Board of Examiners’ Comments

Day 2 and Day 3 Simulations

May 2016 CFE
BOARD OF EXAMINERS’ COMMENTS ON DAY 2 SIMULATION

Paper/Simulation: Day 2 (ASI) – Role Case COMMON REQUIREDS
Estimated time to complete: 300 minutes
Simulation difficulty: Average
Competency Map coverage: Financial Reporting (5 Assessment Opportunities)

Evaluators’ comments by COMMON Assessment Opportunity (AO), for all roles

AO#1 (Investment in Freeze)

ASI’s audit committee expressed concerns about the preliminary financial statements and asked candidates to review the draft financial statements, discuss any accounting issues, and identify any accounting adjustments required. Appendix I contained excerpts from ASI’s 2016 financial statements. In Appendix III of the case, candidates were provided with some additional details on the investment in Freeze the Shell Co. (Freeze). They were also directed to the issue of accounting for the investment in Freeze within the minutes of the audit committee meeting. The information stated that ASI had purchased 18% of the outstanding shares of Freeze for $1,754,000, and it included additional details, such as the fact that the remaining shares of Freeze were widely held, ASI held two out of the five seats on the board of directors of Freeze, and ASI was able to participate in policy decisions for Freeze. To demonstrate competence on this assessment opportunity, candidates had to determine, using case facts and guidance from the Handbook (IFRS), how the investment in Freeze should be accounted for.

Candidates performed well on this assessment opportunity. Most candidates used case facts and Handbook guidance to support their conclusion that ASI had significant influence over Freeze despite owning less than 20% of the outstanding shares and, as a result, should account for Freeze using the equity method. Most candidates then provided a journal entry to record 18% of Freeze’s net income since its acquisition and remove the dividends that ASI had received from Freeze.

Strong candidates supported their analysis with multiple case facts and demonstrated an understanding of how ASI would account for Freeze on an ongoing basis, including a discussion of the intangibles (goodwill and customer list) that arose on acquisition.

Weak candidates generally either jumped right to a conclusion and did not use the case facts provided to support their discussion or did not perform a reasonable calculation of the adjustment that should be made to correctly state the investment in ASI’s financial statements at year end.

AO#2 (Vessel Impairment)

As stated above, candidates were asked to review the draft financial statements for ASI, discuss any accounting issues, and identify any accounting adjustments required. Appendix I contained excerpts from ASI’s 2016 preliminary financial statements. Appendix IV contained details on the Lobster I vessel that was owned by ASI. They were also directed to the issue of the potential Lobster I vessel impairment within the minutes of the audit committee meeting. Candidates were supplied with the net book value of the Lobster I, as well as its estimated pre-tax cash flows for the next four years and a recent appraisal from a local dealer. To demonstrate competence, candidates were expected to realize that there was an indicator of impairment and to calculate two items for the Lobster I: its
value in use and its fair value less costs of disposal. They were then expected to compare the higher of these two amounts to its current carrying amount to determine if impairment existed and, if so, to prepare the required journal entry to write down the vessel.

Candidates performed as expected on this assessment opportunity. Just over half of the candidates were able to calculate the two values according to the criteria outlined within IFRS and determine that a write-down was required. Candidates were then generally able to provide a reasonable journal entry to adjust the carrying value of the *Lobster I* to its fair value less costs of disposal.

Strong candidates had a clear understanding of the *Handbook* guidance in this area and approached the issue in a methodical manner by first going through the two fair value approaches and calculating reasonable amounts for each. They then compared the higher of the two amounts to the carrying value and recognized the required write-down. Some strong candidates were also able to further determine the impact of the write-down on depreciation going forward.

Many weak candidates did not seem familiar with or misapplied the IFRS guidance in this area and performed incomplete calculations or chose (in error) the lower of the two amounts they had calculated. Other weak candidates calculated only one amount and jumped to a conclusion without recognizing that both amounts were necessary because IFRS required the higher value.

**AO#3 (New Crane)**

As stated previously, candidates were asked to review the draft financial statements for ASI, discuss any accounting issues, and identify any accounting adjustments required. Appendix I contained excerpts from ASI’s 2016 preliminary financial statements. Appendix V contained details on a new technologically advanced crane that ASI purchased for its *Lobster II* vessel. They were also directed to the issue of the new crane purchase within the minutes of the audit committee meeting. Candidates were given details of the amounts that had been capitalized related to the purchase of the new crane. They were also told that vessels have three major components: the crane, the engine, and the vessel structure. The new crane replaced the old crane on the vessel, and the new crane had an estimated useful life of 20 years. That was substantially longer than the estimated remaining useful life of the *Lobster II*, which was 12 years. To demonstrate competence, candidates were expected to discuss which of the amounts capitalized for the new crane met the IFRS standards for capitalization and to address the componentization issue surrounding the new crane and its different useful life. Candidates could have also discussed how to account for the old crane, which remained on ASI’s dock but had no value.

Candidates performed below expectations on this assessment opportunity. While most candidates discussed and properly excluded some of the specific costs that ASI had capitalized related to the new crane, they did not recognize or analyze the componentization issue and the resulting impact on the depreciation going forward. In addition, few candidates addressed how to account for the old crane that had been replaced.

Strong candidates provided a detailed discussion of each of the five costs that had been capitalized for the new crane and used IFRS to support their conclusion as to why each could or couldn’t be capitalized. Strong candidates also understood that the new crane was a separate component of the *Lobster II* and, therefore, had to be accounted for as such with a new estimated remaining useful life, resulting in a new depreciation rate. They also recognized the fact that the old crane had no value and had to be written off ASI’s books.

Weak candidates generally provided an incomplete analysis of the issue. They provided a
superficial analysis of the costs associated with the new crane, many incorrectly concluding on which costs were eligible for capitalization. In addition, most weak candidates did not recognize either the componentization issue or the old crane de-recognition issue.

**AO#4 (Research and Development)**

As stated above, candidates were asked to review the draft financial statements for ASI, discuss any accounting issues, and identify any accounting adjustments required. Appendix I contained excerpts from ASI’s 2016 preliminary financial statements. The audit committee also discussed the progress of a recent project that ASI had undertaken to improve the blanching process and to reduce waste water. To date, $300,000 had been spent on this project and had been capitalized as part of equipment. To demonstrate competence, candidates were expected to use case facts to identify the fact that these costs could not be capitalized to equipment and to determine whether ASI could capitalize the costs incurred to date as development costs. To do so, candidates were expected to apply the six development criteria stated in IFRS and to apply the specific case facts presented to determine whether these costs met the development criteria.

Candidates struggled with this assessment opportunity. Many candidates jumped to a conclusion quickly without fully analyzing the issue. They either simply applied the intangible asset criteria and concluded that the costs met the definition of an intangible asset, but did not proceed further to analyze whether the costs met the six criteria required for capitalization, or assumed the work done to date was research, with little to no support, and concluded that the amounts needed to be expensed.

Strong candidates approached the issue in a methodical manner by working through all of the six criteria required for capitalization of development costs. For each criterion, they supported their analysis with the case facts presented before concluding.

Many weak candidates either copied and pasted *Handbook* guidance into their response, without applying case facts to the guidance, or used the same case fact repeatedly to analyze each criterion, even though that fact didn’t always apply. Other weak candidates recognized the issue but never discussed the six criteria. Instead, they provided only a general discussion of whether the costs were research or development in nature.

**AO#5 (Onerous Lease)**

As stated above, candidates were asked to review the draft financial statements for ASI, discuss any accounting issues, and identify any accounting adjustments required. Appendix I contained excerpts from ASI’s 2016 preliminary financial statements. The audit committee also discussed the progress of recent negotiations that ASI had with a landlord for a building that ASI had moved out of. The lease required ASI to pay $2,500 per month for the next 27 months and did not allow for cancellation or subletting. To demonstrate competence, candidates were expected to recognize that ASI would get no future benefit from the lease and, as a result, was required to recognize all future lease costs as a liability at year end.

Candidates did not perform well on this assessment opportunity. Many candidates did not discuss the lease at all, and many who did attempt to discuss the lease struggled to identify what the real issue was.

Strong candidates recognized that this lease represented an onerous contract and, as such, the future lease costs needed to be accrued as a liability at year end. They recognized from the case
facts that ASI was not likely to gain any future benefits from the lease and used this as support in their analysis. They also calculated the present value of the future stream of lease payments using an appropriate discount rate to calculate the liability.

Weak candidates struggled to see the issue at hand. As a result, they either avoided the issue all together or tried to create an issue regarding the lease by, for example, discussing whether it should be treated as a finance or operating lease. This discussion was of no value because the lease was clearly an operating lease, according to the case facts provided.
**AO#6 (Risk)**

Candidates were asked by the engagement partner to assess the risk factors related to the year-end audit, given the current circumstances at ASI. In Appendix VI, candidates were provided with a preliminary risk assessment that had been performed in September. Candidates were expected to discuss some of the new risk factors that had arisen since the preliminary planning had been performed that should be taken into account and to conclude on the overall financial statement risk of the audit engagement.

Candidates performed below expectations on this assessment opportunity. Only about half of candidates were able to provide new and relevant risk factors, explain how they had an impact on the financial statement risk, and provide a conclusion that was in line with their analysis.

Strong candidates provided a more complete list of factors and explained how each of these would increase risk, and they also provided a good overall conclusion on the engagement risk.

Most weak candidates either did not provide a sufficient number of relevant risk factors (sometimes because they focused on existing risks already provided in the case, rather than the new risks for the current year) or simply listed risk factors without explaining how they would result in an increase or decrease in risk.

**AO#7 (Materiality)**

Candidates were asked by the engagement partner for their recommended materiality and performance materiality for the upcoming audit engagement. Candidates were expected to calculate the materiality to be used for the audit engagement, in light of the users, and to support the basis chosen with case facts. They also had to calculate performance materiality.

Candidates performed below expectations on this assessment opportunity. Only about half of candidates were able to provide a reasonable calculation of materiality and performance materiality supported by a discussion of the users and their needs. A surprising number of candidates incorrectly supported their chosen materiality level by linking it to their risk assessment rather than the users’ needs. This is a fundamental assurance/audit concept that candidates appeared to be lacking.

Strong candidates discussed several users and their varying needs and clearly linked the basis they chose on which to calculate materiality to those needs. They also explained the rationale behind their chosen performance materiality level.

Weak candidates did not do a good job of discussing the users and their needs and linking that discussion to the decision of a materiality level. There were several users in this case, all of which
had their own interests. For example, the bank would be concerned about ASI’s ability to repay its debt, the suppliers would be concerned about their bonus, and the shareholders would be concerned about the overall profitability of the company. Weak candidates tended to list a few users but then did not go on to explain what they would be concerned with and how that would affect the selection of a basis for materiality. They also rarely supported the percentage they applied to that basis or their performance materiality percentage.

AO#8 (Approach)

Candidates were asked by the engagement partner to discuss any changes required to the audit approach. The partner went on to specifically ask whether they’d be able to rely on controls again this year and, if not, what procedures would have to be performed. The candidates were told in the case that for the last four months of 2016, the CFO has been ill and unable to perform his duties. They were also provided with a list of key controls that had been tested and relied on in prior audits. In order to demonstrate competence, candidates had to recognize that the CFO was an integral part of several of the controls that had been relied on in the past and that his absence at the end of the current year meant that a different approach would have to be taken this year. They then had to provide a few procedures to substantively test the processes where controls could no longer be relied on. For example, the CFO used to review and approve the weekly sales listing and the related supporting documentation for completed sales. With the CFO no longer performing that function, candidates could have suggested obtaining the sales subledger; selecting a sample of sales; obtaining the supporting sales order, packing slip, and invoice; and agreeing the information to the general ledger.

Candidates performed as expected on this assessment opportunity. This was a more difficult assessment opportunity because candidates had to provide specific procedures to address the lapse in controls, and they performed adequately. The majority of candidates recognized that the CFO’s absence would change the audit approach and explained how. Many of those candidates were also able to provide procedures to address a few of the processes where controls could no longer be relied on.

Strong candidates demonstrated in their discussion that they had a strong understanding of how the approach would need to change, given the CFO’s absence, and provided several procedures to address the processes that could no longer be relied on.

Weak candidates struggled to provide procedures that would address the risk involved, given the breakdown of a specific control. Some candidates did not even attempt to provide procedures, despite the fact that the partner specifically asked for this.

AO#9 (Procedures for Freeze)

Candidates were told that the engagement partner was concerned about the acquisition of Freeze the Shell Co. (Freeze) and were asked to provide procedures related to the balances at the acquisition date and at year end. In order to demonstrate competence, candidates had to provide a reasonable number of procedures that were specific to Freeze at both the acquisition date and at year end.

Candidates performed adequately on this assessment opportunity. Most candidates attempted to provide several procedures and were able to provide a sufficient number of procedures that would successfully address the risks related to the Freeze acquisition.
Strong candidates were able to provide precise and well-described procedures that were clearly tied to the significant risks identified. Strong candidates also provided more procedures that covered both the acquisition date and year-end balances. Many of these candidates tied this discussion to their financial reporting discussion of the same issue and provided procedures to verify that ASI had significant influence over Freeze (verification of number of spots on the board or their ability to be involved in decision-making). This made for a richer discussion.

Weak candidates focused only on the acquisition date balances (often testing only the fair value of assets acquired at the acquisition date) and did not provide any procedures related to the year end. Weak candidates also often provided procedures that were too vague to determine what exactly they were proposing to do and what risk they were trying to cover.

**AO#10 (Internal Controls)**

Candidates were told that ASI had recently implemented a new ordering and invoicing system and that they had received customer complaints regarding incorrect invoice amounts. Candidates were asked for their help in evaluating the system. In particular, the engagement partner asked them to identify any control weaknesses and to suggest improvements. In order to demonstrate competence, candidates had to identify some of the weaknesses with the system, explain the implication of the weakness, and provide a reasonable recommendation to address the problem.

Candidates performed well on this assessment opportunity. The majority of candidates were able to identify some of the control weaknesses, explain their impact, and provide valid recommendations. The most commonly identified issues were the unrestricted access to the pricing file, the lack of approval for customer discount, and the lapse in review of sales orders.

Strong candidates were able to provide good coverage of the issues and propose practical recommendations to address the weaknesses identified. These candidates were more likely to address the less obvious issues, such as the lack of validation of customer information.

Weak candidates did not adequately explain why an internal control weakness they identified would cause issues for ASI or did not provide valid recommendations that would address the weakness. Many weak candidates made impractical recommendations given the size of the company, such as suggesting the CEO approve all sales orders and price file changes.

**AO#11 (Bonus Calculation)**

Candidates were provided with a calculation of the suppliers’ bonus for the year and told that the suppliers were concerned about the amount they were receiving. Candidates were asked by the engagement partner to verify the calculation of the 2016 bonus and to highlight any concerns with regards to its fairness. In order to demonstrate competence, candidates had to adjust the bonus calculation for some of the elements that did not appear fair and recalculate the total amount for 2016.

Candidates performed below expectations on this assessment opportunity. While the majority of candidates recalculated the bonus after making a few adjustments, many failed to support the reason for their adjustments.

Strong candidates discussed several of the elements of the calculation and fully supported their adjustments with case facts. On elements that were grey, these candidates often debated both sides before concluding on what treatment they believed was fairer.
Weak candidates provided either no support for their adjustments or a justification that did not make sense given the case facts. Candidates were asked to look at the fairness of the bonus calculation, and, therefore, when removing an element from the calculation, they were expected to discuss why they believed including that element was not fair to suppliers. For example, while the bonus was for lobster suppliers, it included expenses related to clam sales. Candidates were expected to support removing those expenses by explaining that the calculation should only include amounts related to lobsters.

**AO#12 (Reports)**

Candidates were told that the suppliers had requested that a special report be prepared, asserting that the bonus amount was calculated in accordance with the formula. Candidates were asked by the engagement partner to identify potential special reports, discuss their respective advantages and disadvantages, and recommend the option that would best meet the needs of the suppliers. In order to demonstrate competence, candidates had to discuss at least two valid reporting options and provide a supported conclusion.

Candidates performed adequately on this assessment opportunity. Most candidates were able to identify at least a couple of valid reporting options and briefly discuss their pros and cons before concluding.

Strong candidates discussed several valid reporting options, demonstrated in their discussion that they understood the fundamental differences between the different reports, and explained what each of them could offer the suppliers. Their conclusions were appropriate and well supported.

Many weak candidates did not have a good grasp of the reporting options. As a result, they had a hard time explaining the advantages or disadvantages of the various reports or recommending one that would be best given the situation. Many weak candidates just addressed the level of assurance provided or the cost of the different reports, without really getting into the nature of a report itself and why it may or may not be good for the suppliers. Some weak candidates also recommended reports that would not be appropriate under the circumstances because they would not meet the suppliers' needs.

**AO#13 (Procedures for Report)**

As mentioned in AO#12, candidates were told that the suppliers had requested that a special report be prepared, asserting that the bonus amount was to be calculated in accordance with the formula. In the previous assessment opportunity, candidates were asked to discuss the reporting options and to recommend the option that would best meet the needs of the suppliers. In this assessment opportunity, candidates were asked to design appropriate procedures based on the special report they had recommended. Candidates were expected to provide some procedures that could be performed in the context of their recommended report on the bonus calculation.

Candidates struggled on this assessment opportunity. While most candidates attempted to provide procedures, their procedures were often too vague to determine what exactly they were proposing to do and did not address the appropriate risk.

Strong candidates had a clear understanding of the relevant risks and were able to provide precise and well-described procedures that were clearly tied to the significant risks identified. Strong candidates also provided more procedures that covered more of the bonus calculation elements.
Weak candidates tended to forget what the risk was in this situation, which was that ASI understated revenues and overstated expenses in order to reduce the amount of the supplier bonus. As a result, some candidates provided procedures that were not appropriate; for example, performing subsequent payments testing to verify that all lobster expenses related to 2016 had been recorded.

AO#14 (Covenants and Audit Implications)

Candidates were told that ASI’s long-term debt required them to meet certain covenants (current ratio, total debt to EBITDA, and EBITDA to interest). They were provided with the covenants and told that the CEO was meeting with the bank the following week to review the financial statements and covenant compliance. There was no specific request from the engagement partner to review ASI’s compliance with the covenants at year end; however, this was considered to be a critical part of the assurance role. In order to demonstrate competence, candidates had to recalculate a couple of the covenants, conclude as to whether they were breached, and discuss some of the audit implications of the breach.

Candidates did not perform well on this assessment opportunity. Roughly half of the candidates did not address this assessment opportunity at all. Those who did rarely went beyond a recalculation of the covenants to discuss the impact on the audit. ASI already had a significant amount of debt with the bank, and candidates were told that the CEO was going to approach the bank for additional lending. They were also told that the bank would be looking at the covenant compliance when it met with the CEO. These case facts should have prompted candidates to recalculate the covenants. A breach in the covenants could have a significant impact on the company and the audit, and recognizing that fact was an important part of the auditor role candidates were asked to play. While Day 2 is generally a very directed examination, candidates should still look for case facts that point them towards performing a particular analysis that intuitively should be done as part of their chosen role.
The case stated, “Brian would also like you to provide him with an analysis of ASI’s financial performance and financial condition for 2016, relative to its competitors.” Candidates were also provided with a list of industry ratios that they were expected to use as a comparison when analyzing ASI’s financial performance and position. In order to demonstrate competence, candidates were expected to calculate appropriate ratios for ASI and to provide an interpretation of the ratios using case facts and the scenario presented to support their analysis.

Overall, candidates performed well on this requirement. Candidates calculated appropriate ratios and properly interpreted the ratios, applying case facts to support their analysis. They understood, on an overall basis, that ASI was not performing well compared with its competitors and that ASI’s financial performance and financial position had deteriorated from the prior year.

Strong candidates were able to calculate all eight of the ratios that were outlined for the industry and were able to analyze each of the ratios appropriately, noting where ASI was stronger than the industry (e.g., the days-in-receivables ratio) and where ASI was considerably weaker than the industry (e.g., the current ratio). Strong candidates also used their adjusted financial statements to compute the ratios and tied in case facts to support their analysis. For example, ASI had a days-in-inventory ratio that was considerably higher than that of the industry, and stronger candidates suggested that this could be due to ASI’s unique storage facilities, which allowed it to store and sell live lobsters for three months. Finally, strong candidates provided an overall conclusion with respect to ASI, noting its financial position and performance were weaker than those of the industry and had deteriorated over the past year.

Weak candidates were generally able to calculate appropriate ratios, but their interpretation of the ratios was often generic and superficial. Many of these candidates’ interpretations of the ratios were limited to stating that the ratio was higher or lower than the industry, and these candidates rarely used case facts to support their analysis. These candidates did not explicitly state whether ASI was performing well compared to the industry and did not understand the downward trend ASI was projecting.

The case stated, “You are also asked to look at the recent proposal by the Class B shareholders to exchange their shares. He asks you to assess the impact on the covenants and ASI’s cash flows if this proposal is accepted.” Candidates were also told that the preferred share would be treated as a liability on the balance sheet once the conversion was completed. Candidates were expected to determine the effect of the conversion on the four bank covenants (the current ratio, the debt-to-EBITDA ratio, the EBITDA-to-interest ratio, and the covenant prohibiting any dividends to be paid
without the bank’s approval) and ASI’s cash flows moving forward.

Overall, candidates performed below expectations on this assessment opportunity. Many candidates did not specifically address the bank covenants and instead analyzed the financial implications for ASI and the Class B shareholders. This type of analysis was rewarded in AO#8 (the pros and cons of the share conversion).

Strong candidates understood the fact that the new preferred shares would be treated as debt rather than equity. They understood that this would also lead to the dividends being treated as interest rather than dividends on the financial statements. They then went through each of the four bank covenants and clearly stated what effect the conversion would have on each: the current ratio would not be affected immediately (but might be affected over time); the debt-to-EBITDA ratio would be affected as debt increased; the EBITDA-to-interest ratio would go down because the dividends are recognized as interest; and the covenant requiring bank approval before any dividends were paid might be violated. Strong candidates also provided calculations to support their analysis.

Weak candidates did not explicitly state what effect the conversion would have on each covenant. Many limited their analysis to the cash flow implications for ASI, stating that ASI would need to pay out significant cash flows in the future, and did not address the bank covenants, even though they were specifically directed to address this issue within the scenario.

**AO#8 (Share Conversion Pros and Cons)**

With respect to the share conversion, the case further stated, “Additionally, you are asked to outline the advantages and disadvantages of the proposal, from ASI’s and the Class B shareholders’ perspectives, noting any issues you see with the proposal or modifications that you believe should be made.” In order to perform well, candidates would need to discuss multiple pros and cons of the proposed share conversion from both ASI’s and the Class B shareholders’ points of view. Candidates would also need to make appropriate suggestions in an effort to improve the proposal from either ASI’s or the Class B shareholders’ perspectives.

Overall, candidates performed as expected on this requirement. Most candidates attempted to provide an analysis of the advantages and disadvantages of the proposal and also provided the analysis from both ASI’s and the Class B shareholders’ perspectives.

Strong candidates provided a balanced response, providing multiple advantages and disadvantages of the proposal from both ASI’s (Darrell’s) and the Class B shareholders’ perspectives, and were able to link their analysis with the case facts provided. For example, strong candidates understood that, from ASI’s perspective, there would be some significant disadvantages in the short term, such as the requirement to pay out potentially large sums of cash to buy back the shares under the retractable feature of the proposal, but in the long run Darrell would also have the opportunity to regain 100% ownership of ASI through the redemption option. Strong candidates also suggested modifications to the proposal to ensure that the disadvantages they identified were dealt with appropriately. For example, strong candidates suggested removing or deferring the retractable feature of the preferred shares.

Weak candidates provided a laundry list of pros and cons of the proposal from both ASI’s and the Class B shareholders’ perspectives. They did not sufficiently explain why the items they were referring to were either advantages or disadvantages but simply restated each case fact as a “pro” or a “con.” For example, weak candidates listed the retractable feature of the proposal as a “con” for
ASI without any further explanation.

**AO#9 (New Vessel Investment)**

Candidates were also asked to prepare an analysis of the potential investment in the new vessel and were supplied with ASI’s weighted average cost of capital and its tax rate, in addition to the appropriate revenues and expenditures related to the new vessel. Candidates were expected to provide a quantitative net present value analysis of the potential investment and to conclude on the appropriateness of the potential acquisition.

Overall, candidates performed well on this assessment opportunity. Candidates were generally able to incorporate the information supplied in the case to quantify the potential investment. They were able to discount the appropriate revenues and expenditures at appropriate rates and determine a reasonable net present value for the proposed investment. Many candidates also performed a reasonable qualitative analysis of the proposal.

Strong candidates performed detailed calculations, recognizing all of the following items within their calculations: 1) the initial investment (spread over two years); 2) the annual cash flows that would be generated from the investment; 3) the working capital adjustments at the beginning and end of the investment; 4) the decommissioning costs that would be incurred at the end of the 25 years; and 5) taxes, including the tax shield on the initial investment. Strong candidates also were able to calculate present value for all of these items in a reasonable fashion. Finally, strong candidates incorporated some qualitative factors and came to a reasoned conclusion on whether to proceed with the investment.

Many weak candidates had difficulty incorporating many of the items noted in the previous paragraph, ignoring several of the mentioned amounts. As well, some weak candidates did not know how to calculate a present value for many of the items, and, as a result, their analysis was not reasonable.

**AO#10 (Lobster Licences)**

The case states, “Recently, ASI was approached by a competitor to see if there was interest in ASI purchasing lobster licences for an asking price of $7.5 million. You are to prepare a valuation to assess whether $7.5 million is a reasonable price and, if not, to suggest what would be an appropriate counter-offer.” Candidates were also supplied with four historical lobster licence transactions to use as comparable transactions for this potential deal. Candidates were expected to use the comparable transactions to determine whether the $7.5-million asking price was reasonable.

Overall, candidates performed below expectations on this assessment opportunity. Candidates were generally able to analyze the comparable transactions and were able to identify the one or two transactions that were similar in substance to the licences being offered to ASI. However, candidates struggled to compute a reasonable value for the 500,000-pound lobster licence being offered to ASI because the terms were not identical to any of the comparable transactions. Most notably, the term of licences being offered to ASI were indefinite, which differed from the four transactions supplied. Strong candidates identified the Tiger Limited and Shellfish Harvester Ltd. transactions as the most appropriate comparable transactions based on the fact that both were for offshore lobster and were renewable. They were also able to estimate a value of the licences based on a quota of 500,000 lobsters each year on the assumption that the transactions could be renewed on the same terms.
and conditions as supplied in perpetuity. The costs were then compared to the $7.5-million price being offered to ASI. Qualitative factors were then noted, the most notable one being the indefinite life of the 10 licences being offered to ASI, and a final recommendation or counter-offer price was suggested.

Many weak candidates did not understand the differences in the transactions and blindly used them all as comparable transactions. They also attempted to quantify the “incremental cash flows” that would be generated from each transaction and compare them with the incremental cash flows that could be generated from the 10 licences being offered to ASI. This was not a valid approach to comparing the value of the licences. Some weak candidates also assumed that ASI could purchase the comparable historical transaction licences as an alternative to the indefinite licences being offered to ASI and, as a result, their analysis was of little value to ASI.

AO#11 (Dragon Delights Contract Working Capital and Cash Flows)

ASI was also considering entering into a contract with Dragon Delights, a restaurant chain in China, to supply them with between 2 million and 3 million pounds of clams annually. ASI wanted to know “the impact on ASI’s receivables, inventory, and cash flows” should it proceed with this opportunity. Candidates were expected to quantify the average amount of receivables and inventory that would be required under the contract and to calculate the profitability or cash flows (or both) that would result from the agreement.

Overall, candidates performed as expected on the assessment opportunity. Most candidates were able to quantify and understand that the contract would be profitable and lead to significant incremental cash flows for ASI under the present conditions. Candidates also recognized that the contract would have a significant impact on the receivables and inventory of ASI, although they were not always able to calculate this impact.

Strong candidates used the details supplied in the potential agreement to quantify the profitability of the contract for ASI and quickly understood that these significant profits would lead to large incremental cash flows for ASI over the three-year term of the contract. Strong candidates were also able to quantify the effects of the terms of the contract on ASI’s receivable and inventory balances. Since ASI would extend 60-day credit terms to the customer and would be required to hold two weeks’ worth of inventory on hand as a result of the contract, they used these details to calculate the average receivables and inventory as a consequence of accepting the agreement.

Weak candidates did not incorporate the case facts presented within their quantitative analysis. Many did not calculate or understand the profitability of the contract. As well, their analysis of the receivables and inventory was limited to a narrative discussion that suggested that the effects on receivables would lead to an increase in the days outstanding and the effects on inventory would be that it would increase, with no further analysis or calculations to support their analysis.

AO#12 (Dragon Delights Contract Pros and Cons)

With respect to the Dragon Delights contract, candidates were also asked to discuss “the advantages and disadvantages of accepting the contract.” Candidates were expected to analyze the terms of the contract from a qualitative perspective, presenting a balanced analysis of the clauses contained in the agreement. They were then expected to incorporate all of their analyses (quantitative and qualitative) to provide a reasoned recommendation for ASI.

Overall, candidates performed below expectations on this assessment opportunity. Many candidates
provided a superficial analysis of the advantages and disadvantages of the agreement without adding any significant value for ASI.

Strong candidates clearly understood the terms of the agreement and provided an explanation as to why they considered the terms either advantages or disadvantages. For example, the agreement contained a clause that would allow the contract to be terminated without penalty by either party with 60 days’ notice. Strong candidates understood and explicitly stated that this could be either an advantage (e.g., ASI could get out of the contract if prices for clams rose on the open market) or a disadvantage (i.e., Dragon Delights might terminate this contract after a short time frame, leaving ASI with significant inventory and receivables outstanding). Strong candidates provided several examples of both advantages and disadvantages of the contract, clearly providing support for their analysis using case facts.

Many weak candidates simply provided a laundry list of pros and cons without providing additional value for ASI. Some weak candidates provided only a one-sided argument and, as a result, did not provide a balanced response. A supported conclusion was difficult for some weak candidates to provide due to the weaknesses in their analysis.

**AO#13 (Risk Management)**

Candidates were expected to provide an analysis of the derivative financial instruments that ASI might be able to use to help manage certain financial risks that the company was facing. With respect to the Dragon Delights contract, the case stated, “Additionally, since the contract is in U.S. dollars, you are to prepare a brief discussion of how to manage the risks. Options to be considered include forward contracts, futures contracts, and purchase options to sell U.S. dollars at a certain price.” As well, with respect to the proposed variable rate loan being proposed for the vessel purchase, the case states “Darrel is nervous about this variable rate loan and wonders if there is any way to mitigate the risks associated with fluctuations in interest rates.” Candidates were expected to suggest and explain the derivative instruments that could be used to mitigate the foreign exchange risks and interest rate risks associated with these issues. This was considered to be one of the more difficult requirements.

Overall, candidates performed below expectations on this admittedly challenging assessment opportunity. While most candidates were able to understand the concepts behind an interest rate swap, they were unable to describe how ASI could use the other potential hedging instruments (the forward, futures, or purchase option) to mitigate its foreign exchange risk associated with the Dragon Delights contract.

Strong candidates recognized that ASI could use an interest rate swap to mitigate the risk associated with the variable rate loan on the potential vessel financing. Strong candidates also described how forward contracts, futures contracts, and purchase options could be used to mitigate ASI’s exposure to foreign currency fluctuations on the Dragon Delights contract. They also used case facts to explain how the various derivative instruments would work in practice and provided a reasoned recommendation supported by their analysis.

Weak candidates clearly did not understand how these specific derivative financial instruments worked from a technical standpoint and were unable to apply the instruments to ASI’s specific information. Often, weak candidates attempted theoretical discussions only, but even these discussions contained technical errors.
Paper/Simulation: Day 2 (ASI) – Role Case PERFORMANCE MANAGEMENT

Estimated time to complete: 300 minutes
Simulation difficulty: Average
Competency Map coverage: Performance Management Role (9 Assessment Opportunities):

Evaluators’ comments by Assessment Opportunity (AO) for the Performance Management ROLE

AO#6 (Situational Analysis – Qualitative)

Candidates were asked “to complete a situational analysis,” and this assessment opportunity evaluated the qualitative portion of that analysis. There were numerous elements in the case that candidates could discuss. To achieve competence, candidates needed to present a balanced analysis that covered a spectrum of relevant points and explain why those points were important to ASI. Their discussion should have included relevant, case-based facts on both the internal and external environments facing ASI.

Candidates performed well on this assessment opportunity. Most candidates conducted some form of a qualitative situational analysis, usually in the form of a SWOT. Generally the discussion points were balanced between internal and external and between positive and negative, with a reasonable discussion of each point’s importance to ASI.

Strong candidates provided a balanced analysis of a variety of points and included a clear explanation of their relevance to ASI. Most of these candidates integrated this qualitative analysis into their later analysis of the issues.

Many weak candidates presented a number of bullets points that were no more than a restatement of case facts, and they did not explain why the points were significant to the company or situation. Alternatively, other weak candidates lacked balance in their discussion by, for example, discussing only internal weaknesses or using Porter’s Five Forces model and ignoring all internal factors.

AO#7 (Situational Analysis – Quantitative)

This assessment opportunity evaluated the quantitative portion of the situational analysis that was requested of candidates. This assessment opportunity was not specifically directed to, but the case provided ample figures that candidates should have used in their analysis in order to understand the current situation. Two years of financial statements, key performance measures (return on equity, profit margin, and debt to assets), bank covenants, and a full page in Appendix VI of industry benchmarks were provided.

This assessment opportunity was considered more difficult than average. Candidates performed worse than expected, with a significant number not even attempting a quantitative analysis. Of those who did attempt some calculations, many provided poor interpretations.

Strong candidates provided a reasonable calculation and interpretation of at least one ratio from the four categories (profitability, liquidity, solvency, and activity). Interpretation required integrating case facts, which added value to the response. For example, it was a fact that the company’s inventory
turnover was worse than that of the industry, but it was not a concern because it could be explained by the lobster storage that was unique to ASI. Many strong candidates also included a comparison to one of the covenants, key performance indicators, benchmarks, or trends.

Weak candidates provided a calculation along with a discussion of only two or three ratios. Many weak candidates presented a brief interpretation that had minimal to no value (for example, they stated that the profit margin increased or the current ratio was acceptable since it was higher than 1.0) or an interpretation that was wrong. Some weak candidates only calculated and commented on the figures related to the covenants and simply stated whether the covenant was being met or not met. This discussion was not in the context of a situational analysis; in other words, the discussion lacked recognition of the impact of the covenant calculations on ASI’s business.

**AO#8 (Risk Strategy and Mitigation)**

Candidates were asked “to discuss the risks ASI faces and propose a mitigation strategy.” To achieve competence, candidates were expected to discuss some of the case-based risks facing ASI and recommend an appropriate mitigation strategy within ASI’s capabilities.

Candidates performed relatively well on this assessment opportunity. Most candidates were able to discuss some of the risks presented in the case and recommend logical mitigation strategies to address the risks.

Strong candidates provided a discussion of numerous risks from the case and provided adequate mitigation strategies. Many of these candidates discussed a balance of both internal and external risks.

Weak candidates were unable to identify many of the risks in the case. Many of these candidates discussed just one or two risks, with a reasonable mitigation strategy; made up risks that were not in the case (for example, the risk of severe weather, which was possible but not an issue identified in the case nor something that ASI could mitigate); or discussed irrelevant risks (for example, the risk of competition, which is a generic risk in all businesses).

**AO#9 (Fishermen’s Bonus – Quantitative)**

Candidates were asked to determine whether adjustments were required to the fishermen’s bonus and, if so, to recalculate it. To achieve competence, candidates needed to address a number of questionable costs that were included in the bonus calculation. It was not clear how some costs should be allocated. Candidates should have discussed each component of the bonus calculation presented in Appendix VI and made a case to keep, remove, or revise it.

Candidates performed reasonably well on this assessment opportunity, and they were able to discuss and use the necessary adjustments to come to a revised bonus. Many candidates appropriately identified the adjustments but failed to recognize the need to adjust the proportion of costs between the lobster and clam departments.

Strong candidates were able to make the appropriate proportioned calculations, and most laid out their calculation method clearly. They appropriately discussed each adjustment, and their discussion was logical and relevant. The discussion was then reflected in their calculation.

Many weak candidates miscalculated the revised bonus for a variety of reasons. Some of these candidates would recalculate the bonus using full costs instead of a proportion, while others would
add back costs they meant to subtract or simply ignored some of the adjustments that were required.

**AO#10 (Fishermen’s Bonus – Qualitative)**

Candidates were asked “to outline any other issues or concerns you have regarding the existing agreement, and to make recommendations for changes.” Candidates were expected to integrate their knowledge of incentive schemes with the case facts. For example, a good incentive scheme should measure results that individuals can control; therefore, the inclusion of head office expense is not a suitable cost to include in the bonus calculation. Candidates could have used a number of case facts to make improvements to the structure of the bonus plan.

Candidates performed well on this assessment opportunity. Most provided reasonable discussions on some of the issues with the fishermen’s bonus agreement. Nearly all candidates who attempted a discussion of the issues provided a recommendation.

Strong candidates were able to discuss several elements of a good bonus plan and incorporated many case facts into their discussion. The recommendation they made was consistent with their analysis, and many incorporated other analyses. For example, strong candidates included elements they identified in their situational analysis, like the fact that the lobster quotas were declining and so, as a result, having the bonus plan motivate the inshore lobster fishermen was that much more important.

Weak candidates tended to provide a theoretical discussion of bonus plans and did not incorporate case facts. Alternatively, they simply provided a discussion that lacked both depth and breadth. For example, some would discuss only one issue (such as that a good bonus should include measurable targets) and then conclude (therefore, the bonus plan should include measurable goals). Some weak candidates misinterpreted the case facts and recommended changes to the plan that were already in place (for example, the bonus should be based on the pounds supplied to ASI).

**AO#11 (Management Performance Measures)**

Candidates were asked “to suggest appropriate performance measures and types of incentives for these managers, keeping these KPIs in mind.” The key performance indicators (KPIs) were provided in Appendix VI. To be considered competent, candidates were required to discuss both performance measures and the appropriate incentives and relate both to the KPIs. A candidate’s discussion should have also recognized that each manager has different responsibilities and should, therefore, be measured differently.

Candidates did well on this assessment opportunity and performed better than expected. Most candidates were able to provide reasonable discussions of the performance measures, including a discussion of specific measures for the different management roles. Many candidates integrated either the covenants or KPIs into their discussion and suggested individualized performance measures.

Strong candidates described each manager’s role and responsibility and concluded with measures that related specifically to that role. The measures provided linked to both the covenants and key performance indicators and were both financial and non-financial. Their discussion of incentives aligned with the role of each manager.

Many weak candidates ignored the request for a discussion of performance measures for specific managers and provided a generic, theoretical discussion of performance measures. Many of these
candidates simply recommended a balanced scorecard (BSC), described the four quadrants of a BSC, and outlined generic, non–case specific measures (for example, improve profitability by 10%; reduce employee turnover).

**AO#12 (Dragon Delights Contract Analysis)**

Candidates were asked to analyze a potential fixed contract with a new customer in a country that ASI did not currently operate in. Minimal numbers were provided, but there were many case facts that candidates should have incorporated into their discussion. Candidates were expected to present a balanced, unbiased discussion with a supported recommendation in order to achieve competence.

Candidates did not perform as well as expected on this assessment opportunity. They were expected to use facts from Appendix VI, as well as integrate points from their situational analysis (for example, the fact that there was high demand in China). The depth and breadth of many qualitative discussions were less than expected. Appendix VI also provided candidates with the contribution margin of the contract, which they should have simply compared with the current contribution margin. However, candidates attempted to perform a detailed quantitative analysis with the limited information provided.

Strong candidates included many points in their qualitative discussion that linked to their situational analysis and integrated case facts. These candidates recognized how this potential contract was linked to many internal and external factors presented in the case. These candidates also recognized that there was insufficient information to complete detailed calculations and appropriately used the limited quantitative information provided. They provided a well-supported recommendation.

Weak candidates tended to lack breadth and depth of discussion. They were unable to identify the relevant points within the case, and many included points that were not case-based and were irrelevant, or they used points that were too brief (for example, that this would be a new customer) or obvious (for example, that this contract would increase revenue).

**AO#13 (RLC Contract Analysis – Quantitative)**

Candidates were asked to analyze a proposed contract from a competitor. This assessment opportunity evaluated the quantitative portion of the analysis. The details of the proposed contract included many relevant costs, but also many irrelevant costs that candidates needed to sort through. Candidates also needed to identify and calculate the capacity limitations of ASI, which had an impact on the analysis and ultimate profitability of the contract.

Candidates struggled with this assessment opportunity. Most candidates made attempts at the calculation, including identification and calculation of the capacity constraint, the subsequent opportunity cost, and the resulting profitability impact on ASI. However, most candidates made a variety of errors in their calculations.

Strong candidates clearly understood the situation, and their process to get to a profitability figure was clear. They correctly calculated the capacity constraint and opportunity cost and arrived at an accurate profitability figure. Many differentiated the opportunity cost between lobsters from the inshore fisherman (more expensive) versus ASI’s off-shore catch.

Weak candidates made several fundamental errors. Typical errors included ignoring the capacity constraint, using irrelevant inputs like fixed costs, or missing very relevant inputs. Some candidates
either misunderstood the case or simply did not understand the task at hand, which was demonstrated by erroneous calculations or their use of the wrong tools, such as net present value.

**AO#14 (RLC Contract Analysis – Qualitative)**

Candidates were asked to analyze a proposed contract from a competitor. This assessment opportunity evaluated the candidate’s qualitative portion of the analysis and their recommendation. Candidates had many case facts to use in their discussion and were expected to provide a recommendation that was supported by both the qualitative discussion and the quantitative analysis.

Candidates did fairly well on this assessment opportunity. Generally, candidates were able to discuss a balance of relevant pros and cons. All candidates used their quantitative analysis along with their qualitative discussions to support their recommendation.

Strong candidates provided a variety of relevant case facts in their analysis. Many of these candidates integrated facts from their situational analysis (for example, lobster sales were expected to increase globally by 5% annually for the next 10 years, so ASI may have wanted to save its available capacity for this expected growth). The recommendations provided were convincing and consistent with the analysis.

Weak candidates tended to provide discussions that were brief or biased. Some were unable to identify the pertinent points from the case and included discussion points that were irrelevant and not case-based (for example, ASI could obtain trade secrets from the competitor by entering the contract).
Estimated time to complete: 300 minutes

Simulation difficulty: Average

Competency Map coverage: Taxation Role (8 Assessment Opportunities)

Evaluators’ comments by Assessment Opportunity (AO) for the TAXATION ROLE

AO#6 (Recalculation of 2015 Taxable Income and Income Taxes Payable)

Candidates were told that ASI had recently been audited by the CRA. They were asked to recalculate the taxes payable for 2015, assuming that the CRA auditor’s proposed adjustments were correct. In addition, they were asked to calculate revised taxes payable based on any disagreements they had with the auditor’s assessments. Candidates were expected to recalculate taxable income (or additional taxable income) based on the CRA’s proposed adjustments, integrating a sufficient number of adjustments to show they understood the impact. Adjustments were expected to be correct or consistent with the candidate’s proposals to challenge the CRA’s adjustments. This was considered to be a very straightforward (easy) calculation for candidates.

Candidates performed very well on this assessment opportunity. Most recalculated taxable income and taxes payable based on the CRA’s proposed adjustments and then either copied and pasted their calculation, deleting the adjustments they disagreed with, or did a second calculation reconciling the CRA’s adjusted taxable income to an adjusted taxable income that the candidate agreed with. Average responses included most of the adjustments.

Strong candidates recalculated taxable income and taxes payable based on the CRA’s proposed adjustments as well as based on the candidates’ proposed adjustments, as described above. Most of their responses included all of the adjustments, and they also provided a conclusion on the additional taxes that needed to be paid as a result of the audit, the amount of taxes that would be saved by opposing some of the CRA’s adjustments, or both.

Weak candidates recalculated taxable income based only on the CRA’s proposed adjustments or based only on the adjustments the candidate agreed with. Many weak candidates also missed several of the significant adjustments.

AO#7 (Potential CRA Errors)

Candidates were told that if they disagreed with any of the proposed adjustments, they should explain their disagreement. They were also asked to indicate what ASI could do about the disputed adjustments. Candidates were expected to discuss some errors made by the auditor and provide a recommendation on how to proceed. The recommendation could have been to simply negotiate with the auditor, but candidates also had an opportunity to discuss the escalating objections and appeals process.

Candidates generally performed well on this assessment opportunity, identifying several areas of disagreement with the CRA and explaining why the CRA was incorrect. Average responses also included some discussion of areas in which the CRA was correct and why.
Strong candidates identified several areas of disagreement with the CRA, explaining why the CRA was incorrect. Many integrated specific quotes from the Income Tax Act or Regulations or both in their analyses, especially with respect to the description of Class 12 assets when proving that the tools did indeed belong in that class. These responses also included some discussions of areas in which the CRA was correct and why, and they went on to explain how to go about disagreeing with the CRA and resolving the problem.

Weak candidates identified several areas of disagreement with the CRA, often incorrectly focusing on areas in which the CRA was correct, rather than addressing areas where the CRA was incorrect. Many demonstrated technical errors in their analyses and concluded that the CRA was correct when it was not, and vice versa. Candidates with poor responses very rarely attempted any discussion of how to go about resolving the dispute.

**AO#8 (Calculation of 2016 Taxable Income)**

Candidates were asked to calculate the taxable income for 2016. Candidates were expected to adjust net income for financial statement purposes, incorporating a sufficient number of adjustments, to determine taxable income for the year.

Candidates performed well on this assessment opportunity, generally calculating taxable income and considering a number of the major adjustments. Most responses integrated seven or eight valid adjustments. The most common adjustments were incorporating accounting adjustments from common AOs, adding back depreciation, deducting CCA and CECA, adding back meals and entertainment, and making adjustments for donations (both registered and non-registered).

Strong candidates calculated taxable income, considering many of the major adjustments, and most integrated the more difficult adjustments. In addition to the adjustments performed in average responses, the strong responses included adjustments such as the R&D and prior-year investment tax credit (ITC), the carryforward of the 2015 paragraph 20(1)(e) (financing costs) deduction, and the reversal of some accounting accruals (such as the income from associate, decommissioning costs, impairment, and onerous lease).

Weak candidates calculated taxable income but did not integrate very many adjustments, or they included a large number of inappropriate or incorrect adjustments.

**AO#9 (Calculation of CCA and CECA)**

As part of the analysis of calculating taxable income, candidates needed to calculate CCA deductions. While this was not explicitly requested, significant volumes of information were provided, and over 90% of candidates attempted this assessment opportunity. Candidates were expected to calculate CCA on the depreciable property. Their calculation was expected to incorporate some current-year additions or to integrate changes from either the CRA audit or the financial reporting adjustments, or to do both, and they were expected to calculate CECA.

Candidates performed quite well on this assessment opportunity. They typically attempted a calculation of CCA and CECA, including most or all of the classes, and at least one of the additions. The calculations in the average response were reasonably correct.
Strong candidates correctly calculated CCA and CECA, including all of the classes, both of the additions, and an integration of the accounting adjustment on the crane purchase or of the 2015 CRA audit adjustments.

Weak candidates either attempted a calculation of CCA or CECA, but simply multiplied opening UCC by the CCA rate without doing any additional work, or did not attempt any calculation of CCA or CECA.

AO#10 (2016 Taxes Payable)

Candidates were asked to calculate taxes payable for 2016. They were provided with significant information on both current-year and prior-year SR&ED activities and were expected, as part of calculating the taxes payable, to determine the investment tax credits (ITCs) associated with these. Candidates were expected to calculate taxes payable either using a reasonable, supported tax rate or integrating some attempt at the SR&ED ITCs for the year.

Candidates performed poorly on this assessment opportunity. A typical candidate applied a reasonable tax rate to the taxable income calculated in AO#8, to determine a taxes payable figure, but did not consider SR&ED ITCs at all.

Strong candidates applied a reasonable tax rate to the taxable income calculated in AO#8 to determine a taxes payable figure and considered SR&ED ITCs, and they also gave a brief explanation for the rate chosen.

Weak candidates applied an inappropriate tax rate (usually a small business rate, despite the reminder from the CRA auditor that this was not appropriate) to the taxable income calculated in AO#8. The poorest responses did not include calculations of anything to do with the SR&ED ITCs.

AO#11 (Tax Implication of Stock Options)

Candidates were asked about the income tax implications of a proposed employee stock option plan for the participants and for ASI. Candidates were expected to demonstrate their understanding that an employee benefit would arise for the fair value of the stock options received in excess of the amount they paid for them. They were also expected to demonstrate that they understood some additional implications of the stock options, such as deferral of the benefit, the stock option deduction under section 110, future taxable capital gains, and employer deductibility.

Candidates performed poorly on this assessment opportunity. Many attempted a discussion of both the employee and employer sides of stock option benefits. However, while most recognized that an employment benefit would arise, there were frequently technical errors when they addressed other parts of the issue, including the deferral, deduction, or employer side of the benefit.

Strong candidates attempted a discussion of both the employee and employer sides of stock option benefits. They recognized that an employment benefit would arise and explained how it would be determined. Most also went on to explain the employee stock option deduction and recognized that the employer would not be entitled to any deduction.

Most weak candidates could not identify how the stock option benefit would be taxed to the employee. If they identified it would be taxable at all (some thought it was not), many did not
understand how it would be taxed. Poor responses also stated, incorrectly, that the benefit would be deductible by the employer.

**AO#12 (Implications for Defined Contribution Pension Plan Benefits)**

Candidates were asked for the tax considerations for two alternative proposals for defined contribution pension plans (RPP and RRSP matching), from both the company’s and the employees' perspectives. Candidates were expected to describe the employee and the employer impact of the plans.

Candidate performance was average on this assessment opportunity. Most attempted to discuss the employee and employer side of at least one plan, recognized that the employer contributions would be deductible, and briefly explained the implications to the employee of at least one plan, although many struggled to explain both plans correctly.

Most strong candidates attempted to discuss the employee and employer side of both plans. They recognized that the employer contributions would be deductible and could briefly explain the implications to the employee of both plans, in varying levels of depth.

Many weak candidates conflated the two proposed plans (RRSP and RPP) and discussed them together as if they were exactly the same thing. They often struggled to identify the tax implications to the employee or employer and frequently made technical errors, usually concluding the exact opposite of the correct rule (for example, concluding that employer contributions are not deductible by the employer or that registered pension plan contributions are taxable to the employee at the time they are made).

**AO#13 (Exchange of Common for Preferred Shares)**

Candidates were asked to explain the tax implications of a share-for-share exchange proposal on ASI and, for the shareholders, the implications not only for the initial exchange, but also for the eventual redemption of the new shares. Candidates were expected to discuss, in some depth, at least one alternative for performing the exchange of common and preferred shares (from a tax perspective). Given that section 86 was a fairly logical alternative in this instance, a discussion of this provision that explained how or why it would apply was considered sufficient.

Candidates performed surprisingly well on this assessment opportunity, which was considered to cover difficult concepts. Most identified that section 86 would be applicable in this circumstance because it represented a "reorganization of capital." Most candidates then went on to explain briefly that this would lead to the paid-up capital (PUC) and adjusted cost base (ACB) being transferred to the new class, and that no gains or deemed dividends would result from the exchange.

Strong candidates identified that section 86 would be applicable in this circumstance and provided the explanation described above for how and why it would apply. Better responses also explained the tax implications of the dividends that would be paid in future, as well as the future reRedemptions that could take place.

Weak candidates either identified section 86 (or 85), but struggled to provide any explanation of how it worked (or provided explanations with significant technical errors), or did not identify these sections at all and attempted to discuss the implication of a fair market value exchange, usually incorrectly.
BOARD OF EXAMINERS’ COMMENTS ON DAY 3 SIMULATIONS

Paper/Simulation: Day 3, Case 1 (National Mail)

Estimated time to complete: 80 minutes

Simulation difficulty: Average 2

Competency Map coverage: Management Accounting (2 Assessment Opportunities); Finance (2 Assessment Opportunities); Strategy and Governance (2 Assessment Opportunities); Taxation (1 Assessment Opportunity)

Evaluators’ comments by Assessment Opportunity (AO)

AO#1 (Revenue and Costs for Each Service Line)

Candidates were asked by their manager to determine the revenue and costs, including the allocated costs, for each service line. In Appendix I, candidates were provided with draft financial information that included data necessary to calculate the revenue for each service line. Appendix I also presented total expenditures for the three service lines. Furthermore, the appendix provided additional costs and information on how the costs were allocated, including commentary stating that the headquarters’ administrative costs could not be traced to service lines and the fact that National Mail was questioning whether there was a better basis for the allocation. To demonstrate competence on this depth assessment opportunity, candidates needed to provide a reasonable breakdown of the revenue and costs for each service line, including the headquarters costs.

Candidates performed well on this assessment opportunity. Most candidates were able to use the case facts to calculate the profitability of each service line using the current allocation basis. Most candidates also understood that the headquarters costs was a key item in the case and included the costs in the calculation, allocating it evenly across the three lines.

Strong candidates correctly incorporated the majority of the cost allocations and appropriately split the headquarters costs evenly across the lines, as per case facts. They were also able to correctly calculate the revenues across all service lines using the provided unit prices and volumes. These candidates provided clear, easy-to-follow calculations.

Weak candidates were unable to realize that the profitability calculation was supposed to incorporate the case-provided allocations in order for them to assess the current situation. Instead, weak candidates calculated profitability using their own proposed allocations. These candidates went straight to the recommendation, without first analyzing the current situation. Other weak candidates did not recognize the importance of the headquarters costs and excluded them from their calculation.

AO#2 (Subsidization and Allocation of Costs)

Candidates were asked to assess whether the Government of Canada’s grants for the Mail services benefitted Courier or Concessionary services, as well as to provide thoughts on the cost allocations and whether there were any factors the government should be considering in relation to the allocation formula. Several case facts were provided for candidates to use in their responses. The
maintenance cost allocations were last updated in 2007. Headquarters costs could not be traced to each service line, and National Mail’s management was wondering if there was a better basis for the allocation. In order to achieve competence on this depth assessment opportunity, candidates had to provide a reasonable discussion of the appropriateness of the allocation of costs between the activities and also discuss whether subsidization has occurred. This required was considered the most challenging one in the simulation.

Candidates did not perform well on this assessment opportunity. It appeared that they did not understand the subsidization concept and how the cost allocations could affect whether other service lines were being subsidized or the amount of grant received. Candidates were able to conclude whether a grant would be received based on the results of their calculation but were not able to make the link between the poor cost allocation and subsidization of the other service lines, or they discussed the cost allocation without concluding on whether or not the other service lines were being subsidized. The link between the cost allocation and subsidization seemed to be a challenge for candidates.

Strong candidates were able to discuss the fact that National Mail might have been able to request more funds by allocating costs from Courier and Concessionary services to Mail services, thus causing the government to provide more funding than necessary to support Mail services. These candidates also discussed the fact that the even split of headquarters costs was questionable and did so using a supported analysis. For example, these candidates explained that there were significant differences in the revenues and nature of the activities between each service line. These candidates also recommended a more reasonable allocation basis.

Weak candidates provided a conclusion on the service line totals but did not relate it back to assessing whether subsidization had occurred. Some weak candidates attempted to discuss the appropriateness of the allocations but did not put enough emphasis on the allocation of the headquarters costs, which was key in this case. In other instances, weak candidates proposed a new basis of allocation but did not explain why the current allocation was not appropriate.

AO#3 (Cash Flow)

Candidates were asked to perform a cash flow analysis for 2016. In Appendix II, candidates were provided with a forecast of revenues and expenses for the community mailbox and electronic post initiatives, including cost savings, cost increases, and capital expenditures. The calculations were not difficult. In order to demonstrate competence on this breadth assessment opportunity, candidates had to perform a reasonable cash flow forecast.

Candidates performed relatively well on this assessment opportunity. Most candidates were able to integrate several of the forecasted items into their cash flow calculation, including the operational revenue that they had previously calculated. Although most candidates did not include the amount of the grant in their cash flow analysis, they properly excluded depreciation from their calculation.

Strong candidates provided a complete and useful cash flow calculation. They properly excluded depreciation from their calculation and correctly incorporated several items into their cash flow analysis. Most strong candidates included the operational revenues they had previously calculated, both changes in labour costs, both capital expenditures, maintenance cost increases, additional promotional costs, and the overhead costs. Some strong candidates also included investment revenue in their cash flow calculation, which made it much more useful.

Weak candidates performed incomplete cash flow calculations by not including enough of the data
provided, which produced a less useful analysis. Some also wrongfully included depreciation in their cash flow, which is a fundamental error. Other weak candidates had errors in their calculations, incorrectly excluding significant items such as capital expenditures or confusing the increases and decreases (adjustments going the wrong way).

**AO#4 (Qualitative on Cash Flow)**

Candidates were asked to determine whether National Mail had any liquidity concerns in 2016, and to suggest ways to improve future cash flows. Candidates were expected to provide a supported conclusion on their cash flow calculation and to use their technical knowledge to provide practical and case-relevant cash flow management recommendations in order to demonstrate competence on this breadth assessment opportunity.

Candidates did not perform well on this assessment opportunity. Although candidates were able to conclude on the results of their cash flow calculation, most were not able to support their conclusion on liquidity with a proper analysis. Most candidates ignored the significant investment balance or the fact that the opening balance was unknown and that these two balances should be taken into account while assessing whether National Mail had liquidity concerns. Many candidates also had a difficult time providing practical recommendations on how to improve cash flow in the future.

Strong candidates went beyond their conclusion on cash flow to also analyze whether National Mail had a liquidity concern. Their recommendations to improve cash flow were also practical and relevant to the case, such as delaying some of the capital expenditures or increasing stamp prices. Many also provided multiple recommendations. Overall, these candidates provided useful information to the client.

Weak candidates did not provide any analysis on the cash flow calculation and just concluded whether National Mail was in a cash shortfall or surplus position. Some weak candidates did not provide recommendations that were useful for National Mail, or they provided generic recommendations that were not case specific. For example, some candidates suggested that National Mail improve its collection policy, when there were no signs of collection problems.

**AO#5 (Vision and Mission)**

Candidates were asked to provide their thoughts on whether the new initiatives were a good fit with National Mail’s vision and mission statements. In Appendix III, the vision was clearly stated along with the three mission statements. There were many key attributes of the vision and mission that could have been discussed, including being the world leader in physical delivery solutions, creating value for customers and employees, ensuring customer satisfaction, creating process efficiencies, providing the lowest cost, and minimizing environmental impact. All of these could have been discussed in relation to each of the new initiatives. In order for candidates to demonstrate competence on this breadth assessment opportunity, they had to provide a reasonable analysis as to whether the 2016 initiatives were in line with National Mail’s vision and mission statements and provide a conclusion or recommendations on what needed to be done.

Candidates generally performed well on this assessment opportunity. Almost all candidates identified the need to analyze whether the new initiatives aligned with the vision and mission statements. Most candidates were able to provide a sufficient analysis, usually addressing each of the initiatives in relation to the multiple elements of the vision or mission statements. Candidates generally did a good job of incorporating case facts in their analysis as examples of why they
thought the initiative was or was not in line with the statements.

Strong candidates used each key attribute of the vision and mission statements to provide an analysis of whether the new initiatives were a good fit. They also provided depth in their discussions, which demonstrated their understanding of the initiatives and the vision and mission statements. Some strong candidates also suggested updating the vision and mission statements, since they seemed to be outdated due to the recent changes in the business environment.

Weak candidates did not seem to place enough emphasis on this assessment opportunity, addressing it briefly. They typically provided a high-level conclusion without an in-depth discussion or without tying their conclusion to the specific attributes of the vision and mission statements. Some weak candidates also provided impractical recommendations, such as not proceeding with the initiatives since they were not in line with the vision and mission statements.

**AO#6 (Procedures)**

Candidates were asked to propose substantive procedures for auditing revenue and expenses. The case specified that the auditors were going to take a fully substantive approach for income statement items. In order for candidates to demonstrate competence on the breadth assessment opportunity, they were expected to provide some audit procedures to audit both the revenue and expenses.

Candidates struggled on this assessment opportunity to provide complete procedures. Most candidates had a difficult time providing a procedure that would cover the spectrum of the transaction (from the accounting records to the source document, or vice versa), often forgetting steps in the process. Candidates also struggled to provide procedures that were relevant to National Mail’s specific operations, suggesting generic procedures that could apply to any company at all.

Strong candidates provided several audit procedures that were relevant to National Mail. They were able to provide specific, complete procedures and provided many of them, covering case-specific revenue and expenses. Some strong candidates also realized that allocation was a key risk and provided procedures that addressed this risk.

Many weak candidates provided audit procedures that were vague, suggesting, for example, to “ensure accuracy” without explaining how to do it. They also provided procedures that were incomplete by suggesting, for example, to “vouch invoices” without mentioning where to vouch them from or to and what to look for on the invoice. Other weak candidates provided a general list of audit procedures that were not tied to any of the specific revenue or expense items from the case.

**AO#7 (Matters for the Board’s Attention)**

Candidates were asked to note any matters of significance to share with National Mail’s board. This request referenced the CFO’s notes from Appendix III and also mentioned that National Mail was facing strategic challenges. Key excerpts from the notes included a drop in mail delivery volumes, looking at moving towards more digital means, trying to find ways to manage operating losses, and exploring different funding models. In order to demonstrate competence on this breadth assessment opportunity, candidates had to choose from the different matters that needed attention and provide a discussion with some advice on that matter for the board of directors.

Candidates did not perform well on this assessment opportunity. They struggled to see the bigger
picture but also to find ways to address the challenges National Mail was facing. The challenges had already been identified by the CFO in Appendix III, and candidates had a difficult time adding any value to what the CFO had already mentioned.

Strong candidates realized that there were several distinct points to address and discussed most of them. They were able to provide forward-looking advice that addressed the strategic challenges provided in the case. The most common discussion addressed the changing external environment (move towards digital and less mail delivery) and advised the board to shift strategic focus towards more digital solutions and other lines of service.

Weak candidates repeated statements from the case and did not provide an analysis that added value. Some weak candidates discussed this from the perspective of the current initiatives without providing a forward-looking strategic discussion. Other weak candidates just provided a generic recommendation without applying critical thinking to determine how to address the challenges presented. For example, these candidates mentioned that the mail delivery business had been going down, and that the board should be made aware of it, without providing any ideas on how to deal with this situation.
Paper/Simulation:  Day 3, Case 2 (Perfecto Painters)

Estimated time to complete:  90 minutes

Simulation difficulty:  Average 1

Competency Map coverage:  Management Accounting (2 Assessment Opportunities); Taxation (2 Assessment Opportunities); Audit and Assurance (1 Assessment Opportunity); Strategy and Governance (1 Assessment Opportunity)

Evaluators’ comments by Assessment Opportunity (AO)

AO#1 (Activity-Based Costing)

Candidates were directed to perform an analysis of PPI’s costs when Peter said that he believed “an analysis of PPI’s costs of performing painting services, performing drywall repair work, and providing job support would be useful and might explain the financial results.” In Appendix II, candidates were provided with information about 2015 operations. Peter analyzed the expenses incurred by PPI in 2015 and divided them into major activities he thought added directly to the cost of a job. In addition, he estimated the volume of each activity. On this depth assessment opportunity, candidates were expected to evaluate the cost management technique being used and recommend appropriate methods for residential and commercial jobs. In order to demonstrate competence, candidates had to allocate costs to each activity and apply the volume of activity information (as determined by Peter) to the various activities.

Candidates performed very well on this assessment opportunity. Most candidates were able to use case facts and perform a reasonable allocation of costs to the activities that added to the cost of a job. They were also able to recognize that the cost driver was not the number of square metres painted for each activity performed (painting, drywall, and job support).

Strong candidates were able to correctly calculate the activity rate for each activity by applying the appropriate driver of cost (for example, square metres painted; number of drywall repairs performed; hours of job support provided). The calculations performed by strong candidates were better structured and easy to follow than those performed by others.

Weak candidates were not able to use the data provided in the case to perform a reasonable allocation of costs to the activities that added to the cost of a job. Candidates did not appear to know how to determine what the cost drivers and activity rates were. Their calculations contained numerous errors or inconsistencies in application and did not recognize that there were different drivers of cost depending upon the activity performed.

AO#2 (Residential versus Commercial)

Candidates were directed to this assessment opportunity when told that a decision to serve both the commercial and residential markets in 2015 resulted in PPI reporting a loss on the draft income statement. They were also directed to it when Peter wondered “whether he should stay in both the residential and commercial markets, or whether he should concentrate on only one of them.” In Appendix I, candidates were provided with a draft income statement that included notes on revenue and specific expense categories. In the notes, information was provided on revenue and the fee
structure, credit to commercial customers, salary, wages and benefits, supplies expense, vehicle expense, and loss on investment. In order to demonstrate competence on this depth assessment opportunity, candidates had to calculate a reasonable profitability for residential and commercial jobs using the activity-based costing method and conclude on the profitability of the residential and commercial jobs in 2015.

Candidates performed well on this assessment opportunity. Most candidates were able to use the case facts provided and incorporate the results of their AO#1 analysis to calculate a reasonable profitability for residential and commercial operations, and they were able to conclude on the results of their analysis. Most candidates focused on an analysis of profitability, rather than merely on costs.

Strong candidates provided a better calculation, incorporating the bad debt provision into the analysis of commercial operations or clearly recognizing that other unallocated costs should be excluded from the residential and commercial operational analysis.

Weak candidates did not build upon their AO#1 analysis and, instead, used PPI’s income statement to arbitrarily allocate revenue and expenses between residential and commercial operations. Those candidates were forced to develop their own assumptions with respect to the allocation of expenses, since no information was provided in the simulation (no split of expenses for each of residential and commercial operations). Those candidates also did not recognize that some expenses would not affect Peter’s decision (such as the loss on investment). Other weak candidates provided no conclusion on the results of their analysis, or they considered only total costs rather than profitability.

**AO#3 (Controls)**

Candidates were asked for help because Peter felt he had lost control as the business had grown. Peter believed he could make improvements in several areas. He noted a few issues in Appendix I relating to a decision to extend credit to commercial customers, a new crew of painters he had hired, supplies expense being too high, and crews using PPI vehicles. In order to demonstrate competence on this breadth assessment opportunity, candidates had to discuss recommendations for improvement in the areas in which Peter had already identified issues with the controls.

Candidates performed well on this assessment opportunity. Most candidates were able to provide useful recommendations that Peter could implement to resolve several of the control weaknesses he had identified. The recommendations were clear and concise and demonstrated an understanding of the problem at hand.

Strong candidates provided a complete discussion of the weaknesses identified by Peter, making specific and relevant recommendations in each area that, when implemented, would resolve the issue of concern. Strong candidates also provided multiple recommendations for each area and provided a good coverage of the areas in which Peter had identified weaknesses.

Weak candidates provided recommendations for weaknesses that were the more obvious ones, and their recommendations in other areas were of lesser quality. Their recommendations were either unclear or provided only one part of what would be required to resolve the control issue. Weak candidates addressed fewer of the areas in which Peter had identified control issues and often repeated the weakness as identified by Peter in slightly different words as their discussion of the issue.
AO#4 (Shareholder Loan and Dividend versus Salary)

Candidates were asked for taxation considerations related to the issues identified by Peter. The issues were presented in the notes to the financial statements (Appendix I). Note 2 of Appendix I provided information regarding an interest-free shareholder loan that Peter took out during 2015 in order to meet his personal needs, after a reduction in his salary. Peter also recently heard at a networking event that there may be a tax advantage to declaring dividends instead of taking salary, and he wondered what the tax implications would be of doing so. In order to demonstrate competence on this breadth assessment opportunity, candidates had to explain the tax consequences for Peter’s compensation and loan from PPI.

Candidates performed relatively well on this assessment opportunity since most of them were able to provide sufficient tax knowledge of the treatment of shareholder loans, with few errors, and demonstrated some understanding of the tax treatment of dividends versus salary. Candidates were better able to demonstrate their tax knowledge through a discussion of the shareholder loan than through their dividend-versus-salary discussion.

Strong candidates concisely explained the tax treatment of shareholder loans. They also explained both dividend and salary considerations to Peter, from both an employee and an employer perspective. Strong candidates also demonstrated a general understanding of the theory of integration.

Weak candidates did not know what the tax implications of the shareholder loans were or provided confused explanations. For example, some candidates mentioned that Peter would be taxed on imputed interest at the market rate if he repaid the loan, which was incorrect. Some weak candidates identified that the tax treatment for the two types of remuneration for Peter (dividends and salary) differed but did not explain the difference in the tax treatments between them. Other weak candidates only listed the treatment of either dividend or salary but did not compare the two options. Some weak candidates’ responses presented significant technical errors or omissions or provided information that contradicted information presented in another part of their response.

AO#5 (Other Tax Issues)

Candidates were asked to provide tax advice to Peter. In Appendix I, notes were provided that gave information relating to uncollected and overdue balances for commercial customers, the use of PPI’s vehicles by the crews, Peter’s suspicion that some of the crews were charging PPI for gas used for their own personal vehicles, and a loss on investment in a start-up technology company. In order to demonstrate competence on this breadth assessment opportunity, candidates were expected to discuss some of the tax consequences relating to those issues. Candidates were not specifically directed to this required.

Candidates did not perform well on this assessment opportunity. Most candidates were able to identify the loss on investment and that it was a capital loss for tax purposes, but they did not subsequently recognize the transition of the nature of that loss (capital loss to business loss to ABIL) in their response. Some candidates were able to recognize that employees may have a taxable benefit related to the personal use of company vehicles, and those candidates explained the impact upon their income. However, most candidates did not identify the bad debt issue from a tax perspective; they only considered the uncollectible accounts when discussing control issues.

Strong candidates were able to recognize that the loss on investment in SBI was an allowable
business investment loss (ABIL). These candidates understood the progression of the nature of the loss as well as the application of the ABIL against all types of income up to a certain point in time. Most strong candidates also recognized another tax issue (mainly the taxable benefits related to the personal use of PPI’s vehicles) and appropriately described the impact on employees.

Some weak candidates were unable to identify the non-directed tax issues and, as a result, did not attempt to address this assessment opportunity at all. Some weak candidates identifying the business investment loss were able to recognize that it was a capital loss but did not discuss the subsequent tax treatment of that loss and did not recognize that it was an ABIL. Many of these candidates did not identify other tax issues, such as the bad debt provision or the taxable benefit for personal use of vehicles.

**AO#6 (Strategic Plan for 2016)**

Candidates were not explicitly asked to prepare a strategic plan for PPI. However, they were told that a strategic plan for a profitable 2016 was required by the bank. In addition, they were told that Peter wondered whether he should stay in both the residential and commercial markets, or whether he should concentrate on only one of them. In order to demonstrate competence on this breadth assessment opportunity, candidates were expected to discuss changes that could help improve PPI’s position going forward.

Candidates performed relatively well on this assessment opportunity. Most candidates attempted to provide advice to Peter and used their residential-versus-commercial quantitative analysis to conclude on whether PPI should remain in residential and commercial operations, or they related the results of their internal control analysis to demonstrate the impact on costs if better controls were in place.

Strong candidates were able to integrate the results of the calculations from their management accounting discussions to conclude on whether to remain in residential and commercial activities, and they also provided several specific suggestions to improve the pricing of those services, taking external factors into account, such as the discount providers in the residential market. Strong candidates considered overall profitability, rather than addressing only revenues or only costs. They were able to step back and consider the big picture of PPI’s operations, rather than one individual component that affected the company.

Most weak candidates did not discuss the pricing strategy and did not consider ways to improve the profitability of the company. Many of these candidates responded only to Peter’s question of whether PPI should remain in residential and commercial operations, and few used their quantitative analysis of the residential versus commercial businesses to support that recommendation. Weak candidates provided general strategic advice in response to the bank’s request for a strategic plan, focusing more on how to make sure PPI would get the loan and failing to consider that the plan was for a profitable 2016.
**Paper/Simulation:** Day 3, Question 3 (CHHP)  
**Estimated time to complete:** 70 minutes  
**Simulation difficulty:** Average 1  
**Competency Map coverage:** Management Accounting (1 Assessment Opportunity); Audit and Assurance (1 Assessment Opportunity); Taxation (1 Assessment Opportunity); Financial Reporting (1 Assessment Opportunity); Finance (1 Assessment Opportunity)

**Evaluators’ comments by Assessment Opportunity (AO)**

**AO#1 (Calculation of Price to Charge)**

Candidates were asked to determine the amount to charge for CHHP’s new annual certification exam. Case facts stated that it was expected that 2,000 students would write the exam, but CHHP also wanted to know what to charge if it had 1,000 students and if it had 3,000 students. Candidates were provided with information regarding the cost of the exam in Appendix I. They were also told that 25% of the total writers would be repeat writers starting in Year 2, who would be allowed to rewrite the exam at a reduced rate. In order to demonstrate competence on this depth opportunity, candidates had to provide a reasonable calculation of the price to charge, which included fixed costs, variable costs, and consideration of the repeat writer discount, at multiple student levels. Except for integration of the discount rate, the calculations required were straightforward.

Candidates performed well on this assessment opportunity. Most candidates were able to use the information provided to determine a price to charge for the exam, incorporating both fixed and variable costs and addressing the fact that a repeat writer rate would mean a higher cost for the exam starting in the second year.

Strong candidates were able to take the information provided and perform a complete calculation of the price to charge. They included many of the fixed and variable costs and integrated the repeat writer discount in their calculations, which they performed for all the student levels. They were also able to provide some additional insight to CHHP, such as the fact that pricing needs to be standard over the years (or at least to not fluctuate too much); that student or cost estimates may turn out to be inaccurate, which would affect the cost of the exam; and that the specialized equipment cost (either leasing or purchasing) would have to be incorporated into the cost of the exam.

Weak candidates were not able to provide a reasonable calculation of the price to charge. Many of their calculations missed significant elements, such as variable costs or fixed costs. Some candidates provided only a total of the costs related to the exam, without calculating a price to charge the writers. Others calculated the price to charge for only one of the student levels. Some weak candidates seemed to struggle with how to calculate the price per exam and took fixed costs and divided by the per-exam variable cost. They also spent time discussing whether the exam fit with CHHP’s mission and vision, which was not relevant in this case because the decision had already been made to go ahead with the exam.
AO#2 (Controls)

Candidates were asked to comment on the proposed marking centre operations and processes and recommend improvements where they identified weaknesses. Information regarding the marking centre was provided in Appendix II. In order to demonstrate competence on this breadth assessment opportunity, candidates had to identify several of the control weaknesses, explain their implications, and provide valid recommendations to address the issues.

Candidates performed well on this assessment opportunity. Most candidates were able to identify several control weaknesses surrounding the marking centre processes, explain the implications of each, and provide practical and valid recommendations. The most commonly addressed control weaknesses were the fact that the marking room was unlocked at all times and the potential conflict-of-interest concerns associated with having student names on the exam responses.

Strong candidates discussed a greater number of weaknesses that touched on several different areas. They also provided a better discussion of these weaknesses by adequately explaining the implication for CHHP and suggesting valid, practical recommendations. They also tackled some of the control weaknesses that were more difficult to solve, such as how to prioritize the marker applications, which was a specific concern for CHHP.

Some weak candidates provided recommendations without first explaining why the weakness had an impact on CHHP. Others did not provide recommendations that would sufficiently address the weakness identified. Weak candidates addressed fewer issues, and many provided recommendations that were not practical. They also tended to address the same issue from multiple angles instead of providing recommendations on different areas. Although candidates were presented with many control weaknesses to discuss, some discussed weaknesses that were not related to specific case facts from the simulation. For example, many weak candidates discussed the need for markers to take breaks, which was not a significant issue in this case since case facts mentioned that markers were allowed to take breaks whenever they wanted.

AO#3 (Employee versus Contractor)

Candidates were asked to assess whether CHHP’s markers would be considered self-employed under the current scenario, and whether there was anything that CHHP could change in order to make sure markers were considered self-employed. In order to demonstrate competence on this breadth assessment opportunity, candidates had to provide a reasonable analysis of whether the markers would be considered self-employed, while considering several factors. They also needed to provide CHHP with a recommendation on what it could change to improve its case for self-employment.

Candidates performed well on this assessment opportunity. Most candidates were able to discuss whether the markers were self-employed using several factors of consideration and applying case facts to these factors. They were also able to provide CHHP with advice on how to further strengthen the case for self-employment. The most commonly addressed factors to consider included whether the markers had control over the way the job was performed, whether they used their own tools or those provided by CHHP, and who bore the risks of profit or loss.

Strong candidates provided a supported discussion on whether the markers would be considered self-employed, applying case facts to the several criteria to be considered. They clearly explained each factor and how CHHP would be assessed for each one. They also provided recommendations
on how CHHP could strengthen its case for self-employment. Many strong candidates gave practical recommendations that did not require changing the marking process itself, such as recommending that markers be paid by the paper instead of a flat fee.

Weak candidates generally provided the factors to consider but did not apply case facts to them. They provided general advice and analysis that could be applied to any situation, instead of specifically addressing CHHP’s situation. When they did apply case facts, they did not explain whether a case fact supported the markers being employed or self-employed, as often both arguments could be made. Weak candidates did not discuss each factor in such a way that helped CHHP understand why the factor was relevant.

**AO#4 (Accounting Issues)**

Candidates were asked to prepare a report discussing all accounting implications related to the exam department’s operations. In order to demonstrate competence on this depth assessment opportunity, candidates were expected to address the revenue recognition issue or the banked questions issue in sufficient depth.

Candidates struggled with this assessment opportunity. Most candidates identified both the revenue recognition and the banked questions issues, but were unable to provide a complete analysis of either issue.

Strong candidates were able to provide a complete analysis by first identifying the relevant *Handbook* criteria and then applying appropriate case facts to their analysis. For example, in the case of revenue recognition, candidates discussed whether CHHP met the measurement, collectability, and performance criteria, and they specifically identified that the exam had several milestones that could be used as a basis for the calculation of the percentage of completion. In the case of the banked questions, strong candidates identified that the questions could potentially be an intangible asset and went through the specific criteria that needed to be met. They first focused their discussion on whether the questions met the definition of an asset, discussing whether CHHP could derive a future economic benefit from the banked questions, whether they had control over the questions, and whether the questions resulted from a past transaction. They then went on to discuss the identifiability criterion specific to intangible assets. These candidates understood what the correct treatment should be and, thus, provided CHHP with correct accounting advice.

Many weak candidates did not identify the correct issue. Many quoted NPO fund accounting concepts, which were not relevant in this case. Many weak candidates who did identify the correct issue provided discussions that were technically incorrect. For example, many candidates concluded that revenue for the exams should be recorded on a completed contract basis. These candidates did not provide sufficient explanation to support their conclusion. The case facts support that CHHP meets the criteria for recording revenue on a percentage of completion basis. In addition, many weak candidates incorrectly concluded that the classification as prepaid expenses was the correct treatment for the banked questions or that the questions should be accounted for as inventory, without sufficiently supporting their position. Weak candidates also did not provide *Handbook* criteria to support their discussions, and they tended to focus on the accounting for the specialized equipment lease, which was a minor accounting issue in this case.

**AO#5 (Lease versus Buy)**

Candidates were asked to analyze a lease-versus-buy decision on specialized equipment.
Information on the available options was provided in Appendix III. In order to demonstrate competence on this breadth assessment opportunity, candidates were expected to calculate and compare the present value of the two options presented and provide a supported recommendation.

Candidates did not perform well on this assessment opportunity. Most candidates demonstrated many technical weaknesses in their attempt to calculate present value for the two options. Candidates seemed to struggle with the concept of present value, often recommending the option with the higher present value to CHHP when, in fact, CHHP would want to choose the option with the lower present value.

Strong candidates were able to provide present value calculations for both options that contained minimal errors. In addition, many provided qualitative considerations, such as the fact that more cash is required upfront for the purchase option, which CHHP may not be able to afford, or the fact that the equipment can be used as collateral for any loans that may be required, if purchased. Strong candidates also provided a recommendation on the lease-versus-buy decision, taking into account their present value analysis and qualitative considerations.

Many weak candidates performed present value calculations that contained significant errors. For example, some weak candidates included the sunk costs (the $800 already spent to provide a credit report) in their analysis, despite it being irrelevant for decision-making purposes. This was considered a fundamental flaw. Weak candidates also mistreated the salvage value of the equipment by ignoring it altogether or including it in the lease option. Another common mistake made by weak candidates was to forget to match the payment frequency with the interest rate, using an annual interest rate to calculate present value for a monthly payment stream. Other weak candidates did not calculate the present value of the options at all, but rather compared the lump sums of each option, ignoring the time value of money altogether.