Cream Delight Inc.

To: Chris and Jess Melty
From: Advisor, CPA
RE: Reviewing past year's development, assessing accounting policies + recoomending changes.

Role:

As your advisor, my role is to review ~~the~~ CDI's past year of development, assess the accounting policies of CDI and reccomend any changes that should be made.

Users and objectives:

Maple Bank is the most important user. As CDI is trying to grow, this bank loan we have received is critical to allow the company to have the ability to achieve actual growth. The bank has placed a 2:1 debt-to-equity ratio on CDI in order to maintain the loan. ~~as~~ If CDI keeps ~~up~~ this ratio the bank may agree to extend the loan, which will be good for CDI.

Chris and Jess Melty, you are another user. As Jess is specifically trying to grow the company, you will be interest in seeing profitability in your new ventures.

Constraints:

Jess would like to begin following IFRS, so I will treat IFRS as a constraint. I will also compare IFRS + ASPE to allow Chris to better understand this report.

Issues:

Issue 1: Capitalization of Equipment costs.

The issue here is to determine how much the equipment should be valued at on the balance sheet. The purchase price of

~~$100,000~~ $104,400, the duty of 15,600, transportation costs of $10,000 + cost of the specialist of $2,000, should be included in the cost of the equipment. Therefore, equipment will be recorded at $132,000. Installation team costs are not to be included as they were not successful.

well? explain

Issue 2: Lawsuit against installation team

As per IFRS, any ~~ga~~ contingent gains should not be included on the financial statements. Therefore, if Jess follows up with a lawyer, the amount of the lawsuit cannot be recorded.

Issue 3: Costs of ~~new~~ extention manufacturing facility

The issue here is how to treat the costs of the extension of the manufacturing facility. As per IFRS, any costs related to major overhauls are to be capitalized. Therefore, the $20,000 the extension costed is to be ccapitalicated. Chris, under ASPE, expenses are capitalized regarding ~~benefits~~ the betterment of an asset. This extension is a betterment to the facility, thus it would be capitalized under ASPE as well. This will positively impact the net income of the company, as it will not be ~~expensed~~

Issue 4: Revenue recognition of ice cream for LHI

The issue here is when to recognize revenue made from LHI.

As per IFRS, these criteria must be met to recognize revenue:

1. Significant risks + rewards are transferred to buyer. This criterion has been met when the icecream is given to LHI, as they have the ~~re~~ rewards of having the ice cream in their freezers for their customers. how about risks?
2. Seller has no involvement or control over the goods. This criterion has been met, as the ice cream is given to LHI.
3. Payment is probable. This criterion has been met as it is agreed ~~they~~ u LDI will pay $3 per container sold. LHI is also

a medium sized hotel chain, which ~~a~~ is able to pay for the icecream
4. Revenue can be reasonably measured. On one hand, this criterion has been met, as the ice cream is $3 a container. However, any unsold containers will be returned to CDI. Therefore, it is unknown how many containers will be sold + how many will be returned. Due to the fact that this is a new venture to CDI, it is ~~[illegible]~~ not possible to come up with an estimate of returns therefore, this criterion has not been met.
5. Costs associated with revenue are reasonably measured. This criterion has not been met, as CDI cannot come up with an estimate ~~for~~ an allowance of sales returns account.

Based on these criterion, CDI cannot ~~[illegible]~~ record revenue until the ice cream reaches its 3-month expiry date + is returned to them. This will have to be done for this first year, until an estimate can be made on the allowance for sales returns. This will negatively impact the net income, as they must wait longer to record revenue. This will also negatively impact the debt to equity ratio, as equity will be lower.

Issue 5: Amortization of machines.
The issue here is ~~[illegible]~~ how to amortize the machines. As per IFRS the amortization method that best reflects the use of the machines should be used. One option is to amortize based on the usage of the machines, which have increased from 8 to 11 hours per day. The other option is to amortize based on straight-line method, with a useful life of 20-30 years. I beleive the machines should be amortized based on the second option as it is easier to track years rather than hours per day.

Issue 6: Development costs.

The issue here is if the development costs of the healthy ice cream should be capitalized or expensed. As per IFRS, develop costs can be capitalized if all 6 of the development criteria are met:

1. cost are reliably measurable
   → this criterion is met as it has costed the $150,000 already
2. The product is technically feasible
   → this criterion is met as it is possible to make healthy "sugar substitutes" for ice cream, as they have already developed a first round of products.
3. management intentions are to finish + sell product
   → this criterion is met, as the first round of products was successful, but they are continuing the process.
4. management demonstrats ability ~~to sell product~~
   → This has not been met as it is ~~written~~ not clear if they can sell the product, as no focus group has be created to see if consumers will buy the product
5. management demonstrats ~~abili~~ future economic benefits
   → this is not met as it is unclear what the total costs will be, and what they can sell the product at
6. Adequate resources exist to complete product
   → this is not met, as we don't know how much more money will need to be invested into this development and don't know if ~~we~~ Col ~~has~~ has enough money to do it

Therefore, it is clear that these development costs cannot be capitalized an should be expensed. This will negatively impact the net income + debt-to-equity ratio, as it will lower net income + equity.

Issue 7: Interest on bank loan

The issue here is when to recognize the interest expense. ~~the int~~ Expenses should be matched to the revenue they helped to earn. Interest expenses should be recorded each month. This will negatively impact net income + debt-to-equity as it will lower CDI's net income + equity.

Conclusion:

As CDI is venturing off and creating new products + ways to generate revenue, they must be careful of their debt-to-equity ratio. As they are incurring a lot of expenses, it will negatively impact their statements. +