



Houston We Have A Problem: They Paid Themselves Bonuses!

Pascale Lapointe-Antunes, Brock University

Deborah McPhee, Brock University

Amanda Walsh's first year as Vanderville Plastics Company's (VPC) controller had been quite tumultuous. She had discovered on her first day on the job that VPC's financial situation was precarious, and had since witnessed a change in ownership, repeated requests for funding to the new owners to help alleviate VPC's severe cash flow issues, and more recently, the sudden resignation of Peter Giroux, the company's Chief Financial Officer (CFO). As a result of Giroux's resignation, Amanda was now acting interim CFO and reported directly to Michael Stratton, the Chief Executive Officer (CEO).

A consultant had been hired by the new owners to better understand the causes of VPC's cash flow shortages, and he never seemed satisfied with Amanda's answers. Michael wanted the consultant to make all of his requests to Amanda through him. However, Amanda had no choice but to answer one of the owners' questions when he called her to enquire about a \$1 million decrease in accrued liabilities in January 2006. Amanda discovered to her great disbelief that the new owners did not know about the recent payout of bonuses for the 2005 financial year.

Scared and angry, Amanda started to think about the succession of events since she came to VPC to better understand what this all meant, what was likely to happen next, and what she should do.

VANDERVILLE PLASTICS COMPANY

VPC, a plastics injection molding company, was founded in 1962 by the Vanderville family. A major player in the plastics industry, they supplied products to original equipment manufacturers (OEM) in the health care industry. The Canadian plastics industry was a sophisticated, multi-faceted sector encompassing plastic products manufacturing, machinery, molds, and resins. The plastics industry was very fragmented. There were many hundreds of small and medium enterprises (SMEs), and about a dozen large firms (500+ employees) operating domestically. It was estimated

Copyright © 2018 by the *Case Research Journal* and by Pascale Lapointe-Antunes and Deborah McPhee. This case study was prepared as the basis for classroom discussion rather than to illustrate either effective or ineffective handling of an administrative situation. The authors wish to thank Carolyn Conn, Eric Dolansky, John Lawrence, James Moore, Barbara Sainty, Kevin Veenstra, and the anonymous CRJ reviewers for their helpful suggestions on how to make this a more effective case. An earlier version of the case was presented at the 2016 Annual Meeting of the North American Case Research Association in Las Vegas, Nevada, United States.

that about 95 percent of this sector was Canadian-owned. The industry was concentrated in Ontario, Quebec, British Columbia and Alberta. VPC was located in Meadowbrook, a small borough close to Vancouver, British Columbia, Canada. VPC's location was strategically selected to be near an area heavily populated by hospitals.

The Vandervilles had planned to pass on their company to their two children, but the latter made it clear they wanted to pursue other opportunities. Private equity firms were very interested in working with firms in the plastics industry to earn a lucrative return because plastics manufacturing had grown faster than the general economy, and twice as fast as other manufacturing businesses over the past decade. Globally, plastics was also thought of as one of the industries that would drive innovation, technology, and the knowledge jobs of the future. As word spread that the Vandervilles were looking to sell, VPC quickly became an attractive target for private equity investors. A Miami based private equity firm (Miami) acquired VPC in 1996 for \$20 million and sold 20% of VPC's common shares to some of the senior employees (see Exhibit 1).

Miami planned on buying out several smaller companies to leverage the relationships that VPC had already established with high profile multinationals. They kept the company name because the Vanderville family was highly respected in the industry. Between 1996 and 1998, VPC acquired one company from New York City (New York) that continued to operate independently, and two companies from British Columbia that were amalgamated into VPC (Meadowbrook) (see Exhibit 1). Meadowbrook handled the administration, tax planning, and strategic planning for both locations.

By 2005, VPC had grown to 400 employees in Canada, and 120 employees in New York City. The organizational structure included a Board of Directors made up of the equity owners, the Chief Executive Officer (CEO), Michael Stratton, and the Chief Financial Officer (CFO), Peter Giroux, CPA, CA. There was no separate audit committee. Peter Giroux and Michael Stratton reported directly to Miami. The Vice Presidents of Manufacturing, Commercial Services, Sales, and Engineering (the VPs) reported directly to Michael and were one level below Peter. The Human Resources (HR) Director was on the level below the VPs, and the Controller another level below. In turn, each VP had managers and supervisors with staff reporting to each of their positions. New York's General Manager (GM), Brent Wiseman, reported to Michael (see Exhibit 2 for the organizational chart).

AMANDA WALSH

Amanda Walsh graduated from Simon Fraser University's business school with a concentration in accounting in 1998 before pursuing a Certified Management Accountant (CMA) designation¹. Amanda had been employed by a major electronics supplier as an Assistant Controller for five years when she started to feel that she was no longer challenged. She applied for the position of Controller at VPC in November 2004. It was a smaller organization that suited her desire to be more involved with day-to-day operations and major decision making.

Amanda was interviewed by VPC's HR Director, Janis Turner, Peter, and Michael in early December. After the interview, she was even more excited about the prospects of joining VPC. She could be working for someone who could teach her a lot and doing some interesting and challenging things. It was exactly what she wanted. She received her letter of employment offer at the end of December 2004. VPC paid salaries between the 75th and 90th percentile for the industry. Bonuses were paid if VPC met the performance targets established by its owners. Amanda's bonus could range

between 10% and 15% of her salary. She resigned from her position with her previous employer in January 2005 and began her employment with VPC in February 2005.

AMANDA'S RUDE AWAKENING

On February 7th of 2005, her first day at VPC, Peter introduced Amanda to her team - a senior financial analyst, a financial analyst, an accounts receivable coordinator and an accounts payable coordinator (see Exhibit 2). Peter remained evasive when she asked for the latest financial statements and told her to spend some time learning about VPC by meeting with the senior financial analyst instead. After a week of avoiding her requests, Peter finally provided Amanda with the management letter prepared by VPC's auditors, a large international accounting firm, for the year ended November 30, 2003. The letter was dated September 30, 2004. It included an overview of the audit, a discussion of significant accounting, financial reporting and auditing matters, recommendations for improvements in internal controls, a summary of unadjusted differences (SUD), and consolidated financial statements.

To her disbelief, Amanda discovered that the financial statements for the years ended November 30, 2002 and 2003 were still draft (see Exhibit 3). The balance sheets looked terrible, VPC was incurring large losses, and the following note was printed on the title page:

The Company's current banking agreements have now expired. The Company is currently in negotiations between management and the Company's banking syndicate regarding the establishment of new credit facilities and covenants. As a result, the Company's ability to continue as a going concern and to pay down existing credit facilities is dependent on generating adequate cash flows from operations over the upcoming year, and the continued financial support of its shareholders and creditors. Depending on the final resolution of these matters, the financial statement presentation and related disclosure in the notes to the financial statements for the long-term debt and financing costs will be modified to reflect the circumstances noted. Should the financial statements require release prior to this date, then significant adjustments to the financial statements would be required, to disclose these going concern assumptions and the possibility that the going concern basis may not be appropriate; for example if repayment were to be demanded for the existing credit facilities. This disclosure is currently not reflected in this draft of the financial statements." ²

"Possibly *not* a going concern?!" When Amanda said those words out loud, they did not sound real. "How can I have so many responsibilities for the financial operations of this company and not even know the auditors think VPC might not be a going concern?" Amanda was angry and hurt...and, she felt betrayed. Neither Peter nor Michael had mentioned such significant issues at any point during her interview. Amanda immediately went to Peter to ask him why.

Peter told her they didn't want her to decline their offer because of it. He asked her to please not worry, that he could clarify what was going on, and that everything would be fine. He went on to explain that when Miami acquired VPC in 1996, the Canadian dollar was trading in the mid- to high 1.30s to the US dollar, eventually reaching the low 1.60s for a good part of 2001 and 2002. The strong US dollar gave Canadian companies in labour intensive industries a major competitive advantage over their US competitors because it kept their labour costs much lower, and their margins

high. This was reflected in the multiple of earnings before interest, taxes and depreciation (EBITDA) VPC had to pay for the three companies acquired in the late 90's. Miami had worked with a syndicate of well-known banks to fund the purchases, leaving VPC with \$30 million US debt. Exhibit 1 shows the ownership structure.

In 2003, the Canadian dollar appreciated dramatically, reaching the high 1.20s by the end of the year, and pretty much everyone in the industry suffered significant setbacks. VPC got to the point where they couldn't service the debt anymore. The banks allowed VPC to operate under forbearances for a while, but soon enough the company had to start trading off preferred equity in exchange for some of the debt. The original banks eventually sold their debt and preferred equity at a discount to two other private equity firms from Texas (Houston) and New Jersey (Jersey) (see Exhibit 1). Houston, Jersey and Miami agreed VPC should take advantage of the debt transfer that had happened to clean up its balance sheet before finalizing the 2003 audit. The audit would be done retroactively so VPC could avoid the going concern note and secure third-party financing, and Miami contain its losses.

VPC's financial statements were prepared in accordance with US generally accepted accounting principles (GAAP) to satisfy the needs of its American owners. Peter was not able to complete the debt restructuring because Houston and Jersey needed to agree on new payment terms for the restructuring to comply with SFAS 15.³ According to Peter, Houston was great to work with, but Jersey was more difficult and not very supportive. They were confrontational, particularly with their co-investors from Houston. To complicate matters further, Miami was seeking an exit strategy, and talks were underway on this initiative. Peter told Amanda he still hoped to have everything finalized by the end of 2005.

Amanda left Peter's office still perplexed about VPC's financial position and why Miami was seeking to exit. Amanda realized she had no choice but to stick with VPC for now. Reputation was important, and she did not want anybody to think she was a quitter. Plastics was still a great industry, and she would definitely be challenged. Her job was just going to be more difficult than she had thought.

AMANDA SETTLES IN

Amanda did not regret her decision as she settled into her new position. Her direct reports were qualified and pleasant. Peter was present and involved, and he was always available to answer her questions or concerns. She was learning a lot.

Peter kept Amanda's interactions with the VPs and Michael to a minimum. Peter and Michael tightly controlled the flow of information within and outside of VPC. Most of the corporate governance documentation, such as the shareholders' agreement, were not made available to Amanda. Few of the internal controls were documented, and the job descriptions were not current. The organization chart had not been updated in years. Amanda watched cautiously every month when representatives from Miami, Houston and Jersey came to town and met with Michael and Peter for board meetings. The VPs of Sales, Commercial Services, Manufacturing and Engineering sometimes joined them for parts of the meetings.

Peter also maintained complete control over HR and payroll. Amanda was perplexed about the apparent lack of HR integration. Both Dora Parsons, the payroll manager, and Janis reported to Peter. Dora submitted the payroll to BER, the external payroll service. She made changes for wage rates, new hires, terminations, reviewed BER's payments for accuracy, and she examined BER's report of changes made in the period. The auditors had raised concerns over a lack of segregation of payroll duties in

their report to the audit committee. They thought management should review payroll prior to payment, examine BER's report of changes, and review the overall payments made for reasonableness. Janis was a designated Certified Human Resources Professional (CHRP), and Amanda knew she was sometimes frustrated with not being at the table with the senior members of the organization. One day as Peter and Michael were meeting with the board, Janis told Amanda she wished VPC made better use of her expertise. She was not involved with the design of the bonus structure when it was developed and was not privy to any of the information on bonuses. Janis had tried to discuss her concerns with Peter and Michael, but Peter made it clear that it was not her place to be involved. Michael kept putting off reviewing the reporting relationships, saying he needed to think about it. Amanda's previous organization had a lot more involvement from HR, and there was a VP of Human Resources. She wondered why none of the recommended changes from the auditors had been made.

Miami evaluated Meadowbrook's performance based on its ability to meet the non-consolidated adjusted EBITDA target established at the beginning of each year as part of the budgeting process. Adjusted EBITDA excluded management fees, as well as one-time costs and unusual expenses that were at the discretion of the owners. Bonuses were earned if the target was met. The overall bonus pool in \$ was decided by Michael, Peter and the Miami owners at the beginning of the year. Maximum individual earned bonuses as percentage of total salary depended on rank, and included both a guaranteed component tied to meeting the adjusted EBITDA target and a discretionary component allocated by Michael and Peter as outlined in Table 1:

Table 1 - Maximum Bonus as Percentage of Total Salary			
Rank	Guaranteed bonus as % of total salary	Discretionary bonus as % of total salary	Maximum bonus as % of total salary
CEO and CFO	37.5%	12.5%	50.0%
Vice-Presidents	30.0%	10.0%	40.0%
HR Director and Controller	10.0%	5.0%	15.0%
Sales representatives	15.0%	5.0%	20.0%
Supervisory employees	7.5%	2.5%	10.0%

Declared bonuses were supposed to be paid after the audit of the financial statements was completed to assure management did not artificially inflate EBITDA. These financial reporting requirements had not been made part of the corporate governance documents. The bonuses were paid before the audit was completed for the years ended November 30, 2003 and 2004 because the recent delays in issuing audited financial statements were caused by Houston and Jersey and considered to be outside of management's control. Bonuses for the year ended November 30, 2004 were declared and paid in early 2005 based on the draft non-consolidated financial statements prepared by Amanda's predecessor. Peter asked Amanda to make the finalization of the 2004 financial statements and the preparation of the corporate tax return a priority when she was hired. Amanda, who was much more acquainted with Canadian GAAP, saw this as an opportunity to become more familiar with US GAAP and perfect her understanding of VPC's business. She was done by the end of May 2005, in time to file VPC's corporate tax return before the Canadian Revenue Agency's (CRA) deadline.

Just like Peter had said, VPC's debt was not indicative of the company's success, it was just an anchor weighing it down. The Canadian operation was doing well from an

EBITDA perspective. It just couldn't service its debt and the legacy interest was hurting its cash flow. The cash flow issues started to balloon out of control in the fall of 2005. The estimated cash shortfall to the end of the year was over \$3 million. VPC's days payable outstanding (DPO) was over 110 days, more than 70 days longer than industry, and vendors were threatening to stop supplying them. The company would not be able to meet payroll if it paid its suppliers. Equity owners were the only available source of funding until the restructuring was completed, and there had been no progress made on that front.

Miami sold all of their \$20 million investment in VPC's equity to Houston and Jersey for half a million dollars, pennies for the dollar, in October of 2005 (see Exhibit 1). The common stock was not worth anything because of the large amount of debt on the books (see Exhibit 3). The two private equity firms already controlled the debt. They now also owned about 80 percent of the equity too, with the balance being held by current and former employees. The first order of business for Michael and Peter was to get an influx of cash. VPC's technicians were highly skilled and the industry was suffering from a shortage of qualified labor. If any of them left as a result of missing payroll, they would easily be able to find work at a competitor, and it would be very difficult for VPC to replace them. VPC needed \$1.6 million to repay one of their largest suppliers, \$1 million to repay other vendors, and \$400,000 as extra working capital. Houston stepped up and loaned \$3 million at very high interest rates in late November 2005. Jersey was not pleased with this move by Houston and refused to lend.

BONUSES ARE PAID

Amanda kept busy finalizing the Canadian operation's non-consolidated financial statements for the year ended November 30, 2005 (see Exhibit 4 for an extract) while Peter was dealing with the new owners. She met with Peter in mid-December 2005 to go over the preliminary financial statements.

Amanda told Peter she was done with the 2005 non-consolidated financial statements, except for a couple of outstanding accruals he needed to approve before she booked them. The first one was for expected losses on work-in-process. According to the cost estimates provided by the VP- Manufacturing, expected losses of \$725,000 needed to be recognized for the year ended November 30, 2005.⁴ The second one was for \$225,000 in development costs that were capitalized in early 2005 because VPC expected to be able to bill them back to one of their customers as design costs. The purchase order for which the prototype had been built had not yet materialized from the customer.

Peter thanked Amanda for her diligence and hard work. He asked her to leave the preliminary statements and accruals with him, so he could finalize everything before the Christmas break and work on the board package for the January 17, 2006 meeting.

Peter said he was not sure whether he would book the expected losses on work-in-process now or wait until the contracts to which they relate were completed and the actual losses known. There had been no progress on the restructuring, so the financial statements wouldn't be audited until then. He also said he would probably wait to expense the capitalized development costs until it was more certain the purchase order would not come.

Amanda did not hear further from Peter about the financial statements and she did not ask. She took advantage of the 10-day Christmas break to rest and spend time with her family.

On January 5, 2006, the third day of work after the Christmas break, total bonuses of \$900,000 were declared for the year ended November 30, 2005. Every employee received a letter signed by Michael informing them the Canadian operation had exceeded its adjusted EBITDA target of \$3 million for the year ended November 30, 2005 and telling them the amount and breakdown of their bonus. Individual bonuses are summarized in the table below:

Table 2 – 2005 Bonus Allocation		
	Bonus in \$ (individual)	Bonus in \$ (total for the rank)
Michael Stratton	\$105,000	\$105,000
Peter Giroux	\$100,000	\$100,000
Vice-Presidents	\$ 75,000	\$300,000
Janis Turner and Amanda Walsh	\$ 12,500	\$ 25,000
Sales representatives	\$ 20,000	\$180,000
Supervisory employees	\$ 10,000	\$100,000
Non-management employees	\$500 to \$1,000	\$ 90,000
Total		\$900,000

Amanda was awarded a 15% bonus in the amount of \$12,500. Peter told her she earned her full discretionary bonus because she had done a great job amidst the organization's strife and reached all her goals. He indicated it was important for the owners to reward the employees for their efforts. He also told Amanda that Dora, the payroll manager would be taking care of the bonus accrual. Amanda's thoughts immediately went to Janis, wondering what she was thinking of all this. She knew that Janis would probably be upset because she would not have been privy to any of the discussion on bonus allocation and the payouts through payroll.

The bonuses were paid on January 28, 2006. Amanda knew Meadowbrook was making its target but with the equity debt accumulating, she was astonished that the bonuses were being paid out so early. There was surely enough cash to pay out the bonuses with the influx of cash from Houston. Still, she had not expected anything before at least the summer given the financial position of VPC.

THE NEW OWNERS GET INVOLVED

In February of 2006, Michael Stratton went back to the owners and asked for another \$2 million in working capital funding. Although the previous investment had helped calm down some suppliers, there were still more than \$1.5 million in payables over 60 days and VPC was afraid of missing payroll again. Peter asked Amanda to prepare detailed reports on VPC's working capital cycle, including its days sales outstanding (DSO), DPO, order backlog, customer deposits, and shipments calendar to support the request. Jersey still refused to provide funding, and Houston seemed to have a hard time understanding the reasons for this new request for cash despite the support provided by Peter. The income statement was showing positive EBITDA, there were no capital expenditures, and the interest payments had been reduced, so it just did not make any sense to them that VPC needed cash again. They asked for an EBITDA to cash reconciliation from November to February to understand how to account for the difference (see Exhibit 5).

Houston eventually agreed to inject the funds, at the same high interest rate, but decided to bring in a consultant, Robert Black, to investigate further and be in a better

position to evaluate VPC's future cash needs. Robert was sent to Meadowbrook for as long as would be needed with the official mandate of "helping management improve its accountability and better communicate with the owners".

By April 2006, Amanda felt something was not right with Peter. He wasn't arriving at work as early as he had in the past, was going out for long lunches, and was leaving early. There were a lot of closed-door meetings between Peter and Robert. Robert wanted more detailed reconciliations to support the \$4 million change in working capital accounts between November and February. He was particularly interested in the change in accrued liabilities. Peter insisted the accrued liabilities balance did not mean anything because it included significant legacy interest and foreign exchange translation losses that would be written-off once the pending capital restructuring was completed. This did not seem to satisfy Robert. He wanted to see reconciliations, pro forma financial statements, and cash flow forecasts stripped out of the foreign exchange effects and legacy debt and interest. Peter was passing back the consultant's requests to Amanda. She was a bit lost because she knew that Peter could answer his questions much more quickly than she could. Peter told her this was a good way to grow and that he knew she could handle it. But Robert never seemed satisfied with the information provided to him, even if it was exactly what he had asked for.

AMANDA WALSH, CFO

Peter Giroux resigned as CFO from VPC in late May 2006. He came and told Amanda he had decided to leave because he was tired of having to deal with Houston's and Jersey's constant questioning. It was time for him to move on.

Michael Stratton called Amanda. He asked her if she could step in as interim CFO for six months. He was okay with starting the recruiting process for a new CFO if she didn't feel up to it but was really hoping she would give the position a try.

Amanda could not believe that this was happening. She had been dreaming of the day she would become a CFO, and now that it finally materialized, she was being asked to step up to be... the Captain of the Titanic! She had a long conversation with her husband. If things went well, she had the opportunity to play a key role in rebuilding VPC. But what if they didn't? She came to realize she could always move on. So she accepted the position and began hiring some co-op students to help her out.

It didn't take long for Amanda to find herself in the thick of things. With Peter no longer there, Robert was coming to her to get answers to his inexhaustible questions. He just couldn't understand why VPC constantly needed more working capital funding when the income statement showed positive EBITDA. He asked for a detailed monthly cash flow analysis from August 2005 to today, showing exactly why the funding provided by Houston was needed and how it was used. He wanted the name of the suppliers, the invoice numbers, the dates, everything.

Amanda, who was already busy enough, wondered who Robert thought he was. She reported to Michael, not to him. Amanda went to Michael and told him she was feeling a bit overwhelmed with Robert's constant requests. She told him she felt as if she was providing him with the same information over and over again, and that she was not sure what he was after exactly. Michael told Amanda he was starting to feel frustrated too, and that he knew Robert was not the most accommodating guy around. He said he would ask Robert to stop going to Amanda directly and make his requests through him first. But he wanted her to provide him with what he needed and to be as transparent as possible.

Amanda left feeling she had done the right thing. She had a lot of respect for Michael. He had started on the shop floor and progressed through the ranks until he became the CEO. He was hands-on, and very good at managing sales and relationships. He just needed a strong financial person by his side. Amanda felt that since she had only been there a little more than a year it made sense for Robert to speak directly to Michael. She was relieved she could count on him.

KEN'S CALL

A couple of weeks later, Amanda's phone started ringing. She glanced at the call display screen before picking up: it was Ken Duffy, one of Houston's principals. Why in the world was one of the owners calling her directly? She took a deep breath and answered the phone.

Ken told Amanda he was happy to finally chat with her. He said Houston didn't really know much about her until recently. He knew they were asking for a lot and that things were really hard, and he wanted to offer some support. He promised it would be worth her while for her to stick it out.

Amanda took a moment to calm herself down before telling Ken she was happy to chat with him too. She told him she was shocked when she saw the financial statements during her first week at VPC and just about left right then, but that she was happy she stuck it out because she had learned a lot even if it had been rough. She also said she really appreciated his vote of confidence.

As the conversation went on, Ken began asking for more information. He told her Peter had not been very forthcoming with Robert, never really answering some of their questions. He knew Robert was asking for a lot from her, but they needed to understand why the accrued liabilities had dropped by close to \$1 million at the end of January 2006. He didn't want to hear it was because of the legacy interest or foreign exchange translation gains because no progress had been made on the restructuring. He said the funding Houston had provided in November 2005 was supposed to be used to settle \$2.6 million in accounts payable, not other accrued liabilities. So, could she please explain to him what had happened.

Of course, she could! Amanda told him it was the incentive payment - \$900,000 in bonuses were accrued on January 5, 2006 and paid out on January 28, 2006. Ken interrupted. He asked what bonuses she was talking about. He said Houston had never agreed on a bonus plan for 2005, that it had never even been discussed.

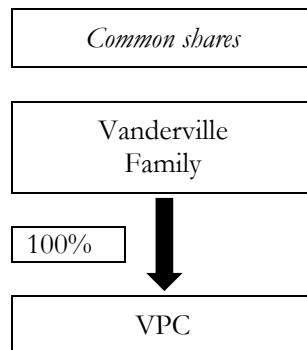
There was a long lull of silence. Amanda felt ill when she realized what the concern had been all along – it was the bonuses.

Amanda went on to explain they were indeed the 2005 bonuses, declared in early January based on meeting the \$3M adjusted EBITDA target for the year. She told Ken that Peter had said the owners wanted to reward the employees for their efforts. She also told him the payroll manager was the one who had booked the accrual and managed the payout. She asked if he wanted her to speak to Dora to see if she had any supporting documentation she could provide to him. But Ken wanted to speak to his partners first. He told Amanda he would get back to her shortly.

Amanda stared at her phone in disbelief. They didn't know! Scared and angry, she started to think about the succession of events since she came to VPC to better understand what this all meant, what was likely to happen next, and what she should do.

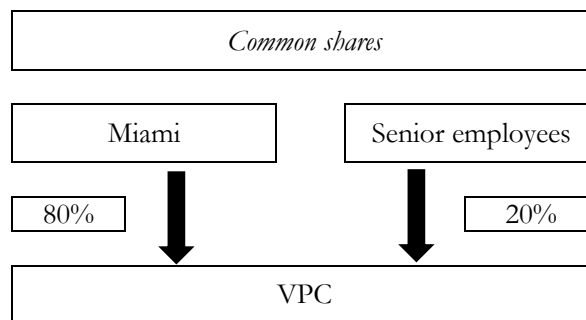
Exhibit 1: Changes in Ownership

1962 to 1996



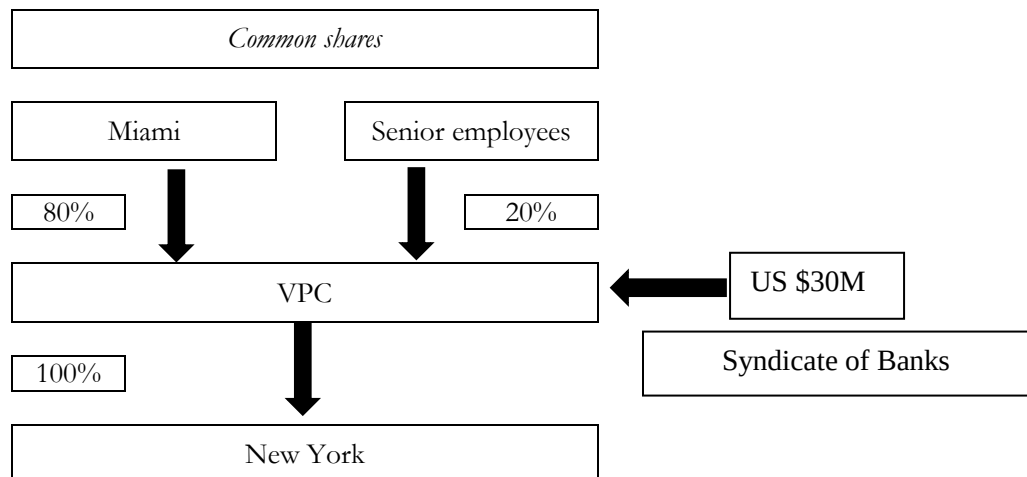
1996

Miami purchases VPC and sells 20% of the common shares to a group of senior employees.



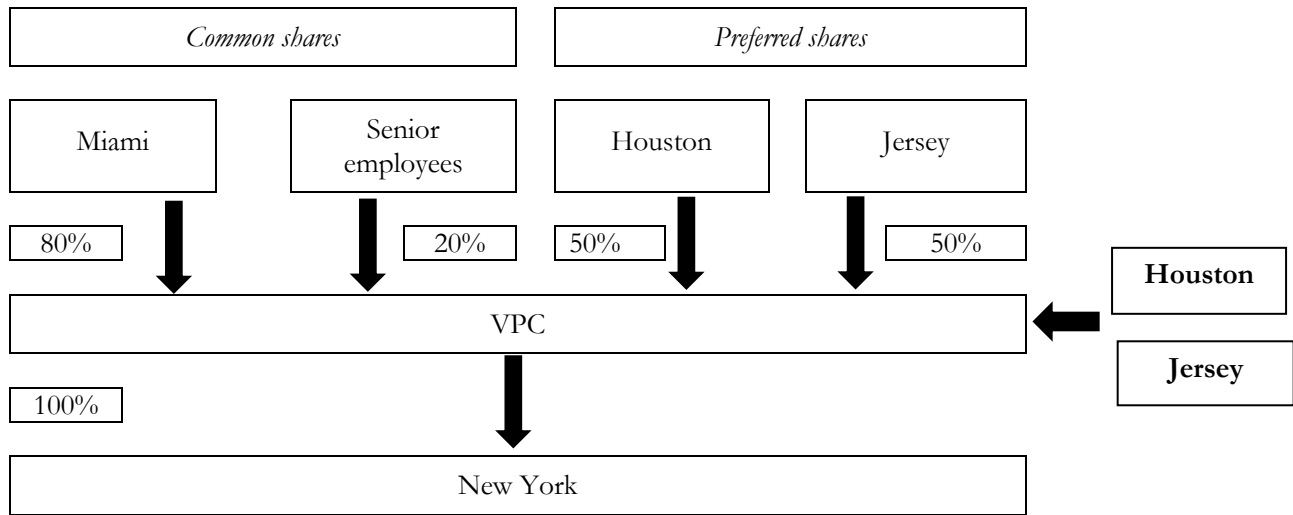
1998

VPC contracts \$US 30M in debt to finance the purchase 3 companies.



2003 to 2005

VPC starts to trade off preferred equity in exchange for some of its debt. The syndicate of banks sells their debt and preferred equity at a discount to Houston and Jersey.



2005-2006

Miami sells its common shares to Houston and Jersey.

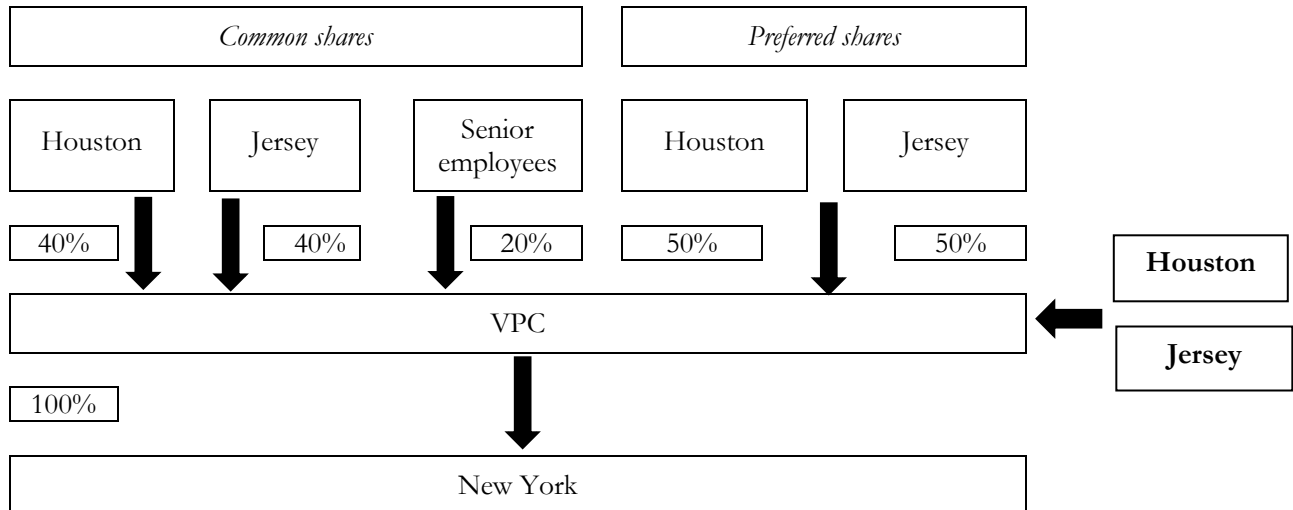


Exhibit 2: Organizational Chart

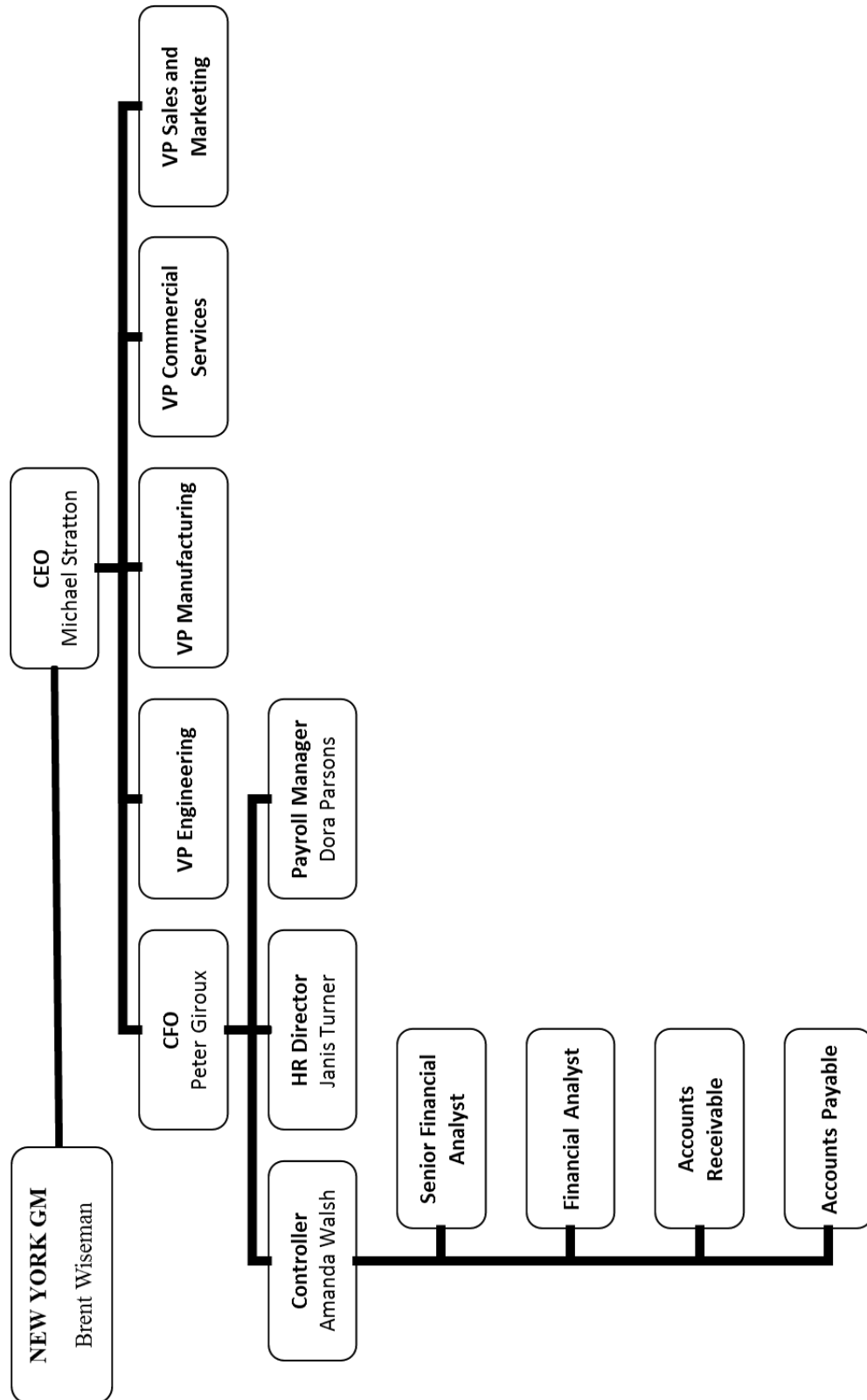


Exhibit 3: – Extract from Consolidated Financial Statements

Vanderville Plastics Company		
Consolidated Balance Sheet		
As of November 30		
	2003	2002
	\$	\$
Assets		
Current assets		
Cash	\$ 469,402	\$ 735,338
Accounts receivable	\$ 5,193,806	\$ 7,801,771
Inventories	\$ 8,555,649	\$ 9,270,595
Prepaid expenses and other current assets	\$ 938,395	\$ 878,962
Income taxes receivable	\$ 2,200	\$ -
	\$ 15,159,452	\$ 18,686,666
Property, equipment and improvements	\$ 19,806,564	\$ 21,530,031
Goodwill	\$ -	\$ 23,139,794
Deferred financing costs	\$ 645,470	\$ 936,977
Investments and other assets	\$ 14,157	\$ 13,153
	<u>\$ 35,625,643</u>	<u>\$ 64,306,619</u>
Liabilities		
Current liabilities		
Bank indebtedness	\$ 6,535,659	\$ 5,487,999
Accounts payable and accrued liabilities	\$ 13,758,482	\$ 11,996,282
Income taxes payable	\$ -	\$ 293,183
Customer deposits	\$ 8,375,480	\$ 10,937,110
Current portion of long-term debt	\$ 28,316,006	\$ 2,798,949
	\$ 56,985,628	\$ 31,513,523
Long-term debt	\$ 2,084,833	\$ 29,599,167
Loans payable	\$ 6,540,233	\$ 5,071,542
Deferred income taxes	\$ 717,816	\$ 487,787
	<u>\$ 66,328,510</u>	<u>\$ 66,672,020</u>
Contingencies and commitments		
Shareholders' Deficiency		
Capital stock	\$ 10,936,681	\$ 10,340,496
Share subscription loans	\$ (720,390)	\$ (706,946)
Deficit	\$ (40,919,157)	\$ (11,998,951)
	<u>\$ (30,702,867)</u>	<u>\$ (2,365,400)</u>
	<u>\$ 35,625,643</u>	<u>\$ 64,306,619</u>
FOR DISCUSSION WITH MANAGEMENT ONLY - SUBJECT TO AMENDMENT		
NOT TO BE FURTHER COMMUNICATED		

Vanderville Plastics Company		
Consolidated Statement of Operations		
For the year ended November 30		
	2003	2002
	\$	\$
Net sales	\$ 52,581,273	\$ 52,057,383
Cost of sales - excluding depreciation	\$ 40,656,119	\$ 37,748,017
	\$ 11,925,154	\$ 14,309,367
Expenses		
Selling, general and administrative	\$ 7,352,520	\$ 6,317,988
Interest expense		
Long-term	\$ 4,160,721	\$ 3,636,623
Bank charges	\$ 96,430	\$ 386,158
Depreciation of property, equipment and improvements	\$ 3,273,068	\$ 3,474,448
Foreign exchange translation loss	\$ 1,313,581	\$ 120,986
Research and development	\$ 869,705	\$ 457,663
Amortization of deferred financing costs	\$ 428,572	\$ 491,510
Loss on sale of property, equipment and improvements	\$ 5,597	\$ 4,866
Amortization of other assets	\$ -	\$ 1,164,351
Interest income	\$ (15,652)	\$ (17,161)
Cumulative effect of change in accounting principle	\$ 23,139,794	\$ -
	\$ 40,626,336	\$ 16,037,431
Loss before income taxes	\$ (28,701,182)	\$ (1,728,065)
Provision for (recovery of) income taxes		
Current	\$ (2,200)	\$ (40,416)
Deferred	\$ 230,029	\$ 498,286
	\$ 227,829	\$ 457,870
Net loss for the year	\$ (28,929,011)	\$ (2,185,934)
FOR DISCUSSION WITH MANAGEMENT ONLY - SUBJECT TO AMENDMENT		
NOT TO BE FURTHER COMMUNICATED		

Exhibit 4: Extract from Non-Consolidated Financial Statements

Vanderville Plastics Company - Meadowbrook	
Non-consolidated Income Statement	
For the year ended November 30	
	2005
	\$
	(unaudited)
Net sales	\$ 51,624,004
Cost of goods sold	\$ 41,777,871
Gross Margin	\$ 9,846,133
Expenses	
Research and development	\$ 834,369
Selling and marketing	\$ 1,540,813
Administration	\$ 3,833,776
	\$ 6,208,958
EBITDA	\$ 3,637,176
Miami management fee	\$ 232,598
Owner driven consulting	\$ 657,768
Depreciation	\$ 2,787,321
Bank charges	\$ 28,956
Interest expense	\$ 4,539,446
Translation (gain)/loss	\$ (581,977)
Interest income	\$ (21,504)
	\$ 7,642,609
Loss before income taxes	\$ (4,005,433)
Provision for (recovery of) income taxes	
Current	\$ -
Deferred	\$ -
	\$ -
Net loss for the year	\$ (4,005,433)
Prepared by Amanda Walsh, CMA	

Exhibit 5: EBITDA to Cash Reconciliation

Cash balance as of November 1 st , 2005	\$500,000
November working capital funding from Houston	\$3,000,000
EBITDA for the quarter ended February 28, 2006	\$900,000
Capital expenditures	(\$50,000)
Cash interest	(\$250,000)
Changes in working capital	<u>(\$4,000,000)</u>
Ending cash balance as of February 28 th , 2006	<u>\$100,000</u>

Prepared by Amanda Walsh, CMA

NOTES

- ¹ CMA Canada granted the CMA designation in accounting through its provincial and territorial affiliated bodies until September 2015. The accounting profession was unified in Canada in 2014 under the umbrella of the Certified Professional Accountants of Canada (CPA Canada). Existing members retained their current professional designations but were also granted the new CPA designation. They are required to use the new CPA designation in conjunction with their existing designation for a period of 10 years. The Canadian CMA designation is different from the US CMA, a global designation granted by the Institute of Management Accountants.
- ² Financial statements prepared in accordance with generally accepted accounting principles (GAAP) in the US and internationally assume the reporting entity will continue as a going concern. According to Accounting Standards Update 2014-15, management should evaluate whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern within one year of the date the interim or annual financial statements are issued. When such conditions or events exist, the entity must disclose in a note to the financial statements information that enable users to understand these conditions and events, management's evaluation of their significance and its plans that are intended to mitigate these conditions or events (FASB, 2014).
- ³ *Statement of Financial Accounting Standard (SFAS) 15 – Accounting by Debtors and Creditors for Troubled Debt Restructurings* defines a troubled debt restructuring as one in which the creditor grants a concession to the debtor that it would not otherwise consider, for economic or legal reasons (FASB, 1977). The debtor is allowed to reduce the carrying amount of the troubled debt to an amount equal to the total future cash payments specified by the new terms and recognize a gain on restructuring if the total future cash payments specified by the new terms are less than the carrying amount of the troubled debt (SFAS 15, paragraph 17).
- ⁴ VPC used the completed-contract method to recognize revenues from its long-term manufacturing contracts. Consistent with *Accounting Research Bulletin (ARB) 45 – Long-Term Construction-Type Contracts*, manufacturing costs were deferred in work-in-process inventory until a contract was completed, with no revenue other than provision for expected losses being recorded until then. Estimates of costs to complete for each uncompleted contract were made at year-end to determine whether there were expected losses that needed to be provisioned.