by 15%

2. Potential acquisition of supplier in Taiwan and outsourcing in China

Qualitative Analysis

Key points from Cap 1 that could be integrated:

- Jennifer did commit PRI to a deal in Cap 1, but Martina was able to back out of it

Key points from Day 1 that could be integrated:

- Assess strategic fit with PRI's objectives (likely conclude it does not fit with mission and vision, etc.)

Additional considerations candidates could discuss:

- Jennifer and Kieran both mention the Asian suppliers, which seems to indicate that the intent is to move Sparky in a new strategic direction (supplying other company with low-cost items)
- Consider if board and Martina can cancel the Taiwan deal
- Consider possible ethical issues (whether employees are well-compensated in Taiwan, etc.)

3. Unionizing

Qualitative Analysis

Key points from Cap 1 that could be integrated:

- Remember the employee issues from the Capstone 1 case and the unhappiness of retail employees
- PRI employees have been accustomed to stable work hours and industry-leading employment packages
- Employees at Sparky unionized just prior to the acquisition

Key points from Day 1 that could be integrated:

- Recognize the risk of unionization at PRI by combining Martina's comments with the staff comments overheard at the store meeting.
- Events at Sparky are causing additional upset with Sparky employees. The new union has not had the impact that employees anticipated. The increase of more overnight shifts and reduction of shifts overall has employees struggling to work enough hours to retain full-time status. This is causing Sparky union members to want to increase their power by including PRI stores in their numbers.
- Advise Martina of the potential impact of unionization of the flagship store. It could result in expansion across all of Phoenix and Cinder.

Additional considerations candidates could discuss:

- Advise Martina of possible implications of Sparky no longer following PRI's values and recognize there is a need to address the issue
- Could link in bonus discussion; i.e., recommend changes to better meet employees' needs outside of management level

Summative Assessment #3 (Conclude and Advise)

Competencies
Enabling 2.1.4 Integrates information to investigate each potentially viable solution or conclusion.
Enabling 2.1.5 Recommends and justifies a solution or conclusion based on an integrative view of information for the situation.

For Summative Assessment #3, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate provided reasonable conclusions for each major issue.

Unsure – The candidate attempted to provide reasonable conclusions for each major issue.

No – The candidate clearly did not provide reasonable conclusions for each major issue.

Competent candidates are expected to provide a logical conclusion that is consistent with their analysis.

Candidates should provide conclusions and advice that align with PRI's vision, mission, objectives, and constraints.

The conclusion should integrate the analysis for all major issues (Jennifer's conflict with Martina; implications of bonus plan; in-store cafés/acquisition of supplier; automated checkouts; unionization).

The recommendation should be consistent with the analysis performed.

As well, an overall conclusion should be presented to provide a sense of completion to the report (a wrapping-up or prioritization of the recommendations) that comments on Sparky's overall performance in Jennifer's hands (which is what Martina asks CPA to assess).

Candidates should provide a conclusion for each of the following:

A) Jennifer's decisions versus Martina's directive (conflict);
B) Implications of Kieran's changes and the new bonus plan;
C) In-store cafés (continue with implementation plan or not) and Taiwan supplier acquisition;
D) Self-checkouts (fit with mission and objectives; recommend one);
E) Unionization threat (next steps); and
F) Overall performance of Sparky.

The response should display good professional judgment. Suggesting that further information is required is acceptable as long as it is justified and consistent with the analysis.

Summative Assessment #4 (Communication Hurdle)

For Summative Assessment #4, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate adequately communicated his or her response.

No – The candidate clearly did not adequately communicate his or her response.

Insufficient communication in a candidate’s response generally includes some of the following:

- The reader needs to re-read sections several times to gain an understanding.
- It is not clear what point the candidate is trying to make.
- The quantitative analysis does not make sense because of a lack of labelling or illogical ordering.
- There is an offensive amount of spelling and grammatical errors.
- The language used is unprofessional.

Summative Assessment #5 (Overall assessment)

For Summative Assessment #5, the candidate must be assessed in one of the following, based on their overall performance:

Clear Pass – Overall, the candidate provided an adequate response clearly meeting the minimum standards for each of the summative assessments.

Marginal Pass – Overall, the candidate provided an adequate response, with some errors or areas of omission, but including the underlying key concepts.

Marginal Fail – Overall, the candidate provided an attempt at a response, with several errors or an incomplete analysis.

Clear Fail – Overall, the candidate did not provide an adequate response because the response was deficient in multiple areas.

To be assessed a Pass, candidates are expected to perform adequately in all the summative assessments and demonstrate that they addressed the issues of importance to Martina and the PRI board in a cohesive, professional manner.

Markers were asked to consider the following in making their overall assessment:

1. Did the candidate step back and see the bigger picture, and then address the broader issues identified?
2. Did the candidate prioritize the issues by discussing the major and minor issues in appropriate depth?
3. Did the candidate use both quantitative (when available) and qualitative information to support their discussions and conclusions?
4. Did the candidate use the appropriate tools to perform quantitative analysis?
5. Did the candidate use sufficient case facts (current case and Capstone 1 case) about the external and internal environment to support their discussions?
6. Did the candidate communicate their ideas clearly, integrating and synthesizing the information?

SAMPLE RESPONSE – PRI VERSION 1

Below is an actual passing candidate response.

To: Martina Legault

From: CPA

Date: October 14, 2017

Subject: PRI Strategic and Operational Analysis

PRI has faced a major change since the previous analysis in that Sparky was purchased on January 1, 2017. This analysis will discuss how Sparky is performing in Jennifer's hands, as well as address the strategic and operational issues being faced by Sparky.

A positive factor since the last analysis is that George and Martina now have a good working relationship and share the same vision for PRI, but it does not appear that Jennifer is working cohesively with PRI as she directs Sparky. The corporate structure and management of Sparky is problematic as it is not in line with PRI's goals and vision, which will be addressed.

There are a number or strategic options that will stange the strategic direction of Sparky, as well as some smaller operational issues that must be dealt with to ensure effective operations at Sparky. A broad analysis of the issues is presented below and will be expanded on later in this memo:

- Management at Sparky: This is a major overarching issue that impacts the entire family of companies. Sparky does not appear to be aligned with PRI's goals and is not operating cohesively with PRI. Sparky is focused on profits and does not seem to place much emphasis on customer satisfaction and employee satisfaction, which are two key factors to the PRI group of companies. Phoenix employees have expressed grumblings since Sparky has been acquired, which will further be analysed. It is essential that all companies share the same mission and vision in order to retain customers, respect the brand and promote reputation.

- Self-checkout systems: Sparky prides itself for being a tech-savvy company that targets the younger market. This market is dominantly made up of young professionals that do not want to wait around and are comfortable using electronic devices for convenience. Self-checkouts are the preferred by shoppers in the 18-45 age range, so may be a worth-while investment for Sparky to pursue.
- New bonus plan at Sparky: Consistent with Sparky's profit-maximization objective, Sparky has implemented a new bonus plan that encourages improved profits and to motiviate all Sparky employees to work as a team. Having a bonus based on financial measures such as profits exposes the company to the risk that management may have a bias and may be temped to manipukate numbers or incorrectly classify figures to obtain hte larger bonus. We must analyse the extent of the manipulation of financial figures and suggest a more effective performance measurement tool for Sparky.
- In-store cafe: Adding a cafe to Sparky would be unlike anything PRI has offered before, but appears to have appeal to the younger demographic that Sparky is targeting. We will need to gather more information on his opportinity to analyze if the benefits outweigh the costs quantitatively, as well as if the advantages outweigh the disadvantages qualitatively. This presentes a major control issue as Jennifer went ahead and planned this significant change without Martina and the board's knowledge and approval, and will be discussed in the Management at Sparky analysis.

Financial Analysis:

Finances at Sparky have a significant user base as there is a contingency that an additional $500 million must be paid if profits remain strong, and managers are using the financial statements to obtain their bonuses. See exhibit I for a preliminary financial analysis of key accounts and an interpretation of the results. Please note that all 2017 figures have been annualized to be comparable to the 12 months in 2016.

Issue 1: Management at Sparky:

The corporate structure and management at Sparky may not be in line with PRI's mission and vision, and could be causing distress for the group of companies. This must be addressed immediately as there are several people that are unhappy including customers and employees. Sparky is not living up to the expectation of adopting PRI's values and the principle of treating customers, suppliers, and employees with integrity and respect. Additionally, Martina and the board are not aware of Sparky's situation proving that there is a lack of cohesiveness.

<u>Jennifer's presence in Sparky:</u>

Jennifer is president of Sparky and was unable to attend the meeting as she is currently in Taiwan. She is unhappy with decisions being Phoenix and is upset that she lost an ally in George. It is important to the board that Sparky retains PRI's vision and Jennifer is supposed to set that tone, but she is not present in the local operations of Sparky. This is problematic as Jennifer is familiar with PRI's objectives and must be present to ensure Sparky is not deviating to the overall goals PRI is trying to achieve.

Jennifer is not reporting to Martina; Martina states that she has not heard a lot from Jennifer.

This is concering as Jennifer reports to Martina and she should be aware of the operations and circumstances being experienced by Sparky. Additionally, it is problematic that the board and audit committee has not had a look at Sparky since due diligence was completed in October 2016. Especially in the early stanges of a new company acquisition, it is essential that the board is actively overseeing operations.

The decision to manufacture in-house-brand products and Candaian-made products in China due to lower labour costs is not aligned with PRI and Phoenix's focus on Canadian brands and local suppliers. Jennifer is in meeting to further lower inventory costs, which could directly impact quality. This goes against the mission statement to provide a "high-quality home and fashion retail experience".

While Jennifer is is Taiwan, she will be formalizing the acquision of a supplier and will later present the signed memorandum of understanding to the board and Martina. This is problematic as it impacts PRI as a whole and should not be signed without prior board approval. Although Jennifer is the President of Sparky, the board's approval should be required on all major agreements of business decisions. The board would be responsible to ensure the acquisition is reasonable and within the objective and goals of PRI.

Jennifer must be present in Sparky and must be aligned with the overall vision of PRI. Although Spatky is separately incorporated, the same vision is still expected by the board and wanted by the customers. Jennifer must actively manage the company to get it back on track. I would recommend that Martina step in and assist Jennifer for the next while to resolve all the issues.

In-store cafes:

Jennifer's studies show that this is a wise strategic decision and a customer comment also stated that there is excitement of the introduction of a cafe being added into the store. The increased satisfaction of customers and increased foot traffic will be positive for Sparky. We do not have enough information to complete a full analysis on this issue to assess whether or not it is a wise strategic move, but the main issue here is that this was planned without the knowledge and approval of Martina and the board. Jennifer enjoys having the freedom and power to express her vision at Sparky, but could be jeopardizing the family empire and harming family relationships.

An agreement must be formalized between Jennifer (on behalf of Sparkys) and the board that requires Sparkys to be in contact with the board and obtain prior approval for all major agreements or changes to the business. This will help the board stay updated on the operations and intervene if necessary.

Kieran Postmaa:

Kieran is the VP of Sparky's operations and is also very excited about the in-store cafe. Kieran is proud that he leared everything he knows from Mr. Snookers, but we are aware that Mr. Snookers' vision was not aligned with PRI's vision. Mr. Snookers did not treat his employee well and focused solely on profit maximization, which is not the goal of PRI. Kieran is responsible to run Sparky when Jennifer is awat and appears to have a major role in the company at all times, so must be aligned with PRI's goals. Additionally, Kieran may not have the level of professionalism and expertise required for this position as he is not taking my visit very seriously. There are several matters that must be dealt with and him suggesting we go golfing in the afternoon seems inappropriate.

Kieran is a determined leader but does not understand the vision of PRI. Kieran should be meeting with the board monthly (and on a less frequent basis in the future) to report on operations at Sparky and to receive guidance on how to manage Sparky. Kieran should be made aware of PRI's objectives and goals so that he can implement them at Sparky.

Employee Satisfaction:

Employees at Sparky are not treated well and are not happy with their situation. Staff are not being given the shifts they request and require to pay their bills, which is causing frustration among all staff over work hours. Staff are at risk of losing full-time status and therefore losing benefits, as well as being required to agree to nigh shifts just to get the additional hours. Sparky employees are very unhappy and this is negatively impacting Phoenix employees as well - they are concerned with changes in employment similar to Sparkys. Sparky employees are willing to take a stand and show how serious they are about their employee rights.

Having unhappy employees goes against the goals of PRI and does not align with the campany goals. This is causing stress at Phoenix as well. Management is focused on reducing employee costs, which is significantly harming employee morale and could result in some major issues is a local union is formed at the Vancouver flagship store.

Additionally, employees do not care about customers satisfaction as they believe they are treated even worse than the customers. This negative attitude is a major issue that needs to be resolved. I recommend that employees go through training to learn how to best provide to the customer's needs and how to satisfy the customer. This training should outline the goals of PRI and alighn the employees objectives with PRI's mission.

Management must listen to the concern of employees and make changes to satisfy the employees requests. Management should set meetings to learn the major concerns of employees and provide thoughful responses and changes in operations.

Customer Satisfaction:

Customers are unhappy with the overall customer experience when shopping at Sparkys. PRI is known to have well-maintained stores with exceptional customer service to provide a positive retail experience, and that is not being carried through to Sparky. Customers are complaing that it is chaos in the store and that they can never find an employee for help. Additionally, customers are treated like an inconveneince and do not experience a positive retail shopping experience when in Sparky. This is likely due to the low staff morale and the fstore being understaffed to cut costs.

Management must listen to customer complaints and strive to satisfy the customer. Every complaint received should be logges and a follow-up action should be determined to prevent receiving the same complaint in the future.

Quality of Products:

Not only is the quality of service lacking, the quality of products may be decreasing as well due to the fact that so many products are being outsourced. This decline in quality will further segregate Sparky's brand from the high-quality offered at PRI and will result in confused and unsatisfied customers. Outsourcing decisions should be approved by the board first to ensure they are acceptable and to ensure the high-quality standard of PRI is maintained.

Recommendation:

There are several issues in the operations of Sparky that result from management's decisions and objectives. Sparky is not aligned with PRI and is not effectively operating the store to represent the PRI image. Sparky is not living up to the expectation of adopting PRI's values and the principle of treating customers, suppliers, and employees with integrity and respect. Immediate intervention is required to mitigate all above concerns and recommendations have been provided in their respective sections. I believe that it is essential to immediately create an agreement between Sparky and PRI that will outline the appropriate protocol for all above issues and realighn the vision of Sparky to be customer focused like PRI. As well, board oversight must be increased substantially. The board has the responsibility to ensure Sparky is being operated effectively and will add to the current success of PRI. Board intervention will help Sparky get on the correct course.

Issue 2: Self-checkout systems:

Sparky is interested in implementing the self-checkout systems if it will be beneficial in future success of the company. This would be in line with Sparky's dominance in the online, automated shopping industry, but must be further analysed to determine if it is the correct strategic fit. Martina is wondering if this should be implemented in all the stores across PRI if it is the best way to provide customer service. There are a number of advantages to implementing an automated system at Sparky as follows:

- The industry is moving towards more automated alternatives for customer service to suit the younger, tech-savvy market. It appears that this is a modern thing to do, and could align well with Sparky's objectives.

- Saves customers time: Sparky customers are young professionals that do not want to wait in lines. This alternative increases convenience for the customer.
- Line-ups are currently out-of control at Sparky, and this would help to get customers through the checkout faster.
- This would replace satff, making it even more difficult for employees to get full-time hours they are seeking. Laying off staff of further reducing their hours will harm morale even more.

There are two different alternatives being assessed: Check-It-Out and Read-It-All. Both systems will be analysed and compared:

<u>Check-It-Out:</u>

- This is the original self-checkout system and is used worldwide by retailers. This means that all of ther errors have likely been worked out and the system is well accepted by the retail industry. This is a positive factor as Sparky would likely not have many technological/functional issues with this reputable system.
- Customers are allowed to pay with deit, credit, or cash. This allows customers the convenience to pay as they choose as they are not limited to only paying by card. This is a positive factor.
- This system is familiar to customers as they have likely used it at other department or grocery stores. This ease of use increases convenience and satisfaction for the customer.
- The scale is quite sensitive and can result in error messages if bagging is not done correctly or if a customer leans or places an item where it is not supposed to go. This is a good system control to have, but cashiers typically clear the error without knowing the reason, which defeats the purpose of the error message. The system is designed to prevent customers from

stealing goods (placing items in their bag that have not been paid for), but the cahier is negating that control by allowing the error message to be ignored. This is a control issue.

- Customers may get frustrated with the number of error messages provided by this sensitive system. This decreases convenience if the customer has to wait for the cashier to come clear the error message before continuing to scan items or pay.
- This is the least expensive option over 4 years, meaning that costs will be reduced and net earnings will be increased.

<u>Read-It-All:</u>

- This system is brand new, so likely will encounter some errors. Although initial feedback has been positive, this system has not been around long enough to test in different ciorcumstances and work out all the potential issues.
- The scanning process is all automatic, which removes the issues with human intervention. This appears to be a strong control to ensure items are not being bagged prior to scanning, and the high-tech system appears to relieve to frustration caused by the other system.
- This system does not accept cash, which may be inconvenient to customers that do not have a card with them or are just making a small purchase.
- The lack of the ability to accept cash means that Sparky would need to continue offering at least a few traditional check-out lanes for the customers that want to pay with cash.
- The system is efficient so has a faster-flow through rate to increase convenience for customers.
- Requires significant up-front cash investment, which would likely require financing depending on Sparky's cash situation.

Quantitatively:

See Exhibit II in excel. Purchasing the automated systems presentes a high-upfront cost with additional annual costs. These self-checkout systems have useful lives of 4 years (so would be capitalized and then the cost would be recognized as depreciation expense evenly over the next 4 years, thus reducing net income). Although the upfront cost of these systems is high, there are major annual savings as the staffing cost is extremely reduced due to the automation of these systems. We must analyse whether it is more cost-effective over the 4 year life of the system to purchase a self-checkout system or continue to use the traditional register. Note that the cost of the traditional register is not included in the analysis as they have already been acquired and therefore are a sunk cost, not incremental to our analysis.

As seen in exhibit II, Check-It-Out is the least expensive system and is the favourable option quantitatively. There is an upfront investment required of $535,000, which is significant, however, it is similar to the annual cost of the traditional registers. Paying this sum upfront may require financing.

Recommendation:

Based on the analysis above, Check-It-Out is the least expensive option over the 4 year period assessed and also has several advantages that will satify customer needs and keep Sparky current and modern. Several advantages such as the system accepting all forms of payment, and being a reputable system that customers are familiar result in this system being superior to the other checkout methods.

One risk that must be mitiagted is the errors messages must be appropriately addressed. Staff should be trained on the system and must be aware of what caused the error prior to clearing it.

This will address the control deficiency and will ensure that customers are not attempting to steal product from the store.

Martina is wondering if this system should be implemented at all of the PRI stores. I would not recommend implementing self-checkout across PRI at this time. Self-checkout is preferred among the 18-45 age group, so would likely be more accepted by Sparky's shoppers. Phoenix and Cinder shoppers do not fit in this younger demographic and may be more comfortable with the in-person experience at this time.

Issue 3: Management Bonus

Prior to his departure, Mr. Snookers introduced a bonus plan which he claimed would motivate managers to achieve higher profits and therefore increase compensation and increase morale.

It is important to note that the purchase price has a contingent payment of $500 million if profits remain at or above 2016 levels for the next 3 years, and the bonus plan implemented by Mr. Snookers was done to motivate managers to achieve higher profits in the next 3 years. This was clearly implemented in Mr. Snookers own self-interest as he wants to receive the additional $500 million payment and does not care how it is achieved. Mr. Snookers continues to be profit-oriented and does not care about PRI's success at all.

The bonus plan includes a few different measures that will be discussed below:

1. The base bonus is equal to the percentage change in profits in any given year: This means that net earnings is the main indicator of the bonus and management will be trying to get this number as high as possible to obtain a large bonus. As it currently stands, there has been a 94% increase in profits which will be equal to a 94% bonus (on each manager's base salary).

2. Base bonus will increase by 1% for every 10% decrease in expense from prior year. This is problematic as cutting expenses is not always favourable. For example, reducing costs of good sold may mean the company is providing a lower quality product, which customers may not be satisfied with. Additionally, cutting employee wage expenses decreases employee satisfaction and limits the quality of customer service offered to shoppers. Additionally, amortization is likely considered an expense even though it is a non-cash expense, and therefore management may be inclined to incorrectly classify and amortize costs. This will be further discussed below.
3. Base bonus will increase by 1% for every 10% in total assets: This could be a positive measure as it encourages investment into the company. However, it is also susceptible to manipulation as costs that should have been expensed are being capitalied to present a higher asset balance. This is discussed below.

The in-store cafes incurred several costs that have been capitalized as branding intangible so nothing appeared on the income statement as an expense. Several of these expenses should have been expensed in the current year instead of being capitalized as they do not meet the criteria of an intangible asset. Please see exhibit III for determination of capitalized costs that should have been expensed. One third of the capitalized costs should have been expensed, which would increase expenses, decrease assets, and decrease net earnings. Due to the fact that this would negatively impact all three bonus areas, it is evident that these costs were incorrectly capitalized to maximize the bonus.

It is not possible to quantify the management bonus at this time as I will need further informaton on the total assets of the company, but I can state that the bonus expense will not be a beneficial expense to the company as it is being given based on measures that are strictly financial to the detriment of other non-financial measures.

Additionally, Jennifer and Martina may not be aware of the bonus plan, which is yet another issue with the management of Sparky as this could result in a major cash payment to management and vice presidents and puts the company at risk for earnings manipulation. As discussed in the Management at Sparky section, all major factors impacting Sparky should be discussed with the board.

I recommend that the bonus program is stopped immediately and that a balanced scorecard approach is used to reward management for good performance. This banlanced scorecard should take into consideration all the areas of the company that PRI cares about with an emphasis on both futurstic and present targets. The balanced scorecard must have realistic targets that management can work to achieve that will benefit PRI as a whole.

<u>Financial:</u>

1. Asset efficiency utilization:

Measure: Return on assets

Target: Increase ROA by 1% each year

2. Amount spent on Canadian suppliers - in line with PRI's Canadian/local focus

Measure: % of costs to Canadian companies

Target: At least half of costs going to Canadian suppliers

3. Revenues - to gain traction in online sales

Measure: % of sales coming from online purchases

Target: At least 40% of sales coming from online by 2022

Customer:

1. Increase market share by satisfying customers:

Measure: Market share

Target: steady increase in market share year after year

2. Customer satisfaction:

Measure: Customer survey

Target: 80% customers express satisfaction with shopping experience

3. Return customers:

Measure: Numer of return customers

Target: Gain customer loyalty by seeing at least 85% customers shop at Sparky again

4. Basket price

Measure: Amount spent by each customer

Target: Increase the amount spent by each customer by making Sparkys a more pleasurable shopping experience. Increas of baset price by $8 in one year.

Internal:

1. Reduce customer complaints

Measure: # of complaints received

Target: Less than 3 complaints per month

2. Resolve restocking issues:

Measure: Number of complaints by customers not finding what they are seeking

Target: Nearly 0 items not restocked promptly.

3. Management cohesion:

Measure: Number of unhealth conflicts between Martina, the board, and Sparky management

Target: Nearly 0 unhealthy conflicts.

Learning and growth:

1. Employee retention

Measure: Employee turnover rate

Target: Decreased turnover due to unsatisfaction by 5% each year

2. Employee satisfaction:

Measure: Employee survey

Target: More than 80% happy employees

3. Employee competency and growth:

Measure: hours of training

Target: At least 5 hours per year

As you can see from the above balanced scorecard, management will be rewarded for their efforts to meet the needs of customers and align with PRI instead of just focusing on profit maximization. This will be benefical to get Sparky's management on the same page and focus their attention on non-financial matters that are importanat to PRI.

Issue 4: Concern at Phoenix

Phoenix is an important part of PRI and is impacted by what goes on at Sparky and in the company as a whole.

Suburban locations were closed and downtown locations were kept, which was hard on the employees. PRI attempted to mitigate this issue by offering those employees jobs at other locations, which may not be ideal to the employee but is respectable of PRI to try to accommodate their needs.

There have been further changes at Phoenix with the introduction of online sales. We will need to obtain additional information to determine if this has impacted employees satisfaction.

Phoenix employees are worried that the acquisition will result tin employment changes similar to Sparky's experience. This proves the severity of the employee issues at Sparkys. Management and the board must ensure that Phoenix employees are aware that their employment situation will not change and that Sparkys is being dealt with to resolve any issues.

As per your request Martina, I would be happy to gather more information on the grumblings at Phoenix after the Sparky situation subsides. For not, I would recommend that you continue to treat Phoenix employees the same great way they have always been treated and assure them that they do not have anything to worry about.

Exhibit I: Assess the Situation - Financial Analysis

Trend Analysis: Increase in Net Earnings	2017 Annualized	2016	$ increase	% increase	
	38796	19,898	18898	0.9497437	Net earnings have nearly doubled since last year. This could be a result of many factors, such as increased success under PRI's operations. However, we must consider that management's bonus is based on this figure and therefore it is likely that this could be inflated due to management bias.
Net earnings margin ratio (Net earnings/Revenue)	0.02448193	0.0129449		0.0115371	Net earnings ratio is a profitability ratios and shows that Sparky has siginificantly increased its profits since prior year. As mentioned about, this may be an inflated figure due to management's bonus being contingent on net earnings.
Cost of merchandise trend analysis	1140968	1117498	23470	0.0210023	Cost of merchandise has increased slightly, likely due to increased sales. Although it was expected that this number would be decreased due to the outsourcing initiatives and the pressure to keep expenses down.
Employee wages and benefits trend analysis	79829.3333	85,371	-5541.667	-0.064913	Employee wages and benefits have decreased since last year, likely due to Kieran's efforts to reduce employee hours (resulting in unhappy employees)

Exhibit II:

	Year 1	Year 2	Year 3	Year 4	
Traditional					
Upfront investment	0				from appendix VI
Annual cost	546,500	546,500	546,500	546,500	from appendix VI
4 year cost:	2186000				Total of all costs

	Year 1	Year 2	Year 3	Year 4	
Check-It-Out					
Upfront investment	535000				from appendix VI
Annual cost	187500	187500	187500	187500	from appendix VI
4 year cost:	1285000				Total of all costs

	Year 1	Year 2	Year 3	Year 4	
Traditional					
Upfront investment	890000				from appendix VI
Annual cost	105000	105000	105000	105000	from appendix VI
4 year cost:	1310000				Total of all costs

Exhibit III

Legal fees	50000	capitalize	
Preliminary market study	200000	expense	200000
Design consulting fee and logo	275000	capitalize	
Market staff salaries	75000	expense	75000
Office overhead	50000	expense	50000
Interior design fees	400000	capitalize	
	1050000		325000

APPENDIX E

THE COMMON FINAL EXAMINATION
DAY 1 PRI VERSION 2 BOOKLET – SEPTEMBER 13, 2017

COMMON FINAL EXAMINATION
SEPTEMBER 13, 2017 – Day 1 PRI Version 2

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

Phoenix Risen Incorporated (PRI) has gone through a period of significant change, with the passing of ownership to the third generation of the Legault family. You, CPA, have become a trusted member of the management team.

It is now January 14, 2018. As part of the ownership transfer, you helped develop a strategy to meet the needs of both PRI and the former controlling shareholders. The senior family members have retired, and Jennifer and Maggie are no longer actively involved in the business. As Martina continues to modernize the company, your advice remains key. Martina and George continue to head up Phoenix and Cinder, respectively, and Martina also oversees PRI as a whole.

PRI did not acquire Sparky, choosing to focus instead on the Phoenix and Cinder brands. Phoenix is in the process of closing its suburban locations because they are unprofitable and no longer fit with PRI's vision. Accepting that online shopping is a reality it must embrace, PRI created a website for Phoenix and is now making longer-term decisions regarding Phoenix's and Cinder's online presence. To avoid the problems experienced with their venture into suburban stores, the move to online must be well executed. The decision to close stores and reduce Phoenix's size has increased the need to grow PRI through online sales in Canada, and possibly into the U.S. and international markets.

There continues to be increasing pressure on margins in the retail industry. This is partly due to the increased popularity of online shopping and to consumers' ability to use technology to research prices and find deals. High-end U.S. retailers are also opening stores in Canada where customers can still have a face-to-face experience. Specialty box stores are starting to open satellite locations in small centres, where many Cinder stores are located. The economy is stable, but the Canadian dollar has lost value relative to the U.S. dollar.

Phoenix proceeded with the sale and leaseback of its flagship Vancouver store. Phoenix obtained good rates and the option to repurchase the property at the end of the 10-year lease. Having the repurchase option made the decision easier; however, there are still many issues to resolve with respect to Phoenix's real estate holdings.

There is concern about the quick pace of change in the industry and the relationship between the online and storefront aspects of PRI's business. Martina is particularly interested in ensuring that decisions in these two areas are made with long-term success in mind. She asks you to advise her, and the board, on whether they are moving in the right direction and on the decisions to be made. Excerpts from the discussions with Martina are included in Appendix I.

INDEX TO APPENDICES

APPENDIX I
EXCERPTS FROM CPA'S DISCUSSIONS WITH MARTINA

Online Shopping

The decision not to proceed with Sparky or its online shopping system was a tough one. Ultimately, its corporate culture differed too much from PRI's, and we were concerned about the data breach that had occurred. This seems to be a common concern for online sales, and other large retailers have experienced similar events. Despite this, I am now convinced of the need for an online presence. As a result, we moved into online shopping.

As you know, Phoenix is one of the few online retailers that serves the Canadian market exclusively. This strategy allows us to fulfill our original mission of "being a hallmark retailer in the Canadian market, with strong traditions and values" while becoming more accessible to a wider market. Our mission statement now reflects the online addition: "Our mission is to serve our customers through our stores by providing a high-quality retail experience. The experience is tailored to meet the needs of Canadians by providing value, quality, choice, and service they can trust. *From in-store to online, we make it easy for Canadians to shop with us*."

In an effort to be online quickly, we rather impulsively entered into an 18-month contract with a service provider, Express Site (Express). With Express, we have put approximately 25% of Phoenix's product line on our website, and we should have the remainder up before the end of the contract. We also want to develop an online presence for Cinder. Once Phoenix's site is fully operational, we will begin bringing Cinder online. We are considering creating "sister sites" and linking the websites so that when a customer visits one site, there is a link to the other, and orders can be combined in one virtual shopping basket and processed with one checkout.

The Express contract expires on June 30, 2018, unless we renew it. We need to decide whether to continue with Express. We have another proposal, from Alpha Shop (Alpha). Both proposals are outlined in Appendix II. While we have been happy with many aspects of Express's service, there have also been issues (Appendix III).

We want to be personal with our customers, even online. There is a lot of opportunity to use technology to target our customers. We think marketing campaigns that cater to our customers' individual needs directly would engage them and benefit our sales. A recent survey of both Phoenix and Cinder customers might help with your analysis (Appendix IV).

The reality is that we need a strategy for e-commerce across PRI. For both Phoenix and Cinder, we must decide how to best approach our clientele.

APPENDIX I (continued)
EXCERPTS FROM CPA'S DISCUSSIONS WITH MARTINA

Warehousing and Distribution – Online Sales

We started closing Phoenix's suburban locations a few months ago and, in order to quickly start online sales for Phoenix, began using our Winnipeg location as a temporary warehousing and distribution centre. Putting staff out of their jobs is not something we like to do. Using this location enabled us to reduce the number of layoffs. If feasible, I would like to continue to use the Winnipeg location for our online orders, but I recognize that its physical layout is not conducive to stocking products so they can be efficiently located, packaged, and readied for customer delivery.

Orders are processed at the Winnipeg warehouse in one to two days, and shipping times range from one to seven days, depending on the customer's location. Shipping from Winnipeg to locations such as Newfoundland is proving to be slower than we thought. I expect that modifications can be made to increase the efficiency and speed up the processing time but am not sure.

Our stores could perhaps be used for online distribution, but they would require renovations in order to accommodate the additional inventory and processing functions. Customer orders would be sent from the closest store with available inventory, so there would be no regional differences to contend with. Processing time from the stores is expected to be three days, since they are not dedicated to this service exclusively, and shipping times would likely range from one to three days, depending on the location of the inventory and the customer's location.

As we get the remaining Phoenix inventory on the website and establish Cinder's website, we anticipate that online sales will continue to grow. We also need to consider any impact from offering free shipping or other options (Appendix V), and any potential expansion to the U.S. market.

APPENDIX I (continued)
EXCERPTS FROM CPA'S DISCUSSIONS WITH MARTINA

Other

Maggie's son Jeff recently graduated with a MBA in international business, and I hired him as the VP of e-commerce, a new position. The VPs of marketing are not happy because they think I am interfering with their area of expertise and giving preference to family members again.

Jeff's vision is to make PRI a global e-commerce retailer. He believes that we need to expand our online presence and let go of our emotional attachment to storefronts, and that we can do this while remaining true to our core beliefs. He sees us promoting Canadian products to the world, starting with the U.S., and supplying Canadians living around the globe through our online presence. He sees us developing an "app" for mobile devices and using social media for promotion and actual purchases. His ideas include shipping directly from suppliers to customers, teaming up with other businesses to reach new customers, creating an interactive web magazine, and possibly adding entertainment to our websites. According to Jeff, we are behind, catering to Generation X when we should be looking ahead to the Millennials!

At the same time, we have to decide what to do with our real estate holdings. We have deferred much needed capital expenditures because we are evaluating whether we should maintain ownership of some or all of our properties. George insists we should be expanding our real estate interests (Appendices VI and VII).

I know we need to continue to evolve, but George and Jeff have such different views about the direction PRI should be heading.

Please consider all this in your analysis of our e-commerce strategy and overall management approach.

APPENDIX II
ONLINE SHOPPING WEBSITE PROPOSAL

Express Site (Express)

Express provided Phoenix with an efficient means of getting its online site operational. Express is an American company that traditionally works with small businesses that want to establish online shopping without the level of sophistication of larger retailers.

Express set up a website, designed in collaboration with Phoenix. The basics of the website image are pre-set and unchangeable, but the store logo and brand colours can be used to customize the look.

The site's categories are organized to match the departments in Phoenix so that Phoenix's customers can easily navigate the layout to find specific items. Inventory items must be individually entered in Express's system by Phoenix, allowing Phoenix to control which items are available to customers online.

When customers find an item to purchase, they add it to their shopping cart and continue shopping until ready to check out.

There is no customer profile or login on the Express site. Customers simply enter a shipping address. Express's checkout system relies on a partnership with FriendlyPay, an online payment service that provides security over payments and a customer guarantee. When customers check out, they are directed to FriendlyPay to submit their payment and are then redirected back to the main site. The FriendlyPay system provides additional controls over the customer's payment information.

Once their order has been submitted, the customer receives an email confirming the order and the amount charged to their credit card. Because the Express platform is unable to synchronize with Phoenix's inventory system, customers receive a second email within 24 hours, confirming that the product is available and providing the anticipated delivery date. If not available immediately, the item's anticipated delivery date is provided based on when it will be restocked.

Phoenix paid $1.25 million upfront to Express for the establishment of the site, which commenced operation on January 1, 2017. An additional $250,000 was paid for the inclusion of the first 25% of inventory items, with the remaining 75% still to be included at an additional cost of $750,000. After 18 months, an ongoing annual maintenance fee of $175,000 is required, and the contract is renewable on a yearly basis at Phoenix's discretion. If Cinder were to use Express, it would incur an additional set of fees, including the upfront payment, the fee for adding inventory, and the ongoing maintenance fees.

Express is capable of adding U.S. versions of its sites. This would require the creation of a separate site, and it would incur an additional set of the fees listed above for each U.S. site.

APPENDIX II (continued)
ONLINE SHOPPING WEBSITE PROPOSAL

Alpha Shop (Alpha)

Alpha is a Canadian IT company specializing in online shopping platforms, mobile applications, and social media. Known as a leader in the industry, Alpha has built its reputation by gaining shoppers' trust and by providing retailers with an easy-to-use system. Each site is customized to reflect the image of Alpha's client company. Alpha aims to reflect online the in-store experience that shoppers are accustomed to. Alpha can customize separate sites for Phoenix and Cinder or, at a reduced rate, can use the same format for both. It can also link the two sites, allowing customers to create one profile and combine orders from both stores.

When a customer enters an Alpha-created site, they are provided with an overview of the store's departments, easy access to the weekly promotions, and a handy search function at the top of the page. The search function allows customers to customize the search and to limit results within specific parameters.

The Alpha system would be synchronized with PRI's inventory so that items are automatically included on the site and customers are aware of inventory levels when shopping. PRI can also choose not to sell certain items online, in which case store inventory details will be provided, but customers will be unable to order the product from the website.

Customers can further improve their individual shopping experience by setting up a profile. The profile includes the customer's billing address and phone number, as well as an option to add additional mailing addresses. Customers can choose to enter their payment information and have it stored in their profile. Alpha's system will track all shopping history and use the information to predict other products that customers may like. PRI could use this information to target customers through direct marketing. For example, a customer who has viewed jewellery and accessories one day may receive an email the next day about similar products.

When a product is selected, customers add it to their shopping cart. Once the customer is ready to check out, the system prompts the customer to either log in using their profile or continue as a guest. Customers review the order before confirming the purchase. PRI has the option to store the credit card information for future use. The system compares the billing address to the address for the credit card entered, which verifies that the card belongs to the user ordering the product. Upon completion of the order, a confirmation email is sent, including an anticipated delivery date. Customers can also log into their account for up-to-date tracking information.

Alpha requires a five-year contract and provides the option of a five-year renewal term. Development of sites for both Phoenix and Cinder would cost $2.6 million in total, with a $1-million annual fee.

Alpha's website is easily convertible to U.S. currency, handles different tax rates, and any shipping options.

APPENDIX III
ONLINE FEEDBACK ON CURRENT PHOENIX WEBSITE

Glad you finally have online shopping available! I like to purchase items in your store, but it was nice to be able to research it online. I was surprised by the selection, though – it seems that you have more available in the store. The site itself seemed rather amateurish in comparison to the quality I expect and associate with Phoenix.

– Shop-a-holic

I ordered a product online for a gift, only to find out a few days later that you don't have it in stock. Now my sister's gift will be late! I didn't even have the option to cancel the order when I discovered this. Unacceptable.

– Mad Sis

I ordered a sweater, which arrived on schedule. I am nervous shopping online, but I trust FriendlyPay, and this made the experience feel secure. Thanks!

– Secure Spender

I loved the free shipping! I will definitely use Phoenix for all future online purchases. It's a great way to send gifts to relatives across the country without additional costs. I also love that you are exclusively Canadian. I am happy to support you!

– Family Afar

The FriendlyPay steps were cumbersome. I disliked having to set up another account! Why can't I just pay you directly? It would be faster.

– Speedy Shopper

I was excited about the site, but the process was quite slow and not comparable to other retailers. I expected more from Phoenix. Not knowing if goods are in stock means I won't be ordering from you.

– High Expectations

Your products are great! I am moving to the U.S. shortly. With online shopping, there is no reason not to expand outside of Canada! My American family had never heard of Phoenix, but I know they would love you.

– Loyal and Hopeful

APPENDIX IV
ONLINE SHOPPING SURVEY

The following survey was provided to both Phoenix and Cinder shoppers. Shoppers were asked to provide an answer on a scale of (1) to (5), with (1) being “strongly disagree” and (5) being “strongly agree.”

The average results were as follows:

	Phoenix	**Cinder**
You regularly use a computer with online access.	4.0	4.9
You frequently (more than six times a year) purchase items online.	2.1	4.0
Before purchasing an item in a store, you research it online.	1.9	3.1
You are comfortable providing information online.	1.9	3.5
Technology invading your privacy is a concern to you.	4.2	3.0
You prefer a website that remembers your information.	1.5	4.1

In addition, customers were asked to provide feedback on what the most important aspects of an online shopping website are to them.

The most common replies were as follows:

Phoenix	**Cinder**
▪ Same experience as in the store	▪ Product information on what is in stock and pricing by store
▪ Ease of purchase	▪ Personalized shopping
▪ Ease of returns	▪ Ease of returns
▪ Security	▪ Navigability

APPENDIX V
SHIPPING AND RETURN POLICIES

Believing in customer service and wanting to maintain a high-end feel, Martina felt that charging for shipping would not meet the expectations of Phoenix's customers. In the current year, all orders were shipped for free. Goods could be returned within thirty days, and customers either returned the goods free of charge to a store or paid for any shipping incurred. Phoenix experienced a quick online ordering uptake, since it allowed customers to purchase goods with little risk.

Approximately 25% of total online orders are currently being returned. This has been frustrating, as Phoenix has historically experienced much lower return rates. The cost of shipping goods is high, particularly when shipping out of Winnipeg. When goods are returned, Phoenix loses the sale and incurs shipping and restocking costs, which is negatively impacting its margins.

Martina has had the marketing department analyze the impact of various shipping options on the volume of sales. She is considering three options: maintaining the free shipping on all orders, providing free shipping on orders of $50 and over, or charging all shipping costs directly to the customer. Ignoring the returns, the estimated 12-month projections for each option are as follows:

	Free Shipping	Free Shipping on Orders of $50 and Over	Shipping Billed to Customer
Number of orders of $50 and over	50,890	75,200	48,362
Number of orders under $50	60,765	13,564	12,975
Total expected revenues*	$ 13,081,000	$ 16,376,000	$ 11,117,000
Total expected COGS*	7,848,000	9,825,400	6,670,200
Margin on orders	$ 5,233,000	$ 6,550,600	$ 4,446,800

*On average, shipping costs are $20 for orders of $50 and over, and $9 for orders under $50. Shipping costs are expected to decrease if shipped from locations closer to the destination, rather than from Winnipeg. In the above table, revenues and cost of goods sold exclude the shipping.

Approximately 75% of orders are from customers residing less than 100 kilometres from a Phoenix store.

Martina would like your assessment of these alternatives. Additionally, she wonders if Cinder should follow the same approach or consider a different policy. If U.S. sales proceed, the preference is to use the same policy for both countries.

APPENDIX VI
NOTES FROM MEETING WITH GEORGE

Just because we decided not to pursue the REIT idea does not mean we should ignore our real estate holdings entirely. Most of our returns have been generated through our real estate. For example, our Toronto retail centre had a $400 million fair market value five years ago, and it is now valued at $700 million (Appendix VII).

The increase in real estate values makes it tempting to sell all our properties. But PRI would then be strictly a retail operation, which, in my opinion, results in us being less diversified and exposed to higher business risk. While Jeff is all about e-commerce, I think real estate and e-commerce can and should support each other.

While we have started closing Phoenix's suburban stores, the downtown stores are part of our history, so upgrading them is important. I think we should also upgrade the two malls we own and use the rental income as a stable revenue source. Converting the retail space in our Winnipeg mall to a warehouse means there is no longer an anchor tenant, which may reduce the mall's attractiveness to other retailers.

PRI should acquire additional commercial rental property in the downtown cores of cities where we currently have stores, and it should look at buying suitable buildings for a store in Halifax and St. John's, so we have stores from coast to coast.

I have updated the information on our Phoenix properties, including their fair values, mortgages, and capital expenditures (Appendix VII). I am convinced that real estate is the only thing guaranteed to provide a good rate of return and increase in value over time. In the past few years, the Toronto retail centre has increased in value by almost 20%. We should have no problem getting mortgages to fund the capital expenditures required and to acquire more properties. We have $1,400 million in equity from our properties that should be easily convertible to cash. If we use the properties as security for a mortgage, the interest rate should be low and we can choose a long amortization period. I plan to get the capital expenditures underway as soon as possible.

In the past, we bought properties for the purpose of opening stores and did not focus on managing the properties as a stand-alone business. I propose that we change that — we should be increasing the number of properties we own, not divesting.

APPENDIX VII
BACKGROUND INFORMATION ON PHOENIX PROPERTIES
(in millions of dollars)

		FMV	Historical Cost	Mortgage	Capital Expenditure Estimates	
					Year	**Amount**
Toronto	Retail centre	$700	$120	$0	2018	$28
Calgary	Retail centre	$490	$300	$104	2018	$13
Montreal	Building	$4	$1	$0	2018	$1
Edmonton	Suburban mall	$300	$375	$90	2019	$20
Winnipeg	Suburban mall	$90	$125	$0	2019	$30
Total		**$1,584**	**$921**	**$194**		**$92**

The mortgages mature in the following years:

Montreal	2018
Edmonton	2029
Calgary	2033

APPENDIX F

DAY 1 (PRI VERSION 2) – SEPTEMBER 13, 2017
MARKING GUIDE AND SAMPLE CANDIDATE RESPONSE

MARKING GUIDE
PHOENIX RISEN INCORPORATED (PRI)
VERSION 2

Summative Assessment #1 – Situational Analysis (Update)

For Summative Assessment Opportunity #1, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate used a reasonable situational analysis when analyzing the major issues facing Phoenix/Cinder/PRI.

Unsure – The candidate attempted to use a reasonable situational analysis when analyzing the major issues facing Phoenix/Cinder/PRI.

No – The candidate clearly did not use a reasonable situational analysis when analyzing the major issues facing Phoenix/Cinder/PRI.

Competencies
2.3.2 Evaluates the entity's internal and external environment and its impact on strategy development

Enabling:
2.1.1 Defines the scope of the problem.
2.1.2 Collects and verifies relevant information.
2.1.3 Performs appropriate analyses.

Competent candidates should complete a sufficient situational analysis. The focus should be on describing the factors that have changed, the factors that will affect the decisions to be made (e.g., new VP of e-commerce, Phoenix closing stores, different views of family members, etc.), and the key factors that are relevant to the decisions to be reviewed. A recap of any of the mission/vision, relevant KSF, and relevant elements of the SWOT is appropriate.

Mission and Vision Points

PRI's vision statement is as follows (from Cap 1):
"We make it easy for Canadians to shop with us."

The company's mission statement is as follows (from Cap 1):
"Our mission is to serve our customers through our stores by providing a high-quality home and fashion retail experience. The experience is tailored to meet the needs of Canadians by providing quality, choice, and service that can be trusted."

PRI's mission statement is updated to reflect the online aspect of retail business: *"Our mission is to serve our customers through our stores by providing a high-quality retail experience. The experience is tailored to meet the needs of Canadians by providing value, quality, choice, and service they can trust.* ***From in-store to online, we make it easy for Canadians to shop with us.****"*

Key Objectives

- Maintain target from 2016 (*Cap 1: ROI of a minimum of 8% over 5 years if Phoenix moved online.)*
- Create a strategy for e-commerce that meets the core values *(Cap 1: PRI prides itself on building employee relationships and treating customers with respect, in order to gain loyalty.)*
- New – Consider a potential expansion of PRI's business: Jeff wants to expand PRI's online presence globally, starting with the U.S., and George wants to expand PRI's business through real estate holdings.

Candidates are NOT expected to recap all the KSFs and SWOT in detail – they may draw upon these in their Day 1 case analysis to highlight important elements and changes.

<u>Key success factors (from Cap 1):</u>

- Maintain high margin per square foot in each store
- Maintain the reputation as a generous company, with high standards and strong moral values
- Quickly respond and ship (online sales)

<u>New information from Day 1</u>

Strengths:

- Vancouver property – Phoenix proceeded with the sale and leaseback of its flagship Vancouver store. Phoenix obtained good rates and the option to repurchase the property at the end of the 10-year lease, freeing up cash.
- Online sales/e-commerce is being pursued for Phoenix, which created a new revenue stream for the company and helped PRI be more competitive in the retail industry. PRI is also considering expanding online business to Cinder.
- Mission was updated to add online to it – reflects PRI's commitment to the online store concept and keeps PRI up with market trends.
- PRI did not acquire Sparky because of the data breach that had occurred – this helped PRI to protect its reputation.
- PRI started closing Phoenix's suburban stores, which enabled PRI to focus on downtown stores and other business opportunities, even though it lost the cash flow/profits from closing.

Weaknesses:

- Conflicting views between family members – George and new VP of e-commerce (Jeff) have conflicting strategic views.
- PRI tends to be reactive to trends and issues (based on Cap 1 and Day 1).
- There are still many issues to resolve with respect to Phoenix's real estate holdings.

Opportunities:

- The expansion and shifting to e-commerce and websites (as an add-on to stores) and the potential use of social media and shopping apps.
- The economy is stable.

Threats:

- There is increasing competition and pressure on margins due to the increased popularity of online shopping and to consumers' ability to use technology to research prices and find deals.
- Specialty box stores are starting to open satellite locations in small centres, where many Cinder stores are located.
- High-end U.S. retailers are also opening stores in Canada, where customers can still have a face-to-face experience.
- The Canadian dollar has lost value relative to the U.S. dollar.

Summative Assessment #2 – Analyzes the Major Issues

For Summative Assessment #2, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate completed a reasonable assessment of the major issues facing PRI.

Unsure – The candidate attempted to complete a reasonable assessment of the major issues facing PRI.

No – The candidate clearly did not complete a reasonable assessment of the major issues facing PRI.

Competencies
2.3.3 Evaluates strategic alternatives

Enabling:
2.1.3 Performs appropriate analyses.
2.1.4 Integrates information to investigate each potentially viable solution or conclusion.

This summative assessment is based on Assessment Opportunities #2 to #5.

Assessment Opportunity #2 (Strategic Issue #1 – E-commerce System/Strategy for Phoenix and Cinder)

Competent candidates will complete both a qualitative and a quantitative assessment of each alternative.

Quantitative analysis – *Compare the cost of each option (Express versus Alpha).*

Qualitative analysis – *Candidates are expected to evaluate the online shopping website choices and PRI's online sales strategies. They should recognize the needs of both Phoenix and Cinder and identify ways in which the customer bases differ. Candidates need to be sensitive to the fact that Phoenix's customers are less comfortable with technology and more protective of their privacy. Cinder's clients will, therefore, be more receptive to aspects such as having a profile and providing direct marketing information. Candidates should analyze and highlight the ways in which Alpha will improve the shopping experience for customers and should recommend the software option that PRI should employ (integrate with social media, etc.) using their situational analysis (links to mission, vision, values, etc.). Candidates could also consider the privacy issues.*

In terms of strategy, candidates should consider the possible expansion into the U.S. market and the possibility of going global.

Quantitative Analysis

Quantitative analysis – Candidates should compare the investment amounts provided and comment on the total investment required for each website.

- The $1.5 million ($1.25 million upfront costs + $250,000 inventory costs) spent on Express is a sunk cost (should not be part of the decision).
- The following is the comparison of the investment amounts. Candidates could have done a net present value over 5 or 10 years, depending on the period they decide to compare the two investments over. If they did, they should have supported the use of the rate chosen. Ideally the rate was one of the rates cited in the Capstone case (link to Cap 1).

<u>Express</u>

Phoenix site:	
Inventory costs	$ 750,000
Cinder site:*	
Upfront payment	$1,250,000
Inventory costs	$1,000,000
Total upfront fees/investment	$3,000,000
Annual maintenance fees	$ 350,000

**Adding a U.S. site would have the same cost.*

Alpha

Upfront investment	$2,600,000
Annual maintenance fees	$1,000,000

Note: Express is a U.S. company. We have to take into account the risk of the US$ exchange rate. The project could cost more.

The capital costs are fairly close. The key difference is the yearly maintenance costs. Express appears to be the better choice based strictly on the comparison of fees, depending on how many sites are set up. If PRI decides to proceed with sites for Cinder and the U.S., then the costs are much closer. Therefore, the choice appears to be driven by qualitative decision factors.

Qualitative Considerations

Qualitative analysis – Candidates should discuss the pros and cons of pursuing each option (Express vs. Alpha), highlighting the risks and benefits, including some integration back to the situational analysis.

Key points from Cap 1 that could be integrated:

- Phoenix and Cinder serve very different/distinct markets.
- Phoenix clientele are hesitant to use technology.
- The importance of online, web-based sales in this market
- Useful features in each website can be linked to "excellent customer service" mission.

Key points from Day 1 case that could be integrated:

- Security risks – PRI did not acquire Sparky because of the security breach. Higher risk of security breach could damage the company's reputation or brand image. Direct marketing feature and personal profile being maintained may increase the security risk.
- PRI is considering the U.S. expansion – the features on each website (e.g., ability to handle U.S. transactions) would be helpful for the expansion.
- Customer surveys (Appendix III and IV of Day 1 case):
  - Survey results show differences between Cinder and Phoenix – Express is a better website for Phoenix clientele (e.g., higher security), and Alpha is a better website for Cinder clientele (e.g., faster, has search function).
  - Future directions of the online shopping and e-commerce strategies for Phoenix and Cinder can be discussed. For example, Phoenix customers do not purchase online as much; therefore, PRI should first focus on online shopping for Cinder clientele.
  - The Express website cannot be customized, and a customer mentioned that the website is amateurish. This does not align with PRI's high-end brand image.
  - The Express website cannot be synchronized with the Phoenix inventory system. Customers are unhappy with the inventory system, and this does not align with PRI's value of keeping customers happy.

<u>Additional considerations candidates could discuss:</u>

- Stakeholders preferences:
  - Alpha is a Canadian IT company specializing in online shopping platforms, mobile applications, and social media, and Jeff wants to develop an "app" for mobile devices and using social media for promotion and actual purchases.
  - Alpha can link two websites (i.e., Phoenix and Cinder sites), and Martina wants to create "sister sites" and link the websites.

Assessment Opportunity #3 (Strategic Issue #2 – Distribution Strategy)

Candidates are expected to highlight the advantages and disadvantages of the distribution alternatives. Candidates are also expected to advise Martina as to the shipping policy that they see as the best fit for Phoenix.
Candidates should make logical assumptions and integrate their previous analysis (i.e., situational analysis and/or e-commerce strategy discussion).
Candidates should recommend an approach that best suits their analysis of the options. Stronger candidates will recognize that the distribution and shipping discussions are linked (decisions regarding shipping will affect distribution and vice versa; i.e., speed of delivery).

<u>Shipping Alternatives</u>

Quantitative analysis – Candidates are required to analyze the shipping options presented to determine which provides the most financial benefit to Phoenix.

Quantitative Analysis

	Free Shipping	Free Shipping on Orders Over $50	Shipping Billed to Customer
Number of orders over $50	50,890	75,200	48,362
Number of orders under $50	60,765	13,564	12,975
Total orders	111,655	88,764	61,337
Average shipping cost to Phoenix – over $50	$20	$20	$ 0
Average shipping cost to Phoenix – under $50	$ 9	$ 0	$ 0
Shipping on orders over $50	$ 1,017,800	$ 1,504,000	$ 0
Shipping on orders under $50	546,885	0	0
Total shipping costs paid by Phoenix	**$ 1,564,685**	**$ 1,504,000**	**$ 0**
Total expected revenues	$ 13,081,000	$ 16,376,000	$ 11,117,000
Total expected COGS (excluding shipping)	7,848,000	9,825,400	6,670,200
Margin before shipping	$ 5,233,000	$ 6,550,600	$ 4,446,800
Cost of shipping (above)	**1,564,685**	**1,504,000**	0
Margin after shipping	**$ 3,668,315**	**$ 5,046,600**	**$ 4,446,800**
Incremental margin to current (free shipping)	$ 0	$ 1,378,285	$ 778,485

Candidates could also include an estimated cost for returns in their analysis.

Based on the quantitative analysis alone, it appears that the best decision is to charge shipping on orders under $50.

Qualitative analysis – Candidates are expected to discuss which shipping option is the best fit from a customer service perspective. Because the company client bases are different (Phoenix vs. Cinder), candidates should identify that using the same approach in Cinder is not necessarily appropriate. Candidates may recognize that Cinder will require a separate analysis.
Strong candidates will also consider the relationship between the distribution decisions and the shipping decisions.

Qualitative Considerations

Qualitative analysis – Candidates should consider the information in the situational analysis (integration) and discuss distribution options (the different shipping options).

Key points from Cap 1 that could be integrated:

- The Legault family places great emphasis on ensuring that their reputation with customers is high by providing friendly service, easy returns, and a general sense of doing their best for customers at all their stores. PRI as a family of stores believes that the customer is always right and that keeping a customer happy means they will come back. Free shipping would support this value.

Key points from Day 1 case that could be integrated:

- Controlling costs is important due to increased pressure on margins.
- Discuss the high rate of returns and relationship to free shipping (25% returns). Free shipping will increase orders from the customers who may not be serious about purchasing products. This may increase additional costs and administrative or logistic work.
- Discuss the difference between Phoenix and Cinder clients – Cinder customers may be more sensitive to the pricing (survey shows this), so PRI may need separate analysis or a different approach.
- Discuss U.S. policy – Martina wants to use same policy if they move to the U.S.; discuss how U.S. expansion may affect the shipping policy.

Additional considerations candidates could discuss:

- Discuss opportunity for upsell – for example, customers may order more products to get the free shipping on $50-or-more purchases.
- Discuss use of a different distribution arrangement that might help reduce costs (could consider outsourcing option in Cap 1).
- Could comment on the order limit of $50 being too low or consider higher minimum sales (e.g., $100 before free shipping applies); Phoenix customers may have more disposable income.

Warehouse Alternatives

Qualitative Considerations

Qualitative analysis – Candidates should consider the information in the situational analysis (integration) and discuss distribution options (Winnipeg warehouse vs. in-store distribution).

Key points from Cap 1 that could be integrated:

- Key success factor – “Being able to quickly respond and ship is key to success in on-line sales.” Candidates should discuss delivery speed from Winnipeg versus in-store distribution.
- PRI value – “PRI continues to treat staff with respect. The family believes that for customers to be treated well, staff need to be treated well first.” Using the Winnipeg location enabled PRI to reduce the number of layoffs.

Key points from Day 1 case that could be integrated:

- Mission – Tie distribution needs to mission of offering "ease of shopping." Customers could easily return their purchases if each store had a distribution centre.
- 75% of the orders are made by clients living within 100 kilometres of a store (case Appendix V), so if PRI decided to ship from the stores, costs and delays could be reduced. However, PRI would need to be able to manage inventory at each store since there would not be just one warehouse to manage.
- Threat – There is increasing competition and pressure on margins, so cost control is key to the success of PRI.
- Stakeholder – Martina expressed wanting to keep the Winnipeg warehouse open if feasible.
- Integrate the online systems discussion, shipping discussion, and desire to enter the U.S. market (INTEGRATION); e.g., location of warehouse affects shipping costs – Alpha website allows the customers to combine orders from both Phoenix and Cinder stores. This could be a potential issue because it will require a large distribution centre that carries stores both lines of products; also, delivering products from the different retail stores may create issues (e.g., cost, system configurations, accuracy, efficiency).

Additional considerations candidates could discuss:

- Consider other options, like Jeff's idea of shipping directly from supplier to customer (e.g., pro: PRI does not need to carry inventory – eliminate inventory costs and inventory risk; con: link to mission – PRI may lose quality control if it goes with direct shipping from the customers); a U.S. warehouse to service U.S. market, etc.
- Discuss other valid pros and cons of distribution from the Winnipeg warehouse (e.g., Cap 1 – affects foot traffic in mall if there's no anchor tenant).
- Discuss other valid pros and cons of distribution from the stores (e.g., renovations are required for the stores, which may interrupt the business; additional costs are required for the renovations, which may increase pressure on margin).

Assessment Opportunity #4 (Strategic Issue #3 – Real Estate–Related Decisions)

Candidates are expected to analyze the real estate decisions and the relationship with the e-commerce decisions. Candidates should discuss the risks and rewards related to the real estate part of the business. Candidates should recognize that the route George is proposing with respect to real estate development is a change from the past (and current mission of PRI). Strong candidates will integrate this discussion with their earlier warehousing/shipping discussion.

Qualitative Considerations

Qualitative analysis – Candidates should consider the information presented in Appendix VII and discuss the risks and benefits of expanding PRI's real estate holdings. Candidates could suggest ways the real estate holdings could be used to address the distribution issue.

Key points from Cap 1 that could be integrated:

- The Toronto retail centre's value has increased by $300 million in the last 5 years. Its return on investment is 12% over the 5 years, and that is higher than the minimum of 8% return on investment.
- May discuss or calculate mortgage balances and capital expenditure requirements to figure out how much leveraging room there is (conclude: significant amount can be financed). [Note: It is not clear in Cap 1 if the 75 Cinder stores are owned or leased.]
- Properties require large capital expenditures to renovate.
- Since online shopping is growing, it may not make sense to focus on the real estate business; on the other hand, high-end retailers are opening stores, so it may make sense.

Key points from Day 1 case that could be integrated:

- Having additional owned properties is a different strategy from the past. Candidates may question whether this option aligns with the current mission (i.e., PRI's mission is to be a hallmark retailer in the Canadian market) or whether it fits PRI's core competency; candidates may consider if PRI has the required competencies to compete.
- George thinks that holding real estate will result in diversification and less risk – fails to consider that real estate in retail sector is closely tied to core business, which reduces diversification.
- Divesting of the real estate would provide very significant cash flows, which could be used to fund other investments, or the cash could be returned to shareholders for other investment opportunities – this should be done if these new investments provide a higher return than the real estate on a risk-adjusted basis.
- PRI can use the rental income as a stable revenue source, which may help address the high pressure on margins.

Additional considerations candidates could discuss:

- George is correct that PRI has a large capacity for debt; however, he does not consider other risks such as risks of borrowing cost/interest rate fluctuations, uncertainties of real estate value (he assumes values will always increase – although this has been the trend in recent years, there are times when property values decline in some locations).
- Candidates may question:
  - PRI let real estate get "run down" in the past. What will it do differently this time?
  - PRI just sold the Vancouver store, did not pursue the REIT, and in the past has not been good at real estate – why go into real estate now? What has changed in terms of goals/objectives, etc.?
  - How would PRI manage additional real estate holdings?

Currently, property development is not part of the mission of PRI. If management wants to proceed down this path, then it is a change that affects the mission and is something that likely should be considered by the board, not just George. The board needs to be the one to decide on the bigger question of online versus storefronts, not Jeff or George on their own.

Assessment Opportunity # 5 – (Minor Issues – Family Conflicts/Nepotism/U.S. Expansion)

Candidates could also address the conflicting views of George and Jeff regarding the e-commerce side of the business and the storefront side. Candidates should also recognize that there are family tensions/nepotism, that PRI's focus has been on short-term decision-making rather than a long-term strategy (proactive versus reactive/catch-up), and that there is a need for a more formal process to hire new generations of the family. Candidates may discuss the alternative of U.S. expansion. Candidates should provide PRI with advice on these issues.

Qualitative Considerations

Family members' conflicting views:

- Discuss the differences in opinion between Jeff and George on the future direction of the company and how this potential conflict could escalate (Cap 1 conflict in past between Martina and Jennifer).
- Recognize that the mission may need to be updated to better reflect whichever direction is chosen (moving to more online sales versus real estate development).

Family favouritism

- Discuss the risks of nepotism (treating family members with favouritism; e.g., VPs are upset over the hiring of a new business grad and family member, Jeff) – it undermines the value of treating employees fairly. Make suggestions to address the issue.

Potential U.S. expansion

- Discuss pros and cons of the U.S. and then global expansion; e.g., consider competition in Canada (U.S. market could be more competitive; however, other geographical areas could be a better option); PRI has been focused on Canadian market and its mission is to serve Canadians. PRI may have a better opportunity to expand into the U.S. market with online business.

Additional considerations candidates could discuss:

- Board decision-making – recognize that PRI, led by Martina, has made some decisions that were impulsive/reactive; e.g., impulsively signed with Express (does not appear to have thought through the issue; why did they implement in Phoenix when Cinder is better suited to online?). The board needs to be thinking longer-term and develop long-term strategies that anticipate market changes.

Summative Assessment #3 (Conclude and Advise)

For Summative Assessment #3, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate provided reasonable conclusions for each major issue.

Unsure – The candidate attempted to provide reasonable conclusions for each major issue.

No – The candidate clearly did not provide reasonable conclusions for each major issue.

Competencies
Enabling:
2.1.4 Integrates information to investigate each potentially viable solution or conclusion.
2.1.5 Recommends and justifies a solution or conclusion based on an integrative view of information for the situation.

Competent candidates will complete a logical conclusion that is consistent with their analysis.

Candidates are asked to advise on whether PRI is moving in the right direction. The case focuses on the development of a long-term strategy for e-commerce.

The focus of this case is on e-commerce and the conflict with keeping storefront real estate. Candidates should recognize that the decisions made throughout the case interlink. They should also recognize the need to make e-commerce an integrative part of the business and take steps to foster cooperation between the real estate operations and the e-commerce side. Candidates should provide advice that is consistent throughout their response and that outlines the steps that PRI should take going forward. PRI seems to be moving in the right direction. Candidates should clearly recognize that the online business and shipping decisions revolve around PRI's need to be able to control shipping costs while providing the high level of service that is expected. Candidates should link their recommendation to both cost and customer expectations. Candidates should address the risks of entering the U.S. market without proper research being done first.

Candidates should provide a conclusion for each of:
A) E-commerce strategy (Express versus Alpha)
B) Distribution strategy (warehousing and shipping policy)
C) Real estate holdings (questioning George's assumptions; alignment with mission)
D) PRI's "direction"

Strong recommendations should

- consider PRI's vision, mission, objectives, and constraints, as well as PRI's internal and external environment.
- recognize that Phoenix and Cinder are very different.
- be consistent with the analysis performed.
- present to provide a sense of completion to the report (a wrapping-up/prioritization of the recommendations/step back and consider the big picture).
- present good professional judgment. Suggesting that further information is required is acceptable as long as it is justified and consistent with the analysis.

Summative Assessment #4 (Communication Hurdle)

For Summative Assessment #4, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate adequately communicated his or her response.

No – The candidate did not adequately communicate his or her response.

Insufficient communication in a candidate's response generally includes some of the following:

- The reader needs to re-read sections several times to gain an understanding.
- It is not clear what point the candidate is trying to make.
- The quantitative analysis does not make sense because of a lack of labelling or illogical ordering.
- There is an offensive amount of spelling and grammatical errors.
- The language used is unprofessional.

Summative Assessment #5 (Overall Assessment)

For Summative Assessment #5, the candidate must be assessed in one of the following, based on their overall performance:

Clear Pass – Overall, the candidate provided an adequate response clearly meeting the minimum standards for each of the summative assessments above.

Marginal Pass – Overall, the candidate provided an adequate response, with some errors or areas of omission, but including the underlying key concepts.

Marginal Fail – Overall, the candidate provided an attempt at a response, with several errors or an incomplete analysis.

Clear Fail – Overall, the candidate did not provide an adequate response because the response was deficient in multiple areas.

To be assessed a Pass, candidates are expected to perform adequately in all the summative assessments and demonstrate that they addressed the issues of importance in a cohesive, professional manner.

Markers were asked to consider the following in making their overall assessment:

1. Did the candidate step back and see the bigger picture, and then address the broader issues identified?
2. Did the candidate prioritize the issues by discussing the major and minor issues in appropriate depth?
3. Did the candidate use both quantitative (when available) and qualitative information to support their discussions and conclusions?
4. Did the candidate use the appropriate tools to perform quantitative analysis?
5. Did the candidate use sufficient case facts (current case and Capstone 1 case) about the external and internal environment to support their discussions?
6. Did the candidate communicate their ideas clearly, integrating and synthesizing the information?

SAMPLE RESPONSE – PRI VERSION 2

Below is an actual passing candidate response.

To: Martina

From: CPA, management at PRI

Re: PRI online strategies and other issues

Date: Jan 14, 2018

Situational analysis

External environemnt

Opportunities

- Canadian economy is stable, so consumers has stable income for retail purchases
- Canadian dollar has lost value relative to US dollar, so it could benefit PRI if it decides to expand into US, since US consumers can buy the goods at a lower cost

Threats

- Retail industry is facing increasing pressure on margins, due to consumers researching to find the lowest price, which decreases profitability of online sales
- Online shopping is very popular, meaning more competition for PRI in this space
- High end retailers are opening stores in Canada to give consumers a face-to-face experience, which may decrease interest in purchasing online
- Speciality box stores are opening in towns where Cinder stores are located, which may decrease Cinder's physical stores's foot traffic and market share

- Data security breach is a common concern for online retailers, and many large retailers have experienced it

Internal environment

Strengths

- Phoenix still serves the Canadian market exclusively, which many consumers appreciate and it helps them differentiate
- Phoenix has launched online to capture the market share of online sales, and online sales are expected to continue to grow
- Vancouver sales leaseback was entered into, but REIT was not pursued
- Phoenix suburban stores were closed in order to clearly define Phoenix's brand

Weaknesses

- Current shipping for online orders from Winnipeg warehouse is slower than management anticipated, which can increase costs, and impact customer satisfaction

Stakeholders and objectives

Martina

- You are concerned with long-term success for PRI, including the online shopping division
- You are also concerned about the relationship between the online channel and physical store fronts, and how they interact

-You would prefer to maintain the same shipping policy for all contries if PRI expands into the US

George

- He wants to expand real estate interests, and maintain physical store prescence

Jeff

- He wants more online sales, and less focus on physical stores, to make PRI a global e-commerce retailer
- He has many ideas to cater to the millenial demographic, including launching a mobile app, and using social media for promotion

Financial analysis

- No information is provided for a financial analysis of PRI

<u>Strategy for e-commerce</u>

Fit with Phoenix

- Based on the customer survey, the majority of Phoenix customers do not purchase items online, and they have a general sense of distrust towards provding any kind of personal information online
- However, the Cinder customer base is more prone to shop online, and they are less guarded towards their online privacy, although they still do not fully embrace providing information online
- With this knowledge, it will be worth considering either terminating the Phoenix online presence and only launch it for Cinder

- However, with the growth of online sales, it will be critical for PRI to have an online prescence, and having a online channel for both stores will be able to attract more new customers, such as millenials, and will provide synergies
- Having an online precsence for both stores is in alignment with PRI's vision to make it easy to shop with them, therefore, both should be kept

Online website developer contract

Issue:

- A decision needs to be made on whether to renew the contract with Express, or to switch to a new contract with Alpha
- The Express contract expires June 30, 2018, so a decision is needed soon

Quantitative

- See exhibit 1
- Since you would like to develop an online site for Cinder as well once Phoenix's site is complete, costs for developing both are considered
- On a pure financial perspective, the Express contract should be renewed since it offers the lowest upront investment cost, as well as ongoing maintenance costs

Qualitative

<u>Express</u>

Pros

- The contract is assessed for renewal each year, so PRI will have more flexbility to decided if it wants to switch to another supplier in the future, in the case that this deal is not working well

- Using FriedlyPay prvides additional controls over the customer's payment information, and customers have expressed that they feel secure using this feature to shop online
- Customers do not need to create a customer profile, they only need to enter a shipping address, which suites the Phoenix customer base, who ranked very low (1.9) on the level of comfort in providing information online

Cons

- Platform cannot sychronize with Phoenix's inventory, so customers will only be informed of the product availability after they've made the purchase. This lack of inventory update function has caused many customer complaints, some of whom has said they won't be ordering from Phoenix if they don't know which items are in stock. This will decrease sales and profitability
- Even though it can create US sites, the site will be a seprarate site from the current Phoenix site, which cannot realize synergies, and customers may be confused about the multiple sights. Additional costs will also be incurred to create it, which does not support PRI's goal of expanding into US

<u>Alpha</u>

Pros

- It is an Canadian company, which alignes with PRI's value of supporting Canadian businesses, and sourcing from canadian suppliers
- Inventory is synched to PRI's system, so customers can get updates on product availability, which is a key consumer demand

- The site can be easily converted to US currency, which will make it very easy to expand into the US should PRI choose to do so
- It has the capability of building mobile apps and social media platforms, which can be helpful if these ideas are lauched under Jeff's suggestion
- It can also link to 2 sites, which will help with PRI's goal of creating sister sites between Phoenix and Cinder

Cons

- PRI will be locked in to a 5 year contract, so it will have no flexbility if something goes wrong to switch to another supplier
- The benefit of setting up an online profile that includes information such as payment information will not be useful to Phoenix customers, who are very uncomfortable with providing information online

Recommendation

- Even though the Alpha option is more expensive, it provides key features that PRI's customers demand, such as real-time inventory tracking
- Alpha also provides many features that will be helpful to PRI's future goals, such as US expansion, and sister-sites
- Therefore, it is recommeded that PRI not renew the Express contract after 1 year, and switch to Alpha
- However, it is recommended that PRI do not use the function of storing credit card info since Phoenix customers do not prefer having a website that remembers their information

- There is an option for Alpha to customize the Phoenix and Cinder sites, at an additional cost, which can be beneficial since the survey has indicated that Phoenix and Cinder customers have different attitudes towards online shopping. For example, Cinder customers would prefer to have their information remembered, such as credit cards, where Phoenix cusomers would not
- More information is needed on the cost of customizing to weigh the benefits against the costs

Target marketing campaign

Issue:

- A strategy is needed to best approach PRI's clientele

Qualitative

- If PRI switches to Alpha, it will track all the shopping history and use this information to predict other products that customers may like, and PRI can choose to use this info to target customers through direct marketing, which is something you want to look into
- However, based on the customer survey, both Phoenix and Cinder customers stated that technology invading their privacy is of high concern to them
- Therefore, this approach will likely cause customers to mistrust PRI, which is against PRI's core values of building trust with their customers

Recommendation

- Therefore, it is not recommended for PRI to use this function
- Instead, PRI will be able to provide the personal touch to online shopping through Alpah's easy to use interface, and the customizable search function

Shipping options and Winnipeg warehouse

Issue:

- A decision needs to be made on the 3 shipping options, and whether continue to use the Winnipeg warehouse makes financial sense
- A decision also needs to be made on whether to use the same policies for Cinder and the US expansion if it is pursued

Quantitative

- See exhibit 2
- From a purley financial perspective, the free shipping over $50 option should be adopted since it provides the highest total margin per order at $550

Qualitative

Pro of free shipping for all

- aligns with PRI's mission of providing high quality customer service
- increases traffic and orders since customers can purchase goods with little risk
- customers like it, so it generates goodwill which can attract new customers

Con of free shipping for all

- since there's no risk, customers are manipulating the system by ordering items, and then returning them, possibly only to try it out, so PRI's returns have increased, and margin has suffered

Winnipeg warehouse vs. regional stores

- using the Winnipeg location has reduced the number of employees layoffs, which is in line with PRI's values of treating employees wirth respect
- However, shipping from this location is slower at 1-7 days, and shipping costs are higher from this location
- Since 75% of orders are from customers who are living less than 100km away from their regional Phoenix stores, shipping from these stores will be faster at 1-3 days, and costs will be lower, which will improve customer satisfaction with quicker shipping, which is one of the key success factors of online sales. It will also improve PRI's margins that are currently suffering
- However, shipping from stores will take 1 day longer to process online order since they are not dedicated to this service exclusively
- They would also require renovations to accomodate the inventory, which can be costly

Recommendation

- I know you would prefer to keep the free shipping for all and the Winnipeg warehouse, however, from a financial perspective, it makes more sense to implement free shipping over $50, and to ship from regional stores
- The shorter shipping times will improve customer service, which is in line with PRI's mission to make it easy to shop with them
- Customers with orders over $50 will still get free shipping, so it still provides a high-end feel and good customer service
- Cinder shipping policy should not be the same since the Cinder customer is looking for lower prices, and therefore they may spend less per purchase, so their free shipping threshold should be

lower. Cidner is also located in small towns, so the distance to ship to them will also be longer, so this needs to be considereed as well

- The same shipping policy to US could work, but the conversion rate needs to be taken into consideration, and the distance of the shipment (farther the shipment, higher cost)

Real estate holdings

Issue:

- A decision needs to be made on whether to expand the real holdings of PRI, or to sell them

Quantitative

- George's belief that the real estate is the only thing gururanteed to provide a good rate of return and increase in value over time is not true, given that the FMV of the Edmonton and Winnipeg malls is lower than their historical costs

Qualitative

- High end US retailers are opening physical stores in canada, so this landscape has become more competitive, and opening more physical stores will face heavy competition
- Since customers are able to shop online and have their items shipped to them across country, there is no need to have physical stores coast to coast
- However, the downtown Phoenix stores are an important part of PRI's tradition since they are prominent buildings, so keeping and upgrading them will be beneficial to increase sales, as Phoenix has a core customer base that visists those stores
- Selling some of the properties now will lose money, so the $1.4M in equity will not be realized, and obtaining financing will not be as easy as George thinks

- PRI's core competence is in retail and not in managing properties, so it will not have the necessary expertise in this area, which can cause loss on investments

Recommendation

- Geroge's suggestions of acquiring more real estate should not be pursued as it is not PRI's core competence, and with the launch of online, more physical stores are not needed
- However, his suggestion to upgrade the Phoenix downtown stores should be pursued, as these stores are in prominent locations, and see high traffic and sales, and would improve Phoenix's brand image of being a high quality retailer

US expansion

Issue:

- A decision needs to be made on wether to expand into the US

Qualitative

- The Canandian dollar has depreciated against the US dollar so PRI will be able to capture market share there as the goods can be bought for cheaper
- There are already customers who are moving to the US so it will help them be able to shop with PRI easier
- However, the US customers have not heard of PRI, so penetrating the market would be difficult

Recommendation

- more information is required on the costs and profts of this expansion in order to make a decision

Overall management approach

- There is a lack of oversight, evident by George's statement that he will get capital expenditures under way as soon as possible, without informing the Board first
- As well as Jeff's vision that's inconsistent with PRI's mission and vision, and his many ideas to target millenials, while PRI's core customers are older, and less adapatable to technology
- The Board should immediatly hold a meeting with George and put his plan of capital expenditures on hold
- The board should also hold a meeting to decide the validity of Jeff's ideas, and whether expanding to target millenials would be a good fit for PRI

Ex 1

Purpose: to compare the costs of the 2 online developers to determine which is less costly

Express

(000's)	Year 1	Year 2	Year 3	Year 4	Year 5	
Phoenix						upfront and 25% inventory fee are sunk costs, not included
75% inventory inclusion	750					
Maintenance	175	175	175	175	175	
Cinder						
Upfront	1250					
Inventory	1000					assume 750k + 250k
Maintenance	175	175	175	175	175	
Total costs	3350	350	350	350	350	

Alpha

(000's)	Year 1	Year 2	Year 3	Year 4	Year 5	5 year contract
Phoenix and Cinder						
Development	2600					
Maintenance	1000	1000	1000	1000	1000	
Total costs	3600	1000	1000	1000	1000	

Conclusion: the total additional costs for both Phoenix and Cinder is lower under Express, both upfront, and ongoing

Ex 2

Purpose: to determine the profitability of each option

	# order over 50	# orders under 50	
Free shipping	50,890	60,765	
Margin per order	103	86	using total margin $5233k
Shipping cost per order	20	9	
Net margin	83	77	
Total net margin	160		
50 and over free ship	75,200	13,564	
Margin per order	87	483	using total margin $6551k
Shipping cost per order	20	0	
Net margin	67	483	
Total net margin	550		
Shipping billed	48,362	12,975	
Margin per order	92	343	using total margin $4447k
Shipping cost per order	0	0	
Net margin	92	343	
Total net margin	435		

Conclusion: the total net margin is the highest under free shipping over $50

APPENDIX G

RESULTS BY SUMMATIVE ASSESSMENT OPPORTUNITY FOR DAY 1 VERSION 1 AND VERSION 2

Results by Summative Assessment Opportunity

Marking Results – PRI Version 1

Indicator	Papers	Did not meet standard[1]	Marginal[1]	Yes, met standard
Situational Analysis	4322	0.79	3.01	96.21
Analysis	4322	4.51	19.23	76.26
Conclude and Advise	4322	0.93	4.67	94.4
Communication	4322	0.58		99.42

Marking Results – PRI Version 2

Indicator	Papers	Did not meet standard[1]	Marginal[1]	Yes, met standard
Situational Analysis	492	9.55	7.32	83.13
Analysis	492	26.22	31.1	42.68
Conclude and Advise	492	4.67	12.2	83.13
Communication	492	2.85		97.15

[1]Clearly failing were marked twice. All marginally failing or passing papers were marked a second time to determine if they met the passing standard. Only the clear passes were marked once, however the results were audited.

APPENDIX H

BOARD OF EXAMINERS' COMMENTS ON DAY 1 SIMULATION VERSION 1 AND VERSION 2

BOARD OF EXAMINERS' COMMENTS ON DAY 1
(PRI VERSION 1 AND PRI VERSION 2)

Paper/Simulation: **Day 1 – Linked Simulation, PRI Version 1 (on Sept 2016 CFE)**

Estimated time to complete: 240 minutes

Simulation difficulty: Average

Competency Map coverage: N/A; Enabling Skills

Evaluators' comments by Summative Assessment Opportunity (SO)

SO#1 (Situational Analysis)

Candidates were expected to highlight new internal factors (e.g., mission, key success factors, strengths and weaknesses) and external factors (e.g., economy and trends) that would influence the decisions PRI was contemplating and would help the company identify problems where they were not obvious. Candidates were rewarded when they made links to the situational analysis in the body of their report in SO#2 and SO#3.

Candidates were specifically asked to provide Martina with an assessment of how Sparky was performing under Jennifer, and most attempted to do this. Most candidates performed an analysis of Sparky's income statement, which was provided in the simulation, and identified the increase in margin and net income. The simulation provided additional information for the candidates to use in their situational analysis (e.g., financial information for the company, trends in the environment, change in the mission and vision), and most used some of that information.

Strong candidates clearly understood the case facts presented; in particular, the incongruences between Jennifer's and PRI's objectives and how the bonus plan might be influencing Kieran's behaviour. They understood that Sparky was not being managed in the best interest of PRI.

Strong candidates also drew on their knowledge from Capstone 1 of the key success factors, the previous conflict between Jennifer and Martina, and financial requirements. Strong candidates linked the increases in the financial results to Jennifer's and Kieran's actions (e.g., outsourcing in Asia, saving on labour) and showed their ability to integrate case facts when discussing issues in SO#2.

Weak candidates spent a lot of time repeating case facts in the first section of their report, which they called a situational analysis. However, repeating facts without discussing their relevance to the new issues facing PRI does not add value. Many weak candidates provided a full SWOT analysis, essentially repeating information given in the simulation and information from Capstone 1 and creating lists that were not used further in their report. This also did not add value. A situational analysis should be used to identify the changes since Capstone 1 and identify which of those factors could affect the company. For example, most weak candidates identified that Jennifer was now the president of Sparky, but they did not make the connection that Jennifer was conducting her business without abiding by PRI's mission and vision.

SO#2 (Analysis of the Issues)

There were four issues that candidates were expected to analyze from both a strategic perspective and an operational perspective. Candidates were not specifically directed to two of those issues, governance and the bonus, by the client. There were many facts in the simulation that should have allowed the candidates to identify and rank the issues. The issues had different priorities, with major issues #1 and #2 being the most important to address on a strategic basis. Candidates were also expected to do a minimum of quantitative analysis, even though the simulation was not focused on the numbers.

Major issue #1: Governance/oversight and Jennifer's actions

Candidates were not specifically directed to this issue, but they were given multiple examples in the simulation of the governance issue. Candidates were expected to see that Jennifer was going against PRI's board even though she was told to operate Sparky just as it was for the current year (she was acquiring a low-cost supplier and had completed in-store café market research, with the intention of moving ahead with those changes). Candidates should have realized that her decisions were not in line with PRI's vision (i.e., she was too profit-oriented and her decisions were resulting in a loss of quality). In addition, the personal conflict between Jennifer and Martina in Capstone 1 continued, and Jennifer was letting Kieran make all the important decisions.

Competent candidates were expected to integrate all the case facts and recognize both that Sparky was required to be run in the best interests of PRI and that Jennifer's actions were not consistent and needed to be reported to Martina and the board. Candidates should have identified examples where Jennifer appeared to be intentionally contravening PRI board's and Martina's directives, and they should have discussed the potential impact it could have on Sparky and PRI.

A surprising number of candidates did not see the governance issue at all. Other candidates responded to the issues at Sparky's reporting level, rather than at the PRI level. They seemed to lose sight of the fact they were addressing their report to Martina and PRI's board and did not see the need to warn Martina of Jennifer's actions.

Strong candidates did a good job of identifying where Jennifer's and Kieran's behaviour was suspect. They questioned their motivation and used their Capstone 1 knowledge to make a case for the issue between Jennifer and Martina continuing. Strong candidates recognized that the decisions made at Sparky could severely affect Sparky and PRI in the long term, even though the short-term results at Sparky had improved.

Many weak candidates failed to see a governance issue. They concluded that the decisions being made by Jennifer and Kieran were good ones based on the recent financial results. These candidates failed to see the broader implications of the decisions being made.

Major issue #2: Impact of the bonus plan implemented by Mr. Snooker

Candidates were not specifically directed to this issue. They needed to integrate the case facts to be able to discuss how the bonus plan, instituted by Mr. Snooker, might have been influencing Kieran's behaviour. They were expected to provide examples of areas in which the decisions made by Kieran that may not have been in the best interests of Sparky and PRI were likely being driven by the bonus plan. Candidates should have considered the impact of the bonus on employees and recognized that it was not meeting the stated purpose of improving employee morale. Candidates were expected to make recommendations to address the issues with the bonus plan itself by recommending changes to it.

Strong candidates questioned the implementation of the bonus plan by Mr. Snooker. They saw that he was motivated to get his payout. They also linked some of Kieran's actions to the manipulation of financial statement items to get his bonus (e.g., café market research was capitalized).

Weak candidates provided a very generic discussion about the possibility of manipulating results with a bonus plan designed like the one Mr. Snooker had implemented. They did not see the specific issue with the capitalized costs as an example of manipulation of the plan. Weak candidates also did not recognize the potential link between the implementation of the bonus plan by Mr. Snooker and the contingency payment that may have been due to him.

<u>Major issue #3: Checkout system</u>

Candidates were asked to look into self-checkout systems, in line with Sparky's goal to remain contemporary. Martina also mentioned in the simulation that, if self-checkouts were determined to provide the best customer service, she might consider implementing them across PRI.

This issue was an operational issue. Candidates needed to focus not just on the operational decision, though, but also on the strategic fit to be considered competent. From Sparky's perspective, candidates were expected to consider not only the cost of the potential systems but also the ways in which the systems may help or hinder customer concerns. The systems' impact on employees, and on employee morale, should have been a consideration in their analysis. In addition, candidates should have considered whether a self-checkout based on weight would work well with items such as clothing. The majority of the quantitative analysis was provided to the candidates, with the upfront and annual costs of each system presented. It was expected that candidates would perform a quick payback calculation or an NPV. Candidates' qualitative analysis should have included an assessment of the pros and cons of each system and, most importantly, a discussion of the strategic fit. Candidates needed to consider PRI's values and recommend decisions that fit with its mission of providing the best customer service.

Most candidates performed a reasonable quantitative analysis, listed the pros and cons of each option, and stepped back to identify at least one implication of a strategic nature, the impact on employee morale being the most common.

Strong candidates performed the operational analysis and then considered the broader strategic implications in more depth (e.g., linked with the targeted demographic for Sparky versus PRI; the trend toward technology, etc.).

Weak candidates addressed this issue in a silo, without a strategic qualitative analysis. They concentrated their discussion on the operational issues only (i.e., familiarity with the products, error potential, checkout speed, etc.).

<u>Major issue #4: Strategic and operational discussions of other issues (in-store cafés, Asian suppliers, and unionization threat/HR issues)</u>

Candidates were not directed to discuss the operational issues related to the in-store cafés. Instead, as a representative of PRI, candidates should have recognized the need to alert PRI to this significant undertaking and let PRI's board know whether the decision was sound. Candidates should have recognized that adding the cafés was a separate issue from that of Jennifer's disregard of Martina's instructions. Candidates should have discussed the strategic implication of adding cafés, realizing that they were in line with PRI's mission to provide clients with a high-quality retail experience. Candidates should have identified that the objective of Sparky, as defined by PRI, was to provide a trendy, appealing environment for young professionals. The market study supported that the café met this objective, as did the analysis of competitors.

Most candidates addressed the in-store café, but many candidates concentrated on minor operational issues (e.g., that the $1 million is a sunk cost; the café might increase traffic by 15%).

Jennifer and Kieran both mentioned the acquisition of a supplier in Taiwan and the manufacturing of in-house-brand products in China. There appeared to be an intent to move Sparky in a different strategic direction, that of becoming a supplier of low-cost items to other companies. Candidates should have recognized that PRI was a retailer and had no experience in the supply business, particularly with overseas operations. Candidates should also have recognized that the quality of the products was probably lower (e.g., sheets that faded) and that these decisions went against PRI's vision and mission of providing high-quality products.

Most candidates recognized that acquiring a supplier in Taiwan was not in line with PRI's mission.

Candidates were provided with information from a staff meeting with management at a Sparky location, and Martina indicated that she had been hearing some grumblings from Phoenix employees. Candidates should have recognized the risk of unionization at PRI by integrating Martina's comments with the staff comments overheard at the store meeting. Candidates needed to remember the employee issues from the Capstone 1 case and the unhappiness of the retail employees. Due to all the changes that were occurring within the organization, including the acquisition of Sparky and the closures of the suburban stores, PRI appeared to be vulnerable to unionization. The changes had created some unrest with employees, who were concerned that they were losing their good working relationship with PRI. After recognizing the risks, candidates were expected to warn Martina of the potential unionization of the flagship store and the risk of it expanding across all of Phoenix and Cinder. Negotiations with employees become very different in a union environment.

Candidates generally provided an adequate discussion of this issue.

Overall, strong candidates properly ranked the issues and were not afraid to challenge the decisions that had been made by Jennifer and Kieran. They clearly understood their role and focused their analysis on the key risk areas to PRI from a strategic point of view.

Weak candidates tended to provide an inadequate analysis. They listed qualitative points that were simply restated case facts for all four issues and tended to focus on the operational factors. They did not see the bigger strategic implications of Jennifer's and Kirean's leadership, made generic comments about the bonus plan, and concentrated on operational issues, spending a lot of time on the checkout system and addressing employees' complaints. They did not see the big picture and the risks to PRI.

SO#3 (Conclusion)

Candidates were expected to conclude on each analysis they completed. Conclusions were expected to be consistent with the analysis performed.

Strong candidates provided thorough conclusions for all the issues analyzed. They recommended increasing the communication between Jennifer and Martina and the PRI board, since many decisions were being made against PRI's mission and in secret. They also recognized the need to change the tone at the top of Sparky and that Kieran should likely be removed due to his relationship with Jennifer and his being a Snooker follower who held a different belief system that was not in line with PRI's. Strong candidates realized that Jennifer could not be fired since she was a shareholder, but that the issue needed to be addressed in some way. Strong candidates summarized their view on Sparky's performance in Jennifer's hands (i.e., Sparky was performing well in the short term, but there was a risk of that not being sustainable in the long term since customers and employees were not happy). Strong candidates recognized that cost-cutting measures could have a negative effect on future results.

Weak candidates failed to remember that PRI was a family-run business and recommended that Jennifer be "fired" (even though she was a shareholder). Many candidates recommended alternate bonus plan structures that were textbook recommendations, without links to the case facts. Many weak candidates were unclear in their recommendations, or their conclusion could only be implied from their discussion.

SO#4 (Communication)

Many candidates did not remember that their role was with PRI and that they reported to Martina. Their discussions should have been within that context. Only a few candidates struggled with effective communication. The approach most candidates took was well structured and the language used was clear.

SO#5 (Overall Assessment)

Overall, candidates were expected to meet minimum acceptable standards in each of the four assessment opportunities listed above in order to obtain a "Pass" on the Day 1 linked case. For each major issue, the Board expected the candidate to provide a high-level analysis before proceeding to a reasonable conclusion. The Board also sought evidence of having incorporated information from Capstone 1 and the changes identified in their situational analysis.

BOARD OF EXAMINERS' COMMENTS (CONT'D)

Paper/Simulation:	**Day 1 – Linked Simulation, PRI Version 2 (on Sept 2017 CFE)**
Estimated time to complete:	240 minutes
Simulation difficulty:	Average
Competency Map coverage:	N/A; Enabling Skills

Evaluators' comments by Summative Assessment Opportunity (SO)

SO#1 (Situational Analysis)

Candidates were specifically asked to provide Martina with an assessment of PRI's e-commerce strategy, distribution channels, and proposed growth strategies, including the possibility of increasing PRI's real estate holdings. Candidates were expected to highlight changes to the mission, vision, values, objectives, and key success factors, as well as to changes in the external environment (e.g., economy and trends), that would influence the decisions PRI is contemplating and would help management identify new issues. Candidates were rewarded when they made links to their situational analysis in the body of their report in SO#2 and SO#3. The Board expected the situational analysis to be used to identify the changes since Capstone 1 and identify which factors could affect the company, which would then be brought into the analysis of the issues to help decide which course of action to pursue.

The simulation provided new information for the candidates to use in their situational analysis (e.g., trends in the environment, change in the mission and vision and objectives for expansion, survey results, changes in the management team, etc.). A majority of candidates used some of the information provided in their analysis.

Strong candidates clearly understood the case facts presented; in particular, the need to tailor the e-commerce strategy to meet the different needs of Phoenix's and Cinder's customers. Strong candidates used the survey results either to support a different approach for each or to ensure that the product chosen for the e-commerce platform was flexible enough to be tailored to their customers and that the shipping policies fit with each market segment. Strong candidates also debated the possible expansion into more real estate holdings (George's idea) versus the possibility of further expanding the web-based business (Jeff's idea). They recognized that these were conflicting views and discussed the matter from a governance aspect as well.

Weak candidates spent a lot of time repeating case facts. Many weak candidates provided a full SWOT analysis, essentially repeating information given in the simulation and information from Capstone 1, and created lists of key success factors that were not used further on in their report. They spent too much time listing the parameters and not enough on the actual analysis of the issues. Repeating facts without discussing their relevance to the new issues facing PRI added no value to their response.

SO#2 (Analysis of the Issues)

There were three major issues that candidates were expected to analyze from both an operational and a strategic perspective: the choice of e-commerce system, the shipping and distribution, and whether to increase real estate holdings. There were two additional issues that candidates could have discussed: the conflict between Jeff and George and the fact that, once again, Martina showed favouritism toward a family member in hiring. Some candidates chose to address the possible expansion to the United States as a separate issue. This was considered a valid discussion as well. Candidates were directed by the client to all the issues other than the governance issue.

Candidates were expected to perform a reasonable quantitative analysis to support their discussions for both the Express versus Alpha decision and the shipping policy choice.

Major Issue #1: Express Site versus Alpha Shop Websites

Candidates were specifically directed to this issue when they were told, "The decision to close stores and reduce Phoenix's size has increased the need to grow PRI through online sales in Canada, and possibly into the U.S. and international markets."

Candidates were expected to assess the option of continuing to use Express and the option to move to the new Alpha platform from both a quantitative and a qualitative perspective. Candidates should have compared the costs of the two systems using comparable information (i.e., if they included Cinder in one option, then they needed to include it in the other option; if they compared it over five years for one option, then they needed to do the same for the other option). Candidates should have used the mission, vision, and objectives, as well as the survey information, to evaluate the pros and cons of choosing one or the other of the systems. Candidates were expected to distinguish between the needs of Phoenix's customers and those of Cinder's customers, as well as to consider the ability to handle the U.S. and international markets should they decide to expand into those markets.

Almost all candidates addressed this issue. However, a surprising number of candidates did a purely operational analysis, listing the pros and cons of each alternative based on the information presented in the appendices without linking those back to the key success factors, mission, vision, values, or objectives for the future. Most candidates discussed the values of PRI and how the choice of website needed to support those values.

Strong candidates recognized that, in order to serve PRI properly, the e-commerce system should take into account not only Phoenix, but also Cinder and the potential U.S. market. They considered the fact that the decision to use Express was a rushed decision and that this time the decision should be a longer-term one. Strong candidates also recognized that the Cinder system would likely be different from Phoenix's due to their different target markets (supported with survey results).

Many weak candidates provided a list of pros and cons but failed to support their analysis with a "why," seemingly assuming that the why was obvious. They often made generic statements like, "This is in line with the mission" but did not explain how or why it was. Whereas strong candidates followed their logic up to the strategic elements of the discussion, weak candidates included a purely operational reason that failed to answer the question, "So what?" to explain the impact on PRI. Many weak candidates made errors in their quantitative analysis, typically including the sunk costs related to Express or failing to use the same basis of comparison when comparing Express's and Alpha's components.

Major Issue #2: Shipping and Return Policy and Warehousing and Distribution – Online Sales

Candidates were specifically directed to the shipping policy decision and the warehousing decision for online sales. Most candidates performed a reasonable quantitative analysis and listed the pros and cons of each shipping option. Competent candidates then identified at least one implication of a strategic nature, the impact on PRI if customer satisfaction is low being the most common. For a candidate to be considered competent, the Board was looking for a strong discussion in either shipping or warehousing.

Strong candidates performed a reasonable quantitative analysis, calculating the cost of shipping and deducting it from the margins to figure out the net margin of the various options. They also considered the qualitative decision factors, including the strategic impact on PRI of changing the policy. They understood that the choice for Cinder was likely not the same as for Phoenix since their customers are so different. Strong candidates integrated their discussions about warehousing/distribution and shipping costs, understanding that shipping costs could be reduced if regional distribution centres were used instead of one central warehouse. Many strong candidates considered the impact of growing online sales and the possible growth into the U.S. market.

Weak candidates focused on the margin percentage (which they calculated as 40% for each) but failed to deduct a shipping cost to determine the net margin. Many weak candidates mentioned the impact on revenue, profit, or shipping costs, stating the obvious (e.g., if they charge more, they will have more revenue). Of the weak candidates who attempted to calculate a shipping cost, many included a shipping cost even for the option for which customers were paying 100% of the shipping. Those who discussed the distribution centres also tended to state the obvious (i.e., if they ship from closer to customers, they will reduce shipping costs). They failed to use the case facts provided to add depth to their discussion (e.g., company values and not wanting to lay employees off; the impact on stores if shipments are made locally; etc.).

As for the warehousing decision that was also part of this AO, most candidates realized that using a single distribution centre located in Winnipeg would create logistical issues for a company shipping products to consumers located across Canada. Strong candidates compared this option to using the current stores for warehousing across the country that could then be used for the online purchases, reducing shipping delays (a key success factor in online shopping), and reducing shipping costs. They integrated into their analysis PRI's values concerning employee retention and the real estate strategy suggested by George, as well as the decision to expand to the United States through online shopping.

Weak candidates spent very little time addressing the warehousing issue, and their discussion was very operational in nature, limited to logistical aspects or restating case facts.

Major Issue #3: Expanding Real Estate Holdings

Candidates were told in the case that there are still issues to resolve with PRI's real estate holdings. They were also told that George wants to expand PRI's real estate holdings. Candidates were provided with information in Appendix VII to be able to assess the returns and potential increase or decrease in value of the various holdings. Candidates were expected to use this information to assess the risk of holding more real estate.

Most candidates recognized that expanding real estate holdings was not in line with PRI's mission to be a quality retailer. They discussed the benefits of diversification versus the risk of real estate values declining, using the information in Appendix VII to support their position.

Strong candidates considered the broader strategic implications of expanding PRI's real estate holdings (e.g., linked with the U.S. competitors buying store fronts, or the fact that the business has "flagship" stores; the trend toward more online sales; etc.). Strong candidates took the discussion to a higher level, discussing how increased real estate holdings either fits or does not fit with the mission, vision, and objectives of PRI, both currently and for the future. Some strong candidates integrated the real estate decision with the distribution decision, or with the conflict between Jeff and George in terms of future direction, which demonstrated a clear understanding of the issues overall.

Weak candidates struggled with this issue, believing that the decision was whether or not to sell all of PRI's buildings, which they thought meant getting out of retail completely (they did not consider the option of leasing, yet leasing played a part in the Capstone 1 case). Others wanted to set up a REIT, which was the issue in Capstone 1, not in the linked case. They used the information in Appendix VII to try to determine a gain on disposal and discussed the amount of cash flow generated compared to the cost of renovations, rather than considering the strategic impact of the decision on PRI.

Other Issues #4: Strategic and Operational Discussions of Other Issues (Jeff's E-commerce Ideas versus George's Real Estate Ideas; Favouritism; U.S. Expansion)

Martina highlights the fact that Jeff and George have different views about the direction that PRI should take, one wanting to move further into online and the other wanting to expand the real estate holdings. Many candidates saw the conflict and discussed the need to resolve it at a management meeting level. Strong candidates recognized that a more strategic decision needed to be made with respect to the future direction of PRI and whether to push further into web-based sales or remain in bricks and mortar with the possibility of expanding further into real estate holdings.

Candidates were not directed to discuss the governance issues related to Martina's hiring of Jeff being another case of favouritism toward family members. Candidates who chose to address the issue were expected to offer a reasonable approach to dealing with the issue. Those who did address the issue generally did a good job.

Overall, strong candidates clearly understood that their role was to address Martina's question and assess whether the company is moving in the right direction. They focused their analysis on the key risk areas to PRI from a strategic point of view, incorporating relevant case facts and elements of their situational analysis.

Most weak candidates provided an inadequate analysis. For all four issues they listed qualitative points that were simply restated case facts and tended to focus on the operational factors. They did not see the bigger strategic implications of each operational decision, and many made generic comments about meeting the mission or vision. Since they concentrated on the operational issues, they spent a lot of time on the decisions regarding the Alpha versus Express systems and the shipping alternatives. They did not see the big picture and the risks and benefits associated with the decisions.

SO#3 (Conclusion)

Candidates were expected to conclude on each analysis they completed. Conclusions were expected to be consistent with the analysis performed.

Strong candidates provided supported conclusions for all the issues analyzed. Strong candidates made their recommendations from the strategic perspective and also were able to integrate their operational analysis into their recommendations.

Weak candidates failed to make recommendations on the primary issues, made recommendations without sufficient support, or provided conclusions that contradicted their analyses.

SO#4 (Communication)

Only a few candidates struggled with effective communication. The approach most candidates took was well structured and the language used was most often clear. Weak candidates tended to list pros and cons, using bullet points that were too short to convey their meaning clearly.

SO#5 (Overall Assessment)

Overall, candidates were expected to meet minimum acceptable standards in each of the four assessment opportunities listed in this report in order to obtain a "Pass" on the Day 1 linked case. For each major issue, the Board expected the candidate to provide a high-level analysis before proceeding to a reasonable conclusion. The Board also sought evidence of having incorporated information from Capstone 1 and the changes identified in their situational analysis.

The CPA certification program prepares future CPAs to meet the challenges that await them. For more information on the qualification process, the common final examination (CFE), and the specific education requirements for your jurisdiction, contact your provincial/regional CPA body.

CPA PROVINCIAL/REGIONAL BODIES AND CPA REGIONAL SCHOOLS OF BUSINESS

CPA Alberta
1900 TD Tower, 10088 – 102 Avenue
Edmonton, Alberta, T5J 2Z1
Toll free: 1 800-232-9406
Email: info@cpaalberta.ca
Website: www.cpaalberta.ca

CPA Bermuda
Sofia House, 1st Floor
48 Church Street, Hamilton HM 12
Bermuda
Telephone: +1 441-292-7479
Email: info@cpabermuda.bm
Website: www.icab.bm

CPA British Columbia
800 – 555 West Hastings Street
Vancouver, British Columbia V6B 4N6
Telephone: +1 604-872-7222
Email: info@bccpa.ca
Website: www.bccpa.ca

CPA Manitoba
1675 One Lombard Place
Winnipeg, Manitoba R3B 0X3
Telephone: +1 204-943-7148
Toll Free: 1 800-841-7148 (within MB)
Email: cpamb@cpamb.ca
Website: www.cpamb.ca

CPA New Brunswick
602 – 860 Main Street
Moncton, New Brunswick E1C 1G2
Telephone: +1 506-830-3300
Fax: +1 506-830-3310
Email: info@cpanewbrunswick.ca
Web site: www.cpanewbrunswick.ca

CPA Newfoundland and Labrador
500 – 95 Bonaventure Avenue
St. John's, Newfoundland A1B 2X5
Telephone: +1 709-753-3090
Email: info@cpanl.ca
Website: www.cpanl.ca

Institute of Chartered Accountants of the Northwest Territories and Nunavut
5016 50th Avenue
P.O. Box 2433
Yellowknife, Northwest Territories X1A 2P8
Telephone: +1 867-873-3680
Email: info@icanwt.nt.ca
Website: www.icanwt.nt.ca

CPA Nova Scotia
1871 Hollis Street, Suite 300
Halifax, Nova Scotia, B3J 0C3
Telephone: + 1 902-425-7273
Email: info@cpans.ca
Website: www.cpans.ca

CPA Ontario
69 Bloor Street East
Toronto, Ontario M4W 1B3
Telephone +1416-962-1841
Email: customerservice@cpaontario.ca
Website: www.cpaontario.ca

CPA Prince Edward Island
600 – 97 Queen Street
P.O. Box 301
Charlottetown, Prince Edward Island C1A 7K7
Telephone: +1 902-894-4290
Email: info@cpapei.ca
Website: www.cpapei.ca

Ordre des comptables professionnels agréés du Québec
5, Place Ville Marie, bureau 800
Montréal, Québec H3B 2G2
Telephone: +1514-982-4606 [6]
Toll free: 1 800-363-4688
Email: candidatcpa@cpaquebec.ca
Website: www.cpaquebec.ca

CPA Saskatchewan
101 – 4581 Parliament Avenue
Regina, Saskatchewan S4W 0G3
Telephone: +1 306-359-0272
Toll free: 1 800-667-3535
Email: info@cpask.ca
Website: www.cpask.ca

Institute of Chartered Accountants of the Yukon Territory
c/o CPA British Columbia
800 – 555 West Hastings Street
Vancouver, British Columbia V6B 4N6
Telephone: +1 604-872-7222
Fax: +1 604-681-1523
Email: info@bccpa.ca
Website: www.bccpa.ca

CPA Canada International
277 Wellington Street, West
Toronto, Ontario M5V 3H2
Email: internationalinquiries@cpacanada.ca

CPA Atlantic School of Business
Suite 1306, 2000 Barrington Street
Halifax, Nova Scotia B3J 3K1
Telephone: +1 902-429-4462
Email: programs@cpaatlantic.ca
Website: www.cpaatlantic.ca/en

CPA Western School of Business
301, 1253 - 91 Street SW
Edmonton, Alberta T6X 1E9
Toll Free: 1 866-420-2350
Email: cpamodule@cpawsb.ca
Website: www.cpawsb.ca