Canadian Restaurant & Hospitality Group Inc.

Comprehensive Case Supplement for:
Modern Advanced Accounting in Canada, 6e; Hilton, M.W. & Herauf, D.;

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Purpose & Scope

This comprehensive case (the 'Case') is intended to test your capabilities in applying several key learning objectives of a course in advanced financial accounting to a particular business situation. Although the scale and particulars of the featured business entity are fictitious, elements of this Case are drawn from real experience. Topical areas covered include:

- Accounting for the acquisition of a subsidiary (e.g. determining & allocating the acquisition differential)
- Foreign currency translation (including translation of the financial statements of foreign operations)
- Preparing consolidated financial statements (including implications of different inter-corporate relationships and the elimination of intercompany transactions & balances)

Finally, considering the overarching purpose of financial accounting and reporting, the Case encourages students to reflect on the factual details and the consolidated financial statements they prepare, for the purposes of providing business advice to the owners of Canadian Restaurant & Hospitality Group Inc.

Which Accounting Standards Apply ?

As students of accounting will be aware, the CICA's Accounting Standards Board adopted a strategy for harmonizing Canada's accounting standards with IFRS. All students of accounting should use this Case as an opportunity to enhance their familiarity with the existence and application of the recommendations of the recent and comprehensive restructuring of the CICA Handbook, notwithstanding that many required implementation dates may be later than the time students are actually engaged in this Case. In other words, if necessary or appropriate, assume early adoption of the relevant accounting standards that the students should expect to be using in professional practice. Although required implementation dates of the revised standards are typically for fiscal years commencing on or after January 1, 2011, requirements for comparative information effectively make such standards applicable to fiscal years commencing on or after January 1, 2010. Entities are permitted to adopt these standards earlier.

More particularly, this recommendation applies to the following standards in Part I as it applies to 'publicly accountable entities' or PAEs':

- Business Combinations – IFRS 3
- Consolidated Financial Statements – IAS27
- Investments in Associates – IAS28, and
- Interests in Joint Ventures – IAS31,

which are based on the Entity Perspective and the Acquisition Method. Students will also need to be knowledgeable about 'The Effects of Changes in Foreign Exchange Rates' – IAS21 to successfully complete the requirements of this Case.

Students should also be aware that accounting standards are always in a state of flux and may be subject to more frequent and pervasive changes with the move to IFRS. Additional changes in accounting standards may occur between the last date of review of this Case prior to publication and the period during which students are analyzing this Case. In particular, watch for changes in the recommendations pertaining to accounting for Interests in Joint Ventures (a new IFRS 10 may be released to replace IAS28 / old Handbook section [Part V] §3055). Students should confirm with their instructors, which changes, if any they should use in completing the Case, but the recommended solution is based on IAS28 (at the time of the last update to this Case, the Accounting Standards Board did not expect the new pronouncement on joint ventures to have an implementation date before 2012).

Suggestions & Hints

Please consult your instructor for suggestions and hints in analyzing this Case with respect to the following:

- Approaches to digesting and organizing significant volumes of data and information,
- Mechanical approaches to consolidation,
- Being alert for the creation of new financial statement line items,
- Examples of procedural guidance on foreign currency translation,
- Expected amount of work and levels of detail, and
- Other suggestions reflecting the preferences and discretion of your instructor.

The Case: Canadian Restaurant & Hospitality Group Inc.

Background Information

Canadian Restaurant & Hospitality Group Inc. was established Dec. 29, 20X1 by two brothers and a sister. Their objective was to build a chain of casual, upscale restaurants catering to the 40+ dining crowd, which they decided to call "Quincy's Diner". Canadian Restaurant & Hospitality Group Inc. ('CRHGI') is owned 30% by each sibling and 10% by their parents. CRHGI is a holding company whose principal assets represent investments in the common shares of incorporated restaurants. On the advice of their lawyers, each operating restaurant (business and related assets & obligations) is separately incorporated. To encourage commitment from onsite management, the owners recruit top-rated chefs and provide them with an equity interest (10% of common shares) in the single restaurant they are expected to manage. They do require each chef to invest a small amount for their individual equity position and the chef is expected to pay this amount in cash. CRHGI arranges the financing to construct and equip each restaurant facility and to provide it with working capital during its start-up period. Equity capital has been sourced from a combination of family resources and arm's length investors.

The brothers and sister opened their first restaurant, 'Quincy's Diner (Square One) Ltd', located in Mississauga, Ontario, on March 1, 20X2. Their second restaurant in Etobicoke, Ontario – 'Quincy's Diner (Woodbine) Ltd', opened later that same year (August 31st). The first two restaurants performed well from the outset and the siblings attributed this to a combination of good timing for market entry and a design / menu combination that was right for the times and target market segment .

In early, 20X3, the brothers and sister saw a significant market opportunity for their concept just across the border in Buffalo, New York. So, they decided it was appropriate to expand there. Their lawyer set up a holding company (CRHG US-Holdings Inc, or 'CRHG-US') which they incorporated federally in Canada to hold investments in restaurant operating companies in the United States. This was completed in early March, 20X3. On April 2, 20X3, CRHG-US acquired 100% of the shares of 'Corkey's Place Inc.' from a New York couple, at a cost of US$279,450. This amount was ultimately finalized based on financial statements that reflected current values of inventory, accounts payable and certain assets and was paid in cash. The Canadian dollar equivalent of this amount was funded through an intercompany loan from CRHGI.

Corkey's was an existing, similar-style restaurant, 3 years old, reasonably profitable and with a clientele that fit the Quincy's demographic. The name Quincy's was not available in New York, so the siblings decided to retain the name Corkey's (actually it was changed slightly to 'Corkey's Eatery (Buffalo) Inc'). The entire acquisition differential arising on the acquisition of Corkey's was attributed to goodwill associated with the name, business and clientele (which they hoped to retain). They closed the restaurant for renovations and when it opened eight weeks later on May 31, 20X3, it was essentially a clone of the two Quincy's Diners in Canada in terms of format, design and menu. The siblings retained the local management team that had worked at Corkey's for the last couple of years. They figured the existing crew knew the clientele, local market and local food and beverage suppliers. Their knowledge and industry connections would allow them to operate essentially independently. This would minimize the risks to the new restaurant chain from investing in the USA, limiting the foreign currency risk essentially to the investment amount (the form of which was part equity – the acquisition cost, and part debt – partial funding of renovations to complement a loan from a local bank).

By August, 20X3, business seemed to be rolling along nicely. The owners were pleased with chain profitability, but growth was about to slow. They had a full slate of opportunities but inadequate personal financial resources to completely fund the development of any more restaurants for at least a couple of years. Not content to wait for organic growth to generate sufficient funds for expansion, they decided to partner with a group of investors operating as Restaurant Capital Ventures Ltd. ('RCV') who would provide financial capital and leave the day-to-day running of the restaurants to CRHGI management. The two organizations negotiated a contractual arrangement between them, a ‘Master Agreement’, that included the following key terms:

- RCV would hold 50% of the common shares of each new, separately incorporated ‘Quincy’s Diner’ for which funding was required by CRHGI; the remaining 50% would be held by CRHGI
- RCV would provide all capital funding required to get the restaurant up & running that could not be raised through other sources; said funding would be documented as a loan secured by restaurant assets, and subordinated to any bank debt as required by the bank
- Chefs would not hold any common shares, but would instead be entitled to a bonus equal to 5% of EBITDA
- Notwithstanding their respective ownership interests, and on the advice of their lawyers, CRHGI negotiated with RCV that their Shareholders’ Agreements would include ‘vote-together’ provisions with respect to certain important strategic operating, investing and financing decisions in respect of the particular operating restaurant; RCV insisted such ‘joint decisions’ specifically include borrowing money or bringing on additional investors.

The Master Agreement was executed by September 10, 20X3. Contemporaneously, a new corporation was established for purposes of developing the first joint investment – ‘Quincy’s Diner (YongEg) Ltd’. Meanwhile, the siblings had identified a new location at Yonge & Eglinton in Toronto, Ontario and had negotiated a lease. They took possession September 15th, renovated the premises, hired and trained staff and opened for business on November 1, 20X3, just in time for the Christmas season.

Additional Information

- All companies in the CRHGI Group have a February year-end.
- A $US-denominated balance sheet is provided for ‘Corkey’s Place Inc’ on the date of acquisition; a $US-denominated balance sheet indicating the revised financial position as at the reopening date of May 31, 20X3 is also provided; if you choose to use an average rate to translate revenues and expenses, compute one for the 9-month operating period following the opening of the renovated restaurant.
- Unaudited financial statements for each of the individual legal entities for the year or part-year ended February 28, 20X4 are presented on the following pages.
- Although all of the entities involved in this family business are ‘private enterprises’, the siblings intend to take CRHGI public within the next five years, subject to the realization of their growth plans and the condition of capital markets; their accountant has advised them that it will be important to use accounting standards for ‘publicly accountable enterprises’ in that event and has encouraged the siblings to adopt these standards and to do so from the outset; in an early Directors’ Meeting, the siblings made a resolution to do so.
- The company’s accountant obtains foreign exchange rates from the Bank of Canada website; these are reproduced in Table 1 following.
- The amount of investment required by a chef is $10,000 (local currency).
- The average effective income tax rate for all entities in all jurisdictions is 20%; inter-corporate dividends are assumed to be non-taxable.
- Amounts advanced from sibling shareholders to the parent-holding company are non-interest-bearing and have no specific terms of repayment.
- CRHGI and all of its subsidiaries and affiliates use the Equity Method to account for inter-corporate investments.
- The Board of Directors of CRHGI required CRHG-US to strip out pre-acquisition Retained Earnings in Corkey’s by way of a dividend; this was declared & paid on February 28, 20X4; CRHG-US used the proceeds as instructed to reduce the amount of its intercompany loan payable to CRHGI.

- The Company's accountant calculates, invoices and records all intercompany charges, on the 3rd last business day of each month; all intercompany charges within the corporate group are settled in cash on the last business day of every month through on-line bank transfers and the accountant journalizes the cash disbursements and cash receipts in every entity's books prior to the preparation of month-end statements. Management services are provided by the siblings and billed from CRHGI directly to each operating company in the currency of the operating company.
- The auditors knew that the Company's accountant was preparing draft consolidated financial statements and e-mailed him to remind him to translate the acquisition differential (i.e. Goodwill) arising on the acquisition of Corkey's at the current rate at the year-end.

Requirements

[*marks are minimums & exclude any bonus marks awarded for exemplary work at your instructor's discretion*]

1. Draw a corporate structure chart for Canadian Restaurant & Hospitality Group Inc., to illustrate all of its inter-corporate investments, equity interests, joint arrangements, non-controlling interests and all information you consider relevant to a full understanding the organization. [10 marks]
2. For each inter-corporate investment between entities in the CRHGI Group in that you identified in #1, identify the nature / extent of control or influence in the relationship and both the accounting and financial reporting implications. [10 marks]
3. Analyze the transaction for the purchase of the U.S. restaurant 'Corkey's Place' in Buffalo, NY, identifying the acquisition differential and showing how it should be allocated and amortized. [10 marks]
4. Translate any financial statements of foreign operations into Canadian dollars using appropriate exchange rates and determine appropriate foreign exchange gains & losses. Explain your choice of translation methods and exchange rates. [15 marks]
5. In good form, record journal entries for the following:
    (a) The acquisition of Corkey's Place Inc; indicate in which legal entity's books will this be recorded and in what currency ? [3 marks]
    (b) Corrections to the financial statements of CRHG-US which have not reflected any investment income or comprehensive income entries under the Equity Method and which show dividends received from Corkey's accounted for as dividend income. [7 marks]
    (c) Eliminations & adjustments necessary for the consolidation of CRHG-US and its subsidiary for the year / period ended February 29, 20X4. [15 marks]
    (d) Eliminations & adjustments necessary for the consolidation of CRHGI and its subsidiaries and affiliates, as appropriate, for the year / period ended February 28, 20X4. [30 marks]
6. What is the revised balance in the investment account on the legal entity statements of CRHG-US Holdings Inc, subsequent to your answer to 5(b) ? (*Note – you may wish to develop your own equity-method-restated F/S for CRHG-US to use in the preparation of consolidate financial statements for both CRHG-US and CRHGI*) .
[3 marks]
7. Prepare a Consolidated Statement of Comprehensive Income for CRHGI for its 20X4 fiscal year (*use any method you prefer; working-paper method is recommended for effectiveness; choice of method does not affect marks, but be sure to show your work / calculations*). [15 marks]
8. Prepare a Consolidated Statement of Financial Position (Consolidated Balance Sheet) for CRHGI as at February 28, 20X4 (*use any method you prefer; working-paper method is recommended for effectiveness; choice of method does not affect marks*). [25 marks]
9. Based on the information in this Case and the results of your work, do you have any business or financial advice for the owners of CRHGI ? [7 marks]

Supporting Information

Table 1: Foreign Currency Exchange Rates

CAD vs. USD

Date	Direct		Indirect	
	Closing	M-Avg	Closing	M-Avg
Yr - Mth - Day	US$1 =	US$1 =	C$1 =	C$1 =
20X3 - Apr - 02	**C$ 1.1630**		**U$ 0.8598**	
20X3 - Apr - 30		C$ 1.1340		U$ 0.8818
20X3 - May - 31	**C$ 1.0700**	C$ 1.0950	**U$ 0.9346**	U$ 0.9132
20X3 - Jun - 30		C$ 1.0650		U$ 0.9390
20X3 - Jul - 31		C$ 1.0500		U$ 0.9524
20X3 - Aug - 31		C$ 1.0580		U$ 0.9452
20X3 - Sep - 30		C$ 1.0250		U$ 0.9756
20X3 - Oct - 31		C$ 0.9750		U$ 1.0256
20X3 - Nov - 30		C$ 0.9670		U$ 1.0341
20X3 - Dec - 31		C$ 1.0030		U$ 0.9970
20X4 - Jan - 31		C$ 1.0110		U$ 0.9891
20X4 - Feb - 28	**C$ 0.9840**	C$ 0.9990	**U$ 1.0163**	U$ 1.0010

Selected Entity Financial Statements

Corkey's Eatery
(Buffalo) Inc
Balance Sheet
As at various dates
($US)

	Feb. 28 20X4	May 31 20X3 (opening)	Apr. 2 20X3 (acquisition)
Assets			
Cash	U$ 33,000	U$ 39,000	U$ 39,000
Inventory	24,000	20,000	5,000
Other assets	15,000	15,000	10,000
Capital assets (net)	538,000	600,000	206,000
	U$ 610,000	U$ 674,000	U$ 260,000
Liabilities			
Accounts Payable	U$ 98,000	U$ 64,000	U$ 60,000
Bank Loan	250,000	250,000	-
Loan Payable - CRHG-US	160,000	160,000	-
	508,000	474,000	60,000
Equities			
Common Stock	1,000	1,000	1,000
Retained Earnings	101,000	199,000	199,000
	102,000	200,000	200,000
	U$ 610,000	U$ 674,000	U$ 260,000

Corkey's Eatery
(Buffalo) Inc
Income Statement
9 months ended February,
($US)

	Feb. 28 20X4
	(9 months)
Sales	U$ 900,000
Operating Expenses	
Cost of food & beverage	288,000
Salaries, wages & benefits	216,000
Other	162,000
	666,000
EBITDA	234,000
Other Expenses	
Management fees - CRHGI	27,000
Interest - CRHG-US	6,000
Interest - other	13,000
Depreciation	62,000
Income before taxes	126,000
Income Taxes	25,000
Net income	U$ 101,000

Corkey's Eatery
(Buffalo) Inc
Statement of Retained Earnings
9 months ended February,
($US)

	Feb. 28 20X4
	(9 months)
Balance, date of acquisition	U$ 199,000
Net Income	101,000
	300,000
Dividends	(199,000)
Balance, end of year	U$ 101,000

CRHG US-Holdings Inc.

Balance Sheet

(Non-consolidated)

As at various dates

	Feb. 28 20X4	Apr. 2 20X3
	(errors ?)	
Assets		
Cash	$ 616	$ 176,000
Loan Receivable (US$) - Corkeys(Buffalo)	157,440	-
Investment - Corkeys(Buffalo)	325,000	325,000
	$ 483,056	$ 501,000
Liabilities		
Accounts Payable	$ -	$ -
Loan Payable - CRHGI	300,000	500,000
	300,000	500,000
Equities		
Common Stock	1,000	1,000
Retained Earnings	182,056	-
	183,056	1,000
	$ 483,056	$ 501,000

CRHG US-Holdings Inc.

Income Statement

(Non-consolidated)

period ended February 28,

	Feb. 28 20X4
	(errors ?)
Revenues	
Interest Income	$ 6,102
Dividend Income	195,816
Investment Income	-
	$ 201,918
Expenses	
Interest - CRHGI	6,102
Foreign exchange loss	13,760
Income before taxes	182,056
Income Taxes	-
Net income	$ 182,056

Quincy's Diner

(Square One) Ltd

Balance Sheet

As at February 28,

	Feb. 28 20X4	Feb. 28 20X3
Assets		
Cash	$ 59,000	$ 95,000
Inventory	25,000	22,000
Other assets	15,000	17,000
Capital assets (net)	710,000	825,000
	$ 809,000	$ 959,000
Liabilities		
Accounts Payable	$ 110,000	$ 120,000
Bank Loan	300,000	360,000
Loan Payable - CRHGI	250,000	400,000
	660,000	880,000
Equities		
Common Stock	12,000	12,000
Retained Earnings	137,000	67,000
	149,000	79,000
	$ 809,000	$ 959,000

Quincy's Diner

(Square One) Ltd

Income Statement

Year ended February 28,

	Feb. 28 20X4	Feb. 28 20X3
Sales	$ 1,450,000	$ 1,200,000
Operating Expenses		
Cost of food & beverage	507,500	395,000
Salaries, wages & benefits	362,500	280,000
Other	290,000	235,000
	1,160,000	910,000
EBITDA	290,000	290,000
Other Expenses		
Management fees - CRHGI	42,000	36,000
Interest - CRHGI	16,000	20,000
Interest - other	30,000	35,000
Depreciation	115,000	115,000
Income before taxes	87,000	84,000
Income Taxes	17,000	17,000
Net income	$ 70,000	$ 67,000

Quincy's Diner

(Woodbine) Ltd

Balance Sheet

As at February 28,

		Feb. 28 20X4		Feb. 28 20X3
Assets				
Cash	$	38,000	$	36,000
Inventory		24,000		20,000
Other assets		15,000		23,000
Capital assets (net)		743,000		854,000
	$	820,000	$	933,000
Liabilities				
Accounts Payable	$	125,000	$	113,000
Bank Loan		330,000		390,000
Loan Payable - CRHGI		300,000		420,000
		755,000		923,000
Equities				
Common Stock		12,000		12,000
Retained Earnings (Deficit)		53,000		(2,000)
		65,000		10,000
	$	820,000	$	933,000

Quincy's Diner

(Woodbine) Ltd

Income Statement

Period ended February 28,

		Feb. 28 20X4		Feb. 28 20X3
				(6 months)
Sales	$	1,350,000	$	550,000
Operating Expenses				
Cost of food & beverage		472,500		185,000
Salaries, wages & benefits		337,500		140,000
Other		270,000		125,000
		1,080,000		450,000
EBITDA		270,000		100,000
Other Expenses				
Management fees - CRHGI		42,000		18,000
Interest - CRHGI		18,000		11,000
Interest - other		30,000		18,000
Depreciation		111,000		55,000
Income before taxes		69,000		(2,000)
Income Taxes		14,000		-
Net income	$	55,000	$	(2,000)

Quincy's Diner

(YongEg) Ltd

Balance Sheet

As at February 28,

	Feb. 28 20X4
Assets	
Cash	$ 9,000
Inventory	24,000
Other assets	15,000
Capital assets (net)	854,000
	$ 902,000
Liabilities	
Accounts Payable	$ 115,000
Bank Loan	405,000
Loan Payable - RCV	350,000
	870,000
Equities	
Common Stock	20,000
Retained Earnings	12,000
	32,000
	$ 902,000

Quincy's Diner

(YongEg) Ltd

Income Statement

Four months ended February 28,

	Feb. 28 20X4
	(4 months)
Sales	$ 400,000
Operating Expenses	
Cost of food & beverage	134,000
Salaries, wages & benefits	95,000
Other	75,000
	304,000
EBITDA	96,000
Other Expenses	
Interest - RCV	12,000
Interest - other	37,000
Chef's Bonus	5,000
Depreciation	27,000
Income before taxes	15,000
Income Taxes	3,000
Net income	$ 12,000

Canadian Restaurant & Hospitality Group Inc.

Balance Sheet

(Non-consolidated)

As at February 28,

	Feb. 28 20X4	Feb. 28 20X3
Assets		
Cash	$ 182,561	$ 205,000
Loan Receivable - QD(Square One)	250,000	400,000
Loan Receivable - QD(Woodbine)	300,000	420,000
Loan Receivable - CRGH-US	300,000	-
Investment - QD(Square One)	125,300	62,300
Investment - QD(Woodbine)	49,700	200
Investment - QD(YongEg)	16,000	-
Investment - CRGH-US	50,824	-
Other assets	35,000	30,000
Capital assets (net)	109,000	95,000
	$ 1,418,385	$ 1,212,500
Liabilities		
Accounts Payable	$ 38,000	$ 14,000
Bank Loan	525,000	500,000
Due to Shareholders	890,000	740,000
	1,453,000	1,254,000
Equities		
Common Stock	10,000	10,000
Retained Earnings (Deficit)	(5,482)	(51,500)
Cumulative Other Comprehensive Inc.	(39,133)	-
	(34,615)	(41,500)
	$ 1,418,385	$ 1,212,500

Canadian Restaurant & Hospitality Group Inc.

Income Statement

(Non-consolidated)

Year ended February 28,

	Feb. 28 20X4	Feb. 28 20X3
Revenues		
Management Fees	$ 111,459	$ 54,000
Interest Income	40,102	31,000
Investment Income	207,457	58,500
	359,018	143,500
Expenses		
Salaries, wages & benefits	189,000	123,000
Other	53,000	48,000
	242,000	171,000
EBITDA	117,018	(27,500)
Other Expenses		
Interest - other	46,000	32,000
Depreciation	13,000	5,000
Income before taxes	58,018	(64,500)
Income Taxes	12,000	(13,000)
Net income	$ 46,018	$ (51,500)