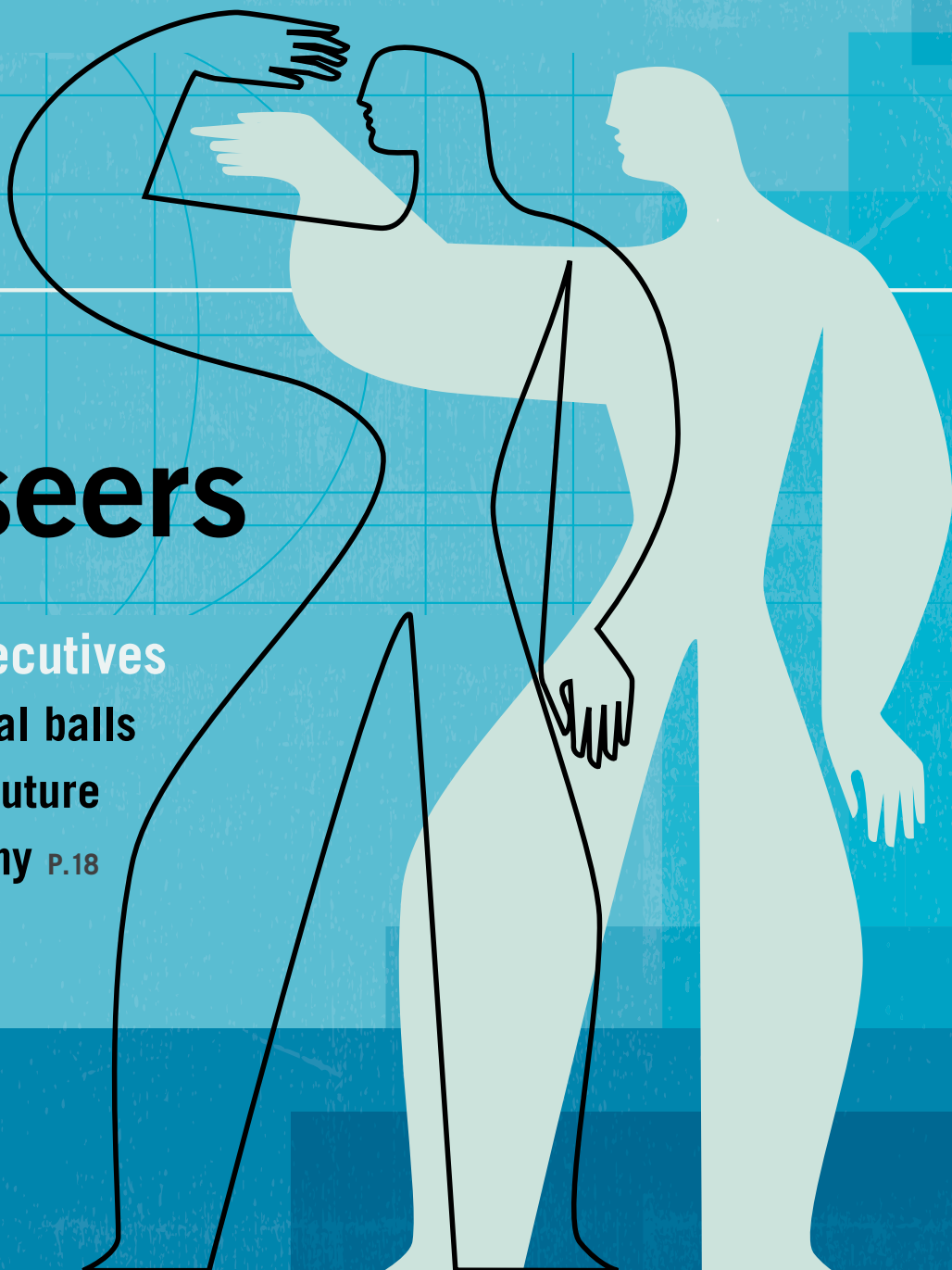


April 2010

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# CEO seers

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*"After 18 years with SYSPRO, we continue to leverage our initial investment...we have a high degree of comfort with the people who provide support. Over the better part of two decades, SYSPRO has definitely earned our trust."*

*Thorsten Knees, Controller, Cedar Grove Building Products.*

## Cedar Grove Building Products and SYSPRO ERP

By definition, enterprise resource planning (ERP) software has to be capable of integrating a wide variety of business activities. For companies with a complex business model, that means satisfying a multiplicity of essential demands. Some companies, however, have less complicated needs. They require practical solutions that work – right out of the box – without the complexity often associated with ERP systems.

Cedar Grove Building Products, for example, is an independent distributor of residential roofing supplies in British Columbia. Founded in 1975, Cedar Grove has seven branches, and approximately 50 employees. A separate company, Precision Metals, with some 25 employees, split off from Cedar Grove in 1998, but remains closely associated. "In the last 10 years we've tripled in size," says company Controller Thorsten Knees, "not by changing our business model, but by doing the same thing we've always done, in multiple locations. The volume has changed, but the way our business works hasn't."

Cedar Grove began using SYSPRO ERP in 1991, at a time when the company had only two locations. "Before that," says Knees, who came on board in 1992, "the accounting was all done manually. When the business began growing, different ERP options were considered. That was when Cedar Grove found SYSPRO."

Roofing supplies is not the most technology-driven business, says Knees. "We have a few national clients, but most of what we do is local. When we need something, it generally arrives within 24 hours. The longest our supply chain extends is two weeks, and none of our customers or suppliers demands a great deal of electronic data. Case in point – we still print dot matrix invoices, because the clientele we deal with continues to like the paper. On the other hand, some of the larger companies we work with could require EDI tomorrow, so it's nice to know that SYSPRO is scalable to our future needs."

Currently, says Knees, Cedar Grove relies mostly on SYSPRO's basic accounting modules, such as Accounts Payable, Accounts Receivable, General Ledger, Purchase Orders, Sales Orders, Sales Analysis, Report Writer and Quotations. "We don't use many manufacturing modules, such as Work In Progress (WIP). Cedar Grove doesn't need them, and much of what Precision Metals makes is quick process."

Nor, says Knees, has Cedar Grove ever felt pressured to use more of the system than the company needs. "Over the last 18 years we've only dealt with three or four people from SYSPRO. They've never tried to upsell us to the 'latest and greatest,' so when they tell us we need an upgrade we tend to trust them. Furthermore, it's an extremely stable system. We use the modules right out of the box, and the upgrades have been very simple. Recently we implemented a fairly major upgrade that took only an hour to complete."

Some five years ago," says Knees, Cedar Grove test drove a different ERP package, one that's commonly used by lumber yards. "Our bottom line was that the cost of change would only be worthwhile if the other product had features that SYSPRO is missing. We didn't change, because frankly, we don't think there's anything missing from SYSPRO."

One of the cornerstones of SYSPRO's business strategy has been to encourage customer longevity through the creation of strong relationships. "After 18 years with SYSPRO," says Knees, "we continue to leverage our initial investment, and continue to believe in the direction that SYSPRO is going. It helps that the system is affordable – Cedar Grove and Precision Metals run under one license, and we've never had to compromise on functionality. In addition, we have a high degree of comfort with the people who provide support. Over the better part of two decades, SYSPRO has definitely earned our trust."

For more information about Cedar Grove please visit: [www.cgrs.ca](http://www.cgrs.ca).

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## Moving forward

What does the new decade have in store, and will the US make the transition to IFRS?

We are moving out of one of the most severe recessions on record and just a few months into a new decade. In addition to the economic situation, the CA profession is facing yet another round of critical changes with the transition to international financial reporting standards, accounting standards for private enterprises and Canadian auditing standards.

To help our readers better understand the issues and what this means for them, their clients and their employers, CAMagazine asked Canadian CEOs from various sectors and regions to share their thoughts about the economy, challenges and trends in the next 10 years. Whether it is globalization, Canada's position as an energy powerhouse, retirement of the baby boomers and the general aging of the workforce, these leaders explained to writer Paul Brent in "Dissecting the decade" (p. 18) their concerns and the solutions they envision for sustainable growth.

Canadian publicly accountable entities have started producing financial reports under IFRS, if only for comparison purposes, and are getting ready for the big change nine months from now. And the Accounting Standards Board has approved the long-awaited accounting standards for private enterprises that will also be mandatory January 1, 2011. So what's next? How about the US? More than a year ago, the SEC issued a road map to move to IFRS. However, it hasn't been heard from since, triggering a wave of skepticism south of the border. Will the US go for it or not? We asked writer Lawrence Richter Quinn to look into the issue in "IFRS: dead in the USA?" (p. 28). Ironically, just at press time, the SEC issued a statement reaffirming its support of global accounting standards ([www.sec.gov/rules/other/2010/33-9109.pdf](http://www.sec.gov/rules/other/2010/33-9109.pdf)). I would also like to bring to your attention a "News from the profession" article showing that Canadian IFRS adopters are falling short of CSA expectations (p. 14).

This month, our Regulars section features taxation ("Mut muts," p. 36), business valuation ("What is it worth?" p. 39), personal financial planning ("A portfolio that adds value," p. 42), auditing standards ("The CAS audit," p. 45) and education ("Transitional questions," p. 48).

In his Netwatch column, Jim Carroll calls organizations to focus on innovation to generate growth as they come out of the recession ("What would a world-class innovator do?" p. 12). Michael Burns is back this month, featuring our "CRM survey 2010" (p. 13) in his column. As for Marcel Côté, he discusses the "Nudge theory" (p. 56) in Outlook and suggests businesses would benefit from well-defined, regulated markets.



Christian Bellavance, Editor-in-chief



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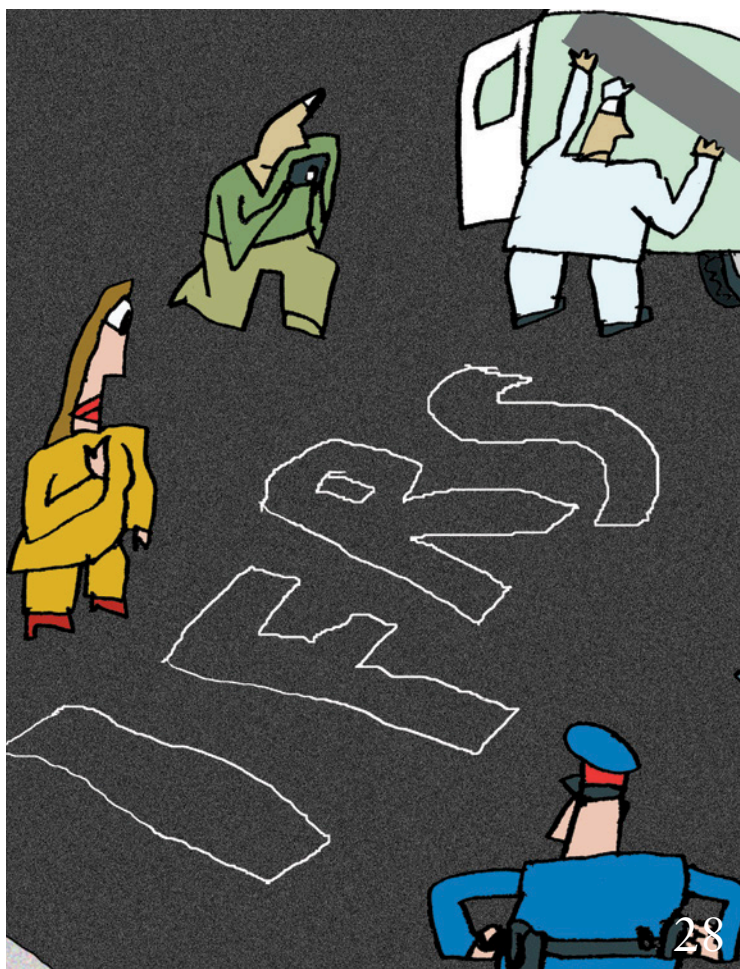
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The debate on IFRS in the US is still unfolding. In one camp, there are those who are disenchanted with it, and in another, those who can gain monetarily. But the two camps do agree on one thing, that the SEC is moving too slowly on clarifying its long-term intentions

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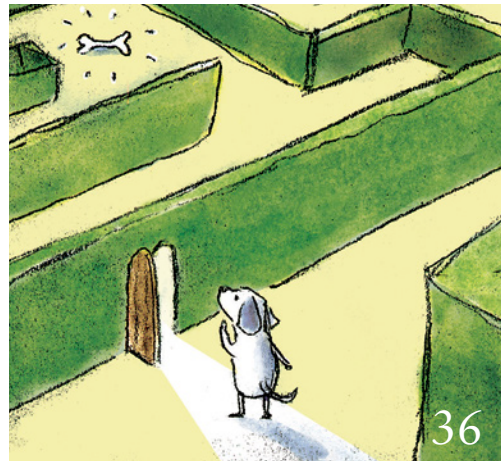
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# Mailbox

## ONE SIZE DOES NOT FIT ALL

Regarding “Ask an Expert” (Upfront, November 2009), David Trahair’s response was pretty trigger happy. With no real knowledge of the client he makes an all-encompassing recommendation to get out of stocks forever. In the January/February issue (David Trahair’s reply, Mailbox) he defends this by suggesting that the TSX after-management fees has experienced a similar rate of return to GICs. In his sample time frame, he opines that investors make bad emotional decisions and he leans to an unempirical look into the future of stock returns.

What if the retiree has the majority of his or her retirement assets in nonregistered investments? Should some consideration not be given to after-tax rates of return? Would it not be prudent to consider a diversified portfolio of assets that

would include other global jurisdictions for investment — maybe Europe, which experienced an 11% rate of return over the same time frame? Maybe he should consider that inflation over that same 50-year period was 4%. A GIC portfolio of 7.35% after taxes — whether in a registered or nonregistered portfolio — would have absolutely no protection against inflation, effectively cutting spending power by more than 50% in 30 years of retirement. Trahair’s rebuttal that he is not counting on the market for the future is a personal belief; his ability, or lack thereof, to predict the future has no place in proper risk management for retirement income generation. A suggestion that we cannot count on the stock market to grow is akin to suggesting that capitalism is dead and those investors can no longer expect a return on invested capital.

The original question was whether or not a client should leverage to make up

market losses. Such a strategy is highly risky and definitely not advised at 57 years of age. But to suggest the client dump all his or her stocks to go to GICs is equally risky; it’s just a different form of risk — the risk of running out of capital.

As expert advice, Trahair’s suggestion is dangerous. It flies in the face of the proper steps in delivering professional advice. Indeed, one size does not fit all.

**Daryn G. Form, CFP**

Saskatoon

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# UP FRONT

News, people, briefs, trends + tips

## Country road



**Calgary CA and musician Jason Hastie will hit the road this year on a cross-Canada tour with his country band, Six West**

Jason Hastie's life story would make a darn good country song. Born to farmers in a tiny Saskatchewan town, he began singing and playing piano at the age of five and eventually headed west to pursue his music dream. It's fitting then that this 35-year-old CA, based in Calgary, is garnering national acclaim as one of the lead vocalists in country band Six West.

With a successful fifth single released in January and a cross-country tour scheduled for 2010, the band is Hastie's full-time passion these days. "Country music has always been my genre and feeling the energy of the crowd and the way the music affects people is what draws me," says the singer who admits to having been terrified going on stage initially. "I like to force myself out of my comfort zone and now it's just a nervous excitement when I perform."

Although he's been dabbling in music from a young age, Hastie made the leap from full-time CA to country star only two years ago. "I don't foresee myself going back to being a full-time CA in the near future, but it's nice to know I'll always have that designation." He hasn't abandoned his former profession though, spending about 15 hours a week consulting for several small clients. He is also in the midst of launching the M-Tracker ([www.mtrackergps.com](http://www.mtrackergps.com)), a device that will help clients better track their business versus personal vehicle mileage using Global Positioning System technology.

"I have a lot of friends who are musicians but it's such a huge benefit being a CA too," he says. "I have the experience with money management and cash flow that many of them don't, and the credibility the CA designation brings is unexplainable." He also points out the merits of playing for clients. "I have that CA connection so I get asked to play a lot of corporate functions and I really enjoy that."

Rosalind Stefanac

### Résumé

**1997** joins Hergott Duval Stack & Partners, Saskatoon

**2001** obtains CA designation (Sask.)

**2006** forms singing duo with Abbey Powell

**2009** releases debut CD, *Beautiful Something*, with Six West

### SOX execution not efficient

Six months prior to the June 2010 deadline for small public companies to comply with Section 404(b) of the Sarbanes-Oxley Act, US companies were still reporting inefficiencies in their implementation of internal accounting controls, finds a survey by consulting firm Ajilon Finance Solutions.

In the poll of 210 US accountants, 73% said their company could be more efficient in its execution of Section 404(b) of SOX, which requires management and external auditors to report on the adequacy of the company's internal control over financial reporting.

Inefficiencies cited include poor training and education on processes and controls; lack of focus in project management and utilizing resources; and a "compliance at all costs" mentality focused on effectiveness but not efficiency.

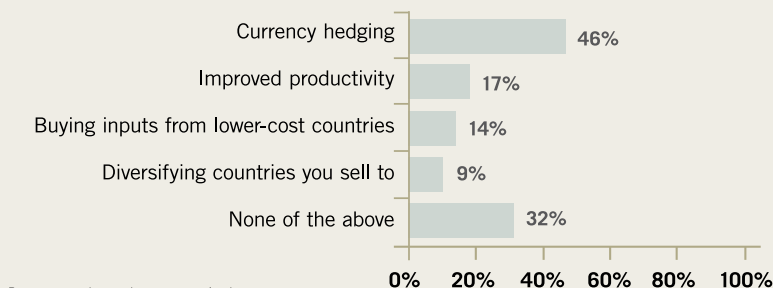
## CURRENCY RISKS EXPOSED

**D**espite the recent volatility in foreign exchange rates, the vast majority of Canadian companies are exposed to international currencies and many are doing nothing to mitigate their currency risks.

According to the fourth-quarter 2009 CICA/RBC Business Monitor survey of executive level CAs at Canadian companies, nearly 80% make purchases and 65% generate revenues in foreign currencies. The survey also found that exposure to foreign currencies is likely to rise over the next year; 39% expect purchases to increase and 50% expect revenues in foreign currencies to increase. Of those who don't expect foreign revenues or purchases to increase, most expect them to stay the same.

Nearly a third of those who have revenues or make purchases in foreign currencies are doing nothing to manage currency volatility. Of those who are doing something, currency hedging is the most common tool, with 46% of respondents using it to

## Methods used to manage currency volatility



Base: respondents whose companies have revenue or make purchases in foreign currencies. Source: CICA/RBC Business Monitor, 2009.

manage currency volatility. Less common methods of managing currency risk include improving productivity (17%), buying inputs from lower-cost countries (14%) and diversifying countries sold to (9%). The majority of those who are using currency hedging are at least somewhat satisfied (63%) and a further 19% say they are neither satisfied nor dissatisfied.

John Tabone is CICA's manager of member value and research services



## ASK AN EXPERT

## I WANT TO EXPAND MY SMALL BUSINESS. SHOULD I DO IT ON MY OWN OR HIRE HELP?

**For many small-business owners, now is the right time to think about hiring and growing their business. And this optimism isn't new — more than half of Fortune 500 companies started in a downturn. Here are five reasons why hiring now could be the right move:**

**Talent is more abundant.** You can benefit from lower labour costs and a growing talent pool of people more open to working for a small company.

**A growth spurt is coming.** Don't be caught napping when the economy rebounds. Hiring now, or having a plan in place, will help you scale up quickly to meet increased demands for your product or service.

**There are unique opportunities.** Every recession brings opportunities such as weakened competition or customers looking for inexpensive

alternatives. Look to see if these opportunities require extra help or if you're able to leverage them on your own.

**Talent is more abundant.** You can benefit from lower labour costs and a growing talent pool of people more open to working for a small company.

**Focus on what matters.** Sole proprietors often spend valuable time on tasks that don't bring in any money. Instead, hire someone to do that and make better use of your time.

**Your inner creativity is valuable.** Today's employees are often contractors, part-time workers or they may work from home. Think creatively about your business. You're not just hiring someone to do a task, you're building for the future.

Rhonda Abrams is a US-based small-business expert and author of *Hire Your First Employee: the entrepreneur's guide to finding, choosing and leading great people*

# #NUMBERS Game

**1** Cost in billions to Canada's healthcare system from ailments related to unemployment, according to a 1994 study.

**9.8** Percentage of unemployed Canadian workers in late 2010 as projected by a fall 2009 OECD forecast. Canada's unemployment rate sat at 8.5% in December 2009.

**15** Number of workers a North York, Ont., factory owner sought in 1987 to keep his woodworking business open. A booming economy forced the man to don a sandwich board and spend two days walking a north Toronto neighbourhood.

**17** Millions of Canadian workers employed in October 2008 — the all-time high. During the following year, 400,000 jobs are lost.



**Labour lag** Canada's economy is rebounding, but jobs shed during the recent recession haven't returned. During this jobless recovery, large-scale unemployment is a permanent fixture

**44** Percentage of jobless workers who qualified for unemployment insurance in 2009; 20 years ago 83% were eligible.

**54** Surplus in billions of Canadian dollars in 2007 accrued in Canada's Employment Insurance fund and funneled into general revenues by the federal government.

**100** Percentage increase in risk of a heart attack for a boss in the week following the firing of an employee, according to a 1998 US study that examined work-related stress.

**15,000** Number of applicants who lined up in January 1995 for jobs at General Motors' Oshawa, Ont., plant in hopes of being hired at \$22 an hour. A similar hiring call at American Motors Canada in 1986 attracted 45,000 people. Steve Brearton

## Going Concern



**DOUGLAS BROWN, CA  
PRESIDENT & OWNER  
H.D. BROWN ENTERPRISES LTD.**

**COMPANY PROFILE:** The St. George, Ont., privately held company employs more than 80 people in its three divisions: Russell Athletic

sportswear (for which it is the exclusive Canadian distributor), sporting goods and equipment manufacturing. It sells its products to major retailers, including the Bay, Canadian Tire, Walmart and SportChek, and exports to the US and Europe. The company was founded by Douglas Brown's father, Hugh, who owned a furniture manufacturing company that made, among other items, oak bars for car roof racks. When Canadian Tire couldn't find a supplier to make straps to fasten the racks to cars, the senior Brown decided to manufacture the straps himself, opening a "cut and sew" business. H.D. Brown is now mostly in the import and distribution business, earning the exclusive rights as the Canadian distributor for some big-name US sports equipment manufacturers.

**HOT FACTOR:** Carving out a niche for itself in the sporting goods industry, H.D. Brown's retail brands are some of the most recognized in their sports, including HDB Baseball and Softball, Road Warrior Street Hockey and Classic Sport.

**COOL PROJECTS:** H.D. Brown signed a deal last year to distribute Dunlop sports equipment, which should account for \$10 million in revenue. That will more than make up for the \$2-million shortfall the company will sustain from shutting down its auto-parts manufacturing business in January, due to a downturn in the automotive industry.

**IN HIS OWN WORDS:** "We're not the kind of business that's necessarily set up for double-digit-type growth, but we expect to grow steadily every year. Canadian consumers will buy sporting equipment whether there's an economic downturn or not. They may not be buying sailboats or other luxury items, but they're still buying bases for softball and clothing to work out in. Leisure activity doesn't stop even during a recession." John Shoesmith

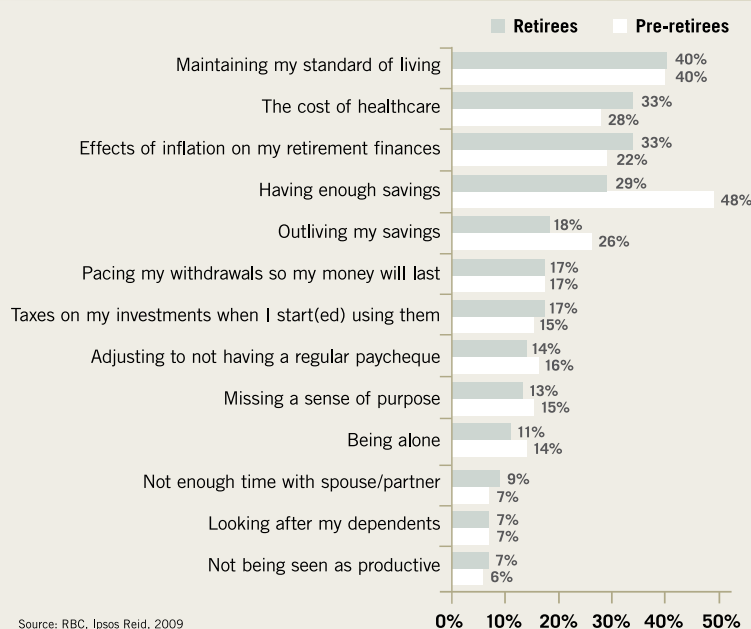


## Post-work worries

While it's natural to fret about retirement, the type of concern that keeps you up at night likely depends on whether or not you're already retired, an RBC poll finds. When thinking about retirement, Canadian retirees surveyed were more liable to worry about the cost of healthcare and the effect of inflation on retirement finances than were their working counterparts, who worried most about having enough savings (see chart).

The study also asked Canadian retirees how much money they spent in their first year of retirement, but 75% had no idea. The respondents who did know spent an average of \$35,395, down 30% from last year's survey (\$50,548).

### What, if anything, worries you about retirement?



## Parents who pay

Six in 10 Canadian parents aged 43 to 63 help their adult children financially with an average \$3,675 per year, an Investors Group survey finds. If this sounds like you, see where you fit in on the parent spectrum, according to Jane Olshewski, manager of financial life planning for Investors Group:

**The venture capitalist (44%):** invests the initial capital (i.e., contributes to post-secondary education) to get their children to the next stage of self sufficiency.

**The service provider (70%):** assists children who do not require boarding, but still need emotional and financial support (e.g., babysitting grandchildren, home maintenance and repairs).

**The funding agency (22%):** provides lodging and financial relief to adult children with insufficient funds.

**The universal coverage provider (10%):** cares for both parents and children.

## WEALTH MORE ELUSIVE

Seven in 10 Americans think it's harder to get rich now than in the past, and more than half think it will be even tougher to become wealthy in the next 10 years. The study, released by personal finance company Bankrate, also found that a minority (21%) of Americans see traditional investment as a feasible route to wealth.

## MEAL AND DEAL

The restaurant beats the golf course for doing business, according to a survey by Robert Half Management Resources. More than a third (36%) of CFOs polled said the location of their most successful business meeting outside the office was a restaurant, followed by a trade show or conference (25%). Only 3% cited the golf course.

## TWICE THE TECH

Consumers in emerging markets are twice as likely as those in developed markets to purchase and use consumer technology in the next year, according to a report by Accenture. In the past year, those in emerging countries were also more than twice as likely to have bought a smartphone or computer, or connected on social networks.

## Canadians moving slowly on pension risk

The past year's market turbulence has many Canadian organizations contemplating — but not yet implementing — actions to better manage the risks associated with their defined benefit (DB) pension plans, according to Hewitt's latest global pension risk survey.

When 400 DB plan sponsors from around the world, including 80 from Canada, responded to the survey in September 2009, it was against a backdrop of extreme volatility. After dropping to 86% from 112% between mid-June and early November 2008, the aggregate funded ratio of S&P/TSX company-sponsored DB plans had swung back up toward the 97% it reached at the end of November 2009. Responses from plan sponsors reflected this volatility, indicating an attitude change toward pension risks from those given in the previous survey. However, employers in Canada showed they are in no rush to make changes. In fact, they are at least a year behind their US and UK counterparts.

Despite their commitment to DB plans (Canada still has the lowest global incidence of plan closures), 44% of Canadian DB plan sponsors have not yet developed a long-term pension risk management strategy.

The survey notes that this lack of initiative on the part of Canadian plan sponsors is especially alarming given the fast-approaching transition date to international accounting standards in 2011. The new standards will result in even greater balance statement volatility associated with pension costs than under the current Canadian standards. For private-sector plan sponsors subject to the new rules, a lack of planning for the increased financial risks could mean lower returns to shareholders in the future.

The survey suggests that Canadian plan sponsors may want to consider some steps to better manage risk. Among other initiatives, they should review the objectives for the pension plan and make sure they are consistent with the direction the company's business is taking and the "new economy."

This is a summary. For an expanded article, please visit [www.camagazine.com/pensionrisk](http://www.camagazine.com/pensionrisk).

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## Focus on people increases M&A success

The way companies approach people issues in a merger or acquisition has a far greater impact on a deal's outcome than many would expect. As new research from Towers Watson and the Canadian Financial Executives Research Foundation shows, organizations that address people issues early in an M&A position themselves far better for deal success.

According to finance and HR executives, who were contacted in separate surveys in late 2009, attention to people issues and the early involvement of HR are the most important "success drivers" in M&A activity. Follow-up interviews with study participants — all senior executives with M&A experience — confirmed that a change in outcome can easily be caused by the way people issues and related risks are managed.

Both studies concluded that successful dealmakers involve HR more often in all phases. For this reason, HR executives believe that nontraditional HR abilities, such as culture alignment and project management, are more important in an M&A than traditional skills such as compensation. Finance executives agree, with successful deal-

makers reporting that increasing HR capabilities in M&A is a high priority, while the less successful tend to focus on improving finance's ability to quantify the people risks.

Ultimately, for the most successful deals, finance and HR work closely together to ensure people-related issues are understood and managed throughout the transaction. Reinforcing this view, the research shows having a good track record in managing people issues during an acquisition is a clear predictor of success in subsequent transactions. Knowing how to evaluate and facilitate cultural alignment and deliver on expected synergies is a key skill set that HR can bring to the table. According to respondents, this is something all organizations contemplating M&A activity would be well advised to take to heart.

This is a summary. For a more in-depth analysis, please visit [www.camagazine.com/mergersuccess](http://www.camagazine.com/mergersuccess).

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Laura L. Lynch, FSA, FCIA, is a principal in the retirement practice in Towers Watson's Calgary office



# Work in process

BY MICHAEL BURNS

USING TECHNOLOGY TO IMPROVE THE WAY YOU DO BUSINESS

## CRM survey 2010

**W**elcome to our latest survey on customer relationship management (CRM). The chart in the online version includes 19 systems from leading vendors and some that are not as well known.

CRM is still very popular. Analyst firm Forrester predicts the CRM market for software and services will reach \$10.9 billion by 2010, up from \$8.4 billion in 2007.

According to Larry Ritter, senior vice-president, global product management and marketing, with Sage CRM Solutions, there are two major trends in CRM: social networks and cloud computing. Facebook boasts more than 350 million users, who use the program to build up their personal networks and so on. LinkedIn has more than 50 million registered users and is used mainly for professional networking. Twitter enables its users to send and read messages known as tweets — text-based posts of up to 140 characters.

Some readers might think social networking tools are for young people with time on their hands. But Sage and others see them as great tools for building relationships — which is also one of the objectives of CRM systems. Imagine you want to prepare for a meeting with someone you don't know very well. You might find useful information about that person and others on these networks. Sage lets you extract information automatically from Facebook and load it into one of its CRM systems. You can also launch a direct search into one of the social networks such as LinkedIn to find information about a specific person. And you can have the CRM system launch a search of Twitter for news about a contact's company or products — even one of his or her hobbies.

Gathering information about other people could be seen as a little creepy; in fact, this kind of search is called “creeping” in Facebook circles. But if people post personal information on the Net, is it not there to be read?

The other big trend is cloud computing — a way of accessing business applications (ERP, CRM, etc.) over the Internet with just a browser. The software and data are

stored on a service provider's computers, so you just pay for the use of the software. And you don't need to maintain your own infrastructure to support the applications. This setup might sound familiar: last year it was called software as a service (SaaS) and a few years ago, application services provider (ASP). Some acronyms stick even when they make little sense, while others evolve. Blame it on marketing specialists who figure their technologies need a little push every now and then.

Sage and others are sending their products to the clouds. Sage is offering a hybrid approach in some cases by allowing customers to license the core functionality using the traditional model and to use the clouds for extensions of the system. One example is eMarketing, which could be used to blast e-mails to thousands of contacts. By using

### Some vendors see Facebook and other social networks as great tools for building relationships

another company's server for e-mail blasts, you can avoid blacklisting by some companies. E-mail blacklists are a common way of reducing spam.

Sage has also taken a different approach than salesforce.com and some other vendors that are normally associated with SaaS or cloud computing. Sage will offer its cloud solution using Amazon's elastic compute cloud (EC2). Amazon is to store and protect the data on its own servers. This makes a lot of sense because Amazon already has the infrastructure to support cloud computing. Sage will also allow its customers to choose whether and when to upgrade to the latest version — something that is not always possible with other cloud systems.

For an expanded version of this article and the survey chart, visit [www.camagazine.com/crmsurvey2010](http://www.camagazine.com/crmsurvey2010).

Michael Burns, MBA, CA•IT, is president of 180 Systems ([www.180systems.com](http://www.180systems.com)), which provides independent consulting services, including business process review, system selection and IT audit. Contact 416-485-2200; [mburns@180systems.com](mailto:mburns@180systems.com)





# Netwatch

BY JIM CARROLL

YOUR GUIDE TO BUSINESS & ACCOUNTING ON THE INTERNET

## What would a world-class innovator do?

**A**s we come out of the economic downturn into a hopeful recovery, more organizations are focusing on what they need to do next. My advice to them is to behave like a world-class innovator.

And what exactly do world-class innovators do that other organizations don't? Here's a rundown:

**Possess a relentless focus on growth** There are unprecedented opportunities for growth in almost every industry. One document I wrote several years ago ("Where's the Growth?") is still a good barometer of some key trends that will provide for economic growth in the future. It's my belief that we live in transformative times that offer tremendous opportunities for growth through innovation.

**Continually transition their revenue source** World-class innovators know they have to evolve from competing on price to a more complex, revenue-rich solution. They're aware they need to have continuous, relentless product innovation to keep their new revenue pipeline full.

**Solve customers' problems before they know it's a problem** World-class innovators excel at anticipatory thinking: where do we need to go with our customers to ensure we continue to have a strong revenue relationship? What trends can we ride to maximum advantage to give customers a constant flood of new, irresistible improvements?

**Source innovative ideas through their customers** World-class innovators know they aren't fully in control of the innovation agenda anymore, and that some of the most brilliant ideas are coming from a new source: customers. As John Hanks, vice-president, industrial and embedded products for National Instruments, said at a conference for engineers and scientists last year: "We could find a customer who is using one of our products in an unexpected and innovative way. It's then possible for us to take that and add value for another customer, which is one of the ways we can help the innovation process as a whole." ("Generation innovation," *The Engineer*, December 7, 2009.)

**Focus on corporate agility** World-class innovators know that their ability to quickly act, react and do will enable their future success. There isn't a lot of time for debate or studying; inertia is abhorred. They simply *do*.

**Achieve long-term wins through constant incremental improvements** Big growth can come from continual small improvements on margins. For example, 7% of power on transmission and distribution lines are lost as heat. Reduce that power loss by 10% and you'll save an amount equal to all the new wind power installed in the US in 2006. Here's another example: today's typical automotive system uses only 25% of the energy in the tank — the balance is lost to waste, heat and inefficiency. Work on increasing that and there will be some pretty solid gains through innovation.

**View skills partnerships as a key success factor** When world-class innovators enter a new, fast-paced market, they realize there might be but a few individuals or organizations in the world that could help them tackle that market. They focus on forming fast teams and partnerships, drawing a lot of innovation oxygen from that external insight.

**Focus on pervasive connectivity for next generation product** Everything around us is plugging together. Soon, every device on the planet will have an IP address on the Internet; we'll be able to access its status and location. This is transformative stuff, and is one of the primary sources for the next new billions of dollars of revenue in countless industries.

**Don't back away from big ideas** While others wallow in indecision and organizational sclerosis, world-class innovators know it's a great time to make bold decisions and forge aggressive new paths against their competitors.

Jim Carroll, FCA, is a well-known speaker, author and columnist. Reach him at [jcarroll@jimcarroll.com](mailto:jcarroll@jimcarroll.com) or log on to his website at [www.jimcarroll.com](http://www.jimcarroll.com)

### MORE INNOVATIVE IDEAS

#### Where's the Growth?

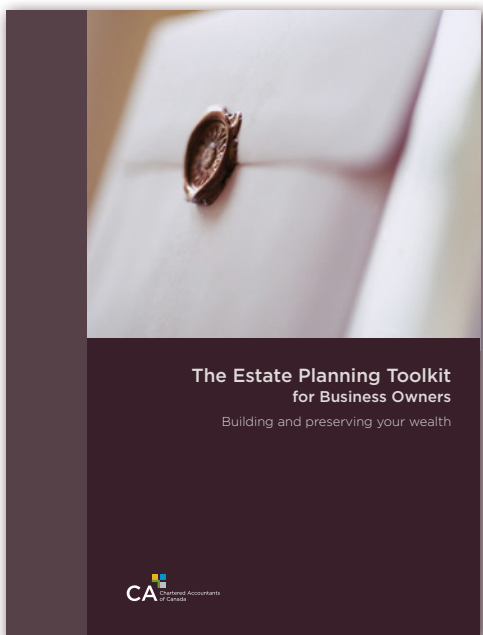
[www.jimcarroll.com/acrobat/Growth.pdf](http://www.jimcarroll.com/acrobat/Growth.pdf)

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## The Estate Planning Toolkit for Business Owners

To order go to: [www.cica.ca/estateplan](http://www.cica.ca/estateplan) — \$29.95

## IFRS adopters falling short of CSA expectations

**A** recent Ontario Securities Commission (OSC) review suggests a large number of IFRS adopters have not adequately disclosed information related to their transition efforts. After reviewing 106 entities' IFRS transition disclosures, the regulator is concerned that some entities may not meet future filing obligations.

The OSC review, reported in Staff Notice 52-718, looked at 2008 annual management discussion and analysis (MD&A) and 2009 interim MD&A. Of the 60% that provided IFRS transition disclosure, approximately half provided a generic description of the plan without any direct application to their own circumstances; 80% failed to describe significant milestones and anticipated time lines associated with key elements of the transition plan; and 48% failed to provide quarterly progress updates in 2009 MD&A.

Many of the 40% that failed to provide any transition disclosure cited resource constraints and a lack of complexity of business operations as the reasons.

While the OSC says the focus of this review was education and awareness, it cautions it may request refilings of MD&A in the future if disclosure obligations are not met. It notes the importance of keeping investors informed during the IFRS transition period about whether changes in financial performance relate to the adoption of different accounting standards or to a change in the issuer's business.

The Canadian Securities Administrators' Staff Notice 52-320 sets out the securities regulators' expectations about disclosures in the period leading up to the changeover. IFRS adopters had been expected to discuss the status of the key elements and timing of their changeover plan in 2008 MD&A. In 2009, they were required to update that information and discuss major identified differences. In 2010, as well as updating the earlier requirements, the CSA expects more detailed discussion of key decisions and changes the entity will be making, including accounting policy choices available under IFRS 1 First-time Adoption of International Financial Reporting Standards and other individual IFRSs that are relevant to the issuer.

Chris Hicks, CA and principal at CICA, says, "Securities regulators have made their expectations very clear and the OSC Staff Notice 52-718 sets out several examples of disclosure for various aspects of the transition that entities should find useful. As well, we've posted examples from actual disclosures on our website. In addition, entities may wish to read the Canadian Performance Reporting Board (CPRB) publication, Pre-2011 Communications about IFRS Conversion. It recommends some best practices and provides a template that can be used to summarize the disclosures. Those that are further down the path in their IFRS transition will be interested in the CPRB's Transition to IFRSs — Communicating the Impact of the Changeover, which suggests ways for the MD&A to summarize the changes between IFRSs and Canadian GAAP."

**While the OSC says the focus of the review was education, it may request refilings of MD&A in the future if disclosure obligations are not met**

All the CPRB IFRS transition documents are available at no charge on the CICA's designated IFRS website.

### IFRS transition planning — a stable platform

IFRS adopters will be pleased to hear the standards that will be mandatory for 2011 have stopped changing. International standard setters have delayed making some significant changes that had been anticipated. IFRS adopters will want to stay informed about a number of notable changes that are expected to be published later this year and next year, and that will take effect in 2012 or 2013. Depending on the entity's circumstances it may be efficient to integrate early adoption of those standards with your overall IFRS transition strategy.

An analysis by Accounting Standards Board, Which IFRSs are Expected to Apply for Canadian Changeover in 2011, identifies changes to IFRS made during 2009 and new or amended IFRSs expected to be issued in 2010 and 2011. It summarizes potential changes to IFRSs that are not expected to be mandatory until after 2011, but which an entity may consider for early adoption.



## Not-for-profit organizations exposure drafts open for comment

**F**ollowing significant stakeholder input, Canadian standard setters have proposed changes to accounting standards for not-for-profit organizations (NFPO). These changes would result in different financial reporting foundations for NFPOs in the public and private sectors. The Accounting Standards Board and the Public Sector Accounting Board (PSAB) issued individual exposure drafts and request that NFPOs share their views on the proposals.

Currently, NFPOs follow the *CICA Handbook — Accounting*. PSAB has proposed that government NFPOs follow the *CICA Public Sector Accounting (PSA) Handbook*, but continue to use the 4400 series of the *Accounting Handbook*. The 4400 series addresses the unique circumstances of the not-for-profit sector and would be

incorporated into the *PSA Handbook* without substantive changes. This proposal will allow government NFPOs to apply standards they are familiar with, while using the *PSA Handbook* as a financial reporting foundation.

Private-sector NFPOs will choose between two sets of standards: international financial reporting standards or new accounting standards for not-for-profit organizations. Accounting standards for not-for-profit organizations will include the 4400 series, along with other standards that specifically relate to not-for profit organization and private enterprise standards.

Comments on the exposure drafts are requested by July 15, 2010. Go to [www.acsbcanada.org/documents-for-comment](http://www.acsbcanada.org/documents-for-comment) or [www.psab-ccsp.ca/documents-for-comment](http://www.psab-ccsp.ca/documents-for-comment).

## Tips for better disclosure in sustainability reporting from CICA's Corporate Reporting Awards

Before sustainability and corporate social responsibility became mainstream concerns, the CA profession was already assessing their relevance in the business landscape by including its Sustainable Development Reporting category in the Corporate Reporting Awards.

The sustainable development reporting category was introduced in 1993 and since that time, CAs have been at the forefront of changes and expectations in the area of sustainability and corporate social responsibility.

During the awards entry period in June and July of each year, submissions are judged by a panel represented by the Canadian Institute of Chartered Accountants, Deloitte Sustainability & Climate Change, Desjardins & Associates Consulting Inc., Ernst & Young LLP, and International Institute for Sustainable Development.

At the conclusion of each year's judging, a snapshot of successful practices emerges, which helps to improve upon sustainability reporting in subsequent years.

Tips for improved disclosure in sustainability reporting from the 2009 awards program (reviewed 2008 reports) include:

- Indicating data integrity and boundaries. Effective reports clearly communicated the scope and quality of the disclosed information. Among other clarifications, they qualified the activities and facilities included within the reporting boundaries, described key measurement techniques and assumptions and indicated those quantities that were subject to external party verification. Rather than confine their focus to a narrow set of

measures, leading companies provided a wide range of applicable environmental and social metrics.

- Maintaining fairness and transparency. In the spirit of transparent disclosure, leading companies tracked their progress against previously defined goals. They also provided valuable contextual information by offering balanced explanations for both achievements and shortfalls. Finally, they demonstrated continued commitment to environmental and social initiatives by establishing specific targets for the upcoming year.

- Ensuring the clarity of communication. The most effective reports were those that employed simple tools to enhance readability. A table of contents and logical reporting flow, for instance, went a long way to improve readers' ability to navigate and digest the information. Likewise, tables, graphs and diagrams allowed companies to communicate absolute results, historical trends and performance relative to internal targets or external benchmarks in a concise reader-friendly format.

- Facilitating Web navigation. Continued migration from printed material to Web-based reports underscored the need for a user-oriented approach. Leading reporters appeared to appreciate the fact that, when it comes to online disclosure, a website's architecture is as important as its content. A dedicated sustainability page, clear outline of site content and minimal mouse clicks were among the design features that simplified data access and navigation.

- External review process. Leading reporters bolstered their credibility through the use of independent reviewers to help

# News from the **profession**

A SUMMARY OF CURRENT CICA PROJECTS AND INITIATIVES

validate the report. Third-party assurance provided a positive reflection of data integrity for the reader. Stakeholder review enhanced completeness of reporting and the unaltered publication of stakeholder feedback created a more balanced report.

Preparers can enhance their disclosures through relatively simple actions such as defining reporting boundaries, outlining measurement approaches and inherent assumptions and discussing entity- and sector-specific issues with candour. Companies can balance users' seemingly contradictory demands for more rigorous data collection and less cumbersome reports by employing tools that emphasize knowledge-transfer over information overload. The effective use of graphics and logical structuring of content, both in printed and Web-based material, are among the tools available.

The benchmarking of independently assured results against

past and future targets and balanced treatment of successes and failures serve to strengthen credibility. So too does the integration of a sustainability mindset into other aspects of corporate behaviour, including product and service selection, process design and supply chain management. Indeed, not only do leading reporters stay one step ahead of regulatory drivers, but they also seize the opportunity to use sustainability reporting as a vehicle to communicate strategy and create value for stakeholders.

*Adapted from an article published in Canada's Chartered Accountants' Corporate Reporting Awards 2009 Judges' Comments prepared by Maureen Johnson and Sylvie Noguier, Deloitte Sustainability & Climate Change Solutions; Stephan Barg, International Institute for Sustainable Development; Lisa French, Canadian Institute of Chartered Accountants*

## Training tomorrow's CAs — opportunities for corporations and the public sector

Historically, CA firms trained virtually all Canadian CAs. Now, it is possible for private and public sector organizations — companies, government departments and agencies, not-for profits — to train CAs as well. Organizations of various structures and sizes have recently been approved as CA Training Offices — organizations such as Investors Group, RIM, Manulife, Sobeys, The Score Television Network, The Brick and the Office of the Comptroller General of Canada. If your organization values the knowledge, expertise and judgment of CAs, it's an opportunity you should explore.

### Why your company should consider training CAs

In today's marketplace, CAs are in high demand, expensive to recruit and command premium salaries. Being recognized as a CA Training Office and growing your own talent offers many benefits.

- **Recruitment:** CA Training Offices can recruit the best and brightest university students directly from undergraduate, co-op and graduate programs. Our corporate and government CA Training Offices have told us that one of the greatest benefits of the program is the quality of the graduates they have been able to hire into their CA training program.
- **Retention:** becoming a CA Training Office can also be an important strategy for growing and retaining your current employees. This could be of particular interest to employees who started the qualification process with a CA firm, and those who meet the profession's academic requirements and want to start the process with your organization.

- **Internationally trained employees:** professionals trained in other countries may need qualifying Canadian experience to become Canadian CAs. Becoming a CA Training Office can help you attract and retain top internationally trained talent.
- **Cost effectiveness:** though not mandatory, most employers subsidize the cost of training CAs. Such costs generally fall within the training and development allowances of most employers.

### How to become a CA Training Office

Organizations of any size can become CA Training Offices. What's required is senior management's commitment to offering a CA Training Program, at least one CA who is com-

## CA Training Offices recruit the best and brightest students directly from undergraduate, co-op and grad programs

mitted to mentoring the CA student and the organization's ability to offer the CA student properly supervised work of sufficient variety and increasing levels of complexity and responsibility.

For more information, visit our website at [www.CATOAdvantage.ca](http://www.CATOAdvantage.ca), or call your provincial institute and ask to talk to a CATO liaison staff. We are available to help you determine whether you have what it takes to be a CA Training Office.

Note: these opportunities are not yet available in Quebec, where required changes are currently in process.

# Standards digest

Want to be kept informed? Log on to [www.cica.ca/subscribe](http://www.cica.ca/subscribe)

## RECENTLY ISSUED PRONOUNCEMENTS

<b>CICA Handbook – Accounting</b> Preface to the CICA Handbook – Accounting (revised) International Financial Reporting Standards (Part I) Accounting Standards for Private Enterprises (Part II) Accounting Standards for Pension Plans (Part IV)	<b>Date issued†</b> April 2010 January and April 2010 December 2009 April 2010
<b>EIC Abstracts</b> Multiple Deliverable Revenue Arrangements, EIC-175 Amendments to a number of Abstracts as a result of issuing Business Combinations, Section 1582	December 24, 2009 February 1, 2010
<b>CICA Handbook – Assurance (Part I)</b> Preface to the CICA Handbook – Assurance Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements, CSQC 1 Canadian Auditing Standards Retained Sections and Guidelines	December 2009
<b>CICA Public Sector Accounting Handbook</b> Introduction to Public Sector Accounting Standards (revised) Tax Revenue, Section PS 3510	December 2009 February 2010

## RECENTLY ISSUED DOCUMENTS FOR COMMENT (to March 31, 2010)

<b>Accounting</b> ED Accounting Standards for Not-for-Profit Organizations EDI Financial Instruments: Amortized Cost and Impairment EDI Liabilities – Improving IAS 37 EDI Termination Benefits (amendments to IAS 19)	<b>Comment deadline</b> July 15, 2010 June 15, 2010 April 12, 2010 March 31, 2010
<b>Auditing</b> ED Dating of the Practitioner's Report for Review and Other Assurance Engagements ED Reporting on Controls at a Service Organization	May 15, 2010 May 6, 2010
<b>Public Sector</b> ED Financial Reporting by Government Not-for-Profit Organizations ED First-time Adoption of Public Sector Accounting Standards by Government Organizations	July 15, 2010 March 25, 2010

## WATCH FOR

<b>Documents for Comment</b>	AASB and PSAB proposals concerning 2010-2013 Strategic Plans IASB proposals on Conceptual Framework: Reporting Entity, Discontinued Operations and Post-employment Benefits
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### Legend

ED – Exposure Draft

DS – Draft SORP

EDI – ED issued by the IASB

ITC – Invitation to Comment

rED – Re-exposure Draft

SOP – Statement of Principles

† Refer to each Handbook pronouncement for the effective date and transitional provisions.

*The information published above reflects best estimates at press time. Please visit our website for the most recent information.*





What are the big concerns confronting Canadian business in the next 10 years?  
Eight business leaders share their thoughts

# Dissecting THE DECADE

By Paul Brent

**A**FTER THE DECADE OF RELATIVE PEACE AND PROSPERITY THAT WAS THE '90s, expectations were that the good times would carry on into the new millennium. Few could have predicted how different the reality would be: the worst terrorist attack in history, two draining US-led wars that continue today, US\$150-a-barrel oil and the near-collapse of the international financial system, which led to a worldwide recession we are just now crawling out of.

Through this decade of turmoil and uncertainty, Canada's economy has fared remarkably well and our dollar has taken flight. Credit the developing world's hunger for our resources as well as our innate cautiousness and relatively strict financial regulations that spared us from the worst excesses leading up to the financial crisis.

So what does the future and decade ahead hold? To find out we asked a number

Illustration by PAUL WEARING

## THE Prognosticators



Joseph Iannicelli  
CEO, Standard Life Assurance  
Co. of Canada



George Faught, CA  
CEO, Aberdeen International Inc.



Linda Hasenfratz  
CEO, Linamar Corp.

of the country's business leaders who represent a broad cross-section of industries — from entertainment to finance to manufacturing — across the country. Some CEOs were sought out because they were CAs and others because their industry or company have a unique perspective on the new decade.

Yes, Canada has had a smoother ride through the recession than the US. Our unemployment rate hovers at 8.4% versus 10% in the US, we got through the financial crisis without massive bank bailouts and the world continues to demand our resources. Yet the Bank of Canada warns that our economy, slow and steady through the recovery, might not pick up the pace. Noting that productivity growth fell during the recession, something that did not occur during any recession of the past three decades, the bank warns that woeful productivity

Ottawa and the provinces. "I don't think our governments, our trade ministers have been aggressive enough in cultivating relationships with [foreign] governments and [foreign] companies and inducing them to come to Canada."

As a country, we used to be ashamed of our boring international reputation, but boring is looking good right now. "We have many things here, whether it is a stable labour force, a stable political environment, good government," says Iannicelli. He adds that Canada's practices in such areas as fiscal management and banking regulation are now drawing admiring looks from officials in much of the developed world, and that we have emerged from the financial crisis and recession "relatively clean."

As befits our emerging energy superpower status (the world's largest producer of uranium, third-largest natural gas producer and seventh-largest oil producer), Canada can only look at

## Boring is looking good. "We have many things here, whether it is a stable labour force, good government"

and an aging population could limit economic growth to 2% for much of the decade ahead.

Against this slow-growth backdrop, Standard Life Assurance Co. of Canada president and CEO Joseph Iannicelli predicts that an economically weaker US will look to forge stronger overseas relationships and hopes that Canada will match those efforts. "The States, because of its slightly weakened position — certainly politically from an influence perspective — may be looking at countries such as China to have more favourable, warmer relations than perhaps they have had in the past."

China, newly assertive and poised to become the world's second-largest economy (in terms of GDP), has secured agreements with some Asian countries, Australia and New Zealand and continues to build up its foreign reserves, held mainly in US dollars. Iannicelli sees the continued rise of China and its preferred trading partners, a re-emergence of Russia, and a more outwardly focused US aggressively seeking new and favourable trade relationships as developments that present challenges for

the development of second-tier countries, which are energy-hungry, as a long-term opportunity. Projected growth "for the BRIC [Brazil, Russia, India, China] countries are going to have a sustained impact on the global economy, in particular the area we focus on, commodities," says George Faught, CA and CEO of Aberdeen International Inc., a publicly traded global investment and merchant banking company focused on mining.

"China in particular is focused on having a supply of commodities that will help them meet their long-term goals and needs," says Faught, who also expects that growth to occur even with a lengthy turnaround in the US economy. "The BRIC countries and China in particular are going to drag the global economy along."

That should be a boon for resource-based economies, he argues. "For Canada in particular, given the energy we produce and given the commodities, the base metals we produce: copper, nickel, zinc" as well as agricultural chemicals and uranium, he says.

The dismal North American auto industry, which witnessed annual US-made vehicle sales halved in the recession and govern-





**Dene Rogers**  
President and CEO,  
Sears Canada Inc.



**Bill Thomas, CA**  
CEO and senior partner,  
KPMG Canada



**Peter Blake, CA**  
CEO, Ritchie Bros.



**Paul Beeston, CA**  
President and CEO, Toronto  
Blue Jays

ment support of General Motors and Chrysler, is showing some optimism again. Linda Hasenfratz, CEO of auto-parts manufacturer Linamar Corp., expects the auto-industry survivors to be poised for a more prosperous period. “I think the next decade could be a time frame of very good opportunity, given the fact that admittedly automotive has gone through a real crisis.”

Faced with the insolvency — and government-led restructuring — of major automotive manufacturers, a soaring Canadian

dollar and a collapse in consumer demand, Hasenfratz expects those that have flattened their operations, cut costs and developed new products will thrive in the years ahead. “Those companies are going to be back in a profitable position and looking at year-over-year growth.”

With 37 plants in Canada, the US, China, Mexico, Europe and Asia, part of a strategy of following its customers, Linamar is taking an increasingly international approach. “I am a big



**Kevin Dancey**

## A few BIG challenges

Much about peering into the future is comprised of identifying long-term trends that will shape business and society. Kevin Dancey, president and CEO of the Canadian Institute of Chartered Accountants, sees a number of issues that will bear directly on the accounting profession over the new decade.

“When I look at the number of challenges out there I think there are at least four or five big ones,” he says. “One clearly is globalization.” Companies are becoming more international and global trade continues to grow, raising questions about international standards for accounting, auditing and education. Creating common standards will benefit CAs looking beyond Canada,” he notes. “It will ease the mobility of professionals around the world.”

Continued globalization ties in with Dancey’s second big trend, namely the looming demographic change that is coming with the retirement of the boomers. “We have to focus hard

on making sure we get the best and the brightest into the profession.” That effort has to extend beyond university campuses, it has to include those entering the profession in midcareer and recent immigrants.

Technological change will also continue to have a great impact. “When I became a CA there was no Internet, no faxes or PCs and cellphones were not really used,” he says. “There will be more going forward, both in terms of how people are interconnected and the explosion of mobile devices.” The shift to real-time reporting will also accelerate.

Finally, the long climb back from the international fiscal crisis and recession will mean a number of significant changes, he says. Dancey expects “an era of increased regulation” that will create greater demands, and opportunities, for chartered accountants.

The issue of managing risk and uncertainty will also gain importance in this new decade, Dancey believes. “The markets were not assessing risk and pricing risk appropriately, whether that was analysts, or credit rating agencies or boards of directors, the business environment did not do a very good job of that.” He expects more transparency with regards to reporting business risks and adding new areas such as climate change and sustainability to this enhanced reporting.

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# The World Bank recently raised its forecast for global growth in 2010 to 2.7% from a 2009 forecast of 2%

believer in manufacturing in close proximity to user markets. I have always pushed hard against the idea of setting up overseas and shipping back to Europe and North America. I think it is a huge mistake because logistically from a cost perspective it is a strategy that will fall apart inside of the next 10 years."

Just as Bank of Canada governor Mark Carney worries about a decade of tepid growth and stubborn unemployment, Sears Canada Inc. president and CEO Dene Rogers wonders where the jobs and disposable income will come from to keep his stores busy and registers humming. "I worry that the stimulus package will expire and that the roughly half-million jobs lost in the private sector won't be replaced," he says. "I don't think the auto industry and the lumber industry are coming back, and I don't think the financial services industry, which shed more than 100,000 jobs, will re-employ because they will figure out ways to remain as productive as they are today."

In the last half of 2009, Canada's retail sales improved slowly, buoyed by recovering auto sales. The World Bank recently raised its forecast for global growth in 2010 to 2.7%, up from a June

2009 forecast of 2%, but cautioned that growth may be slow in the second half of this year because of factors such as slow labour market gains and the expiration of many government stimulus programs.

As with most merchants, Rogers watches employment figures, the state of the economy and other trends that affect consumers buying goods and services. He singles out four emerging trends that will rise in importance over the coming decade: the entry to Canada of foreign retailers from emerging countries; a growing acceptance of buying goods and services over the Internet; a further shift to consumer individualism (for example, today Sears sells 1,900 varieties of appliances versus 300 just 17 years ago); and more emphasis on corporate sustainability on the part of consumers and businesses.

As part of the world's largest industrial auctioneering company, Peter Blake, CA and CEO of auctioneer giant Ritchie Bros. in British Columbia, has a unique perspective on the economy here and abroad with sales concentrated in heavy machinery for construction, agriculture and resource extraction. "We tend

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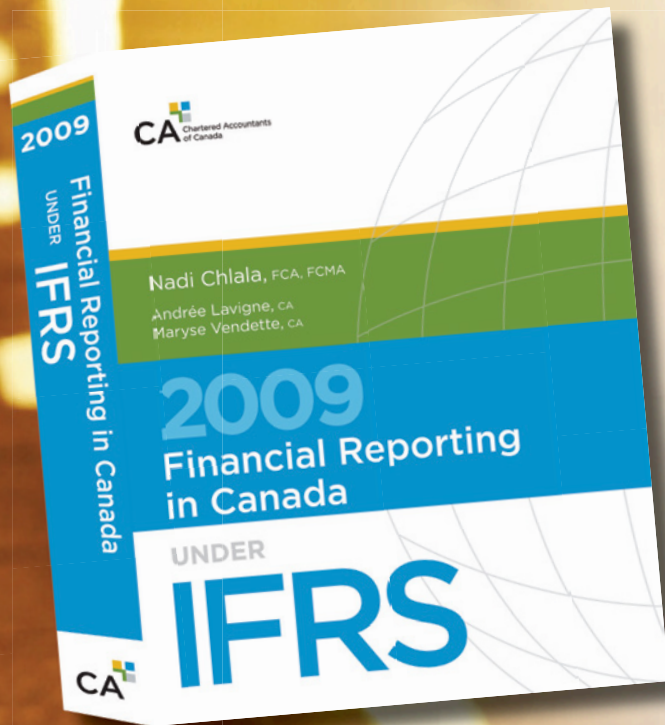
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to understand the economy from the ground up. The customers that attend auctions are the end-users typically. They are the economy. They are the people building the roads and the bridges and buildings.”

Blake, whose company handled US\$3.5 billion in auction sales last year, sees the country’s economic future driven by its wealth of energy and raw materials. “If you take a look at the gas and oil, potash and uranium and all the natural resources in Canada and then you consider the demand for energy in the world with countries such as India and China and their consumption rates that are going to take place over the next 25 to 50 years — that’s Canada’s future to me. A provider of natural resources to many of these economies.”

In 2008 Canadian Association of Petroleum Producers predicted that global oil consumption would rise from about 85 million barrels a day to between 97 million and 113 million barrels a day by 2035. Meanwhile US oil imports from Canada could rise to 23% to 37% in 2035 from 19% in 2008.

In the entertainment business, where competition for Canadians’ disposable income remains fierce and entertainment options seemingly expanding every day, Paul Beeston, FCA, president and CEO of the Toronto Blue Jays, sets a cautious tone. As the global economy continues to mend, he says the decade is going to be a challenge, and the early part particularly challenging. “No matter whether you are reading a Blue Jays’ [financial] statement or whether you are reading any other [corporate] statement, we are all challenged in the sales area.”

Traditionally baseball has done well in recessionary and eco-

nomically challenged times, but that was in the day when there were not as many forms of entertainment as today, he says. “There is real good competition for the entertainment dollar and not to recognize it, I think, is to be oblivious to reality.”

Although Canada may have ridden out the economic storm with less lasting harm than the US, as a country we still face government budget deficits, falling productivity and unemployment about two percentage points higher than prior to the recession. Having invested in heavy stimulus spending last year, Ottawa seems to have a limited ability to further prime the economic pump. The CEOs interviewed suggest that a mix of targeted tax relief, more intelligent economic development and more aggressive marketing of Canada as a place for foreigners to invest in or visit are keys to prosperity in the new decade.

“If we are better positioned by carrying less debt, perhaps we can help induce more foreign investment that would hopefully include Brazilian companies and others that will emerge as global players,” says Iannicelli. “At the same time we should invest more in entrepreneurs in Canada to create a new generation of global players, a new generation of Bombardiers, of SNC-Lavalins and financial services. I don’t think we have enough of those [companies] developing so we can be a player in the long term.”

For the past two years, the Canadian government has actively picked winners and losers by providing financial support to some but not all companies. The Canadian units of GM and Chrysler were supported with federal and provincial bailouts because the governments deemed those automotive jobs and

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# “We have spent the past five, six years looking to diversify our business so we have more areas to grow”

the hundreds of thousands of jobs linked to them too important to lose. Supporting the Detroit-based automakers in partnership with Washington was in essence an emergency measure. Hasenfratz believes business and government needs to take a more systematic approach to industrial policy from now on. “We can’t pretend that we can do the same things that we did in the past with the same people and make the same kind of money,” she says.

“We have to figure out if we are not competitive in certain markets, what are we going to do? The thing that worries me is companies that think when there are shifts globally or in terms of cost, that somehow the old paradigms will come back. Inevitably it doesn’t, so you have got to change your strategy,” says Hasenfratz. “You have got to figure out what can I make today that is going to be competitive?” And that is what Linamar looks to do. “We have spent the past five, six years looking to diversify our business so we have more areas to grow and can mitigate risk of overdependence on any one market, country or sector,” she says.

Sears Canada’s president, like Hasenfratz, also worries that there is no blueprint for growth in place. “Canada needs to create jobs in industries that can be grown dramatically,” says Rogers. “There are things like tourism where the Canadian government can act. I also think the government should take a serious look at raising the standard of living of Canadians by reducing many of the taxes applied to products and services, such as tariffs and interchange fees for credit cards, which are capped in other countries.”

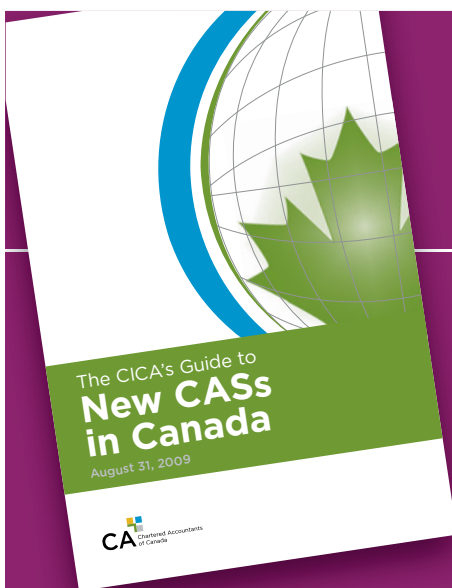
Rogers is especially concerned about the new harmonized sales tax (HST) in BC and in Ontario, which kicks in mid-way through 2010. Currency parity is on the rise, so is Internet shopping and good old-fashioned crossborder shopping, both of which could get a boost from new tax hikes.

“It’s well known that consumers are not paying duties on products they are bringing back from the US,” says Rogers, who is concerned that the HST may drive more shoppers to the US, depriving manufacturers and retailers of sales and Ottawa and Queen’s Park of sales revenue.

Perhaps the most dramatic challenge to Canadian businesses will be the huge shift of baby boomers out of the workforce and into retirement.

“In terms of people entering the workforce over the next 15 years that will be the biggest decline we have seen in the past 25 to 30 years,” says Bill Thomas, CEO and senior partner of KPMG (Canada). “That, for us, when you are very dependent on hiring and attracting the best and the brightest, is a critical factor that we need to respond to.” The 5,000-person accounting and consulting firm added 1,200 new faces to its ranks last year.

The growing army of retired but financially well-off boomers will, however, provide a myriad of opportunities for new and existing businesses. With plenty of time to pursue economic interests as well, it is quite possible that the sort of grey-power rallies that forced the Mulroney government to retreat on pension changes in the mid-’80s will be a regular occurrence. “They will drive the political agenda more so as they age, as they demand services,” says Iannicelli. “I think they will push things like



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private healthcare in the Canadian space because they will have more political clout.”

Facing a mass exodus of older, experienced workers, workplaces will likely have to make modifications to keep boomers longer. “Employers are going to be more tolerant of modified work schedules or work environments such as permanent part-time or three days a week to accommodate some of the needs of these people who would be retiring or younger people requiring more work-life balance,” says Iannicelli.

Canada’s energy and resource sectors, already identified as key engines of growth for the economy in the new decade, could also be hit hard by the coming retirement wave. “I foresee a shortage of technical expertise as baby boomers are reaching retirement age,” says Faught. “This is a very cyclical industry. There was a long period of drought where people were just not going through the technical schools or getting the training in areas this industry needs such as geology and mining engineering. It just wasn’t sexy or thought to be particularly lucrative. I think we are seeing it coming back, but a real challenge is the shortage of technical expertise and skilled trades.”

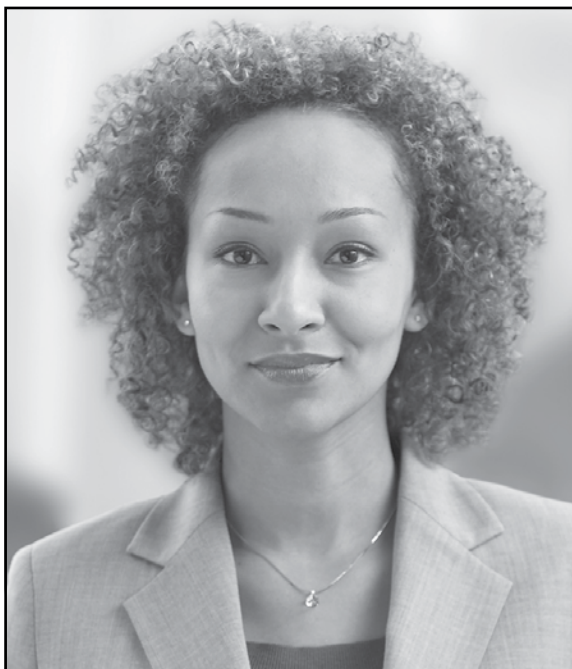
Although it could be that seniors will be prowling the country’s malls and outnumbering teens, retailers are not forecasting a massive change as boomers enter their leisure years. “The fact that more people are retiring doesn’t really affect us that much,” says Rogers. “I think the biggest change that we are seeing is the diversification of Canada — Toronto is almost 50% foreign born.

That tells us that we have to flex our assortment and reach out to those customers who are looking for something different, whether it is a different-sized garment or different cosmetics to appeal to people from Asia or Africa.”

Canada is increasingly viewed as an environmental bad boy in Europe because of our energy-intensive oilsands operations. It is highly unlikely that Canada will scale back production for environmental reasons — or that the US would want us to. “The real issue is the carbon emissions related to natural gas burned to extract sand-trapped oil,” notes Faught. “It is rather ironic that Alberta’s neighbouring province, Saskatchewan, has the world’s richest uranium reserves.” He says it would be logical for Saskatchewan to push for the construction of nuclear reactors to extract the oil for the sands in a more environmentally friendly way.

Embracing the environment may also help fill some of the anticipated void created as boomer-age workers begin leaving the workforce. KPMG, with its well-established presence on campuses across the country, has found that the firms’s environmental- and community-focused programs help with recruitment. What is motivating students on campus today are “corporate social responsibility, the increasing focus on being green and environmentally friendly,” and how employers are embracing these issues, says Thomas.

Paul Brent is a Toronto-based writer



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What exactly is going on with international financial reporting standards in the United States?

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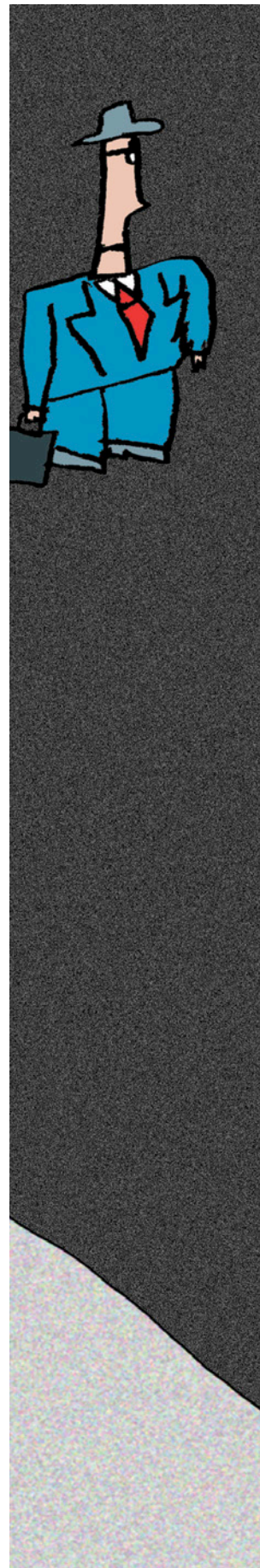
by Lawrence Richter Quinn

# IFRS: dead in the USA?

IT TAKES JUST A COUPLE OF MINUTES with Mariam Morris to understand why so many finance executives around the world wonder if the US will ever become a full-fledged IFRS convert. A few minutes more, people might well walk away believing that today IFRS in the US is, quite simply, DOA.

Morris is former CFO of Sucampo Pharmaceuticals in Bethesda, Md., a midsized company that had two international subsidiaries — one in England, the other in Japan — when the Securities and Exchange Commission (SEC) published its road map to IFRS in late 2008, so moving

Illustration by MIKE CONSTABLE









to one accounting regime made sense intuitively.

Because Sucampo was dealing with three different sets of standards, the company was really interested in the SEC's early adoption program, which its chair, Christ Cox, was pushing. Looking back today, Morris isn't entirely disappointed that the SEC is taking its time dealing with predicted revisions to the road map.

"My understanding is that there is still some resistance at the SEC, and I'm not surprised if there is ambivalence," she says. "I think, given the level of pressure for earnings right now, I wouldn't recommend adoption of IFRS at this point; I'd pull back precisely because of the amount of discretion and interpretation involved and because of the issues raised by cases such as [Bernard] Madoff's. I'd wait for the markets to calm down from a regulatory standpoint. Look at fair value accounting: it can be a nightmare if markets go up or down, inflating value at one moment, deflating it the next. I'm not in favour of big overhauls anyway. With a step-by-step approach, you have a chance to gauge successes and failures, reacting accordingly. With big overhauls you can be inundated with multiple problems."

For the moment, Canadians aren't paying much attention to the unfolding debate in the US regarding if, when and how convergence with or adoption of IFRS will happen. But that could change overnight should the SEC decide that neither convergence nor adoption makes sense for US public and private companies.

Is IFRS in fact dying a slow death in the US? Increasingly, that seems to depend on who is asked. There are those corporate executives on the ground who already have experience with implementing IFRS either in the US or abroad for companies smaller than multinationals (a rapidly growing, increasingly disenchanted group). Then there are those who have the most to gain monetarily from IFRS implementation (the largest sell-side companies) or are global enough in presence that clinging to US GAAP intuitively makes no sense for stakeholders in an increasingly IFRS-centric world.

There is one thing both camps agree on: the SEC is moving far too slowly in clarifying its short- and long-term intentions

and expectations regarding IFRS — whether it will finally require adoption or convergence, and in what time frame.

In fact, the SEC has been remarkably quiet about the standards since it published its proposed road map in the Federal Register on November 21, 2008, asking, as required by law, for comment from any interested parties. The agency received an unexpectedly and uncharacteristically tiny number of comment letters — roughly 200 — and just 70 or so were from nonfinancial corporations, almost all Fortune 500 companies. Since then, no speeches have been made by anyone at the SEC on the is-

## There is one thing both camps agree on: the SEC is moving far too slowly in clarifying its short- and long-term intentions and expectations regarding IFRS

sue and no other official documentation released. (The agency declined to comment for this story.)

Its silence, both camps agree, already virtually promises to cost stakeholders unnecessarily, certainly monetarily — but also in terms of operational efficiencies and possible credibility in number crunching.

A major US grocery chain provides one example of how the move to IFRS is grinding to a halt. The company hired a finance executive with IFRS experience with the specific goal of implementing its new standards strategy, budgeting 40% of that position's time for the issue; today its IFRS-related work is on hold.

Meanwhile, Codexis, a California-based manufacturer of enzymes for pharmaceutical, energy and environmental concerns, has hired IFRS expertise with the goal of switching to those standards this year if its initial public offering is successful. "We're extremely interested in IFRS and are awaiting word from the SEC about how to proceed," says Kristen Pan, senior revenue accountant. So the heady days when eventual adoption of IFRS in the US was considered a matter of faith — a question not of if but when and in what form — are gone.

"The No. 1 question you hear is, when will companies be

### AICPA calls for three- to five-year time line for transition to IFRS

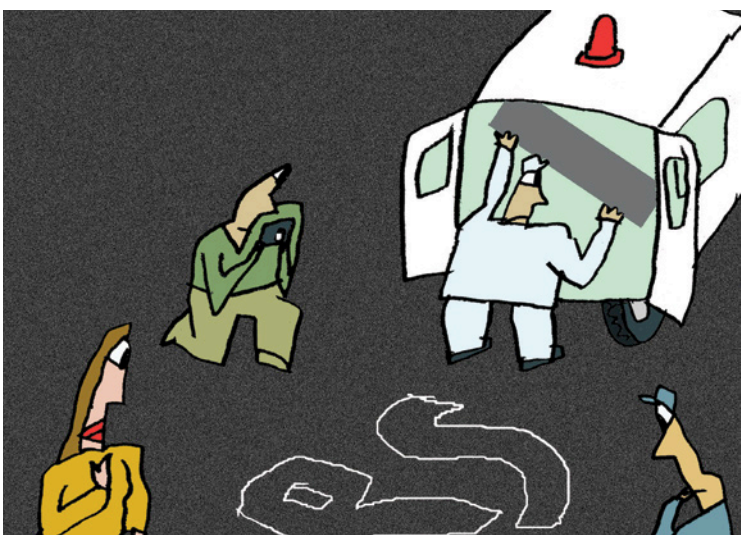
On June 16, 2008, the American Institute of Certified Public Accountants (AICPA) president and CEO Barry Melancon spoke at a Financial Accounting Standards Board forum and called for an orderly transition and reasonable time frame of three to five years for the US accounting profession to adopt IFRS. The forum's purpose was to discuss whether and how to move the US financial reporting system to IFRS, and to broadly define the next steps in that process.

"Awareness is growing among US accountants that IFRS is coming for public companies and most believe it will take three to five years to get ready," Melancon said to representa-

tives from the US and international accounting and finance professions, as well as state and federal regulatory authorities, including the Securities and Exchange Commission and the Internal Revenue Service. A majority of AICPA members polled in a survey in the spring of 2008 said they believed it would take three to five years to prepare for IFRS.

On May 15, 2008, the institute launched [www.IFRS.com](http://www.IFRS.com), a website developed in partnership with CPA2Biz ([www.CPA2Biz.com](http://www.CPA2Biz.com)), to help members and financial professionals learn about and stay informed on IFRS. On May 18, 2008, the AICPA's governing council voted to designate the International Accounting Standards Board, which promulgates IFRS, as an accounting body for purposes of applying IFRS in the US.

LRQ



required to switch from current US GAAP to current IFRS?” says Bruce Pounder, president of accounting education firm Leveraged Logic in Asheville, NC, and author of *Convergence Guidebook for Corporate Financial Reporting*.

“My answer is that it will never, ever happen,” says Pounder. “They will never be required to do so — not for public companies, certainly, nor the far greater number of private companies. They will not be required to do so because the reasons for the US to move in that direction are much less compelling than for other countries.”

Adds Thomas Selling, a former professor at the Thunderbird School of International Management in Glendale, Ariz. (and a former academic fellow in the SEC’s office of the chief accountant), who writes a blog called The Accounting Onion: “According to the respondents of a survey I did on IFRS adoption in the US, IFRS is not perceived to be better than GAAP, and continuing efforts to bring the two bases of accounting closer together are not expected to be worthwhile — unless you are a Big Four auditor or work at a Fortune 500 company. Bottom line: the SEC should make a U-turn on its road map proposal.”

Anecdotal evidence and survey results seem to square with the lack of enthusiasm demonstrated by Selling’s readers. For instance, in a Grant Thornton study last year, only 23% of more than 800 respondents from public companies thought an international independent board such as the International Accounting Standards Board (IASB) should be setting accounting standards for US companies.

“In my recent meetings with potential IFRS clients, many have said that no stakeholders are asking for it,” and because of this, they don’t have a sense of urgency, says Steve Lyman, a partner in advisory services at Grant Thornton LLP’s office in Atlanta. Because clients aren’t getting pressure, he says, IFRS is just not a high priority for them, given the other things they have going on. “I had one client compare the conversion to IFRS with the US conversion to the metric system. He said, ‘It sounded like a good idea at the time, and seemed to have support, but it never took hold in the US even though the rest of the world uses it.’”

Not everyone working for corporate America deplores the advent of IFRS; far from it. Some of the largest US multina-

tionals enthusiastically support the adoption of IFRS and the continuing movement toward convergence; many moved early to get the IFRS ball rolling.

In a 2008 survey by consulting firm Accenture of more than 200 CFOs with more than US\$1 billion in annual revenues, 83% viewed IFRS as providing a significant opportunity to achieve broader transformational change and drive business benefits beyond compliance. Stewart Glendinning, Molson Coors CFO in Denver, is optimistic. “Our enthusiasm isn’t diluted as we consider what IFRS means for us,” Glendinning says. “If we could report in one standard, it would allow both us and our investors to better compare ourselves to our global peer group — companies such as SAB Miller, Heineken and Carlsberg.”

Adoption of IFRS will also allow companies to manage in a more consistent, common way across geographies, he says. “As one example, now trying to recruit people worldwide with experience in US GAAP is not easy. The more proximate they are to the US, the less difficult it is, but one single standard would help eliminate the problem.”

Glendinning believes the timing is right for the conversion. “We want to reduce our costs, driving more profit to the bottom line. One way to do that is to streamline the back office, including our accounting systems,” he says. “Currently we have a separate accounting system in each of our geographies; we’d prefer to have everyone move to a single system at the same time as we move toward IFRS. My guess is that a large number of similarly sized US companies currently are set up exactly as we are.”

Thomson Reuters also saw the benefit of moving to IFRS. The company found itself dealing with three sets of standards (Canadian GAAP, US GAAP and IFRS) when Thomson merged with Reuters. Last year, it successfully completed its 18-month project to move to IFRS reporting alone. To the best of his knowledge, “TR was one of the first large US-headquartered companies to do this,” says Adrian Tannian, who spearheaded the accounting side of its efforts. “At no point did we view this as a waste of time: it was a matter of expediting what otherwise was seen as inevitable.”

Despite these upbeat stories, even at the largest companies, positive thinking about IFRS appears to be the exception, particularly because many of these companies feel they won’t have enough time to implement IFRS. It doesn’t help that some of the initial perceived promises of IFRS — for instance, that converting to a single accounting regime would significantly reduce financial reporting costs over time, producing a significant return on investment or that investors really will be able to make better apples to apples comparisons — seem unlikely to come to fruition.

For instance, new reservations can be heard at Microsoft, where the company has long had a senior executive in charge of following the evolution of IFRS and where it had been hoped that cost savings might be one of the benefits of adoption. “We’ve followed IFRS for years and have been proactively involved as the process moves forward,” says Robert Laux, senior director of financial accounting and reporting in Redmond, Wash. “Nevertheless, we’ve finished our initial assessment of what will be involved in conversion or adoption, and we just don’t see the savings. Having said that, we’re waiting until the SEC provides more guidance on the issue.”

Memphis, Tenn.-based FedEx, which has finished its initial



review of IFRS, ultimately expects the SEC to push forward with mandating adoption and hopes at the very least that it will give US companies more time to comply. “I sum up IFRS this way,” says John Merino, chief accounting officer, “SOX meets Y2K.”

And even supportive executives such as Glendinning are hardly starry-eyed. “I wouldn’t want to see change for change’s sake,” he says. “I can see why a lot of US companies, particularly those with little business outside the US, wouldn’t see the benefit of IFRS. While we see lots of good potentially coming out of this, I haven’t spent a lot of time on this. Like everyone else, we’re waiting for the SEC.”

Any number of other issues have led to a lack of corporate enthusiasm about implementing IFRS, company executives and regulators agree. “Two years ago, as the SEC was coming out with its road map, there was no question that companies were somewhat more enthusiastic about the move toward IFRS,” says Tom Hood, CEO and executive director of the Maryland Association of CPAs. “At that point, there was no recession, no financial crisis; fewer things were on the CFO’s plate. Now among large, publicly traded companies, there is more skepticism, more realism about what they may be facing. In the past 24 months there has been layering on of more and more things for CFOs and their finance teams to contend with: the mandate to move toward XBRL itself has been at least as big a project as IFRS promises to be. Add to that the uncertainty created by so many public policies in play, including healthcare, employee benefits, financial regulatory reform, cap and trade and taxation.”

The result? “In a year-end survey by Financial Executives International, IFRS has moved from No. 2 in 2008 to No. 5 this year as a top challenge facing CFOs,” says Hood.

The one concern almost everyone seemed to share is the lack of time to prepare for IFRS and to get it right.

“What the SEC has said it’s looking for — and what account-

ing regulators everywhere have recognized as necessary — is two years of historical, comparative financial statements, both in US GAAP and IFRS,” says Chad Wekelo, founder and principal of Actualize Consulting in New York, which has worked with two money center banks interested in eliminating their current reporting in multiple sets of standards. “What most companies should be doing is starting to run two sets of parallel books rather than going back and trying to recapture that data later. The question is when to initiate this effort. Right now there’s no rush to the gate, and that will be damaging for all involved down the road.”

Unfortunately, possible damage being done now goes well beyond the discussion that US corporations will have to get their acts together. “Because IFRS is more principles- than rules-based,” says Hood, “many corporate executives worry that trial

## “In a year-end survey by Financial Executives International, IFRS has moved from No. 2 in 2008 to No. 5 this year as a top challenge facing CFOs”

lawyers will have a lot more to argue about precisely because of the leeway allowed by IFRS regarding many individual standards or because IFRS is silent on specific accounting issues or treatments. Liability risk is a major uncertainty; remember, the US was once a principles-based system and evolved to rules-based, mainly driven by litigation.”

Dwayne Cook, partner and mid-Atlantic practice leader at consulting firm Tatum LLC in Washington, says, “Finally, there’s quite a bit of suspicion that we’re involved increasingly in a race to the bottom. We’re talking about fear that major compromises will be made in the rush to converge, sacrificing a single set of high-quality global standards in the process. Instead, major differences need to be thoughtfully resolved — for example, fair value — and complexity needs to be reduced. The end game should be better investment decisions.”

### And here in Canada ...

Assuming the US will move toward IFRS adoption, Canadians are paying scant attention to the back-and-forth between regulators and companies regarding how Americans will get there. In fact, with or without adoption in the US, Canadian-based companies — even those with US operations — already can file financial statements using IFRS with the Securities and Exchange Commission without the need for reconciliation.

In addition, Canada’s public companies will have the option of filing US GAAP under Canadian securities proposals, in effect carrying forward existing rules. And the subsidiaries of private US-based companies may well be able to file statements using US GAAP — at least in most circumstances.

Meanwhile, Canadian regulators aren’t budging on their

commitment to having this country’s companies IFRS-compliant by 2011 — and appear unmoved by the US debate regarding IFRS.

“Our accounting standards board isn’t tied to the US’s discussions about IFRS; it’s quite independent,” says Darla Sycamore, trustee at the Canadian Financial Executives Research Foundation, the research institute of Financial Executives International Canada, an association of senior corporate financial executives.

“Last spring quite a few Canadians were in favour of deferring implementation, but the Canadian Accounting Standards Board said that no time is a good time for implementation,” she says. “It also indicated it had given plenty of notice to Canadian companies — since 2006 — to implement international standards. IFRS is very much a moving target. Complacency is not an option.”

LRQ

Meanwhile the ghost of SOX haunts corporations — soaring, unpredictable costs; the inability to be sure that they had gotten it right as consultants came and went; the moving target aspect of the whole issue. As a result, everyone is rushing to determine just what the price tag for IFRS conversion or adoption will be.

Many think it's a fool's errand. David Rombough, a partner at Accenture who works out of the Toronto and Calgary offices, says, "I've seen estimates saying [companies] expect to spend about 0.5% of their revenue. The SEC, thinking in terms of convergence, says it will be closer to 0.1%. Trying to look at it in terms of an overall percentage is hard because companies have different starting points. The quality of data and their ERP systems, each of these differs from company to company, so in terms of coming up with a formal assessment of the cost, it's very much a rough guess."

John J. Barry, US IFRS leader at PricewaterhouseCoopers in New York, says, "I think cost is individual to every company; it's not really calculable. I don't think anyone has really gotten their hands around this yet, and if they have, it's from 75,000 feet."

While the world waits for the SEC to step up to the plate, some companies and organizations are pressing on, such as small and medium-sized enterprises, which the IASB addressed last year with a simplified — and presumably less expensive — set of accounting standards that should ease the way into the world of IFRS. The only proviso to adopting these SME standards: ultimately, their lenders and other financial counterparties have to sign off on the change, as current loan covenants and other documents have been written with US GAAP as their basis.

## Most recent update

On February 24, 2010, the Securities and Exchange Commission issued a statement that makes it clear that it still believes that a single set of high-quality globally accepted accounting standards would benefit US investors. The statement pointed out that the SEC continues to encourage the convergence of US GAAP and IFRS. The SEC is also working on a work plan that is expected to help the SEC evaluate the impact US company use of IFRS will have on the US securities market. By 2011, if the work plan and various convergence projects are completed, the SEC will decide whether to incorporate IFRS into the US financial reporting system.

It's true, too, for privately held companies based in the US, many of which are jumping in simply because they're so involved internationally that it makes good business sense to go IFRS.

"Back in July the IASB issued standards for so-called small and medium-sized entities that are less onerous than those for larger companies, and US companies in that size range now can use these standards if they wish to do so," says Sean Lager, the partner in charge of international business at Atlanta-based accounting and auditing firm Frazier & Deeter. "The kicker here, though, is

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that if that firm wants to make the switch, it has to get sign-off from its banks and other financial partners. That's because its loan covenants now determine what it reports in, thus the need for these financial intermediaries to give their OK for the shift."

"Meanwhile, the American Institute of Certified Public Accountants [AICPA] has been actively promoting interest in IFRS among small and medium-sized entities," says Paul Cherry, chair of the IASB's Standards Advisory Council and retired chair of the Canadian Accounting Standards Board. "It has already said the IFRS is authoritative and credible and that you can get a clean audit opinion in compliance with these standards. [I stress that this is in the context of private companies.] But it's too early to determine to what extent they'll be used."

In 2008, AICPA president and CEO Barry Melancon took the lead in calling for an orderly, thoughtful transition to IFRS. "Awareness is growing among US accountants that IFRS is coming for public companies and most believe it will take three to five years to get ready," Melancon said at a Financial Accounting Standards Board (FASB) meeting. Since then, the group has been promoting a wide array of webinars, a dedicated website and other educational materials to help in the process.

Regardless of when, if or how the SEC decides to push ahead, efforts to mesh US GAAP and IFRS roll on through the many convergence projects the IASB and FASB are working on together.

"Even if FASB plans to complete all the projects discussed under its memorandum of understanding with IASB, both public and private US companies will incur significant costs to adopt the changes that will result, regardless of whether the SEC

mandates adoption of IFRS," says IASB's Patrick Finnegan.

"These projects will create significant improvements for investors," he says. "It would be sound to adopt these changes once, unwise to incur costs twice as they adopt US GAAP changes, then converge toward IFRS. For that reason, it makes sense to adopt IFRS directly. Bottom line: why not adopt a single language everyone can use once, and do it now?"

If US companies want to implement IFRS efficiently and cost-effectively, they must do what has been advised for years: change how they think about accounting and how it relates to their core businesses and operations, says Peter Welch, founder of consulting firms Sox International and Contractual CFO, which market IFRS training and self-study programs to executives and accountants.

"With IFRS you've got to look at each and every major transaction that goes through a company, asking first if it's truly revenue, how much was economically earned and through what period," he says. "You receive the cash: do you recognize it, treat it as revenue or as deferred revenue? And how much of that money truly is representative of economically earned income versus a contract that goes out well beyond 12 months? In the end they have to come to terms with the economics of the business. These are issues that have never been asked with US GAAP. Everything was about following the rules. If you could sell it to the auditors, that's how you'd account for it. If we can't change that way of thinking, we face a very long, rocky road to IFRS. That's a mistake that none of us as stakeholders can afford."

Lawrence Richter Quinn is an Atlanta-based freelance writer



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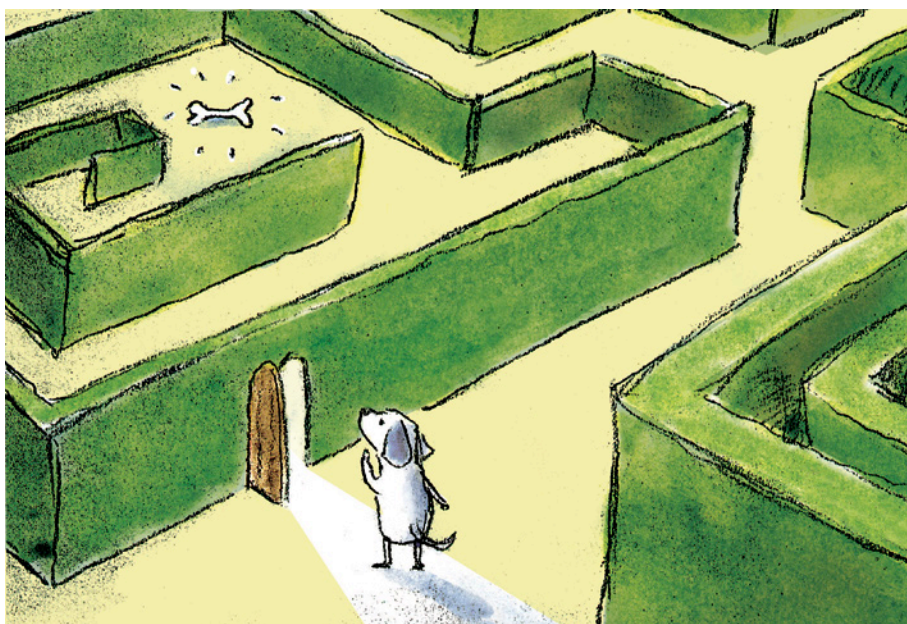
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## Mut muts

Mutatis mutandis provisions under the Income Tax Act may turn out to be new tricks for an old dog



**T**he application of so-called “mutatis mutandis” (mut mut) provisions within the Income Tax Act is a practice that, by its very nature, is fraught with uncertainty. A recent case, *Lord Rothermere Donation v. HMQ* [2007-1938 (IT)G], sheds helpful light on the principles of applying these provisions generally and calls into question the Canada Revenue Agency position that effectively deprives companies of refund interest on amounts assessed under Part XIII of the act.

Mut mut provisions are used within the act as an efficient means to incorporate by reference other provisions intended to be applicable to the particular subject provision. There are more than 100 such provisions within the act. Typically the provision will state that divisions X and Y (or sections this or that) are applicable “with such [any] modifications that the circumstances require.” Prior to 1985 such provisions may have read “divisions X and Y are applicable mutatis mutandis” (meaning, with the necessary changes in points of detail). Clearly, whether

the incorporated provisions require modification in order to apply appropriately to the subject provision is a subjective endeavour — depending on the wording, the circumstances, the reader’s understanding of the policy intent of the subject provision and of the incorporated provision and on the reasonable available options.

The Rothermere decision considered the application of the mut mut provision contained in subsection 227(7) of the act. This is an assessing provision triggered when a nonresident makes an application for a refund of Part XIII tax under subsection 227(6) and the Minister does not agree that the applicant is entitled to the refund requested. Thereunder, “the Minister shall assess any amount payable under that Part by the person and send a notice of assessment to the person, and sections 150 to 163, subsections 164(1) and (1.4) to (7), sections 164.1 to 167 and Division J of Part I apply with any modifications that the circumstances require.” Subsection 164(3), which provides refund interest on overpayments of tax, is thereby encompassed in the mut mut of subsection 227(7).

In its unmodified form, subsection 164(3) determines

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the date from which refund interest will be calculated as the latest of three specified dates. These are:

1. (a) if the taxpayer is an individual, the day that is 30 days after the individual's balance-due day for the year; (b) if the taxpayer is a corporation, the day that is 120 days after the end of the year;
2. (c) if the taxpayer is (i) a corporation, the day that is 30 days after the day on which its return of income for the year was filed under section 150, unless the return was filed on or before the corporation's filing-due date for the year, and (ii) an individual, the day that is 30 days after the day on which his or her return of income for the year was filed under section 150 (at the time in question in Rothermere the provision referred to 45 days rather than 30);
3. (d) in the case of a refund of an overpayment, the day on which the overpayment arose. (If the refund is of an amount in controversy that the taxpayer has applied for repayment of under subsection 164(1.1), a fourth date also applies.)

In Rothermere, the appellant — a trust established in Quebec — in June 2001 caused the winding up and received the assets of two nonresident owned investment corporations. At that time it also sought to receive an advance income tax ruling that Part XIII did not apply. However, the Rulings Directorate declined to issue a ruling on the matter at that time, and the appellant remitted to CRA 25% of the deemed dividend received, partly on July 13, 2001 and partly on September 19, 2001. Subsequently on December 7, 2001, the appellant filed NR7R applications for refunds of the Part XIII tax under subsection 227(6) of the act, which the CRA received on December 10, 2001 and December 13, 2001 respectively. On February 12, 2003, the CRA issued two assessments under 227(7) denying the appellant's applications for refund of the remitted amounts. The appellant filed Notices of Objection to these assessments. Almost four years later and almost six years since the tax was remitted, the CRA issued reassessments on February 5, 2007 granting the refund of the withholding tax remitted, again presumably under subsection 227(7). That provision contains a postamble indicating that "subsections 164(1) and (1.4) to (7), sections 164.1 to 167 and Division J of Part I apply with any modifications that the circumstances require." Consequent to these reassessments, refund interest under subsection 164(3) was calculated from the day the NR7R appli-

cations were received, being December 10, 2001 and December 13, 2001. The appellant objected to the reassessments on the basis that interest should have been calculated from the date of the overpayment, being July 13, 2001 and September 19, 2001.

The issue then in Rothermere was how should subsection 164(3) be modified to provide a date from which refund interest should be paid by the CRA to the taxpayer? The Tax Court determined that interest should be paid 45 days after the individual's written application for a refund was filed under 227(6), by modifying paragraph 164(3)(c)(ii) to substitute the NR7R application date for the return of income date in the unmodified provision.



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While acknowledging that a return of income is quite different in scope from a written application, the Tax Court found that similar information has to be provided in both and that it was not unreasonable for the purposes of subsection 227(7) to make this modification, as it provides a result in harmony with the scheme of the act and the will of Parliament. In so doing the Tax Court also determined that paragraph 164(3)(a) — the reference to the “balance-due date” — could be ignored, given that under Part XIII amounts are remitted forthwith. In the particular circumstances, the modified application date was later than the date in paragraph 164(3)(d) on which the overpayment arose.

More generally, the Tax Court found the current wording of the modification provision is broader than the previous wordings that incorporated the *mut mut* expression, which had been interpreted by Canadian tax courts to allow necessary changes in detail but not changes in substance. In *Rothermere*, Justice Archambeault found that the post-1984 expression “with such modifications as the circumstances require” was not limited to “points of detail” as was the previous Latin expression but “there must be some limits as to what modifications may be made ‘as the circumstances require.’” The Tax Court found with respect to subsection 164(3) that “Parliament intended ... to apply to non-residents subject to Part XIII the tax policy governing the payment of interest to taxpayers [including non-residents] subject to Part I tax,” such policy including “an interest-free processing period when a taxpayer subject to Part I tax claims a refund of taxes, whether paid by withholding at source, by instalment or by payment on the balance-due day.”

Given the frequency with which modification provisions are found in the act, it is somewhat surprising that the CRA has only been called on to express its views on these provisions in a limited number of instances. However, the most explicit interpretation by the CRA’s Rulings Directorate (Document 2007-0228081E5) closely approximates the *Rothermere* situation in considering the application of subsection 164(3) to refunds of Part XIII tax except that the opinion dealt with refunds made to a corporation instead of an individual. Also, instead of the assessment being produced under subsection 227(7), the opinion considers an assessment produced under subsection 227(10.1). Although the two provisions have identical modification post-ambles, subsection 227(10.1) would apply in situations where CRA had produced an assessment unbidden, whereas subsection 227(7) applies to an assessment produced after the CRA denies a taxpayer request made under subsection 227(6) for a refund of Part XIII tax previously remitted. This situation under subsection 227(10.1) may arise for example where a Canadian company withholds 10% Part XIII tax on a trademark royalty paid to its US resident parent. The CRA audits the transaction and determines that the royalty is in excess of an arm’s length amount. Consequently the CRA denies the deduction of the excess royalty to the Canadian resident and deems it to be a dividend paid to the nonresident. The deemed dividend is entitled to a 5% withholding rate under the US treaty and thus the nonresident parent is assessed to provide a refund of the over-remitted Part XIII tax. In transfer-pricing cases in-

volving multinational corporations, the amounts in question can be in the millions of dollars.

The rulings document opines that in the circumstances subparagraph 164(3)(c)(i) would be modified to pay interest from the date that a notice of assessment has been issued rather than from the date that a return of income is filed. Paragraph 164(3)(b), “120 days after the end of the year,” would be ignored as, in Rulings’ view, “the 120 day time period is only relevant if the corporation filed a Part I return on time for a particular taxation year.” Paragraph 164(3)(d), the day on which the overpayment arose, would remain unmodified.

The rulings position, by ignoring paragraph (b) and modifying subparagraph (c)(i) to the assessment date, creates a comparison between the assessment date and the date of overpayment. However, this is not a real comparison to determine the latest of the two dates as, in the circumstances where a refund arises under Part XIII, the date of an assessment to provide the refund will always be later than the date that the overpayment arose. In essence, the outcome of the rulings position is that refund interest will never be paid, even in circumstances where the CRA has retained an overpayment of tax for a number of years.

## **The Tax Court found that the current wording of the modification provision is broader than the previous wordings that incorporated the *mut mut* expression**

Calculating refund interest from the date of assessment means that no interest is provided, as the assessment date and the refund interest date are one and the same.

The Tax Court in *Rothermere* found that the policy intent of subsection 164(3) was to provide refund interest to taxpayers, including nonresident taxpayers paying Part XIII tax, but also to allow the CRA an interest-free processing period. The court modified the return filing date in paragraph 164(3)(c) to the date that the refund was requested rather than the date the tax was assessed, even though there was an assessment date available. Presumably the court considered that the assessment date, being more than four years after the overpayment of tax, was not a reasonable modification to reflect the policy intent to provide refund interest to the nonresident, and further that within the provision the assessing action by the CRA was not a reasonable substitute for the return filing action by the taxpayer. In light of the policy intent of subsection 164(3) as described in *Rothermere*, it is apparent that the rulings position for corporations is unreasonable in providing a harsh result that does not accord with the policy intent of the provision. Given this, the CRA position should be reconsidered in light of the *Rothermere* decision.

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Technical editor: Trent Henry, tax managing partner, Ernst & Young



## What is it worth?

The mechanics of valuing a small, private firm are not difficult; the challenge is in arriving at a reasonable discount

**T**he increasing optimism of economic recovery presents opportunities and challenges for businesses. Some industries contract during volatile economies, others evolve. Within each industry, stronger players acquire weaker ones while others merge to grow or survive. Business valuations become increasingly relevant. In addition to mergers, acquisitions and divestitures, examples of other situations that may require a valuation include business reorganizations, structuring shareholder agreements, minority shareholder actions and other shareholder disputes, employee share own-

ership plans and stock options, estate planning and income tax transactions.

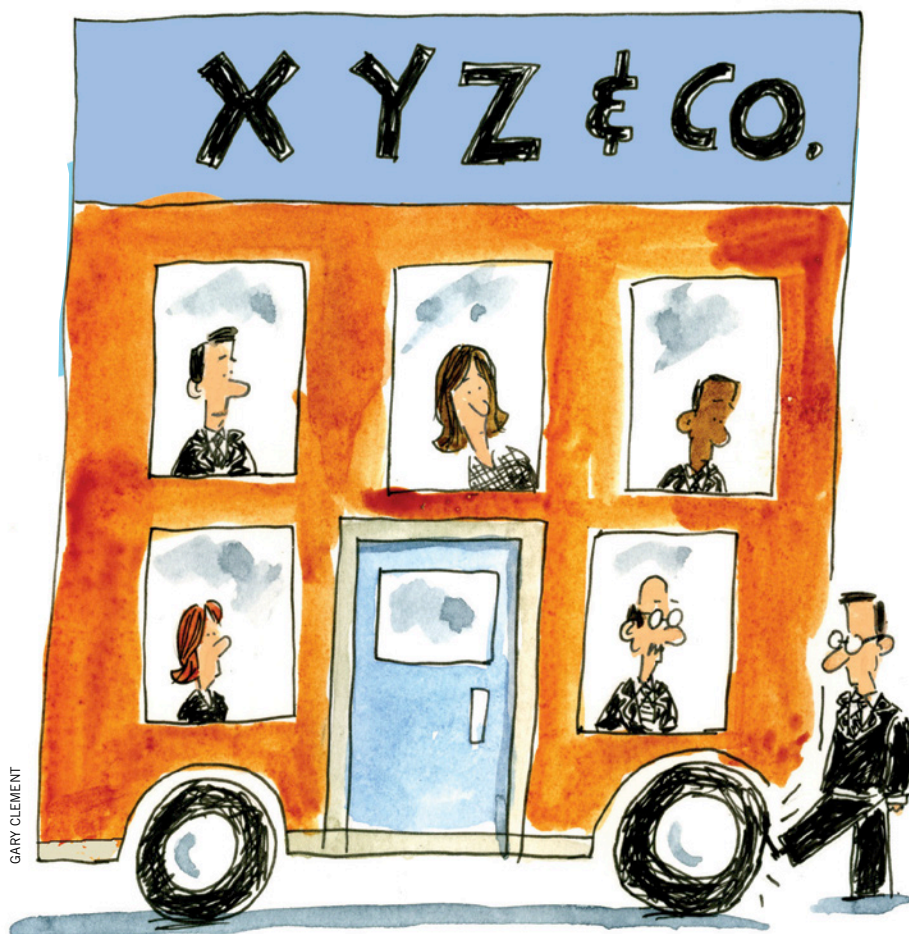
Many Canadian businesses are private and small. Industry Canada defines a small business as one with fewer than 100 employees whereas Statistics Canada defines it as one with fewer than 500 employees and less than \$50 million in annual revenue. Based on Statistics Canada's December 2008 Business Register, 75.2% of Canadian businesses had fewer than 10 employees, 97.9% had fewer than 100 employees and 99.7% had fewer than 500 employees. So, practically speaking, all are small.

Empirical studies show that smaller firms generally attract a higher cost of capital and are viewed by investors as riskier than larger firms. And just what are the cost of capital, the cost of equity and their application in valuing small companies?

### Cost of capital

To value a small, privately held Canadian business, one cannot simply look up its share price on a stock exchange. Calculating the trading multiples of large public companies in the same industry and applying these multiples to a small company does not provide a reasonable solution either. There are several acceptable methods of valuing a business that is a going concern. Most methods are based on the company's earnings or cash flows. Earnings or cash flow valuations utilize capitalization rates or multiples applied to earnings before interest, income taxes, depreciation and amortization (EBITDA), net earnings or after-tax cash flows. Discount rates are applied to forecasted cash flows to calculate a capital value of business operations. All capitalization and discount rates are a function of the cost of capital.

The cost of capital represents the economic cost to a business to finance its operations with debt capital or equity. It is a rate of return that reflects the risks





and opportunities associated with ongoing or projected earnings or cash flows of the business.

Where debt-free cash flow is forecasted, the weighted average cost of capital (WACC) is the basis of the discount rate for a discounted cash flow valuation and the capitalization rate for a capitalized cash flow valuation.

The WACC of a business enterprise is comprised of the cost of equity, the after-tax cost of debt and the optimal capital structure of the company. Of the three components, the most controversial is the cost of equity due to an inherent degree of subjectivity in its derivation.

### Cost of equity

Two common methodologies for estimating the cost of equity of a company are the build-up approach and the capital asset pricing model (CAPM).

The build-up model for estimating the cost of common equity capital is the sum of the risk-free rate, equity risk premium and an industry premium. The build-up model is more often used in the valuation of small and privately held companies.

The conventional CAPM is based on a risk-free rate and an equity risk premium that compensates investors for taking on risk equal to the risk of the equity market. The equity premium is modified by a factor called beta, which measures the extent to which a company is exposed to the equity risk. An industry premium adjustment is not made in the CAPM, as the industry risk is captured in the beta factor. In the valuation of large and publicly traded companies, the CAPM approach is more commonly used. It assumes that the market is perfectly efficient and that all investors can diversify risks from any particular investment by holding a portfolio of investments. In practice, investors do not behave in the manner prescribed by the theories behind the CAPM. To account for the difference, a size premium and a specific company premium are generally added to the cost of equity estimation methods.

### Size effect — regardless of being public or private

Many empirical studies show that equity returns (and as a result the cost of capital) of public companies are higher for small companies than for large firms as smaller firms have greater risk. Most empirical studies use the conventional CAPM to adjust expected equity returns for risk and find that smaller firms consistently generate returns that are above their expected returns predicted by the conventional CAPM. This phenomenon is known as the small firm effect or size effect.

Empirical studies suggest that CAPM's risk measure, beta, underestimates the true risk of small companies. Small firms have risks that are not reflected by beta but are related to size, such as lack of liquidity, higher default risk, lack of information and resulting estimation risk, lack of pricing power, lack of resources to adjust to competitive forces and less control over product and demand. The introduction of the size premium is an appropriate adjustment of the conventional cost of equity estimation models for small companies.

### Size premiums studies

Two separate US studies by Morningstar and Duff & Phelps measure size premiums and are widely accepted and applied by valuation professionals when estimating cost of equity.

Morningstar estimates size premiums based on long-term empirical tests (starting in 1926) of companies that are publicly listed in the US. Companies are grouped into 10 size portfolios (the smallest size portfolio is further broken down in two additional portfolios) and risk premiums for each size category are estimated whereby size is measured by market value of equity. To use the Morningstar size premium, the subject company is placed within the appropriate size portfolio.

Duff & Phelps estimates size premiums based on a similar data basis as Morningstar (although the study starts in 1963) and breaks the market into 25 size portfolios. Other measures of size are introduced as market value of equity is an imperfect measure of size of a company's underlying operations. Also, market value of equity as a measure of size may include certain circularities as some companies are not risky because they are small, but are small because they are risky (the riskier the company, the higher the discount rate and the lower market value of equity). The seven

## Many empirical studies show that equity returns of public companies are higher for small companies than for large companies as smaller firms have greater risk

alternative measures of size are enterprise value, book value of equity, average EBITDA, average net income, total assets, sales and number of employees.

### Limitations of applying size premiums

The Duff & Phelps data is particularly relevant when determining cost of equity for private companies as several fundamental accounting size measures can be used to estimate an appropriate risk measure — rather than market data that is not available for private companies.

All eight Duff & Phelps size measures and Morningstar data should be considered to determine size premium for a subject company being valued. Significant discrepancies in results would indicate that the use of empirical studies may not be a reasonable way to measure small-firm risk. As a result, more emphasis should be placed on identifying and quantifying company specific risk.

The smallest size portfolios of the empirical studies are companies with fewer than 200 employees. The majority of Canadian companies rank at the bottom of the smallest size portfolios. The size premiums of the smallest size portfolio approximates 10% based on the two empirical studies. Size premiums generally increase significantly (approximately 4%) from the second smallest to the smallest size portfolio. This is due likely to a higher number of distressed companies in the smallest size portfolio compared with other size portfolios. The high degree of size premium variability of the smallest size portfolio introduces

high-size premium estimation risk and suggests alternative measures of risk.

The specific underlying risks of the subject company should be reviewed and quantified. Smaller companies are generally riskier than larger companies because of the quality of governance and management, lower ability to diversify operations, supply chain dependencies, less research and development along with fewer resources to defend owned technology and numerous operational risks. On the other hand, small companies may be more nimble when adapting to changes and economic uncertainties. Certainly, Canadian businesses by and large weathered the recent recession quite well, as evidenced by the lack of significant increase in reported bankruptcies from year-to-year.

#### Specific company risks

In addition to the equity and size premiums, valuers often include specific company risks to the cost of equity. Typical specific company risks include those earlier noted plus key-person dependence, key-supplier dependence, key-customers dependence, labour disputes, pending lawsuits and abnormal present or pending events.

To arrive at an appropriate premium for specific company risks, it is important to have a thorough understanding of the subject company as well as its industry. Often, some business risks are common within an industry and not necessarily spe-

cific to the company being valued. These risks would be captured by beta or industry risk premium already.

Sometimes, unintended or duplicative business risks may have been reflected in the size premium. To avoid double-counting a risk factor, it may be more suitable to incorporate foreseeable events through probability-weighting the cash flows rather than by increasing the discount rate.

#### Conclusion

The mechanics of valuing a small private Canadian company are not difficult. The challenge lies in arriving at a reasonable discount or capitalization rate.

With fewer market transactions in the past year that can be used to test the reasonability of the discount rate adopted, a more reasoned approach to determine the equity rate of return needs to be taken.

To remove some of the subjectivity that often forms part of the cost of equity, understanding the economic and social circumstances, the industry and the company itself are essential.

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## A portfolio that adds value

Many investors are realizing that another level of advice can be beneficial and CAs are the right ones to offer a second opinion

In a 2009 study of affluent US investors, consulting firm Spectrem Group reported that the majority of respondents had experienced a 30% drop in net worth since September 2008 and 17% absorbed declines greater than 40% — and that was before the market lows of March 2009. Undoubtedly, with the recent rebound in stock markets, net worths have improved since this study was conducted. Still, it is unlikely that many investors (especially those in or near retirement) are happy with the experienced levels of volatility.

To assess the situation in Canada, four investment professionals (who include portfolio reviews in their service offering and charge an hourly or fixed project-based fee for services but do not sell investment products) were consulted. The two most common portfolio problems cited by all four were a mismatch of portfolio risk with investor risk tolerance and a lack of understandable performance measurement (including how returns are calculated, the impact of fees and which benchmarks are to be used). Also mentioned was that investors are often their own worst enemy because they respond emotionally to market swings. At this critical juncture in North America, with

growing numbers of retirees, many investors are realizing another level of advice/oversight can be beneficial.

### Injecting rational thinking

It turns out that emotional decision making is part of how our brains function. Research in the burgeoning field of behavioural finance indicates our brains are wired to make fast instinctual responses during times of uncertainty, which often results in decisions based on emotion and selective information. Nobel prize-winning psychologist Daniel Kahneman refers to the System 1 brain function that is primarily intuitive. Its dominance can lead to decisions that are biased at best or just plain wrong. Thankfully we also have a System 2 brain function that is rational and capable of a slower reasoned response to uncertainty. However, System 1 and System 2 cannot work simultaneously and, while System 1 is automatic, it takes effort to consciously shift to a System 2 way of thinking. Kahneman points out that the System 1-System 2 framework has come from collaborative research in cognitive psychology in the 1980s and 1990s. Keith Stanovich of the University of Toronto and Richard West of James Madison University in Virginia describe it further in published research. The two academics have done extensive

### Components of a basic portfolio review

1. Understanding the client's investment objectives and time horizon
2. Assessing the risk tolerance and ability to accept volatility
3. Establishing the optimal asset mix between cash, bonds and equities to meet objectives and to match risk preferences (including target rates of return for each category and the overall portfolio)
4. Computing the actual portfolio return for each of these categories and for the portfolio as a whole
5. Comparing actual returns (net of costs) to relevant benchmark and to the target returns to assess performance
6. Ensuring all costs and fees are clearly disclosed
7. Assessing the tax efficiency of the portfolio
8. Clarifying the rebalancing policy (i.e., is it automatically done and what is the frequency of rebalancing computations?)
9. Recommending corrective action as necessary



research in what has been coined the rationality debate and have concluded the way humans reason “cannot be accommodated within a model of perfect rational competence.”

One example of a System 1 dominated investment decision is jumping late into a rising market. This happens because of a misplaced feeling of confidence as others pile in only to ride the market down when it turns — often selling at the next market low when the inevitable uncertainty is too much to bear. This can lead to the buy-high sell-low choices that many investors make (so much so that savvy traders look at the small investor participation in the market as a contrarian indicator). Another System 1 behaviour is pain avoidance, resulting in the classic investing mistakes of selling winners too soon and hanging onto losses too long.

The remedy for System 1 dominance is to bring in more System 2 input and thinking. This is where CAs can add value. CAs are trained to take a rational reasoned approach to data and problems and people know and respect this. Professionals in public accounting firms are also free of many biases (e.g. group think, compensation) that can be apparent in the investment industry.

#### Portfolio reviews

A perfect System 2 tool is a basic annual portfolio review you can provide to clients (see table on p. 42). The goal is to identify big problems that need fixing. For example, a 70-year-old who is dependent on cash flow from his or her portfolio for living needs would be unwise to have 70% allocated to growth equities. Yet during the last bull market run, the four professionals referred to indicated that many such investors ended up with overly risky equity allocations and have since been struggling to recover. Frankly, the hardest part of a portfolio review is determining the appropriate asset mix. Studies have shown that asset allocation is a significant contributing factor to overall investment success. The table on page 44 illustrates the impact of asset allocation on three proxy portfolios.

To augment understanding about asset allocation, books to consider include David Swensen’s *Unconventional Success: A Fundamental Approach to Personal Investment* and Mohamed Elerian’s *When Markets Collide: Investment Strategies for the Age of Global Economic Change*. Then there is always the age-old rule of thumb of subtracting a person’s age from 100 to come up with an appropriate allocation to cash and bonds. For example, someone who is 65 would have an allocation of 35% to equities and 65% to a combination of cash and bonds. Alternatively, several websites and services provide a risk profile questionnaire with an accompanying scor-

ing system that points to an appropriate asset mix.

A secondary way to augment your knowledge of asset allocation would be to meet with your client’s investment advisers/brokers/counselors to review and understand their approaches to portfolio structuring.

A more complex version of a portfolio review would include a detailed analysis of each of the investment vehicles used within the cash, bond and equity categories to ensure sufficient quality and levels of diversification. Within the bond category, there is a range of credit risk, currency and maturity choices. On the equity side, diversification opportunities include by geography, style, sector and manager. There is also the choice to incorporate higher risk choices such as commodities, managed futures or hedge funds.

This is not suggesting that CAs perform a more complex review. That is best left to investment professionals. Also, each province has its own securities legislation and it is important to understand the rules in your province. If you comment on or recommend specific securities in a portfolio review you may be seen to be giving investment advice, which requires a licence.

#### Opportunity for CAs

In speaking with 10 CAs with the CFP designation — seven in public practice and three who provide financial planning services — the conversations began with the question: are clients

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Impact of asset allocation on portfolio return*		
	1 year ending April 30, 2009 (annualized)**	5 years ending Nov. 30, 2009 (annualized)
<b>Portfolio 1</b> Aggressive (20% fixed income and 80% mixed equities/income trusts)	-25.27%	5.25%
<b>Portfolio 2</b> Balanced (50% fixed income and 50% mixed equities/income trusts)	-14.83%	5.97%
<b>Portfolio 3</b> Conservative (80% fixed income and 20% Canadian equities/income trusts)	- 2.69%	6.03%
<p>* Calculations based on iShares ETFs as described in the benchmark return tool at <a href="http://www.weighhouse.com">www.weighhouse.com</a> under Resources</p> <p>** April 30, 2009 was chosen as it was near the market lows and it shows the impact of short-term volatility on returns</p>		

asking you to comment on their investment portfolios and, if yes, how do you respond? The national firm practitioners said they were doing significant tax and estate planning and, to a lesser extent, succession planning, but no portfolio reviews.

Within the regional and local firms, a few professionals did incorporate some degree of portfolio review into their practices. For example, Tim Coakwell, principal wealth planning at Calgary-based Catalyst Wealth Planning Inc. (part of Catalyst LLP) has a tax background. He promotes financial planning with his clients and proactively assumes the quarterback role in assisting clients with their team of professional advisers. As part of the planning process, Coakwell will do a portfolio review that looks to align his client's objectives, risk tolerance, asset allocation, benchmarking, as well as considering fees and other costs incurred when implementing a properly constructed investment policy statement. For this comprehensive financial planning service, his firm generally quotes a fixed fee (agreed upon with the client in advance) that is dependent on complexity. A typical fee would be \$7,500 for less complex cases to \$20,000 for clients with multiple corporate structures. When the client moves on to the implementation phase (requiring coordination with third-party financial professionals) another quote is provided. As more and more owner-managers reach retirement and sell their businesses, Coakwell feels regional and local public accounting firms may lose valuable sources of revenue if they do not reach out to clients and assist with financial and investment planning matters. More importantly, CAs are often a client's most trusted adviser with a deep understanding of his or her goals and needs. By not embracing clients' needs for financial and investment planning, firms may actually be doing clients a disservice.

Karen Slezak, tax partner and member of the wealth management — estates and trusts group at Soberman LLP in Toronto, enjoys playing the coordination and leadership roles with outside investment, insurance and financial planning advisers for her high net worth/owner-manager clients and performs regular reviews of her clients' personal financial affairs. Knowing that

clients are resistant to paying for financial plans, she will ask a client's investment adviser to prepare one (which they often do at no cost) and/or a portfolio sensitivity analysis, and she and the client will review it to make sure it makes sense and fits with the client's needs. In her experience, client portfolio drops of 20% to 30% were common when markets hit their lows in March 2009. Of interest, her clients' investment management fees tended to fall within the 1% to 2% range depending on adviser channel, portfolio size and complexity. If a client wants a second opinion on a portfolio or is unhappy with service and requests a referral, Slezak will suggest other investment advisers and will participate in the meetings as required and add her perspective. She finds this process a great opportunity to review the client's goals. She also will comment on general asset allocation issues as they relate to target rates of return and encourages ongoing joint meetings with the investment adviser. Retirement issues are also a big concern for some clients so she has been reviewing cash flow and retirement projections and looking at strategies such as income splitting, maximizing deductible interest and taking advantage of the low prescribed interest rate for nonarm's-length loans. Slezak finds clients don't mind paying her hourly based fees when they receive value.

Objectivity and analytic skills are among the cornerstones of the CA profession. CAs are in the enviable position of having their clients' trust and being knowledgeable about their affairs. Understanding the principles of asset allocation and portfolio return benchmarking equips a CA with the tools to provide some relevant, emotion-free context to clients looking for the comfort of a second opinion.

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## The CAS audit

What will an audit under the new Canadian auditing standards mean for management and audit committees?



**T**he suite of 36 new Canadian auditing standards (CASs) reflects the requirements of the international standards on auditing and becomes effective in Canada for financial statement periods ending on or after December 14, 2010. The CASs apply to all audits of financial statements, whether for public or private entities, large or small, profit oriented or not. They can be used to audit financial statements prepared in accordance with any acceptable financial reporting framework, not just international financial reporting standards.

What can management of audited entities and audit committees expect in terms of how the audit is conducted and the communications that take place with their auditors? This article deals with this question in relation to the premise of an audit, potential differences in a CAS audit from prior years, the audit committee communications framework and changes to the auditor's report.

### The premise of an audit

The audited financial statements are those of the entity, prepared by management with oversight from the audit committee. The CASs do not impose responsibilities on management or the audit committee nor do they override laws and regulations that govern their responsibilities. However, an audit in accordance with the CASs is conducted on the premise that management and, where appropriate, the audit committee acknowledges certain fundamental responsibilities to:

- prepare financial statements in accordance with the applicable financial reporting framework;
- have such internal control as management determines is necessary for the preparation of the financial statements; and
- provide the auditor with access to all information relevant to the preparation of the financial statements and unrestricted access to persons within the entity from whom the auditor determines it is necessary to obtain audit evidence.



The audit of the financial statements does not relieve management or the audit committee of their responsibilities. This premise is not new but is more explicit in the CASs and is reflected in a few key areas concerning communications between the auditor and management and the audit committee, including the form of the auditor's report. For example, in accepting the audit engagement, the auditor will request the agreement of management and, where appropriate, the audit committee to the premise of the audit.

The auditor must not accept an engagement if this agreement is not obtained. The auditor must also inform the audit committee of the nature of written representations the auditor is requesting from management and in some cases the audit committee itself. These include overall representations indicating that management and, where appropriate, the audit committee have fulfilled their responsibilities under the premise of the audit.

#### **Differences in CAS audit from prior years**

The nature and extent of differences that management and the audit committee might identify from prior-year audits will depend on the circumstances of the entity. The CASs contain several new or significantly changed auditing standards that may have implications for management and the audit committee to the extent they are relevant to the audit of that entity, for example:

- CAS 550 (related parties) is more explicit in how the auditor deals with related parties. The level of communication with the audit committee is beyond what is required by current standards. For example, the auditor is required to communicate with the audit committee nondisclosure by management to the auditor of related parties or significant related-party transactions. The auditor is also required to obtain written representations from management, and where appropriate, the audit committee, with respect to related-party relationships and transactions and their accounting and disclosure in the financial statements.
- CAS 600 (group audits) has broader application than current standards and contains more extensive requirements. There are specific requirements for the group auditor to communicate with the group audit committee and management regarding such things as deficiencies in internal control that are group wide or specific to components of the entity, and fraud.
- CAS 570 (going concern) requires the auditor to evaluate management's assessment of the entity's ability to continue as a going concern and perform specific procedures if events or conditions have been identified that may cast significant doubt about the entity's ability to continue as a going concern, including evaluating management's plans for future actions and communicating with the audit committee.

It is important to understand how the new CASs will change the audit in an entity's specific circumstances, as this will affect the assistance the auditor requires from management in conducting an efficient audit. It will also affect the nature and extent of communication between the auditor and the audit committee relating to specific aspects of the audit.

**Driving effective communications with the audit committee**  
Communications with audit committees are founded on CAS 260 (communications with those charged with governance). This CAS provides an overarching communications framework that emphasizes the importance of effective two-way communication between the auditor and those charged with governance (a subgroup of which is the audit committee) during all phases of the audit. The requirements and guidance in this CAS are more extensive and detailed than under current generally accepted auditing standards (GAAS).

There are four key areas of communication. The auditor must:

- inform the audit committee of the auditor's responsibilities on the audit;
- discuss with the audit committee the timing and scope of the audit;
- obtain from the audit committee information relevant to the audit; and
- inform the audit committee on a timely basis of matters arising from the audit that are likely to be of interest to the committee.

A key CAS requirement is for the auditor to evaluate whether communications with the audit committee have been adequate

## **Audit of financial statements doesn't relieve management or the audit committee of responsibilities. This premise isn't new but is more explicit in CASs**

for the purpose of the audit: that is whether the objectives of such communications have been achieved. Inadequate communications may have significant consequences for the auditor. For example, inadequate communication may indicate an unsatisfactory control environment and influence the auditor's assessment of the risks of material misstatements, such that the auditor may need to perform additional audit procedures in forming the audit opinion. It is therefore important for auditors and audit committees to continually improve their communications.

**Improving communications through the new auditor's report**  
Will the form and content of the auditor's report change under the CASs? Yes. One obvious change is that the auditor's report will be twice as long — six paragraphs rather than three — to more fully describe the responsibilities of management and the auditor. The description of management's responsibility is expanded to indicate that it includes responsibility for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. The description of the audit is expanded to explain, amongst other things, that the auditor's consideration of internal control during the audit is not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

Another change under the CASs will be the date of the auditor's report. Under current GAAS, the auditor can date the report when he or she has identified and sought all the audit evidence

required to support the opinion and has obtained and examined substantially all such evidence. However, the auditor will often be awaiting the final financial statements and specific corroborating evidence or documentation before signing and releasing the report. The CASs require the auditor to have obtained (not just sought) sufficient appropriate audit evidence to support the opinion before dating the report. Sufficient appropriate audit evidence includes, for example, approval of the final financial statements by the board of directors. As a result, the auditor's report will often now be dated somewhat later and nearer the issuance of the financial statements. To address the shorter time frame between completion of the audit and issuance of the financial statements, closer coordination will be needed of the timing of audit committee and board meetings and, for example, of audit communications with the entity's legal counsel.

The new audit reporting model also contains new standards dealing with additional paragraphs that the auditor may add to the auditor's report — "emphasis of matter" and "other matter" paragraphs. An "emphasis of matter" paragraph is used if the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements. The paragraph is included immediately after the opinion paragraph and indicates that the auditor's opinion is not modified in respect

of the matter emphasized. Current GAAS does not permit the auditor to include such paragraphs in the auditor's report.

An "other matter" paragraph is used if the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report. This paragraph is included immediately after the opinion paragraph and any emphasis of matter paragraph. The auditor is required to communicate with the audit committee when he or she expects to include such a paragraph and its proposed wording.

### Conclusions

The requirements in the CASs place explicit recognition on the premise of an audit and change communications with audit committees and the form of the auditor's report. They should improve the audit and the quality and timing of communications between the auditor, management and the audit committee. Early discussion of the new requirements by all involved will facilitate a smooth transition to the CAS audit.

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## Transitional questions

Financial reporting under IFRS is relevant for investors, but is it reliable and comparable?

**T**he advent of global capital markets requires investors to compare firms across countries if they are to build efficient and well-balanced portfolios. Despite their limitations, financial statements remain a critical resource for investors, and the use of a common set of accounting standards by firms across countries should facilitate the task of analysts, investment managers and investors. In that regard, the perceived need for harmonization and comparability in financial statements has led to the emergence of international financial reporting standards (IFRS) as the dominant template for financial reporting in most countries around the world. Canada will be joining the parade in 2011 for organizations that are publicly accountable.

Such a transition raises some questions. For instance, does IFRS meet the stated goals with respect to financial

statements such as improving their relevance, quality — especially their representativeness (formerly, reliability) — and comparability? We review the evidence about these questions from other countries having adopted IFRS. We then conjecture as to the expected impact of IFRS adoption on Canadian capital markets.

### How can we know if accounting standards harmonization works?

In 2005, publicly listed entities from all European Union countries switched from their national accounting standards to IFRS for consolidated statements. A common basis for financial reporting was deemed essential to ensure economic and capital market integration. Currently, the US is the only large economy adhering to locally determined accounting standards. China has adopted IFRS-inspired standards while Japan has published a road map toward IFRS adoption in 2016. Canada's Accounting Standards Board has decided that publicly accountable firms will have to report in accordance to IFRS in 2011.

### Does IFRS translate into more relevant financial statements?

The move toward IFRS confirms the primacy of financial markets in the determination of accounting standards, with the relevance of financial statements being mostly defined in terms of how useful they are to equity investors. Such an approach to standard-setting downplays the importance of accounting information for stakeholders such as regulators, governments, employees, etc. Moreover, stewardship, or the use of accounting information for contractual purposes, is relegated to a secondary role in the determination of accounting standards.<sup>1</sup> Thus, while this evolution in the philosophy underlying standard-setting is debatable, we assess the impact of IFRS using its self-proclaimed goal as a benchmark, i.e., providing investors with relevant information.

The relevance of accounting information can be evaluated through such means as its impact on stock prices, on the accuracy of analyst forecasts and on investment decisions. With respect to stock prices, it appears that IFRS-based financial results map into how investors assess a firm's stock market value. For instance, there is evidence that the IFRS adjustments reported by French firms for





2004 are useful to investors in their assessment of a firm's stock market value (financial statements prior to 2005 prepared according to domestic standards needed to be reconciled with IFRS). Moreover, in the UK, firms reporting IFRS earnings that were lower than those computed according to UK GAAP were penalized by the stock market.<sup>2</sup>

There is some evidence that a switch from domestic standards to IFRS has a modest positive impact on market liquidity and on the cost of equity capital. In other words, with the new information set at their disposal, investors find it easier to buy or sell securities. Such improvement in liquidity most likely results from the reduction in information asymmetry between investors and managers following the implementation of IFRS. Higher quality financial reporting, greater transparency as well as enhanced oversight by analysts, auditors and directors from the use of a common reference in accounting all potentially contribute to this improvement in the information environment.<sup>3</sup> However, firms that voluntarily adopt IFRS ahead of the mandated year of adoption experience a stronger improvement in the liquidity of their stock and in their cost of capital than firms that only adopt IFRS at the required date. Therefore, it is unlikely that IFRS adoption alone drives the improvement in the information set that is available to investors: other regulatory or institutional changes probably take precedence.

The use of IFRS information allows firms to improve their coverage by foreign financial analysts and analysts improve the accuracy of their forecasts.<sup>4</sup> For instance, analysts improve their earnings forecasts following IFRS adoption, especially in countries with high investor protection.<sup>5</sup> However, initial reporting under IFRS probably lead investors to lose their traditional benchmarks in assessing a firm's financial performance and to engage in noise trading.<sup>6</sup> More specifically, while pre-IFRS, individual firms' stock returns are closely aligned with overall market trends, IFRS adoption sees the valuation of individual firms being driven by firm- or industry-specific information, a shift that reverses once the new information is assimilated. This increase in relevance for stock markets is observed for firms highly followed by analysts.

Investors react to the release of IFRS information by rebalancing their portfolios. Investors who rely more extensively on fundamental analysis or on accounting data (foreign investors, value investors) use IFRS-derived financial statements to sell or buy specific securities, much more so than when just domestic standards were used and, on average, increase equity ownership in these firms after IFRS adoption.<sup>7</sup>

Contrary to Canadian GAAP,<sup>8</sup> asset revaluation is allowed under IFRS and UK GAAP. Upward revaluations by UK firms are associated with positive future performance and with higher stock prices for the revaluation year. Finally, the level of details in financial reporting under IFRS is higher than under Canadian GAAP. Under IFRS, firms that detail income statement expenses in terms of function (cost of sales, cost of distribution) must also disclose information about the nature of the expenses (deprecia-

tion, purchases of materials, transport costs, employee benefits, advertising costs). This should provide relevant information to market participants.

Overall, we infer that IFRS financial statements do provide relevant information to investors, thus providing some potentially useful hints as to what Canadian firms and markets may expect from 2011 onward. However, one must keep in mind that the IFRS adoption effect is relatively modest, despite the wide heterogeneity in pre-IFRS financial reporting standards. Moreover, in practice, assessing if IFRS meets stated goals and objectives is difficult for several reasons. In many countries, it is difficult to disentangle if the observed investors' reaction to the release of financial statements is an outcome of adopting IFRS or of the implementation of new regulations requiring more disclosure and better governance. For instance, in France, IFRS adoption closely followed the enactment of new corporate governance and market oversight regulations. In addition, did investors react to IFRS information or to underlying economic trends and news? For example, all European Union countries mandated IFRS by 2005, which implies that all firms switched from domestic accounting standards to IFRS under the same favourable macro-

## **There is some evidence that a switch from domestic standards to IFRS has a modest positive impact on market liquidity and on the cost of capital**

economic conditions. It is difficult also to tease out the information contained in the accounting numbers themselves from the additional information provided in the notes: is the IFRS effect driven by better measurement or by better disclosure? Finally, and perhaps most importantly, IFRS is a symbolic label. At the country level, there is much discretion in the implementation as well as in the enforcement of IFRS. Moreover, at the firm level, several choices available to management have a direct impact on the reported financial statements.

### **Does IFRS affect accounting quality (reliability or representational faithfulness)?**

IFRS provides managers with extensive discretion in financial reporting. For instance, while US GAAP contain numerous rules and bright lines to specify the application of a particular standard, IFRS defers more to professional judgment. Moreover, in many respects, IFRS is much less conservative than current Canadian and US GAAP, the possibility to revalue capital assets being a key illustration (other examples relate to IAS 38, 40 and 41). Finally, at the time of adoption, IFRS allows managers to make several standard exemption choices, which will impact future earnings.

A large-scale study compares the levels of discretionary accruals pre- and post-IFRS adoption.<sup>9</sup> Accruals reflect the measurement of accounts receivable, inventories, provisions, etc. Overall, it can be inferred that at both the country and firm levels, the adoption of IFRS does not translate into an improvement of the

quality of financial reporting. Effective enforcement by institutional and market forces is necessary to ensure that IFRS adoption leads to an improvement in the quality of financial statements.

### Does IFRS enhance comparability across countries?

According to the International Accounting Standards Board, the widespread adoption of global accounting standards, such as IFRS, enhance financial statement comparability across countries, thus facilitating global investing. Is it the case? The evidence is troublesome. One study ranks European countries that have adopted IFRS on the extent of their firms' earnings management, i.e., the magnitude of discretionary accruals.<sup>10</sup> Pre-IFRS, firms from Greece, Austria, Germany, Spain, Portugal and Italy rank among the most likely to manage their earnings, i.e., exhibit high levels of discretionary accruals reflecting aggressive financial reporting by their managers. In contrast, firms from the UK, Sweden and Ireland show financial reporting that more closely map their underlying economic performance.

Post-IFRS, the rankings of these countries do not substantially change, with earnings quality at the aggregate level not varying substantially. Therefore, while in appearance all firms from European Union countries present their financial statements in a format that looks comparable, the numbers reported in these financial statements are not necessarily more comparable than they were prior to the adoption of IFRS: major differences in measurement, recognition, audit and market monitoring practices still remain post-IFRS. Hence, beyond IFRS adoption, its actual implementation and the enforcement of such implementation play a critical role in ensuring that informational benefits from IFRS flow to investors and other market participants.

Overall, the IASB's goal of facilitating international harmonization and comparability of financial statements still appears to be several years ahead of us.

### What is in store for Canada?

From international evidence regarding the adoption of IFRS, we can predict that its impact on Canada's financial markets is likely to be modest at best. The advent of IFRS may improve the information set that is available to market participants and, therefore, enhance the relevance of financial statements. Such effect is likely to be driven by incremental disclosure. However, in many cases, it is also conditional upon the discretionary choices available to management (e.g., revaluations of property, plant and equipment under IAS 16).

On the other hand, firms that had aggressive financial reporting strategies pre-IFRS are likely to remain that way post-IFRS. Moreover, in light of the heterogeneity in the implementation of IFRS around the world and even within countries, the comparability of Canadian firms' financial statements with financial statements from other countries' firms is unlikely to be significantly enhanced. In this regard, what is most critical is the intensity of auditing, regulatory and market monitoring to which Canadian firms are subjected: the adoption of IFRS in itself does not change these dynamics. In that context, is the cost of switching over to IFRS justified? Only time will tell how conversion costs and benefits balance out.

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## Nudge theory

**T**he many laws and rules that govern society assume that consumers make rational decisions. However, recent discoveries in economics, which led to two Nobel prizes, show this is often not the case. While we may be rational beings, many of our decisions are not. Goods and services providers know all too well how to exploit this weakness at our expense. Consumer laws should take this into account and “nudge” our irrationalities where appropriate.

Several factors contribute to this lack of rationality, for example:

- When a purchasing decision is complex, consumers tend to simplify their analysis. When buying a cellphone, we are confronted with numerous options. Most of us will eliminate the majority of these without serious thought and focus on a few options highlighted by the seller.
- When the benefit of an action is not received at the same time as the costs are assumed, we tend to favour the most immediate outcome, regardless of whether or not the decision is rational. This is true both ways, when the benefit is immediate but the costs are deferred, such as eating a doughnut at the risk of gaining weight as a result, or the other way around.
- When faced with an unfamiliar choice, consumers tend to stick with the less-risky status quo, for no real reason. Think about the last time you renewed an insurance policy — a once-a-year occurrence.
- When consumers don’t feel competent to make a decision, they tend to go along with the majority, whether or not this is the right option for them. This explains why such slogans as “best selling” and “the most popular” are so often used in advertising.
- Consumers are lazy. Grocers will place their most lucrative products at eye level, even if they are not necessarily the best option for consumers.
- Magazine publishers are well aware that we are careless when it comes to renewing subscriptions. This is why

there are so many promotions offering subscriptions at low prices. However, when the time comes to renew, the price is usually higher, and consumers often fall into the trap.

Prof. Richard Thaler, a specialist in economic behaviour at the University of Chicago, is the prime developer of the “nudge theory,” arguing that laws should be designed to help consumers make better decisions, especially significant ones, nudging us to better choices. An example of a nudge would be to require subscription service providers, for instance those offering cellphone services, to send a monthly statement with a detailed description of the unit costs, or in the case of credit-card companies, the effective interest rate that will be paid on

**While we may be rational beings, many of our decisions are not, and service providers know how to exploit this**

what we owe if we do not pay in full. These companies should also be required to issue an annual electronic summary of all purchases that consumers could use on the Internet to compare the value of competing offers. Why can’t we plug the unit prices of competitors into our annual usage summary and compare the offers?

Another example of a nudge would be to require service providers to always offer the best option for the most consumers as a default option, or the most advertised one. Take for example the rates posted at parking lots in large cities. Parking lot operators usually publicize in large characters the low evening and weekend rate and in much smaller characters the daytime rates that concern most customers. They should be required to publicize the best prices for the period of greatest use.

Businesses benefit from well-defined, regulated markets. In return, society is entitled to require them to abide by rules that help consumers, when we are rational and when we are not.

Marcel Côté is founding partner at SECOR Consulting in Montreal

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