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CARE
Chartered Accountant
Reciprocity Examination
2003

The Institutes of Chartered Accountants in Canada and Bermuda

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Questions and Approaches
to Solutions

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Chartered Accountant Reciprocity Examination
Summary of Results

Institute	2003		2002		2001	
	Number of Writers	% Pass	Number of Writers	% Pass	Number of Writers	% Pass
British Columbia	22	95	14	86	16	94
Alberta	6	100	83	100	4	100
Saskatchewan	-	-	1	100	-	-
Ontario	54	80	61	79	47	72
Quebec	-	-	1	-	1	-
New Brunswick	-	-	-	-	1	100
Nova Scotia	-	-	1	100	-	-
Total	82	84	82	80	69	78

THE INSTITUTES/ORDRE OF CHARTERED ACCOUNTANTS IN CANADA

CA RECIPROCITY EXAMINATION

DAY ONE – 2003

(100 marks) (3 hours)

NOTES TO CANDIDATES:

1. There are 14 questions and 19 pages in this examination (including the cover page, appendices and question 1 answer sheet).
2. **Do not** write your name on your examination envelope or answer papers. Use your candidate number only.
3. To assist in budgeting time during the examination, the number of minutes available for each question (calculated at approximately 1.8 minutes per mark) is shown at the beginning of each question.
4. Answers or parts of answers to examination questions will not be marked if they are recorded on the question paper.
5. **Ensure that the answer sheet for question 1**, attached as the last page of this examination, is detached and submitted with your other answer papers in the examination envelope provided.
6. It is recommended that you write your responses in **ink** and write on every other line.
7. Two tables are attached to the examination paper. No other reference sources are allowed.

Question 1 (8 marks) (14 minutes)

The question consists of **4 parts worth 2 marks each**. Select the best answer for each part. Indicate your answer by marking an “X” in the appropriate space on the answer sheet attached as the last page of the examination. If more than one answer is given for a part, that part will not be marked. Marks will **not** be deducted for wrong answers. Explanations given will not be taken into account. **When you have completed your answer sheet, detach it and submit it along with your other answer papers.**

(i) Impairment of Long-lived Assets

Haldyne Pharmaceuticals is in the process of reviewing its capital assets accounting policy. As part of this process, they have taken inventory of their capital assets and have determined that they may need to revalue some of the assets. In particular, there is a significant amount of lab equipment. The carrying value is \$2,500,000. The company estimates that the equipment may be used to generate net cash flows of \$2,000,000, which includes the proceeds of disposition after use. The discounted net cash flows is \$1,500,000. The asset has a substantially reduced market value of \$1,750,000 (on a second hand market). The company still plans to use the equipment.

Which one of the following is the appropriate value for accounting purposes of the lab equipment under Generally Accepted Accounting Principles?:

- a. \$2,500,000 since this is the historical cost.
- b. \$2,000,000 since this amount is recoverable from future revenues.
- c. \$1,750,000 since this reflects fair value.
- d. \$1,500,000 since this is the discounted value of the future cash flows.

(ii) Foreign Currency Translation

Keneco Limited (KL) operates in Mexico and is wholly owned by Keneco Corp. (KC), a Canadian corporation. KL local management report daily to KC management as KC is a very centralized organization with all decisions being made at head office. Cash flows are also managed centrally. KL has a significant amount of inventory that has become obsolete. Its current net realizable value is less than its carrying value and management is considering writing the inventory down to its market value.

Which one of the following rates should the inventory be translated at when preparing the consolidated financial statements for KC?:

- a. Historic rate since inventory is a non-monetary item.
- b. Current rate since KL is self-sustaining.
- c. Historic rate since KL is integrated.
- d. Current rate since inventory is carried at market.

(iii) Audit of Accounting Estimates

When auditing accounting estimates, which one of the following would the auditor normally do?

-
- a. Rely on an external specialist.
 - b. Rely on an internal specialist.
 - c. Consider the cumulative effect of bias.
 - d. Calculate a point estimate.

(iv) Communication with Management

During the year-end audit of Tepperland Inc., the auditors discovered an illegal act that was being committed by a middle management employee. After a detailed investigation, the auditors concluded that the illegal act would not have a material impact on the financial statements, but felt that management should be made aware of the situation. Which of the following statements represents the required course of action under Generally Accepted Auditing Standards?

- a. The auditor need not communicate the act prior to the issuance of the year- end auditor's report as long it is communicated on a timely basis.
- b. The auditor must communicate the information to management verbally immediately and in writing as soon as possible.
- c. The communication must be done on a timely basis and be in writing.
- d. The auditor must communicate the information to management at least verbally, as soon as possible.

Question 2 (9 marks) (16 minutes)

Related Party Transactions

Rearton Limited (RL) is in the plumbing business, providing services to homeowners and construction companies. Mick Rearton started the company and has been in business for twenty years. You, CA, are an audit manager with the firm Jones and Jones CAs, who have been the auditors of RL for a number of years.

Mick has always followed a policy of keeping family and business separate. During the current year, Mick was off sick for an extended period of time and asked Andy to look after the shop for him. Andy is married to Mick's sister Mandy. Andy and Mandy have a twenty five year old son, Ralph. Mick gave Andy full authority to enter into transactions for RL. When Mick returned, he found the following transactions between RL and family members:

- (1) Equipment sold to Mandy for \$2,000. The cost of the equipment was \$1,500 and the fair value \$3,000. RL does not normally sell this type of equipment but fair values are readily available.
- (2) Plumbing services provided to Ralph. Ralph had moved into his first house and needed a new bathroom installed. Ralph paid \$3,000 for the services, which were worth \$6,000. Mick estimated that the \$3,000 was close to cost.

Both transactions are material to RL's financial statements.

Required:

Part A: Discuss the relevant accounting issues for both transactions. (4 marks)

Part B: Discuss the impact that the transactions authorized by Andy will have on the current year audit. (5 marks).

Question 3 (9 marks) (16 minutes)

Disclosure of Guarantees

You, CA, have been assigned to the audit of Queen Incorporated (QI), a company operating in the construction industry that has been audited by your firm for many years. During the current year, QI entered into several guarantees with unrelated parties. In one situation, QI has been unable to estimate the maximum amount payable under the guarantee. In another, the client has accrued 50% of the amount of the maximum guarantee as they feel that this will likely be paid out. The amounts related to these and other similar guarantees are material.

Required:

Part A: Discuss any disclosure requirements related to these and other guarantees (4 marks).

Part B: Discuss any audit issues that should be considered for this year's engagement (5 marks).

Question 4 (11 marks) (20 minutes)

Purchase Price Calculation

On January 2, 2003, Jenny Corp. acquired 80% of the issued and outstanding common shares of Jacob Limited for \$2,500,000. Both companies are private companies. Information related to Jacob Limited is as follows:

	Book value	Fair value
Current assets	\$335,000	\$335,000
Building and Equipment	2,700,000	2,700,000
Patents	0	300,000
Broadcast license	100,000	200,000
Liabilities	600,000	600,000

The patent has a ten-year life. The patent will be sold after 5 years at which point it will still be generating significant revenues. The broadcast license expires in 7 years but is renewable at a nominal cost every 7 years provided that regulatory requirements are complied with. At year-end, Jacob Limited had net income of \$1,000,000.

Required:

- Part A Prepare a purchase price allocation as at the acquisition date. (3 marks)
- Part B Calculate the impact of including the net income of Jacob Limited in the financial statements of Jenny Corp. for the year end December 31, 2003. Explain any decisions/choices made regarding the calculation. (5 marks)
- Part C Assuming Jenny Corp. qualifies for differential reporting, what flexibility/relief does this afford them in terms of accounting? (3 marks)

Question 5 (6 marks) (11 minutes)

Not-For-Profit Accounting – Capital Assets

Sunshine Food Service (SFS) is a not-for-profit entity that distributes food to schools as part of a “feed our children breakfast” program. The entity has been operating for 10 years and has been steadily expanding up until this year when revenues dipped for the first time in 5 years below \$500,000.

During the year, two refrigerated trucks were donated to SFS. The trucks are worth \$20,000 each. In addition, SFS purchased a used refrigeration unit for \$5,000. The employees were thrilled with this as the unit was worth at least double this amount. A general contractor donated his services, worth \$1,000, to install the unit.

SFS uses the Restricted Fund method of accounting.

Required:

Discuss the appropriate accounting treatment(s) for these transactions under Generally Accepted Accounting Principles.

Question 6 (7 marks) (13 minutes)

Non-monetary transactions - Definition of a business

Golfing World Limited (GW), a large public company, operates several luxury exclusive golf resorts on the west coast of North America. Golfing Life Limited, an unrelated company, operates several public golf courses on the east coast. In order to diversify, both companies are looking to expand their portfolios and agree to exchange certain properties.

Under the terms of the deal, GW will obtain 4 public golf courses and give up 2 luxury resorts. The personnel of the golf courses will remain the same and GW plans to leave much of the operations in place. They will, however, upgrade the courses and insert a new GW management team. GW will brand the courses under its own brand name.

Required:

Discuss the financial accounting issues for this transaction under Generally Accepted Accounting Principles.

Question 7 (5 marks) (9 minutes)

Asset Retirement Obligations

Uranium Limited (UL) is a publicly traded company in the business of refining precious metals. The refining operation is accomplished through the use of large blast furnaces. After a number of years, these furnaces may become contaminated and are required by law to be inspected for contamination. If contaminated, the interior bricks must be replaced. The level of contamination depends on numerous factors and it is often difficult to predict. UL is legally obligated to dispose of contaminated bricks at its own cost. Several of UL's furnaces have been in use for numerous years. UL has not yet had to replace and dispose of any contaminated bricks.

You, CA, are employed at a public accounting firm that has recently acquired UL as an audit client. The engagement partner has asked you to prepare a memorandum outlining any financial accounting issues for the bricks.

Required:

Draft the report to the partner.

Question 8 (5 marks) (9 minutes)

Long-lived Assets and Discontinued Operations

During the current year, the Board of Directors of DiscOn Inc. (DI) approved a plan to sell its facility that manufactures pre-hung doors in order to free up the time management currently spends on this facility. The facility is available for sale immediately and a broker has been hired to value the assets and to expedite the sale. It is hoped the facility will be sold within the year.

The planned disposal is part of DI's strategy to focus on its core business, which is manufacturing roofing shingles. You, CA, are employed in the accounting policy department of DI. The manager of the department has asked you to prepare a memorandum discussing the financial accounting issues related to the plan.

Required:

Prepare the memorandum to the accounting policy department manager.

Question 9 (5 marks) (9 minutes)

Leases

Air Iceland Limited (AIL) experienced some cash flow troubles during the current year and decided to enter into a contract with Iceland Finance Corporation (IFC) to sell and immediately lease back its fleet of aircraft. The aircraft have an average remaining life of five years and their carrying value immediately prior to the transaction was \$7,500,000. AIL's borrowing rate is 10%. The details of the agreement are as follows:

- €# Sell the aircraft for \$11,360,000 (fair value)
- €# Immediately lease back the aircraft for 5 years
 - Annual payments of \$2,504,565 due at end of year
 - At the end of the lease, title remains with IFC
 - At the end of the 5 years, the planes will have a salvage value of \$2,000,000 which is guaranteed by AIL

The implicit rate is known to AIL and is 8%.

Required:

Prepare the journal entries on the date of sale and leaseback. Explain how this transaction should be accounted for by AIL indicating your reasoning.

Question 10 (8 marks) (14 minutes)

Reports

You, CA, are a manager at a national public accounting firm. Your firm has recently been appointed as auditor of BonBon Ltd., (BBL), a major confectionery retailer, with more than 30 leased stores in shopping malls across Canada. Every lease calls for a base rent plus a percentage of the store's sales. The "sales escalation" clause in each lease requires BBL to have its auditor issue a report to the lessor on the sales of the store covered by the lease. The leases do not specify the nature and extent of the work underlying the report or on the form of the report itself.

The audited financial statements of BBL show only the aggregate figure for sales at all stores. The previous auditors had visited only some of the locations each year on a rotating basis. Procedures were not extended for the purpose of reporting to lessors. The report to the individual lessors read as follows:

As requested by BonBon Ltd. we report that the sales of the corporation's store in Peterborough Plaza for the year ended September 30, 2003 are recorded in the amount of \$ ____ in the general ledger sales account of the corporation.

Our examination of the corporation's financial statement for the year ended June 30, 2003 was not directed to the determination of sales of the individual stores nor have we examined the corporation's financial statements for three-month period subsequent to June 30, 2003. We have not performed an audit of and accordingly do not express an opinion on the amount of sales referred in the preceding paragraph.

uding the owner of nine malls containing BBL stores, have objected to this report stating that it provides no assurance on the sales at individual store locations. The engagement partner has asked you to provide a memorandum addressing specific considerations related to the issuance of a report that addresses the lessors' requirements.

Discuss the factors that you would consider in deciding on the type of report to provide. (2 marks)

Part 2 Discuss the advantages and disadvantages of reports that could be provided with reference to the objectives of both the lessors and BBL. (6 marks)

Question 11 (8 marks) (14 minutes)

Service Organizations

You, CA, are a manager at the public accounting firm that have audited Jack's Fruit Farms Ltd. (JFL) since it began operations in 1965. JFL is a family-run business, owned 100% by Fred Jack. Fred's wife, Silvia does JFL's bookkeeping. In March 2003, Silvia broke her arm and had to reduce her workload to attend therapy sessions for her arm.

JFL contracted Wages-for-You Ltd. to perform the weekly payroll functions for its 75 employees.

Because Wages-for-You Ltd. is a division of a major Canadian Bank, your accounting firm is unable to access the systems and records for your client's payroll. Given that JFL is a highly labour intensive industry, the payroll expense has a material effect on the financial statements.

Fred Jack was very concerned when he read the letter from Wages for-You Ltd. that stated that his auditors would not be allowed to review the payroll records at their premises.

"I need an unqualified audit opinion to meet the bank contingency requirements from our \$5 million loan for the 1999 expansion. The bank will call the loan if we have any reservations in our audit reports," Fred stated in a planning meeting with you. "I negotiated a great interest rate and a ten year term and I do not want to lose this deal. How are you going to be able to issue an unqualified audit report without verifying the payroll costs?"

Required

Prepare a memo to Fred explaining how you can issue an unqualified audit report without being able to audit the payroll records at the Wages-for-You premises. Explain to Fred what you are going to ask Wages-for-You to provide to ensure that the payroll expense number on the financial statement can be verified without visiting the Wages-for-You premises.

Question 12 (5 marks) (8 minutes)

Review engagement – engagement letter

An engagement letter is used to ensure that there is a clear understanding and agreement in writing between the public accountant and the client as to the nature and terms of a review engagement. Information on which the public accountant reports is the representation of management even though in some circumstances it is prepared by or with the assistance of the public accountant. If the client imposes limitations in the scope of the review, the public accountant would consider whether they are so significant as to preclude acceptance of the engagement. The scope of the review is the responsibility of the public accountant and not that of the client.

Required:

Outline the terms of the review engagement that an auditor would specify in a review engagement letter to avoid misunderstanding.

Question 13 (7 marks) (13 minutes)

Signal Allied Incorporated (SAI) is a Canadian public company with approximately \$2 billion in revenues. SAI provides control components, products, systems and services for homes and buildings, aviation and space. SAI has suffered some bad financial results for the past five years. As well, they had an unfavorable ruling on a long-standing court battle over a patent infringement, which has caused the stock price to drop drastically from a high of \$67 per share in 1997 to \$25 per share at the close of 2003.

SAI has changed its business strategies and has implemented a new strategic direction in how to increase its business over the next ten years. “ This company has a strong forecast that will allow them to lead the industry thru the next decade” was the statement made by a leading economist. SAI has a strong commitment to ensure that it meets the forecast and financial plans for the next year ending December 31, 2004.

You, CA, are an audit manager with the public accounting firm that has been the auditors of SAI for the past 20 years. Your firm has a good understanding of the business. During this years planning, materiality for the consolidated financial statements was set at \$900,000. SAI has a number of subsidiaries in North America, Europe and Asia. The same accounting firm audits all subsidiaries locally.

You have been assigned to the SAI consolidated financial statement audit. As part of your responsibilities, you need to prepare a memo for the audit partners of the local accounting firms that will be involved in completing the audits for the subsidiary companies. The memo should explain what the expectations are of the local auditors with respect to materiality, the effect of any misstatements and how a reservation in an audit report would affect the audit report for the parent company.

Required

Prepare the memo to the audit partners of the local accounting firms.

Question 14 (7 marks) (13 minutes)

Auditing in an EDP environment

Stefan Jones has just joined the public accounting firm where you are employed as a staff member. The two of you are meeting with Jonathan Payne, who will be the manager on your next audit, which starts tomorrow. Stefan is very enthusiastic about his first audit assignment, which will provide an opportunity to use CAATs. Stefan says to Jonathan “we should use CAATs for every audit of a client who has an EDP system. That’s the only way to go.”

Jonathan replies, “it’s not quite that simple—there are a number of considerations we have to bear in mind when we’re deciding whether to use CAATs”.

Required

Elaborate on Jonathan’s comment to Stefan. Discuss what considerations should be made in the planning stage on whether to use CAATs or not.

TABLE I

PRESENT VALUE OF \$1 RECEIVED AT THE END OF THE YEAR

<i>Years Hence</i>	2%	3%	4%	5%	6%	7%	8%	9%	10%	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%
1	0.98	0.97	0.96	0.95	0.94	0.93	0.93	0.92	0.91	0.90	0.89	0.88	0.88	0.87	0.86	0.85	0.85	0.84	0.83
2	0.96	0.94	0.92	0.91	0.89	0.87	0.86	0.84	0.83	0.81	0.80	0.78	0.77	0.76	0.74	0.73	0.72	0.71	0.69
3	0.94	0.92	0.89	0.86	0.84	0.82	0.79	0.77	0.75	0.73	0.71	0.69	0.67	0.66	0.64	0.62	0.61	0.59	0.58
4	0.92	0.89	0.85	0.82	0.79	0.76	0.74	0.71	0.68	0.66	0.64	0.61	0.59	0.57	0.55	0.53	0.52	0.50	0.48
5	0.91	0.86	0.82	0.78	0.75	0.71	0.68	0.65	0.62	0.59	0.57	0.54	0.52	0.50	0.48	0.46	0.44	0.42	0.40
6	0.89	0.84	0.79	0.75	0.70	0.67	0.63	0.60	0.56	0.53	0.51	0.48	0.46	0.43	0.41	0.39	0.37	0.35	0.33
7	0.87	0.81	0.76	0.71	0.67	0.62	0.58	0.55	0.51	0.48	0.45	0.43	0.40	0.38	0.35	0.33	0.31	0.30	0.28
8	0.85	0.79	0.73	0.68	0.63	0.58	0.54	0.50	0.47	0.43	0.40	0.38	0.35	0.33	0.31	0.28	0.27	0.25	0.23
9	0.84	0.77	0.70	0.64	0.59	0.54	0.50	0.46	0.42	0.39	0.36	0.33	0.31	0.28	0.26	0.24	0.23	0.21	0.19
10	0.82	0.74	0.68	0.61	0.56	0.51	0.46	0.42	0.39	0.35	0.32	0.29	0.27	0.25	0.23	0.21	0.19	0.18	0.16
11	0.80	0.72	0.65	0.58	0.53	0.48	0.43	0.39	0.35	0.32	0.29	0.26	0.24	0.21	0.20	0.18	0.16	0.15	0.13
12	0.79	0.70	0.62	0.56	0.50	0.44	0.40	0.36	0.32	0.29	0.26	0.23	0.21	0.19	0.17	0.15	0.14	0.12	0.11
13	0.77	0.68	0.60	0.53	0.47	0.41	0.37	0.33	0.29	0.26	0.23	0.20	0.18	0.16	0.15	0.13	0.12	0.10	0.09
14	0.76	0.66	0.58	0.51	0.44	0.39	0.34	0.30	0.26	0.23	0.20	0.18	0.16	0.14	0.13	0.11	0.10	0.09	0.08
15	0.74	0.64	0.56	0.48	0.42	0.36	0.32	0.27	0.24	0.21	0.18	0.16	0.14	0.12	0.11	0.09	0.08	0.07	0.06
16	0.73	0.62	0.53	0.46	0.39	0.34	0.29	0.25	0.22	0.19	0.16	0.14	0.12	0.11	0.09	0.08	0.07	0.06	0.05
17	0.71	0.61	0.51	0.44	0.37	0.32	0.27	0.23	0.20	0.17	0.15	0.13	0.11	0.09	0.08	0.07	0.06	0.05	0.05
18	0.70	0.59	0.49	0.42	0.35	0.30	0.25	0.21	0.18	0.15	0.13	0.11	0.09	0.08	0.07	0.06	0.05	0.04	0.04
19	0.69	0.57	0.47	0.40	0.33	0.28	0.23	0.19	0.16	0.14	0.12	0.10	0.08	0.07	0.06	0.05	0.04	0.04	0.03
20	0.67	0.55	0.46	0.38	0.31	0.26	0.21	0.18	0.15	0.12	0.10	0.09	0.07	0.06	0.05	0.04	0.04	0.03	0.03
21	0.66	0.54	0.44	0.36	0.29	0.24	0.20	0.16	0.14	0.11	0.09	0.08	0.06	0.05	0.04	0.04	0.03	0.03	0.02
22	0.65	0.52	0.42	0.34	0.28	0.23	0.18	0.15	0.12	0.10	0.08	0.07	0.06	0.05	0.04	0.03	0.03	0.02	0.02
23	0.63	0.51	0.41	0.33	0.26	0.21	0.17	0.14	0.11	0.09	0.07	0.06	0.05	0.04	0.03	0.03	0.02	0.02	0.02
24	0.62	0.49	0.39	0.31	0.25	0.20	0.16	0.13	0.10	0.08	0.07	0.05	0.04	0.03	0.03	0.02	0.02	0.02	0.01
25	0.61	0.48	0.38	0.30	0.23	0.18	0.15	0.12	0.09	0.07	0.06	0.05	0.04	0.03	0.02	0.02	0.02	0.01	0.01

TABLE II

PRESENT VALUE OF AN ANNUITY OF \$1 RECEIVED AT THE END OF EACH YEAR

<i>No. of Years Received</i>	2%	3%	4%	5%	6%	7%	8%	9%	10%	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%
1	0.98	0.97	0.96	0.95	0.94	0.93	0.92	0.91	0.90	0.89	0.88	0.87	0.86	0.85	0.84	0.83			
2	1.94	1.91	1.89	1.86	1.83	1.81	1.78	1.76	1.74	1.71	1.69	1.67	1.65	1.63	1.61	1.59	1.57	1.55	1.53
3	2.88	2.83	2.78	2.72	2.67	2.62	2.58	2.53	2.49	2.44	2.40	2.36	2.32	2.28	2.25	2.21	2.17	2.14	2.11
4	3.81	3.72	3.63	3.55	3.47	3.39	3.31	3.24	3.17	3.10	3.04	2.97	2.91	2.85	2.80	2.74	2.69	2.64	2.59
5	4.71	4.58	4.45	4.33	4.21	4.10	3.99	3.89	3.79	3.70	3.60	3.52	3.43	3.35	3.27	3.20	3.13	3.06	2.99
6	5.60	5.42	5.24	5.08	4.92	4.77	4.62	4.49	4.36	4.23	4.11	4.00	3.89	3.78	3.68	3.59	3.50	3.41	3.33
7	6.47	6.23	6.00	5.79	5.58	5.39	5.21	5.03	4.87	4.71	4.56	4.42	4.29	4.16	4.04	3.92	3.81	3.71	3.60
8	7.33	7.02	6.73	6.46	6.21	5.97	5.75	5.53	5.33	5.15	4.97	4.80	4.64	4.49	4.34	4.21	4.08	3.95	3.84
9	8.16	7.79	7.44	7.11	6.80	6.52	6.25	6.00	5.76	5.54	5.33	5.13	4.95	4.77	4.61	4.45	4.30	4.16	4.03
10	8.98	8.53	8.11	7.72	7.36	7.02	6.71	6.42	6.14	5.89	5.65	5.43	5.22	5.02	4.83	4.66	4.49	4.34	4.19
11	9.79	9.25	8.76	8.31	7.89	7.50	7.14	6.81	6.50	6.21	5.94	5.69	5.45	5.23	5.03	4.84	4.66	4.49	4.33
12	10.58	9.95	9.39	8.86	8.38	7.94	7.54	7.16	6.81	6.49	6.19	5.92	5.66	5.42	5.20	4.99	4.79	4.61	4.44
13	11.35	10.63	9.99	9.39	8.85	8.36	7.90	7.49	7.10	6.75	6.42	6.12	5.84	5.58	5.34	5.12	4.91	4.71	4.53
14	12.11	11.30	10.56	9.90	9.29	8.75	8.24	7.79	7.37	6.98	6.63	6.30	6.00	5.72	5.47	5.23	5.01	4.80	4.61
15	12.85	11.94	11.12	10.38	9.71	9.11	8.56	8.06	7.61	7.19	6.81	6.46	6.14	5.85	5.58	5.32	5.09	4.88	4.68
16	13.58	12.56	11.65	10.84	10.11	9.45	8.85	8.31	7.82	7.38	6.97	6.60	6.27	5.95	5.67	5.41	5.16	4.94	4.73
17	14.29	13.17	12.17	11.27	10.48	9.76	9.12	8.54	8.02	7.55	7.12	6.73	6.37	6.05	5.75	5.47	5.22	4.99	4.77
18	14.99	13.75	12.66	11.69	10.83	10.06	9.37	8.76	8.20	7.70	7.25	6.84	6.47	6.13	5.82	5.53	5.27	5.03	4.81
19	15.68	14.32	13.13	12.09	11.16	10.34	9.60	8.95	8.36	7.84	7.37	6.94	6.55	6.20	5.88	5.58	5.32	5.07	4.84
20	16.35	14.88	13.59	12.46	11.47	10.59	9.82	9.13	8.51	7.96	7.47	7.02	6.62	6.26	5.93	5.63	5.35	5.10	4.87
21	17.01	15.42	14.03	12.82	11.76	10.84	10.02	9.29	8.65	8.08	7.56	7.10	6.69	6.31	5.97	5.67	5.38	5.13	4.89
22	17.66	15.94	14.45	13.16	12.04	11.06	10.20	9.44	8.77	8.18	7.65	7.17	6.74	6.36	6.01	5.70	5.41	5.15	4.91
23	18.29	16.44	14.86	13.49	12.30	11.27	10.37	9.58	8.88	8.27	7.72	7.23	6.79	6.40	6.04	5.72	5.43	5.17	4.93
24	18.91	16.94	15.25	13.80	12.55	11.47	10.53	9.71	8.99	8.35	7.78	7.28	6.84	6.43	6.07	5.75	5.45	5.18	4.94
25	19.52	17.41	15.62	14.09	12.78	11.65	10.68	9.82	9.08	8.42	7.84	7.33	6.87	6.46	6.10	5.77	5.47	5.20	4.95

ANSWER SHEET

Question 1

CANDIDATE NUMBER: _____

THE INSTITUTES/ORDRE OF CHARTERED ACCOUNTANTS IN CANADA

CA RECIPROCITY EXAMINATION

DAY ONE - 2003

NOTE:

For each of the 4 parts below, indicate your answer by marking an "X" in the appropriate space.

DETACH THIS ANSWER SHEET from your question paper and submit it with your other answer papers in the examination envelope provided. Do not submit your examination question paper.

Question 1 ANSWER SHEET

- (i) (a) _____ (b) _____ (c) _____ (d) _____
- (ii) (a) _____ (b) _____ (c) _____ (d) _____
- (iii) (a) _____ (b) _____ (c) _____ (d) _____
- (iv) (a) _____ (b) _____ (c) _____ (d) _____

THIS SPACE	

TOTAL	_____
	<u> X 2</u>

THE INSTITUTES/ORDRE OF CHARTERED ACCOUNTANTS IN CANADA

CA RECIPROCITY EXAMINATION

DAY TWO – 2003

(100 marks) (3 hours)

NOTES TO CANDIDATES:

1. There are 9 questions and 15 pages in this examination (including the cover page and the appendices).
2. **Do not** write your name on your examination envelope or answer papers. Use your candidate number only.
3. To assist in budgeting time during the examination, the number of minutes available for each question (calculated at approximately 1.8 minutes per mark) is shown at the beginning of each question.
4. Answers or parts of answers to examination questions will not be marked if they are recorded on the question paper.
5. It is recommended that you write your responses in **ink** and write on every other line.
6. Two tables are attached to the examination paper. No other reference sources are allowed.

SECTION A - TAXATION

Question 1 (15 marks) (27 minutes)

Haley Heinz is a senior salesperson for a Canadian-based clothing manufacturer. On March 1, 2002 Haley was transferred by her employer to Halifax from Toronto. She has made a number of financial transactions related to the move. Haley has asked you for help in determining her 2002 income for tax purposes. She has provided the following information:

1. During 2002, she received a gross salary of \$80,000 as well as commissions of \$5,000. In addition, on her employer's 2002 year end, she was awarded a bonus of \$25,000 payable on June 30, 2003. During 2002 she contributed \$4,000 to the company's registered pension plan, and her employer contributed the same amount. She also paid \$1,673 to the Canada Pension Plan and made Employment Insurance contributions of \$858.

2. Haley's employer has certified that she is required to pay some of her expenses as part of her selling duties. In 2002 she incurred the following costs:

Entertainment:		
Meals & drinks	\$3,600	
Theatre tickets & ball games	2,800	
Golf club dues	<u>1,400</u>	7,800
Automobile – gas, repairs, & insurance		3,960
Purchase of computer		<u>4,000</u>
		<u>\$15,760</u>

3. Haley uses her own car for business activities. At the end of 2001 the car had an undepreciated capital cost of \$26,000. In 2002 she drove the car 24,000 kilometres, of which 8,000 were for personal use. In 2002 she acquired a computer for \$4,000, which she uses at home to maintain customer files. She estimates that 90% of her 2002 computer time was employment-related.

4. In January 2002 Haley sold her home in Toronto for \$380,000. She had acquired the home in 1992 for \$220,000 and had occupied it until the move to Halifax.

5. In relocating to Halifax from Toronto, Haley incurred the following costs:

Real estate commission on sale of Toronto home	\$22,000
Moving household items	5,000
Temporary lodging and meals, in Toronto after the sale of the former home and in Halifax before taking possession of the new home (30 days)	4,600
Legal fees on sale of the Toronto home	3,000
Legal fees to purchase new home in Halifax	2,500
Connecting utilities in new home in Halifax	<u>80</u>
	<u>\$37,180</u>

-
6. On the recommendation of her investment counsellor, Haley used \$40,000 of the \$200,000 mortgage loan on her new home to acquire Canadian public securities. Her mortgage interest payments in 2002 totalled \$12,000. She paid the investment counsellor \$2,000 in 2002 for his advice.
7. Haley received the following additional amounts in 2002:
- | | |
|--|---------|
| Winnings from a provincial lottery | \$1,000 |
| Interest on bank deposits | 1,300 |
| Dividends from taxable Canadian corporations | 4,000 |
8. During 2002 Haley's 2000 tax return was reassessed. She paid accounting fees of \$3,200 in 2002 to appeal the reassessment. The appeal was not successful.
9. In 2002 Haley made donations to registered charities of \$8,000.
10. On January 10, 2003, Haley contributed \$6,000 to an RRSP. For the 2001 taxation year her earned income was \$70,000. In 2001 the combined (employer and employee) contribution to her employer RPP was \$7,500. The \$7,500 was reported in the box entitled "pension adjustment" on her T4 slip for 2001. Haley has always contributed the maximum amount allowed to her RRSP in the past. At the end of 2001 Haley had no unused RRSP deduction room nor undeducted RRSP contributions.
11. Haley and her ex-husband divorced five years ago. She supports her two children, Kristin (age 15) and Stephen (age 20). The children's only income for 2002 was interest income received on Canada Savings Bonds purchased for them in 2001 by Haley. Kristin received interest of \$300 while Stephen received \$500.

Required:

Calculate Haley's taxable income for 2002. Briefly explain why you omitted any items mentioned above.

Question 2 (15 marks) (27 minutes)

Decoma Inc. is a Canadian-controlled private corporation located in Toronto, Ontario. The schedule below outlines the net income for income tax purposes (by source) of Decoma Inc. for its year ended December 31, 2002.

Decoma Inc.
Net Income for Income Tax Purposes (by source)
For the year ended December 31, 2002

Income from manufacturing	\$160,000
Interest income	20,000
Dividends from taxable Canadian corporations	12,000
Taxable capital gain from sale of asset	<u>8,000</u>
Net income for income tax purposes	<u>\$200,000</u>

Additional Information:

1. Decoma Inc. owns 52% of the voting common shares of Maki Ltd. and 7% of the voting common shares of Linux Ltd. Maki Ltd. and Linux Ltd. are Canadian-controlled private corporations. In addition, Decoma Inc. has small investments (less than 1% ownership) in sundry Canadian public companies.
2. Interest income is derived from the following sources:

(a) Bank interest from seasonal investment of excess cash	\$ 6,000
(b) Interest from loan to Maki Ltd.	3,000
(c) Five-year bond issued by a Canadian public company	<u>11,000</u>
	<u>\$ 20,000</u>
3. Dividend income is derived from the following sources:

(a) Maki Ltd.	\$ 10,000
(b) Linux Ltd.	1,200
(c) Sundry Canadian public companies	<u>800</u>
	<u>\$ 12,000</u>
4. During 2002, Decoma Inc. paid dividends to its shareholders totalling \$40,000 of which \$10,000 was a capital dividend. (Election forms were already filed).

5. Balances in the tax accounts of Decoma Inc. as at the beginning of 2002 were as follows:

Charitable donations made in 1998, unused to date	\$ 500
Net capital losses realized in 2001, unused to date	\$ 10,000
Capital dividend account	\$ 2,000
Refundable dividend tax on hand	\$ 1,500
Dividend refund for 2001 received in 2002	\$ Nil
Taxable capital	\$900,000

6. The following information relates to Maki Ltd. for its year ended April 30, 2002:

Taxable income (all Active Business Income)	\$45,000
Business Limit (allocated)	\$30,000
Dividend Refund	\$ 9,000

Required:

Compute the net federal taxes payable by or refundable to Decoma Inc. for its 2002 taxation year. Show all your calculations. Ignore the impact of provincial taxes.

Question 3 (6 marks) (11 minutes)

Global Inc., an international cosmetics wholesaler, has a history of substantial profits. It is now October 1, 2002. For its current year ending December 31, 2002, it projects pre-tax profit of \$7,000,000.

Frost Foods Inc. is a distributor of frozen Canadian beef. Frost Foods Inc. was profitable until 1992. Large losses were incurred in years 1992 through 1995. Since then, it has managed to break even. At the beginning of its current taxation year, Frost Foods Inc. had the following unused losses:

	<u>Non-capital</u>	<u>Net capital</u>
Incurring in its year ended Dec. 31, 1995	\$300,000	\$75,000
Incurring in its year ended Dec. 31, 1996	\$500,000	

Global Inc. plans to purchase all of the issued shares of Frost Foods Inc. on November 1, 2002 and immediately wind up Frost Foods Inc. into Global Inc. The plan is to reduce Global Inc.'s taxable income for 2002 by \$875,000 by deducting the losses incurred by Frost Foods Inc.

Global Inc. and Frost Foods Inc. are unrelated Canadian corporations.

Required:

Comment on Global Inc.'s ability to utilize the Frost Foods Inc. losses.

Question 4 (5 marks) (9 minutes)

The following undepreciated capital cost (UCC) balances were found in the various classes of depreciable assets on the tax return for 2001 of Mediapact Inc.:

Class 1	\$80,000
Class 8	\$75,000
Class 13	\$47,500

Class 1 consists of one warehouse costing \$90,000. During 2002, the warehouse was sold for \$170,000.

Class 8 consists of a number of sundry items. During 2002, new office furniture costing \$12,000 was purchased. The old furniture which had been purchased years ago for \$7,000 was sold for \$3,000.

Class 13 relates to a 6-year lease on the office building with an option to renew for a further 4 years. The original cost of the leasehold improvement in 2001, the year the lease was entered into, was \$50,000.

Required:

Compute the tax impact for each of the above depreciable assets in computing Mediapact's business income for 2002, assuming they will take the maximum deductions allowed.

Question 5 (9 marks) (16 minutes)

Each of the following 3 parts is independent. Each one is worth 3 marks.

1. Andy Marcus is the sole shareholder of Marcus Ltd., a Canadian-controlled private corporation. The common shares of Marcus Ltd. have a fair market value of \$300,000, an ACB of \$50,000, and a PUC of \$1,000. Through an amendment to the Articles of Incorporation of Marcus Ltd., all of the common shares are converted to preferred shares redeemable for \$300,000.

Required:

Indicate the tax consequences of the transaction for Andy. **(3 marks)**

2. Using Section 85 of the Income Tax Act, Jason Goorwah transfers non-depreciable property to a corporation at an elected value of \$6,000. The property has an adjusted cost base of \$6,000 and a fair market value of \$17,000. As consideration he receives a note for \$1,000, preferred shares with a fair market value of \$2,000, and common shares with a fair market value of \$14,000.

Required:

- (a) Indicate the adjusted cost base of the preferred shares and the common shares received by Jason. **(2 marks)**
- (b) In the corporation, what will the adjusted base of the asset be? **(1 mark)**

3. Richard Blackwell owns 100% of the outstanding shares of Black Inc., a qualified small business corporation. The shares have a PUC and an adjusted cost base of \$25,000 and a fair market value of \$700,000. In order to make full use of his lifetime capital gains deduction, Richard uses Section 85 of the Income Tax Act to transfer these shares to Holdings Ltd. at an elected value of \$525,000 on July 23, 2002. As consideration he receives a note for \$425,000 and preferred shares with a fair market value and a legal stated capital of \$275,000. Richard owns all of the shares of Holdings Ltd.

Required:

What are the tax consequences of this transaction for Richard? **(3 marks)**

SECTION B - LAW

Question 6 (10 marks) (18 minutes)

On June 22, 2003, Riverside Meats Inc. (“RMI”) entered into a written agreement with the law firm of Wise and Smart, (“WS”). RMI agreed to supply WS with a large volume of hamburger meat at a price of \$1.40 per pound for a barbecue WS was hosting on September 7, 2003 in support of an individual running as mayor of the municipality in which their firm was located. At the time of entering the agreement, the price of meat was very low as a result of market conditions related to concerns about “Mad Cow Disease”. By mid August 2003, beef prices in Canada had increased significantly. On August 29, 2003, the sales manager of RMI called the office manager of WS to discuss the price for which meat would be provided. The sales manager of RMI told the office manager, “We are losing money here, if you do not agree to pay \$2.25 per pound, we are not going to provide any meat.” The office manager who was in a panic that the event would have to be cancelled, told the sales manager, “I suppose that we have to pay it. It sounds like there is not much market flexibility here. Let’s go ahead based on what you said.”

At the beginning of September 2003, the provincial government ran a series of advertisements warning residents of the province to take care when outdoors in order to avoid coming into contact with mosquitoes and in turn reducing their risk of contracting West Nile virus, a virus that had been a concern annually for a number of years.

The barbecue on September 7, 2003 was very poorly attended. In fact, less than fifty percent of the total number of people expected showed up. The disappointing attendance was attributed to the “fear of contracting West Nile virus.”

At the end of the evening, the WS office manager arranged to have a courier deliver the left over hamburger to RMI. As it was the evening, only a security guard was present at RMI. The guard allowed the courier to leave the remaining meat in the meat cooler in the shipping area of the plant. The next day the employees of RMI threw the meat out, citing the fact that there was no control over the meat and the “integrity of its quality is questionable.”

RMI has sent an invoice to WS for the full amount of the hamburger at a price of \$2.25 per pound, plus an additional fee for “waste disposal” to dispose of the leftover meat.

A senior partner of WS has written to RMI regarding the account. The letter contains the following points:

- š` WS claims that the law firm was acting solely on behalf of the association that was supporting the political candidate and that they have no liability on this matter whatsoever;
- š` in the alternative, if WS had any potential liability, this liability has been released as a result of “frustration – due to West Nile Virus”.

The partner also mentioned that RMI has agreed to this position by virtue of the fact that their employee, the security guard, took back the meat.

RMI is now planning to sue WS for the full amount of their invoice, plus additional legal and court costs.

Required:

Prepare a memo that analyzes in detail the claim made by RMI and the defences/arguments that WS has put forward regarding this claim. Ignore any provincial legislation relevant to the issues and discuss the legal issues based on common law.

Question 7 (10 marks) (18 minutes)

On a Saturday in late August, 2003, a free barbecue was held in support of Johnny Torunziama's bid to represent his party to become a Member of Parliament in the next federal election. Cooking the hamburgers and generally staffing the barbecues at this event was a group of lawyers from the law firm of Trent, Taylor ("TT"). The firm was also the main sponsor of this event.

Subsequent to the barbecue, several individuals in attendance, including members of the media, became very ill with "food poisoning". The public health department has traced the cause of the food poisoning to the barbecued hamburgers and have suggested that the most likely cause of the illness was because the hamburgers were undercooked.

The headline in the local newspaper the next day read, "Torunziama Campaign Poisons His Supporters".

TT issued a press release on the following Monday stating that, "the likely cause of the problem was defective meat from the supplier, Premium Choice Meats Inc. ("PCMI"). As you are aware, many slaughterhouses have been providing diseased animals to the public. This is likely just another example".

PCMI meat is all government inspected and the company has received a Triple Star Rating from the provincial government Agriculture Ministry, the highest rating.

Each of the individuals that became ill missed several weeks of work and suffered loss of income. As a group they are considering a class action law suit.

A partner of TT, who acts as a spokesperson for the firm, when contacted by any individual claiming to have gotten sick has told them, "We are not liable because we are not to blame and as well, we operate as a partnership – which as you know has no liability for such incidents."

Required:

Part A (8 marks)

The above case facts contain several legal issues. Prepare a memorandum identifying the potential plaintiffs, and discussing the nature and merit of their claims and the key elements that they will have to prove to establish their case.

Part B (2 marks)

Johnny Torunziama's popularity has since plummeted and he has withdrawn from seeking the race to become the candidate for the riding. He now wants to sue PCMI claiming "breach of contract." He would also like to sue the law firm of Trent, Taylor, claiming "misrepresentation and mistake of contract". Torunziama takes the view that the firm misrepresented their allegiance to him and that they deliberately "sabotaged" the event to cause him public embarrassment.

Prepare a brief response that discusses the legal merits of the position being put forward by Johnny Torunziama.

SECTION C - RULES OF PROFESSIONAL CONDUCT

Question 8 (23 marks) (41 minutes)

The following situations are unrelated.

Part A (8 marks)

“I am really upset,” said Jerome Nice, CA, a partner of the chartered accounting firm of Good & Nice.

Jerome was referring to certain events relating to his longstanding review client, Tucker Industries Limited (“TIL”). Julia Beagle is TIL’s lawyer. Her son, Tyrone Beagle, a recently qualified chartered accountant, had started to practice in conjunction with his mother, “Beagle & Beagle – Law and Chartered Accountants”.

TIL’s owner, Harold Tucker, told Jerome that for the past five weeks Tyrone had been calling almost daily to see if TIL would want to switch its accounting work to Tyrone’s firm. Harold said the calls were getting so annoying that he decided to give Tyrone some work. Specifically, TIL had recently entered into a contract with a foreign government to provide and install certain water purification devices. Because of the political uncertainty in the region, the controller of TIL wanted some assistance in determining when revenue could be recognized and so retained Tyrone to get his assessment. Tyrone had met with Harold for about an hour and advised that the percentage completion basis would be the most appropriate method of revenue recognition. Tyrone also told Harold that Good & Nice was being too “conservative” in making TIL report similar contracts with other foreign governments on a completed contract basis.

Part B (7 marks)

Jack Roberts, age 64 is the sole shareholder of Roberto Imported Motors Limited (“RIM”). For the past three years, Thomas Richards, CA has completed the individual tax returns for Jack and his spouse. Richards also completed the corporate tax returns and financial statements (Notice to Reader) for RIM.

About two years ago, Richards began doing the individual tax returns for Arnold Roberts and his wife Cecelia. Arnold is one of Jack’s three children and is employed by RIM.

In early January 2003, Jack Roberts casually mentioned to Richards that he was interested in getting his “estate planning in order.” Upon hearing this, Richards contacted Arnold and told him that his father was doing some succession planning. Richards met several times with Arnold. In order to work out estate planning details, Richards had his wife, Tamara Hoggensmart, CA, who is employed by Canada Customs and Revenue Agency (“CCRA”) obtain income information on Jack Robert’s other two children. This information was critical in working out particulars as to the tax implications of any inheritance.

In mid February 2003, Richards approached Jack with a detailed estate and tax plan. The plan provided for an estate freeze, with Arnold becoming the sole common shareholder of RIM. Jack’s other two children were to receive real estate and other personal property held by Jack, after the

death of his spouse. The plan was “very detailed” and included a valuation of RIM. The valuation of RIM was completed based on the financial statements that Richards had prepared the year before.

Jack subsequently met with Arnold, who along with Richards, convinced Jack of the appropriateness of the plan.

To ensure that the full amount for the professional services rendered was tax deductible, Richards subsequently billed RIM for all of the work completed.

Part C (8 marks)

Bruce Hornsby, CA had practiced for approximately 30 years in a rural Canadian town. The practice had grown from a one-person office to a staff of eight. Hornsby spent nearly one-half of his billable time on estate planning for local residents. During this entire time, Hornsby remained the sole chartered accountant in the practice. Six of the staff members provide client accounting services.

Bruce had decided to retire and advertised the sale of his practice in CA Magazine. Peter Landsbridge, CA, was interested in acquiring the practice and a transaction, with specific terms, was negotiated. Landsbridge received his chartered accountancy designation in 2001 and was employed in the general audit group of a national accounting firm.

Subsequent to the purchase, documentation was filed with the provincial Institute which represented the practice as a partnership. Hornsby had fully retired as at the closing date of the sale of his practice and assumed no continuing involvement in the practice.

On the basis of the negotiated transaction, a number of steps to promote the firm were taken. New letterhead was designed as follows:

Hornsby, Chartered Accountants*

***Bruce Hornsby CA (Partner /Associate – retired)**

Peter Landsbridge, B. Com, CA

Weekly advertising in the local newspaper was increased. The advertisements showed the new letterhead and each week featured a new “promotional spin”. For example, two weeks ago, the marketing material focused on the longevity and experience of the firm in the area. Last week, the advertising focused on the importance of estate planning and the fact that members of the firm are specialists in the area of estate planning.

To reduce overhead costs, all future client accounting completed by staff would no longer be supervised by Peter. Instead, a transmittal sheet will be added to all client accounting work stating: ‘**DRAFT – FOR INTERNAL USE ONLY**’. The previous communication that Bruce Hornsby used was abandoned.

Required:

In each of the above situations, breaches or possible breaches of professional ethics have occurred or may occur or Rules of Professional Conduct may have been inappropriately applied.

In each situation, Part A, B, and C identify and discuss the relevant Rule(s) of Professional Conduct and Council Interpretations (related guidelines), which should have guided the actions of the individual chartered accountant(s) involved.

Question 9 (7 marks) (13 minutes)

Each of the following situations is unrelated:

Part A (3 marks)

CA accepts the appointment as auditor of Twango Inc. (“TI”) for the year ended, June 30, 2003. A different firm of chartered accountants had audited TI’s prior years financial statements. In planning for the audit, CA determines that TI plans to apply for a significant bank loan during the next fiscal period and decides that the primary financial reporting objective of management should be to show high earnings. During the audit CA determines that in prior years TI should have capitalized “development costs” rather than expensing them. CA advises the client of this accounting error and requests that it be corrected by way of a “prior period adjustment.”

Part B (2 marks)

CA has an audit client, ToughCo Limited (“TL”) that is having cash flow problems. In order to assist TL, CA offers to reduce his audit fees to a nominal amount on the understanding that, at a later date, TL will issue non-voting, fixed dividend rate, preferred shares to CA’s twenty-three year old daughter. CA’s daughter is a Ph.D. candidate and does not reside with her parents.

Part C (2 marks)

CA is in the process of recruiting a new student-in-accounts for his firm. During a lunch with the potential employee/staff member, CA mentions, “Our firm has a great group of clients. Many of them have factory outlets and you often can get a bargain. As well, once you work here, if you bring a new client to the firm, the partners will pay you a bonus. You will find our firm a great place to work.”

Required:

Comment on the ethical implications as governed by the Rules of Professional Conduct (“the RPC”) for each of the above unrelated situations and briefly identify the steps that the CA should take as a result of the ethical implications. If there is no breach of the RPC, please clearly state so with explanations.

TABLE I

**A FORMULA FOR CALCULATING THE PRESENT VALUE OF
REDUCTIONS IN TAX PAYABLE DUE TO CAPITAL
COST ALLOWANCE**

$$\frac{\text{Investment Cost} \times \text{Marginal Rate of Income tax} \times \text{Rate of Capital Cost Allowance} \times \left(1 + \frac{\text{Rate of Return}}{2}\right)}{\left(\text{Rate of Return} + \text{Rate of Capital Cost Allowance}\right) \times \left(1 + \text{Rate of Return}\right)^{\#}}$$

**MAXIMUM
CAPITAL COST ALLOWANCE RATES
FOR SELECTED CLASSES**

Class 1	4%
Class 3	5%
Class 8	20%
Class 9	25%
Class 10	30%
Class 10.1	30%
Class 12	100%
Class 13	original lease period plus one renewal period (Minimum 5 years and Maximum 40 years)
Class 14	Length of life of property
Class 17	8%
Class 39	25%
Class 43	30%
Class 44	25%

SELECTED PRESCRIBED AUTOMOBILE AMOUNTS

Maximum depreciable cost - Class 10.1	\$30,000 + GST
Maximum monthly deductible lease cost	\$800 + GST
Maximum monthly deductible interest cost	\$300
Operating cost benefit – employee	16 cents
	per kilometre of personal use
Non-taxable car allowance benefit limits	
- first 5,000 km	41 cents per kilometre
- balance	35 cents per kilometre

TABLE II

2002 INDIVIDUAL FEDERAL INCOME TAX RATES
Income Tax Rate Schedule - Individuals

<u>Taxable Income</u>	<u>Tax</u>
\$31,677 or less	16%
\$31,678 to \$63,354	\$ 5,068 + 22% on next \$31,676
\$63,355 to \$103,000	\$12,037 + 26% on next \$39,645
\$103,001 or more	\$22,345 + 29% on remainder

**SELECTED NON-REFUNDABLE TAX CREDITS
PERMITTED TO INDIVIDUALS
FOR PURPOSES OF COMPUTING INCOME TAX**

The tax credits are 16% of the following amounts:

Basic personal amount	\$7,634
Married and equivalent to spouse amount	6,482
Net income threshold for married or equivalent amount	649
Age 65 or over in the year	3,728
Disability amount	6,180
Disabled dependents who reach 18 in the year	3,605
Net income threshold for disabled dependents 18 and over	5,115
Basic amount for:	
Age credit, child tax benefit, and GST credit	27,749
OAS clawback	56,968

CORPORATE FEDERAL INCOME TAX RATE

The tax payable by a corporation under Part I of the Income Tax Act on its taxable income is 38% before any additions and/or any deductions.

PRESCRIBED INTEREST RATES

<u>Year</u>	<u>Jan. 1 - Mar. 31</u>	<u>Apr. 1 - June 30</u>	<u>July 1 - Sept. 30</u>	<u>Oct. 1 - Dec. 31</u>
2002	5	4	5	5
2001	8	8	7	7
2000	7	8	8	8
1999	7	7	7	7
1998	6	7	7	7

The rate is 2 percentage points higher for late or deficient income tax payments and unremitted withholdings.

The rate is 2 percentage points lower for deemed interest on employee and shareholder loans.

Introduction The solutions outlined in the following material represent comprehensive approaches to questions and are based on the full range of available marks. They do not represent responses that candidates could realistically expect to produce in the prescribed time limits. The solutions provide examples of how issues can be dealt with and do not represent the only acceptable responses.

References to sections of the CICA Handbook, the Income Tax Act and the Rules of Professional Conduct have been included solely to assist candidates in their review.

Question 1 (8 marks)

- i) The correct response is c) since this is the most objective estimate of fair value. CICA 3063.04 states that impairment losses should be measured as the carrying value is in excess of fair value. Fair value is the consideration that would be agreed upon in an arm's length transaction.
- ii) The correct response is d). KL is integrated due to the centralized nature of the decision-making and cash flow management. Historic rates would therefore be used for nonmonetary balances. However, since the inventory will be written down to market, which is less than cost, CICA 1650.29 stipulates that the translation be done using the current rate.
- iii) The correct response is c). The auditor would consider the cumulative effect of management bias in all estimates. If management is consistently at the lower end of the acceptable range, this could result in net income being misstated. Answers a) and b) are incorrect since this is not always required. The auditor should consider his/her expertise first (CICA 5049.24 and .26). He/she may already have the expertise to deal with the issues. Answer d) is incorrect since the auditor need not calculate a point estimate - this is the responsibility of management. The auditor would at least calculate a zone of reasonableness that is acceptable to him/her (CICA 5305.06).
- iv) The correct answer is a). Since the event has no impact on the audit, the audit report may be issued first as long as the illegal act is communicated to management on a timely basis. According to CICA 5750.12, it is preferable that the communication be in writing but need not be as long as it is documented.

Question 2 (9 marks)

Related Party Transactions (CICA 3840 and 6010)

Part A (4 marks)

Transaction 1

Though Mandy is Mick's sister, she is not considered to be immediate family to Mick and she is therefore not a related party s3840.04(f). She is also related to Andy, who was acting manager at the time. As his wife, she is considered immediate family and is therefore a related party.

The transaction is not in the normal course of business. As Mandy is a related party, the ownership change is not substantive. The transaction should be recorded at carrying value with the difference charged to equity. Alternatively, it may be argued that as Mandy is not considered related to Mick, there is a substantive change and the transaction should be measured at the exchange amount. The financial statements should disclose the details of the transaction.

Transaction 2

Related parties do not include members of the immediate family who are independent. As Ralph lives on his own and supports himself, he is independent. The transaction took place in the normal course of business. It would remain booked at \$3,000 since this was the exchange amount. The financial statements should disclose the details of the transaction.

Part B (5 marks)

The auditor should inquire as to whether any other related parties exist and whether there have been any other related party transactions. Written representation should be obtained from management regarding related parties and related party transactions.

If inherent risk was assessed as low, the auditor should also be alert for unidentified related parties and transactions. If both inherent risk and combined inherent and control risk is greater than low, the auditor should perform audit procedures to reduce audit risk.

Question 3 (9 marks)

Disclosure of Guarantees (CICA 5140 and AcG 14)

Part A (5 marks)

The following disclosures required by EIC beyond those required for financial instruments generally include:

- €# the nature of the guarantee;
- €# the maximum potential amount of the undiscounted future payments;
- €# where applicable, the reasons why the company is unable to estimate the maximum potential amount of the undiscounted future payments;
- €# the current amount accrued under guarantees;
- €# the nature of any recourse provisions;
- €# the nature of any assets held as collateral;
- €# the extent to which proceeds of collateral might cover the guarantee; and
- €# the accounting policy related to guarantees.

Part B (4 marks)

As this is a new client, the auditor must ensure that they understand the business. The complex transactions are also new and the auditor should ensure that they have an understanding of these transactions in order to plan and execute the audit.

The impact of the transactions on inherent risk must be considered. Inherent risk is higher especially due to the problems with estimating the maximum amount of the guarantees. The auditor should obtain and read the contracts to ensure the completeness.

Question 4 (11 marks)

Goodwill and Intangibles (CICA 1300, 1581 and 3062)

Part A (3 marks)

The purchase price discrepancy of \$472,000 would be allocated as follows:

Allocated to Patent - 80% of \$300,000	240,000
Allocated to Licence 80% of \$100,000	80,000
Goodwill	152,000

Part B (5 marks)

The impact of including the net income of Jacob Limited in Jenny Corp.'s December 31, 2003 financial statements is:

80% of \$1,000,000	\$800,000
Patent amortization \$240/5 years	48,000
Equity pick-up	\$752,000

The patent is amortized over 5 years since the company intends to sell it at the end of that period. The licence has an indefinite life as it is renewable for little cost indefinitely. There is no reason to assume that the company will not comply and renew the licence. Goodwill is not amortized. It is tested for impairment annually.

Part C (3 marks)

Under differential reporting, Jenny Corp may elect to use the cost or equity method instead of consolidating. Goodwill may be tested for impairment only if an event indicates that fair value is less than carrying value. The licence impairment test is the same as for goodwill. The company can apply the impairment test to goodwill and intangible assets existing on January 1. If the company elects to use differential reporting, the accounting policy should be disclosed.

Question 5 (6 marks)

Not-For-Profit Accounting -Capital Assets (CICA 4430)

SFS must continue to follow Section 4430 even though it may not meet the size test this year since revenues are under \$500,000.

Capital assets must be recorded at cost. For the trucks, cost would be considered to be the fair value of \$40,000. As SFS uses the restricted fund method, it would treat the contribution as a contribution to the capital assets fund, as long as a capital asset fund exists. If there is no capital asset fund, SFS would use the deferral method and the contribution would be treated as deferred revenue. The deferred revenue would be amortized over the life of the trucks.

The refrigeration unit would be valued at \$10,000, \$5,000 of which would be a donation. SFS might also choose to recognize the donated services to install the unit as the value of the service is estimable and SFS would have otherwise had to pay \$1,000 for the service. These costs would be capitalized as part of the cost of the asset. Related revenues in the amount of \$6,000 would be deferred and amortized over the life of the asset.

Question 6 (7 marks)

Non-monetary transaction - Definition of a business (EIC 124)

The exchange of the four public golf courses for the two luxury resorts is a non-monetary transaction. The issue is whether the exchange results in the culmination of the earnings process . It may be argued that the transaction is a culmination of the earnings process as luxury golf resorts are different from public golf courses. It may also be argued that there was no culmination of the earnings process as the assets are both golf courses and therefore similar.

If the transaction is considered to result in the culmination of the earnings process, then it should be valued at fair value and gains or losses would result. If not, then the transaction should be valued at the carrying value of the asset given up.

The acquisition of the public golf courses represents a business combination if there is a change in control and if the and if a business as opposed to productive assets was acquired. It may be argued that only productive assets were acquired as GW will re-brand and put new management in the acquired golf courses.

In determining the appropriate accounting treatment, GW would look at inputs, processes and outputs in deciding. Either way, the purchase price must be allocated. If treated as a business combination, there may be goodwill. If treated as the acquisition of a productive asset, the value must be allocated to the assets acquired and there will be no goodwill.

Question 7 (5 marks)

Asset Retirement Obligations (CICA 3110)

The legal obligation to dispose of bricks establishes a clear duty/liability on UL. The cost to decontaminate and dispose of the bricks must be accrued at fair value. It may be difficult to measure the fair value as contamination involves various factors. When the cost is recognized, it should be recorded as part of the cost of the asset. GW can only recognize the costs of decontamination and disposal. Replacement bricks would likely be treated as maintenance unless they prolonged the life of the furnace. Subsequently, the costs must be amortized over the life of asset on a systematic and rational basis. Changes should be subsequently recognized as new information becomes available. Disclosure outlining the details of asset retirement obligations is required.

Question 8 (5 marks)

Disposal of Long-lived Assets and Discontinued Operations (CICA 3475)

Held for sale

The facility represents an asset held for sale as it has been authorized by the Board of Directors and is available for sale. A broker has been hired to value the assets appropriately and facilitate a timely sale. The plan is to dispose of the assets quickly to free up management's time. The assets should be measured at the lower of carrying value and net realizable value. They should not be amortized. They should be presented as held for sale as current and non-current in the balance sheet.

Discontinued operation

The assets represent a separate business component that is operationally distinct. The business is different (doors versus shingles). Strategically, management will not have continuing involvement. The results of operations should be reported and any gain or loss on sale should be separately presented net of tax as a discontinued operation. The details related to the discontinued operation should be disclosed.

Question 9 (5 marks)

Leases (CICA 3065)

The lease is a capital lease to ALL supported by the fact that the present value of the minimum lease payments is approximately equal to the fair value of the leased assets, calculated as follows:

$$\begin{aligned} & \$2,504,565 * 3.993 = \$10,000,728 \\ & + \$2,000,000 * .6806 > \$11,360,000 \text{ (include since guaranteed)} \end{aligned}$$

The gain on the sale of \$3,860 (\$11,360-\$7,500) is deferred and amortized. As this is a sale-leaseback transaction, it is difficult to separate.

A discount factor of 8% should be used as it is the lower of IR and IBR and it is known.

The following journal entries would be used to record the transaction:

dr. Cash	\$11,360,000	
	cr. Equipment	\$7,500,000
	cr. Deferred gain	\$3,860,000
dr. Leased equipment	\$11,360,000	
	cr. Obligation under lease	\$11,360,000

The asset value is capped at its fair value.

Question 10 (8 marks)**Reports (CICA 9100, 5800, 5805, 5815, 8500, 8600)****Part 1 (2 marks)**

The following factors are relevant to the determination of what report should be selected:

- €# Cost of providing an additional report for the lessor is a concern of each store;
- €# Level of assurance required by the lessors, which may be high given the that the lease amount is based on sales and that there is a sales escalation clause; and
- €# The type of information available will determine the procedures that can be completed.

Part 2 (6 marks)

Reports that could be considered include:

1. Section 9100 – Report on the Results of Applying Specified Auditing Procedures to Financial Information Other Than Financial Statements

A section 9100 report does not provide any assurance or opinion. The lessor and the store could agree on the type of procedures to complete that would satisfy the lessor's needs. A section 9100 report would be the least costly.

2. Section 5805 – Report expressing an Audit Opinion on Financial Information Other than Financial Statements

A section 5805 report provides an audit level opinion and hence the highest level of assurance. Due to the extent of work required to support the opinion, this report would be the most costly. Costs may be reduced if some of the work required for the report has been completed for the year-end audit. Sales are interrelated with receivables and therefore work would likely need to be completed on both items. There must be an agreement on the accounting policy for sales. This is not likely an issue for the sale of candy.

3. Section 8500 – Review of Financial Information Other Than Financial Statements

This report, though less expensive than a report providing audit level assurance, does provide a lower level of assurance and may not meet the lessors' needs.

Given the requirement of the lessors, the nature of the sales and the associated cost of each report, it would be preferable to attempt to come to an agreement with the lessors on specific procedures that would satisfy the lessors needs.

Question 11 (8 marks)

Service Organization (CICA 5310)

The use of a service organization does not change the auditor's responsibility under Generally Accepted Auditing Standards to obtain sufficient appropriate evidence. The auditor can issue a clean audit opinion if they obtain a report from WYL. The auditor will need to determine the nature and extent of the services provided by WFY through discussions with them. The auditor should review the agreement between JFL and WYL.

The auditor should determine what audit evidence may be obtained in the form of a report from the service auditor. If the auditor uses a report from the service auditor as audit evidence, then they have discharged their responsibilities in the payroll area only.

If the auditor can't rely on the report from the service auditor as audit evidence then they will have to look at other audit evidence.

The auditor should determine the reliability of the report auditor by considering the professional qualifications, competence and integrity of the service auditor. Given that WYL is a division of a major Canadian Bank, its service auditor is likely qualified and the auditor will be able to rely on the report.

The types of reports that the service auditor can provide Statements, a Section 9100 Report on the Results of Applying Specified Auditing Procedures to Financial Information other than Financial Statements or a Section 5900 Opinion on Control Procedures at a Service Organization.

Only in circumstances that the report of the service auditor contains a reservation of opinion will the auditor assess whether the matter resulting in the reservation is relevant. The auditor would communicate with the service auditor for further details with respect to the reservation. The service auditor report should cover the same reporting period as the financial statement auditor. The 5900 report should address the stated internal control objectives and control procedures relevant to the auditor's examination. The report could provide an opinion on the design and existence of control procedures at some date or provide an opinion on the design, effective operations and continuity of control procedures during a period of time.

The auditor may be able to audit around the service organization by examining input and output for the payroll department.

Question 12 (7 marks)

Review Engagements (CICA 8100)

To avoid misunderstandings of the terms of a review engagement, the public accountant would normally specify the following in the review engagement letter with the client:

- that the public accountant will conduct the review in accordance with generally accepted standards for review engagements;
- the anticipated form and content of the report;
- any restrictions on its use;
- that an engagement is not intended to, and accordingly will not, result in the expression of an audit opinion;
- that, in a situation when there is a statutory or other audit requirement, the engagement will not satisfy that requirement;
- that management will provide the information the public accountant requires;
- that management is responsible for the accuracy and completeness of the information on which the public accountant is to report;
- that a review engagement cannot be relied on to prevent or detect error and fraud;
- that, if the public accountant's association with the information being reported on is to be communicated to third parties, the public accountant's report will be attached to that information; and
- that each page of the information being reported on will be conspicuously marked as being unaudited fees.

Question 13 (7 marks)**Materiality (CICA5130 and AuG 31)**

The materiality level for the consolidated financial statements of SAL of \$900,000 will be used to plan and evaluate the overall audit.

Determining Materiality Subsidiaries

When audit opinions are also being provided on individual subsidiaries included in the consolidated financial statements, a materiality level should be established for each subsidiary. The level would be used in planning and evaluating each audit. The materiality for individual subsidiaries would normally be less than consolidated materiality, which means that extra work will be required at the individual subsidiary to support the audit opinion on its statements.

The audit is planned with the objective of detecting misstatements that are material to the financial statements taken as a whole. The auditor should apply a percentage numerical threshold as an initial step in assessing materiality. A decision will need to be made on the basis (e.g. assets, revenues) for determining materiality. The auditor should also consider the qualitative factors that might affect the determination of materiality for a particular subsidiary audit.

Reporting Misstatements

For the consolidated entity, a summary of misstatements is prepared that includes the unadjusted misstatements of all locations or components. Each subsidiary should provide a copy of all misstatements because such misstatements may be material when aggregated on consolidation. Where the auditor has a reservation of opinion on the statements of a subsidiary, the auditor may still be able to report without reservation on the consolidated financial statements.

All auditors of the subsidiaries will need to consider whether uncorrected misstatements brought forward in the opening equity of the following year, may result in a material misstatement of net income of a subsequent interim or annual period. All misstatements, regardless of the period the misstatement relates to, will be compared against the current period's operating results, financial position and cash flows. In aggregating misstatements, misstatements in opening equity need to be considered in addition to those arising in the current period. Immaterial uncorrected misstatements of prior periods affecting equity are not removed from the financial statements once the auditor's opinion is given. They are brought forward in opening equity and may affect income in the current period.

Question 14 (7marks)

Auditing in an EDP environment (AuG 33 and AuG 34)

Skills and competence of the auditor

When auditing in an EDP environment, the auditor should have an understanding of computer hardware, software and processing systems sufficient to plan the engagement. The auditor should have sufficient knowledge of EDP to implement the auditing procedures, depending on the particular audit approach adopted.

Planning

The auditor should gather information about the EDP environment that is relevant to the audit plan, including information as to:

- ~~☞~~ how the EDP function is organized and the extent of concentration or distribution of computer processing throughout the entity;
- ~~☞~~ the computer hardware and software used by the entity; and
- ~~☞~~ each significant application processed by the computer, the nature of the processing (e.g., batch, online), and data retention policies.

Determining whether to use CAATs

In determining whether to use CAATs, the factors to consider include:

- ~~☞~~ the IT knowledge, expertise and experience of the audit team;
- ~~☞~~ the availability of CAATs and suitable computer facilities and data;
- ~~☞~~ the impracticability of manual tests; and
- ~~☞~~ the effectiveness and efficiency; and timing of CAATs.

When considering the overall plan the auditor should consider matters such as:

- ~~☞~~ determining the degree of reliance, if any, to place on the EDP controls;
- ~~☞~~ the overall evaluation of internal control;
- ~~☞~~ scheduling the work of EDP experts, as applicable; and
- ~~☞~~ planning auditing procedures using computer-assisted audit techniques.

Day 2 - Question 1 (15 marks)

Employment income:

Salary	80,000	
Commissions	<u>5,000</u>	
	85,000	
RPP	(4,000)	
Sales expenses:		
Meals & drinks (50% of \$3,600)	(1,800)	
Theatre & ball games (50% of \$2,800)	(1,400)	
Auto \$3,960 x 16,000/24,000	<u>(2,640)</u>	
	(5,840)	
Limited to commissions	(5,000)	
CCA - auto \$26,000 x 30% x 16,000/24,000	<u>(5,200)</u>	
Employment income		\$70,800

Property income:

Interest on bank deposits	1,300	
CSB Interest attributed from Kristin (15)	300	
Dividends \$4,000 x 5/4	<u>5,000</u>	
	6,600	
Mortgage interest \$12,000 x \$40,000/\$200,000	(2,400)	
Investment counselor fee	<u>(2,000)</u>	
Property income		2,200

Taxable capital gains:

Toronto home: Proceeds	380,000	
	(220,000)	
ACB)	
Selling costs	<u>0</u>	
Gain	160,000	
Principal residence exemption, with support	<u>(160,000)</u>	
Taxable capital gains		0

Other deductions:

	(37,180)	
Moving expenses - incurred)	
Not deductible - 15/30 days x \$4,600 meals & lodging	(34,880)	
	<u>2,300</u>	

Fees paid to appeal tax reassessment		(3,200)	
RRSP: least of (a) contributions	6,000		
(b) 2002 limit \$13,500 - PA \$7,500)	6,000		
(b) 18% x \$70,000 = \$12,600			
- PA	<u>(7,500)</u>	5,100	<u>(5,100)</u>
			(43,180)
Other deductions)
Net income & Taxable income			<u>\$29,820</u>

Omitted items:

The bonus is payable in 2003 and is included in income in the year it is received.

The employer's \$4,000 contribution to the RPP is not a taxable benefit.

CPP of \$1,673 & EI of \$858 contributions are not deductible but a tax credit is allowed in computing tax payable.

Golf club dues \$1,400 are not deductible.

The purchase of the computer is a capital item and is not deductible. CCA on a computer is not deductible in computing employment income.

Selling costs re the Toronto home were claimed as moving expenses and thus are not included in the calculation of the capital gain.

Lottery winnings of \$1,000 are not taxable.

Donations of \$8,000 are not deductible but a tax credit is allowed in computing tax payable.

The interest of \$500 received by Stephen does not attribute to Haley.

Day 2 - Question 2 (15 marks)

Part I Tax:

Net income		\$200,000	
Dividends from taxable Canadian corporations		(12,000)	
Donations		(500)	
Net capital losses (limited to taxable capital gains \$8,000)		<u>(8,000)</u>	
Taxable income		<u>\$179,500</u>	
Federal tax - 38% x \$179,500		\$68,210	
Abatement - 10% x 179,500		<u>(17,950)</u>	
		50,260	
Surtax - 4% x \$50,260		2,010	
Additional refundable tax - 6 2/3% x \$10,500		700	
Investment income: interest earned on five-year bond		11,000	
	taxable capital gain	<u>8,000</u>	
		19,000	
	net capital loss	<u>(8,000)</u>	
		<u>11,000</u>	
		-	
Taxable income \$179,500 - SBD income \$169,000		<u>10,500</u>	
		-	
Small Business Deduction (SBD) - 16% x \$169,000			(27,040)
16% x Least of 3 amounts			
(1)Active Business income (ABI):			
Manufacturing income		160,000	
Canadian bank interest - ancillary income		6,000	
Interest from Maki Ltd - deemed ABI		<u>3,000</u>	
		169,000	
(2)Taxable income		179,500	
(3)Annual Business Limit \$200,000 - \$30,000		170,000	
Manufacturing and Processing Deduction			0
Tax reduction			<u>0</u>
Part I tax Payable			\$25,930

Part IV Tax:

Dividend received from Maki (connected corp) - Dividend refund			
Maki 's Dividend refund \$9,000 x 52%	-	4,680	
Dividend received form Linux \$1,200 x 1/3		400	
Dividend received from sundry Canadian public corps \$800 x 1/3		<u>267</u>	
Part IV tax payable			5,347
Refundable Dividend Tax On Hand (RDTOH):			
RDTOH at Dec 31, 2001		1,500	
Dividend refund received in 2002		<u>0</u>	
		1,500	
Part IV tax			5,347
Refundable portion of Part I tax: least of			
(1) 26 2/3% x Aggregate Investment Income \$11,000	2,933		
(2) 26 2/3% x (\$179,500 - SBD income \$169,000)	2,800		
(3) Part I tax \$25,930 - surtax \$2,010	23,920	<u>2,800</u>	
		<u>9,647</u>	
Dividend Refund:			
Lesser of - 1/3 x taxable dividends paid \$30,000	10,000		
- RDTOH	9,647		(9,647)
Net Federal tax payable			<u>\$21,630</u>

Day 2 - Question 3 (6 marks)

Global Inc. cannot utilize Frost Foods Inc.'s losses in 2002. The losses of Frost Foods Inc. are not available to Global Inc. until 2003, being the taxation year after the year in which the wind up of Frost Foods Inc. commenced.

Non-capital losses are limited to a 7-year carry forward. The 1995 non-capital loss will have expired by 2003 and thus is not available to Global Inc. 2003 is the last year that the 1996 non-capital loss is available.

An acquisition of control occurs when Global Inc. acquires the shares of Frost Foods Inc. on November 1, 2002. The \$75,000 net capital loss expires on the acquisition of control and thus is not available to Global Inc.

The 1996 non-capital loss is deductible by Global Inc. in 2003 only if the distribution of frozen Canadian beef (the loss business) is carried on throughout 2003 at a profit or with a reasonable expectation of profit. If these conditions are met, the 1996 non-capital loss may be deducted in 2003 to the extent Global Inc. has income from the frozen Canadian beef business and/or from a business selling similar products or providing similar services. Wholesaling cosmetics is not similar to distributing frozen Canadian beef. Thus, the 1996 non-capital loss of \$500,000 will be deductible by Global Inc. in 2003 only to the extent there is income in 2003 from the frozen beef distribution business.

Day 2 - Question 4 (5 marks)

Class 1: UCC		\$80,000
Disposal		<u>(90,000)</u>
		<u>(\$10,000)</u>
Recapture to be included in income)
Class 8: UCC		\$75,000
Addition		12,000
Disposal		<u>(3,000)</u>
		84,000
Less 1/2 (\$12,000 - \$3,000)		<u>(4,500)</u>
		79,500
		<u>x 20%</u>
CCA deduction		<u>\$15,900</u>
Class 13: lesser of - 1/5 x \$50,000 cost of improvement	\$10,000	
- \$50,000/ 10 years	5,000	<u>\$5,000</u>

Question 5 (9 marks)

Part 1

On an exchange of shares in the course of a capital reorganization, the recognition of the accrued gain on the shares is deferred for tax purposes automatically [S.86]. Thus for tax purposes, Andy is deemed to dispose of the common shares for proceeds of \$50,000 (ACB), and the ACB of the preferred shares acquired by Andy is deemed to be \$50,000.

Part 2

The ACB of Jason's preferred shares is \$2,000. The ACB of Jason's common shares is \$3,000. The ACB of the asset in the corporation is \$6,000.

Part 3

For tax purposes Richard will have a deemed dividend of \$400,000 ($\$425,000 - \$25,000$) [S.84.1] and a taxable capital gain of 50,000 ($1/2 (\$525,000 - \$400,000 - \$25,000)$). The preferred shares of Holdings Ltd. received by Richard will have an ACB of \$100,000 and a PUC of Nil.

Day 2 - Question 6 (10 marks)

Claim made by RMI

claim for invoice – based on \$2.25 per pound

This is a contract law issue. RMI will argue that the office manager had orally agreed to amend the contract to a higher price. A pre-existing contract obligation existed to provide meat at \$1.40 per pound. WS is arguably not obligated to pay the \$2.25 because they had not received anything new. There was a lack of consideration for the increased price.

RMI calling up at the last minute requesting a price change or refusing to make delivery constitutes an amendment obtained using economic duress. RMI will argue that the initial contract was set aside and that a new contract was entered into to reasonably reflect the legitimate interests of both parties.

Discussion of defences put forward by Wise, Smart LLP (“WS”)

claim that acting for association

WS is claiming that it was merely an agent for the Association. The problem with this claim is that RMI was not aware at the time as to the relationship or who the principal was. Accordingly, as no principal was disclosed, WS would have liability as a principal. RMI could also argue that it was directly in privity of the contract with WS. The position taken by WS in this regard is weak and without merit.

release by “frustration” argument

Frustration exists when some event makes performance impossible or radically undermines the purpose behind the agreement. WS suggests that the contract was frustrated by the West Nile virus. However, West Nile has been around for years and it would be difficult to argue that it was the cause of the poor turnout. Typically a frustrating event is specific, such as a fire that destroys the subject matter of the contract. WS received “full benefit” of the food provided by RMI. A force majeure clause may be in the agreement. Given the facts, the argument for frustration will likely not succeed.

WS is suggesting that they have no liability whatsoever, despite the fact that they used the hamburger and would be unjustly enriched if do not have to pay for any.

acceptance by security guard and subsequent destruction of residual meat

The issue of the return of goods depends on the contract. It does not appear that WS negotiated the ability to return surplus meat to the supplier. The actions by security guard are not indicative of acceptance. The meat processor acted “reasonably” by throwing out the excess meat as they

had no idea how it had been stored or whether it was now safe for consumption. The charge for the disposal costs is justified in “quantum meruit” in that there was an implied promise to pay a reasonable amount.

Based on the above analysis, I would conclude that WS is liable for the full cost of the hamburger delivered at the initial contract price of \$1.40 per pound plus the costs of disposal for the surplus meet returned.

Day 2 -_Question 7 (10 marks)

PART A (8 marks)

Plaintiff – Individuals that became ill

The claim is based in negligence. A class action may be appropriate as all parties have a similar cause of action. The potential defendants in the action would be TT and/or the political party. TT hosted the event and its staff did the barbecuing. The political candidate was the beneficiary of the event and likely sanctioned it.

The plaintiffs will need to prove that:

1. the defendant(s) owed a duty of care to the plaintiff(s). The plaintiff(s) would argue that when the defendants invited individuals to the barbecue and supplied the food, they had a duty to ensure that the food was safe.
2. the defendant(s) breached the duty. The plaintiffs would contend that it is well known that raw hamburgers are a ready source of food poisoning and therefore must be properly cooked.
The public health department stated that the “most likely” cause of the illnesses was that undercooking took place. The plaintiffs would need to establish that on a balance of probabilities (>50% chance) that the lawyers were responsible. Questions as to the training and supervision of lawyers doing the barbecuing are in issue.
3. they suffered damages. Each individual incurred losses of income due to missing work.
4. the damages were directly caused by the defendants breach of their duty of care. The plaintiffs would need to prove that the loss of income was caused by taking time off work due to the bad food they consumed.

1

Plaintiff: PCMI

defamation

PCMI can sue TT on the basis of defamation/libel. TT has made a false statement that could lead a reasonable person to have a lower opinion of PCMI. The press release alleges that PCMI is selling diseased meat, a statement that is likely not true given PCMI's high rating.

Other:

obligations of partnership

The law firm would have liability for negligence and therefore firm assets are exposed. Individual partners do have personal liability for negligence of their partners. The statement made by partner is misleading, as the firm would have liability.

PART B (2 marks)

Johnny will not be able to sue PCMI for breach of contract as he does not enjoy privity of contract. Johnny would also have a problem suing TT on this basis as he is likely not in a contractual relationship with TT. A “misrepresentation” is a statement of fact that induces a party to enter a contract. It does not apply here as there was no representation made. Mistake of contract is very limited and generally relates to a mistake as to the parties or subject matter, and does not apply here.

Johnny would be best to make a claim based tort and not contract. However, unless he has evidence of a deliberate attempt to discredit him, he will not have a cause of action.

Day 2 - Question 8 (23 marks)

Part A (8 marks)

RPC 201.1: Tyrone failed to maintain the good reputation of the profession supported by, for example, criticizing Good & Nice [see CI 201.1]. Appropriate action would have been for Tyrone to seek further explanation/comply with HBK s. 7600.

RPC 202: Tyrone failed to perform his professional services with due care and integrity.

RPC 206: Tyrone failed to comply with professional standards. For example, HBK section 7600 is very specific in advising on accounting policies and Trone failed to comply with the section. Dealing with a fairly complex issue of revenue recognition, Tyrone appears to have given an answer based on his meeting without further investigation.

RPC 217.2: Tyrone was soliciting business in a manner that was persistent and harassing as evidenced by his calling Jerome almost every day.

RPC 401: Tyrone used a practice name that was misleading, indicating that it was a legal and accounting practice. The name should have been Tyrone Beagle – Chartered Accountant.

RPC 211: Jerome Nice may now have an obligation to report Tyrone to the provincial institute.

Part B (7 marks)

Richards

RPC 201: Richards failed to maintain the good reputation of the profession due to breaches cited below.

RPC 202: Richards failed to perform his work with integrity as evidenced by his obtaining personal information on others via a personal connection and by issuing what was likely an unlawful billing.

RPC 203: Richards failed to carry out his functions with professional competence based on the preparation of the business valuation. He completed a valuation based on unaudited financial statements and lack of further information.

RPC 208: Richards breached the rule on confidentiality by telling Arnold and his wife about Jack's estate planning.

RPC 210: Richards had a serious conflict of interest by representing both Jack, Arnold and RIM at the same time regarding corporate ownership.

Hoggensmart

RPC 208: Hoggensmart breached confidentiality. She should not have used tax information for the personal benefit of her spouse.

RPC 202: Hoggensmart failed to perform her work with integrity by using information from CCRA.

RPC 211: Provides that spouses are obligated to report each others' breaches to the provincial institute.

Part C (8 marks)

RPC 201: Landsbridge failed to maintain the good reputation of the profession supported by the breaches cited below.

RPC 205: Landsbridge may be associated with false or misleading statements. Depending on what was filed with the provincial institute, it may be a misleading application to suggest the company was a partnership when in fact it is a sole proprietorship. The actual firm name and /letterhead is misleading as it implies that Hornsby is a partner of the firm when in fact he is not.

RPC 217: The rule with respect to advertising was breached. The advertising contains a misleading statement regarding experience in estate planning, as Hornsby is now retired. Use of the term specialist does not meet the criteria of 217.1 as Landsbridge lacks experience.

RPC 401: The practice name is misleading and not appropriate per provincial institute.

RPC 202: Landsbridge failed to completely carry out his functions with integrity or due care as evidenced by his lack of involvement with client work.

RPC 206: Landsbridge failed to comply with professional standards as he is associated with the work performed in his office which involves compiling financial statements under s. 5020). A Notice to Reader should have been attached, not just a transmittal sheet. He also was not supervising his staff.

Day 2 - Question 9 (7 marks)

Part (a)

RPC 204: It is questionable whether CA has maintained an objective state of mind. Though dealing with an audit client, CA recommended accounting policies that were biased towards “high earnings”.

RPC 201: CA failed to maintain the good reputation of the profession. CA should have contacted his predecessor to discuss the findings and determine whether there was an explanation. His actions constituted an implied criticism of his predecessor.

RPC 211: if the predecessor had in fact erred, CA may be obligated to report them to the provincial institute.

RPC 203: Given CA’s lack of knowledge with respect to a correction of an error, and proposing a prior period adjustment, CA appears to have failed to maintain his professional competence.

RPC 206: CA’s recommendation with respect to the correction of the error is indicative of a failure to comply with professional standards.

Part (b)

RPC 204: indirect ownership of shares here would impact on the objectivity of the auditor. The fact that an adult child holds the shares does not change the breach in light of the intent.

RPC 202: the proposed plan suggests a lack of integrity on the part of CA.

RPC 201: based on the above breaches, CA has failed to maintain the reputation of the profession.

RPC 205: CA is associated with false and misleading statements with respect to his billing practice. CA should have his clients sell the shares to a third party and use the funds to deal with cash flow/professional fees.

Part (c)

RPC 204: Purchasing merchandise from the client would not be a breach of objectivity as long as the terms of the transaction were similar to those granted to other customers in the normal course of business .

RPC 216: Paying an employee of the CA firm for a client referral is not a breach of the rule proscribing payment of commissions. The payment is not to an outside party.



