CPA CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

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

Common Final Examination
September 10, 2024 – Day 1
(Booklet #1 – JRP Version 2)

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

GENERAL INSTRUCTIONS BEFORE THE EXAMINATION

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

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CANDIDATE NAME (Please print) ______________________

SIGNATURE ______________________

Examination Details

The examination consists of:
Booklet #1 – Linked Case (240 minutes) (this booklet)
Booklet #2 – Capstone 1 Case (for reference) and rough notes

The case should be answered using the examination software provided, which includes a word processor and spreadsheet for inputting your response. The main body of your response should be in the word processor file. Only supporting calculations should appear in the spreadsheet file, in **Sheet 1**. All financial tables in the case with ten lines or more have been preloaded into the spreadsheets that follow Sheet 1. Those spreadsheets are in read-only mode. You must copy and paste the financial information into your Sheet 1, where you can then do all your calculations. You are responsible for clearly explaining all your calculations.

Answers or part answers will not be evaluated if they are recorded on anything other than the examination software or, in the event of computer failure, the CPA Canada writing paper provided.

Rough-note paper is available in a separate booklet, which also includes a copy of the Capstone 1 case for reference only. Rough notes, and any other notations made in the examination booklets, will not be evaluated.

The CPA Canada Handbooks, the *Income Tax Act* and the *Excise Tax Act* are available in the examination software throughout the entire examination. These materials provide the standards in effect and tax laws substantively enacted as at December 31, 2023.

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

Candidates are instructed to consider and respond to the examination questions as presented even though the circumstances described in the examination questions may not be reflective of the current environment.

Common Final Examination, 2024

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

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

It is July 15, 2025, and you, CPA, are still working at Quinton and Sparks Consulting LLP (QSC). J.R. Pets Inc. (JRP) has again engaged QSC to assist with JRP's strategic analysis and planning.

Since QSC's last engagement with JRP in 2023, JRP's Board of Directors has remained hesitant to make any major strategic investments. Rather than expand, JRP's board has remained focused on securing the stability of the company's existing 20 pet stores. As a result, JRP's board decided against the acquisition of Bella's Pet Friends Ltd., and did not provide the loan to Osler Farms Pet Kitchen Ltd. The potential investment in the premium dog camp, Bonheur des Animaux au Lac Agathe, was also declined. However, the board decided to renovate five of the company's pet stores to allow for more pet services. Although some of JRP's customers appreciated the new pet services that became available, the overall impact to JRP's bottom line was small, so the board decided against converting the company's remaining 15 stores.

Also, since 2023, the number of sales that JRP has made through its website has continued to increase. Although the online store was introduced by necessity during the global pandemic, it has become increasingly popular with some of JRP's customers.

In March 2025, a new shareholder and board member, Abby Clarke, joined JRP. Abby is a long-time JRP customer who inherited a significant sum of money. She sees a lot of potential in the pet industry and wanted to be part of JRP's team. Before joining JRP, Abby had a long and successful career in e-commerce, where she specialized in logistics. Abby used $5 million of her inheritance to buy shares of JRP.

For the past several years, JRP's net income has declined slightly from one year to the next. Given this continued decline, the board wants to implement a new strategic plan, to help ensure the company's survival and future success by increasing the company's net income. In addition, the board wants to prevent the continued decline of the company's existing pet stores.

The company's vision, mission, and core values have not changed. JRP currently has $5 million to invest (the amount received from Abby for her share issuance). No other additional investment capital is available, and JRP has no desire to access any further debt financing. When comparing investments, JRP's board typically uses a five-year time horizon and a discount rate of 4.9%, the company's weighted average cost of capital.

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JRP's board has asked you, CPA, to review the information that has been provided and draft a report, in which you analyze and make a recommendation for each proposal presented. The board would also like you to comment on JRP's overall strategic direction and on how each proposal could influence that direction. For this engagement, please ignore any tax implications within your analysis and recommendations.

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APPENDIX I
BOARD MEETING WITH CPA IN ATTENDANCE

July 15, 2025

Julia: Thank you, CPA, for coming today. JRP is at a critical time. As the performance of JRP's stores continues to decline, a change is needed.

Elaine: That's right, Julia. And these decisions will be made harder, given the changing conditions within the pet industry. Although our pet stores are still profitable, our income has been squeezed due to increased competition and ongoing supply chain issues that our entire industry has faced since the beginning of the global pandemic.

Julia: Thankfully, our new shareholder and board member, Abby, has come at just the right time. The decisions made now will affect the business for years to come. Abby, I understand that you want to present an opportunity.

Abby: Yes, Julia—it involves manufacturing. At present, only a few dry dog foods available on the market offer exceptional quality and nutrition. This represents a significant opportunity, since dry food is the most purchased type of dog food. JRP could get into the manufacturing business and fill the void that currently exists.

Steve: That sounds interesting, Abby, but manufacturing food involves strict adherence to regulations that we know nothing about. Do we know what's involved in obtaining the necessary licences? Besides, JRP has always focused on selling fresh and frozen foods, which are viewed among pet owners as the most nutritious alternatives.

Elaine: True, but that's because we've never been able to find a dry food that meets our high standards. That being said, I question whether we would be able to secure the supply of necessary ingredients to manufacture the proposed food. Given the ongoing supply chain issues, our ability to manufacture food is limited by the amount of ingredients we can obtain.

Abby: Well, I happen to be friends with the owner of a nearby organic farm. She has offered to provide us with a significant supply of high-quality ingredients. From what I can tell, dry dog food made from these ingredients would be some of the best on the market. She currently sells her ingredients to a manufacturer overseas, but that contract is coming up for renewal, and she would rather work with a local company.

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BOARD MEETING WITH CPA IN ATTENDANCE

July 15, 2025

Steve: I am worried, because we have no experience with manufacturing, or the process of developing product recipes, which would create extra challenges.

Richard: Yes, but I really like the idea. We could put our own brand on the product, which would help JRP build recognition. We could also supply other pet stores with this premium dry food.

Elaine: The upfront investment needed to begin this operation is $3.9 million. With that amount, we would be able to acquire the facility needed, renovate it, and equip it with state-of-the-art manufacturing equipment that could be used for all types of pet food—both dry and fresh.

Richard: Abby, do we know the quantity of ingredients your friend could supply us with?

Abby: Yes. Working with Elaine, we determined that, with the amount of ingredients my friend can provide, we would use approximately 60% of the proposed facility's capacity. Therefore, once we are up and running, we could expand what we manufacture to include many kinds of premium food.

Richard: Sounds exciting! Let's turn our attention to the next investment opportunity.

Our sales via JRP's website have continually increased since its launch in 2022. Regardless, it's clear that we have fallen behind our competitors in this area. Our online ordering system is outdated and hard to use. It's time we upgraded and fully entered the e-commerce world alongside our competitors.

Elaine: Focusing more on online sales would certainly align with market trends. But if we do, we would be competing with the biggest national chains. As a result, we might need to lower our prices somewhat, and that would cause our margins to fall.

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APPENDIX I (CONTINUED)
BOARD MEETING WITH CPA IN ATTENDANCE

July 15, 2025

Richard: That's true, but JRP could improve its fulfilment of online sales orders outside our local geographical region. This expansion would allow us to quickly ship our products all over Canada. Our sales would increase significantly.

If we decide to proceed with this investment, the upfront cost is $4.05 million. With that amount, we would acquire three fulfilment centres across Canada, where our products would be shipped from. Our average delivery time would be reduced from five days to just three. Included in the upfront cost is also the amount needed to upgrade our existing website, to improve its function.

Julia: I like the idea of having dedicated fulfilment centres that are separate from JRP's existing stores. With our current process, our store employees are spending too much time packaging and shipping orders rather than helping in-store customers.

But I worry, because JRP's reputation was built on superior customer service, which is an advantage we have over our competitors. I don't think we can offer our customers the same type of experience online. And although some people do prefer to buy online, we hear from our customers all the time how much they love coming into one of our locations. We still have a strong demand for in-store purchases.

Elaine: And what about the ongoing industry-wide supply constraint? We are already having a hard time stocking our store shelves.

Steve: At some point, the supply chain will be restored to its pre-pandemic level, although experts don't know how long that will take. But it's not like JRP is the only company struggling with this, and we might be able to find other suppliers to help us build our inventory.

Abby: Regardless of the challenges, I think this is a great opportunity. With my background in e-commerce and logistics, I would be able to take the lead on this project. Over time, it could become a cornerstone of JRP's business.

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APPENDIX I (CONTINUED)
BOARD MEETING WITH CPA IN ATTENDANCE

July 15, 2025

Julia: Okay. Let's move on. BeWild Foods (BWF) is a small and relatively new premium pet-food manufacturer that produces a unique product line consisting of 100% raw food. At present, they only sell their products at JRP stores. BWF's products have quickly become a favourite with JRP's customers, and we regularly sell out of them. But at BWF's current level of production, they only have enough inventory to stock a few of our Ontario stores. They want to expand production but need our help to do so.

Steve: In recent months, BWF has been in contact with me, asking for advice on the best way to find additional manufacturing space. To scale up production, they need a larger facility.

Abby: Logistically, it would be a challenge to ship BWF's fresh, raw-food products over even a short distance. There is a risk that the food spoils in transit.

Elaine: But this is a niche product line that is in high demand, and one that our competitors don't offer. Because BWF's products need to be kept refrigerated and fresh, they can only be offered in-store, which has drawn more customers to JRP locations.

Also, BWF has a lot of potential. One of BWF's owners is a pet nutritionist and the other is a food chemist, both of whom have a lot of experience. I expect they will continue to release new and innovative product recipes as time goes on. Julia, what has BWF proposed?

Julia: They want us to become part of their business! For $578,000, JRP could acquire a 20% equity stake in BWF. They believe both companies have a better chance of success if we team up.

Abby: I'm not convinced. Although they have been successful so far, their business and team are not yet proven. I don't want us to sink our time and effort into helping a new company get on their feet. And with the ongoing industry supply constraint, how do they intend to find the additional ingredients they will need, to scale up their production?

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July 15, 2025

Elaine: Although I like BWF, Abby raises a good point. And because BWF's food is of the highest quality, their ingredient costs are also high, so the profit margin of their products is lower than that of other food manufacturers.

Steve: Moving on, we have an opportunity to change the way we offer pet supplies. Koda Co. (Koda) is a pet-supply company that produces private-label pet supplies for stores such as JRP. They are giving us the opportunity to sign a purchase agreement that would allow us to replace most of the pet supplies we currently offer with JRP-branded products.

Richard: I have heard of Koda. They are a respected company that has been around for a while. Given their size, they have been less affected by the industry's ongoing supply chain issues.

Steve: One thing to note is that the agreement comes with an annual minimum purchase guarantee, which means that JRP would face a penalty if we failed to purchase that amount of product from Koda. Based on the amount of pet supplies JRP purchased last year, we would have met this threshold if we made all those purchases through Koda.

Julia: That means we will likely need to sever the long-standing relationships we have with our current providers of pet supplies if we agree to this purchase agreement. And how are we supposed to build a relationship with a company the size of Koda? What kind of quality can we expect from Koda's products?

Richard: Their products have a standard, mid-range quality—not cheap, but not premium either. One advantage of this is that our overall cost to purchase pet supplies would go down somewhat.

Julia: Our customers are used to high-quality products. This seems like a pretty big change from what JRP has historically been known for.

Elaine: You're not wrong, Julia, but most of our current suppliers are smaller businesses than Koda, and are struggling to fill our orders because of supply chain issues. I would rather have a mid-range selection of pet supplies to stock our shelves with, than nothing at all.

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Steve: As well, the agreement has no upfront cost and would provide plenty of room for growth. Koda is confident that they would be able to fulfil our orders well above the minimum purchase guarantee. This contract offers us the ability to rid ourselves of the supply constraint for many years to come.

Abby: Okay, we have one last opportunity to discuss. My previous employer, Pro Software Consultants (PSC), builds mobile applications for small- to mid-size retail companies similar to JRP. The app is fully customizable and comes with a suite of modules to choose from. We could use this app to implement things such as an improved loyalty program, or to provide valuable information to customers. We could even use the e-commerce module to drive up our online sales.

Julia: My concern is that this would drive customers away from visiting JRP stores because they could just use the app to purchase our products. As well, we can't offer JRP's superior in-store customer service through a mobile application.

Steve: I hear what you're saying, Julia, but if we don't get with the times, we'll be left behind.

Abby: Also, I think you might be surprised at how well PSC's applications function. Typically, PSC receives great reviews from their customers. Plus, we could choose only the modules that make sense for our business and strategic direction. We might even be able to continue to provide exceptional service in different ways!

Julia: I am not opposed to upgrading our technology, but I just want to ensure that JRP remains known as a company that cares about its customers and serves them with great pride.

CPA, with all that in mind, can you have a look at the opportunities available? Meeting adjourned.

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APPENDIX II
INDUSTRY UPDATE

During the global pandemic, online sales increased as it became harder for customers to visit physical stores. Large retailers who already had a strong online presence prior to the pandemic experienced a growth in sales, whereas smaller retailers struggled to keep up. At present, some customers have returned to making most of their purchases in-store, but others have become accustomed to purchasing items online. Online purchasing is especially prominent with the younger generations, who tend to use their mobile phones to make online purchases.

The effects of the pandemic on the global supply chain are still ongoing. It has become a challenge for many retail companies—especially small- to mid-size companies—to reliably stock their shelves with products. There is a debate about how long the supply chain issue will last. Some experts think the flow of goods and products should return to pre-pandemic levels within a year or two from today, while others estimate that it could take up to four years. In addition, some goods and products will become available before others.

Specific to the pet industry, it has become challenging for retailers to acquire their desired levels of both pet food and pet supplies, so those that have successfully secured their supply of products have experienced a growth in sales. Small retailers have struggled more than larger retailers in this respect—especially small retailers that do not have strong relationships with their suppliers. Manufacturers of pet food have also struggled due to supply chain issues, because of increased competition for the ingredients needed to produce pet food.

Finally, the trend toward purchasing premium, high-quality pet food and pet supplies has continued to increase. Fresh and frozen pet food is still the most popular premium choice for pet owners; however, the demand for premium dry food has also increased, given that it is less expensive and has a longer shelf life.

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APPENDIX III
MANUFACTURE JRP-BRANDED DOG FOOD

Prepared by Elaine

The facility and equipment we would purchase for manufacturing JRP's new dog food has the capacity to produce a total of 1.8 million kilograms of dry food per year, whereas the quantity of ingredients from Abby's friend would only allow us to produce a maximum of 1.08 million kilograms of dry food. We have not developed a product recipe yet; however, we already know that, in addition to the ingredients that Abby's friend can provide, we will still require a few more ingredients before we have all that is needed to complete the production of the first 1.08 million kilograms of premium dry dog food. Because of that, we still need to find a few more suppliers that can provide these additional ingredients.

We estimate that we can sell this dry dog food for $5.90 per kilogram. Given the product's superior quality, I estimate that we will be able to achieve a 60% gross margin on these product sales. We could even offer JRP's existing loyalty reward members a discount if they purchase this new product in stores. The annual fixed overhead costs of running the operation would total $2.85 million.

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APPENDIX IV
EXPAND E-COMMERCE OPERATIONS

Prepared by Richard

Given my market research, and the size of our three proposed fulfilment centres, I estimate that JRP's annual online sales could increase by as much as $7,529,000. However, because of the ongoing supply constraint, I suspect we could currently achieve only 80% of that maximum increase in sales. In addition, I estimate that around 15% of the online orders we receive will be from customers who would have otherwise made that purchase within a JRP store.

The gross margin on these sales will equal 45%, the same margin that we currently earn from in-store sales. All applicable shipping costs will be added to the customer's bill at checkout. The annual overhead costs of running the operation would equal $1.35 million.

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APPENDIX V
PURCHASE EQUITY IN BEWILD FOODS

Prepared by Julia

During 2024, JRP's revenue from the sale of BWF's products was $225,000, and had a gross margin of 25%. As part of BWF's proposal, if JRP becomes an equity investor, BWF will decrease what they charge JRP for their products so that JRP's gross margin would increase by 5%. BWF would also formally agree to only sell their products through JRP.

At BWF's current volume, JRP is only able to stock five of its Ontario store locations with BWF products. With JRP's investment, BWF would be able to expand production to the point that they could stock an additional 10 JRP stores (with roughly the same amount of product per store that they currently provide to JRP).

BWF intends to use JRP's investment to lease a bigger manufacturing facility, and buy the equipment necessary to increase their production volumes.

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APPENDIX VI
KODA CO.'S AGREEMENT

Prepared by Steve

In 2024, JRP's total revenue from pet supplies was $13.5 million, with a gross margin of 30%. If JRP were to have stocked and sold only Koda's products, there would have been a 15% drop in revenue, given that Koda's products are priced lower when compared to what we currently offer. However, that drop in revenue would have been offset by an increase in gross margin, which would equal 40% on all Koda products that are sold.

Additional terms provided by Koda are as follows:

- Total annual purchase minimum will be $6.5 million.
- All products purchased will be branded with the JRP logo.
- The agreement has a term of eight years, with a $1 million penalty if JRP cancels the agreement prior to the end of the term.

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APPENDIX VII
PRO SOFTWARE CONSULTANTS APP DEVELOPMENT

Prepared by Abby

The cost of the base mobile application platform is $250,000, and its annual maintenance cost is estimated to be $12,000. To give the application its functionalities, at least one module needs to be built on top of the base platform. PSC offers a series of modules that can be added, to increase the functionality of the mobile application. Here are some of the modules available that might be applicable to JRP:

Module	Investment	Annual Maintenance
E-commerce	$ 236,000	$ 95,000
Loyalty program and marketing	$ 114,000	$ 4,000
Learning and information library	$ 74,000	$ 3,000

Further details for each module are as follows:

<u>E-commerce</u>

This module will provide a user-friendly shopping experience for JRP customers who want to make purchases directly within the mobile application. The forecasted annual increase in JRP's gross profit from these mobile app sales is expected to be $432,000.

<u>Loyalty program and marketing</u>

This module will allow customers to earn loyalty reward points for their online purchases, whereas this is currently only possible for in-store purchases. This module will also connect the loyalty program across all of JRP's stores. Finally, it will give JRP direct access to customers, to notify them of marketing initiatives such as discounts, sales, and promotions. The forecasted annual increase in JRP's gross profit from this module is expected to be $87,000.

<u>Learning and information library</u>

This module will give JRP's customers access to a library of product information, advice, blog posts, and online courses on various pet topics. JRP would be responsible for producing the content. JRP could choose to make the information free, or charge a small subscription fee. If JRP charges a subscription fee, the forecasted annual increase in JRP's gross profit from this module is expected to be $23,000.

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End of Examination

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CPA COMMON FINAL EXAMINATION
REFERENCE SCHEDULE

Present Value of Tax Shield for Amortizable Assets

Present value of total tax shield from CCA for a new asset acquired after January 1, 2024, and before January 1, 2028, other than those eligible for immediate expensing, which would normally be subject to the half-year rule.

$$= \frac{CdT}{(d+k)}$$

Present value of total tax shield from CCA for a new asset acquired after January 1, 2024, and before January 1, 2028, other than those eligible for immediate expensing, which would not normally be subject to the half-year rule.

$$= \frac{CdT}{(d+k)}\left(\frac{1+1.25k}{1+k}\right)$$

Present value of total tax shield from CCA for a new asset acquired after November 20, 2018, and before January 1, 2024, other than those eligible for immediate expensing.

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

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

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Selected Prescribed Automobile Amounts

Item	2023	2024
Maximum depreciable cost — Class 10.1	$36,000 + sales tax	$37,000 + sales tax
Maximum depreciable cost — Class 54	$61,000 + sales tax	$61,000 + sales tax
Maximum monthly deductible lease cost	$950 + sales tax	$1,050 + sales tax
Maximum monthly deductible interest cost	$300	$350
Operating cost benefit — employee	33¢ per km of personal use	33¢ per km of personal use
Non-taxable automobile allowance rates		
— first 5,000 kilometres	68¢ per km	70¢ per km
— balance	62¢ per km	64¢ per km

Individual Federal Income Tax Rates

For 2023:

If taxable income is between	Tax on base amount	Tax on excess
$0 and $53,359	$0	15%
$53,360 and $106,717	$8,004	20.5%
$106,718 and $165,430	$18,942	26%
$165,431 and $235,675	$34,208	29%
$235,676 and any amount	$54,579	33%

For 2024:

If taxable income is between	Tax on base amount	Tax on excess
$0 and $55,867	$0	15%
$55,868 and $111,733	$8,380	20.5%
$111,734 and $173,205	$19,833	26%
$173,206 and $246,752	$35,815	29%
$246,753 and any amount	$57,144	33%

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Selected indexed amounts for purposes of computing income tax

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

Item	2023	2024
Basic personal amount, and spouse, common-law partner, or eligible dependant amount for individuals whose net income for the year is greater than or equal to the amount at which the 33% tax bracket begins	$13,520	$14,156
Basic personal amount, and spouse, common-law partner, or eligible dependant amount for individuals whose net income for the year is less than or equal to the amount at which the 29% tax bracket begins	15,000	15,705
Age amount if 65 or over in the year	8,396	8,790
Net income threshold for age amount	42,335	44,325
Canada employment amount	1,368	1,433
Disability amount	9,428	9,872
Canada caregiver amount for children under age 18, and addition to spouse, common-law partner, or eligible dependant amount with respect to the Canada caregiver amount	2,499	2,616
Canada caregiver amount for other infirm dependants age 18 or older (maximum amount)	7,999	8,375
Net income threshold for Canada caregiver amount	18,783	19,666
Adoption expense credit limit	18,210	19,066

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Other indexed amounts are as follows:

Item	2023	2024
Medical expense tax credit — 3% of net income ceiling	$2,635	$2,759
Old age security repayment threshold	86,912	90,997
Annual TFSA dollar limit	6,500	7,000
RRSP dollar limit	30,780	31,560
Lifetime capital gains exemption on qualified small business corporation shares	971,190	
Lifetime capital gains exemption for dispositions before June 25		1,016,836
Lifetime capital gains exemption for dispositions on or after June 25		1,250,000

Prescribed interest rates (base rates)

Year	Jan. 1 – Mar. 31	Apr. 1 – June 30	July 1 – Sep. 30	Oct. 1 – Dec. 31
2024	6	6	5	
2023	4	5	5	5
2022	1	1	2	3

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

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Maximum capital cost allowance rates for selected classes

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

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