

CANADIAN AIR MOBILE

Canadian Air Mobile Ltd (CAM or Company) is a small Canadian public company with telecommunication operations throughout Northwestern Ontario, Canada. The company sells cellphone handsets and offers a range of data and voice calling plans.

The Company is currently undergoing restructuring and is in the midst of union negotiations. The Chief Financial Officer (CFO) is committed to reducing costs and bringing the company back to profitability in the future. In a recent news release the CFO was quoted saying “this year, we expect to incur a net loss of approximately \$690,000 coupled with a significant increase in debt levels...the union needs to understand that the Company cannot operate at this level and salary concessions will need to be made...the Company needs to become profitable and solvent!”

You have been recently hired by the CFO as the new Vice-President of Finance, responsible for overseeing all accounting matters, including finalization of the draft financial statements.

On your first day, you receive a request from Shura Raman to review selected financial information (outlined in Appendix A) and provide your preliminary comments. As the largest shareholder of CAM and a prominent member of several internal committees, Mrs. Raman is concerned about the drastic drop in profitability and that the CFO may have influenced some of the accounting decisions.

Your professional opinion is requested on this matter.

It is currently February 17, 2017.

Required:

Prepare a professional memo addressed to the Shura Raman. Among other things, ensure your memo:

- is detailed, specific, and well supported;
- includes restated (i.e., adjusted) financial statements (if necessary); and
- includes any ratio analysis you feel is necessary to support your overall analysis.

APPENDIX A: SELECTED FINANCIAL INFORMATION

Canadian Air Mobile		
Income Statements		
For the Years Ended December 31st		
	<u>2016</u>	<u>2015</u>
Revenue	\$1,970,624	\$2,463,280
Other income	\$25,000	\$7,000
Operating costs	\$1,904,108	\$1,341,516
Depreciation and amortization	\$220,000	\$264,000
Impairment - underperforming stores	\$199,000	\$0
Loss on share repurchase	\$129,000	\$0
Termination pay	\$100,000	\$0
Pension expense	\$90,000	\$45,000
Other	\$47,123	\$20,121
Income tax expense	\$0	\$155,000
Net (Loss) Income	<u>-\$693,607</u>	<u>\$644,643</u>

Canadian Air Mobile		
Balance Sheets		
As of December 31st		
	<u>2016</u>	<u>2015</u>
Cash	\$275,125	\$250,235
Receivables	\$159,000	\$430,000
Inventory	\$595,612	\$920,000
Current assets	<u>\$1,029,737</u>	<u>\$1,600,235</u>
Capital assets (net)	\$239,000	\$525,000
Lease asset - IBM 3000 server (net)	\$519,537	\$692,716
Investment in CML	\$250,000	\$0
Other	\$1,210,007	\$1,257,251
	<u>\$3,248,281</u>	<u>\$4,075,202</u>
Accounts payable and other	\$201,000	\$719,934
Termination pay liability	\$100,000	\$0
Current liabilities	<u>\$301,000</u>	<u>\$719,934</u>
Long-term debt (at 5% interest)	\$135,361	\$12,022
Lease liability - IBM 3000 server	\$544,650	\$709,190
Other long-term liabilities	\$1,781,667	\$1,454,846
Common shares	\$1,000,000	\$1,000,000
Retained earnings	-\$514,397	\$179,210
	<u>\$3,248,281</u>	<u>\$4,075,202</u>
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- The Company has historically billed customers for voice calling services on the 30th day of each month, for the services provided during that month. To speed-up cash-flow, effective January 1, 2016, Company now has two billing cycles. It bills 50% of its customers on the 15th day of each month and the remainder on the 30th day. Due to the increased uncertainty of collection arising from this change, the accounting department has been instructed by the CFO to record revenue when, and only when, the customer makes full payment.
- On December 1, 2016, the CFO has instructed management to immediately close-down two underperforming cell-phone stores and terminate all associated employees. The inventory of cell phones (\$133,000) in those stores will be transferred to other profitable stores and any associated equipment (\$66,000) will be sold in the liquidation market for any reasonably offered price. The company has hired a popular online auction website to facilitate the disposal process. Along with their Happy New Year card, 20 store employees are scheduled to receive termination letters, informing them of their dismissal and termination payment of \$5,000.
- On January 1, 2016, the Company had 2,000,000 common shares authorized and 1,000,000 common shares issued and outstanding. On September 30, 2016, in the normal course of operations, the Company repurchased 12,900 common shares from its common shareholders for \$129,000.
- The CFO renegotiated the rental agreement for the IBM 3000 server, a device that provides functionality for other critical technology programs and devices. Effective 2016, the server is rented on a year-to-year basis (with no long-term commitment) rather than its entire useful life of 5 years. Annual rental payments continue to be \$200,000. A new server costs approximately \$800,000.
- In 2016, the CFO adjusted several estimates inherent in the defined-benefit pension liability, including increasing the estimated the number of year's employees will live after retirement. In addition, a concern exists that the annual pension expense is not the same as the annual pension funding contribution.
- The Company purchased 2,250,000 common shares of Cell Makers Ltd., a family owned and operated cellphone repair business (CML) for \$250,000. The investment represents an 18% interest in CML and gives CAM two out of the five seats on CML's Board of Directors. The other three seats are held by the founding family of CML – three brothers who are active in the business but are considered estranged from each other. In 2016, CML had net income of \$12,555,555 and paid a total dividend of \$100,000.
- To expedite the financial statement preparation process, the CFO has asked several managers in the accounting department to reduce the amount of time they spend reviewing the financial statements. Instead, he has requested that this time be spent analyzing predatory pricing strategies and tax evasion techniques.