Better World Storage Corporation

You are an accountant working at Robi & Co. George Maranzan, a partner in your firm, leaves you the following voicemail message:

"The scheduling manager tells me you have some time available. We have recently been advised that management of Better World Storage Corporation (BWSC) has received an offer from Ventura Capital Partners to sell 100% of all issued and outstanding common shares. I have a meeting with management in two weeks regarding this issue, and I haven't had much time to think about this engagement.

I have prepared some background information on the company for you to review, including background information on the client (Exhibit I), the company's most recent internal financial statements (Exhibit II), and the proposed share purchase agreement (Exhibit III). I also met with BWSC management earlier this month and made some notes from that meeting (Exhibit IV). They should all be in your inbox by now.

Exhibit I

Background Information

Better World Storage Corporation (BWSC) duplicates, DVDs, MP3s, and all forms of electronic files from master copies provided by its clients. The company started operations in 2000 in the basement of the home of part-owner, Samantha Arthurs. Sales increased quickly, and within one year of starting operations the company moved into a rented space in downtown Toronto. The market that BWSC currently serves is mainly large companies that require training programs, corporate messages, and so on.

The company is owned equally by Samantha Arthurs, Grant MacArthur, and Ashley Carvalho. Samantha started the venture and has always managed the sales function. In order to keep the company growing, she brought in Grant and Ashley as equal shareholders. Grant and Ashley each paid $30,000 for one-third of Samantha's shares.

Grant is a good administrator and handles the accounting functions for the company. Samantha's skills are mainly in sales. Ashley looks after the production end and stays abreast of changes in technology.

BWSC has an October 31 fiscal year end.

Exhibit II

Internal Financial Statements

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Exhibit II

Internal Financial Statements

Statement of Financial Position

As at October 31 (unaudited)	2020	2019
Assets		
Current		
Cash	$ 151,764	$ 160,502
Accounts receivable	334,894	411,760
Inventory	86,800	124,200
Prepaid insurance	4,720	2,060
	578,178	698,522
Capital assets (note 1)	661,897	417,158
Future income tax asset (note 2)	35,000	35,000
Long-term note receivable	20,000	0
	$1,295,075	$1,150,680
Liabilities and shareholders' equity		
Current		
Accounts payable	$ 158,318	$ 130,176
Bank loan—current portion	41,998	72,000
Income taxes payable	44,609	92,720
	244,925	295,096
Long-term bank loan (note 3)	35,334	77,334
Due to shareholders	58,100	53,100
Common shares	1,200	1,200

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Due to shareholders	58,100	53,100
Common shares	1,200	1,200
Preferred shares	20,000	20,000
Contributed surplus	4,000	0
Retained earnings	931,516	703,950
	956,716	725,150
	$1,295,075	$1,150,880

Statement of Income

For the years ended October 31 (unaudited)	2020	2019
Sales	$2,531,760	$2,221,720
Cost of sales		
Opening inventory	124,400	26,860
Purchases —materials	1,018,972	959,138
—wages	289,663	219,416
Total	1,433,035	1,205,414
Closing inventory	(86,800)	(124,400)
	1,346,235	1,081,014
Gross profit	$1,185,525	$1,140,706
Expenses		
Commissions	$199,372	$ 174,957
Depreciation	127,684	104,796
Management salaries and benefits	110,448	110,040
Management fees	109,600	112,600
Rent	75,840	74,020
Office and general expenses	48,723	46,877

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Management fees	109,600	112,600
Rent	75,840	74,020
Office and general expenses	48,723	46,877
Advertising and promotion	37,585	31,284
Repairs and maintenance	27,173	24,686
Automobile and travel	26,326	22,782
Bad debt	15,596	21,188
Interest	16,864	39,320
Computer system installation	13,760	0
Telephone	13,458	10,510
Insurance	10,864	10,214
Legal and accounting	8,083	3,414
Lease expense	18,143	0
	$859,519	$ 786,688
Operating income	326,006	354,018
Gain on sale of equipment	4,560	0
Income before taxes	330,566	354,018
Provision for income taxes	99,000	112,000
Net income	231,566	242,018
Opening balance—retained earnings	703,950	465,932
Dividend on preferred shares	(4,000)	(4,000)
Closing balance—retained earnings	$ 931,516	$ 703,950

Notes to the Financial Statements

1. Capital assets

			2020	2019

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Closing balance—retained earnings	$ 931,510	$ 703,950

Notes to the Financial Statements

1. Capital assets

			2020	2019
		Accumulated	Net Book	Net Book
	Cost	Depreciation	Value	Value
Furniture and fixtures	$ 23,434	$ 12,418	$ 11,016	$ 13,770
Computer equipment	50,842	12,835	38,007	18,421
Leasehold improvements	19,404	19,404	0	2,842
Vehicle	40,352	27,985	12,367	17,667
Production equipment	931,074	330,567	600,507	364,458
	$1,065,106	$403,209	$661,897	$417,158

2. Future income tax asset

A future tax asset has been recorded for noncapital losses carryforward. The losses were incurred during a bad year in fiscal 2018. BWSC expects strong future profits to be able to generate taxable income to fully utilize the tax losses. The owners decided not to use the tax losses in the 2020 or 2019 fiscal years because they expect their marginal tax rate to increase significantly in the near future due to significant growth in income.

3. Bank loan

A small business bank loan and line of credit for $200,000 (presently unused) are secured by a general security agreement, a registered general assignment of book debts, and chattel mortgages on duplication equipment. Principal repayments on the small business loan are due as follows during the years ended October 31:

2021	$41,998
2022	20,034
2023	11,700
2024	3,600

Interest on the small business bank loan is paid at 12% on the outstanding monthly balances. Interest on the line of credit is calculated at prime plus 1.5% on outstanding monthly balances.

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Exhibit III

Share Purchase Agreement

Purchase Price Calculation

The final purchase price is to be determined based on an adjusted book value approach, whereby all assets and liabilities are adjusted to their fair values to determine the fair value of the equity. In addition, a premium for goodwill will be calculated based on a multiple of net income for the most recent fiscal year.

Therefore, the purchase price is calculated as follows:

- Purchase Price = Adjusted Equity Value + (Net Income × Earnings Multiple)

Earnings Multiple

A goodwill multiple of between 1 and 2 is common for similar companies.

Net Income

Net income must be determined based on generally accepted accounting principles (IFRS).

Adjusted Book Value

All assets, liabilities, and equities must be recognized and measured in accordance with generally accepted accounting principles (IFRS).

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Exhibit IV

Notes From George's Meeting with Grant Macarthur

New lease agreement

BWSC signed an agreement on November 1, 2019, to lease equipment from Sultan Leasing. The following information relates to the agreement:

1. The term of the noncancellable lease is five years, at which time the asset is expected to have a residual value of $7,000, which is not guaranteed.
2. The asset's fair value, at November 1, 2019, is $80,000, with an economic life of seven years.
3. The asset will revert to Sultan at the end of the lease term, at which time the asset is expected to have a residual value of $7,000, which is not guaranteed.
4. Sultan leasing assumes direct responsibility for the executory costs.
5. The agreement requires equal annual rental payments of $18,143, beginning on November 1, 2019.
6. The lessor's implicit rate is 10% and is known to BWSC.

Grant has recorded this as an operating lease and expensed the annual payment during the fiscal year.

Provision for income taxes

The provision for income taxes included in the financial statements is recorded based on the taxes payable in the current period (that is, the amount payable based on taxable income). Management has prepared the calculation by focusing only on the undepreciated capital cost (UCC) and depreciation difference because they are unsure of any other differences.

A review of Schedule 8 of the Corporate T2 reveals UCC balances of the following:

	Cost	UCC
Furniture and fixtures	$23,434	$10,518
Computer equipment	50,842	6,835
Leasehold improvements	19,404	19,404
Vehicle	40,352	29,985
Production equipment	931,074	289,567

The total capital cost allowance taken in 2020 was $140,545. The average tax rate for BWSC is 31.16% on the current year's income.

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Preferred shares

On November 1, 2019, BWSC issued 2,000 redeemable and retractable preferred shares at a value of $10 per share. The shares are redeemable by BWSC at any time after January 2021. The shares are retractable for the original $10 per share at the discretion of the holder at any time up to January 2021, after which the retractable feature expires. The preferred shares require the payment of a mandatory $2 per share during the retraction period, after which the dividends become noncumulative and are paid at the discretion of the board only.

Long-term note receivable

On July 1, 2020, BWSC provided certain services to a preferred customer in exchange for a long-term note receivable. BWSC provided its services in exchange for five payments of $4,000. BWSC provided its preferred customer with this offer to help stimulate the sale given the recent financial crisis. The first payment is due July 1, 2021.

Loyalty program points

During the most recent board meeting, it was decided that BWSC will begin offering points under a loyalty program. BWSC will provide its customers with 1 point for every $100 spent. The points can then be redeemed for a discount on future services. A total of 100 points will result in a $500 discount.

Postretirement benefits

BWSC has just implemented and sponsored a defined benefit plan for its employees in fiscal 2020. No past service benefits have been granted.

The following additional information was obtained from an actuarial report that has been prepared as at the year end:

Service cost for 2020:	$95,000
Discount or settlement rate:	8%
Actual return on plan assets for 2020:	8%
Contribution (plan funding) in 2020:	$87,000
Expected rate of return for 2020:	8%

The initial contribution of $87,000 was made on August 1, 2020. Currently, BWSC has expensed the contribution as part of the management salaries and benefits (on the income statement).

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Can you please prepare a report that I can use for the upcoming meeting?
I am glad that you have some time available!"

Required

Prepare the report for George.

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